



HIGHLIGHTING THE CONVERGENCE BETWEEN THE PRINCIPLES OF ISLAMIC FINANCE AND THE PRINCIPLES OF SUSTAINABLE FINANCE

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ABSTRACT

Sustainable finance and Islamic finance hold significant potential to facilitate sustainable development. Both systems are continually being developed, researched, and advanced by academics, global industry players, and policymakers. However, to the best of the author's knowledge, a limited amount of research specifically explores the convergence between the principles of Islamic finance and sustainable finance. Therefore, this study aims to examine and highlight the convergence between the principles of the two concepts as they continue developing better financial models based on ethical values. Using a qualitative approach and based on comparative research, the paper found several convergences between the principles of sustainable finance and the principles of Islamic finance. The goals of the two concepts show equal concern for people and the planet. Sustainable and inclusive development are the main points of both concepts. Finally, this study argues that Islamic finance itself promises a more sustainable model for the financial industry.

Keywords: Sustainable Finance, Islamic Finance, *Maqasid al-Shariah*, ESG, Sustainability

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INTRODUCTION

Sustainable finance has become a key focus in economics and finance, attracting attention from both scholars and practitioners. Many countries and organizations are adopting and developing sustainable finance concept. Investors are increasingly interested in the growing variety of investments and financial products related to sustainability. Consequently, sustainable finance has emerged as an important trend that continues to evolve across financial industries worldwide (Budiharjo & Ismail, 2020; Wardhana, 2021).

Similarly, several countries have embraced and advanced Islamic finance to foster inclusive and sustainable development through financial mechanisms emphasizing profit-sharing and the prohibition of interest. Furthermore, Islamic finance prioritizes promoting social welfare and justice, ensures equitable wealth distribution, and prohibits exploitative practices and other unlawful contracts (Ayub, 2007; Iqbal & Mirakhor, 2011). Its implementation extends beyond Muslim-majority countries, reaching various nations around the world. It is known that Islamic banks nowadays not only operate in Muslim countries but have also extended their wings to Western countries to serve both Muslims and non-Muslims. The nature of Islamic finance is indeed for all people, regardless of religious considerations.

Global industry players and policymakers accept and advance both systems to foster holistic development through financial facilitation. Given the potential of sustainable finance and Islamic finance to facilitate sustainable development, both systems are continually being researched and advanced. However, to the best of the author's knowledge, a limited amount of research specifically explores the convergence between the principles of Islamic finance and sustainable finance. Thus, conducting a comprehensive study to investigate the convergence between Islamic finance and sustainable finance, particularly their foundational principles, is essential.

The study is structured into five sections, including the introduction. Section 2 reviews the literature regarding the principles of Islamic finance and sustainable finance. Section 3 focuses on the research method, and Section 4 discusses and analyzes the results. Section 5 concludes the study and provides suggestions for future research.

LITERATURE REVIEW

Islamic Finance and Its Basic Principles

There are several definitions of Islamic finance. According to Rosly and Zainal (2009), Islamic Finance is defined as a field of study and professional practice that concerns the Shariah compliance status of, among other things, economics, banking, takaful, asset and investment management, unit trust, wealth planning activities and business. Ayub (2007) stated that Islamic finance is conceived as finance in consonance with Islam's ethos and value system. Accordingly, Islamic finance refers to financial operations, products, and transactions that adhere to Islamic law.

Islamic Finance's primary purpose is to achieve *maslahah* (public welfare and benefit) and *maqashid al-Shariah* (the objectives of *Shariah*). The *maqashid al-Shariah* is comprised of five protective objectives: 1) *hifz ad-din* (protection of faith), 2) *hifz an-nafs* (protection of life), 3) *hifz an-nasl* (protection of lineage), 4) *hifz al-aql* (protection of intellects), and 5) *hifz al-maal* (protection of wealth/property). *Hifz al-bi'ah* (protection of the environment) has also been added. However, it is considered an integrated part of the five (Al-Qaradhawi, 2001).

Scholars and researchers present differing views regarding the principles of Islamic finance. While some identify five principles, others recognize six, although the fundamental





essence remains consistent across these perspectives. Here, the author categorizes them into two groups: core principles and ethical principles.

Core Principles of Islamic Finance

First, the prohibition of *riba*. *Riba* literally means surplus, gain, or growth (*lughatan*). Technically (*istilahan*) refers to a sum of money/payment that the debtor must provide to the creditor in addition to the principal loan, as a condition of the loan, or as payment for an extension of the loan deadline (Askari et al., 2015; Iqbal & Mirakhor, 2011).

Second, avoidance of *gharar*. *Gharar* denotes dishonesty, ambiguity, risk, or hazard that might lead to destruction and loss. It refers to the doubt of one or both parties over the particulars of the object of the contract or uncertainty of its existence at the moment of transaction. *Gharar* may lead to a conflict due to unfairness and satisfaction of the parties involved in the contract—examples of *gharar* include insurance, futures, and options contracts. Extreme *gharar* is called *maisir* or gambling, and it is strongly forbidden in Islam (Adelabu et al., 2011; Iqbal & Mirakhor, 2011; Laldin & Furqani, 2013).

Third, Islam forbids the collection of interest. However, it encourages investor-entrepreneur partnerships rather than creditor-debtor relationships. In addition to sharing profits, investors also share losses, whereas creditors do not. The goal of the idea is to ensure that investments are made in productive and real-sector activities for the ultimate benefit of the community (Kettell, 2011).

Fourth, the engagement in real economic activities. Islam favors economic and commercial transactions involving tangible goods. In contrast to traditional financial systems, the Islamic system is built on illiquid assets that generate actual assets and inventory (Usmani, 1998). Interests make “false” money without creating the equivalent quantity of actual commodities.

Fifth, creating money from money is prohibited. In Islam, money is defined as a unit of measurement and used as an exchange tool for business or commercial transactions (Mohsin, 2011). From an Islamic perspective, money is not regarded as a commodity to be traded for profit. Consequently, utilizing money to generate profit through fixed-interest payments is prohibited.

Sixth, Shariah approved activities. Only enterprises that adhere to *Shariah* principles are permitted. For instance, it is permissible to engage in commercial activities like selling, trade, service, as well as custody, and social activities like *zakat*, *infaq*, and *waqf*. However, Islam prohibits activities or companies involving *haram* (illegal) goods such as alcohol, pork, and pornography (Budiharjo & Ismail, 2020; Laldin & Furqani, 2013).

Ethical Principles of Islamic Finance

There are three ethical principles of Islamic finance, which are as follows:

First, fair and transparent financial dealings. According to Quranic provisions, all transactions in Islamic finance must be done with the mutual consent of the parties (Quran, 4:29). Because the formation of a contract is based on the mutual consent of the parties, contracts formed under duress are prohibited. In order to reach mutual consent, all parties should disclose any information regarding the contract. Islamic finance upholds the disclosure and transparency of information (Askari et al., 2010). In addition, it forbids taking advantage of someone’s ignorance and charging a high price. For example, they may hide defective goods or reduce the buyer's weight. The mutual consent concept covers the relationship between seller and buyer and between employer and employee. The exploitation of any party in a business,





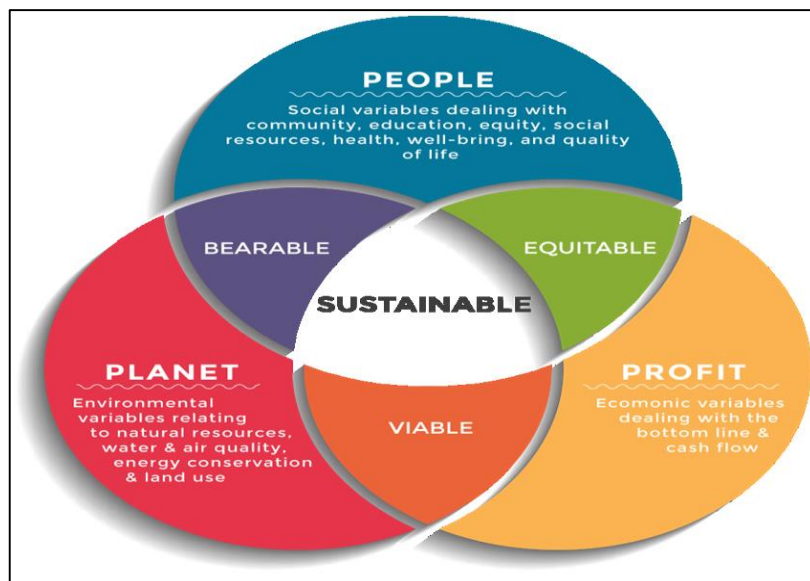
for example, exploiting cheap labour in pursuit of material profits, is against Shariah principles. Islam emphasizes the protection of property rights and a balance between the rights of individuals, society and the state (Budiharjo & Ismail, 2020).

Second, the avoidance of prohibited activities is a key principle. The objective of all Shariah prohibitions is to ensure the realization of *maslahah* (public welfare or public interest) and to prevent harm. Shariah aims to ease people's lives and alleviate suffering. In line with the Islamic legal maxim (*al-qawa'id al-fiqhiyyah*), harm must be eliminated wherever possible. (Lahsasna, 2011). Shariah forbids any activity that could harm or endanger human life. It prohibits practices such as hoarding, monopoly, exploitation, oppression, violation of others' rights, and fraud. Additionally, Islam disallows investments in businesses deemed unethical or immoral, including those that unnecessarily exploit natural resources, exploit cheap labour for material gain, or contribute to the pollution of water and air.

Third, commitment of Islamic values. *Ihsan* (excellence), *'adl* (justice), *tawazun* (balance), *wuduh* (transparency) *khalifah* (vicegerent), *tazkiya* (purification), and *rahmatan lil aalamiin* (compassion for all creation) are some examples of the Islamic ideals. They are applicable across various sectors, including finance. For instance, incorporating *ihsan* in Islamic Finance can manifest through various practices, such as ensuring good governance, promoting environmentally sustainable business operations, engaging in Corporate Social Responsibility (CSR), supporting charitable initiatives, and implementing robust risk management strategies (Budiharjo & Ismail, 2020; Dusuki & Abdullah, 2007).

Sustainable Finance and Its Principles

Discussions about sustainability and sustainable finance dominate today's academic and professional discourses. Sustainability addresses current needs without jeopardizing future generations' ability to meet their own. Economic, environmental, and social factors all contribute to sustainability. The notion is also known as the Triple Bottom Line (TBL), which is a sustainability concept created by Elkington (1997). This TBL dimension is also called the Triple-P or 3Ps: people, planet, and profits. A sustainability Venn diagram can be used to illustrate the relationship between these three components. The diagram can be seen below:



Source: Dalibozhko & Krakovetskaya (2018)

Figure 1: The relationship of the three pillars of sustainability



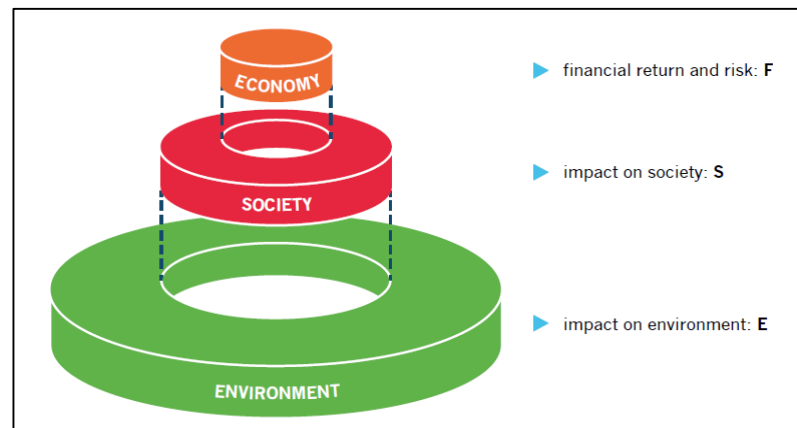


The diagram in Figure 1 shows that to achieve sustainability, it is absolutely essential to equalize the social, economic, and environmental aspects. People + profit = equitable, people + planet = bearable, profit + planet = viable, and only through balancing people + profit + planet will sustainability be achieved (Dalibozhko & Krakovetskaya, 2018; Slaper, 2011). According to Schoenmaker (2019), connections between the economy, society, and environment are always existing.

The framework for controlling sustainable development is depicted in Figure 2. Rockström and Sukhdev (2016) argue that sustainable development is organized into three categories: the economy, society, and environment. Nonetheless, they highlight the SDG levels' interconnectedness. For example, a decent salary and sufficient job for all (at the economic level) lead to the attainment of objectives (level of society). Families can purchase groceries, send their children to school, and provide healthcare coverage for their families if they earn a decent salary. Then, sustainable consumption, production, and urban areas play a significant role in the fight against climate change (level of the environment).

Therefore, sustainable finance refers to any form of financial service including banking, investment, accounting, insurance, trading and financial reporting, that goes beyond business by integrating environmental, social and governance (ESG) criteria into the business or investment decisions for the lasting benefit of clients, stakeholders and society at large (Edwards et al., 2019; Krauss et al., 2016; Swiss Sustainable Finance, 2019). It can also be defined as financial decision-making with a long-term focus that incorporates governance, social, and environmental factors.

Furthermore, according to OJK (Otoritas Jasa Keuangan) the principles of sustainable finance programs in Indonesia comprise the following (Otoritas Jasa Keuangan Indonesia, 2014): *First*, risk management concept that incorporates parts of environmental and social security into Financial Services Industries' (FSIs) risk management in order to prevent, reduce, and limit any adverse implications and promote more significant value in FSI's financing and operational operations.



Source: Schoenmaker (2017).

Figure 2: Managing Sustainable Development

Second, establishing an inclusive and sustainable priority economic sector concept by increasing funding activities, particularly in the industrial, energy, agriculture, infrastructure, and Small and medium enterprise sectors, while retaining stability between economic, environmental, and social criteria. *Third*, the environmental and social governance and reporting concept: implementing precise and effective environmental and social governance strategies in the FSIs' operations and the practices administered by the FSIs' clients. *Fourth*,





the capacity development and collaborative partnership concept establishes cooperation between FSIs, regulators, governments, and other domestic and international institutions.

Table 1: Framework for Sustainable Finance

Sustainable Finance Typology	Value created	Ranking of factors	Optimisation	Horizon
Finance-as-usual	Shareholder value	F	Max F	Short term
Sustainable Finance 1.0	Refined Shareholder value	$F > S$ and E	Max F subject to S and E	Short term
Sustainable Finance 2.0	Stakeholder value	$T = F + S + E$	Optimise T	Medium term
Sustainable Finance 3.0	Common good value	S and $E > F$	Optimise S and E subject to F	Long term

Note: F = financial value; S = social impact; E = environmental impact; T = total value. At Sustainable Finance 1.0, the maximisation of F is subject to minor S and E constraints.

Source: Schoenmaker (2017).

Furthermore, sustainable finance typology consists of three stages, as outlined in Table 1 above. These stages progress from a finance-first approach to a balanced consideration of all aspects and ultimately to prioritizing social and environmental impact (as seen in the ranking of factors in the third column). Ultimately, the fundamental principles of sustainable finance can be summarized as follows: 1) Integration of Environmental, Social, and Governance (ESG) factors into business or investment decisions; 2) A long-term approach to financial and investment strategies; 3) Responsible and ethical financing practices; 4) Promotion of priority economic sectors; and 5) Emphasis on coordination and collaboration (Budiharjo et al., 2023).

Additionally, Sustainable finance investment strategies can be classified as either negative/exclusionary or positive/integrated. *First*, negative (exclusionary) strategies focus on identifying risks based on non-financial performance measured by ESG (Environmental, Social, and Governance) criteria. This approach recalibrates the long-term risk profile of companies, particularly those with high carbon emissions. As a result, investors may choose to divest from or avoid high-risk ESG investments, with the most common focus being on companies with high carbon intensity.

Second, positive (integrated). This category intends to gain a ‘double delta’ effect by providing new and extra capital and emphasizing high start-ups or impact companies with significant growth potential. Positive sustainable finance is frequently linked to having a more significant contribution to one or more of the 17 SDGs. Positive sustainable finance investment approaches prioritize allocating additional capital to high-impact businesses (Nicholls, 2021).

RESEARCH METHOD

This research uses comparative approach. According to Abubakar (2021, p. 7), comparative research is the research that compares two objects. It finds similarities and differences between things, procedures, ideas, or systems. This research tries to find the convergences between the principles of Islamic finance and the principles of sustainable finance. Therefore, a comparative study should be the most suitable approach. Comparison is the core of the majority of social sciences research. Comparative analysis is characterized by examining different entities to find important similarities and differences.

According to Gibbs (2007, p. 73), comparison is a crucial phase of analysis that allows one to move beyond mere description. He emphasized that tables play a key role in facilitating





this process. Therefore, several tables were employed in this study to conduct the comparative analysis. This study relies on secondary data from various internal sources, including the Internet and libraries. It draws upon existing literature on Islamic finance, Shariah, *maqasid al-Shariah*, and sustainable finance. Furthermore, it incorporates Islamic sources (*turats*) and the interpretation of Quranic texts and Hadith (*nusus*). Finally, all data are analyzed using content analysis.

RESULTS

Sustainable finance emerged in response to the neglect of social and environmental issues in traditional economic considerations. Pursuing profit should not diminish the commitment to protecting and preserving the environment or enhancing social well-being. At its core, sustainable finance emphasizes inclusive and sustainable development. Similarly, Islamic finance aligns with this focus, prioritizing social welfare, justice, and equitable distribution of wealth. It prohibits practices such as *riba* (interest), *gharar* (excessive uncertainty), *maisir/qimar* (gambling), exploitation, and other unlawful contracts. Shariah strictly forbids these elements in financial transactions, as they lead to injustice, exploitation, and conflict between parties.

Sustainable finance has emerged as a new paradigm that integrates ethical values into the market. Likewise, Islamic finance emphasizes socio-economic justice and encompasses a comprehensive framework of ethical principles. Considering their features, both Islamic finance and sustainable finance promote an economic concept that goes beyond the financial system, positioning them as key components of a value-based social system. Both systems place equal importance on people and the planet. Sustainable finance incorporates environmental, social, and governance (ESG) factors into business operations.

Similarly, Shariah greatly emphasizes environmental stewardship and the responsible use of natural resources. It prohibits extravagance and economic activities that excessively exploit resources, exploit cheap labour for material gain, or cause water and air pollution. In alignment with the *khalifah* (stewardship) concept, humans are entrusted to use the planet's resources responsibly and protect all of creation (*rahmatan lil 'alamin*). These concepts demonstrate apparent similarities and convergence, as reflected in their core principles. The table below illustrates how Islamic Finance (IF) and Sustainable Finance (SF) align regarding their fundamental features and principles.

Table 2: The Convergence

IF's Principles	Implication	SF's Principles	The Convergence
<ul style="list-style-type: none"> Prohibition of <i>riba</i> Avoidance of <i>gharar</i> Creating money from money is prohibited 	<ul style="list-style-type: none"> No gap between real and financial sector No bubble economy Stability of financial system 	<ul style="list-style-type: none"> Responsible and ethical financing 	<ul style="list-style-type: none"> Economic well-being





IF's Principles	Implication	SF's Principles	The Convergence
<ul style="list-style-type: none"> Profit and loss sharing The engagement in real economic activities 	<ul style="list-style-type: none"> Promote the establishment of new enterprises The creation of work Economic growth 	<ul style="list-style-type: none"> Long-term financial and investment approach Development of priority economic sector 	<ul style="list-style-type: none"> Long-term orientation
<ul style="list-style-type: none"> Shariah approved activities Avoidance of forbidden activities 	<ul style="list-style-type: none"> No social problem No destruction of environment Social stability Poverty reduction Preservation of environment 	<ul style="list-style-type: none"> ESG integration 	<ul style="list-style-type: none"> Concern both for people and the planet Inclusive and sustainable development
<ul style="list-style-type: none"> Fair and transparent financial dealings 	<ul style="list-style-type: none"> Mutual consent concept Manage moral hazard risk Socio-economic justice No exploitation of any party in a business No exploiting cheap labor 	<ul style="list-style-type: none"> Responsible and ethical financing 	<ul style="list-style-type: none"> Ethical values
<ul style="list-style-type: none"> Commitment to Islamic values 	<ul style="list-style-type: none"> Good governance Environmentally-friendly business Impact investing CSR 	<ul style="list-style-type: none"> Coordination and collaboration ESG integration 	<ul style="list-style-type: none"> Preserving interest of the next generation

From the table above, it is obtained that there are at least six convergences between the principles of SF and IF. It can be described in Figure 3.

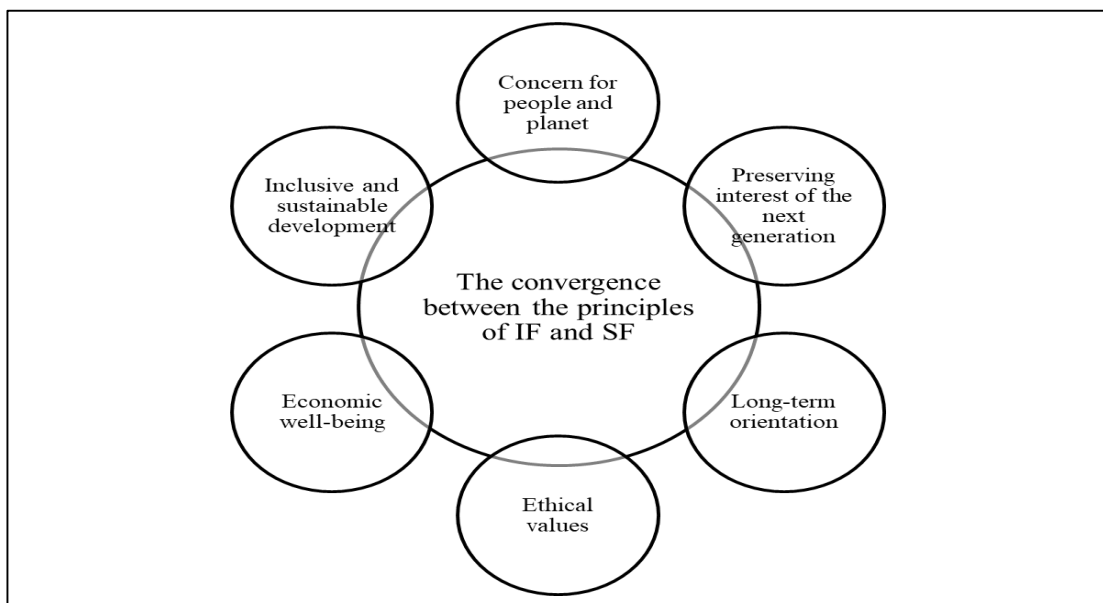


Figure 3: The Convergence Between The Principles of SF and IF





Moreover, Islamic financial contracts (*aqd*) and instruments are in harmony with the goals of sustainable finance, actively contributing to its objectives. These instruments highlight that the Islamic financial system naturally incorporates many of the fundamental principles and features associated with sustainable finance.

Table 3: Islamic Contract (*Aqd*) and Instruments that Support Sustainability

SF's Principles	<i>Aqd</i> and Instruments in IF
ESG integration	Waqf, zakat, <i>infaq</i> , <i>shadaqa</i> , sukuk, Islamic micro-financing (<i>Baitu al-Maal wa at-Tamwil</i>),
Long-term financial and investment method	<i>Waqf</i> , sukuk, <i>musharakah</i>
Responsible and ethical financing	<i>Murabaha</i> , <i>mudharabah</i> , <i>musyarakah</i> , <i>salam</i> contract, <i>khiyar</i>
Development of sustainable priority economic sectors	<i>Waqf</i> , green sukuk, <i>musyarakah</i> , <i>mudharabah</i> , Islamic micro-financing
Capacity development and collaborative partnership	Micro-takaful, profit-sharing, <i>musyarakah</i> , <i>mudharabah</i> , zakat, <i>infaq</i> , <i>waqf</i>

Hence, several previous research also argued that Islamic finance is essentially a more sustainable model for dealing with the real sector, addressing poverty, financial inclusion, and environmental sustainability issues. Many Islamic financial contracts (*'aqd*) and instruments support the sustainable development agenda (Budiharjo & Ismail, 2020; Shaikh & Hassan, 2020; Sheng, 2013). Moreover, many previous studies concluded that Islamic microfinance institution is essentially embedded with the sustainable finance concept in which the institution incorporates ESG (environmental, social and governance) value into its business vision, mission, strategy and operation (Ascarya, 2018, 2014; Ascarya & Widodo, 2012; Begum et al., 2019; Rashid et al., 2018; Shaikh, 2014).

Other than that, various instruments and institutions were established throughout Islamic history, contributing to economic, environmental, and societal sustainability. These instruments can be summarized as follows:

Table 4. Islamic Institutions for Sustainability Objectives

No.	Instruments	Explanation
1.	<i>Ihya al-mawat</i> (revival of dead land)	Individuals can acquire land ownership by irrigating or rehabilitating dead or barren land. Whoever revitalizes such land is entitled to its produce. Land that can be acquired through <i>ihya al-mawat</i> refers to land not owned by anyone.
2.	<i>Iqta'</i> (state grants land)	Under Shariah, governments are authorized to issue <i>iqta</i> grants of unowned land to individuals and institutions for reclamation and development purposes. These grants may include concessions for activities such as agriculture, horticulture, construction, and more, as well as relocation of such developments to suitable areas away from undesirable locations.
3.	<i>Hima</i> (natural reserves)	Wildlife and natural resources are protected under Shariah through the implementation of zoning areas.
4.	<i>Haram</i> (zoning and land use planning)	This includes safeguarding water resources, communal pastures, woodlands, and lands that contain resources essential to the community's welfare objectives.
5.	<i>Waqf</i>	An institution is established by dedicating a person's assets to permanently allocate the generated income toward fulfilling specific needs, according to the preferences and conditions set by its founder.





6.	<i>Hisbah</i> (market regulation)	A religious institution operating under the state's authority designates individuals to uphold the responsibility of promoting what is right when people begin to neglect it and prohibiting what is wrong when they engage in it. Muslim states historically controlled, intervened in and supervised various economic activities through this institution.
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In conclusion, Sustainable finance incorporates many elements of Shariah. The goals of *maqasid al-Shariah* (objectives of Shariah) and the objectives of sustainable finance are closely interconnected. The relationship between Islamic finance, and Shariah is depicted in the Figure 4 below. It highlights Shariah as the foundation of the Islamic financial system and as part of the core principles within the sustainable finance framework in Islamic finance. While Shariah largely encompasses sustainable finance principles, there are key distinctions between the two, such as the prohibition of *riba* (interest), *gharar* (excessive uncertainty), *ghish* (deception), profit-sharing mechanisms, and perspectives on money, which are not addressed within the sustainable finance framework.

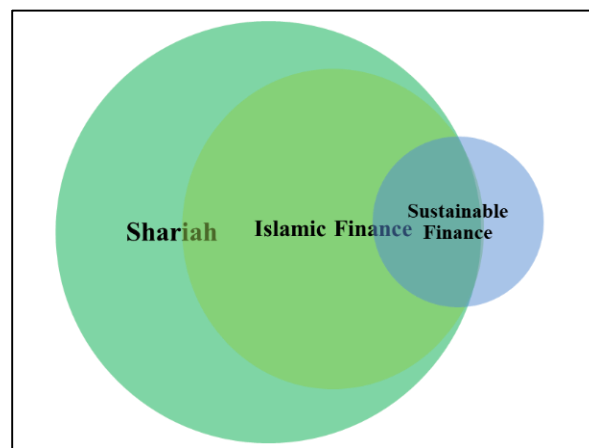


Figure 4: The relationship among Shariah, IF and SF Principles

CONCLUSIONS

This study has achieved its primary objectives, namely, to examine and highlight the convergence between the principles of sustainable finance and Islamic finance. Sustainable finance and Islamic finance share similar goals and missions for society. There are significant convergences between the principles of Islamic finance and those of sustainable finance, which include (1) a commitment to the welfare of both people and the planet; (2) a focus on safeguarding the interests of future generations; (3) a long-term perspective; (4) the incorporation of ethical values; (5) the promotion of economic well-being; and (6) the pursuit of inclusive and sustainable development. The essential principles of sustainable finance are found in the Islamic financial system. However, this study has its limitations, particularly the need for more discussion on the convergence of both systems from a practical perspective.

Based on the above discussion, the authors argue that Islamic finance essentially promises a more sustainable model for dealing with the real sector, addressing poverty, financial inclusion, and environmental sustainability issues. Moreover, many Islamic financial contracts (*'aqd*) and instruments support the sustainable development agenda. Islamic finance has great potential to be developed into a sustainable finance concept with its ethical values.

However, Islamic finance's task is to further transform the Islamic concepts of *Tawhid*, *tazkiya*, *tayyiba*, *ihsan*, *mizan* and voluntary charity into a mechanism that the public can readily





adopt, especially by the financial sector in this discussion. Finally, the author concludes that the current gap is due to a need for more effort to further transform Islamic concepts from their sources into a concept that IFIs (Islamic Financial Institutions) can quickly implement like conventional concepts by developing ESG concepts. Indeed, transformation is the purpose of Islamic economic inquiry itself, and the concept of Tawhid gives rise to the purpose 'to transform', making Islamic economics inherently transformational.

Therefore further research is expected following the findings of this study. The authors suggest to conduct the research in developing sustainable finance model rooted in Islamic principles, given its significant potential to serve as a sustainable framework for the financial industry, particularly for IFIs.

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