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Syariah accounting, sustainable finance, and financial performance: evidence from Indonesian Islamic banks

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Abstract

Purpose - This study examines the effect of Shariah Accounting (Islamic Social Reporting, Corporate Social Responsibility, and productive zakat/waqf) and Sustainable Finance (green financing, green sukuk, and green project financing) on the financial performance of Islamic banks in Indonesia.

Method - A quantitative approach with Partial Least Squares–Structural Equation Modeling (PLS-SEM) was applied using secondary data from the annual reports of Islamic banks in Indonesia during 2021–2024, selected through purposive sampling.

Result - The findings indicate that CSR, productive zakat and waqf, and green project financing significantly reduce the operational efficiency ratio (BOPO), reflecting improved cost efficiency. Green financing negatively affects Return on Assets (ROA), implying a short-term trade-off between profitability and sustainability. Meanwhile, Islamic Social Reporting (ISR) and green sukuk show no significant influence on any financial performance indicators.

Implication - These results highlight the importance of embedding ethical values and sustainability practices into the strategic management of Islamic banks to achieve a balance between social responsibility and financial objectives.

Originality - This study provides novelty by simultaneously testing the integration of Islamic social finance and sustainable finance instruments within a comprehensive empirical model in Indonesia.

Keywords: Syariah accounting; sustainable finance; CSR; productive zakat; Islamic banking performance

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Introduction

Financial performance is a fundamental indicator that reflects the health, competitiveness, and sustainability of financial institutions, including Islamic banks. Achieving sound financial performance has been proven to enhance stakeholders' trust, strengthen financial system stability, and contribute to national economic development, as well as the achievement of the Sustainable Development Goals (SDGs) (Oktaviyah, 2024; Saputri, 2024). In Indonesia, the role of Islamic banks has become increasingly significant, as reflected in the growth of Islamic banking assets by 9.93% year-on-year in 2024 (OJK, 2025).

Nevertheless, the financial performance of Islamic banks still faces serious challenges. Profitability fluctuations, high levels of non-performing financing, and suboptimal operational efficiency compared to conventional banks often become the main obstacles (Minarni et al., 2023; Nisa' et al., 2023; Roziq & Ilma Ahmad, 2024). In addition, the impact of social and sustainability instruments such as productive zakat, productive waqf, and green finance still shows mixed results; some studies find significant contributions to performance, while others report limited effects (Reza Ronaldo et al., 2024; Yundari et al., 2025).

The literature has proposed various solutions to address these conditions. Strengthening Islamic Social Reporting (ISR) and Corporate Social Responsibility (CSR) disclosure is believed to improve transparency, reputation, and public loyalty (Abidin et al., 2023; Mohamed Sultan et al., 2024a; Widodo et al., 2023). Productive zakat and waqf instruments have been developed as socio-economic funding sources that not only support the social performance of Islamic banks but also expand the funding base and reinforce financial performance (Mohd Zain & Johari, 2024; Putra & Firmansyah, 2023). On the other hand, green finance, which includes green financing, green sukuk issuance, and environmentally friendly project funding, is expected to enhance long-term profitability and support sustainability agendas (Ahmad Febriyanto et al., 2023; Anggraini et al., 2020; MEI et al., 2025). A case study of Bank Syariah Indonesia, for instance, shows that green banking policies integrated with ESG have successfully strengthened the image of Islamic banks and increased public trust (Widiyanti et al., 2025).

The effectiveness of these solutions remains inconsistent. Several studies report that the green banking index does not always have a significant effect on ROE (Bimantara et al., 2025; Ernawati & Utami, 2024), while the practice of productive waqf still faces challenges related to efficiency, reporting, and governance that are yet to be standardized (Finashih, 2024; Saputra, 2025). Similarly, although the governance of boards and independent commissioners has the potential to strengthen sustainability

disclosure, its impact on profitability has not been fully stable (Safiullah, 2021). This inconsistency suggests that the relationship between social and sustainability instruments and financial performance may not be direct, but instead operates through intermediate mechanisms such as efficiency and governance.

However, the existing literature still tends to position Islamic social finance and sustainable finance as separate analytical domains, rather than as an integrated system within Islamic banking operations. This separation becomes theoretically insufficient, particularly because Islamic banks are not solely profit-oriented institutions, but entities that simultaneously pursue financial performance, social redistribution, and sustainability objectives (Alghafes et al., 2024; Faizulayev, 2026; Mohamed Sultan et al., 2024b). In this regard, productive zakat and waqf function as redistributive instruments that strengthen social legitimacy and resource allocation efficiency, while green finance represents a forward-looking investment strategy that enhances long-term resilience and environmental sustainability (Joshipura et al., 2025; J. Zhang, 2025).

Despite their complementary roles, prior studies rarely explain how these instruments interact within the internal operational mechanisms of Islamic banks. Most empirical works examine zakat, waqf, or green finance independently, or focus on CSR/ISR disclosures as reputational signals, without explicitly modeling the transmission process through which these variables influence financial performance (Chang et al., 2024; Mahmod et al., 2024; Masrick Hasan et al., 2025). As a result, the literature lacks a coherent explanation of whether these instruments directly improve profitability or instead operate indirectly through efficiency improvements and governance strengthening, which is particularly relevant given the mixed empirical findings reported in previous studies (Ahmad et al., 2024; Elmahgop et al., 2025; Habib et al., 2025; Thapliyal et al., 2025).

This limitation is important in Islamic banking in Indonesia, where social finance instruments and sustainability practices are still evolving and may not immediately translate into higher profitability. Instead, their contribution is more likely reflected in operational efficiency, cost management, and institutional legitimacy, before eventually affecting financial returns (Siswanti et al., 2024; Yusuf et al., 2025). This perspective is consistent with the empirical reality that sustainability-oriented strategies often involve short-term trade-offs while generating long-term benefits (Ghosh & Singh, 2025; Jarbou et al., 2024; Zuhroh & Rofik, 2024).

Accordingly, the gap of this study lies in the absence of an integrated framework that explains how Islamic social finance and sustainable finance jointly influence financial performance through specific transmission channels. This study addresses this gap by positioning productive zakat and waqf as mechanisms of social redistribution and efficiency enhancement, and green finance as a strategic investment mechanism, both of

which are expected to affect financial performance primarily through operational efficiency and risk management rather than direct profitability.

Thus, the purpose of this study is to analyze Shariah Accounting, Sustainable Finance, and Financial Performance: Evidence from Indonesian Islamic Banks. The novelty of this study lies not merely in examining these variables simultaneously, but in proposing an integrated empirical framework that reflects the operational logic of Islamic banking. This study emphasizes that the relationship between social finance, sustainable finance, and financial performance is mediated by efficiency and governance mechanisms, which aligns with the characteristics of Islamic banking systems in emerging markets (Fakhrunnas et al., 2025; Tumewang et al., 2025). By doing so, this research provides a more realistic and theoretically grounded explanation of how Islamic banks balance social responsibility and financial sustainability.

Literature Review

Conceptual Framework and Theoretical Foundation

The financial performance of Islamic banks should be understood within a broader framework that integrates economic, social, and sustainability objectives. In this regard, stakeholder theory posits that Islamic banks are responsible not only to shareholders but also to a wider group of stakeholders, including beneficiaries of zakat and waqf, thereby requiring banks to balance financial outcomes with social value creation (Khémiri & Alsulami, 2023; Shatila et al., 2025). This implies that the utilization of Islamic social finance instruments may enhance financial performance through improved stakeholder trust and resource mobilization (Maulina et al., 2023).

Legitimacy theory explains that Islamic banks seek to maintain alignment with societal expectations by demonstrating accountability through social and ethical practices (M. K. Alam & Miah, 2024; Kadi, 2023). The implementation of zakat, waqf, and sustainability-related initiatives such as green finance can therefore serve as legitimacy signals, which strengthen public confidence and institutional reputation, ultimately influencing financial performance (Nenavath & Mishra, 2023).

Furthermore, sustainability theory emphasizes that financial institutions must integrate environmental, social, and economic considerations to achieve long-term performance (Candio, 2024; Fu & Li, 2023; Lei & Yu, 2024; Luo et al., 2024; Thi Thu Loan et al., 2024; Xu & Zhu, 2024). Within this framework, green finance is not merely an ethical commitment but a strategic investment that enhances resilience and risk management, although its impact may not always be immediately reflected in short-term profitability (Al Frijat et al., 2025; Anton et al., 2025; Sun et al., 2023).

By integrating these perspectives, this study conceptualizes that productive zakat and waqf function as mechanisms of social redistribution and legitimacy enhancement, while green finance operates as a sustainability-driven investment strategy (Islam et al., 2023). These instruments are expected to influence financial performance both directly and indirectly, particularly through efficiency improvements and governance-related mechanisms (Madah Marzuki et al., 2023; Rahim et al., 2024; Raimi et al., 2024).

Productive Zakat and Waqf

Zakat and waqf have long been recognized as effective wealth redistribution instruments to reduce poverty and expand financial inclusion (Razak, 2020). Empirical studies demonstrate that zakat contributions have a significant positive impact on the profitability of Islamic banks, both in Malaysia and Indonesia (Yetty et al., 2021). More recent studies even affirm zakat as a valid indicator to measure Islamic banks' performance, as it reflects the alignment between economic and social functions of banks (Haron et al., 2021).

Productive waqf is increasingly being integrated into socio-economic projects. Case studies in the agriculture and livestock sectors reveal that combining zakat and waqf funds can generate sustainable projects that empower impoverished communities (Mohd Ali et al., 2022). Waqf-led social finance has also proven effective in poverty alleviation in Pakistan and other countries (Haq & Ahmad, 2020).

Nevertheless, the literature reports mixed findings. Some studies suggest that while zakat enhances the social legitimacy of banks, its impact on profitability can be weak or even negative, especially when moderated by CSR (Amelia et al., 2024). This indicates variations across institutional, regulatory frameworks, and research methodologies.

These findings suggest that the role of zakat and waqf is not limited to social redistribution, but also involves institutional mechanisms such as legitimacy building and efficiency enhancement, which may explain their varying impact on financial performance.

Green Finance and Sustainability

Green finance has emerged as a key pillar in supporting sustainable development through instruments such as green sukuk, green financing, and the utilization of zakat and waqf for environmental purposes (Alan Nur & Herianingrum, 2023). The integration of *maqasid al-shariah* with green finance is believed to accelerate the achievement of the SDGs by financing clean energy, sustainable cities, and climate change mitigation (Rahim et al., 2024).

However, the literature also highlights limitations. Although zakat and waqf hold potential for climate financing, shariah requirements such as distribution to mustahik

(eligible recipients) may restrict their scope of utilization. Moreover, regulatory gaps and limited green infrastructure remain significant barriers to the implementation of green finance in developing countries (Lubis et al., 2024).

From the literature, it is clear that zakat, productive waqf, and green finance are equally acknowledged as important instruments for enhancing both financial performance and sustainability of Islamic banks. Nonetheless, empirical findings remain inconclusive: while some studies report significant positive effects (Haron et al., 2021; Rosman et al., 2019; Yetty et al., 2021), others reveal weak or context-dependent results (Amelia et al., 2024). Differences in methodology, sample size, and regulatory environments account for these inconsistencies.

The main research gap lies in the scarcity of studies simultaneously examining the roles of productive zakat, productive waqf, and green finance within a single empirical framework, particularly in Indonesia. Most existing studies remain fragmented, focusing exclusively on zakat, waqf, or green finance. Accordingly, this study contributes novelty by integrating these three Islamic socio-economic instruments into a comprehensive model of Islamic banking financial performance.

Based on the theoretical arguments above, this study proposes that Islamic social finance and sustainable finance are not independent mechanisms, but complementary drivers of financial performance. Productive zakat and waqf are expected to strengthen financial performance through legitimacy and stakeholder-related channels, while green finance is expected to influence performance through sustainability and risk management mechanisms. However, their effects may vary depending on operational efficiency and institutional conditions, which leads to the formulation of the research hypotheses.

Hyphotesis Development

Islamic Social Reporting (ISR) can be explained through legitimacy theory, which suggests that organizations disclose social and ethical information to align with societal expectations and maintain legitimacy (Wijayanti & Setiawan, 2022). In Islamic banking, ISR serves as a signal of accountability and transparency, which can strengthen stakeholder trust and institutional credibility (Alhammadi et al., 2022). This improved legitimacy is expected to enhance financial performance, either directly or through increased customer confidence and operational stability.

H1: Islamic Social Reporting (ISR) has a significant effect on the financial performance of Islamic banks

From the perspective of stakeholder theory, Corporate Social Responsibility (CSR) reflects the commitment of Islamic banks to address the interests of broader

stakeholders beyond shareholders (Awa et al., 2024). CSR activities can reduce information asymmetry, improve governance quality, and enhance operational efficiency, which in turn may contribute to financial performance (Khémiri & Alsulami, 2023; Mohamed Sultan et al., 2024b). Additionally, CSR functions as a legitimacy mechanism that strengthens social acceptance and long-term sustainability (Befekdadu Tessema, 2025; Nejati & Shafaei, 2023; K. Zhang & Hao, 2024).

H2: Corporate Social Responsibility (CSR) disclosure has a significant effect on the financial performance of Islamic banks

Productive zakat and waqf (PZW) can be understood within both stakeholder and legitimacy frameworks, where these instruments function as mechanisms of social redistribution and institutional accountability. By channeling funds to productive sectors, PZW may enhance financial inclusion, strengthen social capital, and improve resource allocation efficiency. These effects can contribute to financial performance, although the impact may vary depending on operational efficiency and governance conditions (Coelho et al., 2023; Elmahgop et al., 2025; Harahap et al., 2023; Syarifuddin, 2024).

H3: Productive zakat and waqf (PZW) have a significant effect on the financial performance of Islamic banks

Green finance is grounded in sustainability theory, which emphasizes the integration of environmental, social, and economic objectives to achieve long-term performance. In Islamic banking, green finance represents a strategic investment that enhances resilience, risk management, and long-term value creation (Al-Refai et al., 2026; Masrick Hasan et al., 2025). However, due to high initial costs, its impact on financial performance may not always be immediate and may operate through efficiency and cost optimization mechanisms (Faizulayev, 2026; Kashi et al., 2025; Shalhoob, 2025).

H4: Green finance has a significant effect on the financial performance of Islamic banks

Green sukuk can be interpreted through legitimacy and sustainability perspectives, as it signals the commitment of Islamic banks to environmentally responsible financing. The issuance of green sukuk may enhance institutional reputation and attract socially responsible investors, thereby strengthening financial performance (Kashi et al., 2024; Kuanova et al., 2025; Supriyadi et al., 2023). However, its impact may depend on market development and institutional participation (A. Alam et al., 2023; M. Billah et al., 2023; S. M. Billah & Adnan, 2024).

H5: Green sukuk has a significant effect on the financial performance of Islamic banks

Green project financing aligns with sustainability and efficiency perspectives, where environmentally oriented investments can reduce long-term operational costs and improve resource efficiency (Abuatwan, 2023; Setyorini & Hakam, 2025). In Islamic banking, such financing may enhance financial performance through improved cost

structures and risk mitigation, particularly in the medium to long term (Jalili et al., 2025; Kashi et al., 2025).

H6: Green project financing has a significant effect on the financial performance of Islamic banks

Research Methods

Research Design

This study employs a quantitative explanatory approach with an associative–causal design. The objective is to examine the causal relationships between productive zakat, productive waqf, and green finance on the financial performance of Islamic banks in Indonesia. A quantitative approach is considered appropriate as it enables objective hypothesis testing using numerical data and statistical analysis.

Population and Sample

The population comprises all Islamic Commercial Banks registered with the Financial Services Authority. The inclusion criteria are banks that consistently publish audited annual reports during the observation period (2021–2024). Exclusion criteria include banks that have undergone mergers or do not provide complete annual reports. The sampling technique is purposive sampling, based on the availability and relevance of data to the research indicators.

Operational Definition of Variables

Shariah Accounting in this study is represented by three indicators, namely Islamic Social Reporting (ISR), Corporate Social Responsibility (CSR) disclosure, and productive zakat and waqf (PZW). The ISR index is measured by the ratio of disclosed items to the total ISR disclosure checklist, expressed as a percentage. CSR disclosure is proxied by the natural logarithm of the total social expenditures reported in the annual report. Productive zakat and waqf are measured by comparing the amount of productive zakat and waqf funds allocated to the total Islamic social funds managed by the bank.

$$ISRj = \sum_{t=1}^{nj} Xij \qquad (1)$$

Green Finance is measured through three main indicators that reflect the bank's commitment to sustainability. Green financing is measured by the proportion of total financing allocated to environmentally friendly sectors, including renewable energy, green SMEs, and eco-friendly projects. Green sukuk is measured by the ratio of outstanding green sukuk to the total sukuk outstanding. In addition, green project financing is assessed by comparing the total value of green projects financed to the overall value of projects funded by the bank.

Financial Performance is the dependent variable in this study, measured using four ratios commonly applied in banking performance analysis in Indonesia. Return on Assets (ROA) is calculated as the ratio of net income to total assets, while Return on Equity (ROE) is calculated as the ratio of net income to total equity. Non-Performing Financing (NPF) is measured by comparing problematic financing to the total financing portfolio. Operational efficiency is captured through the BOPO ratio, which compares operating expenses to operating income. These four indicators jointly provide a comprehensive measure of profitability, efficiency, asset quality, and risk management in Islamic banking performance.

Data Analysis Technique

Data were analyzed using Partial Least Squares–Structural Equation Modeling (PLS-SEM) with SmartPLS 4. PLS-SEM is appropriate for prediction-oriented research and complex models, and it can be applied to secondary financial ratio data as well as formative constructs. In this study, financial performance is modeled as a formative construct composed of ROA, ROE, NPF, and BOPO, which represent different dimensions of banking performance (profitability, risk, and efficiency).

The analysis followed three stages: (1) Measurement Model Evaluation (Outer Model): Assessed by factor loadings (≥0.70) for convergent validity and composite reliability for internal consistency. (2) Structural Model Evaluation (Inner Model): Assessed through collinearity (VIF < 5), coefficient of determination (R^2) with thresholds of weak (0.25), moderate (0.50), and strong (0.75), and effect size (f^2) categorized as small (0.02), medium (0.15), and large (0.35). (3) Hypothesis Testing: Conducted using bootstrapping with 5,000 resamples. Relationships are considered significant if t-statistics ≥ 1.96 ($\alpha = 0.05$) or p-values ≤ 0.05. Direct, indirect (mediation), and total effects were reported.

Results

Convergent validity test

The outer loading test was used to assess convergent validity, namely the extent to which each indicator is able to reflect the construct it represents. Based on Table 1, all indicators in the variables Sharia Accounting, Green Finance, and Financial Performance have loading factor values ≥ 0.70, which means they are valid. This indicates that all indicators adequately explain their respective constructs and can be used for further analysis.

Table 1

Outer Loading

Variables	Indicator	Loading Factor	Sig.
Syariah Accounting	ISR	1.000	Valid
	PZW	1.000	Valid
	CSR Disclosure	1.000	Valid
Green Finance	GFfinance	1.000	Valid
	GFsukuk	1.000	Valid
	GFproject	1.000	Valid
Financial	ROA	1.000	Valid
Performance	ROE	1.000	Valid
	NPF	1.000	Valid
	BOPO	1.000	Valid

Source: SmartPLs Output (2025)

Table 2

Average Variance Extracted (AVE)

Variables	AVE	Critical Value	Result
ISR	1.000	>0.50	Meet
PZW	1.000	>0.50	Meet
CSR Disclosure	1.000	>0.50	Meet
GFfinance	1.000	>0.50	Meet
GFsukuk	1.000	>0.50	Meet
GFproject	1.000	>0.50	Meet
ROA	1.000	>0.50	Meet
ROE	1.000	>0.50	Meet
NPF	1.000	>0.50	Meet
BOPO	1.000	>0.50	Meet

Source: SmartPLs Output (2025)

Collinearity Assessment

The Average Variance Extracted (AVE) test was conducted to assess the strength of latent constructs in explaining the variance of their indicators. Based on Table 2, all variables have AVE values > 0.50, which means each construct explains more than 50% of the variance of its indicators. Thus, the model meets the criteria for discriminant validity and can proceed to reliability and structural model testing. Overall, these results indicate that all constructs demonstrate adequate convergent validity and are suitable for further structural analysis.

Table 3

R-Square

Variables	R-Square	R-Square adjusted	Influence
ROA	0.501	0.381	Moderate
ROE	0.180	-0.017	Weak
NPF	0.244	0.062	Weak
BOPO	0.401	0.258	Moderate

Source: SmartPLS Output (2025)

Table 4

Effect size (f^2)

Variables	Indicator	Value	Influence
Syariah Accounting > Financial Performance	ISR>ROA	0.682	Large
	ISR>ROE	0.999	Large
	ISR>NPF	0,982	Large
	ISR>BOPO	0,987	Large
	CSR>ROA	0.750	Large
	CSR>ROE	0.999	Large
	CSR>NPF	0.965	Large
	CSR>BOPO	0.505	Large
	PZW>ROA	0.866	Large
	PZW>ROE	0.963	Large
	PZW>NPF	0.985	Large
	PZW>BOPO	0.413	Medium
Green Finance	GFfinance >ROA	0.387	Medium
	GFfinance >ROE	0.778	Large
	GFfinance >NPF	0.775	Large
	GFfinance >BOPO	0.587	Large
	GFsukuk>ROA	0.948	Large
	GFsukuk>ROE	0.816	Large
	GFsukuk>NPF	0.974	Large
	GFsukuk>BOPO	0.671	Large
	GFproject>ROA	0.570	Large
	GFproject>ROE	0.752	Large
	GFproject>NPF	0.982	Large
	GFproject>BOPO	0.455	Medium

Source: SmartPLS Output (2025)

Coefficient of Determination (R^2)

The R-Square value is used to show the proportion of variance in the dependent variables (ROA, ROE, NPF, and BOPO) explained by the independent variables (Sharia Accounting and Green Finance), as presented in Table 3. The results indicate: (1) R^2 ROA

= 0.501 (moderate), (2) R^2 ROE = 0.180 (weak), (3) R^2 NPF = 0.244 (weak), (4) R^2 BOPO = 0.401 (moderate). These findings suggest that the model is able to explain part of the variation in financial performance, particularly in terms of asset profitability (ROA) and operational efficiency (BOPO). Overall, the model shows moderate explanatory power for ROA and BOPO, while its ability to explain ROE and NPF remains relatively weak.

Table 5

Path coefficients

Variables	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P-values
CSR -> BOPO	-0.440	-0.501	0.218	2.020	0.043
CSR -> NPF	-0.059	-0.088	0.163	0.360	0.719
CSR -> ROA	0.180	0.177	0.148	1.215	0.224
CSR -> ROE	0.011	-0.055	0.254	0.043	0.966
GFfinance-> BOPO	0.746	0.802	0.442	1.688	0.091
GFfinance-> NPF	0.358	0.427	0.301	1.190	0.234
GFfinance-> ROA	-0.895	-0.789	0.413	2.168	0.030
GFfinance -> ROE	0.661	0.678	0.679	0.974	0.330
GFProject -> BOPO	-1.076	-1.183	0.430	2.503	0.012
GFProject -> NPF	0.132	-0.006	0.471	0.280	0.780
GFProject -> ROA	0.635	0.505	0.449	1.414	0.157
GFProject -> ROE	-0.761	-0.825	0.656	1.161	0.246
GFSukuk -> BOPO	0.382	0.431	0.267	1.427	0.154
GFSukuk -> NPF	0.133	0.267	0.394	0.337	0.736
GFSukuk -> ROA	0.228	0.296	0.301	0.758	0.449
GFSukuk -> ROE	0.312	0.346	0.331	0.943	0.346
PZW -> BOPO	-0.469	-0.512	0.215	2.185	0.029
PZW -> NPF	0.034	0.025	0.147	0.230	0.818
PZW -> ROA	0.200	0.230	0.173	1.156	0.248
PZW -> ROE	0.087	0.071	0.261	0.333	0.739
ISR -> BOPO	0.048	0.013	0.300	0.161	0.872
ISR -> NPF	0.053	0.081	0.240	0.221	0.825
ISR -> ROA	-0.374	-0.369	0.242	1.542	0.123
ISR -> ROE	-0.015	-0.046	0.354	0.042	0.967

Source: SmartPLS Output (2025)

Effect size (f^2)

Effect size (f^2) is used to assess the magnitude of influence of each exogenous variable on the endogenous variables. A value of $f^2 \geq 0.35$ is categorized as large, 0.15 as medium, and 0.02 as small.

Table 4 shows that most relationships between variables have high f^2 values, particularly the relationships between Sharia Accounting (ISR, CSR, and PZW) as well as Green Finance and financial performance. For example, CSR on BOPO ($f^2 = 0.505$) and PZW on ROA ($f^2 = 0.866$) demonstrate strong effects on efficiency and profitability. Overall, the results indicate that most exogenous variables have substantial effects on financial performance, particularly in influencing operational efficiency and profitability.

Discussion

Table 5 shows that CSR (β = -0.440, p = 0.043), PZW (β = -0.469, p = 0.029), and green project financing (β = -1.076, p = 0.012) have a significant negative effect on BOPO, while green financing negatively affects ROA (β = -0.895, p = 0.030). Meanwhile, other variables are statistically insignificant (p > 0.05). This pattern indicates that the social and sustainability approaches in Islamic banking are more effective in influencing short-term efficiency rather than directly enhancing profitability. The phenomenon reflects a paradigm shift in Islamic banking from a purely profit-oriented model toward one emphasizing sustainability and social legitimacy.

ISR shows no significant effect on financial performance, as indicated by its relationship with ROA (β = -0.374, p = 0.123), ROE (β = -0.015, p = 0.967), NPF (β = 0.053, p = 0.825), and BOPO (β = 0.048, p = 0.872). This suggests a decoupling between reporting and practice, where ISR is often symbolic rather than substantive (Widodo et al., 2023). Within legitimacy theory, ISR in Indonesia still strengthens the religious image of banks without creating tangible financial value (Ariyani et al., 2025). This phenomenon is common in the early stages of ethical reporting adoption, where social pressures have not been fully offset by the readiness of internal systems (Roziq & Ilma Ahmad, 2024). Therefore, more substantial reporting transparency and *an integrated reporting framework* are needed for ISR to truly become a catalyst for sustainable financial performance (Muhamad et al., 2022; Susbiyani et al., 2023). Thus, H1 is not supported, highlighting the need for a more integrated reporting framework to transform ISR into a driver of sustainable financial performance.

CSR has a significant negative effect on BOPO (β = -0.440, p = 0.043), but shows no significant relationship with ROA, ROE, and NPF (p > 0.05). CSR programs reduce transaction costs, increase customer loyalty, and expand public trust. Although CSR initially raises expenditure, it lowers the cost-to-income ratio in the medium term (Khan & Gupta, 2024; Mohamed Sultan et al., 2024a; Panjaitan et al., 2025). These findings are

consistent with Hossain et al. (2023) which highlights that CSR disclosure enhances stability and efficiency in Islamic banks without immediately improving profitability. The insignificance of CSR for ROA and ROE supports the argument of a lag effect, where financial benefits only materialize once CSR is strategically integrated into core business operations (Gunardi et al., 2022; Gesso & Lodhi, 2025; Safiullah, 2021). This partially confirms H2, indicating that CSR disclosure improves efficiency rather than direct profitability.

PZW significantly reduces BOPO (β = -0.469, p = 0.029), but has no significant effect on ROA, ROE, and NPF. Productive zakat and waqf build social capital, expand non-commercial funding bases, and reduce external costs (Mohd Ali et al., 2022; Mohd Zain & Johari, 2024; Putra & Firmansyah, 2023). However, their insignificant effects on ROA and ROE reveal that profitability benefits remain limited due to off-balance sheet treatment and externalized management of zakat and waqf funds in Indonesia (Finashih, 2024; Kossay et al., 2025). This contrasts with findings from Malaysia and the Middle East (Haron et al., 2021; Yetty et al., 2021), where zakat is already embedded in risk and reputation management. Hence, institutional and regulatory explain the divergence in results (Haq & Ahmad, 2020; Razak, 2020). These findings partially support H3, indicating that PZW primarily enhances efficiency rather than profitability.

Green financing has a significant negative effect on ROA (β = -0.895, p = 0.030), while its effects on other indicators are not significant. Green lending projects often involve high initial costs, long payback periods, and untested technological risks (Ahmad Febriyanto et al., 2023; Ahmed et al., 2024). While this finding aligns with sustainable finance theory (Gangi et al., 2019; Rahim et al., 2024), it suggests that green finance currently reduces short-term profitability in Indonesian Islamic banks. However, in the long run, such investments may strengthen resilience and reputation (Lubis et al., 2024; Widiyanti et al., 2025). These results partially support H4, confirming its significance but in a negative direction.

Green sukuk shows no significant effect on financial performance, as all relationships have p-values above 0.05, likely due to issuance being dominated by the government rather than Islamic banks themselves (Anggraini et al., 2020; Ernawati & Utami, 2024). The underdeveloped secondary market also limits financial spillover effects (Araminta et al., 2022; Mahama & Yakubu, 2025). Differences in market structure and regulatory incentives explain the inconsistency of these results with cross-border studies that found a positive relationship between green sukuk and profitability (Guettar & Mecerhed, 2024; Hamouda & Bouhssane, 2025). Therefore, H5 is not supported, indicating that green sukuk currently provides more reputational legitimacy at the macroeconomic level rather than the micro-level financial performance in banks.

Green project financing significantly reduces BOPO (β = -1.076, p = 0.012), but has no significant effect on profitability and risk indicators, reflecting its role in improving efficiency through energy-saving measures, digitalization, and eco-friendly technology adoption (Bimantara et al., 2025; MEI et al., 2025; Yundari et al., 2025). This finding confirms H6, emphasizing that green investments create operational benefits before contributing to profitability.

Overall, the findings confirm that operational efficiency serves as the central transmission mechanism linking Islamic social finance and sustainable finance to financial performance. Empirically, CSR (β = -0.440, p < 0.05), PZW (β = -0.469, p < 0.05), and green project financing (β = -1.076, p < 0.05) consistently reduce BOPO, indicating significant improvements in cost efficiency, while their effects on profitability (ROA and ROE) remain statistically insignificant. This pattern suggests that the benefits of social and sustainability initiatives in Islamic banking materialize initially through efficiency gains rather than immediate financial returns.

These results provide important theoretical implications by demonstrating that the relationship between social responsibility, sustainability practices, and financial performance is indirect and staged, rather than linear and instantaneous. Operational efficiency functions as an intermediate outcome that precedes profitability, reflecting the institutional reality of Islamic banking, where social legitimacy and resource optimization are prioritized before financial maximization.

Furthermore, the findings reinforce the maqasid al-shariah perspective, which emphasizes the integration of economic, social, and environmental objectives. Rather than pursuing short-term profit maximization, Islamic banks appear to adopt a more balanced performance orientation, where efficiency, social redistribution, and sustainability act as foundational drivers of long-term financial resilience (Putra & Firmansyah, 2023; Rahim et al., 2024).

Conclusion

This study concludes that the integration of Shariah principles and sustainability significantly influences the operational efficiency of Islamic banks, although its short-term impact on profitability remains limited. The findings reveal that CSR, productive zakat and waqf, and green project financing contribute to reducing BOPO ratios, thereby enhancing efficiency and governance. Conversely, green financing negatively affects ROA, reflecting transitional costs in adopting sustainable finance practices, while ISR and green sukuk show no significant effect due to their limited adoption in Indonesia. Overall, the results highlight that ethical transformation through Shariah-based accounting and green finance first enhances operational stability before contributing to direct profitability.

The novelty of this study lies in the simultaneous examination of Islamic social finance and green finance within one empirical model, which has rarely been investigated in Indonesian Islamic banking. Theoretically, this research extends the literature by demonstrating that operational efficiency serves as the primary mechanism linking social responsibility and sustainability with financial performance.

This study is constrained by a short observation period and a limited sample of Islamic banks in Indonesia, which restricts the generalizability of the findings. Additionally, the exclusion of mediating or moderating variables, such as governance quality or ESG maturity, limits the depth of causal analysis. Future research should broaden the geographic scope, lengthen the observation period, and utilize longitudinal methods to better capture the evolving dynamics of sustainable financial practices.

The findings offer regulators a foundation to enhance Islamic green taxonomy and fiscal incentives that integrate Islamic social instruments with sustainable finance. For practitioners, the results highlight the importance of embedding social and environmental values within core business strategies. For academics, this study presents opportunities to investigate hybrid models that combine Islamic social finance, sustainability, and digital innovation, thereby reinforcing the position of Islamic finance as an ethical, resilient, and sustainable system.

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