

CHAPTER I

INTRODUCTION

1.1 Background of Research

Islamic economics in Asia holds significant power worldwide, as most of its population follows Islam. The Asia-Pacific region constitutes about 25% of the global financial sector¹, and the continent is a key contributor to the world economy through its thriving Islamic financial systems, including Islamic banking and Sukuk investments².

Table 1. Breakdown of the Global IFSI by Sector and Region (USD billion) (2022)

Region	Islamic Banking Assets	Ṣukūk Outstanding	Islamic Funds Assets	Takāful Contributions	Total	Share (%)
Gulf Cooperation Council (GCC)	1342.9	356.6	24.1	16.7	1740.4	53.6%
South-East Asia (SEA)	307.2	411.4	32.8	6.0	757.4	23.3%
Middle East and South Asia (MESA)	478.3	57.8	62.9	5.9	604.9	18.6%
Africa	49.6	2.9	1.9	0.8	55.2	1.7%
Others	71.2	1.0	14.9	0.6	87.7	2.7%
Total	2249.2	829.7	136.6	30.0	3245.5	100.0%
Share %	69.3%	25.6%	4.2%	0.9%	100%	

Source: Islamic Financial Services Industry Stability Report 2023

The Islamic banking sector leads in asset size, as seen in the table above. Islamic banking accounts for 69.3% of the global IFSI asset value, equivalent to USD 2.25 trillion at the end of 2022. The Asian area predominates the Islamic financial market, as seen by the growth of worldwide Islamic financial assets in 2023³. Islamic finance in Asia has shown remarkable growth, as indicated by the faster expansion of Islamic banking institutions relative to their conventional

¹ Chloe Domat, *Islamic Finance: Just for Muslim-Majority Nations*, at [13.00], Global Finance Magazine, <<https://gfmag.com/banking/islamic-finance-just-muslim-majority-nations/>> viewed on January 1, 2024.

² Nurhayati, *Menilik Perkembangan Perbankan Syariah di Kawasan Asia*, kumparan, <<https://kumparan.com/user-27022022124522/menilik-perkembangan-perbankan-syariah-di-kawasan-asia-lxfdhlMwsdi>> viewed on May 7, 2024.

³ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2023*, <<https://www.ifsb.org/publication-document/islamic-financial-services-industry-stability-report-2023/>> viewed on June 26, 2024

counterparts⁴. In line with this, economic growth must be proportional to social inclusion and environmental preservation⁵.

In accordance with the Sustainable Development Goals (SDGs) regarding development, social, economic, and environmental sustainability must be balanced. The SDGs aim to emphasize the importance of sustainable development which must take environmental balance into account⁶. Maintaining ecological balance must be implemented by all sectors, from the community to the financial industry, especially banking⁷.

Along with the world's increasing attention to environmental issues, the banking sector is making changes to its operational activities. Banking is beginning to focus on the concept of the green economy, which differs from the general economic concept. The green economy aims to enhance well-being and social equity through strategies of net-zero emissions and resource efficiency⁸.

The banking sector functions as both a mediator and a catalyst, enabling the movement of goods and services⁹. To meet the need to maintain environmental balance, the scope of banking must be expanded by becoming a more strategic and environmentally friendly institution¹⁰.

⁴ Everington, *The Banker's Top Islamic Financial Institutions 2023*, <<https://www.thebanker.com/The-Banker-s-Top-Islamic-Financial-Institutions-2023-1698828332>> viewed on May 9, 2024.

⁵ April, 'Mengapa menerapkan prinsip keberlanjutan?' Alasan saya bergabung dalam Sustainability Professional Development Programme di APRIL, April Group, <<https://www.aprilasia.com/id/our-media/artikel/mengapa-menerapkan-prinsip-keberlanjutan-alasan-saya-bergabung-dalam-sustainability-professional-development-programme-di-april>> viewed on June 27, 2019.

⁶ SDGs Knowledge Hub, *Advancing Goals the Sustainable Development Goals in Your Community*, SDGs Indonesia, <<https://sdgs.bappenas.go.id/>> viewed on May 9, 2024.

⁷ Ikram Ullah Khan et al., *Green Banking Practices, Bank Reputation, and Environmental Awareness: Evidence from Islamic Banks in a Developing Economy*, Environment, Development and Sustainability, <<https://doi.org/10.1007/s10668-023-03288-9>> viewed on May 5, 2023.

⁸ Admin, *Pembangunan Berkelanjutan Melalui Prinsip Ekonomi Hijau Berbasis Syariah*, IIQ An Nur Yogyakarta (blog), <<https://iiq-annur.ac.id/pembangunan-berkelanjutan-melalui-prinsip-ekonomi-hijau-berbasis-syariah/>> viewed on January 3, 2024.

⁹ Ahmad Mansur, "Peran Bank Syariah di Dalam Pembangunan Ekonomi (Analisis Teoritis Atas Mobilisasi, Alokasi dan Utilisasi Sumber Daya Ekonomi)", *El-Qist*, Vol. 01, No. 01 (2011), p. 8.

¹⁰ Khan et al., *Green Banking Practices, Bank Reputation, and Environmental Awareness, Environment, Development and Sustainability*, p. 4-6.

The use of green economy concept within the banking sector is referred to as green banking¹¹. Green banking is a sustainable banking concept that focuses on environmental aspects¹². The incorporation of green banking into banking operations can be realized by reducing paper usage through a paperless strategy and embedding environmental sustainability standards into services such as loans, investments, and portfolios, for example, by funding green energy projects or issuing green bonds¹³.

Numerous Asian nations have adopted sustainable development policies based on frameworks established by the United Nations Environment Programme (UNEP), the International Union for Conservation of Nature (IUCN), and the World Wide Fund for Nature (WWF). Consequently, green banking has emerged as a policy aligned with the tenets of the green economy and sustainable development projects¹⁴.

Green banking seeks to conserve the environment, protect natural resources, mitigate the adverse environmental effects of banking activities, and improve the ecological performance of financial institutions¹⁵. Research from Ratna¹⁶, Ningsih and Iqbal¹⁷, and Lestari¹⁸ demonstrates that green banking implementation contributes to improved financial performance through energy efficiency and long-term operational cost reduction. This practice also strengthens the bank's reputation among environmentally-conscious investors. This does not mean that banks

¹¹ Setyo Budiantoro, *Mengawal Green Banking Indonesia Dalam Kerangka Pembangunan Berkelanjutan* (Jakarta: Responsi Bank Indonesia, 2014), p. 19.

¹² Xin Zhang et al., "Do Green Banking Activities Improve the Banks' Environmental Performance? The Mediating Effect of Green Financing," *Sustainability*, Vol. 14, no. 2 (2022), p. 989.

¹³ Sulistyowati, "Green Banking," *Fakultas Ekonomi Dan Bisnis Islam - IAIN Kediri*, n.d.

¹⁴ Mohammad Masukujjaman et al., "Banker's Perception on Green Banking an Empirical Study on Islamic Banks in Bangladesh," *Management & Marketing*, (2015), p. 7.

¹⁵ Ratna Kusuma Dewi, "Analisis Pengaruh Implementasi Green Banking Terhadap Kinerja Keuangan Dan Kinerja Lingkungan Perbankan" (*Skripsi UIN Syarif Hidayatullah*, 2023), p. 68.

¹⁶ Dewi.... p. 75

¹⁷ Nur Wahyu Ningsih and Fatullah Iqbal, "Green Banking terhadap Profitabilitas Bank Umum Syariah di Indonesia," *Jurnal Fidusia* Vol. 3, no. 2 (November 2023).

¹⁸ Diah Lestari, "Pengaruh Optimalisasi Green Banking Terhadap Kinerja Keuangan Bank Umum Syariah di Indonesia Periode 2016-2021," *Skripsi: UIN Raden Intan Lampung*, 2023.

abandon efforts to maximize profits; rather, they strive to maximize profits while prioritizing environmental sustainability¹⁹.

The prevailing view is the company with good environmental performance will provide a high level of environmental disclosure to maintain its reputation. Environmental performance reflects a company's contribution to environmental conservation by engaging in activities and using materials that do not harm the environment²⁰. The goal of environmental performance is to serve as a consideration for investors, in addition to financial aspects. Environmental performance can be assessed using the Environmental Performance Index (EPI)²¹.

The Environmental Performance Index (EPI), developed through a partnership between Yale University and Columbia University and backed by the World Economic Forum, offers a broad evaluation of a country's environmental achievements. The EPI evaluates ten domains, categorized into two principal sub-components: ecological health and ecosystem robustness. These sub-components encapsulate the repercussions of pollution on human welfare and the adverse consequences on ecosystems resulting from environmental deterioration. The combined weighted score of these sub-components determines a nation's overall ecological ranking²².

Asia ranks as the second-lowest among global regions in terms of EPI scores. With a score of 50, Asia remains significantly below the global average score of 56²³. The primary reason for Asia's low ranking is poor environmental health performance. Asia's low EPI ranking is largely due to inadequate environmental health management, with rapid urbanization and industrial growth outpacing

¹⁹ Statista Research Department, *Green Banking*, Statista, <<https://www.statista.com/topics/9069/green-banking/>>, viewed on October 7, 2024.

²⁰ Muchlisin Riadi, *Kinerja Lingkungan (Environmental Performance) dan PROPER*, at August 26, 2023, <<https://www.kajianpustaka.com/2023/08/kinerja-lingkungan.html>> viewed on August 31, 2023.

²¹ Prima Gladia and Surya Rahardja, "Pengaruh Environmental Performance terhadap Environmental Disclosure dan Hard Environmental Disclosure Perusahaan," *Diponegoro Journal of Accounting*, Vol. 2, No. 2 (2013), p. 3.

²² Bihong Huang and Yining Xu, "Environmental Performance in Asia: Overview, Drivers, and Policy Implications," *SSRN Electronic Journal*, No. 990 (2019), p. 4.

²³ *Environmental Performance Index by Country 2024*, <<https://worldpopulationreview.com/country-rankings/environmental-performance-index-by-country>> viewed on October 27, 2024.

sustainable practices. This has resulted in widespread pollution, while limited access to clean resources leaves populations vulnerable to high levels of air and water contaminants. This weak performance suggests a higher susceptibility of the Asian population to air and water pollution, along with heightened exposure to harmful substances like heavy metals²⁴.

The fundamentals of Islamic economics provide a sustainable framework for the management of economic resources. The values embodied in Islamic economics align with sustainable development²⁵. When Islamic values are integrated into the application of sustainability principles, it creates unique opportunities for collaboration in achieving sustainability goals²⁶.

Research by Rajput et al²⁷, finds that banks with strong Environmental Performance (EP) can attract investors who prioritize sustainability, thereby strengthening financial aspects. Banks with high EP are more likely to gain support from communities and governments, contributing to long-term stability and growth.

Islamic banking offers financial services that adhere to Sharia principles and are responsible for meeting stakeholder expectations in conducting halal business activities. One of the considerations for Islamic banking in maintaining sustainability is the implementation of good corporate governance (GCG)²⁸.

With the growing responsibility for banks to prioritize environmental care, Islamic banks in Asia are encountering difficulties in adhering to external regulations concerning the effective implementation of good corporate governance (GCG)²⁹. Some Islamic banks experience difficulties in enforcing GCG effectively

²⁴ Huang and Xu, "Environmental Performance in Asia,"... p. 8.

²⁵ Rizal, *Apa Kontribusi dari Islamic Finance terhadap SDGs?* FEB UGM, at October 2, 2023, <<https://feb.ugm.ac.id/id/berita/4333-apa-kontribusi-dari-islamic-finance-terhadap-sdgs>> viewed on June 26, 2024.

²⁶ Admin, *Pembangunan Berkelanjutan Melalui Prinsip Ekonomi Hijau Berbasis Syariah*.

²⁷ Dr Namita Rajput, Simple Arora, and Akanksha Khanna, "An Empirical Study of Impact of Environmental Performance on Financial Performance in Indian Banking Sector," *International Journal of Business and Management Invention*, Vol. 2, no. 9 (September 2013): 19–24.

²⁸ Dwi Lutfiana, "Pengaruh Islamic Corporate Governance (ICG), Islamic Corporate Social Responsibility (ICSR), Dan Islamicity Performance Index (IPI) Terhadap Kinerja Keuangan Bank Umum Syariah" (*Skripsi: IAIN Purwokerto, 2021*), p. 68.

²⁹ *Ibid*, 70.

and in an Islamic manner³⁰. To address these operational weaknesses, Islamic economic experts have developed Islamic Corporate Governance (ICG) as a solution.

Islamic corporate governance refers to business governance that integrates Islamic precepts. Its operations and economic activities must adhere to Sharia principles. ICG shares identical objectives with GCG in traditional enterprises, although its ethical framework is grounded in Islamic principles³¹.

One component that can improve the financial performance of banks is ICG³². Islamic banks that proficiently execute ICG can enhance their financial performance. Research from Juwariyah³³, Nabila et al³⁴ and Lutfiana³⁵ indicates that ICG significantly enhances financial performance. Sharia-based governance encourages high levels of transparency and accountability, making it a critical component for modern banking challenges.

ICG adoption should be aligned with Islamic values to ensure community well-being, as Islamic banks prioritize not only profitability but also social responsibility and environmentally sustainable initiatives³⁶.

Despite previous investigations into the effects of green banking practices, Islamic corporate governance, and environmental performance on financial

³⁰ Agus Suryanto, "Analisis Pengaruh Penerapan Good Corporate Governance terhadap Kinerja Keuangan," *Jurnal Bina Manajemen* Vol.8 No.1 (September 2019), p. 3.

³¹ Nova Rini, "The Implementation of Islamic Corporate Governance (ICG) on Sharia Banking in Indonesia," *TIJAB (The International Journal of Applied Business)*, Vol. 2, no. 1 (February 21, 2019), p. 29.

³² Lutfiana, Pengaruh Islamic Corporate Governance (ICG), Islamic Corporate Social Responsibility (ICSR), Dan Islamicity Performance Index (IPI) Terhadap Kinerja Keuangan Bank Umum Syariah, p. 76.

³³ Siti Juwariyah, "Pengaruh Islamic Corporate Governance (ICG) terhadap Kinerja Keuangan Bank Umum Syariah di Indonesia," *Jurnal Darussalam; Jurnal Ekonomi dan Bisnis Islam* Vol. 0, No. 0-11 (September 2021), p. 23.

³⁴ Khairunnisa Putri Nabila, Hendra Harmain, and Kusmilawaty, "The Effect of Sharia Compliance and Islamic Corporate Governance on Financial Performance in Islamic Commercial Banks in Indonesia for the 2016-2021 Period," *Jurma: Jurnal Program Mahasiswa Kreatif* 7, no. 1 (May 29, 2023): 7–10, <https://doi.org/10.32832/jurma.v7i1.1631>.

³⁵ Lutfiana, "Pengaruh Islamic Corporate Governance (ICG), Islamic Corporate Social Responsibility (ICSR), Dan Islamicity Performance Index (IPI) Terhadap Kinerja Keuangan Bank Umum Syariah."

³⁶ Lutfiana, Pengaruh Islamic Corporate Governance (ICG), Islamic Corporate Social Responsibility (ICSR), Dan Islamicity Performance Index (IPI) Terhadap Kinerja Keuangan Bank Umum Syariah, p. 30.

performance, there is a lack of studies analyzing the combined impact of these three factors on the financial performance of Islamic banks in Asia. This creates a significant research gap, considering the key role of Islamic banks in Asia, which are required to adhere to Sharia standards and account for their environmental impact.

The collaboration between green banking practices and Islamic corporate governance offers a new dimension in efforts towards sustainability. Green banking practices include sustainable financing and energy efficiency, enhancing environmental performance, while Islamic corporate governance emphasizes social responsibility and ethics. Therefore, this research will help understand how Islamic banks in Asia integrate these aspects and their impact on financial performance.

By analyzing the relationship between green banking practices, Islamic corporate governance, and environmental performance, this research aims to deliver fresh perspectives on how Islamic banks in Asia can better fulfill their social and environmental obligations. The results of this research can offer valuable input for industry practitioners, regulators, and the community in developing sustainable banking strategies based on Islamic ethics.

1.2 Research Questions

Based on the background explanation above, the problems identified in this research are as follows:

1. Does green banking positively influence the financial results of Islamic banks in Asia?
2. Does Islamic corporate governance positively influence the financial results of Islamic banks in Asia?
3. Does environmental performance positively influence the financial results of Islamic banks in Asia?

1.3 Research Objectives

1. To determine the impact of green banking practices on the financial performance of Islamic banks in Asia.

2. To determine the impact of Islamic corporate governance on the financial performance of Islamic banks in Asia.
3. To determine the impact of environmental performance on the financial performance of Islamic banks in Asia.

1.4 Benefits of Research

The outcomes of this research are anticipated to yield advantages for the subsequent stakeholders:

1. Benefits for academia

This study seeks to advance academic insights within the finance discipline, with a special focus on sustainable and Islamic finance. By examining the influence of Green Banking Practices, Islamic Corporate Governance, and Environmental Performance on the financial performance of Islamic banks, the research aims to deepen the understanding of financial sustainability in Islamic banking. Additionally, it offers valuable perspectives on how these factors can be strategically integrated to drive financial resilience and ethical practices, aligning with both Islamic principles and broader sustainable finance goals.

2. Benefits for practitioners

This research can aid regulators, especially central banks, in evaluating the financial performance of Islamic banks throughout several Asian nations.