Sustainability of the Family Ownership in a Family Business via Inheritance: An Appraisal with Special Reference to the Malaysian Law

1Wan Noraini Mohd Salim and 2Zuhairah Ariff Abd Ghadas

1Assistant Professor, Ahmad Ibrahim Kulliyah of Laws, International Islamic University Malaysia, Malaysia
2Associate Professor, Ahmad Ibrahim Kulliyah of Laws, International Islamic University Malaysia, Malaysia

Abstract: Family succession attributes influence the firm’s performance and the family ownership is positively related with the firm’s performance. The writers also observed that families are motivated to work efficiently when they hold more shares in the business. Furthermore, the results reveal that successors-managed firms have better firm performance than founder-managed firms. The findings provide evidence that Malaysian family firms do plan for their successions. However, in absence of the succession plan, it is observed that the family business structure could still maintained by the application of the law of inheritance. This paper intends to highlight how the inheritance laws play its role in maintaining the family ownership in family business. The scope of discussion in this paper is focus on family businesses in Malaysia and the law of inheritance, which are applicable to Muslim and non-Muslim in Malaysia. Research methodologies applied in this paper are statutory and doctrinal analysis.

Key words: Family business, Inheritance, Succession planning

INTRODUCTION

A family business is an interesting business structure as it combines the elements of personal relationship, shareholding and management in the business. There is also a confinement of ownerships mainly or solely to family members to ensure the business legacy of the family name. All over the world, family business structure has a profound establishment as one of the main actors in the country’s economy.

In ensuring the sustainability of the family ownerships, the business often finds it difficult when the family ties falls apart for example due to a divorce or death. Recently, the country was stirred by the case Khalilullah Che Ibrahim and Ors v Che Ibrahim Che Ismail, whereby eleven siblings took a legal action against their estranged father over their inheritance and their deceased mother’s matrimonial property (Adham Shadan, 2011). The children succeeded in their application for an ex parte interim order to restrain their father from entering into any form of transaction on the claimed property. The lawsuit is expected to be in the millions as it involves numerous properties and shares belonging to the defendant.

This paper shall highlight issues relating to inheritance’s rights of children and family members in family business by way of legal analysis. The main objective of this paper is to highlight that sustainability of family ownership in family business could be achieved by applying the law of inheritance.

Family Business:

The family controlled firm or family ownership is the most common form of business organization in the world (Ibrahim, Haslindar et al, 2010). In the US, family-owned or controlled businesses account for over 80% of all firms (Anderson and Reeb, 2003). According to a research conducted by Sraer and Thesmar (2006), Favero et al (2006), Gursoy and Aydogan (2002), Mishra et al. (2001), Yeh et al. (2001), Gorriz and Fumas (1996), family firms have superior performance compared to non-family firms.

There are many angels applied to define family business though most writers focus on the ownership structure. For example family business is where the family members owned at least 60 percent of the equity (Donckels and Frohlinch (1991: 152) or majority ownership or control lies within a single family (Rosenblatt et.al (1985: 4-5). Villalonga and Amit (2006: 385-417) define a business as a family business if a minimum of 20 percent of the ownership is in the business. According to Ibrahim, Haslindar et al (2010), both family and non-family firms are classified according to their ownership structure whereby the ownership structure of family business can be grouped into firms with controlling owners or concentrated ownership.

In Malaysia, a report of a national survey conducted by Grant Thornton and Malaysian Institute of Management in 2002 (Shamsir Jasan, 2002), highlighted that majority of family businesses in Malaysia is small
scale enterprises and generally managed by the founder. The report also underlines the characteristics of family business in Malaysia, which can be summarized as:

• 59% of the business is still run by the founder and 30% are run by the second generation, the majority of who are children of the founder.
• 65% of small-scale enterprises are managed by the founders.
• 55% of family businesses in the small-scale enterprises employ less than 51 persons.
• 35% of family businesses in the medium scale enterprises employ between 51 - 250 persons.
• 10% of family businesses from large-scale enterprises employ more than 250 persons.
• Main activity of family business lies in manufacturing (35%), followed by retailing (12.9%) and construction (10%).

The concerns in Family Business:

Report of the survey highlighted two main concerns in a family business structure:
1. Means to finance the business
2. Involvement /Participation of family member

![Chart 1: Concerns over losing control if outsiders were to involve in financing the business.](image)

The above chart showed that it is in the small scale business that members are most concerned about losing control if they obtain external finance. For the large scale business, the concern on external participation is not much on the financing aspect but rather on the possibility of change in the management system. 52% of the respondents from the large scale business express their concern on the possibility of changes in the way the business is run if outsiders come into the picture.

Family Relationship:

As regards to family involvement, the survey’s report stated that 48% of the large scale enterprises seemed to be less concerned about bringing family members into business as compared to the small scale (31%) and the medium scale enterprises (29%). Nevertheless, majority of the respondents, regardless sizes of business, strongly agree that:
1. Children should be introduced to the business at an early age.
2. Children's education should be geared towards the business needs.
3. There can only be one management successor.
4. Criteria should be set up to decide how family members join and leave the business.
5. The business is stronger with family members involved.
6. Parents should retire when the children are ready to take over the business.
7. Founder and subsequent generations should always have a formal role in the business.
8. Family and business affairs should be kept separate.
9. Professional advisers should understand the unique issues facing the family business.

For the children’s participation, the report highlighted that:
• 21% of the respondents wanted their children to be involved in the business
• Of the 24% of children involved in the family run business:
  - 46.5% is the first child
  - 28.2% is the second child
  - 13.7% is the third child
  - 11.4% is the fourth child.
The survey also seeks responses on outsiders’ participation in the family business. It was found that only 39% of the respondents from the large scale business were concerned about outsiders coming into the business and take control of the business whilst in the medium scale businesses, 43% of the respondents expressed their concern about external participation in the family business. On top of that, 44% of the respondents in the medium scale business expressed their worry over losing control if outsiders are allowed to be in the family business.

The above discussions highlighted the importance of retaining family ownership in family business and such concern may be alarming when the parent as founder of the business died prior to aligning the successor for the business from among the children. Nonetheless, it is observed in absence of the succession plan, the family ownership could be retained by applying the laws of inheritance.

**Jurisdiction in the Administration of Deceased Estates:**

In Malaysia there are three relevant authorities that deal with the administration and distribution of a deceased’s estate, Muslims and non-Muslims (Halim, AH et al, 2009). They are the High Court, the Small Estate Distribution Office and the Public Trust Corporation. The jurisdiction of these authorities in the administration and distribution of estates depends on the type and value of the estates. Estate is of two types; testate and intestate estate. As far as testate estate is concerned, the high court is given the exclusive jurisdiction to deal with its administration and distribution regardless of value. Testate estates refer to the estate that is subject to disposition through wills or wasiyyah.

Another type of estate is intestate estate and it refers to the estates of a deceased, which are not subjected to disposition according to the will or wasiyyah or hibah (Salim WNM, 2011). Intestate estate is further classified as small estate and non-small estate depending on the value of the estate left by the deceased. Under section 3(2) of the Small Estates (Distribution)(Amendment) Act 2008, a small estate is defined as the estate of a deceased person consisting wholly or partly of immovable property situated in any state not exceeding two million ringgits in total value.

The law governing the administration and distribution of this estate is the Small Estates (Distribution) Act 1955 and the Small Estates (Distribution) Regulations 1955. The Act gives the power to the Collector to hear cases pertaining to distribution of a small estate.

A non-small estate, on the other hand, refers to any estate regardless of whether it is movable or immovable but the value of the estate is more than RM2 million in total values at the time of death of the deceased person. The jurisdiction to deal with the administration and distribution of this estate is given to the high court. By virtue of S 24(f) of the Courts of Judicature Act 1964, the jurisdiction to grant Letters of Administration lies on the high court. The person entitled to apply for the grant is determined in accordance with S 30 of the Probate and Administration Act 1959 that is the one who has interest in the residuary estate of the deceased. The application for Letters of Administration is made to the Registrar or Senior Assistant Registrar of the High Court according to the procedures provided in Order 71 of the Rules of High Court 1980.

Another body that deals with distribution of estate on death is the Public Trust Corporation (Amanah Raya Berhad (ARB). By virtue of s 17(1) of the Public Trust Corporation Act 1955, the corporation deals with summary administration and distribution of movable property only of value RM600 000 and below. However, by virtue of S 7(2) of the Public Trust Corporation Act 1955, the corporation is also empowered to administer any movable asset (normally in form of money) and give a form of written direction that carries the effect as letters of administration issued by the high court for the purpose of withdrawing the assets from any bank or financial institutions. The bank or financial institution will only make any payment to the person named in the direction.

**Inheritance to Property for Non-Muslims:**

When a person dies leaving a valid will, his estate will be divided according to the will as long as the will was executed when the testator was mentally capable and had intention and free will to make it. Any balance of the estate that is not bequeathed in the will, will be divided according to the Distribution Act 1958 to the relevant heirs. Similarly if a person dies leaving no will or the will is not valid, all the deceased’s estate will be divided according to Distribution Act 1958. There are three main inheritors who will be entitled to certain portions of the estate depending on circumstances of death. They are the spouse (husband or wife), parent or parents and issue (descendants) of the deceased. As long as one of them survives the deceased, the intestate estate will not be inherited by any siblings or other relatives of the deceased. They will only inherit in the absence of all the three main inheritors in accordance with the order of priority. The law provides the manners of distribution as follows (Section 6 (1) (a)-(j)):

(a) If an intestate dies leaving a spouse and no issue and no parent or parents, the surviving spouse shall be entitled to the whole of the estate;

(b) If an intestate dies leaving no issue but a spouse and a parent or parents, the surviving spouse shall be entitled to one-half of the estate and the parent or parents shall be entitled to the remaining one-half;
(c) If an intestate dies leaving issue but no spouse and no parent or parents, the surviving issue shall be entitled to the whole of the estate;
(d) If an intestate dies leaving no spouse and no issue but a parent or parents, the surviving parent or parents shall be entitled to the whole of the estate;
(e) If an intestate dies leaving a spouse and issue but no parent or parents, the surviving spouse shall be entitled to one-third of the estate and the issue the remaining two-thirds;
(f) If an intestate dies leaving no spouse but issue and a parent or parents, the surviving issue shall be entitled to two-thirds of the estate and the parent or parents the remaining one-third;
(g) If an intestate dies leaving a spouse, issue and parent or parents, the surviving spouse shall be entitled to one-quarter of the estate, the issue shall be entitled to one-half of the estate and the parent or parents the remaining one-quarter;
(h) Subject to the rights of a surviving spouse or a parent or parents, as the case may be, the estate of an intestate who leaves issue shall be held on trusts set out in section 7 for the issue;
(i) If an intestate dies leaving no spouse, issue, parent or parents, the whole of the estate of the intestate shall be held on trusts for the following persons living at the death of the intestate and in the following order and manner, namely;

(i) Firstly, on the trust set out in section 7 for the brothers and sisters of the intestate in equal shares; but if no person takes an absolutely vested interest under such trusts;
(ii) Secondly, for the grandparents of the intestate, and if more than one survive the intestate in equal shares absolutely; but if there are no grandparents surviving, then
(iii) Thirdly, on the trusts set out in section 7 for the uncles and aunts of the intestate in equal shares; but if no person takes an absolutely vested interest under such trusts, then
(iv) Fourthly, for the great grandparents of the intestate and if more than one survive the intestate in equal shares absolutely; but if there are no such great grandparents surviving, then
(v) Fifthly, on the trusts set out in the section 7 for the great grand uncles and great grand aunts of the intestate in equal shares;
(j) in default of any person taking an absolute interest under the foregoing provisions the Government shall be entitled to the whole of the estate except insofar as the same consists of land.

Inheritance to Property for Muslim:
In An-Nisa (4): 7, it is clearly stated
“From what is left by parents and those nearest related, there is a share for men and a share for women, whether the property be small or large, a determinate share.”

The above verse clearly acknowledges the right of men and women in any estate of a deceased parent or parents or other relatives. An estate means anything that is left by the deceased at the time of his death and owned by him. It includes any valuable item, money, land, as well as family businesses. The estate extends also to shares in a company or partnership, unit trust such as under the Amanah Saham Nasional (ASN) and Amanah Saham Bumiputera (ASB) and financial institutions. The method of distribution will be based on the law of faraid which is founded on the verses of inheritance in surah al-nisa’ (chapter 4; Verses 11, 12 and 176) of the Holy Quran and the prophetic traditions.

There is a list of persons who are entitled for specific portions of a deceased’s property under the scheme of faraid, and the persons are classified into two classifications. The first classification is termed as Qur’anic heirs since they are mentioned in the Quran with prescribed portions. The second classification is referred to as residuary heirs or asabat and they would be entitled to either the whole or balance of the estate according to circumstances.

The Qur’anic Heirs:
The Qur’anic heirs consist of twelve individuals; nine females and three males who are related to the deceased by blood, except for the spouse. However, they will not inherit at the same time. There are specific situations for their inheritance. Nevertheless five of them will always get a share as long as they remain Muslims or have not caused the death of the deceased. They are the wife, husband, daughter, mother and father. The son of the deceased falls into the second category of heir.

The rest of the Qur’anic heirs are agnatic granddaughter, agnatic (paternal) grandfather, grandmother, germane sister, consanguine sister, uterine sister and uterine brother. Being agnatic means the grandchild and grandfather must be related to the deceased through the male link of the deceased. This is because distribution of estate according to faraid is based on patriarchal system originated from the Arab practices that gave priority to inherit to the males and relatives from the male side. Thus, a father of the father of a deceased person inherits but not a father of the mother of the deceased. Likewise, a daughter of the son is entitled to a portion as against a daughter of the daughter of the deceased.
The germane, consanguine and uterine sisters are the female siblings of the deceased but the degree and strength of blood ties differ. The germane and consanguine sisters share the same father but different mother. Germane sister is stronger in blood ties to the deceased as compared to the consanguine sister because she shares the same father and mother with the deceased. Consanguine sister only shares the same father with the deceased. Uterine sister and brother, on the other hand only share the same mother with the deceased.

**The Residuary Heirs:**

The residuary heirs are mainly males and except for the son and father, must be related through the male link (or must be agnatic). They are the first and main type of the three classifications of residuary heirs. They belong to the first classification that is residuary heirs in their own right (asabat nasabiyah bin nasabiyah) who are all males and consist of son, agnatic grandson, father, agnatic grandfather (paternal), germane brother (male sibling of the deceased who shares the same father and mother), consanguine brother (same father), son of germane brother (nephew), son of consanguine brother (nephew), germane brother of father (paternal uncle), consanguine brother of father (paternal uncle), son of germane brother of father (male cousin) and son of consanguine brother of father (male cousin).

A residuary heir by his own right (asabat nasabiyah bin nasabiyah) is entitled to either the whole estate, in the absence of any Qur’anic heir or its balance in the presence of any Quranic heir. The entitlement, however, is subjected to the rule of priority, which is based on the degree of blood relationship to the deceased. The one closer in degree of blood ties to the deceased will take the priority to take either the whole or the balance of the estate to the extent of excluding the rest of the residuary heirs. As an example, if a person dies leaving a son and a germane brother, the whole estate goes to the son and nothing for the germane brother. In another case, if a wife and a son survive the deceased, the son will take the balance after the wife takes her 1/8 portion of the estate.

Secondly, residuary heirs through another (asabat nasabiyah bil ghayr) consisting four female Qur’anic heirs who will take either the whole or the balance of the estate in the presence of their male counterparts of the same class and degree. They are the daughter, the agnatic granddaughter, the germane sister and the consanguine sister. They will share the whole estate in the absence of other Qur’anic heirs or the balance in their presence, on the ratio of two portions for the male and one portion for the female. The daughter of the deceased will become residuary heir through the son of the deceased (from any valid marriage of the deceased and whether the marriage is still subsisting or not); the agnatic granddaughter through the agnatic grandson, the germane sister through germane brother and the consanguine sister through consanguine brother. The entitlement of the residuary heirs through another is also based on the order or priority. The presence of son or agnatic grandson will exclude the brothers and sisters from the inheritance. The son will exclude the agnatic grandson and granddaughter of the deceased.

Thirdly, residuary heirs in the company of another (asabat nasabiyah ma’al ghayr) consisting of two female Quranic heirs namely the germane and consanguine sisters. They will become the residuary heirs in the company of female descendant of the deceased but must be in the absence of son or agnatic grandson or father or germane brother of the deceased. The consanguine sister will only become the asabah nasabiyah bil ghayr in the absence also of germane brother and sister. The residuary heirs in the company of another will only take the balance and not the whole estate.

**Pre-Distribution Process:**

In some cases, a deceased might have died leaving debts and few financial liabilities that have not been paid. It then becomes the responsibility of the heirs to settle all the liabilities before any distribution according to faraid is made. It is, however, not a duty of the heirs to pay the debts and other liabilities from their own pocket. The amount of the liabilities must be deducted from the deceased’s estate. Only then the balance will be distributed in accordance with the law of faraid.

There are also situations where the spouse of the deceased claimed to be entitled in a property of a deceased as part of jointly acquired property or harta sepencarian. Jointly acquired property means property acquired during the subsistence of the marriage between husband and wife. By custom, on demise of either spouse, the survivor has the right to claim parts of the property or its value. The claim of the jointly acquired property, however, does not hinder the distribution of the rest of the estate to proceed.

Apart from the debts and claim for jointly acquired property, the estate of the deceased may also be subjected to deduction for any amount of wasiyyah or wills executed by the deceased during his lifetime. A will can be made to anybody except for the next of kin and spouse and not exceeding 1/3 of the estate. The rational for this rule is that the next of kin such as children and parents as well as the surviving spouse already have their allocated portions that are prescribed in the Quran. If they were to receive extra portion from a will of the deceased, they will indirectly deprive the right of other heirs who supposedly to get more in term of quantum from the estate. This can also be understood from the words of the Prophet through Abu Ummaimah that: “I heard the Messenger of Allah, peace and blessings of Allah be on him, say in his sermon in the farewell pilgrimage:
“Surely Allah has given to everyone entitled to anything his due, therefore, there shall be no bequest for one who inherits.” Thus, in a family business for example, if the head of the family bequeaths that the business will be taken over by his eldest son and he meant by inheritance then it is not fair for the rest of the family members who are also entitled to the business under faraid should the head of the family dies.

However, the rules that the quantum of the will cannot exceed 1/3 and cannot benefit a legal heir are not rigidly imposed. A will exceeding 1/3 to the next of kin and spouse will be valid and enforceable with the consent of all the affected heirs after the decedent’s death. The consent of all heirs plays an important role to enable a Muslim to effectively bequeath certain property or specific portion of his estate to anybody he likes especially in cases where he has only daughters and he wants the daughters to get more than what is prescribed for them in the Quran. Alternatively, he can give more to the daughter/s and wife or wives through hibah or gift, which takes effect during his lifetime and nobody can challenge it.

As far as family businesses are concerned, any will or gift made to anybody must not infringe the rights of other family members. In other words, the will or gift must relate only to what rightly belonged to the person making it. It must be from his property or his parts of the businesses.

**Methods of Distribution:**

After all debts and other liabilities of the deceased are settled, the balance of his estate will be distributed according to the rules of faraid. If a deceased died leaving only one or more wife and no other heirs, the wife or wives will take 1/4 and the balance 3/4 will go to baitulmal. If there are two or more wives, they will share the portion equally.

If a husband survives a deceased wife and no other heirs survive her, then the husband will take half of her estate and the balance will go to baitulmal.

In a case where a person dies leaving a wife, a son, a daughter, a mother and a father, the wife will inherit 1/8 of the estate, the mother and father 1/6 each and the balance is shared between the son and daughter on the ratio of 2:1. In other words, the son will take double than the portion of the daughter from the balance of the estate. After the wife, mother and father have taken their portions the estate leaves the balance of 13/24 and divided between the son and daughter. The daughter will take 17/72 and the son will take 34/72 or 17/36 from the balance. Any siblings of the deceased will not inherit anything from the deceased estate in the presence of the son or father except through will. The will to the siblings is valid though they are legal heirs since they are included in the presence of son and/or father.

In another situation, if a person dies leaving a wife, a germane brother and a germane sister, the wife will take 1/4 and the balance is to be given to the siblings who will share on ratio 2:1; the brother will take double portion than the sister. Thus 3/4 is to be divided into three portions. One portion that is equivalent to 1/4 from the estate belongs to the sister and 1/2 belongs to the brother. Many people are quite reluctant to allow their siblings to inherit their estate upon death on the argument that the siblings contributed nothing to the acquisition of their wealth. The one who is always there for them is the wife and because of that she should inherit more. The siblings are given the right to inherit by the Lawgiver as prescribed in the Quran and nobody can deny the right. However, any husband can give more to his wife via gift inter vivos or hibah. At least, the actual amount of estate to be inherited by the siblings is reduced.

A person who has no son but daughters only also expresses similar concern. According to the law of faraid a daughter or daughters will not take all of the father’s estate on the latter’s death but fixed portion. If there is one daughter she takes half and if there are two or more daughters they share one third equally. The balance will go to the siblings, if any. Otherwise, the balance will go to baitulmal. The advice that is normally given is to provide more to the daughter or daughters through hibah. The only worry that a person may have is the fear that he will lose everything before death or that he may be thrown out from the house he is residing or that the daughters will spend the money or dispose of the property while he is still alive. Alternatively, many people opt for execution of will or wasiyyah in favour of the daughter or daughters but what they are not aware of is the legal effect of the will or wasiyyah depends on the consent of other heirs after the decedent’s death. Without the consent the will or wasiyyah cannot be given any effect.

**Observation:**

(i) **Inheritance Law and Family Business:**

The discussions on inheritance law both for the Muslim and non-Muslim highlighted the legal imposition on family members’ rights in the property of a deceased. As such, in the case of deceased of a father or a mother who have interests in the family business, be it tangible assets or intangible assets, for example land, buildings, shares and investments, the interest shall be divided to the children and family members according to the inheritance law. It is clear that under the inheritance law, the persons who are entitled to the property of the deceased must be family members and related to the deceased and such principle shall be very relevant in the context of preserving the family ownership and interest in the family business.
As such, it can be concluded that even without a proper succession plan, the family ownership in family business could be retain by applying the law of inheritance.

(ii) Retention of Inherited Rights in Family Business:

Nonetheless, subsequent issues which may arise out inheritance of interest in family are what should be done to ensure that the inherited shares in family business are not sold off to an outsider and what would happen if the family members who inherited the family business’s interest refused to hold the inherited interest. These concerns could be resolved by inserting a clause in the company’s Article of Association or in case of partnership firms, in the partnership agreement on the restriction to sell off any family interest to an outsider. Such clause shall operate to ensure that if the family members who inherited the interest decided to sell off his interest in the family business, it could only be sold to family members.

(iii) Succession Plan V Inheritance Law:

Another issue which could arise out of inheritance is what happens if before the deceased parent died, they prepared a succession plan which did not include the children or family members and when they died, the children or family members who are not in the succession plan inherited the interest in the family business. In such a case, it is observed that the inheritance law will prevail over the succession plan unless the succession plan is in the form a will, which shall be executed subject to the principles of will. For example, under the Islamic law, only less than 1/3 of the property could be distributed by will. If the succession plan or will is transferring all interest of the parent to a particular person, then it shall not be executed and the law of inheritance shall be applicable.

Conclusion:

In a family business, the confinement of family ownership is one of the important elements in sustaining the business structure. One of the ways to ensure sustainability of family ownership in family business is via succession plan, which includes the children or family members as successor of the family interest in the business. Nonetheless, it is observed that even in the absence of the succession plan, the reservation on family ownership in family business could be implemented through the inheritance law, which specified clearly on the rights of family members in deceased’s property. The principles of inheritance law, both for non-Muslim and Muslim clearly indicated that only persons related in blood or family members shall have rights in the deceased property.

However, there are some issues which could arise in the implementation of inheritance law over interest in the family business, such as disposition of the inherited interest to outsider and exclusion of the entitled parties under the inheritance law from the deceased’s succession plan. These issues however could be resolved by documents of incorporation, agreement and also by operation of the inheritance law it self.

REFERENCES


