

**Ownership v Expansion;
The conundrum in family businesses. A case study in Malaysia.**

By

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Abstract

A family business connotes the structure whereby the ownerships, the management and the decision making power are retain and intended to be reserved only for the family members. The confinement is structured as such from the beginning as it is meant to establish a business legacy of the family name. In many countries, be it developed or developing, the family business structure has a profound establishment as one of the main actors in the country's economy.

In ensuring the confinement of ownerships, the family business structure often find it difficult when the business grow bigger and expand to the level that it attracts many people to own it, including investors who are not family members. Despite enjoying limited liability of merely being an investor rather than owner of the business, there are many circumstances whereby the success and establishment of the business attracted the outsiders to be part of the business organization rather than merely being an external contributor. In such a case, the expansion of business may become a threat to the whole idea of setting up a family business. Other than the outside interest, disputes for power and ownerships between existing members in the due course of expansion may also occur to the extent that the original or founder of the business may be ousted.

This paper intends to look at the effect of expansion of family businesses in relation to ownerships by way of case study in Malaysia. This paper also aim to propose a business structure in which the conundrum of maintaining ownership in the course of expanding the family business can be minimize if not resolved.

Introduction

As in other countries in Asia, the family business structure in Malaysia has a long and strong standing in the market place. The themes which underpinned the family business are relationships and their obligations,

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particularly those of father to son and brother to brother, and the values of reciprocity and respect.² There are two main factors which justify the survival of family business:³

- Decisiveness in the marketplace which allows the companies to be aggressive and effective.
- The family ties/relationship ensure cohesiveness and trust that makes such companies formidable adversaries.

Nonetheless, despite its secured tenure in the market place, the extension of family business faced two main threats.⁴ Firstly, the inability of succeeding generations to maintain the entrepreneurial spirit and success of the founders. Secondly, the issue of sustainability. A family business is claimed to be able to expand only up to a certain size, and beyond that size, the enterprise can only operate effectively through the application of more universal rules, more impersonal processes, and without reliance on individual links of kinship.⁵ This second factor is actually the impetus behind this paper which meant to highlight the possible diversion of ownership in the due course of expansion of the family business.

Family Business in Malaysia

The report of a national survey covering 225 companies conducted by Grant Thornton and Malaysian Institute of Management in 2002⁶, stated that majority of family businesses in Malaysia is small scale enterprises and generally managed by the founder. Manufacturing, retailing or constructions are the notable sectors in which family business ventured most.⁷ It is also found that most of the family businesses were initiated by people having six years or more of work experience. This indicates that family businesses were commenced by people with appropriate experience.

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 whom are children of the founder.

² Peter Sheldrake, Keeping business in the family, Business Asia, October 31, 1999. Retrieved from http://www.findarticles.com/p/articles/mi_m0BJT/is_21_7/ai_57745787 on 1 September 2006.

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Shamsir Jasani, Report on Malaysia's Family Business, The Family & The Business International Survey, Grant Thornton & Malaysian Institute of Management

⁷ Ibid.

- 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%).

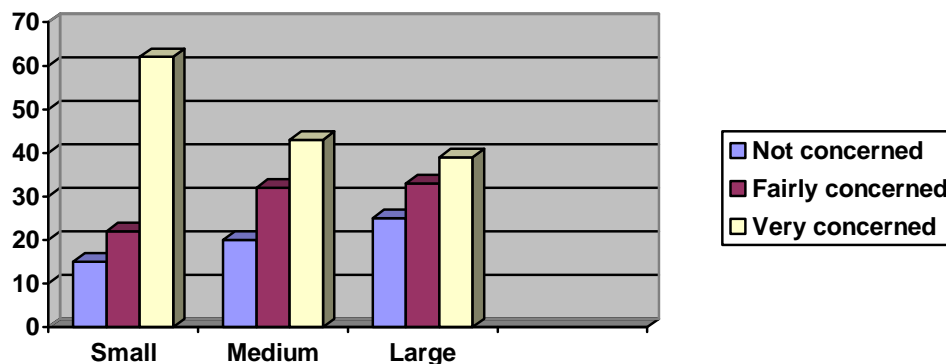
The concerns in Family Business

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

Although this two factors are seen to be distinct, in practice they are actually interrelated with one another. In starting up, carrying out and expanding the business, often family business faced not only the challenge of getting sufficient financing but also the appropriate source of finance.

Chart 1 : Concerns over losing control if outsiders were to involve in financing the business



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.

Blood Relation???

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.
- 52% of respondents are in the opinion that their children should join the business only if they wanted to and this was especially derived from respondents in the large scale enterprises (69%).

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.

A Case Study

A good case law to illustrate the problem faced in the family business structure pertaining to ownership and expansion is *Tan Kim Hor & Ors v Tan Chong Consolidated Sdn. Bh & Ors*.⁸ This case law is an example of how disputes between members (even they are family members) in the due course of expansion of the business had nearly resulted to the ‘death’ (winding up) of one of the family business.

Facts of the case:

Tan Chong & Co was established in the early 1930s by the patriarch Tan Chong as a sole proprietorship. In the late 1940s, a partnership of Tan Chong & Co. (TC & Co.) was founded with the partners being the late Tan Chong and his two sons, namely Tan Kim Hor and his brother, the late Tan Sri Tan Yuet Foh. The business was in food supply. Over the years, business of the partnership flourished and the brothers saw an opportunity in the automobile business. The partnership later became the distributor for Nissan and Datsun cars in addition to the then existing business of food supply.

On 16th February 1959 Tan Chong & Sons Motor Company Sdn. Bhd. (TCM) was incorporated to carry out the automobile business. The first subscribers and directors were the two brothers. The food supply business remained with TC & Co. The automobile business expanded and diversification of the business came into being. TCM went into car rentals, distribution of commercial vehicles and industrial equipment and tour and travel services. There was therefore a necessity to incorporate several companies to accommodate the various businesses. There was also a regional expansion of the business with the setting up of companies in nearby Singapore as for instance in 1966 the Tan Chong & Sons Motor company (Singapore) Private Limited (TCCS) was established while in 1968 the Singapore Automotive Industries Private Limited (SAI) was acquired.

With the expansion of the business, came the involvement of the younger generation of the family to assist the older members in the management. There was also a motion for the company to go public but with the caution that the Tan Chong family must continue to be in controlling position. To achieve that plan the family was advised to set up an investment holding company to be a holder of a controlling stake of shares in the company that would be public listed. And it was also planned that only members of the Tan Chong family would be the shareholders of the proposed investment holding company. In effect, the Tan Chong family would continue to dominate the intended public listed company.

As a result, on 1 September 1973, Tan Chong Motor Holdings Berhad (TCMH) became a public listed and with that establishment, all other companies of the family including TCM were acquired by TCMH.

On 7th June 1973, the Respondent was set and the first subscribers and directors were the Tan Kim Hor and the late Tan Sri Tan Yuet Foh on the equity ratio of 50:50 respectively. Subsequently this ratio was changed to 44,583:55,417 with Tan Sri Tan Yuet Foh having the larger portion. On 16th June 1973, the respondent resolved to purchase 9,230,000 shares of RM1.00 each from the shareholders of TCMH before its conversion into a public listed company. The shareholders who were involved were Tan Yuet Foh for 5,111,000 shares and Tan Kim for 4,115,000 shares respectively. In turn the Respondent in two installments allotted the purchased shares to the respective family members of the late Tan Sri Tan Yuet Foh and Tan Kim Hor. As a result, as at 28.08.1974 the family members of the former were in control of 55.417% of the shares in the Respondent while the balance of the shares were with the family members of the Petitioner.

The demise of Tan Sri Tan Yuet Foh on 08.10.1985 saw the passing of leadership in his family to Tan Heng Chew but the arrangement in the management of the business by the two families remained as before the death save that the key figures of the families were the Petitioner and Tan Heng Chew.

The petitioners contended that the quasi partnership which was the basis on which the 2 families conducted themselves upon mutual trust, understanding and co-operation has irretrievably broken down and therefore seek for the winding-up of the respondent upon just and equitable grounds. The petitioners in their application have adduced factual circumstances and have made allegations against the respondents *inter alia* as follows:

⁸ [2003] 1 AMR 445

1. Ever since the formation of TCC, all the decisions were made or taken on a consultative basis, with mutual trust and understanding being the underlying relationship in this quasi partnership;
2. However, since 1997, the first and the second respondents have made major decisions as regards the four listed companies without consulting and discussing with the petitioners, in particular, the first petitioner who is the rounder of the Tan Chong Group of Companies which origins go back to 1957 when Tan Chong & Sons Motor Company was formed with shareholding restricted to the Tan Chong family members only i.e. the first petitioner and his late younger brother;
3. Both the petitioners and the respondents have, premised upon this quasi-partnership, a legitimate expectation to participate in the management of the Tan Chong Group of Companies;
4. The interests of the petitioners have been disregarded by the respondents;
5. The petitioners' participation in the management of the public listed companies in the Tan Chong Group has been marginalised;
6. The mutual trust and confidence which existed between the petitioners and the respondents have irretrievably broken down and negotiations to get back their own respective shares failed;
7. The first respondent (Tan Heng Chew), barely 2 weeks after the first petition filed by the petitioners was struck out, commenced his vindictive actions against the petitioners with support from the other respondents(The petitioners had on 21-5-2001 filed in a Winding-up Petition No D2-28-507-2001 ["the first petition"] pursuant to s 218(1)(i) of the Companies Act 1965. Her ladyship Zainun Ali J under the first petition in striking out the said petition *inter alia* stated that the petitioners had acted against the interests of TCC and its shareholders and the interests of the public company.)

Decision of the High Court:

In approaching the application, the learned Judge accepted the legal principle that it is a question of fact whether or not to wind up a company and that each case has to be decided on its own particular facts. The learned Judge also noted that the Petitioners were seeking for equitable relief alleging breakdown in the mutual trust and confidence between the two families whilst the Respondents denied such assertion. The Judge held that the Petition application is an abuse of process and there is no ground shown that satisfy the requirement of just and equitable ground to wind up the Respondent.⁹

⁹ Zulkefli Ahmad Makinudin J held that that the petitioners have filed a winding-up petition herein to wind-up TCC on the just and equitable ground which is not a writ action. The petitioners also applied for injunctive reliefs and have under the application in encl. (26) claimed for "an injunction for split

Case Study- Practical Experience

In a conference organized by Federation of Malaysian Manufacturer (FMM)¹⁰, issues on continuity of family business had been discussed by panelists and speakers who had practical experiences in family business. Among observations made from the presentations are:

1. Khind Holdings Bhd.

The company originated from a sole proprietorship. In 1961, the founder, Mr.Cheng Kin Fa set up a company, under the name Syarikat Letrik Kee Hin. The initial capital of the business was RM3 000. In 1963, the brother of Mr.Cheng Kin Fa, Dato' Hup joined the company. The business was prosperous between year 1970 – 1980 and later in 1987 to 1997, the second generation joined the business. In 1998, the company became a public listed company. Despite the positive expansion, in 2003, after 40 years of a strong partnerships between the family members, the relationships between the two brothers got worse which made Dato' Hup sold his share and resulted to a split in the partnerships.

According to Mr.Cheng Ping Keat, Group CEO of Khind Holdings Bhd, who is the son of Mr. Cheng Kin Fa, the Khind family partnerships stood for 40 years due to certain aspects:¹¹

proxies". However the provisions in respect of an application for interlocutory injunctions are governed by Order 29 of the Rules of High Court 1980. Since the application in encl. (26) is filed under the winding-up petition only the provisions of the Act should apply and the provisions of the Rules of High Court 1980 are prima facie not applicable. Furthermore, the Order 29 r 1 of the Rules of the High Court 1980 may not be applicable to a winding-up petition, particularly in view of the wordings of Order 29 r 2 which do not include reference to a petition. Hence on grounds of lack of jurisdiction and the wrong mode of commencing an action alone the petitioners application should be dismissed *in limine*.

The judges further stated that even assuming that the court has the jurisdiction to consider the petitioners application in encl. (26), he would still dismiss the said application as applying the test and the principles for the granting of an interlocutory injunction as laid down in the case of **American Cyanamid Co v Ethicon Ltd** [1975] 1 All ER 504 and the local case of **Keet Gerald Francis Noel John v Mohd Noor Abdullah** [1995] 1 AMR 373; [1995] 1 MLJ 193, the petitioners have not raised bona fide serious issues to be tried. Looking at the nature of the orders prayed for in the petitioners application in encl. (26) it does not show that it relates to the winding- up petition of TCC. The complaint made by the petitioners does not relate to TCC at all. The company being complained of is Warisan which is a public listed company in which TCC owns 42% of the shares. Warisan is also not a subsidiary of TCC. The petitioners are filing the petition only in their capacity as shareholders of TCC.

¹⁰ Federation of Malaysian Manufacturer Conference Proceedings "Family Owned Business in a Globalize Environment- Challenges & Opportunities", 2 March 2006, Kuala Lumpur.

¹¹ Cheng Ping Keat, *Family owned Businesses- Overcoming Challenges & Ensuring Continuity*, Federation of Malaysian Manufacturer Conference Proceedings "Family Owned Business in a Globalize Environment- Challenges & Opportunities", 2 March 2006, Kuala Lumpur.

- Respect for elders and leadership experience
- Mutual trust and respect
- High degree of give and take
- Shared value, common goals and strategies
- Open communication
- Teamwork

However, when dispute between the family members arise and became worse, it resulted to:

- Energy Draining – energy are used more on internal disputes which resulted to less energy are left to fight the business/outside wars
- Affect teamwork – the disputes resulted to two or more groups in the company
- Affect decision making- Speed v Quality and Logic v Emotion
- Ineffectiveness and inefficiency in the organisational structure

From his experiences, Mr.Cheng Peng Kiat, highlighted the importance of good relationship between the members in family business and suggested that if the good relationship can not be maintained, it is better for the members to split up so that it can save both the family relationship and the family business from getting worse.

According to him, in order to maintain harmony in family owned business, it is important to have:

- Consensus and shared goals
- Proper communication which requires honesty and disclosure
- Respect for seniority and leadership
- Professionalism- Good management
- Balance in both the family needs and the business needs
- Mutual trust and respect
- A good succession planning

2.Eu Yan Seng International Limited, Singapore

This international reputable company has an origin from a sole proprietorship business of selling chinese medicine “Yan Sang” by Mr. Eu Kong in 1879.¹² The business was later transferred to Mr.Eu Kong’s son, Mr.Eu Tong Sen who succeeded to turn the business into an empire comprising of tin mining, rubber

¹² Richard Eu, *Family owned Businesses- Overcoming Challenges & Ensuring Continuity*, Federation of Malaysian Manufacturer Conference Proceedings “Family Owned Business in a Globalize Environment- Challenges & Opportunities”, 2 March 2006.

estates, foundries, property developments and investments, remittance, banking, theatres and chinese medicine. In 1973, the company, now known as Eu Yan Seng(EYS), was listed in Singapore and Malaysia stock exchange. In 1990, there was a company acquisition by Lum Chan which resulted to change of ownership in EYS. In 1993, Eu Yan Seng International was incorporated and Lum Chan shares were buy out by the family. In 2000, the business become bigger and was listed in SGX mainboard. Comparing the business in 1989, where the company has only 8 outlets with the business in 2005, where it owns 106 outlets, it has been proven that through good management and venture capital schemes, the family business can become big and at the same time retained the family ownership.

According to Richard Eu¹³, the key to success of the company is to retains the forefathers' values but continues to innovate in ensuring that the business is relevant to today's lifestyle.

Business Strategy

The Khind and Eu Yan Seng International success story highlighted the importance to have certain business strategy to ensure that the family legacy can be maintained in the due course of expansion. According to Mr.Mark Lea¹⁴, it is important to have a sucession planning in a family business and this can be done through wills, trusts and choosing appropriate business structure, for example limited partnerships.¹⁵ This paper intend to focus on limited partnership as one of the business vehicle for family business.

Limited Partnerships

The limited partnerships structure is claimed to be recognized by the medieval legal community prior to general partnerships. Its origin is believed to go back to the early Roman law relating to the principle of limited liability.¹⁶ In England, the limited partnership was unknown prior to 1908. The Limited Partnership Act 1907 was enacted when the Partnership Act 1890 failed to cover the problems on limited partnerships. Under the Limited Partnership Act 1907, a limited partnership is a firm which did not display three of the essential characteristics of general partnership, namely:

- a) the unlimited liability of every partner
- b) the implied authority of each partner to bind the firm in all matters within the ordinary scope of the partnership business

¹³ Group CEO, Eu Yan Sang International Ltd, Singapore.

¹⁴ Pertner, Lea & White, an International Law firm with offices in Hong Kong and Singapore.

¹⁵ Mark Lea, *Organising For Growth- Extending the Family Businesses*, Federation of Malaysian Manufacturer Conference Proceedings "Family Owned Business in a Globalize Environment- Challenges & Opportunities", 2 March 2006.

¹⁶ Robert W.Hillman, Limited Liability in Historical Perspective, *Washington and Lee law Review*, Vol.54, 1997 at p 616

- c) the right of each partner to take part in the management of the business, subject to any contrary agreement.

The main objective of the LPA 1907 is to allow persons to enter into a partnership, subject to certain requirements, with the terms that the liability of some of them would be limited to the amount contributed by them in cash or property when the partnership was originally created. However, it was a fundamental condition that the liability of at least one of the partners should be unlimited. The former type of partner was called 'limited partner' while the latter was known as 'general partner'. During the continuance of the partnership, the limited partner had no implied authority to bind the firm, had no right to take part in the management of the firm and might not be repaid any part of his capital contribution. Hence, even though the limited partners may limit their liability in the business, they had to take a passive role akin to that of the more traditional dormant partner. The general partner on the other hand enjoys all the management rights but has unlimited liability.

In Malaysia, the limited partnership structure is only practiced in Labuan. It is observed that the main purpose of introducing limited partnerships in Labuan is to make the offshore compatible with other off shores in the region and also to attract more investment by providing more option of business vehicle.¹⁷

The structure of Labuan limited partnership is similar to the UK's offshore limited partnerships, for example the Jersey, Guernsey and Isle of Man limited partnerships. Although the offshore limited partnerships are generally similar to the mainland partnerships, there are some distinguishable criteria between the two. For example, unlike the mainland limited partnerships, the offshore limited partnerships allow a person to become both the general and limited partners. In such a case, the person can limit his liability up to certain amount as a limited partner but at the same time take part in the management of the firm. This criterion is equally applicable in the Labuan limited partnerships. Another interesting structure of the Labuan limited partnership is that it has a corporate tax status despite its partnership entity.

Family Business and Limited Partnership

Choosing the limited partnerships structure as the business vehicle in the family business is one of the strategy which can minimize lost of ownership to outsider in the due course of expansion. By reserving the position of general partners only to family members, whilst outsiders or investors/business partners could only be as limited partners, the worry that the business may be taken over by outsider can be reduced.

In the USA, the family limited partnerships are popular as it provides significant advantages in reducing gift taxes, reducing estate taxes, facilitating family succession and protecting assets. By creating a family

¹⁷ Parliamentary Debate (Malaysia), 15th April 1997

limited partnership (FLP), family members (usually parents) put assets into a partnership, then give a minority interest to other family members (still retaining control of the assets). Through the FLP structure, parents can begin to shift wealth to their children, introduce them to asset management, educate them about investments and wealth, facilitate and manage pooled resources, and achieve different economies of scale. In short, the limited partnership structure is very useful for estate planning rather resolving internal rivalry/disputes.

As a conclusion, one of the problem of family business in the due course of expansion , i.e lost of ownerships to outsiders can be resolved/minimized by choosing limited partnerships as the business vehicle. However, the rivalry between family members can not be settled by this structure as it is more of an internal crisis rather than a business problem.

The views of many successful family business entrepreneurs are indeed true that, in the due course of expansion it is acceptable to have some outsiders in the business, who can make the business more thriving rather than having only family members who works on bringing down the family business.¹⁸ The concern of these entrepreneurs is that the family business legacy/ goodwill must go on and prosper despite the composition of the owners only being the family members.

¹⁸ Mr.Clinton Ang Kim Tuan, MD of Hock Tong Bee Group of Companies, Mr.Meer Sadik Habib, MD of Habib Jewels Sdn Bhd and Mr. Richard Eu, Panel Discussion, Federation of Malaysian Manufacturer Conference Proceedings “Family Owned Business in a Globalize Environment- Challenges & Opportunities”, 2 March 2006, Kuala Lumpur.