

An Evaluation of Environmental, Social and Governance (ESG) from Islamic Perspectives

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Abstract

Environmental, social and governance (ESG) is increasingly becoming a crucial aspect of tolerance for firms when dealing with investments. By engaging with ESG, firms will be able to attract more investors and invest in ethical and responsible investments. Apart from contributing towards responsible investments, engagement with ESG also means firms are supporting Sustainable Development Goals (SDG) as outlined by the United Nations (UN) which help to promote sustainable development. A number of literatures has been highlighting fundamental similarities between ESG, SDG and maqasid al-Shariah. Basically, all three principles focus on addressing benefits for human beings now and in the future. Nevertheless, even though their fundamental values are the same, some specific components of practice are different.

Keywords: ESG, SDG, Maqasid al-Shariah

1.0 Introduction

Maximizing shareholders' wealth is an ever-lasting objective that firms intend to achieve. According to Gary M. Pfeiffer, the CFO of Du Pont in 2004, one way to achieve it was through enhancing environmental and social performance (The Global Compact, 2004, p.1). In 2004, United Nations Global Compact officially developed Environmental, Social, and Governance (ESG) principles. According to the report (The Global Compact, 2004, p.3), integrating environmental, social, and corporate governance (ESG) factors more effectively into investment decisions will ultimately lead to more stable and predictable markets, benefiting all market participants. Moreover, numerous studies show that how a company handles ESG issues is often a reliable indicator of overall risk levels and management quality in which both key factors are important in determining a company's long-term success (p.9). Even though the official ESG principles were officially developed in 2004, the informal adoption of ESG has begun as early as 1970s through socially responsible investing (SRI), which primarily focused on social issues such as human rights and supply chain ethics.

In September 2015, the United Nations (UN) introduced the 2030 Agenda for Sustainable Development, which includes 17 Sustainable Development Goals (SDGs). These goals aim to unite the world's countries in eradicating all forms of poverty, reducing inequalities, promoting human rights, combating climate change, and ensuring good governance in organizations. ESG and the SDGs are closely linked. While the SDGs have a broad focus on global sustainability,

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ESG highlights responsible and ethical investments from firms' perspectives. Both engrave the same idea, which is to promote sustainability. Figure 1 specifies the 17 areas of SDGs.



Figure 1: Sustainable Development Goals (SDGs)

Nowadays, ESG is an important aspect of businesses, especially when deciding to make investments. By incorporating ESG into their operations, firms can make responsible investments while attracting investors who value ethical practices. The Malaysian capital market has also been actively promoting ESG principles. This emphasis on ESG stems from a desire to create lasting positive impacts on society and the environment, with a specific focus on sustainability. Sustainability and ESG are closely intertwined, as the promotion of ESG supports the long-term sustainability of businesses, the environment, and their stakeholders. Figure highlights the specific example of components of ESG as derived by FTSE Russell. Each of these components is related to any of the SDGs' areas.

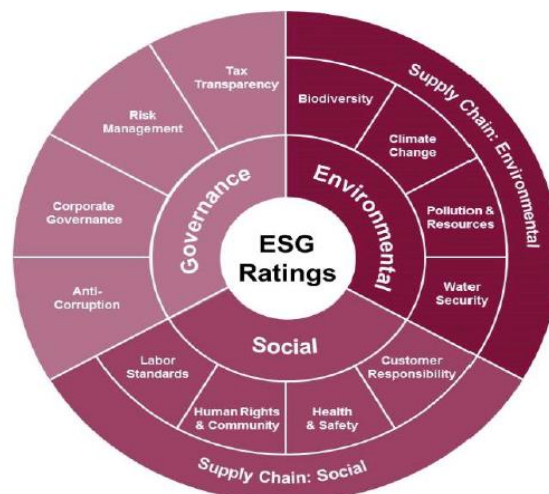


Figure 2: FTSE Russell ESG Ratings

1.1 Maqasid Al-Shariah

Maqasid al-Shariah can be defined as the purposes, meanings, and wisdom established by Shari'ah Islamiyyah to protect human welfare. It is categorized into three levels: *dharuriyyat*

(necessities), *hajiyyat* (needs/convenience), and *tahsiniyyat* (embellishments/refinement), each of which focuses on preserving religion, life, intellect, progeny, and wealth.

According to Dato' Seri Dr. Awang Adek Hussin, Chairman of the Securities Commission Malaysia, *maqasid al-Shariah* promotes a balance between profit generation, societal benefit, and harm prevention (Securities Commission Malaysia, 2023). In addition to promoting *masalih al-'ibad* (human welfare) as its primary goal, *maqasid al-Shariah* serves as a guiding set of overarching principles for embracing an ideal, meaningful, and purposeful life (Securities Commission Malaysia, 2023). Figure 3 shows the components of *maqasid al-Shariah*.

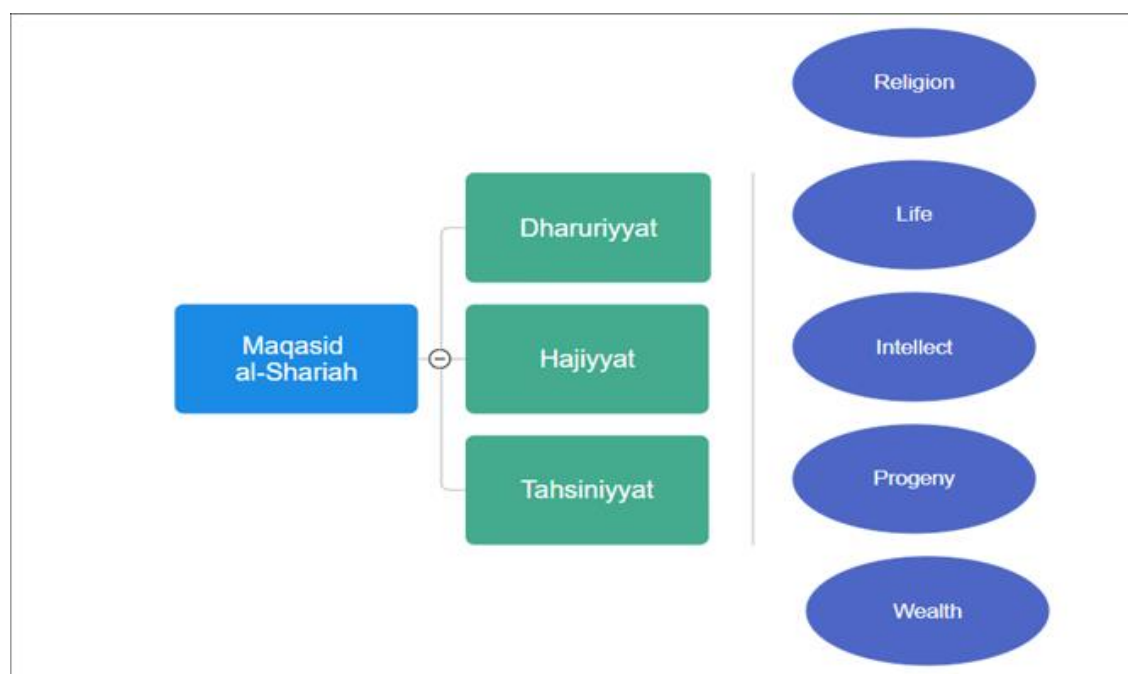


Figure 3: Maqasid al-Shariah

Even though *maqasid al-Shariah* is regarded as an Islamic principle, the rule which is established based on Quran and Sunnah, its guided principles to preserve religion, life, intellect, progeny and wealth fundamentally tallies with the promotion of sustainability as brought up by ESG and SDGs. Generally, they are promoting the same interest which is to protect human beings. However, when we search in depth in terms of permitted practices, there are certain specific components of *maqasid al-Shariah* that divert from ESG and SDGs, and their prohibitions is not just because of the command of the religion, but due to their potential negative impact, especially in the long term.

2.0 Research Methodology

This study is conducted using desktop research. Desktop research is secondary research that gathers existing data and information from publicly available sources, typically without direct interaction or original data collection. Basically, this study is conducted from a desk using various resources such as online databases, reports, academic papers, articles, and other publications. Since no specific data can be used to conduct an analysis relevant to the study, most of the support comes from past empirical literature and words from the Quran and Sunnah.

3.0 Theoretical Literature

The theory most closely aligned with both ESG and Maqasid al-Shariah is the stakeholder theory. This business model emphasizes the interests of all stakeholders including employees, customers, communities, and suppliers in addition to the alongside shareholders. From an ESG perspective, businesses must not only focus on profit but also prioritize environmental protection, social justice, and strong governance. This involves acting ethically by safeguarding the environment, promoting social justice, and upholding good governance.

In Islamic finance, in accordance with the principles of Maqasid al-Shariah, protecting stakeholders' interests is an ethical obligation that must be upheld throughout business operations. Both ESG and Maqasid al-Shariah, therefore, focus on promoting and protecting the interests of stakeholders. Importantly, this protection extends beyond humans to include other living creatures and the environment.

The responsibilities toward both human and non-human life are clearly outlined in the Qur'an and Sunnah. For example, in Surah Al-An'am (6:151), God commands, "Do not take any human being's life, which God has declared sacred, except in the pursuit of justice. This has He enjoined upon you so that you may use reason." The Prophet Muhammad (pbuh) also emphasized fairness, stating, "Give to everyone who possesses a right, his right." Another hadith from Abu Hurairah r.a recounts the Prophet (pbuh) saying: "When a person is walking on a road and finds a thorny stick, removes it, Allah thanks him and forgives him" (Bukhari).

While ESG and Maqasid al-Shariah originate from different practices, they share similar core values. Islam provides a clear framework for stewardship (Khalifah) and the avoidance of harm. The earth and its resources are a trust from God, and humankind, as stewards, is responsible for managing them wisely. This principle aligns with ESG's focus on environmental protection. In terms of social responsibility, the Islamic concept of justice (*adl*) is a fundamental ethic applied across business activities to ensure the welfare, rights, and well-being of all individuals, including shareholders and stakeholders.

When it comes to governance, transparency, accountability, and ethics are strongly emphasized in Maqasid al-Shariah, much like the ESG framework developed by FTSE Russell ESG Ratings. Thus, by integrating the principles of Maqasid al-Shariah with ESG, businesses can create a holistic, comprehensive model that promotes long-term sustainability and performance without compromising stakeholders' interests (Radin et al., 2024).

4.0 Empirical Literature

Past literatures have empirically proven that ESG practices and the application of Maqasid al-Shariah bring positive impacts to firms' performance, reducing business risks, protecting the stakeholders and promoting social welfare. Numerous studies have shown that when businesses adopt ESG practices and incorporate the principles of Maqasid al-Shariah, they experience measurable benefits. These practices help firms navigate ethical challenges, address environmental and social concerns, and strengthen governance, all of which contribute to improved business performance. Additionally, by focusing on the welfare of stakeholders,

businesses can reduce risks such as reputational damage or legal issues. The application of ESG and Maqasid al-Shariah also aligns businesses with broader societal values, promoting long-term sustainability and enhancing social welfare.

ESG practices have been found to enhance the firms' value and performance in various countries (Ansari & Alanzarouti, 2020; Abdullah & Rao, 2022; Paltrinieri et. al., 2020; Asl et. al., 2024). Research across different countries consistently shows that ESG practices lead to higher firm value and better financial performance. For instance, firms that prioritize environmental sustainability and good governance tend to be more resilient and attract more socially conscious investors. This is particularly important in today's global market, where ethical considerations increasingly influence investment decisions. By aligning their business strategies with ESG principles, firms can enhance their reputation, improve operational efficiencies, and boost long-term profitability.

A number of studies show a strong connection between Islamic financing or shariah compliant businesses and ESG (Paltrinieri et al., 2020; Lee, 2018/2019; Ansari & Alanzarouti, 2020; Jan et al., 2023). Islamic finance and Shariah-compliant businesses share several ethical principles with ESG, such as social justice, environmental stewardship, and responsible governance. Studies have found that the moral and ethical dimensions of Islamic finance, especially its emphasis on fairness, transparency, and the prohibition of harmful practices (e.g., environmental degradation, exploitation), align closely with the goals of ESG. This connection suggests that Shariah-compliant businesses are naturally inclined to adopt practices that are in line with ESG objectives, making them better equipped to promote sustainable development.

In addition, Hassan et al. (2021) discover a positive impact of ESG and Shariah screening on reducing market risks. Hassan et al. (2021) found that businesses employing ESG principles alongside Shariah screening experience lower market risks. Shariah screening ensures that companies avoid sectors or practices considered harmful (such as gambling, alcohol, or environmental damage), while ESG screening encourages a broader commitment to ethical and sustainable business. Together, these frameworks minimize exposure to volatile or high-risk sectors, leading to more stable returns and better risk management, ultimately making the firms more resilient in fluctuating markets.

Hassan et al. (2022) reveal that Shariah-compliant firms are more likely to engage in sustainable and responsible practices, especially towards the environmental dimension which suggests that the integration of ethical and religious-oriented incentives can improve sustainability practices and resilience of firms. Hassan et al. (2022) demonstrate that Shariah-compliant firms show a stronger commitment to sustainability, particularly when it comes to environmental protection. The integration of religious and ethical guidelines motivates firms to adopt long-term, sustainable practices. For instance, Shariah-compliant businesses are more likely to implement environmentally friendly initiatives, such as reducing their carbon footprint, responsibly managing natural resources, and minimizing waste. This proactive approach not only aligns with Islamic values but also strengthens the firm's resilience by preparing it for future challenges such as regulatory changes or environmental risks.

In summary, combining ESG with Maqasid al-Shariah creates a robust framework for improving firms' sustainability, reducing risks, and fostering social and environmental responsibility. These frameworks have consistently been shown to enhance both the financial performance and ethical standing of businesses across different regions and sectors.

5.0 Findings On The Relationship Beyween Sdg, Esg And Maqasid Al-Shariah

While the Sustainable Development Goals (SDG), Environmental, Social, and Governance (ESG) practices, and Maqasid al-Shariah may appear to be distinct concepts, they all share a common goal: the protection and well-being of humanity. Despite their shared fundamental values, there are key differences that set Maqasid al-Shariah apart from SDG and ESG.

One significant distinction lies in the treatment of certain activities like wine and gambling. In the Quran, Allah says, *“They ask you about wine and gambling. Say, ‘In both, there is great sin, and some benefits for people. And their sin is greater than their benefit.’”* (Surat Al-Baqarah 219). From the perspective of Maqasid al-Shariah, wine and gambling are strictly prohibited based on this divine guidance. In contrast, SDG and ESG do not impose an outright ban on these activities but may regulate them under specific circumstances, such as in relation to social responsibility or harm reduction.

Maqasid al-Shariah also takes a long-term view, particularly in its emphasis on sustainability, which aligns with the broader aims of both SDG and ESG. However, Maqasid al-Shariah is rooted in religious teachings that were revealed over 23 years (610–632 AD) to Prophet Muhammad (p.b.u.h) in the Quran. In contrast, the modern frameworks of SDG and ESG were developed in the 21st century, reflecting contemporary global challenges.

Maqasid al-Shariah focuses on five key aspects of human welfare—religion, life, intellect, progeny, and wealth. These principles are underscored by verses from the Quran and hadiths, which highlight the importance of moral and ethical conduct. For example, Allah says, *“Indeed, in this [Quran] is a notification for a worshiping people. And We have not sent you, [O Muhammad], except as a mercy to the worlds.”* (Quran: 21:106-107). The Quran also emphasizes the importance of using wealth responsibly, as seen in the verse: *“Wealth and children are the embellishment of worldly life, but the everlasting virtues are much better with your Lord (Allah), both in reward and in creating good hopes.”* (Al-Kahfi: 46).

Other Islamic teachings further illustrate the ethical imperatives of charity and compassion. The Prophet (p.b.u.h) taught, *“Those who spend their wealth [for goodness in Allah’s cause] by night and day, in secret and in public, they shall have their reward with their Lord. On them shall be no fear, nor shall they grieve.”* (Al-Baqarah: 273). This aligns with the Islamic emphasis on social justice and welfare. Similarly, in a hadith, the Prophet (p.b.u.h) frequently supplicated, *“O our Lord, grant us the best in this life and the best in the next life, and protect us from the punishment of the Fire.”* (Agreed upon).

The Prophet (p.b.u.h) also emphasized the importance of compassion, stating, *“The one with no pity for others is not pitied.”* (Al-Bukhari and Muslim). Further, wisdom and good character are highly valued in Islamic teachings. Luqman al-Hakim advised his son, *“My son! Sit with*

the learned men and keep close to them. Allah gives life to the hearts with the light of wisdom, as Allah gives life to the dead earth with the abundant rain of the sky.” (Muwatta Malik). This principle of continuous learning and wisdom is echoed in the hadith: *“The noblest of you in the sight of Allah is the one with the greatest taqwa [God-consciousness].”* (Al-Adab Al-Mufrad 899).

Although Maqasid al-Shariah, SDG, and ESG originate from different contexts and time periods, they all contribute to the overarching aim of creating a just, ethical, and sustainable world for present and future generations. Hence, Figure 4 describes the connection between ESG, SDGs and maqasid al-Shariah. Even though they promote similar fundamental values, there are certain aspects which differentiate them.

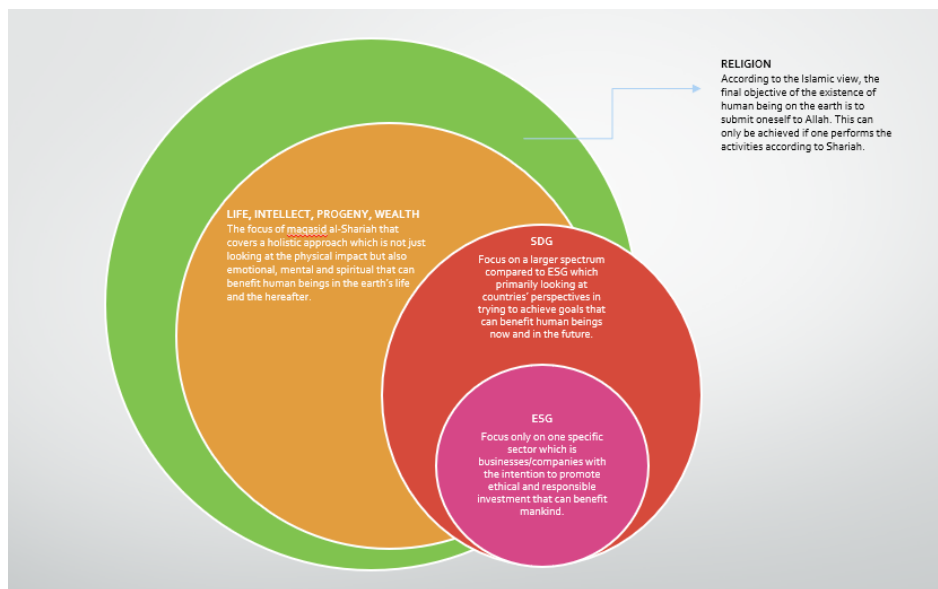


Figure 4: A Holistic Framework of SDG, ESG and Maqasid al-Shariah

6.0 Conclusion

Although the Sustainable Development Goals (SDG), Environmental, Social, and Governance (ESG) principles, and Maqasid al-Shariah all share similar fundamental values aimed at improving human welfare, their practices can differ significantly. Specifically, certain actions deemed haram (forbidden) by Maqasid al-Shariah may be permitted under SDG and ESG frameworks. For example, Maqasid al-Shariah prohibits certain activities such as alcohol consumption and gambling, as outlined in Islamic teachings. In contrast, SDG and ESG frameworks may regulate these activities under specific conditions rather than imposing a complete ban. This illustrates a key difference in how each framework approaches ethical and moral issues.

Furthermore, while SDG and ESG may view religion as a separate or secondary consideration, Maqasid al-Shariah integrates religious obligations into its framework. The fulfillment of Maqasid al-Shariah is fundamentally about adhering to one's duties to Allah, which encompasses not only spiritual obligations but also social and environmental responsibilities.

In Islam, the satisfaction of fundamental needs such as preserving life, intellect, progeny, and wealth also inherently addresses religious duties. This is because Islam encompasses not only the relationship between God and individuals but also between individuals themselves and their environment. Thus, Maqasid al-Shariah can be seen as a comprehensive guide to achieving prosperity. It integrates spiritual, social, and environmental dimensions into a holistic approach that ensures both individual and collective well-being. This approach aligns closely with the ultimate goal of fostering a just and sustainable world, reflecting the core values shared by SDG and ESG frameworks.

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