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The effects of Islamic law on business practices

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Abstract

Purpose – The purpose of this paper is to give professionals working in Islamic countries a better understanding of the legal system in those countries. As a rule, multinational companies are more equipped in dealing with problems when governed by Western legal philosophies and jurisprudence. However, when certain issues fall on the jurisdiction of an Islamic country they have to address it by using the Islamic laws (*Shariah* laws) maintained in the *Qur'an*.

Design/methodology/approach – The source of material for this paper is literature review based on texts and references sourced in the business environment. The literature used is Islamic literature in the Bosnian and English languages.

Findings – The findings are that Islamic laws compel companies to be wary of interest, uncertainty or risk. This means that companies that rely on compelling interest on the consumer are prohibited in operating in Islamic states. The law is there to protect the welfare of all the parties involved. The strict nature of these laws often seeks to provide justice and fairness to both parties. Thus, for organisations and international companies who intend to deal with companies based in Islamic countries and adhere to *Shariah* law should always be mindful of the fairness of their offers and the fairness of the outcomes of these agreements.

Research limitations/implications – Islamic laws tend to adhere strictly on the principles and values intimated in the *Qur'an* and *Hadith*. This paper summaries the core of Islamic business laws. However, this research is limited to theory alone. For this reason, future research perhaps could look at case studies and see if what works in theory indeed does work in practice too. The review has been limited to Bosnian and English language texts. In addition, this paper has some limited literature review on such a complicated and sensitive topic.

Originality/value – This paper will provide important business factors that will essentially assist international businesses in their understanding of the legal standards in this region.

Keywords Law, Finance, Business environment, Islam, International business

Paper type Literature review

Glossary

<i>Allah</i>	God (God in Arabic).
Believers	Muslims.
Muslim	Adherents of the Religion of Islam.
Islam	A religion (second largest religion in the world).
The word Islam	means “submission”.
<i>Qur'an</i>	Religious text of Islam.
The holy book	<i>Qur'an</i> .

Introduction

Islam has been considered as perhaps one of the oldest religions in the world, and notably it has acquired a significant number of followers (Najeebabadi, 2001). In the Middle East, some countries such as the United Arab Emirates (UAE) adhere to Islamic customs. Simultaneously, the UAE implements the laws on which the *Qur'an* commands



“Allah has made business lawful for you” (*Qur’an* 2:275). Since Islamic laws are implemented this means that the UAE implements its own set of laws which is considerably distinct to the other jurisprudence in other Arabic states (Williams, 1992). Normally, multinational companies are more equipped in dealing with problems when governed by western legal philosophies and jurisprudence. However, when certain issues fall under the jurisdiction of an Islamic country they have to address it by using the *Shariah* laws maintained in the *Qur’an*. According to Carnegie Endowment, in the UAE the law is not only based on Islamic legal principles, but it is also influenced by English common law as well as Egyptian legal traditions. It is mainly influenced by the English since the UAE and the UK had a treaty relationship which lasted for about 20 years (Al Abed and Hellyer, 2001). This paper will describe the elements of the *Shariah* laws implemented in the Middle Eastern countries mainly focusing on the UAE. At the same time, it will review certain parts of the *Qur’an* and identify a number of provisions pertaining to the conduct of business in these countries. In doing so, this paper will provide a review of the important business factors that will assist international businesses in its understanding of the legal practices in this region.

Laws in the UAE

To this day, there are still some traditionally Islamic countries such as Iran and the Kingdom of Saudi Arabia which continue to use the jurisprudence of the *Shariah* law (Williams, 1998; Idris, 2007). Conversely, there are other Islamic countries such as Egypt, Libya and the UAE that have taken steps to accommodate the demands for reform by instituting a dual system in their court proceedings with secular courts and religious courts (Robinson, 2003). The UAE’s law system is based on the Egyptian law system, which in turn is French based. The UAE has evolved its existing laws over time and incorporated the principles of *Shariah* law.

In the UAE the federal court has three levels:

- (1) The Federal Supreme Court.
- (2) The Courts of First Instance.
- (3) The Appellate Courts.

Completing the Supreme Court and Courts of First Instance are the emirate-based *Shariah* courts (Williams, 1998). In the UAE the Federal Supreme Court judge is appointed by the ruler of the UAE and this is followed by the supreme council of rulers approval. The Federal Supreme Court can consist of up to five judges and one chairman (Williams, 1998). The Federal Supreme Court only occasionally deals with commercial cases, this court deals with very serious crimes against the UAE federation, constitutional matters and disputes that may arise in the emirate and federal governments. It is the job of the Courts of First Instance to deal with matters such as; criminal, commercial civil and personal disputes.

Presiding over those courts is the emirate-based *Shariah* courts. The *Shariah* courts deal with breaches of religious law, moral crimes matters that, for example, involve blood money (*diyya*; Williams, 1998). Those courts are presided over by religious scholars who identify and interpret the tenets covered by a crime or misdemeanour provided by the *Qur’an* and the *Sunna*; this is very different from judicial courts in common law and civil law countries (Kurzman, 1998). Moreover, the implemented laws differ significantly from their western counterparts. Given that the edicts of these

laws are more often than not based on centuries-old principles, and sometimes their punishments can be rather severe. Additionally, in other democratic countries civil liberties have a different interpretation to some of those countries in the Middle East such as the UAE.

The *Shariah* law's effect on business

As it has been indicated in the earlier parts of this paper, the *Shariah* has a considerable effect on every single aspect of Muslim culture. Some scholars have to some extent indicated that the religion of Islam is very comprehensive, seeing it as influencing the realm of business with its special provisions. Verse 2:275 of the *Qur'an*, states that *Allah* permits people to conduct commerce. This practice has been seen even in ancient periods, where Muslim traders have circled the globe with their merchandise. It is believed that this has triggered the surge of Islamic foundations in countries in the Southeast Asian countries, such as Malaysia and Indonesia (Hefner and Horvatic, 1997). However, whilst the *Qur'an* states that *Allah* permits trade, it has certain restrictions, which still apply. The relevant restrictions and specified guidelines will be discussed in the following parts. Likewise, the implications on doing business in the UAE will be highlighted in the process.

***Shariah* law and its effects on contracts**

In Islam, commitments between people are held highly. For instance, the *Qur'an* characterised the believers (Muslims) of the faith (Islam) as being trustworthy especially those with goods or currency deposited to them and the agreements that they make (*Qur'an* 23:8). Another verse in the *Qur'an* intimated that even the initiator has to hold true to his commitments. Furthermore, verse 5:1 of the same book, states that the believers are compelled to fulfil their obligations. Comparable to the western ideals of contracts as a binding document, Islamic laws have placed more weight on it. As it does not constitute fulfilment of any of the common law requirements; like offer, consideration, and acceptance. In the context of Islamic law, an agreement is equivalent to an obligation. Based on the words of *Allah* failing to take certain steps to fulfil that obligation is a clear violation of the laws. In this regard, dealing in Islamic countries international businesses have to take certain measures to ensure that they keep track of their agreements.

Written agreements and the necessitate of witnesses

According to the *Qur'an*, Islamic societies are obliged to make written proofs in instances where they engage in financial transactions. In verse 2:282 of the *Qur'an*, there is a detailed set of guidelines on how to avert any possibility of breaking an agreement. The said verse intimates two possible financial transactions that require being written down. These include those involving immediate transactions and those that involve credit:

[...] When you contract a debt for a fixed period, write it down [...] And get two witnesses out of your own men. And if there are not two men (available), then a man and two women, such as you agree for witnesses, so that if one of them (two women) errs, the other can remind her [...] You should not become weary to write it (your contract), whether it be small or big, for its fixed term, that is more just with Allah; more solid as evidence, and more convenient to prevent doubts among yourselves [...] take witnesses whenever you make a commercial contract [...] (verse 2:282 of the *Qur'an*).

In the context of immediate transactions, it is suggested to write down the actual agreement, and it must be emphasised that the presence of a witness is required. It may appear that these practices are taxing for the parties doing the transaction. However, in instances where huge multinational corporations and other major businesses are involved, this essentially makes perfect sense. Having a witness in these types of situations as well as written agreements will basically establish the reality and validity of a contract.

The principles surrounding Islam requires its believers to adhere to deep-seated moral values which are intimated in the verses of the *Qur'an* (Benthall, 1999). This is done by making sure that the terms of the contract are fair and at the end of transactions, no party exceeds the other in terms of the acquired benefits in the transaction.

In the case of transactions involving credit, witnesses are also required. Specifically, the *Qur'an* (2:282) states:

When you deal with each other, in transactions involving future obligation in a fixed period of time reduce them to writing and get two witnesses out of your own men and if there are not two men, then a man and two women.

Basically, this is interpreted by several studies in the context where females in the Islam religion tend to have limited acquaintance with labour, employment and other business transactions. Additionally, there is also the interpretation that one party may marry the other witness, thus making any later testimony on her behalf biased.

On the part of non-Muslim businesses, this piece of information is significant as it builds on how these companies rely on evidence so as to compel the other party to honour the commitments held in a particular contract. In the same regard, companies must make their legal representative converse with the other party and make sure that the terms provided in the contract fits what the two parties have actually agreed upon.

The good faith principle

Essentially, the thorough process on which Islamic law provides for those engaging in financial transactions tends to discourage any possibility of a breach. In the same manner, it also indicates that there is always a presumption of good faith in every transaction. More than that, the principles surrounding Islam requires its believers to adhere to deep-seated moral values which are intimated in the verses of the *Qur'an* (Benthall, 1999). These are normally called the *taqwa*. Basically, the *taqwa* is used to collectively describe the respect of an individual to the moral principles triggered by faith and belief in God. Thus, every international organisation that seeks to make legal transactions with Islamic companies has to make sure that the terms of the contract display good faith. This is done by making sure that the terms of the contract are fair and at the end of transactions, no party exceeds the other in terms of the acquired benefits in the transaction.

Financial arrangements

Islamic countries have their own form of financing and banking which originates from the system of belief of the *Qur'an* (Maurer, 2002). A major area of business that is affected by the *Shariah* laws is finance and banking. Predominantly, there are certain investments that are considered unacceptable in Islamic states, but normally would be seen as standard in other parts of the world. For this reason, there are only a few types

of investments that can be executed in Islamic countries. For this reason, non-Muslim investment companies have a social responsibility to follow the standards of the specific Islamic countries.

Places such as the UAE which have immense wealth and investments in the oil industry have developed their own means of finance and banking to safeguard their assets. According to Siddiqi (2002), the Arabs have established two ideas for these kinds of situations: the *riba* and the *gharar*. The *riba* can be deciphered as the thought of leaning at exorbitant interests. Conversely, the term *gharar* is associated with the idea of risk and uncertainty. On the whole, those conditions elucidate the accepted type of arrangements in Islamic countries, arrangements which are fair in terms of the risks that the parties face and the repugnance to any agreement that relates to *riba* or *gharar*.

In this view, financial companies that deal with equity financing have to tread carefully in their operations in Islamic states. At its core the application of interests as well as offering insurance premiums normally falls on the classifications of *riba* and *gharar*. In the case of interest, Siddiqi (2000) states that it should be seen a way to reward the one who provided the loan, meaning that interest payments should not be forced and the payee should give it voluntarily. Moreover, in the case of insurance, its uncertain nature falls on what has earlier been described as *gharar*. Though, one should take note that there are certain financing arrangements that are not permissible in Islamic states and some that are permitted.

The *mudarabah*: sharing losses and gains

The *mudarabah* is a type of arrangement that establishes a partnership of one entity to another (Maurer, 2002). The partnership is based on capital provision and commercial investment. According to Khorshid (2004), in Islamic terms, the capital provider is called the *rabb-ul-maal* while the partner who invests it to a commercial enterprise is called the *mudarib* (Khorshid, 2004). In this partnership, there is the possibility that the capital provider will provide a specific type of business that the *mudarib* could invest in. However, this is not always the case, as some capital providers tend to give the *mudarib* free rein on the type of business he/she intends to build. This means that the *mudarabah* could be restricted or unrestricted. The common denominator in these types of arrangements is that the distribution of profit is predetermined.

In this sense, profit-and-loss sharing between these partners determines the dynamics of the business (Aggarwal and Yousef, 2000). This arrangement is also seen in banks operating in Islamic states. However, before investing in a set of mutual funds, the investments are often screened by the parties involved to fit the requirements of *Shariah* law. With the prerequisite of pre-determined profit and loss sharing, this means that instead of a percentage of the capital amount, the investors are to receive a fixed return (Maurer, 2002).

The *musharakah*: partnership among equals

Like the *mudarabah*, the *musharakah* also denotes sharing of both profits and losses among the parties involved. In non-Muslim states, this arrangement is equivalent to partnership and joint stock ownership. One type of arrangement of the same kind to the *musharakah* is the declining balance shared equity partnership (Siddiqi, 1997). This is considered as the most common type of home acquisition method available for Islamic states. In this context, the financial institution gives a certain percentage of the

capital required by the other person. In this arrangement, there is an assumed understanding that the two will essentially share the profits and losses based on a prescribed formula agreed upon by the parties involved (Starr and Yilmaz, 2007). In the case of real estate purchases, the principle behind *musharakah* are to make the homebuyer pay a certain fee on a regular basis to the investor to reach the latter's equity, and in return, the homebuyer is allowed to live in the said property. *Musharakah* also exists in non-Islamic states; however it is noted as a lease-to-own arrangement. Additionally, there is also an understood agreement between the investor and the buyer that the latter will be purchasing the property from the former in the future. Since this takes place in a *Shariah* setting, then the agreement is assumed to be equivalent to a binding contract (Siddiqi, 1997).

The '*ijarah* principle

According to Smith (2007), in Islamic jurisprudence, the definition of *ijarah* connotes the definition provided in hire, rent, or lease contracts. Normally, this principle is applied in the context of a property, a house or a car leased to a particular person. It is said, that the principle of *ijarah* is completed when two parties are involved (Khorshid, 2004). This principle should constitute an offer and consequent acceptance of the agreement. Moreover, the agreement also entails the specification of the reimbursement pattern or possible compensation requirements in the process. Along with these elements, the procedure will have to be specified to keep the other party informed and maintain transparency in the agreement. It is of high importance to note that without any of these factors, the *ijarah* is deemed null and void.

In the same manner, there are certain conditions that transacting non-Muslim parties should be aware of. For instance, the property under lease has to be in a condition that is usable (Khorshid, 2004). This means that the property will have to at least operate based on the intended purpose of the lessee. Second, the *ijarah* principle applies only to goods that are classified as inconsumable. In addition, the lessee is not allowed to damage the subject or use it as an entity not specified by the contract (Smith, 2007). For instance, a residential property described in the contract is not permitted to be converted into a commercial space or anything other than a place of residence.

Exemption to the *gharar* rule: *salam* and '*istisna*

As mentioned in the earlier parts of the paper, in Islamic countries the element of uncertainty or *gharar* is avoided by many in the business sector. This is particularly true when it comes to commodities that are intended to be sold by a seller. The principle of *gharar* maintains that these commodities, which are intended to be sold, should actually be or constructively remain in the ownership of the seller. However, a certain condition regarding the validity of sale appears to be the exemption in this rule: *salam* and '*istisna*. However, these are hardly ever seen in the form of financing.

In the case of *salam*, it comprises a sale, whereby the seller accepts the assignment to provide certain goods to the buyer on a specified date in the future provided that the exchange is paid immediately in full (Siddiqi, 1999). In today's business terminology, this is tantamount to a pre-paid transaction. Initially, the principle of *salam* is implemented to help small business owners and keep them from engaging in loans that would render them helpless in the future. However, in the current setting, transactions

made in *salam* normally provide a lower price from the buyer and allow the seller to acquire the sale price immediately.

Istisna, on the other hand, is relevant to the transactions on the field of manufacturing. This usually comes in instances where the manufacturer is ordered to make a particular product for the purchaser (Siddiqi, 2006). This is manifested in made-to-order garments and other commodities. In any case, the contract is binding and may not be cancelled unilaterally.

Conclusion

The intended goal of this paper is to give professionals working in Islamic countries a review of the key factors influencing business transactions in Islamic countries. Through this it is hoped that a better understanding of the legal system operating in those countries can be gained. Better business relationships are likely to develop if western companies appreciate the key factors in doing business in Islamic countries. The rules are often not more onerous, but introduce universal concepts of fairness and transparency into the practices and relationships between buyer and seller or provider and receiver of services. As a rule, multinational companies are better equipped in dealing with problems when governed by western legal philosophies and jurisprudence. However, when certain issues fall on the jurisdiction of an Islamic country they have to address it by using the Islamic laws (*Shariah* laws) defined in the *Qur'an*.

Islamic laws tend to adhere strictly on the principles and values intimated in the *Qur'an*. Nevertheless, based on the discussion above this paper has observed that many of the principles and practises noted at the core of Islamic law are, and can, be related to the practice of business in Islamic countries. The law is there to protect the welfare of all the parties involved. The clearly stated nature of these laws can make business easier and have less risk. A central tenet of Islamic law is that it seeks to provide justice and fairness to both parties. Thus, for organisations and international companies who intend to deal with companies based in Islamic countries and wish to adhere to *Shariah* they should always be mindful of being open or transparent in their dealings and to ensure the fairness of their offers and the fairness of the outcomes of these agreements is maintained.

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