Malaysia: Franchise Industry

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Summary

Malaysia is one of Southeast Asia's fastest growing franchise markets. With support from the Government of Malaysia, the private sector, and general receptivity from consumers, the market growth trend of 15% per annum for the past decade is expected to continue into the next decade. Currently, franchise businesses contribute to about 3.5% of the Gross Domestic Production (GDP). With its desire to be a regional franchise hub, as well as a developed nation by 2020, Malaysia needs to double its income level and national capital base from the current per capita income of US$14,000 (adjusted for purchasing power parity). Translated, the upside to demand growth for the franchise industry is very high.

Market Demand

The Government of Malaysia (GOM) has indentified franchising as catalyst for increasing the number of entrepreneurs in Malaysia and is strongly supporting this endeavor. Towards this end, it has allocated about US$5.7 million/ RM20 million (US$1=RM3.50) for franchise development programs to establish new franchises in the country during the 9th Malaysian Economic Plan (9MP) period of 2005-2010. This translates to about 1000 franchisees and 50 franchisors. As of November 2009, there are 46 such franchisors in the country. Franchise businesses contribute about 3.5% towards the Malaysian Gross Domestic Production (GDP).

Although the GOM's first priority is to encourage more home grown franchise concepts, they are very much open to introducing more unique foreign franchise concepts to Malaysia. The Ministry of Domestic Trade, Co-operatives and Consumerism oversee this sector. Perbadanan Nasional Berhad is a corporatized government owned entity tasked to lead and develop the franchise industry in Malaysia. PNS also provides financial assistance and advice to Malaysian Bumiputra franchisors.

In addition to increasing the number of Malaysian-grown franchisors, the long term franchise development plan under the 9MP is to establish Malaysia as a franchise and Halal franchise hub in the South East Asian region. There are certain sectors that the Malaysian government had identified as being market viable. They are services centric such as education, auto servicing, business consultancy, hotels, cleaning services and quick printing.

On the private sector side, food and beverage (F&B) franchise concepts remains the main driver of growth for Malaysia for the next few years. Currently, F&B encompass 31% of the franchise market share and it holds the largest market pie. The next largest franchise industry segment is apparel and accessories, which is half of F&B. Increasingly, casual dining and full service restaurants are gaining popularity. US casual dining F&B franchise concepts located in shopping malls are doing very well in Malaysia compared to the standalone stores. Fast food/ delivery segments are exceptions to the rule and are doing well located either in the malls, or in standalone stores. The Malaysian population's adventurous culinary tendencies will ensure continued success for the F&B sector.

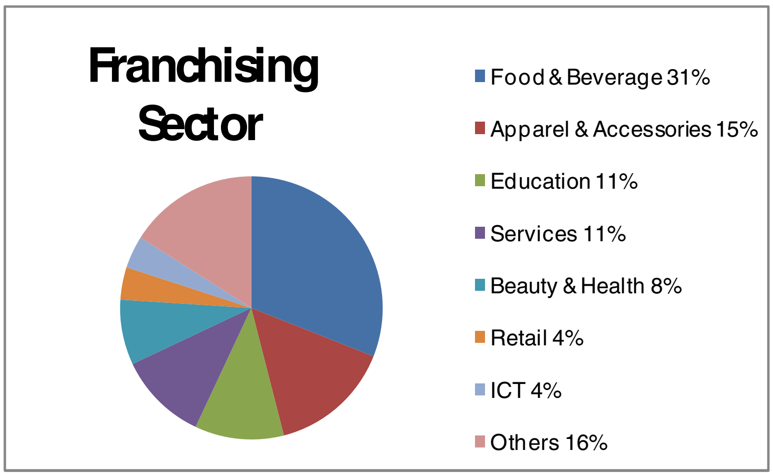
In the F&B sector, the current niche seems to be donuts. Although Dunkin Donuts has been in Malaysia for many decades, the market demand was not large until new entrants like J Co. (an Indonesia brand) and the Malaysian brand, Big Apple Donut made inroads in the Malaysian market. With the emergence of J Co and Big Apple Donuts, it has stirred up donut frenzy in the market. Seeing the market potential, Krispy Kreme recently entered the Malaysian market. Ironically, J Co. and Big Apple were set up as an alternative to Krispy Kreme, as the market consensus was that they mimic Krispy Kreme.

As more of the population gets exposure to foreign food franchises, they are now slowly accepting these brands. This receptivity bodes well for the continued demand growth of the F&B franchise industry. Coupled with the rising disposable income and time constraints that a large part the populace faces each day, foreign fast food is gaining a strong following. Further, huge advertisement and promotion outlays by the F&B foreign franchisors ensure strong brand recognition among the younger generation. So much so that even the toddlers recognize the McDonalds, KFCs, and the Dominos advertisements and logos.

As of 2009, Malaysia's per capita income, adjusted for purchasing power parity is about US$14,000. Malaysia aspires to be a develop nation by 2020. In order to achieve this, it would need to double its income level and the national capital base. With this tall aspiration, the demand for all goods and services is expected to increase in the next 12 years.

Market Data

2008 Malaysian Franchise Market Share



Source: Ministry of Domestic Trade, Co-operatives and Consumerism.
Exchange rate: US$1=RM3.50

The Malaysian franchise industry registered a healthy 15% growth in 2008. In 2009, the global recession is expected to reduce this somewhat. Almost 44% of the franchises operating in Malaysia are foreign franchises. U.S. franchises account for around 34% of these franchises.

Out of the entire Malaysian franchise market, 56% are home-grown. Twenty-seven of the domestically grown franchise brands have made inroads to 48 overseas markets. These brands are mostly in the food, early child education, clothing and accessories and beauty sectors. As of October 2009, there are 388 franchise businesses operating in the country. Food and beverage takes up 120 of these franchises, while maintenance and services have 46 franchises.

Best Prospects

The Food and Beverage sector commands one-third of the market share and remains the franchise best prospect for Malaysia.   Unique food and beverage franchise concepts would still be in demand.

Education has always been important to Malaysians. Malaysia, as part of the Commonwealth countries, has traditionally based its education system on the British model. Even so, an increasingly large number of Malaysians are being exposed to U.S. tertiary education. Children of foreign tertiary educated parents are partial towards their alma mater, and have the tendency to follow their parents' footsteps in entering these education systems. This inclination sometimes guides the decision on which international school systems they would put their children in. International schools are private schools based on foreign curriculum (U.S., British or Australian). These tendencies are slowly becoming a market trend, especially with the recent relaxation of the Malaysian education policy on international school enrollment. Previously, only expatriate children were allowed to enroll into international schools for K-12. Prior to this, Malaysians were only allowed to enroll their children into private schools based on the Malaysian curriculum. With this relaxation, Malaysian enrollment in international schools has increased tremendously.

Segments of the population have encountered a lack of admission opportunity in the local public universities. Alternative means to fulfilling this market segment is via foreign tertiary education institutions. Hence, extending this demand to foreign curriculum for K-12 level is a natural progression. The principal consumers of private education are the Malaysian Chinese and Indian ethnic groups, and a small segment of the high-income Malay community. As these segments of the student population are privately funded, cost effectiveness and accreditation of the private institutions would be the main criteria for consideration. Hence, U.S. K-12 franchise educators should capitalized on this new market trend.

Other franchise service sectors gaining market acceptance are in the health and beauty and retail sectors. Low capital investment and entry cost franchises also are attractive to first time franchise entrepreneurs.

Key Suppliers

Major domestic franchise players that have successfully expanded overseas are mainly in the food and beverage sectors. Secret Recipe Cakes and Cafe, Marrybrown Fried Chicken, D'Tandoor, and Nelson are some of the Malaysian food and beverage related franchise companies that had expanded to Asia and Middle-East. The England Optical and Smart Reader Childcare Center are some of the other successful franchisors. Smart Reader has over 300 outlets and is one of the largest home grown education franchise concept. Edaran Otomobil Nasional (EON) is one of Malaysia's largest automotive franchise dealers. As of July 2009, Malaysia has 381 home grown franchise brands.

U.S. franchise market share in Malaysia is about 34%. Some of the U.S. brands available are: KFC, McDonalds', Pizza Hut, Starbucks, Wendy's, Tony Roma's, Burger King, Carl's Jr., Dominos, Krispy Kreme, Papa John's, Popeye, Subway, Dunkin Donuts, etc. U.S. non-food brand in the market are: Borders, Levis, Foot Solutions, 7-Eleven, Merry Maids, Mail Boxes, etc. KFC is one of Malaysia's largest foreign franchises and it has been so entrenched in the Malaysian economy that it has expanded its business into a complete integrated upstream to downstream supply chain.

Other countries that have made inroads into the Malaysian franchise market are from Australia, U.K., Italy, New Zealand, Ireland, Canada, France, Japan and Singapore.

Prospective Buyers

There are a handful of large corporations in Malaysia who see franchise as a main money earner for the company. Due to the large number of franchises these companies hold, large market capitalization franchises are rather limited in market potential. If these conglomerates were to take up any franchises, they want the best in class franchise concepts. Niche selling points and renowned branding is absolutely essential in attracting their interests. Most of the successful US franchise concepts in the market are in the food and beverage industry. The major corporate franchise players in Malaysia are the Berjaya Group, QSR Brands Bhd, and the Naza Group. Berjaya Group is one of the most receptive corporations towards franchise business. The franchise brands in their stable include: Starbucks, Borders, 7-Eleven, Kenny Roger Roaster, Papa John's Pizza, and Krispy Kreme.

Large corporations and conglomerates notwithstanding, the other Malaysian franchise investors are constantly on the lookout for moderate price range franchise potential. Some of the very successful home grown franchisors are also looking at unique foreign franchise concepts. This is especially so if they find synergies in the franchise concepts. Although food and beverage sectors continue to be in the forefront of demand, increasingly the education, health and retail sectors are gaining popularity.

While most of the populace still needs to be educated on franchise concepts, the market is gradually becoming more aware of franchise as a means to producing entrepreneurs. The Malaysian government's constant encouragement and promotion of franchise as a means to improve the number of entrepreneurs is slowly gaining traction. Perbadanan Nasional Berhad (PNS) is a corporatized government entity tasked as lead agency in developing the Franchise Development Program under the 9MP. It also comes under the guidance and purview of the Ministry of Domestic Trade, Co-operatives and Consumerism. Even though PNS's main focus is in encouraging more home grown franchise concepts, they are not adverse to exploring collaboration with foreign franchise concepts. Primarily, its function is to identify, acquire, launch, facilitate and encourage both local and international franchise brands. PNS is leaning towards lower cost service sectors as the next prime mover for the entrepreneurs.

Market Entry

Large franchise fees are the main hurdles to the purchase of franchise concepts for the majority of Malaysian investors. Due to the geographic distance between the U.S. and Malaysia, U.S. franchisors need to take into consideration the disparity in cost of goods and the Malaysian standard and cost of living. Flexibility on the purchase of franchise merchandise, upfront franchise fee, advertising and marketing funds, area development rights/exclusive territory, and balloon payments should reflect the cost of living in Malaysia. For instance, if the cost of goods is lower in Malaysia, then, perhaps US franchisors could entertain the idea of local procurement rather than importing the merchandise from the U.S.

Often times when issues such as these are not handled up-front, quality erosion ensues. To sustain quality control, minor localization may be necessary. U.S. franchisors would need to work closely with Malaysian franchisee in coming out with a workable long term solution. The big question of financial feasibility of the franchise for worthwhile acquisition must be answered. Typical retail franchise on a three year return on investment of about 33.3% per annum is deemed acceptable to the industry.

Once the U.S. franchisor has identified a Malaysian franchisee, the next step for the franchisor is to register with Registrar of Franchise (ROF). In Malaysia, franchising is governed by the Malaysian Franchise Act 1998. This Act applies to the sale of franchises throughout Malaysia. A franchise sale is deemed made in Malaysia when an offer to sell or buy a franchise is made in the country the offer is accepted within or outside of the country; it is made outside Malaysia and accepted within the country; or when the franchise business is or will be operating in Malaysia. There are four registration categories under the Malaysian Franchise Act 1998.

Category	Definition
Franchisor	A person who grants a franchise to a franchisee and includes a master franchisee and his relationship with a sub-franchisee
Master Franchisee	A person who has been granted the rights by a franchisor to sub franchise to another, at his own expense, the franchise of the franchisor
Franchisee of a Foreign Franchisor	A person who has been granted the rights by a foreign franchisor but does not sub franchise to another person
Franchise Broker	A person doing business as an agent or representative of a franchisor to sell a franchise to any person for a certain consideration but does not include any director, officer or employee of the franchisor or franchisee

Various fees imposed are as follows:

Category	Fee
Registration of franchisor/master franchisee/ franchisee of foreign franchisor/ franchise broker	RM50.00 processing fee RM1,000 registration fee (upon approval)
Registration of franchise broker	RM50.00 processing fee
Registration of new franchise package by a	RM50.00 processing fee

registered franchise	
Approval under section 54	RM50.00 processing fee
Amendment to disclosure document	RM50.00 processing fee

ROF comes under the purview of the Ministry of Domestic Trade, Co-operatives and Consumerism. Additionally, Malaysian has fashioned its own Franchise Disclosure Document similar to the Uniformed Franchise Offer Circular (UFOC) in the U.S. A franchisor would need to lodge the document with the ROF at least 10 days prior to signing of franchise agreement.

Section 54 of the Franchise Act 1998 states that a foreign person who intends to sell a franchise in Malaysia or to any Malaysian citizens is required to submit an application for approval from ROF. Currently, a processing fee of RM50 (approximately US$14.30) applies for each application. Basic documentation required for ROF applications are as follows.

- The letter of intent should include the following information: date of incorporation, and commencement of business, franchise concept and background of company, franchise experience (if it is self-owned, and the number of existing franchise outlets), and the identity of proposed Malaysian master franchisee/ franchisee
- *Certified true copy of incorporation from the relevant agencies in the country of origin
- *Certified true copy of proof of trademark and/or intellectual property mark registration
- Company brochure and annual report with photograph of the outlets

* Note: Certified documents by a public notary, commissioner of oaths, advocate, solicitors, magistrate, or judge.

Franchises established prior to the enactment of the Malaysian Franchise Act 1998 are exempt from registration. Licensing agreements, instead of franchising agreements is exempt from registration as well.

Market Issues & Obstacles

For religious reasons, Hindus and devotees of Taoist deity Guan Yin abstain from eating beef. Muslims do not consume pork. Hence, chicken and fish have greater mass market appeal. As over 60% of the Malaysian population is Muslim, US food and beverage related franchise companies that intend to sell to Muslim consumers should be aware of Halal requirements. Halal is defined as what is permissible under the Islamic Shariah Law. Malaysian standard MS1500:2400 is used in the production, preparation and handling of Halal food. This standard prescribes to the practical guidelines for the food industry on the preparation and handling of Halal food (including nutrient supplements) and serves as a basic requirement for food product and food trade or business in Malaysia. It is used by JAKIM as the basis for certification. JAKIM is Malaysia's Halal certifying body.

Malaysia also recognizes three Islamic bodies in the U.S. These certifying bodies are:

- Halal Food Council International (HFCI)/ Halal Food Council South East Asia (HFC-SEA), Salisbury, Maryland
- Islamic Services of America (ISA), Cedar Rapids, Iowa
- The Islamic Food and Nutritional Council of America (IFANCA), Chicago, Illinois

Some see stringent Halal certification as a non-tariff trade barrier. Islamic law has a prescribed slaughtering ritual which they perform on all animals consumed, except fish and most other seafood. Pork is forbidden to be consumed. U.S. abattoir/ meat exporters who intend to export to Malaysia must be mindful of the Halal requirements and certification process. With only a handful of meat exporters willing to go through the Halal certification process, there are a finite number of suppliers. The cost of goods is high due to the lack of competition. U.S. franchisors need to take this into consideration as part of their franchise financial feasibility study for each country. This is also useful as a market selling price determining factor.

As for the education sector, under Malaysian law a private educational institution must first obtain approval from the Ministry of Education prior to commencement. In addition to the approval, all the courses offered by the private educational institution must be endorsed by the national quality assurance agency, the Malaysian Qualification Agency (MQA). Without MQA's approval, the private educational institution's programs would not be accredited.

The following Acts may be of interest to U.S. education franchisor venturing into Malaysia:

- National Accreditation Act 1996 (Act 556)
- Education Institutions (Discipline) Act 1976 (Act 174)
- Education Act 1996 (Act 550)

Trade Events

- Facon Education Fair Kuala Lumpur, March 2010, Kuala Lumpur City Center, Kuala Lumpur
- Franchise International Malaysia 2010, July 30-August 1, 2010, Putra World Trade Center, Kuala Lumpur

Resources & Contacts

Ministry of Domestic Trade, Co-operative and Consumerism (MTDCC)
Franchise Development Section/ Registrar of Franchise
Level 4 Tower Block
18 Persiaran Perdana Precincts 2
Federal Government Administration Center
62652 Putrajaya
Malaysia
Tel: 60-3-8880-5508, 60-3-8880-5507
Fax: 60-3-8880-5617
Website: www.kpdnkk.gov.my

- Ministry of Domestic Trade, Co-operatives and Consumerism (MDTCC)
- Malaysia Franchise Association
- Perbadanan Nasional Berhad (PNS)
- Halal Malaysia
- Malaysian Qualification Agency (MQA)
- Malaysian-American Commission on Educational Exchange (MACEE)

For More Information

The U.S. Commercial Service in Kuala Lumpur, Malaysia can be contacted via e-mail at: Tracy.Yeoh@mail.doc.gov; Phone: 60-3-2168-5089; Fax: 60-3-2142-1866; or visit our website: www.BuyUSA.gov/Malaysia

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