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Revisiting ESG Performance in Islamic Capital Markets: Sustainable Leadership as a Strategic Moderator

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Abstract
This study aims to analyze the effect of Environmental, Social, and Governance (ESG) practices on projected financial performance using Return on Assets (ROA) and market performance measured by stock prices, with sustainable leadership as a moderating variable. The research subjects are companies listed on the SRI-KEHATI Index and the Indonesian Sharia Stock Index. The research method used is quantitative with a causality approach, using multiple regression tests and Moderated Regression Analysis (MRA) through E-Views software. The research subjects are companies listed on the SRI-KEHATI Index and the Indonesian Sharia Stock Index. The research method used is quantitative with a causality approach, using multiple regression tests and Moderated Regression Analysis (MRA) through E-Views software. The results show that ESG practices have a significant positive effect on financial performance (ROA), but a significant negative effect on stock prices. Originality/Values: These findings indicate that although the implementation of ESG can improve company efficiency and profitability, the high implementation costs can actually cause negative investor perceptions in the short term. Furthermore, sustainable leadership was found to moderate the effect of ESG on ROA, but not on stock prices. Thus, the results of this study emphasize the importance of an ESG implementation strategy that is integrated with sustainable leadership in order to improve financial performance without reducing the company's market value.

Keywords: *ESG; Financial Performance; ROA; Stock Price; Sustainable Leadership*

1. Introduction

Discussing the sustainable development goals (SDGs), which is a global agenda developed by the United Nations to achieve inclusive, sustainable, and equitable development by 2030. Indonesia, as a developing country with great economic potential, faces significant challenges and opportunities in integrating environmental, social, and governance (ESG) with SDGs to achieve sustainable development goals. Regulations on sustainability are also outlined in Presidential Regulation No. 59 of 2017 concerning the implementation of sustainable development goals (SDGs), Regulation of the Minister of National Development Planning/Head of BAPPENAS No. 7/2018 which stipulates Indonesia's national action plan for SDGs, and POJK No. 51 of 2017 concerning the sustainable finance (Darmawati, 2024).

Attention to sustainability has increased in recent years, with environmental and social impacts becoming topics of discussion in corporate activities. Methods have emerged to measure and report on companies' contributions to sustainability issues, as outlined in the ESG framework (Sultana, 2018). ESG includes responsibility for managing environmental impact, social welfare, and good governance (Alsayegh et al., 2023).

The implementation of ESG is not only encouraged by the public and the government but also by stakeholders such as investors, who increasingly consider ESG performance as one of the main indicators in making their investment decisions. Studies show that companies with good ESG performance tend to have better access to funding, lower capital costs, and increased company value.

In addition, effective ESG implementation can help companies reduce environmental and social risks and strengthen their reputation and competitiveness in the global market (Sopian et al., 2022). However, the real impact of ESG implementation on corporate financial performance is still a topic of debate, as some studies have found negative effects related to high implementation costs and potential conflicts between various stakeholders. Research conducted by Nopiawati & Prasetiono found negative results regarding ESG implementation with sustainable leadership.

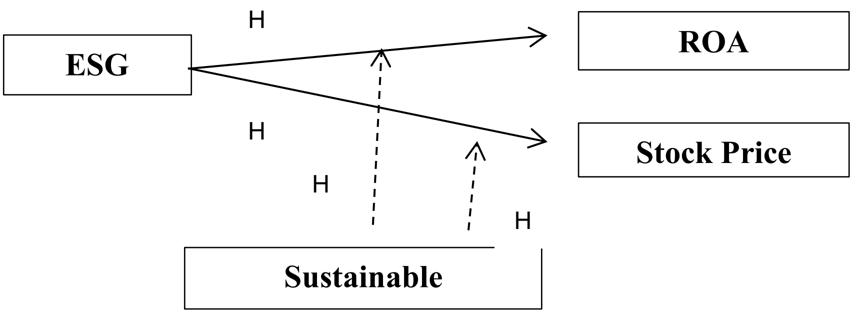
Corporate strategies integrated with ESG are important for fostering sustainable leadership at various levels of management within an organization (Lee & Isa, 2023). The implementation of sustainable leadership is considered important for organizations as a means of controlling strategy to maximize the positive impact generated for the long-term success of the organization in achieving financial sustainability (Farihadhy & Anis, 2024a). Therefore, with the implementation of ESG practices and supported by sustainable leadership, it is hoped that there will be an improvement in the company's financial and market performance.

The novelty of this research lies in its integration of Environmental, Social, and Governance (ESG) practices with the concept of sustainable leadership in the context of Indonesian companies that are specifically listed on two important indices, namely the SRI-KEHATI Index and the Indonesian Sharia Stock Index (ISSI). Previously, most ESG research in Indonesia only focused on the direct impact on financial performance without considering the moderating role of sustainable leadership and without distinguishing between companies based on sustainability and sharia compliance. Thus, this study contributes academically to enriching the literature on the integration of sustainability, leadership, and sharia finance theories within the ESG framework.

Some previous research results on ESG include a study by Lee & Isa in 2023 (Lee & Isa, 2023), which shows that good ESG practices have a positive and significant effect on financial performance, reinforced by research conducted by Leony et al., (2024); Nugroho & Nurfaizah (2020). However, different results were presented by Saygili et al., (2022) that ESG practices have a negative effect on financial performance, where this study was conducted on the Istanbul Stock Exchange (Saygili et al., 2022). The impact of ESG on market performance has been studied previously, with results showing that high ESG momentum scores can increase stock prices (Berk et al., 2023) and that high ESG scores also receive a positive response from investors, thereby increasing stock prices (Leite & Uysal, 2023). However, in 2025, research results emerged showing that ESG does not affect a company's market performance (Escobar-Saldívar et al., 2025).

Based on the differences in research results and the importance of sustainability efforts, the purpose of this study is to understand the role of sustainable leadership in moderating the relationship between ESG practices and the financial and market performance of companies in Indonesia.

Hypotheses Development



Picture 1: Research Framework

Stakeholder theory explains that companies that integrate sustainability principles into their practices will gain support from stakeholders, thereby improving financial performance (Mahajan et al., 2023). This is supported by Prayitno research which states that Environmental, Social, and Governance have a positive effect on the Return on Assets (ROA) (Utomo, 2024).

H_1: ESG affects return on assets (ROA) in stocks included in the Sri Kehati index and Indonesian sharia stocks.

Signaling theory explains that ESG disclosure sends a positive signal to investors regarding a company's prospects and sustainability, thereby increasing its stock value ("Signalling Theory," 2022). This is in line with the findings of Elazar Elazar et al. (2025), who state that ESG has a significant positive effect on stock prices. This means that an increase in a company's stock price will be in line with an increase in ESG, and vice versa.

H_2 : ESG affects stock prices for stocks included in the Sri Kehati index and Indonesian sharia stocks.

The Resource-Based View (RBV) emphasizes that sustainable leadership is an internal capability that can strengthen the positive impact of ESG on financial performance. This is in line with research (Farihadhy & Anis, 2024b) which shows that sustainable leadership is able to moderate the influence of ESG practices on profitability as measured by ROA.

H_3: Sustainable leadership is able to moderate the influence of ESG on Return on Assets (ROA) in companies included in the Sri Kehati index and Indonesian sharia stocks.

Leadership characteristics and styles influence corporate strategy, including in managing ESG to create market value (Hambrick, 2018.). Sustainability-oriented leadership leads companies to focus on factors that have a long-term impact, particularly in incorporating ESG practices into company operations, making them attractive to investors looking to invest in the company.

H_4: Sustainable leadership can moderate the impact of ESG on stock prices included in the Sri Kehati index and Indonesian sharia stocks.

2. Method

The type of research used is causal research with a quantitative analysis approach. In this case, it will be tested whether it has an effect on financial and market performance and whether sustainable leadership is able to moderate the effect of ESG practices on financial and market performance in companies indexed by SRI KEHATI and included in the sharia stock index for the period 2021–2024. The population used in this study is all companies included in the Sri Kehati index and also included in sharia stocks in Indonesia for the period 2021–2024. This population was selected because the Sri Kehati index already has criteria for stocks in the Assessed Universe that meet the minimum ESG score and have passed the ESG controversy screening.

Purposive sampling is used to determine the sample used for research. Several criteria used are companies that consistently publish sustainability reports, companies that publish financial reports during the research period, and companies that publish data needed for research. Based on these criteria, a sample of 17 companies was obtained. The independent variable used was environmental, social, and governance (ESG) practices using 30 indicators based on the Nasdaq Reporting Guide 2.0.

Table 1. Indicator for Environmental, social and Governance (ESG)

Environmental (E)		*Social (S)*		*Corporate Governance (G)*	
E1.	GHG Emissions	S1.	CEO Pay Ratio	G1.	Board Diversity
E2.	Emissions Intensity	S2.	Gender Pay Ratio	G2.	Board Independence
E3.	Energy Usage	S3.	Employee Turnover	G3.	Incentivized Pay
E4.	Energy Intensity	S4.	Gender Diversity	G4.	Collective Bargaining
E5.	Energy Mix	S5.	Temporary Worker Ratio	G5.	Supplier Code of Conduct
E6.	Water Usage	S6.	Non-discrimination	G6.	Ethics & Anti-corruption
E7.	Environmental Operations	S7.	Injury Rate	G7.	Data Privacy
E8.	Circular Oversight / Board	S8.	Global Health & Safety	G8.	ESG Reporting
E9.	Climate Oversight / Management	S9.	Child & Forced Labor	G9.	Disclosure Practices
E10.	Climate Risk Mitigation	S10.	Human Rights	G10.	External Assurance

The dependent variables used were stock price as market performance and return on assets (ROA) as financial performance. The moderating variable used was sustainable leadership, which was measured using the sustainable leadership index (SLEAD). The measurement of sustainable leadership was conducted using an index based on the foundations of leadership practices, which comprises 14 (fourteen) leadership practices, resulting in the Sustainable Leadership Index (SLEAD) developed by Baird et al., (2023). The overall index is then evaluated using dummy variables based on the company's statements regarding each index. If a company makes a statement in its annual report or sustainability report that is published regarding the index, it is assigned a value of 1 (one); conversely, if there is no relevant statement, it is assigned a value of 0 (zero). From the total index scores obtained from the sample, the ratio is then calculated based on the maximum possible score, resulting in the following formula for the Sustainable Leadership Index (SLEAD) as follows:

$$SLEAD = \frac{Sustainable\ Leadership\ Index\ (SLEAD)}{Total\ Score\ (14)}$$

The data analysis method used is a verificative method, which aims to test hypotheses through statistical calculations to obtain results proving whether a hypothesis is accepted or rejected. The data analysis method used is the E-views program with normality tests, multiple regression tests, and moderation through MRA tests or interaction tests.

3. Results and Discussion

The Impact of Environmental, Social, and Governance (ESG) on Company Financial Performance

The statistical analysis began with a normality test to examine the effect of ESG on ROA. The Kolmogorov-Smirnov test produced a significance value of 0.378, indicating that the data were normally distributed. Subsequent tests included the Chow test, Hausman test, and LM test. The results of the Chow and Hausman tests indicated that the appropriate regression model was the fixed effect model. The statistical results showed a coefficient of 0.007 with a significance level of 0.00 (less than 0.05), suggesting that a one-unit increase in ESG leads to a 0.007 increase in ROA.

Table 2. Results of the ESG t-test on ROA

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
ESG	0.007182	0.000384	18.70809	0.0000
C	-0.004784	0.000308	-15.55445	0.0000

Statistical research results show that ESG has a positive and significant effect on projected company value using return on assets (ROA). This is evidenced by a coefficient value of 0.007182 and a probability value of 0.0000, which is less than 0.05. Thus, the first hypothesis is accepted, which means that ESG has an effect on ROA in Sri Kehati Index companies and Sharia Stocks.

The Impact of Environmental, Social, and Governance (ESG) Factors on Company Stock Performance

The results of the normality test using Kolmogorov-Smirnov showed a probability value of 0.09 or < 0.05. Thus, it can be concluded that the data used is normally distributed. The next tests conducted were the Chow test, Hausman test, and LM test to determine which model was best used to see the effect of the two variables. Based on the test results, it was found that the appropriate model to use was the random effect model.

Table 3. Results of ESG t-Test on Stock Prices

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
C	9.679082	0.231539	41.80321	0.0000
ESG	-4.164721	0.427103	-9.751085	0.0000

Based on table 3 regression test, which produced a coefficient value of -4.164 with a probability of 0.00. Thus, the second hypothesis is accepted, which means that ESG has an effect on stock prices in companies listed on the Sri Kehati index and Indonesian Sharia Stocks. However, the effect of ESG on stock prices is negative: when ESG increases, stock prices will decrease.

Sustainable Leadership Can Moderate the Impact of ESG on Financial Performance

The moderating effect of sustainable leadership on the relationship between Environmental, Social, and Governance (ESG) performance and stock prices was analyzed using a moderated regression model, and the estimation results are presented in Table 4.

Table 4. Results of ESG Moderation Testing on Stock Prices of Companies in the Sri Kehati Index and Sharia Stock Index

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
C	9.724822	0.243550	39.92945	0.0000
ESG	-2.911434	2.024733	-1.437935	0.1552
ESG_KB	-1.437562	2.269694	-0.633373	0.5287

Based on the results of the MRA test on table 4 conducted in the moderation test, the probability value was 0.00 < 0.05 with a coefficient of 0.100. Therefore, it can be concluded that the fourth hypothesis is accepted, namely that sustainable leadership can moderate the influence of ESG on

ROA in companies listed on the Sri Kehati Index and the Indonesian Sharia Stock Index.

Sustainable Leadership Moderates the Impact of ESG on Stock Performance

Untuk menguji peran moderasi kepemimpinan berkelanjutan dalam hubungan antara kinerja Lingkungan, Sosial, dan Tata Kelola (ESG) dan kinerja saham, dilakukan analisis regresi moderasi. Hasil uji moderasi disajikan pada Table 5.

Table 5. Results of ESG Moderation Testing on ROA of Companies in the Sri Kehati Index and Indonesian Sharia Stock Index

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
C	0.069221	0.004660	14.85475	0.0000
ESG	-0.087790	0.006185	-14.19485	0.0000
ESG_LEADERSHIP	0.100129	0.006320	15.84207	0.0000

The MRA test that has been conducted shows a probability value of 0.5287 > 0.05. Therefore, it can be concluded that the fifth hypothesis is rejected. Sustainable leadership is unable to moderate the influence of ESG on stock prices of companies included in the Sri Kehati index and the Sharia stock index in Indonesia.

The Impact of Environmental, Social, and Governance (ESG) on Company Financial Performance

Companies with good ESG performance tend to manage resources more efficiently and minimize operational risks, thereby positively impacting ROA. Environmental aspects encourage companies to implement energy-efficient technologies, optimize raw material utilization, and reduce waste. Social practices, such as improving employee welfare, training, and a safe working environment, can reduce turnover, absenteeism, and recruitment costs. Strong governance aspects, such as financial reporting transparency, legal compliance, and internal controls, help avoid fines, litigation, and damaging scandals. The measurement of ESG disclosure, based on the NASDAQ ESG Reporting Guide 2.0, consists of 10 indicators for each category: environmental, social, and corporate governance. For the Environmental category, the indicators include greenhouse gas (GHG) emissions, emission intensity, direct and indirect energy consumption, energy intensity, energy mix, water usage, environmentally friendly operations, climate oversight by the board and management, and climate risk mitigation efforts. In the Social category, the indicators cover CEO-to-employee pay ratio, gender pay gap, employee turnover rate, gender diversity, proportion of temporary workers, anti-discrimination policy, workplace injury rate, global health and safety standards, policies on child and forced labor, and human rights commitments.

Meanwhile, for corporate governance, the measurements include board diversity, board independence, performance-based remuneration, collective bargaining rights, supplier code of conduct, ethics and anti-corruption policies, data privacy protection, ESG reporting, transparency and disclosure practices, and external assurance or verification. Thus, companies included in the Sri-Kehati list and sharia stocks can adopt these indicators as a framework for assessing and reporting ESG practices in a comprehensive, consistent, and internationally compliant manner (Hossain, 2023). Significant impact is illustrated by one of the large companies on the ESG disclosure indicator, namely Antam, which in 2024 showed an increase in ESG practices of 8%, thereby also impacting the ROA value, which increased by 13% in that year. Companies with better ESG commitments will increase their company value in the form of return on assets (ROA). A similar situation occurred at Indofood CBP, which showed an increase in ESG practices from 2022 to 2023 of 0.25%, resulting in an increase in ROA from 2022 to 2023 of 0.15%. This proves that a company's commitment to ESG practices will lead to an improvement in its financial performance.

According to stakeholder theory, companies that are active in ESG tend to build strong relationships with stakeholders ranging from employees to consumers, suppliers, and regulators. These good relationships can reduce operational risks and open up new market opportunities, allowing the company's assets to be utilized more productively. The positive relationship between ESG practices and ROA can be explained from an Islamic economic perspective through the framework of *Maqāṣid al-Sharīʿah* and the concept of *maslahah* (public interest). ESG implementation reflects the protection of wealth (*hifz al-māl*) through sound governance, the protection of life and the environment (*hifz al-nafs* and *hifz al-nasl*) through responsible environmental practices, and the promotion of social justice through equitable labor policies.

These elements collectively generate long-term value creation and operational efficiency, which are consistent with the Islamic objective of achieving sustainable welfare (*al-falāḥ*). Moreover, in the concept of *khalifah* and *amanah*, corporate leaders are entrusted with managing resources responsibly and ethically, ensuring that business activities create not only financial returns but also broader societal benefits. Therefore, the improvement in ROA observed in companies with stronger ESG commitments can be interpreted as the realization of economic value aligned with Islamic sustainability principles.

The results of the study are supported by Leony et al., (2024) which show that ESG has a positive and significant effect on projected company value using ROA. Companies with good ESG performance are able to manage resources efficiently, reduce operational costs, and minimize business risks. The implementation of environmental aspects helps companies save energy and minimize waste, while social aspects increase employee loyalty and good relationships with stakeholders. Strong governance also increases transparency, reduces the potential for fraud, and improves relationships with investors, which cumulatively drives increased profitability.

The Impact of Environmental, Social, and Governance (ESG) Factors on Company Stock Performance

Statistical research results show that ESG has a negative and significant impact on stock performance. This hypothesis was rejected due to several factors, one of which is the high cost of meeting ESG standards, such as environmentally friendly technology, sustainable social programs, or strengthening governance systems. These costs can reduce short-term profits, leading investors to view ESG costs as wasteful, especially if the long-term benefits are not immediately apparent. This, of course, can reduce stock performance due to negative investor reactions.

This is in line with signaling theory, which emphasizes that every managerial action sends a signal to the market. High ESG can be interpreted in two ways by investors. On the one hand, it can be a signal of commitment to sustainability, but on the other hand, it can be seen as an indication of problems or burdens on the company due to regulatory pressure or significant reputational risks, causing investors to respond with selling actions that can lower stock performance (Spence, 1973). Negative market reaction to ESG practices can be interpreted as a divergence between short-term market orientation and the long-term objectives of *Maqāṣid al-Sharīʻah*. While ESG initiatives aim to promote *maslahah* (public benefit) through environmental protection, social justice, and ethical governance, capital market investors may prioritize immediate financial returns over sustainable value creation.

In this context, the principle of *al-falāḥ* (holistic and long-term prosperity) embedded in Islamic economics is not always fully internalized in market pricing mechanisms, particularly in emerging markets. Consequently, ESG-related expenditures may be perceived as short-term cost burdens rather than strategic investments aligned with the role of humans as *khalifah* (stewards) entrusted to manage resources responsibly. This gap between Islamic sustainability values and short-term investor expectations may explain why ESG performance does not necessarily translate into higher stock prices in the observed period.

This negative impact is also evidenced by data showing that the average ESG value in the observation period from 2021 to 2022 decreased by 0.016, but the average stock price in the observation period showed an increase of 256.47. This reinforces the finding that improvements or declines in a company's ESG practices do not always have a positive impact on market performance. This phenomenon is in line with research that found that in some emerging markets, strong ESG implementation is not yet fully appreciated by investors and may even be considered an additional burden that does not provide instant added value to stock market performance (Gao & Zhang, 2025).

This finding is consistent with the studies conducted by Suhairi et al., (2023) and Hasanah et al., (2024) which reported that ESG implementation has a negative and statistically significant effect on stock performance among 37 companies listed on the Jakarta Islamic Index 70 (JII70). Their findings suggest that investors in the Indonesian capital market, particularly within the Islamic equity segment, tend to prioritize short-term financial returns over the long-term benefits generated by ESG initiatives.

Consequently, the substantial costs associated with environmental investments, social responsibility programs, and governance improvements are often perceived as reducing current profitability, thereby triggering negative market reactions. Similar evidence was reported by Yonathan Nugraha et al., (2024) and Aditama (2022) who found that higher ESG implementation is associated with lower market value. These studies argue that, particularly in emerging markets, investors have not fully incorporated ESG information into their valuation models and continue to rely primarily on conventional financial indicators such as earnings, dividends, and short-term profitability. As a result, although ESG initiatives may enhance corporate sustainability and resilience over the long run, the market may initially interpret these activities as additional costs rather than value-creating investments, leading to a decline in stock performance.

Sustainable Leadership Can Moderate the Impact of ESG on Financial Performance

Based on statistical test results, it is stated that sustainable leadership can strengthen the influence of ESG on projected company value with ROA listed on the Sri Kehati Index and the Indonesian Sharia Stock Index. If a company has leaders who are strongly oriented towards sustainability, consistent leaders, and visionaries, then the impact of ESG on company value will be greater. This is demonstrated by the positive value of the moderating variable, meaning that the more companies have elements of sustainable leadership, ranging from human resource development, labor relations, and environmental responsibility to a shared vision for the future, which become important strategic tools, the greater the impact of ESG practices on return on assets (ROA). Sustainable leadership is a leadership style that focuses on achieving long-term goals while taking into account economic, social, and environmental factors. Sustainable leaders are committed to creating long-term positive change that benefits the organization, employees, and society (Judijanto & Muhtadi, 2024).

The findings of this study are consistent with those of Rahman et al., (2023) who demonstrated that sustainable leadership strengthens the positive relationship between ESG practices and firm performance by ensuring that sustainability initiatives are integrated into long-term strategic decision-making. Similarly, Farihadhy & Anis (2024) found that sustainable leadership reinforces the positive impact of ESG implementation on corporate profitability, indicating that leadership commitment plays a crucial role in transforming sustainability initiatives into superior financial outcomes. These consistent findings suggest that sustainable leadership functions as a strategic capability that enables organizations to allocate resources more effectively, encourage innovation, and enhance stakeholder trust, thereby maximizing the value created through ESG practices. Leaders with a strong sustainability orientation are more capable of embedding environmental, social, and governance principles into corporate culture and operational strategies, ensuring that ESG implementation is not merely a compliance mechanism but a long-term source of competitive advantage and improved company performance.

Sustainable Leadership Moderates the Impact of ESG on Stock Performance

The magnitude of sustainable leadership is unable to increase or decrease the influence of ESG on stock prices for stocks listed on the Indonesian Sharia Stock Index and the Sri Kehati Index. Investors do not view sustainable leadership as an important factor in their decision to buy or sell shares, because they focus on financial reports, macro and microeconomic conditions, or industry trends. In addition, stock market performance often fluctuates, while sustainable leadership has a long-term impact that is not immediately reflected in stock price movements. The results of this study are supported by research conducted by (Farihadhy &

Anis, 2024). This shows that sustainable leadership is unable to moderate the influence of ESG on a company's stock performance.

4. Conclusion

This study provides empirical evidence on the impact of implementing Environmental, Social, and Governance (ESG) practices on the financial and market performance of companies listed in the Sri Kehati Index and the Indonesia Sharia Stock Index (ISSI). The findings indicate that ESG implementation has a significant positive effect on firm value, suggesting that such practices play an important role in enhancing long-term sustainability and fostering investor confidence. However, ESG practices also show a significant negative effect on stock performance, implying that the market tends to perceive ESG activities as short-term cost burdens, which can directly reduce investor returns. The study also emphasizes the moderating function of sustainable leadership. Sustainability-oriented leadership is shown to strengthen the positive relationship between ESG practices and firm value, indicating that visionary and sustainability-committed leaders play a crucial role in optimizing the benefits of ESG implementation. However, sustainable leadership does not moderate the relationship between ESG practices and stock performance, implying that leadership alone may be insufficient to alter short-term market reactions to ESG activities. Overall, the findings of this study enrich the existing literature by providing a deeper perspective on the dual influence of ESG on financial and market aspects. The results highlight the need to align ESG implementation with effective leadership strategies to generate long-term value, while also acknowledging the challenges of balancing sustainability goals with short-term market expectations.

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