

# ESG and Islamic Finance: A Natural Alignment

“Bridging Faith-Based Finance and Modern Responsible  
Investing”

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For decades, finance was often seen as a numbers game, profit was king, and ethical questions were sometimes treated as secondary or optional. However, the world is changing. Investors, regulators, and the public are increasingly asking: Can money be made in a way that does not harm people, society, or the planet?

This search for responsible investment has given rise to ESG - Environmental, Social, and Governance investing, a modern framework designed to ensure that financial decisions consider sustainability, social impact, and ethical leadership. At the same time, an older, deeply rooted system has been doing the same for centuries: Islamic finance.

Islamic finance is often misunderstood as merely “finance without interest,” but it is, in reality, a comprehensive ethical system. It guides how wealth is earned, invested, and shared, insisting on fairness, accountability, risk sharing, and care for both people and the environment.

While ESG is a contemporary answer to global financial and ethical challenges, Islamic finance shows that the idea of integrating ethics into economics is not new. The two approaches, though separated by time and culture, share a natural alignment. Both advocate for a system where profit is balanced with purpose, where economic activity serves society, and where ethical responsibility is inseparable from financial decision-making.

In this article, we will explore how Islamic finance and ESG principles overlap, examine their shared values, and explain why Islamic finance could emerge as a compelling ethical alternative in the global financial landscape.

ESG is built on three core pillars that help investors look beyond financial profit and evaluate how a company behaves in the real world.

**Environmental** refers to how a company interacts with the planet. This includes its carbon emissions, energy use, waste management, water consumption, and overall impact on natural ecosystems. In today's climate-conscious world, this pillar asks an important question: Is this business contributing to environmental damage, or is it part of the solution? Companies that invest in renewable energy, reduce pollution, and use resources efficiently are seen as more sustainable in the long term, both environmentally and financially.

**Social** focuses on how a company treats people. This covers employee rights, workplace safety, fair wages, diversity, customer protection, and relationships with local communities. A profitable company that exploits workers or ignores human rights risks reputational damage and long-term instability. ESG investing recognizes that businesses thrive when employees, customers, and communities, are treated with dignity and fairness.

**Governance** looks at how a company is run. It includes leadership ethics, board independence, transparency, anti-corruption measures, and accountability to shareholders. Poor governance often leads to scandals, fraud, or mismanagement, which can destroy both trust and value. Strong governance, on the other hand, builds confidence and long-term resilience.

An ESG-conscious investor, therefore, does not only ask, "How much profit will this company make?" but also, "How is this profit being made?" They tend to avoid companies that pollute heavily, exploit labor, or are involved in bribery and corruption. Instead, they favor businesses that actively reduce environmental harm, respect human rights, and operate with honesty and transparency.

In this sense, ESG investing is not about sacrificing profit, it is about redefining success. It promotes the idea that long-term financial performance and ethical responsibility are not opposites, but partners. In short, ESG is about profit with responsibility, where financial returns go hand in hand with positive impact on society and the planet.

### **What Islamic finance Is Really About**

Islamic finance is often reduced to a single idea: “no interest.” While the prohibition of *riba* (interest) is important, this description barely scratches the surface. Islamic finance is not just a technical adjustment to conventional banking, it is a **comprehensive ethical framework** that shapes how wealth is **earned, invested, distributed, and protected** within society.

At its core, Sharia views money not as a commodity to be traded for its own sake, but as a **tool to support real economic activity and human well-being**. Wealth is considered a trust, and financial activity must serve society rather than harm it.

Its ethical foundation rests on several interconnected principles:

#### **No Harm (La Darar wa la Dirar)**

This principle means that financial activity should not cause injury to individuals, communities, or the broader economy. A transaction that enriches one party while creating serious harm for another contradicts Islamic ethics. This idea extends beyond physical harm to include economic injustice, exploitation, and social damage. Finance must benefit society, not destabilize it.

#### **Risk Sharing Instead of Risk Dumping**

Conventional finance often guarantees returns to capital providers while transferring most of the risk to borrowers. Islamic finance challenges this imbalance. It promotes contracts where **profit is earned only when risk is shared**. Investors and entrepreneurs become partners, not adversaries. This encourages responsible decision-making, because all parties have something at stake. It also connects finance directly to the performance of real economic activity, rather than allowing money to grow detached from production.

#### **Justice and Fairness (‘Adl)**

Justice is a central objective in Islamic law. Financial contracts must be fair, transparent, and mutually agreed upon. Hidden conditions, manipulation, and exploitation are unacceptable. The goal is balance, ensuring that neither party dominates unfairly. Wealth circulation is encouraged, but concentration of wealth in a few hands is discouraged.

### **Social Responsibility and Care for the Vulnerable**

Islamic finance is tied to broader social ethics such as charity (*zakat*), voluntary giving (*sadaqah*), and support for those in need. Financial systems should not ignore the poor or exclude vulnerable groups. Economic growth is meaningful only if it contributes to social welfare.

To protect these principles, Islamic finance prohibits certain practices:

- **Interest (Riba):** Because it guarantees gain without sharing risk and can lead to debt exploitation.
- **Excessive Uncertainty (Gharar):** Transactions involving extreme ambiguity or speculation are restricted, as they resemble gambling and can create instability.
- **Harmful Industries:** Activities that damage individuals or society, such as alcohol, gambling, and other destructive sectors are excluded.

However, Islamic finance is not defined only by prohibitions. Its real strength lies in what it **actively promotes**:

- Investment linked to tangible assets
- Entrepreneurship and trade
- Partnership-based finance
- Transparency and accountability

In other words, Islamic finance seeks to build a system where money flows into the **real economy**, supports productive activity, and strengthens social cohesion. It aims for balance, between profit and ethics, individual gain and social good, financial growth and moral responsibility.

It is therefore not merely “finance without interest.” It is an attempt to create a **fair, stable, and socially conscious financial order**, where wealth creation and ethical responsibility move together rather than in conflict.

## Environmental Responsibility

One of the most powerful and far-reaching principles in Islam is the obligation to prevent harm. This idea goes beyond personal conduct and extends into economic behavior, social relations, and humanity's relationship with the natural world. In Islamic ethics, causing widespread damage, whether to people, communities, or the environment, is not morally neutral. It is considered a violation of responsibility.

The Qur'an describes human beings as stewards (khalifah) of the Earth. This concept gives a very different perspective on nature. The environment is not simply a collection of resources available for unlimited exploitation. Instead, it is a trust placed in human hands. A trustee is expected to preserve and protect what has been entrusted to them, not exhaust or destroy it for short-term gain. This sense of stewardship introduces moral limits to economic activity and consumption.

Islamic teachings also emphasize the idea of balance (mizan) in creation. The natural world is created in harmony, and human actions that disturb this balance, through pollution, wastefulness, deforestation, or environmental destruction, are described as forms of corruption on Earth. From this viewpoint, environmental damage is not just an economic side effect; it is an ethical and spiritual issue.

This perspective connects closely with the Environmental pillar of ESG investing. ESG frameworks evaluate whether companies contribute to environmental degradation or work toward sustainability. Businesses that rely on heavy pollution, irresponsible resource extraction, or practices that accelerate climate change are increasingly seen as risky and unethical. Likewise, companies that invest in renewable energy, reduce emissions, and adopt sustainable practices are viewed more favorably.

From a Sharia perspective, profit earned through environmental harm contradicts the principle of stewardship. Economic activity must respect the limits of nature and protect the well-being of future generations. When ESG investors avoid companies that destroy ecosystems or contribute heavily to climate change, they are acting in a way that reflects the Islamic value of preserving balance in creation.

What adds a unique dimension in Islamic ethics is accountability. Responsibility is toward not only regulators, markets, or public opinion, but ultimately before God. This belief creates an internal moral awareness that environmental responsibility is not optional or temporary; it is part of a person's duty. It encourages long-term thinking rather than short-term profit seeking that ignores consequences.

In this way, both ESG environmental standards and Sharia principles arrive at the same conclusion: economic growth should not come at the expense of the planet. True success lies in maintaining harmony between financial activity, human well-being, and environmental sustainability.

### **Risk-Sharing and Social Justice**

Modern finance often works by transferring risk to the weaker party. Borrowers carry the burden while lenders earn fixed returns, no matter what happens. Islamic finance rejects this imbalance. Instead, it promotes **risk sharing** through contracts like:

- **Mudarabah** (investment partnership)
- **Musharakah** (joint-venture)

Here, profits and losses are shared. Everyone has skin in the game. This creates a sense of partnership, not exploitation. This aligns strongly with the **Social** pillar of ESG, which promotes:

- Fair treatment of stakeholders
- Financial inclusion
- Community development

Islamic finance encourages investment in the real economy, businesses that create goods, services, and jobs, instead of speculative activities that benefit a few while risking systemic damage.

At its heart, this is about **economic justice**, a value both ESG and Sharia strongly uphold.

### **Justice and Governance**

Good governance in ESG is about how power is exercised inside a company. It focuses on transparency, accountability, and ethical leadership. Investors want to know that decisions are not made in secrecy that leaders are answerable for their actions, and that

companies are managed with integrity rather than personal interest. Weak governance is often the hidden cause behind major corporate scandals, financial collapses, and corruption cases. Strong governance builds trust, stability, and long-term value.

Islamic finance demands these same standards, but it goes further by grounding them in a moral and spiritual framework. In Islamic ethics, honesty in business is not just good practice; it is a religious duty. Fraud, deception, bribery, and manipulation are strictly condemned. Even small forms of dishonesty, such as hiding defects in a product or inserting unfair clauses in contracts, are considered violations of ethical responsibility.

A central requirement in Sharia transactions is clarity in contracts. All terms must be known and agreed upon. Ambiguity that could lead to disputes or unfair advantage is discouraged. This protects all parties and reduces conflict. The goal is not only legal compliance but also fairness and mutual satisfaction.

Transparency in Islamic business ethics also relates to truthfulness in communication. The Prophet Muhammad (peace be upon him) emphasized that truthful and trustworthy traders are honored, while dishonesty removes blessing from transactions. This moral teaching creates a culture where ethical conduct is part of personal character, not just corporate policy.

Accountability is another key element. In ESG governance, accountability usually means responsibility to shareholders, regulators, and the public. In Sharia, accountability has an additional layer: accountability before God. This belief introduces an internal moral control that does not depend solely on external supervision. A person may avoid unethical behavior not only because it is illegal, but because it is morally wrong even if no one is watching.

Fairness in contracts, protection of rights, and prohibition of exploitation also align closely with modern governance principles like shareholder protection and anti-corruption standards. However, Sharia frames these not merely as legal requirements but as elements of justice. Leadership,

in this view, is a trust, and abusing authority for personal gain is a breach of that trust.

The result is a powerful combination of external regulation and internal conscience. ESG governance relies heavily on rules, reporting standards, and oversight bodies. Sharia governance supports these mechanisms but strengthens them with ethical intention and spiritual responsibility.

In Islamic teaching, business ethics are not optional add-ons, they are considered part of one's moral duty and even an act of worship when conducted correctly. This transforms governance from a compliance exercise into a value-driven commitment. It encourages leaders to act ethically not only to avoid penalties, but because integrity itself is a form of accountability and devotion.

### **Built-In Ethical Screening**

Many ESG funds exclude industries like tobacco, gambling, and weapons. Islamic finance has done this for centuries. Islamic screening naturally avoids sectors linked to:

- Addiction
- Social harm
- Moral degradation

This built-in filter makes Islamic finance one of the most **strict ethical investment frameworks** in the world.

### **Could Islamic Finance Become a Global Ethical Alternative?**

Islamic finance is no longer a niche religious system. It has the potential to become a **global ethical model** for several reasons.

### **Ethical Consistency**

ESG standards can vary between countries and rating agencies. Sharia principles, however, are rooted in a long-established moral and legal tradition. This gives Islamic finance a **stable ethical foundation**.

### **Stability Through Risk Discipline**

By avoiding excessive speculation and debt-based bubbles, Islamic finance promotes real-asset-backed activity. This can reduce systemic risk — something the world has struggled with since the 2008 financial crisis.

## **Universal Moral Appeal**

Although based on Islamic law, the core values — justice, responsibility, avoiding harm — are universal. Non-Muslim investors increasingly view Islamic finance as an ethical alternative, not just a religious one.

## **Alignment with the Future of Finance**

The global direction of finance is clear: sustainability, responsibility, and accountability. Islamic finance is already built on these pillars. Rather than adapting to ESG trends, it has embodied them for centuries.

## **Challenges to Overcome**

Of course, challenges remain:

- Limited public understanding of Islamic finance
- Differences in Sharia interpretations
- Need for better integration with global ESG reporting systems

However, these are technical issues, not value-based ones. The ethical foundation is already strong.

## **Conclusion**

The rise of ESG investing shows that the modern financial world is going through an important reflection. After decades in which profit was often pursued without enough attention to consequences, investors, regulators, and societies are now asking finance to reconnect with ethics. ESG represents this effort — a structured attempt to ensure that environmental protection, social well-being, and good governance are not afterthoughts, but central to economic decision-making.

Sharia finance, however, approaches this from a different starting point. It does not try to add ethics to finance, because ethics were never separate from economics in the Islamic worldview. From its earliest foundations, financial activity in Islam has been tied to moral responsibility, social justice, and accountability. Wealth is seen as a trust, business as a form of social interaction, and economic behavior as part of a person's moral life.

This is why the alignment between ESG and Islamic finance is not coincidental. Both systems aim to protect the planet from reckless exploitation, to ensure that economic growth does not come at the expense of human dignity, and to promote governance based on

honesty, transparency, and responsibility. They share the belief that how money is earned matters just as much as how much is earned.

Yet Islamic finance contributes something distinctive to this conversation. It offers a holistic ethical vision where environmental care, social justice, and ethical governance are not separate categories but interconnected duties. It also adds a strong internal moral dimension through the concept of accountability beyond legal systems. This can reinforce responsible behavior even in situations where regulation is weak or enforcement is limited.

As the global financial system faces challenges such as climate change, inequality, and loss of public trust, the demand for values-based finance will continue to grow. In this context, Islamic finance is not simply a niche religious model. It presents a time-tested framework that integrates profit with purpose, markets with morality, and growth with responsibility.

The future of finance may not belong to systems that maximize returns at any cost, but to those that balance efficiency with ethics. In that search, the principles of Sharia finance, aligned naturally with ESG ideals, offer guidance toward a more just, stable, and sustainable global economy.