Journal of Islamic Business and Management
2025, 15 (02), 223-245
https://doi.org/10.26501/jibm/2025.1502-006

PRIMARY RESEARCH

Do Sharīʿah and ESG-Compliant Firms Outperform Others? Evidence from S&P 500 Index Companies

Zul Hakim Jumat[1*]
College of Islamic Studies, Hamad Bin Khalifa University, Qatar
Islamic Wealth Management, Maybank Singapore, Singapore

Keywords:
Sharīʿah-compliance; Sharīʿah screening;
ESG integration;
Firm performance;
Ethical screening;
Islamic finance;
Dynamic panel analysis.

Received: 10 November 2025
Accepted: 08 December 2025
Available Online: 10 December 2025

Abstract

Background: Sharīʿah-compliance and Environmental, Social, and Governance (ESG) principles represent two major ethical paradigms shaping contemporary finance. Yet, empirical evidence on their combined impact on firm performance remains limited.

Objective: This study investigates how Sharīʿah and ESG compliance, individually and jointly, affect firm performance, focusing on both accounting-based (ROA) and market-based (Tobin's Q) indicators.

Methods: Using a dynamic panel dataset of 504 firms from the S&P 500 index spanning 2012–2022, the research applies the System Generalized Method of Moments (GMM) to address endogeneity and unobserved heterogeneity. Two novel frameworks are employed: (1) the Sharīʿah Compliancy Score (SCOMS), which quantifies degrees of Sharīʿah financial and business compliance; and (2) a Sharīʿah–ESG Integrated Rating Model, combining SCOMS with ESG performance metrics to evaluate holistic ethical alignment.

Results: Findings reveal that Sharīʿah financial compliance significantly enhances both ROA and Tobin's Q, while Sharīʿah business compliance alone exerts limited or negative effects. Standalone ESG compliance similarly shows weak performance links. However, firms demonstrating high compliance across both Sharīʿah and ESG dimensions achieve significantly superior financial and market outcomes, confirming the synergistic value of integration.

Conclusion: The study validates the effectiveness of an integrated ethical framework that unites Sharīʿah and ESG principles. Such alignment strengthens stakeholder trust and corporate resilience, offering an empirically grounded model for sustainable and faith-consistent value creation.

KAUJIE Classification: H11, H12, I23, I41, I43, L41, L43, I23, T4

JEL Classification: C33, C58, G30, M14, Z12

*Corresponding author: Zul Hakim Jumat
†Email: zul.hakym@gamil.com ; ORCID: 0000 0002 8409 669X

INTRODUCTION

The way societies manage their economies affects how resources are utilised responsibly and how they are abused wastefully. As societies and economies progress, economic development creates increasing pressure on environmental conditions and human well-being. The OECD (2012) warns that without changes to operational practices and the management of natural resources, the world will face more severe climate conditions and experience biodiversity decline and water scarcity, alongside rising urban pollution and heightened health risks.

In response to these mounting issues, businesses have begun adopting Environmental, Social and Governance (ESG) approaches within their long-term strategies to achieve sustainable outcomes that benefit all stakeholders. Institutions within Islamic finance are cognizant of these concerns as well, having embedded ethical considerations within their operational principles since inception.

The ethical framework of Islamic finance, grounded in Sharīʿah principles and tenets, places the industry in a strong position to confront socio-environmental challenges. Within its investment practices, Islamic finance excludes participation in gambling, alcohol production, tobacco manufacturing and interest-based financial services. These exclusions, which stem from moral and social considerations, naturally correspond with ESG principles.

The Sharīʿah legal maxim of "la ḍarar wa la dirar", which means there shall be neither harm nor reciprocating harm, reinforces this alignment through its ideological commitment to preventing harm and promoting collective welfare. Furthermore, the higher objectives of Sharīʿah (*Maqāṣid* al- Sharīʿah), which focus on the safeguarding and promotion of religion, life, intellect, lineage and property, share important similarities with the fundamental principles that underpin the United Nations Sustainable Development Goals (SDGs).

Despite the conceptual alignment often highlighted between Sharīʿah principles and ESG values, existing Sharīʿah screening practices have not consistently incorporated the broader spectrum of ESG related considerations. Prior studies, including Williams and Zinkin (2010), Erragraguy and Revelli (2015, 2016) and Azmi et al. (2019), suggest that combining Sharīʿah and ESG perspectives may offer complementary advantages. However, empirical research examining the joint impact of Sharīʿah-compliance and ESG engagement on firm performance remains limited, and the available evidence has largely assessed each framework in isolation.

This paper, therefore, investigates a central question: what drives firm performance when firms operate within overlapping ethical domains? More specifically, the paper assesses whether performance is shaped primarily by adherence to Sharīʿah compliant financial and business requirements, by alignment with ESG principles, or by the interaction of both frameworks. The analysis evaluates their individual and combined effects on two key indicators: Return on Assets, which reflects accounting-based performance, and Tobin's Q, which captures market-based valuation.

By addressing this gap, the paper contributes empirical evidence to ongoing discussions on the convergence of Sharīʿah and ESG standards. It clarifies how each framework, separately and together, influences firm value. The remainder of the paper is

organised as follows. Section 2 reviews the relevant literature and develops the hypotheses. Section 3 describes the data and methodology. Section 4 reports and discusses the empirical findings. Section 5 concludes with implications and avenues for future research.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Sharīʿah screening and firm Performance

Sharīʿah screening comprises two dimensions: financial screening and business screening. The financial screening process limits exposure to unlawful income sources, interest-bearing debt, leverage ratios, and liquid assets. In contrast, business screening eliminates investments in industries such as alcohol production, gambling operations and traditional banking.

The emergence of Sharīʿah-compliant investing has been central to the development of Islamic capital markets. Since the introduction of the Dow Jones Islamic Market Index in 1999, research on the performance of Islamic equities relative to conventional ones has expanded. However, findings remain mixed. Al Shakfa and Lypny (2011) and Hayat and Kraeussl (2011) argue that the underperformance of Islamic funds stems from a limited investment universe. In contrast, studies by Alam and Rajjaque (2010) and Ashraf (2014) indicate that Sharīʿah-compliant funds perform better than conventional indices during periods of financial turbulence due to their minimal debt exposure and reduced speculative activity.

Research by Derigs and Marzban (2008) and Htay and Abdeen (2013a, 2013b) further critiques inconsistencies in screening methodologies across Sharīʿah indices, noting that the lack of harmonisation creates confusion and leads to fragmented investment strategies.

These limitations underscore the need to determine whether financial screening, business screening or a combination of both drives firm performance. To address this, a novel screening approach is employed to measure the Sharīʿah Compliancy Score (SCOMS), which is an enhanced quantitative framework that refines traditional binary Sharīʿah screening by quantifying degrees of compliance.

H1a: *Sharīʿah financial screening (SCOMS) is positively associated with firm performance.*

H1b: *Sharīʿah business screening (SBS) is positively associated with firm performance.*

H1c: *The interaction between financial and business screening (FIN × BUS) enhances firm performance, indicating complementarity between the two.*

ESG screening and firm Performance

More firms are adopting ESG investing strategies to meet both financial goals and societal demands. To date, there are two main contrasting theories that frame the academic discussion on the effects of ESG on performance. Agency theory, proposed by Jensen and Meckling in 1976, views ESG activities as inefficient and self-serving, whereas stakeholder theory, according to Freeman in 1994, argues that ESG practices strengthen stakeholder relationships and create long term value.

Empirical findings remain inconclusive. Research by Benabou and Tirole (2010), Masulis and Reza (2015), and Kruger (2015) shows detrimental effects arising from

excessive social investments, which lends support to the agency theory perspective. Research by Waddock and Graves (1997), Jo and Harjoto (2011), and Ferrell et al. (2016) indicates that ESG practices improve transparency and reduce risk, which in turn enhances firm performance.

Research conducted by Li et al. (2018) demonstrates that UK firms that adopt ESG practices, particularly in relation to governance, experience increased firm value. As for Malaysian firms, Wan Hussin et al. (2021) and Wong et al. (2021) show that ESG disclosures lead to better market valuation outcomes based on metrics such as ROA and Tobin's Q.

Combined Sharīʿah – ESG Screening and firm performance

Despite the limited number of studies that integrate both Sharīʿah and ESG frameworks, the alignment of ethical values between ESG principles and Sharīʿah-compliance is becoming increasingly acknowledged. Williams and Zinkin (2010) demonstrate how Islamic principles correspond with international CSR standards.

Erragraguy and Revelli (2015), Azmi et al. (2019), and Qoyum et al. (2021) provide early evidence that investment portfolios applying both Sharīʿah and ESG screening have the potential to match or surpass conventional benchmarks during periods of economic instability. Lee and Isa's (2020) study further confirms that ESG practices improve the financial performance of Sharīʿah-compliant firms while mitigating agency problems.

The foundation of this theoretical pursuit stems from the synergy between ethical exclusions in Sharīʿah and proactive ethical inclusions in ESG. While Sharīʿah screening focuses on a firm's business and financial operations by avoiding harm (*ḍarar*), ESG promotes positive corporate behaviours such as transparency, sustainability, and stakeholder engagement. Therefore, combining both frameworks may amplify performance outcomes.

In addition, the proposal for a holistic integration approach is grounded in Islamic theological principles, as illustrated in Surah An Nahl (16:68 to 69). In these verses, Allah says:

"*And your Lord inspired the bee, 'Take for yourself among the mountains houses, and among the trees and in that which they construct. Then eat from all the fruits and follow the ways of your Lord laid down for you.' There emerges from their bellies a drink of varying colours in which there is healing for people. Indeed, in that is a sign for those who reflect."*

These verses vividly illustrate the concept that obedience to divine guidance leads to beneficial outcomes. The bees, by adhering closely to divine instruction, produce honey which provides nourishment and healing not only for themselves but also for the wider ecosystem, including human beings. By analogy, ethical corporate behaviour guided by comprehensive adherence to Sharīʿah and ESG principles can likewise generate significant societal and environmental benefits.

The theological insight emphasises that sincere adherence to divine guidance naturally produces outcomes that extend beyond individual gain, promoting collective well-being. When applied to corporate and financial contexts, firms that operate according to comprehensive ethical standards, including environmental stewardship, social responsibility, and ethical governance, inherently produce positive societal impacts that go

beyond financial returns.

To examine this proposition, the second novel Sharīʿah screening model is employed. This is the Sharīʿah ESG Integrated Rating Model, which combines Sharīʿah-compliance scoring (SCOMS) with ESG performance metrics.

H2a: *ESG and Sharīʿah screening (SCOMS x SBS) jointly improve performance.*

H2b: *The interaction between Sharīʿah screening and ESG compliance (SCOMS × SBS × ESG) is positively associated with firm performance.*

H2c: *Higher Sharīʿah and Higher ESG compliance is positively associated to higher firm performance.*

DATA AND METHODOLOGY

Sample overview

This study uses panel data of 504 firms listed on the S&P 500 index, obtained from Refinitiv for the period 2012 to 2022. The final sample comprises 5,533 firm-year observations. Of these, approximately 3,000 firm-year observations meet the criteria for Sharīʿah-compliance in a given year. The S&P 500 index represents large-cap United States equities. It is widely regarded as a benchmark for the United States equity market, making it an appropriate universe for assessing performance implications across varying levels of Sharīʿah and ESG compliance.

Variables and Proxies

Table 1 provides an overview of the variables used in the analysis.

In line with contemporary literature, the choice of firm performance measures includes both accounting-based and market-based metrics to provide a more holistic view of a firm's performance. Return on Assets (ROA) reflects a firm's historical performance relative to its asset base and is widely used in the literature (for example, Duque Grisales and Aguilera Caracuel, 2021; Guenster et al., 2011; Ortas et al., 2015). While ROA is straightforward and widely accepted, it can still be influenced by earnings management practices (Choi and Wang, 2009).

Table 1: Description of Main Variables

Variables		Symbols	Description and Calculation
Dependent Variables			
Return on Assets		ROA	Net profit / Total assets
Tobin's Q		TobinsQ	(Market value of equity + Preferred stock + Debt) / Total assets
Independent Variables			
Sharī'ah Screening[1]	Financial	SCOMS, L.SCOMS	Composite score based on financial ratio compliance (e.g., income, debt, leverage, and liquidity)
Sharī'ah Screening[2]	Business	SBC	Dummy variable = 1 if compliant with Sharī'ah business sector screening, 0 otherwise

ESG Compliance Score	ESGCS, LESGCS	Combined score of environmental, social, governance, controversy performance
Interaction Term (2 - way)	Interaction	SCOMS × SBC – captures joint Sharīʿah financial and business screening effect
Interaction Term (3 - way)	Threeway	SCOMS × SBC × ESGCS – captures integrated ethical compliance effect
Quintile Interaction Term (3-way)	i.e., S1_E5	Dummy variable of different quintile acrossSharīʿah and ESG compliance score. Where 1 = lowest quintile and 5 = highest quintile.
Internal Control Variables		
Firm Size	LnSize	Natural logarithm of total assets
Sales	LnSales	Natural logarithm of total revenue
Financial Leverage	Leverage	Total debt / Total assets
External Control Variables		
GDP Growth	GDP	Annual growth rate of national gross domestic product
Market Volatility	VIX	CBOE Volatility Index – a measure of market uncertainty and investor sentiment

Source: Author's own.

To complement ROA, Tobin's Q is included as a forward-looking market-based performance metric. It is computed using the approximation suggested by Chung and Pruitt (1994), which is the ratio of a firm's market value to its replacement cost of assets. This provides an investor sentiment-based assessment of firm value and future growth potential (McConnell et al., 2008; Vieira et al., 2019).

Firm-level control variables, including size, turnover and leverage, are incorporated to account for structural firm characteristics. These variables have been used in numerous ESG and finance studies, such as Flammer (2013), Ferrell et al. (2016), and Han et al. (2016). Larger firms may have better access to capital, while leverage levels and revenue volumes often influence firm risk and efficiency.

External control variables, specifically GDP growth and the VIX, are included to capture macroeconomic and market sentiment factors. GDP growth proxies the broader economic environment, while the VIX reflects investor uncertainty and market volatility. Both have been validated in previous literature on ESG performance and market sensitivity

[1]Sharīʿah financial screening refers to the application of numerical thresholds to assess a company's compliance with Sharīʿah principles in its financial structure and operations. Recognising that modern corporations seldom avoid all forms of impermissible activities or interest-related transactions, Sharīʿah scholars have established tolerance limits for specific financial ratios, such as interest-bearing debt, interest-based cash holdings, and income from non-permissible sources. These thresholds are grounded in the principle of *jurisprudential flexibility* and guided by the Islamic legal maxim, *"what is inescapable is tolerable"*, allowing for a practical and consistent approach to evaluating Sharīʿah-compliance in contemporary capital markets.

[2]Sharīʿah business screening evaluates a company's fundamental business operations by measuring them against specific prohibitions set forth by Islamic law (Sharīʿah). Identifying which activities are permissible (Ḥalāl) and which remain impermissible (Ḥarām) depends on explicit textual evidence obtained from the primary Islamic sources—the Qur'ān and the Sunnah.

(Wang and Sarkis, 2017; Brown and Cliff, 2004; Smales, 2017).

Model Design

Dynamic panel regression is employed using the Arellano-Bond Generalised Method of Moments (GMM) estimator. This is suitable for addressing potential endogeneity and autocorrelation in the data. All estimations are run using the xtabond2 command in STATA with two-step robust standard errors and instrument collapsing.

Each model includes a lagged dependent variable, either ROA or Tobin's Q, to account for persistence in performance. Internal controls and macroeconomic variables are applied consistently across all specifications.

Table 2: Hypotheses and Model Alignment

Model	Description	Hypotheses Addressed
Model 1	Sharī'ah Financial vs Sharī'ah Business screening	***H1a:*** *Sharī'ah financial screening (SCOMS) is positively associated with firm performance.* ***H1b:*** *Sharī'ah business screening (SBS) is positively associated with firm performance.*
Model 1b	Sharī'ah Financial × Sharī'ah Business interaction	***H1c:*** *The interaction between financial and business screening (SCOMS × SBS) enhances firm performance, indicating complementarity between the two*
Model 2	ESG + Sharī'ah Screening (Financial x Business)	***H2a:*** *ESG and Sharī'ah screening (SCOMS x SBS) jointly improve performance.*
Model 3	ESG × Sharī'ah Screening (Financial x Business)	***H2b:*** *The interaction between Sharī'ah screening and ESG compliance (SCOMS × SBS × ESG) is positively associated with firm performance.*
Model 4	Different ESG Quintile × Different Sharī'ah Quintile (Financial x Business)	***H2c:*** *Higher Sharī'ah and Higher ESG compliance is positively associated to higher firm performance.*

Source: Author's own.

The inclusion of lagged dependent variables addresses concerns of autocorrelation and endogeneity commonly associated with firm-level financial data. To test the proposed hypotheses, each model is designed to address specific hypotheses regarding the impact of Sharīʿah screening and ESG compliance on firm performance (*see Table 2)*.

To test **Hypotheses H1a and H1b**, the following baseline model is estimated:

$$P_{it} = \alpha + \beta_1 P_{it-1} + \beta_2 SCOMS_{it} + \beta_3 SBS_i + \beta_4 INTF_{it} + \beta_5 EXTF_{it} + \epsilon_{it} \quad (1)$$

Where:

- P_{it}: Firm performance (ROA or Tobin's Q)
- $SCOMS_{it}$: Sharī ah-compliance financial screening score
- SBS_i: Business screening dummy
- $INTF_{it}$: Internal firm control variables
- $EXTF_{it}$: External control variables

To test **Hypothesis H1c**, the author includes an interaction term between financial and business screening:

$$P_{it} = \alpha + \beta_1 P_{it-1} + \beta_2 SCOMS_{it} + \beta_3 SBS_i + \beta_4 INTF_{it} + \beta_5 EXTF_{it} + \beta_6 (SCOMS \times SBS)_{it} + \epsilon_{it} \quad (1B)$$

To test **Hypothesis H2a**, the author introduces ESG compliance as an explanatory variable, along with the two-way interaction term:

$$P_{it} = \alpha + \beta_1 P_{it-1} + \beta_2 SCOMS_{it} + \beta_3 SBS_i + \beta_4 INTF_{it} + \beta_5 EXTF_{it} + \beta_6 (SCOMS \times SBS)_{it} + \beta_7 ESG_{it} + \epsilon_{it} \quad (2)$$

To test **Hypothesis H2b**, a three-way interaction term is incorporated to capture the synergy between Sharīʿah financial, Sharīʿah business, and ESG screening:

$$P_{it} = \alpha + \beta_1 P_{i[t-1]} + \beta_2 SCOMS_{it} + \beta_3 SBS_i + \beta_4 INTF_{it} + \beta_5 EXTF_{it} + \beta_6 (SCOMS \times SBS \times ESG)_{it} + \beta_7 ESG_{it} + \epsilon_{it} \quad (3)$$

Lastly, to test **Hypothesis H2c**, 25 dummy variables are introduced to capture the synergy between Sharīʿah-compliance and ESG compliance across different quintiles.

$$P_{it} = \alpha + \beta_1 P_{i[t-1]} + \beta_2 SCOMS_{it} + \beta_3 SBS_i + \beta_4 INTF_{it} + \beta_5 EXTF_{it} + \beta_6 \sum_{j=1}^{24} (SCOMS \times SBS \times ESG)_{it} + \beta_7 ESG_{it} + +\epsilon_{it} \quad (4)$$

The inclusion of lagged dependent variables addresses concerns of autocorrelation and endogeneity commonly associated with firm-level financial data.

EMPIRICAL ANALYSIS AND RESULTS

Preliminary panel diagnostics were conducted to determine the suitability of the system GMM estimator. The F test results led to the rejection of pooled OLS in favour of fixed effects ($F(502, 4904) = 17.57$, $p < 0.001$), indicating significant heterogeneity at the firm level. The Breusch Pagan Lagrangian Multiplier test ($chibar^2 = 7389.59$, $p < 0.001$) also provided strong evidence against the null hypothesis of no random effects. In addition, the Hausman test favoured the fixed effects specification by rejecting the random effects model, as shown by a significant chi square value of 578.34 with a p value below 0.001, demonstrating correlation between firm level effects and the regressors.

The fixed effects estimator becomes biased and inconsistent when lagged dependent variables, specifically ROA and Tobin's Q, are included due to dynamic panel bias. Explanatory factors such as Sharīʿah-compliance (SCOMS) and ESG scores (ESGCS) also demonstrate potential endogeneity, raising concerns regarding simultaneity and reverse causation. Consequently, the two step system GMM estimator is preferred, as it effectively resolves these issues through the use of internal instruments.

Furthermore, all models show no evidence of second order serial correlation in the residuals based on diagnostic evaluations, including the Arellano Bond AR(2) test. The Sargan and Hansen J tests confirm that the selected instruments are valid, supporting the reliability of the GMM estimation results (Roodman, 2009).

For these reasons, the research employs the two-step system Generalised Method of Moments estimator, due to its effectiveness in addressing the econometric challenges

inherent in dynamic panel data analysis. The system GMM approach, introduced by Arellano and Bond (1991) and extended by Blundell and Bond (1998), provides a robust solution to issues related to endogeneity, autocorrelation, and unobserved heterogeneity.

The use of this method is further supported by the descriptive statistics in Table 3, and the correlation matrix in Table 4, both of which show strong associations between the main explanatory variables SCOMS, SBC, and ESGCS and the firm performance measures ROA and Tobin's Q. These correlations indicate the possibility of simultaneous relationships and potential bias arising from endogeneity.

The issue of autocorrelation in dynamic panels, resulting from the relationship between current and past dependent variable values, can be addressed by adding lagged dependent variables and performing appropriate diagnostic evaluations, as recommended by Blundell and Bond (1998). The persistent nature of performance indicators such as ROA and Tobin's Q, demonstrated through their significant correlations and variation in Table 3, further supports this approach.

Through differencing the data and using internal instruments, researchers can control unobserved heterogeneity, which refers to firm-specific characteristics that are not directly captured by the model (Baltagi, 2008; Roodman, 2009). The high standard deviations observed for ROA, Tobin's Q, and ESGCS across firms in Table 3 highlight the importance of using the system GMM estimator to account for these unobserved firm-specific factors.

Descriptive statistics and correlation matrix

Tables 3 and 4 present the descriptive statistics and the Pearson correlation matrix of the main variables used in this study. The average Tobin's Q for 2012-2022 is approximately 1.875, with a standard deviation of 2.086, indicating significant variation in market valuations across the sampled firms. ROA shows an average of 0.754 and a modest standard deviation of 0.073, suggesting relatively stable profitability across firms, though the minimum value of −0.473 indicates that some firms experienced financial losses.

Table 3: Descriptive Statistics

Variable(s)	Obs.	Mean	SD	Min	Max
ROA	5533	0.754	0.073	-0.473	0.7625
TobinsQ	5426	1.875	2.086	0.000	22.909
SCOMS	5533	0.343	0.926	-43.788	0.983
SBC	5533	0.805	0. 396	0	1
ESGCS	5533	49.705	21.365	0.000	93.227
LnSize	5426	23.674	1.495	17.709	28.951
LnSales	5437	22.925	1.343	17.913	27.074
Leverage	5447	0.916	1.297	0.000	25.626
GDP	5533	0.460	0.030	-.0150	0.107
VIX	5533	17.734	4.185	11.040	25.420

The average Sharīʿah-compliance Financial Score (SCOMS) is 0.343 but ranges widely from −43.788 to 0.983, reflecting substantial differences in Sharīʿah-compliance across firms. The average value of the Sharīʿah Business Compliance dummy variable (SBC) is 0.805, indicating that approximately 80% of firm-year observations meet Sharīʿah business sector criteria. The ESG combined score (ESGCS) records an average value of 49.705 but

spans from 0 to 93.227, showing considerable variation in ESG commitment across firms in the sample.

Regarding firm-specific control variables, both firm size (LnSize) and sales (LnSales) show comparable mean values of 23.674 and 22.925, respectively, with moderate variation. Financial leverage displays substantial variability (mean = 0.916; SD = 1.297), highlighting diverse capital structures among firms. For external controls, GDP growth and market volatility (VIX) show relatively low variability, with mean values of 0.460 and 17.734, indicating moderate macroeconomic stability throughout the study period.

Table 4 displays the bivariate correlation matrix and highlights correlations significant at the 5% level or lower. The results show that both ROA and Tobin's Q have positive statistical correlations with the Sharīʿah-compliance variables (SCOMS and SBC), indicating that compliance activities are associated with better firm performance. ESGCS exhibits a positive relationship with ROA but a negative relationship with Tobin's Q, suggesting that ESG practices may have differing effects on accounting-based and market-based performance measures.

Table 4: Correlation Matrix

	ROA	TobinsQ	SCOMS	SBC	ESGCS	LnSize	LnSales	Leverage	GDP	VIX
ROA	1.000									
TobinsQ	0.536**	1.000								
SCOMS	0.280**	0.270**	1.000							
SBC	0.204**	0.171**	0.310**	1.000						
ESGCS	0.090**	-0.060**	0.053**	0.038**	1.000					
LnSize	-0.267**	-0.463**	-0.353**	-0.316**	0.279**	1.000				
LnSales	0.014	-0.281**	-0.115**	-0.029**	0.272**	0.774**	1.000			
Leverage	-0.327**	-0.222**	-0.354**	-0.184**	0.029**	0.288**	-0.147**	1.000		
GDP	0.094**	0.037**	0.012	0.001	0.109**	0.069**	0.084**	-0.009	1.000	
VIX	0.040**	0.025*	-0.022	0.001	0.093**	0.055**	0.052**	0.008	0.036**	1.000

*Note: * $p < 0.1$, ** $p < 0.05$*

Among the control variables, firm size (LnSize) is negatively correlated with both ROA and Tobin's Q, suggesting that larger firms in this sample may face diminishing returns or reduced market valuations. In contrast, sales (LnSales) display a positive association with ROA but a negative association with Tobin's Q. Leverage also shows negative correlations with performance, supporting earlier findings that high debt levels reduce profitability and market valuation (Ammann et al., 2011; Ding et al., 2016). GDP growth and market volatility (VIX) present weak but positive correlations with ROA, indicating a nuanced influence of macroeconomic and market conditions on firm performance. Overall, all correlations remain below the standard threshold of 0.8, thereby ruling out multicollinearity concerns.

These initial results provide a foundation for understanding the interrelationships among the variables used in this research. They also highlight the need for comprehensive multivariate analysis to assess these relationships more effectively, which will be conducted in subsequent sections.

Sharīʿah Financial and Business Compliance Impact on Firm Performance

The summarised System GMM regression results that analyse the separate and joint impacts of Sharīʿah-compliance financial screening score (SCOMS) and business

screening dummy variable (SBC) on firm performance in terms of ROA and Tobin's Q are presented in Table 5. In contrast, Table 22 provides the complete regression outputs. Model 1 examines the independent effects of each Sharīʿah screening criterion, whereas Model 1B evaluates their combined interaction effects.

In line with Hypothesis H1a, the results show that Sharīʿah financial screening (SCOMS) is positively associated with firm performance. Specifically, financial compliance significantly improves firm outcomes. The estimates indicate a positive relationship between Sharīʿah financial screening and performance, with ROA showing $\beta = 0.008$ and $p < 0.01$, and Tobin's Q showing $\beta = 0.238$ with $p < 0.01$.

These findings are consistent with earlier studies, which argue that adherence to Sharīʿah financial standards reduces firm risk and strengthens investor confidence (Farhat & Hili, 2021; Alam & Rajjaque, 2010). However, the business screening criterion (SBC) displays a mild negative effect on Tobin's Q ($\beta = -0.148$, $p < 0.10$), suggesting that investors may perceive sectoral restrictions under Sharīʿah business compliance as operational constraints. As such, Hypothesis H1b is not supported, indicating that standalone business compliance does not independently enhance performance.

Table 5: Summarized system GMM regression result for ROA and Tobin's Q (Model 1 and Model 1B)

Model	Dependant Vars	Key Variable(s)	Coefficient(s)	Interpretation
Model 1	ROA	SCOMS	0.008***	Sharī'ah financial compliance significantly improves firm performance (*supports H1a*).
		L.SCOMS	-0.000	No meaningful lagged impact, past compliance has no residual effect.
		SBC	-0.004	Business compliance has no significant effect on ROA in isolation (*rejects H1b*).
	Tobin's Q	SCOMS	0.238***	Market rewards firms with strong Sharī'ah financial compliance (supports H1a).
		L.SCOMS	-0.053	Lagged compliance has no strong effect on market valuation.
		SBC	-0.148*	Mildly negative impact; sectoral restrictions may deter investors (*rejects H1b*).
Model 1B	ROA	SCOMS	0.001	Direct effect weakens, suggesting moderation by interaction.
		L.SCOMS	-0.006	Lagged effect not significant
		SBC	-0.014***	Standalone business compliance negatively affects firm performance.
		Interaction (SCOMS × SBC)	0.026***	Strong synergy—combining financial and business compliance enhances ROA (*supports H1c*).

	L.Interaction (SCOMS × SBC)	0.007*	Previous year's synergy also contributes positively (*supports H1c*).
Tobin's Q	SCOMS	0.039	Direct effect weakens, suggesting moderation by interaction.
	L.SCOMS	-0.160***	Negative lag, prolonged financial compliance alone may dampen value.
	SBC	-0.362***	Strong negative market reaction to standalone SBC.
	Interaction (SCOMS × SBC)	0.628***	Very strong positive synergy—**market** highly rewards firms aligned in both SCOMS and SBC (*supports H1c*).
	L.Interaction (SCOMS × SBC)	0.133 **	Sustained investor confidence in past alignment (*supports H1c*).

*Source: Author's estimation. Notes: Significance levels: * p < 0.10, ** p < 0.05, *** p < 0.01.*

The interaction term (SCOMS × SBC) in Model 1B shows significant positive effects on both ROA (β = 0.026, p < 0.01) and Tobin's Q (β = 0.628, p < 0.01), providing strong support for Hypothesis H1c. This synergistic effect demonstrates that firm performance improves substantially when financial and business compliance operate jointly rather than in isolation. The significant lagged interaction terms further indicate that integrated compliance continues to yield benefits over time, supporting the stakeholder theory view that ethical alignment strengthens stakeholder relationships (Freeman, 1994; Erragraguy & Revelli, 2015).

Sharīʿah and ESG Compliance Impact on Firm Performance

Table 6 summarises the findings on the combined effects of Sharīʿah and ESG screening criteria, and Table 7 provides the detailed regression results. Model 2 examines the joint impact of ESG and Sharīʿah screening dimensions (SCOMS and SBC), whereas Model 3 assesses the three-way interaction among Sharīʿah financial, business, and ESG compliance.

In Model 2, ESG compliance alone (ESGCS) does not show a significant direct effect on either ROA or Tobin's Q. However, the two-way interaction between Sharīʿah financial and business screening remains strongly significant (ROA: β = 0.025, p < 0.01; Tobin's Q: β = 0.635, p < 0.01). This indicates that ESG criteria, when considered in isolation, do not meaningfully drive firm performance unless they are integrated with other ethical frameworks. This provides initial support for Hypothesis H2a (Erragraguy & Revelli, 2015; Wong et al., 2021).

The results from Model 3, which incorporate the three-way interaction term (SCOMS × SBC × ESGCS), provide strong support for Hypothesis H2b. The interaction significantly improves both firm profitability (ROA: β = 0.002, p < 0.05) and market valuation (Tobin's Q: β = 0.008, p < 0.01). This positive three-way synergy highlights the enhanced performance outcomes that arise when firms fully integrate Sharīʿah financial and business compliance with ESG commitments. The significant lagged effects further demonstrate the sustained benefits of adopting this comprehensive ethical approach.

These findings are consistent with existing studies that emphasise the strategic advantage of aligning Sharīʿah and ESG compliance frameworks, confirming that

combined ethical alignment leads to superior financial and market outcomes (Azmi et al., 2019; Qoyum et al., 2021). They also reinforce the argument that integrated ethical frameworks strengthen stakeholder perceptions, increase firm resilience, and support long-term market success (Williams & Zinkin, 2010; Erragraguy & Revelli, 2015).

Table 6: Summarized system GMM regression result for ROA and Tobin's Q

Model	Dependant Vars	Key Variable(s)	Coefficient(s)	Interpretation
Model 2	ROA	SCOMS	0.001	Still not significant – absorbed by interaction effect.
		L.SCOMS	-0.007	Still no meaningful lagged impact.
		SBC	-0.014***	Business compliance alone continues to lower firm performance.
		Interaction	0.025***	Robust synergy remains when ESG is added (*supports H2a*).
		L.Interaction	0.000	Prior Sharī'ah compliant alignment still improves firm performance.
		ESGCS	0.000	ESG on its own does not impact firm performance
		L.ESGCS	0.000	No lagged ESG effect.
	Tobin's Q	SCOMS	0.042	Direct effect still not significant.
		L.SCOMS	-0.159***	Prolonged Sharī'ah financial compliant alone may hurt valuation.
		SBC	-0.359 ***	Strongly penalised by market when not paired with SCOMS.
		Interaction (SCOMS × SBC)	0.635 ***	Very strong synergy effect, market rewards integrated compliance (*supports H2a*).
		L.Interaction (SCOMS × SBC)	0.132 **	Past alignment contributes to sustained valuation.
		ESGCS	0.001	ESG alone does not improve market value.
		L.ESGCS	-0.003 ***	Negative lag; outdated ESG efforts may lower value.
Model 3	ROA	SCOMS	0.007 **	Regains significance — Sharī'ah financial compliance matters when ESG is included synergistically.
		L.SCOMS	-0.009 **	Negative lag — compliance must be current to remain effective.
		SBC	-0.012 **	Business compliance still drags ROA when isolated.
		ESGCS	0.000	ESG alone still not impactful.
		L.ESGCS	-0.000	No meaningful lag effect.
		Three-way (SCOMS × SBC x ESGCS)	0.002 (**)	Significant synergy from full compliance (SCOMS + SBC + ESG) enhances firm performance (*supports H2b*).
		L.Three-way (SCOMS × SBC x ESGCS)	0.003 (***)	Past integration continues to benefit ROA over time.
		SCOMS	0.093	Not significant alone, suggesting ESG is key in enhancing effect.
		L.SCOMS	-0.101**	Market penalises prolonged static compliance.
		SBC	-0.294***	Negative effect—when not part of integration.

Tobin's Q	ESGCS	-0.002	ESG on its own not valued.
	L.ESGCS	-0.003 ***	Past ESG compliance viewed unfavourably unless linked to broader strategy.
	Three-way (SCOMS × SBC x ESGCS)	0.008 ***	Market highly rewards full-spectrum Shari'ah plus ESG alignment (*supports H2b*).
	L.Three-way (SCOMS × SBC x ESGCS)	0.002 *	Sustained market appreciation for integrated compliance efforts.

*Source: Author's estimation. Notes: Significance levels: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.*

Table 7: System GMM Results for ROA and Tobin's Q (Model 1, Model 1B, Model 2, Model 3)

	(M1) ROA	(M1) TQ	(M1B) ROA	(M1B) TQ	(M2) ROA	(M2) TQ	(M3) ROA	(M3) TQ
L.ROA	0.470***		0.430***		0.441***		0.458***	
	(0.115)		(0.123)		(0.118)		(0.116)	
L.TobinsQ		0.581***		0.566***		0.568***		0.571***
		(0.068)		(0.069)		(0.070)		(0.068)
SCOMS	0.008***	0.238***	0.001	0.039	0.001	0.042	0.007**	0.093
	(0.003)	(0.067)	(0.004)	(0.061)	(0.004)	(0.060)	(0.004)	(0.065)
L.SCOMS	-0.000	-0.053	-0.006	-	-0.007	-	-	-0.101**
				0.160***		0.159***	0.009***	
	(0.001)	(0.048)	(0.004)	(0.047)	(0.004)	(0.047)	(0.003)	(0.045)
SBC	-0.004	-0.148*	-	-	-	-	-0.012**	-
			0.014***	0.362***	0.014***	0.359***		0.294***
	(0.004)	(0.080)	(0.005)	(0.108)	(0.005)	(0.108)	(0.005)	(0.096)
LnSize	-0.018***	-	-	-	-	-	-	-
		0.400***	0.020***	0.445***	0.020***	0.438***	0.019***	0.418***
	(0.004)	(0.074)	(0.004)	(0.077)	(0.004)	(0.076)	(0.004)	(0.074)
LnSales	0.016***	0.127***	0.018***	0.156***	0.018***	0.158***	0.017***	0.143***
	(0.004)	(0.046)	(0.004)	(0.047)	(0.004)	(0.047)	(0.004)	(0.045)
Leverage	-0.003*	0.009	-0.003**	-0.006	-0.003**	-0.006	-0.003**	-0.000
	(0.002)	(0.024)	(0.001)	(0.020)	(0.001)	(0.020)	(0.001)	(0.020)
GDP	0.227***	-0.186	0.218***	-0.252	0.214***	-0.212	0.213***	-0.238
	(0.021)	(0.540)	(0.021)	(0.535)	(0.021)	(0.543)	(0.021)	(0.538)
VIX	0.000***	-0.006**	0.000***	-0.006**	0.000***	-0.005**	0.000***	-0.006**
	(0.000)	(0.003)	(0.000)	(0.003)	(0.000)	(0.003)	(0.000)	(0.003)
Interaction (SCOMS X SBC)			0.026***	0.628***	0.025***	0.635***		
			(0.008)	(0.160)	(0.007)	(0.161)		
L.Interaction (SCOMS X SBC)			0.007*	0.133**	0.007*	0.132**		
			(0.004)	(0.054)	(0.004)	(0.054)		
ESGCS					0.000	0.001	0.000	-0.002
					(0.000)	(0.001)	(0.000)	(0.002)
L.ESGCS					0.000	-0.003**	-0.000	-
								0.003***
					(0.000)	(0.001)	(0.000)	(0.001)
Threeway (SCOMS X SBC x ESGCS)							0.002**	0.008***
							(0.000)	(0.002)
L.Threeway (SCOMS X SBC x ESGCS)							0.003***	0.002*
							(0.000)	(0.001)
Constant	0.080**	7.571***	0.096***	7.989***	0.105***	7.827***	0.109***	7.868***
	(0.035)	(1.314)	(0.036)	(1.357)	(0.038)	(1.345)	(0.039)	(1.322)
AR(1)	0.002	0.000	0.003	0.000	0.002	0.000	0.002	0.000
AR(2)	0.926	0.165	0.783	0.134	0.794	0.141	0.980	0.155

Hansen test	0.912	0.089	0.865	0.104	0.951	0.125	0.779	0.080
Sargan test	0.864	0.000	0.788	0.000	0.916	0.000	0.630	0.000
Number of instruments	11	11	13	13	15	15	15	15
Number of groups	503	503	503	503	503	503	503	503

*Source: Authors' estimation. Note: Standard errors in parentheses; * p < 0.1, ** p < 0.05, *** p < 0.01*

Degree of Sharīʿah and ESG compliance impact on firm performance

This section further investigates the impact of different levels of Sharīʿah and ESG compliance on firm performance using quintile based System GMM regressions. This more detailed analysis aims to empirically test Hypothesis H2c, which proposes a positive relationship between higher compliance with Sharīʿah and ESG standards and improved firm performance.

Differential Impact of Compliance Levels on Firm Performance

The summarised regression results for ROA and Tobin's Q across the five compliance quintiles of SCOMS and ESGCS are presented in Tables 8 and 9, while Table 10 provides the detailed System GMM coefficients for every quintile combination from S1 E1 to S5 E5. Together, these tables allow a comprehensive assessment of compliance synergy.

Table 8: Summarized system GMM regression result for ROA across different Sharīʿah and ESG compliance level.

ESG ↓ / SCOMS →	Q1 (Low)	Q2	Q3	Q4	Q5 (High)
Q1 (Low)		0.025***	0.026***	0.030***	0.030***
Q2	0.003	0.015**	0.022***	0.026***	0.040***
Q3	-0.000	0.014*	0.018**	0.025***	0.034***
Q4	-0.002	0.007	0.016*	0.022**	0.032***
Q5 (High)	-0.005	0.005	0.006	0.015	0.032***

*Source: Author's estimation. Notes: Significance levels: * p < 0.10, ** p < 0.05, *** p < 0.01.*

Table 9: Summarized system GMM regression result for ROA across different Sharīʿah and ESG compliance level.

ESG ↓ / SCOMS →	Q1 (Low)	Q2	Q3	Q4	Q5 (High)
Q1 (Low)		0.724***	1.264***	1.233***	1.743***
Q2	0.560***	0.646***	0.981***	1.059***	1.604***
Q3	0.563***	0.750***	0.928***	0.997***	1.475***
Q4	0.585***	0.723***	0.879***	1.038***	1.589***
Q5 (High)	0.621***	0.787***	0.909***	1.015***	1.694***

*Source: Author's estimation. Notes: Significance levels: * p < 0.10, ** p < 0.05, *** p < 0.01.*

The consistent findings validate Hypothesis H2c by showing improved firm performance when Sharīʿah and ESG compliance reach higher combined levels. Firms in the highest compliance quintiles (S5 E5) record robust and statistically significant performance gains (ROA: $\beta = 0.032$, $p < 0.01$; Tobin's Q: $\beta = 1.694$, $p < 0.01$). This clearly indicates that the market strongly rewards firms that align their ethical practices across both Sharīʿah and ESG dimensions.

In contrast, firms within the lowest compliance quintiles (S1 E2 to S1 E5) display very

weak or statistically insignificant ROA effects, ranging from β = 0.003 to −0.005. This suggests that limited compliance does not generate meaningful performance outcomes. Tobin's Q, however, remains positively significant, although notably lower than in the higher compliance categories. This indicates that while the market offers some recognition for minimal ethical alignment, it strongly favours firms that achieve higher levels of combined Sharīʿah and ESG compliance.

Interaction Dynamics of Sharīʿah and ESG Compliance

Table 10 shows that independent compliance measures do not generate substantial improvements in firm performance. Standalone Sharīʿah-compliance (SCOMS and SBC) and standalone ESG compliance (ESGCS) produce coefficients that are either negative or not statistically significant (SCOMS: ROA β = −0.004; Tobin's Q β = −0.108, p < 0.01; SBC: ROA β = −0.004; Tobin's Q β = −0.133, p < 0.10; ESGCS: negligible effect).

However, the incremental benefits become most evident when higher levels of Sharīʿah and ESG compliance interact positively. The strong performance of high compliance combinations such as S5 E4 (ROA β = 0.032; Tobin's Q β = 1.589) clearly exceeds that of lower compliance combinations, reinforcing the complementary nature of Sharīʿah and ESG compliance.

Table 10: System GMM Results for ROA and Tobin's Q (Model 4)

	(M4) ROA	(M4) TQ
L.ROA	0.470***	
	(0.114)	
L.Tobin's Q		0.550***
		(0.071)
SCOMS	-0.004	-0.108***
	(0.002)	(0.032)
SBC	-0.004	-0.133*
	(0.004)	(0.077)
ESGCS	0.000	-0.002
	(0.000)	(0.003)
S1_E2	0.003	0.560***
	(0.007)	(0.121)
S1_E3	-0.000	0.563***
	(0.008)	(0.138)
S1_E4	-0.002	0.585***
	(0.011)	(0.164)
S1_E5	-0.005	0.621***
	(0.012)	(0.190)
S2_E1	0.025***	0.724***
	(0.007)	(0.147)
S2_E2	0.015**	0.646***
	(0.007)	(0.130)
S2_E3	0.014*	0.750***
	(0.008)	(0.156)
S2_E4	0.007	0.723***

	(0.009)	(0.176)
S2_E5	0.005	0.787***
	(0.012)	(0.196)
S3_E1	0.026***	1.264***
	(0.007)	(0.232)
S3_E2	0.022***	0.981***
	(0.007)	(0.168)
S3_E3	0.018**	0.928***
	(0.008)	(0.183)
S3_E4	0.016*	0.879***
	(0.009)	(0.182)
S3_E5	0.006	0.909***
	(0.011)	(0.212)
S4_E1	0.030***	1.233***
	(0.008)	(0.212)
S4_E2	0.026***	1.059***
	(0.008)	(0.178)
S4_E3	0.025***	0.997***
	(0.009)	(0.184)
S4_E4	0.022**	1.038***
	(0.009)	(0.194)
S4_E5	0.015	1.015***
	(0.011)	(0.211)
S5_E1	0.030***	1.743***
	(0.009)	(0.330)
S5_E2	0.040***	1.604***
	(0.010)	(0.215)
S5_E3	0.034***	1.475***
	(0.009)	(0.225)
S5_E4	0.032***	1.589***
	(0.009)	(0.233)
S5_E5	0.032***	1.694***
	(0.011)	(0.253)
lnTA	-0.018***	-0.398***
	(0.004)	(0.073)
lnTR	0.015***	0.124***
	(0.004)	(0.042)
Leverage	-0.003*	0.013
	(0.001)	(0.019)
GDP Growth rate	0.221***	-0.191
	(0.021)	(0.516)
VIX (Close)	0.000***	-0.007***
	(0.000)	(0.003)
Constant	*0.065**	*6.849****
	(0.036)	
AR(1)	*0.001*	
AR(2)		*(1.217)*
Hansen test		*0.000*
Sargan test	*0.886*	*0.206*
Number of instruments	*0.872*	*0.100*
Number of groups	*0.791*	*0.000*
	303	303
	35	35

*Source: Author's estimation. Notes: Significance levels: * p < 0.10, ** p < 0.05, *** p < 0.01.*

These empirical findings provide further confirmation that integrated ethical frameworks, particularly those combining Sharīʿah and ESG compliance, significantly enhance stakeholder value and strengthen firm resilience. This aligns with earlier theoretical arguments and empirical evidence presented by Azmi et al. (2019) and Qoyum et al. (2021).

Visual Evidence of Compliance Synergy

Figure 1 provides a clear graphical summary of the quintile analysis, showing that firms with high levels of Sharīʿah and ESG compliance achieve superior performance compared to those with lower levels of compliance. The graphical evidence supports the regression results and offers strong confirmation of the synergistic compliance effect proposed in Hypothesis H2c.

The empirical findings provide strong support for Hypothesis H2c by demonstrating that firms that sustain high levels of combined Sharīʿah and ESG compliance attain better financial and market performance than firms with fragmented or lower ethical compliance standards. These results indicate that firm performance and investor valuation reach their highest potential when strategic alignment and comprehensive ethical practices are implemented consistently across both Sharīʿah and ESG compliance dimensions.

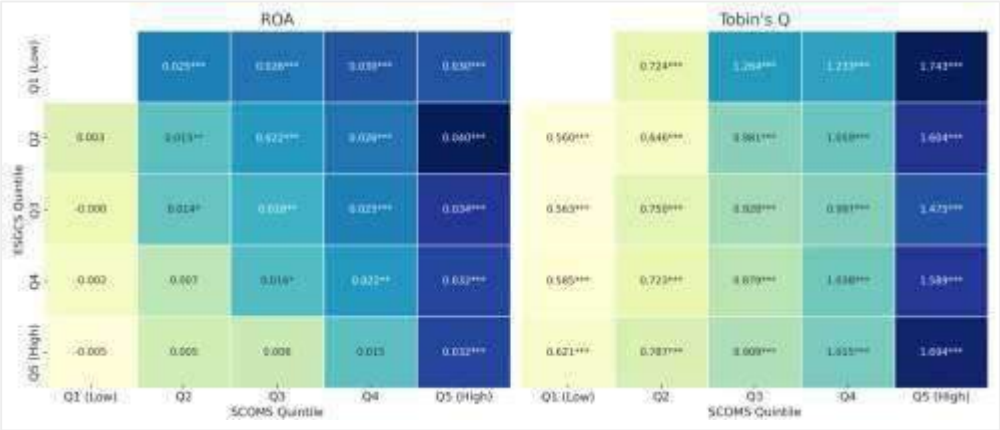

Figure 1: ROA and Tobin's Q effects by different Sharīʿah and ESG compliance levels.

IMPLICATIONS FOR PRACTICE, POLICY, AND EDUCATION

The results of this study suggest several meaningful ways in which Islamic finance can continue to mature within today's capital markets. Building on the ideas behind the Screening 2.0 model (Jumat, 2025), which moves gradually from enhanced quantitative Sharīʿah-compliance scoring (SCOMS), to a more blended Sharīʿah and ESG lens, and eventually to assessments grounded in *maqāṣid* and real societal impact, the evidence indicates that firms progressing along this path tend to perform better. These insights may matter for practitioners, regulators, and educators who are trying to strengthen both the *maqāṣid* spirit and practical usefulness of Islamic finance.

Implications for Practice

Using Screening 2.0 as a More Comprehensive Evaluation Tool

The study shows quite clearly that relying on isolated compliance markers no longer delivers any real performance advantage. Practitioners benefit much more when they apply the layered structure of Screening 2.0. The first phase, SCOMS, sharpens the view of financial purity instead of relying solely on binary pass or fail thresholds. The second phase adds the Sharīʿah and ESG integration lens, and the third draws attention to whether a firm contributes positively to society in any substantive way. Taken together, this helps managers spot stronger, better aligned firms that combine compliance with meaningful purpose.

Better Product Structuring and Portfolio Design

Because firms in the higher Sharīʿah and ESG compliance brackets show a consistent performance uplift, product designers have real grounds to structure offerings around this framework. Asset managers can craft Islamic ESG mandates that are multi layered, or build portfolios that bring together Sharīʿah principles with sustainability goals in a more intentional way. Such strategies are likely to resonate with investors who want ethical value and not only financial gain.

More Effective Stewardship and Engagement

The evidence points to a clear pattern. Firms that maintain coherence between their financial discipline, business conduct, and ESG commitments tend to be more profitable and better valued by the market. This gives asset managers and Sharīʿah committees a stronger basis to engage companies on risk oversight, sustainability integration, and broader responsibilities to stakeholders. This shift represents the move from defensive screening into an approach that actively encourages value creation, which is very much in line with the spirit of Phase 3.

Implications for Policy

Rethinking Conventional Sharīʿah Screening Ratios

Traditional ratio based screening still plays an important role, although its limitations have become more visible. It does not fully capture the Sharīʿah depth or performance characteristics of modern firms. The results therefore strengthen the case for regulators and standards setters to refine existing criteria. Screening 2.0 offers a direction that is more multidimensional, bringing compliance closer to the purpose and spirit of Sharīʿah instead of merely satisfying numeric boundaries.

Closer Alignment with Global Sustainability Reporting

The performance benefits that arise when Sharīʿah and ESG compliance reinforce each other add weight to the idea that Islamic finance should be more aligned with global sustainability reporting regimes, including the IFRS Sustainability Standards. Integrating these elements into Sharīʿah governance raises transparency, improves comparability with global markets, and positions Islamic finance as a serious and credible pillar within the broader ethical finance ecosystem.

Encouraging *Maqāṣid*-Oriented Behaviour

The journey toward Screening 2.0 also opens the door for targeted policy initiatives. Regulators may consider incentives or recognition programmes for firms that clearly operationalise *maqāṣid* oriented practices. Structured disclosures or specific reporting requirements can help highlight organisations that are genuinely contributing to societal well-being. Over time, this can shift the industry from fulfilling formal compliance to demonstrating real impact.

Implications for Education

Bringing a Multi-Phase Ethical Framework into Teaching

The Screening 2.0 model shows that Islamic finance education needs to balance between traditional jurisprudential material and meaningful tangible outcomes. Programmes should expose learners to quantitative ethical assessment techniques, interdisciplinary sustainability content, and the principles behind *maqāṣid* driven analysis. This prepares future practitioners for a much more complex ethical investment environment.

Building Competence Across Disciplines

The findings highlight the importance of merging analytical skills with deeper ethical reasoning. Effective training, therefore, requires learners to be comfortable interpreting data-driven compliance metrics and to judge whether firms are genuinely contributing to welfare, sustainability, and fairness. This blend reflects the intellectual foundation of Screening 2.0.

Upskilling Sharīʿah Advisors and Industry Professionals

As screening practices evolve, both Sharīʿah scholars and finance professionals will need to deepen their understanding of macro-level ESG principles, sustainability disclosure standards, and impact assessment tools. The results presented in this study support this need and offer empirical backing for educational programmes that strengthen these cross-functional skill sets. Such capabilities are increasingly essential for decision-making that is both integrated and aligned with *maqāṣid*.

CONCLUSION

This research addresses key gaps in the existing literature regarding the combined role of Sharīʿah-compliance and ESG standards in improving firm performance. It strengthens theoretical claims about the alignment of Sharīʿah and ESG-compliant firms by providing empirical evidence based on rigorous dynamic panel methods, including the two-step System GMM estimator.

The empirical evidence strongly supports the study's initial hypotheses by showing that independent Sharīʿah financial compliance improves firm performance. In contrast, the independent application of Sharīʿah business screening produces neutral or negative outcomes, indicating the limitations associated with strict sectoral restrictions. However, the interaction between Sharīʿah financial requirements and business screening reveals substantial synergies, demonstrating that integrating these elements within a Sharīʿah framework produces significant performance advantages.

The performance assessment of firms applying ESG screening on its own shows minimal effects, confirming that ESG activities require strategic alignment with other ethical frameworks, particularly Sharīʿah-compliance. The study provides compelling evidence that firms achieving high compliance with both Sharīʿah and ESG standards generate superior performance outcomes, as shown in the strong results within the highest compliance categories.

The findings from the quintile analysis show that as firms progress toward higher compliance levels, each incremental improvement results in increasingly substantial performance gains. The analysis also highlights the strategic value of comprehensive ethical management by showing that firms benefit most when Sharīʿah financial and business compliance benchmarks are integrated with ESG compliance standards.

Overall, this research contributes meaningful insights to the academic literature by offering comprehensive empirical evidence on how Sharīʿah and ESG compliance work together. It advances discussions on ethical investment approaches and provides practical value for policymakers, corporate leaders, and investors by emphasising the importance of integrated ethical frameworks for sustainable long term organisational performance.

Future research should examine these dynamics across different markets and sectors to strengthen generalisability. Qualitative investigations into managerial motivations, governance practices, and decision making concerning ethical compliance could also provide further insight into the mechanisms driving these empirical outcomes.

REFERENCES

Alam, N., & Rajjaque, M. S. (2010). Sharīʿah-compliant equities: Empirical evaluation of performance in the European market during credit crunch. *Journal of Financial Services Marketing, 15*(3), 228–240. https://doi.org/10.1057/fsm.2010.8

Al-Shakfa, O., & Lypny, G. (2011). Islamic investment and the cost of observance. *Journal of Investing, 20*(2), 101–109. https://doi.org/10.3905/joi.2011.20.2.101

Arellano, M., & Bond, S. (1991). Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations. *Review of Economic Studies, 58*(2), 277–297. https://doi.org/10.2307/2297968

Baltagi, B. H. (2008). *Econometric analysis of panel data* (4th ed.). John Wiley & Sons.

Benabou, R., & Tirole, J. (2010). Individual and corporate social responsibility. *Econometrica, 77*(1), 1–19.

Blundell, R., & Bond, S. (1998). Initial conditions and moment restrictions in dynamic panel data models. *Journal of Econometrics, 87*(1), 115–143. https://doi.org/10.1016/s0304-4076(98)00009-8

Choi, J.-H., & Wang, H. (2009). Stakeholder relations and the persistence of corporate financial performance. *Strategic Management Journal, 30*(8), 895–907. https://doi.org/10.1002/smj.759

Chung, K. H., & Pruitt, S. W. (1994). A simple approximation of Tobin's q. *Financial Management, 23*(3), 70–74. https://doi.org/10.2307/3665623

Derigs, U., & Marzban, S. (2008). Review and analysis of current Sharīʿah-compliant equity screening practices. *International Journal of Islamic and Middle Eastern Finance and Management, 1*(4), 285–303. https://doi.org/10.1108/17538390810919600

Erragraguy, E., & Revelli, C. (2015). Should Islamic investors consider SRI criteria in their investmentstrategies?*FinanceResearch Letters, 14*, 11–19. https://doi.org/10.1016/j.frl.2015.06.005

Farhat, A., & Hili, A. (2021). The impact of Sharīʿah-compliance on firm's performance and risk. *Review of Financial Economics, 39*(4), Article 100663. https://doi.org/10.1002/rfe.1227

Ferrell, A., Liang, H., & Renneboog, L. (2016). Socially responsible firms. *Journal of Financial Economics, 122*(3), 585–606. http://ssrn.com/abstract=2464561

Flammer, C. (2013). Corporate social responsibility and shareholder reaction: The environmental awareness of investors. *Academy of Management Journal, 56*(3), 758–781. https://doi.org/10.5465/amj.2011.0744

Freeman, R. E. (1994). The politics of stakeholder theory: Some future directions. *Business Ethics Quarterly, 4*(4), 409–421. https://doi.org/10.2307/3857340

Han, J., Kim, H. J., & Yu, J. (2016). Empirical study on relationship between corporate social responsibility and financial performance in Korea. *Asian Journal of Sustainability and Social Responsibility, 1*(1), 61–76. https://doi.org/10.1186/s41180-016-0002-3

Hayat, R., & Kraeussl, R. (2011). Risk and return characteristics of Islamic equity funds. *Emerging Markets Review, 12*(2), 189–203. https://doi.org/10.1016/j.ememar.2011.02.002

Htay, S., Abedeen, Z., & Salman, S. (2013a). Towards standardization of Sharīʿah screening norms and practices. *International Journal of Humanities and Social Science Invention, 2*(11), 23–30.

Htay, S. N. N., & Abdeen, A. M. (2013b). Challenges of Islamic equity investment: Issues and constraints. *Economic Insights–Trends and Challenges, 65*(2), 115–126.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305–360. https://doi.org/10.1016/0304-405X(76)90026-X

Jumat, Z. H. (2025). Between Sharīʿah negative screening and ESG positive screening: Developing a conceptual enhanced *maqāṣid* al- Sharīʿah screening framework. *World Scientific Annual Review of Islamic Finance*. Advance online publication. https://doi.org/10.1142/s2811023425500030

Knoll, M. (2002). Ethical screening in modern financial markets: The conflicting claims underlying socially responsible investment. *The Business Lawyer, 57*(2), 684–689.

Kruger, P. (2015). Corporate goodness and shareholder wealth. *Journal of Financial Economics, 115*(2), 304–325. https://doi.org/10.1016/j.jfineco.2014.09.008

Li, Y. W., Gong, M. F., Zhang, X. Y., & Koh, L. (2018). The impact of environmental, social, and governance disclosure on firm value: The role of CEO power. *The British Accounting Review, 50*(1), 60–75. https://doi.org/10.1016/j.bar.2017.09.007

Masulis, R., & Reza, S. W. (2015). Agency problem of corporate philanthropy. *Review of Financial Studies, 28*(2), 592–636. https://doi.org/10.1093/rfs/hhu082

McConnell, J. J., Servaes, H., & Lins, K. V. (2008). Changes in insider ownership and changes in the market value of the firm. *Journal of Corporate Finance, 14*(2), 92–106. https://doi.org/10.1016/j.jcorpfin.2008.02.001

Qoyum, A., Al Hashfi, R. U., Zusryn, A. S., Kusuma, H., & Qizam, I. (2021). Does an Islamic-SRI portfolio really matter? Empirical application of valuation models in Indonesia. *Borsa Istanbul Review, 21*(2), 105–124. https://doi.org/10.1016/j.bir.2020.11.002

Waddock, S. A., & Graves, S. B. (1997). The corporate social performance-financial performance link. *Strategic Management Journal, 18*(4), 303–319. https://doi.org/10.1002/(SICI)1097-0266(199704)18:4<303::AID-SMJ869>3.0.CO;2-G

Wan-Hussin, W. N., Qasem, A., Aripin, N., & Ariffin, M. S. M. (2021). Corporate responsibility disclosure, information environment and analysts' recommendations: Evidence from Malaysia. *Sustainability, 13*(6), 3568. https://doi.org/10.3390/su13063568

Williams, G., & Zinkin, J. (2010). Islam and CSR: A study of the compatibility between the tenets of Islam and the UN Global Compact. *Journal of Business Ethics, 91*(4), 519–533. https://doi.org/10.1007/s10551-009-0097-x

Wong, W. C., Batten, J. A., Ahmad, A. H., Mohamed-Arshad, S. B., Nordin, S., & Adzis, A. A. (2021). Does ESG certification add firm value? *Finance Research Letters, 39*, Article 101593. https://doi.org/10.1016/j.frl.2020.101593

****