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Exploring the Moderating Role of Sharia Compliance on the Effect of ESG Score on Financial Performance

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Abstract

This study examines the effect of Environmental, Social, and Governance (ESG) performance on corporate financial performance and investigates the moderating role of Sharia compliance in this relationship. The research focuses on non-financial companies listed on the Indonesia Stock Exchange (IDX) that have ESG scores provided by Morningstar Sustainalytics. This study employs panel regression analysis on a sample of 58 non-financial companies listed on the Indonesia Stock Exchange from 2021 to 2024. The results indicate that ESG performance has a statistically significant negative effect on corporate financial performance. These findings suggest that companies with higher ESG scores, as measured by the Sustainalytics risk-based framework, are associated with greater perceptions of ESG-related risks, and therefore lower financial performance. Furthermore, Sharia compliance does not moderate the relationship between ESG and financial performance. These results imply that although ESG practices and Sharia principles share ethical and sustainability-oriented foundations, they do not operate synergistically in enhancing firm financial performance within the Indonesian capital market context. The findings contribute to the ESG and Islamic finance literature by highlighting the importance of ESG measurement approaches and market context. The study also offers insights for investors, regulators, and corporate managers regarding the interpretation of ESG scores and the role of Sharia compliance in investment decision-making.

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1. INTRODUCTION

The primary way to build and maintain a company's reputation is by improving its performance. Company performance serves as a key indicator of a company's development and competitiveness. Performance is crucial to stakeholders, including investors, creditors, and the government, who rely on it to assess risks and potential returns (Awa et al., 2024). A company's financial performance also serves as a reference in formulating strategies to address increasingly fierce competition (Zhang & Lucey, 2022).

For investors, analyzing financial performance is crucial to assessing whether their investment returns are expected to be achieved. Before deciding to invest, investors need to ensure that the company's financial performance can meet their expectations while minimizing potential risks (Fadrul et al., 2021; Wang & Wang, 2017). A company's stock price is also an important indicator for investors in assessing the company's financial performance and prospects.

Furthermore, long-term stakeholder expectations for transparency in the use of funds, both financial and non-financial, put pressure on companies to present informative and reliable reports (Crous et al., 2022; Hadro et al., 2022). This non-financial disclosure encompasses the company's responsibility to stakeholders to invest in economic and social sectors, as well as its commitment to sustainable corporate governance, known as Environmental, Social, and Governance (ESG) (Aluchna et al., 2023). ESG implementation encompasses integrating sustainable development goals into business strategies, operations, and corporate social responsibility (Erin et al., 2022).

ESG serves as a benchmark for companies to demonstrate non-financial accountability in environmental sustainability, social welfare, and corporate governance, ultimately supporting the achievement of goals such as reducing carbon emissions and advancing a green economy (Khan, 2022). ESG reporting promotes transparency and accountability regarding a company's role in these initiatives, with frameworks like the Global Reporting Initiative (GRI) or the Sustainability Accounting Standards Board (SASB) ensuring the reports are both relevant and quantifiable (United Nations Department of Global Communications, 2023). Through the adoption of ESG practices, companies can enhance their reputation with stakeholders and improve issuer performance (Gomez-Trujillo et al., 2020).

Several studies have shown that ESG performance has a positive impact on corporate profitability by increasing operational efficiency and reducing environmental risks (Galeazzo et al., 2024; Rosamartina et al., 2022). However, some studies have found no significant relationship between ESG implementation and corporate performance, particularly in the short term (Ramos et al., 2022; Tyan et al., 2024). In fact, some studies indicate that participation in ESG activities can be a waste of resources, resulting in lower corporate performance (Barko et al., 2022; Sheehan et al., 2023).

The inconsistency in these research findings underscores the need for further investigation into the dynamics between ESG implementation and corporate performance. According to Baron & Kenny (1986), moderating variables become important when empirical findings show a weak or inconsistent relationship. Several recent studies, such as those by Lee & Isa (2023), Adomako & Tran, (2022), and Tóth et al., (2021) examined the potential moderating effects of variables on the relationship between ESG report and corporate financial performance.

The selection of Sharia compliance as a moderating variable in this study was based on research by (S. Lee & Isa, 2025), which demonstrated increasing interest in ESG studies linked to Sharia compliance. The findings are consistent with those of Idris, et al., (2022), who empirically suggested broadening the ESG criteria to incorporate halal principles, such as businesses being free from tobacco, alcohol, and gambling, which are already addressed by Sharia compliance. However, while Sharia compliance includes some ESG ethical guidelines, it is considered inadequate to cover all the ESG criteria necessary for sustainable corporate governance (Jaiyeoba et al., 2025).

The Indonesian capital market, which has experienced rapid development over the past decade, has become an important context for examining ESG performance and Sharia compliance in the context of discussing financial performance and sustainability reporting (Al Adawiyah et al., 2025; Modjo et al., 2025). Furthermore, as a country with the largest Muslim population in the world, Sharia-compliant investment principles play a central role in corporate governance and investor expectations (Hati et al., 2023). This unique combination of emerging-market dynamics and the significant influence of Sharia creates an opportunity to examine how ESG practices and Sharia compliance interact to shape corporate financial performance. Therefore, the research focuses on Indonesian companies to examine the interaction between ESG and Sharia compliance in the context of emerging-market capital markets.

The purpose of this study is to examine the effect of ESG Score on corporate financial performance by considering the moderating role of Sharia compliance. By using a signaling theory approach, this research is expected to provide a significant contribution to corporate governance practices oriented towards sustainability and Sharia principles, as well as deepen understanding of the interaction between ESG performance score and Sharia compliance in influencing corporate financial performance.

1.1. Literature Review

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

In the context of modern corporate management, attention to environmental, social, and governance (ESG) practices is increasingly important in assessing corporate performance (Singh & Rahman, 2021). Various previous studies have examined the relationship between ESG and corporate financial performance, showing mixed results, with both positive and negative effects, strongly influenced by the institutional context, market characteristics, and the ESG measurement methods used.

Numerous studies have shown that ESG implementation and rating can improve corporate financial performance. Corporate social responsibility activities are positively associated with firm value, as reflected in market indicators such as Tobin's Q, which captures investors' appreciation of a company's sustainability commitment (Liu & Song, 2023).. Research by Junius, et al., (2020) corroborates these findings, stating that ESG practices can strengthen a company's image and reputation, thus improving financial performance. Cheng et al., (2023) similarly found that ESG practices positively contribute to corporate performance in Germany, suggesting that ESG can be a strategic tool in corporate value creation.

However, other studies have shown that ESG practices do not always have a positive impact on financial performance. Ren & Lin, (2024) found a negative relationship between ESG activities and profitability indicators such as ROA and ROE, indicating that ESG implementation can incur costs that impact financial performance. Sahut (2015) also suggested that investing in ESG activities may depress a company's financial performance, particularly when the company perceives ESG as an additional source of costs that are not offset by tangible economic benefits. These differing findings suggest that the impact of ESG on financial performance is contextual and influenced by market characteristics and investor perceptions.

In summary, although the academic community remains divided on how and to what extent ESG affects company performance, most studies agree that ESG scores have a positive impact on company performance. While fulfilling corporate social responsibility does come at a cost, when these investments begin to show results, companies can benefit through energy savings and emission reductions, enhanced reputation, greater investor appeal, increased employee loyalty, policy support, and increased work efficiency, both tangible and intangible. These benefits ultimately offset the costs incurred, realize the scale effect of the investment, and subsequently improve company performance. Therefore, this study proposes the following hypothesis:

H_1: Environmental, social, and governance (ESG) score has a positive impact on financial performance.

The ESG Score on Financial Performance Moderated by Sharia Compliance.

Sharia compliance ensures that a company's activities do not involve behavior prohibited by Islamic law and ensures that revenue is generated in accordance with Sharia principles. Operationally, the Sharia framework also emphasizes accountability and social justice in all aspects of operations and financial reporting (Idris et al., 2022). These principles not only enhance social legitimacy but also strengthen shareholder confidence in the company's resource accumulation and allocation processes. Sharia-compliant companies receive a trust premium from investors specifically seeking ethical investments, thereby increasing stock liquidity and company valuation (Jaiyeoba et al., 2025).

According to Lee & Isa, (2023), Sharia-compliant companies are expected to demonstrate strong management practices, including active involvement in environmental, social, and governance activities. Based on stakeholder theory, implementing ESG practices increases value by strengthening stakeholder relationships and enhancing transparency. Sharia principles also emphasize transparency towards stakeholders. Therefore, the combination of ESG implementation and Sharia compliance is expected to improve further a company's financial performance (S. Lee & Isa, 2025).

The convergence of Sharia principles and ESG dimensions, particularly in governance and social justice, creates a synergistic effect. Research by Lee & Isa (2023) shows that companies that combine Sharia compliance with high ESG performance achieve superior financial performance. Sharia compliance provides a solid ethical foundation, while ESG practices translate into measurable operational actions (Ahmed et al., 2025; Karudin et al., 2025). Therefore, Sharia compliance acts as a positive moderator in the relationship between ESG score and corporate financial performance.

H_2: Sharia compliance strengthens the impact of ESG Score on financial performance.

Conceptual Framework

The conceptual framework for the hypothesized relationship in this study is grounded in theoretical foundations and empirical evidence relevant to the influence of ESG implementation on corporate financial performance, with Sharia compliance as a moderating variable. The relationship between Environmental, Social, and Governance (ESG) implementation and disclosure and corporate financial performance has been widely supported by both theoretical and empirical literature, which shows that ESG practices play a role in improving operational efficiency, reducing risk, and strengthening a company's reputation among investors, stakeholders, and consumers (Lee et al., 2022; Ren & Lin, 2024; Singh & Rahman, 2021). These findings indicate that ESG value is a strategic instrument with the potential to create economic value for companies.

In the context of this study, this relationship is not only direct but is also influenced by the characteristics of value-based corporate governance, particularly Sharia compliance. Sharia compliance is believed to strengthen the quality and credibility of ESG scores because Sharia principles emphasize transparency, accountability, and prohibit speculative and unethical activities. Therefore, ESG implementation by Sharia-compliant companies are expected to send a stronger signal to the market about the company's commitment to sustainability and long-term risk management, ultimately impacting its financial performance (Jaiyeoba et al., 2025; S. Lee & Isa, 2025).

Based on this relationship, this study develops a conceptual framework that illustrates the influence of ESG Score on corporate financial performance, with Sharia compliance as a moderating variable influencing the strength of this relationship. This conceptual framework is presented to explain the hypothesized causal relationships and serves as the basis for empirical testing using appropriate statistical approaches.

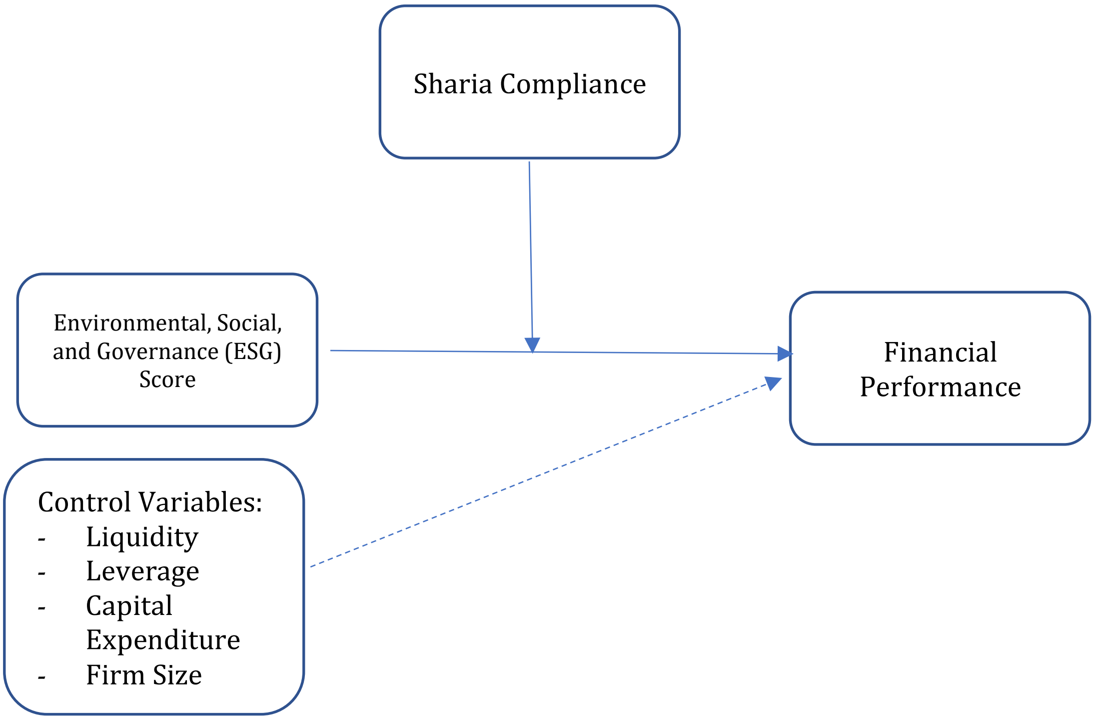

Figure 1. Conceptual Framework
Source: Development by Researchers (2025)

2. METHODS

The sample in this study consisted of 58 listed non-financial companies with Environmental, Social, and Governance (ESG) scores available on IDX. The sample was selected purposively, based on the following criteria: non-financial companies that consistently published ESG scores and had complete financial data throughout the observation period. The study period spanned four years, from 2021 to 2024, enabling a more comprehensive analysis of the dynamics of ESG implementation and disclosure, and their implications for corporate financial performance.

ESG data was obtained from ESG score of IDX Listed Companies by Morningstar Sustainalytics, a recognized and credible provider widely used in academic research and capital market practice, as it provides standardized, comparable ESG indicators across companies. Meanwhile, financial performance data and control variables were obtained from the companies' annual financial reports. To examine the effects of ESG Score on corporate financial performance and the moderating role of Sharia compliance, this study employed panel data regression analysis. Control variables included liquidity, leverage, capital expenditure, and firm size to minimize potential bias and isolate the influence of ESG on financial performance.

The panel dataset was analyzed using an estimation approach appropriate to its characteristics, with diagnostic tests used to determine the best model, including both fixed and random-effects models. This approach was chosen to obtain efficient, consistent estimates of the relationship between ESG scores, Sharia compliance, and corporate financial performance during the study period.

2.1. Description of Research Variables

a. Dependent Variable: Financial Performance

In general, financial performance can be measured through various indicators such as Return on Assets (ROA), Return on Equity (ROE), Tobin's Q, and logarithmic stock returns

(Shan, 2019; Zhang & Lucey, 2022). In this study, company financial performance was measured using Tobin's Q. Tobin's Q was chosen as a proxy because it better reflects the market's assessment of company value, including investor expectations for the company's long-term growth prospects and performance. This ratio is calculated as the company's market value divided by the book value or replacement value of its assets.

b. Moderating Variable: Sharia Compliance

The moderating variable in this study is Sharia compliance, measured using a dummy variable. Sharia compliance is assigned a value of 1 if the company is included in the Indonesian Sharia Stock Index (ISSI) in a given observation year, and 0 if it is not. The use of the ISSI as a basis for measuring Sharia compliance is based on the selection criteria applied in the index, which include the type of business activity, financial structure, and compliance with Sharia principles established by the relevant authorities (Rusmita et al., 2023).

c. Independent Variable: ESG Score

This study measures ESG (Environmental, Social, and Governance) implementation using an ESG score, which serves as an indicator of a company's reputation for sustainable practices in these areas. The Indonesia Stock Exchange partnered with Morningstar Sustainalytics to conduct the ESG assessment. Sustainalytics evaluates ESG risks using a risk-decomposition approach, identifying companies involved in incidents that could harm stakeholders, the environment, or the company's operations. A higher ESG score indicates a greater environmental and social impact, while a lower ESG score reflects stronger ESG risk management by the company (Bisri et al., 2025).

d. Control Variables: Liquidity, Leverage, Capital Expenditure, and Firm Size

This study uses several control variables to isolate the influence of ESG and Sharia compliance on corporate financial performance including liquidity, leverage, capital expenditure, and firm size (S. Lee & Isa, 2025). Liquidity, measured by the ratio of current assets to short-term liabilities, reflects a company's ability to meet short-term obligations, which can influence perceived risk and firm value. Leverage, measured by the ratio of total debt to total assets, is included as a control variable because a company's funding structure influences financial stability and performance. Capital expenditure, measured by the Net Increase in fixed assets plus depreciation expense, captures the intensity of a company's investment in fixed assets, reflecting its growth strategy and potential for future value creation. Firm size is included because larger companies generally have greater resources to implement ESG practices. Firm size in this study is measured using the natural logarithm of total assets.

2.2. Model specification

H1: The Impact of ESG Reporting on Financial Performance.

The first model was designed to test the direct effect of ESG Score on corporate financial performance, controlling for liquidity, leverage, capital expenditures, and firm size.

$$FP_{it} = a_0 + a_1 ESGR_{it} + a_2 LIQ_{it} + a_3 LEV_{it} + a_4 CAPEX_{it} + a_5 FS_{it} + e_{it} \quad \text{.....................(1)}$$

H2: Sharia compliance strengthens the relationship between ESG reporting on financial performance.

The second model was developed by adding Sharia compliance and the interaction term between ESG Score and Sharia compliance to test whether Sharia compliance strengthens the relationship between ESG implementation and corporate financial performance.

$$FP_{it} = a_0 + a_1 ESGR_{it} + a_2 SC_{it} + a_3 ESGR_{it} * SC_{it} + a_4 LIQ_{it} + a_5 LEV_{it} + a_6 CAPEX_{it} + a_7 FS_{it} + e_{it} \quad \text{..........(2)}$$

Where a_o is a constant, while a_1 to a_7 are regression coefficients indicating the influence of each independent variable, moderating variable, interaction variable, and control variable on a company's financial performance, Firm Performance (FP) is a company's financial performance as measured by Tobin's Q. $ESGR$ is the ESG implementation score by Morningstar Sustainalytics. SC is Sharia compliance, measured by a dummy variable equal to 1 if the company is included in the Indonesian Sharia Stock Index (ISSI) in the observation year and 0 otherwise.

ESGR*SC represents the interaction variable between the ESG Score and Sharia compliance. LIQ is a liquidity variable of the company, calculated using the current ratio. LEV reflects the company's leverage level, measured as the ratio of total debt to total assets. CAPEX, or capital expenditure, is determined by the change in fixed assets plus depreciation expenses within a year. FS (firm size) is measured using the natural logarithm of total assets.

3. RESULT AND DISCUSSION

3.1. Results

Descriptive Statistics

Table1 presents descriptive statistics of the study variables. Financial performance (FP), measured by Tobin's Q, has an average value of 1.87, indicating that, on average, the market values firms above their book value, with considerable variability across firms (SD = 2.01). ESG Reporting (ESGR) records a mean score of 28.27, suggesting a moderate level of ESG score among sample firms, with noticeable dispersion (SD = 9.81). Sharia compliance (SC) has a high mean of 0.88, indicating that most firms in the sample are classified as Sharia-compliant. Liquidity (LIQ) averages 2.04, reflecting generally adequate short-term solvency, while leverage (LEV) average 0.23, with limited variability (SD = 0.177). Capital expenditure (CAPEX) shows a large variation with a mean value of around 2,230,000 and a relatively high standard deviation (4,440,000). Firm Size, in log form, averages 29.551 with a substantial range (20.672–29.334).

Table 1. Descriptive Statistics

Variables	Mean	Std. Dev	Min	Max	Observation
FP	1.87	2.01	0.54	18.24	N=232
ESGR	28.27	9.81	7.11	54.02	N=232
SC	0.88	0.31	0	1	N=232
LIQ	2.04	1.46	0.25	10.08	N=232
LEV	0.23	0.177	0.0002	0.78	N=232
CAPEX	2,230,000	4,440,000	5,823,000	36,220,000	N=232
FS	29.551	27.024	20.672	29.344	N=232

This table presents the descriptive statistics consisting of 232 firm-year observations

Source: Data Processed (2025)

Multicollinearity Test

Table 2 reports the variance inflation factor (VIF) values, The results of the multicollinearity test indicate that all independent variables in the research model have variance inflation factor (VIF) values below the commonly used critical limit of 10.

Table 2. Variance Inflation Factor

Variables	VIF	1/VIF
ESGR	1.286	0.778
SC	1.078	0.928
LIQ	1.022	0.978
LEV	1.014	0.986
CAPEX	4.341	0.230
FS	1.034	0.967
Mean VIF	1.629	

Source: Data Processed (2025)

The average VIF value of 1.629 indicates that overall, there are no serious multicollinearity issues in the regression model. The variables ESGR, Sharia compliance, liquidity, leverage, and company size each exhibit relatively low VIF values, reflecting a weak correlation between the independent variables. Although the capital expenditure (CAPEX) variable has a relatively higher VIF value than the other variables, at 4.341, this value is still within acceptable limits. Thus, the regression model used is free from multicollinearity issues, allowing for reliable interpretation of the regression coefficient estimates and not distorted by strong linear relationships between the independent variables.

Regression Analysis

Table 3 presents the regression estimation results used to test the effect of ESG reporting on financial performance, while Table 4 presents the moderated regression results after including the moderating variable of Sharia compliance. The regression test results for Model 1 show that the ESGR variable has a coefficient of -0.324 with a t-value of -3.740 and a p-value of 0.010, indicating a negative and significant effect on financial performance. The liquidity variable (LIQ) has a coefficient of -0.074 with a p-value of 0.223, thus being insignificant. The leverage variable (LEV) shows a positive coefficient of 0.981 with a t-value of 2.640 and a p-value of 0.040, indicating significance. Meanwhile, CAPEX has a coefficient of 0.032 with a p-value of 0.158, and firm size (FS) has a coefficient of -0.017 with a p-value of 0.124, neither of which is statistically significant.

In Model 2, the regression results show that ESGR has a coefficient of -0.0341 with a t-value of 1.984 and a p-value of 0.034, thus remaining significant. The Sharia Compliance (SC) variable has a coefficient of 0.284 with a p-value of 0.742, indicating insignificance. The ESG*SC interaction variable has a coefficient of -0.004 with a t-value of -0.755 and a p-value of 0.433, thus insignificant. The LIQ, LEV, CAPEX, and FS variables each have p-values of 0.236, 0.155, 0.153, and 0.136, respectively, indicating that all of these control variables are statistically insignificant in Model 2.

Table 3. Regression Results on the Impact of ESG Score on Firm Performance

Model	Variables	Coefficients	Std.Err.	t-statistics	p-value	Sig
1	(Constant)	17.341	0.779	4.341	0.000	***
	ESGR	-0.324	0.091	-3.740	0.010	***
	LIQ	-0.074	0.018	1.422	0.223	
	LEV	0.981	0.034	2.640	0.040	**
	CAPEX	0.032	0.018	1.410	0.158	
	FS	-0.017	0.015	-1.141	0.124	

*** p<.01, ** p<.05, * p<.1
Source: Data Processed (2025)

Table 4. Moderated Regression Analysis (MRA) with the Interaction Variables

Model	Variables	Coefficients	Std.Err.	t-statistics	p-value	Sig
2	(Constant)	17.732	0.215	3.136	0.000	***
	ESGR	-0.0341	0.000	1.984	0.034	***
	SC	0.284	0.015	0.344	0.742	
	ESG*SC	-0.004	0.271	-0.755	0.433	
	LIQ	-0.085	0.200	-1.186	0.236	
	LEV	0.098	0.012	1.424	0.155	
	CAPEX	0.032	0.015	1.432	0.153	
	FS	-0.031	0.035	-1.220	0.136	

*** p<.01, ** p<.05, * p<.1
Source: Data Processed (2025)

3.2. Discussion.

a. The Impact of ESG Scores on Company Financial Performance

The analysis found that the ESG score had a negative, significant effect on financial performance. This finding indicates that, in the context of this study, ESG is perceived more as a risk indicator than as a direct driver of corporate value creation. The Sustainalytics ESG score conceptually represents a company's level of risk across environmental, social, and governance factors, with lower scores indicating lower ESG risk and higher scores indicating greater ESG risk (Eccles et al., 2014). Therefore, the negative relationship found suggests that companies with more manageable ESG risks tend to achieve better market valuations and demonstrate higher financial performance.

This finding aligns with the literature suggesting that ESG activities and management can entail costs that affect a company's financial performance. Companies with high ESG scores generally face more complex environmental, social, and governance management demands, including regulatory compliance and reporting costs, as well as investments in internal control and governance systems (Choi et al., 2024; Tóth et al., 2021). These cost burdens can suppress a company's financial efficiency and flexibility, leading to a decline in company value. Stakeholders perceive this condition as increased risks and non-financial costs, negatively impacting financial performance (M. A. Khan, 2022; Sheehan et al., 2023). Companies with higher ESG scores are perceived as having greater risk complexity, both because of the characteristics of their business sectors and the breadth of ESG issues they must manage. Conversely, companies with lower ESG scores are perceived as having lower ESG risks and are therefore considered more stable and attractive from a financial performance perspective (Brighi et al., 2025; Landi et al., 2022).

The negative impact of ESG scores on financial performance in this study reflects the risk-oriented nature of the Sustainalytics assessment framework, which emphasizes a company's exposure to environmental, social, and governance (ESG) risks rather than simply the level of compliance or disclosure (Mandas et al., 2024). In emerging markets like Indonesia, companies with higher ESG scores face additional regulatory and operational costs associated with managing complex ESG obligations, which can temporarily reduce profitability (Apergis et al., 2022; Odell & Ali, 2016). Furthermore, investors may interpret higher ESG scores as an indicator of greater operational complexity and potential risk exposure, rather than a direct financial benefit. This finding contrasts with analyses from developed markets where ESG adoption is often associated with increased efficiency and improved reputation, highlighting the importance of market context in interpreting the relationship between ESG and financial performance. These insights show that while ESG investing supports long-term sustainability goals, it can negatively impact short-term financial performance, particularly in resource-constrained environments or in less mature ESG frameworks.

Furthermore, this study's results confirm that ESG's influence on financial performance depends significantly on the measurement approach used. Unlike ESG indices that emphasize compliance levels or disclosure quality, risk-based ESG scores, such as those from Sustainalytics, emphasize a company's potential vulnerability to ESG issues (Chaudhry et al., 2023; U. Khan & Liu, 2023). Therefore, the negative relationship found in this study reflects that the higher a company's inherent ESG risk, the lower the market's assessment of its financial performance.

b. Sharia compliance in moderating the relationship between ESG Score on financial performance

The study's results indicate that Sharia compliance does not moderate the relationship between ESG and corporate financial performance. The insignificant interaction coefficient between ESG and Sharia compliance indicates that a company's status as a Sharia-compliant entity neither strengthens nor weakens ESG's influence on financial performance. Although ESG and Sharia compliance both stem from ethical principles, sustainability, and social responsibility, they do not operate in a synergistic manner to influence corporate financial performance. In other words, implementing ESG in Sharia-compliant companies does not provide a higher level of financial added value than in non-Sharia-compliant companies. This finding aligns with previous research that suggests Sharia compliance does not always have a significant impact on financial performance or firm value (Alam et al., 2022; Boulanouar et al., 2024).

Furthermore, the lack of support for the moderating role of Sharia compliance may be due to the homogeneity of company characteristics, with the majority of companies included in the Sustainalytics ESG score analysis being members of a Sharia index. When the majority of companies in the sample have met minimum Sharia compliance standards, the variation in information captured by the market is limited. This condition means Sharia compliance has little effect on the relationship between ESG and financial performance.

The analysis shows that Sharia compliance does not significantly moderate the relationship between ESG scores and financial performance. This finding reflects several factors related to measurement and sample characteristics. First, Sharia compliance in this study is measured using a binary indicator based on membership in the Indonesian Sharia Stock Index (ISSI), which only captures whether a company meets minimum Sharia standards, without distinguishing the intensity or quality of compliance (Jaiyeoba et al., 2025; Jihadi et al., 2021). Second, the high prevalence of Sharia-compliant companies in the sample creates limited variability, reducing the ability to detect a moderating effect.

4. CONCLUSION

Based on the empirical analysis, this study concludes that ESG scores have a significant negative impact on the financial performance of non-financial companies listed on the Indonesia Stock Exchange. The negative impact suggests that companies with lower ESG scores tend to perform better financially, indicating that lower ESG scores correspond to lower ESG risk. Consequently, this study offers an alternative perspective to ESG literature by highlighting the importance of understanding the context in which ESG scores are assessed, particularly in emerging markets. Additionally, the study found that Sharia compliance, as measured by membership in the Indonesian Sharia Stock Index, does not moderate the relationship between ESG and financial performance.

The findings of this study provide several actionable implications for corporate managers and policymakers. First, managers should be aware that ESG initiatives, particularly when measured using a risk-based framework, can incur short-term costs and operational complexity that do not directly improve financial performance. Therefore, it is important to prioritize ESG activities that align with the company's core strategy and resource capacity to maximize sustainability impact and economic value. Second, for Sharia-compliant companies, membership in the ISSI alone may not yield additional financial benefits from ESG adoption; managers should focus on integrating ESG practices into operational and governance processes to enhance credibility and investor confidence. For policymakers, the results of this study highlight the need to provide clearer guidelines and incentives for ESG reporting and Sharia compliance, ensuring that the two frameworks complement each other and support long-term market stability.

This study has several limitations that require consideration. First, the sample size is limited to 58 non-financial companies with Morningstar Sustainalytics scores during the 2021–2024 period. Therefore, generalization of the study results to other sectors or longer time periods should be approached with caution. Second, this study uses an aggregate ESG score without separating the analysis into environmental, social, and governance pillars, thus failing to capture the specific influence of each ESG dimension on financial performance. Third, sharia compliance is measured using a dummy variable based on ISSI membership, which is binary and does not fully reflect the level or quality of a company's Sharia compliance in greater depth.

Based on these limitations, future research is recommended to expand the sample size by including the financial sector or conducting cross-country comparisons to gain a more comprehensive understanding of the relationship between ESG, Sharia compliance, and financial performance. Future research could also examine each ESG pillar separately to identify which dimensions are most relevant in influencing a company's financial performance. The insignificant moderating effect of sharia compliance may be due to methodological limitations rather than the absence of an underlying relationship, highlighting the need for alternative measures of Sharia compliance in future research.

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