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The role of financial slack in moderating the effect of ESG on firm performance in sharia & non-sharia companies

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Abstract

This study aims to examine the effect of ESG on company performance and the role of financial slack in moderating the relationship between ESG and company performance in 9 countries with the highest Islamic financial assets. A total sample of 686 companies was analyzed using panel data and processed with STATA as the analytical tool. The results show that ESG has a significant effect on company performance as measured by ROE. However, financial slack does not play a moderating role in the relationship between ESG and company performance. This study focuses only on companies in the 9 countries with the highest Islamic financial assets, considering that Islamic principles may serve as a foundation for ESG practices to improve company performance. Sharia compliance, measured using a dummy variable, is included as a control variable to observe its effect on company performance.

Keywords: ESG, Firm performance, Financial slack, Shariah compliance, Sustainability

INTRODUCTION

The current development of the business world no longer focuses solely on profit as the main goal, but also places increasing emphasis on environmental, social, and governance (ESG) issues. Companies are expected to pay attention to environmental concerns, such as the impact of their operations on the environment, as a form of corporate responsibility (Triyani et al., 2020). Investors today are increasingly interested in investing in companies that disclose non-financial information to assess performance and risk profiles, especially those demonstrating strong environmental awareness (Bax et al., 2024). Companies with positive ESG behavior tend to be more valued by shareholders, while there are no penalties for poor ESG performance (Nyakurukwa & Seetharam, 2023). Therefore, socially conscious investors are more likely to favor companies with good ESG practices.

Basically, financial reports have not fully added to the information needs of report users to assess company performance. This is because in general, financial statements only contain partial information on operations and still exclude the consequences of a company's existence on the environment (Aboud & Diab, 2018). Companies that consider additional sustainable reports including environmental, social and governance aspects will help create better corporate value. The environmental aspect relates to how a company manages the surrounding environment. The social aspect will examine how to establish relationships with employees, suppliers, consumers, and communities where the company operates. Governance aspects include leadership within the company, executive pay, audit and control, and shareholder rights (D. S. P. Lee, 2019).

The problem occurs when not all companies do ESG reporting as expected while ESG provides positive financial benefits for companies and stabilizes capital markets in the long run (Chininga et al., 2024). Quoted from the report Sustainability Counts II: State of Sustainability Report in Asia Pacific developed by PwC Singapore and the Center for Governance and Sustainability (CGS) National University of Singapore (NUS) states that more than 10,000 companies in the world have used the Global Reporting Initiative (GRI) as their sustainability report standard. However, only 75%

of companies in 2021 and increasing to 81% of companies in 2022 have disclosed their GRI standards. The survey was conducted among the top 50 listed companies across 14 jurisdictions in Asia Pacific, including Australia, China, Hong Kong, India, Indonesia, Japan, South Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan, Thailand and Vietnam. Of these 14 countries, only 1 country has succeeded in disclosing 100% of the GRI standards, namely South Korea. Apart from South Korea, there is still a level of GRI disclosure below 100% with the 3 lowest countries in disclosing GRI standards below 80%, namely China at 76% of companies, Vietnam at 50% of companies, and New Zealand at only 44% of companies. The rest are above 80% but less than 100%, namely Australia, Hong Kong, India, Indonesia, Japan, Malaysia, Philippines, Singapore, Taiwan, and Thailand. Following their GRI disclosure levels, the disclosure levels of ESG factors in New Zealand and Vietnam are also still below 80% in 2022. From the survey data, in reality ESG is still not a non-financial aspect that is maximally applied in every company. The lack of ESG implementation can be caused by several obstacles. First, companies need additional funding and resources (Nareswari et al., 2023). Second, ESG measurement standards are unclear, making it difficult for investors to evaluate the program (Nareswari et al., 2023). Third, ESG is difficult to prioritize because not all stakeholders react positively to the program and there are still some management in the company who focus on the short term (Nareswari et al., 2023).

The lack of ESG implementation in companies can also be due to the weak religious approach taken, especially in companies that adhere to Islamic sharia. As we know, Islam is a religion that has guidelines in carrying out every activity. Islam teaches every human being not to take actions that can have a negative impact on others (Wardiwiyono, 2022). Such as the prohibition of doing wrong and obeying the rules in running a business which has been applied and taught during the time of the Rasulullah SAW (Wardiwiyono, 2022). Every human behavior is based on religion, and this is what should be applied in running a business. The goodness of a company in implementing sharia compliance will be a measure of the health of a company (Sudarni & Puspitasari, 2023). This teaching principle can be applied to a company so that the implementation of ESG practices is expected to increase. Increasing ESG ratings can increase attractiveness in the eyes of stakeholders (Chininga et al., 2024).

A religious approach to the issue of social sustainability has also been taken in research related to the practice of Corporate Social Responsibility (CSR). This research revealed that the philosophical basis of why CSR is needed is the reason why CSR is weakly implemented. Thus, CSR needs to be maximized with a religious approach that is a source of ethical and moral teachings (Wardiwiyono, 2022). The similarity between CSR and ESG, lies in the form of corporate treatment in showing concern for the impact of business activities centered on environmental preservation and social services for the community (Xaviera & Rahman, 2023).

There have been many studies conducted related to ESG but there are still few that relate it to Islamic companies concepts. Instead, more research has only linked ESG practices to company performance in general, without filtering whether the company concept is sharia or not (Choi et al., 2024); (Chininga et al., 2024); (Nareswari et al., 2023); (Chawarura et al., 2025); (Bamel et al., 2025); (Handoyo & Anas, 2024). One of the most recent studies related to ESG with sharia that we found is research by S. P. Lee & Isa (2020). This study examines ESG in sharia companies and its impact on company performance. The results show that sharia-compliant companies with good ESG practices can improve their performance. However, this study only focuses on sharia companies, whereas our study will also consider non-sharia companies. This is demonstrated by the addition of a control variable, namely sharia compliance, measured using a dummy variable. A value of 1 represents sharia-compliant companies, and 0 represents non-sharia-compliant companies. Thus, the study will examine the impact of a company's sharia and non-sharia status on the relationship between ESG and company performance.

Most studies still focus on the influence of ESG on company performance directly and rarely use other factors, in this case financial slack, which can affect the relationship between the two. Therefore, financial slack will act as a moderating factor in the relationship between ESG and firm performance. Financial slack refers to the availability of corporate financial resources that are not optimally used for a project, investment, or other activities. The existence of financial slack can provide additional funds for companies to invest in ESG, which in turn improves company performance (Duque-Grisales & Aguilera-Caracuel, 2021). In general, this study will contribute to adding literature and further understanding of the effect of ESG on firm performance moderated by financial slack in sharia and non-sharia companies. This research is different from previous studies. In this study, sharia compliance will be a control variable shown in two types of companies, both sharia and non-sharia companies. The existence of Sharia compliance as a control variable will be a novelty in this study. The use of data between 2014-2024 will also be a broader data coverage than previous studies. The selection of countries by taking countries that have the highest Islamic financial assets as the object of research is also a differentiator in this study.

The study aims to reveal whether ESG can improve company performance in the presence of financial slack as a moderating relationship between the two in sharia and non-sharia companies. Hopefully, this study can contribute and provide empirical evidence that Islamic companies also have good ESG practices that improve company performance plus the presence of financial slack that will strengthen the relationship between ESG and company performance.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Literature Review

Agency Theory

Jensen & Meckling (1976) describe agency theory as the relationship between the owner and his agent. The agent will act as a party who carries out the responsibilities that have been given in order to achieve a goal. It is not uncommon for both parties to have different interests and try to have their own benefits. Like managers who carry out ESG activities to gain their personal benefits (S. P. Lee & Isa, 2020). Managers will easily obtain more information, so they tend to prioritize their personal interests over the main objectives that have been set, in this case maximizing shareholder wealth (Adeneye & Kammoun, 2022). From this point of view, the existence of ESG activities can be considered as a waste of company resources, thereby reducing company performance (S. P. Lee & Isa, 2020). Managers will pursue and prioritize their own projects rather than pay attention to shareholder wealth (Azeem et al., 2023). Basically, the implementation of ESG at the corporate level requires additional funding and resources (Nareswari et al., 2023). When this happens, the company's performance will decline due to the use of company assets to finance these activities. The negative relationship of ESG to firm performance is also described in the research of (Nareswari et al., 2023); (Khandelwal et al., 2023).

Stakeholders Theory

Stakeholders define as any group or individual who can affect or be affected by the achievement of corporate goals (Freeman et al., 2010). In running its business, a company manager has a responsibility to all shareholders and other stakeholders (D. S. P. Lee, 2019). Stakeholders will have a positive view of the company if they are as attentive as possible to the stakeholders so that a good relationship will be created between the two. ESG activities can be one way to build these relationships. This is because ESG has a main focus on improving and fostering healthy relationships with stakeholders that will also improve the economic sustainability of the company (Lin, 2024). For this reason, support from stakeholders is necessary for the survival of the company in order to improve company performance. The positive relationship between ESG and company performance can be seen from the results of the study belonging to (Triyani et al., 2020); (S. P. Lee & Isa, 2020); (Xie et al., 2019).

Environmental, Social and Governance (ESG)

Environmental, Social and Governance (ESG) covers three main aspects, namely environmental, social and governance, which is one of the frameworks in evaluating corporate performance and responsibility. Environmental refers to the company's concern in handling environmental issues. The social aspect looks at how the company treats its employees, suppliers, customers and society at large. While the governance aspect focuses on how the company is managed and controlled.

ESG disclosure is also utilized by some companies as a strategy to obtain regulatory leeway from the authorities regarding their investment portfolio (Lubis & Rokhim, 2021). Although ESG provides several benefits, it is different when there is poor ESG disclosure. This will pose a threat because of the concept of green and sustainable development that must be carried out, which this concept can reduce the company's margins (Senadheera et al., 2021). So considerable attention is paid to environmental aspects to reduce bad environmental issues that will risk the company's long-term financial well-being and survival.

Firm Performance

Firm performance is the result of the company's achievement in carrying out its business activities in order to achieve predetermined goals. The performance of an organization is described as a combination of four main dimensions, namely profitability, liquidity, growth, and stock market performance (Hamann & Schiemann, 2021). Achieving company performance involves a manager's ability to increase company value. Reliable managers will contribute positively to firm performance even in financially weak firms and legal systems (Inam Bhutta et al., 2021). A positive increase in performance is clearly beneficial to the company, so that many investors will also be interested in the company.

Financial Slack

Bourgeois (1981) directs Slack as a resource belonging to the organization that allows it to adapt to significant changes in the external environment with little impact as well as to try new approaches either through new products or innovation. In addition, financial slack can be considered a form of liquidity that can be quickly used to support company initiatives, especially during an economic crisis (Chan et al., 2023). Thus, the role of financial slack in a company can provide its own advantages.

ESG can be one of the implications of financial slack in companies as a new approach to improving company performance. Through ESG, investors' attention to companies will increase. This is because, in selecting securities, investors also pay attention to ESG performance as part of their awareness of the importance of environmental friendliness for the survival of companies (Qin, 2023). This increased investment will improve company performance.

Sharia Company and Non- Sharia Company

Sharia companies are companies that in carrying out their activities comply with Islamic sharia. Sharia companies prohibit transactions that are contrary to Islamic values, such as usury (interest), alcohol, gambling, and certain entertainment industries. The culture of sharia compliance will incorporate sharia principles and values into the organization, so that the organization will ensure that all transactions are carried out in accordance with the principles and standards of sharia law (Supian & Nan, 2024).

In contrast, non-sharia companies are more general and conventional, so that in running the company, they are not guided by Islamic religious sharia. They will find it easier to conduct any business without considering the prohibitions set forth in sharia.

ESG and Sharia Compliance

Islam is one of the religions that has prohibitions and rules that must be obeyed for each of its followers. These rules also apply to business people who run businesses. Business must be carried out based on existing Islamic law, in this case it is said to be sharia compliance. Sharia compliance is a rule based on Islamic law for the company (organization) with other parties. In this study, sharia companies refer to companies that have sharia compliance in running their business. The Islamic Finance Development Report 2024 shows that the total assets of Islamic finance in 2023 amounted to US$ 4.9 trillion. This data shows that the Islamic finance market has high growth. However, there is still little research on sharia-compliant companies on ESG. Only the research by S. P. Lee & Isa (2020) discusses ESG practices in Sharia companies that we found.

The concept of ESG is not much different from the concept of sharia compliance. ESG and sharia compliance both provide an understanding that companies in running their business must pay attention to all parties concerned, both environmentally, socially, and governance. It is strictly forbidden to do actions that are detrimental or negative to Islamic sharia. Similarly, in companies that implement ESG, that negative impact or damage becomes a point that must be resolved and avoided so as not to reduce the value of the company in the eyes of the community and other stakeholders. For this reason, it is expected that companies that comply with sharia will have an influence on the application of better ESG so as to improve company performance.

The concept of Sharia compliance will enrich the theoretical understanding of the relationship between ESG and corporate performance from an Islamic perspective. The presence of Sharia compliance provides an expansion of theory into the context of religion-based governance. This offers a deeper understanding of the Sharia concept, exploring whether Sharia-based companies will have a different impact on ESG practices that can influence corporate performance.

Hypothesis Development

The Effect of ESG on Company Performance

ESG is an issue that many business people pay attention to in order to maintain the company's survival. ESG refers to a framework used to assess company performance covering environmental, social, and corporate governance aspects. The implementation of ESG in the company can increase consumer loyalty, investor confidence, increase access to financing and create a positive social reputation (Choi et al., 2024). The implementation of good ESG practices can also improve company performance (S. P. Lee & Isa, 2020). The company's performance will be the focus of investment strategies that are responsible for estimating the returns earned by investors. In this study, company performance will be shown as the company's financial performance.

The improvement in company performance cannot be separated from the support of stakeholders. Therefore, companies must pay attention to the needs of stakeholders as they should. In line with stakeholder theory, ESG has become one of the strategies in meeting stakeholder needs. The existence of ESG will improve the company's image as well as operational efficiency, which in turn will improve service quality and sales (Wang, 2024). This increase in sales can serve as an indicator of improved company performance, which will benefit stakeholders. However, the situation is different when considering agency theory. In this theory, ESG can lead to conflicts of interest between owners and their agents. Owners may view ESG practices as detrimental, perceiving them as a waste of company resources. Meanwhile, agents referring to managers, may engage in ESG for their own personal gain.

The results of previous studies show a positive relationship between ESG and company performance. Research conducted by Triyani et al. (2020) shows that ESG has a positive effect on company performance. The better the quality of ESG will improve company performance as measured by ROE. Further research, owned by S. P. Lee & Isa (2020) which connects ESG to the financial performance of Islamic companies shows that the aggregate ESG and its individual dimensions are positively related to company performance, consistent with stakeholder theory. Furthermore, Xie et al. (2019) revealed that most ESG activities have a positive relationship with corporate financial performance.

However, Nareswari et al. (2023) study found that the regression showed a negative effect of ESG scores on financial performance. An increased ESG score causes financial performance to decrease because it requires more investment costs and opportunity costs. Another study by Khandelwal et al. (2023) showed negative results that a high level of ESG disclosure in a company earns less profit than a company with a low level of disclosure.

Because the two theories used have opposing views of each other, the resulting hypothesis will not indicate the direction of the hypothesis. When the test results show positive or negative outcomes, it will still indicate that ESG has an influence on company performance regardless of the direction. Therefore, the next hypothesis is decided as follows:

H1: ESG affects firm performance.

The Moderating Role of Financial Slack

Financial slack can be described as unused resources that can assist in making strategic and operational decisions. Financial slack will make it easier for management to make decisions. This convenience also makes companies tend to carry out ESG practices if they have a lot of internal resources (S. P. Lee & Isa, 2020).

In addition, companies that have financial slack can negotiate for external financing on more favorable terms, thereby lowering their cost of capital (Chipeta & Nkiwane, 2020). This reduction in the cost of capital will reduce company expenses which can improve company performance. Thus, companies can remain involved in ESG while still paying attention to its financing. Guo et al. (2019) shows that financial slack drives company performance. Thus, in this study, financial slack will moderate the relationship between ESG and company performance. So, the next hypothesis is as follows:

H2: Financial slack acting in conjunction with ESG engagement would have a positive effect on firm performance.

METHODS

Data Samples

Research data are observable data from the company's financial and non-financial reports that can be measured directly. This data is considered secondary data because it is obtained from documents and databases that have already been published. The research uses a quantitative approach method with the research population is all companies listed on the MSCI World Index. The sample will be selected using purposive sampling technique, which is based on certain criteria and considerations. For this reason, the companies selected are only companies that disclose ESG information as seen from the ESG score in the country with the highest Islamic financial assets. Based on the IFDI (Islamic Finance Development Indicator) report in 2024, the top 10 countries with the highest Islamic financial assets are Malaysia, Saudi Arabia, UAE, Indonesia, Pakistan, Kuwait, Bahrain, Iran, Qatar, and Turkey. The observation period is 11 years, between 2014-2024.

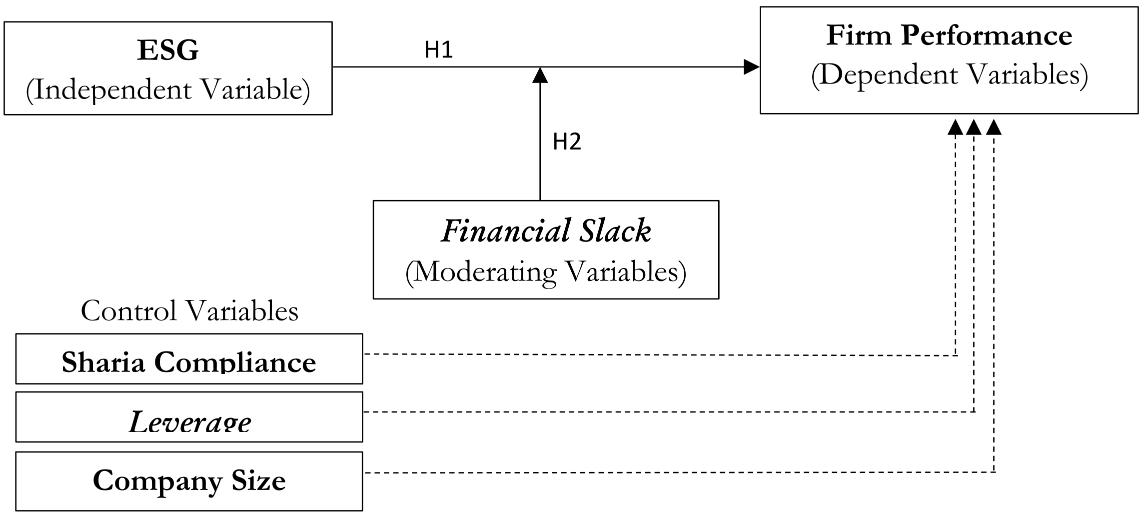

Figure 1. Conseptualization of hypotheses

Description:

$\longrightarrow$: main relationship (direct and moderation)

$\dashrightarrow$: additional influence relationship of control variables

H1 : ESG affects firm performance

H2 : financial slack acting in conjunction with ESG engagement would have a positive effect on firm performance

Variable Measurement and Technical Analysis

ESG will be the independent variable measured by the ESG composite score. The ESG composite score includes the overall ESG score for all its pillars, both environmental, social, and corporate governance. ESG scores range from 0 to 100. The higher the ESG score, the better the company's performance (Triyani et al., 2020).

The dependent variable for this study is company performance. Where for company performance will be measured using two measurements, namely return on assets (ROA) and return on equity (ROE). ROA comes from net income divided by total assets (S. P. Lee & Isa, 2020). Meanwhile, ROE is measured by net income divided by total equity at the end of the fiscal year (Triyani et al., 2020).

The moderating variable in the form of financial slack will use two financial ratios to represent it, namely: (1) cash ratio, calculated as the ratio of cash and equivalents to total assets, and (2) current ratio measured from current assets to current liabilities (S. P. Lee & Isa, 2020).

It is possible that the relationship between ESG and company performance is influenced by variables that will control. The control variable is sharia compliance proxied as the type of company. The type of company is divided into sharia and non-sharia companies which are measured using dummy variables. Value 1 for sharia companies and value 0 for non-sharia companies. This research uses the website musaffa.com as a tool to determine whether a company is classified as a Sharia (Islamic) company or not. The reason this website is used is because it is easy to access for us, so the identification of Sharia and non-Sharia companies will refer to the information on this website. If the relevant company is labeled halal on the website, it will be given a score of 1. Conversely, if the company is labeled non-halal, it will be given a score of 0.

Following Triyani et al. (2020), we include other control variables in the form of leverage and firm size. Leverage is measured using Debt to Equity Ratio (DER), which is total debt divided by total equity. Meanwhile, firm size is measured by the natural logarithm of total assets.

Tests were conducted using panel data analysis. In this study, ESG will be the independent variable and company performance as the dependent variable. The research also analyzes the effect of ESG and financial slack interaction on company performance. Some control variables are also used, namely sharia compliance, leverage, and company size. Thus, the research model is as follows:

H1: ESG affects firm performance

$$\mathbf{FP}_{it} = \alpha + \boldsymbol{\beta}_1\mathbf{ESG}_{it} + \boldsymbol{C}_2\mathbf{Sharia\ Compliance}_{it} + \boldsymbol{C}_3\mathbf{Leverage}_{it} + \boldsymbol{C}_4\mathbf{Firm\ Size}_{it} + \boldsymbol{\varepsilon}_{it}$$

H2: financial slack acting in conjunction with ESG engagement would have a positive effect on firm performance

$$\mathbf{FP}_{it} = \alpha + \boldsymbol{\beta}_1\mathbf{ESG}_{it} + \boldsymbol{\beta}_2\mathbf{Financial\ Slack}_{it} + \boldsymbol{\beta}_3\mathbf{ESG}_{it}\ \boldsymbol{x\ Financial\ Slack}_{it} + \boldsymbol{C}_4\mathbf{Sharia\ Compliance}_{it} + \boldsymbol{C}_5\mathbf{Leverage}_{it} + \boldsymbol{C}_6\mathbf{Firm\ Size}_{it} + \boldsymbol{\varepsilon}_{it}$$

Description:

FP: Firm Performance

RESULT AND DISCUSSION

Descriptive Statistics

The testing was conducted on data samples that met the criteria, namely companies with ESG scores. From the screening results, the final number of samples tested was 686 companies. Only 9 of the 10 countries with the highest Islamic financial assets were included in this sample, namely Malaysia, Saudi Arabia, the UAE, Indonesia, Pakistan, Kuwait, Bahrain, Qatar, and Turkey. Iran, which is also among the top 10 countries with the highest financial assets in this testing, was not included. This is because, according to our findings, the number of companies with ESG scores in Iran was 0, as shown in Table 1. In contrast, Malaysia has the largest number of data among the others, with a total sample of 346 companies. It is followed by Turkey, Indonesia, Saudi Arabia, and the UAE, which have more than 50 companies. However, the other 4 countries still have less than 50 companies. These ESG scores indicate that the companies have implemented ESG practices. This means that while ESG practices in some countries are already quite well-established, there are still some companies in those countries that have not fully implemented ESG practices. Therefore, a religious approach could serve as an incentive for companies to adopt ESG practices, thereby improving their performance, given that these 9 countries are among those with the highest Islamic financial assets.

Tabel 1. Data Sample

Number	Country	Companies	Number of Observations
1	Malaysia	346	1285
2	Saudi Arabia	60	239
3	UAE	55	167
4	Indonesia	68	419
5	Pakistan	4	19
6	Kuwait	9	43
7	Bahrain	7	25
8	Iran	0	0
9	Qatar	31	150
10	Turkey	106	515
Total Sample		**686**	**2862**

Table 2 presents the results of the descriptive statistics of each research variable used in this study. The average value of ROA is 6.98% with a minimum value of -31.84%, and a maximum value of 32.46%. ROE and ESG have an average value of 6.25% and 33.36%, with a minimum value of ROE -55.13% and ESG 85.18%. The maximum ROE value is 61.94% and ESG 47.06%. The average value for financial slack as a moderating variable is 48.10%.

The control variable in this study, namely sharia compliance, has an average value of 34.2%, which indicates that around 34.2% of companies in the sample fulfill sharia principles. While the average leverage is 73.38%, and company size with an average of 91.95%. The results of these descriptive statistics show that there is great diversity in financial performance, ESG implementation, and capital structure among the companies in the sample.

Tabel 2. Descriptive Statistics

Variable	Obs	Mean	Std. Deviation	Min	Max
ROA	2,862	.0698027	.4300009	-17.31846	13.32464
ROE	2,862	.0625826	3.188165	-114.5513	11.61942
ESG	2,861	43.33367	21.38068	.8518158	94.47061
FINANCIAL_~K	2,862	2.481081	6.752241	.0074419	253.0873
ESGFinanci~k	2,862	93.29015	188.2775	0	7600.417
SHARIA~E	2,862	.3420685	.4744853	0	1
LEVERAGE	2,862	1.733822	11.63796	-213.5188	458.6533
FIRM_SIZE	2,862	20.91953	1.761319	14.76719	27.22086

Regression Result

Table 3 shows the regression results of hypothesis 1 with firm performance as the dependent variable measured by ROA and ROE. STATA was used as a tool in testing this regression model. From the test results, it is found that ESG has an effect on firm performance. ESG significantly affects ROE at the 0.05 level. However, when using ROA as the independent variable, it shows different results, i.e. no significant effect. This proves that companies with ESG practices will improve company performance as measured by ROE. This means that the better the ESG score, the higher the return on equity earned by shareholders. In other words, every ESG activity will provide added value to the company. This result supports the findings of (Triyani et al., 2020; Ramic, 2019) and reject the findings (Chaabouni et al., 2024).

This positive relationship of ESG to firm performance is consistent with stakeholder theory and rejects agency theory. In its view, companies should not only provide benefits to owners but also to all stakeholders. These benefits can be obtained by ESG practices in the company. ESG encourages social responsibility to employees, shareholders, suppliers, customers and the wider community. When ESG practices increase, the company's performance will also increase, this can have a positive impact on stakeholders. Companies that are concerned with the environment, social, and good governance (ESG) will receive support from stakeholders. This will create long-term value through increased investor confidence in the company.

Contrary to agency theory, these findings do not support the view of that theory. In agency theory, ESG is considered to potentially generate additional costs and serve as an opportunity for managers to pursue their own benefits, which could reduce company performance. However, the research results provide evidence that ESG can improve company performance rather than being an activity that harms the company, thereby contributing to the development of theories regarding the relationship between ESG and company performance.

The adjusted R Square value of 0.2% and 8.3% indicates that the independent variables are able to explain the variable ROA of Sharia and non-Sharia companies by 0.2% and ROE by 8.3%, while the remaining 99.8% and 91.7% are explained by other variables not included in this research model.

Tabel 3. The Effect of ESG on Company Performance

	(1) ROA	(2) ROE
ESG	0.0006	0.0066*
	(0.0004)	(0.0028)
SHARIA_COMPLIANCE	0.0368*	0.1434
	(0.0171)	(0.1215)
LEVERAGE	-0.0009	-0.0786***
	(0.0007)	(0.0049)
FIRM_SIZE	0.0018	0.0019
	(0.0048)	(0.0344)
_cons	-0.0026	-0.1750
	(0.0985)	(0.7001)
N	2861	2861
adj. R^2	0.002	0.083

Standard errors in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

In relation to financial slack, the presence of sufficient resources indicates that the company has a strong financial condition, so the company's involvement in ESG practices is very possible. Our second hypothesis is to test the moderating role of financial slack on the effect of ESG on firm performance. However, due to limited data access, the research was originally designed to use two proxies in measuring financial slack, namely the cash ratio and the current ratio, then only uses the current ratio as a single proxy.

Table 4 reports the regression results of the test. It can be seen that the coefficient of the interaction variable ESG*FinancialSlack on firm performance shows insignificant results. This means that the role of financial slack has no effect in strengthening the relationship between ESG and firm performance. This result does not support the assumption that the existence of high financial slack makes the company will do more ESG practices to improve company performance. This finding is in line with the results of (S. P. Lee & Isa, 2020).

The adjusted R Square value of 0.1% and 8.3% indicates that the independent variables are able to explain the ROA variable of Sharia and non-Sharia companies by 0.2% and ROE by 8.3%, while the remaining 99.9% and 91.7% are explained by other variables not included in this research model.

Tabel 4. Financial Slack as Moderating Variables

	(1) ROA	(2) ROE
ESG	0.0005	0.0079*
	(0.0005)	(0.0032)
FINANCIAL_SLACK	0.0003	0.0173
	(0.0032)	(0.0226)
ESG*FinancialSlack	0.0000	-0.0006
	(0.0001)	(0.0008)
SHARIA_COMPLIANCE	0.0369*	0.1507
	(0.0172)	(0.1219)
LEVERAGE	-0.0009	-0.0787***
	(0.0007)	(0.0049)
FIRM_SIZE	0.0022	0.0018
	(0.0049)	(0.0346)
_cons	-0.0127	-0.2160
	(0.0999)	(0.7099)
N	2861	2861
adj. R^2	0.001	0.083

Standard errors in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The only control variable found to have a significant effect at the 0,05 level was Shariah compliance, measured using ROA. The significant coefficient shows that Sharia-compliant companies generate higher profitability (ROA) compared to non-Sharia-compliant companies. This indicates that companies that comply with Sharia principles tend to exhibit stronger financial performance, likely because ESG activities, which share similarities with Sharia concepts, provide companies with a platform to demonstrate care and protection for the surrounding environment. These ESG practices, in turn, positively impact the company's performance. A company's Sharia background can serve as a foundation for implementing ESG practices. ESG reflects concern for environmental, social, and governance issues, which aligns with Sharia principles that emphasize ethics, sustainability, and social justice aimed at protecting life, wealth, and the environment. This similarity suggests that Shariah-compliant companies are more likely to implement good ESG practices.

The control variable leverage showed a significantly negative effect at the 0,001 level on company performance, as measured by ROE. Companies with high leverage may face financial constraints that limit their ability to effectively implement ESG initiatives, thus failing to enhance firm performance. As a result, managers may prioritize short-term activities. Meanwhile, another control variable, namely company size, does not affect company performance. Therefore, Sharia compliance and leverage, also becomes an important factor to consider when measuring the effectiveness of ESG on company financial performance.

The regression results on the moderating variable show that financial slack does not affect the relationship between ESG and company performance, which is not in line with stakeholder theory and agency theory. Given that high financial slack does not lead companies to engage in more ESG practices, ESG as a strategy to gain stakeholder support is not functioning effectively. In line with this, companies have not been able to meet stakeholder needs through ESG to improve corporate performance.

CONCLUSION

This study examines the effect of ESG practices on the performance of sharia and non-sharia companies with an observation period of 2014-2024. The final data sample consisted of 686 sharia and non-sharia companies from 9 countries with the highest financial aspects. In addition, this study also analyzes the involvement of financial slack in moderating the relationship between ESG and company performance. Company performance is measured using ROA and ROE. The control variables used in this study are sharia compliance, leverage and company size. Screening of research data is done by taking companies that have ESG scores and classifying companies based on their sharia compliance. Dummy variables are used in measuring sharia compliance. Value 1 is given to sharia companies and value 0 for non-sharia companies.

The results found that ESG has a significant effect on firm performance when measured by ROE. However, it does not significantly affect the company's performance when measured by ROA. This means that the higher ESG practices will improve company performance as measured by ROE. These results are in line with stakeholder theory and reject agency theory. This means that the implementation of ESG practices will benefit stakeholders, so ESG practices are not activities that will cause harm but rather are advantageous. Then, the moderation analysis of whether ESG practices on financial performance are influenced by financial slack shows insignificant results. Thus, financial slack does not strengthen the relationship between ESG and company performance. The existence of financial slack in the company does not cause ESG practices to increase which in turn does not affect the improvement of company performance.

Companies with sharia principles in running their business have basically integrated most of the ESG principles. Thus, ESG practices carried out in improving company performance usually come from sharia practices that have been carried out previously in the company. With this, sharia compliance can also be quite an influential factor in improving corporate performance through ESG.

Our findings provide evidence of the importance of ESG factors on company performance. So, this research contributes by providing additional literature on sustainability activities and corporate performance, demonstrating that ESG serves as a non-financial factor that plays an important role in improving company performance, not merely as a corporate image. Therefore, management needs to pay more attention to and consider sustainability activities as one of the long-term business strategies.

However, our study only analyzed ESG factors in aggregate and used a single proxy for financial slack due to data limitations. Therefore, future studies should examine the individual effects of ESG factors and add other proxies to measure financial slack. In addition, further research is also expected to find more complete company data so that testing can be carried out fully in the 10 countries with the highest Islamic financial assets.

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