

# The Determinants of Spiritual Islamic Risk Management and The Impacts on The Value of The Firm In The Context of Socio-Economic Welfare and Managerial Performance (Evidence on Moslem Entrepreneurs in East Java Indonesia)

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## ABSTRACT

The study aims to test the determinants of Spiritual Islamic Risk Management (maqashid as-shariah, Islamic values, and the concept of fiqh mu'amalah) and the impacts on the value of the firm in the context of managerial performance and socio-economic welfare. The data of the study were obtained from the Moslem Entrepreneurs in East Java, Indonesia. The Partial Least Square was used to analyze the data. The result of the research showed that only maqashid asy-syari'ah has influence to the practice of Islamic spiritual risk management. The results also showed that Islamic spiritual risk management has significant effect on the value of the firm either in the context of managerial performance or socio-economic welfare. It implies that the Islamic spiritual risk management conducted by Moslem Entrepreneurs in East Java, Indonesia gives some benefits and improves the prosperity of stakeholders.

**Keywords:** Islamic Spiritual Risk Management, Islamic Values, Maqashid Asy-Shari'ah, The Concept Of Fiqh Mu'amalah, Managerial Performance, Socio-Economic Welfare

## INTRODUCTION

There is growing concern about awareness and appreciation for the efforts to eliminate the risk of becoming a crucial factor in all business sectors. Accepting and managing risk is part of the company's activities that importantly to be done in order to survive. Company's management will always seek to measure and control the risks that arise. Therefore, decision and risk management should be a central part of the activities to be taken by the company. Generally, from Islamic perspective, understanding the concept of risk can be obtained from the history of prophets before Prophet Muhammad SAW, so that all of Moslems around the world could take a lesson from these experiences. The story of Prophet Yakub or Jacob (Yusuf's or Joseph's father) on risk management as advice to their children in order to enter the state of Egypt through different doors (Qur'an surah Yusuf, 12: 67).

Henschel (2010) stated business management literature has largely neglected the theme of risk management for Small Medium Enterprises (SMEs). Jayathilake (2012) argued that risks are considered to be less catastrophic and most studies have concentrated solely on the risks associated with safety and occupational health in the SMEs. Therefore, it is important for SMEs' owner-managers to develop an effective and efficient process whereby all SME dimensions are evaluated, in order to escalate the importance of risk identification and also to minimize it in their organization.

Risk management enables SME owner-managers to objectively examine their actions (Smit and Watkins, 2012), because evaluate decisions will help to determine the enterprise's future strategy. By incorporating risk management into SMEs operations will enable organization to transform an expenditure activity into an activity that can yield a positive return. SMEs often flourish on their adaptability and agility such as their openness towards new ways of working, their close proximity to their customers, and their risk taking approach, but many SMEs are still susceptible to major external shocks (Smit and Watkins, 2012). Managing risk is one of most important roles of the corporation's management. Risk management is an ongoing process that will help to improve operations, prioritise resources, and prevent loss or damage to the entity.

Islamic spiritual-based risk management to be considered as the answer to the void Islamic risk management framework implemented in the real sector companies, also especially in SMEs. The Islamic risk management framework also focused on

the developing SMEs sector using conventional risk management framework, but adopted with Islamic perspective. Abdullah (2012) explained that risk management in Islam is not merely about reducing risk, but also how to manage it effectively according to *sharī'ah* principles.

This is consistent opinion of Mirakhor Iqbal (2007) as cited in Rosman (2009) since risk management framework are developed, the risk technique could be applied to the different situation, products, instruments, and institutions. Siddiqi (2009) suggest that there a must in ensure the Islamic risk management among others, which consist of: (1) the debt proliferation limited, (2) did not practice the elements of interest in debt, (3) did not trade in debt, and (4) the risk is shared between the owner of the funds with entrepreneurs. When observed the above requirements is the conception of *fiqh mu'amalah*. Thus, there are similarities between the two Islamic risk management frameworks that are common in the financial sector with the management of risk-based Islamic spiritual, which are equally based on *fiqh mu'amalah*. Implementation of risk management claimed to improve performance and corporate value (Fatemi, 2000; Beasley, 2006; Pagach and Warr, 2007; 2008; Gordon, 2009; Berk, 2010). Firm's performance and value created in business often treated as validity in business related with financial aspects but it does not include immaterial aspect.

Value creation beyond the material limits to meet the business objectives is also the establishment of Islamic values that is based on the values among other public welfare which are relevant to everyone's concern about humanity in the near future. This is intended to slow the rate of deviant behaviour, especially the manager and to gain essential and provide benefits to the people. In addition, it also offers the most reliable way to build sustainability and to build a peaceful world. The condition is also necessary to minimize their social jealousy or feeling unfair in the community. This study aims to examine the risk management model based spiritual Islam (Islamic Risk Management) following antecedents and outcomes observed in the conceptual framework of the study. In the context of the growth of firm value, it is assumed that the Islamic risk management can strengthen the impact of *Maqashid Ash-Shari'ah*, Islamic values, *Fiqh Mu'amalah* to firm value based management and socio-economic performance.

This study provides an understanding and developing construct of *Maqashid Ash-Shari'ah*, Islamic values, and *Fiqh Mu'amalah* and also Islamic risk management. An alternative theoretical perspective based on Islamic perspective which focusing on the how well risk management of small medium enterprises will lead to greater firm value which acts as the competitive advantages. This study also expands the concept of firm value based on shareholders' interest and *shari'ah* principle to management's and socio-economic performance.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### Concept of *Maqashid Ash-Shari'ah*

Terminologically, *syari'ah* (or *Sharī'ah*) means rules, regulation, or law, as the road that is clear and bright, about which is beneficial (*maslahat*) and harmful (*mudharat*) to human kind (Wahyudi, et al. 2015). Regarding to concept of wealth, Islamic rules are very fair and precise. The one of beautiful things in Islam, that is human kind are given the largest chance or opportunity to enter into any kind of *mu'amalah* transaction, as long as there are no arguments or rules that prohibit it.

The Arabic word *Sharī'ah* refers in its literal meaning to the road to the watering place, the straight path to be followed. The technical meaning of *sharī'ah* refers to designating a rule of law, or a systemic value of law, or the whole of the message of particular prophet (Wahyudi, et al. 2015). However, in the Islamic context *Sharī'ah* refers to the laws, rules, commandments and way of life prescribed by Allah to human being. *Sharī'ah* is the code of life that consists of ideology, faith, behaviour, and obligation in the practical daily matters; since it is a divine law, it is a legislation based on the totality of Allah's commands revealed to Prophet Muhammad.

Lahsasna (2014) stated that:

- *Sharī'ah* consists of rules, regulations, law, commands, obligations, guidance, principles, ideology, faith, attitude and behaviour that govern the human being in every aspect of life.
- *Sharī'ah* includes all aspects of human life in this world.
- *Sharī'ah* is meant for two different worlds, happiness in this life and in the hereafter.
- *Sharī'ah* is the whole divine law and values as given by Allah, whereas *fiqh* is the law extracted by Moslem jurists from the sources of Islamic law.

*Maqashid Ash-Shari'ah* comprises of all the benefits and advantages for the human being, which simultaneously wards off evil and other negative form which could harms from the Ummah (Abdullah, 2012). *Maqashid Ash-Shari'ah*, based on Imam

As-Syatibi (Ghazanfar and Islahi, 1997; Utomo, 2002; Munir, 2007, Abdullah, 2012) include: (1) protection of religion (*hifdh al-din*), (2) protection of soul or life (*hifdh an-nafs*), (3) protection reproductive organs (*hifdh an-nasl*), (4) protection of intellect (*hifdh al-'aql*), and (5) protection of wealth or property (*hifdh al-mal*). Maqashid Ash-Shari'ah function in human being drawn to the economic outlook as well as the main purpose of the meaning of development (Chapra, 2009), consist of: (1) because humanity is the goal, life or success must be guaranteed, and (2) because humanity is also means of developing, and it must have motive as character and ability to do whatever is needed to guarantee their lives.

### Islamic Values

Islam integrates religious practices of business activities with personal worship, which in good intention combining these practices is called an *ibadah* (Rafiki and Wahab, 2014). Those individuals who working in organization, and with, cultures that have Islam as their "moral filter" should recognize the role Islamic Values plays in shaping organization and management practices.

Islamic values are the values that inherent in business activities and risk management consisting both of substantial and instrumental value. Substantial value is *maslahah*, as a forms of circumstances, both material and non-material, in which is capable of improving the position of man as a creature of the most noble (P3EI, 2011). Forster and Fenwick (2014) explained that existing research which highlights the pervasive and intensifying presence and influence of Islamic values is not just because of a geopolitical issue, but also a business and management issue. Thus, this religion can affect individual values importantly in a variety of ways including social economy behaviour.

From an Islamic perspective and pointed out that Islam values and respects entrepreneurship as a noble profession in which Allah has permitted the sale and purchase, and forbidden usury (Al-Baqarah, The Cow 2:275). Involvement in religious institutions and family religiosity are viewed as factors that influence nature of entrepreneurial behaviour in operating business. Scholars interested in the role of Islamic values in entrepreneurship and business focus on textual and contextual factors influencing religious beliefs including the Quran, Sunnah, Ijma and Qiyas (Forster, 2014).

Extant research in business and management related with subject of Islamic values follows one of three paths (Forster, 2014): First, a theoretical foundation of what role of Islam and its values and moral lessons in which should plays role in shaping organizational and management practices, presenting an 'ideal' of what those practices should look like in particularly. Second, the implementation of Islamic principles to organizations bring new horizon, whether it is possibly with a cultural flavour brought into the mix by the writers themselves. Third, the undertaking of empirical research in order to explore the extent to which, and sometimes the reasons why, Islamic values are embraced by employers and employees alike in their day-to-day organizational and management practices.

### Concept of Fiqh Mu'amalah

Business activities defined as a form of *mu'amalah*. Mu'amalah the rights and obligations of the two people who do set up such transactions in fiqh mu'amalah (each party right up to the owner, and no one is taking something that is considered to be wrong). Thus, the relationship between human with another is well established and harmonized, because no adverse parties and feeling aggrieved.

*Fiqh al-m'uamalah* is known as Islamic commercial jurisprudence. An individual may be expert in Islamic financial institutions and also have knowledge of Islamic commercial jurisprudence. *Fiqh Mu'amalah* also includes Islamic transaction or commercial law and preferably specialising in both areas. It shall include the review of existing and new products, covering end-to-end the product- development process. This jurisprudence also ensure the fulfilment of the contract requirements and conditions according to *Shari'ah* and the proper implementation of *Fiqh Mu'amalah* principles.

Fiqh mu'amalah is a knowledge that discusses the rules related with human affairs based on the Qur'an, hadith, ijma' and qiyas, as a purpose of law approach (*maqashid al-shari'ah*), namely *maslahah*, which is one of two approaches in Islamic law (Dahlan, 2010). All of them aimed at preserving the five basic goals of the *maqashid al-shari'ah* which is defined as *maslahah*. The priorities in implementing the shari'ah principles based on the sequences of the five fundamentals about preservation and safeguarding according the essentials or necessities in living as Moslem. Instead, an attempt to capture the benefits or refuse the bad things solely for the sake of world living without considering compliance of Shari'ah principles, cannot be defined as *maslahah*, but on the contrary it is called as *mafsadah* (evil). That is why an activities or decision in order to reject *mafsadah* also defined as *maslahah*.

## Islamic Risk Management

Risk is often defined as uncertainty about the occurrence of loss, variability in future outcomes, possibility of adverse deviation from a desired outcome. Risk is an approach used to handle risk, and there are a number of methods used to manage risk that includes avoidance, loss control, retention, non-insurance transfers, and insurance or *takaful*. SMEs may not have wherewithal to manage and control risks due to their very size and several limitations. That is why SMEs will need much more than robust risk management system. Risk management is the core principle that implied in SMEs, and also entrepreneurial or management focus should be focussed at recognizing future uncertainty, deliberating risks, possible manifestations and effects (Smit and Watkins, 2012).

In Islam, risk is defined similarly with additional reference to submit to the Almighty Allah upon making efforts and prayers to achieve goodness in this world and the hereafter as every event in the life of a Muslim is fated and only the Almighty Allah knows best the fate and future of every being. On the other hand, since only Almighty Allah knows what lies ahead of human being, uncertainties concerning future events can also imply a positive thing when the outcome is a windfall. The juristic principle of “*al-ghunm bil-ghurm*” means that “one is entitled to a gain if one agrees to bear the responsibility for the loss” is often the most quoted source of Islamic values about risk (ghurm). It is shown that mentioning of risk (ghurm) in Islamic law and principle is always accompanied with the possibility of gains (Rosly and Zaini, 2008).

In general, risk is mostly defined as the uncertainty which is associated with results or future events. Risk has no practical significance if it cannot be measured. The general trend of human thought that given the risk in a simple sense, they tend to divide it into two things, which consist of high and low risk. Therefore, at present seems there are various ways to measure and classify the risk, because of the tendency of unwanted results have distinctly different levels (Elgari, 2003). Risk management in business as well as recognized in conventional financial theory also accepted in Islam (Rokhman, 2010; Siddiqi, 2010; Rosman, 2009). It seems as a way to ensure achievement in order to fulfil the goals and objectives, which ultimately could bring happiness (*Sa'adah*) in the world and afterlife. In the Islamic perspective, the risk is classified into two: (1) risk hereafter, and (2) risk of the world. Risks associated with hell hereafter. The world risks associated with the primary objective the provision of *Shariah* (*maqashid ash-shari'a*) which is a basic foundation for individual and social life. It is also reflected in the maintenance of welfare pillars of human being which includes 'five welfare' in *maqashid ash-shari'a*. In this concept (*maqashid ash-shari'a*), risk management is the fifth pillar that has its aim to maintain and preserve the treasure or wealth. Thus, if a business cannot perform its function to maintain and protected *maqashid ash-shari'a*, then the business itself will always synonymous with risk.

Organizations have to struggle for their survival and individuals to secure their interests. Therefore, risk management in Islam has to conform to the objectives of *Shariah* that promotes harmony among its Ummah (Abdullah, 2012). Concepts relating to the welfare and protection of all stakeholders of organization presented emerge from Islamic teachings through Al-Qur'an and Hadith. This will provide protection and warding off harm and disaster for the well being of Ummah in this life and the hereafter.

In Islamic business activities, rather than based on the Islamic values, there are also principles known as *mu'amalah* (Muslich 2010), which are: (1) *mu'amalah* is the world life affair, (2) *mu'amalah* should be based on consent and willingness of both parties, and (3) *mu'amalah* as norms or values made as basic of law, (4) *mu'amalah* should not harm themselves and others. Mohammad Daud Ali explain about eighteen principles that principles of Islamic law in field of *mu'amalah* (Muslich, 2010): (1) principle of ability or permissible, (2) principle of benefit of life, (3) principles of freedom and voluntarism, (4) principle of rejecting harm and benefit, (5) principle of kindness, (6) principle of family or togetherness equal, (7) principle of fair and balanced, (8) principle of putting obligations of rights, (9) principle of prohibition of self-harm and ors, (10) principle of ability to do or act, (11) principle of free enterprise, (12) principle of getting rights for businesses and services, (13) principle of protection of rights, (14) principle of property social function, (15) principle of good will must be protected, (16) principle of risk imposed on property, not worker, (17) principle of organizing and giving instructions, and (18) principle of written or spoken in front of witnesses.

## Firm Value

### *Firm Value in Management Performance*

Based on the *Shari'a* principle and economic fairness, there are some principles to support the achievement of economic fairness, one of which is the principle of added value or profit (Haq, 2002). Value added in the Qur'an referred to as *Fadl* whose meaning is value increased. This means that all of the effort which was not able in adding value; it would not be an economic

enterprise desired based on *Shari'a* principles. The value added derived from this economic activity can be used as a part in economic welfare which is fundamental value in Islam.

The firms would create more value for the company if it has a value-added, and only firms that obtain profit could creating value added for the benefits received by the company remaining after spend budget including all costs derived from firm's activities in processing raw material into products that distribute to consumer. Thus, firm's ability to obtain meaningful profits as well as create value-added is important for sustainability. Firm's ability to gain its profit represents the good performance of the management. In this case it is believed that firm value added would be defined as result of management's performance.

When evaluating the firm or unit performance, the unit contributes to shareholder wealth only insofar as it's economic value added surpass the cost of its contribution firm's risk. Consequently, most of performance evaluation has been done only from the economic or financial aspects (value and profit). This performance would be defined as result of management that perform their work. Therefore, management's performance should not be assessed in the financial perspective only, but also in non-financial or immaterial perspective. Both this performance models should be aligned because basically every human being is composed of two elements, which are body and soul. Both must always to be achieved in order to reach perfect happiness. Financial perspective is dominant stimulate human efforts to meet the material needs. Integrating Islamic values in financial perspective, it suggests the use of shariah and charity value as a performance indicator. The value added of shari'ah is the "halalan toyyibah value added". Thus, this value added would be perfectly fit to be obtained, processed, and distributed to those entitled through legal means.

### ***Firm Value in Socio-economic Performance***

Islam stresses the practice of justice and equality, truthfulness and transparency, and protection of minorities, accountability and adequate disclosure. Shari'ah law is not a system that tends to emphasize the positivity on the legal system only, but also on the side of morality (Zaman *et al.*, 2015). It is very integral and comprehensive, also governs all multi facets of life. Understanding the Islam which means safe, tranquil, secure, and peaceful, that is manifested by level of social and economic welfare which refers to the state of the community or society at large.

As previously discussed, there are two major perspective in evaluate firm performance (financial and non-financial perspective). Management's performance would be defined as one typical of firm value that suited with SMEs. But, sometimes management behaviour often violates utilitarian ethics in society. Eventhough people behaviour will undermine social cohesion, natural ecosystems, and the man himself. Conversely, if the measurement of performance across boundaries of the material world, the deviant behaviour can be eliminated and even encourage people to return to the Creator (Triuwono, 2006). Therefore, concept of benefit (*Maslahah*) would be fit in evaluate individual or organizational performance or achievement.

Basic human *Maslahah* constituted by the need to achieve individual and social welfare. These needs are classified into three hierarchies, (Akgunduz, 2011), namely: (1) necessities (*dlaruriyyat*) or primary needs; (2) convenience (*hajiyyat*) or secondary requirement; and (3) refinements (*kamaliat*) or tertiary needs. The third requirement is intended to maintain and preserve *maqashid ash-shari'ah* (Zunaich, 2011) that must be met so that people can live happily in this world and hereafter. If one of *maqashid ash-shari'ah* does not fulfilled or unbalanced, undoubtedly happiness of life could not be achieved perfectly. Thus, happiness will not be viewed only from one point of view. Concept of property is abundant not guarantee happiness because the abundant wealth does not necessarily make someone increase his or her prosperity. It is believed in fairly economic achievement, another important value added principle as firm value indicators is socio-economic performance.

### ***Conceptual Framework and Hypotheses***

One of basic concept of a firm is about managing risks that might generate profits and ensure firm's sustainability leads to shareholders' confidence. Existing theoretical arguments and previous empirical evidence of risk management mostly seems as a means to maximize shareholder value (Allen and Santomero, 1997), with the question regarding the relationship between risk management and firm value has been raised for financial institutions (Allen and Santomero, 1997). Among their sample of large nonfinancial firms with foreign currency exposures, Allayannis and Weston (2001) directly investigate the relationship between risk management and firm value. Such previous studies (Meshane, *et al.* 2011; Carter, Rogers, & Simkins, 2006; Allayannis and Weston, 2001) are helping to understand the reasons that firms deciding to hedge risk and provide a theoretical justification for the link between risk management and firm value.

Ghofar and Islam (2015) argued that managing risks is an attempt to manage and convert risks from potentially damaging factors to opportunities for gaining competitive advantages. In term of management as general, Forster and Fenwick (2014)

have explore about how Islamic values influence management and business practice in Morocco. Principal motives among people, which are elicited from participants include one of them is ‘*living*’ *Islam* (including the interaction of Islam and personal beliefs, alongside the influence of kindness). This motive is ever-present in their influence on management practice, yet in each individual’s pattern of their own belief and character.

Previous literature in conventional business perspectives suggests various antecedents or factors influencing risk management implementation in organizations, such as board characteristic (Dabari and Saidin, 2012; Daud and Yazid, 2009), external auditors (Dabari and Saidin, 2012), internal audit effectiveness (Dabari and Saidin, 2012), human resource competency (Dabari and Saidin, 2012), regulatory influence (Dabari and Saidin, 2012). Thus, Abdullah (2012) suggests it as an effective risk management tool that confirms to the maqasid of Shariah. In this case, protection of human dignity, as deliberate concept about risk management based on Islamic norms and values must be prioritized to honour and treasure individuals without discrimination.

In SMEs, controlling plays an essential role in organizing and improving risk management (Henschel, 2010). It is also essential that there is a holistic integration into the existing business planning systems. Enterprise risk management could create firm value by enabling management to quantify and manage the risk-return trade-off that faces the entire firm (Nocco and Stulz, 2006). By adopting this perspective, risk management practices would helps the SMEs maintain access to the capital markets and other resources necessary to implement its strategy (Nocco and Stulz, 2006; Smit and Watkins, 2012) and business plan (Nocco and Stulz, 2006; Henschel, 2010). In context of SMEs, effective Islamic risk management should be a better estimate of expected value and better understanding of unexpected losses.

Based on the literature review, the theoretical framework is proposed for the study is as depicted in Figure 1 below:

In order to answer the research objectives the following hypotheses which are formulated below:

- H1 : Higher compliance of *maqashid as syari’ah* will lead to better Islamic risk management in small medium enterprise.
- H2 : Higher Islamic Values in business implementation and risk practices will lead to better Islamic risk management in small medium enterprise.
- H3 : Higher compliance of *fiqh mu’amalah* will lead to better Islamic risk management in small medium enterprise.
- H4 : Higher Islamic risk management will increase corporate value in term of corporate management performance of small medium enterprise.
- H5 : Higher Islamic risk management will increase corporate value in term of corporate socio-economic performance of small medium enterprise.

## RESEARCH METHOD

This section includes of the empirical method, such as sample selection, specification of the model, and measurement of the variables used in this study. This quantitative study is conducted in East Java, Indonesia. In order to test our proposed model, we examined from a cross sectional data from Moslem entrepreneurs perception about antecedents and outcomes of Islamic risk management.

### Sample Selection

In this study, the sampling frame consisted of Moslem entrepreneurs who have operating their SMEs. Thus, respondents were obtained through a purposive sampling, with criteria of their SMEs business are in real sector. From the first we provided

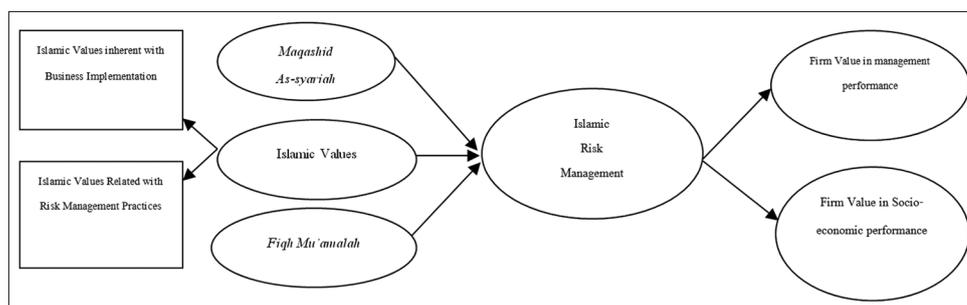


Figure 1: Conceptual framework

a brief overview of the survey and the research in general to Moslem entrepreneurs as participants in this study. Data were collected (1) using a confidential and anonymous questionnaire, and (2) using self-administered questionnaires to examine the preceding issues because of responses could be easily quantified and summarized. A total of 200 questionnaires were administered to potential respondents chosen around East Java, Indonesia. Total of 87 usable questionnaires from 107 which was returned giving a response rate of 43.5 percent.

### Specification Model and Measurement of Variables

As a second generation multivariate technique, Partial Least Square (PLS) approach was used to test the research hypotheses in structural equation modelling. PLS-based was used to evaluate simultaneously the measurement model (outer model) and the structural model (inner model) with the purpose to minimize error variance (Chin, 1998). The goal of PLS path modelling is primarily to estimate the variance of endogenous constructs and in turn their respective manifest variables.

Variables relevant to the current study are described below. Referring to related theory and previous research, a survey questionnaire was developed to collect data that could test the validity of the model and research hypotheses. Based on previous empirical and theoretical foundation, we have developed the research instruments which are used to measure the variables observed in this study.

#### 1. *Maqashid as-Syari'ah*

*Maqashid as-syaria'ah* was developed based on seven indicator of the fifth pillar of wealth concept about masalah developed by Ibrahim (2011). A scale which consist of 7 item developed to measure moslem entrepreneurs' perception of *Maqashid Ash-Sharia'ah* used a likert scale ranging from zero to five (0 = Very Disagree, 5 = Very Agree) to evaluate about how well they engaged with every pillars of *Maqashid Ash-Sharia'ah*.

#### 2. Islamic Value

Islamic values that inherent with business implementation based on Indrawati, *et al.* (2012), build on ten indicators which are: *Akhlak, Fathona, Istiqomah, Amanah, Tawakal, 'An taraadhin minkum, Shiddiq, Ukhuwah, Ikhlas, and Ihsan*. Therefore Islamic values that inherent with risk management practices build on four indicators are: persistence, discipline, empowerment, and *khusnudzdzon* (positive thought toward God – Allah almighty). Respondents rate their agreement for each of the 5-items of Islamic Value using a 5 - point likert scale.

#### 3. *Fiqh Mu'amalah*

*Fiqh mu'amalah* in this study refers to basic Islamic principles and as Islamic law foundation about trade and commerce. A *Fiqh mu'amalah* scale which consist of eight item developed by Shaikh (2011), to measure moslem entrepreneurs' perception used a likert scale ranging from zero to five (0 = Very Disagree, 5 = Very Agree) to evaluate about how well they engaged with *fiqh mu'amalah* in trade and commerce. These indicators are:

- a. Restriction on *maysir* activities
- b. Restriction on *gharar* activities
- c. Restriction on *riba* activities
- d. Restriction on *bathil* activities
- e. Restriction on fraud activities
- f. Restriction on stealing activities
- g. Restriction on robbery activities
- h. Restriction on violence activities

## ISLAMIC RISK MANAGEMENT

Islamic risk management is a traditional risk model developed with spiritual force – *khusnuzhan* – a positive thought toward Allah Almighty and based on Islamic values and *fiqh mu'amalah* relate with firm value and socio-economic context. Islamic risk management model in this study that developed by Indrawati, *et al.* (2012), which its measurement based on five phase of risk assessment. Scoring on this construct based on phase of risk management implementation in SMEs. Respondents indicated the extent of implementation from 1 (phase one) to 5 (phase five).

## FIRM VALUE

Firm value defined as value creation which is derived from business activities that will distribute to stakeholder (human and nature).

## Management's Performance

In this study firm value not only measured using financial ratios, as indication of assessment of the firm's past performance and future prospects. Firm value based on material and immaterial piety adopted from Triyuwono (2006) and Indrawati, et al. (2012), in which material piety consist of profit, *zakat*, and alms. In otherside, the examples of immaterial piety such as peaceful, glad, happy, comfort, love.

## Socio-economic Performance

Firm value related with socio-economic fairness based on Ibnu Qayyim cited in Utomo (2002), which consist of *hikmah* (wisdom), *masalah* of *ummah* (human being) in life and hereafter, equal justice, graceful justice, prosperous justice, and wisdom justice.

## RESULTS

The results of descriptive analysis showed the characteristics of respondents, which were divided to entrepreneurs and employees, as well as firm characteristics of each are shown in Table 1 and Table 2.

Table 1 above documented that as much as 75% entrepreneurs and 70% employees are the men, while 25% entrepreneurs and 30% employees are the women. From these entire respondents, known that 54.02% of all them as a young entrepreneur who have 21 to 25 years old, and then 64.37% of all respondents have 26 to 30 years old so we categorize as mature employees.

From the education background, almost all entrepreneurs (70.11%) are from undergraduate but 52.87% of employees are only high school. Employee's work experiences are about 1 to 5 years with proportion 57.47%.

Moreover, the analysis result with PLS method can be seen in Table 3 below.

Table 3 reported that the first hypothesis is accepted, with a t-value of 3,189 is greater than t-table 1.96. Thus, the more compliance the business activities in Maqashid Ash-Shari'ah will further improve the practice of the Islamic risk management.

**Table 1: Characteristics of respondents**

Characteristics	Entrepreneurs		Employees	
	Frequent	Percentage (%)	Frequent	Percentage (%)
Sex				
Men	65	75	61	70
Women	22	25	26	30
Total	87	100	87	100
Age				
2-25 years old	47	54.02	15	17.24
26-30 years old	25	28.74	56	64.37
Above 30 years old	15	17.24	16	18.39
Total	87	100	87	100
Education background				
Elementary school	-	-	1	1.15
Junior high school	-	-	10	11.49
General high school	26	29.89	46	52.87
University	61	70.11	30	34.48
Total	87	100	87	100
Work experience				
< 1 year	-	-	30	34.48
1 year to 5 years	-	-	50	57.47
>5 years	-	-	7	8.05
Total	-	-	87	100

**Table 2: Firm characteristics**

Characteristics	Frequent	Percentage (%)
Firm age		
< 3 years	35	40.23
3–5 years	30	34.48
>5 years	22	25.29
Total	87	100
Product resulted		
1 type	30	34.49
> 1 type	57	65.51
Total	87	100

**Table 3: Hypotheses testing result**

	Coefficient $\beta$	t-statistic	Cut off (t-table)	Hypothesis test result	R-square
X1 → Y	0.319	3.189	1.96	Significant	18.4%
X2 → Y	0.094	0.890	1.96	NS	
X3 → Y	0.085	0.791	1.96	NS	
Y → Z1	0.369	6.084	1.96	Significant	13.6%
Y → Z2	0.437	5.819	1.96	Significant	19.1%

The second and third hypotheses are rejected caused by the t-value on each of 0.890 and 0.91 are smaller than t-table 1.96, meaning that the higher Islamic values and Fiqh Mu'amalah cannot improve Islamic risk management.

The better of Islamic risk management practices will further improve both in management and socio-economic performance. This is indicated by the t-value on each of 6.084 and 5.819 are greater than t-table 1.96, so it can be said that the fourth and fifth hypothesis are accepted.

Variations in Islamic risk management can be explained as much as 18.4% from Maqashid Ash-Shari'ah, Islamic values, and Fiqh Mu'amalah, while the remaining of 81.6% is explained by other factors outside the research model. Otherwise, Islamic risk management is able to explain 13.6% of the variation of management performance and 19.1% of socio-economic performance, the remaining of respectively 86.4% and 80.9% explained by other factors outside the research model.

## DISCUSSION

The finding of this study revealed that Maqashid Ash-Shari'ah have positive significant effect on Islamic risk management, while Islamic values and Fiqh Mu'amalah are not. The Islamic risk management has mediation role in effect of Maqashid Ash-Shari'ah on management and socio-economic performance of SMEs in East Java. In addition, Islamic risk management was also known to have a greater influence on the socio-economic performance than management's performance. This indicates that the mediating role of Islamic risk management is more reflected by improvement of socio-economic performance of SMEs in East Java.

This result confirmed the previous study by Indrawati (2012) who created the Islamic risk management model by using the post positivist paradigm. In order to implement risk management, it is very important for Moslem entrepreneurs to have self-awareness toward Maqashid Ash-Shari'ah, in which is a basic trust of individual and social life reflected by five *maslahah* (benefits). This condition occur when all the pillar of Maqashid Ash-Shari'ah are well preserved, which consist of (1) protection of religion, (2) protection of life (3) protection of reproductive health and honour, (4) protection of sense (5) protection of treasure. In contrary, risks will arise if the pillars of Maqashid Ash-Shari'ah are not properly preserved, so the human welfare will lost.

Several studies using either deductive or inductive method of the sources of Islamic Shariah has been confirmed that the main purpose of Shariah is to give the benefit to humans. Therefore, the laws of shariah are under concept of *maslahah* which ensure

the humans not only in this life but also hereafter. From this perspective, it can be argued that everything related with “Islam” also known as *maslahah*. Basically, priorities in implementing the Islamic Shari’ah in accordance with the sequences of five constituents of the *Maqashid Ash-Shari’ah*. Instead, an attempt to accept the beneficiary or refuse the unbeneficial solely for the sake of worldly without considering compliance with the Shari’ah objectives, it’s called with *mafsadah* (badness). In other words, refusing *mafsadah* is also being a *maslahah*.

In context of risk management, significance effect of *Maqashid Ash-shari’ah* on Islamic risk management practices consequences that all of activities which carried out by Moslem entrepreneurs are intended to give *maslahah* for human life, including nature and environment in accordance with the duties as caliph in the earth. Thus, everything that happens in this world, especially related with business activities have always strived to maintain and preserve the property. The people will suffering the loss when they treasure have preserved but the *Maqashid Ash-Shari’ah* have not. Consequently, implementation of risk management practices should refer to the preservation of *Maqashid Ash-Shari’ah*.

The Islamic value of *maslahah* is substantial value of business operation that is achieved by implementing of instrumental Islamic values (Indrawati, 2012). In many countries, religious values play an important role in defining national culture and have a significant effect on business practices (Doupnik and Perera, 2009). In other side, Danila et al., (2010) argued that religion affects the ethics and morality in life, which reflected by decisions and choices. The religion influences the culture by questioning, reasoning, and provides an alternative way as well as society functions. Implementation of religious values that are formed in general principles of Islamic business ethics were adapted to the dimension of time, so it is probable that Islamic values are applied in business. Moreover, when linking risk management practice, it is natural that Islamic values gives broaden perspective in cultural of business risks based on Shari’a principles.

Related with Shari’ah principle, the business activities could be defined as a manifestation of *mu’amalah*. Rights and obligations of the two people who do such transactions will set up in *Fiqh Mu’amalah* (so that each right up to the owner, and no one is taking something that is not right). Thus, the relationship between each of human beings are well established and harmony, and also have a good benefits. The framework of Islamic risk management is not rigid (Siddiqi, 2009); it can be applied to five aspects of Islamic risk management practices which lead to *fiqh Mu’amalah* as the basic of social and business activities.

The finding of this study indicate that the conception of *Fiqh Mu’amalah* have no significant effect on Islamic risk management. This result is not accordance with Indrawati (2012) who revealed that the *Fiqh Mu’amalah*, as a basic principle of Islam that has been set on trade or commerce, which are implemented through the prohibition of *maysir*, *gharar*, *usury*, and *bathil* activities and being a guidance business activities and risk management practices.

*Fiqh mu’amalah* is underlying business activities and risk management practices based on Islamic values and principles in the boarding school. From the results of average value, it shown that respondents have a good perception of *Fiqh Mu’amalah*, so there is a possibility to interpret the difference perceived in the conception of *Fiqh Mu’amalah* in relation to risk management practices in Moslem entrepreneurs.

The result of this study also revealed that implementation of Islamic risk management will increase the firm value, both in management and socio-economic performance. These findings confirm previous study by Indrawati (2012) who states that the firm value, which is the management performance in the form of material and immaterial, has reflected by piety of economic or material, mental and social, and spiritual, as well as the socio-economic context is the impact of risk management practices based on Islamic values and the principles in the boarding school.

## CONCLUSION

Several conclusions based on research finding implies in this study are: (1) *Maqashid Ash-Shari’ah* plays a basic role for Moslem entrepreneurs when implementing Islamic risk management in their firms; (2) Islamic values which is composed of the values associated with business and values related to Islamic risk management are not inherent in the activity of Moslem entrepreneurs in managing risks; (3) *Fiqh mu’amalah* on which the business operated by Moslem entrepreneurs is not plays important role as the basis of their Islamic risk management practices; (4) Islamic risk management which applied by Moslem entrepreneurs in their SMEs have important role in fostering firm value both in context of management and socio-economic performance.

There are several limitations in this study, resulting study is cross-sectional and still relatively small number of samples obtained in the study. Future studies are recommended to carry out research in methods of longitudinal and or in a broader

scope, allowing variation data obtained greater. Model conceptual framework and measurement in this study are also advised to be replicated in the context of different objects that are expected to strengthen the research developed modelling constructs.

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