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ESG Investment (*Environmental, Social, and Governance*): A Solution in Achieving Maqashid Syariah

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Abstract

ESG investment is often defined as an investment activity that considers the company's environmental, social and governance ("ESG") factors in making investment decisions. The aim is to improve the long-term performance and competitiveness of the business that is the investment destination, as well as the long-term positive impact on society and the environment. Meanwhile, the Islamic finance industry aims to promote companies that are included in sectors or industries that provide added value to the real economy. Both the concept of ESG Investment and Islamic finance, both have similar values. Sharia investment is carried out based on sharia principles with the aim of achieving Maqasid Sharia (i.e. protecting the soul, religion, mind, lineage and property). Even in the concept of ESG investment, screening of certain business sectors is required. Thus, it has the potential to attract more interest from public companies as they seek to fulfill their social goals without compromising their business side operations. This paper offers insight into the ESG investment model from an Islamic perspective, particularly with regard to the concepts of maqasid sharia and maslahah mursalah. Further cooperation and education between regulators and professionals in the capital market industry is expected, leading to policies and initiatives such as promoting transparency and disclosure of investors, fund managers and companies in integrating ESG issues.

Keywords
investment; ESG; capital market; maqashid sharia; maslahah mursalah

I. Introduction

Currently, the impact of climate change has been felt by the global community. Unbalanced natural cycles have spurred increasing environmental and social problems. At a time when the global community is facing the Covid-19 pandemic, climate change is allegedly able to increase the variability of weather patterns so that it can accelerate disease transmission. Covid 19 pandemic caused all efforts not to be as maximal as expected (Sihombing and Nasib, 2020). The Covid-19 pandemic that has occurred in all parts of the world has triggered an extraordinary crisis and at the same time it becomes a momentum for all parties to evaluate the importance of implementing environmental, social, and governance aspects in all development activities.

ESG investment is often defined as an investment activity that considers the company's environmental, social and governance ("ESG") factors in making investment decisions. The aim is to improve the long-term performance and competitiveness of the business that is the investment destination, as well as the long-term positive impact on society and the environment. In simple terms, environmental factors include business activities in preserving nature. Meanwhile, social factors look at business activities in managing relationships with employees, suppliers, customers and the surrounding

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community. The governance factor looks at aspects of the company's organizational structure, audit activities, internal control and transparency.

Meanwhile, the Islamic finance industry aims to promote companies that are included in sectors or industries that provide added value to the real economy. Investors have an interest in following sharia, but they hope to get a return on their investment and in order for investors to invest in sharia instruments, they must follow Islamic investment principles that are in line with sharia principles. For example, Investments in fixed-income financial instruments, such as preferred stock, bonds, and some derivatives (such as options) are unacceptable, because they promise a fixed rate of return and do not provide voting rights. In addition, Islamic investors are not allowed to buy shares of companies whose main business activities are alcohol, gambling, conventional financial services, entertainment, pork-related products, tobacco, and weapons. Certain financial ratios should also be used to screen companies. For example, when the debt level in a company is more than a third of the market capitalization, then the company's shares are not sharia-compliant shares.

As the fourth most populous country in the world, with around 270 million peopleIndonesia is rich in both renewable and non-renewable sources. Moreover, Indonesia, as one of the largest Muslim countries in the world, is still lagging behind Malaysia in terms of Islamic finance fundamentals. Apart from the increasing need for the trend of Islamic returns, along with the increasing number of investment needs and potential as the largest Muslim population in the world, the opportunities to develop Islamic investments are increasing. Islam attaches great importance to the moral, environmental and social dimensions, there are several verses of the Qur'an that define and praise the environment, and encourage people to take care of it.

Both the concept of ESG Investment and Islamic finance, both have similar values. Sharia investment is carried out based on sharia principles with the aim of achieving Maqasid Sharia (i.e. protecting the soul, religion, mind, lineage and property). Even in the concept of ESG investment, *screening* of certain business sectors is required. However, sharia investment will continue to emphasize the religious aspect in every activity and prohibit investing in businesses that are not in accordance with sharia principles, while in the concept of ESG investment, derivatives are allowed. Investments will be made in companies with the highest ESG scores. However, such an election does not exist in Islamic investment.

Sustainable development centers on the overlapping factors between Islamic finance and ESG investment, namely economic, environmental and social impacts. Therefore, this paper offers insight into the ESG investment model from an Islamic perspective, particularly with regard to the concepts of maqasid sharia and maslahah mursalah. Thus, we can explain the similarities of the principles of ESG Investment with the values brought by Islam through maqashid sharia principles. Thus, it has the potential to attract more interest from public companies as they seek to fulfill their social goals without compromising their business side operations.

This article is conceptual in nature but may have some practical relevance, serving as a guide for interested parties. The structure of this article is as follows: the next section will explain what an ESG Investment is, its objectives and areas of implementation. This will then be followed by a section on Principles for Responsible Investment ("PRI"). After that, this article will discuss the basics of maqashid sharia and the concept of maslahah mursalah. This paper then describes the concept of ESG Investment from the perspective of maqasid sharia and maslahah mursalah, taking into account the underlying foundations of these models. Finally, conclusions and some suggestions will be given at the end.

II. Research Method

The research method used in this paper is normative juridical, namely research that is focused on analyzing a legal problem against the norms or positive legal rules that apply. Using this normative juridical research method, the author conducts his research by examining library materials or secondary data as the basis for research by conducting a search on regulations and literature related to the problems studied.

III. Results and Discussion

3.1 Understanding the Concept

Investment ESG investment is widely seen as a “sustainable” way of investing—where investments are made with the environment and human well-being in mind, as well as the economy. This is based on the growing assumption that an organization's financial performance is increasingly affected by environmental and social factors.

The principles of ESG investing are not new. Hundreds of years ago, religious and ethical beliefs influenced investment decisions. Muslims establish investments that comply with Sharia law, including a gun ban. The first ethical guardianship units in the US and UK were developed by Quakers and Methodists. Today, the growing prominence of corporate social responsibility (CSR) and social sustainability has led to increased investor awareness of ethical participation in the market. ESG investment may have officially entered the mainstream investment discourse following the issuance of the Principles for Responsible Investment (“PRI”) in 2006 – a set of United Nations guidelines for incorporating ESG factors into business policies and strategies. The PRI has more than 2,000 signatories and is widely considered the official point of reference for all things ESG investment.

Recent years have seen a significant expansion of ESG investment worldwide as organizations and individuals increasingly recognize the interdependence of social, environmental and economic issues. The COVID-19 pandemic, in particular, is driving this trend. The market disruption and uncertainty caused by the pandemic in 2020 led many investors to turn to ESG funds for increased resilience. In fact, in the first three months of 2020 there was $45.6 billion flowing into this fund globally. $30.7 trillion is currently in sustainable investment funds worldwide, and it is estimated this could increase to about $50 trillion in the next two decades. More investors are looking to fund organizations and products that support and promote sustainability, and comply with emerging regulations such as climate change regulations. This demand has been met with increased action on ESG issues in the business world, as well as higher returns on investment for ESG funds due to their resilience to conventional market disruptions.

Portfolios that combine ESG and sustainability also often perform better over the long term than those that don't. For example, US financial services firm Morningstar found that over a 10-year period, 80% of mixed equity funds that invest sustainably outperformed traditional funds. They also found that 77% of ESG funds that existed 10 years ago have survived, compared to 46% of traditional funds.

This boom in ESG investment can be attributed to a variety of factors. As supply chains become more complex, there is a greater awareness of social, labor, and human rights issues and risks to the business world. Growing concern for environmental issues such as climate change also influences investors' decisions. The increased involvement of groups previously less involved in traditional investing—especially youth and women—is also thought to have contributed to the ESG investment boom. To reflect the values and norms of this evolving society, it is important for organizations to adopt forward-looking ESG practice if they are to remain competitors in their industry and contribute to the common good.

An industry that has been slow to accept this change is receiving increasing criticism and pressure from concerned stakeholders, investors and citizens. Legal obligations are also expected to be further tightened for these industries. In May 2021, a Dutch court ruled that Royal Dutch Shell would cut greenhouse gas emissions by 45% by 2030. That same week, ExxonMobil and Chevron faced pressure from their shareholders to reduce the company's contribution to climate change. It is likely that this event will trigger a further transformation in the industry.

ESG issues cover a wide range of topics that apply to all industries and organizations in one way or another. While the avoidance of “sin stocks” has traditionally been considered essential for ethical investing, ESG investments cover a wider range of issues, including:

Table 1. Scope of ESG Investments

Environment	Social	Governance
Climate change	Working conditions	Business ethics
Greenhouse gas emissions	Equal opportunities	Salary executive
Resource depletion	Human rights	Diversity and board structure
Waste and pollution	Employee diversity	Bribery and corruption
Water and energy efficiency	Health and safety	Political lobbying and donations
Deforestation	Child labor and slavery	Tax strategies
Biodiversity	Community engagement	Compliance

Source: ADEC ESG Solutions,”*What is ESG Investing*?”

There are some (if any) areas of business operations where ESG is irrelevant. However, not all ESG issues are given equal weight in terms of investment. Just as every investor in the market has different values and motivations, it is unlikely that organizations will (or should) prioritize all ESG issues in their business strategy. Those that investors and organizations prioritize are determined by the current environmental, social, and economic circumstances, and what companies deem to be more important and material, given their industry, geography, and particular circumstances. Some of the prominent ESG issues affecting investors include:

a. Organizational efforts to mitigate climate change and other environmental disasters such as loss of biodiversity. For example, have they achieved or are on their way to achieving net zero emissions?
b. Human rights issues in the organization's supply chain. For example, have they published a Modern Slavery Statement or disclosed supply chain details in annual reports?
c. Workplace diversity and equal opportunities. For example, what proportion of the organization's employees are identified as an underrepresented group? How diverse is management? Is there equal representation at the executive and C-suite levels?

Organizational performance on ESG issues helps stakeholders make important decisions, and there are many tools available to measure or report on ESG performance. Some of the most popular include CDP, Global Reporting Initiative (GRI), Task Force on Climate-related Financial Disclosures (TCFD), and EcoVadis. These groups help companies measure and report on performance in areas including governance, climate-related risks and opportunities, emissions, resource management, procurement, engagement strategy, and many others.

Several other platforms commonly used by investors to determine a company's ESG rating include the Dow Jones Sustainability Index (DJSI), Morgan Stanley Capital International (MSCI), FTSE4Good, and ISS ESG. The index tends to be more investor-oriented, providing concise metrics about a company's financial performance. However, there are a myriad of ESG indices, frameworks, and standards that organizations can choose to report on or align with, and each should make its own assessment that best fits their investors' goals and preferences in order to optimize their ESG reporting.

3.2 Know the Principles for Responsible Investing ("PRI")

The United Nations-backed Principles for Responsible Investment ("PRI") initiative is an international network of investors working together to implement the six Principles of Responsible Investment. The aim is to understand the implications of sustainability issues for investors and support signatories to incorporate these into their investment decisions and ownership practices. By implementing PRI, signatories contribute to the development of a more sustainable financial system. Initiative is rapidly becoming a leading global network for investors to learn about responsible investing and the degree of collaboration with their partners, companies and policymakers to generate sustainable long-term investment returns for their clients and beneficiaries.

In early 2005, the then Secretary-General of the United Nations, Kofi Annan, invited the world's largest group of institutional investors to join the PRI development process. The 20-member Investor Group is drawn from institutions in 12 countries supported by a 70-person expert group from the investment industry, intergovernmental organizations, and civil society. The Principles was launched in April 2006 on the New York Stock Exchange.

The principles are voluntary and aspirational. They offer a menu of possible actions to incorporate ESG issues into investment practices across asset classes. Responsible investing is a process that must be adapted to suit each organization's investment strategy, approach and resources. The principles are designed to be compatible with the investment styles of large, diversified institutional investors operating within traditional fiduciary frameworks. The PRI does not recommend or require a specific approach to screening positive or negative based on ESG criteria – although some signatories may find this appropriate. PRI's approach to responsible ownership focuses on engaging with companies to encourage increased disclosure and management of ESG issues that are critical to long-term value creation.

Here are the commitments of the PRI signatories:

"As institutional investors, we have an obligation to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social and corporate governance (ESG) issues can affect the performance of an investment portfolio (to varying degrees across companies, sectors, regions, asset classes and over time).

We also recognize that applying these Principles can better align investors with the goals of the wider society. Therefore, if consistent with our fiduciary responsibilities, we commit to the following:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure of ESG issues by the entities we invest in.
Principle 4: We will encourage the acceptance and application of the Principles in the investment industry.
Principle 5: We will work together to increase our effectiveness in implementing the Principles.
Principle 6: We will each report on our activities and progress towards implementing the Principles.

The Principles for Responsible Investment were developed by a group of international institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. This process is organized by the Secretary-General of the United Nations.

In signing the Principles, we as investors are publicly committed to adopting and implementing them, if they are consistent with our fiduciary responsibilities. We are also committed to evaluating the effectiveness and improving the content of the Principles from time to time. We believe this will improve our ability to meet our commitments to beneficiaries and align our investment activities with the interests of the wider community.

We encourage other investors to adopt the Principles."

3.3 The Basics of Maqashid Syariah and the Concept of Maslahah Mursalah

"Maqasid" is an Arabic word which is the plural form of "maqsad", which means; straightness of paths, justice and balance, and directed goals. While "Sharia" is translated as a source of water or the road to it. Sharia symbolizes the teachings of Islam, which establishes a set of norms, values, and laws that govern every aspect of life. In other words, the Shari'a establishes rules that cover the entire belief system, the concept of morality and ethics, the relationship between man and God, and the relationship that exists between man and man. Together, "maqashid sharia" can be loosely translated as "the higher goal of Islam".

Based on the traditional classification, maqasid is divided into three levels: necessity (daruriyyat), pleasure or comfort (hajiyyat), and luxury (tahsiniyyat). Meanwhile, Abu Hamid al-Ghazali, classified five basic needs according to the Shari'a (Al-Dharuriyyat al-Khams), namely: maintaining faith (deen), life (nafs), reason ('aql), offspring (nasl), and property (mal).). According to Auda, several jurists added another dimension, namely "maintenance of honor". These needs are considered important to improve the welfare of the community. Ibn Tamiyyah expanded on Al-Ghazali's work by expanding the list of maqasid sharia to such things as fulfilling contracts, maintaining kinship, respecting the rights of neighbors, respecting acts for the love of God, sincerity, trustworthiness, and moral purity. Abu Zaharah, also expanded the scope of al-Ghazali's maqasid, namely to include education, justice, and the public interest (maslahah). He explained that the focus of Islam is on the development and education of individuals to build a good society. In addition, he saw justice as a noble goal of Islam and expanded it to include judicial justice, social justice, and economic justice.

Ibn Ashur explained that the overall goal of the Shari'ah is to promote human welfare and virtue so that the social order of society can be maintained and developed in a healthy manner. He continued that virtue consists of the health of the intellect, righteousness of deeds, and the goodness of the things of the world that we live in and possess. Ashur also explained that in order to protect the welfare of the world, the Shari'ah has covered the essential welfare of human beings with the means of perpetual protection, even where there is no benefit. Even the life of a foolish, weak, senile, and diseased person without any outward benefit to society must be protected and sanctified because the maintenance of world order depends on the purity of the human soul under any circumstances. Therefore, maqasid sharia incorporates all the principles, values, and messages given by revelation along with the various dimensions of human need to achieve human well-being (maslahah) at the individual micro level as well as at the macro level of society.

The word “maslahah” means the highest truth and goodness and is the plural form of “masaalih”, which is a synonym for manfa'aah (benefit, usefulness, welfare, or interest) in Arabic. Maslahah can also be interpreted as seeking benefit and rejecting harm as directed by the Lawgiver. Al-Ghazali defines maslahah as “an expression for obtaining benefit or denying harm or harm, but that is not what we mean, because obtaining benefit and denying harm represents the human goal, i.e. human welfare through the attainment of that goal. What we mean by maslahah, however, is the preservation of the goals of sharia.” Al-Ghazali emphasized that the basic meaning of maslahah is for the preservation of sharia, which includes the preservation of five key elements. namely faith, life, lineage, reason, and wealth, as defined earlier.

Meanwhile, Al-Shatibi defines maslahah as "what produces benefits for people on a collective or individual level and is acceptable to humans because of its importance to their lives". Thus, maslahah includes both public and private interests. We can clearly see that maslahah is rooted in the objective of the shari'ah to ensure that the interests of society are safeguarded and nurtured for the sake of obtaining good in this life, as well as in the hereafter. Scholars have used the terms 'maqashid' and 'maslahah' almost interchangeably because they can both imply the same meaning. Both concepts are built by upholding the public interest, which is considered to be the embodiment of the Shari'a emphasis on compassion.

3.4 ESG Investment from a Maqasid Syariah Perspective

In this section, this article attempts to put forward the idea that the ESG investment model is a concept that embodies the philosophy of socially responsible investment extensively, as well as the values of maqashid sharia and maslahah. Dusuki and Abdullah define corporate social responsibility as “showing corporate activities beyond generating profits, such as protecting the environment, caring for employees, being ethical in trade, and engaging in local communities". This concept of socially responsible investment is not foreign to Islamic philosophy. In fact, these concepts are very much in line with the "Goals of Sharia" (Maqasid Syariah) and "General Good" (Maslahah) which embodies the philosophical foundation and *raison d'etre* of Islamic economics and finance.

According to Ashur, the main objective of the Shari'ah is to build a stable society with a strong and stable community and to promote the orderly functioning of its affairs by achieving comprehensive welfare and preventing crime. Therefore, anything that operates to build a better society, create an environment for social welfare, and eliminate society's disadvantages fulfills the objectives of sharia, which also applies to ESG investments. The ESG approach looks at more complex issues to reduce risk and increase long-term returns and screening is one of the most widely used tools. For example, a *screening* can be used to exclude the highest emitters of greenhouse gasses from a portfolio (*negative screening*) or target only the lowest emitters (*positive screening*). The screening process can be traced to a belief-based approach to avoiding, or disengaging from, companies engaging in activities deemed inconsistent with a set of beliefs or values.

Table 2. Comparison between ESG and Sharia Investments Sharia

	Systematic	**ESG**
ESG integration	Medium	level Low level
Screening	High level based on specific client/fund specific screening policies	based implementation sharia
Company involvement in environmental and social issues	High	level Low level
Voting	High level	Low
Dividend	No restrictions	100% of dividends are subject to a "purification" process
Interest/usury earned	No restrictions	No usury allowed
Security lending	High rates with reputable practitioners implementing rules that ensure they can vote	No *security lending* allowed, assets must have, and usury prohibited
Short sell	Low rate	No *short sell* allowed, and asset must be owned
Limit on *leverage* high	No prohibition	100% implementation to avoid earning usury directly and indirectly through exposure to high income companies i

Source: UN PRI and CFA Institute, "*ESG Integration and Islamic Finance: Complementary Investment Approach*".

A study on ESG and Shariah investing that included 6,500 publicly traded companies found a direct correlation between Shariah compliance and higher ESG scores. Shariah-compliant companies have ESG scores that are on average 6% higher than those issued by the Shariah screening process. For non-financial companies, the difference rises to 10%.

Source: Refinitiv and RFI Foundation, "*Islamic Finance ESG Outlook 2019: Shared Values*".

Figure 1. *Sharia-compliant companies have higher ESG scores*

Another study constructing a portfolio based on *universe* of 2,500 stocks with ESG and Sharia screening found that by applying ESG screening, *universe* was reduced to 850 stocks, of which 50-70 stocks were selected to enter the ESG portfolio.portfolio *screening* plus ESG has 30-50 stocks screened from *universe* a smallerThe results of this study found that the two portfolios had a broadly correlated performance over a 5 year period.

Meanwhile, the Sharia ESG index has outperformed the conventional ESG index due to better financial management and the lower leverage nature of the company. See Figure 2. This is evident in the post-Covid-19 equity market recovery from March 2020 where the Sharia-compliant equity index (S&P Global 1200 ESG Shariah Index) experienced a decline due to volatility identical to that of the conventional stock index (S&P Global 1200 ESG Index), but the Sharia ESG index showed a better recovery.

Source: Bloomberg. S&P Global 1200 ESG Index and S&P Global 1200 ESG Shariah Index for the period 30 June 2016 – 25 June 2021.

Figure 2. *Sharia ESG Index Shows Better Recovery Than ESG Index*

V. Conclusion

It is very important for organizations to recognize and embrace the changes taking place in the investment world. The term “investor” no longer refers only to a specific group of people. Instead, investing is increasingly understood as a means of voting with one's money, attracting a wide variety of people around the world. The range of factors investors consider when making decisions is much broader, reflecting the gradual spread of these more progressive and holistic ESG values into the investment arena.

As issues such as climate change and COVID-19 have demonstrated the fragility of the business-as-usual approach, they also highlight the importance of organizational resilience. Shareholders and stakeholders expect a transition to more environmentally, socially and economically sustainable business activities to support future generations. Organizations must build their adaptive capacity taking into account the wider range of metrics in their business operations and long-term strategy.

The areas of implementation of ESG investments cover a wide range of social issues such as crime prevention, child care, orphanages, education, youth empowerment, job training, health care, homelessness, welfare issues, and community outreach. The objectives and areas of implementation are comprehensive in accordance with the elements of maqashid sharia and maslahah. Thus, this article argues that ESG investment can be regarded as a financial model that symbolizes the ethical and moral framework of sharia. Not only does it provide social impact, it also provides an opportunity for investors to diversify their portfolios and fulfill their business-side responsibilities.

As an innovative investment model, ESG investment is still in its development stage but continues to attract the interest of institutions around the world. Therefore, this paper is a simple attempt to explain the idea of ESG investment, and serve as a guide for attracting Islamic institutions in fulfilling maqashid sharia and maslahah, without leaving the business side and investment elements.

Given the growing importance of Islamic and ESG policies, further cooperation and education between regulators and professionals in the capital market industry is expected, leading to policies and initiatives such as promoting transparency and disclosure of investors, fund managers and companies in integrating ESG issues. Fiscal incentives to improve practices plus adoption of sustainable standards for companies and integrating Islamic principles into ESG policies will facilitate greater adoption.

Sharia and ESG investments are becoming popular. Both Muslim and non-Muslim investors are increasingly emphasizing the impact of climate change on their portfolios and allocating their portfolios accordingly. Prospective investors should take into account the fact that sharia principles combined with ESG investments offer competitive risk-adjusted returns across multiple time periods. This supports the belief "doing well by doing good".

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