

The Impact of Islamic Business Ethics on the Sustainable Competitive Advantage of SMEs: An Empirical Study

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Abstract :

This study examines the impact of Islamic business ethics on the sustainable competitive advantage of small and medium enterprises (SMEs) in Lumajang Regency. The research is grounded in the argument that ethical business conduct is not merely a normative religious obligation, but also a strategic resource that can strengthen long-term business performance. Using a qualitative approach with a case study design, this study explores how the implementation of Islamic business ethics is reflected in everyday business practices and how it contributes to the sustainability of competitive advantage. Data were collected through in-depth interviews, observation, and documentation involving SME owners, employees, and customers. The data were analyzed using data condensation, data display, and conclusion drawing/verification. The findings show that Islamic business ethics, particularly honesty, trustworthiness, fairness, and responsibility, plays a significant role in building customer trust, strengthening loyalty, enhancing business reputation, and supporting long-term relationships with consumers. These elements collectively form an intangible basis for sustainable competitive advantage. The study also reveals that ethical values are operationalized through simple but consistent practices, such as transparent pricing, truthful product information, fair service, and responsible complaint handling. Theoretically, this study contributes to the literature by positioning Islamic business ethics as a strategic intangible resource in explaining sustainable competitive advantage. Practically, the findings suggest that SME development should integrate ethical capacity alongside technical and economic strengthening. This study highlights the importance of value-based business practices in enhancing the resilience and sustainability of SMEs in a competitive market environment.

Keywords : *Islamic business ethics; sustainable competitive advantage; SMEs; customer trust; business sustainability; Lumajang Regency*

Abstrak :

Penelitian ini mengkaji dampak etika bisnis Islam terhadap keunggulan kompetitif berkelanjutan usaha kecil dan menengah (UKM) di Kabupaten Lumajang. Penelitian ini berlandaskan argumen bahwa perilaku bisnis yang beretika bukan hanya

kewajiban agama yang normatif, tetapi juga sumber daya strategis yang dapat memperkuat kinerja bisnis jangka panjang. Dengan menggunakan pendekatan kualitatif dengan desain studi kasus, penelitian ini mengeksplorasi bagaimana implementasi etika bisnis Islam tercermin dalam praktik bisnis sehari-hari dan bagaimana hal itu berkontribusi pada keberlanjutan keunggulan kompetitif. Data dikumpulkan melalui wawancara mendalam, observasi, dan dokumentasi yang melibatkan pemilik UKM, karyawan, dan pelanggan. Data dianalisis menggunakan kondensasi data, tampilan data, dan penarikan kesimpulan/verifikasi. Temuan menunjukkan bahwa etika bisnis Islam, khususnya kejujuran, kepercayaan, keadilan, dan tanggung jawab, memainkan peran penting dalam membangun kepercayaan pelanggan, memperkuat loyalitas, meningkatkan reputasi bisnis, dan mendukung hubungan jangka panjang dengan konsumen. Unsur-unsur ini secara kolektif membentuk dasar tak berwujud untuk keunggulan kompetitif berkelanjutan. Studi ini juga mengungkapkan bahwa nilai-nilai etika dioperasionalkan melalui praktik-praktik sederhana namun konsisten, seperti penetapan harga yang transparan, informasi produk yang jujur, pelayanan yang adil, dan penanganan keluhan yang bertanggung jawab. Secara teoritis, studi ini berkontribusi pada literatur dengan memosisikan etika bisnis Islam sebagai sumber daya tak berwujud strategis dalam menjelaskan keunggulan kompetitif berkelanjutan. Secara praktis, temuan menunjukkan bahwa pengembangan UKM harus mengintegrasikan kapasitas etika bersamaan dengan penguatan teknis dan ekonomi. Studi ini menyoroti pentingnya praktik bisnis berbasis nilai dalam meningkatkan ketahanan dan keberlanjutan UKM dalam lingkungan pasar yang kompetitif.

Kata Kunci: *Etika bisnis Islam; keunggulan kompetitif berkelanjutan; UKM; kepercayaan pelanggan; keberlanjutan bisnis; Kabupaten Lumajang*

INTRODUCTION

Micro, small, and medium enterprises play a strategic role in economic development, job creation, and the strengthening of social resilience in society (Shailendra, 2024). However, the sustainability of MSMEs' competitive advantage is not determined solely by price, product innovation, or market access, but also by the foundation of business ethics that shapes public trust. Its impact is evident in collective social welfare (Astuty, et al., 2024). In a society that is increasingly sensitive to issues of honesty, responsibility, and sustainability, Islamic business ethics becomes relevant because it offers principles that balance profit, benefit, and justice (Sulaeman et al., 2025). Principles such as trustworthiness, honesty, fairness, and the prohibition of gharar and fraud can strengthen long-term relationships between business actors, consumers, suppliers, and local communities (Lahmar & Al Qaruty, 2026). Therefore, research on the impact of Islamic business ethics on sustainable competitive advantage is important for society at large, especially to encourage business practices that are not only competitive, but also dignified and sustainable (Santoso, et al., 2026).

In many regions, MSME actors still face fundamental problems in the form of intense competition, limited capital, weak product differentiation, and low ability to build customer loyalty (Rizkita, et al., 2025). These problems are often exacerbated by business practices that are not yet fully ethics-oriented, such as inconsistent quality, lack of transparency in product information, unfair service, and weak commitment to business promises (Winkler, 2023). As a result, consumer trust can easily decline and the position of MSMEs becomes

vulnerable in long-term competition (Vasani & Abdulkareem, 2024). In the context of a Muslim-majority society, this issue becomes important because business activities should ideally not merely pursue profit, but also uphold sharia values in every transaction (Sarwar, 2025). When Islamic business ethics has not been strongly internalized, MSMEs risk losing opportunities to build a solid reputation, healthy business relationships, and sustainable competitive advantage amid market changes. This problem is evident in many small businesses (Susiang, et al., 2024).

Field phenomena show that many MSMEs are able to survive operationally, but not all of them have succeeded in building a long-lasting competitive advantage (Badwan, 2025). In Lumajang Regency, various MSMEs operate in the sectors of food, handicrafts, trade, and services, with increasingly dynamic market characteristics (Sobirin, et al., 2023). Some business actors have implemented values such as honesty in pricing, transparency regarding product quality, and friendly and trustworthy service, thereby gaining customer trust and repeat purchases (Darmawan, 2025). However, there are still MSME actors who face consumer complaints related to inconsistent quality, unclear product information, or services that do not yet meet expectations (Radhakrishnan & Vanithamani, 2025). This condition indicates that the implementation of Islamic business ethics at the practical level is still uneven (Santoso et al., 2026). These differences raise an important question regarding the extent to which Islamic business ethics truly influences the formation of sustainable competitive advantage among MSMEs in Lumajang (Buenafe, et al., 2025). This phenomenon continues to recur (Xiong et al., 2025).

A number of previous studies have discussed Islamic business ethics, business performance, customer loyalty, and competitive advantage in MSMEs as well as in larger-scale companies (Supatminingsih et al., 2025). The general findings indicate that business behavior characterized by honesty, fairness, and responsibility tends to increase customer trust, business image, and the continuity of business relationships (Liu, Ma, et al., 2025). Other studies have also emphasized that sustainable competitive advantage is influenced by internal resources, innovation, market orientation, and service quality (Elgarhy & Abou-Shouk, 2023). Nevertheless, studies that specifically link Islamic business ethics with sustainable competitive advantage in the context of regional MSMEs remain limited (Susiang et al., 2024). Many previous studies have placed ethics merely as a normative variable, not yet as a strategic factor capable of generating long-term advantage (Alam, et al., 2023). In addition, local studies focusing on Lumajang Regency are still scarce, so there is an important research gap to be filled through a more contextual empirical approach in greater depth (Zulgani et al., 2023).

The novelty of this study lies in its effort to position Islamic business ethics not merely as a moral obligation, but as a strategic asset capable of shaping sustainable competitive advantage among MSMEs in Lumajang Regency (Santoso et al., 2026). This research presents a state of the art by combining the perspectives of Islamic ethics and strategic management within one empirical framework oriented toward the local context (Santoso et al., 2026).

Thus, this study not only examines the relationship between variables, but also clarifies how the values of trustworthiness, honesty, fairness, and responsibility can be translated into market trust, customer loyalty, business reputation, and competitive resilience (Yan, et al., 2022). The urgency of this research is even greater because MSMEs need strategies that are relevant to the socio-religious identity of the local community (Astuti, et al., 2025). Solving this problem is important so that MSME development does not stop at technical aspects, but is also based on a sustainable ethical foundation (Purnomo & Purwandari, 2025). This approach also enriches the values-based MSME literature (Sulaiman & Novandari, 2025).

Based on the explanation above, the research problem of this study is whether Islamic business ethics affects the sustainable competitive advantage of MSMEs in Lumajang Regency, and how such influence can be explained empirically (Insan & Nuzil, 2025). The argument proposed in this study is that the higher the implementation of Islamic business ethics principles, the stronger the ability of MSMEs to build trust, retain customers, strengthen reputation, and create value that is difficult for competitors to imitate (Ismaeel & Blaim, 2012). In other words, Islamic business ethics is presumed to be not merely a normative complement, but a source of strategic advantage that contributes to business sustainability (Ismaeel & Blaim, 2012). This study is expected to provide a theoretical contribution by expanding the study of the relationship between Islamic ethics and competitive strategy, as well as a practical contribution by serving as a basis for recommendations for MSME actors and stakeholders in designing business development that is competitive, ethical, and sustainable (Susiang et al., 2024). The findings may become a basis for value-based MSME development policies (Vrbka, 2020).

RESEARCH METHOD

Qualitative case study research design and the basis for its selection and research location and the reasons for selecting the location

This study employed a qualitative approach with a case study design (Gammelgaard, 2017). This design was chosen because the research aims to gain an in-depth understanding of how the implementation of Islamic business ethics shapes the sustainable competitive advantage of MSMEs, rather than merely measuring the relationship between variables statistically. A qualitative approach enables the researcher to explore meanings, values, behaviors, and the subjective experiences of business actors in carrying out their daily business activities. Meanwhile, the case study design was selected because the focus of the research is directed at a specific context, namely MSMEs in Lumajang Regency, so that the local social, cultural, and economic realities can be understood comprehensively. Lumajang Regency was selected as the research location because it has diverse MSME development in the trade, culinary, handicraft, and service sectors, and represents community economic activities closely related to Islamic values. In addition, this location is relevant to the

research focus because it provides an opportunity to directly observe the practice of Islamic business ethics in the real dynamics of business competition (Sulaeman et al., 2025).

Data collection techniques and data analysis

The data collection techniques in this study were carried out through in-depth interviews, observation, and documentation (Romero, et al., 2019). In-depth interviews were used to obtain direct information from MSME actors regarding their understanding, implementation, and challenges in practicing Islamic business ethics and its relationship to business sustainability. Observation was conducted to examine business behavior, service patterns, interactions with customers, and business practices taking place in the field. Documentation was used to complement the data through business archives, activity records, photographs, or other documents relevant to the focus of the study. Data analysis was conducted interactively through the stages of data condensation, data display, and conclusion drawing/verification. In the data condensation stage, the researcher selected, focused, simplified, and categorized the data according to the research themes. Furthermore, the organized data were presented in the form of narratives, matrices, or simple tables to make them easier to understand. The final stage was data verification, namely interpreting the meaning of the data and drawing conclusions continuously while still examining the consistency of the findings in the field (Miles & Huberman, 1984).

Table 1. Data Validity Checking

No.	Aspect of Data Validity	Validation Technique	Implementation in the Study
1	Credibility	Source triangulation	Data were examined by comparing information from several informants, such as MSME owners, employees, and customers, in order to obtain consistent information.
2	Credibility	Technique triangulation	Interview data were compared with the results of observation and documentation to ensure consistency between the informants' statements and the actual conditions in the field.
3	Credibility	Member check	The preliminary findings of the study were

No.	Aspect of Data Validity	Validation Technique	Implementation in the Study
			reconfirmed with the informants to ensure that the researcher's interpretation was in accordance with the informants' intentions and experiences.
4	Transferability	Contextual description	The researcher provided a detailed description of MSME characteristics, research location, and research situation so that the findings could be understood and their relevance to other contexts could be assessed.
5	Dependability	Audit of the research process	The researcher documented the entire research process systematically, from data collection and analysis to conclusion drawing, so that the process could be traced.
6	Confirmability	Audit trail and peer discussion	The researcher kept field notes, interview transcripts, and supporting documents, and discussed the findings with others to reduce subjectivity.

Source: Authors' own work

Data validity checking in this study was carried out to ensure that the findings truly reflected the reality in the field (Morse, et al., 2002). The validity of the data was examined through credibility, transferability, dependability, and confirmability. Credibility was established through source triangulation, technique triangulation, and member checking so that the collected data had a high level of trustworthiness. Transferability was achieved by presenting a detailed description of the research context so that readers could assess the possible applicability of the findings to other contexts. Dependability was ensured by documenting the research process systematically and consistently. Meanwhile, confirmability was achieved through the provision of an audit trail and discussions with peers so that the research findings would be more objective and not merely influenced by the researcher's subjectivity (Cutcliffe & McKenna, 2004).

FINDINGS AND DISCUSSION

FINDINGS

Operational definition of the sub-finding in the field

In the field, the impact of Islamic business ethics on sustainable competitive advantage is understood as the ability of SME actors to build market trust through the implementation of values such as honesty, trustworthiness, fairness, responsibility, and good service, which in turn affect customer loyalty, business stability, and the sustainability of competitive advantage. This sub-finding is reflected in business behavior that is not merely oriented toward short-term profit, but also toward maintaining product quality, transparency of price information, consistency between promises and business practices, as well as good relationships with customers and business partners. Thus, in this study, Islamic business ethics is not positioned merely as a normative value, but as a real practice that shapes business reputation and strengthens the position of SMEs in facing continuously evolving competition.

Interview result from informant 1 and the researcher's interpretation

Informant I1, as the owner of an SME, stated that the success of the business in retaining customers could not be separated from its commitment to honesty in transactions. The informant explained, "*We never exaggerate the quality of our goods. If there is even a slight defect, we inform the buyer from the beginning so they know the actual condition. In my opinion, that is what makes customers trust us and come back again.*" This statement indicates that honesty in explaining product conditions becomes a strategy that directly builds customer trust. The researcher interprets that this practice of transparency represents the implementation of Islamic business ethics, which contributes to strengthening business reputation. In the context of SME competition, the trust that grows from honest transactions becomes important capital for creating repeat purchases and long-term relationships with consumers, thereby forming a more durable competitive advantage.

Interview result from informant 2 and the researcher's interpretation

Informant I2, as an SME employee, explained that the business owner always emphasized the importance of providing fair service to all customers regardless of their social status or purchase quantity. The informant stated, "*The owner's instruction is clear: all customers must be served well. Whether they buy a little or a lot, our attitude must be the same, because service is part of trustworthiness.*" These data show that the values of fairness and trustworthiness are implemented not only at the owner level, but are also transmitted into the internal work culture. The researcher interprets that such consistency in service strengthens positive customer experience, which ultimately increases loyalty and business image. From the perspective of sustainable competitive advantage, fair service becomes a non-material differentiator that is difficult for competitors to imitate, because it is rooted in values, commitment, and organizational habits that are continuously formed in everyday business practices.

The sub-theme flow and its interpretation

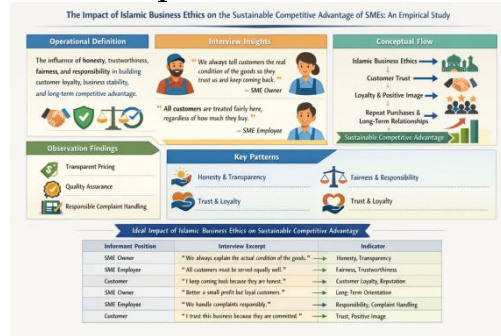


Figure 1 : Islamic business ethics and SME advantages

Source: Authors' own work

The flow of this sub-theme can be described as follows: the implementation of Islamic business ethics → the growth of customer trust → the formation of loyalty and a positive business image → increased repeat purchases and long-term business relationships → the creation of sustainable competitive advantage. This flow shows that Islamic business ethics operates through both social and economic mechanisms. The values of honesty, trustworthiness, and fairness at the initial stage create a sense of security in transactions. That sense of security then develops into trust, which in turn generates customer loyalty and strengthens business reputation within the market environment. The researcher interprets that the competitive advantage resulting from this process is sustainable because it is not based solely on price or product, but on a value-based relationship embedded between SMEs and their consumers, making it more difficult for competitors to displace.

Observation results and the researcher's interpretation

The observation results showed that several SME actors at the research site implemented business practices aligned with Islamic business ethics, such as displaying prices openly, explaining product quality to buyers, serving consumers politely, and responding to complaints with responsibility. The researcher also found efforts to maintain product quality consistently so as not to disappoint customers. In several interactions, business actors appeared to prioritize maintaining consumer trust over seeking immediate profit, for instance by replacing products considered unfit without prolonged argument. The researcher interprets that this pattern of behavior reflects the internalization of Islamic business ethics in everyday business practices. These observational findings strengthen the interview data that Islamic business ethics functions as a foundation for building trust, satisfaction, and the continuity of business relationships that support the competitiveness of SMEs.

Overall, the research data confirm that Islamic business ethics has a positive impact on the sustainable competitive advantage of SMEs. The central content of the data shows that when business actors consistently apply the principles of honesty, trustworthiness, fairness, and responsibility, customers respond by giving trust, making repeat purchases, and spreading a positive image of the business to others. The pattern emerging from the data is that

ethics does not stop at the moral dimension, but develops into a strategic force that strengthens the business position in the long term. Thus, the competitive advantage of SMEs is not formed merely by aspects such as price, location, or product variety, but also by the quality of social relationships built through ethical business practices. This pattern explains why Islamic business ethics becomes an important element in the sustainability of SME competitiveness.

Table 2. The Ideal Impact of Islamic Business Ethics on Sustainable Competitive Advantage

Informant Position	Interview Excerpt	Indicator
SME Owner	"We always explain the actual condition of the goods. If there is any deficiency, the buyer must know from the beginning so they do not feel disadvantaged."	Honesty, transparency, customer trust
SME Employee	"The owner emphasizes that all customers must be served equally well, because fair service is part of business responsibility."	Fairness in service, trustworthiness, customer satisfaction
Customer	"I often come back to buy here because the seller is honest, and if there is a problem, it is handled immediately."	Customer loyalty, business reputation
SME Owner	"I prefer to gain a little profit but keep customers coming back, rather than make a big profit once and disappoint customers."	Long-term orientation, responsibility, business sustainability
SME Employee	"If there is a complaint, we are instructed to resolve it properly so that the relationship with the customer is maintained."	Responsibility, complaint handling, long-term relationship
Customer	"A business like this makes me trust them, because they do not only sell products, but also uphold commitment."	Trust, positive image, sustainable competitive advantage

Source: Authors' own work

The table above shows that the ideal impact of Islamic business ethics on sustainable competitive advantage is reflected in three main patterns. First, the values of honesty and transparency build customer trust. Second, the values of trustworthiness, fairness, and responsibility strengthen service quality and long-term relationships with consumers. Third, the accumulation of trust, loyalty, and positive business image results in sustainable competitive advantage, because the business gains a differentiation that is not only economic, but also ethical and social. Thus, the table confirms that Islamic business ethics functions as a source of strategic value that supports the

sustainability of SMEs.

DISCUSSION

The findings of this study indicate that Islamic business ethics has a positive impact on the sustainable competitive advantage of SMEs through the formation of customer trust, loyalty, business reputation, and long-term business relationships (Al-Hakimi, et al., 2023). This finding is consistent with the literature that positions business ethics as an important foundation for building non-material added value that is difficult for competitors to imitate. In many studies, honesty, trustworthiness, fairness, and responsibility are understood not only as moral demands, but also as strategic resources that strengthen business sustainability. In this study, these dimensions were clearly reflected in the behavior of SME actors who prioritized transparency in product information, fair service, and a commitment to maintaining quality. This alignment confirms that Islamic business ethics has a broader function than merely being a religious norm, namely as a social mechanism that generates market trust and ultimately supports business competitiveness in a sustainable manner (Sulaeman et al., 2025).

On the other hand, the findings of this study also extend the existing literature, which has mostly emphasized competitive advantage from the aspects of innovation, efficiency, market orientation, and internal resources (Elgarhy & Abou-Shouk, 2023). While previous studies have tended to position ethics as a supporting variable, the results of this study show that Islamic business ethics can actually function as the core of competitive strategy, especially for SMEs operating in a social environment where religious values are embedded in everyday economic practices. This difference is important because it demonstrates that competitive advantage is not always shaped by material or technical factors, but also by the quality of social relationships built through ethical conduct. Thus, this study highlights that in the context of SMEs, Islamic business ethics is not peripheral to business strategy, but rather constitutes a central element that strengthens competitive position in a more enduring way (Santoso et al., 2026).

The interview and observation findings also reveal that the influence of Islamic business ethics operates through a consistent process: the implementation of ethical values creates a sense of security in transactions, this sense of security builds trust, trust encourages customer loyalty, and loyalty in turn strengthens business stability and market reputation (Tlaiss, 2015). This pattern is in line with theoretical views suggesting that reputation and trust are intangible assets that are highly decisive in sustaining competitive advantage. However, this study demonstrates a distinctive feature: in SMEs, such intangible assets do not develop abstractly, but are built through repeated simple practices, such as honestly explaining product conditions, treating all customers equally, and handling complaints responsibly. From a theoretical perspective, this finding enriches the discussion on the relationship between ethics, trust, and competitive advantage by showing that Islamic values can be operationalized as a concrete source of strategic advantage at the level of small

and medium enterprises (Atobishi & Podruzsik, 2025).

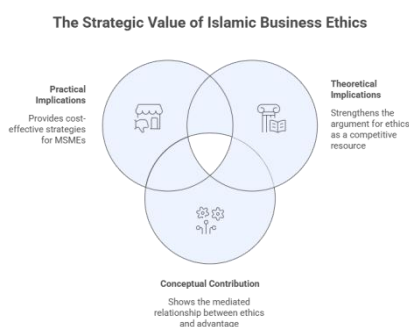


Figure 2. The Strategic Value of Islamic Business Ethics

Source: Authors' own work

The theoretical implication of this study is the strengthening of the argument that Islamic business ethics can be understood as a strategic intangible resource that contributes to sustainable competitive advantage (Khan, et al., 2019). This means that theories of competitive advantage, which have long emphasized economic resources and organizational capabilities, need to become more open to ethical and spiritual dimensions as part of the sources of business advantage. This study also provides a conceptual contribution by showing that the relationship between Islamic business ethics and competitive advantage is not merely direct, but is mediated by the development of trust, loyalty, and a positive business image. From a practical standpoint, these findings convey that SME actors do not always need to rely on costly strategies to gain an advantage in competition. Commitment to honesty, trustworthiness, fair service, and responsibility can instead become realistic and effective strategies for retaining customers and building long-lasting business differentiation (Melewar, et al., 2017).

Practically, the findings of this study are relevant for SME actors, business development institutions, and local governments. For SME actors, these findings emphasize that the implementation of Islamic business ethics should be understood as a long-term investment rather than merely an individual moral obligation (Smallbone & Welter, 2001). For business support institutions and local governments, the results of this study can serve as a basis for designing SME empowerment programs that focus not only on capital access, digitalization, and marketing, but also on the development of an ethical business culture. Training on transaction transparency, trustworthiness-based service, and responsibility toward consumers can become part of a more comprehensive SME development strategy. Therefore, this study confirms that the sustainable competitiveness of SMEs will be stronger when supported by the integration of business capacity and Islamic ethical values, so that businesses not only grow economically, but also gain strong social legitimacy (Ahmad, Wu, & Khattak, 2023).

CONCLUSION

This study concludes that Islamic business ethics plays a significant role in shaping the sustainable competitive advantage of SMEs. The findings demonstrate that the consistent implementation of ethical values such as honesty, trustworthiness, fairness, and responsibility contributes not only to the moral foundation of business practice, but also to the development of strategic advantages that are difficult for competitors to replicate. In the context of SMEs in Lumajang Regency, Islamic business ethics was found to strengthen customer trust, encourage loyalty, enhance business reputation, and support long-term business relationships. These results confirm that ethical conduct should not be viewed merely as a normative religious obligation, but also as an intangible strategic resource that supports business sustainability. Accordingly, this study extends the discussion on competitive advantage by emphasizing that ethical and value-based practices can function as a core mechanism through which SMEs maintain resilience and continuity in an increasingly competitive market environment.

The study also highlights important theoretical and practical implications. Theoretically, it contributes to the literature by positioning Islamic business ethics as a relevant construct in explaining sustainable competitive advantage, particularly in value-oriented and socially embedded business contexts. Practically, the findings suggest that SME development strategies should move beyond technical and economic considerations by integrating ethical capacity as a key dimension of business strengthening. For SME actors, this means that the internalization of Islamic business ethics can serve as a realistic and effective pathway toward long-term competitiveness. For policymakers and business development institutions, the findings provide a basis for designing empowerment programs that incorporate ethical business training alongside capital, marketing, and digital support. Future research may further examine this relationship in broader regional settings and explore the possible mediating roles of trust, customer satisfaction, and business reputation in greater analytical depth.

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