

THE MODERATING ROLE OF GREEN INNOVATION IN THE EFFECT OF SRI SUKUK AND ESG PRACTICES ON ORGANIZATIONAL PERFORMANCE

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Abstract: *Sustainable and Responsible Investment (SRI) Sukuk has emerged as a significant Islamic financial instrument that supports sustainable development while adhering to Shariah principles. As part of the broader green finance movement, SRI Sukuk is designed to finance projects that generate positive environmental and social impacts, such as renewable energy, sustainable infrastructure, and energy-efficient developments. This study examines the impact of SRI Sukuk on the performance of Bank Rakyat, focusing on both financial and non-financial dimensions. The analysis explores how participation in SRI Sukuk initiatives contributes to revenue growth, portfolio diversification, risk management, corporate reputation, and alignment with Environmental, Social, and Governance (ESG) objectives. The study also highlights the challenges associated with implementing SRI Sukuk, including regulatory compliance, reporting requirements, and limited investor awareness. Drawing upon Stakeholder Theory and the Triple Bottom Line framework, the study suggest that SRI Sukuk can enhance Bank Rakyat's long-term sustainability and competitiveness by promoting responsible financing practices and supporting national sustainable development goals. The framework proposes green finance through SRI Sukuk not only strengthens financial performance but also improves stakeholder trust and institutional resilience. Therefore, SRI Sukuk represents a strategic opportunity for Bank Rakyat to create a large scale of impact to environmental and social well-being.*

Keywords: *Sustainable and Responsible Investment (SRI) Sukuk, Green Finance, Bank Rakyat, ESG, Sustainable Development, Islamic Finance, Financial Performance.*

Introduction

The increasing concern over climate change, environmental degradation, and social inequality has accelerated the demand for sustainable finance worldwide (United Nations, 2015). As a result, the SRI has gained significant attention by integrating Environmental, Social, and Governance (ESG) considerations into investment decisions to achieve long-term financial returns while creating positive environmental and social impacts. Within the Islamic finance industry, Sustainable and Responsible Investment (SRI) Sukuk has emerged as an innovative Shariah-compliant financing instrument that supports sustainable development through investments in renewable energy, green infrastructure, and social impact projects (Bhattacharyya, 2022; Securities Commission Malaysia, 2023).

Malaysia has positioned itself as a global leader in Islamic sustainable finance through the introduction of the Securities Commission Malaysia's Sustainable and Responsible Investment Sukuk Framework. As one of the country's leading Islamic financial institutions, Bank Rakyat has strengthened its commitment to sustainable finance by promoting responsible banking practices, ESG implementation, and innovation. These initiatives are expected to enhance financial performance, strengthen stakeholder trust, improve corporate reputation, and support long-term organizational sustainability.

Green innovation has become a critical organizational capability that enables firms to transform sustainability initiatives into sustainable competitive advantages. It involves the development and adoption of environmentally friendly technologies, green products and services, sustainable business processes, and innovative solutions that reduce environmental impacts while enhancing organizational performance (Barney, 1991; Fu et al., 2023). Through the adoption of green technologies, eco-friendly financial products, sustainable business processes, and digital solutions, organizations can improve operational efficiency while achieving both environmental and business objectives (Fu et al., 2023; Bhattacharyya, 2022). However, despite growing interest in sustainable finance, limited studies have examined the combined effects of SRI Sukuk and ESG practices on organizational performance through the mediating role of green innovation, particularly within the context of Bank Rakyat.

Bank Rakyat strengthened its commitment to sustainable finance through the issuance of its first RM500 million ASEAN Sustainability SRI Sukuk under the RM10 billion Sukuk Wakalah Programme in 2024. The Sukuk finances projects aligned with environmental and social sustainability objectives, including affordable housing, renewable energy, green buildings, and clean transportation. As of December 2024, 100% of the Sukuk proceeds had been allocated, with 36.17% invested in affordable housing, 26.03% in renewable energy, 12.52% in socioeconomic development, and the remaining funds supporting green buildings, financial inclusion, clean transportation, waste management, and education (Bank Rakyat, 2024).

Therefore, this conceptual paper proposes a framework to examine the relationships among SRI Sukuk, ESG Practices, Green Innovation, and Organizational Performance. Drawing upon Stakeholder Theory and Resource-Based View (RBV) theory, the study seeks to provide a better understanding sustainable finance and innovation contribute to enhancing organizational performance in Islamic financial institutions.

Research Objectives

The objectives of this study are as follows:

1. To determine the influence of SRI Sukuk on organizational performance.
2. To determine the influence of ESG Practices on organizational performance.
3. To assess the influence of SRI Sukuk on Green Innovation.
4. To assess the influence of ESG Practices on Green Innovation.
5. To evaluate the influence of Green Innovation on Organizational Performance.
6. To investigate whether Green Innovation mediates the relationship between SRI Sukuk and Organizational Performance.
7. To investigate whether Green Innovation mediates the relationship between ESG Practices and Organizational Performance.

Literature Review

Sustainable and Responsible Investment (SRI) Sukuk

SRI Sukuk is a sustainable financial instrument developed to finance projects that generate positive environmental and social outcomes while complying with Islamic financial principles. According to Bhattacharyya (2022), sustainable investment instruments such as green bonds and green Sukuk have become increasingly important in supporting climate action, renewable energy development, and sustainable economic growth. These instruments facilitate capital mobilization toward environmentally responsible projects while providing investors with opportunities to contribute to sustainability objectives.

Fu et al. (2023) describe green finance as a financial system that integrates environmental protection and sustainable development into investment and financing decisions. Within this framework, SRI Sukuk serves as a mechanism for funding renewable energy projects, green infrastructure developments, social impact programs, and sustainable investment initiatives. The authors argue that sustainable financing instruments not only support environmental objectives but also contribute to economic stability and long-term value creation.

The key indicators of SRI Sukuk in this study include renewable energy financing, green project financing, social impact financing, and sustainable investment initiatives. Renewable energy financing supports the transition from fossil fuels to cleaner energy sources, while green project financing promotes environmentally sustainable infrastructure development. Social impact financing addresses social challenges such as healthcare, education, and community development. Sustainable investment initiatives encourage responsible investment practices that generate both financial and social returns (Bhattacharyya, 2022; Desalegn & Tangl, 2022; Fu et al., 2023).

Previous studies suggest that sustainable financing improves institutional competitiveness, enhances stakeholder trust, and creates opportunities for long-term growth. Therefore, SRI Sukuk is expected to contribute positively to organizational performance.

ESG Practices

Environmental, Social, and Governance (ESG) practices have become central to sustainable finance and responsible investment strategies. Fu et al. (2023) highlight ESG as one of the most

important pillars of green finance because it enables organizations to integrate sustainability considerations into strategic decision-making and operational activities.

Environmental responsibility refers to organizational efforts to minimize environmental impacts through resource efficiency, carbon reduction, and environmental conservation initiatives. Social responsibility focuses on employee welfare, customer satisfaction, community engagement, and ethical business conduct. Governance encompasses transparency, accountability, ethical leadership, and effective oversight mechanisms. Sustainability reporting provides stakeholders with information regarding an organization's environmental, social, and governance performance (Friede et al., 2015; Bhattacharyya, 2022; Fu et al., 2023).

Bhattacharyya (2022) emphasizes that ESG practices have become essential for financial institutions seeking to enhance resilience and manage sustainability-related risks. Organizations that successfully implement ESG strategies are more likely to attract investors, improve stakeholder confidence, and achieve sustainable growth. Furthermore, ESG performance has increasingly become an important criterion for evaluating organizational effectiveness and long-term value creation.

As a result, ESG practices are expected to positively influence both green innovation and organizational performance.

Green Innovation

Green innovation refers to the development and implementation of environmentally sustainable technologies, products, services, and processes. According to Desalegn and Tangl (2022), green innovation plays a critical role in achieving sustainable development because it enables organizations to improve environmental performance while maintaining economic competitiveness.

Bhattacharyya (2022) argues that green finance provides the financial resources required to support innovation activities that promote environmental sustainability and facilitate the transition toward a greener economy. Similarly, Fu et al. (2023) emphasize that green finance plays a crucial role in encouraging sustainable innovation by directing investments toward environmentally responsible projects and technologies. According to Chen (2008), green innovation can be reflected through the adoption of green technologies, the development of eco-friendly financial products, sustainable process innovation, and digital green solutions, all of which enhance organizational efficiency while contributing to environmental sustainability.

Green technology adoption involves implementing environmentally friendly technologies that reduce energy consumption and environmental impacts. Eco-friendly financial products include sustainable investment products, green financing solutions, and environmentally responsible banking services. Sustainable process innovation focuses on improving operational efficiency through environmentally conscious business processes. Digital green solutions involve the application of digital technologies to support sustainability objectives and reduce resource consumption (Chen, 2008; Bhattacharyya, 2022; Fu et al., 2023).

Fu et al. (2023) note that innovation serves as a key mechanism through which green finance generates positive environmental and economic outcomes. Organizations that embrace green innovation are better positioned to achieve sustainability goals, improve operational efficiency, and strengthen competitive advantages. Therefore, green innovation is expected to mediate the

relationship between sustainability-oriented financial practices and organizational performance.

Organizational Performance

Organizational performance represents the extent to which an organization achieves its strategic objectives and creates value for stakeholders. Modern approaches to performance measurement recognize both financial and non-financial dimensions of organizational success (Kaplan & Norton, 1996; Richard et al., 2009). The present study measures organizational performance using four indicators: financial performance, customer satisfaction, corporate reputation, and sustainability performance. Financial performance reflects profitability, revenue growth, and operational efficiency. Customer satisfaction represents customers' perceptions of service quality and value. Corporate reputation reflects stakeholder trust and confidence in the organization. Sustainability performance measures the organization's success in achieving environmental and social objectives (Kaplan & Norton, 1996; Richard et al., 2009; Friede et al., 2015).

According to Fu et al. (2023), organizations that integrate green finance principles into their operations often achieve superior long-term performance because sustainable practices reduce risks, improve efficiency, and strengthen stakeholder relationships. Similarly, Desalegn and Tangl (2022) found that organizations implementing sustainable finance initiatives experience improvements in both economic and environmental performance. Therefore, organizational performance is expected to be positively influenced by SRI Sukuk, ESG practices, and green innovation.

Relationship Between SRI Sukuk and Green Innovation

Green finance literature suggests that sustainable financing mechanisms provide critical support for innovation activities. Bhattacharyya (2022) argues that green financial instruments facilitate investments in environmentally sustainable technologies and innovative business models. Through renewable energy financing, green project financing, and sustainable investment initiatives, SRI Sukuk provides organizations with resources to develop green technologies and sustainable financial products.

Fu et al. (2023) further explain that sustainable finance promotes innovation by encouraging investments in projects that support environmental sustainability and climate resilience. Consequently, organizations involved in SRI Sukuk activities are more likely to adopt green innovations.

Relationship Between ESG Practices and Green Innovation

ESG practices create organizational incentives for innovation by encouraging companies to improve environmental and social performance. According to Fu et al. (2023), ESG integration promotes strategic decision-making that supports sustainable technologies and innovative solutions.

Organizations with strong ESG commitments often invest in green technologies, sustainable business processes, and environmentally friendly products to meet stakeholder expectations and regulatory requirements. Desalegn and Tangl (2022) also emphasize that ESG-oriented organizations are more likely to pursue innovation strategies that contribute to long-term sustainability. Therefore, ESG practices are expected to positively influence green innovation.

Green Innovation and Organizational Performance

Green innovation has been widely recognized as an important driver of organizational success. Desalegn and Tangl (2022) argue that organizations implementing green innovations often experience improvements in operational efficiency, customer satisfaction, environmental performance, and competitive advantage.

Similarly, Fu et al. (2023) suggest that innovation enhances the effectiveness of green finance initiatives by transforming sustainability investments into tangible organizational outcomes. Green innovation enables organizations to respond to environmental challenges while improving financial and non-financial performance. Therefore, green innovation is expected to positively influence organizational performance.

Theoretical Framework

This study is underpinned by stakeholder theory and RBV Theory. These theories on SRI Sukuk and ESG Practices influence organizational performance through the mediating role of Green Innovation. Stakeholder Theory, developed by Freeman (1984), suggests that organizations create long-term value by meeting the expectations of stakeholders, including customers, investors, employees, regulators, and society. Accordingly, the adoption of SRI Sukuk and ESG practices is expected to enhance stakeholder trust and organizational performance.

The RBV theory, introduced by Barney (1991), argues that sustainable competitive advantage is achieved through valuable organizational resources and capabilities. In this study, green innovation is viewed as a strategic capability that enables Bank Rakyat to transform sustainability initiatives into improved organizational performance. Together, these theories provide a strong foundation for explaining the proposed relationships among SRI sukuk, ESG practices, green innovation, and organizational performance.

Theory Integration in the Study

Theory	Role in the Study	Supported Relationships
Stakeholder Theory (Freeman, 1984)	Explains stakeholder-driven sustainability initiatives	SRI Sukuk → Organizational Performance; ESG Practices → Organizational Performance
Resource-Based View Theory (Barney, 1991)	Explains capability development through innovation	SRI Sukuk → Green Innovation; ESG Practices → Green Innovation; Green Innovation → Organizational Performance
Combined Theories	Explain mediation mechanism	SRI Sukuk → Green Innovation → Organizational Performance; ESG Practices → Green Innovation → Organizational Performance

Research design

This study adopts a quantitative, cross-sectional survey design to examine the relationships among SRI sukuk, ESG practices, green innovation, and organizational performance at Bank Rakyat. A quantitative approach is appropriate for testing the proposed hypotheses and analysing the relationships among the study variables using statistical techniques.

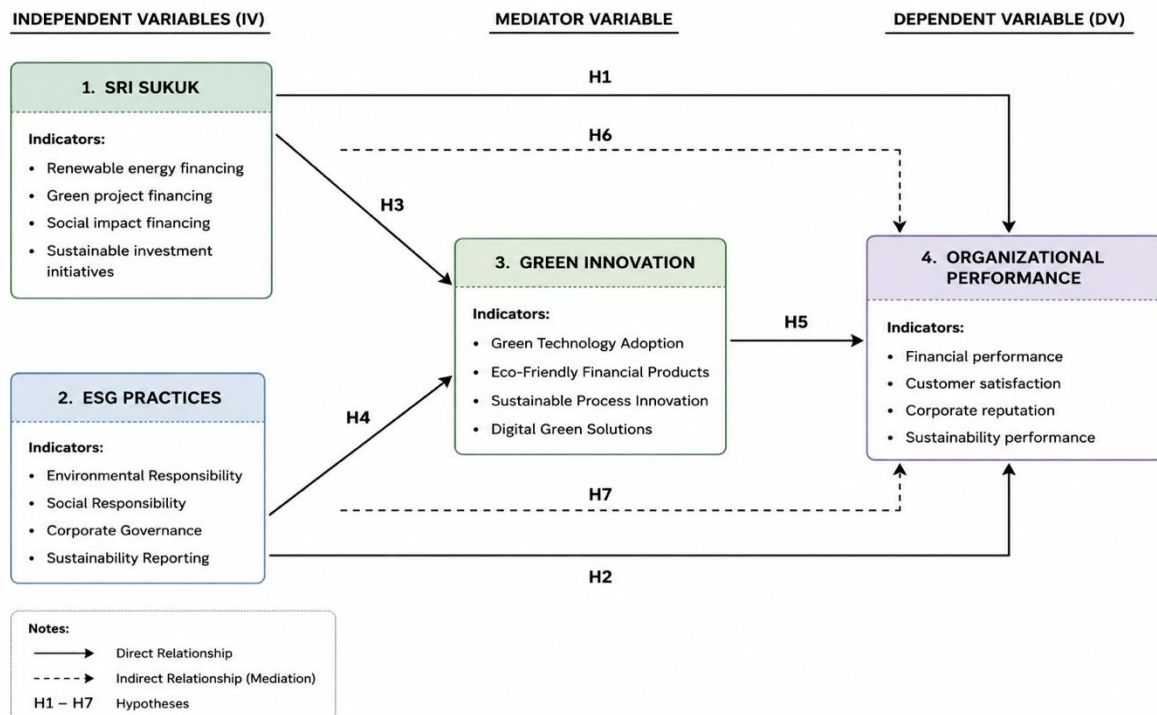


Figure 1: The Conceptual Framework

Conclusion

The study proposes that SRI sukuk and ESG practices positively influence organizational performance. Meanwhile, green innovation is expected to mediate this relationship by transforming sustainability initiatives into improved competitiveness, operational efficiency, and long-term organizational performance.

The growing emphasis on sustainability has transformed financial institutions from solely generating financial returns to creating long-term economic, environmental, and social value. In the Islamic banking sector, SRI sukuk and Environmental, Social, and Governance (ESG) practices are important strategic mechanisms for promoting responsible finance while supporting sustainable development. This conceptual study proposes a comprehensive framework to examine the influence of SRI sukuk and ESG practices on organizational performance, with green innovation serving as a mediating variable in the context of Bank Rakyat.

Drawing on stakeholder theory and the RBV theory, the study suggests that SRI Sukuk and ESG practices can enhance organizational performance, both directly and indirectly, through Green Innovation. By investing in renewable energy financing, sustainable investment initiatives, environmental responsibility, social accountability, and good corporate governance, Bank Rakyat can strengthen stakeholder trust, improve corporate reputation, enhance operational efficiency, and achieve superior financial and sustainability performance. Green Innovation, through the adoption of green technology, eco-friendly financial products, sustainable process improvements, and digital green solutions, represents the strategic capability that transforms sustainability initiatives into long-term organizational value and competitive advantage.

The proposed framework contributes to the existing literature by integrating Islamic sustainable finance, ESG practices, green innovation, and organizational performance into a single model. It also addresses the limited research examining these relationships within Islamic financial institutions, particularly Bank Rakyat. From a practical perspective, the study provides valuable guidance for financial institutions, policymakers, and regulators to strengthen sustainable finance initiatives, enhance ESG implementation, and promote innovation-driven organizational performance. The findings further suggest that sustainability should be regarded as a strategic business imperative rather than merely a regulatory or ethical obligation.

As this study is conceptual in nature, future research is recommended to empirically validate the proposed framework using quantitative approaches such as Structural Equation Modelling (SEM) or Partial Least Squares Structural Equation Modelling (PLS-SEM). Future studies may also extend the research by including other Islamic financial institutions, examining additional mediating and moderating variables, employing longitudinal or mixed-method research designs, and investigating the role of emerging technologies such as artificial intelligence, fintech, blockchain, and digital banking in advancing Green Innovation and sustainable finance. Overall, the successful integration of SRI Sukuk, ESG practices, and Green Innovation has the potential to become a strategic pathway for Bank Rakyat and other Islamic financial institutions to achieve sustainable organizational performance, strengthen competitiveness, and contribute to Malaysia's sustainable development agenda.

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