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Sharia characterization of a sales-based royalty in an Indonesian beverage franchise agreement: A contractual analysis under DSN-MUI fatwas and AAOIFI standards

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Abstract

The present study analyses recurring royalty in the context of its Sharia contractual equivalence using two datasets: relevant DSN-MUI fatwas and AAOIFI Sharia Standards for comparative assessment. This study employs qualitative document and content analysis informed by one anonymizing Franchise Cooperation Agreement from a local tea beverage brand XYZ in Indonesia. A comprehensive analysis of the agreement was conducted, with each clause being examined to determine the allocation of rights and assets, services, payment obligations, countervalues and business risks. These were then categorized and analyzed in the context of substantive bai‘, ijārah, shirkah, ju‘ālah contract law. The findings indicate that the franchise fee, which is paid once only, includes the trademark license, equipment, and primary training (a hybrid transaction). In contrast, the 5% from net sales is more indicative of revenue-based royalty as opposed to actual profit sharing. The subject under discussion fails to meet the criteria for a partnership, as defined by Shirkah. In this context, the contributions of the parties are not treated as capital for the partnership. Furthermore, payment to the franchisee is charged against sales and not realized profit. It is evident that business losses or burdens of loss are predominantly experienced in franchise industries. It also cannot be described as ju‘ālah, since there is no separate franchisor function or quantifiable outcome that would give rise to entitlement to the payment. Equally important, the written agreement does not specify the right, benefit or continuing service that is the countervalue of the monthly royalty. This gharar is in the subject matter of the exchange, which engenders a risk of duplicate compensation. This is because trademark use and initial training are included in the base fee, while new-employee training is charged separately. This conclusion relates to the contractual specification and does not imply that in practice no services were being rendered continuously. The proposed framework is a clause-to-cash-flow model that connects each franchise payment and its associated legal object, countervalue, trigger and risk bearer. The report also advises distinct treatment of franchise payments, and clear specification of the continuing benefits, liabilities and payments associated with each charge.

Keywords: Islamic franchising; royalty fee; hybrid contracts; shirkah; ju‘ālah; ijārah; gharar; Sharia governance

1. Introduction

Franchising can be defined as a strategic initiative employed by business to expand their networks without requiring each outlet to be run independently by the brand owner. The franchisor grants access to a trademark, a standardized operating system, technical know-how (to run the business), recipes, training and network support. Meanwhile, capital and labor supply at the outlet-level is provided by legally independent franchisees. This model is most evident within food and beverage markets due to the standardization enabling rapid outlet concept replication. Several contemporary tea and coffee businesses have also experienced similar expansion in Indonesia, with entry packages that are used to sell the business to small entrepreneurs along with paths for ongoing commercial support (Hisyam et al., 2024; Yunika & Cahyani, 2024). As these networks evolve, it becomes ever more critical how contracts apportion payments, benefits, control and business risk.

Franchise fees are typically comprised of two main components: an initial fee and one or more ongoing charges. The upfront/initial franchise fee mostly includes the right to become a part of the network, the utilization of the brand and logo, the provision of supplies/equipment (such as signage), the initial provision of inventory/supplies, training and other services provided by franchisors during this stage. The determination of the royalty is typically based on either gross sales, net sales, or the profit of the recurring royalty itself. These bases are not interchangeable. A gross-sales royalty arises from sales revenues prior to a franchisee's operating expenses, while net-sales royalties allow for some sales deductions yet remain separate from net profit. Profit-based payments are taken from the amount remaining subsequent to the recognition of applicable costs. It is thus crucial to note that royalties represent a calculation method, but do not constitute

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evidence that the parties involved have reached an agreement concerning the profit share.

The concept of continuing royalties is addressed in the realm of economic literature through a variety of factors including agency costs, incentive alignment, monitoring, brand investment protection and the financing of continuing support. In addition, the discussion should address the assertion that sales-based royalties are more readily verifiable than net profit but they can link the franchisor's income to the outlet performance. Nevertheless, the economic effect of such agreements is intrinsically related to the overall agreement, encompassing the provisions for territorial safeguarding, compulsory purchases (including before and even financing), quality control measures and physically supportive development (Bang et al., 2023; Guo, 2023; Sadeh et al., 2024; Zeißler et al). In addition, up-front fees, royalties, and margins on mandatory inputs have been identified as contributing factors (Vázquez, 2005; Maruyama & Yamashita, 2012, 2014). This means that royalty can be validly commercial, but the mere fact of royalty inherently determines the legal basis for the franchisor's entitlement.

Drawing on the most recent research on franchise, there is more exact supporting documentation available on the subject of recurring royalties and how they are counterbalanced against one another. Bang et al. (2023) conducted research to examine the correlation of between royalty fees and types of franchisor support including training, marketing, pre-opening assistance, operational support and financial assistance. This is like the findings of Sun and Lee (2024), who posited that ongoing royalties may also be a payment for the right to continue accessing the franchisor's business model and associated services such as advertising/marketing. As demonstrated in Zeißler et al., (2023); Li et al., (2023); and Sadeh et al., (2024), other studies have embedded royalty rates in a broader package of contractual governance including territorial rights monitoring, financing support and network coordination. Altogether, this literature suggests that a sales-based royalty does not inherently function as a profit-sharing mechanism. The legal and economic nature of the professional will depend on his/her intellectual-property rights and services, as well as any continuing obligations that constitute the counter-performance offer of the franchisor in connection with this agreement.

This raises the fundamental issue of difference of opinion in Sharia business law. In the context of commercial terms, the term royalty is not an independent nominate contract under Fiqh Muamalah. A particular payment cannot simply be measured as compliant; rather a takyif fiqhi will be required, necessitating the ascertainment of the franchisee receipt, the franchisor’s entitlement to impose a charge, the stage at which this entitlement arises, and the parties who takes on that risk. It is possible that the output is not perfect; it may be an intangible right, a service, property transferred over the sample space, participation in a joint venture through statistics, or achievement of a quantitative result. It is only after this contractual nature been established that the payment can be evaluated against the definitions of ijarah, bai', shirkah, ju'alah or any other applicable contract.

A franchise royalty is most often initiated as a form of compensation for the utilization of expertise and/or business system. DSN-MUI Fatwa No. 112/2017 and AAOIFI Sharia Standard No. 9 both include an identifiable usufruct or known service in exchange for payment under ijarah, which is defined as a lease (or rent, lease agreement). With incredible specificity, AAOIFI Sharia Standard No. 42 further identifies trademarks, copyrights, commercial licenses, and technical know-how as valuable rights that can be transferred or used in exchange for consideration. Thus, temporary access to the trademark and franchise system could be characterized as a license based on ijarah, while training, marketing support, ongoing system updates and other continuing assistance might comprise an Imarah al-a'mal. Equipment and consumable inputs that enter the ownership of the franchisee would instead be classified under bai'.

Thus, royalty based on turnover is not fundamentally incompatible with Sharia. If the licensed benefit or continuing service, contract period, calculation method and the obligation of parties are sufficiently ascertained, it can act as a variable ujrah. The crucial question therefore is not the basis of the payment as a percentage of sales, but rather the existence of a meaningful and autonomous countervalue that support it. The issue arises as soon as a considerable part of the initial franchise price is related to the usage of the brand name and training (clearly the case if billed in a package) or even when specific services are charged separately. In such a situation, the agreement should demonstrate the additional benefit derived from these royalties (i.e. what continued performance purchase them) or risk being regarded as an unclear element or duplicative of already made compensation.

This is only justified in the limited case of shirkah and ju'alah, since they are distinct forms of exploitation from usha, and only then when their own constituent elements are present. In the case of shirkah, which is a part of DSN-MUI Fatwa No. 114/2017 and AAOIFI Sharia Standard No. 12, there is a requirement for identifiable inputs to jointly operate a venture with profits being calculated above an agreed ratio and capital loss should be distributed proportionately to individual capital commitment [8]. As stipulated in DSN-MUI Fatwa No. 62/2007 and AAOIFI Shariah Standard No. 15, the concept of Ju'alah stipulates the entitlement to a certain amount of reward for undertaking actions that produces a identified result. This present study does not assume that royalty fees pertain to either classification. These tests are significant to the ABC, given that the recurring payment of ABC is specifically characterized as "profit sharing," and ju'alah has been suggested as an appropriate basis for variable compensation. This approach does not equate them with the legal nature of royalties by default, rather, it is an attempt to test those characterizations against the substance of the payment.

Franchise agreements are therefore more accurately described as hybrid agreements. It is possible that some of their constituent elements might be constituted by an ijarah-based license, contracts for services such as ijarah al-a'mal and bai' to cover machinery and materials. Furthermore, associated security provisions and governance may also be present. The existence of multiple contracts within one single commercial relationship does not make hybrid structures impermissible. The legality of these arrangements is determined by the lawfulness and clarity of each element and whether their combined effect establishes an illicit arrangement or conflicting commitments (Susamto, 2016; Harrieti, 2018; Hasanudin et al., 2022). In this context, a similar approach is adopted by AAOIFI Sharia Standard No. 25 with regard to the combination of contracts. In addition, AAOIFI Sharia Standard No. 31 is applicable in cases where the contractual basis, countervalue, calculation base or performance obligation are materially objectable. However, it is important to note that ordinary commercial risks should be distinguished from unnecessary ambiguity in the contract.

The definition utilized in AAOIFI Sharia Standard No. 31 is a conventional Fiqh approach to define gharar. Gharar, as delineated by Ibn Taymiyyah, is defined as al-majhūl al-ʿāqibah, signifying a transaction with an uncertain future outcome. As another example, al-Nawawī himself defined as an affair as a condition whose result is uncertain and whose existence is hidden. While al-Māwardī specified that there are two possible (one against another) joints. Ibn al-Qayyim specified it with other situations in which the realization, delivery, quality and quantity of a contract are uncertain (Ibn Taymiyyah, n.d.; al-Nawawī, n.d.; al-Māwardī, n.d., Ibn al-Qayyim, n.d.). These classical formulations of gharar closely reflect the notion articulated by AAOIFI in their definition of gharar as uncertainty due to an unknown component of a transaction, especially where the expected outcome is uncertain. Furthermore, the division of gharar as excessive, moderate, or marginal according to the standards of AAOIFI aligns with the classification system proposed by al-Qarāfī who categorized gharar as kathīr, mutawassiṭ, and qalīl (al-Qarāfī, n.d.; AAOIFI, 2015).

The two normative frameworks utilized in this study play distinct yet complementary roles. DSN-MUI Fatwas Highlights, the common reference on this case is provided by the DSN fatwas that translate mu'amalah principles into certain standards related to Indonesian practices of transactions (Hidayati et al., 2023; Hasanudin et al., 2023). Indonesian positive law does not directly enforce AAOIFI standards; however, they provide a more clearly defined comparative standard for the following: (1) financial rights, (2) the legal characterization of contracts, (3) money compensatory flows and remuneration and profit and loss sharing principles; as well as combinations of contracts (Hassan & Rabbani 2022). This means that comparison is employed to ascertain areas of convergence including additional detail and potential variance in emphasis. This approach is undertaken rather than treating the two sources as interchangeable.

Existing studies tend to identify franchise and royalty payments as acceptable if the parties are acting voluntarily, the payment is at a fair market value and the arrangements do not include riba, gharar, maysir, tadlis or other forbidden elements. Darmawan (2010) received a royalty from the profit net, while Afifah et al. (2021) placed emphasis on transparency and called for interest imposed for late payment to be considered as riba. In the 2023 study by Hasfri & Sative, supported by DSN-MUI Fatwa No. 114/2017, the assertion that the fixed royalty, which is distributed as profit shares regardless of the business performance, provides a comprehensive representation of the definitions, is not entirely accurate. While these studies elucidate crucial compliance issues, they typically start either with shirkah/Qabalah or broad norms of permissibility. The prior question of whether a royalty properly understood as ujrah for intellectual-property licensing or continuing services has received relatively little attention.

The gap is related to the interaction of the individual payments in a franchise arrangement. Newer franchise scholarship offers micro-accounts of royalty design, governance, monitoring and support, incentives and risk sharing/transfer—largely as it intersects with Islamic-finance scholarship that has produced an impressive literature on hybrid contracts. However, none of the studies that were included in this review systematically analyze a snapshot analysis of a current beverage franchise agreement to determine transfers of rights, goods, services, money, results and risks. Furthermore, none compare the characterization for each monetary flow under DSN-MUI fatwas and AAOIFI Sharia Standards. Previous studies have also seldom asked whether the intellectual property rights or services provided are paid by an initial and a recurring royalty simultaneously. While the commercial justification for a sales-linked royalty is well-established, its Sharia basis remains largely unexplained.

The present article addresses this gap in the literature by providing a comprehensive and substantive analysis of a contemporary beverage franchise cooperation agreement. With a particular focus on its financial implications. The conceptual use of the framework brings to the table a clause-to-cash-flow characterization. The identification of the legal object of a clause is achieved through comprehensive analysis, then followed by the determination of the direction and trigger of the wealth transfer. The process involves the establishment of the matching countervalue and bearer of risk, the selection of the most viable Sharia contract. The final step involves the application of rules set by distinct DSN-MUI and AAOIFI standards. Franchise supporters say that this sequence shifts the analysis away from a single contract approach or the assumption that every percentage payment is profit sharing. It also provides an opportunity to examine different hybrid business models. At the moment, economic value is being generated through the process of wealth creation.

The present study attempts to examine the suitable Sharia contractual characterization of the controllable future royalty in the ABC agreement and to determine whether such payment is consistent with the relevant DSN-MUI fatwas and AAOIFI Sharia Standards. The following questions are posed: What right, service, asset or continuing obligation is counter valent to royalty? What Sharia contract best explains the way that payment should be properly a claim of the franchisor? Does this mechanism meet any substantive requirement of the selected contract? The analysis also examines whether the interrelationship between the initial franchise fee, additional services either charged separately from the total fee or provided gratis with purchase of a franchise (at least one) and recurring royalty contributes to ambiguity, multiple compensation, and/or disproportionate risk allocation.

2. Method

This present research applies qualitative normative legal research encompassing purposeful content analysis and a comparative document analysis approach. The present study draws entirely on documentary material, with no interviews or participant observation carried out. The objective is to ascertain the legal and economic substance of the monetary arrangements documented in a franchise contract, establish their most plausible Sharia classification and then measure them with the relevant national or international standard through normative frameworks.

This paper employs a case study of contemporary Indonesian tea beverage franchise relationship to illustrate the significance of the covenant, which is identified as the key contract document. The Franchise Cooperation Agreement (FCA) is proposed as a model for analysis. The identity of the franchisor, franchisee and commercial brand is withheld due to the fact that the agreement contains commercially sensitive information. For this purpose, the parties will be referred to as Brand ABC. The document comprises recitals and Articles 1–13, and it expressly requires a one-time franchise fee plus a refundable security deposit, as well as 5% of net sales to be paid on a recurring basis that the contract refers to as 'profit sharing.'

The FCA was sampled purposively based on four criteria. This is the first point to consider. It is important to note that this is a real agreement used in an actual franchisee relationship. Secondly, the focus is on the modern-day drink franchise in Indonesia. Thirdly, the franchise agreement delineates both an upfront franchise fee and royalty calculated on percentage of repeat sales, thereby facilitating analysis of the contractual relationship. Fourthly, it provides sufficiently full clauses dealing with trademark use, equipment, training, mandatory purchases and reporting, operational control, sanctions renewal and risk allocation to allow Sharia analysis at the clause level.

The agreement is viewed as a single-case source of information that cannot be generalized to add to the statistic body of Indonesian franchising contracts. The selection of a single case allows a detailed analysis of the interrelationships among the initial fee, royalty limitations, expectations regarding performance by both parties, as well as costs and the distribution of downside risk. The inference, as intended, is analytical rather than statistical in nature. The case serves to develop and test a repeatable framework for characterizing franchise payments, rather than to establish the prevalence of identical clauses in the industry.

The normative documents are DSN-MUI Fatwa No. 112/2017 regarding ijarah, Fatwa No. 114/2017 (shirkah), and Fatwa No. 62/2007 about ju'alah; in addition to AAOIFI Sharia Standards: the following documents are to be examined: Ijarah (SS#9), Sharikah Musharakah and Modern Corporation (SS#12), Ju'alah (SS#15), Combination of Contracts (SS#25), Controls on Gharar in Financial Transaction (SS#31), and Financial Rights and How They Are Exercised and Transferred (SS#42). The FCA offers contractual facts. The DSN-MUI fatwas of Indonesia are widely regarded as the main benchmark for Sharia compliance, with AAOIFI standards providing the international complements, incorporating supplementary specifications on financial rights, contract elements, remuneration and risk. The conceptual framework is constructed, and the results are analyzed through previous literature instead of using it as a piece of primary empirical data.

First, the FCA article was subjected to individual screening. by article. In the case of each article comprising multiple obligations, each paragraph or clause was analyzed as a component. At this level, the analyzed unit is an individual contractual clause or if several provisions that are legally and economically interrelated create one arrangement, then a group of clauses. To maintain context for the agreement, all clauses were mapped; however, our monetary analysis was narrowly defined as clauses that establish, condition, secure or quantify a transfer of value. When the change was on payment rights, contractual benefits, costs, liability, termination consequences or allocation of business risks governance provisions were to be retained.

The term of ‘transfer of wealth’ was defined broadly to include the assignment or inter vivos delivery of cash, property, title (including both real, personal assets, as well as intangible assets and residual property), rights of usufruct (i.e., if one party is permitted to freely use the resources provided by another party), services (if this was paid for) whether in commerce or not conducted within trade; payment delayed in exchange for virtue such as lending without interest (at cost); the option to receive income from claims; and deferred taxes under statutory provisions in both national tax laws. The analysis included at least the provider and recipient, the legal object, the amount or calculation formula (termed price in this context) with respect to a financial trigger for payment and its timing, countervalue (the equivalent of debt; most commonly money), duration (if it is time-dependent - usually transactions are not continuous but instead are discrete actions), possible conditions on refunding or deduction if cancellation is announced, and how it will allocate costs and losses. These included a franchise fee, continuing royalty and trademark license, an equipment buy-out fee, associated training and any security deposit or mandatory purchases by the franchisee; financial penalties imposed as sanctions for non-compliance with the agreement; a renewal payment of around 40% of the operating agreement’s value and other economically relevant commitments.

Table 1. Coding framework and alignment with Results and Discussion

Analytical category	Information extracted	Fiqh question	Results section
Rights and initial package	Trademark, business system, equipment, training, deposit	What legal objects and countervalues are transferred?	Contract profile and initial package
Recurring payment	5% of net sales, trigger, timing, reporting, support	What is the basis of entitlement and most plausible contract?	Royalty and economic burden
Operational obligations	Purchases, staffing, renovation, SOPs, additional training	Which party bears costs and supplies performance?	Recurring duties and transfers
Ancillary financial clauses	Penalty, renewal, deposit refund, tax, termination	Are compensation, security, and deductions sufficiently defined?	Sanctions, renewal, and costs
Risk and governance	Control, force majeure, liability, confidentiality, disputes	How are downside risk, discretion, and loss allocated?	Residual-risk analysis
Sharia characterization	License/service, sale, partnership, specified result, hybrid effects	Which contract applies, and are its requirements satisfied?	Ijārah, shirkah, ju'ālah, and integrated assessment

The coding process was divided into four stages (see Table 1 for the coding framework employed). The FCA by this study was initially divided the FCA into two stages, which were segmented with descriptive codes for each unit based on their direction of transfer and contractual function. The second step involved the identification of the sabab al-istihqaq (the legal grounds for a claim to payment by the receiving party) to record the relevant right, asset, service, effort or result. Then, the third layer of the system performed a type of contract selection, considering contexts, and defined dominant types of contracts. The dominant types of contracts were as follows: Bai' for physical transferred property; ijarah or licensing for trademark, business model, or other usufruct use; ijarah al-a'mal for services per se; shirkah (partnership) for authentic joint investment as well as profit-and-loss sharing; and ju'alah when compensation is contingent on known outcome. At the fourth stage of the process, the selected characterization was examined considering the relevant DSN-MUI and AAOIFI requirements.

The analysis did not assume that royalty is similar with profit sharing. It is pivotal to commence this examination with an analysis of royalty payments associated with intellectual property usage and support as these represent an important aspect of franchise practice. These payments serve to compensate for continuing services provided through licensing of locally operated IP assets. The application of the shirkah test was because Article 3(4) itself terms the 5% as "profit sharing"; it is thus a test for the accuracy of description and not as an imposition of shirkah by default. In instances where the determination of payment was dependent on a specified franchisor outcome, Ju'alah was assessed as a separate potential basis of entitlement.

Each of these units was classified as compliant if the necessary requirements were met. A designation of partial compliance was assigned when only some requirements were fulfilled. In cases where clauses outdid words associated with their contractual strictures, an ambiguity status was attributed. Finally, units were designated as non-compliant when constraints conflicted with a discrete requirement. The evaluation separated the events' commercial label from the legal and economic reality of the payment. The study also explored the aggregate co-dependency of clauses. This is defined as the phenomenon in which the same mark-related good or service appeared is compensated by both an initial fee and a continuing royalty.

Multiple strategies were employed to enhance trustworthiness and mitigate interpretive bias. The coding categories were determined prior to the final evaluation from the selected fatwah and standards. Separate records of contractual facts, Sharia characterization, compliance assessment, and researcher interpretation were made; each conclusion was linked to the relevant FCA clause and normative criterion to create an audit trail. The coding decisions were subjected to repeated checks for internal consistency and provisions that were ambiguous or appeared contradictory provisions were classified as ambiguous and not automatically coded as non-compliant. The studies on each agency's results were cross-examined with the relevant AAOIFI provisions. Since the study relied on neither interviews nor observation, this was normative source crosschecking rather than methodological triangulation [18].

This lack of interviews and direct observation constrains the kinds of claims that can be made. The analysis does not establish, among other things, whether the parties had a shared understanding regarding the royalty payment's purpose, what specific ongoing services were rendered if any, or how well an outlet operated, nor does it explain how the royalty impacted profits. The results of the study serve to provide a contextual-based normative evaluation of the formal ABC deal. The identification of contractual problems and the establishment of the basis for analytical propositions that can be evaluated in analogous franchise models is achieved without determining the number or functional impact of those problems throughout the franchise sector.

3. Results and Discussion

3.1. Contractual profile and analytical sequence

The unit of analysis is one Franchise Cooperation Agreement (FCA) for an Indonesian contemporary tea beverage outlet, anonymized as the ABC brand. The document under consideration comprises recitals and Articles 1–13. To avoid the treatment of the contract as a single undifferentiated transaction, the analysis proceeded clause by clause through four linked questions: The following questions must be addressed: (1) what right, asset, service, obligation, or risk is created; (2) whether wealth moves between franchisor and franchisee; (3) which Sharia contract category best describes that movement; and (4) whether the payment and risk-allocation mechanism satisfies the substantive requirements of that category. Table 2 provides a comprehensive overview of the contractual map, while Tables 3–6 offers a detailed breakdown of the clauses by function.

Table 2. Complete map of the ABC franchise cooperation agreement

Clause	Principal function	Wealth transfer	Analytical significance
Recitals	Ownership of the ABC mark, system, SOPs and know-how; franchisee's intention; grant of operating rights.	No direct transfer	Establishing the licensable intellectual property and contractual intent.
Art. 1	Outlet location, 3-km exclusivity radius, measurement method and mall/office exception.	No direct transfer	Reducing the territorial uncertainty and potential gharar.
Art. 2	Initial IDR 120 million package and IDR 30 million security deposit.	Yes	Core hybrid transaction: license, sale, services and security.
Art. 3	Renovation, staffing, 5% of net sales, exclusive purchases, reporting, training, SOPs and other operating costs.	Yes; direct and indirect	Core recurring payment and operational-risk provisions.
Arts. 4–5	Non-compete, confidentiality, brand controls, 20% deposit penalty and termination.	Conditional	Testing the proportionality, actual loss and permissible sanctions.

Table 2 (continued). Complete map of the ABC franchise cooperation agreement

Clause	Principal function	Wealth transfer	Analytical significance
Art. 6	Four-year term, renewal, fee of 50% of prevailing franchise compensation and deposit refund.	Yes/ conditional	Confirming the license duration and refundable nature of deposit.
Arts. 7–9	Assignment/succession, taxes and outlet construction supervision.	Mostly franchisee costs	Allocating the public charges, construction costs and control rights.
Art. 10	Force majeure notice, consequences, repair costs and discretionary extension.	Potential losses	Concentrating the physical and financial risk of the franchisee.
Arts. 11–13	Confidentiality compensation, dispute settlement, addendum and execution.	Conditional	Supporting ta'wīḍ for proven loss, ṣulḥ and contractual certainty.

The map demonstrates that the FCA is not merely a trademark license. It combines rights to use an intangible asset, sales of equipment and supplies, training and supervisory services, security arrangements, exclusivity obligations, sanctions, and extensive allocation of costs and risks. Consequently, the Sharia assessment must be payment specific. It is pivotal to note that a finding concerning the recurring royalty does not automatically invalidate the sale, service, license, or security components that are independently capable of satisfying their own rules.

3.2. Foundational rights and the initial franchise package

Table 3. Foundational clauses and initial transfers of wealth

Clause/ item	Contractual substance	Sharia characterization	Finding
Recitals	Franchisor owns ABC trademark, system and know-how and grants an operating right.	Intellectual-property benefit and license	Creating the legal basis for compensation, but stating no payment mechanism.
Art. 1(1)–(4)	Location, territorial exclusivity and objective mapping method.	Specification of licensed territory	No wealth transfer; clearer boundaries reduce gharar.
Art. 2(1)(a): brand	Part of IDR 120 million for use of ABC trade name.	Ijārah/licensing of usufruct	Permissible if benefit, period and allocated consideration are clear.
Art. 2(1)(a): equipment	Equipment included in the same package.	Bai'	Ownership, specifications and allocated price should be identifiable.
Art. 2(1)(a): training	Initial business training included in the package.	Ijārah al-a'māl	A valid service component if scope and delivery are ascertainable.
Art. 2(1)(b)	Refundable IDR 30 million security deposit.	Security/hamish jiddiyyah; possibly rahn in accordance to purpose	Use, custody, deductions and refund conditions must be explicit; it is not franchisor income.

Article 2 consolidates three distinct countervalues into a single IDR 120 million franchise fee, encompassing the utilization of the mark, the transfer of equipment, and the provision of training. This is a hybrid contract (al-'uqūd al-murakkabah), but the presence of hybridity alone does not make the arrangement impermissible. The material issue is whether each component remains identifiable, independently lawful, and free from contradictory effects (Akmal & Sirajulhuda, 2019; Harrieti, 2018; Hasanudin et al., 2022). The absence of an allocated value for the license, equipment, and training has been demonstrated to weaken price transparency and make it difficult to determine which continuing benefits remain uncompensated after the initial payment. This is a crucial consideration when assessing the recurring royalty.

3.3. Recurring payments, operational duties, and transfer of economic burden

Table 4. Article 3: Recurring payments and operational obligations

Clause	Requirement	Transfer/risk	Sharia relevance
3(2)	Franchisee renovates and furnishes outlets to prescribed standards.	Capital cost borne by franchisee	No payment to franchisor but increasing the franchisee investment exposure.
3(3)	Franchisee hires and manages outlet personnel.	Labor cost and operational risk borne by franchisee	Demonstrating that day-to-day business performance principally is generated by the franchisee.
3(4)	Monthly 5% payment calculated from net sales and labelled 'profit sharing'.	Wealth moves to franchisor regardless of actual profit or loss	Economic substance is a revenue-based royalty, not profit sharing.
3(5)	Exclusive purchases from franchisor/designated suppliers.	Repeated sale transactions	Bai'; prices, quality and restriction must remain fair and transparent.
3(6)–(7)	Sales reports and business information.	No direct transfer	Verification and supervision supporting royalty calculation.
3(8)	Franchisor provides continuing training.	Continuing service benefit	Potential ijārah countervalue, but scope, frequency and relation to royalty must be specified.
3(9)	Compliance with SOPs.	Control obligation	Quality control and protection of brand integrity.
3(10)–(11)	Biennial renovation and uniform replacement.	Additional capital/operating costs borne by franchisee	Reinforcing the asymmetrical cost allocation.
3(12)	New-employee training costs IDR 1.5 million per person.	Separate payment to franchisor	A separately priced ijārah al-a'māl service; raising the duplication question if royalty is also justified by training.
3(13)	All employee-related costs borne by franchisee.	Full employment risk borne by franchisee	Further separating the royalty from a genuine joint-profit-and-loss arrangement.

The decisive finding is the mismatch between terminology and calculation. As stated in Article 3(4), the payment is referred to as 'profit sharing. However, the contractual basis for this payment is net sales. Profit is defined as the residual after allowable costs, whereas sales are revenue before the franchisee's rent, wages, utilities, renovation, taxes, and other operating expenses. Consequently, the 5% remains payable even when the outlet suffers an accounting loss. As demonstrated in Articles 3(2), 3(3), 3(10), 3(11), and 3(13), the franchisee is responsible for supplying the outlet investment, labor, and most operating expenditure. Consequently, the payment effectively removes revenue from the party that is primarily exposed to the risk of loss.

Article 3(8) represents the strongest possible contractual basis for a continuing service fee because it promises ongoing training. However, Article 3(12) establishes a separate pricing structure for training for newly recruited employees, amounting to IDR 1.5 million per person. The contract does not identify the residual training, monitoring, marketing, system updating, or network support that is to be remunerated by the 5% royalty. The issue is therefore not that every sales-based royalty is inherently prohibited, but rather that this FCA does not establish a sufficiently distinct and measurable continuing countervalue.

Article 3(4) stipulates the payer, recipient, calculation base, rate, and monthly payment deadline; however, it does not identify the counter-performance that entitles the franchisor to receive 5% of net sales. The initial franchise fee already covers the right to use the trademark, equipment, and initial business training, while training for newly recruited employees is separately charged. The most plausible basis for a recurring royalty would therefore be a package of continuing benefits, such as business-system updates, brand development, network marketing, product innovation, operational assistance, technology support, and supply-chain coordination. As posited by Agrawal & Lal, (1995); Bang et al., (2023), royalty fees are associated with franchisor support and continuing investment in brand value. However, these benefits cannot be presumed merely from the existence of a franchise relationship. They must be specified as continuing franchisor obligations and are distinguished from rights, goods, and services that have already been compensated through the initial franchise fee or separate charges.

3.4. Ancillary clauses: Sanctions, renewal, costs, and risk allocation

The ancillary provisions are of significance in that they reveal the contract's distributive structure. The franchisee is responsible for the payment of taxes, labor, renovation, uniforms, most of construction and force-majeure repair costs. Conversely, the franchisor retains control over standards, renewal, and relief. Article 12(2) acknowledges the possibility of a business failing without the fault of either party. However, yet Article 3(4) does not suspend or adjust the royalty when the franchisee is unprofitable. When considered collectively these clauses indicate that the revenue claim and commercial downside are not proportionately linked. The cumulative reading provided herein serves as the analytical bridge from clause description to the Sharia assessment.

Table 5. Articles 4–6: Restrictions, sanctions, and renewal

Clause	Principal content	Financial effect	Evaluation
Art. 4(1), (4)–(6)	Product/brand exclusivity; limits on assignment and relocation.	Indirect constraint	Protecting the network identity; application should remain proportionate.
Art. 4(2)	Similar-business prohibition during the term and for four years afterward.	Restricting the future earning activity	Requiring a reasonableness and proportionality assessment.
Art. 4(3)	Trade-secret confidentiality.	No immediate transfer	Protecting the legitimate intellectual property and know-how.
Art. 5(1)	Warning, penalty equal to 20% of deposit, and termination.	Conditional deduction	Gharāmah/ta'wīḍ requires legal basis, proportionality, stated use and—where compensatory—actual proven loss.
Art. 5(2)	Trademark and franchise attributes cease upon termination.	Licensed benefit ends	Being consistent with termination of a time-bound license.
Art. 6(1)–(2)	Four-year term and renewal procedure.	No immediate transfer	Clarifying the duration and procedure.
Art. 6(3)	Renewal fee equals 50% of prevailing franchise compensation.	New payment	Can be license consideration, but basis and deliverables must be transparent.
Art. 6(4)	Security deposit refunded at expiry.	Return of franchisee's property	Confirming that the deposit is security rather than permanent income.
Art. 6(5)	Renewal may be refused after franchisor appraisal.	Affecting the continuity and sunk investment	Criteria should be objective and disclosed to prevent arbitrary discretion.

Table 6. Articles 7–13: Governance and allocation of residual risks

Clause	Principal content	Risk/transfer	Evaluation
Art. 7	Assignment requires approval; lawful successor continues after incapacity or death.	Continuity risk	Confirming personal character while preserving contractual succession.
Art. 8	Taxes, levies and statutory charges are borne by franchisee.	Public financial burden	Separating legal responsibilities but adding to franchisee's downside exposure.
Art. 9	Contractor choice subject to TOR; progress reporting and opening postponement.	Construction cost plus franchisor control	Quality control is legitimate, while cost remains with franchisee.
Art. 10(1)–(4)	Force majeure definition; 24-hour notice; non-recognition and continued duties.	Procedural and performance risk	Strict notice and consequences require proportional and fair application.
Art. 10(5)–(7)	Repair costs borne by franchisee; extension up to 30 days at franchisor discretion; franchisor duties continue.	Physical loss concentrated on franchisee	Material evidence of asymmetrical loss allocation.

Table 6 (continued). Articles 7–13: Governance and allocation of residual risks

Clause	Principal content	Risk/transfer	Evaluation
Art. 11	Confidentiality and compensation for unauthorized disclosure/misuse.	Conditional compensation	Ta'wīḍ is defensible when confined to actual, demonstrable loss.
Art. 12	Consultation first; no liability for good-faith failure; District Court if unresolved.	Business-failure risk	Ṣulḥ is consistent with Sharia; risk clause must be read against fixed revenue royalty.
Art. 13	Written amendment by consent; execution in witnessed counterparts.	No direct transfer	Supports tarāḍī, contractual freedom, certainty and evidence.

3.5. Sharia tests applied to the 5% net-sales royalty

3.5.1. Shirkah test

Table 7. Shirkah compliance test

Requirement	Normative benchmark	Evidence in FCA	Assessment
Capital contribution	Parties' capital or contribution must be identifiable.	Franchisee supplies outlet investment, labor and costs; franchisor contribution is not valued as partnership capital.	Not established as shirkah capital.
Profit base	Profit share is an agreed proportion of realized profit, not a guaranteed nominal return or revenue charge.	5% is calculated from net sales and paid monthly.	Fails the profit-based requirement.
Loss allocation	Commercial loss follows capital contribution, except loss caused by misconduct or breach.	Costs and losses, including repair and operating exposure, are predominantly allocated to franchisee.	No proportional loss-sharing mechanism.
Management and risk	Return should correspond to contribution and shared exposure.	Franchisor controls brand standards, but franchisee runs and finances the outlet.	Control/support does not convert the royalty into partnership profit.
Overall characterization	Substance prevails over contractual label.	Clause says 'profit sharing' but operates as recurring revenue royalty.	Not a valid shirkah distribution under DSN-MUI Fatwa No. 114/2017 and AAOIFI standards.

Under the shirkah test (see Table 7), the presence of royalty is invalidated on the basis of three cumulative reasons. Firstly, the capital contributions of the parties are not constituted as partnership capital. Secondly, the distributable base is sales rather than realized profit. Thirdly, losses are not allocated according to capital contribution. The label 'profit sharing' cannot cure these substantive defects. This conclusion is narrower than declaring the entire FCA prohibited: it means only that Article 3(4) cannot be justified as a shirkah profit distribution in its present form (DSN-MUI, 2017; AAOIFI, 2015).

3.5.2. Ju'ālah test

Table 8. Ju'ālah compliance test

Element	Normative benchmark	Evidence in FCA	Assessment
Promisor and performer	Jā'il promises reward to 'āmil for producing a specified result.	Franchisee pays franchisor, but franchisee's own capital, employees and sales activity generate the sales base.	Roles do not reflect the claimed performance-reward logic.
Specified task/result	Work or result must be sufficiently ascertainable.	No distinct franchisor task or measurable result is designated as the trigger for 5% payment.	Essential object is absent or ambiguous.
Reward trigger	Reward becomes due upon achievement of the promised result.	Royalty accrues automatically from monthly net sales.	Payment follows turnover, not verified achievement by franchisor.
Causal link	The result must be attributable to the relevant effort within the agreed undertaking.	Sales depend principally on franchisee's operation; ongoing training is not tied to the royalty formula.	Insufficient causal nexus.
Overall characterization	All essential elements must be present.	Recurring sales percentage without a separately specified franchisor result.	Cannot be sustained as ju'ālah under DSN-MUI Fatwa No. 62/2007.

The ju'ālah test (see Table 8) produces a consistent result through a different route. The performance of an identified tasks by the performer is rewarded with a ju'ālah. In this particular FCA, the franchisor receives the payment, but the sales triggering that payment are primarily generated by the franchisee's capital, employees, and daily operations. It is evident that the absence of an independent target, such as a specified marketing outcome, system upgrade, or measurable support result, assigned to the franchisor precludes the possibility of treating the royalty as a valid ju'ālah reward merely because it varies with sales.

3.5.3. Ijārah/licensing and duplicate-compensation test

In the context of a sale, the payment can be considered as variable ujrah for an allowed and identifiable service that is on-going in nature. On the evidentiary side, the ABC FCA can be challenged on the basis that: (1) In the absence of lump sum commercial consideration in exchange for a kind of value, e.g. a name and training services really carried out in lieu, compensation is already provided under some description by an initial franchise fee that is separately charged. Another category describes employee training with a different price. If all three categories are considered together, the question arises of how to measure whether a fixed recurring royalty should remain largely immunized from scrutiny regarding whether it serves as compensation either incompletely or definitively or not. The potential for residual effect upon both entity and franchisor is determined by non-FIXATED worth, which is 1332. If the entity behaves like a bad faith manager instead, this persists essentially to get tied long-run vn. This generates jahālah vis-à-vis the countervalue and there is a risk of double charging for the same benefit. Consequently, this finding must be interpreted as indicating the absence of such a mechanism under current framework, rather than a universal prohibition on royalty fees. A compliant contract may remedy the defect, by splitting bai', ijārah of intellectual-property benefits meaning performance and risk — with a price and a risk rule for each.

Table 9. Possible recurring countervalues and contractual gaps

Possible basis	Existing clause	Required clarification	Finding
Trademark/system license	Initial IDR 120 million already covers use of trade name; term is four years.	Allocating initial price and state whether royalty buys an additional or continuing benefit.	Risk of duplicate compensation if the same usufruct is charged twice.
Ongoing training	Article 3(8) promises training; Art. 3(12) separately charges new-employee training.	Defining scope, frequency, recipient, service level and which activities the royalty covers.	Potential ijārah basis exists, but current countervalue is insufficiently specified.
Monitoring/SOP support	Reporting, supervision and SOP compliance are stated.	Identifying deliverables, franchisor obligations and measurable performance.	Control rights alone do not establish a priced service.
Marketing/network development	Not identified as a separate royalty-funded obligation.	State campaign, territorial benefit, budget, reporting and accountability.	No ascertainable countervalue in the analyzed clauses.

AAOIFI Sharia Standard No. 42 views trademarks, commercial claims, and technical know-how as monetary rights, which are subject to ownership transfer or usage in exchange for compensation. Furthermore, the text fails to specify whether that consideration must be paid in a single lump sum, on a periodic basis or as a percentage of sales. It also does not inherently verify a revenue-based royalty calculation. It must, therefore, be clearly indicated in the original contract with regards to which one (the utilization period schedule of payment and calculation basis) will govern based on the relevant provision of ujrah and ijārah. The four-year term of the ABC agreement governs the length of the trademark and business-system license, but makes no clear indication as to whether an initial franchise fee is in fact compensation for that usufruct over that same period or whether a recurring 5% royalty represents yet another benefit flowing out to ABC after the initial seven-year period.

As stated in article 3(4), the relevant uncertainty is independent of the payer, the 5% rate, the basis of the net-sales calculation and the time limit for filling, which is required on a monthly basis. This relates to what is given in exchange for the recurring payment: there was an absence of specific details regarding the basis of the franchisor's entitlement under a contractual countervalue, in relation to additional license benefits or ongoing service. Its omission creates jahālah regarding the subject matter of the exchange and it leaves open the possibility that a non-compensable license duplicates consideration previously paid in respect of entry through the initial franchise fee or additional training fees. Nonetheless, consistent with AAOIFI Sharia Standard No. 31, the legal effect should still be evaluated based on the extent and significance of the uncertainty. The document introduces a material contractual ambiguity that necessitates clarification. Absent the proof of actual performance, it does not establish a lack of continuing benefit as practiced (see Table 9).

3.6. Engagement with previous studies and scholarly contribution

Table 10. Comparison with previous franchising and Sharia studies

Study stream	Prior finding	Relationship to this study	Contribution of the FCA analysis
Franchise economics	Up-front and recurring fees allocate incentives, support costs and risk (Vázquez, 2005; Maruyama & Yamashita, 2012, 2014; Bang et al., 2023).	Supporting the need to examine economic substance rather than the fee label.	Showing that a sales royalty may shift downside risk when franchisee bears most variable costs.
Sharia franchise fees	Darmawan (2010) and Afifah et al. (2021) question royalty structures lacking clear profit-and-risk alignment.	Supporting their concern but specifies the contractual pathway.	Connecting the findings to exact clauses on sales base, labor, costs, force majeure and failure.
Royalty as shirkah	Hafsari and Sativa (2023) assess brand royalties through DSN-MUI Fatwa No. 114/2017.	Qualifying a broad shirkah characterization.	Demonstrating that a royalty is not partnership profit without identified capital and proportional loss allocation.
Hybrid contracts	Hybrid structures are permissible when components remain transparent and independently valid (Harrieti, 2018; Hasanudin et al., 2022).	Extending the literature from product classification to payment-specific analysis.	Separating license, sale, service, security, sanction and royalty instead of judging the FCA as one contract.
Sharia governance	DSN-MUI provides Indonesian authority, while AAOIFI offers cross-jurisdictional standards (Hassan & Rabbani, 2022; Hidayati et al., 2023).	Utilizing the standards complementarily rather than interchangeably.	Proposing a traceable clause-to-standard audit for franchise governance.

The findings uphold earlier concerns regarding royalty charges separated from real benefit and business misfortune yet expand those investigations in three ways. The main point is that the analysis finds hyper compliance, which is not solely attributed to the presence of the term in contract, but rather it is identified as a fee-based contractual mechanism. Also, it fulfills our second requirement: It shows that the assessment of hybrid-contract must be in relation to specific payment — as bai', license, service and security components could still stand if the recurring royalty does not pass the shirkah and ju'ālah tests. Finally, the revenue basis(s), countervalue, capital contribution and loss allocation are all brought together in the same analytical sequence. This is the reason why two payments that share a commercial label may be given differential Sharia treatment.

The theoretical contribution of this study is a clause-to-cash-flow framework for Islamic franchising (see Table 10). How it works: The framework starts with the legal object – right, asset, service or risk – and proceeds to identify how and when each wealth transfer occurs. It then selects an appropriate nominate contract and tests payment and loss allocation against the substantive requirements of that contract. This approach transcends the binary conclusion of 'franchise is/is not Sharia-compliant' by incorporating Sharia governance at the level where economic value is transferred.

3.7. Contractual and policy implications

For contract design, the IDR 120 million package is required to disclose the allocated values of the trademark license, equipment, and initial training. The security deposit is to state custody, permitted deductions, and refund procedure. The 5% payment is to be tied to clearly specified continuing services as transparent ujrah, converted into genuine profit sharing with identifiable contributions and Sharia-compliant loss allocation, or linked to a measurable franchisor result under a properly constituted ju'ālah. Sanctions should distinguish deterrent penalties from compensation for actual loss. Furthermore, the renewal and force-majeure discretion should be governed by objective criteria.

For Sharia governance, DSN-MUI standards serve as the primary national reference, given the operational presence of the FCA in Indonesia. Conversely, AAOIFI standards can provide comparative detail and consistency, making them as a valuable supplementary reference. Reviewers, Sharia advisers, and regulators should not approve the arrangement based solely on Islamic terminology. They should require a schedule mapping every payment to its countervalue, calculation base, trigger, recipient, risk bearer, and applicable Sharia contract. Such a disclosure would make compliance auditable and reduce gharar, duplicate compensation, and disproportionate transfer of business risk.

4. Conclusion

Based on the contractual and Sharia analysis, the recurring royalty fee stipulated in the Franchise Cooperation Agreement cannot be validly characterized as a ju‘ālah arrangement. Despite the franchisee’s formal commitment to provide compensation, the sales that serves as the basis for calculating the royalty are generated primarily through the franchisee’s own capital, labor, and operational activities. Meanwhile, the agreement does not specify any specific task to be performed or measurable result to be achieved by the franchisor as a condition for entitlement to the reward. The essential relationship between the franchisor’s performance, the achievement of a predetermined result, and the payment of the ju‘l is therefore absent.

It is evident that the royalty fee is still not practiced, which could allow the payees to be considered as partners, given that the previous framework of shirkah has not been fulfilled. The agreement fails to identify the amount, type and proportion of capital contributions by each party or provide a proper procedure for handling business losses. It is important to note that the royalty rate is applied to net sales revenue as opposed to being a fixed ratio of realized profit. As a result, it functions as an expense on the franchisee's income statement and must be paid whether the business ends up making a profit or losing money; instead of representing a real return on investment under shirkah.

Furthermore, the recurring royalty does not offer an identifiable and independent countervalue. The franchise fee frequently includes the right to utilize the brand, equipment purchases, and the provision of initial training as part of business operations. If the franchisor fails to provide additional continuing services with sufficient particularity, an additional royalty may be regarded as a duplication of fees if the franchise fee originally covered similar benefits. This creates an asymmetrical contract whereby the franchisee incurs capital expenditure, operating costs and business risks while the franchisor retains a percentage of sales entitlement that is not related to profitability or a separate identified performance obligation.

While franchise literature links ongoing royalties with things such as brand development, system updates, marketing, monitoring and operational support, the ABC contract does not explicitly indicate that some or all these activities are countervalue for the monthly 5%. The review of the documentation thus substantiates the existence of contractual uncertainty and the potential for dual remuneration, not that no continued services were performed.

This uncertainty concerning the countervalue constitutes gharar in the subject matter of the exchange as the agreement does not clearly specify the additional right, benefit, or ongoing service received by the franchisee in exchange for the monthly royalty. The uncertainty is material because it concerns the contractual basis of the franchisor’s entitlement to 5% of net sales and creates a risk of duplicate compensation for benefits already covered by the initial franchise fee or separate charges.

Consequently, the royalty contract examined in this paper is not materially consistent with the Sharia rules that apply to ju‘ālah and shirkah. The revenue-generating nature, coupled with a lack of unique countervalue, allows ẓulm to transfer unbalanced wealth and business risk transfer to franchisees. For an agreement to be considered a substantive Sharia-compliant, it must delineate between consideration covered by the franchise fee and any ongoing services whose continued provision is represented by the royalty. The royalty structure, on its own or the way it's being sold, should either be predicated on real profit sharing. This is the economic principle that dictates its utilization should be reserved for instances involving 'profit/risk-sharing' as opposed to commissioned sales agents where it is just saleable services or of a measurable result.

The first limitation of this article is that it does not perform a monastic analysis except in the context of payment-denominated payments, and more specifically, franchise and royalties through one Franchise Cooperation Agreement for beverage franchises. The investigation does not extend to the examination of the entirety of contractual and operational relationships nor does it entail the conduction of interview with franchisors, franchisees, Sharia scholars and regulators. Without this data, it is impossible to evaluate whether royalty aligns with the expected continuing services of the franchisor and how it influences franchisee profitability. In addition, the Sharia analysis is centered only on shirkah and juʻālah; thus, this research results are particular to the studied subject cannot be generalized for all franchise agreements.

It is recommended that future research should study a larger set of franchising agreements from multiple industries and include interviews with stakeholders, operational evidence, and financial data on the outlet level. In addition, it is beneficial to conduct comparative and longitudinal studies to assess the implications of royalty fees on profitability, as well as risk allocation among various business conditions. Future research is required on other Sharia constructs, including the different forms of ijārah, bayʻ and related contracts in terms of how they can be distinctly separated over ownership [ijārah al-aʻmāl], partnership [shirkah], and incentives for performance-based service fees [juʻālah]. The objective is to establish a practical Sharia-compliant FCA model that would then clearly separate payments associated with using a brand usage and/or assets; training; ongoing support; and performance award services.

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