

Client Alert

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New Minister of Trade Regulation Provides for More Flexible Supply Chain for Onshore Manufacturers

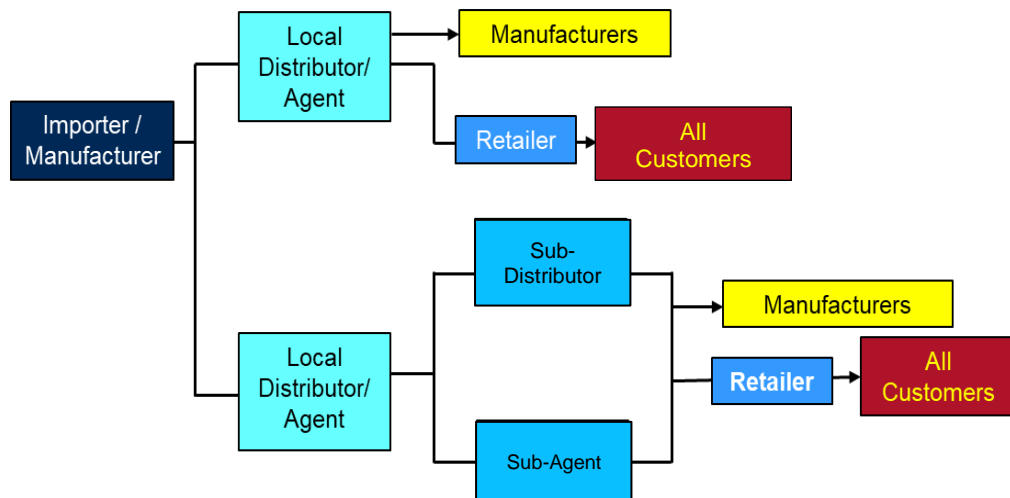
The Minister of Trade has issued Regulation No. 66 of 2019 ("**Regulation 66**") on the Amendment to Minister of Trade Regulation No. 22/M-DAG/PER/3/2016 on General Provisions for Distribution of Goods ("**Regulation 22**"). Regulation 66 is a long-awaited revision of Regulation 22 which has been criticized for being too rigid in regulating how goods should be sold by their manufacturers to consumers.

Under Regulation 22, except for direct sales of raw and supporting materials by manufacturers to other manufacturers, sales (whether to businesses or end-consumers) must be carried out via at least a distributor and a retailer. Distributors are not allowed to sell directly to manufacturers. Rather, they must sell through a retailer, at least. Manufacturers, other than small and medium sized ones, are not allowed to sell directly to retailers. Manufacturers may only sell their goods to other manufacturers as raw or supporting materials.

Considering that each layer of supply involves an additional margin and imposition of VAT, the above-mentioned restrictions have been criticized as too costly and therefore harmful to consumers. In the case of industrial goods such as heavy machinery, the requirements are also seen as unrealistic, considering that there is no available retailer for many products of this type. Further, this policy is also seen as contrary to the government procurement policies, which stress the need to do away with intermediaries as much as possible to cut costs.

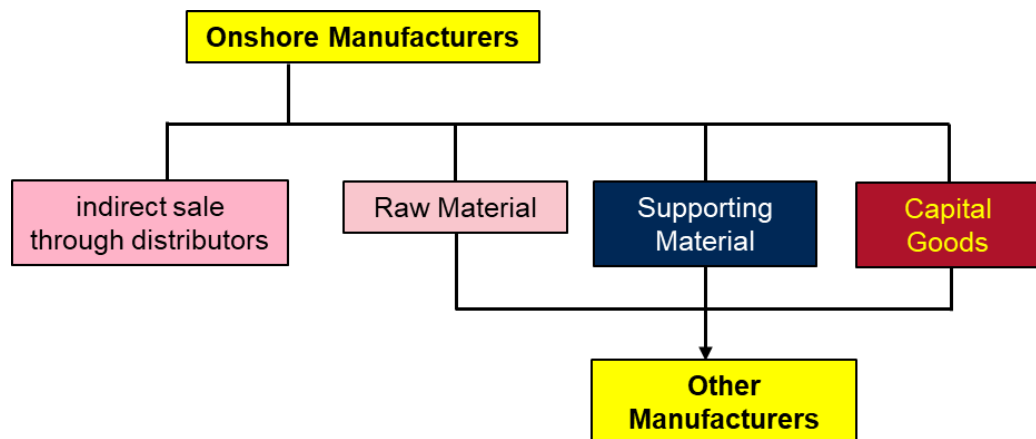
For foreign-investment ("**PMA**") distribution companies, the issues with Regulation 22 have been compounded because of Ministry of Industry and Trade Regulation No. 11/M-DAG/PER/3/2006 ("**Regulation 11**") on registration of agents and distributors, which provides that PMA companies in trading had to appoint a local intermediary (either an agent or distributor). So, for PMA distribution companies the chain of supply had to include at least itself (as distributor), a local agent/sub-distributor and a retailer.

Regulation 66 relaxes some of the restrictions of Regulation 22. Distributors, sub-distributors, agents and sub-agents are now allowed to sell directly to manufacturers. There is no longer a requirement to sell through a retailer. So, for a local (non-PMA) distributor the flow of goods can be illustrated as follows:



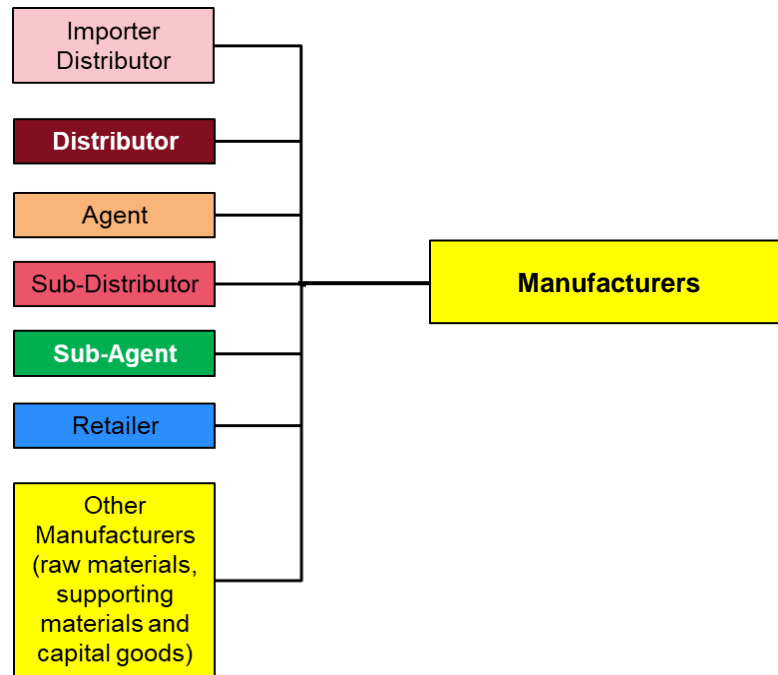
This is a significant development. The layers of intermediaries that must be involved to supply goods to a manufacturer have been reduced thus potentially reducing costs.

Further, the types of products that a manufacturer may supply direct to other manufacturers have been expanded. Now a manufacturer may sell its goods directly to other manufacturers to be used as capital goods. Previously Regulation 22 allowed them to supply goods as either raw or supporting materials only. The structure of this direct supply can be illustrated as follows:

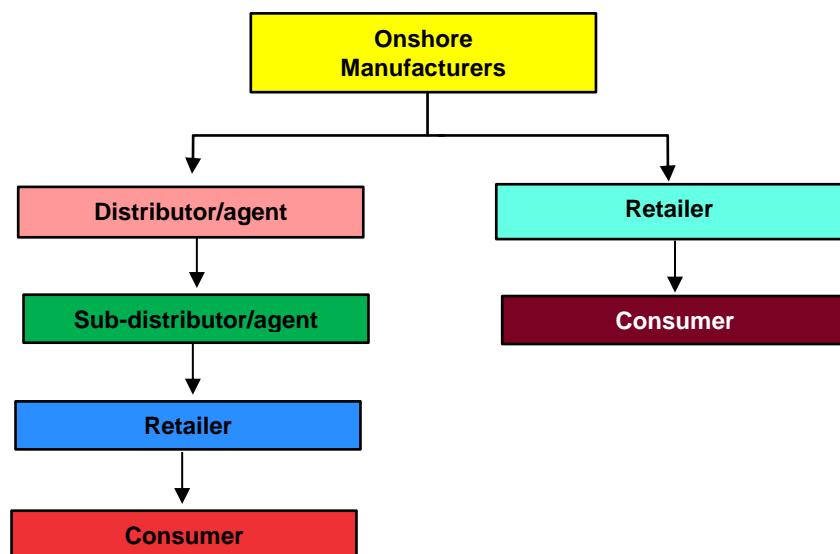




Onshore manufacturers now have a wider range of options to purchase products, as can be illustrated below:



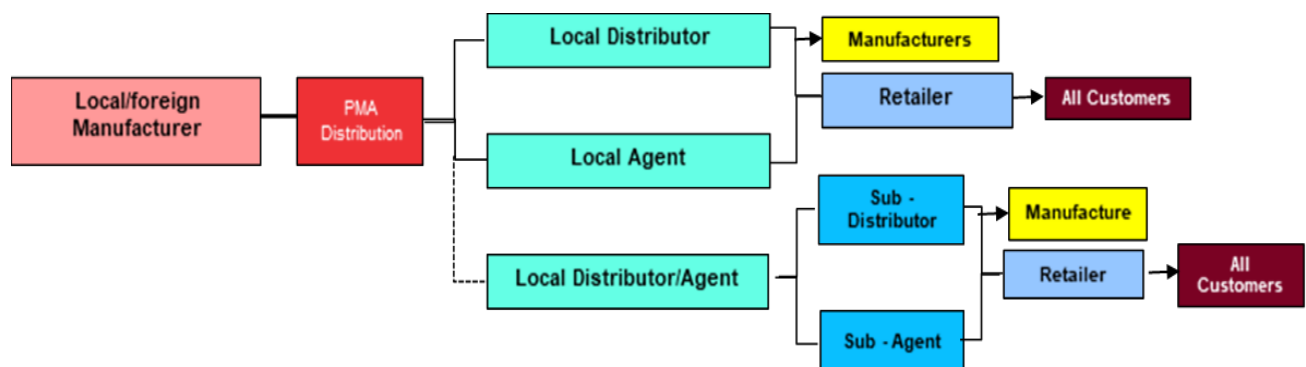
Regulation 66 appears to have also removed the prohibition for large scale manufacturers to sell their products directly to retailers. The new chain of supply of manufacturers can be illustrated as follows:





Regulation 66 also makes it clear that government procurement is no longer subject to the requirements of Regulation 22. So, the government may purchase directly from manufacturers, achieving its objective of eliminating intermediaries.

Unfortunately, given Regulation 11 is still in place, the situation has not changed much for PMA distribution companies. They are still disadvantaged as they are still required to appoint a local distributor or agent, one more layer than what is required of a non-PMA distribution company. But they are also freed from the requirement to sell to customers via a retailer. The minimum structure for a PMA distribution company is as follows:



Another quirk of Regulation 22 that remains unresolved is supply to non-manufacturers. As can be seen above, all of the above initiatives apply to manufacturers, not to service companies. This is a shame because the service sector is of growing importance to the economy, and it also deserves the cost-efficiencies that come from eliminating intermediaries from its chain of supply.



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