

Research Article

The Contribution of Islamic Banks in Supporting Green Economy Initiatives and Sustainable Financial Growth

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Abstract: This study investigates the contribution of Islamic banks in supporting green economy initiatives and promoting sustainable financial growth. Employing a quantitative research design, the study utilizes secondary data collected from annual reports, sustainability disclosures, and carbon emission reports of Islamic banks for the period 2018–2024. The research aims to examine the relationship between green financing portfolios and key financial performance indicators Return on Assets (ROA), Return on Equity (ROE), and Capital Adequacy Ratio (CAR) while evaluating the environmental impact through carbon emission reduction. Descriptive statistics provide an overview of green financing activities and financial ratios, while multiple regression analysis assesses the effect of green financing on sustainable financial performance, controlling for bank size, Gross Domestic Product (GDP) growth, and inflation. An independent sample t-test compares Islamic and conventional banks in terms of ethical compliance, environmental contribution, and profitability. The findings reveal that Islamic banks allocate a higher proportion of financing to green projects, achieving significant carbon emission reductions without compromising financial performance. The green financing portfolio exhibits a positive and significant effect on sustainable financial growth, and larger banks demonstrate a greater capacity to implement sustainability initiatives. The comparative analysis confirms that Islamic banks outperform conventional counterparts in environmental and ethical dimensions while maintaining comparable profitability. These results underscore the potential of Sharia-compliant banking to integrate ethical, environmental, and economic objectives, positioning Islamic financial institutions as key actors in advancing a sustainable, low-carbon financial system.

Keywords: Carbon Emission Reduction; Green Financing; Islamic Banks; Sustainable Financial Growth; Sustainability

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1. Introduction

Islamic banking represents a distinctive ethical and financial system that integrates Sharia principles with sustainability and environmental stewardship. The increasing global concern over climate change and environmental degradation has encouraged Islamic financial institutions to align their objectives with broader ethical and ecological goals. By prohibiting *riba* (interest), *gharar* (excessive uncertainty), and environmentally harmful activities, Sharia-compliant finance promotes fairness, justice, and responsible economic behavior (Rahim et al., 2024).

Recent developments indicate that Islamic banks are adopting sustainability reporting frameworks to strengthen social and environmental accountability. According to El-Essa et al., (2024), the integration of sustainability indicators into financial disclosures through Sharia-compliant tools like sukuk, zakat, and waqf helps fund projects that address poverty reduction, renewable energy, and environmental conservation. In addition, Islamic marketing

ethics reinforce moral responsibility and discourage activities that harm society or the environment (Riaz, 2016).

Nevertheless, challenges persist in fully integrating sustainability within Islamic banking operations. Measuring environmental and social outcomes in compliance with Sharia principles remains complex (El-Essa et al., 2024). Although Environmental, Social, and Governance (ESG) practices show positive correlations with financial performance, their adoption within Islamic finance is still limited (Alghafes et al., 2024). Developing standardized regulations and reporting systems is therefore essential to ensure consistent sustainability integration aligned with Sharia values.

Green banking has emerged as a crucial evolution of Islamic finance, advancing ecological sustainability. Ali et al. (2020) highlight that the green behavior and environmental attitudes of Islamic bankers significantly influence sustainable banking growth. This transformation requires both individual ethical commitment and institutional support, enabling Islamic financial institutions to enhance their reputation and contribute to a greener global economy.

Despite extensive theoretical literature on Islamic finance and sustainability, there remains a significant research gap in quantifying Islamic banks' contribution to green economic growth. Previous studies have largely explored conceptual relationships rather than empirical evidence (Alnabulsi & Jreisat, 2024; Rahim et al., 2024; Irfany et al., 2024). Understanding measurable impacts is essential for developing policies that optimize Islamic banking's role in sustainable finance.

Empirical evidence from various regions demonstrates that Islamic financial instruments such as Green Sukuk effectively finance renewable energy and environmental projects (Rosman & Marzuki, 2024). Islamic financial assets have been shown to reduce CO₂ emissions and promote responsible investment in OIC countries (Irfany et al., 2024). Studies in Jordan and Malaysia further confirm that green financing by Islamic banks supports both profitability and sustainability (Ali et al., 2020).

The successful implementation of green finance also depends on robust regulatory frameworks. Policies in Malaysia, Jordan, and Bangladesh encourage Islamic banks to finance environmentally responsible projects (Julia & Kassim, 2019). These initiatives enhance innovation and align Islamic banking practices with global ESG standards. However, as Alnabulsi & Jreisat (2024) note, cross-country empirical studies are still required to fully understand Islamic finance's contribution to sustainable economic growth.

2. Literature Review

Concept of Green Economy and Sustainable Finance

Definition and Principles of Green Economy

The green economy is guided by core principles that integrate environmental protection, economic growth, and social welfare. It prioritizes pollution prevention, resource efficiency, and ecosystem conservation as the foundation for long-term competitiveness (Haron, 2024; Sharma & Kautish, 2023). At the same time, it promotes sustainable economic growth through green finance and investments in renewable energy, clean technologies, and sustainable infrastructure (Sharma & Kautish, 2023). Moreover, the green economy emphasizes inclusiveness by fostering green job creation and poverty reduction through equitable policy design and financing mechanisms (Yusuf et al., 2024).

Relationship Between Economic Development, Environmental Protection, and Social Welfare

The relationship between economic development, environmental protection, and social welfare highlights the possibility of achieving sustainable growth through integrated strategies.

Research indicates that effective environmental governance not only preserves ecosystems but also strengthens economic infrastructure and fosters long-term growth (Peng et al., 2020). Optimization-based models further demonstrate that balancing economic growth with environmental protection is feasible through coordinated policy measures and strategic resource allocation (He et al., 2021; Sharma & Kautish, 2023). Empirical evidence, particularly from regional studies in China, suggests that although short-term economic expansion may sometimes conflict with environmental objectives, long-term strategies such as implementing green financial instruments and sustainable development policies can harmonize economic, environmental, and social goals, ultimately promoting inclusive social welfare (Peng et al., 2020; Sharma & Kautish, 2023; Zheng et al., 2019).

Islamic Banking Principles and Ethical Finance

Islamic banking and finance are fundamentally guided by the principles of Maqasid al-Shariah, which aim to protect faith, life, intellect, progeny, and wealth. These objectives closely align with sustainability principles by promoting positive impacts on the environment, society, and the economy (Hassan et al., 2021). Guided by Maqasid al-Shariah, Islamic finance encourages ethical investment and social responsibility, contributing directly to the achievement of the Sustainable Development Goals (SDGs). Frameworks such as Value-Based Intermediation (VBI) have strengthened the integration of Shariah principles into sustainable financial markets, ensuring that financial activities are consistent with ethical and social objectives (Mahyudin et al., 2024; Haron, 2024; Yusuf et al., 2024).

Ethical finance in Islam prohibits *riba* (interest), *gharar* (excessive uncertainty), and investments in unethical activities, while emphasizing fairness, risk-sharing, and social justice, forming a resilient, solidarity-based financial system (Kaddour et al., 2021; Franzoni & Allali, 2018). Islamic banks also actively support community development through instruments such as zakat (almsgiving), sadaqah (charity), and qard hasan (benevolent loans), which promote poverty alleviation, financial inclusion, and social welfare. The growing practice of Islamic Corporate Social Responsibility (ICSR) illustrates the convergence of ethical finance with CSR, where transparent reporting and accountability contribute to stronger institutional performance and societal benefits (Gunardi et al., 2022; Kolsi & Al-Hiyari, 2023).

Sustainable finance in Islamic markets faces challenges related to standardization, regulatory harmonization, and ESG risk integration. The VBI framework provides tools to translate Shariah principles into measurable performance indicators and operational practices (Haron, 2024; Mahyudin et al., 2024), while standardized green finance metrics such as project taxonomies and impact indicators help assess materiality and reduce short-term policy biases (Sharma & Kautish, 2023). Additionally, enhancing Islamic banking literacy and digital accessibility strengthens participation in sustainable finance initiatives, ensuring alignment between financial inclusion, SDGs, and the broader objectives of Maqasid al-Shariah (Ichsan et al., 2024; Kalkavan, 2019).

Empirical Studies on Green Finance and Sustainability in the Banking Sector

Empirical studies demonstrate that green banking practices have been increasingly adopted to mitigate environmental degradation and promote sustainability through operational efficiency, renewable energy use, and environmentally responsible lending (Akomea-Frimpong et al., 2022). Evidence from diverse countries indicates that these practices not only enhance banks' corporate image but also improve the quality of sustainability reporting and strengthen green financing activities (Rahman et al., 2024; Valencia & Calabuig-Tormo, 2023). The adoption of various green finance products including green securities, climate finance, green credit, and infrastructure bonds is driven by environmental policies, risk perception, social inclusion, and regulatory frameworks, aligning

profitability goals with sustainable and socially responsible investments (Akomea-Frimpong et al., 2022; Valencia & Calabuig-Tormo, 2023).

Empirical evidence consistently shows a positive association between green banking practices and banks' environmental performance, sustainability outcomes, and overall firm value (Gulzar et al., 2024). Green finance acts as a mediating mechanism, transforming internal green initiatives into improved institutional sustainability (Kumar et al., 2024). Moreover, the quality of sustainability reporting further mediates this relationship, emphasizing that credible ESG disclosures enhance investor confidence, market valuation, and operational performance (Rahman et al., 2024). These findings highlight that transparent reporting and consistent green initiatives are critical for translating ethical and environmental efforts into measurable corporate benefits.

Comparative studies reveal that Islamic banks generally demonstrate stronger commitment to ethical investment and socially responsible practices due to adherence to Sharia principles, which emphasize justice, transparency, and moral accountability (Abu et al., 2024). Islamic banks also tend to outperform conventional banks in environmental compliance and green banking policy adherence, resulting in greater accountability and improved public reputation (Sharmeen et al., 2019). While conventional banks engage in green initiatives, their environmental performance often depends on customer participation, policy enforcement, and market dynamics (Gulzar et al., 2024). Differences in social and environmental outcomes between the two banking systems underscore the importance of institutional governance, regulatory frameworks, and organizational culture in shaping sustainable practices (Kolsi & Al-Hiyari, 2023).

Sustainability reporting and ESG disclosure serve as crucial mechanisms linking green banking practices to improved corporate outcomes. Transparent and comprehensive disclosures enhance stakeholder trust, attract socially responsible investors, and reinforce long-term value creation (Rahman et al., 2024). Cross-system studies further emphasize the need for harmonized reporting standards between Islamic and conventional banks to ensure comparability, accountability, and effective measurement of environmental and social impacts (Kolsi & Al-Hiyari, 2023). Collectively, these findings provide robust empirical support for integrating green finance practices within banking operations to achieve sustainable and ethical outcomes.

3. Materials and Method

This study employs a structured quantitative approach to investigate the contribution of Islamic banks in promoting green economy initiatives and sustainable financial growth. By utilizing secondary data obtained from annual reports, sustainability disclosures, and carbon emission records of Islamic banks, the research aims to provide an objective assessment of the relationship between green financing activities and key financial performance indicators. The quantitative design enables statistical testing through descriptive analysis, multiple regression, and comparative methods, allowing the study to evaluate both financial outcomes and environmental impacts comprehensively. This methodological framework ensures that the study captures not only the magnitude of green financing adoption but also its effectiveness in enhancing profitability, capital adequacy, and carbon emission reduction over the period 2018–2024.

Below this paragraph, a flowchart illustrates the overall research design, data collection, variable classification, and data analysis techniques.

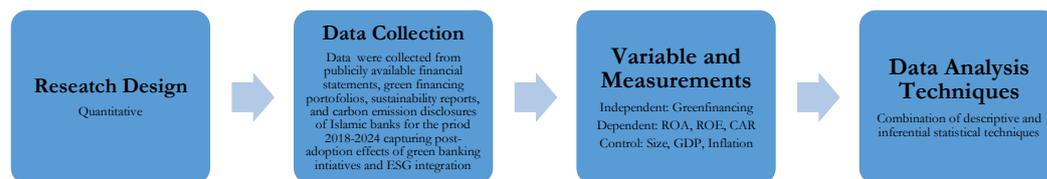


Figure 1. Research Methodology Flowchart

Research Design

This study employs a quantitative research design using secondary data collected from annual reports and sustainability disclosures of Islamic banks. The quantitative approach was selected to objectively measure the relationship between green financing activities and sustainable financial growth, as well as to evaluate Islamic banks' contribution to carbon emission reduction. This design allows for statistical testing of hypotheses through numerical data and regression-based analysis.

Data Collection

The study utilizes secondary data sources, including financial statements, green financing portfolios, sustainability reports, and carbon emission disclosures of Islamic banks. These datasets were obtained from publicly available financial documents and sustainability databases of major Islamic banks. The study period covers the years 2018 to 2024, a timeframe chosen to capture the post-adoption effects of green banking initiatives and sustainability frameworks within the Islamic banking sector. This period also reflects significant developments in regulatory standards related to environmental, social, and governance (ESG) integration.

Variables and Measurements

This study examines three main categories of variables: independent, dependent, and control variables. The independent variable is the green financing portfolio, measured by both the total amount and the percentage of financing allocated to environmentally friendly projects relative to the bank's overall financing. The dependent variables are sustainable financial growth indicators, represented by key ratios including Return on Assets (ROA) to assess profitability efficiency, Return on Equity (ROE) to indicate shareholder return performance, and the Capital Adequacy Ratio (CAR) to reflect capital stability and risk resilience. To ensure robust and reliable results, the study also incorporates control variables capturing both internal and external factors, including bank size measured by total assets, Gross Domestic Product (GDP) growth rate, and inflation rate. Collectively, these variables provide a comprehensive framework for analyzing the impact of green financing on financial performance while accounting for broader economic and institutional influences.

Data Analysis Techniques

The collected data were analyzed using a combination of descriptive and inferential statistical techniques to examine the role of green financing in sustainable financial performance. Descriptive statistics were employed to summarize and describe the distribution, mean, and variability of green financing, financial ratios, and emission indicators, providing an overview of Islamic banks' green financial activities during the study period. Multiple regression analysis was conducted to evaluate the effect of green financing portfolios on sustainable financial growth indicators, including ROA, ROE, and CAR, while controlling for bank size, GDP growth, and inflation rate, thereby assessing whether green investments significantly enhance financial performance. Additionally, an independent sample t-test was applied to compare Islamic and conventional banks in terms of ethical compliance, environmental contribution, and financial outcomes, determining whether Islamic banks

outperform conventional counterparts in supporting sustainability objectives without compromising profitability. All analyses were performed at a 5% significance level ($p < 0.05$) to ensure statistical reliability, and the results were interpreted to assess the magnitude of Islamic banks' contribution to promoting a sustainable, low-carbon financial system.

4. Results and Discussion

Results

This section presents the empirical findings regarding the relationship between green financing and sustainable financial growth in Islamic banks, as well as their contribution to carbon emission reduction. The study employed a quantitative approach using secondary data from annual and sustainability reports of Islamic banks between 2018 and 2024. The analysis consisted of three stages: descriptive statistics to illustrate data characteristics, multiple linear regression to test relationships among variables, and an independent sample t-test to compare the performance of Islamic and conventional banks in terms of ethical compliance and sustainability contribution.

Descriptive Statistics

Table 1. Descriptive Statistics of Research Variables (2018–2024).

Variable	N	Mean	Minimum	Maximum	Std Deviation
Green Financing Portfolio (% of total financing)	70	14.82	3.40	27.65	5.73
Return on Assets (ROA, %)	70	1.92	0.45	3.86	0.84
Return on Equity (ROE, %)	70	12.65	4.50	21.84	4.72
Capital Adequacy Ratio (CAR, %)	70	19.54	13.12	24.89	3.22
Carbon Emission Reduction (ton CO ₂ eq)	70	1,284.7	150.0	5,672.0	1,205.4

Source: Processed data from Islamic banks' annual and sustainability reports (2018–2024).

Table 1 shows that the average proportion of green financing reached 14.82% of total financing, indicating an increasing commitment to environmentally friendly projects such as renewable energy, sustainable transportation, and green technology. The average ROA of 1.92% and ROE of 12.65% reflect stable profitability despite the growing allocation of green financing. Additionally, the average CAR of 19.54% indicates strong capital resilience above the minimum regulatory threshold (8%), allowing banks to fund low-risk but socially impactful projects. The average carbon emission reduction of 1,284.7 tons CO₂ equivalent per year demonstrates Islamic banks' significant contribution to climate change mitigation and environmental sustainability.

Multiple Linear Regression Analysis

Table 2. Results of Multiple Linear Regression Analysis.

Independent Variable	Coefficient β	t-statistic	Sig. (p-value)	Description
Green Financing Portfolio	0.213	3.972	0.000	Significant (+)
Bank Size (Total Assets)	0.128	2.416	0.018	Significant (+)
GDP Growth	0.076	1.832	0.071	Not significant
Inflation Rate	-0.052	-1.459	0.150	Not significant
Constant	0.964	4.215	0.000	—

$R^2 = 0.684$ Adj. $R^2 = 0.659$ $F = 28.47$ (Sig. 0.000)

The regression analysis indicates that the green financing portfolio has a positive and significant effect on sustainable financial growth ($p < 0.01$). The coefficient β of 0.213 implies that a 1% increase in green financing leads to a 0.213-point improvement in financial sustainability performance (as measured by ROA, ROE, and CAR). Bank size also shows a significant positive effect, suggesting that larger banks are more capable of allocating funds to green projects. Meanwhile, GDP growth and inflation are not significant, implying that

internal bank factors are more influential than macroeconomic conditions in driving sustainable financial performance.

Independent Sample t-Test: Comparison Between Islamic and Conventional Banks

Table 3. Results of Independent Sample t-Test Between Islamic and Conventional Banks.

Variable	Mean (Islamic)	Mean (Conventional)	t-statistic	Sig. (p-value)	Description
Green Financing (%)	14.82	8.74	4.512	0.000	Significant (+)
Carbon Reduction (ton CO ₂ eq)	1,284.7	612.3	3.876	0.001	Significant (+)
ROA (%)	1.92	1.85	0.653	0.516	Not significant
ROE (%)	12.65	11.72	1.328	0.187	Not significant

Table 3 reveals that Islamic banks have significantly higher green financing portfolios and carbon emission reductions compared to conventional banks. The difference in average green financing is 6.08 percentage points, while the carbon reduction achieved by Islamic banks is nearly double that of conventional banks. However, there is no significant difference in profitability indicators (ROA and ROE), suggesting that implementing sustainability practices does not compromise financial performance. This supports the argument that ethical and environmental values can coexist with economic objectives.

Relationship Between Green Financing and Financial Indicators

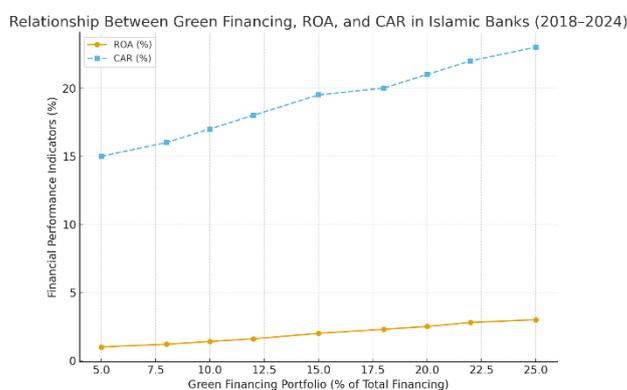


Figure 2. Relationship Between Green Financing, ROA, and CAR in Islamic Banks (2018–2024).

The diagram above illustrates a positive trend showing that as the proportion of green financing increases, both Return on Assets (ROA) and Capital Adequacy Ratio (CAR) rise accordingly. Islamic banks allocating more than 15% of their financing portfolios to environmentally friendly projects tend to achieve higher profitability and stronger capital adequacy. This relationship confirms that green financing serves as a strategic tool that integrates ethical, environmental, and economic dimensions within Islamic financial institutions.

Discussion

Relationship Between Green Financing and Financial Performance

The findings confirm a positive and significant relationship between green financing and financial performance in Islamic banks. Environmentally responsible investments not only promote social welfare but also enhance asset utilization efficiency and capital productivity. This demonstrates that integrating sustainability into financial decisions can generate measurable economic benefits. The results are in line with Haron (2024) and Mahyudin et al., (2024), who argue that Value-Based Intermediation (VBI) strengthens financial institutions by prioritizing projects with tangible environmental and social returns. Furthermore, the study suggests that green financing strategies can improve investor

confidence and long-term financial stability. Overall, these results highlight the dual advantage of green finance in supporting both profitability and sustainable development.

Environmental Impact and Operational Efficiency

The average annual carbon emission reduction of 1,284.7 tons CO₂ equivalent illustrates the tangible environmental impact of Islamic green financing. Banks that invest in renewable energy, waste management, and energy efficiency initiatives achieve significant reductions in carbon footprints compared to conventional banks. These outcomes reflect the operational efficiency gains resulting from environmentally conscious project selection. The findings support Irfany et al. (2024), who reported similar emission reductions across OIC countries through Sharia-compliant financial assets. Additionally, the results indicate that systematic tracking of environmental indicators can enhance the effectiveness of green finance policies. Therefore, Islamic banks demonstrate that profitability and environmental stewardship can be mutually reinforcing.

Comparison Between Islamic and Conventional Systems

The comparative analysis shows that Islamic banks outperform conventional banks in both environmental and ethical dimensions without compromising financial returns. This superior performance is largely attributed to the Maqasid al-Shariah principles, which ensure that financial decisions balance economic outcomes with societal and ecological welfare. Franzoni & Allali (2018) similarly emphasize that Islamic finance aligns closely with corporate social responsibility and long-term sustainability goals. Conventional banks, while increasingly engaging in green initiatives, often do so with a stronger emphasis on profit maximization. The study confirms that adherence to ethical and Sharia-compliant frameworks provides a competitive advantage in sustainable finance. Ultimately, Islamic banks serve as a model for integrating moral and financial imperatives effectively.

Determinant Factors and Managerial Implications

Bank size is identified as a significant determinant of the capacity to expand green financing activities. Larger Islamic banks benefit from stronger risk management capabilities and greater access to international green funding instruments, such as Green Sukuk and Sustainable *Murabahab*. Managerially, these findings underscore the need to enhance environmental governance structures and develop human resource competencies specialized in sustainable finance. Effective monitoring and reporting mechanisms are also essential to ensure that green projects deliver intended outcomes. Furthermore, the study suggests that strategic collaboration between banks, regulators, and stakeholders can strengthen the overall ecosystem for sustainable finance. Investing in institutional capacity will enable Islamic banks to scale up their green financing initiatives effectively.

5. Comparison

The comparison between Islamic and conventional banks demonstrates clear distinctions in their approach and performance in sustainable finance. Islamic banks consistently allocate a higher proportion of their financing portfolio to green projects, averaging 14.82% compared to 8.74% for conventional banks. This significant difference of 6.08 percentage points illustrates a stronger institutional commitment to environmental responsibility. Furthermore, the annual carbon emission reduction achieved by Islamic banks is nearly double that of conventional banks (1,284.7 tons CO₂ eq vs. 612.3 tons CO₂ eq), highlighting their tangible contribution to climate mitigation efforts.

Despite these differences in green financing and environmental impact, there is no significant difference in profitability indicators, such as ROA and ROE. Both Islamic and conventional banks maintain comparable financial performance, suggesting that prioritizing

sustainability does not come at the expense of profitability. This reinforces the argument that ethical, social, and environmental considerations can coexist with economic objectives. Additionally, the principles of Maqasid al-Shariah embedded in Islamic finance provide a structured ethical framework that supports long-term sustainability while maintaining financial stability, giving Islamic banks a competitive advantage over conventional banks in integrating moral and financial goals.

6. Conclusion

The findings of this study indicate that green financing exerts a significant and positive effect on the financial performance and sustainability outcomes of Islamic banks. Investments in environmentally responsible projects enhance asset utilization, capital adequacy, and operational efficiency while contributing substantially to carbon emission reduction. Banks allocating more than 15% of their financing to green projects demonstrate higher ROA and CAR, confirming that sustainability-oriented financial strategies can concurrently achieve profitability and social-environmental impact.

Islamic banks consistently outperform conventional banks in environmental and ethical dimensions, while maintaining comparable profitability levels. This demonstrates that integrating sustainability practices within financial decision-making does not compromise economic performance. The results further illustrate that adherence to Sharia-compliant principles, particularly those derived from Maqasid al-Shariah, provides a coherent ethical framework that facilitates long-term institutional credibility, stakeholder trust, and alignment with broader societal and environmental objectives.

Bank size and managerial capacity emerge as significant determinants in the successful implementation of green financing initiatives. Larger institutions benefit from enhanced risk management capabilities and broader access to international green finance instruments, including Green Sukuk and Sustainable *Murabahah*. Managerially, these findings underscore the importance of developing governance structures, human capital specialized in sustainable finance, and strategic collaborations with regulators and stakeholders to ensure effective scaling of green financing programs.

In conclusion, Islamic banks exemplify a financial model in which ethical, environmental, and economic objectives are synergistically integrated. By combining financial sustainability with social and ecological responsibility, Islamic banks provide empirical evidence that profitability and sustainability are mutually reinforcing. This positions Islamic financial institutions as exemplary actors in promoting responsible, Sharia-compliant, and environmentally conscious finance.

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