

Case for Following the Business Ethics

"And eat up not one another's property unfairly / wrongfully (in any illicit way e.g. stealing, robbing, deceiving, etc) nor give bribery to the rulers that you may knowingly eat up a part of the property of others sinfully (2: Al-Baqar'ah: 188).

"You who believe, stand steadfast before Allah as witness for (truth and) fair play" (IV: An-Nisā': 135).

There are many lessons in the global business history of last ten / fifteen years that maintaining integrity and practicing business ethics are paramount for sustainable success in businesses. The business scandals over this period refer to the recurrent issues rooted in management style, organizational behavior, finance and accounting which call for practicing the established business ethics in letter and spirit. The most of the scandals pertained to withholding information about financial troubles, improper use of reserves and acquisition accounting, revenue and earnings inflation, revenue and expense recognition, use of off-balance-sheet entities, accounting for the transfer of loans, loans and looting, artificial increase of cash flow and profits, backdating of sales contracts and accounting for vendors' allowances and financing.

It must prompt the good institutions to introduce detailed code of ethics covering all areas relating to truthfulness, integrity, commitment and value creation for the society. Any code of business ethics must fulfill the basic requirements of the valid contracts and businesses. Besides, it must ensure complete disclosure and transparency, integrity, competence, diligence, respect for all stakeholders including public, clients, employers, employees, shareholders, co-investors, and other in the markets. It has to encompass all the areas of finance and accounting, production, marketing and trading.

The ethics were once tightly interwoven with business and economics. The father of modern economics, Adam Smith (1723-1790), was actually a scholar of moral philosophy and believed in strong morality in all economic activities. His book, "The Theory of Moral Sentiments" (TMS:1759) provided ethical and philosophical bases to his later works

like “The Wealth of Nations” (WN:1776) and “Essays on Philosophical Subjects” (1795). There is a consistency in outlook and general compatibility between TMS and WN - TMS is concerned with ordering of moral behavior and maximization of virtue, while WN is concerned with ordering of economic behavior and the maximization of wealth as a means to a higher end.¹

Morality pertains to socio-economic norms and teachings - making morally good decisions and their earnest implementation. It necessitates distinction between fair and unfair or right and wrong. But many do not believe in any business ethics or do not consider it their responsibility focusing only on the ‘profit maximization’. Different people take different view in this regard. For example, “*It’s only a CEO’s job*”, or “*only an ombudsperson should have concern for ethics*”. Some others may say, “*When in Rome, do as the Romans do. It’s a dog-eat-dog world. We have to play the game their way if we mean to do business there*” (the theory of moral relativism); or “*It’s too complicated. Civilization has been arguing about ethics for 3000 years. You expect me to master it in my lifetime?*” None of the arguments are tenable. The job has to be done, and if everyone assumes that someone else owns the job of ethical practice, then perhaps no one will be doing it.²

The culture of ethics and integrity serves as a shield against frauds when applied along with effective governance and vigilance. But, without strong ethical behavior, even strict controls and strong governance may fail in avoiding the failures and crises. Focus on integrity and respectable position in the market is an established part of business ethics. Warren Buffett, CEO of *Berkshire Hathaway*, and one of the most successful investors in modern history, used to issue every year a letter to each of his operating managers, “*We can afford to lose money. We can afford to lose a lot of money. But we cannot afford to lose one shred of our reputation. Make sure everything you do can be reported on the front page of your local newspaper written by an unfriendly, but intelligent reporter.*”³ The recent cases of business failures reveal that unethical behavior ultimately harms the companies, investors and employees and damages investor confidence and trust. “*Fraud and earnings management share a common*

¹Younkins, Edward W. (2005); “Adam Smith’s Moral and Economic System”; Capitalism and Commerce, Montreal, April 15, 2005; No. 153 <http://www.quebecoislibre.org/05/050415-16.htm>

² Bruner, Robert F. (2006) “*Ethics in Finance*” in “*Business Case Studies*” The University of Virginia Darden School Foundation, Charlottesville, VA.

³ Russ Banham, (2002); *Chief Executive*; <http://www.robertpmiles.com/BuffettSchool.htm>

*soil: a culture of aggressive growth. Although growth is one of the foremost aims in business, the mentality of growth at any price can warp the thinking of otherwise honorable people”.*⁴

Ethics Relevance to the Modern Corporate Business

A pertinent question with regard to the corporate business is: for whose interest one should be working – for stockholders or for stakeholders. The objective of the former approach is to create and enhance value of the firm to create wealth for the shareholders. Nobel laureate Milton Friedman has argued that the objective of business is to return value to its owners, and that to divert the objective to other ends is to expropriate shareholders' value and threaten the survival of the enterprise⁵. The other view is that stakeholders at broader level like employees, customers, suppliers, and the community also have a stake in the activities and the success of the firms. Its leading proponents argue that the firms should be managed in the interest of the broader spectrum of constituents⁶. This view is nearer to Islamic approach on organization behavior and management. Although complex and daunting in terms of ensuring equitable treatment of different stakeholder groups across the time, it could bring better results in terms of satisfaction of various groups of stakeholders along with comparable business profits. Further, this approach enhances loyalty of the management and the operations personnel to the community and society as a whole.

Unethical practices of the corporate sector are the source of injustice to many of the stakeholders and may also cause business failures. It may involve, due to lack of proper disclosure and transparency, overvaluation or undervaluation of shares, heavy pays / perks to Directors / sponsor shareholders, target based compensation of the managers, unnecessary transfer of profits to reserves and insiders trading. As argued by Jenson (2005), overvaluation of stocks may be more challenging than undervaluation as in latter case the problems could be resolved with the instruments of hostile takeovers, proxy fights, leveraged buyouts, and so on while there is little remedy in the case of overvalued equity. Many times, the price exceeds the intrinsic value of the shares and performance necessary to produce that price cannot generally be attained except by good fortune. The problem increasingly worsens as telling the truth to investors about overvaluation is extremely painful, which results

⁴ Bruner, op.cit.

⁵ Friedman, M. *Capitalism and Freedom*. (Chicago, IL: University of Chicago Press), 1962.

⁶ Edward Freeman (1984); *Strategic Management: A Stakeholder Approach*.

ultimately in failure of big names in corporate businesses.⁷ It implies the importance of truthful disclosure and transparency as advised by Islamic law of business contracts.

Bruner (2006) has identified the following benefits of good ethical behavior in corporate businesses: i) Ethical behavior builds teams and leadership, which underpin process of excellence; ii) Ethics set a higher standard than laws and regulations; iii) Reputation and conscience (ethics serve more for inner satisfaction than merely for greed based maximization) – having regard for family, friends, and the community at large.

Ethics are particularly relevant in banking and finance in present day businesses because ethics based finance practices are fundamental for enduring and sustainable financial enterprise. It needs a change in mind-set of the current finance world to ensure a corrective process against rampant unethical behavior. As argued by Heiko *et al.* (2012) in their work, “*Banking with Integrity*”, many financial institutions were doing well even during the recent global financial crisis mainly by dint of their operations based on financial and accounting related ethics.⁸ Although the business ethics based on conventional wisdom intrinsically lead to injustice due to *riba* and *gharar* based businesses, yet they were safe because of better disclosure and transparency policies and relatively lesser reliance on greed based businesses in financial derivatives.

Ethical behavior is equally important in marketing and branding with commitment for purity, truthfulness, performance, or other attributes of quality, as it builds trust which ultimately rewards. Branding seeks to create a bond between producers and the consumers which is built by trustworthy behavior.

What Constitute the Business Ethics?

The terms ethics, ethical business and more specifically, ethical finance, although being used for last three decades, are still oxymoron. Different institutions working for promoting ethics based business and / or investments define it differently. It comprises a number of attributes that include values-based decision making criteria, services, institutions and instruments relating to business and finance like socially responsible investments (SRI), sustainable and responsible Investments (SRI),

⁷ Jensen, M. “The Agency Costs of Overvalued Equity.” *Financial Management* (Spring 2005): 5– 19.

⁸ Heiko Spitzeck, Michail Pirson and Claus Dier Usmeizr (2012); *Banking with Integrity: The winners of Financial Crisis?* Palgrave Macmillan, (UK)

sustainable Investments (SI), environmental, social and governance (ESG), etc. But the element of distributive justice and equity is missing in all these. Although disclosure requirement is a part of all SRI based vehicles, yet little importance has been given to the factors of equity and justice which may be considered as the corner-stone of *riba* and *gharar* free Islamic business and finance. The social aspects can better be taken care of if due consideration is given to the distributive justice.

Logically, the bifurcation of the acts into right and wrong might be sufficient to decide the components of business ethics. But sometimes it might be difficult to determine what is right or wrong in true sense, as in professional life there could sometime be little difference between the alternatives. Islam has provided following broad criteria for this:

- i) All that is expressly prohibited by the texts of the Sharī‘ah (Naṣṣ of Qur’ān and Sunnah) is wrong, that the believers must avoid;
- ii) A logical and established criterion provided by the Holy Prophet (pbuh): *“Piety is good character while sin is what pinches you and you dislike that people should know about it”* (Jami‘e al Tirmizi);
- iii) One has to avoid what is doubtful in term of prohibition and validity⁹, particularly in terms of rights of others. Giving the people their due right is the cardinal principle of Islamic system of ethics. The belief in the *hereafter* requires that man should not take any one’s right in any way or form. Some encouragements like benevolence, proper transparency and disclosures, proper documentation of transactions leading to precision about the rights and liabilities of the parties are also part of the Islamic framework of business norms.

It defines right and wrong as defined by virtues. According to Ernest Hemingway, *“what is moral is what makes one feel good after and what is immoral is what makes one feel bad after”*. [Although this feeling may differ from person to person based on his / her behavior and approach over the time, yet it provides a good criterion for deciding good or bad based on general view held by rational members of a society].

Another approach for deciding right or wrong is to see the consequences and the outcome: what are impacts of any actions on others

⁹ The Holy Prophet (pbuh) said, *“Truly, what is lawful is evident, and what is unlawful is evident, and in between the two are matters which are doubtful, which many people do not know. He who guards against doubtful things keeps his religion and honour blameless, and he who indulges in doubtful things indulges in fact in unlawful things, Beware, every king has a preserve, and the things Allah has declared unlawful are His preserves.”* [Ṣaḥīḥ al-Bukhārī & Muslim].

and the society; what might be the benefit of an action for the people at broader level? “Who is hurt or helped must be taken into consideration. Therefore, the right action is that which produces the greatest good for the greatest number of people. ...It is vital to ask whether an action would show respect for others and whether that action was something a rational person would do: If everyone behaved this way, what kind of world would we have?” (Bruner, 2006).

The need for all pervasive ethical norms provided by Islam

The individual business proprietors as also the corporate world must accept, and act accordingly, that ethical issues are pervasive in all types of business pertaining to commodities, services or the banking and finance sectors. The selfish nature and greed of human beings, pursuit of self-interest and profit maximization necessitate any discipline to be implemented both at individual and corporate levels.

The pursuit of profit maximization without care for the ethics has received criticism even in the mainstream economics; more so in Islamic economics. “*Perhaps focusing on issues other than profits ... will actually enhance the bottom line.... Perhaps we should view profits as a consequence of good business practices rather than as the goal of business.*”(Norman Bowie; cf. Bruner: 2006). Social good and the promotion of Sharī‘ah objectives with regard to safeguarding life, honour, wealth and intellect of human beings work as the main motivational force in the Islamic system which gives priority to the promotion of social interest, if individual interest is in conflict with it. The core values of justice, fair play and general business ethics are the *raison d’être* of any economic system to be sustainable in the long run.

Besides some major prohibitions, Islamic law has prescribed a number of norms and boundaries in order to avoid inequitable gains and injustice. These norms and ethics require that all economic agents in a society must avoid injustice and unfair dealing with others and that harm should not be inflicted upon any member of the society. *Riba*, *gharar* and gambling / games of chance are the main prohibitions which have to be avoided any way for conformity of businesses and transactions with tenets of the Sharī‘ah. By prohibiting *riba*, Sharī‘ah has prohibited all benefits accruing to a person without any labour, risk, or expertise. *Gharar* means uncertainty in any business or contract about the subject matter of a contract or its price, or mere speculative activities that may lead to undue

loss to one party and unjustified enrichment of the other. Gambling is also a form of *gharar* and, therefore, prohibited.¹⁰

Practicing business ethics does not mean negation of 'self-interest'. According to Adam Smith, the four principal virtues in a person's life are justice, prudence, benevolence, and self-command. It is through the exercise of self-command, Smith's cardinal virtue, that a man can rein in his selfish impulses, regulate his conduct, and indulge benevolence¹¹. Pursuit of self-interest ushers in morality; it promotes civility and consideration for others. "Pursuit of self-interest demands that one should be conscious of the interest of others and should avoid hurting them. The requirement invokes mutual respect and calls for cooperation - not conflict - for promoting the interest of each other"¹²

Business Norms and Islamic Ethical Code

The Holy Qur'ān and the Sunnah refer to a number of norms and principles which govern the rights and obligations of parties to the contracts. Principles enunciating justice, mutual help, free consent and honesty on the part of the parties to contracts, avoiding fraud, misrepresentation and misstatement of facts, and negation of injustice or exploitation provide grounds for the valid contracts.¹³ The Holy Prophet (pbuh), in his celebrated speech at the time of last *pilgrimage*, declared the inviolability of the rights of the human beings in all the three categories of person, property and honour.

Islamic business norms are related to truthfulness in socio-economic dealings and accountability of human beings before Allah (swt) and, therefore, have different implications from that of the norms of mainstream business ethics. Truthfulness requires that goods are produced, marketed and traded with complete disclosure and transparency without unnecessarily luring the consumers / purchasers. Below we discuss these norms briefly:

Justice that means fair dealing with all and keeping a balance is the cementing force between various segments in a society. The Holy Qur'ān says, "...*And let not the enmity and hatred of others make you avoid justice. Be just; that is nearest to piety...*" (V: Al-Mā'idah: 8). Stressing

¹⁰ For details: Ayub, 2007, Pp. 44-71.

¹¹ Younkings, Edward W. op.cit.

¹² Hasan, Zubair; (2011); "*Scarcity, self-interest and maximization from Islamic angle*," MPRA Paper 29414, University Library of Munich, Germany.

¹³ Hasanuzzaman, S. M; (2003); "*Islam and Business Ethics*", IIBI, London.

this point, Qur'ān also says: *“You who believe stand steadfast before Allah as witness for (truth and) fair play”* (IV: An-Nisā': 135). At the State's level, emphasis needs to be given to the character building of the masses to ensure justice, fair play with one another and the resultant harmony in the society.

A number of norms and good practices stem from the overall principle of fair play and justice. Foremost of them are honesty, truthfulness, fulfilling the covenants, timely payment of the liabilities, mutual cooperation, removal of hardships and care for others that are the basic lessons taught to Muslims by the Sharī'ah with relatively more emphasis in respect of business transactions. As the Holy Prophet (pbuh) said, *“The truthful and honest merchant shall be with the Prophets, the truthful and the martyrs on the day of resurrection.”* He also cautioned, *“It is not lawful for a Muslim to sell to his brother something defective without pointing out the defect”*. Deception, misappropriation or defrauding others in respect of specifications of the goods and their prices is prohibited with the purpose to ensure that the seller gives commodity as per its known and apparent characteristics and charges the fair price. Holy Qur'ān says, *“Make full the measure when you measure, and weigh with a perfectly right balance.”* (17: Al-Ā'rāf: 35; and verses of 86: Al-Tāriq: 1-6). Dishonesty and lack of punctuality are characteristics of hypocrisy that deprive a person from being a true believer.¹⁴ The Prophet (pbuh) says: *“he who cheats is not one of us”* and, *“the signs of a hypocrite are three: he lies when he speaks, he betrays when is trusted and he does not fulfill when he promises.”*

Sharī'ah does not approve publicity which leads to concealing facts about the business, exaggeration about the product and the financial position of any entity. Fair dealing encompassing honesty, straightforwardness, free consent, and negation of misstatement, misrepresentation and exaggerated description of products are important pillars of business ethics as per Islamic Sharī'ah.

We can conclude that for smooth functioning of the global business and financial system and welfare of the mankind, there is a need for revisiting the concept of business ethics to necessarily include the justice and fair treatment with all stakeholders. It requires the need for changing the basis of profit entitlement from risk-free to risk based techniques and effectively closing all channels of excessive uncertainty (*gharar*) based

¹⁴ Monzer Kahf, Ausaf Ahmad and Sami Homud, IRTI; 1998

http://monzer.kahf.com/papers/english/Isbnk_and_dev_alternative_banking_concept.pdf

and other unjust earnings. Hence, the scope of the terms ethics, ethical business or ethical finance has to be broadened to include the elements of equity and justice for fair distribution of the income and the profit / transfer of resources among various factors of production and members of society.

Some attempts have been made to provide moral and ethical bases for global business and finance particularly with regard to Corporate Social Responsibility (CSR). However, these attempts have been widely criticized for problems relating to justification, conceptual clarity and possible inconsistency, and for failing to give adequate ethical guidance to the decision makers and business executives who must decide which courses to pursue for dispensing justice / fairness and with how much commitment.¹⁵ The "invisible hand" as assumed to be working in free economy is not actually working in directions that benefit all groups in a society mainly because of imperfect definition of morals, particularly justice, fairness and other business ethics.

Business ethics as embodied in the Qur'ān and Sunnah are probably the most distinctive element of Islamic business and management. However, these ethics have not been explicitly related to the economic behavior and business and financial dealings in the market. The role of Islamic business ethics particularly needs to be studied in the context of various contemporary management theories, corporate governance issues and the sense of social responsibility.

The socio-economic problems emanating from global business are escalating despite the remedial measure taken by multilateral institutions and the regulators after the global crisis erupted in 2008. It calls for fulfilling ethical and social responsibilities by redefining the elements and the measures of CSR and by strengthening the corporate governance with objective to ensure fair treatment with all stakeholders. The corporate bodies and the individual businesses need to adopt the business ethics with wider scope to cater to the socio-economic needs of the human societies suffering presently due to value and ethics neutral businesses and the markets.

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¹⁵Wajdi; Asyraf Dusuki; Ethical and Social Responsibility Models for Islamic Finance; available at www.b-mashura.com