

## The Changing Aspect of Partnership Business Structure in Malaysia

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### ABSTRACT

*Partnership business structures have been accepted as a major venture capital vehicle, which is generally opted for by small and medium businesses, or by professionals that are prohibited from incorporating under the respective laws. The main objectives of this paper are first to highlight the changes in the legal attributes of general partnership structures, resulting from its evolution to limited liability partnerships (LLP). Secondly, it investigates the suitability of the LLP structure for some business partners, particularly professionals, as businesses grow with rising trade costs and litigation issues that have forced partners to take precautions regarding business liabilities. These situations have led to a tendency for existing partnerships to change from general to a hybrid entity (LLP). Thirdly, it also analyses the benefits and drawbacks of LLPs as an option for general partnerships. This paper adopts doctrinal and statutory analysis as the research methods, whereby secondary analysis of relevant documents and legal acts that govern partnership businesses are referred to. Some interviews were conducted with the LLP partners, registration bodies, and bankers, to review the current implementation issues related to LLPs. This research found that the general partnership business structure has many problems, mainly related to unlimited liability and accounting procedures, which affect the obligations and protections of partners' benefits. To conclude, the question of whether LLPs is the best alternative for partners to opt for from a general partnership finds that it is the easiest choice, compared with incorporation, but many impediments occur in its implementations that must be considered by partners. although partners can protect themselves in LLPs with the partnership agreement, there are still many loopholes in its business implementation when it comes to integrity, trust, financing, reporting, sharing of profits, and other issues.*

**Keywords:** Partnerships, Limited Liability Partnerships, Partnership Agreement

### INTRODUCTION

A business entity is an organization that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services. In Malaysia, business organizations come in different types and different forms of ownership, including sole proprietorships, partnerships, and corporations. This paper will firstly outline the research scope, objectives, and identify the problems, followed by a review of the literature on partnerships, as one

type of business structure. The research methodology highlights how the information was collected to achieve the objectives. The findings of the research are then discussed and conclusions drawn, followed by recommendations for future research. The discussion ends with perspectives about the future direction of LLPs, to ensure a better business environment for partnerships in Malaysia.

## **RESEARCH SCOPE AND PURPOSE**

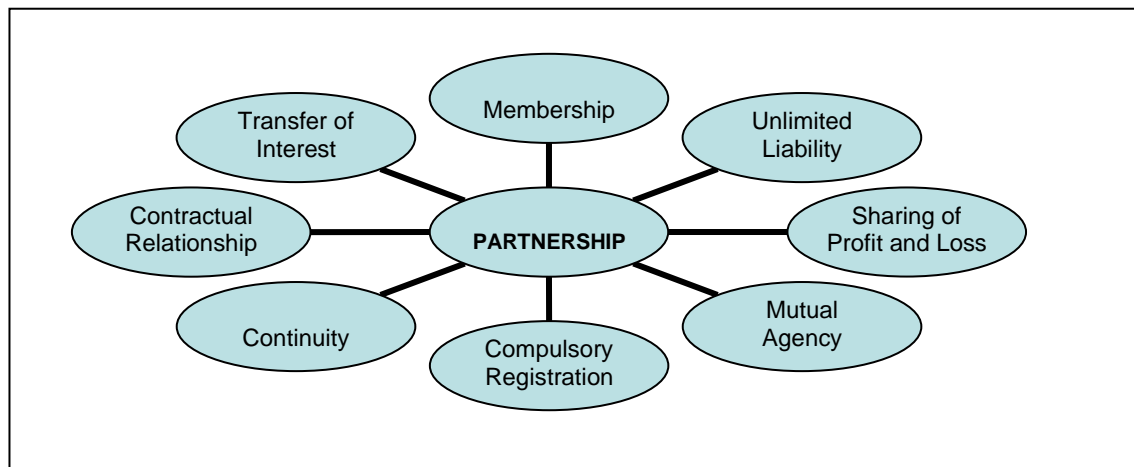
The scope of this research will focus on the partnership business structures in Malaysia only, including both general partnerships and the new hybrid limited liability partnership (LLP). The main purpose of this paper is to present the evolution of partnerships towards LLP, to consider what are the main issues that distort this evolution, and what should be done to ensure the continuity and improvement of this new LLP hybrid structure. There are three main objectives in conducting this research:

- 1) Firstly, to highlight the changes to the legal attributes of the general partnership structure, due to its evolution into limited liability partnerships (LLP), and how one can evolve into the hybrid structure of the limited liability partnership (LLP) - which came in as a new choice for business partners, that provides the advantage of “limited liability” to partnerships;
- 2) Secondly, to investigate the suitability of the LLP structure for some types of business partners - particularly professionals, as businesses grow with rising trade costs and litigation issues, that has forced partners to take precautions regarding business liabilities. These situations have led to a tendency among existing partnerships to change their structure from general to a hybrid LLP entity; and
- 3) Thirdly, to analyze the benefits and drawbacks of LLPs as an option for general partnerships, which includes reviewing impediments that result from imperfections in its characteristics. This new hybrid LLP evolution is distorted due to the various problems - particularly in legal aspects of governance, due diligence, accountability, accounting and auditing procedures, or others. These may make businesspeople re-consider LLPs as their choices of business form.

## **LITERATURE REVIEW**

Partnership business has long been accepted as one of the major venture capital vehicles. A partnership business is an entity that consists of two or more partners with mutual interests in advancing a business’s vision, mission, and goals. Those partners can be individuals, businesses, government bodies, or any legal entity that can hold equities, and can be normally governed by a contract in the form of a Partnership Agreement. Partnerships are generally opted for by small and medium-sized businesses, and by professionals who are not allowed by their respective regulatory bodies to incorporate. In Malaysia, partnerships are governed by the Partnership Act 1961, which has undergone revision to ensure the progress of partnerships, accordingly to changes in the business environment.

A partnership business in Malaysia can be characterized by a few of the following aspects outlined in Figure 1, that includes:



**Figure 1: Characteristics of Partnership**

- a. **Membership:** Partnerships must have two or more members without limitation of the maximum, but to ensure effective management the number should not be too big. The partners should have legal competency to become partners - such as not being a minor, insolvent, mentally incompetent, or otherwise - since they will have to enter into legal agreements, open bank accounts, and other responsible duties;
- b. **Unlimited Liability:** The members of a partnership have unlimited liability, whereby each partner is collectively and individually liable for the partnerships' financial obligations, debts, or liabilities. In case of failure to fulfil financial debts, personal assets or belongings can be confiscated to repay creditors;
- c. **Sharing of Profit and Loss:** Every partner shares profit and loss at agreed ratios, as detailed in the partnership agreement. In the absence of an agreement between partners, the profits or losses are divided equally among all the business partners;
- d. **Mutual Agency:** The acts of any partners are undertaken as an act of the partnership since each partner is a principal, as well as an agent in the partnership. Therefore, in cases of crime committed by any of the partners or the partnership, responsibilities are bound on both;
- e. **Compulsory Registration:** Partnership business must be registered under the Registrar of Business to avoid any legal issues arising from their existence, and to manage conflict with other firms or outside parties, or filing of cases;
- f. **Continuity:** There is a lack of continuity in partnerships, where events such as death, bankruptcy, retirement, or insanity of any partner, can cause the partnership to end. The remaining partners can create a new partnership agreement to continue the partnership;
- g. **Contractual Relationship:** The obligations on the sharing of liabilities, profit and loss, or other matters between partners, is based upon a partnership agreement, as a binding contract, which may be oral, written, or implied; and
- h. **Transfer of Interest:** Mutual consent of all the partners is required for the transfer of interests in the firm to any external party, decision making, and control of the regular business operation.

The incorporation of companies in Malaysia, the United Kingdom, Singapore, and India are subject to specific company laws, while partnerships are governed by specific partnership laws in the respective countries. In general, the formulation of a partnership is less complicated than the incorporation of a company. In identifying whether LLPs are treated more like partnerships or corporations, it is notable that the treatment by scholars of LLP law is generally determined based on the conceptual understanding of what an LLP is. This is often done without any specification of the established laws themselves.

## **RESEARCH METHODOLOGY**

The methodology for this research involves doctrinal and statutory analysis, whereby secondary analysis of the existing relevant documents and legal acts that govern partnership businesses are referred to as the main sources of information. Unstructured interviews with experts in this area, LLP partners, registration bodies, and bankers, reviewed the issues of implementation for LLPs - especially in determining problems faced by the LLPs, as new business structure.

## **RESEARCH FINDINGS AND DISCUSSIONS**

The findings of this research will be presented within a few sub-topics of discussion, for easier comprehension of the changing aspects of partnership business structures in Malaysia - including impediments due to partnership imperfections, the current evolution of partnership business structures, issues in changing facets of partnerships in Malaysia, and LLPs as a new business vehicle.

### **Impediments Resulting from Partnerships Imperfections**

The imperfections of partnerships (as one of the popular business structures) lies within its characteristics. Partnerships are easy to set-up and start business activities since the legal requirements and 'red tape' involved are typically minimal. Partnership agreements can start with a handshake or verbal discussion but are better be off when formalized with a proper Partnership Agreement prepared by an attorney. The agreement must spell out in writing terms which set forth how decisions will be made, profits will be shared, the tax will be divided, disputes will be resolved, how future partners will be admitted to the partnership, how partners can be bought out, or what steps will be taken to dissolve the partnership when needed. There must be a definite process for how the partnership should be legally recognized, and how much capital should be invested by each partner. Nevertheless, under partnership laws, the existence of the partnership agreement does not enable separately distinguishing the business from its owners – thus making the partnership very vulnerable to break-up, even near the start of its life. This can result from feelings of insecurity - especially when partners are not well-known to each other, or where partners' relationships are very new.

The unlimited liability that applies to partnerships is one of the major impediments, whereby a partner is not only responsible for the business's debts, but also those of the other partners as well. In situations where other partners incur debts, or when there are any legal judgments against the business, every partner can be held legally responsible for them. Disputes among partners can also be a problem unless there are written agreements on how the business should operate, and what it should aim to accomplish. Generally, with taxation issues, each partner is required to file their tax return (which can often reduce disputes) if tax is based on the partnership business entity. In another word, to reduce some of the problems that may incur in partnerships, the written agreement signed by all partners can help reduce any disputes in a court of law, based on the law of the contract.

### Current Evolution of Partnership Business Structure

Traditionally, a small business that starts as a sole proprietorship can upgrade to a partnership or corporation (Figure 2), as the business venture enhances in its capital, profit, and wealth. Changes occur when the owner(s) seek for “limited liability” from any consequences from the business is capable of paying its debts, or becoming bankrupt. Both sole proprietorships and conventional partnerships do not protect owners from legal actions by courts of law to take possession of their assets or belongings, in such circumstances.

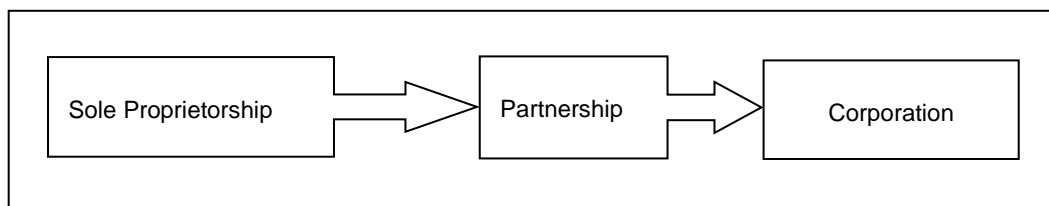


Figure 2: Traditional Transition of Business Forms to Achieve Limited Liability

Interestingly, with the introduction of limited liability partnership; there is another choice for the existence of limited liability without a need for the partnerships to advance to a corporation – which would otherwise require huge investment and larger and more complex costs for compliance with accounting and auditing regulations.

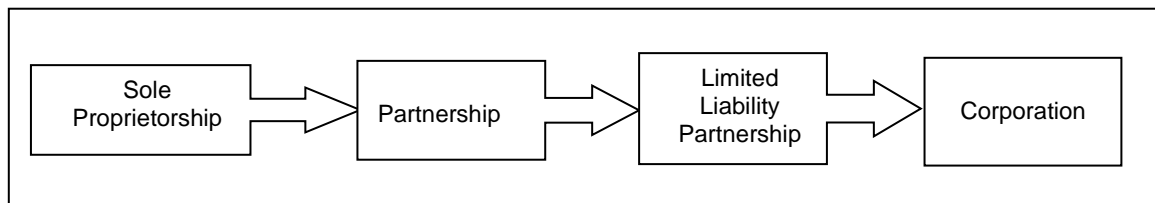


Figure 3: Limited Liability Partnership as Choice of Business Forms Transition

Businesses can progress from sole proprietorship structures to partnerships and later change into LLPs (Figure 3). Nevertheless, businesses can decide to opt from a sole proprietorship, straight to LLP, without first registering as a partnership. A new business can also directly register as new LLP.

### Issues in Changing the Facets of Partnerships In Malaysia

There are a few issues with changing the facets of partnerships in Malaysia - especially with the formation of a limited liability partnership (LLP), as a new business structure, as follows:

**a. Partnerships Business Purposes and Governance Roles**

Partnerships are originated from a group of individuals who become partners and share the same purpose for operating the business. Partnerships are a legal entity by law that is constructed to accumulate capital and to fund entrepreneurial growth activities, to share knowledge and expertise, and to manage certain risks together. Being a profit-making entity,

partnerships must ensure that all the partners understand the roles of governance in their business practices - particularly in managing the resources, and in the receiving of residual profits. The ability of the partnership to return partners' investments is crucial as an assessment of whether the partnership is effective and efficient in conducting business. Nevertheless, the purpose of a partnership should not only be to maximize partners' profit values but should also be to expand for broader societal value. There should be a balance in the partnership interests, and its contribution to the society, as stated within the Malaysia Partnership Act 1961, and the Limited Liability Act 2012.

Two scholarly perspectives can be distinguished concerning the balance of governance roles and the responsibilities of the partnerships. Firstly, partnerships should focus on improving the attention to financial reporting and compliance, and the members' independent functions. Although it is not compulsory for partnerships (including LLPs) to undergo accounting audits, they must follow the rules set by SSM for preparing proper accounting documents for checking. Secondly, there should be a proper mechanism in place for assessing the accountability of partners and their proxies, in nominating the management teams, and the suppliers, following the rules and laws that govern ethical business practices. The question that emerges in balancing the business purpose with good governance, is whether partnerships alter the balance between the roles of partners and whether any shifted activities are beneficial or detrimental to partnerships, under given federal law and regulations, listing rules, and other related influential factors.

***b. Short-Term Returns v. Long-Term Investment of Partnerships***

Similar to other business entities, the management of partnerships face significant pressure to focus on short-term results, at the expense of making the investment necessary to position the partnership in the market for long-term success. Therefore, there is a need for partnerships to have systematic and proper management teams that run the business based on the correct standard operating procedures (SOPs). To resolve this issue in the long run, partners must support the management team to balance between the pressures of achieving long term results, vs profit-making and stakeholders demand for monetary or other benefits. Certain pressures may result in a tendency for unethical business conduct that should be avoided by partnerships - such as the misuse of business money, bribery, illegal activities, fraud, and other actions that unfairly promote higher profits. Otherwise, these business activities jeopardize the fulfilment of the good governance of partnerships for the betterment of society.

***c. Governance of Partnerships with Integrity and Trust***

Partnership businesses should be managed with high levels of integrity, and with the trust from society, in its direction of wealth creation for the partners. Partnerships' contribution to the economy extends well beyond the return of profit since partnerships can provide employment, support innovation, purchase goods and services, pay taxes, and support various social and charitable programs. Given the important role that partnerships play in our society, concerns about the use of management power and the expectations from partners and stakeholders in these partnerships to continue to expand require oversight of risk management, compliance, and social responsibility.

Partnerships need to approach these issues with objectivity and fiduciary judgment, to ensure that the governance over the assessment of the quality of internal reporting is valued, and plays a critical role in the partnership's success. Management integrity is also key to

building trust with customers, suppliers, employees, regulators, and investors. Integrity and trust can be difficult to assess, but it should none-the-less be of particular concern in efforts to focus on the long-term interests of the business and its shareholders, balancing a host of competing special interests and pressures, and addressing the expectations of the broader society.

Partnerships may face challenges with avoiding partners' proxies, such as suppliers or business clients, that can unduly influence management decisions. The absence of a compulsory legal requirement for auditing exposes the partnership these situations, particularly if each partner favors certain proxies in operation the partnership. When applying good governance will reduce conflicts arising between partners, or with the management as the caretaker of the partnership. Improper governance practices to control proxy's engagement may lead to some degree of consternation and concern among partners, management and public. As a result of the disparities from a conventional corporate structure, it is noted that corporate governance frameworks for partnerships cannot operate as a company, albeit its similarity in having body corporate status (Abd. Ghadas, 2013).

### **Limited Liability Partnerships as a New Business Vehicle**

As the Malaysia economy has developed, the general partnership structure has been found to no longer be suitable for some businesses - particularly professionals. The rising cost of trade and litigation has forced partners to take precautions regarding liabilities on the business. These have led to the development of partnership structure in Malaysia, into the new hybrid entity of limited liability partnerships (LLP). A Limited Liability Partnership (LLP) is an alternative business vehicle newly introduced in Malaysia that combines the characteristics of a private company and a conventional partnership and is regulated under the Limited Liability Partnerships Act 2012, LLP is a body corporate and has a legal personality separate from its partners, which are a separate legal entity (Walker, 1998).

At any time, two or more individuals or body corporates may form an LLP as a separate entity for any lawful business, following the terms of an LLP agreement established between them. The liabilities on the partners of an LLP are limited, and the LLP has unlimited capability in conducting business and holding property. An LLP is also capable of suing and being sued, has perpetual succession, and any change in the partners of the LLP will not affect the existence, rights, or liabilities of an LLP. LLPs also provide the stakeholders with freedom and flexibility to select the suitable business model with their business structure, through the partnership agreement.

Interestingly, the legal status of LLPs differs according to the recognition of law within different countries. At present, LLPs can either have the legal status of a partnership (or a legal entity which is not a body corporate), or a legal entity of a body corporate. In the United Kingdom, for example, offshore LLPs (such as those based in the Isle of Jersey), have the status of a legal entity which is not a body corporate; however, on the mainland (on-shore) LLPs have the status of a body corporate. This demonstrates that there is no "common or standardized" legal status for LLPs. Such uniqueness is justified by the doctrine of legal personality, which essentially highlights that an entity can be recognized as a legal person if the law of the country recognizes it. In certain countries, partnerships are recognized as a legal person. For example, in the US, section 201 of the Revised Uniform Partnership Act (RUPA) 1994, clearly stated that "A partnership is an entity distinct from its partners." In Scotland, France and Sweden, partnerships are also granted some degree of legal personality. In the United States of America (USA), the partnership structure has undergone a more rapid evolution, to include master limited partnerships and family limited partnerships. A master limited partnership is a publicly-traded entity that combines the tax benefits of a partnership, with the

liquidity of publicly traded securities. A family limited partnership is normally set-up to transfer wealth from one generation to another, with management by one or more general partners. LLPs can either be recognized by the law as a body corporate, or a non-body corporate legal entity, or a partnership with a legal entity. In the Southeast Asian region, LLPs can only be registered in Hong Kong, Singapore, and Malaysia (Meggitt, 2012). These LLPs have the status of a body corporate (Chaudhry, 2010). LLPs have become a popular chosen business vehicle due to the tax benefits, and the limited liability that provides a wealth of benefits to be enjoyed by the partners (Agnich, Goldstone, Jacobs, du Pont & Goldman, 2000).

Goforth provides an analysis on the statutory alternatives for limiting the liability of partners in an LLP, where she emphasizes that LLPs are more or less similar to traditional partnerships, based on the nature of LLP laws (Goforth, 1996). Many more recent scholarly opinions hold that LLPs can be treated as neither corporations nor partnerships. Based on the nature of LLP laws, LLPs have their nature that celebrates the best features from the forms of corporations and partnerships. This view is supported by Mohd. Sulaiman (2011), who celebrates the nature of LLPs, where founders are not agents to one another while carrying out business - thus making limited liability of the partners possible. Due to an LLP's unique nature, LLPs are a suitable alternative for business structures in Malaysia. This is emphasized by research by Chan et. al (2018). Concordantly Chan *et. al.* (2018) and Ghandi and Thakur (2014) confirm through their research that LLPs are a successful emerging business structure for entrepreneurs in India. According to Vena's study of Indian LLPs, LLPs support the globalization of local legal firms, increasing their opportunities. This also conversely increases competition, since this mechanism reduces obstacles for foreign legal firms to establish LLP structured legal firms in India (Vena, 2011). From the United Kingdom, Freedman (2000) identifies that LLPs are now not only suitable to fulfil the perceived needs of professional firms such as legal, accounting, and auditing firms but are also suitable for ordinary small businesses. This is due to the unique internal flexibility and specific nature of limited liability for its founders. This can result in LLP's founders or partners being more responsible in conducting their business.

## CONCLUSION

This research provides some insight into partnerships in Malaysia, and the new limited liability partnership (LLP), as a new business structure that offers the advantage of "limited liability" to its partners. Nevertheless, many issues arise surrounding partnerships in various aspects of law, including due diligence, governance, and many others, that require further attention. Partnerships in Malaysia require greater attention to enable them to grow in future and become more realistic to operate - particularly LLPs. Though this new form of partnership is hybrid and more flexible to operate compared to conventional partnerships, the incorporation of laws that rule partnerships and corporation into the LLP Act 2012 itself, creates confusion for lawmakers, business owners, and their stakeholders, regarding its applicability and stages of implementation. It can therefore be recognized that there is a need to strengthen laws governing partnerships.

Since LLPs have only recently been introduced as a new business vehicle in Malaysia, their popularity among existing sole proprietors and conventional partnership businesses is still extremely low. Not many understand the benefits of becoming an LLP - particularly regarding the protection of partners' assets from liability from the business. Partnerships demonstrate only a vague understanding of the differences between conventional partnerships, LLPs, or corporations, as business entities. The only element that attracts them to convert their business from sole proprietorship or partnership to become an LLP is the aspect of "limited liability", which will protect partners' assets, and frees them from legal actions if the LLP fails to repay debts or liabilities with suppliers or other stakeholders.



In future, Malaysian businesses can investigate various new forms of limited liability partnership that are in existence in other countries. For example, in the USA partnership structures have undergone a more rapid evolution to include master limited partnerships and family limited partnerships. To conclude, even though LLPs are the best alternative for partners to opt from the general partnership, and it is proven that it is an easier choice compared with incorporation, many impediments still occur in implementation that must be considered by partners. Though the partners can protect themselves in an LLP with a partnership agreement, there are still many loopholes in its business implementation when it comes to integrity, trust, financing, reporting, the sharing of profits, and others. These areas must further be investigated in future for the betterment and advancement of LLPs in Malaysia.

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