

## ISLAMIC BUSINESS ETHICS IN SMALL AND MEDIUM ENTERPRISES (SMEs): AN ANALYSIS

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### ABSTRACT

*Islamic business ethics is essential for SME industry. The challenge of Islamic business ethics is to make that inevitable ethical decision making explicit to make it better and in line with the Shariah principles. Far from being anti-business, ethics actually provides essential support for maximizing long-term business value. In an Islamic system, ethics and business are not only compatible but also inseparable because Islam is not just a religion. It projects a perfect way of life. A human manner and behavior in small and medium enterprises cannot be effectively clarified without references to the Islamic ethics which can manage it. Thus, this paper will discuss the issues pertaining to the concept of business ethics in Islamic perspective toward Small and Medium Enterprises (SMEs). This is because of their significant contribution in the Malaysian economics at large. Furthermore, this study also explains how SME could adapt the Islamic business ethics system in their day-to-day business activities.*

**Field of Research:** *Islamic business ethics, Small and Medium Enterprise (SME).*

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### 1. Introduction

Currently, many question why the global economy appears so unjust, with huge income and wealth disparities and exploitation all too apparent. Rewards in business are too often unrelated to effort but rather the result of sharp practices (Hasanuzzaman, 2003). The question of ethics has always attracted the interest of scholars and others throughout the history of mankind. In modern times, this question has occupied the attention of many countries, their governments, societies and corporate communities. Business ethics has thus become a major issue of debate for academicians, professional associations, civil authorities and other related organizations (Hanafi & Sallam, 1997; Ullah & Jamali, 2010).

This is particularly important as the controversy in the Malaysian context today as there were also reported cases of unethical practices in religious affiliated institutions like the National Pilgrimage Board (LTH) and others (Abdul Rashid & Ibrahim, 2005). In the year 2003, top managers in the National

Pilgrimage Board were not spared with breach of trust in investment decisions. Such incident demonstrated the extent and prevalence of unethical practices in Malaysia and elsewhere worldwide.

As such, it is the purpose of this article to explore, analyze and synthesize the pertinent verses in the Quran and the Hadith of Prophet Muhammad (p.b.u.h) in order to develop the essential ethics theories in small and medium industries. A specific consideration is given to SME issues because of its significant role in influencing business environment as a whole.

The first part of this article discusses on the concept of Islamic business ethics. The second part will look at the specific issues on how SME should act ethically in the framework of Islamic business ethics.

## 2. The Concept of Business Ethics in Islamic Context

Ethics in general can be defined as the system of rules governing the ordering of values (Bateman & Snell, 2002). Ethics also refers to the rightness or wrongness of the decisions and behaviors of individuals and the organizations of which they are a part (Hellriegel et al., 2001). Business ethics sometimes referred to the moral principles and standards that guide behavior in the world of business (Beauchamp & Bowie, 2004).

The aim of ethics is to identify both the rules that should govern people's behavior and the "goods" that are worth seeking. In fact, ethical issues influence the decision that employees make daily (Malachowski, 2001). Some ethical issues involve factors that blur the distinction between "right" and "wrong". As a result, employees may experience ethical dilemmas. According to Ferrell & Fraedrich (as cited in Bateman & Snell, 2002), an ethical issue is a situation, problem or opportunity in which an individual must choose among several actions that must be evaluated as right or wrong (Hartman, 2005).

From the Islamic context, the dimensions of ethics are numerous, far-reaching and comprehensive. Ethical system in Islam derived from the teachings of the Quran and from the Sunnah (recorded saying and behavior of Prophet Muhammad, peace be upon him) (Reinhart, 1983). Islamic ethics deals with all aspects of human life (Carney, 1983). It deals with relationships between man and Allah, man and his fellowmen man and other elements and creatures of the universe, and man his innermost self (Hanafi & Sallam, 1997). Furthermore, the goals of Islam itself are not primarily materialistic. They are based on Islamic concepts of human well-being and good life that emphasize brotherhood and socioeconomic justice and require a balanced satisfaction of both material and spiritual needs of all humans (Rice, 1999).

According to Abdul Rashid & Ibrahim (2005), Islam considers ethics as an offshoot of imam (a Muslim belief system), and it emerges from the Islamic worldview of human life. Ethics also is known as *akhlak*. *Akhlak* is a set of Islamic moral values which have been prescribed fundamentally in the Quran and implemented by Prophet Muhammad (p.b.u.h) during his life (McGee, 2012).

Principally, there are two (2) types of *akhlak*, good or *mahmudah* and bad or *mazmumah*. Islam emphasizes the important of practicing good *akhlak* (*mahmudah*) in all aspect of human life and recognizes it as one of the purpose of sending His messengers (Amir, 2005). Prophet Muhammad (p.b.u.h) said: "I have been sent only for the purpose of perfecting the qualities of good *akhlak*" (Imam Malik). Beekun (1997) mentioned that the term most closely related to ethics in the Quran is *khuluq*. Allah says in the Quran:

“And thou (standest) on an exalted standard of character.” (68:4).

The Quran also uses a whole array of terms to describe the concept of goodness such as *khayr* (goodness), *birr* (righteousness), *qist* (equity), *’adl* (equilibrium and justice), *haqq* (truth and right), *ma’ruf* (known and approved) and *taqwa* (piety). Pious actions are described as *salihat* and impious actions are described as *sayyiat*.

### 3. Small and Medium Enterprises (SMEs)

According to Small and Medium Industries Development Corporation (SMIDEC, 2007), an enterprise is considered an SME in each of the representative sectors based on the Annual Sales Turnover or Number of Full Time Employees. SMEs are divided into two sectors; manufacturing, manufacturing related services and agriculture industries; and services (including ICT) and primary agriculture.

Category	Sector	Definition
<b>Micro Enterprises</b>	manufacturing, manufacturing related services and agriculture industries	Sales Turnover less than RM 250,000 OR less than 5 employees
	services (including ICT) and primary agriculture	Sales Turnover less than RM 200,000 OR less than 5 employees
<b>Small Enterprises</b>	manufacturing, manufacturing related services and agriculture industries	Sales Turnover between RM 250,000 to less than RM 10 million OR employees between 5 – 50
	services (including ICT) and primary agriculture	Sales Turnover between RM 200,000 to less than RM 1 million OR employees between 5 - 19
<b>Medium Enterprises</b>	manufacturing, manufacturing related services and agriculture industries;	Sales Turnover between RM 10 million to RM 25 million OR employees between 51 – 150
	services (including ICT) and primary agriculture	Sales Turnover between RM 1 million to RM 5 million OR employees between 20 - 50

**Table 1:** Category of Small and Medium Enterprises (SMEs)

Furthermore, according to Department of Statistics, Malaysia; the distribution, establishment by sector are divided into three; manufacturing, services and agriculture. The most highest distribution is from service (87.9%), followed by agriculture (7.1%) and manufacturing (5%) (Normah, 2006).

Sector	No. of establishments	%
Manufacturing	85,946	5.0
Services	1,523,842	87.9
Agriculture	123,762	7.1
<b>Total</b>	<b>1,733,550</b>	<b>100.0</b>

**Table 2:** Distribution of establishments by sector

#### 4. Small and Medium Enterprises (SMEs) and Business Ethics

This study attempts to explore the concept and the way of business ethics in Islamic perspective focusing especially in Small and Medium Enterprises (SMEs). In addition, we need to know how important is business ethics for Small and Medium Enterprises (SMEs). According to United Nations Economics Commission for Europe (2004), the advantages of business ethics in Small and Medium Enterprises (SMEs) activities is business leaders increasingly recognize the direct relationship between fulfilling a company's responsibilities and corporate survival. When a business is clear of its core purpose and values and aligns its brand, it is more likely to attract and keeps talented people, reduce inefficiency and stress caused by conflicting messages and also attract more clients, customers and also supplier who deliver goods to the same high standards. Perhaps, the clear of the importance of business ethics will assist the business leaders to implement and practice ethical business and management.

#### 5. The Structure of Islamic Ethics in Small and Medium Enterprises (SMEs)

The idea of ethics in SME is generally discussed within a framework of customer rights and good management of SME. Theoretically, there are many principles of ethics in Islam that derived from Quran and Hadith of The Prophet Muhammad (p.b.u.h). However, for the purpose of this article, the Islamic business ethics that only correlate with small and medium industry are discussed.

##### 5.1 Trust (*Amanah/I'timan*)

Scholars and practitioners widely acknowledge trust's importance. Trust makes cooperative endeavors happen. Trust is a key to positive interpersonal relationships in various settings because it is central to how we interact with others (McKnight & Chervany, 1996). Trust is another fundamental ethical principle of Islam. The essence of the trust is the sense of accountability which implies the sense of having to appear before Allah and to account for ones actions. Indeed, trust is greatly emphasized in the Qur'an and Hadith. Some examples are as follows:

Allah says: *"If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust, and let him fear his Lord. Conceal not evidence; for whoever conceals it, his heart is tainted with sin. And Allah knoweth all that ye do."* (2: 283)

*"O ye that believe! betray not the trust of Allah and the Messenger, nor misappropriate knowingly things entrusted to you." (8: 27)*

*"Allah doth command you to render back your Trusts to those to whom they are due; and when ye judge between man and man, that ye judge with justice: verily how excellent is the teaching which He giveth you! for Allah is He Who heareth and seeth all things." (4: 58)*

The Prophet (p.b.u.h) mentioned the importance of trust in this public administration as follows:

*"Any ruler who has been entrusted with the affairs of a group of Muslims and who dies as a dishonest ruler, to him paradise is forbidden by Allah."*

*"God will bless the transaction in which the buyer and the seller are unambiguous and frank and have goodwill for each other."*

*"Whoever appoints a person over a group of people, while among that group there is another person who's more acceptable to Allah than the appointed one, indeed, he has not lived up to the trust of Allah, His messenger, and the believer."*

Islam considers human life and all its resources are a trust reposed by Allah in man (Saeed et al., 2001). Thus, every SME manager is responsible for the workers and other resources with whom he is entrusted. Trust is especially important for Muslim business persons in SME industry because of the need to make profit and the temptations to enhance the attributes of their product or service during a sales pitch. All resources of SME business should be treated as a divine trust by the SME businessman (Obaidullah, 2001). Therefore, the SME businessman or manager should make the most efficient and socially desirable use of the business resources. The SME activities should in no case of destruction or damage the society or the natural environment. Indeed, Islam emphasizes man's role towards the natural environment by making him responsible of his surroundings as Allah's vicegerent.

## 5.2 Justice ('Adl)

Justice or 'Adl means to treat people equally is a pre-requisite of fairness and justice. Justice is the sum-total, in a sense, of all recognized rights and duties, as it often consists of nothing more than a balanced implementation of rights and duties. The Qur'an is emphatic on the objectivity of justice, so much so that it defies any level of relativity and compromise in its basic conception. Allah says,

*"Allah commands justice, the doing of good and liberality to kith and kin. He forbids all shameful deeds and injustice and rebellion; he instructs you, that ye may receive administration." (16:90).*

The following is a selection of verses in the Qur'an as regards to justice:

*"Lo! We have created everything by measure." (18:46)*

*"Thus when they fulfill their term appointed, either take them back on equitable terms or part with them on equitable terms; and take for witness two persons from among you, endued with justice, and established the evidence for the sake of Allah. Such is the admonition given to him who believes in Allah and the Last Day. And for those who fear Allah, He (ever) prepares a way out." (65:2)*

*"To those who believe and to deeds of righteousness hath Allah promised forgiveness and a great reward." (5:9)*

In these *āyāt*, Allah explicitly mentioned the importance of justice in all aspects of Muslim activity include in business and commercial activity. The property of justice is more than a characteristic of nature but it is a dynamic characteristic, which each Muslim must strive for, in their entire life. Allah stresses the need for justice when He labels the Muslim as *ummatun wasatun* (Siddiquia, 1997).

In the context of its application in SME activity, the principle of justice applies both literally and figuratively. In terms of relationship between SME manager and its subordinates, the principles of justice implies that managers should exercise fair and equal treatment to all workers regardless of genders, races, physical differences, religion and political beliefs. Indeed, skills, experience and attitude will determine the potential qualities of the workers. Additionally, Islam is totally rejected the practice of favoritism and cronyism that lead to the injustice in hiring and promoting employees. In fact, employees should be chosen or promoted based on their academic qualification, level of experience, moral qualities as well as their technical competency (Amir, 2005). It is interesting that another meaning of *'adl* is equilibrium and equity. As can be seen from the *ayat* in the above citation of Qur'an, a balanced transaction between SME companies and customers is also equitable and just (Mohamed, et al., 2010). In general, Islam does not aim to create a society of martyr-like entrepreneur, doing business for purely benevolent reason. Instead, Islam wants to control man's propensity for covetousness and his love for possessions (Beekun, 1997).

### 5.3 Sincerity (*Ikhlas*)

Sincerity is generally understood to be truth in word and act. Sincerity also can be defined as the quality or state of being sincere; honesty of mind or intention; freedom from simulation, hypocrisy, disguise, or false pretense; sincereness. Islam has emphasized this code of ethics as we see in Quran and Hadith. Allah says,

*"So woe to the worshippers, Who are neglectful of their Prayers, Those who (want but) to be seen (of men), But refuse (to supply) (even) neighbourly needs." (107: 4- 7)*

*"And they have been commanded no more than this: to worship Allah, offering Him sincere devotion, being True (in faith); to establish regular Prayer; and to practice regular Charity; and that is the Religion right and Straight." (98: 5)*

The following is a selection of Hadith as regards to sincerity:

*"The Prophet (p.b.u.h) said in relation to sincerity: "Allah does not look to your bodies, to your faces, but He looks to your hearts and your deeds."*

*The Prophet (p.b.u.h) said: "Actions are but intention and every man shall have but which he intended. Thus he whose migration was for Allah and His messenger, and he whose migration was to achieve some worldly benefit or take some woman in marriage, his migration was for that for which he migrated."*

*The Prophet (p.b.u.h) also the mentioned that religion is sincerity! We said: To whom? He said: To Allah, and his Book and His messenger and to the leaders of the Muslims and common folk."*

Therefore, Islam attaches great importance to the sincerity of intentions and actions in every walk of life. The performance of duties requires that all individuals in SME companies work with sincerity and fidelity. Indeed, sincerity results in more efficiency of SMEs' workers as well as high rate of productivity in SMEs' line of productions. In addition, such ethical code also discourages manipulation or exploitation of others for personal reasons (Ahmad, 1991). For that reason, a sincere SME businessman is not expected to deceive, harm and take advantage of others intentionally.

#### 5.4 Truthfulness (*Sidqun*)

Truthfulness is a basic ethical value of Islam. Islam is, in a way, the other name of truth. Allah speaks truth, and commands all Muslims to be straight forward and truthful in their dealings and utterances. Allah says,

*"Oh believers! Fear Allah, and say the right thing." (33:70)*

Islam strongly condemns falsehood and deceit in any form (Ahmad, 1991). Truthfulness is repeatedly mentioned in both the Qur'an and Hadith which the following examples illustrate:

Allah say, *"Say: Allah speaketh the truth. So follow the religion on Ibrahim, the upright. He was not the idolators." (3:95)*

*"That Allah may reward the true men for their truth, and punish the hypocrites if He will, or relent towards them (if He will). Lo! Allah is forgiving, merciful." (33:73)*

*"O ye who believe! Fear Allah, and be with those who are truthful." (9:19)*

The following is a selection of Hadith as regards to truthfulness:

*The Prophet (p.b.u.h) was asked: "Can the believer be frugal in his Spending?" He said yes. "Can he be coward?" He said yes, "Can he be a liar?" He said, no.*

*The Prophet (p.b.u.h) said: "He who has reinforced the truth with his tongue, his reward will continue growing until the day of Resurrection where Allah will pay him his full reward."*

This value has philosophical implications for the conduct of business. SME managers have to be honest, truthful and clear-cut in all of his conducting a business. There is no scope for cheating, swearing too much, speaking lies and false advertising in Islamic framework of business. Once he chooses to become a Muslim, he must submit his will to Allah's. He joins to collective of the ummah, and assumes his rightful position as Allah's trustee on earth (Beekun & Badawi, 2005). Nevertheless, it is pertinent to note that in Islam the principles of truthfulness and honesty are not to be followed as matters of SMEs' policy or business strategy, which is the Western approach. To a certain extent, truthfulness is the obligations of a true Muslims' faith in Allah or what we call as *Iman* (Ahmad, 1991).

#### 5.5 Benevolence (*Ihsan*)

As far as kindness is concerned, benevolence to others is defined as an act which benefits persons other than those from whom the act proceeds without any obligation. It also means fineness, proficiency or magnanimity in dealing with others. Along with the concept of justice, the concept of benevolence is also frequently repeated in the Qur'an and the Hadith. Allah says,

*"Spend your wealth for the cause of God, and be not cast by your own hands to ruin; and do good. Lo! God loves those who behave with ihsan." (2:195)*

*"Those who spend in ease and adversity, those who control their wrath and are forgiving toward mankind; God loves such doers of ihsan." (3:134)*

The Prophet (p.b.u.h) is reported to have said:

*"The inmates of Paradise are three types: one who wields authority and is just and fair; one who is truthful and has been endowed with power to do good deeds; and the person who is merciful and kind-hearted towards his relatives and to every pious Muslim, and who does not stretch out his hand in spite of having a large family to support." (Sahih Muslim)*

Absence of justice in all of the business dealings in SME's companies inflicts harm and disturbs peace and harmony, but the absence of benevolence does not harm anybody. It implies a more liberal treatment than what justice requires (Hasanuzzaman, 2003). Besides justice, the relationship between SMEs' managers and workers should be on the basis of benevolence. Allah says in the Quran:

*"Lo! God enjoins 'adl and ihsan, and giving to kinsfolk, and forbids lewdness and abomination..." (16:90)*

SMEs' managers are encouraged to offer fringe benefit packages, although certain employee paybacks are not stipulated in the contract. The practices of offering children education sponsorship, family assistance programs, human development courses and paid holidays or vacations by some companies today provide good examples. It appears that, benevolence is the essential elements to establish corporate culture that emphasize on achieving physical and spiritual need for employees (Abdallah, 2010; Amir, 2005).

## 6. Conclusion

The Islamic perspective concerning SME business code of ethics has been presented in view of a sample from the Quran and Hadith related of the 5 axioms, namely, justice, truthfulness, benevolence, sincerity and trust. It is beyond the ability of researcher to have comprehensive and all-inclusive coverage of the area of ethics. Thus, the objective of this study has been to present the Islamic business ethics from the perspective of Small and Medium Enterprise (SME).

Overall, the study aims at providing an explanation on how SME should perform ethically according to the framework of Islamic business ethics. Thus, Islamic business ethics is necessary for SME industry. It is vital because it is a valuable business tool, essential for identifying and resolving questions of business conduct.

Indeed, this study is able to provide an overview of the suitability of Islamic ethics in the practice of SME. Nevertheless, this study is an eye-opener for practitioners and academicians about the important of Islamic business ethics in SME.

However, although this study has successfully achieved its objective, there is one issue remaining unanswered, which needs to investigate in the future study. This issue is about a limited evident of

empirical results about the usability of Islamic ethics in SME practice. Therefore, this limitation can be overcome by pursuing a survey relevant to the topic of study.

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