ESG on Stability and Bank Performance: The Moderating Role of Diversity and Inclusion in OIC Countries

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Abstract
This study analyses the impact of environmental, social and governance (ESG) performance on the stability and performance of Islamic banks, considering the moderating role of diversity and inclusion. Using panel data from 60 Islamic banks in 11 Organisation of Islamic Cooperation (OIC) countries during the period 2014-2023, the research finds that ESG performance positively affects the stability and performance of Islamic banks, confirming the role of sustainability in enhancing the financial resilience of the Islamic banking sector. However, this study also finds that diversity and inclusion weakens the positive impact of ESG performance on the stability and performance of Islamic banks. Additional analysis shows that these results are consistent only in the environmental and social pillars. These findings highlight the importance of managing diversity and inclusion to enhance ESG implementation in Islamic banks. Poorly managed diversity and inclusion efforts may weaken ESG effectiveness, hindering performance and stability. For stakeholders, including investors and regulators, fostering inclusion is essential to support sustainability and long-term stability.

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1. Introduction

In the last decade, global attention to sustainability issues has increased since the climate protection agreement in the 2015 Paris Agreement and the United Nation's introduction of the 2030 Sustainable Development Agenda. One is the shariah banking financial institutions that align their actions with environmental, social, and governance (ESG) goals (Quick & Monteforte, 2023). This implementation aligns with the principles of maqasid al-shariah, which emphasise social justice, environmental protection, and good governance (Hassan *et al*., 2022). As a systemic financial institution, banking is required to pursue profitability and pay attention to its activities' social and ecological impacts. This makes ESG an essential indicator in assessing a bank's intrinsic value and its ability to survive in the long term (Buallay *et al*., 2020; Shakil *et al*., 2019).

Several studies show that implementing ESG principles can improve banks' financial performance (Buallay *et al*., 2020; Nathania & Ekawati, 2024; Sain & Kashiramka, 2024; Shakil *et al*., 2019) and enhance stability (Chiaramonte *et al*., 2022; Choi *et al*., 2024; Gupta & Kashiramka, 2024; Sain & Kashiramka, 2024; Sendi *et al*., 2024). Research also indicates that ESG has a positive and significant impact on the economic performance of Islamic banks, as the implementation of ESG can enhance stakeholder trust in line with the legitimacy theory, which emphasizes the importance of legitimacy that will strengthen the company's reputation and reduce capital costs, thereby increasing asset efficiency (return on assets) and market value (Tobin's Q) (Buallay *et al*., 2020). In addition, implementing ESG can have a significant impact on bank stability by reducing risk-taking, improving internal efficiency, and strengthening public trust, thereby reducing reputational risk and enhancing the long-term resilience of financial institutions (Sendi *et al*., 2024).

In the context of the Organisation of Islamic Cooperation (OIC) countries, the challenges in implementing ESG and improving governance remain significant. Although ESG is highly compatible with the values of maqasid al-shariah, this normative alignment has not yet been fully reflected. A study by Buallay *et al*. (2020) shows that the level of ESG disclosure by companies in OIC countries is still low, even though legitimacy and signalling theories indicate that a company's perceived importance can increase stakeholders' trust and perception of reputation, including through the implementation of ESG. In some cases, social disclosure even negatively impacts financial performance and is exacerbated by weak sustainability regulations and low managerial awareness of the importance of ESG in building institutional resilience (Buallay *et al*., 2020). However, both theoretically and empirically, ESG has been proven to enhance banks' performance and stability by reducing risks, strengthening reputation, improving operational efficiency, and increasing access to capital (Sendi *et al*., 2024; Shakil *et al*., 2019). Therefore, the impact and effectiveness of ESG implementation are not universal but are greatly influenced by a company's internal and external conditions and characteristics.

In this context, a new approach is needed to bridge the gap between ESG values and their implementation in the Islamic banking sectors of OIC countries. One potential strategic approach is to strengthen diversity and inclusion, which are defined as the diversity of demographic and cognitive characteristics within the organizational structure, such as the board of directors, including aspects of gender, culture, and professional experience, as well as the creation of an inclusive and fair work environment (García-Meca *et al*., 2015). Recent research shows that diversity and inclusion efforts can strengthen ESG performance (Tumewang *et al*., 2024). Islamic banks with high scores in diversity, inclusion, and human resource development tend to have better ESG performance, especially in the environmental and social pillars. This effect is even more substantial in Islamic banks compared to conventional banks (Alhammadi *et al*., 2022).

Thus, further research integrating ESG with the moderating factors of diversity and financial inclusion is essential, especially to guide improvements to banking performance and stability to support sustainable development. It is hoped that this research can fill the gap in the literature, provide policy input, and serve as a strategic reference in the institutional reform and governance of Islamic banks in the future, especially in OIC countries.

2. Literature Review and Hypothesis Development

2.1. Stakeholder Theory

Freeman's stakeholder theory states that an organisation's sustainability is greatly influenced by its ability to meet the expectations and interests of all stakeholders, including investors, regulators, employees, and the community (Freeman, 1984). Stakeholder theory suggests that companies should consider the demands and interests of their stakeholders, including how their actions impact the environment and society as a whole (Roberts, 1992). Thus, ESG becomes a strategic corporate responsibility framework towards various stakeholders. By implementing ESG, banks can build mutually beneficial long-term relationships with stakeholders, ultimately enhancing performance and strengthening banking stability. Therefore, the stakeholder theory perspective is essential in analysing ESG impact on companies.

2.2. Legitimacy Theory

Legitimacy theory states that corporate disclosure is a strategy for obtaining, maintaining, or enhancing legitimacy in the eyes of stakeholders (Deegan, 2002). Organizations must operate within the boundaries of values and norms accepted by society to remain viable. Legitimacy theory also predicts that companies facing higher rates of threats and pressure to their legitimacy, such as companies which excessively pollute the environment, will be affected. Therefore, ESG is a social legitimacy instrument that helps banks gain and maintain public trust. Through the selective disclosure of strict environmental performance indicators, the perception of the accuracy and credibility of ESG practices can be enhanced, which can build public trust and increase legitimacy. However, intense public scrutiny poses a risk for companies with poor environmental performance, which can damage the company's reputation and perceived integrity. In the context of Islamic banks, ESG disclosure meets market expectations and reflects the integrity of Islamic values in business practices.

2.3. Signalling Theory

Signalling theory focuses on how companies send signals to the market and stakeholders regarding their internal quality through external information that distinguishes them from poor performance; through superior environmental performance, they can provide credible information that is not easily imitated. (Connelly *et al*., 2011). In the context of ESG, companies use ESG disclosures as signals to reduce information asymmetry and to demonstrate superior governance and commitment to sustainability. Transparent and high-quality disclosures can serve as a positive signal that the company has good management, low risk, and long-term commitment to sustainability. This signal can enhance investor confidence, expand financing access, and improve the company's performance and stability.

2.4. Perspective of Maqasid al-Shariah

The principle of maqasid al-shariah emphasizes that every economic and financial activity must be directed towards a normative foundation that underlines the protection of religion (ḥifẓ al-dīn), life (ḥifẓ al-nafs), intellect (ḥifẓ al-'aql), lineage (ḥifẓ al-nasl), and property (ḥifẓ al-māl) (Chapra, 2008). In Islamic banking, maqasid encourages financial institutions to pursue profitability and ensure social justice, wealth distribution, and protection for vulnerable groups. This makes the principles of ESG highly relevant, as ESG serves as a concrete operational means of implementing the values of maqasid institutionally. Therefore, integrating ESG into Islamic banking practices follows global trends and is integral to implementing maqasid al-shariah, making sustainability, ethics, and welfare the primary goals

2.5. ESG on Performance and Islamic Bank Stability

Based on signalling theory and stakeholder theory, it is evident that implementing good ESG practices can serve as a positive signal to stakeholders, indicating that the company is committed to sustainability and ethics, which can enhance reputation and ultimately contribute to the financial performance and stability of the bank. These theories are consistent with the findings of several previous studies which show that ESG implementation positively impacts the profitability and operational efficiency of banks, as it enhances reputation, public trust, and access to cheaper financing (Buallay *et al*., 2020; Shakil *et al*., 2019). In addition, ESG performance has been proven to reduce reputational and systemic risks and enhance institutions' resilience to external pressures, thereby strengthening long-term stability (Chiaramonte *et al*., 2022; Sendi *et al*., 2024). In the context of Islamic banking, the integration of ESG is highly relevant because ESG values strengthen the implementation of maqasid al-shariah and provide a strong foundation for the stability of the Islamic financial system.

Therefore, the first two hypotheses proposed by this research are:

H1: ESG has a positive impact on Islamic bank stability in OIC countries.

H2: ESG has a positive impact on Islamic bank performance in OIC countries.

2.6. Diversity Moderates the Relationship between ESG, Performance and Islamic Bank Stability

The impact of ESG on organizations is not universal, as its effectiveness is greatly influenced by the internal characteristics, one of which is diversity. Diversity in the board of directors is defined as the variety of personal and professional attributes of gender, age, nationality, and educational background that influence how financial institutions interpret and execute ESG policies. Based on cognitive diversity theory, a diverse board can enrich strategic discussions and anticipate various ESG risks through broader and more varied perspectives (Hillman *et al*., 2002; Tumewang *et al*., 2024). However, in Islamic banks in OIC countries, where governance is still developing, diversity also risks causing communication fragmentation, value conflicts, and decision-making inconsistencies, especially if it is not accompanied by an inclusive organisational culture (Elnahass *et al*., 2023; García-Meca *et al*., 2015;

Talavera *et al*., 2018). Therefore, although diversity promises theoretical benefits, it can become a serious challenge for Islamic banks if not managed strategically and contextually.

The third and fourth hypothesis of this research are:

H3: Diversity moderates the relationship between ESG and Islamic bank performance in OIC countries.

H4: Diversity moderates the relationship between ESG and Islamic bank stability in OIC countries.

2.7. Inclusion Moderates the Relationship between ESG, Performance and Islamic Bank Stability

Studies show that the implementation of ESG positively contributes to the operational efficiency, stakeholder trust, and long-term resilience of Islamic banks (Buallay *et al*., 2020; Shakil *et al*., 2019). However, the success of ESG is also greatly influenced by the internal conditions of the organization, especially to the extent to which the value of inclusion is applied. Inclusion refers to a work environment that encourages equal participation, values diversity, and supports the development of all individuals without discrimination. Research by Tumewang *et al*. (2024) show that high diversity and inclusion scores strengthen ESG performance, particularly a Islamic banks. This shows that inclusive banks tend to be able to implement ESG more effectively, resulting in a greater impact on performance and stability. In the context of OIC countries, where the implementation of ESG still faces structural challenges, inclusion can be an essential driving factor for ESG to truly deliver tangible results.

The final two hypotheses of this research are:

H5: Inclusion moderates the relationship between ESG and Islamic bank performance in OIC countries.

H6: Inclusion moderates the relationship between ESG and Islamic bank stability in OIC countries.

3. Method

3.1. Research Design

This study uses a quantitative approach with secondary data from the Bank Focus database for the company scale, Refinitiv Eikon for the market scale, and the World Bank for the country-level database. The sample used in this study is panel data of 60 Islamic banks from 11 OIC member countries, such as Bahrain, Bangladesh, Egypt, Indonesia, Jordan, Kuwait, Malaysia, Pakistan, Palestine, Saudi Arabia, and the United Arab Emirates (UAE), from 2014 to 2023.

3.2. Dependent, Independent, and Control Variables

This study uses two dependent variables: stability and bank performance. Stability is measured using the z-score, an essential measure for assessing a bank's ability to cope with potential bankruptcy risk (Salah Mahdi *et al*., 2023; Vo *et al*., 2021). Z-score indicates how far a bank is from the possibility of defaulting. This Z-score is calculated using the following formula:

$$\text{Z-Score}=\frac{ROA + \left(\frac{TE}{TA}\right)}{Sd(ROA)}$$

The higher the z-score, the more stable the bank is, indicating a lower likelihood of financial failure (Galletta *et al*., 2023; Saïdane, 2023). Meanwhile, the bank's performance is measured using return on assets (ROA). ROA illustrates the extent to which a bank can generate profits relative to its total assets (Buallay *et al*., 2020) and is an important indicator in assessing the operational efficiency of a bank in generating profit (Prasad & Mondal, 2025). ROA is measured by the ratio of net income divided by total assets and demonstrates how effectively the bank utilises its assets to achieve optimal performance (Bătae *et al*., 2020; Menicucci & Paolucci, 2023).

The ESG score acts as the independent variable in this study, and is based on previous research by Chebbi *et al*. (2024) and Landi *et al*. (2022). The ESG score is obtained from the Refinitiv database and calculated based on verified ESG reports from banks. The score ranges from 0 to 100 and is categorised into various indicators. Overall ESG performance is assessed based on three main pillars: environmental (ENV), social (SOC), and governance (GOV).

In this study, we also use two moderating variables: diversity and inclusion. According to Tumewang *et al*. (2024), diversity refers to the diversity possessed by banks, which includes eight main pillars: analytic board cultural diversity, policy diversity opportunity, targets diversity opportunity, women employees, new women employees, women managers, analytic board female, and analytic executive members gender diversity. Each of these scores us used to measure diversity. The higher the score, the more the bank demonstrates its commitment to diversity. Meanwhile, Tumewang *et al*. (2024) define inclusion as an effort to create an environment that supports equal participation for all individuals, regardless of background or environmental conditions, which includes the LGBT Equality Index, flexible working hours, day care services to support employees with young children, support for employees with disabilities, and HIV/AIDS programs to provide attention to affected employees. These policies help create a more inclusive and fairer workplace.

Table 1. Definition of Operational Variables

Variable	Formula	Notation	Sources
Dependent Variables			
Stability	Z-score = ROA (TE/TA)	zscore	Bank Focus
Performance	ROA = ni/ta	ROA	Bank Focus
Independent Variables		ESG	Refinitive
ESG Performance	ESG score	ENV	Refinitive
Environmental Pillar	ENV score	SOC	Refinitive
Social Pillar	SOC score	SOC	Refinitive
Governance Pillar	GOV score	GOV	Refinitive
Moderating Variables			
Diversity	Dip Diversity scores from 8 indicators	Div	Refinitive
Inclusion	DI Inclusion from 5 indicators	INC	Refinitive
Control Variables			
Size	Log of total assets	Size	Bank Focus
Loan Ratio	Gross loans/Total assets	LR	Bank Focus
GDP	GDP index	GDP	World Bank
FDI	FDI index	FDI	World Bank

Two control variables are used at the bank level: bank size (measured by the log of total assets) and loan ratio (measured by gross loans divided by total assets). Then we use country-level variables such as gross domestic product (GDP) and foreign direct investment (FDI) (Gutiérrez-Ponce, H., & Wibowo, 2023; Shabir *et al*., 2023). All variables used are summarized in Table 1.

3.3. Regression Equation Model

To examine the effect of the ESG score on stability, we use the following econometric

Main Model

$$zscore_{it} = \alpha i + \beta 1\ ESG_{it} + \varphi\ X_{it} + \varepsilon_{it} \ldots (1)$$

$$ROA_{it} = \alpha i + \beta 1\ ESG_{it} + \varphi\ X_{it} + \varepsilon_{it} \ldots. (2)$$

Moderating Regression (stability)

$$Zscore = \beta 0 + \beta 1\ esgit + \beta 2\ div + \beta 3\ esgxdiv + \sum controlsit + \varepsilon it \ldots(3)$$

$$Zscore = \beta 0 + \beta 1\ esgit + \beta 2\ inc\ \beta 3\ esgxinc + \sum controlsit + \varepsilon it \ldots(4)$$

Moderating Regression (Performance)

$$ROA = \beta 0 + \beta 1\ esgit + \beta 2\ div + \beta 3\ esgxdiv + \sum controlsit + \varepsilon it \ldots.(5)$$

$$ROA = \beta 0 + \beta 1\ esgit + \beta 2\ inc + \beta 3\ esgxinc + \sum controlsit + \varepsilon it \ldots.(6)$$

i and t represent the company's index and year, respectively, and the score is a proxy for measuring the bank's stability and performance (Joudar *et al*., 2023; Ozili & Iorember, 2024). X is the control variable that includes bank size, loan ratio (LR), GDP, and FDI. We use several control variables because all can affect bank efficiency, and macroeconomic factors can influence bank performance and stability. Diversity (div) and inclusion (inc) are the moderating variables used in this study. This study uses unbalanced panel data due to variations in data availability between companies and observation years. This is common in empirical economic research and does not affect the validity of the model as long as the estimation is carried out with an appropriate approach (Gujarati & Porter, 2013). Therefore, the fixed-effect model is still used because it can handle unbalanced data structures.

4. Results and Discussion

4.1. Descriptive Statistics

Table 2 provides the descriptive statistics for several variables in this study. The z-score variable averages 0.037 with a standard deviation of 0.333, reflecting significant variation in bank stability. ROA shows an average value of 0.007, indicating poor bank performance in most samples. ESG has an average of 0.51, with lower variation, while the pillars ENV, SOC, and GOV show average values of 0.51, 0.532 and 0.528, with ENV having more significant variation. The size of the bank has an average of 15.18 with a standard deviation of 1.139, indicating size variations among banks. LR and GDP have average values of 0.795 and 1.538, respectively, while FDI varies significantly. The diversity and INC variables show averages of 3.292 and 3.747, respectively, with moderate variation among the smaller sample.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	118	.007	.015	-.079	.038
Z-score	118	.037	.333	-1.889	.203
ESG	118	.51	.188	.059	.848
ENV	118	.532	.258	.175	.977
SOC	118	.528	.25	.06	.96
GOV	118	.552	.205	.073	.9
size	118	15.189	1.139	11.077	17.457
LR	118	.795	.299	.144	1.554
GDP	118	1.538	.381	.719	2.182
FDI	118	1.861	1.593	-.503	6.461
diversity	71	3.292	.487	1.609	4.007
INC	51	3.747	.422	2.833	4.477

4.2. Influence of ESG on Stability and Performance of Islamic Banks

Table 3 reports the results of the impact of ESG performance on the stability and performance of Islamic banks in OIC countries. Model 1 shows that ESG performance has a significant positive impact on stability at the 1% level. This means that every improvement in ESG performance will enhance the stability of Islamic banks. These findings are consistent with previous studies that state that ESG can strengthen governance, improve public trust, and reduce systemic and reputational risks, thereby contributing to the financial stability of banks (Chiaramonte *et al*., 2022; Gupta & Kashiramka, 2024; Sain & Kashiramka, 2024). Thus, Hypothesis 1 is accepted.

Table 3. ESG Effect on Stability and Bank Performance

	(1)	(2)
	zscore	ROA
ESG	0.0143***	0.0143***
	(2.72)	(2.72)
size	0.00294***	0.00294***
	(2.62)	(2.62)
lev	1.025***	0.0252***
	(256.58)	(6.31)
LR	-0.0192***	-0.0192***
	(-6.63)	(-6.63)
GDP	0.000450	0.000450
	(1.49)	(1.49)
FDI	-0.000228	-0.000228
	(-0.39)	(-0.39)
_cons	-0.0307*	-0.0307*
	(-1.68)	(-1.68)
N	115	115
N_g	24	24
r2_w	0.955	0.0270

t-statistics in parentheses
* p < 0.1, ** p < 0.05, *** p < 0.01

Next, model 2 shows that ESG performance has a significant positive impact on the performance of Islamic banks at the 1% level. This means that every improvement in ESG performance will enhance the performance of Islamic banks. These findings are in line with previous literature that shows ESG can improve operational efficiency, strengthen reputation, and attract investor support through signals of sustainability and social legitimacy (Buallay *et al*., 2020; Nathania & Ekawati, 2024; Shakil *et al*., 2019). In the context of shariah, the implementation of ESG aligns with the principles of maqasid al-shariah, which emphasize welfare, social justice, and trust. Therefore, shariah-compliant banks that integrate ESG enhance business performance and fulfil ethical responsibilities following Islamic principles (Alghafes *et al*., 2024).

Table 4. Moderating Role of Diversity and Inclusion

	Diversity		**Inclusion**	
	(3)	(4)	(5)	(6)
	zscore	ROA	zscore	ROA
ESG	0.330**	4.904*	0.0760*	2.017***
	(2.23)	(1.90)	(1.78)	(2.98)
diversity	0.0694**	1.096**		
	(2.67)	(2.40)		
ESGxdiversity	-0.131***	-1.968**		
	(-2.72)	(-2.33)		
inc			0.00115**	0.0524***
			(2.00)	(5.62)
ESGxinc			-0.00240**	-0.0904***
			(-2.37)	(-5.64)
size	-0.0247**	-0.104	-0.00585	0.0896
	(-2.10)	(-0.47)	(-0.49)	(0.45)
LR	0.0256	-0.600	0.0184	-1.143***
	(0.99)	(-1.33)	(0.88)	(-3.23)
GDP	-0.00586	0.207	-0.0168*	0.180
	(-0.83)	(1.58)	(-1.78)	(1.25)
FDI	-0.00771**	0.00630	-0.00119	-0.0629
	(-2.34)	(0.11)	(-0.38)	(-1.24)
_cons	-0.0758	-7.329***	0.0868***	-5.050***
	(-0.93)	(-5.17)	(2.92)	(-10.23)
N	65	63	63	60
N_g	15	15	13	13
r2_w	0.427	0.221	0.204	0.552

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

4.3. Moderating Role of Diversity and Inclusion

Table 4 reports the results of the moderating role of diversity and inclusion on the impact of ESG performance on the stability and performance of Islamic banks. Models 3 and 4 show that the interaction of ESG and diversity has a significant negative effect on the stability and performance of Islamic banks at the 1% and 5% levels, respectively. Furthermore, in models 5 and 6, the interaction of ESG and inclusion has a significant negative effect on the stability and performance of Islamic banks at the 10% and 1% levels, respectively. This means that diversity and inclusion efforts which are not effectively managed can hinder the effectiveness of ESG implementation, ultimately negatively impacting bank stability and performance. For example, in the context of diversity among women employees and managers, several studies have shown that when women are placed on boards of directors not based on competence but merely to meet quotas, their presence can encourage managerial opportunism and reduce the effectiveness of oversight (Kutubi *et al*., 2018). Furthermore, Ji *et al*. (2021) and Simons & Peterson (2000) explain that the differences in characteristics among board members can hinder communication and coordination in decision-making. Fragmentation of opinions, internal conflicts, and lack of cohesion within the managerial team can create uncertainty in strategic decision-making.

Additionally, in the context of cultural diversity, several studies indicate that the presence of foreign directors can lead to value conflicts and miscommunication among board members, undermining the effectiveness of strategic decision-making (Alharbi, 2024). In the context of shariah, risk management and caution (tahdhir) are key principles in safeguarding the trust of community wealth (al-mal). Therefore, diversity not aligned with an adaptive shariah governance structure can become a source of weakness in implementing ESG principles. Thus, diversity and inclusion that are not managed adaptively can weaken the relationship between the implementation of ESG principles and the stability or financial performance of the bank.

4.4. Additional Analysis

4.4.1. Role of Diversity in the Impact of ESG on Stability and Performance of Islamic Banks

Table 5 reports the additional analysis results in this study by examining each of the environmental, social and governance pillars. The results show that the positive impact of ESG performance on the stability and performance of Islamic banks is only significant on the environmental and social pillars. In contrast, its effect on the governance pillar is not substantial. Environmental practices such as green financing and energy efficiency reduce operational risks while increasing profitability (Shakil *et al*., 2019). Meanwhile, the social pillar has the most substantial impact on the stability of Islamic banks because it strengthens social connectivity, customer loyalty and the ethical perception of the institution, which ultimately reduces systemic risk and increases the Z-score (Sendi *et al*., 2024). For models 7, 8 and 9, the interaction between the three pillars with diversity shows that diversity weakens the positive effect on the stability of Islamic banks in the environmental and social pillars. Furthermore, in models 10, 11 and 12, the interaction also shows that diversity weakens the positive effect of ESG on the performance of Islamic banks in the environmental and social pillars. This means that high diversity in Islamic banks, such as gender and cultural differences, can hinder the effectiveness of ESG policy implementation, particularly in the environmental and social aspects, due to the mismatch between the internal complexity of the organization and the available governance capacity (Elnahass *et al*., 2023). Such diversity tends to slow decision-making, create value conflicts, and weaken cross-functional coordination, especially in the context of ESG, which demands multidimensional commitment and strong strategic consensus.

In many OIC countries, not all banks have systems and organizational cultures that are ready to integrate ESG, resulting in its implementation being normative and not strategic (García-Meca *et al*., 2015; Tumewang *et al*., 2024). In this situation, diversity that should encourage innovation instead becomes a burden, worsening the effectiveness of the environmental and social aspects, ultimately negatively impacting Islamic banks' stability and performance (Talavera *et al*., 2018).

Table 5. Moderating Role of Diversity

	(7) zscore	(8) zscore	(9) zscore	(10) ROA	(11) ROA	(12) ROA
ENV	0.336***			2.460*		
	(2.81)			(1.82)		
diversity	0.0733***	0.0676**	0.0219	0.584**	0.777**	0.275
	(3.31)	(2.53)	(0.64)	(2.36)	(2.06)	(0.61)
ENVxdiversity	-0.138***			-1.057**		
	(-3.48)			(-2.32)		
SOC		0.433**			4.446*	
		(2.52)			(1.92)	
SOCxdiversity		-0.146**			-1.538**	
		(-2.72)			(-2.16)	
GOV			0.0625			0.387
			(0.41)			(0.18)
GOVxdiversity			-0.0312			-0.327
			(-0.62)			(-0.48)
LR	0.0219	0.0229	0.0372	-0.773*	-0.597	-0.384
	(0.78)	(0.76)	(1.13)	(-1.68)	(-1.29)	(-0.80)
size	0.00407	0.00257	0.00220	0.0399	0.0240	0.0193
	(1.32)	(0.79)	(0.63)	(1.02)	(0.54)	(0.43)
GDP	-0.0123	-0.00879	-0.00710	0.152	0.154	0.221
	(-1.49)	(-1.03)	(-0.74)	(0.72)	(1.14)	(1.55)
FDI	-0.00516	-0.00771*	-0.00744*	-0.0106	-0.0127	-0.001
	(-1.37)	(-1.95)	(-1.74)	(-0.39)	(-0.21)	(-0.00)
_cons	-0.0561	-0.0790	0.0515	-5.771***	-6.709***	-5.371***
	(-0.80)	(-0.89)	(0.47)	(-5.98)	(-5.29)	(-3.58)
N	55	55	55	63	63	63
N_g	13	13	13	15	15	15
r2_w	0.507	0.438	0.342	0.200	0.171	0.125

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

4.4.2. Role of Inclusion in the Impact of ESG on Stability and Performance of Islamic Banks

Table 6 reports additional analysis results in this study by examining each pillar. In models 7,8 and 9, the interaction between ESG and inclusion shows that inclusion weaken the positive effect of ESG on the stability of Islamic banks in the environmental and social pillars. Furthermore, in models 10, 11 and 12, the interaction shows that inclusion also weakens the positive effect of ESG on the performance of Islamic banks in the environmental and social pillars. These findings highlights that if inclusion programs are not strategically designed – that is, they are merely symbolic or not integrated with the bank's core strategy – they can potentially burden organizational resources and weakening the effectiveness of ESG implementation.

Findings from previous studies indicate that not all inclusion programs have a positive impact if they are not supported by a mature organizational system and equal access. For example, research by Blake-Beard *et al*. (2010) shows that work flexibility is often only enjoyed by certain groups and tends to discriminate against women, low-wage workers, and minorities. This indicates that inclusion programs can widen the gap and increase the burden on organizations without an inclusive policy framework and comprehensive implementation. In the context of ESG in Islamic banks, poorly-managed inclusion efforts reduce the effectiveness of ESG in enhancing performance and stability and obscures the social objectives at the core of Islamic financial values.

Table 6. Moderating Role of Inclusion

	(13)	(14)	(15)	(16)	(17)	(18)
	zscore	**zscore**	**zscore**	**ROA**	**ROA**	**ROA**
ENV	0.0578*			1.070**		
	(1.71)			(2.00)		
inc	0.00137***	-0.000567**	0.0000321	0.0349***	0.0325***	0.0111
	(3.09)	(-1.97)	(0.07)	(4.87)	(5.37)	(1.39)
ENVxinc	-0.00257***			-0.0532***		
	(-3.50)			(-4.96)		
SOC		0.0178*			1.092**	
		(1.74)			(2.07)	
SOCxinc		-0.000627*			-0.0509***	
		(-1.84)			(-5.58)	
GOV			0.0335			0.0310
			(1.12)			(0.05)
GOVxinc			-0.000277			-0.0136
			(-0.37)			(-1.06)
LR	0.0188	0.0120	0.0227	-1.378***	-1.224***	-0.816
	(0.87)	(0.62)	(1.02)	(-3.99)	(-3.63)	(-1.45)
size	0.00284	0.00464**	0.00290	0.0318	0.0127	-0.0187
	(1.23)	(2.00)	(1.15)	(0.88)	(0.37)	(-0.38)
GDP	-0.0186**	-0.0219**	-0.00895	0.167	0.156	0.393**
	(-2.15)	(-2.05)	(-0.98)	(1.21)	(1.18)	(2.35)
FDI	-0.00432	-0.000339	-0.000840	-0.0958*	-0.0917*	-0.0280
	(-1.42)	(-0.11)	(-0.27)	(-1.89)	(-1.86)	(-0.39)
_cons	0.0978***	0.159***	0.0871***	-4.524***	-4.623***	-4.751***
	(3.39)	(6.16)	(2.80)	(-9.56)	(-10.13)	(-7.35)
N	63	63	63	70	70	70
N_g	13	13	13	15	15	15
r2_w	0.345	0.0729	0.110	0.421	0.486	0.188

t statistics in parentheses
* p < 0.1, ** p < 0.05, *** p < 0.01

5. Conclusion

This research examines the impact of ESG performance on the performance and stability of Islamic banks in OIC countries. The results indicate that implementing ESG generally has a significant positive impact on the stability and performance of Islamic banks in OIC countries. These findings reinforce the view that integrating ESG aligns with the principles of maqasid al-shariah and can enhance operational efficiency and investor confidence. However, the research findings also reveal that diversity and inclusion, if not managed strategically, can weaken the positive impact of ESG, particularly in the environmental and social pillars. The negative interaction between ESG and diversity and inclusion indicates that internal organizational complexity, value conflicts, and weak managerial cohesion can hinder the effective implementation of ESG.

Theoretically, the findings of this study expand the literature on the relationship between ESG and the stability and performance of banks by adding the moderating perspective of diversity and inclusion, particularly in the context of Islamic banking. This research contributes to the development of theory by demonstrating that poorly-managed diversity and inclusion efforts can hinder effective ESG implementation. These findings have practical implications for managing Islamic banks and regulators. First, Islamic banks need to formulate diversity and inclusion policies that are not merely symbolic but are substantially integrated into ESG governance and risk management strategies. Second, regulators and stakeholders are advised not only to encourage the quantitative adoption of ESG but also to ensure institutional readiness, including organizational structure, human resources, and reporting systems, so that ESG can be implemented consistently and effectively. With its novelty, this research has limitations, including the limited data used for Islamic banks in OIC countries. This is due to the restricted access to comprehensive and standardized information regarding Islamic banks in the OIC region and significant variations in the reporting and implementation of ESG policies in each country. In the future, further research can expand the scope of data to obtain a more comprehensive picture of the dynamics of diversity, inclusion, and ESG in both the conventional and Islamic banking sectors, or to achieve more comprehensive results through comparisons.

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