

# PERSPECTIVE

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## Climate Change: Can We Fix The Future Through Franchising?

*Michael T Schaper and Jason Gehrke\**



McDonald's has adopted an emissions target in the region. The contractual power that franchisors have places them in a unique position to speedily transition many other businesses into low-emissions, more climate-friendly activity. In this picture, people wearing face masks queue outside a McDonald's fast-food restaurant in Singapore on May 11, 2020. Photo: Roslan Rahman, AFP.

*\* Michael T Schaper is Visiting Senior Fellow with the ISEAS – Yusof Ishak Institute, and an Adjunct Professor with the John Curtin Institute of Public Policy, Curtin University, Western Australia. Email: [michael.schaper@gmail.com](mailto:michael.schaper@gmail.com). Jason Gehrke is Director of the Franchise Advisory Centre in Brisbane, Australia, and a Past Chairman of the World Franchise Council. Email: [jason@franchiseadvice.com.au](mailto:jason@franchiseadvice.com.au).*

**EXECUTIVE SUMMARY**

- Significantly reducing business-related greenhouse gas emissions (GHGs) in Southeast Asia will require governments to work with the small-and medium-sized enterprise (SME) sector, many of which trade as franchisees of major chains.
- There are now at least 4,300 franchise systems operating in the ASEAN region, with more than 150,000 franchisee SME firms. The real figure is likely to be much higher.
- The contractual power that franchisors have places them in a unique position to speedily transition many other businesses into low-emissions, more climate-friendly activity. They can potentially require their franchisees to move to climate-friendly products and processes; additionally, they can use their large-scale purchasing power to ensure the firms they source raw materials from also adopt low emissions practices.
- Little attention to greening the franchise sector has yet taken place in Southeast Asia, and is hampered by the absence of franchising regulators and comprehensive data on the sector in most ASEAN member states.
- Practical steps governments can undertake include identifying the franchise systems operating in their jurisdictions; engaging with master franchisors; ensuring that environment agencies become familiar with the sector; and working with national franchise industry associations.

## INTRODUCTION

Jollibee. Phuc Long Coffee and Tea. Café Amazon. Kebab Turki. Old Town White Coffee. These are the face of modern franchising in Southeast Asia, and they may just also be crucial in its attempts to minimise global warming.

How can Southeast Asian countries reduce their carbon emissions, and help be part of the global solution to climate change? Many different steps are required, and a central one will be bringing the region's 70 million small and medium-sized enterprises (SMEs) along on the journey to a low-carbon economy.

SMEs are a highly diversified, fragmented group of businesses. Found in every country and in every industry, it has been difficult for policymakers to identify effective ways to bring large numbers of small firms into the emissions reduction and climate-adjustment process.

However, one particular group of SMEs – franchisees – are readily identifiable, easily reached, and have the potential to contribute significantly to regional efforts to reduce greenhouse gas emissions.

Franchisees are, in effect, part of a local, regional or global supply chain. They are contractually bound to follow the production and procurement processes, logistical and transport arrangements established by their franchisor. As such, the possibility exists that changes in franchise arrangements can be remodelled in a way that results in significantly reduced carbon emissions.

## THE FRANCHISING SECTOR IN SOUTHEAST ASIA

At its most basic, a franchise is a contractual relationship in which the rights holder of a piece of intellectual and commercial property (the franchisor) licenses another party (the franchisee, which is typically a small firm) to use or sell under that brand for a fixed period of time, on certain terms and conditions. It is an agreement between two different businesses to work together to make and sell goods or services, typically in a way prescribed by the franchisor (Schaper, Volery, Weber & Gibson 2014).

There are essentially two different types of franchise systems. In a *product franchise* arrangement, a franchisee is empowered to sell a particular good or commodity, such as clothing, cars, household goods, or petroleum. The franchisee has a wide degree of freedom in how they operate their business, and the franchisor's role is largely focused on providing sufficient quantities of the requisite goods, monitoring product quality, and supervising the level of after-sales customer service.

In contrast, a business format franchise<sup>1</sup> is a far more comprehensive arrangement. The franchisor provides a small business franchisee with all the knowledge and ingredients necessary to start and run a business, including premises, the product/service, production and operating systems, management controls, staff training, IT support, raw materials input, advertising and marketing, and accounting. Usually the result of substantial prior experience

and business development, the business system model is a complete package created by a franchisor which simply needs an operator franchisee to fund and manage. Many of the most recognisable international franchise chains are structured in this way, such as those in fast food, professional services, wellness and beauty care, retail and accommodation services.

Central to a business format franchise is the substantial (and, sometimes, almost total) control that the franchisor exerts over the franchisee. The franchisor can usually exercise discretion over the inputs, processes and outputs of the franchisees in its system, with which the franchisee is contractually required to comply.

First popularised in the United States in the late 1800s, over the last century franchising has grown substantially as a popular business model. In the Southeast Asian region, it became especially popular from the 1980s onwards, spearheaded by a number of fast food outlet groups operating as business system franchises, such as McDonald's, Subway and KFC. This in turn also catalysed a number of local entrepreneurs into developing their own systems (Tomiyama 2015).

Today, franchising is a major phenomenon in Southeast Asia, with an estimated 4,310 chains in operation. As Table 1 below indicates, there are more than 152,000 individual franchisees across the region – and this is likely to be a major underestimate, given the paucity of data. Whilst many franchise systems remain relatively small, with perhaps 10-20 franchisee members, others have grown into large-scale ventures operating in multiple ASEAN member states, some of them with more than a thousand franchisee-owned outlets.

Franchise chains in the region now include a mix of both international systems that have originated elsewhere, as well as some highly visible, home-grown ones. Many of the former are US-based fast food chains, such as McDonald's, Burger King, Wendy's, Dunkin Donuts, KFC, Starbucks, Pizza Hut, and Dominos. Some local major chains have proven themselves to be highly entrepreneurial: Filipino chain Jollibee now has over 1,000 stores spread over not just The Philippines, but much of Southeast Asia as well. Its parent company also owns four other food chain systems – Greenwich, Red Ribbon Bakeshop, Chowking, and Mang Inasal (US Commercial Service 2018).

Policy oversight and the regulation of franchising varies across ASEAN. Malaysia has the most developed governmental framework, which includes a *Franchising Act* (1998), a statutory Registrar of Franchises, and a national franchise development agency, Pernas. Indonesia has a series of specific *Franchise Regulations* administered by the Ministry of Trade; Thailand also has a number of mandatory franchising regulations issued by the Office of Trade Competition Commission under the country's *Trade Competition Act*<sup>2</sup>; and in Vietnam the sector is regulated by relevant clauses of the *Commercial Law of Vietnam*, compliance with which is overseen by the Ministry of Industry & Trade. However, in other Southeast Asian nations, there is no specific franchise legislation *per se*; instead, the general laws of contract, competition and related matters apply (Das, Dube & Loewinger 2019).

**Table 1: Franchise Systems in Southeast Asia**

	Estimated number of franchise systems	Estimated number of franchisees
Brunei	200**	Not known
Cambodia	100**	Not known
Indonesia (2019)	1,000	Not known
Laos	50**	Not known
Malaysia (2020)	1,000	Not known
Myanmar	100**	Not known
Philippines (2018)	500	100,000
Singapore (2012)	600	40,000
Thailand (2018)	500	12,000
Vietnam	260	Not known
Total	4,310	152,000

*Sources: ASL Law (2021); Li & Chong (2021); Paul Hype Page & Co (2021); Pugnatorius Business Research (2020); Rose & Lee (2020); US Commercial Service (2018)*

*\*\* Indicates no reliable published country data available; figures based on estimates by in-country franchising consultants.*

## FRANCHISING AND SUPPLY CHAINS

The power that franchisors have places them in a unique position to speedily transition many other businesses into low-emissions, more climate-friendly activity. They can, in effect, use their clout as a buyer and contractor to generate and implement eco-friendly changes that might not otherwise occur.

Franchise systems have the capacity to play a major role in two ways: firstly, by requiring their franchisees to move to new, climate-friendly products and processes; secondly, by requiring the firms they source raw materials from to also adopt climate-friendly, ecologically sustainable practices.

This is because modern franchise systems are also parts of significant supply chains, both horizontally and vertically. Large-scale franchises in the fast food sector, for example, typically purchase substantial quantities of agricultural and commercial inputs from other supplying business, which they then distribute to their franchisee restaurants for final end-use production and sale. Franchisors thus also have the capacity to require suppliers to their brands to move to low-emission, climate-friendly products and processes, or else risk losing the franchisors' business.

This potential has already been recognised by some multilateral agencies. The OECD (2021), for example, has noted that significant potential exists to improve the environmental performance of smaller firms through the pressure exerted on them by the organisations that provide their raw materials. Requiring small firms to adopt certain low-emissions or green practices, technology and raw inputs are some of the ways in which this can occur.

Why would franchisors choose to do this? A first driver for such change is reputational. There is the risk of brand damage if members of the franchise system supply chain are seen to be guilty of poor environmental behaviour (OECD 2021). Conversely, a positive “green” or climate-friendly approach can also be treated as part of the strategic positioning and marketing of the franchise system, increase its unique selling proposition and enhance its public profile.

This is an important driver in the ASEAN region, where a growing educated middle class has become more exposed to sustainability issues internationally, and often come to expect this also in their home countries. These consumers are increasingly demanding climate-friendly products and services.

A second is risk management. Firms with international or major national supply chains and outsourcing strategies are often highly exposed to environmental risks posed by a changing climate, so mitigation or improvement programmes are one way in which to manage such threats.

A third, important impetus is economic self-interest. Many climate-friendly business practices and eco-friendly activities now clearly generate positive financial returns, even for the simplest of business franchise operations (OECD 2021). For example, the reduction of waste can lead to lower input costs and waste disposal fees; renewable energy is becoming cheaper; and changing heat and energy sources can reduce expenses.

Getting franchise systems to make these changes is not an easy task, though. Some international franchisors (such as US-based fast food chains) still source original products across extended distances, which contributes to the emissions generated by those goods. Complex supply chains can make it difficult for parent companies (franchisors) to successfully impose green practices, as production is dispersed across multiple companies and countries; many of them are autonomous or independent firms bound only to comply with these edicts on the basis of a commercial contract. Nor is it always easy for franchisors to monitor compliance with the terms of such legal agreements (OECD 2021: 16).

Another potential problem can be franchisee resistance. When changes are imposed without prior consultation, individual franchises may be reluctant to adopt new initiatives. This can often be the case if the reason for the changes is not clearly spelt out, or is perceived as providing no benefit to the franchisee. Cost is another issue. While there are many simple changes that can be made at low expense, other changes in product lines, manufacturing and production processes can come with significant outlays, most of which may be passed on to the franchisee. Ideally, franchisors need to help underwrite these expenses, and ensure that any financial benefits are shared with their franchisees (Matteson-Teig 2020).

## **SOME TENTATIVE STEPS SO FAR**

Different franchise systems in the region have taken some steps towards a more climate-friendly approach. Toyota, for example, has publicly committed to moving to an ultimate zero-emissions business model and a “carbon free society.” McDonalds has adopted an

emissions target, whilst Dunkin' Donuts has a voluntary programme to encourage franchisees to take up more eco-friendly processes (Matteson-Teig 2020).

But few systems have committed substantially to specific emissions goals, to major reductions in their carbon footprint, or to a net-zero future. Likewise, it is difficult to find many public statements which show franchise chains helping franchisees prepare for a warmer global environment that is likely to have more extreme weather events.

Interestingly, there are now an emerging number of franchise systems promoting the sale of environmental services to the general public, as well as actively soliciting new franchisees for their chain. These include firms in the vegan foods, cleaning services, "green" technology, energy and recycling sectors (Franchise Direct 2019).

### **SOME PRACTICAL ISSUES TO BEAR IN MIND**

Despite the overall size of the sector, the franchising community in Southeast Asia has not been targeted as a priority climate-action field by policymakers, environmental advocates or regulators. This is a substantial omission, as franchise systems collectively have the capacity to make a significant difference.

Moving the dial to more climate-friendly franchising requires a number of steps by governments in the region:

*Understanding and engaging with the franchise sector.* Franchising is, in many ways, quite different to the traditional concept of a "stand alone" business, since it involves a highly complex, ongoing and symbiotic relationship between two legally independent business operators. Government bodies attempting to work with this sector therefore need to spend time at the outset understanding how this model works, and engaging with both the formal and informal influencers within the sector. Whereas nations with a formal franchising regulatory system already in place (such as Malaysia and Indonesia) will have much of this knowledge, other countries will not. This engagement should include the various national franchising associations that exist in most (but not all) ASEAN member states (see Table 2 below), major influential franchisors, and the franchisee councils that many systems have set up to give their franchisee SMEs a representative forum.

**Table 2: Franchise Industry Associations in Southeast Asia**

	Principal Franchise Association
Brunei	<i>No apparent association</i>
Cambodia	Cambodian Business & Franchise Association
Indonesia	Asosiasi Franchise Indonesia (Indonesian Franchise Association)
Laos	<i>No apparent association</i>
Malaysia	Persatuan Francais Malaysia (Malaysian Franchise Association)
Myanmar	Myanmar Franchise Association
Philippines	Philippine Franchise Association
Singapore	Franchising & Licensing Association (Singapore)
Thailand	Franchise & License Association (Thailand)
Vietnam	<i>No apparent association</i>
Regional	Asia-Pacific Franchise Confederation World Franchise council

*Tripartite involvement and co-ordination.* There are two, and sometimes three, different arms of government that may potentially be involved in any greening of franchising supply chains – sustainability/environment ministries, SME agencies, and franchising regulators. They will need to work together to develop a common strategy and approach.

*Working with master franchisors.* Given the very hierarchical nature of most franchise arrangements, in which almost all substantial changes to procurement and products require the support and endorsement of a franchise system’s head office, it will be critical to get the support of the master franchisor in each region or country. Only once the franchisor is on board will franchisees also become actively involved. This may be easier to do with large, “home grown” systems that have originated in Southeast Asia, compared to those that are ultimately owned and controlled from outside the region.

*Working with the “right” franchise systems.* Not all franchise arrangements work in the same way, and some will be easier to green than others. Because of the ‘complete package’ they offer, business format franchises will have the potential to generate more significant changes than product franchise arrangements. And much will also depend upon the nature of the franchising contract that exists between the franchisor and its franchisees. Can the franchisor mandate changes to procurement and production processes, or does each franchisee have liberty to make their own decisions in these areas? Does the contract make it easy for parties to change their practices at short notice to be more climate-friendly, or not? Finally, some systems have already made a public commitment to climate-friendly activity, whereas others may have been silent on the issue.

## CONCLUSION

Often overlooked, franchising provides a powerful avenue to generate climate-friendly changes in a large number of firms across Southeast Asia, and should be a priority for policymakers working on this issue. Franchising is different to many other business-to-

business and business-to-consumer arrangements, so it can provide different solutions to this growing problem.

Will it require additional effort by climate bodies and governments? Yes. Will it require a different way of helping SMEs reduce emissions and adjust to a warmer future? Yes. Should we be doing this now? Yes. Global warming is an urgent problem, and governments should be acting promptly to work with the sector, rather than delaying until some indeterminate future date.

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<sup>1</sup> Also sometimes referred to as a “business system” franchise

<sup>2</sup> A specific franchising law has also been proposed for Thailand but not yet legislated.

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