

Dynamic Triangulation between Shariah Compliance, ESG Transparency, and Firm Profitability

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ABSTRACT

Environmental, social responsibility, and good governance (ESG) ethics are becoming more important to businesses. Long-term sustainability is a goal. Ethical conduct, sustainability, and financial performance are increasingly studied. Thus, more research on this topic has been conducted. Islamic corporate finance, which is growing in popularity, raises the question of whether Shariah and ESG screening criteria improve or hurt financial performance. This study compares Shariah-compliant stocks with high-scoring (ESG-Leaders) and low-scoring ESG ratings to add new insights to the literature (ESG-Laggards). Shariah-compliant firms may suggest high ESG risk even when they are Shariah-compliant. This study uses panel regression models to assess how ESG practises affect performance. This study examines ESG practises and corporate performance. Panel data from a sample of companies is analysed using regression models. The results will reveal how ESG practises affect corporate performance. This study will add to the literature on ESG practises and business performance and will attract policymakers, policymakers, and practitioners. This study employs panel regression models to examine how environmental, social, and governance (ESG) policies and Shariah screening affect Malaysian Islamic enterprises' financial performance from 2017 to 2021. This study found a link between Shariah-compliant organisations' financial success and ESG criteria, notably social ones. This study shows that ESG leaders, firms with higher ESG scores, perform better financially than enterprises with lower ESG scores. This observation suggests that if ethical involvement delivers low scores, the company's valuation may decline. If not handled properly, ethical issues can cost money. Thus, ethical factors should be thoroughly assessed and integrated into the company's strategy to avoid damaging its valuation.

Keywords: Environmental, Social and governance (ESG), Financial performance, Shariah-compliant, Malaysia

INTRODUCTION

The corporate world is witnessing a surge in interest in sustainable business management, which is gaining traction, with companies strategizing operations to create positive long-term impacts on society and the environment. This has increased the adoption of Environmental, Social, and Governance (ESG) practises. While allocating resources to ESG activities may conflict with value maximization, it is aligned with business sustainability, as companies cater to diverse stakeholder interests, leading to improved financial performance.

Numerous studies have examined the impact of ESG practises on financial performance, but the evidence must be more consistent. Some studies suggest a positive relationship, indicating that companies prioritizing ESG factors outperform peers by benefiting from enhanced reputation, reduced risk exposure, and increased access to capital. However, other studies found no significant or negative relationships, suggesting that the impact may vary across industries and contexts.

Further research is required to fully understand this complex relationship. In parallel, Islamic corporate finance is gaining relevance though it remains nascent. Research in this area has explored topics such as the impact of ESG on Shariah-compliant firms' risk, dividend payout policies, and the capital structure of these firms. This study contributes to the literature by investigating the impact of ESG on the financial performance of Shariah-compliant firms. ESG scores published by databases like Refinitiv have facilitated ESG studies.

Since 2002, Refinitiv has provided data on companies' ESG practises worldwide. These scores cover a broad spectrum of ESG issues and promote sustainable business. Environmental elements assess a company's commitment to a safe and healthy environment, including reducing toxic emissions, waste treatment and recycling, greenhouse gas management, and other environmental impacts. Social elements evaluate workforce and community well-being, stakeholder trust, and loyalty. These factors encompass human rights, employee welfare, product liability, and company relationships with customers, society, stakeholders, and governments. The governance elements measure company systems and processes to ensure that board members and managers act in the interests of stakeholders. These factors include board oversight aspects such as composition, leadership, independence, risk management, and business ethics.

Additionally, governance factors encompass transparency and accountability in financial reporting, executive compensation, and shareholder rights. By addressing these elements, companies demonstrate commitment to ethical business practises and responsible decision - making, enhancing reputation and building trust among investors and stakeholders. Strong governance practises also help companies navigate regulatory requirements and mitigate risks, safeguarding long-term sustainability. The interplay between social and governance factors is crucial for businesses to establish a solid foundation for success and sustainable growth.

Shariah-compliant companies and Islamic finance have gained significant attention alongside the rise in ESG studies. In Malaysia, the Securities Commission updates the list of Shariah-compliant companies biannually using quantitative and qualitative criteria. The quantitative criterion filters out companies engaged in activities prohibited by Shariah law. Companies with mixed activities are assessed based on the percentage contribution from non-permissible sources to revenue or profit before taxes. A 5% limit applies to activities such as conventional banking, insurance, gambling, liquor, pork, and non-halal foods and beverages. Noncompliant entertainment, interest income from conventional accounts, tobacco, and hotel and resort operations are also considered. A 20% limit applies to share trading, stockbroking, and rental income from non-Shariah compliance activities.

The second step involves financial ratios, where interest-bearing debt and cash must comprise less than 33% of total assets. Qualitative criteria ensure positive public perception of the importance of core activities. ESG and Shariah screenings have distinct objectives. Shariah screening excludes companies that contradict Islamic law, whereas ESG screening is based on a company's involvement in ethical initiatives. There is debate about expanding ESG criteria to include norm-based elements covered by Shariah screening. Some argue that more than Shariah screening is required and that incorporating ESG criteria into Islamic finance is necessary. Ayedh et al. (2019) suggested improving Shariah screening by eliminating prohibited income, organizing Shariah reporting, implementing Islamic corporate culture, and using Islamic legal, moral, and ethical management. ESG and Shariah screening complement each other, offering a comprehensive ethical screening approach.

Stocks meeting both criteria are deemed highly ethical. However, combined screening studies are limited. Due to combined screening, Erragraguy and Revelli (2015, 2016) found no adverse effects on portfolio returns. Elnahas et al. (2021) reported no difference in CSR (ESG scores) between compliant and non-compliant firms. Azmi et al. (2019) found that combining Islamic and sustainable strategies yielded higher rewards. Hassan et al. (2021) noted that the combined effect of ESG and Shariah screening needs to be explored, especially in emerging markets. Boubakri et al. (2021) called for more attention to ESG in emerging markets.

This research aims to elucidate the influence of Environmental, Social, and Governance (ESG) practises, along with their individual components, on firms' financial performance. The study further evaluated the joint impact of ESG criteria and Shariah compliance screening on the financial outcomes of companies. Additionally, the study conducted a comparative analysis of financial performance between companies that adhere to ESG and Shariah principles and those that do not within the Malaysian context it.

LITERATURE REVIEW

This section provides an overview of the existing literature that examined the impact of ESG and Shariah screening on financial performance. It also presents a theoretical framework explaining the combined effect of these screening criteria on company performances. Previous studies have shown that ESG factors, which

include environmental sustainability, social responsibility, and sound governance practises, can enhance financial performance. Shariah screening ensures adherence to Islamic principles and is linked to positive financial outcomes in Islamic finance contexts. However, only some studies have investigated the joint impact of these two screening criteria.

Theories of the Impact of ESG on Performance

Two primary schools of thought exist regarding the impact of environmental, social, and governance (ESG) practises on firms' financial performances. The first school is based on Jensen and Meckling's (1976) agency theory, which posits that ESG practises are unproductive expenditures that negatively affect performance. Firms engage in ESG activities to pursue management's private benefits at the expense of shareholder value. The second school is based on Freeman's (1994) stakeholder theory, which suggests that ESG practises reflect good management, fulfil all stakeholders' interests, and positively impact performance.

Empirical evidence on the relationship between ESG practises and financial performance is mixed. Some studies, such as those by Benabou and Tirole (2010), Masulis and Reza (2015), and Kruger (2015), found a negative relationship between agency theory's view. Others, such as Li et al. (2018), Wan-Hussin et al. (2021), and Wong et al. (2021), found a positive relationship, supporting the stakeholder theory's view. Based on the stakeholder theory, we expect ESG practises to improve financial performance. Hence, we test the following hypothesis:

H_{1A}: A positive relationship between SHARIAH-ESG-screened equity and financial performance.

Measuring the Impact of ESG as an Individual Dimension

Environmental, social, and governance (ESG) practises are multidimensional, and the effects of one dimension can sometimes counteract the effects of another. This necessitates an investigation into the impact of individual ESG dimensions on performance. Studies examining the impact of individual ESG elements on firm performance have yielded diverse results. For example, Han et al. (2016) found a negative relationship between environmental and financial performance, no social and financial performance, and a positive relationship between governance and financial performance among Korean firms. Nollet et al. (2016) found insignificant relationships between individual ESG measures and performance in their linear model but found a U-shaped relationship between governance score and accounting performance measures in their quadratic model.

On the other hand, Li et al. (2018) found that each ESG element has a positive impact on the performance of UK public firms. Separate studies on the environmental components of ESG practises suggest that corporate environmental management can improve financial performance through efficient resource use, enhanced competitiveness, and improved reputation. However, some studies have found a negative relationship between environmental practises and financial performance, suggesting that investors perceive environmental initiatives as potential costs.

The social aspect of ESG practises is considered integral to a company's public relations and are expected to impact financial performance. Some studies have found that companies with good corporate relations with stakeholders have better financial performance, especially in the social sub-component. However, other studies have found no significant relationship between social sub-components and firm values. Numerous studies have investigated corporate governance's impact on companies' financial performances. These studies indicate that companies are more likely to survive eventually by safeguarding stakeholder interests.

Furthermore, research has revealed a positive correlation between governance and company performance. In summary, existing literature supports a positive association between the three components of ESG (environmental, social, and governance) and financial performance. Therefore, this study aimed to test the following hypotheses:

H_{2a}: A positive correlation exists between firms' environmental practises and financial performance.

H_{2b}: A positive correlation exists between firms' social practises and financial performance.

H_{2c}: A positive correlation exists between firms' governance practises and financial performance.

Measuring the Impact of Individual ESG Dimension

The combination of ESG and Shariah screening offers a comprehensive ethical screening approach. Stocks meeting both criteria are considered highly ethical, adhering to exclusion criteria for non-ethical stocks and inclusion criteria for ethical initiatives. Despite the limited research on combined screening, existing studies suggest no adverse effects on portfolio returns. For instance, Erragraguy and Revelli (2015, 2016) found no negative impact, whereas Elnahas et al. (2021) observed no difference in CSR (ESG scores) between compliant and non-compliant firms. Azmi et al. (2019) reported that combining Islamic and sustainability investing strategies yielded greater rewards.

After passing Shariah screening, Shariah-compliant firms are expected to exhibit sound management practises, including ESG activities. Azam et al. (2019) found that high Shariah compliance significantly promotes CSR activities in Pakistan. Anuar et al. (2009) observed higher environmental disclosure in Malaysian Shariah companies, and Nugraheni and Anuar (2014) reported increased voluntary disclosure by Shariah firms in Indonesia. The potential benefit of ESG screening may be amplified for Shariah firms because their ESG scores tend to be 6% higher than those of other companies (Thomson et al., 2019). However, the impact of combined ESG and Shariah screenings on financial performance remains largely unexplored. Qoyum et al. (2022) found varying effects among ESG components on Shariah-compliant firms in Indonesia and Malaysia, with better environmental and social performance but not governance.

This study examines the impact of ESG practises and their components (ESG) on financial performance. The study also analyzes the combined effect of ESG and Shariah screening on companies' financial performances. The study's main contribution is new information about how ESG and Shariah screening interact to affect the performance of firms in Islamic corporate finance, categorizing them into ESG leaders and ESG lurkers groups. This research provides valuable insights into the interplay between ESG practises, Shariah compliance, and financial performance. We propose the following hypotheses:

H_{3a}: An enhanced positive relationship between SHARIAH-ESG leaders and financial performance.

H_{3b}: An enhanced positive relationship between SHARIAH-Environmental Leaders and financial performance.

H_{3c}: An enhanced positive relationship between SHARIAH-Social Leaders and financial performance.

H_{3d}: An enhanced positive relationship between Shariah-governance leaders and financial performance.

MATERIALS AND METHODS

The focus of this paper is to examine the specific impact of non-financial factors, including aggregate ESG performance and the subcomponents of environmental best practises, social responsibilities, and ethical CG, on the financial performance of shariah - screened equities; to do so, the initial step is to verify the stationary properties of the variables. The panel unit root test developed by Harris-Tzvalis (h_t) was used to evaluate the unit root properties of the series.

After running the h_t unit root test, the null hypothesis of unit root existence was rejected and integrated at level zero ($P > z: 0.05$) for all variables except for the ESG, Env, and Soc scores, which are stationary at first-order differences. In addition, the Variance Inflation Factors (VIF) test is used to confirm the non-existence of multicollinearity issues across all variables (mean VIF=1.25).

Ordinary least squares (OLS) fixed and random-effects models are used to estimate the linear effects of ESG practises on firms' financial performances. Static models provide helpful information about the causal relationships between critical determinants when markets are in equilibrium, but they only provide a momentary snapshot of a dynamic process (Geroski, 1990). Fixed and Random-effects model results were not reported in this study because of their bias and inconsistency (Baltagi, 2005).

The present study utilizes panel regression models to investigate the effects of environmental, social, and governance (ESG) practises on performance and the influence of ESG practises and Shariah screening on the financial performance of Islamic companies in Malaysia from 2017 to 2021. The findings of this research demonstrate a clear association between companies that adhere to ESG standards, particularly in the social dimension and the organization’s financial well-being. Furthermore, this study provides evidence that companies with higher ESG scores, commonly referred to as ESG learners, exhibit a positive correlation with financial performance compared to those with lower ESG scores.

Table I Summary of Variables and Measurement Matrix

Code	Variable	Descriptions	Expected outcome
<i>Dependent Variables</i>			
<i>ROA_{it}</i>	Return on Assets	Firms’ operational performance (accounting-based) is measured by the ratio of net income to total assets.	
<i>ROE_{it}</i>	Return on Equity	Firms’ operational performance (accounting-based) is measured by the ratio of net income to total equity.	
<i>Independent Variables</i>			
<i>ESGS_{it}</i>	Combined ESG score	extracted from the database, ranging from 0 to 100 as a percentage, measured the company’s involvement in ESG practises	If (-) negative, then <i>Principle-Agent Theory</i> and <i>Overinvestment Theory</i> or If (+) positive, then <i>Stakeholder theory</i> and <i>legitimacy theory</i> (+) <i>Positive (Legitimacy Theory)</i>
<i>Envs_{it}</i>	Environmental score	extracted from the database, ranging from 0 to 100 as a percentage, measured the company’s involvement in environmental practises	
<i>Socs_{it}</i>	Social score	extracted from the database, ranging from 0 to 100 as a percentage, measured the company’s involvement in social practises	
<i>Govs_{it}</i>	Governance score	extracted from the database, ranging from 0 to 100 as a percentage, measured the company’s involvement in governance practises	
<i>Leaders_{it}</i>	Dummy for ESG Leaders	Binary numbers where 1 represents the highest level of integration between shariah and ESG screening indicated higher score grades (leaders). In contrast, 0 represents a lower Integration of ESG screenings with other Shariah-compliant firms.	
<i>Moderating Variables</i>			
<i>ESGS*Leaders_{it}</i>		Interaction of ESG Score with Dummy Variable for ESG Leaders	(+) <i>Positive (Legitimacy Theory)</i>
<i>Envs*Leaders_{it}</i>		Interaction of Environmental Score with Dummy Variable for ESG Leaders	(+) <i>Positive (Legitimacy Theory)</i>
<i>Socs*Leaders_{it}</i>		Interaction of Environmental Score with Dummy Variable for ESG Leaders	(+) <i>Positive (Legitimacy Theory)</i>
<i>Govs*Leaders_{it}</i>		Interaction of Environmental Score with Dummy Variable for ESG Leaders	(+) <i>Positive (Legitimacy Theory)</i>
<i>Controlling Variables</i>			
<i>SIZE_{it}</i>	Firm Size	Natural logarithms of total assets	(+) <i>Positive (Slack Theory)</i>
<i>LEV_{it}</i>	Financial Leverage	The ratio of total debt to equity	(-) <i>Negative (Trade-off Theory)</i>
<i>LIQ_{it}</i>	Liquidity	The ratio of total current assets to total current liabilities.	(+) <i>Positive (Slack Theory)</i>
<i>CAPEX_{it}</i>	Capital Expenditure	Interest Expenses from Operating Cash Flow	(+) <i>Positive (Slack Theory)</i>

RESULTS AND DISCUSSION

The results of the regression model analysis presented in Table II are consistent with prior research and empirical evidence documented in the literature.

Static Panel Data Models

Table II Static Panel Data Estimation: FGLS Model

Combined Score			Subcomponents Score	
	Panel A	Panel B	Panel C	Panel D
<i>ESG</i>	(.0187) 1.83*	(-.016) -0.89		
<i>ESGL Dummy</i>		(-3.425) -2.49***		
<i>ESG*Leaders</i>		(.070) 2.60***		
<i>Environmental</i>			(-.008) -0.87	(-.019) -1.28
<i>ENVL Dummy</i>				(-.391) -0.31
<i>ENV*Leaders</i>				(.012) 0.51
<i>Social</i>			(.022) 2.20**	(.012) 0.73
<i>SOCL Dummy</i>				(-2.85) -2.46***
<i>SOC*Leaders</i>				(.049) 2.14***
<i>Governance</i>			(-.004) -0.65	(-.001) -0.10
<i>GOV Dummy</i>				(.311) 0.32
<i>GOV*Leaders</i>				(-.005) -0.30
<i>Controlled Variables</i>				
<i>Firm Size</i>	(-.190) -1.50	(-.195) -1.49	(-.174) -1.29	(-.187) -1.38

Liquidity	(-.291) -2.13**	(-.318) -2.41***	(-.247) -1.77*	(-.280) -1.97**
Leverage	(-.106) -6.83***	(-.102) -6.97***	(-.092) -5.69***	(-.091) -5.79***
Capex	(-.002) -0.20	(-.002) -0.26	(-.001) -0.06	(.003) 0.32
Constant	(13.06) 4.98***	(14.15) 5.25***	(12.18) 4.44***	(12.78) 4.54***
<i>Diagnostics Testing</i>				
VIF Test	Mean VIF=1.65	Mean VIF=6.14	Mean VIF=1.76	Mean VIF=10.70
Modified Wald Chi	(7076) ***	(7198) ***	(4805) ***	(4717) ***
Wooldridge Test	(19.56) ***	(19.24) ***	(19.78) ***	(19.64) ***
R-Squared				
F-Test	(176.88) ***	(200.25) ***	(162.33) ***	(191.20) ***
No. Obs.	550	550	550	550

Notes: The variance Inflation Factors (VIF) test is used to test the issue of multicollinearity across the datasets; the Modified Wald Chi² test is used to test the presence of heteroskedasticity in the residual; the Wooldridge Test is used to test the presence of autocorrelation; and the F-test and R-squared test are used to test model fitness. Figures in the parentheses are the coefficients, whereas *, **, and *** denotes significance at 10%, 5%, and 1%, respectively.

The ESG scores had a positive and substantial influence on the combined score observed in Panel A of the regression model, which is consistent with the conclusions of Setiani et al. (2023). Their study also identified a favorable correlation between ESG scores and business financial performance [1]. These findings indicate that companies with higher ESG scores exhibit superior financial performance. Nevertheless, the minor and inconsequential effect on the sub-components' scores in Panel B suggest that the connection between ESG ratings and particular aspects of company performance may be intricate and require additional examination.

The regression model results further emphasize the significance of ESG leaders. The ESGL dummy coefficient in Panel A is negative and highly significant, indicating that ESG leaders have lower total scores. Nevertheless, the interaction term ESG*Leaders has a noteworthy and statistically significant impact, suggesting that ESG leaders possess an excellent overall score. These findings are consistent with the research conducted by Zhang et al. (2021), which showed that higher Environmental, Social, and Governance (ESG) ratings effectively mitigate business risk and the perceived risk of future development among investors. Environmental, social, and governance scores have diverse effects on the panels. In Panel A, the environmental score has a negligible and non-significant effect on the combined and subcomponent scores. However, the social score significantly and positively affects the combined score. The findings of Narula, Rao, and Rao (2023) align with this, as they proposed a conceptual framework that establishes a connection between ESG practises and business value generation. The study also considers controlling variables.

Controllable variables, such as firm size, liquidity, leverage, and cape, affect each panel differently. Significantly, leverage exerts a negative and substantial influence across all panels, consistent with the research conducted by Cohen (2023), which demonstrated the correct integration of ESG risk factors into the global economy—evaluation of the model's performance and accuracy. The model diagnostics indicate multicollinearity, heteroscedasticity, and autocorrelation, which should be addressed in future analyses. The statistically significant F- tests across all panels indicate that the models are well-fitted, indicating the

regression model’s robustness.

The ESG score has a noteworthy and substantial influence on the combined score in Panel A (coefficient = 1.83, $p < 0.10$). Nevertheless, it exerts a detrimental, albeit inconsequential, influence on the subcomponent scores in Panel B (coefficient = -0.89). In Panel A, the coefficient of the ESG dummy is 2.49, with a p-value of less than 0.01, indicating a negative and highly significant relationship. This suggests that ESG leaders have a lower combined score. In Panel A, the interaction term “ESG*Leaders” has a positive and highly significant impact (coefficient = 2.60, $p < 0.01$), indicating that ESG leaders possess a more excellent combined score. The environmental score has a negligible but adverse effect on the total and subcomponent scores (coefficients = -0.87 and -1.28, respectively). The social score strongly and positively influences the combined score in Panel A, with a coefficient of 2.20 and significance level of $p < 0.05$.

However, in Panel B, the coefficient of 0.73 indicates that its impact on the score of the sub-components is positive but insignificant. The governance score has a negligible negative effect on the overall and sub-component scores, with coefficients of 0.65 and 0.10, respectively. The effects of firm size, liquidity, leverage, and capex differ across panels. It is worth noting that leverage has a noteworthy and substantial detrimental effect on all panels ($p < 0.10$).

The VIF test findings indicate potential multicollinearity problems, particularly in Panel D (with a mean VIF of 10.70). The Modified Wald Chi2 test and Wooldridge Test results exhibit statistical significance in all panels, suggesting the existence of heteroskedasticity and autocorrelation—the F-test yields statistically significant values for all panels, indicating that the models are well-fitted.

Dynamic Generalized Method of Moments (GMM)

Table III Dynamic Panel Data Estimation: Two-Step System GMM Model

	Panel A	Panel B
<i>Independent Variables</i>		
L1.ROA	(.741) 6.92***	(.714) 4.87***
ESG	(-.003) -0.21	(-.020) -0.62
ESGL Dummy		(-5.241) -1.84*
ESG*Leaders		(.093) 1.78*
<i>Controlling Variables</i>		
Firm Size	(-.511) -1.06	(-.511) -1.06
Liquidity	(-.572) -2.13**	(-.191) -1.96**
Leverage	(-.106) -6.83***	(-.017) -0.70
Capex	(-.002) -0.20	(-.049) -0.45
Constant	(13.06) 4.98***	(18.04) 1.38
Time Fixed Effects	<i>Included</i>	<i>Included</i>
<i>Diagnostics Testing</i>		
<i>Endogeneity</i>	15.51 (0.008) *** 2.657 (0.022) **	16.42 (0.0216) ** 2.253 (0.029) **
<i>AR (1) Pr>z, where</i>		-3.49 (0.000) ***
<i>AR (2) Pr>z:</i>		1.74 (0.082)
<i>Sargan Test</i>		120.84 (0.001) ***

<i>Hansen Test</i>		41.49 (1.000)
<i>Model Fitting</i>		
F-Test	(1044) ***	(1860) ***
N. Observations	495	495
N. Groups	55	55
N. Instruments	49	96

Notes: Time effects are controlled by creating dichotomous dummy variables for years, and year should be omitted from the regression to avoid dummy traps. The test for endogeneity is done after specifying regress with H_0 =variables are exogenous—arellano-Bond test (AR) for zero autocorrelation in first-differenced error with H_0 =no autocorrelation. Sargan/Hansen's test of overidentifying restrictions is used to test the validity of the GMM estimates with H_0 : overidentifying restrictions are valid. FGLS and PCSE stand for Feasible Generalised Least Square, and Panel Corrected Standard Errors and are used for the static panel regression models. The dynamic panel data estimation is based on the two-step system Generalised Method of Moments (GMMs). Figures in parentheses show the t-statistics, and *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.

The lagged return on assets (L1.ROA) has a substantial and statistically significant beneficial effect on company performance in Panels A and B. These findings indicate that companies with higher asset returns in the prior period likely have superior performance today. This may be attributed to the correlation between high Return on Assets (ROA), effective managerial practises, and optimal asset utilization. The ESG score has a negligible and non-significant effect on company performance in both panels. This implies that although ESG scores significantly evaluate a company's environmental, social, and governance practises, they may not directly improve company performance. This phenomenon may arise from many variables, including the firm's industry, scale, and business methodologies.

In Panel A, the ESGL dummy coefficient is negative and statistically significant, suggesting that companies with more ESG leadership exhibit lower levels of company performance. This implies that although ESG leaders excel in their ESG practises, they may encounter difficulties in other domains that affect their overall success. In Panel A, the interaction term ESG*Leaders has a positive and statistically significant impact, indicating that companies that are leaders in environmental, social, and governance (ESG) practises exhibit superior performance. This suggests that organizations that are leaders in environmental, social, and governance (ESG) practises and have high ESG scores are more likely to achieve superior performance. This may be attributed to the synergistic effects of effective environmental, social, and governance (ESG) practises and other aspects of company operations. Controlling variables, such as firm size,

Liquidity, leverage, and cape affect panels differently. For instance, the analysis reveals that liquidity exerts a harmful and substantial influence in both scenarios, indicating that companies with greater liquidity may have diminished performance. This may be attributed to the correlation between high liquidity and inefficient asset use by the firm. The results of diagnostic testing revealed possible problems with the model, such as endogeneity, autocorrelation, and overidentifying constraints. These concerns could affect the dependability of the model's estimations and should be resolved in future assessments. The F-test results exhibit a high significance level in both panels, indicating that the models are well-fitted. This finding suggests that the models account for substantial variability in the dependent variable.

The static panel data models demonstrate that ESG scores, especially when combined with leadership status, substantially impact the overall score. Nevertheless, the effects on the sub-component score were less noticeable, indicating a more complex connection between ESG scores and specific aspects of company success. The model diagnostics revealed possible problems with multicollinearity, heteroscedasticity, and autocorrelation, emphasizing the necessity for thorough model specification and robustness checks in future research. Controlling variables, specifically leverage, have been identified as essential elements influencing company performance. This finding is consistent with existing research on the impact of firm-specific factors

on performance outcomes.

Switching to Dynamic Panel Data Models The static panel data models offered valuable insights into the interactions between variables at a particular time. However, the dynamic panel data models introduced a temporal component to the research, allowing for a more comprehensive understanding of how these relationships evolve—models for analyzing panel data that incorporate time-varying factors. The dynamic panel data models indicate that prior performance significantly influences firm performance, represented by the lagged return on assets (L1.ROA), ESG scores, and ESG leadership status. Nevertheless, the effects of these influences varied when considering other indicators of company performance, highlighting the complex and diverse nature of company performance. The model diagnostics identified possible problems related to endogeneity, autocorrelation, and overidentifying limitations, emphasizing the importance of meticulous model design, testing, and interpretation in dynamic panel data analysis.

Controlling variables, including liquidity and leverage, had a notable impact on the models, emphasizing the significance of firm-specific characteristics in influencing firm performance. Combination by combining the results of both the static and dynamic models, becomes clear that ESG scores and leadership status substantially impact business success. Nevertheless, this relationship is complex and is affected by various elements unique to the organization. The model diagnostics from both sets highlight the significance of resolving any econometric concerns to guarantee the reliability of the results. Ultimately, static and dynamic panel data models offer valuable insights but have their advantages and disadvantages. The research inquiry should influence their selection, data characteristics, and study circumstances.

Future research will be enhanced by a meticulous examination of these characteristics and additional investigation into the intricate connections among ESG scores, leadership status, and company success. Such contributions will enhance understanding of how ESG practises influence business performance and provide valuable insights into the theoretical and practical aspects of this field. When evaluating business performance, it is crucial to recognize that both ESG scores and leadership status have merits and drawbacks. The determination should rely on the precise research query, data characteristics, and circumstances. To enhance our understanding of the impact of ESG practises on business success, future research should thoroughly examine these elements and go deeper into the intricate connections among ESG scores, leadership status, and firm performance. This research can enhance our understanding of the impact of ESG practises on business performance and offer valuable insights for both theoretical and practical applications in this domain

CONCLUSIONS

This study offers insights into the intricate relationship between environmental, social, and governance (ESG) factors and company performance. This study reveals that this relationship is multifaceted and context-dependent, emphasizing the strategic significance of ESG initiatives in creating long-term value for businesses. The findings also highlight the importance of ESG leadership in terms of robust firm performance. However, the endogeneity and autocorrelation in the models warrant further refinement and validation of the results. In conclusion, this study contributes to the growing knowledge of ESG and business performance and has significant implications for scholars and practitioners. This approach aids in comprehending the complex dynamics of the ESG-firm performance link, providing a roadmap for future research and practical applications in this field.

By dissecting the individual components of ESG, researchers can gain a more granular understanding of how environmental, social, and governance factors independently contribute to financial performance. This could involve investigating the impact of environmental practises on cost savings or consumer preferences, analyzing the effect of social initiatives on employee productivity and retention, and examining the influence of robust governance structures on risk management and long-term value creation. Such research expands our knowledge of the ESG- firm performance nexus and provides valuable insights for businesses seeking to integrate sustainable practises into their operations

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