

## THE IMPLEMENTATION OF ESG PRINCIPLES IN SUKUK INNOVATION: CHALLENGES AND OPPORTUNITIES

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### ABSTRAK

Meningkatnya perhatian global terhadap prinsip Environmental, Social, and Governance (ESG) telah mendorong perkembangan keuangan berkelanjutan, termasuk dalam sistem keuangan syariah. Sukuk sebagai instrumen utama pasar modal syariah memiliki potensi besar dalam mendukung pertumbuhan ekonomi yang berkelanjutan dan inklusif apabila selaras dengan prinsip ESG. Penelitian ini bertujuan untuk mengkaji penerapan prinsip ESG dalam inovasi sukuk, dengan menitikberatkan pada tantangan dan peluang yang dihadapi oleh lembaga keuangan syariah dan regulator. Penelitian ini menggunakan pendekatan kualitatif dan konseptual dengan menganalisis kesesuaian antara kerangka ESG dan prinsip dasar keuangan syariah, serta perkembangan terkini inovasi struktur sukuk seperti sukuk hijau, sukuk sosial, dan sukuk berkelanjutan. Hasil kajian menunjukkan bahwa prinsip ESG pada dasarnya sejalan dengan tujuan syariah (maqasid al-shariah). Namun demikian, terdapat sejumlah tantangan dalam implementasinya, antara lain belum adanya standar pengukuran dan pelaporan ESG yang seragam, fragmentasi regulasi, kompleksitas tata kelola syariah, serta keterbatasan pemahaman pasar. Di sisi lain, integrasi prinsip ESG dalam inovasi sukuk membuka peluang yang signifikan. Sukuk berbasis ESG berpotensi meningkatkan daya saing pasar, menarik investor yang berorientasi pada keberlanjutan, memperkuat transparansi, serta mempertegas peran keuangan syariah dalam pencapaian tujuan pembangunan berkelanjutan. Penelitian ini diharapkan dapat memberikan kontribusi terhadap pengembangan literatur keuangan syariah berkelanjutan serta menjadi rujukan bagi pengambil kebijakan dan praktisi dalam mendorong inovasi sukuk berbasis ESG

**Kata Kunci:** Sukuk; ESG; Keuangan Berkelanjutan; Keuangan Syariah; Inovasi Sukuk

### ABSTRACT

*The growing global emphasis on Environmental, Social, and Governance (ESG) principles has significantly influenced the development of sustainable finance, including within the Islamic financial system. Sukuk, as a key instrument of Islamic capital markets, holds substantial potential to support sustainable and inclusive economic growth when aligned with ESG principles. This paper examines the implementation of ESG principles in sukuk innovation, with a particular focus on the challenges and opportunities faced by Islamic financial institutions and regulators. Using a qualitative and conceptual approach, this study analyzes the compatibility between ESG frameworks and the foundational principles of*

*Islamic finance, as well as recent developments in innovative sukuk structures such as green sukuk, social sukuk, and sustainability-linked sukuk. The findings indicate that while ESG principles are largely consistent with the objectives of Shariah (maqasid al-shariah), several challenges remain. These include the lack of standardized ESG measurement and reporting, regulatory fragmentation, Shariah governance complexities, and limited market awareness. Despite these challenges, the integration of ESG principles into sukuk innovation presents significant opportunities. ESG-based sukuk can enhance market competitiveness, attract socially responsible investors, strengthen transparency, and reinforce the role of Islamic finance in achieving sustainable development goals. This paper contributes to the ongoing discourse on sustainable Islamic finance by providing insights into how ESG-oriented sukuk innovation can be effectively developed to support long-term economic sustainability and inclusive growth.*

**Keywords:** Sukuk, ESG, Sustainable Finance, Islamic Finance, Sukuk Innovation

## INTRODUCTION

Over the past few decades, sustainability issues have emerged as one of the central agendas in the global economic and financial system. The increasing risks of climate change, social inequality, and corporate governance crises have driven various stakeholders—including governments, financial institutions, and investors—to integrate sustainability principles into economic decision-making processes. One of the most widely used frameworks for assessing the sustainability of business activities is the Environmental, Social, and Governance (ESG) framework. ESG not only evaluates a company's financial performance but also considers its environmental impact, social responsibility, and the quality of corporate governance. This approach aligns with the concept of the triple bottom line, which emphasizes a balance between economic, social, and environmental aspects in sustainable development (Elkington, 1997).

The development of ESG-based investment has shown significant growth in recent years. Global investors are increasingly incorporating sustainability factors into their long-term investment strategies. This trend has encouraged financial institutions to develop various financial instruments that integrate ESG principles, including green bonds, social bonds, and other sustainable financing instruments. In this context, the Islamic finance market has also begun to adopt ESG approaches as part of its sustainable finance development strategy.

Islamic finance possesses unique characteristics that make it conceptually aligned with sustainability principles. The Islamic financial system is based on principles of justice, transparency, and social responsibility, and it prohibits speculative or socially harmful economic activities. These principles are closely related to the objectives of Islamic law (*maqasid al-shariah*), which emphasize the protection of human welfare and the sustainability of social life. Therefore, many scholars argue that the integration of ESG into Islamic finance is not merely an adaptation to global trends but rather a manifestation of ethical values that have long been embedded in the Islamic economic system (Dusuki & Abdullah, 2007).

One of the main instruments in the Islamic capital market is *sukuk*. Unlike conventional bonds, which are debt-based, *sukuk* are structured based on asset ownership or participation in real economic activities. This characteristic gives *sukuk* significant potential to support the financing of projects that generate both economic benefits and social and environmental impacts. In recent years, *sukuk* innovation has grown rapidly with the emergence of various sustainability-oriented instruments, such as green *sukuk*, social *sukuk*, and sustainability *sukuk*. These instruments are designed to finance projects that support sustainable development, including renewable energy, environmentally friendly infrastructure, and community empowerment programs (Takengon & Soemitra, 2025).

Indonesia is one of the countries playing a significant role in the global development of sustainability-based *sukuk*. The Indonesian government has been a pioneer in issuing green *sukuk* to finance various sustainable development projects, including clean energy and environmentally friendly infrastructure. This initiative demonstrates that the integration of ESG principles into the Islamic financial market has substantial potential to support the achievement of the Sustainable Development Goals (SDGs). Furthermore, the growing interest of global investors in sustainable investment presents broad opportunities for the development of ESG-based *sukuk* in international financial markets (Dewi et al., 2025).

However, the integration of ESG into *sukuk* innovation still faces several significant challenges. One of the main challenges is the absence of global standards that specifically integrate ESG frameworks with sharia principles. Although various international institutions have developed ESG standards, most of these standards

do not fully accommodate the unique characteristics of Islamic financial instruments. In addition, regulatory fragmentation across jurisdictions and the complexity of sukuk structures may hinder the development of financial instruments that combine ESG principles with sharia compliance (Judijanto et al., 2025).

Beyond regulatory and standardization issues, challenges also arise from market understanding. Many investors and financial industry players still have limited knowledge of ESG-based sukuk and the added value they offer. This limitation may impede the development of the sustainable sukuk market, particularly in countries where Islamic financial systems are still in the early stages of development. Therefore, more comprehensive academic studies are needed to explore how ESG principles can be effectively integrated into sukuk innovation.

On the other hand, the integration of ESG into sukuk also presents various strategic opportunities for the development of Islamic finance. ESG-based sukuk have the potential to attract global investors who increasingly consider sustainability aspects in their investment decisions. Moreover, the application of ESG principles in sukuk can enhance transparency, accountability, and the social impact of financed projects. Thus, ESG-based sukuk innovation can not only strengthen the competitiveness of the Islamic financial market but also reinforce the role of Islamic finance in supporting sustainable development (Bahauddin et al., 2025).

Although the literature on ESG and Islamic finance continues to grow, most studies still focus on the conceptual relationship between ESG and maqasid al-shariah or on sustainable finance policies in general. Studies that specifically examine the integration of ESG principles into sukuk structural innovation remain relatively limited, particularly those that systematically connect conceptual and practical aspects.

Therefore, this study aims to analyze the application of ESG principles in sukuk innovation by focusing on the identification of conceptual alignment, the development of instruments, and the challenges and opportunities in their implementation. This research also seeks to propose a conceptual framework

linking ESG, maqasid al-shariah, and sustainable sukuk innovation as a contribution to the development of Islamic finance literature.

This study is expected to provide both academic and practical contributions, particularly in advancing the literature on sustainable Islamic finance and serving as a reference for regulators and practitioners in designing more effective ESG-based sukuk instruments. Furthermore, this research aims to fill a gap in the literature by providing a cross-country comparative analysis of ESG implementation in sukuk and proposing an integrative conceptual framework based on maqasid al-shariah.

Research on the integration of ESG into Islamic finance has grown significantly in recent years. Judijanto, Prasetyo, and Nugroho (2025) demonstrate that the integration of ESG into Islamic finance can enhance financial system stability while strengthening responsible investment practices.

In addition, Siregar (2025) emphasizes that Islamic accounting plays a crucial role in supporting transparency and accountability in the implementation of ESG within Islamic financial institutions. ESG reporting transparency is a key factor in increasing investor confidence in sustainable financial instruments.

Another study by Bahauddin, Khan, and Rahman (2025) shows that ESG integration in the Islamic banking sector can improve the sustainability performance of financial institutions. The study also highlights that Islamic finance has significant potential to support the transition toward a green economy.

In the context of sukuk, Rahmade and Surklik (2025) find that sharia compliance is a critical factor in the development of sustainable investment. The integration of ESG standards with sharia principles can enhance the credibility of Islamic financial instruments in global markets.

Nevertheless, most previous studies have primarily focused on conceptual or policy aspects. Research that specifically examines ESG integration within sukuk structural innovation remains relatively limited. Therefore, this study seeks to fill this gap by comprehensively examining the challenges and opportunities in implementing ESG principles in sukuk innovation.

The conceptual framework of this study is based on the integration of three main concepts: ESG principles, maqasid al-shariah, and sukuk innovation within the Islamic financial system.

ESG principles consist of three main dimensions: environmental, social, and governance. These dimensions serve as key indicators in assessing the sustainability of economic activities. In the context of Islamic finance, these values are aligned with the concept of maqasid al-shariah, which aims to preserve human welfare.

The environmental dimension of ESG relates to the protection of natural resources and sustainable environmental management. This aligns with the Islamic concept of human responsibility as stewards (khalifah) of the Earth. The social dimension is associated with social welfare, social justice, and the protection of vulnerable groups, all of which are integral to the objectives of sharia. Meanwhile, the governance dimension is concerned with transparency, accountability, and integrity in organizational management, which are also fundamental principles in Islamic financial practices.

The integration of ESG and maqasid al-shariah subsequently drives innovation in Islamic financial instruments, particularly sukuk. This innovation is reflected in various forms of sustainable sukuk, such as:

- Green sukuk for financing environmentally friendly projects
- Social sukuk for financing social programs
- Sustainability sukuk that integrate both environmental and social aspects

Through this integration, sukuk functions not only as a financing instrument but also as a mechanism to support sustainable development.

ESG principles serve as a primary driver of sustainable finance development. The environmental, social, and governance dimensions are key indicators in evaluating the sustainability of financial instruments.

Maqasid al-shariah functions as a normative framework that ensures financial innovation remains aligned with Islamic values. This concept emphasizes the protection of human welfare and the sustainability of social life.

The integration of ESG and maqasid al-shariah encourages innovation in sukuk structures, including the development of sustainability-based sukuk such as green sukuk, social sukuk, and sustainability sukuk.

Conceptually, the relationship among these three components can be illustrated as follows:



This model demonstrates that the integration of ESG and sharia values can drive sukuk innovation that contributes to sustainable development.

Although numerous studies have examined the relationship between ESG and Islamic finance, most remain descriptive and focus on normative alignment. These studies have not thoroughly explored how ESG principles can be operationally integrated into sukuk structural innovation. Furthermore, there is still a lack of a conceptual framework that systematically links ESG, maqasid al-shariah, and sukuk development. Therefore, this study not only examines conceptual alignment but also emphasizes innovation and implementation aspects within the context of ESG-based sukuk.

## **METHOD**

This study employs a qualitative approach using a conceptual review method and literature analysis to explore the integration of ESG principles in sukuk innovation within the Islamic financial system. The data used are secondary data obtained from academic journal articles, financial institution reports, and policy documents relevant to ESG, Islamic finance, and sustainable finance.

The analysis is conducted using a thematic approach, which involves identifying, categorizing, and interpreting key themes emerging from the literature, particularly related to: (1) the alignment between ESG principles and maqasid al-shariah, (2) the development of ESG-based sukuk innovation, and (3) the challenges and opportunities in its implementation.

The literature sources are selected based on their relevance, recency, and academic credibility to ensure the validity of the analysis. Through this approach, the study aims to develop a comprehensive conceptual understanding and to formulate an analytical framework regarding the integration of ESG in sukuk innovation

## **DISCUSSION**

### **Alignment between ESG and Maqasid al-Shariah**

The findings indicate a strong alignment between ESG principles and maqasid al-shariah. Both frameworks emphasize the importance of ethical responsibility, social justice, and sustainability in economic activities. The environmental dimension of ESG aligns with the Islamic concept of khalifah, which highlights human responsibility in preserving the environment.

The social dimension reflects principles of justice and societal welfare, while the governance dimension corresponds to values of transparency, accountability, and integrity in Islamic finance. Therefore, the integration of ESG into Islamic finance is not merely an adoption of external concepts but rather a reinforcement of the fundamental values embedded in the Islamic economic system.

This integration demonstrates that Islamic finance has significant potential to become part of the global sustainable financial system. By adopting the ESG framework, Islamic financial institutions can enhance transparency, accountability, and the social impact of their financing activities.

### **ESG-Based Sukuk Innovation**

The development of ESG-based sukuk reflects a transformation in the role of Islamic finance toward a more sustainability-oriented system. Instruments such as green sukuk, social sukuk, and sustainability sukuk illustrate how financial innovation can simultaneously integrate economic, social, and environmental dimensions.

Indonesia's experience in issuing green sukuk demonstrates that ESG integration is not merely conceptual but also practically implementable. These instruments are capable of attracting global investors while supporting the financing of sustainable

projects, thereby enhancing the credibility of Islamic finance at the international level.

Furthermore, ESG-based sukuk innovation can broaden the investor base by appealing to sustainability-oriented investors. This indicates that Islamic finance is not only relevant to Muslim communities but also has the potential to become part of a more inclusive and sustainable global financial system.

As a key instrument in the Islamic capital market, sukuk holds substantial potential to support sustainable development financing. In recent years, sukuk innovation has increasingly incorporated ESG principles into financing structures. Several forms of sustainability-based sukuk innovation include:

### **1. Green Sukuk**

Green sukuk are sharia-compliant investment instruments issued to finance environmentally friendly projects, particularly in renewable and clean energy, as well as natural resource preservation. These instruments serve as a strategic tool to support sustainable economic development while meeting both environmental and sharia compliance standards (Karina, 2019).

Green sukuk are used to finance projects with positive environmental impacts, such as renewable energy, sustainable transportation, and waste management (Takengon & Soemitra, 2025). Their development demonstrates that sustainability principles can be embedded within sukuk structures without compromising sharia compliance.

Indonesia's experience shows that green sukuk not only attract global investors but also effectively support energy transition and sustainable development agendas. According to a 2025 report by the Institute for Development of Economics and Finance (INDEF), Indonesia's green sukuk issuance between 2019 and 2024 has shown a positive trend in both domestic and international markets.

In the domestic retail market, issuance grew significantly, reaching IDR 10 trillion in 2022 before stabilizing at around IDR 4–5 trillion in 2023–2024. In the global market, issuance remained relatively stable, ranging from USD 750 million to USD 1.5 billion, with a peak in 2022. The proportion of green investors increased from 29% in 2019 to 57% in 2021, before stabilizing at around 36–41%. Domestic investor participation also rose sharply, reaching approximately 35,000 investors in

2022 before declining to around 13,000–21,000 between 2022 and 2024. Overall, green sukuk have proven to be strategic in attracting investors while supporting energy transition initiatives.

## **2. Social Sukuk**

Social sukuk are sharia-based investment instruments aimed at financing social projects such as affordable housing, education, and healthcare. These instruments align with ESG principles and maqasid al-shariah by linking investor capital with positive social impact.

Social sukuk focus on improving societal welfare through projects such as healthcare facilities, education, and community empowerment programs. They combine financial returns with measurable social benefits, including innovative instruments such as Cash Waqf Linked Sukuk (CWLS).

CWLS represents a unique innovation that integrates Islamic endowment (waqf) with sovereign financing instruments. Under this scheme, funds from donors (wakif) are channeled through Islamic financial institutions and managed by nazhir in the form of sovereign sukuk (SBSN-CWLS). The principal remains preserved, while returns are allocated to social projects in education, healthcare, and community development.

## **3. Sustainability Sukuk**

Sustainability sukuk combine both environmental and social aspects within a single financing instrument. These instruments are designed to support projects that generate positive impacts across economic, social, and environmental dimensions.

Sustainability sukuk represent thematic Islamic bonds used specifically to finance environmentally and socially responsible projects in line with ESG principles. In Indonesia, examples include sustainability sukuk issued by Islamic banks and sovereign green sukuk issued by the government, where financing allocation is based on environmentally sustainable business activities (KUBL) and socially sustainable business activities (KUBS).

These innovations demonstrate that sukuk can function as strategic instruments for supporting sustainable development while strengthening the position of Islamic finance within the global financial system.

Overall, ESG principles show strong alignment with the foundational values of Islamic finance, particularly *maqasid al-shariah*. Economic activities in Islam aim not only at financial gain but also at achieving social welfare and environmental balance. Thus, ESG integration represents a reinforcement of long-standing ethical principles within Islamic economics.

The environmental dimension aligns with the concept of *khalifah*, emphasizing environmental stewardship. The social dimension reflects social justice and equitable wealth distribution, where instruments such as social *sukuk* play a crucial role. Meanwhile, the governance dimension emphasizes transparency, accountability, and integrity—core principles in Islamic financial institutions.

Therefore, ESG integration enhances the ethical and social legitimacy of Islamic finance while increasing its relevance in addressing sustainable development challenges.

The integration of ESG into *sukuk* innovation also has several key implications:

First, it enhances the attractiveness of the *sukuk* market to global investors who increasingly prioritize sustainability, thereby expanding the investor base and improving market liquidity.

Second, it strengthens governance in Islamic financial institutions, particularly in transparency, accountability, and sustainability reporting, which are essential for building investor trust.

Third, ESG-based *sukuk* can serve as strategic instruments for financing sustainable development, including achieving the Sustainable Development Goals (SDGs), thereby enabling Islamic finance to play a more significant role in inclusive and sustainable economic development.

### **Cross-Country Comparison of ESG Sukuk Development**

The development of ESG-based *sukuk* varies significantly across countries, depending on the maturity of Islamic financial markets, regulatory support, and national sustainability strategies. There is no single model for ESG *sukuk* development; instead, approaches tend to be contextual and adaptive to each country's conditions.

Globally, the sukuk market continues to grow significantly, with total issuance reaching approximately USD 180 billion in 2024. Major contributors include Malaysia, Saudi Arabia, and Indonesia. In the ESG segment, global ESG sukuk issuance reached around USD 15.2 billion in 2024, representing a 14% increase from the previous year.

However, ESG sukuk still account for a relatively small share—approximately 1.8%—of total global ESG bond issuance. This indicates that despite its strong potential, ESG sukuk development remains at an early stage.

Research by Alam et al. (2025) shows that Malaysia adopts a market-driven approach supported by strong regulatory frameworks, particularly in encouraging private sector participation in green sukuk issuance. In contrast, Indonesia employs a sovereign-driven approach, where government-issued green sukuk act as a catalyst for market development and global investor attraction.

These findings are supported by Rahman and Sulaiman (2024), who highlight that Indonesia emphasizes impact-oriented financing, particularly for projects related to carbon emission reduction and sustainable development. Meanwhile, Malaysia focuses on strengthening regulatory frameworks and financial innovation through private sector engagement.

A cross-country study by Ahmed et al. (2023) further indicates that the role of sukuk within ESG frameworks varies across jurisdictions such as Saudi Arabia, the United Arab Emirates, Turkey, Malaysia, and Indonesia. These differences are influenced by institutional quality, financial market structures, and national policy priorities.

Moreover, Hassan et al. (2024), in a comparative study of Indonesia, the UAE, and Morocco, find that sukuk function not only as financing instruments but also as public policy tools tailored to national development needs. Indonesia stands out in utilizing sukuk for environmental financing, while other countries tend to focus more on infrastructure development and economic stability.

Based on these comparisons, it can be concluded that ESG integration in sukuk is not homogeneous but is highly influenced by institutional contexts and national development strategies. This highlights the importance of developing

conceptual frameworks that are not only normative but also adaptive to both global and local dynamics.

Despite the alignment between ESG principles and maqasid al-shariah, several studies identify a gap between conceptual frameworks and practical implementation. In some cases, ESG sukuk tend to be label-driven without comprehensive impact measurement. This phenomenon may lead to the risk of “ESG-washing,” where financial instruments are categorized as sustainable without delivering significant real-world environmental or social impact (Ahmed et al., 2023).

**Table 1 : Cross-Country Comparisons**

Country	Strength	ESG Focus	Shariah Integration	Key Challenge
Indonesia	Pioneer green sukuk	Environmental + social impact	Strong (maqasid-linked)	Market depth
Malaysia	Global sukuk hub	Governance & standardization	Moderate	ESG differentiation
Saudi Arabia (GCC)	Large issuance volume	Financial expansion	Limited explicit maqasid	ESG integration depth
Global (OIC)	Growing market	Mixed	Fragmented	Lack of unified framework

Cross-country comparisons indicate that not all countries integrate ESG into sukuk using the same approach. Indonesia tends to adopt an impact-oriented approach, Malaysia emphasizes standardization and regulatory strengthening, while GCC countries focus more on market expansion and issuance volume. These differences suggest that ESG integration in sukuk is influenced not only by sharia principles but also by institutional contexts and each country’s economic strategy.

### **Implementation Challenges**

Despite its significant potential, the integration of ESG into sukuk innovation faces several complex challenges.

The first challenge relates to the standardization and harmonization of ESG frameworks with sharia principles. Although various international institutions have developed ESG standards, most are designed for conventional financial systems and do not fully accommodate the unique characteristics of Islamic finance.

The second challenge concerns regulatory fragmentation across jurisdictions. Each country adopts different regulatory approaches to sustainable financial instruments, including sukuk. These differences may create uncertainty for investors and hinder the global development of ESG-based sukuk markets.

The third challenge involves the complexity of sukuk structures and sharia governance. The issuance process involves multiple stakeholders, including sharia supervisory boards, financial institutions, and regulators. Integrating ESG into sukuk structures may further increase complexity in the design and implementation process.

Additionally, there are challenges related to limited market understanding. Many investors and financial industry participants still lack a comprehensive understanding of ESG concepts within the context of Islamic finance, which may affect demand for ESG-based sukuk instruments.

### **Development Opportunities**

On the other hand, ESG integration in sukuk presents significant strategic opportunities. The growing global demand for sustainable investment creates space for ESG-based sukuk to attract a broader range of investors, including non-Muslim investors.

Moreover, ESG implementation can enhance transparency and accountability, ultimately strengthening investor confidence. ESG-based sukuk also hold strong potential to support sustainable development financing, particularly in achieving the Sustainable Development Goals (SDGs), especially in developing countries facing financing constraints.

Another opportunity lies in the contribution of ESG-based sukuk to SDG achievement. Many developing countries face limitations in financing sustainable development projects. In this context, sukuk can serve as an effective financing instrument for supporting sustainable infrastructure, renewable energy, and social development programs.

Furthermore, ESG integration can improve transparency and accountability within the Islamic financial system. More comprehensive ESG reporting can enhance investor confidence and strengthen the global reputation of Islamic financial institutions.

### **Strategic Implications**

Several strategic implications emerge for Islamic financial institutions in developing ESG-based sukuk.

First, Islamic financial institutions need to develop governance frameworks that integrate ESG principles with sharia standards. This is essential to ensure that sukuk innovation remains compliant with Islamic principles while meeting global sustainability standards.

Second, regulators need to promote the development of ESG reporting standards integrated with Islamic finance. Such standards can enhance transparency and facilitate investors in assessing the sustainability impact of sukuk instruments.

Third, improving market literacy regarding ESG-based sukuk is crucial. Educating investors, financial institutions, and the broader public can enhance understanding of the benefits and potential of these instruments in supporting sustainable development.

With the right strategies, ESG-based sukuk can become a key instrument in strengthening the role of Islamic finance in the global financial system while supporting inclusive and sustainable economic development.

### **Policy Recommendations**

Based on the findings of this study, several policy recommendations can be proposed to support the development of ESG-based sukuk:

#### **Development of ESG Standards Integrated with Sharia Principles**

Regulators and international standard-setting bodies should develop frameworks that integrate ESG principles with Islamic finance principles, providing clear guidance for designing sustainable sukuk instruments.

#### **Regulatory Harmonization of Sustainable Sukuk Markets**

Differences in regulatory frameworks across jurisdictions can hinder market development. Therefore, harmonization efforts through cooperation between national regulators and international institutions are essential.

### **Strengthening Governance and ESG Transparency**

Islamic financial institutions need to enhance transparent and accountable governance practices in implementing ESG principles. Comprehensive sustainability reporting can increase investor confidence.

### **Enhancing Market Literacy and Education**

Improving literacy on ESG-based sukuk is crucial to expand investor understanding and participation. Educational programs and awareness campaigns can help boost demand for sustainable financial instruments.

### **Support for Sustainable Financial Innovation**

Governments and regulators should encourage innovation in sustainability-oriented Islamic financial instruments. Policy incentives, such as tax incentives or regulatory support, can accelerate the growth of the ESG sukuk market.

This study contributes theoretically by developing a conceptual framework that integrates ESG principles with maqasid al-shariah in the context of sukuk innovation. Unlike previous studies that tend to be descriptive, this research emphasizes a cross-country comparative approach and identifies variations in ESG sukuk implementation based on institutional contexts. Therefore, this study not only strengthens the conceptual linkage between ESG and Islamic finance but also provides new insights into how such integration is implemented differently across jurisdictions

## **CONCLUSION**

This study analyzes the application of Environmental, Social, and Governance (ESG) principles in sukuk innovation within the framework of Islamic finance. The findings indicate that ESG principles are strongly aligned with maqasid al-shariah, particularly in terms of environmental sustainability, social justice, and good governance. This confirms that the integration of ESG into Islamic finance is not merely an adaptation to global trends, but rather a reinforcement of the fundamental values embedded in Islamic economics.

Furthermore, ESG-based sukuk innovations—such as green sukuk, social sukuk, and sustainability sukuk—demonstrate significant potential as instruments for financing sustainable development. These instruments not only support projects

with social and environmental impacts but also enhance the attractiveness of Islamic financial markets at the global level.

However, the implementation of ESG in sukuk innovation still faces several challenges, including the absence of integrated standards between ESG and sharia principles, regulatory fragmentation, the complexity of sukuk structures, and limited market literacy. These challenges highlight the need to strengthen institutional and regulatory frameworks to support the development of ESG-based sukuk.

On the other hand, the growing global demand for sustainable investment presents strategic opportunities for the development of ESG-based sukuk. ESG integration has the potential to broaden the investor base, improve transparency, and strengthen the role of Islamic finance in achieving sustainable development goals.

This study contributes by proposing a conceptual framework that links ESG principles, maqasid al-shariah, and sukuk innovation as a foundation for sustainable Islamic finance development. Practically, these findings may serve as a reference for regulators and financial institutions in designing policies and strategies for ESG-based sukuk development.

Future research is recommended to adopt empirical approaches to quantitatively examine ESG implementation in sukuk and to explore more operational models for integrating ESG and sharia principles in financial market practices.

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