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The role of Islamic banking in achieving ESG and SDG sustainable development goals

SUMMARY

This study examines the role of Islamic banking in advancing environmental, social, and governance (ESG) principles and the United Nations Sustainable Development Goals (SDGs), with particular attention to ethical investment practices and Shariah-compliant financial instruments that promote sustainability. A qualitative approach is applied, based on a review of relevant literature and a case study analysis of Islamic banking practices in Malaysia, Indonesia, Saudi Arabia, and the United Arab Emirates, with particular focus on green sukuk, Islamic social finance, and microfinance initiatives. The findings indicate that Islamic banking, grounded in ethics, justice, the prohibition of interest, and social responsibility, naturally aligns with ESG values and SDG objectives, contributing to clean energy, responsible infrastructure, poverty alleviation, and social inclusion. Challenges remain, including regulatory gaps, differing Shariah interpretations, and limited awareness among stakeholders. The study highlights the importance of standardisation, investor education, and the use of digital technologies to expand Islamic banking's impact on sustainable development. At the same time, it underscores the need for stronger collaboration among regulators, financial institutions, and Shariah boards. By combining theoretical insights and practical examples, the research underlines the strategic role of Islamic banking in achieving the SDGs, particularly in affordable and clean energy, sustainable cities, and climate action, with

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green sukuk emerging as a key instrument for financing projects that align ethical principles with global sustainability goals.

Keywords: Islamic finance, ESG, sustainable development goals (SDGs), green sukuk, ethical investment.

Uloga islamskog bankarstva u postizanju ESG i SDG ciljeva održivog razvoja

SAŽETAK

Ova studija ispituje ulogu islamskog bankarstva u podršci ostvarivanju načela životne sredine, društvene odgovornosti i korporativnog upravljanja (ESG), kao i Ciljeva održivog razvoja Ujedinjenih nacija (SDGs), sa posebnim naglaskom na etičke investicione prakse i šerijatski usklađene finansijske instrumente koji promovišu održivost. Primenjen je kvalitativni pristup zasnovan na analizi relevantne literature i studija slučaja praksi islamskog bankarstva u Maleziji, Indoneziji, Saudijskoj Arabiji i Ujedinjenim Arapskim Emiratima, sa fokusom na zelene sukuke, islamske instrumente socijalnih finansija i mikrokreditne inicijative. Nalazi pokazuju da se islamsko bankarstvo, zasnovano na etici, pravdi, zabrani kamate i društvenoj odgovornosti, prirodno usklađuje sa ESG vrednostima i ciljevima SDG agende, doprinoseći razvoju čiste energije, održive infrastrukture, smanjenju siromaštva i unapređenju socijalne inkluzije. Međutim, izazovi i dalje postoje, uključujući regulatorne nedostatke, različita tumačenja šerijatskih principa i ograničenu svest među ključnim akterima. Studija naglašava značaj standardizacije, edukacije investitora i primene digitalnih tehnologija u cilju proširivanja uticaja islamskog bankarstva na održivi razvoj, kao i potrebu za snažnijom saradnjom regulatornih tela, finansijskih institucija i šerijatskih odbora. Kombinovanjem teorijskih uvida i praktičnih primera, istraživanje ističe stratešku ulogu islamskog bankarstva u ostvarivanju ciljeva održivog razvoja, posebno u oblastima pristupačne i čiste energije, održivih gradova i klimatskih akcija, pri čemu se zeleni sukuk izdvaja kao ključni instrument za finansiranje projekata koji povezuju etičke principe sa globalnim ciljevima održivosti.

Ključne reči: islamske finansije, ESG, ciljevi održivog razvoja (SDGs), zeleni sukuk, etičko investiranje.

Introduction

Islamic finance is a financial system grounded in Shariah principles, emphasising ethics, justice, the prohibition of interest, and strong social responsibility. Unlike the conventional financial system, it promotes fair capital allocation, equitable wealth distribution, and the prevention of exploitation, reflecting not only religious and moral norms but also

universal values that are increasingly relevant in today's global context. Sustainability has become a fundamental component of modern finance. The ESG (environmental, social, and governance) framework serves as a global standard for assessing environmental responsibility, social impact, and corporate governance. In parallel, the United Nations Sustainable Development Goals (SDGs) define international priorities for addressing climate change, social inequality, and governance challenges while promoting responsible resource use and long-term development.

The ESG approach significantly shapes investment flows, influences regulatory practices, and strengthens institutional and corporate strategies. The connection between ESG principles and Islamic finance has gained prominence amid global environmental and social challenges. Shared foundations, including ethical conduct, stakeholder protection, and the pursuit of social welfare, enable a strong synergy between the two systems.

Numerous studies confirm the compatibility of ESG criteria with the objectives of Islamic law (Maqasid al-Shariah), as highlighted by Shallhoob (2025), Muhamad et al. (2022), and Zain et al. (2024). Challenges persist, including regulatory inconsistency, lack of standardisation, limited education, and low awareness among investors and financial institutions, which hinder the systematic adoption of ESG elements in Islamic financial products (Judijanto et al., 2025; Najid et al., 2024; Utomo et al., 2024; Rusmita et al., 2024). Despite that, innovative instruments such as green sukuk, Islamic microfinance, and socially responsible investment funds demonstrate strong potential to advance sustainable finance within the Islamic framework (Elamin, 2023; Agustin et al., 2023).

The objective of this research is to provide an analytical overview of the opportunities for integrating ESG principles into Islamic financial instruments, to identify regulatory and operational barriers, and to offer practical recommendations for strengthening sustainable development aligned with socially responsible economic values. Drawing on contemporary literature and relevant case studies, this study contributes to a profound understanding of the role that Islamic finance can play in the global transition towards a more sustainable, equitable, and ethically oriented economic system.

Literature review

In many countries, financial inclusion remains limited due to the incompatibility of conventional products with Shariah norms; however, empirical evidence shows that financial inclusion and economic growth

reinforce each other, highlighting the developmental importance of Shariah-compliant instruments (Kim, Yu & Hassan, 2018).

Growing attention to sustainability has positioned green sukuk as a key innovation linking Islamic finance with ESG objectives. Research identifies their role in funding renewable energy, climate resilience, sustainable transport, waste management, and agriculture, with strong investor demand and high perceived security (Fitrah & Soemitra, 2022). Broader governance and CSR considerations in emerging markets underscore the importance of transparency, accountability, and stakeholder protection, which align with both ESG standards and Islamic principles (Boubaker & Nguyen, 2014).

The literature consistently highlights the conceptual compatibility between Islamic finance and ESG, although practical integration remains constrained by regulatory inconsistencies, limited standardisation, and varying interpretations of Shariah (Sharipuddin et al., 2021; Shalhoob, 2025). Positive effects of ESG on financial performance depend heavily on institutional structures; for example, stronger governance mechanisms and Shariah supervisory boards enhance investor confidence and profitability (Hussain, Shahmoradi & Turk, 2016; Muneer et al., 2025). However, adoption levels differ considerably, and in the GCC region, both over-reliance on generic ESG scores and politically motivated ESG activity may weaken the link between ESG reporting and firm performance (Al-Jalahma et al., 2020).

Comparative studies indicate that Islamic banks in the MENA region lag behind conventional banks in ESG performance, indicating the need for more robust regulatory frameworks and clearer integration strategies (Jawad et al., 2022). Environmental reporting, however, has been shown to strengthen financial outcomes and institutional value, particularly in Indonesia, where transparency is a key determinant of bank valuation (Dwianto et al., 2024).

Recent research further explores integrated models that combine ESG and Maqasid al-Shariah, particularly in Takaful, demonstrating strong normative compatibility but also the need for unified reporting standards and practical implementation tools (Judijanto et al., 2025; Zain et al., 2024; Agustin et al., 2023). Bibliometric studies point to rapidly growing interest in green sukuk and sustainable Islamic finance but also emphasise the persistent gaps in regulation, measurement frameworks, and financial literacy (Utomo et al., 2024; Mohamed, 2024).

Overall, evidence shows that Islamic finance can significantly contribute to sustainable development when supported by strong governance, transparent reporting, and harmonised standards. The

integration of ESG practices with Shariah principles, particularly through environmental accountability, board expertise, and digital transformation, can position Islamic finance as a global leader in ethical and sustainability-oriented financial systems (Muneer et al., 2025).

Methodology

This research aims to provide an analytical overview of how ESG and SDG principles can be integrated into Islamic financial instruments. It also looks at the main regulatory and operational challenges and offers practical suggestions to improve sustainable development in line with the values of Islamic economics. Using qualitative research methods, including comparative analysis and case studies from Muslim countries and global practices, this study seeks to improve the understanding of the role that Islamic finance can play in supporting ethical, responsible, and sustainable business at the global level.

Islamic finance is a unique financial system based on Shariah principles. It focuses on ethics, fairness, and the prohibition of interest while promoting social responsibility. It supports fair and moral capital management, encourages equal wealth distribution, and avoids exploitation. ESG and SDG principles are used to evaluate companies' sustainability and responsibility. These principles are becoming more important in modern finance and are shaping investment decisions, regulations, and business strategies worldwide. Islamic finance and ESG share common values, such as ethical behaviour and protection of all stakeholders' interests, which creates room for strong cooperation between the two. Nevertheless, there are some challenges to this integration, such as regulatory differences, a lack of unified standards, and limited awareness among investors.

These issues often slow the adoption of ESG practices in Islamic financial products. Even so, there are promising innovations such as green sukuk (Islamic green bonds), Islamic microfinance, and social impact investment funds that show strong potential to support sustainable finance. Real-world examples, such as the development of green sukuk in Indonesia, indicate that these instruments can follow Shariah principles while also helping protect the environment and supporting long-term development.

Case studies of ESG, SDG, and Islamic finance integration

Key characteristics of Islamic finance

Islamic finance is founded on key principles that distinguish it from traditional banking, including justice, risk sharing, joint ownership, and fair distribution of both profits and losses. This system is more resilient to global economic shocks because it is tied to the real economy and avoids speculative financial instruments. In Islamic finance, all parties share risks and rewards, fostering a stable business environment in which no one wishes to incur losses and profits are equitably distributed. While this structure promotes stability, Islamic finance still faces risks and requires careful risk management. A key advantage is that risks are spread across all participants rather than being concentrated on one side. Islamic banks also face challenges, especially in managing rapid growth and adapting to changing business environments, which may demand coordinated structural and operational adjustments to avoid negative effects. This model offers a more stable foundation than conventional banking, underscoring fair resource and risk distributions over guaranteed fixed profits.

Islamic banking growth might be slower, as it tends to be more sustainable and balanced in the long term. As Islamic banks increasingly operate within conventional financial systems, understanding their unique financial contracts, legal frameworks, and liquidity conditions is crucial. They face specific risks, partly due to limited liquidity access and underdeveloped interbank markets and financial instruments. A central model in Islamic banking is profit-and-loss sharing (PLS), in which clients earn returns based on the actual profits or losses from investment projects rather than fixed interest. This shifts some risk from banks to clients, reducing credit risk but exposing bank funds to business uncertainties, similar to that faced by equity investors rather than fixed-return depositors. Despite progress, Islamic finance still struggles with developing fully functional markets, instruments, and regulations. The literature compares Islamic and conventional products, explores legal challenges for investors, and assesses Islamic banking performance, highlighting the need for further development and problem resolution (Zaher & Hassan, 2001).

The prohibition of conventional derivatives reduces the ability of Islamic banks to effectively protect themselves against certain risks, such as changes in interest rates or currency risks. Nevertheless, certain characteristics of the Islamic business model can make these banks more resilient to shocks than conventional banks can be. For example, in the case

of adverse events affecting income from PLS investments, the loss can be shared with investors, thereby reducing pressure on the bank's balance sheet (Hesse et al., 2008).

Islamic finance naturally aligns with ESG goals, raising questions about its role in financial stability. A study comparing conventional-only systems with dual systems (Islamic and conventional banks) revealed that Islamic banks enhance stability. They are more liquid, have higher cash reserves, and avoid risky instruments such as derivatives. Despite their lower net worth, they generate more liquidity per asset and often support conventional banks during crises. Compared with dual systems, conventional-only systems cause more bankruptcies. The study suggests that introducing Islamic banking can increase stability and reduce risk. Future research should include the roles of central banks, regulators, and consumer behaviour (Tekdogan & Atasoy, 2021).

Table 1. Islamic financial instruments and their ESG/SDG focus

Instrument	SDG/ESG Focus Areas	Key outcomes
Green Sukuk	Clean energy, climate action	Mobilises capital for green infrastructure
Zakat & Waqf	Poverty, social inclusion	Supports vulnerable groups, reduces inequalities
Islamic Microfinance	Financial inclusion, SMEs	Empowers entrepreneurs, fosters local development
Socially responsible funds	ESG integration, ethical investing	Promotes responsible corporate behaviour

Source(s): Table by author

Islamic financial instruments, such as green sukuk, zakat, and waqf, Islamic microfinance, and socially responsible investment funds, play a key role in achieving the Sustainable Development Goals (SDGs) and ESG principles. Their basic characteristics are as follows:

1. Green Sukuk are specialised bonds used to finance environmentally sustainable projects, such as renewable energy and green infrastructure projects. This instrument enables the mobilisation of capital for projects that have a positive impact on the environment, such as solar and wind turbines or green buildings.
2. Zakat is the obligatory giving of a portion of one's wealth to the poor, whereas waqf is a form of permanent donation that is used to finance

charitable activities. These instruments help reduce poverty and social inequality by enabling the fair distribution of wealth and supporting vulnerable groups in society. In Islamic finance, *zakat* and *waqf* play key roles in supporting social inclusion and reducing poverty.

3. Islamic microfinance provides financial services to small entrepreneurs and impoverished communities who would otherwise not have access to traditional banks. This instrument enables inclusion in the financial system without the use of interest, instead applying the principles of profit and risk sharing. Microfinance supports the development of SMEs and helps the local economy, particularly in developing countries, by providing opportunities for economic growth and improving living standards.
4. Socially responsible funds (SRFs) are investment funds that focus on ESG (environmental, social, and governance) criteria. These funds invest in companies that respect ethical standards and avoid industries such as alcohol, gambling, and weapons. In line with Islamic principles, SRFs promote responsible corporate behaviour and accountability towards society, the environment, and good governance, enabling investors to invest in projects with positive social impact.

Owing to its fair principles, Islamic finance can be categorised as high-fair finance, which aligns most closely with sustainable finance and business according to ESG principles. A detailed explanation of how ESG principles are realised through Islamic finance is provided below:

1. The prohibition of interest
2. Risk sharing
3. Investing in halal sectors
4. Connecting with the real economy
5. Ethics and social responsibility

Shariah principles closely align with ESG values by promoting ethical, asset-backed, and socially responsible financing. Profit is earned through real investments and shared risk, whereas activities involving alcohol, gambling, speculation, or weapons are prohibited. Financial products must be tied to tangible assets, aiming for fair wealth distribution, transparency, and social benefits. Regulatory bodies play a key role in this alignment. Central banks oversee banking operations, licence issuance, and sukuk regulation. Agencies such as Malaysia's Securities Commission and Indonesia's Financial Services Authority regulate capital markets and ESG compliance. International bodies such as AAOIFI and IFSB set standards and promote ESG integration in Islamic finance.

A key innovation is green sukuk, Islamic bonds designed to fund environmentally sustainable projects. They promote ESG goals and the UN SDGs by encouraging efficient resource use and green energy investment. While green sukuk alone cannot solve climate issues, it is a vital part of broader strategic sustainability efforts. Achieving lasting impact requires collective global action and greater investment in green projects. Green sukuk offers a quick, accessible way for issuers and investors to support climate-friendly initiatives (World Bank, 2025).

Case studies of Malaysia and Indonesia

Malaysia and Indonesia are key centres of Islamic finance in Southeast Asia, each developing its sector differently. Malaysia, with Kuala Lumpur as its financial hub, has established an advanced Islamic banking system and sukuk market that includes innovative tools such as green sukuk. These developments are strongly supported by government regulations, expert training, and international promotion. Indonesia, home to the largest Muslim population, focuses primarily on expanding Islamic banking for its domestic market and promoting financial inclusion. While there is some competition between the two to attract international investment, they cooperate well in international forums and share experiences. Malaysia leads in innovation, whereas Indonesia adopts a more conservative, local approach. Together, they drive growth in the regional Islamic finance sector.

Malaysia pioneered green Islamic financial instruments by issuing the world's first green sukuk in 2017 to fund solar power plants, laying the foundation for sustainable investing under Islamic principles. This success stems from strong government support, including the creation of specialised Islamic finance institutions, the issuance of government sukuk, expert training, and research centres. These initiatives blend Shariah compliance with financial innovation, enabling Muslim investors to participate in green projects. Malaysia leverages its position outside traditional Islamic finance centres to create products with international acceptance. Green sukuk also advances Malaysia's environmental and social goals and enhances its reputation as a leader in Islamic finance innovation.

Owing to its robust institutions and market backing, Malaysia has become a global leader in integrating sustainability within Islamic finance. The Securities Commission of Malaysia developed the green sukuk framework to achieve economic, political, and environmental objectives through standards, promotion, and international collaboration with organisations such as ASEAN, the UNDP, and the Islamic Development

Bank. Partnerships with the World Bank help align these efforts with global standards while offering financial incentives, training, and regional expansion. Green sukuk forms part of a broader strategy to expand the Islamic finance market, promote sustainable investment, and increase environmental responsibility in line with Malaysia's long-term national plans. Local credit agencies have also created their own sustainable finance rules, illustrated by the verification of the fourth green sukuk in January 2018, signalling growing domestic demand.

The true environmental impact of green sukuk remains uncertain. Out of ten issued sukuk, two did not receive the highest environmental certification, and one was rated "Tier 3", indicating minimal contribution to a low-carbon future. That finding reveals weaknesses in the Green Bond Principles, including the risk of greenwashing, showing that these instruments only partially support real environmental change. While green sukuk is an important innovation and political achievement, it has not fully addressed greenwashing or the deep application of Islamic principles for environmental protection. Financial ecology analysis highlights the complexity of these tools and the need for further research on how policies, markets, and environmental needs interact in different contexts (Liu & Lai, 2021).

Despite these challenges, green sukuk finance is vital, as it promotes ESG and SDG principles. Significant progress has been made, and Islamic finance has contributed to sustainable development goals. Current strengths and weaknesses should inform the creation of improved solutions that boost financing aligned with ESG and SDGs. Finance combined with ethics plays a crucial role in driving sustainability by directing capital towards environmentally responsible projects. Ethics ensures that financial decisions consider not only profit but also social and environmental impacts, emphasising transparency, responsibility, and fairness, which help reduce abuse and harm to society and the environment. A study of 23 Shariah banks in Indonesia and Malaysia from 2017 to 2022 revealed that Islamic social reporting significantly enhances Maqasid Shariah performance, underscoring its importance in meeting ethical and Shariah goals. The Maqasid Shariah index measures how well institutions align with Shariah principles, focusing on sustainability, responsibility, and ethics. Intellectual capital and corporate governance had little or slightly negative effects, suggesting that they alone do not improve Maqasid Shariah performance without strong social reporting (Puji Astuti & Raharja, 2024).

Indonesia issued its first sovereign green sukuk in 2018 to fund renewable energy and combat climate change. The government has launched several green sukuk series, including a global series in 2018 and a retail series in 2019, which attracted many young investors. Funds are allocated only to projects that meet the “Eligible Green Projects” criteria and are aligned with green bond principles, such as renewable energy, sustainable transport, waste management, sustainable agriculture, and climate resilience. Green sukuk finances low-carbon projects and helps build economic resilience, supporting national and global sustainable development goals. They play a vital role in funding infrastructure projects that protect the environment and advance the SDGs, making them key tools for transitioning to a sustainable economy.

Despite their growing popularity, research on measuring the „greenness” of these tools is still evolving, especially post-COVID-19. Major challenges include weak greenhouse gas emission measurement methods, the management of green projects, and a lack of standardised accounting frameworks (Alam et al., 2023). The success of the green sukuk market depends on international cooperation, the involvement of regulators and experts, investor awareness, and alignment with global standards. Transparency in sharing sustainability information is crucial; a study of Indonesian commercial banks reveals that simply sharing sustainability information positively impacts company value, whereas ESG scores and digital transactions alone do not have the same effect without effective stakeholder communication (Triyani & Siswanti, 2024). These findings confirm the importance of quality reporting and institutional support in sustainable finance. A comparative study of Bank Syariah Indonesia and Maybank Islamic Berhad shows that while both follow Shariah practices, they differ in detail and quality of sustainability reporting, particularly in corporate social responsibility and environmental transparency. Harmonising sustainability reporting standards among Islamic banks is needed to strengthen the ethical and responsible nature of this sector (Adirestuty et al., 2024).

Another study on Indonesian Shariah banks from 2012 to 2020 revealed that sharing information on Islamic corporate governance and Islamic corporate social responsibility positively affects banks’ financial performance. Integrating governance and socially responsible practices helps improve business efficiency and build investor trust, aligning with Shariah values and long-term sustainability principles (Nasution et al., 2022).

The Gulf countries: The UAE, Saudi Arabia, Kuwait, and Oman

The UAE and Saudi Arabia have successfully used green sukuk to finance sustainable infrastructure and energy transitions. The Saudi Electricity Company (SEC) has developed a comprehensive framework for Saudi Arabia's sustainable energy transformation, responding to the growing demand for electricity and the need to reduce fossil fuel use. The SEC was the first issuer in the region to issue green sukuk instruments aimed at financing renewable energy and energy efficiency projects. The company implements an ESG strategy that encompasses the transition to a low-carbon economy, community empowerment, and ethical business practices. Through internal monitoring and reporting mechanisms, the SEC ensures that the proceeds from sukuk are used to finance only qualified green projects, while investments in renewable sources and network automation enhance the capacity, efficiency, and reliability of the electricity system, contributing to the reduction of greenhouse gas emissions and improving the quality of service for customers (Shalhoob, 2023).

This contributes to the development of renewable energy and increases investor confidence because the rules are clear and consistent. Additionally, research shows that actors in Saudi Arabia's Islamic finance sector perceive a positive link between ESG reporting and financial performance, particularly when ESG practices align with Maqasid al-Shariah (the objectives of Islamic law). The integration of ESG principles with Islamic values further strengthens stakeholder trust, promotes corporate responsibility, and contributes to long-term sustainability. However, the research does not measure direct financial outcomes, and perceptions vary depending on industry and demographic factors (Shalhoob, 2025).

In contrast, Kuwait and Oman face difficulties due to fragmented regulations. Laws and rules are not unified, consistent, or harmonised. Instead of having a clear, coherent rule regulating a specific area, various laws or regulations may be scattered, contradictory, or unrelated, leading to confusion and making implementation difficult. This means that laws and regulations are misaligned or opaque, reducing investor confidence and making it harder to finance green projects.

The implementation of technologies such as blockchain contributes to greater transparency and efficiency in tracking funds. It enables a clear, immutable record of all transactions, reducing the risk of misuse of funds and facilitating the tracking of how money is used. Public-private partnerships (PPPs) and risk sharing allow investments in renewable projects to be safer and more profitable. Inspiration from Africa and Southeast Asia shows that such models increase project success because they

involve shared responsibility between the state and private investors, thereby reducing risks and encouraging greater investment (Morshed, 2025).

Countries with clear, coordinated laws that utilise new technologies and partnerships are more successful in attracting funds for green projects, whereas those with fragmented regulations struggle to draw investors. In GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE), individual ESG factors positively affect Islamic banks' financial performance: social factors improve multiple indicators, governance impacts return on equity, and environmental factors correlate with Tobin's *Q*, reflecting market value and ecological responsibility. Although the overall ESG score has no significant effect, Islamic banks have strong potential to support sustainable development through improved ESG practices and niche services. The authors recommend that bank management, investors, and policymakers integrate ESG factors into strategies and develop tailored ESG frameworks suited to Islamic banking's unique ethics and operations (Alghafes et al., 2024).

Research also indicates that ESG integration can expand into Islamic finance areas such as *Takaful* (Islamic insurance). One study proposes a framework embedding ESG principles into *Takaful* models, which are aligned with Islamic law's core values – protecting life, faith, intellect, progeny, and wealth. This approach helps *Takaful* operators enhance ethical standards, social impact, and environmental responsibility. This paper calls for standardised ESG reporting and further practical research, emphasising that ESG-driven practices can strengthen financial stability, social cohesion, and sustainable development goals (Judijanto et al., 2025).

Research combining the 17 SDGs and ESG principles with Shariah values has created a comprehensive framework that shows strong alignment, particularly in protecting life, religion, intellect, progeny, and wealth. This provides *Takaful* operators with guidance to enhance ethical credibility, social impact, and environmental responsibility. The study also calls for a standardised disclosure index to transparently communicate their commitment to ethics and sustainability, fostering responsible Islamic finance growth (Zain et al., 2024).

A broader bibliometric analysis of green and sustainable finance in Islamic banking from 2001 to 2024 confirms the increasing interest in green *sukuk*, ESG investments, and climate finance, alongside greater alignment with global sustainability goals. However, challenges, such as the lack of regulatory standards and underdeveloped financial technologies, are highlighted. The study recommends clearer ESG guidelines and increased investment in innovation to increase Islamic finance's role in combating

climate change, encouraging further research and advanced product development (Utomo, Sudarmanto & Muhammadong, 2024).

Empirical research on 85 Islamic banks from OIC countries (2007–2016) shows that ESG reporting varies with institutional and economic conditions. Larger, more leveraged banks report more on ESG. Governance reporting is more common in stronger economies, whereas social and environmental reporting is more common in less developed economies. Tobin's Q predicts ESG activity, and overall ESG performance increases bank performance. However, only environmental reporting improves ROA and Tobin's Q; social and governance reporting may negatively affect operational performance. This study suggests mandating ESG reporting and creating regulations aligned with Islamic sustainability values (Buallay et al., 2020).

Environmental reporting within ESG frameworks plays a crucial role in boosting the market value of Islamic banks, especially when aligned with financial performance. A systematic review highlights the importance of Maqasid Al-Shariah in enhancing financial results by promoting environmental sustainability, strengthening corporate governance, and achieving long-term shareholder goals. By integrating Maqasid principles into the ESG framework, Islamic banks can balance shareholder interests with Shariah and sustainability objectives, leading to more stable operations.

The research has also emphasised that stakeholder engagement, transparency, and social responsibility significantly improve financial performance. The impact of corporate governance on stock returns is analysed in this context, with justice and societal welfare, which are key Maqasid principles, being fundamental to business success. This study concludes that aligning ESG with Maqasid Al-Shariah is essential for long-term sustainable development and broader societal progress (Radin et al., 2024).

For effective implementation, enhanced financial literacy, proper regulatory frameworks, and stronger corporate governance are needed. This integration promises improved social and economic outcomes, reinforcing the sector's sustainability (Marpaung and Lubis, 2025). These findings highlight the important connection between Islamic finance and global sustainable development efforts.

Discussion and recommendations

Islamic finance is positioned as a bridge between traditional ESG frameworks and ethically motivated, religiously grounded financial models. Its role in achieving the Sustainable Development Goals (SDGs) is

particularly significant in Muslim-majority countries, but also in the global context, which is seeking more stable, fair, and sustainable financial systems.

At the core of Islamic finance are principles of ethics, justice, the prohibition of interest, the avoidance of speculation, and an emphasis on real economic transactions. These values align naturally with ESG principles and sustainable development goals. Instruments such as green sukuk bonds facilitate the financing of renewable energy projects, sustainable infrastructure, energy efficiency, and environmental protection, all of which are in accordance with Shariah values. At the same time, Islamic microfinance institutions contribute to the financial inclusion of marginalised groups, directly supporting SDG 1 (poverty eradication), SDG 10 (reduced inequalities), and SDG 11 (sustainable cities and communities). Additionally, Islamic finance places a strong focus on the real economy and emphasises the avoidance of excessive speculation, which contributes to greater stability within the financial system. Key instruments that integrate ESG and Islamic values include green sukuk, Islamic microfinance, waqf (charitable investments), and socially responsible investments (SRIs) within the Shariah framework. Nevertheless, despite its clear advantages, the Islamic financial sector faces several challenges, such as the following:

1. A lack of regulatory harmonisation and differing interpretations of Shariah norms between countries make the standardisation and comparability of ESG reporting difficult.
2. Weak transparency and the absence of specific ESG standards for Islamic finance reduce trust and complicate impact measurement.
3. Insufficient education and awareness about ESG integration in the Islamic context hinder progress.
4. Technical and institutional limitations, particularly in developing countries, complicate the implementation of complex evaluation models.
5. The limited international perception of Islamic instruments as being locally or religiously confined reduces global demand and liquidity.

Green sukuk, as an innovative Shariah-compliant instrument, successfully integrates Islamic and ESG principles and is widely used to finance renewable energy projects, climate change resilience, and sustainable transportation. However, the market faces challenges such as a lack of global standardisation, which hinders verification and comparability; high issuance costs due to separate Shariah and ESG audits; and limited interest from international investors, who still see green sukuk as a niche Islamic financial product. To overcome these obstacles, efforts

should focus on developing globally relevant ESG standards, including clear ESG metrics, to ensure alignment. Greater cooperation between regulatory bodies can help harmonise these financial instruments and their financial and ESG interpretations, contributing to consistent global standards. Digitisation and fintech solutions can improve transparency, lower issuance costs, and facilitate ESG impact tracking. Education and awareness among stakeholders, including investors, regulators, decision-makers, and the public, are also vital to highlight the potential of these innovations for sustainable development.

Binding global standards are needed, particularly concerning the SDGs and ESG, with institutions such as the International Organisation for Standardisation (ISO) and the UN Development Programme (UNDP) playing leading roles in establishing certification frameworks. Although ISO 26000 is an important social responsibility standard, its impact is limited by the absence of certification options, underscoring the need for mandatory certification mechanisms overseen by regulatory bodies. While international ESG frameworks such as GRI, SASB, TCFD, ISSB, and ISO standards 14001, 45001, and 37001 exist, the lack of a universal certification system remains a major barrier to consistent application and comparability. The situation is similar for the SDGs, where tools such as the UN SDG Compass exist. However, a global certification system is unavailable, thus highlighting the need for a unified certification institution under the UNDP to ensure universal oversight and application of ESG and SDG principles.

Results

Islamic finance can significantly contribute to achieving sustainable development goals (SDGs) through alignment with ESG principles. By investing in projects that promote environmental preservation, social inclusion, and responsible governance, Islamic financial institutions can act as catalysts for sustainable change. Instruments such as green sukuk bonds enable the financing of renewable energy projects, energy efficiency, and sustainable agriculture, and are important tools for stimulating sustainable development. Additionally, Islamic microfinance institutions can support the development of affordable housing and infrastructure in poorer communities, contributing to the goals of sustainable cities and communities (SDG 11) and affordable and clean energy (SDG 7). In this way, Islamic financial instruments have become tools for long-term development that balance economic benefits with social and environmental values.

Although green sukuk demonstrates significant potential for financing low-carbon projects and contributing to the SDGs, the market for this instrument faces several challenges that may limit its reach and effectiveness.

First, the lack of global standardisation makes comparability, verification, and mutual trust among investors, regulators, and issuers difficult. Without unified international frameworks, the practice of issuing green sukuk varies across countries, leading to regulatory fragmentation and making integration into the global sustainable finance market more challenging.

Second, high issuance costs, which include the complex processes of Shariah compliance review and verification of the “greenness” of projects, pose a significant barrier for smaller institutions and countries with limited technical capacity. The double verification processes, in line with sustainability principles and Islamic financial rules, require expertise, time, and additional resources.

Third, and perhaps most importantly, there is a need for greater interest from investors outside the Islamic world. Despite the universal sustainability component of green sukuk, many international investors still perceive it as a special financial instrument that is confined to Muslim countries or Islamic communities. That limits liquidity and market depth, further increasing risk and reducing its attractiveness to a broader investor base.

The key challenges identified include regulatory shortcomings, differing interpretations of Islamic financial principles, a lack of transparency, and the absence of ESG and SDG standardisation in the Islamic context.

Conclusion

There is clear evidence of complementarity between ESG principles and Shariah goals, with Islamic financial institutions demonstrating the potential to lead in sustainable and ethical practices. Full integration requires the following:

1. Strengthening regulatory frameworks and standardising ESG reporting.
2. Enhancing institutional capacity and educating management structures.
3. Developing financial instruments that link green goals with Shariah compliance.

4. Expanding empirical validation of the effects of ESG performance on financial performance and social impact.

Future research should focus on longitudinal analyses, comparative studies between Islamic and conventional institutions, and evaluations of the impact of digital technologies on ESG implementation in Islamic banking. Green sukuk represents an innovative instrument that links the principles of Islamic finance and sustainable development. Its role is not only in mobilising capital but also in contributing to the global transition towards a green economy. With further development of regulations, standardisation, and expansion of the investor base, green sukuk could become a key instrument in combating climate change and promoting responsible finance. Countries such as Malaysia, Indonesia, the UAE, and Saudi Arabia are examples that success is based on coordinated legislative frameworks, technological innovations, partnerships, and market actor education.

Although challenges such as the standardisation of green criteria and the avoidance of greenwashing still exist, it is clear that Islamic financial principles, combined with ethics and the ESG framework, represent a powerful tool for achieving sustainable development, directing capital not only towards financial returns but also towards positive social and environmental outcomes. For Islamic finance, particularly for instruments such as green sukuk, realising their full potential requires coordinated advancement in standardisation, regulation, digitalisation, and capacity building. The establishment of harmonised global standards and robust certification frameworks, supported by leading international bodies, would mitigate existing structural barriers and enhance market credibility. Going forward, key priorities include rigorous quantitative assessment of the economic and sustainability impacts of Islamic finance, the development of innovative financial instruments aligned with ESG principles, stronger collaboration between regulatory authorities and ESG specialists, and the systematic integration of Islamic finance into global sustainability and responsible investment architectures. To further encourage investment in environmentally sustainable practices, one effective proposal is to introduce tax incentives, such as capital gains tax exemptions for investments in green sukuk and other green financial instruments. Such measures could significantly stimulate investors and accelerate the growth of the green bond market, thereby strengthening the contribution of the Islamic financial sector to sustainable development on a global scale. Only through such synergistic efforts can long-term sustainability and efficiency in the Islamic financial sector be achieved while also driving broader social and ecological transformation.

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