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Sole Proprietorship Business Succession in Malaysia: A Perspective of Civil and Islamic Law*

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Abstract

Issues relating to business inheritance are a primary focus for business owners. Business inheritance is critical to ensuring that the business can be managed by the next generation and family members can benefit from the earnings and revenues. Therefore, preliminary planning must be done while the business owner is still alive by selecting the appropriate business inheritance mechanism for Muslims in Malaysia. The mechanisms of business inheritance, notably *faraid*, *hibah*, *amanah*, and *hibah amanah* will be examined in this paper from both a civil and Islamic perspective. By reviewing written journals and previous research, this research utilizes the library method. According to this study, business succession can be carried out by naming a beneficiary as a partner in the company or by completing the ownership transfer process while the owner is still living. In the other situation, it can be done by anyone among the heirs agreeing to re-register the business as usual. Meanwhile, there are four main instruments in Islamic law that can be used: *faraid*, *hibah*, *amanah*, and *commercial hibah*. According to this study, each instrument has a different impact on business succession. Entrepreneurs should use these instruments in their firm succession planning.

Keywords: Business Inheritance, Sole Proprietorship Business, *Hibah*, *Amanah*

JEL Classification Code: K22, M19

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1. Introduction

Islam actively urges its followers to make succession plans for their assets, whether they are moveable or immovable. This planning should be done while the owner is still alive to protect the owner's interests and maximize the use of wealth throughout one's life, as well as to the heirs or beneficiaries after death (Hasbulah & Daud, 2015). Allah SWT considers this as a charity because the wealth inheritance can guarantee the well-being of heirs after an individual's death. In addition, it also assists heirs with the emotional, spiritual, and economic aspects because previously they had only depended on their parents.

Wealth planning is "a plan that can be implemented in a certain way during an individual's lifetime, upon having acquired, managed, and distributed one's assets to heirs and beneficiaries in a discretionary and fair manner, since the assets can be controlled, monitored, and utilised for the recipient or heirs, the individual, and one's family during lifetime and after death." In general, there are four important elements in wealth planning, namely setting the objectives to be achieved, the methods that will be used in the transfer

of the property, the life planning for the convenience of the owner, and the heirs who will inherit the wealth (Hasbulah & Daud, 2015).

Some Muslim communities do not engage in wealth planning because they depend entirely on the *faraid* law (Islamic inheritance law) which has been outlined by the Shariah (Islamic law). *Faraid* is a method of dividing wealth upon the death of the owner to the heirs who are entitled according to the rate set by Allah SWT. The lack of knowledge on wealth planning causes most to assume that the *faraid* system is sufficient in solving the problem of wealth division. However, Islam actually provides various other methods for wealth distribution or inheritance, such as wills, *waqf*, *hibah*, *amanah* (trust), and so on, according to the suitability and situation of each family (Hasbulah & Daud, 2015). Therefore, all assets owned need to undergo an efficient and organized planning process so that benefits can be enjoyed during one's lifetime or after death. For this study, the author will focus on business succession planning and related assets.

2. Business Succession Planning

Business succession planning is a critical and important issue for all businesses, especially for those that are stable and have passed the survival phase. In academic studies related to the family business, issues of inheritance planning are the most discussed and elaborated by researchers (Bizri, 2016; Ip & Jacobs, 2006; Merchant et al., 2017; Miller et al., 2003; Sharma et al., 2003). Planning to transfer a business to the new generation needs to be made not only for personal reasons, such as the business owner's plan for retirement, or a plan to change careers, but also because of environmental factors such as market changes and the emergence of new products, or due to unforeseen circumstances such as the death of the business owner, health complications, or divorce (Duh, 2012; Lussier et al., 2012).

The main objective of business succession is the ability to maintain the wealth of family members and to ensure the continuity of the family business. In addition, it can ensure family members' achievement in the future, maintain a personal or family legacy, and create a positive impact on the country's economic growth (Duh, 2012; Ng et al., 2021). This is due to the fact that family businesses are considered the foundation of economic development in most countries around the world as they provide employment opportunities and contribute to a large portion of national income (Ip & Jacobs, 2006; Lee & Li, 2009).

Mokhber et al. (2017) stated that 70% of family businesses are mostly non-permanent and will undergo foreclosure after the death of their founders due to the failure of planning business succession. No more than 1/3 of family businesses have managed to transfer the business to

subsequent heirs (second generation). Also, approximately 1/3 of them have managed to transfer business to the third generation and beyond (Wang et al., 2004), while other businesses will be foreclosed after having been managed by the second generation due to various complications such as ownership issues and management (Duh, 2012).

Most business owners are aware of the importance of planning business succession, but many have not followed through with their business, while some business owners only provide informal or unwritten succession planning (Bozer et al., 2017; Duh, 2012; Wang et al., 2004).

In summary, business succession planning can be defined as a process of change or transfer of ownership of a business within a company (Ip & Jacobs, 2006). The transfer process can also involve the leadership, ownership, and management aspects of one family member to another. According to Sharma et al. (2003), it is a formal process that facilitates the transfer of management and ownership of a business from the first generation to the next generation among family members.

From these definitions, there are two main aspects of business succession, namely management inheritance and ownership inheritance. Succession management discusses who will handle the business, changes that occur afterward, and when the heir is considered to be readily responsible for managing the business, while ownership inheritance refers to who will own the business and when and how the process should occur (Ramadani et al., 2017).

Transfer of ownership can take place among family members or outsiders, through the means of selling companies or shares to employees, outsiders, and other companies, or by affiliated methods with other companies (Duh, 2012). These two aspects of inheritance show that some business owners transfer management and ownership to only one heir and some business owners transfer only one aspect to family members while another aspect involves outsiders.

Inheritance is a long-term process that requires continuous support from owners and heirs. It is not just a transfer of duty when the owner dies or retires, but a process that should be planned at the early stage of the business and throughout its operation; this process must be made through discussions, preparations, and changes that are appropriate for the family business. Continuous involvement and the shared roles between owners and heirs are crucial in creating a successful leader who will continue the business (Ramadani et al., 2017). This process undergoes several phases before the heirs are involved in the business. It goes through a formal selection process for prospective heirs, the training and establishment of heirs, the transition phase, and finally the actual transfer phase.

The accomplishment of business succession can be realized if the company can continue to operate at least in the short term (Ip & Jacobs, 2006) and if positive relationships

among family members can be maintained while internal conflicts, competition, and hostilities can be avoided. The success of inheritance can be assessed from two perspectives, namely from the perspective of the stakeholder's satisfaction with the process of inheritance and from the perspective of the company's efficiency and performance after the succession (Sharma et al., 2003).

3. Sole Proprietorship Business in Malaysia

In Malaysia, every business and company must be registered under the *Suruhanjaya Syarikat Malaysia* (SSM). Among the importance and advantage of registering a business with SSM is to ensure that the business becomes a legal entity, to guarantee that consumers are more confident when dealing with a business, and to certify the obtainment of potential assistance related to community development and business prospects from the government. There are five forms of registered business entities namely sole proprietorship, partnership, private limited company or public limited company, cooperative limited company, and public corporation. Each of these business entities is subject to certain acts such as Business Registration Act 1956, Companies Act 1965, Co-operative Societies Act 1993, State Government Enactment, as well as the Parliament Act (Ahmad Zamil, 2017; Ismail et al., 2008; Noor Afza et al., 2005; Wan Liz Ozman & Sulzari, 2002).

Sole proprietorship and partnership businesses are the most widely registered types of businesses per year under the SSM compared to the limited liability partnership company type due to its low cost and ease of management. In 2018, 420,556 registrations were registered, accounting for 89.04% of the total business and company types; in 2019, there were 362,600 registrations at 87.68%, and in 2020, a total of 389,915 registrations were recorded at 89.07%. This type of business is the most basic and can be easily established due to fewer rules and conditions that need to be adhered to.

A sole proprietorship business is a business owned by a single owner under the Business Registration Act 1956. Business owners have complete control over business management, decision-making, and business policies. They are usually assisted by family members or several hired employees. The business name usually applies the owner's name or a trade name such as *Kedai Dobi Mewah*; the owner only needs to fill out 'Form A' or 'New Business Registration Form', which is available for free at the Business Division, SSM. In fact, the registration fee is also inexpensive at RM30 if using the owner's name, or RM60 if using a trading name.

This business can be divided into three types, i.e., hawkers, stalls, or commercial premises. The hawker business is run by hawkers who move from one place to another either on foot or using a vehicle. Hawkers often sell cheap and small items such as cakes and fruits. Stall businesses, on the other

hand, owns either fixed or temporary stalls/booths. They sell everyday necessities such as fruits, fish, and home appliances. Next is the commercial premises, which include fixed shops in villages or towns. Commercial premises consist of general shops such as grocery stores, specialty shops selling certain items such as shoe stores and bakeries, as well as service stores such as barbershops, clinics, and small legal firms.

In terms of capital, the initial capital used by this business is small, usually from personal savings or loans, either from family members, trusted friends, or banks that offer microloans. In terms of liability, the owner will bear all unlimited liabilities, i.e., losses and debts throughout the business will involve personal property claims if the business property has insufficient funds to settle the loss or debt. The court also reserves the right to declare bankruptcy if the owner fails to settle the business debt.

In terms of profit, the owner is entitled to the full profit; the income tax imposed is low as the tax rate is subject to the total income of the business owner. Subsequently, the business operation is deemed to be expired should the owner dies, but the beneficiary cannot take over the business automatically from the deceased. However, the transfer of title to the heir can be done by the owner by filling out Form B or Business Information Change Registration Form.

In summary, the advantages of a sole proprietorship business include the ease to manage and set up, independent administration and decision by owners, owners' initiative to work hard since business success or failure depends on the owner, small capital requirement, total ownership of profits, and close relationships with the clients or customers. The downside of this business type is the limited potential for business growth due to small capital, unlimited liability, total risks, unsustainable business life span which depends on the age of the owner, greater workload, and limited expertise of the owner. All these may hinder business growth.

4. Method of Business Succession from Civil Law Perspective

Based on the description of the registration process for a sole proprietorship business as explained above, it is understood that this business can only be registered under a single owner's name. The lifespan is limited, so if the owner dies, the business will be dissolved. Therefore, several alternatives will ensure that the business succession process can be carried out, resulting in legal ownership by law. The first is to appoint a beneficiary as a partner in the business or to carry out the ownership change process while the owner is still alive. The appointment of a partner and the change of ownership can only be done while the owner is still alive if a trading name is used as the business name; if the business name is the owner's identity card name, change cannot be done. The process is as follows:

- i. Business owners and potential new owners visit any SSM office
- ii. Fill out the Business Information Change Form (Form B)
- iii. Make a payment of RM20
- iv. Information will be updated by SSM

Next, if the business owner passes away without having time to process ownership transfer, the business can then be re-registered as usual by anyone among the heirs upon agreement. However, in this case, it should be taken into account that the business assets and related assets will be considered as the deceased's *faraid* entitlement. If there is no agreement among the beneficiaries in determining who is eligible to register the business under the owner's name, then re-registration cannot be carried out and the business property will be divided according to *faraid*. However, if there is an agreement, the process is as follows:

- i. The beneficiary will go through the process of distribution of inheritance based on Court Order.
- ii. The beneficiary may bring a Probate Grant or Letter of Administration to SSM.
- iii. Fill out the Business Change Information Form (Form B).
- iv. Upon submission, SSM will change the name of the business owner to the relevant beneficiary.
- v. If there is no application until the date of termination, then the business will be terminated.

5. Method of Business Succession from Islamic Perspective

5.1. Faraid (Islamic Inheritance Law)

For Muslims, each asset left by the deceased either movable or immovable will be divided according to the *faraid* ruling. *Faraid* will be accomplished if it meets its three pillars: the deceased (*al-muwarith*), the heir (*al-warith*), and the inheritable assets (*al-mauruth*). Heirs can be classified into three divisions, namely *ashab al-furud*, *asabah*, and *dzawil arham*, all of which are 25 heirs, 15 being male heirs and 10 being female heirs. If all of these heirs exist, then five heirs will be given priority, namely daughter, son, father, mother, husband, or wife. They will not be removed from receiving an inheritance under any circumstances.

The determination of their share has been set to either 1/2, 1/3, 1/4, 1/6, 1/8, or 2/3, while for sons, their share is equal to two shares of daughters. The divisions and rates of the assets received differ and vary according to their respective circumstances as described in the al-Qur'an Surah *al-Nisa'* verses 11 and 12:

“Allah (thus) directs you as regards your children’s (inheritance): to the male a portion equal to that of two females: if only daughters two or more their share is two-thirds of the inheritance; if only one her share is a half. For parents a sixth share of the inheritance to each of the deceased left children; if no children and the parents are the (only) heirs the mother has a third; if the deceased left brothers (or sisters) the mother has a sixth. (The distribution in all cases is) after the payment of legacies and debts. Ye know not whether your parents or your children are nearest to you in benefit. These are settled portions ordained by Allah and Allah is All-Knowing All-Wise (11). In what your wives leave your share is a half if they leave no child, but if they leave a child ye get a fourth; after payment of legacies and debts. In what ye leave their share is a fourth if ye leave no child; but if ye leave a child they get an eighth; after payment of legacies and debts. If the man or woman whose inheritance is in question has left neither ascendants nor descendants but has left a brother or a sister each one of the two gets a sixth; but if more than two they share in a third; after payment of legacies and debts; so that no loss is caused (to anyone). Thus, is it ordained by Allah and Allah is All-Knowing Most Forbearing (12).

In summary, the divisions can be seen in Table 1.

This method of distribution applies to all types of the deceased's property such as cash, house, land, vehicle, business, etc. Before being divided among the heirs who are entitled according to the *faraid* ruling, all debts borne by the deceased must be repaid, including personal debts, business debts, and debts to Allah SWT such as *zakat* and *kaffarah*. In addition, it is also necessary to deduct the share

Table 1: Division of Properties for Major Heirs

Heir	Situation	Part Acquired
Daughter	Only one	1/2
	Two or more	2/3
	If there is a son	Receive half of the son's share
Son	–	Receive 2 parts of the daughter's share
Father	No child	<i>Asabah</i>
	With sons	1/6
	With daughters	1/6 + <i>Asabah</i>
Mother	No child	1/3
	With children	1/6
Husband	No child	½
	With children	1/4
Wife	No child	¼
	With children	1/8

of the property claimed by the deceased’s spouse and the will made by the deceased, if any. The recipient of the will must not be among the heirs, with a rate not more than 1/3 of the deceased’s property, for the rights of the other heirs to be preserved (Mohd Salim & Ariff Abd Ghadas, 2012).

In a situation where the deceased has a business, all assets related such as assets and shares will undergo the same method of distribution as above. Upon the death of the business owner, and if the heirs agree not to continue the business, all assets in the business will be valued according to the market value, then divided amongst the heirs according to the *faraid* ruling. However, if heirs wish to continue the deceased’s business but no inheritance plan has been made by the deceased that specifies who will inherit and manage the business after his/her death, then all heirs are entitled to the inheritance based on the *faraid* ruling. Thus, the business inheritance will take place through the method of *syirkat al-milk ghayr ikhtiyari*, i.e., the beneficiaries will become partners in the business automatically upon the death of the owner as shown in Figure 1.

5.2. Hibah (Islamic Inter Vivos)

The *hibah* is one of the instruments used to plan for property inheritance (Islamic inter vivos). *Hibah* is a Sunnah practice that Islam strongly encourages. A business owner has the free choice to decide which specific heirs are to inherit the business, as well as the value of the property to be granted. The *hibah* instrument is deemed suitable if the business owner only has daughters as heirs. According to the *faraid* ruling, she is entitled to 1/2 of the property or if there are two or more persons, then their share is 2/3 while the balance will be divided to other rightful heirs. In addition, for couples who do not have children, the wife’s share is only 1/4 of the property left behind. In this situation, the business owner may transfer his property to his daughter, wife, or anyone desired to complement the obtainable *faraid* part.

Hibah from a linguistic aspect denotes grant, gift, or charity. *Hibah* as defined by the *Syara*’ means a contract that

includes the gift of a person’s property while he/she is still alive to another person without expecting any recompense. *Hibah* will be accomplished when it fulfills four requisites, namely the *hibah* provider (*al-wahib*), the *hibah* recipient (*al-mauhub lahu*), the property to be granted as *hibah* (*al-mauhub*), and contractual agreement (*sighah ijab & qabul*). There are additional elements that need to be available to ensure that *hibah* is executed, i.e., the transfer of ownership (*al-qabd*). Without *al-qabd*, *hibah* is still considered unfulfilled (Kamarudin et al., 2020) as in the case of Tengku Haji Jaafar ibni Almarhum Tengku Muda Ali [1987] 2 *MLJ* 74 (p. 131):

“As regards the gift of land, whether it be to a Muslim or a non- Muslim, the gift will not be valid unless the recipient takes possession of the gift of land at the time the gift is made. In other words, a gift will transfer the ownership of the subject matter of the gift to the recipient only upon the latter taking possession of it.”

Based on the general concept of *hibah* as described, the *hibah* property will belong to the grantee (*hibah* recipient) and will take effect immediately upon the completion of the *ijab*, *qabul*, and *al-qabd*. The *hibah* provider may not withdraw or cancel the *hibah* after an effective *al-qabd* except the *hibah* from a father or grandfather to his children or grandchildren. Therefore, the *hibah* provider no longer holds rights in the reserved property either in the form of material or benefit. This type of *hibah* is known as absolute *hibah* or *hibah al-munjazah*. Therefore, a business owner who wishes to transfer one’s business to a particular beneficiary needs to understand that *hibah* will take effect immediately and he/she will have no rights or authority in the business. The *hibah* recipient will have the right to manage the business in accordance with its requirements; its ownership will be wholly owned by the *hibah* recipient (Figure 2).

Nevertheless, the most crucial aspect before handing over a business to heirs is to ensure that business debts can be resolved, and the business can continue to operate without the

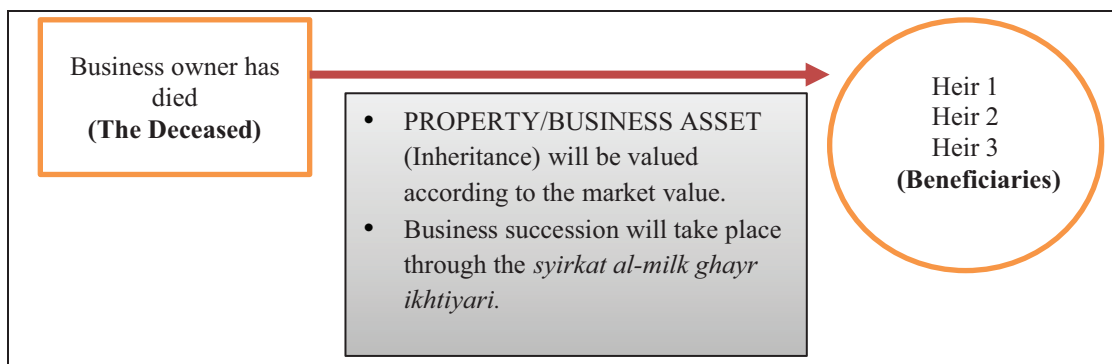


Figure 1: Business Succession through *Faraid*

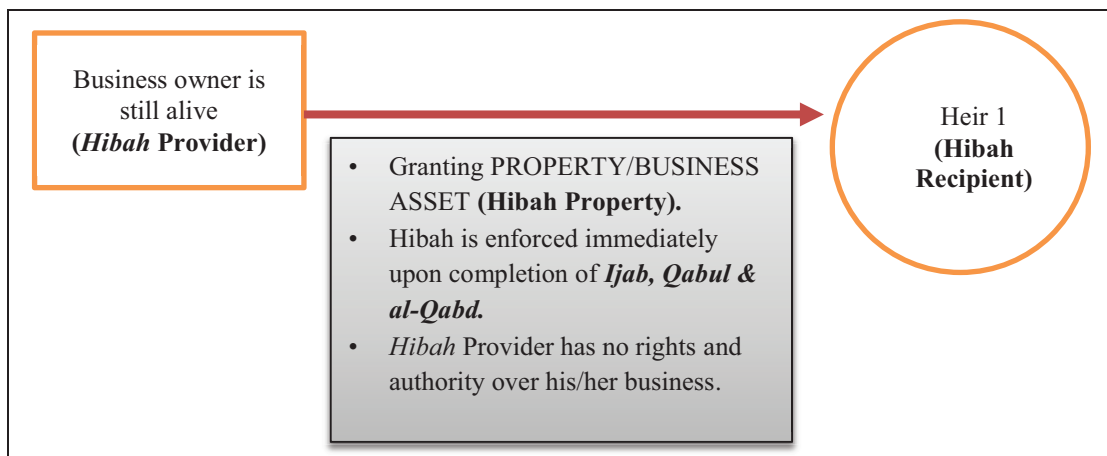


Figure 2: Business Inheritance through *Hibah*

company having to be liquidated or dissolved, i.e., a process where the company's assets will be collected and liquidated to pay off the company's debts to creditors, at least one year after the handover of business to the next of kin (Malaysian Department of Insolvency, 2021). This is extremely important to ensure that the objective of inheritance is attained and that the business can generate income and benefits for the heirs.

5.3. Amanah (Trust)

Amanah (trust) is one of the mechanisms of property inheritance that is subject to civil law. In civil law, there is no clear interpretation of *amanah*. However, in summary, *amanah* can be understood as a trustee who holds trust property for the benefit of a particular person. *Amanah* shall be formed when a person appoints a trustee responsible for managing the trust based on conditions agreed together either during life or after the death of the trustee. Nor Muhammad (2012) listed several definitions of trust or *amanah* from Professor Keeton and McLaren, namely:

Professor Keeton: ".....A trust is a relationship that exists when a person appointed as a trustee has been required by equity to hold either movable property or private property, by law or equity in the interest of another party or some objects permitted by law whereby the actual benefit of the property held is not for the trustee, but otherwise for the beneficiary or other objects of the trust....."

Mc Laren: "....A trust can be defined as a benefit made by the party transferring the property to a trustee so that the trustee can fulfill the trust provider's instructions in respect of the management and disposal of the property..."

Owing to the aforementioned definitions of *amanah*, there are three important elements for forming *amanah* legally in

accordance with the law, namely the *amanah* keeper (trustee), parties that benefit from the *amanah* (beneficiary), and the trust property itself. Two more elements have been added by Nor Muhammad (2012), namely the person making the *amanah* (*the settlor*), and the instructions specified in the trust.

Figure 3 can be described as follows:

- A trustee is a person responsible for managing the trust property for the benefit of the beneficiary. When a trustee is appointed, he/she is the temporary legal owner of the trust property. Therefore, the trustee shall administer the trust with honesty and fairness, perform all terms of the trust, take no personal profit, as well as perform other related duties.
- All trust assets will be received by the beneficiary if the trust has been fully implemented by the trustee. However, for non-adult beneficiaries, the trustee will be responsible for the trust property and will only hand it over to the beneficiary upon reaching adult age or in accordance with the instructions in the trust.
- Trust property is the property to be bequeathed to the beneficiary, such as movable property in the form of cash, shares, jewelry, cars, *takaful*, etc., and immovable property in the form of land, house, etc. The implementation of the trust is valid even if there is no transfer of trust property directly to the beneficiary.
- A settlor is free to place any condition in the trust deed.

For Muslim property trusts, there are arising issues as to whether their jurisdiction is placed under the Syariah Court or the Civil Court. Based on the cases of *Dato' Kadar Shah Tun Sulaiman vs. Datin Fauziah Haron* [2008] 7 MLJ 779 and *SMASJ vs. SSSMJ* (10000-040-0041-2015), the Honourable Judge decided that the issue of trust made by will or letter

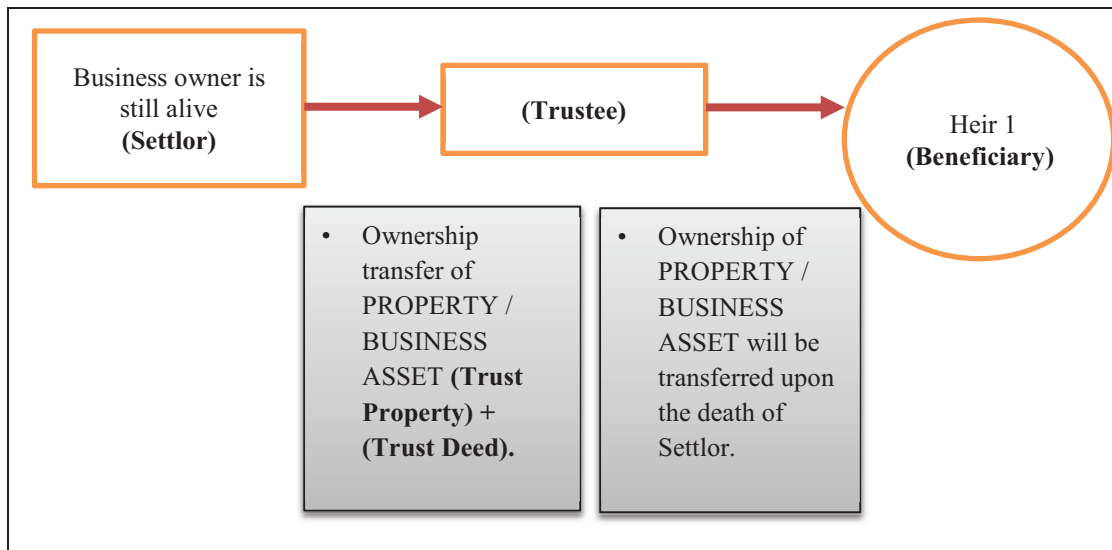


Figure 3: Business Succession through Trust

of trust shall be decided by the Civil Court before the issue of the estate would be determined in the Syariah Court, as there were other acts which bond the issue of trust, among them are the Trust Companies Act 1949, Trustees Act 1949, Public Corporations Act 1995, National Land Code 1965 and other relevant Acts and State Enactments. Nevertheless, exceptions were granted to trusts formed through *waqf*, as they are placed under the jurisdiction of the Syariah Court; the Islamic Religious Council is appointed as the sole trustee for *waqf* properties.

5.4. Commercial *Hibah* (Islamic Inter Vivos) / Amanah (Trust)

From the perspective of legislation in Malaysia, *hibah* is placed under the jurisdiction of the Syariah Court, based on the provisions stated in Item 1, List II, and 9th Schedule of the Federal Constitution. Among the *hibah*-related cases that have been tried in the Syariah Court include *hibah* verification, *hibah* rate dispute, and *hibah* withdrawal. These cases have proven that *hibah* can be challenged in the Syariah Court. Therefore, commercial *hibah* and documentation have been introduced to reduce these problems.

Various new terms of documentation exist, which are offered by trust companies such as ‘*Hibah* Declaration Document,’ ‘*Hibah Amanah*,’ ‘*Hibah* Declaration,’ ‘Pre *Hibah*,’ and other various terms. *Hibah* documentation allows the order of *hibah* confirmation from the Syariah Court to be approved faster and smoother, while its validity in terms of the legal aspects of civil and *Syariah* is guaranteed. *Hibah* documentation involves the implementation of *ijab*

and *qabul* (contractual agreement) in writing and signed by the provider and the recipient of the *hibah*, along with two witnesses. The introduction of the *hibah* document ensures the validity of the *hibah* so heirs cannot challenge any decision of the property change. The process of inheriting property becomes clearer and the *hibah* property will be excluded from the legal inheritance.

This commercial *hibah* takes a conditional *hibah* approach and combines the mechanism of *hibah* with *amanah*. Basically, Islam states that conditional *hibah* is invalid due to conflict with the will and nature of *akad hibah*, e.g., *hibah* by placing conditions contrary to the requirements of *hibah*, such as prohibiting *hibah* recipients to dispose or transfer *hibah* property; *hibah* with impossible conditions to be achieved, or *hibah* with conditions that are contrary to ethics and law. However, some circumstances are allowed, despite disagreements among the Islamic scholars, such as *hibah* with the condition that the *hibah* provider can still enjoy the benefits of a business that has been granted as *hibah* as long as one still lives, or *hibah* with ‘*umra* and *ruqba* conditions (Figure 4).

These conditions may be included when the *hibah* provider wants to grant a *hibah*, and this is agreed by both parties, i.e., the *hibah* provider and the *hibah* recipient. These conditions allow the *hibah* provider to enjoy the benefits of the property that has been made a *hibah* for as long as one still lives. It can also safeguard the life and the future of the *hibah* provider if problems arise, such as the possibility of children neglecting their parents after obtaining *hibah* property due to greed. Under the *ruqba* conditions, the *hibah* provider may reacquire the *hibah* property if the nominated

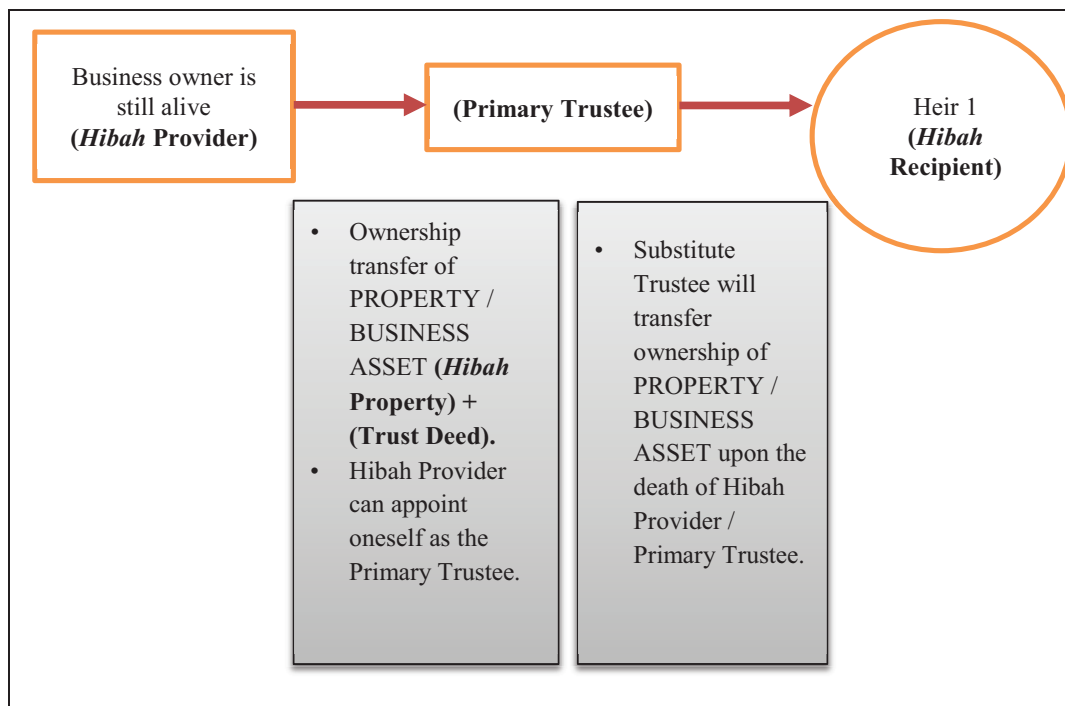


Figure 4: Business Succession through *Hibah* and *Amanah* (Trust)

recipient happens to die first. Furthermore, commercial *hibah* integrates the *hibah* and *amanah* mechanisms (trust). Both elements are merged as an estate planning tool according to the property owner's wishes and needs. Because *al-qabd* was implemented throughout the hibah provider's lifetime, the grant of this declaration is in the best interests of the *hibah* provider and guarantees the right of the *hibah* recipient. It also allows the hibah supplier to keep possession of the property as long as he or she is still alive.

6. Conclusion

Every business owner, especially a sole proprietorship business, should ensure that a succession plan is carried out during one's lifetime to confirm that the business legacy can be continued by the heirs. Succession planning is highly demanded in Islam. Islam has provided a number of appropriate mechanisms to achieve this goal. Legal aspects should also be taken into account, as every business in Malaysia is subject to the Companies Commission of Malaysia (SSM).

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