

Vital Roles of Value-Based Intermediation within Sustainable Finance Framework: A Theory Synthesis and Model Approaches

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Abstract

Sustainability has been discussed in four pillars, namely human, social, economic, and environmental. These pillars ensure that people meet their needs today without compromising the ability of future generations to meet theirs. Sustainable development, particularly finance, helps nations while addressing challenges in economic growth, social inclusion, and environmental protection. It plays a crucial role in achieving sustainability by directing funds into projects that support development and incorporating environmental, social, and governance (ESG) factors into business and investment decisions. This approach is designed to provide long-term benefits to clients and the broader society, which is aligned with the Bank Negara Malaysia (BNM) initiative introduced a fresh approach through the introduction of Value-Based Intermediation (VBI). VBI highlights a guide to a resilient, equitable recovery in Malaysia's economic and social systems. It enhances Islamic banks' offerings, providing impactful and rewarding services. VBI and sustainable finance prioritise ethical values and long-term benefits, ensuring development meets current needs without compromising future generations. Thus, this paper aims to discuss the strategy of VBI and its prospective implementation from a Shariah perspective, and the integration between the VBI and the sustainable finance towards the inclusion outcomes as a novel approach to achieving sustainable development. Furthermore, this paper examines how Islamic banks apply VBI in addressing the current financial challenge. This paper is essential for the industry in responding to the strategic paper issued by the BNM, which aims to maximise the benefits for the community and shareholders.

Keywords: Sustainability, Sustainable Finance, Value-Based Intermediation, ESG

Introduction

The introduction of VBI in 2017 aligned with the Sustainable Development Goal (SDG) that was introduced in 2015. VBI is an initiative in Islamic finance that aims to align the operations and activities of Islamic banks with the broader societal goals and ethical principles of Islam. VBI emphasises the integration of financial and non-financial considerations, promoting social, environmental, and ethical objectives alongside economic profitability. It's also an effort to enhance the positive impact of Islamic banking on society while ensuring compliance with Shariah principles. This idea within the domain of Islamic finance underscores the synchronisation of fiscal undertakings with ethical and societal factors. The objective is to establish a more comprehensive stance towards banking and finance, prompting financial establishments to direct their attention not solely towards profits, but also towards the welfare of society and the environment. Sustainable Finance, with its emphasis on ESG considerations, and Value-Based Intermediation, rooted in ethical principles and responsible banking, are emerging as linchpins of this transformation. Based on the objective of VBI, it seems the VBI can prioritise financing for projects that stimulate economic growth, support job creation, and empower marginalised segments of society to ensure a more inclusive and equitable recovery. Previously, the world faced the worst pandemic, which led the country to implement the lockdown. Before the lockdown, small businesses had been disproportionately affected. Thus, the VBI seems to play a role in revitalising these businesses by offering financing options and resources tailored to their needs, contributing to local economic revitalisation. Together, these approaches represent a powerful and timely response to the interwoven crises of our time: health, climate, inequality, and ethics. This exploration dives deep into the integration of Sustainable Finance and Value-Based Intermediation, especially in an era marked by unprecedented global challenges. The financial industry stands at a critical juncture. As societies grapple with the repercussions of climate change, social inequalities, and ethical lapses, there is an increasing recognition that finance must evolve beyond traditional profit-centric paradigms. In the wake of this transformative event, these two paradigms in finance have taken centre stage, offering a path forward that transcends mere recovery and ushers in an era of lasting resilience and ethical responsibility. The pandemic has highlighted the need for financial institutions, including Islamic banks practising VBI, to play a more active and responsible role in supporting communities and addressing. As the world emerges from the shadow of the unprecedented COVID-19 pandemic, it does so with a heightened sense of urgency and purpose, and socio-economic challenges.

The initiative by Bank Negara Malaysia (BNM) is grounded in Shariah principles, aiming to foster practices that generate sustainable impact across the economy, society, and environment. This approach marks a shift from traditional Shariah compliance towards a more holistic framework that innovates policies and systems to realise the full value proposition of Shariah. The integration of Value-Based Intermediation (VBI) with sustainable finance is particularly significant, as it offers a promising solution to address the estimated annual funding gap of \$2.5 trillion needed to achieve the United Nations Sustainable Development Goals (UN, 2018). By expanding the role of Islamic Banking Institutions (IBIs) beyond compliance to actively creating value, this integration enhances the utility and effectiveness of Islamic finance in driving sustainable development. This study is important and timely, as it explores a novel approach that not only aligns with global sustainability agendas but also strengthens the socio-economic impact of Islamic finance. The findings will

be beneficial to policymakers, financial institutions, and researchers seeking to understand and implement sustainable financial practices within a Shariah-compliant framework.

Literature Review

Malaysia is in a unique position to support the Sustainable Development Goals (SDGs) as it also aligns with the VBI through its Islamic finance sector. The country is committed to Islamic finance, which follows the principles of Maqasid Shariah, or the objectives of Islamic law. These principles are compatible with the global trends of environmental, social, and governance (ESG) criteria, which seek to create positive social and environmental impacts. Malaysia's government, central bank, Securities Commission, and stock exchange (Bursa Malaysia) have all taken measures to encourage Islamic finance, VBI and ESG integration. The private sector is also involved in creating innovative products and services that meet the increasing demand for ethical and sustainable investments. Malaysia is therefore well-positioned to be a leader in Islamic finance and ESG, and to help the global efforts to achieve the SDGs. Following the

Stakeholder Theory

Many studies emphasise that stakeholder collaborations may make strong practical contributions towards corporate sustainability management. The stakeholder theory is applied to describe the nature of an organisation, the way of managing, the board's reaction towards the interest of corporate constituencies and the way the corporation is managed, and to explain specific corporate characteristics and behaviours (Donaldson & Preston, 1995). The stakeholder theory states that the main objective of an organisation is to maximise stakeholders' value, emphasising stakeholder-related issues in an organisation (Rehman et al., 2020). The stakeholder theory is becoming better known because many researchers have recognised that the activities of corporate entities affect external environmental factors and require organisational accountability to a broader scope rather than limited to the shareholders (Yusoff & Alhaji, 2012). Similarly, Meutia et al. (2022) emphasised the stakeholder theory in their study on sustainability to assess materiality analysis. Stakeholder theory underscores that a company's objectives should extend beyond merely financial and economic performance, recognising that the actions of a firm influence a wide range of stakeholders (Liu, and Wu, 2023). This is in line with the principles of corporate governance, known as the system, to ensure the board and corporate management strike a balance between the interests of various stakeholders (Rossouw, 2008). Mitchell et al. (1997) provide three characteristics of stakeholders: Power, legitimacy, and urgency. The manager needs to be aware of the entities in an environment where he is in power and intends to execute his interests in the firm. Power and urgency must be taken if the manager serves the law and the interests of legitimate stakeholders (Mitchell et al., 1997). According to Salami et al. (2014), the stakeholder theory builds satisfaction. It promotes stakeholders' interests that always aim to ensure each area receives some satisfaction. Furthermore, stakeholders are recognised as assets, while managers are expected to manage them effectively (Rehman et al., 2020). This theory is the nexus of a contract between the firm and interested parties that are known as stakeholders, such as employees, shareholders, creditors, government, and other stakeholders (Obid and Naysary, 2014; Sanda et al., 2005), by participate in the role of the management process of the firm and control (Iqbal and Mirakhor, 2004). However, some studies argue that this theory is narrow since shareholders are considered the only interest group of a corporate entity (Yusoff & Alhaji, 2012). According to Phillips and Reichart (2000),

the stakeholders' significant weaknesses identify the stakeholders' identity, distinguishing between the stakeholders and those who are not. Similarly, according to Mitchell et al. (2006), the definition of the stakeholder is narrow, as the managers cannot attend to all actual or potential claims. This argument views that corporate governance structures highlight stakeholders' rights by reducing the information asymmetry and emphasising enforcement components to protect the rights of stakeholders (Bonnafeus-Boucher, 2005; Donaldson & Preston, 1995; L'Huillier & Marie L'Huillier, 2014). Unlike the agency theory, the stakeholder theory does not mention the information asymmetry between managers and shareholders. However, it argues that the right of the stakeholders to participate in the decision-making process (Obid and Naysary, 2014). It concerns the interests of both parties, which are the stakeholders and shareholders (Yusoff and Alhaji, 2012). A study by Rehman et al. (2020) states that the stakeholder management assumption of the theory is a helpful tool to gain profitability.

Legitimacy Theory

The legitimacy theory is the central thought of the social contract between organisations and society by considering the rights of the public in general, not merely focusing on the rights of investors alone (Yusoff & Alhaji, 2012). In this effort, a firm will disclose the social activities information to the public to strengthen its image towards being socially responsible for attracting its stakeholder groups. Meutia et al. (2022) applied legitimacy theory in their study on sustainability to assess materiality analysis in sustainability reports based on the perspectives of legitimacy theory and stakeholder theory. From the CSR perspective, the legitimacy theory emphasises that the community allows an organisation to use natural resources legally and allows the organisation to obtain human resources by employing people from the local community. With these resources, an organisation utilises them to benefit its business by producing its products and services, yet unfortunately, pollutes the environment through its waste (Aslam et al., 2018). To maintain this relationship, an organisation needs to demonstrate its good behaviour as a corporate member to the community. They act as a corporate body that shows that the community needs their support by providing facilities and assistance. In response, the community accepts all their activities and actions. However, failure to meet the society's expectations of its propensity can trigger unforeseen actions against the operations and cause restrictions on its resources and demand (Yusoff & Alhaji, 2012). For instance, health and safety are society's main concerns, and it can change society's perception if corporate bodies emphasise the importance and provide this facility to society (Grey et al., 1995).

Regarding the aim of a business, it is recognised that maximising profit and giving shareholder value is a direction to gain business success. Therefore, numerous studies have examined a firm's performance based on profitability since profit maximisation is an indicator of corporate performance (Yusoff & Alhaji, 2012). However, according to Ramanathan (1976), from the legitimacy theory perspective, profit is seen as an indicator of organisational legitimacy in total. On the other hand, many empirical studies applied legitimacy theory in social and environmental reporting and related corporate disclosures and community expectations (Deegan, 2004). Hillman et al. (2000) consider external environmental factors' potential influence and reduce uncertainty to reduce transaction costs related to external relationships. Consistent with Gales and Kesner (1994), state that legitimacy potentially reduces uncertainty. In addition, Islamic banks will continue to strive to ensure that their

companies are seen to operate according to the boundaries and norms of society, and they also always ensure that their corporate activities are accepted by external parties (Azmi et al., 2020). Based on the theory of legitimacy, in the effort of Islamic banks to seek legitimacy from the community or other external parties, they need to disclose relevant information as an intermediary between Banks and the public. Likewise, disclosing information about banks' activities in supporting the community can attract banks' customers to respond to banks' efforts in serving the community.

Sustainable Finance

The definition of sustainable finance, however, is very broad, encompassing myriad dimensions of sustainable ways to achieve finance and investment goals. The concept seamlessly involves the practice of integrating environmental, social, and governance (ESG) criteria into financial decision-making processes. Sustainable finance is driven by the recognition that traditional financial practices can have significant impacts on the world, and there is a growing need to align financial activities with broader sustainability goals (Fatemi & Fooladi, 2013). It encompasses a range of financial activities and investment strategies that aim to promote not only financial returns but also positive and sustainable outcomes for society and the environment (Sharma, G. D., Verma, M., Shahbaz, Gupta, M., and Chopra, R., 2022). The European Commission (2021) defines sustainable finance as an evolving process of considering environmental, social, and governance (ESG) factors in financial and investment decisions. This definition extends to a broader and more encompassing definition that speaks to sustainability at large (World Economic Forum, 2021). It could help to overcome the economic and environmental crisis because of its capacity to gather resources to promote investment and to foster economic growth with a low socio-environmental impact (Pisani and Russo, 2021). It refers to the ability to harmonise life without endangering ecosystems, while also securing the well-being of stakeholders across generations. Navigating sustainable finance via VBI in the aftermath of the COVID-19 pandemic presents significantly greater challenges. In this regard, Sharma et. al (2022) propose that sustainable finance should encompass all activities and factors that would make finance sustainable and contribute to sustainability. In line with this, the Islamic social finance (ISF) is crucial for ensuring financial stability, fairness, and economic growth, in line with the goals of Maqasid al-Shari'ah. Raimi, Abdur-Rauf, and Ashafa (2024) highlight that ISF tools like Islamic Green Sukuk, Socially Responsible Investment Funds, Islamic Microfinance, and Islamic Impact Investing play a significant role in achieving the Sustainable Development Goals (SDGs). These tools support sustainable practices and projects, promoting inclusive and sustainable economic development.

In addition, Ye & Dela (2023) state that to pursue profits, the financial approach needs a positive contribution to environmental and social well-being. This objective can be achieved by advocating for sustainable and ethical financing practices. Indeed, the attainment of sustainable policy objectives across numerous jurisdictions can be achieved through various ways, such as climate finance, carbon and ESG disclosure, green bonds, and socially responsible investment (Alsaifi et al., 2020; Barua & Chiesa, 2019; Lokuwaduge and Heenetigala, 2017; Migliorelli, 2021; OECD, 2020; Widyawati, 2020). All these aspects fall within the scope of our comprehensive definition of sustainable finance.

Addressing the evolving post-pandemic requirements involves a focus on responsible banking, entailing the identification of optimal strategies for maximising positive social and environmental impacts across product offerings, services, operations, and activities. The post-pandemic objective is geared towards actively seeking opportunities. Financial inclusion fosters financial stability by creating an optimal marketplace that channels resources to all, thereby promoting growth without causing excessive strain on the economy (BNM, 2017). Considering the broad nature of sustainable finance and its importance for achieving the sustainability agenda, many studies have been undertaken to enhance the understanding and practice of sustainable finance (Kumar et al., 2022).

The concept of sustainable finance has been discussed and examined in various studies. It seems to influence every part of economic activity. A literature review analysis on the topic of sustainable finance and investment conducted by Cunha, Meira, and Orsato (2021) concludes that sustainable finance and investment participants have collaborated to promote positive social and environmental impacts through financial and investment activities. They opined that the greatest challenges facing the field are the under-theorisation of the sustainable finance and investment concept, the traditional short-term nature of financial logic, and a lack of evidence on sustainable finance and investment impacts on society and the environment. It is consistent with the sustainable finance approaches that influence and interrelate and connect with the environment and human life.

The expert in this field asserts that there's an intrinsic link between our environment and society, implying that the welfare of one directly influences the other. In the realm of sustainable finance, this suggests that financial decisions should encompass more than just economic aspects, but also the impacts on the environment and society (Thompson, 2021). For example, investing in a business that negatively affects the environment might offer immediate financial benefits, but could lead to societal expenses in the long run (such as healthcare costs from pollution-related diseases), which could subsequently affect the economy. Hence, sustainable finance champions a comprehensive approach where financial decisions are made with their long-term effects on the environment and society in mind. This strategy strives to promote overall sustainability, ensuring that our actions today do not jeopardise the ability of future generations to fulfil their needs.

Value-Based Intermediation (VBI)

The issuance of the VBI strategic paper by BNM in 2018, before the onset of the pandemic, appears as a momentous stride for the financial institutions industry. VBI's strategy opens a new holistic layer for Islamic banks in providing the public at large with impactful and profitable services (Ahmad and Mahadi, 2020). According to a report by The Sunday (2018), the chairman and deputy president of the Association of Islamic Banking and Financial Institutions Malaysia mentioned that the application of VBI practices would result in better facilitation of entrepreneurship, community well-being, sustainable environment, and economic growth, which are aligned with shareholders' focus on sustainable, long-term returns. Following the issuance of the VBI by the Bank Negara, the OECD has introduced the OECD Development Policy Paper. The paper addressed the opportunities that Islamic finance presents for donors as they look to deliver the Sustainable Development Goals (SDGs). The SDG presented is consistent with the Maqasid Shariah and has been discussed the SDG in an Islamic perspective in the various fields.

Consistent with the Maqasid Shariah, BNM has comprehensively released a trio of guidance documents aimed at effectively fostering the implementation of VBI. These documents include the Implementation Guide for VBI, the VBI Financing and Investment Impact Assessment Framework (VBI AF), and the VBI Scorecard. All of which collectively support the seamless integration of VBI principles. VBI will be a game changer to drive the Islamic finance industry to its next level of growth, while giving equal importance to social, ethical, and environmental considerations towards sustainable value creation (The SUNDAILY, 2018; Ambank, 2021). BNM has established collaboration with five prominent Islamic banks in Malaysia, including Bank Islam Malaysia Berhad (Chair of VBI CoP), Bank Muamalat Malaysia Berhad, AgroBank, CIMB Islamic Bank Berhad, and HSBC Amanah Malaysia Berhad, which aims to culminate in the formation of the VBI Community of Practitioners (CoP). The collaboration has developed the strategies to promote the application of VBI practices, which will lead to an improved suite of products and services offered by Islamic banks.

In this perspective, the concept of VBI is seen as a unique approach; the VBI bears resemblances to ethical finance, Environmental, Social, and Governance (ESG) principles, as well as Socially Responsible Investment (SRI) concepts. These similarities lie in their shared focus on assessing the sustainability and ethical implications of investments in businesses or companies (Mahyudin and Rosman, 2020). The VBI could potentially augment and enrich the values for Small and Medium Enterprises (SME) entrepreneurs and communities. This can be achieved by fostering a sustainable environment, promoting economic growth, and enhancing the returns for the Islamic Banking Institutions' (IBIs) shareholders (Roshayani, Ruhaini, Ramesh, and Idora, 2018). Furthermore, according to Mohamed (2022), VBI aims to achieve the triple bottom line of people, planet and profit or prosperity, which matches the sustainability goals of the SDGs as the global objectives for development, and the Principles for Responsible Banking (PRB) guidelines for responsible banking issued by the United Nations Environment Program Finance Initiative. As Mohamed (2022) pointed out, Malaysia has a unique advantage in supporting Sustainable Development Goals (SDGs) because of its distinctive qualifications. The government, central bank, Securities Commission, Bursa Malaysia, and major private sector corporations all share the vision of making Malaysia a leader in Islamic finance. The country continuously expands the dialogue on the common values between the foundation of Islamic finance based on the Maqasid Shariah perspective, which promotes socially responsible investment, and the global trends of incorporating environmental, social, and governance (ESG) principles in financing SDGs.

Islam is a religion that promotes peace, justice, and harmony among people and with nature. It teaches its followers to be responsible stewards of the earth and to care for the well-being of all living beings. Islam also encourages its adherents to seek knowledge, innovation, and development that benefit humanity and the environment, as stated in the VBI. These principles are compatible with the Sustainable Development Goals (SDGs) that aim to improve the quality of life for everyone and to end poverty, hunger, and inequality. Islam and the SDGs share a common vision of a prosperous, inclusive, and sustainable world (Slamet, 2020).

Recently, there have been many studies that have been conducted on the SDG. For instance, Dariah, Salleh and Shafiai (2016) suggest a new way to use Islam to help Muslim countries reach SDGs. They base their idea on three Islamic relationships: between humans

and Allah SWT, between humans, and between humans and nature. They opined that these relationships teach Muslims to act with justice, mercy, compassion, balance, and stewardship. This way, Muslims can do their duties to Allah SWT, themselves, others, and the environment. The paper also shows how to combine Islamic guidance and SDGs in a framework with four parts: (1) the sources of Islamic guidance, such as the Quran and the Sunnah; (2) the dimensions of Islamic guidance, such as beliefs and morals; (3) the indicators of SDGs, which show how well Muslim countries are doing in reaching the 17 goals and 169 targets; and (4) the strategies of implementation, which include planning, action, monitoring, evaluation, and feedback. The paper says this approach has benefits and challenges for Muslim countries. The benefits are making SDGs more relevant and legitimate for Muslims, supporting Islamic values and identity, creating social cohesion and harmony, and improving human and environmental well-being. The challenges are dealing with the diversity and complexity of Muslim countries, solving the gaps and conflicts between Islamic guidance and SDGs, involving and empowering stakeholders, and getting the political will and commitment of leaders.

The other recent study by Khan and Haneef (2022) presents an Islamic perspective on Sustainable Development Goals (SDGs). It emphasises human capital development, crucial for economic growth, and highlights the use of Islamic social financial tools like Zakat and Waqf to address poverty, hunger, gender equality, and inequality. The principle of Wasatiyyah is linked to sustainable consumption and production, while the concept of Khalifah is associated with the utilisation of water, sanitation, and energy. The paper also discusses the application of Maslahah in dealing with natural resources and connects the principles of Salam and 'Adl wa al-Ihsan to peace, justice, and strong institutions. Lastly, *Ta'awwun 'Alal-Birri* to partnerships for the goals, emphasising cooperation in goodness. Similarly, according to an Islamic perspective, the Sustainable Development Goals (SDGs) encompass environmental and resource protection, as well as livelihoods related to the environment. The study underscores the Islamic visions and recommendations for sustainable development processes, particularly in the areas of water, sanitation, and health. The findings suggest that achieving the SDGs can be facilitated by robust internal and external partnerships, broad awareness, and spiritual growth through the practice of Islam.

To conclude, Islamic views on sustainability are compatible with the aims of VBI and SDG, as they emphasise the balance between environmental and human needs. Islam offers guidance and solutions for sustainable development challenges, especially in water, sanitation, and health sectors. The study highlights the importance of strong cooperation, education, and spiritual development through Islamic practices for achieving the SDGs.

Methodology

In empirical papers, the recipe typically is the research design that provides the paper structure and logic, guiding the process of developing new knowledge and offering conventions for reporting the key elements of the research (Flick 2018, p. 102). The research design explains how the ingredients of the study were selected, acquired, and analysed to effectively address the research problem, and reviewers can evaluate the robustness of this process by reference to established conventions in the existing literature.

Table 1

Four Approaches of Conceptual Article

| Approaches | Potential goals and applications | Research design considerations | References |
|---|---|--|---|
| <p><i>Theory synthesis:</i></p> <p>i. Stakeholder theory</p> <p>ii. Legitimacy theory</p> <p>Conceptual integration across multiple theoretical perspectives*</p> | <p><i>Summarising and integrating current understanding</i></p> <ul style="list-style-type: none"> • Outlining the conceptual domain of a new phenomenon or idea • Structuring a fragmented field by analysing it through a particular theoretical lens | <p>Starting point: Phenomenon or concept</p> <ul style="list-style-type: none"> • Choice of domain theory/theories: Literature that can be argued to address some aspect of the phenomenon/concept • Choice of method theory: Theory for organising the key dimensions of the phenomenon | <p>Becker and Jaakkola (2020); White et al. (2019); Lemon and Verhoef (2016); Kozlenkova et al. (2014); Möller (2013); Vargo and Lusch (2004)</p> |
| <p><i>Model:</i></p> <p>Building a theoretical framework that predicts relationships between constructs.</p> | <ul style="list-style-type: none"> • <i>Explaining and predicting relationships between constructs</i> • Identifying novel connections between constructs • Development of theoretical propositions that introduce new constructs and/or relationships between constructs • Explaining why a sequence of events leads to an outcome | <p>Starting point: Phenomenon or theory/concept</p> <ul style="list-style-type: none"> • Choice of domain theories: Literature that addresses key elements of the phenomenon/concept to be explained • Choice of method theory: Theory that enables the explanation of relationships between the studied variables | <p>Huang and Rust (2018) Payne et al. (2017) De Brentani and Reid, (2012) MacInnis and De Mello (2005)</p> |

Sources: Adopted from Jaakkola (2020)

This paper integrates theory synthesis and model technique based on Jaakkola's (2020) in producing the research outcome. The synthesised theory technique summarises and integrates current understanding across the multiple theoretical perspectives applied based on Value-Based Intermediation and Sustainable Finance variables.

Following the methodology technique framework applied in this paper, that developed based on the synthesis of theory and model approaches.

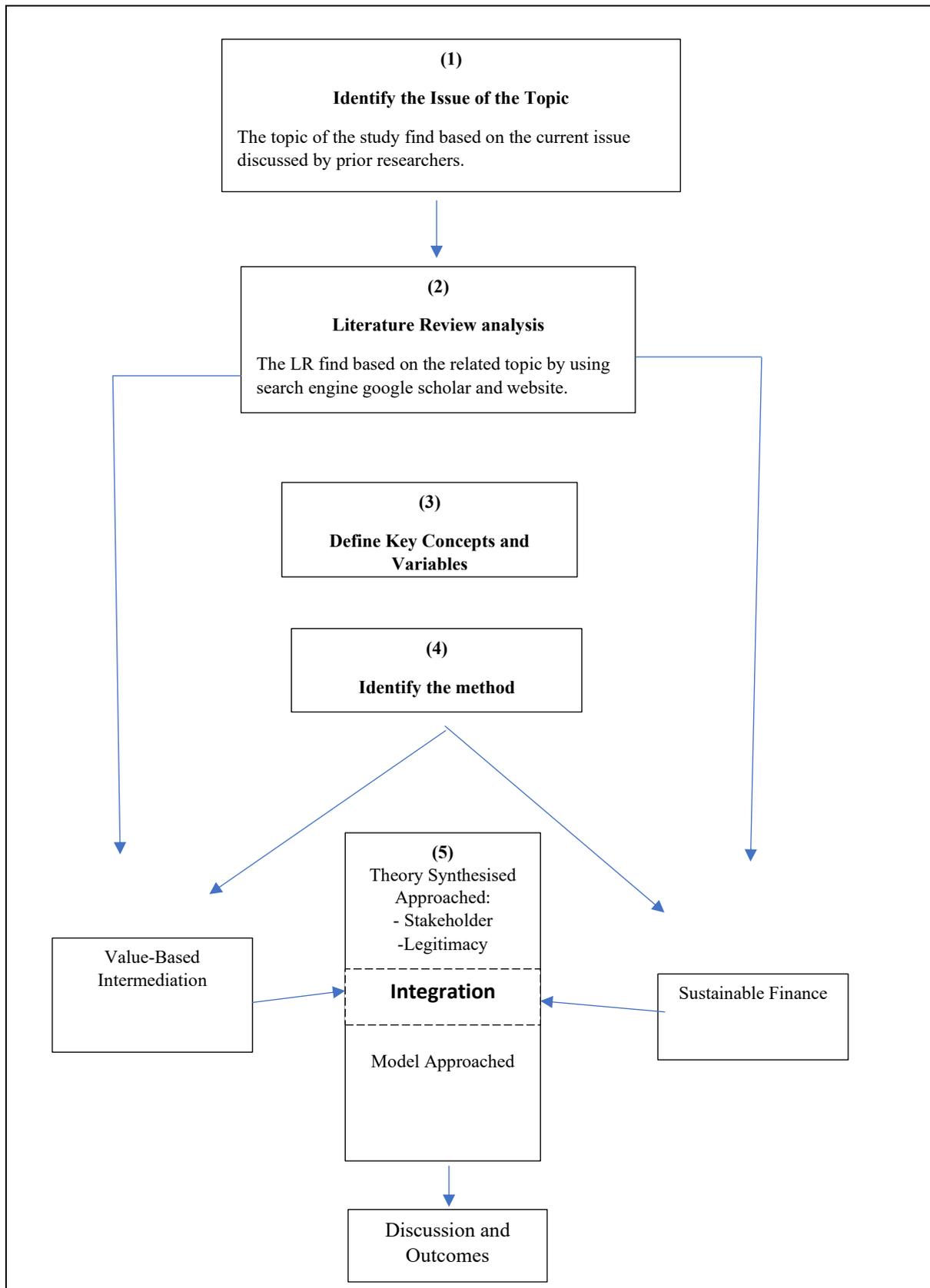


Figure 2: Research process- synthesising theory and model approaches

This research paper employs a systematic five-step process. The initial step involves identifying the guiding research problem. This is followed by a literature review, where

existing theories, models, and frameworks related to research problems are examined. The third step defines the study's relevant key concepts and variables. Subsequently, identifying the method to be applied in this study. The final step of this paper integrates and discusses VBI and financial sustainability by synthesising the theory and model approach. This paper applies the theory synthesised by integrating multiple theories or perspectives on a phenomenon, providing new insights and explanations through a process. This approach can address complex or contradictory problems, identify gaps or inconsistencies in existing literature, and generate novel or testable hypotheses.

Discussion

The following section will discuss the integration of sustainable finance and VBI applied in the Islamic financial institutions.

Sustainable Finance and VBI

The adoption of sustainable finance and VBI by Islamic banks is a progressive step that aligns with the ethical and socially responsible principles inherent in Islamic finance. This adoption can be seen by embracing several approaches. It should incorporate meticulous ethical investment screening procedures rooted in Shariah principles. For instance, Islamic banks can expand these criteria to include environmental, social, and governance (ESG) considerations (Abdullah and Haron, 2022). This would ensure that investments are not only Shariah compliant but also contribute to sustainability and ethical objectives, mainly towards the social implication (Mohamad Ariff, Abd Majid, Kamarudin, Zainul Abidin, and Muhmad, 2023). However, it must emphasise regulatory compliance by updating with evolving regulatory requirements related to sustainable finance and ESG reporting, which are essential for demonstrating its commitment to responsible banking (Vanishvili and Katsadze, 2022).

On sustainable product development, Islamic banks can develop a range of financial products that are in line with sustainable finance principles (Kunhibava, Ling and Ruslan, 2018). These may include green financing options, social impact investment vehicles, and ethical funds that cater to environmentally conscious and socially responsible customers (Tok, et. al., 2022). Moreover, an Islamic bank can adopt the value-based approach in providing the fund by considering the ethical and social impact of the project on the environment (Hassan and Harahap, 2010). They should prioritise projects that align with sustainability goals, such as renewable energy, affordable housing, and clean technology initiatives (Tok and Yesuf, 2022).

Consistent with the VBI and ESG to ensure sustainable finance and ESG reporting, there is a need to ensure diligent maintenance of up-to-date regulatory compliance. It is essential for demonstrating their commitment to responsible banking. Similarly, it is also critical to enhance transparency by reporting on their sustainability and ethical performance, Md Zain (2022), by disclosing the activities that align with ESG criteria and Shariah principles and providing stakeholders with clear information on their ethical and sustainable practices. For instance, the integration of ESG factors into their risk assessment and credit evaluation processes can assist in identifying and mitigating ESG-related risks while supporting investments that align with sustainability objectives (Zoon, 2022). That can finally build a relationship between the stakeholders and the industry. This engagement opportunity can be utilised by gaining input from these groups to ensure that their practices and products

resonate with ethical and sustainability concerns. In addition, emphasising the transparency and reporting can be enhanced by providing clear information on how they adhere to Shariah principles and sustainable finance goals. By incorporating these elements, banks are able to offer a thorough overview of their ethical, social, and environmental conduct. This enables stakeholders to make decisions based on well-rounded information. This helps build trust among customers and investors, which is consistent with the legitimacy theory.

Finally, the collaboration and partnerships program is an advantage for the Islamic banks in collaborating with industry, including other financial institutions, NGOs, and government bodies, to promote sustainable finance and ethical banking practices (BNM, 2021; BNM, 2017). These partnerships can help create a more substantial impact on sustainability initiatives. However, in line with this effort, there is a responsibility towards the community such as VBI has emphasised sustainability towards the community. For instance, addressing social issues can be more effectively achieved by focusing on delivering aid or services that have a lasting impact. The Value-Based Intermediation (VBI) approach is a strategic initiative by the government to ensure that the outcomes of a company's social responsibility efforts are valuable and sustainable, thereby contributing to the socio-economic well-being of the community (BNM, 2018). To strengthen the impact of VBI within a collaborative framework, it is suggested that a waqf orientation be established. This will enhance the strategic outcomes of corporate collaboration and ensure that these results are continuously propagated in a way that benefits the socio-economic development of both the company and the community it serves in the long run (Ibrahim, Noor, Arsyad, Ismail, 2019). In addition, it can be realised through the allocation of a portion of the profits for community development initiatives, which is in line with the Islamic concept of Zakat.

Through the adoption of sustainable finance and value-based intermediation, Islamic banks can bolster their significance in an evolving financial environment, all while maintaining their ethical principles. This integration allows them to provide financial services that align with both Shariah principles and the growing demand for socially responsible and sustainable banking options. It also positions Islamic banks as influential players in the global movement towards more ethical and sustainable finance.

Addressing sustainable finance and VBI by Islamic Banks

Islamic banks, guided by Shariah principles, take a distinct approach to sustainable finance that is consistent with ethical, social, and environmental values. Shariah law requires Islamic banks to refrain from investing in unethical or haram sectors. These industries include those dealing with alcohol, gambling, pork, and other illegal activities. As well as avoiding speculative and leveraged transactions, which can lead to financial insecurity. This risk-averse approach aligns with sustainability goals by lowering the likelihood of financial crises. Thus, adhering to these principles could promote ethical and sustainable investment. These Shariah principles embedded in Islamic financial institutions differentiate between Islamic finance and conventional practices. The VBI initiative, launched by Bank Negara Malaysia (BNM), is designed to enhance the role and impact of Islamic banking institutions. It does this through practices and offerings that create a positive and sustainable impact on the economy, community, and environment. (BNM, 2018). Within the context of VBI, Islamic principles are incorporated into banking practices in a way that goes beyond mere compliance with

regulations. Instead, these principles guide banks in creating value for the economy, community, and environment (BNM, 2018).

Alternatively, Islamic banks frequently use profit and loss sharing (PLS) models such as Mudarabah and Musharakah, in which both the bank and the customer share in the profits and losses of an investment (Saleem, Daragmeh, Zahid and Sági, 2023). This promotes a long-term perspective and risk-sharing, which is consistent with the principles of sustainable finance. By recognising and promoting ethical business practices among their clients. They can lend to companies that adhere to ethical and sustainable standards, thereby promoting responsible corporate behaviors. Moreover, Islamic finance indeed encourages the payment of Zakat. Zakat is one of the Five Pillars of Islam, and it is an essential element of Islamic financial and ethical principles. Promoting the payment of Zakat as an integral part of its ethical and financial framework (Rabbani, Ali, Ur Rahiman, Atif, Zulfikar and Naseem, 2021). Zakat is not only a religious duty but also a means of promoting economic justice, wealth redistribution, and social welfare within the Muslim community.

Islamic financial institutions often play a role in facilitating the proper calculation and distribution of Zakat to ensure it aligns with Shariah principles. The commitment to environmental sustainability is evident in the active participation in green and ethical projects by financial institutions. These institutions invest in environmentally friendly and ethical initiatives, such as renewable energy, sustainable agriculture, and affordable housing (Jaiwant and Kureethara, 2023). These investments not only yield returns but also have a positive impact on society and the environment (Raimi et al., 2024; Mir and Bhat, 2022). Stakeholder engagement is often emphasised, involving interactions with customers, employees, regulators, and communities to understand their concerns and align banking practices with their values and needs. This is in line with international environmental, social, and governance (ESG) standards, which are increasingly significant in sustainable finance (OECD, 2014). This approach enhances the ability to not only disclose ESG performance but also to seamlessly integrate ESG factors into investment decisions. In the context of environmentally sustainable development, VBI can play a significant role.

By aligning the principles of Islamic finance with the goals of sustainable development, Islamic banks can contribute to addressing environmental challenges (OECD, 2020). This is achieved by prioritising investments and financing in sectors and projects that are environmentally friendly and sustainable (Khan, Hameed, Khan, and Khan, M. A., 2023). Under the VBI initiative, the role of Malaysia's Islamic Banking Institutions (IBIs) has evolved beyond just ensuring Shariah compliance. Now, they also strive to create value for the economy, society, and environment. One of the ways they do this is by addressing climate change through Climate Change and Principle-based Taxonomy (CCPT). This tool evaluates the economic activities and overall business operations of the banks' customers to understand their impact on the climate. This approach allows IBIs to contribute to environmental sustainability while also fulfilling their financial roles (Shahrom and Kunhibava, 2023).

For Islamic banks to successfully implement VBI, a significant paradigm shift is necessary. This shift involves moving away from a focus on maximising profits and towards a value-driven approach. This change not only requires a transformation in the mindset of key

personnel and shareholders but also a recalibration of the bank's culture to align with this value-driven paradigm (Ismail, Hameed, Suhaimi, Jamaludin, & Shahimi, 2020). However, the primary challenge that Islamic financial entities encounter in fully adopting the sustainability agenda is likely related to disclosure (Gould and Nurunnabi, 2022). Jensen et al. (2022) explained that only a small number of institutions have pledged to adhere to internationally recognised standards such as the UN Principles of Responsible Investment and the UN's Principles of Responsible Banking. These principles necessitate comprehensive disclosure of sustainability initiatives and their outcomes. Nevertheless, the growing trend of environmental stewardship is enticing Islamic financial institutions to leverage the expanding demand to reach a broader investor demographic. This is often the primary motivation for these institutions to embrace Islamic sustainable finance (Ahmed, Mohieldin, Verbeek, and Aboulmagd, 2015).

In summary, Islamic banks are ideally situated to adopt sustainable finance due to their shared values and principles. They can utilise their ethical and Shariah-compliant framework to develop innovative financial solutions that are both adherent and sustainable. For instance, they can offer green financing products that back projects with beneficial environmental impacts. By incorporating sustainable finance into their operations, Islamic banks can improve their social, environmental, and financial performance. This will allow them to better cater to their stakeholders and align with the worldwide sustainability agenda.

Integration of Sustainable Finance and VBI based on the Theory Synthesis and Model Approaches

VBI is an initiative in Islamic finance that aims to align the operations and activities of Islamic banks with the broader societal goals and ethical principles of Islam. VBI emphasises the integration of financial and non-financial considerations, promoting social, environmental, and ethical objectives alongside economic profitability. It's also an effort to enhance the positive impact of Islamic banking on society while ensuring compliance with Shariah principles. This idea within the domain of Islamic finance underscores the synchronisation of fiscal undertakings with ethical and societal factors. The objective is to establish a more comprehensive stance towards banking and finance, prompting financial establishments to direct their attention not solely towards profits, but also towards the welfare of society and the environment. The integration of sustainable finance and VBI represents a comprehensive approach to banking and finance that not only considers financial returns but also incorporates ethical, social, and environmental principles into banking operations and decision-making. Both sustainable finance and VBI aim to promote responsible and ethical practices within the financial industry, and their integration amplifies their impact, which is consistent with the goals of Islam, where the objectives of the sustainable development agenda (SDGs) are to increase economic growth and realise a prosperous life and eliminate poverty (Slamet, 2020). Value-Based Intermediation has gained traction within the Islamic banking industry. Several Islamic financial institutions have adopted VBI principles to varying degrees. The extent of adoption and the implementation of these principles may vary from one institution to another. VBI holds significant potential to contribute to the well-being of communities in the post-COVID-19 era. The pandemic has highlighted the need for financial institutions, including Islamic banks practising VBI, to play a more active and responsible role in supporting communities and addressing socio-economic challenges.

Table 1

Addressing Sustainable Finance and VBI

| No. | | Descriptions | References |
|-----|---|--|--|
| 1 | Shared Ethical Foundation | Sustainable finance and VBI share a common ethical foundation. They both emphasise the importance of ethical and socially responsible conduct in the financial sector. This alignment forms the basis for their integration. | Ahmed, Omar, and Mohamed, (2023); Ma'ruf, Mahomed, and Mohamad, (2021) |
| 2 | Environmental and Social Considerations | Sustainable finance integrates environmental, social, and governance (ESG) factors into investment and lending decisions. VBI, on the other hand, focuses on ethical considerations in banking activities. When integrated, they ensure that banks not only provide financial services but also consider the ethical and social implications of their actions. | (BNM, 2018); |
| 3 | Long-term Value Creation | Both approaches recognise the importance of creating long-term value. Sustainable finance emphasises investments that generate positive environmental and social outcomes while also delivering financial returns. VBI encourages banks to operate in a manner that is sustainable over the long term, which aligns with the sustainability aspect of finance. | BNM (2018); Weber (2016) |
| 4 | Risk Management | Integrating sustainable finance and VBI can lead to more robust risk management practices. Assessing ESG risks and ethical risks helps banks make informed decisions and avoid potential harm to their stakeholders. | Al Muhairi and Nobanee, (2019); Al Ahababi and Nobanee (2019) |
| 5 | Stakeholder Engagement | Sustainable finance and VBI emphasise the importance of engaging with stakeholders, including customers, communities, and regulatory bodies. Integration ensures that banks actively seek input and address the concerns of all stakeholders, fostering trust and accountability. | Akpan, Oluwagbade and Owonifari (2023). |
| 6 | Product Innovation | The integration of sustainable finance and VBI can drive product innovation. Banks can develop financial products and services that not only adhere to ethical and social principles but also contribute to sustainability goals. | Shahrom and Kunhibava, S. (2023). |
| 7 | Regulatory Compliance | Many regulators are increasingly encouraging banks to integrate ESG factors and ethical considerations into their operations. The integration of sustainable finance and VBI helps banks stay compliant with evolving regulatory requirements. | Dias (2022); BNM (2018) |
| 8 | Reporting and Transparency | Both approaches promote transparency and reporting. Integrating them ensures that banks provide comprehensive information on their ethical, social, and environmental performance, allowing stakeholders to make informed decisions. | Liu & Wu (2023); BNM (2018) |
| 9 | Impact Assessment | Integration allows banks to assess the impact of their operations comprehensively, not only in terms of financial metrics but also regarding their contributions to sustainability and ethical goals. | Gleißner, Günther, and Walkshäusl (2022); BNM (2018) |

In summary, the integration of sustainable finance and value-based intermediation represents a holistic approach to banking and finance. It aligns financial practices with ethical, social, and environmental principles, creating a banking sector that is not only financially sound but also socially responsible and environmentally sustainable. This integration can lead to more responsible and impactful financial services, benefiting both the financial industry

and society. For instance, banks wield a substantial influence in propelling social welfare and inclusivity forward. Their commitment to inclusive finance, bolstering community improvement, and channelling investments into education, healthcare, and housing collectively work to diminish disparities and nurture a fairer, more encompassing society, especially in the wake of the pandemic's repercussions. For the community, VBI holds significant roles in the aftermath of the pandemic by exerting its influence through several avenues. For instance, firstly, in terms of sustainable recovery, VBI principles emphasise sustainable and responsible financing, which can play a crucial role in supporting communities as they recover from the economic impacts of the pandemic. By directing financing towards projects and businesses that prioritise social and environmental benefits, VBI can contribute to a more resilient and sustainable economic recovery.

Stakeholder Theory and Legitimacy Theory

In the stakeholder theory perspective, this theory views a business as a network of relationships among various groups or individuals who have a stake or interest in the business. These stakeholders can include customers, employees, shareholders, suppliers, regulators, communities, and the environment. Stakeholder theory suggests that a business should manage its stakeholder relationships in a way that creates value for all parties and contributes to the common good (Valentinov, 2023). VBI and sustainable finance are two frameworks that apply stakeholder theory to the financial sector. The VBI stands for Value-Based Intermediation, which is an initiative by Bank Negara Malaysia to promote Islamic finance practices that create positive and sustainable impact on the economy, society, and environment (Aras, 2019). Sustainable finance is a broader concept that refers to the integration of environmental, social, and governance (ESG) factors into financial decision-making and regulation (Freudenreich, 2020).

Legitimacy theory is a perspective that views an organisation as a social entity that needs to justify its existence and actions to its external environment. An organisation is said to be legitimate when its values, goals, and practices are consistent with the expectations and norms of the society in which it operates. Legitimacy theory suggests that an organisation will seek to maintain or enhance its legitimacy by communicating its performance and achievements to its stakeholders, especially when there is a gap or a threat to its legitimacy (Gulluscio, 2020). VBI and sustainable finance are two frameworks that apply legitimacy theory to the financial sector. The aim of VBI is an initiative by Bank Negara Malaysia to promote Islamic finance practices that create a positive and sustainable impact on the economy, society, and environment (Aras, 2019). Sustainable finance is a broader concept that refers to the integration of environmental, social, and governance (ESG) factors into financial decision-making and regulation (Meutia et al, 2022). Thus, through the incorporation of sustainable finance into their operations, Islamic banks have the potential to improve their social, environmental, and financial outcomes. This approach not only allows them to better cater to their stakeholders' needs but also positions them in alignment with the worldwide sustainability objectives (Ahmed, Mohieldin, Verbeek, and Aboulmagd, 2015). Both VBI and sustainable finance aim to align the financial sector with the Sustainable Development Goals (SDGs) and the principles of responsible banking. They also seek to address the challenges and opportunities posed by climate change, social inequality, and environmental degradation. By adopting VBI and sustainable finance, financial institutions can enhance their stakeholder value creation, risk management, and innovation capabilities. By adopting VBI and sustainable

finance, financial institutions can demonstrate their legitimacy to their stakeholders and society by disclosing their ESG performance, impacts, and risks (Shahrom, Kunhibava, 2023; Freudenreich, 2020).

Conclusion

This paper discusses VBI's strategy and its potential application from the viewpoint of Shariah. VBI emerges as a guiding light for financial institutions seeking to navigate this complex landscape. By integrating ethical considerations, social impact, and sustainable development into their operations, financial institutions practising VBI can contribute significantly to building a world that is not only economically robust but also socially inclusive and environmentally responsible. As it is collectively strived to rebuild and re-imagine a better future, VBI stands as a catalyst for positive change, steering the financial sector towards a pivotal role in shaping resilient prosperity. This paper also discusses Islamic banks' activities in implementing VBI. Islamic banks have a natural affinity with sustainable finance due to their adherence to ethical and Shariah principles. By aligning their practices with sustainable finance principles, Islamic banks can contribute to a more ethical, socially responsible, and environmentally sustainable financial sector. This not only benefits their customers and shareholders but also aligns with broader global sustainability objectives. VBI, with its emphasis on delivering value to all stakeholders, aligns perfectly with the principles of stakeholder theory, which advocates for the consideration of all stakeholders in decision-making processes. This alignment fosters a banking environment that is not only focused on profit maximisation but also on creating value for all stakeholders, including the community and environment. Sustainable finance further enhances this approach by ensuring that financial activities contribute positively to sustainable development. It encourages investments in sectors that have a positive environmental and social impact, thereby aligning with the global sustainability agenda. Consistent with the legitimacy theory, which posits that organisations seek to ensure that their actions are perceived as legitimate by their stakeholders, reinforces the need for Islamic banks to adopt VBI and sustainable finance. By doing so, Islamic banks can enhance their legitimacy among stakeholders, who are increasingly demanding that financial institutions play a more active role in addressing social and environmental challenges. Therefore, by integrating VBI, sustainable finance, stakeholder theory, and legitimacy theory, Islamic banks can enhance their social, environmental, and financial performance, better serve their stakeholders, and align with the global sustainability agenda. This holistic approach positions Islamic banks as key players in the transition towards a more sustainable and inclusive global financial system.

In conclusion, the integration of disclosure elements in Islamic banking practices is crucial for the successful implementation of sustainable finance. It ensures transparency, accountability, and adherence to ethical and Shariah principles, thereby contributing to the achievement of sustainable development goals.

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