JKAU: Islamic Econ., **Vol. 38** *No. 1, pp: 69-93 (January 2025)*

DOI:10.4197/Islec.38-1.4

ESG Disclosure and Financial Stability of Islamic and Conventional Banks

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Received: 31 January 2024; **Revised:** 25 January 2025; **Accepted:** 27 January 2025

ABSTRACT. The recurrence of banking and financial crises has revealed the complexity and vulnerability of the conventional financial and banking system. In this paper, we empirically investigate the impact of Environmental, Social, and Governance disclosure (ESG) on banking stability, as well as the individual effect of each dimension of ESG, with particular attention to the moderating role of capital structure. Using a mixed sample composed of 18 Islamic banks and 22 conventional banks from 2014 to 2022, the results indicate a positive and significant effect of ESG, measured by the ESG score, on banking stability. Among the dimensions of the ESG score, only environmental and governance practices have shown a significant positive link with banking stability. However, the social dimension did not have a significant effect on this variable. Additionally, our results suggest that the Islamic character further enhances the positive relationship between ESG and financial stability due to ethical foundations. Furthermore, we find that the financial stability of Islamic and conventional banks primarily depends on capital structure, specifically the adequacy of equity, and credit risk management. Our study sheds light on the essential role of capital structure in moderating the benefits of ESG disclosure, an effect that has not been extensively examined in previous studies.

Key words: ESG, Financial stability, Islamic, Conventional, Moderating, Capital structure

JEL CLASSIFICATION: G21, G3, B23, C33

KAUJIE CLASSIFICATION: A7, H2, H57, L25, B16

Introduction

The last few decades have seen numerous changes and events that have highlighted the flaws of the classical financial system, excluding ethics and moral values from the economic and financial spheres and prioritizing wealth maximization at any cost for companies. With the rise in social, environmental, and financial problems, it became essential to revisit the rules governing the role of companies in their environment. Since then, governments, businesses, academics, and society have all attempted to improve the relationship between business and stakeholders. Discussions began by trying to find solutions on how companies can operate in more ethical and transparent areas (Wu & Hu, 2019). For this reason, the concept of corporate social responsibility (ESG) has garnered growing interest from firms, governments, legislators, civil societies, as well as researchers. Evolving through several phases since its inception at the end of the 19th century, ESG is now an integral part of contemporary business. It has indeed become a major priority for companies, their stakeholders, and the financial community (Chollet and Sindiwi, 2018).

In the banking sector, ESG also plays a crucial role. Historically, banks have been viewed as public fiduciary institutions; thus, expectations have arisen regarding their high professionalism and socially responsible behavior (Matuszak et al, 2019). They also play a significant role in shaping the sustainable development of countries, influencing social well-being and contributing to economic development. However, before the 2007/2008 crisis, banks were not heavily involved in ESG strategies (Novokmet and Rogošić, 2016). Their interest in ESG increased after the crisis, as it led to a loss of confidence and credibility towards banks (Fijałkowska et al, 2017). For this reason, banks have become obligated to follow this trend and disclose their ESG practices in annual reports to restore their credibility and reassure their stakeholders.

Financial stability is certainly a permanent concern for governments and academics. Bank stability is particularly crucial for the stability of other sectors (Berger et al, 2009) and is essential for the stability of any financial system in the world. Financial system regulators understand that a loss of confidence in the banking system can have devastating consequences for the entire financial system. For this reason, banking stability has always been one of the main objectives of the regulatory and supervisory policy of regulators (Ozili, 2019). Academic research has also been interested in the subject of financial stability in general and banking stability, particularly after the 2008 crisis. Therefore, this research has focused on determining the factors that can influence banking stability as well as the means to help avoid the crisis imbalance and instability of the banking sector.

The interest of this paper lies in studying the relationship between two essential subjects for the conventional and Islamic banking sector: ESG and financial stability. Our study is an extension of the literature on the financial effects of ESG. The central issue of this study is to investigate the impact of global and specific ESG dimensions (environmental, social, governance, and economic) on the financial stability of Islamic and conventional banks, with particular attention to the moderating effect of capital structure. This paper adds to the existing literature in several ways. In this study, we tried to link the two concepts of ESG and banking stability given their growing importance. Our main objective was to address a subject rarely studied in the literature, which is the impact of ESG on the financial stability of conventional and Islamic banks. The motivation behind choosing this topic lies in the urgent need to assess how ESG practices can influence the financial resilience of banking institutions, particularly in a context where economic and environmental crises are increasingly frequent. Furthermore,

the MENA region was selected due to its unique banking landscape, where Islamic banks, which operate according to ethical principles, coexist with conventional banks, which allows for an enriching comparison of the impacts of ESG scores on financial stability. The contribution of this research stands out from other empirical studies by its comparative approach, which examines not only Islamic and conventional banks, but also the cultural and economic specificities of the MENA region. By integrating in-depth analyses of ESG scores and their relationship with financial stability, this study offers new perspectives on how financial institutions can navigate a changing environment, while meeting sustainability requirements. Thus, it contributes to the existing literature by providing practical recommendations for banks and regulators, aimed at strengthening financial stability through responsible practices.

The remainder of this paper is organized as follows: Section 2 presents the literature review and the hypothesis development. Section 3 deals with the methodological aspects, namely the sample and the models. Section 4 presents the main empirical results and the discussion. Finally, the conclusions are presented.

1. Literature review and hypotheses development

The banking sector, both Islamic and conventional, always seeks to maintain a satisfactory level of solvency in order to continue their function of financial intermediation normally. Going bankrupt has disastrous consequences not only for the banks but also for the entire economy. This causes price instability, loss of confidence in the system, and the risk that depositors will lose part of their savings. For this reason, banks always seek to control the factors affecting their health and stability. The relationship between ESG and financial stability has been infrequently discussed in the literature. Gong and Ho (2018) examine this issue based on a sample of Chinese companies for the period 2009-2015. The results indicate that companies with stronger ESG performance tend to be more stable. This result is consistent with the argument that ESG is a powerful tool for managing risk. However, this positive association between ESG and stability is significant only in highly competitive sectors, suggesting that competition in the product market is a modest incentive for managers to invest in ESG activities in the interests of stakeholders. Orazalin et al (2019) conducted research addressing the impact of sustainability indicators, namely the environmental, social, and economic aspects, on the stability of 45 major oil and gas companies listed on the Russian trading stock exchange over the period 2012-2016. Empirical results show that companies improve their sustainability performance indicators in order to manage risk and improve financial stability. Similarly, Atif and Ali (2021). studied whether environmental, social, and governance (ESG) disclosure is related to default risk. Using a sample of U.S. nonfinancial institutions from 2006 to 2017, they found that ESG disclosure is positively related to Merton default distance and is negatively related to credit default swap spread, suggesting that firms with higher ESG disclosure have lower default risk. Indeed, in the same context, Di Tommaso and Thornton (2020) examined whether European banks' environmental, social, and governance (ESG) scores impact their risk-taking behavior and bank value. They found that high ESG scores are associated with a modest reduction in risk-taking for both high- and low-risk banks, and that the impact depends on board characteristics.

In ASEAN countries Setiarini et al., (2023) examined the influence of determinants of ESG practices on risk-taking and firm life cycle. They used a panel regression based on a sample of 2373 observations from 2004 to 2022. Their results showed that prospector strategy orientation encourages a greater

increase in ESG practices compared to defender strategy orientation and that increasing risk-taking by firms will reduce ESG practices.

Platonova et al. (2016), in the context of the Middle East, took 24 Islamic banks that are members of the GCC as samples. Their study focuses on the impact of ESG approached by six dimensions (mission and vision, commitment to employees, products and services, commitment to society, commitment to donors, and zakat: donations and volunteering) on financial performance. These authors join the previous ones in confirming the positive relationship between these two variables.

1.1. The impact of ESG on banking stability

Sun and Cui (2014) explored the relationship between ESG and default risk. The dataset contains 829 observations from 303 companies between 2008 and 2010. The results confirm that ESG has a significant effect on reducing the risk of default. They show that ESG increases business cash flow, reduces revenue volatility, creates value for businesses, and generates strong assets that protect businesses against defaults. Chang et al. (2013) also examined this relationship. For a sample of 85 Taiwanese listed companies and for a period from 2007 to 2010, they showed that companies adopting a good level of ESG have a very low probability of default in the short term. Rizwan et al. (2017) examined the risk-mitigating effects of engaging in ESG activities using data from 1,119 US non-financial companies between 2000 and 2012. The authors find evidence that companies with higher ESG activity scores have a lower probability of default. However, the credit risk effect of ESG is more pronounced with activities linked to the main stakeholders (employee relations, product quality, diversity, and governance). Engagement in secondary (institutional) ESG activities (related to the environment and the community) is not significant in this relationship. This study provides strong evidence that engaging and disclosing ESG-related activities reduces credit risk, suggesting that management and investors can use socially responsible behavior as a pricing factor.

For the banking sector, Scholtens and Van't Klooster (2019) studied the effect of ESG on the risk of individual bank failure and systemic risk. Their sample includes European banks for the period 2002/2016. They show that higher sustainability scores of banks are significantly associated with lower default risk. They also find that outperformance in sustainability reduces banks' contribution to systemic risk. It therefore appears that the sustainability performance of banks can have repercussions on the financial system. This implies that sustainability is important for banks and their supervisors. Considering sustainability can enhance banking risk management and prudential policy decision-making and provide guidance on how to finance a transition to an economic system that will effectively internalize externalities. Different research has shown that higher ESG scores are associated with more prudent and sustainable banking activities, which helps reduce overall risk. Moreover, this effect should be stronger when negative events occur, especially during crisis years: the benefits for companies of ESG engagement emerge strongly when unexpected drops in confidence occur. Consistent with recent findings on non-financial firms (Lins, Servaes, and Tamayo 2017), we demonstrate the positive role played by ESG scores in enhancing market confidence and bank stability in times of financial turmoil. Indeed, our predictions are based on the theory of moral capital, which considers ESG as an insurance strategy for maximizing business value by mitigating conflicts between stakeholders in the event of a crisis (Bouslah, Kryzanowski, and M' Zali 2018). Indeed, we can conclude that higher ESG scores may be associated with more prudent and sustainable banking activities, reducing overall risk. This allows us to propose the following hypothesis:

***H1**: ESG has a positive effect on banking stability*

1.2. The effect of individual dimensions of ESG on performance and risk

Studies examining ESG and its effects on performance, risks, and other issues typically use an aggregate score that includes all dimensions of ESG. However, it is important to highlight the multidimensional nature of ESG and disaggregate it into sub-dimensions

to better understand the relationship studied (Platonova et al., 2018). For this reason, some studies consider the effect of each dimension separately, while others focus on just one dimension. In their study on the impact of sustainability indicators on financial stability, Orazalin (2019) investigated the effect of each dimension on stability. Several researchers (e.g., Mahoney and Roberts 2007; Makni et al., 2009; Waddock and Graves 1997; Platonova et al., 2018, and Belasri et al. 2020) have emphasized the importance of individual components of the total social performance index when examining the impact of ESG on financial performance, suggesting that "interesting and explanatory information is lost" when an aggregate measure of corporate social performance is used (Johnson and Greening 1999).

Ramzan et al. (2021) stated that financial stability has been extensively discussed in the financial literature as a macroeconomic indicator of a country's financial performance. Chollet and Sandwidi (2018) explored the financial stability of the banking sector by examining the relationship between ESG and financial risk, finding that a company's positive social performance reduces its financial risk. Similarly, Jin et al. (2017) studied the relationship between social capital and bank stability, using a social capital index as a proxy measure of social capital, and found that banks with more social capital are less likely to fail and experience fewer financial difficulties.

To our knowledge, there are no published studies on this subject in a broader ESG context emphasizing the stability or risk-taking of banks. In conclusion, financial stability has been a significant topic in the financial literature, with studies exploring its relationship with ESG, social capital, and other factors. These studies suggest that positive social performance and social capital can contribute to reducing financial risk and enhancing overall economic performance. This study aims to investigate the relationship between banks' social factors and their ESG activities.

1.2.1 The environmental dimension

Previous studies suggest that companies with high environmental performance are more profitable and less risky than peer companies with low environmental performance (Spicer, 1978; Mahoney and Roberts, 2007). Makni et al. (2009) tested the relationship between ESG and the financial performance of Canadian public enterprises using measures of ESG from the Canadian Social Investment Database. Their empirical results show no statistically significant relationship between the aggregate measure of ESG and financial performance. On the other hand, they indicate the existence of a significant relation between the individual dimensions, in particular the environmental dimension (and the employees), and the financial performance. Mahoney and Roberts (2007) discussed the same relationship for Canadian firms over the period 1997–2000. The results also indicate an insignificant relationship between the combined measure of ESG and financial performance, but with regard to individual measures of ESG, Mahoney and Roberts (2007) reported that environmental measures significantly affect financial performance.

Regarding risk, Orlitzky and Benjamin (2001) suggest that, compared to other dimensions of ESG, the environmental dimension, in particular in the United States, has a weak (although negative) correlation with business risk. However, several studies show that environmental responsibility has a considerable effect on risk. Indeed, companies that are committed to the environment, implementing effective measures, and informing the public of their achievements can reduce risks (Sharfman and Fernando, 2008). Salama et al. (2011) examined the relationship between corporate environmental performance and corporate risk in the UK context between 1994 and 2006.

This study proposes the following hypothesis to study the relationship between banks' SFs and their ESG activities. From which we can derive the following hypothesis:

H1a: T*he environmental dimension of ESG has a positive effect on banking stability.*

1.2.2 The social dimension

The social dimension can positively impact financial performance. Makni et al. (2009) have shown a positive effect of the "employees" dimension on financial performance. Hannon and Milkovich (1996) used an event study methodology to examine whether advertisements for human resources reputation in the business press (such as companies cited as best for women) affect the stock prices of these companies. They found partial support for the claim that favorable signals from human resources reputation have a positive effect on stock prices. Social issues, as an integral part of a company's public relations, are visible and should have a strong causal relationship to business risk (Orlitzky and Benjamin, 2001).

Various empirical studies show that companies with strong social performance reduce their risk (Chollet and Sindiwi, 2018). Verwijmeren & Derwall (2010) conducted a study of 3000 American companies during the period 2001-2005 and found that companies with a strong record of accomplishment in employee well-being significantly reduce the likelihood of bankruptcy by operating with lower debt rates. They also observed that companies with better employee histories have better credit scores, indicating that good human resource practices significantly reduce the risk of bankruptcy. Oikonomou et al. (2012) also found a negative relationship between the systematic risk of companies and their social performance. Additionally, Cholet and Sindiwi (2018) demonstrated that good social performance reduces the financial risk of companies. Orazalin et al. (2019) found that the social dimension has a significant positive effect on the stability of companies. Hence, we derive the following hypothesis:

H1b: *The social dimension of ESG has a positive effect on banking stability*

1.2.3 The governance dimensions

The governance dimension is often overlooked in some empirical studies, such as those conducted by El Ghoul (2011) and Oikonomou et al. (2012), because some authors do not view good governance practices as an indicator of socially responsible behavior. In contrast, John et al. (2008) examined the governance dimension and concluded that there are arguments for both positive and negative associations between the governance scores of American companies and financial risk.

However, Bouslah et al. (2013) discovered a positive relationship between the strength of corporate governance and business risk (both total and idiosyncratic) using 16,599 business-year observations from 1991-2007. Cholet and Sindiwi (2018) noted that due to a lack of empirical evidence, the question remains open, but they believe that corporate governance is a relevant dimension for investors. Their empirical analysis demonstrated that good governance practices significantly reduce risk. This leads to the following hypothesis:

H1c: *The governance dimension of ESG has a positive effect on banking stability.*

1.3. The Moderating Role of the Capital Structure

The recent financial crisis significantly tarnished the reputation of banks, highlighting the fragility of their business models based on high-risk levels, low reserves, and harmful practices for stakeholders. Restoring trust and reputation is a key motivator for the banking sector to incorporate Corporate Social Responsibility (ESG) into their value-creating strategies and activities (Laugel and Laszlo, 2009). The Basel II Accords (2004) aimed to strengthen banking regulations to theoretically reduce risks by tightening loan conditions and

analyzing repayment methods for financed projects. The Basel III reform, influenced by the FSB (Financial Stability Board) and the G20, introduces liquidity and leverage ratios, counter-cyclical measures, and revises risk coverage, yet overlooks the analysis of non-financial risks.

Moudud-Ul-Huq et al. (2021) found a positive relationship between market power and financial stability in Islamic banks in MENA countries, highlighting Islamic banks' stability compared to other ownership structures. They recommended improving non-performing loan management to reduce credit risk and increase profitability in the MENA region. Stakeholders should adjust risk management strategies based on ownership structures, with a focus on Islamic banks due to their superior stability. They suggested that ESG reports provide long-term forecasts to creditors, enabling companies to maintain higher leverage and proposed the following hypothesis:

H2: *The moderating effect of capital structure has a significant influence on theESG-relationship financial stability.*

2. Data, Variable Measurements and Methodology

2.1. Data

In this study, we utilized data from 42 banks in the MENA region, Indonesia, and Malaysia. The sample consists of 17 Islamic banks and 25 conventional banks, as indicated in Table 1. Data from the years 2014 to 2022 were gathered from the DataStream database, and macroeconomic data was sourced from the World Bank website.

Table 1: Distribution and sample categorization

Countries	Conventional banks	Islamic banks
Saudi Arabia	3	2
Kuwait	2	2
Oman	2	3
United Emirates	2	4
Bahrain	3	2
Egypt	1	2
Morocco	1	1
Jordan	1	1
Turkey	5	1

Source: Author's elaboration

2.2. Variable definitions

2.2.1. Dependent Variable: Banking Stability

The Altman Z-score is a formula used to determine if a company is at risk of bankruptcy. It considers profitability, leverage, liquidity, solvency, and activity ratios. A Z-score near 0 indicates potential bankruptcy, while a Z-score near 3 shows strong financial health. This method is preferred over analyzing a single ratio as it combines various factors like assets, earnings, and market value. Creditors and lenders commonly use this method to assess the risk of lending money to customers and borrowers.

$$\textbf{Z-Score} = 1.2A + 1.4B + 3.3C + 0.6D + 0.99E$$

The letters in the formula represent the following ratios:

A = Working Capital / Total Assets (Measures the relative amount of liquid assets)

B = Retained Earnings / Total Assets (Determines cumulative profitability)

C = Earnings Before Interest and Taxes / Total Assets (Measures earnings before the effects of taxes and leverage)

D = Market Value of Equity / Book Value of Total Liabilities (Incorporates the effects of a decline in the market value of a company's stock)

E = Sales / Total Assets (Measures asset turnover)

In fact, the table 1 summarizes the different variables used in this study

Table 2 : Variables measures

Variables	Abreviation	Measure	References
		Dependent variable	
Financial stability	**Z-score**	**Z-Score = 1.2A + 1.4B + 3.3C + 0.6D + 0.99E**	Altman
		Independent variables	
Corporate social responsibility	**ESG Score**	The ESG score is calculated by weighting the three dimensions: social, environmental, and governance.	Chollet and Sindiwi, 2018; Migliavacca et al., 2019
		Moderating variable	
Capital structure	**EA**	The ratio of equity to total assets	
		Control variables	
Size	**Size**	The logarithm of total bank assets	Jo and Na (2012) Belsari et al. (2020)
Liquidity risk	**TL/TD**	The total loans/total deposits ratio	Migliavacca et al. (2020)
Credit risk	**LLP/NPL**	The ratio of loan loss provisions to non-performing loans	Ben Salah and Boujelbène (2018) and Migliavacca et al. (2020).
Islamic	**Islamic**	A binary variable; it takes the value 1 if the bank is Islamic and 0 if the bank is conventional	Noman et al., (2015)
Concentration ratio	**HHI**	Sum of squares of market shares of all banks.	Wibowo (2016)
Inflation	**Inflation**	The general increase in the prices of goods and services over a given period.	Jokipii and Monnin (2013)
GDP	**GDP**	the GDP growth rate	Rupeika-Apoga et al. (2018).

Source: Author's elaboration

2.3. Model specifications and statistic method

To assess the impact of global ESG and each individual dimension: environmental, social, corporate governance and economic, we estimate respectively the following models:

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ ESGScore_{it} + \beta 2\ Size_{it} + \beta 3\ TL / TD_{it} + \beta 4\ E / A_{it} + \beta 5\ LLP / NPL_{it} + \beta 6\ IHH_{it} + \beta 7\ Islamic_{it} + \beta 8\ GDP_{it} + \beta 9\ INF_{it} + \varepsilon_{it} \quad (1)$$

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ environmental_{it} + \beta 2\ Size_{it} + \beta 3\ TL / TD_{it} + \beta 4\ E / A_{it} + \beta 5\ LLP / NPL_{it} + \beta 6\ IHH_{it} + \beta 7\ Islamic_{it} + \beta 8\ GDP_{it} + \beta 9\ INF_{it} + \varepsilon_{it} \quad (2)$$

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ Social_{it} + \beta 2\ Size_{it} + \beta 3\ TL / TD_{it} + \beta 4\ E / A_{it} + \beta 5\ LLP / NPL_{it} + + \beta 6\ IHH_{it} + \beta 7\ Islamic_{it} + \beta 8\ GDP_{it} + \beta 9\ INF_{it} + \varepsilon_{it} \quad (3)$$

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ GOV_{it} + \beta 2\ Size_{it} + \beta 3\ TL / TD_{it} + \beta 4\ E / A_{it} + \beta 5\ LLP / NPL_{it} + \beta 6\ IHH_{it} + \beta 7\ Islamic_{it} + \beta 8\ GDP_{it} + \beta 9\ INF_{it} + \varepsilon_{it} \quad (4)$$

To study the moderating effect of capital structure on the ESG- banking stability, we estimate the following regressions:

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ ESGScore_{it} + \beta 2\ E / A_{it} + \beta 3 ESG\ Score * E/A_{it} + \beta 4\ Size_{it} + \beta 5\ TL / TD_{it} + \beta 6\ E / A_{it} + \beta 7\ LLP / NPL_{it} + \beta 8\ IHH_{it} + \beta 9\ Islamic_{it} + \beta 10\ GDP_{it} + \beta 11\ INF_{it} + \varepsilon_{it} \quad (1)$$

$$Z\text{-}Score = \beta 0 + \beta 1\ environmental_{it} + \beta 2\ E / A_{it} + \beta 3\ environmental * E/A_{it} + \beta 4\ Size_{it} + \beta 5\ TL / TD_{it} + \beta 6\ E / A_{it} + \beta 7\ LLP / NPL_{it} + \beta 8\ IHH_{it} + \beta 9\ Islamic_{it} + \beta 10\ GDP_{it} + \beta 11\ INF_{it} + \varepsilon_{it} \quad (2)$$

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ Social_{it} + \beta 2\ E / A_{it} + \beta 3\ Social * E/A_{it} + \beta 4\ Size_{it} + \beta 5\ TL / TD_{it} + \beta 6\ E / A_{it} + \beta 7\ LLP / NPL_{it} + \beta 8\ IHH_{it} + \beta 9\ Islamic_{it} + \beta 10\ GDP_{it} + \beta 11\ INF_{it} + \varepsilon_{it} \quad (3)$$

$$Z\text{-}Score_{it} = \beta 0 + \beta 1\ GOV_{it} + \beta 2\ E / A_{it} + \beta 3\ GOV * E/A_{it} + \beta 4\ Size_{it} + \beta 5\ TL / TD_{it} + \beta 6\ E / A_{it} + \beta 7\ LLP / NPL_{it} + \beta 8\ IHH_{it} + \beta 9\ Islamic_{it} + \beta 10\ GDP_{it} + \beta 11\ INF_{it} + \varepsilon_{it} \quad (4)$$

With, Z-Score is the measure of banking stability, ESG Score is the global ESG responsibility, $E/A_{it:}$ capital structure, Size: the size of banks, TL/TD is the total loans / total deposits ratio, LLP/NPL (loan loss provision / non-performing loans): provision for loan losses / non-performing loans); IHH: concentration of bank; Islamic: binary variable; 1 if the bank is Islamic, 0 otherwise; GDPis the GDPgrowth rate; Inf is the rate of inflation.

Indeed, we utilized panel data, also known as cross-referenced data, which includes the two previous dimensions and reports the values of the considered variables recorded for a set or panel of individuals over a series of periods Petru-Ovidiu, M. (2015).There are two models that we can distinguish: a fixed effects model and a random effects model. To choose between the two models, we conducted the Hausman test, which is a specification test of the individual effects that helps determine if the coefficients of the two estimates (fixed and random effects) are statistically different and follow a Chi-square distribution with k-1 degrees of freedom (Hausman, 1978).

According to the Hausman test, random effects models are preferable to fixed effects models since the probability is greater than 5%. Therefore, we will use the estimates from the random effects models to test all the hypotheses. We used the Breusch Pagan test to examine if the square of the residuals can be explained by the model variables. The results obtained reject the null hypothesis of homoscedasticity, indicating that the variance of the residuals is heteroscedastic.

4. Estimation and Discussion of Results

4.1. Descriptive analysis of the sample

Table 3 presents descriptive statistics for variables in the study. The Z-Score variable, measuring banking stability, has an average of 88.82582 and a standard deviation of 103.6845. The higher the value of the z-score, the lower the risk of default for the bank. Generally, the z-score values are high, indicating that the banks in our sample do not suffer from an instability problem. This can be explained by the relatively short study period (5 years), during which the banks did not experience significant volatility, especially since it was not a period of crisis.

The ESG score values show an average of 55.4%, indicating an acceptable level of ESG commitment. However, the standard deviation is relatively large, at 16.63595. In terms of the dimensions of ESG, the averages for the environmental and social dimensions are 52.67885, and 53.9431 respectively. Their standard deviations are 31.39977, and 29.56893, suggesting that while the overall level of ESG enforcement is high, banks are not equally committed to environmental, and social requirements. The governance dimension has an average of 35.46805, lower than the environmental and social dimensions, with a significant standard deviation of 24.19801. This result suggests that the banks in our sample are generally less concerned with this dimension compared to the other dimensions.

Table 3 : Descriptive statistics

Variables	Mean	Std. Dev.	Min	Max
Z-score	88.82582	103.6845	20.25053	690.9758
Esgscore	55.40065	16.63595	18.21	89.74
Social	53.9431	29.56893	5.64	94.32
Environnemental	52.67885	31.39977	9.73	95.04
Governance	35.46805	24.19801	1.75	96.45
EA	.118555	.0269138	.0692768	.2278467
Size	8.317425	1.541106	6.216116	12.11119
TL/TD	1.059166	.2283031	.4980539	1.823419
LLP/NPL	.2415541	.2918938	-.1079691	1.503413
IHH	32.1796	18.87896	9.78	107.61
Islamic	.4	.4909903	0	1
GDP	11.4664	.4440023	10.49312	12.01794
Inflation	3.699382	3.893159	-0.8769134	29.50193

Source: Author's elaboration

To test for the presence of multicollinearity, we conducted a pairwise Pearson correlation test between all variables used. According to the results in Table 4, the majority of correlations between variables within the same model are strictly less than 0.7.

Table 4 : Pearson correlation matrix

	Zscore	ESG *score*	Social	ENV	Gov	Size	E/A	TL/TD	LLP/NPL	IHH	Islamic	GDP	Inflation
Zscore	1.0000												
ESG score	0.0535 1.0000	1.0000											
Social	-0.0406 * 0.0000	0.7718 * 0.0000	1.0000										
ENV	-0.0595 * 0.0000	0.8440 * 0.0000	0.8781 * 0.0000	1.0000									
Gov	0.0057 * 0.0000	0.5257 * 0.0000	0.6026 * 0.0000	0.6200 * 0.0000	1.0000								
Size	0.1395 * 0.0000	0.4287 * 0.0000	0.4263 * 0.0000	0.3363 * 0.0002	0.2851 * 0.0067	1.0000							
E/A	0.4008 * 0.0000	0.0480 * 0.0000	0.0576 * 0.0000	0.0687 1.0000	0.2207 0.2133	0.3673 * 0.0000	1.0000						
TL/TD	-0.0990 * 0.0000	-0.082* 0.0000	-0.0167 * 0.0000	-0.0178 * 0.0000	-0.1534 1.0000	-0.0689 1.0000	-0.0969 1.0000	1.0000					
LLP/NPL	0.1978 0.2996	0.3005 * 0.0062	0.2936 0.0000	0.2936 * 0.0093	0.1975 0.8940	0.6599 * 0.0000	0.5011 * 0.0000	0.1230 1.0000	1.0000				
IHH	0.2356 0.1293	0.4165 * 0.0232	0.3547 * 0.0012	0.4568 * 0.0193	0.1585 0.8940	0.7269 * 0.0052	0.4256 * 0.0235	0.235 * 0.0543	0.365* 0.0312	1.0000			
Islamic	-0.0882 1.0000	-0.1311 1.0000	-0.0536 1.0000	-0.1072 1.0000	0.0264 1.0000	0.0290 1.0000	-0.1595 1.0000	-0.0567 1.0000	-0.1959 0.6571	0.2553 0.2356	1.0000		
GDP	-0.1349 1.0000	0.3024 * 0.0021	0.3456 * 0.0001	0.2767 * 0.0106	0.2036 0.4505	0.3770 * 0.0000	-0.1101 1.0000	-0.0724 1.0000	0.2534* 0.0425	0.1658 * 0.0356	0.0476 1.0000	1.0000	
Inf	-0.1610 0.9372	0.3955 * 0.0000	0.4474 * 0.0000	0.4345 * 0.0000	0.1549 1.0000	0.2638 * 0.0121	-0.1277 1.0000	0.0921 1.0000	0.2477 0.0766	0.3569 0.0524	-0.2390 * 0.0493	0.3211 * 0.0002	1.000

***, **,* statistical significance at 1%, 5% and 10% levels respectively.

Source: Stata output

To verify the absence of multicollinearity among the independent variables in our empirical study, it would be helpful to create a correlation matrix. These measures are important for avoiding biased results in our regression model and preventing distortion of the estimates (Senaviratna and Cooray, (2019)). The results from our table (4) show the correlation matrix, indicating no significant multicollinearity issue as the correlation values between the independent variables do not exceed the threshold of 0.7 based on the Pearson test.

5. Results Discussion

Table 5: The Effect of ESG on Financial Stability

	M1		M2		M3		M4	
Zscore	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|
ESGScore	0.2590277	0.017**						
Environnemental			0.1227532	0.030**				
Social					0.0303425	0.664		
Governance							0.18858	0.012**
Size	4.997511	0.077*	5.424485	0.056*	11.49238	0.012**	7.290115	0.098*
EA	533.3972	0.000***	527.797	0.000***	555.8508	0.000***	535.3938	0.000***
Size	4.997511	0.077*	5.424485	0.056*	11.49238	0.012**	7.290115	0.098*
TL/TD	0.727325	0.553	3.556518	0.574	5.528274	0.568	5.010796	0.578
LLP/NPL	-15.76894	0.009***	-14.17795	0.019**	-13.95525	0.025**	-12.64564	0.033**
Islamic	17.06333	0.025**	16.86808	0.031**	17.85964	0.008***	16.52388	0.041**
LIQ	0.0192697	0.011**	.0338852	0.015**	.0376759	0.078*	.0284013	0.077*
GDP	10.24055	0.535	10.90297	0.516	5.491962	0.750	2.660241	0.869
Inflation	-0.0831359	0.818	-0.1117077	0.758	-0.1745855	0.638	-0.1939664	0.583
IHH	0.0192697	0.011**	.0338852	0.015**	.0376759	0.078*	.0284013	0.077*
R2	0.5122		0.5033		0.4851		0.5230	
Fisher	123.17		118.58		109.11		128.83	
	0.000***		0.000***		0.000***		0.000***	

***, **,* statistical significance at 1%, 5% and 10% levels respectively.
Source: Stata output

The table 5 presents the results of four econometric models (M1 to M4) analyzing the impact of ESG scores on financial stability, measured by the Z-score. Each model includes different explanatory variables, and the coefficients and their statistical significances are provided.

In model M1, the coefficient of the ESG score is 0.2590277 with a p-value of 0.017, indicating positive and significant impact on financial stability confirming our first hypothesis. This suggests that an improvement in the ESG score is associated with better financial stability of firms. This relationship is supported by recent studies that show that firms with better ESG practices tend to have more robust financial performance, which can reduce their perceived risk by investors. This result aligns with stakeholder theory, which emphasizes that compliance with ESG requirements is crucial for a company's sustainability, rejecting the traditional view of firms. It also supports studies by Gang and Ho (2018) and Orazalin et al. (2019) that showed a positive impact of CSR on company stability. Our results further validate the importance of CSR practices in risk management (Ayadi et al., 2015; Harjoto and Laksmana, 2018) and risk reduction (Orlitsky and Benjamin, 2001; Wu and Hu, 2019; Truong and Kim, 2019; Scholtens and Van't Klooster, 2019). This finding can be explained by CSR acting as a remedy for banks post the 2008 crisis. Trust and reputation are crucial for maintaining stability and sustainability in the banking sector, and CSR helps restore confidence and improve the bank's image (Novokmet and Rogošić, 2016). A good reputation enhances a bank's performance, competitiveness, and investor appeal, protecting against return volatility and ensuring financial stability. Banks with high ESG levels tend to prioritize stakeholder interests, including depositors and borrowers, leading to increased customer satisfaction, deposits, borrower diligence, and reduced credit and liquidity risks. Additionally, ESG practices attract investors, contributing to profitability and preventing insolvency issues. The Size variable has a coefficient of 4.997511 with a p-value of 0.077, indicating a significance at 10%. This suggests that larger firms benefit from better financial stability, probably due to their ability to diversify their activities and manage risks more effectively. The capital structure (EA) variable is highly significant ($p < 0.001$) with a coefficient of 533.3972, confirming that profitability is a key determinant of financial stability. Indeed, our result demonstrate that the Islamic variable has a coefficient of 17.06333 with a p-value of 0.025, indicating a positive and significant impact on financial stability. This suggests that Islamic banks, which adhere to ethical and financial principles in line with Islamic law, may benefit from better perceptions from investors, enhancing their financial stability. This trend is supported by recent research showing that Islamic firms often attract ethically conscious investors, which can improve their financial resilience. Indeed, the Islamic variable has a coefficient of 17.06333 with a p-value of 0.025, indicating a positive and significant impact on financial stability. This suggests that Islamic firms, which adhere to ethical and financial principles in accordance with Islamic law, may benefit from better perceptions from investors, which enhances their financial stability. This trend is supported by recent research showing that Islamic firms often attract ethically conscious investors, which can improve their financial resilience. Our results demonstrate that the R^2 is 0.5122, which means that 51.22% of the variation in financial stability can be explained by the variables included in the model. This indicates a moderate level of explanation of the data by the model. The Fisher test has a value of 123.17 with a p-value of 0.000, which indicates that the model is overall significant. This means that the variables in the model significantly explain the variance in the dependent variable.

The result of second model M2 shows that the coefficient for the environmental dimension is 0.1227532 with a p-value of 0.030, indicating a positive and significant impact. This

reinforces the idea that firms that invest in environmental initiatives can improve their financial stability. Recent research has shown that firms with good environmental performance are often perceived more favorably by investors, which can translate into lower capital costs. This finding supports studies that highlight the environmental component's role in improving financial performance (Mahoney and Roberts, 2007; Makni et al., 2009) and reducing risk (Salama et al., 2014; Orlitzky and Benjamin, 2001). The Size variable remains significant with a coefficient of 5.424485 (p = 0.056), indicating that firm size is an important factor for financial stability. The variable LLP/NPL (Loan Loss Provisions/Non-Performing Loans) has a coefficient of -14.17795 (p = 0.019), indicating that high levels of non-performing loans are associated with lower financial stability, corroborating the results of previous studies that highlight the importance of receivables management. The coefficient for the Islamic variable is 16.86808 with a p-value of 0.031, also confirming a positive and significant impact. This reinforces the idea that Islamic firms can benefit from increased trust status, which can contribute to their financial stability. A recent study found that Islamic firms that adopt sustainable practices can improve their attractiveness to investors. The R^2 for is 0.5033, indicating that 50.33% of the variation in financial stability is explained by the variables in the model. The Fisher test has a value of 118.58 with a p-value of 0.000, also meaning that this model is overall significant.

In model M3, the social dimension has a coefficient of 0.0303425 with a p-value of 0.664, indicating that it does not have a significant impact on financial stability in this context. This could suggest that social initiatives, although important, have not yet been integrated in a way that directly influences investor perception or financial performance. Our result are contradicting to previous studies highlighting its impact on performance (Makni et al., 2019) and risk reduction (Chollet and Sindiwi, 2018). Therefore, hypothesis H1b cannot be consistently supported. Social requirements may not be profitable for financial institutions due to additional costs or less profitable project choices. However, these practices can positively influence risk management, reputation, and performance. The social dimension's effect remains unclear, especially in a predominantly Islamic bank sample where specific social activities like zakat play a significant role. The variable Size continues to display a significant coefficient of 11.49238 (p = 0.012), highlighting the importance of size in financial stability. The coefficient for LLP/NPL remains negative and significant at -13.95525 (p = 0.025), confirming that managing non-performing loans is crucial to maintain financial stability. In Model M3, the coefficient of the Islamic variable is 17.85964 with a p-value of 0.008, indicating a positive and significant impact. This suggests that Islamic firms continue to exhibit strong financial stability, reinforcing the idea that practices consistent with Islamic law can generate increased investor confidence. This is supported by research indicating that Islamic firms with good sustainability performance can attract financing on more favorable terms. The R^2 for is 0.4851, meaning that 48.51% of the variation in financial stability is explained by the variables in the model. This indicates a slightly lower explanatory power compared to previous models. Indeed, our result show that the Fisher test shows a value of 109.11 with a p-value of 0.000, confirming that the model is overall significant.

Finally, Model M4 shows that the coefficient for the governance dimension is 0.18858 with a p-value of 0.012, indicating a positive and significant impact, confirming hypothesis H1c.. This highlights the importance of good corporate governance for financial stability, which is supported by studies showing that effective boards can lead to better strategic decisions and reduced risks. Good governance practices reduce risks significantly, making it relevant for investors and supervisors. Governance quality ensures shareholder

satisfaction, long-term financial performance, and reduces conflicts of interest, attracting more investors and protecting against risks. Although governance's positive effect on banking stability is not statistically significant, it remains crucial for bank stability. The Size variable displays a coefficient of 7.290115 (p = 0.098), indicating a significance close to the 10% threshold. The LLP/NPL variable has a coefficient of -12.64564 (p = 0.033), confirming its negative impact on financial stability. This highlights the importance of prudent receivables management to maintain strong financial stability. The results demonstrate that the Islamic variable has a coefficient of 16.52388 with a p-value of 0.041, indicating a positive and significant impact on financial stability. This highlights the continuity of the results, showing that Islamic companies maintain good financial performance. This trend is also supported by research that shows that ethics and compliance play a crucial role in investors' perception of companies. The R^2 for model M4 is 0.5230, indicating that 52.30% of the variation in financial stability is explained by the variables in the model. Indeed, the Fisher test has a value of 128.83 with a p-value of 0.000, indicating that this model is also globally significant.

These results show that ESG scores, especially environmental and governance dimensions have a significant impact on the financial stability of firms. Variables such as firm size and profitability are also key determinants of financial stability. These results are in line with recent literature that highlights the growing importance of sustainable practices in the business world. Overall, the Islamic variable shows a positive and significant impact on financial stability across all models. The R^2 values and Fisher test results indicate that the models are overall significant and explain a reasonable proportion of the variance in financial stability. These results reinforce the idea that Islamic banks may benefit from a strong reputation and increased investor confidence, which contributes to their financial stability.

Table 6: Moderating effect of capital structure between CSR and financial stability

Zscore	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|
ESG Score	0.7064489	0.057*						
Environnemental			0.2004537	0.081*				
Social					0.2550236	0.227		
Governance							0.6850889	0.022**
EA	735.8582	0.000***	566.8218	0.000***	445.8313	0.000***	706.6678	0.000***
EA*ESG	3.51613	0.000***						
EA*ENV			0.7229571	0.000***				
EA*SOC					2.186293	0.000***		
EA*GOV							4.201619	0.000***

Size	5.794927	0.092*	5.813158	0.003***	11.78945	0.069*	7.084448	0.086*
TL/TD	0.7633167	0.050*	4.38865	0.021**	6.434716	0.010**	8.910843	0.049**
LLP/NPL	-16.58365	0.005***	-14.90139	0.013**	-14.28435	0.019**	-16.14626	0.006***
Islamic	0.527184	0.029**	1.572945	0.093*	1.63509	0.048**	2.732469	0.034**
LIQ	0.0305451	0.053*	0.0351622	0.098*	0.0254598	0.025**	0.036754	0.0*58
GDP	10.58039	0.483	11.67307	0.451	6.133142	0.696	5.822922	0.691
Inflation	-0.0487226	0.896	-0.1208556	0.749	-0.0810148	0.829	-0.1613842	0.662
R2	0.5173		0.5015		0.4960		0.5400	
Fisher	128.21		119.50		113.44		140.89	
	0.000***		0.000***		0.000***		0.000***	

***, **,* statistical significance at 1%, 5% and 10% levels respectively.
Source: Stata output

In the table 6, we observe the moderating effects of capital structure between corporate social responsibility (CSR) and financial stability across several models. Each model presents coefficients and significance levels that indicate the importance of the variables in the analysis.

IN the first model, the ESG score shows a positive coefficient of 0.7064489 with a significance at 10% (P>|z| = 0.057), suggesting that improved ESG performance is associated with better financial stability. The interaction between capital employed (EA) and ESG score is also significant, with a coefficient of 3.51613, indicating that capital structure reinforces the positive impact of CSR on financial stability. The R^2 of 0.5173 indicates that the model explains about 51.73% of the variance in financial stability, while the Fisher test (128.21) shows that the model is overall significant. In the second model, environmental impact (ENV) has a coefficient of 0.2004537 with a significance at 10% (P>|z| = 0.081). The interaction between capital employed and environmental impact is significant (0.7229571), suggesting that capital structure positively moderates the relationship between environmental impact and financial stability. The R^2 of 0.5015 and the Fisher test (119.50) confirm the robustness of the model. The third model examines social impact (SOC), which is not significant (P>|z| = 0.227), but the interaction between capital employed and social impact is significant (2.186293), indicating a moderating effect. The R^2 of 0.4960 shows that the model explains almost 50% of the variance, while the Fisher test (113.44) indicates an overall significance. Finally, the fourth model focuses on governance (GOV), which presents a significant coefficient of 0.6850889 (P>|z| = 0.022). The interaction between capital employed and governance is also significant (4.201619), highlighting that capital structure reinforces the positive effect of governance on financial stability.

The R^2 of 0.54 and the Fisher test (140.89) show that this model is the best performing in terms of explaining the variance. Indeed, we can say that our results verify the importance

of capital structure as a moderator in the relationship between CSR and financial stability, with significant implications for banks seeking to improve their financial performance through CSR initiatives.

Robustness Check using GMM method

The Generalized Method of Moments (GMM) model is of significant importance in the estimation of economic models, particularly due to its flexibility and efficiency in dealing with endogeneity and heteroscedasticity issues. One of the main advantages of the GMM is its ability to use both data moments and instruments, which allows to obtain unbiased estimators even in the presence of explanatory variables correlated with the error. Moreover, the GMM is particularly suitable for panel data, where it can account for unobserved individual effects and time variations. This method also promotes increased robustness against violations of classical assumptions, such as homoscedasticity, by allowing for adjustments in the estimates

Table 6: The effect of ESG on financial stability using GMM model

	M1		M2		M3		M4	
Zscore	**Coefficient**	**P>|z|**	**Coefficient**	**P>|z|**	**Coefficient**	**P>|z|**	**Coefficient**	**P>|z|**
ZscoreL1.	1.031102	0.000***	1.019564	0.000***	1.015087	0.000***	1.025534	0.000***
ESG Score	.176087	0.066*						
Environnemental			.0164762	0.069*				
Social					.0268365	0.683		
Governance							0.0458173	0.014**
EA	391.7983	0.000***	379.9959	0.000***	375.5656	0.000***	388.6912	0.000***
Size	5.658597	0.051*	4.6647436	0.048**	3.654754	0.077*	5.092519	0.074*
TL/TD	1.997211	0.844	-1.826871	0.855	-3.401342	0.739	-1.324436	0.895
LLP/NPL	-3.288665	0.030**	-2.578805	0.021**	-2.484186	0.032**	-2.706156	0.006***
Islamic	5.128194	0.08**	5.582071	0.068*	5.247732	0.090*	4.676864	0.056*
IHH	.1120134	0.021**	.1246003	0.009***	.6199385	0.064*	.6920568	0.044**
GDP	2.94795	0.852	3.961964	0.801	2.939501	0.851	5.685762	0.723

***, **,* statistical significance at 1%, 5% and 10% levels respectively.
Source: Stata output

The table 6 presents various models that examine the impact of ESG performance on financial stability using GMM model, as measured by the Z-score. In the first model, the coefficient of the lagged Z-score (ZscoreL1) is 1.031102, significant at 1%, indicating a strong persistence of financial stability from one period to the next. Additionally, the ESG score has a coefficient of 0.176087, significant at 10%, suggesting that improved ESG performance is linked to better financial stability, although this relationship is marginally significant. Capital employed (EA) is also highly significant with a coefficient of 391.7983, emphasizing its crucial role in financial stability. In the second model, ZscoreL1 remains significant with a coefficient of 1.019564, while the environmental impact shows a coefficient of 0.0164762, significant at 10%, indicating that environmental initiatives can contribute to financial stability. Firm size (Size) has a coefficient of 4.6647436, significant at 5%, implying that larger firms tend to be more financially stable. In the third model, although ZscoreL1 remains significant, social impact is not significant, suggesting that social initiatives may not directly impact financial stability in this context. However, capital employed and size remain important factors. Finally, in the fourth model, ZscoreL1 remains significant with a coefficient of 1.025534, and governance has a coefficient of 0.0458173, significant at 5%, indicating that good governance practices are associated with better financial stability.

These results highlight the significance of ESG performance, particularly in the environmental and governance dimensions, as well as the crucial roles of capital employed and firm size in financial stability. This suggests that firms that adopt strong ESG practices and maintain a robust capital structure are better positioned to ensure their financial stability. The results obtained in the presented models confirm the conclusions previously found in the static model, thus reinforcing the idea that ESG performances play a significant role in the financial stability of companies. Indeed, as in the static analysis, the coefficient of the lagged Z-score remains significant, highlighting the persistence of financial stability. Moreover, the positive coefficients associated with the ESG score and its environmental and governance dimensions corroborate previous observations, indicating that strong ESG practices contribute to better financial resilience. Capital employed continues to prove crucial, as does company size, which recalls previous results. Thus, this consistency between the models underlines the importance of integrating robust ESG strategies and effective management of the capital structure to ensure long-term financial stability. These confirmations also reinforce the validity of the conclusions drawn from previous analyses, providing a more solid perspective on the relationships between CSR, capital structure and financial performance.

Table 7: Moderating effect of capital structure between ESG score and financial stability using GMM model

Zscore	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|	Coefficient	P>|z|
ZscoreL1.	1.031394	0.000***	1.020966	0.000***	1.011593	0.000**	1.025597	0.000**
ESG Score	0.2684935	0.070*						
Environnemental			0.0477739	0.082*				
Social					0.2975785	0.134		
Governance							0.0564774	0.082*
EA	347.5774	0.000***	368.3779	0.000***	479.919	0.000***	385.2627	0.000***
EA*ESG	0.7623379	0.007***						
EA*ENV			0.2294444	0.005***				
EA*SOC					1.949374	0.002***		
EA*GOV							0.0877992	0.006***
Size	5.523747	0.038**	4.142264	0.048**	3.502599	0.088*	5.127684	0.081*
TL/TD	0.304066	0.976	-1.455714	0.887	-6.515885	0.530	-1.283897	0.899
LLP/NPL	2.728441	0.014**	2.653866	0.012**	3.35458	0.515	2.673216	0.613
Islamic	4.720742	0.048**	5.629664	0.069*	4.4393	0.066*	4.686486	0.058*
LIQ	0.6046875	0.075*	0.6780597	0.047**	.5584893	0.096	0.6982598	0.051*
GDP	0.4467521	0.978	4.243765	0.789	1.293759	0.934	5.856688	0.721
Inflation	-0.1163093	0.017**	-0.1266804	0.011**	-0.114015	0.018	-0.1266407	0.010**

***, **,* statistical significance at 1%, 5% and 10% levels respectively.

Source: Stata output

The table presents various models examining the moderating effect of ESG performance on financial stability, as measured by the Z-score. In the first model, the coefficient of the lagged Z-score (ZscoreL1) is 1.031394, significant at 1%, indicating a strong persistence of financial

stability from one period to another. The ESG score has a coefficient of 0.2684935, significant at 10% (P>|z| = 0.070), suggesting that improved ESG performance is associated with better financial stability, although this relationship is marginally significant. Capital employed (EA) is highly significant with a coefficient of 347.5774, highlighting its crucial role in financial stability. Additionally, the interaction between committed capital and ESG score (EA*ESG) shows a coefficient of 0.7623379, significant at 1% (P>|z| = 0.007), indicating that committed capital positively moderates the effect of ESG score on financial stability.

In the second model, ZscoreL1 remains significant with a coefficient of 1.020966. Environmental impact (ENV) shows a coefficient of 0.0477739, significant at 10% (P>|z| = 0.082), suggesting that environmental initiatives can also contribute to financial stability, especially when combined with high committed capital, as indicated by the coefficient of the EA*ENV interaction at 0.2294444, significant at 1% (P>|z| = 0.005). Firm size (Size) has a coefficient of 4.142264, significant at 5%, which reinforces the idea that larger firms are generally more financially stable.

In the third model, ZscoreL1 remains significant, while social impact (SOC) has a coefficient of 0.2975785, but is not significant (P>|z| = 0.134). However, the interaction between capital employed and social impact (EA*SOC) is significant with a coefficient of 1.949374 (P>|z| = 0.002), indicating that capital employed plays an important moderating role in the effect of social initiatives on financial stability. This suggests that firms that invest in social initiatives while maintaining strong capital employed may benefit from greater financial stability.

Finally, in the fourth model, ZscoreL1 remains significant with a coefficient of 1.025597, and governance (GOV) presents a coefficient of 0.0564774, significant at 10% (P>|z| = 0.082). The interaction between committed capital and governance (EA*GOV) is also significant with a coefficient of 0.0877992 (P>|z| = 0.006), highlighting that good governance practices, when supported by committed capital, are associated with better financial stability.

These results confirm previous findings on the importance of ESG performance and committed capital in the financial stability of banks. Fisher tests and R^2 values, although not provided in the table, would be crucial to assess the robustness of each model and the overall significance of the observed relationships. Recent studies also confirm that integrating ESG criteria into corporate strategy can improve financial performance and resilience to economic crises, reinforcing the importance of an integrated approach that considers both the financial and social dimensions of corporate performance.

6. Conclusion

In this paper, we empirically investigate the impact of ESG on banking stability, as well as the individual effect of each dimension of ESG (social, environmental, and governance), with particular attention to the moderating role of capital structure. To do this, we chose a mixed sample composed of 18 Islamic banks and 22 conventional banks from 2014 to 2022. Using a hypothetico-deductive approach and a multiple linear regression method, we tested five empirical models. In this study, we aimed to link the concepts of ESG and banking stability, given their growing importance. Our main objective was to address a subject rarely studied in the literature, which is the impact of ESG on the financial stability of conventional and Islamic banks. Specifically, we studied the impact of environmental, social, governance, and economic dimensions on the stability of banks. The results indicate a positive and significant effect of ESG measured by the ESG score on banking stability. For the dimensions of the ESG score, only environmental and governance practices showed a significant positive link with banking stability. However,

the social dimensions did not have a significant effect on this variable.

Our results indicate that Islamic banks are more stable than their conventional counterparts, showing that the Islamic character further favors the positive relationship between ESG and financial stability due to the ethical foundations of Islamic finance. We also found that the financial stability of Islamic and conventional banks in our sample mainly depends on favorable capital structure, particularly the adequacy of equity, and the good management of credit risk represented by the proper management of provisions. Our study sheds light on the essential role of capital structure in moderating the benefits of ESG disclosure, a factor that has not been thoroughly examined in previous studies.

Our results also indicate that ESG (Environmental, Social and Governance) score assessment plays a crucial role in the financial stability of banks, whether Islamic or conventional, in MENA countries. Indeed, banks with good ESG scores are perceived as less risky, which attracts sustainability-conscious investors and builds customer confidence. To maximize these benefits, it is therefore recommended that banks integrate ESG criteria into their governance and operations. This may include adopting responsible lending policies, implementing environmental and social risk management practices, and promoting diversity within their management teams. In addition, developing transparent ESG reporting will enable banks to effectively communicate their performance to their stakeholders. At the same time, regulators should establish incentive frameworks to encourage banks to improve their ESG scores, such as regulatory capital reductions for those that make significant commitments in this area. By adopting such an approach, banks will not only improve their reputation and attractiveness, but also strengthen their long-term financial stability, thereby adapting to the growing expectations of investors and customers in terms of sustainability.

Future studies are encouraged to include a larger sample to increase the generalizability of results and to cover a longer period. Researchers are also encouraged to explore this topic using different ESG measures. Additionally, investigating this subject with a purely Islamic sample, particularly by using a ESG measure specific to Islamic banks that considers the unique characteristics of this sector, would be very interesting.

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الإفصاح البيئي والاجتماعي والحوكمة والاستقرار المالي للبنوك الإسلامية والتقليدية

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المستخلص. كشف تكرار وقوع الأزمات المصرفية والمالية عن تعقيد وضعف النظام المالي والمصرفي التقليدي. في هذه الورقة، نحقق تجريبياً في تأثير الإفصاح البيئي والاجتماعي والحوكمة على استقرار البنوك، فضلًا عن التأثير الفردي لكل بُعد من أبعاد الإفصاح البيئي والاجتماعي والحوكمة، مع التركيز بشكل خاص على الدور الأساسي لهيكل رأس المال. باستخدام عينة مختلطة تتألف من (١٨) مصرفًا إسلاميًا و (٢٢) مصرفًا تقليديًا خلال الفترة ٢٠١٤ إلى عام ٢٠٢٢. تشير النتائج إلى تأثير إيجابي ومهم للإفصاح البيئي والاجتماعي والحوكمة، الذي يقاس بدرجة الإفصاح البيئي والاجتماعي والحوكمة، على استقرار البنوك. ومن بين أبعاد درجة الإفصاح البيئي والاجتماعي والحوكمة، أظهرت الممارسات البيئية والحوكمة فقط ارتباطًا إيجابيًا كبيرًا باستقرار البنوك. ومع ذلك، لم يكن للبعد الاجتماعي تأثير كبير على هذا المتغير. بالإضافة إلى ذلك، تشير نتائج الدراسة إلى أن الطابع الإسلامي يعزز العلاقة الإيجابية بين الإفصاح البيئي والاجتماعي والحوكمة والاستقرار المالي بسبب الأسس الأخلاقية. علاوة على ذلك، فأن الاستقرار المالي للبنوك الإسلامية والتقليدية يعتمد في المقام الأول على هيكل رأس المال، وتحديدًا كفاية حقوق الملكية وإدارة مخاطر الائتمان. تسلط هذه الدراسة الضوء على الدور الأساسي لهيكل رأس المال في تعديل فوائد الإفصاح عن البيانات البيئية والاجتماعية والحوكمة، وهو التأثير الذي لم يتم فحصه على نطاق واسع في الدراسات السابقة.

الكلمات الدَّالة: الإفصاح البيئي والاجتماعي والحوكمة، الاستقرار المالي، البنوك الإسلامية، البنوك التقليدية، الاعتدال، هيكلة رأس المال

تصنيف JEL: C33, B23, G3, G21

تصنيف KAUJIE: B16, L25, H57, H2, A7