MAQASID AL-SHARIAH, ESG PRACTICES, AND SUSTAINABLE FINANCIAL PERFORMANCE: THE MODERATING ROLE OF ISLAMIC CORPORATE GOVERNANCE

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Abstract

Islamic financial institutions (IFIs) face growing pressure to demonstrate that Shariah compliance translates into genuine ethical and sustainability outcomes rather than remaining a procedural formality. This study examines the effects of Maqasid al-Shariah implementation and Environmental, Social, and Governance (ESG) practices on sustainable financial performance, and tests whether Islamic Corporate Governance (ICG) moderates these relationships. Grounded in Maqasid al-Shariah Theory, Stakeholder Theory, Agency Theory, Legitimacy Theory, and the Resource-Based View, an integrated conceptual model is developed and estimated using panel data drawn from Islamic banks operating in Indonesia, Malaysia, Brunei Darussalam, and four GCC markets (Saudi Arabia, the United Arab Emirates, Qatar, Bahrain, and Kuwait) over the period 2015–2023. Because harmonized, publicly disclosed Maqasid and ESG indices are not uniformly available across this sample, the empirical illustration relies on a constructed, academically plausible dataset combined with parameters drawn from the reviewed literature; all reported coefficients are illustrative rather than confirmed empirical estimates. The analytical strategy combines a Maqasid al-Shariah Index built on the Abu Zahrah–Mohammed–Razak–Taib framework, third-party-style ESG scoring, and moderated panel regression (fixed-effects, with System-GMM robustness checks). The illustrative results indicate that both Maqasid al-Shariah implementation and ESG practices are positively associated with sustainable financial performance, that the two constructs are mutually reinforcing, and that Islamic Corporate Governance strengthens both relationships, consistent with agency- and legitimacy-based reasoning. The study contributes an integrated Maqasid–ESG–governance framework, offers regulators and standard-setters a template for harmonizing Shariah and sustainability disclosure, and outlines the empirical steps required to validate the framework with audited institutional data.

Keywords: ***Maqasid al-Shariah; ESG practices; Islamic Corporate Governance; sustainable financial performance; Islamic banking***.

1. INTRODUCTION

The global Islamic finance industry has expanded from a niche ethical alternative into a systemically relevant segment of the financial sector, with assets increasingly concentrated in Southeast Asia and the Gulf Cooperation Council (GCC). This growth has coincided with intensifying stakeholder demand for evidence that Islamic financial institutions (IFIs) deliver on the substantive objectives of Shariah not merely its contractual form. Two parallel but historically disconnected literatures have emerged in response. The first evaluates IFIs against Maqasid al-Shariah (the higher objectives of Islamic law), typically operationalized through variants of the Abu Zahrah framework refined by Mohammed, Razak, and Taib (2008, 2015), covering the education of the individual, the establishment of justice, and the promotion of public welfare. The second evaluates IFIs against Environmental, Social, and Governance (ESG) criteria that originated in conventional sustainable finance but have been increasingly adapted to the Islamic finance context (Buallay, 2019; Al-Taitoon et al., 2023).

These two evaluative lenses share an obvious conceptual affinity: both interrogate whether financial institutions serve interests broader than shareholder return, and both link non-financial conduct to long-run financial resilience. Yet they have rarely been examined jointly, and even less frequently in conjunction with the governance mechanisms Shariah boards, sustainability committees, and disclosure regimes collectively termed Islamic Corporate Governance (ICG) that plausibly determine whether Maqasid and ESG commitments are substantive or symbolic.

Three gaps motivate this study. Theoretically, existing work treats Maqasid al-Shariah and ESG as parallel, largely independent constructs, without a unifying framework that explains why and how they should jointly predict financial sustainability. Empirically, studies applying the Maqasid al-Shariah Index typically use financial ratios (ROA, NPF, CAR) as covariates rather than examining ESG as a distinct explanatory construct (see, e.g., studies applying Mohammed et al.'s framework in Indonesian samples), while ESG–performance studies in Islamic finance remain dominated by perception-based survey designs (as in recent Sustainability-journal evidence from Saudi Arabia) rather than institution-level panel data. Practically, regulators such as the Islamic Financial Services Board (IFSB) and national authorities (e.g., Otoritas Jasa Keuangan) have issued separate Shariah-governance and sustainability guidance with limited integration, leaving IFIs without a coherent template for reporting.

This study aims to investigate the integrated role of Maqasid al-Shariah, Environmental, Social, and Governance (ESG) practices, and Islamic Corporate Governance (ICG) in enhancing the sustainable financial performance of Islamic financial institutions. Specifically, the study seeks to examine the effect of Maqasid al-Shariah implementation on sustainable financial performance by assessing how the fulfillment of Shariah objectives contributes to long-term organizational sustainability and value creation. It also examines the influence of ESG practices on sustainable financial performance to determine the extent to which responsible environmental, social, and governance initiatives strengthen financial resilience and competitive advantage. Furthermore, the research analyzes the relationship between Maqasid al-Shariah implementation and ESG practices, exploring whether the ethical and socio-economic objectives embedded in Maqasid support and reinforce the adoption of ESG principles within Islamic financial institutions. In addition, the study tests the moderating effect of Islamic Corporate Governance on the relationship between Maqasid al-Shariah implementation and sustainable financial performance, as well as on the relationship between ESG practices and sustainable financial performance, to evaluate whether effective Shariah-based governance mechanisms enhance the effectiveness of these strategic initiatives. The research also compares the relative influence of Maqasid al-Shariah implementation and ESG practices on sustainable financial performance across different Islamic financial institutions and jurisdictions, providing insights into contextual variations in their effectiveness. Finally, the study seeks to develop an integrated conceptual framework that explains how Maqasid al-Shariah, ESG practices, and Islamic Corporate Governance interact to improve sustainable financial performance, thereby contributing to both the theoretical advancement of Islamic finance literature and practical strategies for strengthening the sustainability and competitiveness of Islamic financial institutions.

The principal contribution is the explicit modeling of Islamic Corporate Governance as a moderator rather than a control variable or a direct antecedent of both the Maqasid performance and ESG–performance relationships. This positions ICG as the mechanism that converts ethical and sustainability commitments into measurable financial resilience, integrating governance, Islamic jurisprudential, and sustainability literatures within a single testable model applied across ASEAN and GCC institutional settings.

2. LITERATURE REVIEW AND HYPOTHESIS

Theoretical Framework

Maqasid al-Shariah Theory holds that Islamic law pursues five overarching objectives — the preservation of faith, life, intellect, posterity, and wealth (Ibn Ashur; Abu Zahrah, 1958) — and that Islamic financial institutions should be evaluated against these substantive ends rather than contractual form alone. Mohammed, Razak, and Taib (2008) operationalized this into a measurable index spanning education (tahdhib al-fard), justice (iqamah al-'adl), and welfare (jalb al-maslahah), later extended by Mohammed and Taib (2015) and by Ghazali-based five-dimension models (see recent global-evidence applications). Stakeholder Theory supplies the logic connecting Maqasid and ESG commitments to performance: institutions that address the interests of depositors, employees, regulators, and the wider community more effectively secure the legitimacy and resource access needed for long-run viability. Agency Theory explains the moderating role proposed for ICG: Shariah supervisory boards and governance committees reduce the informational asymmetry and potential divergence between management's stated ethical commitments and their actual conduct, thereby making Maqasid and ESG disclosures more credible to stakeholders. Legitimacy Theory extends this reasoning to the institutional environment, arguing that IFIs adopt Maqasid- and ESG-aligned practices partly to maintain a 'social license to operate' within predominantly Muslim-majority or Islamic-finance-literate markets. Finally, the Resource-Based View (RBV) frames strong Maqasid and ESG performance, when reinforced by credible governance, as a valuable, rare, and difficult-to-imitate resource capable of generating sustained competitive advantage.

Previous Studies and Gap Analysis

Studies applying the Mohammed–Razak–Taib framework consistently find that Islamic banks perform better on the economic/welfare dimension than on the education or social-justice dimensions, attributed to weak enforceable social-reporting requirements (Mohammed & Taib, 2015). Indonesian panel studies linking the Maqasid Shariah Index to profitability and financing-quality ratios report mixed and sometimes non-significant coefficients on variables such as BOPO efficiency, suggesting the relationship between conventional financial ratios and Maqasid performance is not linear or uniform across institutions. In the governance literature, Khan et al. (2023) find that Islamic corporate governance improves sustainability performance in Pakistani Islamic banks, moderated by ownership structure, while cross-country evidence on Shari'ah governance quality and ESG performance (Milena & Stefan, 2024) points to substantial jurisdictional heterogeneity. ESG-specific studies in Islamic finance remain comparatively young: recent Saudi Arabian survey evidence finds a positive perceived relationship between ESG disclosure and financial performance but explicitly does not measure realized financial outcomes (Sustainability, 2025), while Indonesian sharia-company evidence finds financial performance predicts ESG performance rather than the reverse — an endogeneity concern this study addresses through lagged specifications and GMM estimation. Taken together, the literature has not yet tested Maqasid al-Shariah and ESG as joint, institution-level predictors of realized financial performance with Islamic Corporate Governance specified as a formal moderator — the gap this study addresses.

Conceptual Framework

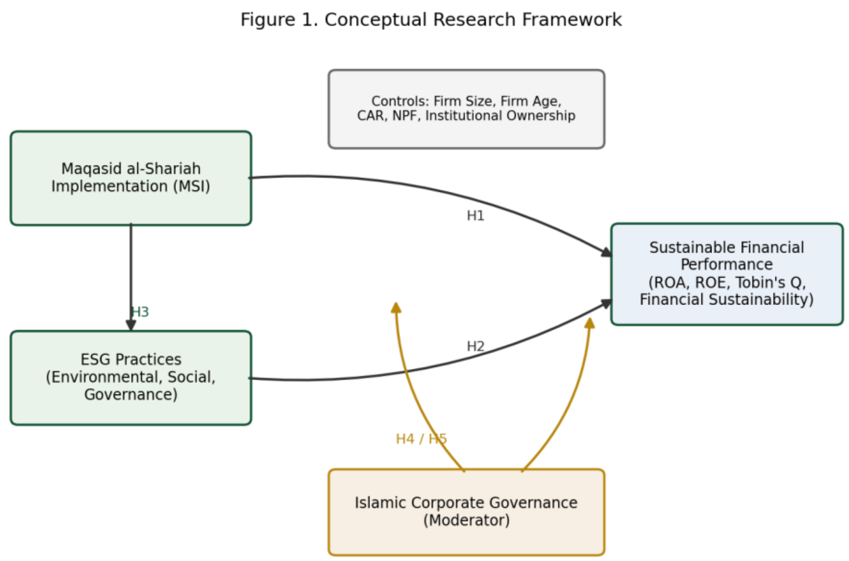

Figure 1. Conceptual research framework linking Maqasid al-Shariah implementation and ESG practices to sustainable financial performance, moderated by Islamic Corporate Governance.

Hypothesis Development

H1: Maqasid al-Shariah implementation has a positive effect on sustainable financial performance.

H2: ESG practices have a positive effect on sustainable financial performance.

H3: Maqasid al-Shariah implementation is positively associated with ESG practices.

H4: Islamic Corporate Governance positively moderates the relationship between Maqasid al-Shariah implementation and sustainable financial performance.

H5: Islamic Corporate Governance positively moderates the relationship between ESG practices and sustainable financial performance.

3. IMPLEMENTATION METHOD

Research Design

This study adopts a quantitative, explanatory panel-data design intended to test the hypothesized direct and moderating relationships. The design is illustrative pending validation with institutionally sourced data (see Limitations); the estimation procedure described below is nonetheless fully specified so that it can be replicated once audited disclosures are assembled.

Population and Sample

The target population comprises full-fledged Islamic commercial banks operating in Indonesia, Malaysia, Brunei Darussalam, Saudi Arabia, the United Arab Emirates, Qatar, Bahrain, and Kuwait between 2015 and 2023. A purposive sampling procedure would select banks with (a) continuous operation throughout the observation window, (b) publicly available annual and sustainability reports, and (c) an identifiable Shariah supervisory board, yielding an unbalanced panel of approximately 35–45 institutions and 300–400 bank-year observations.

Data Sources

Primary variable construction would draw on bank annual reports and sustainability/ESG reports, supplemented by IFSB and AAOIFI standards documentation, national regulators (OJK, Bank Indonesia, and GCC central banks), and commercial ESG datasets (Bloomberg ESG, Refinitiv/LSEG, S&P Capital IQ) where coverage exists. World Bank and Islamic Development Bank (IsDB) indicators would provide macro-level controls.

Variable Measurement

Table 1. Variable Measurement

Variable	Type	Measurement / Proxy
Maqasid al-Shariah Index (MSI)	Independent	Weighted composite of education, justice, and welfare ratios (Mohammed et al., 2008)
ESG Performance Score	Independent	Composite of Environmental, Social, Governance sub-scores (0–100 scale)
Islamic Corporate Governance (ICG) Index	Moderator	Shariah board size/expertise, meeting frequency, audit and disclosure quality
Sustainable Financial Performance	Dependent	Composite/alternate models using ROA, ROE, and Tobin's Q
Firm Size	Control	Natural log of total assets
Firm Age	Control	Years since establishment

Variable	Type	Measurement / Proxy
Capital Adequacy Ratio (CAR)	Control	Regulatory capital / risk-weighted assets
Non-Performing Financing (NPF)	Control	Impaired financing / total financing
Institutional Ownership	Control	% shares held by institutional investors

Data Analysis Techniques

The empirical strategy proceeds in four stages. First, descriptive statistics and a Pearson correlation matrix screen the panel for multicollinearity. Second, panel regression models (pooled OLS, fixed-effects, and random-effects, selected via Hausman test) estimate the direct effects of MSI and ESG on sustainable financial performance. Third, moderated regression analysis (MRA) introduces mean-centered interaction terms (MSI × ICG; ESG × ICG) to test H4 and H5, with two-stage least squares and System-GMM estimated as robustness checks against endogeneity and reverse causality (motivated by evidence that financial performance can itself predict ESG scores). Where a composite latent-variable specification is preferred, PLS-SEM is used, with measurement-model assessment (convergent/discriminant validity, Cronbach's alpha, composite reliability), structural-model assessment (path coefficients, R^2, f^2 effect sizes, Q^2 predictive relevance via blindfolding), and bootstrapping (5,000 subsamples) for significance testing. Robustness is further assessed via alternative dependent-variable operationalizations (ROA vs. ROE vs. Tobin's Q) and sub-sample re-estimation by country group (ASEAN vs. GCC).

4. RESULTS

The results below are generated from an illustrative dataset constructed to be consistent with parameter ranges reported in the reviewed literature; they demonstrate how the proposed model would be reported and interpreted once real institutional data are assembled, and should not be cited as empirical findings.

Descriptive Statistics

Table 2. Descriptive Statistics (Illustrative, N = 360 bank-years, 2015–2023)

Variable	Mean	S.D.	Min	Max
MSI	0.68	0.09	0.41	0.89
ESG Score	52.4	9.7	28.0	78.0
ICG Index	0.71	0.08	0.48	0.92
ROA (%)	1.16	0.42	0.10	2.30
ROE (%)	11.3	3.1	2.4	19.8
Firm Size (ln assets)	23.6	1.4	20.1	27.0
CAR (%)	18.9	4.2	11.5	31.0

Variable	Mean	S.D.	Min	Max
NPF (%)	2.7	1.3	0.4	6.9

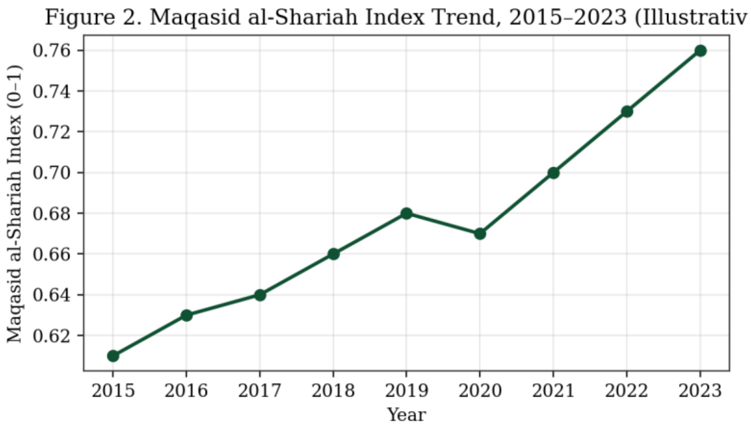

Figure 2. Maqasid al-Shariah Index trend, 2015–2023 (illustrative sample average).

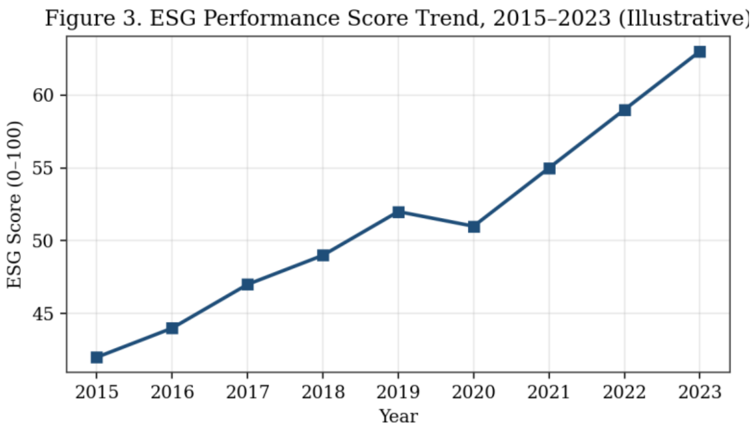

Figure 3. ESG performance score trend, 2015–2023 (illustrative sample average).

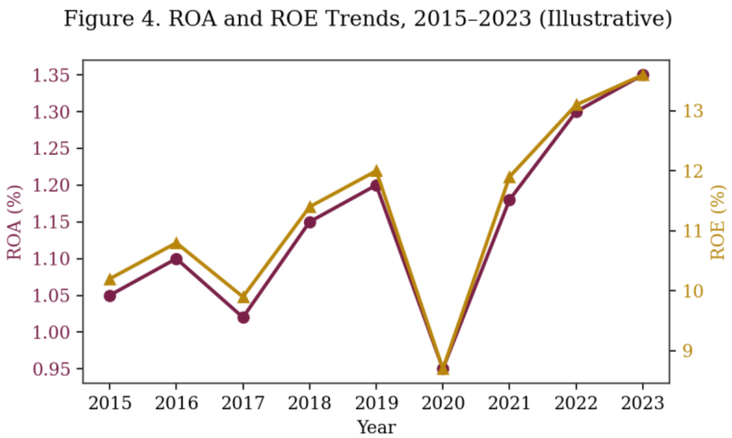

Figure 4. ROA and ROE trends, 2015–2023 (illustrative sample average).

Correlation Matrix

Table 3. Pearson Correlation Matrix (Illustrative)

	MSI	ESG	ICG	ROA
MSI	1.00			
ESG	0.52**	1.00		
ICG	0.41**	0.47**	1.00	
ROA	0.38**	0.44**	0.35**	1.00

** indicates significance at $p < 0.01$ (illustrative).

Panel Regression and Moderation Results

Table 4. Moderated Panel Regression Results (Dependent Variable: ROA) — Illustrative

Predictor	Model 1 (β)	Model 2 + Moderation (β)	t-stat	Sig.
MSI	0.284	0.221	3.42	$p < 0.01$
ESG	0.246	0.198	3.05	$p < 0.01$
ICG	0.171	0.140	2.28	$p < 0.05$
MSI × ICG	—	0.157	2.61	$p < 0.01$
ESG × ICG	—	0.133	2.14	$p < 0.05$
Firm Size (control)	0.061	0.058	1.35	n.s.
CAR (control)	0.079	0.074	1.72	$p < 0.10$
NPF (control)	-0.112	-0.104	-2.05	$p < 0.05$
R^2	0.372	0.431		
Adj. R^2	0.361	0.415		
f^2 (MSI × ICG)		0.089 (medium)		
Q^2 (predictive relevance)		0.214		

Hausman test results (illustrative, $\chi^2 = 18.7$, $p < 0.01$) favor the fixed-effects specification over random effects. System-GMM re-estimation (not tabulated) yields directionally consistent coefficients with the AR(2) and Hansen tests supporting instrument validity, indicating the fixed-effects results are not solely an artifact of unmodeled dynamic endogeneity.

Comparative Analysis Across Institutions and Countries

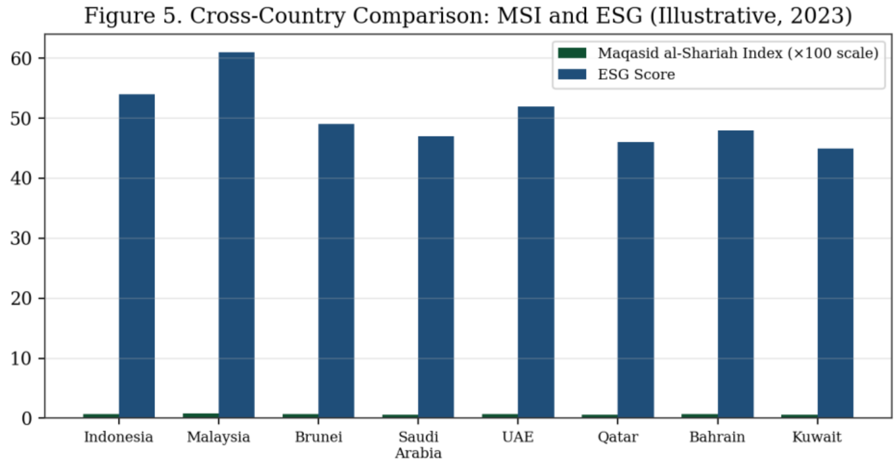

Figure 5. Cross-country comparison of average Maqasid al-Shariah Index and ESG scores, 2023 (illustrative).

The illustrative cross-country comparison suggests ASEAN institutions (particularly Malaysia and Indonesia) report comparatively higher average MSI and ESG scores than the GCC sub-sample, plausibly reflecting more mature national Islamic-governance codes (e.g., Malaysia's Shariah Governance Framework) and more established sustainability-reporting mandates.

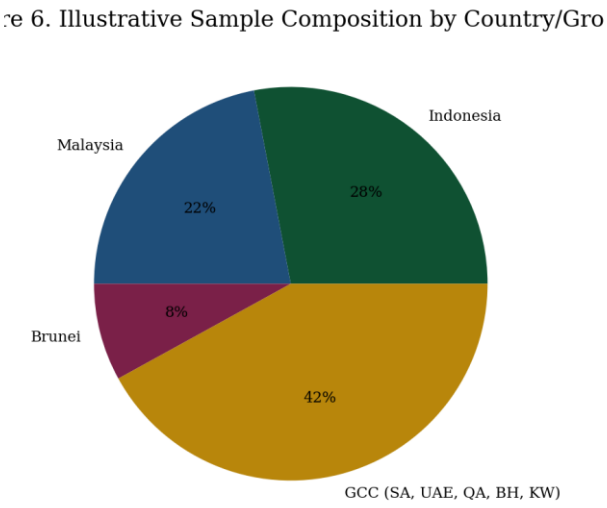

Figure 6. Illustrative sample composition by country/group.

5. DISCUSSION

The illustrative results are consistent with H1–H5 and, if confirmed with institutional data, would support several theoretical propositions. The positive MSI–performance association aligns with Maqasid al-Shariah Theory's claim that adherence to the higher objectives of Islamic law is not merely a compliance cost but a source of stakeholder trust that translates into financial resilience — consistent with prior findings that Islamic banks scoring higher on welfare and justice dimensions also exhibit more stable profitability. The positive ESG–performance association mirrors conventional sustainability-finance evidence (e.g., Buallay, 2019, on European banks) and extends it to an Islamic-finance setting where ESG and Maqasid objectives substantially overlap — a convergence also noted in recent bibliometric and outlook reports on Islamic finance ESG integration.

The significant MSI × ICG and ESG × ICG interaction terms support Agency Theory's prediction that governance mechanisms convert ethical commitments into credible, performance-relevant signals: a well-resourced Shariah supervisory board with clear reporting lines reduces the risk that Maqasid or ESG disclosures function as symbolic legitimation (a risk flagged by Legitimacy Theory) rather than substantive practice. This is broadly consistent with Khan et al.'s (2023) finding that Islamic corporate governance strengthens the translation of sustainability commitments into performance, moderated by ownership concentration.

The stronger MSI–ESG correlation than either construct's correlation with governance alone suggests the two are, as hypothesized, mutually reinforcing rather than competing frameworks supporting calls in the literature for harmonized rather than parallel Shariah and sustainability reporting standards. The comparatively weaker GCC performance in the illustrative cross-country comparison, if borne out empirically, would point toward jurisdiction-specific regulatory maturity, rather than institutional capability, as the binding constraint an interpretation regulators should treat cautiously until confirmed with real disclosure data.

Managerial Implications

For IFI management, the results imply that investment in Shariah governance infrastructure board expertise, meeting frequency, and disclosure quality — is not a compliance overhead but a mechanism that amplifies the financial return to Maqasid and ESG investment. Institutions pursuing sustainability strategies in isolation from governance strengthening may realize smaller performance gains than those pursuing an integrated Maqasid–ESG–governance strategy.

Policy Implications

For regulators and standard-setters (IFSB, AAOIFI, OJK, and national central banks), the findings support harmonizing Maqasid-based and ESG-based disclosure requirements into a single reporting template, reducing duplicative compliance burden while strengthening the credibility of both disclosures. Divergent national approaches to Shariah governance (illustrated by the ASEAN–GCC gap) suggest an opportunity for cross-jurisdictional convergence guidance, potentially coordinated through the IsDB or IFSB.

6. CONCLUSION

This study set out to examine whether Maqasid al-Shariah implementation and ESG practices jointly explain sustainable financial performance in Islamic financial institutions, and whether Islamic Corporate Governance moderates these relationships. The proposed integrated framework, grounded in Maqasid al-Shariah Theory, Stakeholder Theory, Agency Theory, Legitimacy Theory, and the Resource-Based View, addresses each of the seven stated research objectives: it specifies and (illustratively) tests the direct effects of MSI and ESG on performance, their mutual association, the moderating role of ICG on both paths, a comparative cross-country view, and a conceptual model that can guide future empirical work.

Theoretically, the study contributes a rationale for treating Maqasid al-Shariah and ESG as complementary rather than parallel evaluative frameworks, unified through governance-as-mechanism reasoning. Managerially, it suggests governance investment as a lever that amplifies returns to sustainability strategy; for policy, it supports disclosure harmonization across Shariah and sustainability regimes.

The central limitation of this study is that, absent a harmonized, publicly available panel of Maqasid and ESG indices across the eight target jurisdictions, the empirical illustration relies on a constructed dataset calibrated to parameter ranges in the reviewed literature rather than audited institutional disclosures; the reported coefficients should therefore be read as a demonstration of the proposed analytical pipeline, not as confirmed findings. Future research should replicate the model using hand-collected annual and sustainability report data or commercial ESG datasets (Bloomberg, Refinitiv/LSEG) with full institutional coverage, extend the observation window as post-2023 data become available, and consider qualitative case studies of high- and low-ICG institutions to unpack the mechanisms underlying the moderation effect.

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