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Dayang Nuradzlina Radin

Norhasimah Shaharuddin

Imbarine Bujang

Igo Febrianto Rijanto

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SPECIAL ISSUE ARTICLE

The Interaction of Maqasid Al-Shariah in the Relationship Between ESG and Firm Financial Performance

Dayang N. Radin [a], Norhasimah Shaharuddin [b,*], Imbarine Bujang [c], Igo F. Rijanto [d]

[a] Department of Postgraduate and Professional Studies, Faculty of Business and Management, Universiti Teknologi MARA, Shah Alam Campus, Selangor, Malaysia
[b] Faculty of Business and Management, Universiti Teknologi MARA, Puncak Alam Campus, Selangor, Malaysia
[c] Faculty of Business and Management, Universiti Teknologi MARA, Kota Kinabalu Campus, Sabah, Malaysia
[d] Faculty of Economics and Business, Universitas Lampung, Indonesia

Abstract

This paper aims to analyse the role of Maqasid Al-Shariah as a value-added factor in the implementation of ESG for firms' financial performance. Most publicly listed firms are encouraged to get involved in sustainability reporting; however, the adoption rate of ESG among non-financial firms seems unattractive. Therefore, this paper will evaluate the literature review using the systematic literature review approach to justify the role of Maqasid Al-Shariah in implementing ESG. The general conclusion suggested that ESG plays an essential role in financial performance despite the implementation focusing more on cost. The inclusion of Maqasid Al-Shariah in ESG believes that the sustainability of the environment and governance is seen as a robust integration for the long-term benefit of business stakeholders.

Keywords: Sustainability ESG, Maqasid Al-Shariah, Firm financial performance

1. Introduction

A corporation's financial performance can be seen as the financial position that the firm has maintained over a specific period. Financial performance refers to the appraisal of the firm's financial state in a specific context, focusing on acquiring and allocating funds. Traditionally, this assessment is often conducted using capital adequacy, liquidity, and profitability indices. Metrics most widely argued in the literature, which offer a significant perspective and intricate comprehension of a company's financial performance, are profitability, leverage, liquidity, and efficiency ratios. Additionally, financial ratios, typically employed as financial performance indicators, are further broken down into three major groups that give an overview of a company's financial situation. These categories include ratios that reflect structural change inside a firm, ratios that show the profitability of the firm, and ratios that influence the companies' market value. Similar to Alsayegh et al. (2020), the present study seeks to corroborate whether firm-specific characteristics, such as financial liquidity, leverage, firm size, and firm age, are significant underlying factors that influence the

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* Corresponding author.
E-mail addresses: shimasaha@uitm.edu.my, dayangnuradzlina@gmail.com (D.N. Radin), imbar074@uitm.edu.my (I. Bujang), igofebrianto@gmail.com (I.F. Rijanto).

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degree of financial stability can motivate management to achieve superior financial performance. Researchers across various countries have conducted numerous studies to investigate the influence of liquidity, leverage, firm size, and firm age on the financial performance of businesses. Most of the research findings on the financial performance of businesses demonstrated a significant positive effect of the individual independent variable and the combination of such variables (liquidity, leverage, firm size, and firm age).

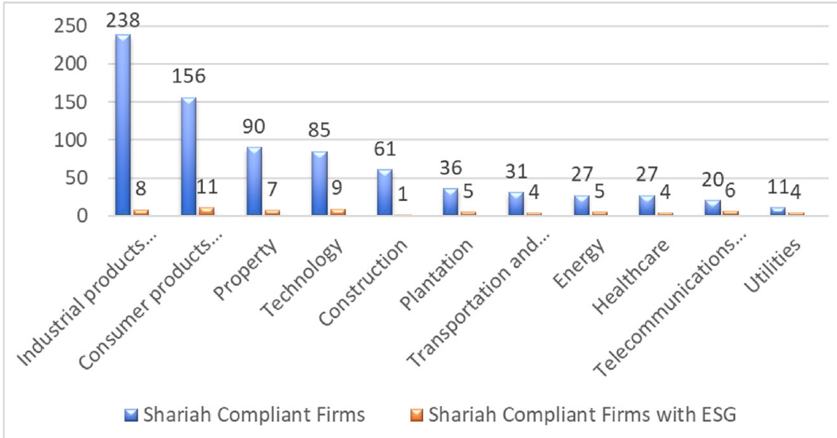
In recent years, ESG concerns have become a priority for stakeholders and governments for risk management purposes, while corporations are incorporating them into their competitive strategy. There has been a notable rise in public consciousness regarding the relevance of environmental and social welfare, as well as the involvement of corporations in these domains. This phenomenon has heightened demands for firms to engage in environmentally friendly, sustainable, and socially responsible practices. Practices such as the triple bottom line have gained significant traction recently, aiming to establish a substantial connection between corporate operations and environmental, social, and governance (ESG) values. This emerging trend seeks to elevate corporate social performance (CSP) to the same level of importance as corporate financial performance (CFP). Simultaneously, the research findings indicate a positive relationship between each dimension of environmental, social, and governance (ESG) factors and the financial performance of Shariah-compliant firms (Peng & Isa, 2020). Investors are inclined to select firms that demonstrate ethical excellence, actively participate in ESG activities, and exhibit good corporate citizenship.

Incorporating ESG into company business practices has provided significant benefits that are fruitful in improving interactions with the public and employees (Peng & Isa, 2020). Nevertheless, robust ESG practices can serve as a guide for the overall management quality of a company, which translates into superior financial outcomes. However, the question of interest in this study is the interaction between ESG practices and Maqasid Al-Shariah. Despite mounting evidence for improved financial performance and comprehension of ESG, the non-financial industry has seen many scandals and crises in recent decades. Concerning the 1997 Asian financial crisis, the 2007–2008 global financial crisis, the Enron scandal, and other documented faults in conventional business transactions are among the recent financial crises and scandals that collide with the widespread preference for triple bottom lines with the Shariah perspective. One of the fundamental reasons for the deteriorating performance was an ineffective application of corporate governance on a conventional basis. Thus, Shariah in organisations promotes humanity and faith in all social and economic affairs, underpinning equality and justice. Islamic firms should relate economic endeavours to Shariah objectives in their vision and mission statements. However, only right behaviour, moral conduct in related management, and charitable giving in wealth distribution can advance Shariah's broader purposes.

Initially, the United Nations (U·N.) launched the Sustainable Development Goals (SDGs) 2030 in 2016 to revitalise the Millennium Development Goals (MDGs) era (2000–2015), which yielded mixed outcomes. Meanwhile, the MDG-1, eradicating absolute poverty, remains mostly unachieved (Khan, 2019; Tuyon et al., 2021). A notable change in perspective involves faith (local aspirations) as a constructive means to achieve Sustainable Development Goals (SDGs), contrasting with the previous MDGs approach that viewed faith as an obstacle to accessing health, education, and financial services. As a result, the SDGs-focused effort, the ESG principle, and Maqasid Al-Shariah are complementary in their recognition of human stewardship and accountability, social welfare, and the preservation of the environment.

However, the findings do not consistently present evidence for a universal relationship between Maqasid Al-Shariah and financial benefits, which leads to whether being ESG-focused and Shariah compliance is worthwhile. Table 1 shows FTSE Russell data among 782 Shariah-compliant companies; there are 64 Shariah public-listed firms other than the financial industry that have incorporated ESG practises in 2022 are on the market, which is slightly modest (Bursa Malaysia, 2022). Thus, there is room for the Maqasid Al-Shariah components to be harmonised with ESG dimensions to develop a comprehensive investment instrument to improve the financial performance of Islamic firms while considering non-financial factors. Therefore, with the apparent relation between Maqasid Al-Shariah and ESG, this study determines the relationship between the individual dimension of ESG and the financial performance of Islamic non-financial firms. Simultaneously, the direct impact of Maqasid Al-Shariah mechanisms on the financial performance and the impacts of the application of Maqasid Al-Shariah on ESG dimensions towards the financial performance of Islamic non-financial firms.

Table 1. ESG integration in Shariah based firms in Malaysia.



Source: Securities Commission Malaysia & FTSE Russell.

2. Literature review

2.1. Stakeholder theory

According to the management literature, stakeholders' interests are the key to any organisation's longevity. Consistent with the stakeholder theory proposed by Freeman and peers, an organisation's primary goal is to maximise the value creation for all its stakeholders. According to the stakeholder concept, meeting stakeholders' expectations can be viewed as requiring superior financial performance. In contrast, the endeavours would require virtuous conduct in business management to create a balancing effect on the environment, society, and good corporate governance. Therefore, the stakeholder perspective adopts a fundamentally different point of view from the current literature on the earlier corporate finance that is largely shared conviction; the firms' goal is merely about creating financial value, indicating only one group of stakeholders, primarily shareholders that would benefit from this action most of the time—hence spawning the corporate social responsibility (CSR) field of research. Corporate social responsibility (CSR) strategies encompass many practices that firms can employ to satisfy the demands of numerous stakeholders, including the environment, society, and shareholders.

2.2. ESG and financial performance

2.2.1. Environmental

Much empirical research has been done to throw light on the relationship between ESG practices and the financial performance of Shariah firms. It is consistent with the findings; corporate environmental performance (CEP) is believed to impact corporate financial performance (CFP). Moral character and innovation have driven them financially while building an environmental leadership reputation. Accounting and market-based corporate financial performance (CFP) correlate positively with environmental performance (E.P.). Sustainable packaging, green construction regulations and supply chain management policies minimise costs and have a favourable correlation with accounting-based and market-based CFP. However, the adoption of ISO 14001 concerning the green aspect appears to have a negative financial impact based on the findings of the cross-country analysis. Likewise, the E.P. determined through return on assets has negatively impacted the CFP. An extensive study conducted by incorporating panel data regression analysis for Norwegian listed firms' financial performance from 2010 to 2019 also has provided results of the regression model, in which return on assets (ROA) serves as the dependent variable and has a definite negative impact. While ESG rises, Tobin's Q rises. The results indicate that ESG-integrated corporations may reduce short-term earnings but not long-term value.

2.2.2. Social

A significant body of literature has been dedicated to empirical study on the association between the social proxy in ESG and financial performance. However, no clear consensus has been reached. The social score result is significant using a static panel regression to testify on the 36 public-listed firms on the FTSE4Good Bursa Malaysia index components from 2015 to 2019. It suggests that the firms' investment in sustainability increased shareholders' return on equity (ROE) (Tuyon et al., 2021). The engagement of stakeholders in corporate management improves operational efficiency. Besides that, successful CSR initiatives proxied by social dimension resulted in favourable return announcements and remarkable accounting performance. Companies that adopt the finest CSR practices have less financial risk. Numerous studies indicate that companies with more significant social responsibility disclosures have a higher market value. As such, corporations on the FTSE 350 Index, the Brazilian Stock Exchange, and some German companies have received praise for their social disclosures.

2.2.3. Governance

Khan (2019) investigates whether companies' environmental, social, and governance (ESG) performance, including corporate governance, can accurately predict stock returns. It led to the formulation of new corporate governance and ESG metrics to determine the relationship between the stock returns of companies and their ESG performance. It was discovered that these metrics can predict the stock returns of companies globally. Furthermore, the study made on the German market has shown that ESG practises have a definite positive impact on return on assets (ROA), which the governance dimension has excelled at compared to environmental and social dimensions. Investing in companies with more excellent corporate governance (C.G.) concentration provided investors with higher returns than investing in companies with lower C.G. concentrations (Tuyon et al., 2021), showing that the manager is fully capable of managing funds while maintaining a high level of integrity and generating significant profits. Contrastively, it has been reported that C.G. has a negative relationship with CFP. Studies on the impact of the board structure on CFP yielded varied findings. The benefits and compensation of the board, the business experience of board members, and the inclusion of female directors were essential in enhancing accounting-based CFP.

2.3. Maqasid Al-Shariah and financial performance

The term *maqsid*, while the plural *maqasid*, refers to a purpose, principle, objective, goal, intent, and end. *Maqasid* of Islamic law is pertinent to the objectives behind the Islamic rulings. In general, the objective of Shariah is to promote that which is beneficial and sound, to protect people from that which is harmful, and to safeguard the interests of all people; as bound to some Islamic legal theorists, it is the alternate expression to the interests of the people. Shariah divides man's best interests into three categories: *daruriyyat, hajiyyat,* and *tahsiniyyat*. As a performance metric for Islamic businesses, Maqasid Al-Shariah plays a crucial part in a society's pursuit of prosperity. The technique strives to have a good effect on the environment and society while appealing to Muslims and non-Muslims. Although several studies analyse the impact of Maqasid Al-Shariah features on financial performance, there has been little research on its influence towards the financial performance of Islamic non-financial corporations. To be summarised, three basic concepts judge the fulfilment of Maqasid Al-Shariah by Islamic corporations: educating the individual *(tahdhib al-fard),* establishing justice *(iqamat al-adl),* and improving the welfare of society *(jalb al-maslahah).*

Nonetheless, an extensive literature review revealed a lack of empirical analysis. Researchers explored the relationship between intellectual capital and the financial performance of companies using 81 multinational corporations as a sample, and a significant positive correlation between intellectual capital and financial performance was established. In the study of Thailand's manufacturing industry, intellectual capital has a beneficial influence on profitability, revenue growth, and employee efficiency. Furthermore, an establishment of justice between people and communities is considered the second objective in Maqasid Al-Shariah, as the source of the *Quran* includes precise guidance concerning justice: *"Indeed, Allah commands justice …* " *(An-Nahl 16:90)*. While promoting justice is a crucial aim in Islam, it is supported in many aspects of life. However, the concept of fairness in Islamic firms can only be realised if there are no disadvantaged stakeholders and they are mutually beneficial (Ifwat Ishak & Mohammad Nasir, 2021). The core element of Islamic development is attaining social justice combined with economic and materialistic prosperity. In an ideal Islamic society characterised by peace and equity, justice necessitates the provision of equal chances for all individuals to enhance their socio-economic status, encompassing access to the natural riches bestowed by Allah (Ifwat Ishak & Mohammad Nasir, 2021). Nevertheless, no access to finance or financial exclusion is, without a doubt, the most crucial factor in the failure of Islam to realise its egalitarian goal. It should be noted that most emerging companies, increasingly concerned with expanding their business, engage in financial services.

As *maslahah* encompasses Shariah's vital objectives, the scholars contend that religion *(al-din)*, life *(al-nafs)*, intellect *(al-'aql)*, progeny *(al-nasl),* and property *(al-mal)* are regarded as the supreme goals of Shariah throughout the corpus of rulings. Following the stakeholder theory presented by Freeman and colleagues, it is posited that organisations should prioritise the maximisation of value creation for all their stakeholders. As the source of the *Quran*, the following guidance is understood: *"Whoever saves one life, it is as if he has saved all of humanity." (Quran 5:32).* Thus, the lifetime of any organisation is believed to be contingent upon the interests of stakeholders. Within the context, corporate social responsibility (CSR) strategies include several practices that firms may use to satisfy stakeholders, including the environment, society, and shareholders. Several researchers have posited that corporate social responsibility (CSR) has the potential to result in cost reductions, impact employee recruitment, retention, and motivation, and improve a firm's image and reputation, thereby differentiating it and fostering customer loyalty. Although multiple studies have found that a firm's CSR initiatives can improve its competitiveness, the findings do not consistently offer evidence for a universal relationship between CSR and financial gains.

2.4. ESG and maqasid Al-Shariah

The essence of the central bank's (Bank Negara Malaysia) move in the commencement of the ESG framework as the way forward for Islamic firms is part of the industry's effort in supporting SDGs agenda application through commercial business. Thus, Shariah non-financial corporations have an essential role. It deduces from the Assistant Governor of BNM in his speech at the 2019 IFN Green and Sustainable Finance Forum who called for sustainable finance:

> "Under the 11th Malaysia Plan (2016–2020), green growth has been identified as the game changer in bringing Malaysia towards a sustainable socio-economic development path. Since 2016, several new legislations, policies, and action plans have been introduced, while existing financing mechanisms have been strengthened to support the uptake of green initiatives. As 2020 approaches, Malaysia is committed to implementing its strategic long-term plans and green-friendly policies. Budget 2020 reflects this commitment, with a matching fund of RM10 million towards a joint United Nations SDG-government fund to co-finance SDG initiatives in Malaysia. While government funding is important to realise the SDGs, most investments must be sourced from the private sector. An annual target of RM350 billion from private investments by 2020 was identified in the national roadmap for the SDGs, in line with achieving the targets of the 11th Malaysia Plan."

When examining the ESG pillars' objective entirely, ESG rating breaks down into three pillar scores: Environmental, Social and Governance, formed by 14 thematic scores dedicated to implementation methods with the support of the practical indicators (Bursa Malaysia, 2022). The paradigm shift in ESG principles brought about by the Sustainable Development Goals (SDGs) enables Islamic non-financial corporations to fully embrace Islamic aspirations (Maqasid Al-Shariah), which was not feasible under the MDGs (Khan, 2019; Nasir & Seman, 2022). Still, Paltrinieri et al. (2020) remarked on whether and how the expansion of Islamic firms coincides with long-term sustainability strategies. Subsequently, the findings demonstrate a favourable correlation between Islamic Financial Development Institutions and ESG ratings, which primarily centre on the social pillar (ESG data; the MSCI ESG Intangible Value Assessment database) (Nasir & Seman, 2022). This result unquestionably strengthens the tie between Islamic finance and its responsiveness and commitment to environmental-based and social responsibility despite the nonlinear nature of sustainability gains (Nasir & Seman, 2022).

Fig. 1 and Table 2 illustrate the close alignment between the ESG framework and the SDGs agenda embraced by the Islamic Finance and Maqasid Al-Shariah even before the official declaration of the SDGs agenda by the United Nations (Khan, 2019). It should be made clear at the beginning of introducing Islamic corporate finance, and an adequate framework should be set up. The fact that Islamic corporate finance players have recently started to use ESG may lead to the pessimistic conclusion that Islamic corporate finance started on the wrong foot. Islamic firms can develop a balancing measurement that bridges the gap between the ESG framework and Maqasid Al-Shariah's approaches to sustainability. Still, it is undeniable that the absence of standardised ESG measures and criteria explicitly developed for Islamic corporate finance makes it challenging to coordinate the ESG framework with Maqasid Al-Shariah (Qoyum et al., 2022). Moreover, researchers observed the documented practice of sustainability disclosure on Shariah-compliant firms

Fig. 1. Mapping of ESG pillars with the 17 SDGs.
Source: Khaled et al. (2021).

Table 2. Mapping of SDGs with Maqasid Shariah.

Mapping SDG with Maqasid Shariah						
SDG1	No Poverty	Life	Faith	Intellect	Progeny	Wealth
SDG2	Zero Hunger	Life	Faith	Intellect	Progeny	Wealth
SDG3	Good Health and Well-Being	Life	Intellect	Progeny		
SDG4	Quality Education	Intellect	Faith	Life	Wealth	Progeny
SDG5	Gender Equality	Life	Faith	Progeny		
SDG6	Clean Water and Sanitation	Life	Faith	Progeny		
SDG7	Affordable and Clean Energy	Life	Wealth	Progeny		
SDG8	Decent Work and Economic Growth	Wealth	Life	Progeny	Faith	Intellect
SDG9	Industry, Innovation and Infrastructure	Wealth	Life	Progeny	Faith	Intellect
SDG10	Reduced Inequalities	Wealth	Life	Progeny		
SDG11	Sustainable Cities and Communities	Life	Wealth			
SDG12	Responsible Consumption and Production	Life	Wealth	Faith	Progeny	
SDG13	Climate Action	Life	Progeny	Wealth	Faith	
SDG14	Life Below Water	Life	Progeny	Wealth	Faith	
SDG15	Life on Land	Life	Progeny	Wealth	Faith	
SDG16	Peace, Justice and Strong Institutions	Life	Wealth	Progeny	Faith	Intellect
SDG17	Partnerships for the Goals	Wealth	Life	Faith		

Source: Kasbani (2018).

in Malaysia (year 2009–2018) to identify the specific environmental, social-oriented, and governance elements (i.e., ESG and Maqasid Al-Shariah) practises in their unique ways to the best of their capacities and abilities (Qoyum et al., 2022).

3. Discussion and conclusion

Based on the Systematic Literature Review (SLR), it can be said that the role of the Maqasid al-Shariah seems inconclusive regarding its direct effect on the firm's financial performance. Therefore, the Maqasid al-Shariah is believed to be the interaction between ESG and financial performance. The influence of ESG towards financial performance also remains plausible regarding the cost structure that embraces companies that are mindful investors and other stakeholders.

Conflict of interest

All the authors contributed to the papers. I acknowledged no conflict of interest exist in preparing the paper.

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