

*Research Article*

## Aligning Shariah And Environmental, Social, And Governance Criteria In Islamic Finance Perspective

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### Abstract

This study addresses a conceptual and practical gap in the literature regarding the systematic alignment between Shariah principles and Environmental, Social, and Governance (ESG) criteria within Islamic finance. Although both frameworks emphasize ethical conduct, social responsibility, and sustainable value creation, existing studies typically examine Shariah compliance and ESG performance in isolation, resulting in fragmented insights and a lack of an integrated analytical framework. This research aims to explain how Shariah principles can be aligned with ESG dimensions particularly governance and social responsibility and to identify challenges that hinder their effective integration into Islamic financial products. Using a qualitative research design, the study employs document and thematic analysis of prior empirical studies, regulatory standards, and institutional reports related to Islamic finance and ESG practices. The findings show that Shariah governance plays a key role in enhancing ESG performance; however, inconsistencies in interpretation, measurement, and regulatory harmonization remain significant obstacles. This study contributes an integrative perspective that positions Shariah as a normative framework capable of strengthening ESG objectives and advancing sustainable Islamic finance.

Keywords: Shariah, ESG, Islamic finance, sustainability, financial products

JEL Classification: G20, G30, Z12

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## 1. Introduction

The development of Islamic finance over the past two decades has shown significant growth, along with growing global awareness of ethical, fair, and sustainable financial practices. Islamic finance is based on Sharia principles such as justice ('adl), balance (mizān), the prohibition of riba (riba), gharar (gharar), and maysir (gambling), as well as an emphasis on asset-based economic activity and risk sharing. These principles align normatively with the Sustainable Development Goals and ethical values, which are now widely articulated through the Environmental, Social, and Governance (ESG) framework (Osman & Elamin, 2023; Billah et al., 2023). Therefore, Islamic finance is often positioned as a financial system inherently compatible with the global sustainability agenda.

As investor and regulatory attention to sustainability issues increases, the ESG framework has become the dominant standard for assessing the non-financial performance of financial institutions and products. ESG serves as an evaluation tool to ensure that business activities not only generate financial returns but also address environmental impacts, social responsibility, and good governance. In this context, Islamic financial institutions face a strategic opportunity to strengthen their legitimacy and competitiveness by integrating ESG principles into Sharia-compliant financial practices and products (Alam et al., 2022).

However, despite substantial normative overlap between Sharia and ESG, the academic literature indicates that their alignment remains fragmented, both conceptually and operationally. Most previous studies tend to discuss ESG in the context of Islamic banking's financial performance or efficiency (Alam et al., 2022; Peng & Isa, 2020), while others focus on Sharia compliance aspects without systematically linking them to ESG dimensions (Noordin et al., 2018). Consequently, there is no unified understanding of how Sharia principles can be mapped conceptually and practically to the ESG indicators widely used in the global financial system.

Differences in methodological approaches and theoretical perspectives in existing literature further exacerbate this fragmentation. Some studies view ESG as an external concept that needs to be "added" to Islamic finance, rather than as a framework that can be enriched by Sharia values (Haji Wahab & Naim, 2020). This approach risks placing ESG and Sharia in a parallel rather than an integrative relationship, potentially leading to inconsistencies in sustainability implementation and reporting by Islamic financial institutions.

Furthermore, the absence of global standards that explicitly harmonize Sharia and ESG principles further deepens this conceptual gap. Variations in Sharia interpretations across jurisdictions and financial institutions lead to differences in how sustainable and responsible practices are defined in an Islamic context (Khan et al., 2022). This situation not only makes it difficult for investors to assess the credibility of Sharia-compliant financial products but also opens the door to greenwashing or Sharia-washing practices that can undermine public trust (Ur Rehman et al., 2020).

On the other hand, several studies have begun to demonstrate that Sharia governance plays a significant role in strengthening ESG performance, particularly in the governance and social dimensions (Boudawara et al., 2023). However, these findings remain scattered and have not yet been consolidated into a comprehensive conceptual framework. Thus, there is an urgent need to re-examine the relationship between Sharia and ESG more systematically, not only as shared normative values, but also as complementary operational frameworks.

In light of this situation, this study addresses a key gap in the Islamic finance literature: the lack of an integrative approach that explicitly explains how Sharia principles can be conceptually and practically aligned with ESG dimensions. Unlike previous research, which tends to be fragmented, this study seeks to develop a more comprehensive understanding of the intersections, challenges, and opportunities of Sharia-ESG integration in Islamic finance. The primary focus of the research is to identify the conceptual, institutional, and methodological barriers that contribute to this less-than-optimal alignment.

The novelty of this research lies in its integrative perspective, which positions Sharia not merely as a legal compliance system but as a normative framework that can enrich and deepen ESG objectives. Using a qualitative approach grounded in document analysis and the thematic analysis of empirical studies, regulations, and institutional reports, this research helps bridge the gap between Islamic finance discourse and global sustainability practices. This approach is expected to provide a more solid conceptual foundation for the development of sustainable Islamic financial products.

Practically, the findings of this research are expected to have important implications for regulators, practitioners, and academics. For regulators, the results of this research can serve as a basis for formulating policies and standards that better integrate Sharia and ESG. For practitioners, this study offers strategic insights into designing financial products that are not only Sharia-compliant but also ESG-credible. Meanwhile, for academics, this research opens the door to further, more empirical and interdisciplinary studies on sustainable Islamic finance.

## 2. Literature Review and Hypothesis

### Literature Review

#### Islamic Finance and the Sustainability Paradigm

Islamic finance is inherently grounded in ethical and moral principles that emphasize justice ('adl), social welfare (maslahah), and the prohibition of harmful economic activities. These foundational values position Islamic finance as a natural partner to the global sustainability agenda (Billah et al., 2023; Osman & Elamin, 2023). In recent years, the concept of sustainable finance has gained significant traction, driven by environmental degradation, social inequality, and governance failures within conventional financial systems. As a response, Environmental, Social, and Governance (ESG) criteria have emerged as a dominant framework for assessing corporate responsibility and long-term value creation.

Several scholars argue that Islamic finance not only aligns with sustainability goals but also offers a more holistic ethical framework than conventional ESG-based finance (Kammer et al., 2022). However, despite this normative compatibility, empirical and conceptual integration between Islamic finance and ESG remains limited. Much of the existing literature continues to treat ESG as an external performance metric rather than as an endogenous extension of Shariah principles, thereby constraining the development of a unified sustainability framework within Islamic finance.

#### Shariah Governance and ESG Performance

Shariah governance plays a pivotal role in ensuring compliance with Islamic principles across financial institutions. It encompasses structures such as Shariah supervisory boards, internal Shariah review mechanisms, and external audits. Recent studies indicate that robust Shariah governance frameworks positively influence transparency, accountability, and stakeholder trust—core components of the ESG governance pillar (Boudawara et al., 2023; Khan et al., 2022).

Empirical evidence suggests that Islamic banks with robust Shariah governance mechanisms tend to demonstrate superior ESG performance, particularly in governance and social dimensions (Alam et al., 2022). Nevertheless, inconsistencies in Shariah interpretation across jurisdictions continue to fragment ESG disclosures and sustainability reporting. This fragmentation undermines comparability and limits the credibility of ESG claims made by Islamic financial institutions (IFIs).

Furthermore, recent literature highlights the absence of standardized ESG measurement tools explicitly tailored to Shariah-compliant institutions (Zarrouk et al., 2021). Conventional ESG rating methodologies often fail to capture Islamic ethical dimensions such as zakat, waqf, and profit-and-loss sharing, leading to potential underestimation of sustainability performance in Islamic finance.

### **Green Sukuk and Sustainable Islamic Financial Instruments**

Green and sustainable sukuk have emerged as flagship instruments demonstrating the practical intersection of Islamic finance and ESG objectives. Sukuk structures inherently comply with asset-backed and risk-sharing principles, making them suitable vehicles for financing environmentally and socially responsible projects. Recent studies document the growing issuance of green sukuk, particularly in emerging markets such as Indonesia and Malaysia (Fitrah & Soemitra, 2022; Smaoui & Nechi, 2023).

Empirical findings indicate that green sukuk not only enhances environmental outcomes but also strengthens investor confidence and market legitimacy (Hassan et al., 2023). However, scholars caution that the rapid growth of green sukuk has not been matched by consistent regulatory oversight and harmonized Shariah–ESG frameworks, increasing the risk of greenwashing (Naeem et al., 2024). This reinforces the need for an integrated analytical framework that aligns Shariah compliance with ESG verification mechanisms.

### **ESG Measurement Challenges in Islamic Finance**

Despite increasing interest in ESG integration, measuring ESG performance within Islamic finance remains methodologically challenging. Conventional ESG indicators are designed mainly for interest-based financial systems and may not adequately reflect Islamic ethical imperatives (Peng & Isa, 2020). Recent studies emphasize the need to recalibrate ESG metrics to incorporate Shariah-specific elements such as social redistribution, ethical screening, and governance accountability rooted in Islamic jurisprudence (Zheng et al., 2022; Yusuf et al., 2024).

The literature further reveals a lack of consensus on whether ESG should be treated as a complementary or substitutive framework to Shariah governance. This unresolved debate contributes to conceptual ambiguity and fragmented implementation across Islamic financial institutions.

### **Hypothesis Development**

Drawing upon stakeholder theory and Islamic ethical finance principles, this study formulates the following hypotheses:

H1: Strong Shariah governance mechanisms positively influence ESG performance in Islamic financial institutions.

H2: The alignment between Shariah principles and ESG criteria enhances the credibility and sustainability of Islamic financial products.

H3: Green and sustainable sukuk serve as effective instruments for operationalizing Shariah–ESG integration in Islamic finance.

H4: The absence of standardized Shariah-based ESG measurement frameworks contributes to fragmented sustainability reporting in Islamic finance.

These hypotheses provide a clear analytical direction and serve as the foundation for examining how Islamic finance can evolve toward a more coherent and credible sustainable finance paradigm.

## **3. Data and Method**

### **Research Design and Approach**

This study adopts a qualitative research approach to examine the alignment between Shariah principles and Environmental, Social, and Governance (ESG) criteria within Islamic finance. Qualitative design is appropriate because the research seeks to explore conceptual relationships, ethical foundations, and governance narratives rather than to test causal relationships using statistical techniques. Qualitative research is particularly well-suited to studies that aim to develop integrative frameworks and to interpret normative principles embedded in institutional practices and scholarly discourse (Creswell & Poth, 2018).

Accordingly, this study does not employ quantitative methods such as regression or correlation analysis. Instead, it focuses on interpretive and analytical examination of texts to understand how Shariah principles are conceptualized and aligned with ESG dimensions. This approach allows the research to address the fragmented nature of existing literature and to provide a deeper understanding of the ethical and governance foundations of Islamic sustainable finance (Osman & Elamin, 2023).

### **Data Sources and Scope of the Study**

The data utilized in this research consist exclusively of secondary qualitative data derived from documentary sources. These sources include peer-reviewed academic journal articles, regulatory and standard-setting documents, institutional reports, and published case studies related to Islamic finance, Shariah governance, ESG implementation, and sustainable financial instruments such as green and sustainable sukuk. Documentary data are widely used in qualitative research to examine policy frameworks, institutional practices, and theoretical developments (Bowen, 2009).

The study focuses on literature published between 2018 and 2024, with a particular emphasis on recent publications from 2021 to 2024 to capture contemporary developments in Islamic sustainable finance and ESG integration. The scope is limited to English-language publications to ensure consistency in interpretation and academic rigor.

### **Data Selection Criteria**

The selection of documents followed specific inclusion criteria to ensure relevance and analytical coherence. Included sources explicitly address Islamic finance, Shariah principles, ESG criteria, sustainability, or green and sustainable sukuk, and provide conceptual, regulatory, or empirical insights relevant to Shariah–ESG alignment. Peer-reviewed journal articles and authoritative institutional reports were prioritized for their methodological rigor and academic validity.

Sources that focus solely on conventional finance without reference to Islamic principles, as well as publications lacking clear analytical or methodological foundations, were excluded. This selective process is consistent with qualitative research practices that emphasize theoretical relevance and depth over sample size (Miles, Huberman, & Saldaña, 2014).

### **Data Collection Method**

Data collection was conducted using qualitative document analysis. Document analysis enables systematic examination and interpretation of textual materials to identify patterns, meanings, and themes related to the research objectives (Bowen, 2009). This method is particularly appropriate for this study because it allows the integration of diverse materials, including academic theories, governance frameworks, and policy documents, into a coherent analytical structure.

Each selected document was reviewed in detail to extract information on Shariah principles, ESG dimensions, governance mechanisms, sustainability objectives, and the challenges of integrating Shariah and ESG frameworks within Islamic finance. This process facilitates a comprehensive understanding of both normative concepts and practical applications.

### **Data Analysis Technique**

The study employs thematic analysis as the primary data analysis technique. Thematic analysis is a flexible qualitative method used to identify, analyze, and report recurring patterns or themes within textual data (Braun & Clarke, 2006). The analysis began with repeated reading of all selected documents to achieve familiarity with the data and context.

Subsequently, initial coding was conducted to identify key concepts related to Shariah governance, ESG performance, sustainable Islamic financial instruments, measurement challenges, and conceptual fragmentation. These codes were then grouped into broader themes that reflect the study's core analytical dimensions. The themes were reviewed and refined iteratively to ensure internal coherence and alignment with the research objectives. Through this systematic process,

the study provides a structured interpretation of how Shariah principles and ESG criteria intersect and where conceptual gaps remain.

#### 4. Results

This section presents the findings of the qualitative thematic analysis derived from the reviewed literature, regulatory documents, and institutional reports. Rather than reporting statistical relationships, the results are organized into key analytical themes that reflect how Shariah principles and ESG criteria are aligned, operationalized, and challenged within Islamic finance. These themes directly correspond to the gaps and hypotheses identified in the literature review.

##### **Shariah Governance as a Foundation for ESG Performance**

The analysis reveals that Shariah governance is consistently identified in the literature as a central mechanism for strengthening ESG performance in Islamic financial institutions. Strong Shariah supervisory structures, including Shariah boards and internal compliance systems, contribute to greater transparency in governance, ethical accountability, and stakeholder trust. These elements closely correspond to the governance dimension of ESG, suggesting that Shariah governance provides a normative and institutional foundation for ESG implementation (Boudawara et al., 2023; Khan et al., 2022).

Several studies emphasize that Shariah governance extends beyond legal compliance by embedding ethical oversight into decision-making processes. This ethical orientation reinforces social responsibility, fairness, and risk-sharing, which are core aspects of both Islamic finance and ESG principles (Osman & Elamin, 2023). However, the findings also indicate that variations in Shariah interpretation across jurisdictions lead to inconsistent governance practices, limiting the comparability of ESG outcomes among Islamic financial institutions.

##### **Conceptual Alignment and Fragmentation Between Shariah and ESG**

The findings demonstrate that while there is strong normative alignment between Shariah principles and ESG objectives, this alignment remains conceptually fragmented in existing frameworks. Many studies acknowledge overlapping values such as justice, sustainability, and social welfare, yet fail to articulate a coherent mapping between Shariah principles and specific ESG indicators (Haji Wahab & Naim, 2020; Kammer et al., 2022).

This fragmentation is particularly evident in ESG reporting practices, where Islamic financial institutions often adopt conventional ESG metrics that fail to reflect Shariah-specific ethical dimensions adequately. As a result, Shariah is frequently treated as a parallel compliance framework rather than an integrated foundation for ESG assessment. This finding supports the argument that the absence of a unified conceptual framework undermines the effective integration of Shariah and ESG in practice.

##### **Green and Sustainable Sukuk as Operational Instruments**

The thematic analysis identifies green and sustainable sukuk as the most tangible instruments for operationalizing Shariah–ESG alignment. The literature consistently highlights that sukuk structures, which are asset-backed and risk-sharing, are well-suited to financing environmentally and socially responsible projects (Fitrah & Soemitra, 2022; Smaoui & Nechi, 2023).

Case-based evidence, such as the issuance of Sustainable and Responsible Investment (SRI) sukuk, demonstrates that Shariah compliance can coexist with ESG objectives, particularly in the environmental and social dimensions (Noordin et al., 2018). Nevertheless, the findings also reveal concerns about the lack of standardized criteria for classifying sukuk as "green" or "sustainable," which raises the risk of greenwashing and inconsistent Shariah interpretation (Naeem et al., 2024). This highlights the need for stronger governance and verification mechanisms.

##### **ESG Measurement and Reporting Challenges in Islamic Finance**

Another prominent theme emerging from the analysis concerns challenges in ESG measurement and reporting in Islamic finance. The reviewed literature indicates that conventional ESG rating

systems are not fully compatible with Shariah-based financial institutions, as they often overlook Islamic ethical instruments such as zakat, waqf, and profit-and-loss sharing arrangements (Peng & Isa, 2020; Zarrouk et al., 2021).

The absence of Shariah-sensitive ESG indicators contributes to fragmented sustainability disclosures and limits stakeholders' ability to accurately assess the ethical and social impact of Islamic financial products. This finding reinforces the argument that standardized ESG measurement frameworks tailored to Islamic finance are essential for enhancing transparency, comparability, and credibility (Yusuf et al., 2024).

### **Implications for Sustainable Islamic Finance Development**

Overall, the results indicate that Shariah principles have significant potential to strengthen ESG implementation when embedded within robust governance structures and supported by appropriate measurement frameworks. However, conceptual fragmentation, regulatory inconsistency, and measurement limitations continue to constrain this potential. These findings directly align with prior literature emphasizing the need for integrative frameworks that position Shariah as a normative driver of sustainability rather than a separate compliance layer (Billah et al., 2023).

By synthesizing these themes, the study demonstrates that effective Shariah–ESG alignment requires not only ethical compatibility but also institutional coherence, standardized reporting mechanisms, and clear conceptual articulation.

## **5. Discussion**

This study aims to examine how Shariah principles can be aligned with Environmental, Social, and Governance (ESG) criteria within the framework of Islamic finance. The discussion interprets the findings by situating them within the broader discourse on Islamic sustainable finance and by evaluating their implications in relation to the study's objectives.

A key insight from this study is that Shariah governance functions as a foundational mechanism for ESG implementation in Islamic financial institutions. Rather than operating merely as a compliance tool, Shariah governance embeds ethical oversight, accountability, and transparency into institutional decision-making. This finding reinforces earlier studies that argue that Shariah supervisory structures enhance governance quality and stakeholder confidence, particularly in Islamic banking and capital market instruments (Noordin et al., 2018; Boudawara et al., 2023). However, this study extends prior scholarship by emphasizing that Shariah governance should be viewed as a normative driver of ESG performance rather than a parallel or supplementary framework.

The discussion also highlights the persistent conceptual fragmentation between Shariah and ESG frameworks. Although both systems share ethical foundations such as justice, social welfare, and sustainability, the literature and institutional practices often fail to articulate a coherent, integrative model. Previous studies have similarly observed that ESG metrics are frequently adopted from conventional finance without sufficient adaptation to Islamic ethical values (Haji Wahab & Naim, 2020; Peng & Isa, 2020). This study deepens that argument by demonstrating that such fragmentation weakens the interpretive power of ESG disclosures in Islamic finance and limits their ability to reflect Shariah-based social and governance objectives.

Another important aspect discussed in this study concerns the role of green and sustainable sukuk as practical instruments for Shariah–ESG alignment. Existing research has shown that sukuk structures are inherently suitable for financing sustainable projects due to their asset-backed and risk-sharing characteristics (Fitrah & Soemitra, 2022; Smaoui & Nechi, 2023). The present study supports this view but further argues that the effectiveness of green sukuk depends heavily on the clarity of Shariah–ESG standards and verification mechanisms. Without harmonized criteria, the risk of greenwashing and inconsistent Shariah interpretation remains a critical concern, as also noted by recent studies on sustainable finance credibility (Naeem et al., 2024).

The findings further suggest that ESG measurement and reporting remain one of the most significant challenges in Islamic finance. Conventional ESG rating systems often fail to capture Islamic ethical instruments, such as zakat, waqf, and profit-and-loss-sharing arrangements. This limitation has been acknowledged in earlier research (Zarrouk et al., 2021; Yusuf et al., 2024), yet this study emphasizes that the absence of Shariah-sensitive ESG indicators contributes to fragmented sustainability narratives and reduces the comparability of Islamic financial institutions globally. Addressing this gap is essential for strengthening both market credibility and regulatory alignment.

From a theoretical perspective, this study contributes to the literature by repositioning Shariah principles as an integrative ethical framework that enriches ESG objectives rather than merely aligning with them. This perspective supports arguments advanced by scholars who view Islamic finance as a holistic system of ethical finance rather than a niche alternative to conventional sustainability models (Alam et al., 2022; Osman & Elamin, 2023). In practice, the discussion underscores the need for regulators and standard-setting bodies to develop harmonized guidelines that explicitly link Shariah governance with ESG reporting standards.

Overall, the discussion demonstrates that effective Shariah–ESG alignment requires more than value compatibility. It demands conceptual clarity, institutional coherence, and governance mechanisms that translate ethical principles into measurable and credible sustainability outcomes. These insights are consistent with the study's objectives and provide a foundation for advancing sustainable Islamic finance across academic research and industry practice.

## 6. Conclusion

This study examines the alignment between Shariah principles and Environmental, Social, and Governance (ESG) criteria within the Islamic finance framework, responding to the growing demand for ethically grounded, sustainable financial systems. The findings indicate that although Shariah principles and ESG share strong normative foundations such as justice, social responsibility, transparency, and sustainability their integration remains conceptually fragmented and inconsistently implemented. Existing practices often treat ESG as an external or parallel framework, rather than positioning Shariah as a foundational ethical system capable of guiding sustainability objectives in Islamic finance.

The study further demonstrates that Shariah governance plays a critical role in strengthening ESG performance, particularly in governance and social dimensions. Robust Shariah supervisory mechanisms enhance ethical oversight, accountability, and stakeholder trust, thereby reinforcing the credibility of Islamic financial institutions. In addition, green and sustainable sukuk emerge as the most practical instruments for operationalizing Shariah–ESG alignment, especially in financing environmentally and socially responsible projects. However, the absence of harmonized standards and Shariah-sensitive ESG measurement frameworks continues to pose challenges, limiting transparency, comparability, and the overall effectiveness of sustainability reporting.

From a theoretical perspective, this research contributes to the literature by offering an integrative view that positions Shariah principles not merely as compliance requirements but as a normative framework that can enrich and strengthen ESG objectives. By synthesizing prior studies and institutional practices, the study fills an important gap in Islamic finance literature and provides a clearer conceptual foundation for future research on sustainable Islamic finance.

From a managerial and policy perspective, the findings suggest that regulators and standard-setting bodies should prioritize developing harmonized frameworks that explicitly integrate Shariah governance with ESG standards. Islamic financial institutions are encouraged to strengthen Shariah governance structures, enhance sustainability disclosure practices, and adopt ESG measurement tools that reflect Islamic ethical values. Such efforts would improve market credibility, attract socially responsible investors, and support the long-term development of a resilient and sustainable Islamic finance ecosystem.

## Recommendation

Regulators and standard-setting bodies are advised to develop harmonized frameworks that explicitly integrate Shariah governance with ESG standards to improve consistency and credibility in Islamic finance. Islamic financial institutions should strengthen Shariah governance structures and adopt Shariah-sensitive ESG measurement and reporting tools to enhance transparency and comparability. Practitioners are encouraged to expand the issuance of green and sustainable sukuk supported by clear verification mechanisms to mitigate greenwashing risks. Future research should focus on developing standardized ESG indicators tailored to Islamic finance and conducting empirical validation across jurisdictions.

## Limitations and avenues for future research

This study is limited by its qualitative, document-based design, which relies on secondary sources and does not incorporate primary or empirical data. The conceptual focus may limit generalizability across jurisdictions with varying interpretations of Shariah and ESG regulations. Future research should employ empirical methods, develop Shariah-sensitive ESG metrics, and conduct cross-country or case-based studies to validate and extend the proposed integrative framework.

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