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ISLAMIC WORK ETHIC AND SME PERFORMANCE: EVIDENCE FROM INDONESIA AND MALAYSIA

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ABSTRACT: This study examines the effect of Islamic Work Ethic (IWE) on SME business performance in Indonesia and Malaysia through Innovative Work Behavior (IWB) and Islamic Social Entrepreneurship (ISE). The study advances the literature by demonstrating that Islamic ethical values influence firm performance through behavioral and entrepreneurial mechanisms rather than direct moral orientation alone. Using a quantitative explanatory design, data were collected from more than 300 SME owners in 2024 and analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM). The results show that IWE significantly enhances innovative work behavior and Islamic social entrepreneurship, both of which positively influence business performance, with innovative work behavior partially mediating the relationship. These findings indicate that embedding Islamic ethical principles in entrepreneurial practices strengthens innovation capacity and value creation, offering strategic guidance for SMEs seeking sustainable performance in Muslim-majority economies.

Keywords: Islamic Work Ethics, Innovative Work Behavior; Islamic Social Entrepreneurship; Business Performance; SMEs

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INTRODUCTION

Small and medium-sized enterprises (SMEs) operate under increasing pressure to remain competitive while maintaining ethical and socially responsible business conduct. This pressure is particularly significant in Indonesia and Malaysia, where SMEs constitute the backbone of national economies. In Indonesia, MSMEs number approximately 64.2 million, contribute around 61% of national GDP, and absorb nearly 97% of the workforce. Similarly, SMEs in Malaysia contributed RM613.1 billion to GDP in 2023. Despite this central economic role, SMEs continue to face persistent challenges related to managerial capability, innovation capacity, and ethical governance. These conditions suggest that business performance cannot be understood solely through financial or technical perspectives, but must also consider the ethical values guiding managerial decisions and organizational behavior.

Within this discussion, work ethic has long been recognized as an important determinant of organizational behavior and performance. Islamic Work Ethic (IWE) provides a distinctive framework grounded in Qur'anic principles and prophetic teachings that view work not merely as economic activity but also as a moral responsibility and a form of worship. This ethical orientation emphasizes justice, sincerity, cooperation, and disciplined effort in economic activities (Ali & Al-Owaihan, 2008; Ahmad, 2011; Yousef, 2001). Empirical studies consistently demonstrate that IWE strengthens commitment, workplace attitudes, and organizational outcomes (Abbasi et al., 2012; Abdi et al., 2014; Qasim et al., 2021; Udin et al., 2022). However, scholars increasingly argue that ethical values rarely improve performance directly. Instead, their influence often emerges through organizational behaviors that translate ethical principles into practical managerial actions.

Two mechanisms are particularly relevant in this process. First, Innovative Work Behavior (IWB) reflects the generation, promotion, and implementation of new ideas that improve organizational processes and outcomes (Jong & den Hartog, 2008; Parker et al., 2006). Ethical environments rooted in Islamic values may encourage creativity, initiative, and collaborative problem solving, thereby strengthening innovative behavior within organizations (Javed et al., 2017; Fauzan et al., 2023; Nora et al., 2024). Second, Islamic Social Entrepreneurship (ISE) integrates entrepreneurial activity with social welfare and ethical responsibility, emphasizing community benefit and sustainable economic development (Ramadani, 2018; Yasmeen, 2023; Yasmeen, 2024). Prior studies suggest that socially oriented entrepreneurship can enhance legitimacy, stakeholder trust, and long-term business sustainability (Asfiah, 2021; Paramita & Indarti, 2022; Zafar et al., 2022). Yet existing research often examines innovation behavior and social entrepreneurship separately, leaving limited understanding of how these mechanisms jointly translate Islamic ethical values into improved business performance.

Accordingly, the main theoretical gap lies in the absence of an integrative explanation of how Islamic Work Ethic contributes to business performance through behavioral and entrepreneurial pathways. Previous studies frequently investigate IWE, IWB, or Islamic entrepreneurship in isolation, or assume a direct relationship between ethical values and performance outcomes (Yousef, 2001; Javed et al., 2017; Ali et al., 2024). Empirical research simultaneously positioning Innovative Work Behavior and Islamic Social Entrepreneurship as complementary mediating mechanisms remains limited, particularly within SME contexts in Muslim-majority economies. This study addresses this gap by developing an integrative framework linking Islamic Work Ethic, Innovative Work Behavior, and Islamic Social Entrepreneurship to explain business performance in SMEs. Using SME data from Indonesia and Malaysia, the research examines how Islamic ethical values are translated into innovative behaviors and socially oriented entrepreneurial practices that ultimately enhance business performance.

THEORETICAL REVIEW

Islamic Work Ethic (IWE) represents a value-based orientation that shapes how individuals perceive work, responsibility, and organizational participation. Rooted in Qur'anic teachings and the traditions of the Prophet Muhammad, IWE frames work not merely as an economic activity but as a moral and spiritual obligation that contributes to individual development and social welfare (Ali & Al-Owaihan, 2008; Ahmad, 2011). Within this perspective, productive effort is seen as a legitimate path to both material prosperity and moral fulfillment, emphasizing principles such as justice, honesty, cooperation, and dedication to quality (Abbasi et al., 2012; Yousef, 2001). Islamic ethical teachings encourage individuals to pursue excellence and accountability in their professional roles, reflecting the Qur'anic principle that humans obtain only what they strive for (QS. An-Najm: 39). Consequently, IWE functions as an ethical infrastructure that guides workplace conduct and strengthens commitment to organizational goals. Previous studies have shown that such ethical orientation can foster discipline, trust, and responsibility within organizations, thereby influencing employee attitudes and organizational outcomes (Abdi et al., 2014; Qasim et al., 2021; Udin et al., 2022).

Within organizational contexts, ethical values often translate into performance outcomes through behavioral mechanisms, one of which is Innovative Work Behavior (IWB). IWB refers to the intentional generation, promotion, and implementation of new ideas that improve products, processes, or organizational practices (Jong & den Hartog, 2008; Parker et al., 2006). Unlike routine work activities, innovative behavior requires individuals to actively explore opportunities, propose creative solutions, mobilize support, and implement changes that enhance organizational effectiveness. Research suggests that employees who demonstrate innovative behavior contribute beyond formal job requirements and help organizations adapt to dynamic business environments (Al-Omari et al., 2019; Sjahruddin et al., 2024). Ethical work climates grounded in values such as responsibility, sincerity, and cooperation may strengthen innovative behavior by encouraging knowledge sharing, collaboration, and constructive problem solving (Javed et al., 2017; Fauzan et al., 2023). In this sense, Islamic ethical principles can provide a normative foundation that motivates individuals to pursue creative initiatives and continuous improvement within the workplace.

Another pathway through which Islamic ethical values influence organizational outcomes is Islamic Social Entrepreneurship (ISE). Social entrepreneurship generally refers to entrepreneurial initiatives that integrate economic objectives with social value creation. Within Islamic perspectives, however, entrepreneurship carries a stronger moral orientation rooted in justice, stewardship, and community welfare (Ramadani, 2018; Yasmeen, 2023). Islamic social entrepreneurship therefore emphasizes business activities that simultaneously generate profit and address societal needs while adhering to ethical and religious principles (Mulyaningsih & Ramadani, 2016). Prior research indicates that socially oriented entrepreneurial activities can enhance organizational legitimacy, strengthen stakeholder trust, and contribute to sustainable business growth (Asfiah, 2021; Paramita & Indarti, 2022). These entrepreneurial practices are characterized by initiatives aimed at improving community welfare, promoting fairness, supporting social development, and conducting business activities consistent with Islamic ethical guidelines.

The outcomes of these ethical, behavioral, and entrepreneurial mechanisms ultimately manifest in Business Performance (BP), particularly within small and medium-sized enterprises. SMEs play a critical role in economic development but frequently face structural constraints including limited capital access, managerial capability gaps, and intense market competition (Munizu, 2010). Business performance therefore reflects the extent to which firms effectively utilize resources, adapt to market opportunities, and achieve strategic objectives. Previous research suggests that SME performance is influenced by multiple internal and external factors including managerial capability, innovation capacity, market positioning, and institutional support (Vargas, 2015; Aslam et al., 2023). Indicators commonly used to assess business performance include sales growth, financial expansion, market development, and profitability improvement. Within this study, business performance is reflected through indicators such as human resource quality, access to funding, product quality, networking capability, identification of new market opportunities, and strategic planning. When ethical values shape innovative behavior and socially oriented entrepreneurship, SMEs may develop stronger capabilities that enhance both competitiveness and long-term organizational sustainability.

Islamic Work Ethic (IWE) is widely recognized as a value system that shapes individual attitudes and professional conduct within organizations. Such ethical orientation is expected to strengthen discipline, commitment, and accountability in organizational settings. Empirical research consistently demonstrates that Islamic ethical values enhance employee attitudes and work-related outcomes, including task performance, adaptive performance, and contextual performance (Abbasi et al., 2012; Abdi et al., 2014; Qasim et al., 2021; Udin et al., 2022). These findings suggest that individuals guided by Islamic ethical principles tend to exhibit stronger motivation and responsibility in performing their work roles. In SME environments, where managerial values strongly influence organizational practices, ethical orientation may therefore translate into improved organizational outcomes. Consequently, Islamic Work Ethic is expected to positively influence business performance.

Beyond its direct impact on performance, Islamic Work Ethic may also shape behavioral processes that facilitate organizational improvement. Ethical work environments grounded in Islamic values foster trust, cooperation, and responsibility among organizational members, conditions that are conducive to the emergence of innovative behaviors. Innovative Work Behavior (IWB) refers to the generation, promotion, and implementation of new ideas aimed at improving products, services, or work processes (Jong & den Hartog, 2008; Parker et al., 2006). Prior studies indicate that ethical leadership and strong ethical climates stimulate employees' willingness to explore new ideas and engage in creative problem-solving (Javed et al., 2017; Fauzan et al., 2023). In particular, Islamic work ethics have been shown to encourage knowledge sharing, intrinsic motivation, and proactive work attitudes that support innovation in organizations (Nora et al., 2024; Caniago et al., 2023). Thus, individuals who internalize Islamic ethical values are more likely to demonstrate innovative work behavior that contributes to organizational effectiveness.

H2: Islamic Work Ethic has a significant positive effect on Innovative Work Behavior.

The ethical orientation embedded in Islamic Work Ethic may also encourage entrepreneurial initiatives that prioritize social welfare alongside economic objectives. Islamic Social Entrepreneurship (ISE) represents entrepreneurial activity that integrates Islamic ethical principles with social value creation. From an Islamic perspective, business activities are not only aimed at generating profit but also at contributing to social justice, community welfare, and sustainable development (Ramadani, 2018; Yasmeen, 2023). Individuals with strong moral identity and ethical awareness are more likely to perceive entrepreneurship as a moral endeavor and to engage in socially oriented business practices (Chell et al., 2014; Paramita & Indarti, 2022). In this sense, Islamic ethical values may motivate entrepreneurs to adopt socially responsible business models that align with the broader objectives of Islamic social entrepreneurship. Therefore, Islamic Work Ethic is expected to encourage the development of socially oriented entrepreneurial initiatives within SMEs.

H3: Islamic Work Ethic has a significant positive effect on Islamic Social Entrepreneurship.

Innovative Work Behavior has also been widely recognized as an important driver of organizational performance. Employees who actively generate and implement new ideas contribute to improvements in productivity, service quality, and competitive advantage (Al-Omari et al., 2019; Sjahruddin et al., 2024). Through continuous experimentation and problem solving, innovative behavior allows organizations to adapt to dynamic market conditions and improve operational effectiveness. Empirical evidence further indicates that innovative work behavior enhances individual job performance and contributes to improved organizational outcomes, particularly in knowledge-driven and entrepreneurial environments (Aslam et al., 2023; Hock-Doepgen et al., 2025). In SME contexts, where innovation often emerges from individual initiative rather than formal research structures, innovative work behavior may play a crucial role in improving overall business performance.

H4: Innovative Work Behavior has a significant positive effect on Business Performance.

In addition to innovation, socially oriented entrepreneurial practices can also enhance business performance. Islamic Social Entrepreneurship integrates economic objectives with social responsibility, encouraging firms to pursue both financial sustainability and community welfare (Ramadani, 2018; Yasmeen, 2024). Businesses that embed social value within their operations often gain stronger legitimacy, trust, and stakeholder support, which can improve long-term competitiveness and sustainability (Asfiah, 2021; Zafar et al., 2022). In SME environments, where reputation and community relationships play an important role in market success, socially oriented entrepreneurial initiatives may strengthen market positioning and customer loyalty. Therefore, Islamic social entrepreneurship is expected to positively influence business performance.

H5: Islamic Social Entrepreneurship has a significant positive effect on Business Performance.

Finally, ethical values often influence organizational outcomes indirectly through behavioral and entrepreneurial mechanisms. Islamic Work Ethic may stimulate innovative behavior among SME actors, which subsequently improves business performance through enhanced creativity, efficiency, and adaptability (Javed et al., 2017; Fauzan et al., 2023). Likewise, Islamic ethical principles may motivate entrepreneurs to engage in socially oriented entrepreneurial activities that strengthen organizational legitimacy and sustainability, ultimately contributing to improved performance outcomes. These mechanisms suggest that innovative work behavior and Islamic social entrepreneurship function as pathways through which Islamic ethical values translate into business success. These hypothesis arguments pave the presentation of research as in Figure 1.

H6: Islamic Work Ethic affects Business Performance through Innovative Work Behavior.
H7: Islamic Work Ethic affects Business Performance through Islamic Social Entrepreneurship.

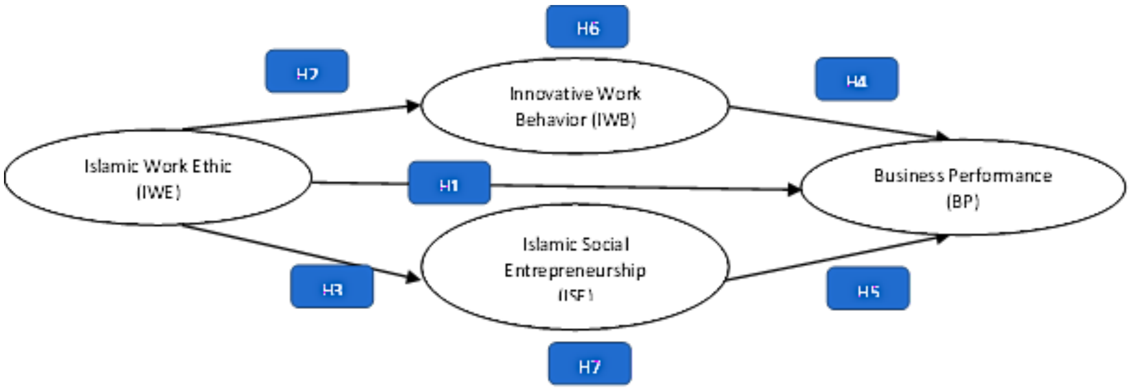

Figure 1. Conceptual Framework

RESEARCH METHOD

This study employs a quantitative explanatory research design to examine the relationships between Islamic Work Ethic, Innovative Work Behavior, Islamic Social Entrepreneurship, and Business Performance among small and medium-sized enterprises (SMEs). The quantitative approach was selected because the research aims to test theoretically derived hypotheses using statistical analysis. Data were collected through a structured questionnaire using a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The questionnaire method enables the systematic collection of standardized responses from a large number of SME actors, allowing empirical testing of the proposed conceptual model.

The target population consisted of SME owners or business leaders operating in Indonesia and Malaysia. These individuals were selected because they play a central role in shaping organizational values, innovation practices, and strategic decision-making within SMEs. Since the exact population size of SMEs participating in Islamic-oriented business networks could not be determined, this study employed a non-probability sampling approach, specifically purposive sampling. Respondents were selected based on two criteria: (1) actively managing or owning an SME and (2) operating a business within Indonesia or Malaysia. The questionnaire was distributed online through professional and community networks, including WhatsApp groups, social media platforms, and business associations such as Muhammadiyah Business Charity (AUM) and ‘Aisyiyah networks in Indonesia, as well as SME networks connected to Management Science University (MSU) Malaysia. Data collection was conducted over a two-month period. Following recommendations for structural equation modeling analysis (Hair et al., 2019), a minimum sample size of 200 respondents is generally sufficient for models with multiple constructs. A total of 254 valid responses were obtained and used for analysis.

The research instrument was developed by adapting measurement indicators from established studies to ensure content validity. Islamic Work Ethic (IWE) was measured using indicators adapted from Udin et al. (2022), including dedication to work, justice, generosity, striving for quality, personal development, meaning of work, and hard work. Innovative Work

Behavior (IWB) was measured based on the framework proposed by Jong and den Hartog (2008), which conceptualizes innovation behavior through four dimensions: opportunity exploration, idea generation, championing, and idea implementation. Islamic Social Entrepreneurship (ISE) was measured using indicators adapted from Asfiah (2021), reflecting social welfare improvement, equality, responsibility toward social issues, initiative and innovation, community support, sincerity, friendliness, and adherence to Islamic business principles. Business Performance (BP) was also measured using indicators adapted from Asfiah (2021), including human resource quality, access to funding, product quality, identification of new market opportunities, networking capability, profit growth, and strategic orientation.

Data analysis was conducted using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS software. PLS-SEM was chosen because it is suitable for exploratory and predictive research models involving multiple latent constructs and mediation relationships (Hair et al., 2019). The analysis followed a systematic two-stage procedure. First, the measurement model (outer model) was evaluated to assess the reliability and validity of the constructs. Indicator reliability was examined using outer loadings, with values above 0.70 considered acceptable, although loadings above 0.60 were retained during early measurement evaluation. Convergent validity was assessed using Average Variance Extracted (AVE), where values above 0.50 indicate satisfactory validity. Internal consistency reliability was evaluated using Cronbach's Alpha and Composite Reliability, with recommended thresholds above 0.70.

Second, the structural model (inner model) was evaluated to test the hypothesized relationships between constructs. This stage included assessment of path coefficients, coefficient of determination (R^2), and predictive relevance (Q^2). Hypothesis testing was conducted using the bootstrapping procedure with resampling to estimate t-statistics and p-values. Relationships between variables were considered significant when the t-statistic exceeded 1.96 and the p-value was below 0.05. Mediation effects of Innovative Work Behavior and Islamic Social Entrepreneurship were examined through indirect effect analysis within the PLS structural model. Through this procedure, the study systematically evaluates the proposed relationships between Islamic Work Ethic, Innovative Work Behavior, Islamic Social Entrepreneurship, and Business Performance among SMEs in Indonesia and Malaysia.

RESULTS

This research used a questionnaire as a data collection instrument. Based on 254 respondents across Indonesia and Malaysia, the characteristics were presented in Table 1.

Table 1. Respondent Characteristics

Category	Description	Frequency	Percentage
Gender	Male	102	40.1%
	Female	152	59.9%
Age	18-30 year	136	53.5%
	31-45 year	104	41.0%
	> 45 year	14	5.5%
Socio-economic Status	Upper	113	44.4%
	Middle	101	39.7%
	Lower	40	15.7%

The respondent profile reflects a predominantly female representation, suggesting that women play a significant role in managing and leading SMEs within the observed context. The sample is largely composed of younger entrepreneurs, indicating the increasing participation of early-career individuals in business activities, particularly within digitally connected environments. In terms of socio-economic positioning, respondents are generally situated within relatively stable income categories, implying that the participating SMEs possess sufficient financial capacity to engage in value-driven and innovation-oriented practices.

Following the descriptive analysis, the measurement model was evaluated to assess construct validity and reliability. Convergent validity was examined using outer loading values for each indicator, where loadings above 0.70 are considered ideal, although values above 0.60 remain acceptable in exploratory research stages. As presented in Table 2, the majority of indicators satisfy the recommended threshold, indicating adequate indicator reliability and supporting the validity of the measurement model.

Table 2. Measurement Model Evaluation: Indicator Loadings, Reliability, and Convergent Validity

Construct	Item	Loading	Alpha	Rho-A	CR	AVE
Business Performance	BP1	0.733	0.864	0.865	0.896	0.552
	BP2	0.714				
	BP3	0.795				
	BP4	0.758				
	BP5	0.771				
	BP6	0.731				
	BP7	0.693				
Islamic Social Entrepreneurship	ISE1	0.776	0.841	0.844	0.880	0.512
	ISE2	0.776				
	ISE3	0.686				
	ISE4	0.756				
	ISE5	0.730				
	ISE6	0.737				
	ISE7	0.731				
	ISE8	0.752				
	ISE9	0.700				
Innovative Work Behavior	IWB1	0.607	0.909	0.910	0.925	0.554
	IWB2	0.660				
	IWB3	0.703				
	IWB4	0.755				
	IWB5	0.762				
	IWB6	0.777				
	IWB7	0.767				
	IWB8	0.765				
	IWB9	0.855				
	IWB10	0.762				
Islamic Work Ethics	IWE2	0.691	0.896	0.896	0.915	0.546
	IWE4	0.676				
	IWE5	0.704				
	IWE6	0.727				

Note: Outer loading values above 0.60 indicate acceptable indicator reliability, although loadings above 0.70 are generally recommended. Convergent validity is considered adequate when the Average Variance Extracted (AVE) exceeds 0.50. Internal consistency reliability is supported when Cronbach's Alpha and Composite Reliability values exceed 0.70 (Hair et al., 2019). Reliability statistics are reported once for each construct.

Source: Adapted Smartpls 4 Output (2025)

The measurement model was evaluated by assessing indicator reliability, internal consistency, and convergent validity. As presented in Table X, the indicators generally demonstrate acceptable loading levels, indicating that the observed variables adequately represent their respective latent constructs. Although a few items exhibit relatively moderate loadings, they were retained due to their theoretical relevance and their contribution to the overall construct integrity. Internal consistency reliability is well established, as all constructs exhibit strong and consistent reliability across multiple indicators. Convergent validity is also confirmed, with each construct capturing sufficient variance from its indicators, thereby supporting the adequacy of the measurement model. Given that the measurement model satisfies the required reliability and validity criteria, the analysis proceeds to the structural model evaluation. This next stage examines the hypothesized relationships among Islamic Work Ethic, Innovative Work Behavior, Islamic Social Entrepreneurship, and Business Performance, as presented in Table 3.

The structural model results indicate that all hypothesized relationships are statistically significant, providing strong support for the proposed framework. Islamic Work Ethics demonstrates both direct and indirect effects on Business Performance, while also strongly influencing Innovative Work Behavior and Islamic Social Entrepreneurship. These findings confirm that ethical values act as a foundational driver that shapes both behavioral and entrepreneurial mechanisms within SMEs. In turn, Innovative Work Behavior and Islamic Social Entrepreneurship significantly enhance Business Performance, reinforcing their roles as key transmission mechanisms through which ethical principles are translated into organizational outcomes.

Table 3. Hypothesis Testing

Relationship	Path	*t*-value	*p*-value
H1 Islamic Work Ethics → Business Performance	0.209	4.071	0.000
H2 Islamic Work Ethics → Innovative Work Behavior	0.681	17.594	0.000
H3 Innovative Work Behavior → Business Performance	0.244	3.196	0.001
H4 Islamic Work Ethics → Islamic Social Entrepreneurship	0.707	18.992	0.000
H5 Islamic Social Entrepreneurship → Business Performance	0.483	7.289	0.000
H6 Islamic Work Ethics → Innovative Work Behavior → Business Performance	0.166	3.070	0.000
H7 Islamic Work Ethics → Islamic Social Entrepreneurship → Business Performance	0.341	6.992	0.000
R2 Business Performance		0.746	
R2 Innovative Work Behavior		0.464	
R2 Islamic Social Entrepreneurship		0.500	

Source: Adapted Smartpls 4 Output (2025

Beyond path significance, the predictive relevance of the model was assessed using the Stone–Geisser Q² value obtained through the blindfolding procedure. The Q² value was calculated using the formula $Q^2 = 1 - (1 - R^2_{BP})(1 - R^2_{IWB})(1 - R^2_{ISE})$, incorporating the R² values of all endogenous constructs. The resulting Q² value exceeds zero, indicating that the model has adequate predictive relevance and demonstrates its capability to predict observed data effectively.

$$Q^2 = 1 - (1 - 0{,}746)\ (1 - 0.464)\ (1 - 0.500) \ \ldots\ldots..(1)$$

$$Q^2 = 0{,}931$$

This result strengthens the robustness of the model, confirming that the integration of Islamic Work Ethics, Innovative Work Behavior, and Islamic Social Entrepreneurship provides not only explanatory power but also meaningful predictive capability in explaining SME performance. This study also presents the finding as displayed in Figure 2.

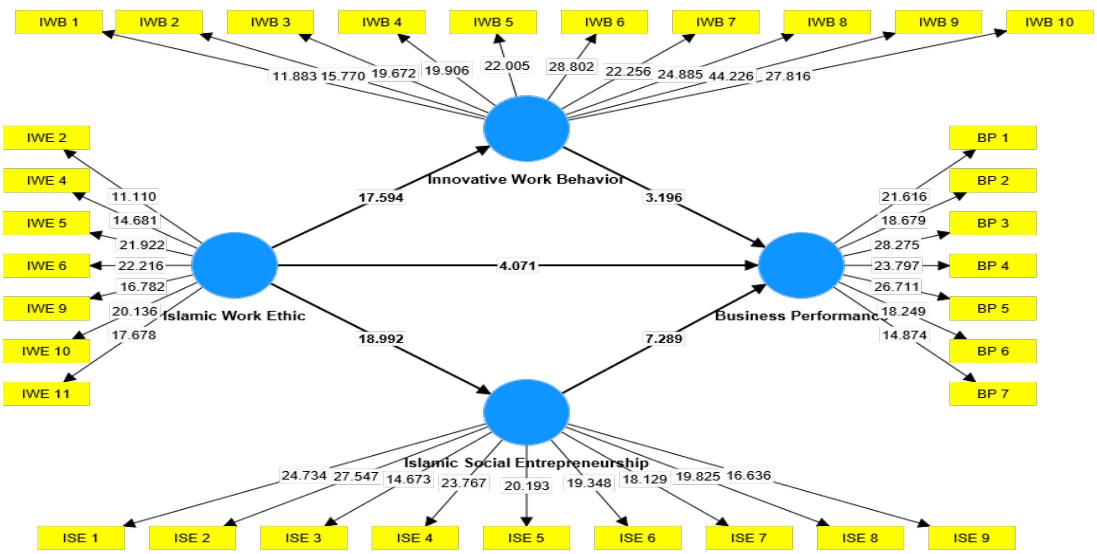

Figure 2. Bootstrap Finding
Source: SmartPLS 4 Output (2025)

DISCUSSION

The findings confirm that Islamic Work Ethics (IWE) is a significant determinant of business performance, but more importantly, they clarify how ethical values operate within SME contexts. Rather than functioning as abstract moral ideals, IWE acts as a behavioral governance mechanism that shapes discipline, accountability, and long-term orientation among business actors. Rooted in Qur'anic and prophetic principles, IWE frames work not merely as economic activity but as a form of worship, embedding responsibility, sincerity, and social accountability into daily business practices (Ali & Al-Owaihan, 2008; Ahmad, 2011). This orientation aligns with prior evidence that ethical value systems enhance organizational commitment, trust, and performance outcomes (Abbasi et al., 2012; Qasim et al., 2021; Udin et al., 2022). However, the present findings extend this literature by demonstrating that the performance effect of IWE is not solely attitudinal but structurally embedded within SME decision-making, where ethical values guide both operational behavior and strategic direction. This helps explain why SMEs grounded in Islamic ethics exhibit stronger sustainability orientation, as previously noted by Asha'ari and Daud (2018), while also maintaining economic performance.

More critically, the results reveal that IWE functions as an antecedent of innovative work behavior (IWB), supporting the argument that ethical climates are not constraints on innovation but enablers of it. This finding challenges the implicit assumption in some management literature that strong moral frameworks may limit risk-taking or creativity. Instead, Islamic ethical principles such as trust (amanah), consultation (shura), and cooperation (ta'āwun) create psychological safety and collective responsibility, which are essential conditions for idea generation and implementation (Javed et al., 2017; Caniago et al., 2023; Nora et al., 2024). In line with proactive behavior theory (Parker et al., 2006) and innovation behavior frameworks (Jong & den Hartog, 2008), individuals are more likely to engage in innovation when they perceive their environment as fair, supportive, and meaningful. The present study strengthens this theoretical linkage by showing that IWE enhances not only ethical conduct but also adaptive and creative capacities, thereby positioning ethics as a catalyst rather than a barrier to innovation.

The significant relationship between innovative work behavior and business performance further reinforces the central role of behavioral mechanisms in organizational success. Innovation enables SMEs to respond to dynamic market conditions, improve operational efficiency, and develop competitive advantage through continuous improvement (Aslam et al., 2023; Hock-Doepgen et al., 2025). Consistent with prior studies, individuals who actively generate and implement new ideas contribute directly to improved organizational outcomes (Al-Omari et al., 2019; Chaiyapruksayanonde & Ponchaitiwat, 2025; Yen et al., 2025). However, the present findings extend this understanding by situating innovation within an ethical framework, suggesting that innovative behavior is more sustainable and impactful when guided by value-based principles. In this sense, innovation driven by IWE is not purely efficiency-seeking but also socially responsible and aligned with long-term organizational goals.

In parallel, the study demonstrates that Islamic Work Ethics significantly promotes Islamic Social Entrepreneurship (ISE), highlighting the moral foundation of entrepreneurial behavior in Muslim-majority contexts. Islamic entrepreneurship is inherently dual-oriented, combining economic objectives with social welfare and community development (Ramadani, 2018; Yasmeen, 2023; Yasmeen, 2024). The findings support the view that individuals with strong ethical orientation are more likely to engage in socially responsible entrepreneurial activities, consistent with moral identity theory and social entrepreneurship literature (Chell et al., 2014; Paramita & Indarti, 2022). This extends prior work by showing that IWE does not only influence internal organizational behavior but also shapes external value creation through socially oriented business models. In practical terms, SMEs guided by Islamic ethics tend to prioritize community empowerment, fairness, and sustainability, which strengthens their legitimacy and long-term viability.

The positive effect of Islamic Social Entrepreneurship on business performance further confirms that social value creation and economic performance are not mutually exclusive but mutually reinforcing. Businesses that integrate social responsibility into their operations tend to build stronger stakeholder trust, enhance brand reputation, and achieve more sustainable growth (Zafar et al., 2022; Asfiah, 2021). This finding directly addresses the ongoing debate regarding whether socially oriented enterprises sacrifice profitability for social goals. Instead, the results demonstrate that Islamic-based social entrepreneurship provides a strategic advantage by aligning business success with societal benefit. In SME contexts, where community relationships and trust are critical, this alignment becomes a key driver of competitive positioning.

We also found that the mediation results provide the most important theoretical contribution of this study. The influence of Islamic Work Ethics on business performance is not merely direct but operates through two complementary mechanisms: innovative work behavior and Islamic social entrepreneurship. This finding addresses a critical gap in the literature, where prior studies have largely examined IWE, innovation, and social entrepreneurship in isolation (Ali et al., 2024; Yousef, 2001). The present study demonstrates that ethical values must be translated into concrete behavioral and entrepreneurial actions to produce meaningful organizational outcomes. In other words, ethics alone is insufficient unless it is operationalized through innovation and socially responsible practices. This integrative mechanism offers a more comprehensive explanation of how value-based systems drive performance, particularly within SMEs in Indonesia and Malaysia. It also responds directly to calls for more holistic models that connect ethical orientation with behavioral and strategic outcomes in Islamic management research.

CONCLUSION AND FURTHER STUDY

This study confirms that Islamic Work Ethics enhances business performance both directly and through Innovative Work Behavior and Islamic Social Entrepreneurship. Ethical values function not as symbolic norms but as operational drivers that shape innovation and socially oriented business practices. The findings highlight that SMEs achieve stronger performance when ethical principles are translated into concrete behaviors and entrepreneurial actions. Practically, this implies that embedding Islamic values into daily management can strengthen innovation, trust, and long-term competitiveness. This study is limited by its cross-sectional design, non-probability sampling, and reliance on self-reported data. Future research should adopt longitudinal approaches, incorporate objective performance measures, and explore moderating variables such as leadership or digital capability. Expanding the model across different institutional contexts may further enrich understanding of how ethical systems drive innovation and performance.

ETHICAL DISCLOSURE

All participants provided written informed consent prior to their participation in the study. They were informed about the purpose of the research, the voluntary nature of their participation, their right to withdraw from the study at any time, and the confidentiality of their responses. The data collected were used solely for academic purposes, and all information obtained from participants was kept confidential and analyzed anonymously.

CONFLICT OF INTERESTS

The authors declare that there is no conflict of interest regarding the publication of this paper.

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