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Sharia Governance and ESG Performance: Evidence from Islamic Financial Institutions

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Abstract
This study aims to examine the influence of Shariah Governance (SG) on Environmental, Social, and Governance (ESG) performance among Islamic financial institutions in Indonesia, while considering bank characteristics including bank size (total assets), profitability (ROA), and bank age (AGE) as control variables. A quantitative research approach was employed using secondary data obtained from annual reports, sustainability reports, and Shariah governance disclosures of Islamic commercial banks in Indonesia for the period 2021–2024. Data were analyzed using the Partial Least Squares–Structural Equation Modeling (PLS-SEM) method with the assistance of SmartPLS version 4 software. The results reveal that Shariah Governance has a significant negative effect on ESG performance, indicating that the increasing focus on compliance-oriented Shariah governance does not necessarily translate into stronger sustainability commitments. In contrast, profitability (ROA) positively affects ESG performance, suggesting that financially stronger banks are more capable of implementing sustainability initiatives. Bank size shows no significant effect, while bank age demonstrates a negative influence, meaning that older banks tend to be less adaptive to sustainability practices compared to younger ones. Overall, the findings underscore the importance of integrating Shariah Governance with maqasid al-shariah principles to strengthen the sustainability framework of Islamic financial institutions. The study contributes both theoretically and practically by providing empirical insights that may assist regulators, practitioners, and academics in promoting a more holistic and sustainable Islamic banking model.

Keywords: *ESG Integration, ESG Performance, Islamic Financial Institution, Shariah Governance, Sustainable Finance*

Introduction

The development of the Islamic finance sector in recent years shows that Islamic financial institutions are no longer solely focused on generating profits, but increasingly emphasize ethics, sustainability, and social responsibility. Within the context of Islamic finance, Shariah Governance plays a central role as a mechanism that ensures all operational activities adhere to shariah principles. The Shariah Governance system encompasses various components, including the presence of a Shariah Supervisory Board, shariah audit procedures, and compliance with standards set by international organizations such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) (Arrazi, 2023).

At the global level, the banking sector also faces increasing challenges related to sustainability. Questions regarding what institutions should disclose and how such disclosures should be presented have become more critical not only for stakeholders but also for policymakers worldwide (Buallay, 2019). Consequently, many financial institutions, both conventional and Islamic, have begun to recognize the importance of incorporating

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Environmental, Social, and Governance (ESG) principles into their business strategies. The adoption of ESG principles is not merely a response to global market demands; it also reflects a commitment to accountability for environmental and social impacts,(Milena & Stefan, 2024) ESG consists of three key pillars environmental, social, and governance and its integration within financial institutions is crucial for maintaining reputation, managing non-financial risks, and supporting broader sustainable development goals.

In the Islamic banking landscape, the relationship between Shariah Governance and ESG performance holds significant importance because both concepts share complementary foundational values. Principles of fairness, transparency, and social responsibility, as reflected in maqasid al-shariah, are naturally aligned with the objectives and values embedded in ESG frameworks (Siregar, 2025). However, for Islamic financial institutions, achieving optimal ESG performance depends heavily on the role of Shariah Governance. As a system designed to regulate and monitor adherence to shariah principles, Shariah Governance ensures that every decision considers both social and environmental impacts. Thus, it functions not only as a guardian of compliance but also as a key driver in advancing comprehensive sustainability initiatives.

Islamic banking, grounded in principles of social justice and sustainability, has substantial potential to lead in the effective implementation of ESG. Nevertheless, much of the existing literature focuses primarily on the relationship between Shariah Governance and financial performance, while research that directly explores the influence of Shariah Governance on ESG performance remains scarce. Evidence from studies in various countries suggests that strong Shariah Governance can positively affect ESG outcomes in Islamic banks, yet empirical findings specific to developing economies such as Indonesia remain limited.

As one of the world's largest Islamic finance markets, Indonesia holds a strategic position in advancing ESG implementation aligned with shariah principles. However, institutional characteristics such as bank size (total assets), profitability (return on assets/ROA), and bank age may affect how effectively banks adopt ESG policies. Larger banks typically have more resources to invest in sustainability programs, whereas newer banks may face constraints in implementing comprehensive ESG initiatives (Milena & Stefan, 2024).

Despite the growing literature on Shariah Governance and ESG as separate topics, empirical studies that directly examine the effect of Shariah Governance on ESG performance within Islamic financial institutions remain limited (Boudawara et al., 2023a). Therefore, this study seeks to address this gap by investigating the impact of Shariah Governance on ESG performance in Islamic financial institutions and by exploring the role of control variables such as bank size, profitability, and bank age in facilitating the achievement of sustainability objectives.

Overall, this research is expected to contribute both theoretically and practically to the field of Islamic finance and sustainability. Moreover, it aims to offer practical recommendations for Islamic financial institutions in enhancing transparency, accountability, and their social environmental performance.

Literature Review

A. Shariah Governance

Shariah Governance refers to the system established to supervise and manage the activities of Islamic financial institutions in order to ensure full compliance with Islamic legal

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and ethical principles. According to the Islamic Financial Services Board (Islamic Financial Services Board (IFSB), 2025), Shariah Governance encompasses institutional structures that enable the Shariah Supervisory Board (SSB) to provide guidance, conduct reviews, and oversee the operations of Islamic financial institutions. (Islamic Financial Services Board (IFSB), 2025), Shariah Governance encompasses institutional structures that enable the Shariah Supervisory Board (SSB) to provide guidance, conduct reviews, and oversee the operations of Islamic financial institutions

In this study, Shariah Governance is measured using three key indicators:

a. Number of Shariah Supervisory Board Members, which reflects the supervisory capacity and diversity of perspectives necessary to maintain compliance with shariah principles.
b. Frequency of Shariah Supervisory Board Meetings, indicating the level of engagement and effectiveness of the supervisory function
c. Disclosure of Shariah Compliance Reports, assessing how well institutions communicate the implementation of shariah principles to the public.

Prior studies demonstrate that a strong and proactive Shariah Supervisory Board can enhance public confidence and strengthen the social performance of Islamic financial institutions (Puspitasari & Kasri, 2023). Moreover, transparency in shariah compliance reporting promotes accountability and aligns with the ethical values embodied in ESG principles (Boudawara et al., 2023b).

B. Environmental, Social, and Governance (ESG) Performance

ESG performance represents the extent to which financial institutions conduct their business operations with the principles of sustainability in mind. ESG performance comprises three main dimensions:

a. Environmental E, policies and initiatives related to environmental stewardship, including energy efficiency, waste management, and environmentally responsible financing.
b. Social (S), the institution's responsibilities toward society and employees, such as community development programs, education and health initiatives, and labor rights protection.
c. Governance (G), organizational structure, information transparency, business ethics, and internal oversight systems.

Within Islamic banking, ESG implementation aligns closely with maqasid al-shariah, which emphasizes social welfare, justice, and sustainability (Milena & Stefan, 2024). Islamic banks equipped with strong Shariah Governance systems are therefore expected to deliver more comprehensive and higher quality ESG disclosures.

C. Shariah Governance and ESG Performance

The relationship between Shariah Governance and ESG performance is grounded in the shared foundational values of justice, transparency, and social responsibility. A strong, active, and transparent Shariah Supervisory Board (SSB) ensures that Islamic financial institutions adhere not only to shariah principles but also to social and environmental considerations in their operational practices

Empirical findings reported by (Boudawara et al., 2023b) indicate that both the number of SSB members and the frequency of SSB meetings positively influence the quality of ESG disclosures among Islamic banks across countries. Furthermore, the extent of shariah compliance reporting reflects institutional transparency, which constitutes a core element of the governance pillar within the ESG framework.

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Accordingly, stronger implementation of Shariah Governance is expected to be associated with improved ESG performance.

Hypothesis 1 (H1).

Shariah Governance as measured by the number of SSB members, frequency of SSB meetings, and the level of shariah compliance disclosure positively influences ESG performance in Islamic financial institutions.

D. Bank Size (Total Assets) and ESG Performance

Bank size reflects the operational scale and resource capacity of a financial institution. Banks with larger asset bases generally possess greater resources to invest in social responsibility programs and sustainable environmental initiatives (Milena & Stefan, 2024). In addition, larger banks typically face greater reputational pressures, which may motivate them to strengthen their ESG disclosures and sustainability commitments.

Hypothesis 2 (H2).

Bank size (total assets) positively influences ESG performance in Islamic financial institutions.

E. Profitability (ROA) and ESG Performance

Profitability indicates the institution's ability to generate returns from its assets. Financial institutions with higher levels of profitability have more resources available to allocate toward environmental and social initiatives. Moreover, more profitable banks may be motivated to enhance their reputation by improving the quality and extent of their ESG disclosures (I. Khan et al., 2016).

Hypothesis 3 (H3).

Profitability (ROA) positively influences ESG performance in Islamic financial institutions.

F. Bank Age and ESG Performance

Bank age represents the institution's operational experience and stability. Banks that have been established for longer periods often possess more mature governance structures and stronger stakeholder relationships, which may enhance their ability to implement sustainability policies effectively (Puspitasari & Kasri, 2023).

Hypothesis 4 (H4).

Bank age positively influences ESG performance in Islamic financial institutions.

Research Metodology

This research is a quantitative and explanatory study aimed at examining the impact of Shariah Governance on ESG performance in Islamic financial institutions in Indonesia while incorporating bank characteristics as control variables. A quantitative approach is appropriate because the study relies on numerical data analyzed statistically to test the predefined hypotheses.

The analytical technique employed is Structural Equation Modeling (SEM) using Partial Least Squares (PLS), facilitated by SmartPLS version 4. SEM–PLS is selected due to its ability to analyze complex relationships between latent variables simultaneously, including direct and indirect effects, and its suitability for relatively small sample sizes and data that deviate from normal distribution assumptions (Hair & Alamer, 2022).

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The study population consists of all Islamic Commercial Banks (BUS) operating in Indonesia and registered with the Financial Services Authority (OJK) during the observation period of 2021–2024.

A. Research Sample

The sample was selected using purposive sampling, meaning that institutions were chosen based on specific criteria relevant to the research objectives. The sampling criteria are as follows:

a. Islamic Commercial Banks that operated continuously during 2021–2024.
b. Banks that published complete annual reports and/or sustainability reports during the research period.
c. Banks that disclosed relevant information related to the research variables, including the number of SSB members, SSB meeting frequency, shariah compliance reporting, and ESG disclosure.

B. Data Types and Sources

This study uses secondary data obtained from official documents published by the respective institutions. The main data sources include:

a. Annual Reports of Islamic Commercial Banks for the 2021–2024 period.
b. Sustainability Reports available on the official websites of Islamic Commercial Banks.
c. Supporting data from the Financial Services Authority (OJK), Bank Indonesia (BI), and the Indonesia Stock Exchange (IDX) regarding financial and institutional characteristics.

C. Data Collection Technique

Data collection was conducted through documentation, involving systematic retrieval and recording of relevant information from annual reports and sustainability reports of Islamic banks. Each variable in the study was measured based on predetermined indicators and matched with publicly available data.

D. Operational Definition and Variable Measurement

Table 1. Independent Variable: Shariah Governance (X)

Indicator	Operational Definition	Source
Number of SSB Members	This indicator measures the total number of individuals serving on the Shariah Supervisory Board of an Islamic bank	(Puspitasari & Kasri, 2023)
Frequency of SSB Meetings	This indicator captures the number of formal meetings conducted by the Shariah Supervisory Board within a fiscal year.	(Alif et al., 2025)
Shariah Compliance Report (Disclosure)	This indicator reflects the extent to which Islamic banks disclose their Shariah compliance reports or statements in annual reports or sustainability disclosures.	(Islamic Financial Services Board (IFSB), 2025)

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Table 2. Dependent Variable: ESG Performance (Y)

Dimension	Indicator	Operational Definition
Environmental (E)	Disclosure of environmental policies and activities	(Milena & Stefan, 2024)
Social (S)	Disclosure of social activities	(S. Khan et al., 2023)
Governance (G)	Disclosure of governance practices	(Boudawara et al., 2023a)

ESG performance was measured using a disclosure index constructed from the content reported in annual reports and sustainability reports. Each disclosure item was assigned a score of 1 if disclosed and 0 if not disclosed. The total score for each institution was then summed and divided by the total number of expected disclosure items, producing a proportional ESG disclosure index that reflects the comprehensiveness of sustainability reporting.

Table 3. Control Variables

Variable	Measurement	Operational Definitin	Source
Bank Size	Ln (Total Assets)	Natural logarithm of the bank's total annual assets	(Milena & Stefan, 2024)
Profitability (ROA)	ROA = Net Profit / Total Assets	Ratio of net income to total assets	(S. Khan et al., 2023)
Bank Age	Years of Operation	Number of years since the bank's establishment until the observation year	(Puspitasari & Kasri, 2023)

E. Data Analysis Technique

The data analysis procedure began with the assessment of the outer model (measurement model), which aims to evaluate the validity and reliability of the constructs. Convergent validity was examined through the outer loading values (expected > 0.70) and the Average Variance Extracted (AVE) (expected > 0.50). Subsequently, discriminant validity was assessed using cross-loading analysis and the Fornell Larcker criterion. Construct reliability was evaluated using Composite Reliability (CR) and Cronbach's Alpha, where values exceeding 0.70 indicate adequate reliability.

Once the measurement model met the required criteria, the analysis proceeded to the inner model (structural model) to test the relationships among latent variables. The quality of the structural model was evaluated using the R^2 coefficient (coefficient of determination), which reflects the extent to which variations in ESG Performance are explained by Shariah Governance and the employed control variables. The significance of the relationships among variables was assessed through path coefficients and t-statistics obtained via the

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bootstrapping procedure, with significance determined by a t-value greater than 1.96 at α = 0.05.

The structural model estimated using SmartPLS can be formulated as follows:

$$ESG = \beta_0 + \beta_1(SG) + \beta_2(Size) + \beta_3(ROA) + \beta_4(Age) + \varepsilon$$

where: ESG denotes the Environmental, Social, and Governance performance; SG represents the Shariah Governance index; Size refers to bank size measured using the natural logarithm of total assets; ROA indicates bank profitability; Age captures the operational age of the bank; and ε represents the error term.

Although PLS-SEM does not require data to follow a normal distribution, several additional diagnostic tests were conducted to ensure the robustness of the model. Multicollinearity was assessed using the Variance Inflation Factor (VIF), where values below 5 indicate the absence of serious multicollinearity issues. Model significance was evaluated through a bootstrapping procedure with 5,000 resamples. In addition, the Goodness of Fit (GoF) index was employed to assess the overall adequacy of the structural model.

The results were subsequently interpreted and presented through a path diagram, tables reporting outer loadings, Average Variance Extracted (AVE), Composite Reliability (CR), Cronbach's Alpha, as well as the bootstrapping output used for hypothesis testing. The interpretation focused on the direct effects of Shariah Governance on ESG Performance, while also examining the role of control variables in strengthening or weakening this primary relationship.

The use of PLS-SEM was justified by its flexibility in handling models with numerous indicators and its suitability for predictive and exploratory research, particularly in the context of Islamic financial institutions where data are derived from secondary public disclosures. Through this analytical approach, the study aims to enhance the understanding of how Shariah Governance contributes to strengthening the sustainability performance (ESG) of Islamic financial institutions in Indonesia.

Results and Discussion

This study investigates the relationship between Shariah Governance and ESG performance, drawing evidence from Islamic financial institutions. The research begins with a content analysis approach, conducted by reviewing the annual reports, Good Corporate Governance (GCG) reports, and sustainability reports of each Islamic Commercial Bank. This method enables the extraction of relevant qualitative and quantitative information pertaining to Shariah Governance practices and ESG disclosures.

Consistent with the sampling criteria, the study employs a sample of Islamic banking institutions (Bank Umum Syariah) operating during the period 2021–2024. Based on the data specifications outlined earlier, a total of 44 Islamic Commercial Banks were identified within the Indonesian Islamic banking sector over the four-year observation period. These institutions constitute the population from which the study draws its analytical insights.

A. Data Analysis Results

a. Outer Model Assessment

The evaluation of the outer model was conducted using three primary criteria: convergent validity, discriminant validity, and composite reliability. These assessments are essential to determine whether the measurement model adequately reflects the latent constructs in the study. The results of the data analysis for the outer model are presented in Table 4.

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Table 4. Outer Loading (Mesurent Model)

Variable	Outer Loading
SG1 (Number of SSB Members)	0,760
SG2 (Frequency of SSB Meetings)	0,706
SG3 (Sharia Compliance Report Disclosure)	-0,385
E (Environmental Aspect)	0,875
S (Social Aspect)	0,506
G (Governance Aspect)	0,867
TA (Bank Size)	1,000
ROA (Profitability)	1,000
AGE (Bank Age)	1,000

Source: Author's (2025)

Outer loadings indicate the extent to which each indicator (AGE, E, G, S, SG1, SG2, SG3, ROA, TA) reflects the latent variable it is intended to measure (AGE, ESG, SG, ROA, TA). In general, higher loading values—approaching +1—demonstrate a stronger ability of the indicator to represent the underlying construct. The commonly used reference thresholds are as follows:

1. **≥ 0.70**: indicates excellent indicator reliability and is preferred for confirmatory research.
2. **0.60–0.70**: acceptable for exploratory studies, provided that the Average Variance Extracted (AVE) exceeds 0.50.
3. **0.50–0.60**: may be retained in developmental or early-stage model testing, although the indicator contributes relatively weakly to the construct.
4. **< 0.50 or negative**: indicates insufficient convergent validity; such indicators should be considered for elimination from the measurement model.

- **AGE, ROA, and TA** demonstrate convergent validity, as each is measured using a single indicator with an outer loading of 1.000.
- **ESG Construct**:
  - The **Environmental (E)** and **Governance (G)** indicators exhibit strong and valid loadings, indicating robust convergence with the latent construct.
  - The **Social (S)** indicator is borderline; it may be retained for developmental or exploratory research, although its contribution is weaker. The inclusion of this indicator should therefore be supported by adequate theoretical justification.
- **Shariah Governance (SG) Construct**:
  - **SG1** and **SG2** demonstrate acceptable and sufficiently strong loadings, confirming convergent validity.
  - **SG3**, however, does not satisfy the criteria for convergent validity (loading < 0.50 and negative), and thus should be considered for removal from the measurement model.

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b. Discriminant Validity

Discriminant validity is assessed to ensure that each construct in the model is truly distinct from the other latent variables. This evaluation confirms whether the indicators of a particular construct share a stronger relationship with their own latent variable than with others. The results of the discriminant validity assessment are presented as follows:

Table 5. Discriminant Validity Score (cross loading)

	SG	ESG	TA	ROA	AGE
SG		*1,048*		*0,508*	*0,685*
ESG					*0,179*
TA	*0,627*	*0,236*		*0,435*	*0,064*
ROA		*0,186*			*0,113*
AGE					

Source: Author's (2025)

Based on Table 5. it can be observed that the loading factor values for each indicator are highest when associated with their respective constructs compared to other constructs. This indicates that each variable demonstrates satisfactory discriminant validity, as none of the indicators show higher loadings on constructs to which they do not belong. In other words, the indicators of each construct exhibit stronger correlations with their own latent variable than with any other construct, confirming that discriminant validity has been adequately met.

c. Composite Reliabilitydan Average Variance Extracted (AVE)

The criteria for validity and reliability can also be assessed through the composite reliability values of each construct and the Average Variance Extracted (AVE). A construct is considered to exhibit satisfactory reliability when its composite reliability exceeds 0.70, and its AVE is greater than 0.50. Table 6. presents the composite reliability and AVE values for all constructs included in this study.

Table 6. *Cronbach's Alpha Composite Reliability dan Average Variance Extracted* (AVE)

	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)	Average variance extracted (AVE)
ESG	0.665	0.786	0.805	0.592
SG	-0.206	0.311	0.397	0.408

Source: Author's (2025)

d. Evaluation of the Structural Model (Inner Model)

Evaluation of the structural model in PLS begins with an examination of the R-squared (R^2) values for each endogenous latent variable, which indicate the predictive accuracy of the model. According to (Ghozali & Latan, 2015), R^2 values of 0.75, 0.50, and 0.25 are interpreted as substantial, moderate, and weak, respectively. The R^2 value therefore reflects the proportion of variance in the endogenous construct explained by the exogenous variables in the model.

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Table 7. R Square

	R-square	R-square adjusted
ESG	0.430	0.372

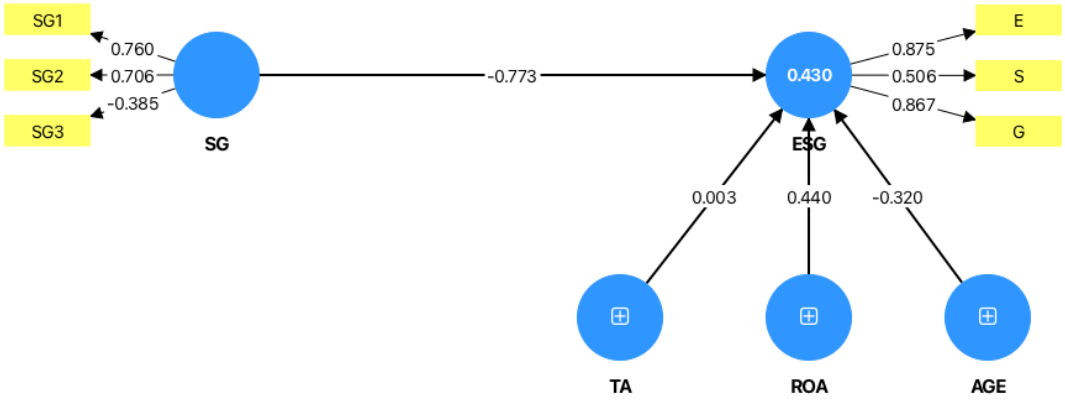
Source: Author's (2025)

As shown in Table 7, the ESG construct has an R^2 value of 0.430, indicating that 43% of the variation in ESG performance is explained by the independent variables included in the model. This level of explanatory power suggests a moderate predictive capability of the structural model.

e. Significance Testing and Hypothesis Assessment

In Partial Least Squares (PLS), statistical testing of the hypothesized relationships is conducted through a resampling-based simulation procedure. Specifically, the bootstrap method is employed to generate repeated subsamples, allowing for the estimation of standard errors, t-statistics, and the significance levels of the structural paths.

The results of the bootstrapping procedure, which provide evidence for the acceptance or rejection of each hypothesis, can be examined in the inner weight output generated by the PLS analysis. These results are visually represented in the structural model diagram, which illustrates the magnitude and significance of the causal relationships among the latent variables.



Figures 1. Model Structural
Source: Author's (2025)

Based on the structural model illustrated above, the following section presents the hypothesis testing results and explains the empirical findings associated with each proposed hypothesis..

f. Hypothesis Test

The structural model, or inner model, represents the component of SEM that is used to predict and assess the causal relationships among latent variables (Ghozali & Latan, 2015). In the context of this study, the structural model was employed to evaluate the hypothesized causal pathways between Shariah Governance, bank-

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specific control variables, and ESG performance. The estimation of causal relationships within the SEM–PLS framework was conducted using SmartPLS 4.0, following the required analytical procedures to determine the significance, direction, and magnitude of the hypothesized effects.

Table 8. Result For Inner Weights

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values	Result
SG -> ESG	-0.773	-0.734	0.213	3.628	0.000	Significant
TA -> ESG	0.003	-0.020	0.227	0.015	0.988	No Significant
ROA -> ESG	0.440	0.400	0.177	2.490	0.013	Significant
AGE -> ESG	-0.320	-0.282	0.138	2.313	0.021	Significant

Source: Author's (2025)

Based on the results of the hypothesis testing in the table above, the analysis indicates that the ESG performance of Islamic financial institutions is influenced not only by financial aspects such as profitability but also by institutional characteristics, including bank age and the quality of Shariah governance. However, an interesting finding emerges from the negative direction of the relationships between SG and AGE, suggesting further research opportunities to explore the dynamics of ESG implementation within the context of Islamic banking in Indonesia.

B. Discussion

a. The Influence of Shariah Governance on ESG Performance

The results of the bootstrapping analysis conducted using Smart-PLS 4 indicate that Shariah Governance (SG) has a significant negative effect on ESG performance (coefficient = –0.773, $p < 0.001$). This finding is quite surprising, as it contrasts with the initial expectation that stronger Shariah governance would enhance the commitment to sustainability. On the contrary, improvements in Shariah governance quality as measured by the number of members on the Shariah Supervisory Board (SSB), the frequency of SSB meetings, and the level of Shariah compliance disclosure are associated with lower ESG performance.

Previous studies by (Boudawara et al., 2023a) indicate that an increase in the number of SSB members and more frequent meetings tend to improve ESG disclosure quality among Islamic banks in various countries. Similarly, (Milenia & Syafei, 2021) found that the frequency of SSB meetings and the board's composition influence Islamic social disclosure but do not necessarily extend to the environmental (E) or modern governance (G) dimensions of ESG.

Subroto et al. (2025) further show that more frequent SSB meetings may increase the risk of Shariah non compliance, creating a trade off: while the SSB becomes more engaged in ensuring compliance, it may have less capacity to promote structured ESG initiatives. This supports the view that overly active SSB involvement can divert managerial focus and resources from ESG related activities to immediate internal compliance matters.

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The negative impact of Shariah Governance can also be understood from the perspective of Maqasid al-Shariah. For SSBs to serve as pioneers in advancing ESG, their orientation needs to evolve beyond jurisprudential compliance toward social and environmental wellbeing. This aligns with (Sofya & Puteri, 2024), who recommend integrating ESG with Maqasid al-Shariah as a strategic framework for Islamic banks to adopt a more holistic sustainability approach.

b. The Influence of Bank Size on ESG Performance

Regarding bank size (Total Assets), the analysis shows no significant effect on ESG performance (coefficient = 0.003, p = 0.988). This indicates that the asset size of Islamic banks in Indonesia does not play a decisive role in the implementation of sustainability practices. This finding contrasts with studies such as (Milena & Stefan, 2024), which suggest that larger banks possess greater capacity to invest in social responsibility programs and sustainable environmental policies. Similarly, (Mayliza & Yusnelly, 2021) found that although good governance (including the role of the SSB) influences Islamic CSR, bank size does not necessarily serve as the main determinant of Islamic social commitment. Hence, the present study reinforces the understanding that ESG performance is shaped more by strategic orientation and internal capacity rather than by sheer financial size.

c. The Influence of Profitability on ESG Performance

Profitability (ROA) exhibits a positive and significant effect on ESG performance (coefficient = 0.440, p = 0.013). This finding suggests that more profitable Islamic banks tend to demonstrate better ESG performance. It is consistent with(S. Khan et al., 2023), who argue that highly profitable banks possess more financial resources to allocate toward social, environmental, and governance initiatives. Previous research also supports this result, noting that financially sound Islamic banks are more capable and motivated to invest in sustainability as part of their corporate reputation and social responsibility strategies.

d. The Influence of Bank Age on ESG Performance

The variable representing bank age (AGE) shows a significant negative effect on ESG performance (coefficient = –0.320, p = 0.021). This means that older Islamic banks tend to disclose lower levels of ESG information compared to younger banks. This result aligns with (Puspitasari & Kasri, 2023), suggesting that older institutions may be more conservative and less responsive to emerging sustainability trends. In contrast, newly established Islamic banks tend to be more innovative, as they have operated during a period when global awareness of ESG has increased significantly. (Sofya & Puteri, 2024) further argue that younger banking institutions are better positioned to integrate maqasid al-shariah with ESG principles, emphasizing social welfare and sustainability in their operations.

Conclusion and Recommendations

A. Conclusion

Based on the results of the SEM–PLS analysis, this study demonstrates that the proposed model explains approximately 43% of the variance in ESG performance among Islamic financial institutions through Shariah Governance and the control variables of bank size, profitability, and bank age. The core empirical finding contrary to theoretical expectations is that Shariah Governance exerts a negative and significant effect on ESG performance. This suggests that the current practice of Shariah Governance does not automatically translate into enhanced sustainability performance. The orientation of the Shariah Supervisory Board (SSB) appears to remain heavily focused on formal shariah compliance, with limited integration into

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broader environmental, social, and governance agendas embedded within contemporary sustainability frameworks.

The control variables reveal additional noteworthy dynamics. Bank size (total assets) does not significantly affect ESG performance, indicating that asset magnitude alone is not a determinant of sustainability practices; instead, ESG performance appears to be shaped more by managerial orientation and strategic commitment than by operational scale. Conversely, bank age has a negative and significant effect, implying that younger Islamic financial institutions tend to be more responsive to ESG agendas compared to their older, more established counterparts, which may be bound by more conservative operational traditions.

From a measurement standpoint, the ESG construct meets the required validity and reliability criteria. However, the Shariah Governance construct exhibits a limitation, with one indicator (SG3) failing to demonstrate convergent validity. This signals an important methodological constraint in the current study related to the robustness of the measurement instrument.

Overall, the findings imply that the existing implementation of Shariah Governance has not yet evolved into a mechanism that enhances ESG performance. Instead, the results underscore the need to reformulate the role of Shariah Supervisory Boards to align more explicitly with maqasid al-shariah, which encompasses environmental, social, and governance dimensions not merely transactional fiqh compliance

B. Recommendations

First, for the management of Islamic financial institutions, a strategic reorientation of the roles and performance indicators of the Shariah Supervisory Board is necessary. The SSB should not focus solely on formal shariah compliance, but should also oversee the integration of ESG principles into banking strategies and operations. Practical steps include: incorporating ESG considerations explicitly into the SSB charter, aligning SSB key performance indicators (KPIs) with sustainability objectives, and enhancing SSB competencies through training on sustainable finance and maqasid al-shariah with environmental and social perspectives.

Second, for regulators and standard setting bodies (such as OJK and DSN–MUI), the findings highlight the importance of synchronizing Shariah Governance regulations with national ESG frameworks. Future Shariah Governance regulations could be enriched by including guidance on ESG integration in relation to SSB composition, competency requirements, and supervisory scope. Simultaneously, regulators may encourage more comprehensive and standardized ESG reporting among Islamic financial institutions to facilitate measurement, benchmarking, and cross bank comparisons of sustainability performance.

Third, for academic development and future research, the limitations of this study provide meaningful avenues for improvement. Measurement of Shariah Governance should be refined by incorporating more diverse and higher quality indicators (e.g., SSB competence, independence, involvement in risk or sustainability committees) while eliminating non-valid indicators. Future studies are encouraged to adopt a broader sample (across countries or across different Islamic financial institution types), use panel or longitudinal data to capture ESG dynamics over time, and incorporate mediating or moderating variables such as organizational culture, sustainability strategy, or stakeholder pressure to better understand the mechanisms through which Shariah Governance can positively influence ESG performance. Strengthening empirical evidence in this manner will support the ongoing sustainability transformation within the Islamic finance sector.

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