

Legal and Contractual Framework in Supply Chain Management and Distribution Channels: An Indonesian Perspective

Evita Isretno Israhadi

Borobudur University

evita_isretno@borobudur.ac.id

Abstract---The subject matter of this paper concerns the Legal and contractual framework in supply chain management and distribution channels in the Indonesian perspective. A questionnaire survey was carried out with regulatory dimensions and such criteria that will enable the researcher to get information on legal and contractual framework in supply chain companies of various sectors such as coal, cement, construction, timber, and agriculture in Indonesia. A theoretical sustainable SCM model was devised to carry out this empirical study. The data collected was examined through content analysis approach. The findings revealed the absence of a formal and written legal and conceptual framework in the sampled organizations. These findings are expected to help supply chain managers and stakeholders in various industry sectors to in Indonesia to design such legal and contractual frameworks for supply chain management and distribution networks that would help Indonesian businesses operate smoothly.

Keywords: *supply chain, distribution channels, legal and contractual framework, industry, Indonesia*

1. Introduction

The term supply chain management has seemed many literary definitions since Keith Oliverits first coined this phrase [1]. The word ‘supply’ in this phrase refers to the ‘flow’ of resources such as material, labour, information, skills and competencies required to satisfy a demand. The term ‘chain’ represents linkages or relationships across these resources involving people and organizations; the term ‘management’ refers to the ‘processes’ or ‘procedures’ inside an organization that aims at facilitating the people to succeed through the systems and procedures. Hence, in order to understand the Supply chain management (SCM), it requires a holistic perspective with people, procedures, resources and the organizational platform a part of it [2]. With the growing prevalence of SCM principles in the current industrial scenario, a new need is felt to provide a legal and contractual framework to the SCM [3-4]. A supply chain contract of either people or resources

or flow of information across verticals in an organization requires a legal and contractual framework.

A legal and contractual framework in supply chain companies requires robust documentation including such clauses and items that are enforceable and appropriate in all types of distribution channels, agencies and dealerships [4]. Such a contractual framework also applies to all types of agreements in export-import regulations, logistics, transportation and customs. A regulatory framework is signed between two or more parties agreeing to exchange a flow of goods or services, data or technical know-how. It often happens that in the absence of such contractual agreements and legal provisions, one or more parties of the supply chain get the opportunity to optimize their own profits [5], thus disturbing the whole supply chain and violating the conditions of an unwritten contract. Hence, a need is always felt to execute legal and contractual agreements in order to coordinate with all members of the supply chain.

1.1 Supply chain regulatory framework in Indonesia

The Indonesian legal framework and distribution channels are largely grounded on the outcomes of an annual event called Indonesia Transport, Supply Chain & Logistics (ITSCCL) which brings together all areas of transport and logistics and their segments by creating an end-to-end multimodal viewpoint [6]. The ITSCCL 2018 will take place on September 12-14, 2018 at Jakarta. The agenda of this year’s event is to start a dialogue with the Transport and Logistics industry professionals on a number of issues including transport (road, shipping, rail, air), freight (waterways, land, rural, e-commerce, etc.), use of information systems in legal affairs, supply chain management, infrastructure, real estate and several such areas that make use of logistics solutions with the help of technology and supply chain [7]. The event is also an opportunity for all supply chain experts and contract managers to design and improvise more robust compliance and policy channels to become a part of the legal framework. The purpose of such events is to streamline commercial contractual terms and align them with the supply chain requirements of different business

areas across Indonesia. It also acts as a platform for designing a legal interface for the compliance of activities such as audits and other surveillance practices. In short, Indonesia needs more such initiatives to develop and implement policy framework for its supply chain function across industries, for their internal as well as external controls and smooth contract management.

1.2 Problem statement

The Legal professionals in Indonesia although do not lack experience in supply chain transactions, but they lack skills in drafting and negotiating contracts, hence their approach has been to avoid disputes and litigations [4]. It is therefore a challenge for the legal professionals and SCM experts in Indonesia to design appropriate and unambiguous documentation in order to achieve business objectives of the companies.

A second issue faced by the Indonesian industry in almost all sectors is that there is an absence of any legal and regulatory framework that would deal with such SCM practices like data protection, digital identity, and supply chains in logistics and transportation [8]. The companies functioning in different sectors are also supposed to know what legislations are required in their respective domain areas. However, there exists lawyers and agents specialized in Commercial Law who can prepare contractual documentation to meet any supply chain requirements. Such chains might relate to an agency, dealership, franchise, supply and transportation agreements or any kind of distribution channel agreements across sectors in Indonesia. This study has attempted to examine the requirement of a legal and contractual framework in order to determine the extent to which supply chain management makes these sectors functional to meet the modern challenges of logistics, transportation and flow of information.

The rest of the paper is structured as follows. Section 3 is the literature review of legal and regulatory SCM in the Indonesian perspective. Section 4 explains the research methodology and the development of the dimensions of the study. Section 5 discusses the findings and results of the study based on the questionnaire survey. Finally, Section 6 presents the conclusion, suggestions and recommendations.

2. Literature Review

2.1 Prerequisites of Supply Chain Contractual framework

In the manufacturing sector, a company's supply chain might be a source of both risk and value, which can be mitigated by maximizing the robustness of its supply chain. [4]. This study suggests a few prerequisites of supply chain contracts particularly if it is entered with a third party or an external agency. The first and foremost prerequisite is the agreement on commercial terms through a written documentation, failure of which might lead to disputes over the contract itself. Secondly, a SCM agreement must clearly articulate the quantity terms in sale of goods, for instance, a contract without the mention of quantity or number will be unenforceable. Third, a supply chain agreement ought to mention the duration of the agreement or a time agreed upon when either party having the right to terminate it though this brings flexibility in supply chain, but also creates a lack of stability [9]. In case of an early termination, a supply chain contract should also have the negotiation clause providing the possibility of a bargain or an alternative to terminations. Next, a supply chain contract should also include warranties applicable on goods and services and a permitted limit to damages and their remedies. A similar study [10] examines the success criteria of regulatory frameworks of Supply Chain Logistics and its legal Implications in the European Union (EU) legislation. It investigates how a legal framework mandates the operation of the supply chain in its two important sectors, Transport and logistics. The study reiterates the need to understand the legal provisions in the EU law that deals with dimensions such as data protection, digital identity and online payments.

2.2 Legislations and Regulatory Framework

A supply chain in an organization can have far reaching consequences. These consequences are reflected in the regulatory framework designed for a specific supply chain in an organization [4] [9]. For instance, there are tax efficient supply chains in many organizations that prepare business models for companies operating in different countries. These companies design and implement a supply chain in such a manner that their cross-national operations result in profits. These companies legally optimize their supply chains in order to acquire a tax efficient business operation. Often, it is also alleged that too much legislation and regulations complicate the supply chain in an organization particularly when the company engages a third party to manage its

supply chain [11]. Table 1 provides a few examples of Acts and Regulations whose compliance requires robust SCM systems. Here are a few legislations:

Table 1. Regulations concerning products and services for SCM organizations

Regulation/ act	Prohibitions / restrictions	Compliance /Legal provision
California's safer consumer products regulation	Chemicals and other hazardous substances	Disclose the amount and exposure limits to substances .
California's Transparency in Supply Chains Act	Human trafficking	Disclosure to eradicate slavery and human trafficking through their supply chain
U.K.'s Modern Slavery Act	Slavery and bonded labor	Disclosure about their supply chains not engaged in slavery.
EU's Regulation on Registration, Evaluation, Authorization and Restriction of Chemical (REACH)	Chemicals in paint, clothing, electronic products, furniture,	The companies must give evidence that their product is safe.
Washington state's children's safe product act	Chemicals and other hazardous substances harmful to children	Disclosure about their products if they contain substances (chemicals) of high concern to children

These acts and regulations are meant to monitor and control the companies engaged in manufacturing goods that could be potentially hazardous to children and to public health, in general. In France, legislation called *the Devoir de Vigilance* — or duty of care - requires French companies to remove from their global supply chains any sign of environmental or human rights violations, negligence of which was a punishable offence. The French law prohibits any unethical recruitment over detention of human labor that amounts to slavery or bonded labor.

2.3 Legal Risk in Supply Chain and Third Parties Operations

A recent example of February 2018 can be cited of KFC involved in a supply chain issue with its third

party logistics and supply partner, DHL [12]. Almost two-third KFC stores in the UK were shut due to supply chain issues with its new logistics partner, DHL. The KFC stores had run out of fresh chicken since DHL faced a few difficulties in its supply operations. This example suggests how a failure of the supply chain might result in financial risks and losses partly due to third party operations. Hence, a legal and regulatory framework in the form of a robust agreement is required to avoid such incidents. Hence there is a legal risk in all types of third party operations. To protect against financial and legal penalties, organizations are therefore required to manage and mitigate risk across their supply chains. Studies [4] [9] [35] [36] have provided different types of Legal Risks such as compliance risk, which means complying to the country's laws and regulations in which the business operates, particularly following the law related with unethical practices and not to force human labor to work in unethical and illegal conditions; contract risk when a third-party business / logistics partner, vendor or supplier fails to meet the terms of contract and put the company to financial damage; or risks related to Trademark/Patent Infringement when infringing on a patent, trademark or a copyright material violates the intellectual property law putting on damage the organization. The author recommends managing these risks in order to prevent supply chain and business disruptions.

2.4 Sustainable Operation of A Supply Chain

An example of poor sustainability of SCM and backward Supply Chain Management can be seen in Carillion's Downfall [13]. A company of 43,000 global employees and 30,000 auxiliaries with a market capitalization of nearly £1bn in its supply chain owed approximately £2bn to its subcontractors before declared insolvent. Until its insolvency was made public, it boasted on its website: "under our Sustainable supply chain, [having] an international supplier spends of around £3 billion, our supply chain partners can help us make a tangible positive impact on sustainability." However, on the contrary, Carillion was not sustainable since it followed traditional technologies to manage its widespread supply chain. This resulted in failure of many of its supply chain companies due to ineffective and irrevocable letters of credit to its contractors and sub-contractors, unpaid services, lack of insurance support, lack of modernization, poor control of labor, and mismanagement of materials and services across its projects.

In the Indonesian perspective, a pioneering study [14] drew attention to SCM policy and regulations as major factors for a successful and sustainable operation of a supply chain. The authors cited examples of government regulations and legal

provisions which include several dimensions including market forces, stakeholders' expectations about issues such as global warming and fast depletion of natural resources in the name of industrial growth. Another study in the Indonesia context [15] examined the sustainable SCM of the coal industry devising a multi-criterion decision making method with far-fetched policy implications for the coal industry of Indonesia. This study was consistent with a previous study [16] which also had emphasized upon devising a regulatory framework for reducing environmental deterioration caused due to supply chain companies. The study felt the necessity of sustainable, ecofriendly supply chain practices that would introduce regulatory practices such as waste disposal, recycling and remanufacturing in the production chain. However, other experts [17] [21] [37] [38] [39] [40] have argued and raised doubts about having a truly sustainable supply chain due to the presence of several MNCs in Indonesia that have established their factories such as Nike, Bayer, Loreal, and General Motors but failed to build a sustainable regulatory and legal framework. There are a few other studies [22 – 24] on sustainable supply management procedures highlighting eco-design, reducing environmental impacts, waste reduction, and pollution prevention as variables of a green supply chain in the Indonesian manufacturing organizations.

3. Research Methodology

Data for the study was collected through a questionnaire distributed to diverse manufacturing and supply chain companies in Indonesia which included coal and timber industry, copper mines, cement plants and automobile factories all of which had reported implementation of a SCM framework. Secondly, all these Indonesian companies are expected to adopt sustainability in their supply chains. The objective was to examine the legal and contractual framework and various distribution channels in the sampled organizations. Questionnaires were distributed by email to large companies involving in coal supply chain in Indonesia and were collected from January 2018 to June 2018. To overcome certain difficulties in obtaining data and to have in-depth information, the researchers had a personal access to a few companies in Jakarta and nearby area for a face-to-face interaction. The respondents were mainly executives in sales and distribution, financial services, suppliers and legal advisors involved in the execution of the supply chain across the verticals of each organization. A theoretical sustainable SCM coordination model was also devised to carry out this empirical study.

4. Findings and Analysis

The demographic data had revealed that more than 60% of the respondents were directly overseeing sustainable supply management in their company as supply chain managers or supply and purchasing managers. The sample was not restricted to a single company and, the respondents belonged to a wide spectrum of sectors including coal, cement, and timber, copper and automobile. However, there was a common element that each sampled organization had a supply chain management in the form of sales and distribution, power generation or management information system. All companies were fully Indonesian owned firms operating for more than 10 years employing more than 1000 people.

Right at the outset, the respondents were asked to describe the legal and contractual framework of their respective organization. It was observed that these organizations followed very basic guidelines regarding legal procedures. For instance, there were four main concerns in their legal framework: a written contract; regulations and models for the supply chain followed closely; supply chain policies applicable on all employees; and an unwritten constitution related to the economic sustenance of the organization (Figure 1)

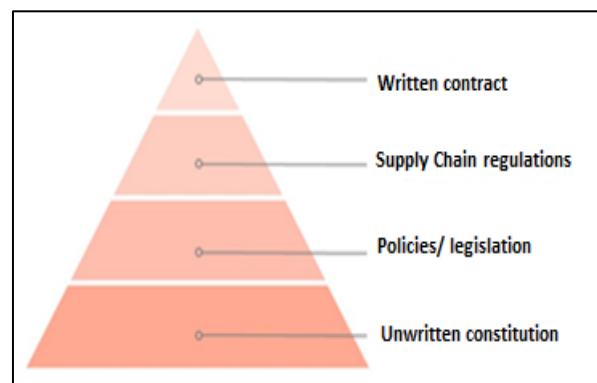


Figure 1: Guidelines for legal procedures in Indonesian companies

Each legal framework had a provision of commercial relationship and supply chain coordination with external suppliers, while internal stakeholders were responsible only for technical management of supply chain including quality, service specifications, safety, and availability of resources and work execution. Any commercial agreement or contract with external could not be directly undertaken by any internal stakeholders without involving a legal procurement official. For the purpose of this study, a supply chain cycle (Figure 2) was devised in order to understand the coordination between internal and external

stakeholders as far a legal framework was concerned.

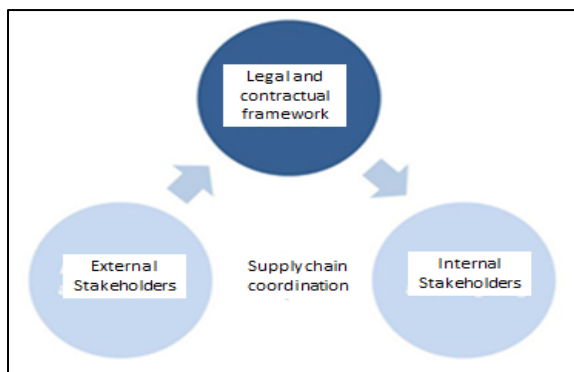


Figure 2. Supply chain coordination model within legal framework

The evidence of this study suggests that each sampled organization managed the supply chain by means of a sort of breakdown in products and services in terms of people's activities, logistics, distribution of information and resources including the raw materials. However, the physical infrastructure was found to be complex, requiring design compatibility with the supply chain requirements. This made the supply chain appear relatively unstable and fragmented.

In all the sampled organizations, the supply chain relationship for individual projects were found to be short term, usually following informal legal practices focusing only on the individual project but not the business. For this reason, any of the stakeholders failed to make any impact on the legal or contractual framework. However, many respondents agreed that a change in the perspective was required and a more focused approach was required on the process and procedures rather than the end product itself. This is possible only if they enter into a long-term relationship or partnership with their clients, customers and suppliers, particularly in the construction sectors. ITSCl proves to be a good platform to define the Indonesian government's construction strategies, and identify procurement and legal frameworks to establish a SCM process. It also welcomes initiatives from private agencies and prime contractors to design and build such SCM distribution channels that can integrate all verticals in an organization with internal and external stakeholders including contractors, designers, suppliers, site managers, and so on (Figure 2).

These findings are consistent with [21] [24] which emphasized upon green supply practices such as eco-design, waste reduction and pollution prevention as variables and inclusion of these practices in a legal and contractual framework. Similarly, two other studies support the findings of

the current research. First, the Unilever study [25], [34] for Indonesia (2011) which insists upon designing a sustainable SCM and make it authentic through a legal contract; second, a study on Astra and Sinar Mas Group (2014), leading coal producers in Indonesia, shows the blueprint of designing a SCM framework with legal and regulatory considerations [23] [26], [32], [33]. The Group has amalgamated its environmental, social and economic practices with a single regulatory framework and directly all its employees to relate their operational performance within its guidelines. Such an initiative needs to be popularized in Indonesia which can associate all distribution channels in a single supply chain including stakeholders, government, and socio economic environment. Such initiatives offer solutions to the legal and contractual issues created during tenders and other procurement activities.

5. Conclusion

The study concludes with such evidences proving the significance of legal and contractual governance through a supply chain in Indonesian organizations. Looking at the technological, transportation and communication challenges in today's market it is increasingly difficult to operate in the absence of a written legal contract. A supply chain is incomplete without a contractual agreement binding the two or more parties in a common mode of compliance. Such a legal framework acts a mechanism to keep contractual parties in close association. It also offers lean support to a company's ERP System in making faster implementation of processes across all verticals with lesser need for training [27]-[31]. A supply chain therefore acts as a legal framework and integrates with the ERP system or any other distribution channel of an organization. The study therefore recommends that Indonesian organizations should have a robust written supply contract. These supply chain contracts help in rectifying the issues and take necessary steps required. A written contract has a legal binding and helps all parties to deal with issues such as delivery failures, defective goods, or time delays. The warranty issues or indemnity for losses in respect of goods or services will also be easily dealt with under a written contract. Besides, this study has strong implications for supply chain professionals and external/internal stakeholders. This study has also paved new directions on logistics and supply chain management in manufacturing sectors of Indonesia. SCM projects with the help of information technology, for example, can be taken up to regulate the legal affairs of e-business and related distribution channels. The supply chains can be used with new methods like cloud technique and big data generation as innovative research directions for future studies.

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