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Navigating Market Volatility: ESG and Islamic Stock Performance amidst Covid-19 Stringency

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Abstract

Research Originality: This study examines the relationship between ESG and Islamic stocks under the exceptional circumstances of the COVID-19 pandemic. Researchers included the stock volatility and involved policy stringency, extending the recent literature focusing on accounting-based performance.

Research Objectives: This study examines the relationship between ESG practices and Islamic stock performance during the COVID-19 pandemic.

Research Methods: This study applied panel regression analysis. Researchers used Shariah-compliant stocks with ESG scores ranging from 2020 to 2022, resulting in 96 observations.

Empirical Results: This study posits the ability of Social and Governance practices to reduce market volatility. The stringency of COVID-19 significantly affected stock volatility, highlighting the importance of government intervention during the Pandemic.

Implications: These findings support the need for implementing measures and regulations that incentivize companies to adopt comprehensive ESG practices, which are expected to contribute to stock market stability, particularly during turbulent times.

Keywords:

environment social and governance; Islamic stock market; covid-19; stock return; stock volatility

How to Cite:

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INTRODUCTION

The dominant view of socially responsible companies is that they maximize shareholders' welfare by engaging in environmental, social, and governmental (ESG) activities (McWilliams & Siegel, 2001). This principle is often summarized as "doing good by doing well", meaning that ESG activities benefit shareholder interests while pursuing important social objectives. Many countries, including Indonesia, have incorporated environmental and social concerns into their practices. Indonesia has started implementing ESG sustainability practices and integrated business strategies and regulatory frameworks that address various environmental issues, such as CO2 emissions, energy consumption, energy efficient policies, total waste, and emission reduction policies (Alareeni & Hamdan, 2020).

The consecutive global crises, starting with the subprime mortgage crisis, followed by geopolitical tensions worldwide, have increased the prominence of ESG issues. Recently, the sudden onset of the Covid-19 pandemic has proved to have caused a global economic downturn, including in the capital market (Al-Awadi et al., 2020; Baker et al., 2020; Ashraf et al., 2020; Agustin, 2021). During this circumstance, the notion of a "green recovery" aims to leverage the current situation to promote climate action, implement a circular economy, and shift towards robust social and economic models that can resist disasters and infectious diseases (Taghizadeh-Hesary & Rasoulinezhad, 2023). In other words, the ESG perspective will continue to draw more significant attention in the financial markets due to the prevalent worldwide trend.

Regarding environmental concerns, Islamic Stock has long been present with principles that are in line with the principles of Sustainable Development Goals: to achieve the perfection of sustainable human life. Shariah seeks to create a fair, equitable, and just society to enhance welfare (*maslahah*) and prevent harm (*Mafsadah*) to human well-being. Islamic Stock under Sharia Law compliance provides an alternative – ethical investment for investors with social and ethical concerns. With various screening criteria, it is not surprising that many studies show that Islamic stocks are more resilient than conventional stocks (Asutay et al., 2022). Qoyum (2021) reveals that Sharia-compliant companies in Indonesia and Malaysia have better environmental and social practices. Another strand of studies also suggests that Islamic stocks can be a haven asset in times of economic downturn (Shear & Ashraf, 2022). In Indonesia, Islamic Shariah stock has been awarded several times as the Best Islamic Capital Market in 2022 at the international Global Islamic Finance Award (GIFA). This award is the fourth time Indonesia has received it since 2019. Considering this notable performance, studies on Islamic stocks are interesting to explore, mainly related to ESG practices.

Nonetheless, like numerous other nations, Indonesia's Islamic stock market underwent considerable volatility and changes throughout the pandemic. This market, exemplified by the Indonesia Sharia Stock Index, saw a significant fall in early 2020, reflecting worldwide market sentiments. During the epidemic, the Indonesian Islamic stock market showed volatility, reacting to global market movements, COVID-19 case updates, and economic indicators (Herwany et al., 2021; Agustin, 2021; Utomo et al., 2021). In addition, previous studies argue that the Indonesian Islamic stock market is

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inefficient in a weak form, leading to the detachment of stock prices from their intrinsic value (Agustin, 2019; Mubarok et al., 2020; Wang et al., 2021). Nonetheless, there were intervals of recovery, propelled by factors such as advancements in vaccine research, the relaxation of restrictions, fiscal and monetary policies aimed at stimulating the economy, and an enhanced economic outlook.

Investigating the relationship between financial performance and sustainability values at the company level relies on two major classical theories: Traditional Principal Agency Theory (Jensen & Meckling, 1976) and Stakeholder Theory (Freeman & Philips, 2002). From the perspective of stockholders, the conventional principal-agent theory posits those contemporary enterprises experience agency issues stemming from the division of ownership and managerial rights. In this context, the company's executives function as shareholders and are accountable for the company's business activities. When a company is involved in a project, led by top executives, it means that the company pursues executive interests by leveraging stockholders' costs, resulting in a fall in share returns. This agency theory then extended into trade-off theory (Brammer et al., 2006; Branco & Rodrigues, 2008), which views ESG as an additional cost that may lead to inefficient resource usage and have a negative adverse effect on shareholders' wealth. Hence, the Agency and Trade-off theory argues that ESG and firm value have a negative relationship. This theory is demonstrated by several studies that support this hypothesis (Albuquerque et al., 2020; Lins et al., 2017; Bae et al., 2021; Demers et al., 2021; Ramelli & Wagner, 2020).

Along with the increasing quality of the study on this topic, reman and Phillips (2002) introduced stakeholder theory, asserting that the rationality of diverse stakeholders has been acknowledged mainly by law and expressed in relevant policy frameworks and legal stipulations. Modern enterprises must acknowledge current patterns and refrain from limiting themselves to shareholders' interests. Instead, they have to take responsibility for ESG for the sake of various stakeholders. By fulfilling their obligations to these stakeholders, organizations can establish sustainable and ethical processes that benefit all parties concerned. Consequently, when a corporation undertakes stakeholder management, it will get support from its stakeholders. When a firm demonstrates superior ESG performance, banks and financial institutions enhance their credit ratings and provide advantageous interest rates, lowering the company's debt expenses.

On the other hand, consumers are more likely to increase their investment in companies that have built a positive brand image and social reputation (Christopher et al., 2024). This is particularly valid for consumers who care about the environment and tend to show greater brand loyalty in response to company environmental efforts. Investors like companies have robust scientific management and control competencies alongside consistent income rates that mitigate the risk of losses. This ultimately motivates investors to augment their equity holdings in these companies. An affirmative corporate culture enhances internal employee identification and motivation, augmenting organizational performance. Consequently, ESG performance directly correlates with the company's financial performance, substantially influencing stock returns. This theory is then supported by numerous studies that have proven that ESG practices can improve

company performance (Alareeni & Hamdan, 2020; Bang & Ryu, 2024; Bhaskaran et al., 2021; Bodhanwala & Bodhanwala, 2021; Makhdalena et al., 2023; Qoyum et al., 2021; Yoo & Managi, 2022). In addition, Melinda and Wardhani (2020) revealed that disclosing ESG aspects is important to increase a company's value, resilience, and sustainability. Furthermore, it is widely believed that ESG engagement can boost corporate stocks to be more immune against global shocks since the ESG approach helps the company raise public trust, offering the potential to reduce risk in times of crisis (Ricci et al., 2024; Torre et al., 2020; Zhang et al., 2022; Lemma et al., 2022; Xu et al.,2023).

On the other hand, Lins et al. (2017) noted that the benefits of ESG are not constant over time but are strongly related to the level of public trust in the financial markets and the corporations. These benefits will be higher as public trust rises and vice versa. This is because companies with ESG concerns tend to have better management, which is critical in times of crisis. Another explanation is that stocks with good ESG scores are perfectly consistent with the appetite of investors with social and ethical objectives. This type of investor tends to be more loyal by holding their assets in times of crisis (Siddiq & Javed, 2014). A considerable number of studies have focused on the global financial crisis and revealed that companies with good ESG scores have high stock returns and lower volatility during the turmoil period (Gul & Altuntas, 2024; Horobet et al., 2024; Liu et al., 2023; Naseer et al., 2024; Zhou & Zhou, 2023; Chininga et al., 2024; Engelhardt et al., 2021).

In the context of the COVID-19 pandemic, which has a unique dynamic, it is important to revisit the ESG theory and its relationship with firm performance. More specifically, can ESG performance improve stock resilience in companies that implement ESG? While many previous studies have used accounting-based performance measures (Alareeni & Hamdan, 2020; Bang & Ryu, 2024; Bhaskaran et al., 2021; Bodhanwala & Bodhanwala, 2021; Makhdalena et al., 2023; Qoyum et al., 2021; Yoo & Managi, 2022), or Stock Return to measure Stock performance (Gul & Altuntas, 2024; Horobet et al., 2024; Liu et al., 2023; Naseer et al., 2024; Torre et al., 2022), Researchers added stock volatility as another dimension of stock performance. Additionally, with the rapid development of Islamic stock market capitalization in Indonesia, the focus was on shariah-compliant stocks, which, to the best of researchers' knowledge, have been scarcely studied in this area.

In light of the explanation above, recent studies on the ESG-stock performance nexus still yield mixed results. This condition may be because stock performance can be asymmetric if it is viewed solely based on accounting or return performance. During market turbulence like COVID-19, market performance is also heavily dependent on volatility, which more clearly illustrates the element of risk for investors (Kayani et al., 2024). In addition, the government's spectrum of interventions might lead to different results regarding companies' performance in stock volatility (Tu et al., 2023).

This study is expected to contribute to the recent literature threefold. First, adding stock volatility as a market dimension will provide more valuable information for investors to evaluate market performance during periods of uncertainty, particularly in managing risks during high uncertainty periods. This is imperative because investors tend to shift their perceived risks and appetites during a crisis (Gubareva et al., 2022; Liu et al., 2023) and

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face a new turning point in asset selection and allocation. Second, this study offers more precise insights for ethical investors who are concerned about sustainable and Sharia-compliant investments. By assessing the impact of ESG on stock market performance, investors can evaluate the market durability and resiliency of companies with good ESG performance and shape their portfolio plans. Third, it is widely recognized that COVID-19 is the most complex global health issue, which has triggered economic downturns; companies have focused on maintaining high earnings, resulting in environmental factors becoming a luxury cost for corporations. This situation is exacerbated by the Indonesian government's regulations that restrict activities to minimize the spread of the COVID-19 virus, ultimately harming the country's economy. Hence, determining the COVID-19 stringency as the moderating variable is expected to depict the government intervention during the pandemic in Indonesia. To the best of our knowledge, this is the first study investigating whether government stringency moderates the effect of ESG engagement on the Indonesia Islamic Stock Market.

METHODS

The data was obtained from the Thomson Reuters Database and the Indonesia Stock Exchange (IDX) website. We collected data on Indonesian Sharia Stock Index (ISSI) companies spanning from 2020 to 2022 which covers Covid-19 Pandemic. Since ESG reporting is still voluntary, not all companies have ESG performance data in the Thompson Reuters database. The following are the criteria for sample selection in this study. First, the company has completed financial reports and is consistently indexed on the ISSI during the COVID-19 period (2020-2022); Second, the company has completed ESG performance values in the Thompson Reuters database. Due to the limited ESG performance scores in the Thompson Reuters database, 32 companies were selected for analysis based on these criteria.

Table 1. Data and Variable Measurement

Variable	Formula	References	Source
Dependent Stock Return Stock Volatility	$Return = Ln\left(\frac{Price_{i,t}}{Price_{i,t-1}}\right)$ $Volatility = STD(Return) \times \sqrt{252}$	Erdem (2020); Schwert (2002)	Thompson Reuters Database (Refinitiv)
Independent ESG Scores	ESG Score as provided by Thompson Reuters Database (Refinitiv).	Gillan et al., (2021)	Thompson Reuters Database (Refinitiv)
Moderating Variable Covid-19 Stringency	The Government stringency Index	Hersh et al, (2023)	OurWorldindata.org
Control Variables ROE Firm Size	$ROE = ROA \times \frac{Asset}{Equity}$ $Size = Ln\,(Total\ Asset)$	(Cho & Tsang, 2020; Van Beurden & Gossling, 2008)	Thompson Reauters Database (Refinitiv)
ROA	$\frac{Net\ Income}{Total\ Assets}$		
Leverage	$\frac{Total\ Debt}{EBITDA}$		

Source: Authors (2024).

This study employed panel regression estimations using STATA software with the following model specification.

$$Return_{i,t} = \propto_0 + \propto_1 Covid_{i,t} + \propto_2 ESG_{i,t} + \propto_3 Covid_{i,t} * ESG_{i,t} + \propto_4 X_{i,t} + \delta_i + \mu_{i,t} \quad (1)$$

$$Volatility_{i,t} = \propto_0 + \propto_1 Covid_{e,t} + \propto_2 ESG_{i,t} + \propto_3 Covid_{i,t} * ESG_{i,t} + \propto_4 X_{i,t} + \delta_i + \mu_{i,t} \quad (2)$$

Where:

Remarks: $\boldsymbol{R_{i,t}}$ is the annual stock return for each company; $\boldsymbol{Vol_{i,t}}$ a measurement of volatility in annual stocks in the Indonesia Sharia Stock Index (ISSI). $\boldsymbol{ESG_{i,t}}$ is the ESG Scores aggregate taken from Thompson Reuters Database. **Covid** represent the stringency index during the Covid-19 pandemic taken from OurWorldInData. **Xi,t** is a vector of corporate-specific control variables, consists of firm size, leverage, Return on Asset and Return on Equity. The control variables respresents the financial ratio which can affect the company's financial performance (Cho & Tsang, 2020; Van Beurden & Gossling, 2008). In the regression analysis, the aggregate ESG scores and the E, S, and G scores from Thomson reuters are added sequentially to replace the aggregate ESG scores.

RESULT AND DISCUSSION

Table 2 shows the statistical descriptions of each variable. In the stock return variable, the mean is positive, but it shows a negative median, which means that during the Covid-19 period, more than 50% of companies experienced an average return that was negative. From the perspective of volatility, a small difference between the median and mean values indicates that the overall trend has a similar volatility tendency. The E, S, G, ESG scores respectively indicate the performance score of each pillar based on the Thomson Reuters database. Among the three pillars, the social pillar has the highest average value, with the lowest standard deviation. Meanwhile, the environmental pillar has the lowest average value.

Table 2. Descriptive Statistics

	Mean	Median	Maximum	Minimum	Standard Deviation
Stock Return	0.09828	-0.08727	4.60284	-0.69715	0.65914
Volatility	0.02892	0.02810	0.04820	0.01270	0.00887
E	48.07853	49.68848	87.17503	0.12097	22.76179
S	59.62186	59.37455	96.01648	20.91628	18.33597
G	54.33620	56.50458	94.01335	2.97733	23.38589
ESG	54.33620	55.32329	87.80243	17.31286	16.98901
Firm Size	31.53358	31.41728	33.65519	29.38026	0.92196
COVID_19	49.89333	66.69000	68.06000	14.93000	24.85895
ROA	0.09820	0.06225	1.06212	-0.18581	0.16464
ROE	0.19862	0.11950	1.74400	-0.75000	0.33696
Leverage	0.44875	0.41733	0.96131	0.11207	0.20577

Source : Author's Calculation (2024)

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Table 3. Pearson Correlation Analysis

Variable	Stock Return	Stock Volatility	E	S	G	ESG	Covid-19	Firm Size	Leverage	ROA	ROE
Stock Return	1.000000										
Stock Volatility	0.071042	1.000000									
E	0.053911*	-0.182798*	1.000000								
S	0.153629	-0.061372**	0.642838***	1.000000							
G	0.142979	-0.079147**	0.487172***	0.586293***	1.000000						
ESG	0.131104	-0.071218	0.815139***	0.868277***	0.828125***	1.000000					
Covid-19	-0.145699	0.455556***	-0.126959	-0.105660	-0.102068	-0.144048	1.000000				
Firm Size	-0.083381	-0.259155***	0.125666	0.072498	-0.230925***	-0.004957	-0.082525	1.000000			
Leverage	0.127805	0.184846*	-0.028554	0.028757	0.104024	0.044456	0.103565	0.098474	1.000000		
ROA	-0.030831	-0.258409***	0.270922**	0.205313*	0.187856***	0.270307*	-0.147096	-0.180145***	-0.245846	1.000000	
ROE	0.099213	-0.115649	0.306063**	0.234870**	0.210390***	0.307125*	-0.165036	-0.229784***	0.280861	0.40082***	1.000000

Source: Author's calculation (2024)

Table 4. Regression Results for stock return and Stock Volatility

Variables	(1a)	(1b)	(1c)	(1d)	(2a)	(2b)	(2c)	(2d)
	Stock Return				Stock Volatility			
ENVIRONMENT	0.000792				-0.000803			
	(0.007711)				(-0.000841)			
SOCIAL		0.013667				-0.000188*		
		(0.009164)				(0.000103)		
GOVERNANCE			0.002838				-0.000220***	
			(0.007414)				(-0.000072)	
ESG				0.005369				-0.000286***
				(0.010700)				(0.000103)
E*COVID	-0.000065				-0.000002*			
	(0.000126)				(0.000001)			
S*COVID		-0.000139				-0.000003*		
		(0.000155)				(0.000002)		
G*COVID			-0.000003				-0.000004***	
			(0.007414)				(0.000001)	
ESG*COVID				-0.000002				-0.000005***
				(0.000177)				(-3.271755)
FIRM SIZE	-0.094901	-0.106050	-0.065590	-0.090225	-0.002686	-0.002992	-0.002611	-0.002923
	(0.083243)	(0.078554)	(0.082433)	(0.080493)	(0.000907)***	(0.000879)***	(0.000905)***	(0.000885)***
ROA	-0.287157	-0.376379	-0.302442	-0.354869	-0.008004	-0.009654	-0.009790	-0.009838
	(0.522777)	(0.502560)	(0.522488)	(0.526184)	(0.005698)	(0.005622)*	(0.005378)*	(0.005369)*
ROE	0.029344	0.004750	0.063772	0.022246	-0.003134	-0.003768	-0.003926	-0.003710
	(0.271556)	(0.262030)	(0.272705)	(0.27007)	(0.002960)	(0.002931)	(0.002706)	(0.002663)
Covid-19 Stringency	-0.007658	0.004136	-0.004396	-0.004288	0.000243	0.000332	0.000345	0.000435
	(0.006925)	(0.009844)	(0.007641)	(0.010494)	(0.0000755)***	(0.000110)***	(0.0000718)***	(0.0000968)***
Leverage	0.399998	0.353879	0.341974	0.349257	0.009693	0.008804	0.008587	0.008593
	(0.428664)	(0.417891)	(0.444895)	(0.436192)	(0.004673)**	(0.004675)*	(0.004684)*	(0.004581)*
Industry Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	3.163682	2.647021	2.063043	2.677901	0.102280	0.104394	0.091298	0.097111
	(0.029722)	(2480486)	(2.699881)	(2.580835)	(0.028151)***	(0.027748)***	(0.029481)***	(0.028217)***
R-Squared	0.064358	0.090132	0.065945	0.071245	0.372061	0.371873	0.409869	0.409297

Note: Standard error in parentheses; *indicate significance at 10% level, ** indicate significance at 5% level, *** indicate significance at 1% le

As provided in Table 3, Pearson correlation values were used to see the relationship between variables and detect potential multicollinearity problems. Some of the correlations between E, S, G, Combined ESG Scores, Covid-19 Stringency, Stock return, and Stock volatility show a significant value, which indicates a correlation between the independent and dependent variables in this study. Meanwhile, the correlation between independent and control variables also shows significant results at the 5% level. However, the correlation coefficient value is still below the threshold of 0.7, indicating no potential multicollinearity is detected.

Table 4 shows the regression test results for the two specified models. In addition to using firm size, ROA, and ROE as control variables, the regression model is also controlled by firm and industry effects. Regression (1a), (1b), (1c), and (1d) are fractions of (1), which show the relationship between each aspect, namely Environment, Social, Governance, and Aggregate ESG score on Stock Return. The individual E, S, and G aspects and the combined ESG scores have insignificant influence on stock return. This result indicates that implementing ESG in Islamic companies in Indonesia is insufficient to enhance stock returns. This condition is reflected in all aspects, namely the Environment, Social, and Governance, as well as their combined score.

Likewise, regression (2a), (2b), (2c), and (2d), which are breakdowns from equation (2), show the influence of each aspect on stock volatility. The results show that all aspects, including the ESG combined score, have a negative impact on stock volatility. The negative coefficients signify the role of each ESG Aspect in reducing stock volatility. Among the three aspects, governance plays a significant role since it has the strongest impact on stock volatility, which is reflected by the highest coefficient. The significant influence of the ESG combined score and the high coefficient indicates that combining all three aspects will strongly affect market volatility.

Descriptive statistics in Table 2 show that the ESG score still has a low average score. Thus, this score is insufficient to affect the stock return significantly. In addition, during the pandemic, Islamic stock performance in Indonesia declined, resembling the global stock market. Financial instability in a crisis also makes investors risk-averse rather than pursuing high returns. Since market prices rely on supply and demand, liquidity decreases, followed by a significant decline in stock returns (Agustin, 2021). This finding supports the study by Behl et al. (2022) and Li and Guo (2023), which found that ESG does not significantly affect stock returns and firm value. Patel (2021) argued that when investing in ESG stocks, investors expect lower short-term returns and higher returns in the long term. Azmi (2021), through his study, found a possible U-shaped relationship between ESG and stock return in emerging countries where ESG scores are still at low levels.

In the relationship between ESG scores and volatility, there is a significant influence between Social, Governance, and ESG combined scores on volatility. These three variables have a negative impact, which means that ESG practices on Islamic companies were able to lower stock price volatility during the COVID-19 pandemic. This result aligns with

the study by Liu et al. (2023) and Zhou and Zhou (2022), which stated that ESG scores can impact stock volatility with lower risk in their respective countries. The coefficient value shows that the ESG combined score has the most significant role in lowering the volatility level, implying the importance of applying all three pillars to result in lower volatility. This result confirms Lins et al. (2017), which emphasized that ESG practice can enhance public trust and social image, which is important for financial stability, particularly during turbulent times such as the COVID-19 pandemic.

Further, while Covid-19 stringency has a significant effect on volatility, it was also found that the interaction between Covid-19 Stringency and ESG disclosure positively influences stock volatility. This result is in line with a study by Liu et al. (2023) and Hersh et al. (2023), which demonstrate the importance of government regulations as an immunizer for stock market performance, particularly in reducing market volatility. A study by Agustin (2021) also shows that implementing large-scale social restrictions in Indonesia negatively impacted Islamic stock performance. Government intervention, measured by Covid-19 stringency, describes the government's strategic response to the pandemic. This response might lead to a positive or negative impact on economic activity. A high level of stringency is believed to reduce COVID-19 cases, which will boost public confidence, channel positive sentiment, and reduce uncertainty among market participants. Other opinions state that lockdown restricts all economic activities, including corporate operational activities, ultimately leading to a fundamental downturn in corporate performance. In addition, amidst the uncertainty of the pandemic, the level of stringency signals to investors that the covid case is deteriorating, which can generate negative sentiment, causing stock market conditions to be more volatile. This study confirms the later argument, which suggests that the higher the stringency rate, the more volatile the stock market conditions will be. These results confirm that ESG practices in companies need to be accompanied by dynamic interaction with government regulations.

This study enhances the theoretical understanding of the relationship between stock volatility and ESG performance. It provides empirical evidence and insights into how ESG disclosure can impact risk management during the highly volatile period, building upon existing theories such as agency, stakeholder, and market-based theories. In addition, the result contributes to the development of ethical investment by concentrating on Shariah compliance stocks. Further, this study suggests that authorities and regulatory entities should enact regulations that incentivize corporations to embrace and openly disclose comprehensive environmental, social, and governance (ESG) practices. According to findings, incorporating Social and Governance aspects can reduce stock volatility, particularly in times of crisis such as the COVID-19 epidemic. Therefore, boosting Environmental, Social, and Governance (ESG) practices can enhance the overall stability of financial markets. Policymakers should prioritize the explicit integration of ESG criteria into Shariah compliance rules. By linking Islamic finance principles with worldwide trends in sustainable and ethical investing, this integration can potentially increase the attractiveness of Islamic stocks.

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CONCLUSION

As the massive growth of ESG practices is believed to improve firm performance, the Black Swan event of the COVID-19 pandemic raises new questions about whether ESG can improve company resilience. This study has three main findings. First, partial and aggregate ESG scores have no significant impact on Indonesia's return on Islamic stock. Second, the combined Social, Governance, and ESG scores significantly negatively impact stock price volatility. Third, COVID-19 stringency significantly impacts volatility, which shows the importance of government intervention in dealing with the pandemic, particularly regarding the implementation of social and economic restrictions. The insignificant relationship between ESG score and stock return is mainly due to the significant decline in the movement of stock return during the COVID-19 period. However, ESG practices in companies can reduce the level of risk in the stock market.

The results also emphasize that ESG information is crucial for companies and governments as regulators. Governments and related departments should establish an ESG disclosure system in Indonesia and improve the information guidelines of public companies. Promoting the integration of Environmental, Social, and Governance (ESG) principles within Shariah-compliant stocks will help to reduce stock market volatility, especially in times of crisis like the COVID-19 pandemic. Policies encouraging ESG adoption among Islamic stocks can enhance market stability and investor confidence. In addition, Governments and market regulators should consider introducing incentives for companies to adopt robust ESG frameworks. Tax incentives, subsidies, or favorable listing conditions for companies with higher ESG scores can motivate businesses to engage in sustainable practices. This condition includes setting clear guidelines for transparency, ethical business practices, and strong internal controls. By fostering better corporate governance, companies will likely be more resilient during crises, reducing overall stock market instability.

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