

**ESG ACTIVITIES AND FINANCIAL STABILITY IN INDONESIAN ESG-  
LISTED FIRMS: DOES SHARIA-COMPLIANT MATTER?**



**THESIS**  
**SUBMITTED TO THE FACULTY OF ISLAMIC ECONOMICS AND**  
**BUSINESS**  
**STATE ISLAMIC UNIVERSITY OF SUNAN KALIJAGA YOGYAKARTA**  
**IN FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF**  
**MASTER OF SHARIA ECONOMICS**

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**FACULTY OF ISLAMIC ECONOMICS AND BUSINESS**  
**STATE ISLAMIC UNIVERSITY SUNAN KALIJAGA YOGYAKARTA**  
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**STATE ISLAMIC UNIVERSITY SUNAN KALIJAGA YOGYAKARTA**  
**2025**

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**Yth. The Respectable Dean of The Faculty of Islamic Economic and Business  
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*Assalamu`alaikum Wr. Wb.*

After reading, researching, providing guidance and corrections, and making necessary improvements, we are as supervisors, are of the opinion that your thesis:

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St. Number : 23208012020  
Thesis Title : ESG Activities and Financial Stability in Indonesian ESG-  
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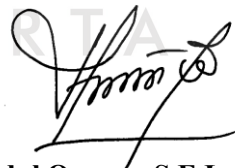
It can be submitted to the Faculty of Islamic Economics and Business, Master of Sharia Economics, UIN Sunan Kalijaga Yogyakarta as one of the requirements for obtaining a Master's Degree in Islamic Economics.

We hope that your thesis can be submitted soon. For that, we thank you.

*Wassalamu`alaikum Wr. Wb.*

Yogyakarta, 28 November 2025

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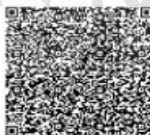
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Faculty : Islamic Economic and Business  
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St.N 23208012020

## MOTTO

لَا يُكَلِّفُ اللَّهُ نَفْسًا إِلَّا وُسْعَهَا لَهَا مَا كَسَبَتْ وَعَلَيْهَا مَا اكْتَسَبَتْ ...

*“Allah tidak membebani seseorang, kecuali menurut kesanggupannya. Baginya ada sesuatu (pahala) dari (kebajikan) yang diusahakannya dan terhadapnya ada (pula) sesuatu (siksa) atas (kejahatan) yang diperbuatnya...”*

**[Q.S Al-Baqarah: 286]**

“Life can be heavy, especially if you try to carry it all at one, part of growing up and moving into new chapters of your life is about catch or release. What I mean by that is, knowing what things to keep and what things to release.”

**[Taylor Swift]**

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## DEDICATED PAGE

*Bismillahirrahmanirrahim*

*Alhamdulillah* Praise to Allah Swt. with this dedicated page, I have completed my studies and now, I am ready to persue the other my dreams.

\*\*\*

I would like to express my gratitude to my parents, Mr. Kastim, S.Ag., Almh. Yati Haryati, and also Mrs. Siti Fatimah, for their patience and love, which have to be able me to reach my education in master degree program.

\*\*\*

I would like to thank my elder brother and sisters, Dede Muhamad Ridho and Fiathika Budiono, and also my younger sisters, Anisa Fadhilah and Clariesta Aulia Angel Lin, who always supported me and motivated me to completed my education in master degree program.

\*\*\*

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## ARABIC LATIN TRANSLITERATION GUIDELINES

The transliteration of Arabic words used in this study is guided by the Joint Decree of the Minister of Religion and the Minister of Education and Culture of the Republic of Indonesia Number: 158/1987 and 0543b/U/1987.

### A. Single Consonant

Arabic Front	Name	Latin Letters	Description
ا	Alif	Not symbolized	Not symbolized
ب	Ba	B	Be
ت	Ta	T	T
ث	ṣa	ṣ	Es (with the above point)
ج	Jim	J	Je
ح	ḥa	ḥ	Ha (with the above point)
خ	Kha	Kh	ka and ha
د	Dal	D	De
ذ	Zal	Ẓ	zet (with the above point)
ر	Ra	R	Er
ز	Zai	Z	Zet
س	Sin	S	Es
ش	Syin	Sy	Es and Ye
ص	ṣad	ṣ	Es (with the above

Arabic Front	Name	Latin Letters	Description
			point)
ض	ḍad	ḍ	De (with the above point)
ط	ṭa	ṭ	Te (with the above point)
ظ	ẓa	ẓ	Zet (with the above point)
ع	Ain	...‘...	Inverted comma above
غ	Gain	G	Ge
ف	Fa	F	Ef
ق	Qaf	Q	Qi
ك	Kaf	K	Ka
ل	Lam	L	El
م	Mim	M	Em
ن	Nun	N	N
و	Wawu	W	We
هـ	Ha	H	Ha
ء	Hamzah	...’...	Apostrof
ي	Ya	Y	Ye

## B. Dual Consonants for Shaddah Written in Multiple

سَّكْرَانِ	written	<i>Muta`aqqidīn</i>
عِدَّة	written	<i>`iddah</i>

### C. Ta Marbutah

1. When turned off h

هبة	written	<i>Hibbah</i>
جزية	written	<i>Jizyah</i>

2. If ta marbutah lives or with harakat, fathah, kasrah and dammah it is written t

زكاة الفطر	written	<i>zakātul fiṭri</i>
------------	---------	----------------------

### D. Short Vowels

Vokal	Fathah	written	A
َ	Kasrah	written	I
ُ	Dammah	written	U

### E. Long Vowels

fathah + alif جاهلية	written	A <i>Jāhiliyyah</i>
fathah + ya sukun ياسر	written	A <i>yas'ā</i>
kasrah + ya sukun كريم	written	I <i>Karīm</i>
dammah + wawu sukun فروض	written	U <i>furūd</i>

## F. Double Vowels

fathah + ya' sukun يَا	written	Ai <i>bainakum</i>
fathah + wawu sukun قَوْل	written	Au <i>Qaul</i>

## G. Sequential Short Vowels in One Word Separated with Apostrophe

أَنْتُمْ	written	<i>a'antum</i>
أَعِدَّتْ	written	<i>u'iddat</i>
لَنْ تُنْكِرُ	written	<i>la'in syakartum</i>

## H. The Article Alif + Lam

1. If followed by the Qomariyyah letter:

الْقُرْآنُ	written	<i>al-Qur'ān</i>
الْقِيَاسُ	written	<i>al-Qiyās</i>

2. If followed by the letter Syamsiyah written by duplicating the letter Syamsiyah that follows it, and removing the letter (el).

السَّمَاءُ	written	<i>as-samā</i>
الشَّمْسُ	written	<i>asy-syams</i>



## I. Arrangement of words in a series of sentences

ذوي الفروض	written	<i>ẓawī al-furūd</i>
------------	---------	----------------------



## ACKNOWLEDGEMENTS

All praises belong to Allah Swt. for His mercy and blessings, which have enabled the author to complete this final project entitled **“ESG Activities and Financial Stability in Indonesian ESG-Listed Firms: Does Sharia-Compliant Matter?”**. May Sholawat and Salam be upon our Prophet Muhammad SAW.

This thesis was written to fulfill one of the requirements for a Master's degree in Sharia Economics at the Faculty of Islamic Economic and Business, UIN Sunan Kalijaga Yogyakarta. The writing of this thesis would not have been possible without the help of various parties. Therefore, the author would like to take this opportunity to express his gratitude to those parties, including:

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UIN Sunan Kalijaga Yogyakarta.

3. Dr. Muhammad Ghafur Wibowo, S.E., M.Sc., Head of the Master of Sharia Economics Study Program, Faculty of Economics and Islamic Business, UIN Sunan Kalijaga Yogyakarta.
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6. All administrative staff and employees of the Faculty of Islamic Economics and Business, UIN Sunan Kalijaga Yogyakarta.
7. All of the author's friends who have always brought joy into the author's life.

Hopefully, all the good that is given from all parties will get a reward from Allah SWT. The author realizes that there are still many shortcomings in writing this thesis, so constructive criticism from readers will be highly appreciated. Finally, the writer hopes that this thesis will be useful.

Yogyakarta, 28 November 2025

Author



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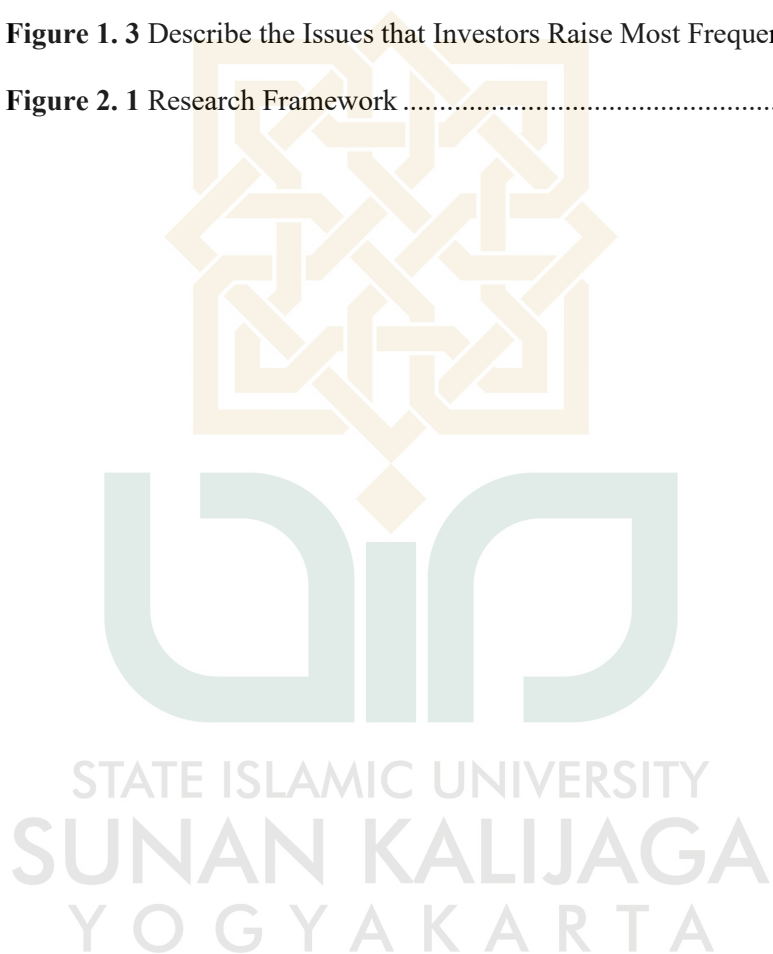
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## ABSTRACT

Companies have an important responsibility to contribute in pursuing and achieving the Sustainable Development Goals (SDGs), introduced by the United Nations. The company's approach used as an opportunity to contribute is engagement in practices that cover environmental, social and governance (ESG) aspects. The purpose of this thesis is to analyze whether ESG activities has an impact on financial stability. In addition, this research wants to know does Sharia-compliant states has an impact on the relationship between ESG activities and financial stability. By using 27 sample of companies during the period 2009-2019, this study estimates a two-step system GMM dynamic panel data model. The findings indicate that Sharia-compliant status exerts a selective and dimension-specific moderating effect on the relationship between ESG activities and financial stability. Although the ESG composite index demonstrates a direct positive association with financial stability, its interaction with Sharia compliance is negative and statistically significant. This suggests that aggregated ESG measures may mask the distinct legitimacy mechanisms that are particularly relevant for Sharia-compliant firms. Further disaggregated analysis reveals that Sharia-compliant significantly strengthens the positive effects of social and governance index on financial stability, reflecting a strong alignment between Islamic ethical principles and stakeholder expectations. In contrast, the moderating effect of Sharia-compliant on environmental index is statistically insignificant to financial stability. Furthermore, these findings have important implications for investors, regulators, and companies in integrating ESG and sharia values into corporate risk management and sustainability strategies.

**Keywords:** Environmental, social, governance (ESG), financial stability, sharia-compliant.

## ABSTRAK

*Perusahaan memiliki tanggung jawab penting untuk berkontribusi dalam mengejar dan mencapai Tujuan Pembangunan Berkelanjutan (SDGs) yang diperkenalkan oleh PBB. Pendekatan yang digunakan perusahaan sebagai kesempatan untuk berkontribusi adalah keterlibatan dalam praktik-praktik yang mencakup aspek lingkungan, sosial, dan tata kelola (ESG). Tujuan tesis ini adalah untuk menganalisis apakah aktivitas ESG memiliki dampak terhadap stabilitas keuangan. Selain itu, penelitian ini ingin mengetahui apakah Sharia-compliant memiliki dampak terhadap hubungan antara aktivitas ESG dan stabilitas keuangan. Dengan menggunakan 27 sampel perusahaan selama periode 2009-2019, studi ini mengestimasi model data panel dinamis two-step system GMM. Temuan menunjukkan bahwa status Sharia-compliant memiliki efek moderasi yang selektif dan spesifik dimensi terhadap hubungan antara aktivitas ESG dan stabilitas keuangan. Meskipun indeks komposit ESG menunjukkan hubungan positif langsung dengan stabilitas keuangan, interaksinya dengan Sharia-compliant bersifat negatif dan secara statistik signifikan. Hal ini menyarankan bahwa ukuran ESG yang agregat dapat menyembunyikan mekanisme legitimasi yang unik yang khususnya relevan bagi perusahaan yang Sharia-compliant. Analisis yang lebih rinci menunjukkan bahwa Sharia-compliant secara signifikan memperkuat efek positif kinerja sosial dan tata kelola terhadap stabilitas keuangan, mencerminkan keselarasan yang kuat antara prinsip etika Islam dan harapan pemangku kepentingan. Di sisi lain, efek moderasi Sharia-compliant terhadap kinerja lingkungan tidak signifikan mempengaruhi stabilitas keuangan. Selain itu, temuan ini memiliki implikasi penting bagi investor, regulator, dan perusahaan dalam mengintegrasikan nilai-nilai ESG dan syariah ke dalam manajemen risiko Perusahaan dan strategi keberlanjutan.*

*Kata kunci: Environmental, social, governance (ESG), stabilitas keuangan, sharia-compliant.*

# CHAPTER I

## INTRODUCTION

### A. Background of Study

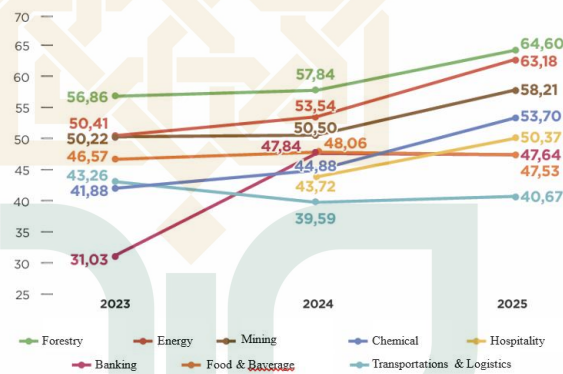
The global business landscape has a lot of transformation over the past few decades, marked by a fundamental shift from a traditional shareholder-oriented approach to a more comprehensive, stakeholder-oriented business model (Porter & Kramer, 2011). This paradigm shift has been catalyzed by the appearance and evolution of Environmental, Social, and Governance (ESG) considerations as critical determinants of corporate strategy and performance evaluation (Gillan et al., 2021; Whelan et al., 2021). Specifically, this shift was driven by the understanding that managing ESG issues creates business opportunities and reduces risks significantly, which contributes to shareholder value. In addition, the concept of ESG appearance from the growing of conscious that businesses operate within complex ecosystems, where their

actions extend far beyond financial returns to shareholders (Kolk & van Tulder, 2010).

The term of "ESG" was first initiated in the 2004, United Nations Global Compact report "Who Cares Wins" which emphasized the integration of environmental, social, and governance factors (UN Secretary General & UN Global Compact, 2004). Environmental, Social, and Governance (ESG) is a framework that assesses the sustainability and social impact of corporate operations in three main areas: Environmental, Social, and Governance (Au et al., 2023). ESG issues are now seen as critical to the economic environment, impacting the stability of the economy as a whole (Menicucci & Paolucci, 2023). It is because ESG helps to manage important emerging risks, including market instability, social problems, ecosystem damage, and financial crises.

In Indonesia, the importance of ESG implementation has gained significant momentum, particularly following the commitment of government to

achieve net-zero emissions in 2050 (Ministry of Environment and Forestry, 2021). Because of this dedication, Indonesian businesses must incorporate ESG principles into their operational plans in order to meet the country's sustainability goals. Therefore, the illustration of ESG development in Indonesia, as below:



**Figure 1. 1**

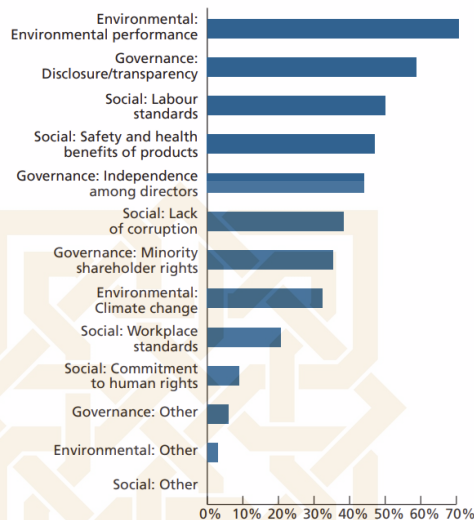
ESG Index Development per Industry Sector

Source: Katadata ESG Index, 2025

In Figure 1.1, in general, the development of the ESG index per sector from 2023 to 2025 shows an increase from year to year, although some sectors actually show fluctuations or slight declines. For example, the Banking sector recorded a sharp jump from 31,03 in 2023 to 47,84

in 2024, but then declined slightly to 47,64 in 2025. Similarly, the Food & Beverage sector experienced a slight decline from 48,06 in 2024 to 47,53 in 2025. A similar pattern was also seen in the Transportation & Logistics sector, which declined in 2024 before increasing slightly in 2025. In 2024, the Plantation sector ranked first with a median ESG score of 57,84, outperforming other sectors. This positive trend continued into 2025, with the Plantation sector again recording the highest score of 64,60. With this achievement, Plantation remained consistent as the sector with the highest ESG score for two consecutive years, demonstrating stability and significant improvement in ESG performance.

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**Figure 1. 2**

Describe the Issues that Investors Raise Most Frequently

*Source: IFC/Economist Intelligence Unit survey, 2007*

Leading businesses have demonstrated that they are prepared to have a sophisticated conversation with investors on financially significant ESG issues and have made significant progress in integrating ESG issues into their strategy, possibly faster than investors. The ESG concerns that investors brought up most frequently with emerging market companies are shown in *Figure 1.2*. However, as was the case in 2007, there are still issues with producing reliable and comparable ESG data and incorporating the most important issues into investor relations communications.



Given the current trends, governments in both developed and developing nations, as well as businesses and their investors, are becoming more and more interested in the topic of sustainable development. This is due to the fact that social responsibility and sustainability can boost business stability and performance, making them crucial for capital providers. (Alexandra et al., 2024). The selection of financial stability as the impact of ESG activities is predicated on several compelling reasons that reflect contemporary business realities (Flammer & Bansal, 2015). In an era characterized by increasing volatility, uncertainty, complexity, and ambiguity (VUCA), the ability of firms to maintain stability has become a concern for investors, regulators, and other stakeholders (Bennett & Lemoine, 2014; Schoemaker et al., 2018).

According to Baird (1987), bankruptcy occurs when a company experiencing financial distress is unable to meet its obligations, including the payment of maturing debts, and must therefore go through a collective process to settle its creditors' claims. The source of financial distress can stem from various factors, such as internal failures, industry decline, and economic pressures (Wruck, 1990), including global financial crises and pandemics such as COVID-19. The occurrence of bankruptcy is also influenced by the economic cycle, where during periods of

rapid economic growth, only a few companies face financial pressure, while during periods of recession, many companies experience difficulties due to external factors.

Additionally, prior research indicates that a company's financial stability may benefit from participation in ESG initiatives. They draw attention to the potential benefits of incorporating ESG into business plans and the way that ESG initiatives can reduce financial risk (Choi et al., 2024; Friede et al., 2015). In this study, try to reexamine the effect of ESG activities on financial performance using the economic condition as control variable. Some studies find that ESG activities boost firm performance by providing product differentiation and reducing systematic risk (Broadstock et al., 2021; Friede et al., 2015). Even, mostly recent studies have focused on bank activity, as like how banks' CSR activity impacts bank value (Azmi et al., 2021), bank efficiency (Belasri et al., 2020), and bank stability (Chiaramonte et al., 2022; Di Tommaso & Thornton, 2020), ESG activities affect banks' lending (Danisman & Tarazi, 2024).

Moreover, based on the existing literature review, researchers have not found Sharia-compliant as a moderating variable, which is sharia-compliant as one that affects ESG activities such as (Ashraf et al., 2025; Kabir Hassan et al., 2021; Qoyum et al., 2022). From a theoretical perspective, stakeholder theory specifically reveals that Islamic companies maximize benefits for stakeholders, not just profits (Qoyum et al., 2022). This study also has another interesting finding, where the financial criteria applied in Sharia screening have a significant effect on firm performance, it is in line with legitimacy theory by (Suchman, 1995). Hence, this study creates a new contribution to the further academic literature.

The inclusion of Sharia-compliant principles as a moderating variable in this study is grounded in both theoretical and practical considerations that reflect the unique characteristics of Islamic business practices (Dusuki, 2008). Islamic finance and business principles, which form the foundation of Sharia-compliant, emphasize

ethical conduct, social justice, environmental stewardship, and stakeholder welfare (Haniffa & Hudaib, 2007; Kamla & Haque, 2019). These principles align closely with ESG objectives, suggesting that Sharia-compliant companies may demonstrate stronger ESG performance and consequently, greater financial stability (Aribi & Gao, 2011; Williams & Zinkin, 2010).

Sharia-compliant companies are expected to exhibit superior ESG scores compared to conventional companies for several interconnected reasons (Abdullah et al., 2015; Farook et al., 2011). First, Islamic business principles inherently emphasize environmental conservation (*hifz al-bi'ah*) and social welfare (*maslaha*), which directly correspond to the environmental and social dimensions of ESG (Dusuki & Abdullah, 2007). Second, According to Qoyum et al. (2022) that Sharia compliant principles cannot engaged in activities involving *riba* (usury), *gharar* (speculation), and *maysir* (gambling). Third, Sharia-compliant requires adherence to ethical business practices

and prohibition of activities that may harm society or the environment (Chapra, 2000; Khan, 2013). The theoretical expectation that Sharia-compliant companies should demonstrate better ESG performance is supported by empirical evidence from various studies (Salma Sairally, 2013). Research by (Kabir Hassan et al., 2021; Platonova et al., 2018) has shown that Islamic financial institutions and Sharia-compliant companies often exhibit superior social and environmental performance compared to their conventional counterparts.

Companies that meet sharia criteria are not only required to demonstrate formal ESG performance, but must also avoid speculative practices, excessive leverage, and unethical sources of income, resulting in a more conservative and sustainable asset structure and growth (Sendi et al., 2024). In this context, ESG activities in Sharia-compliant companies have the potential to produce different implications for asset change dynamics compared to non-Sharia companies, both through mechanisms that

strengthen legitimacy in the eyes of stakeholders and through financial restrictions that affect asset expansion flexibility. Therefore, sharia compliance is positioned as a moderating variable to capture these institutional and ethical differences, while also explaining whether and how sharia compliance strengthens or alters the direction of ESG activities' influence on corporate financial stability.

There are two main theories about what the ultimate purpose of companies should be and who should profit from them. These are the stakeholder and the legitimacy theory. The first, the stakeholder theory (Freeman, 1984), argues that business leaders should take account of the interests of all stakeholders, internal and external, because this is the only way to ensure long-term success for companies. Then, the theory of legitimacy (Suchman, 1995), argues that companies must operate within societal expectations to retain their "license to operate."

Based on the academic literature reveals several novelties of this study: firstly, researchers noticed a scarcity

in the research exploring the direct effect of ESG activities on the financial stability by using asset change ratio as a proxy (Skousen, 2008). Secondly, the sample of this study is Indonesian ESG-listed firms, where most of the studies were conducted in GCC, EU, US, and OIC countries such as the study from (Almulla et al., 2025; Athari, 2024; Islam et al., 2025; Lupu et al., 2022). Lastly, this study tried to investigate the role of Sharia-compliant as the moderating relationship between ESG activities and financial stability. This study uses control variables include economic growth, inflation rate, and unemployment rate, to isolate the specific effects of ESG activities on financial stability with sharia-compliant as moderating variable.

Based on the research background, this research is titled **“ESG Activities and Financial Stability in Indonesian ESG-Listed Firms: Does Sharia-Compliant Matter?”**.

## **B. Research Questions**

Based on the research background above, this research will encompass the impact of ESG activities on financial stability with Sharia-compliant as a moderating variable. The following questions will be addressed in this study:

1. Does Composite ESG Index effect to the financial stability in Indonesian ESG-listed firms?
2. Does Environmental Index effect to the financial stability in Indonesian ESG-listed firms?
3. Does Social Responsibility Index effect to the financial stability in Indonesian ESG-listed firms?
4. Does Governance Index effect to the financial stability in Indonesian ESG-listed firms?
5. Whether Sharia-compliant able to moderate the variable of ESG activities on the financial stability in Indonesian ESG-listed firms?

## **C. Research Objectives**

The main objectives of the study are as follows:



1. To test and explain the effect of Composite ESG Index on the financial stability in Indonesian ESG-listed firms.
2. To test and explain the effect of Environmental Index on the financial stability in Indonesian ESG-listed firms.
3. To test and explain the effect of Social Responsibility Index on the financial stability in Indonesian ESG-listed firms.
4. To test and explain the effect of Governance Index on the financial stability in Indonesian ESG-listed firms.
5. To test and explain the effect of ESG activities on the financial stability in Indonesian ESG-listed firms.

#### **D. Research Contribution**

This research is expected to contribute to several parties as follows:

1. For Theoretical

The results of this study expected that will be able to serve new knowledge and perspectives, and also it will have a deeper understanding of the world of ESG activities and financial stability in Indonesian ESG-

Listed firms. But this study has also chosen the potential variable of Sharia-compliant as a moderation variable to affect the performance of the Indonesian ESG-Listed firms.

## 2. For Practical

This Research is expected to provide some important information for the Indonesia ESG-Listed firms as a consideration in the company to continue implementing ESG activities and pay attention to the policy in the Sharia-compliant. Then, this research can provide an overview for the stakeholder. This research hopes for the general public, especially for the investor to pay attention and consider investments in the company from the research results. Then, this research is also expected to provide information and input as material for consideration in making decision and policies for all off the companies that was included in Indonesian ESG-Listed firms.

## **E. Systematic Discussion**

The systematics of this writing can be explained in 5 parts, first, CHAPTER 1 Introduction which contains an overview of which contains the background with an explanation of the reasons why this study chosen the title of this research and provides an explanation regarding the differences between this study and previous studies. Then the formulation of the problem is also described in this background, and there are goals and benefits expected.

Second, CHAPTER II Theoretical Basis and Literature Review, this chapter discusses the theories relevant to this research problem. The study consists in two main theories; Stakeholder theory and Legitimacy theory. Furthermore, there are several explanations of the variables that used in this research. It will be continued with a summary of the previous research descriptions those are relevant to this research.

Third, CHAPTER III Research Methodology as part of this research discusses the research methods to be used. The quantitative method is the method used. Then, part of the explanations what are the proxies or measurement of each operational independent, dependent, and moderating variable.

Furthermore, an explanation of the data processing techniques and analytical tools used in the study.

Fourth, CHAPTER IV Result and Discussion Includes a description of the research subject, key findings, and analysis and interpretation of data. This section explains in detail how the data was processed and the conclusions that can be drawn from the research results. The last, CHAPTER V Conclusion which will be the final part of the study contains the conclusions and results of the data processing process. As well as suggestions that describe the deficiencies and input for further research.



## CHAPTER V

### CONCLUSION

#### A. Conclusion

This study examined the effect of ESG performance and Sharia- compliant on financial stability in ESG-listed firms in Indonesia during the period 2009–2019. The empirical results provide several important conclusions. First, the Composite ESG Index has a positive and significant impact on financial stability, confirming that overall ESG engagement contributes to long-term resilience. This finding reinforces the idea that ESG activities, when implemented holistically, strengthen stakeholder trust and reduce risks.

Second, when ESG is disaggregated into its three pillars, the results are mixed. The Environmental Index shows no significant effect, indicating that environmental initiatives in Indonesian firms may not yet deliver measurable stability benefits. The Social Index and the Governance Index both display negative and significant

effects, suggesting that social and governance practices may increase costs or create inefficiencies in the short term. These results highlight that ESG dimensions do not contribute equally to stability and that context matters in shaping outcomes.

Third, the moderating role of Sharia-compliant reveals further complexity. Sharia-compliant has a negative significantly strengthen the effect of the Composite ESG Index on stability. However, environmental index does have effect to financial stability. Surprisingly, it significantly amplifies the positive effects of the Social Index and Governance Index, reflecting the alignment between Sharia principles and these two ESG pillars.

Overall, the findings show that while ESG and Sharia-compliant have the potential to improve financial stability, their effects are nuanced and context-dependent. The study challenges the assumption that all ESG dimensions and governance practices automatically

enhance resilience and underscores the importance of aligning ESG with cultural, institutional, and religious contexts.

## **B. Contributions**

### **1. Theoretical Contribution**

This study makes several contributions to the literature.

- a. Based on the analyzing ESG both as a composite index and through its individual pillars, this research demonstrates that not all dimensions affect financial stability equally. This supports calls in the ESG literature to move beyond composite measures and examine the heterogeneous effects of environmental, social, and governance practices.
- b. The study extends Stakeholder Theory and Legitimacy Theory by incorporating Sharia-compliant as a moderating variable. The results show that Sharia principles strengthen the effect of social and governance practices, but not

environmental. This provides a new perspective on how religious values intersect with sustainability practices in Muslim-majority markets.

- c. The result shows the contrary too much of the prior literature, this study finds a negative relationship between composite ESG index and stability in Indonesia, especially when moderated by Sharia-compliant. This challenges the universalist assumption that social and governance always improves resilience, suggesting that institutional and regulatory contexts play a decisive role.

## **2. Practical Contribution**

The findings also carry important practical implications for firms, regulators, and investors.

### **a. For Firms**

The results of the study indicate that ESG implementation should be carried out holistically rather than partially. While the composite ESG index improves financial stability, focusing only on



individual pillars may not yield the same benefit.

Firms should also ensure that social and governance initiatives are strategically aligned with core business goals to avoid inefficiencies and negative effects on stability.

b. For Regulators

The insignificant environmental effect suggests that stronger regulatory frameworks and enforcement are needed to ensure that environmental initiatives translate into tangible benefits. Similarly, governance standards must be designed in a way that supports firms rather than imposing excessive compliance costs.

c. For Investors

The results highlight that ESG performance is an important indicator of stability, but careful attention must be paid to the specific ESG pillars. Additionally, in contexts where Sharia-compliant is relevant, investors should recognize that Sharia-

compliant firms may deliver stronger stability benefits from social and governance practices, but not necessarily from environmental initiatives.

### **C. Limitation and Suggestion**

Acknowledging this study have limitations, and these limitations is essential to contextualize the findings and provide a foundation for future research directions. First, regarding measurement. The study relies on ESG data from listed firms in Indonesia for the period 2009–2019. While the ESG indices used are standardized, they may not fully capture the qualitative aspects of sustainability practices, such as firm culture, innovation, or stakeholder perceptions. Moreover, the Environmental, Social, and Governance sub-indices may not equally reflect local business realities, which could partly explain the unexpected negative results for the social and governance dimensions. Future research may incorporate qualitative data, case studies, or alternative ESG scoring methods to gain a deeper understanding.

Second, regarding scope and sample. The study focuses on ESG-listed firms in Indonesia, which limits the generalizability of the findings. The Indonesian context is unique, with specific institutional, cultural, and religious dynamics that shape ESG implementation and Sharia-compliant. Future research could expand the analysis to cross-country comparisons, especially among other emerging markets or Muslim-majority economies, to examine whether the patterns observed here are context-specific or more universal.

Third, regarding methodology. Although the study employs the GMM (Generalized Method of Moments) approach to address endogeneity and dynamic panel issues, no method is without limitations. The selection of instruments, lag structures, and cut-off periods may influence the robustness of the results. Future studies could use alternative econometric techniques, such as panel threshold regression, difference-in-difference analysis, or structural equation modeling, to validate and extend these

findings.

Fourth, regarding Sharia-compliant. This study treats Sharia-compliant as a binary classification (Sharia vs. non-Sharia). However, in practice, Sharia-compliant may exist on a spectrum, with varying levels of adherence to Islamic finance principles. Future research could adopt a more nuanced measurement of Sharia-compliant, such as using Sharia screening ratios, corporate disclosures, or Sharia audit reports, to capture differences in depth and rigor of implementation.

Finally, regarding the time frame. The dataset ends in 2019, just before the COVID-19 pandemic. The pandemic created extraordinary disruptions to financial markets and corporate stability, which could alter the ESG and financial stability relationship. Future studies should extend the analysis into the post-pandemic period to examine whether ESG and Sharia-compliant provide greater resilience during global crises.

In summary, while this study provides valuable

insights into the ESG and financial stability relationship in Indonesia, future research can address these limitations by broadening datasets, refining measurements, and employing alternative methodologies. Such extensions would not only validate the current findings but also contribute to a more comprehensive understanding of how ESG and Sharia-compliant interact to influence financial stability across different institutional contexts.



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