



## **DETERMINANTS OF ISLAMIC BANKS PERFORMANCE USING THE MAQASID AS SHARIAH: A CASE STUDY OF INDONESIA**

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### **ABSTRACT**

Islamic banks are financial institutions that operate according to Sharia rules and primarily provide financing and other services. As a financial intermediary entity, Islamic banks gather and distribute funds from and to the public in accordance with Sharia rules. Islamic banking focuses on Sharī'ah aims and operates with interest-free transaction rates, distinguishing it from traditional banking models. Upon reviewing the aforementioned plethora of research papers, the study concludes that relatively few studies have tackled the determinants of Islamic Banks' financial, ethical, social, economic, and environmental performance. This study used the Maqasid As-Shariah index to investigate the factors that influence Islamic bank performance. The study concludes that the main determinants of Islamic bank performance using Maqasid As-Shariah in Indonesia are GDP, political civil liberties index, and human development index, thus all variables have significant effect on Islamic Bank performance at 5% level of significance. However, this study found that the financial development index was insignificant, making it an unimportant component to examine Islamic Bank performance using Maqasid as Shariah in Indonesia.

**Keywords:** Islamic bank; performance; maqasid shariah; Indonesia

## INTRODUCTION

Islamic banks are financial institutions that operate according to Sharia rules and primarily provide financing and other services. As a financial intermediary entity, Islamic banks gather and distribute funds from and to the public in accordance with Sharia rules. Islamic banking focuses on Sharī'ah aims and operates with interest-free transaction rates, distinguishing it from traditional banking models. When compared to traditional banking, Islamic banking is anticipated to provide superior financial and non-financial services (Kasmir, 2015). This demonstrates that the presence of Islamic banking has provided a breath of new air to the banking industry and the contemporary economy.

The sharia-based financial business is likewise in high demand, both among Muslims and non-Muslims. Sharia finance industry implementation is based on Islamic sharia principles and must adhere to sharia standards. The Islamic finance and banking industry has earned widespread trust and support, particularly since Islamic banking's success during the 2008 economic crisis. According to global finance magazine news, the Islamic banking sector achieved a higher return on assets in 2023, rising to 1.8% from 1.6% in 2022. Last year, Islamic banks' balance sheets expanded by about 8%, slightly less than the previous year's increase but still higher than conventional banks' asset growth. The general health of Islamic banks remains strong, with an average capital to risk-weighted assets ratio of 19% and a nonperforming loan ratio of roughly 3% (Darren Stabing, 2024).

To gain stakeholders' faith in the funds in which they participate, Islamic banking development must be balanced with strong performance (Makrufflis, 2019). Thus, performance is a crucial goal for every organization to achieve because it represents the company's capacity to manage and deploy its resources. By measuring performance, Islamic banks can see how much success they have achieved over a given period of time (Sebtianita and Khasanah 2016). Indonesia is anticipated to outperform other Islamic banks worldwide, given that it is home to the world's largest Muslim population. However, the data indicates that Al Rajhi Bank continued to hold its position as the world's strongest Islamic bank in 2023, as determined by an evaluation of balance sheets. Six categories of balance sheet financial performance are used to evaluate the banks. When compared to their Asian counterparts, the Islamic banks in the Middle East demonstrated larger scale and profitability. The strongest Islamic banks overall are found in

Saudi Arabia and Kuwait, where they exhibit remarkable capitalization, liquidity, and profitability metrics. Pakistan's Islamic banks demonstrated the strongest financial standing among Asian banks, driven by remarkable growth, profitability, and liquidity on their balance sheets (Darren Stabing, 2024) global finance magazine news.

Numerous studies have been carried out to identify the variables that impact Indonesian Islamic banks' performance and prevent them from outperforming other Islamic banks worldwide. According to Ahmad Badawi's 2017 research, Indonesian Islamic banks' performance is significantly impacted negatively by the BOPO variable, but not significantly by the NOM or NPL variables. Additionally, the study by Rahman, t., & Santos, A. (2019) found that while good corporate governance does not significantly affect Islamic bank performance, capital adequacy ratio has a negative and significant impact on the latter. Additionally, Mergaliyev A. et al. (2021) draw the conclusion that the disclosure of Islamic Bank performance in Indonesia is positively impacted by the CEO duality, leverage variables, Shari'ah governance, and Muslim population indicator.

Furthermore, Muwazir, Mohd. et al. (2020) discovered that, according to the Impulse Response Function results, the shock that affects the liquidity variables CR, LR, FDR, and CAR will affect ROE financial performance more than ROA and will take approximately 45 months to manifest. Subsequently, the Variance Decomposition results show that, with a contribution of 4.71% to ROA, the CR and LR variables have the largest impact, and, with a contribution of 20.21% to ROE, the CAR and LR variables have the largest impact. Additionally, Amarah, S., & Masturin, M. (2018) found that risk-taking behaviour has a negative impact on Islamic Bank performance, but profit-sharing financing has a positive influence. Cost effectiveness, however, has no bearing on maqasid shariah-based performance.

Despite the fact that much of the research on the determinants of Islamic bank performance in Indonesia has focused more on the financial performance of Islamic banks. Therefore, this study examines the primary determinants (social, economic, financial, and political factors) and their effects on Islamic banks' performance in light of Maqasid as Shariah principles.

## LITERATURE REVIEW

*There are numerous studies that evaluate the performance of Islamic banks. The following is a summary of some of the studies that looked at the variables affecting Islamic bank performance:*

Using the Maqasid Sharia Index (MSI), which was created expressly to evaluate Islamic bank performance in compliance with Maqasid sharia principles, Nastiti, A.S. (2023) examined the variables impacting the performance of Islamic banks in Indonesia. The sample was created using 57 data points that were acquired between 2016 and 2020 from 12 Islamic commercial banks that were registered with the Financial Services Authority. Multiple linear regression was used in the study's quantitative approach to data analysis. The findings showed that Islamic corporate governance had a noticeably positive effect on MSI, while temporary shirkah funds and Islamic intellectual capital had a significant negative impact.

Taufik, M., et al. (2023) investigated the relationship between the features of the sharia supervisory board (SSB) and the Maqashid sharia performance (MSP) of Islamic Banks (IBs), as well as the effects of MSP on PSIAHs and profitability. Panel data regression is used to analyse the IBs' annual reports from 2010 to 2018 in Indonesia and Malaysia. The results indicate that in Indonesia, MSP is attenuated by SSB education level, with only minor effects from other characteristics. However, in Malaysia, MSP is reinforced by SSB reputation, size, and education while other factors are ineffective. Because MSP is pseudo-Islamic in both nations, their clientele disregards religion. However, because sharia assurance is more transparent in Malaysia, MSPs there can increase profitability; in contrast, because sharia assurance is less transparent in Indonesia, MSPs there are unable to do so.

The ethical, social, environmental, and financial performance of Islamic banks was assessed by Mergaliyev A. et al. in 2021. The main factors that influence maqasid performance as demonstrated by disclosure analysis are also examined in this study. Panel data analysis is used to identify the primary determinants of the maqasid disclosure performance. A number of important variables are included, along with aspects related to corporate and Shari'ah governance, ownership structures, and the political and socioeconomic environment. 33 fully operational Islamic banks from 12 different countries are included in the sample for the years 2008–2016. The results demonstrate that the disclosure of maqasid performance is positively impacted by the CEO duality,

leverage variables, Shari'ah governance, and Muslim population indicator. Nonetheless, the country's political and civil rights, institutional ownership, GDP, financial development, and human development index, as well as a larger percentage of independent directors, all have a detrimental overall effect on the maqasid performance.

The study by Utami, S. A. et al. from 2021 determined the effect of good corporate governance implementation on the Sharia Maqashid Index of Indonesia's Islamic banking industry. This study used a saturated sample approach, utilizing a sample of thirteen Indonesian Islamic Commercial Banks. An explanatory method using a quantitative approach was employed in this study. The Sharia Maqashid Index was significantly impacted by good corporate governance, according to the findings. To boost the performance of Islamic banking, a plan is required, as the Sharia Maqashid Index in Islamic Commercial Banks has not seen a notable rise.

Also, Amarah, S., and Masturin, M. (2018) investigated the factors that influence Islamic banks in Indonesia's maqasid, or shariah-based, performance. The information was taken from Indonesia's Islamic banks' publicly available annual audited reports for the years 2014–2017. Multiple linear regression analysis and correlation were used in this study to investigate the suggested hypotheses. The Maqasid Index served as a proxy for the Maqasid Shariah-based performance. The following variables are suggested to be indicators of maqasid shariah-based performance: risk-taking tendencies, cost effectiveness, and profit-loss sharing financing. The study's findings indicate that while risk-taking behavior has a negative effect, profit-sharing financing has a positive influence on maqasid shariah-based performance. Maqasid shariah-based performance is unaffected by cost effectiveness.

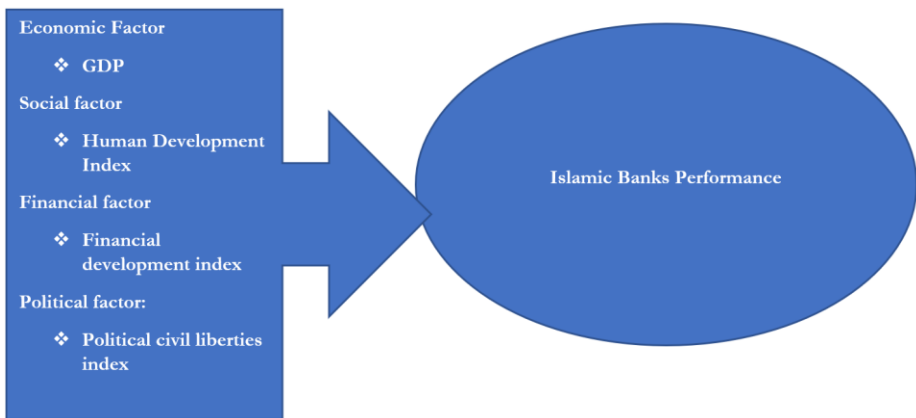
The practice of Maqasid al-Shari'ah based performance measures, factors influencing its effective implementation, and its effect on Islamic banks' performance were all investigated in the study by Mohamad, M.H. et al. (2016). All 16 of Malaysia's Islamic commercial banks' business units received 146 questionnaires. The study discovered that, despite modern skepticism, Islamic banks in Malaysia are actively working to advance and demonstrate their commitment to achieving Maqasid al-Shari'ah by putting the necessary performance measures in place. In particular, the study discovered that Islamic banks frequently employ performance metrics for justice and the public interest.

The use of Maqasid al-Shari'ah based performance measures as an Islamic bank's performance driver becomes more potent with the advancement of communication technology and regulatory compliance.

In a study published in 2015, Gazdar, K., and Grassa, R. examined the factors that contributed to the Islamic financial sector's explosive expansion in the Gulf Cooperation Council (GCC) region. The study covered five GCC nations between 1996 and 2010: Saudi Arabia, the United Arab Emirates, Bahrain, Qatar, and Kuwait. The results of panel data analysis under fixed and random effects specifications indicate that, while the institutional environment is not a good predictor of the promotion of the Islamic bank, macroeconomic factors like per capita income, economic openness, population, and oil revenues are important determinants of Islamic banking in the GCC region. The report also shows that the events of September 11th have an impact on the expansion of Islamic banks.

### ***Research gap***

Upon reviewing the aforementioned plethora of research papers, the study concludes that relatively few studies have tackled the determinants of Islamic Banks' financial, ethical, social, economic, and environmental performance. These determinants are crucially framed within the framework of Islamic finance by Maqasid al-hari'ah, and they encompass both the institutional or socio-political context and organizational features. Their study focused more on panel regression model. Therefore, this research aims to bridge this gap by examining the primary determinants (social, economic, financial and political factors) and their effects on Islamic banks performance in light of Maqasid as Shariah principles using Multiple linear regression model.



**Figure 1:** Conceptual framework for the study variables

## RESEARCH METHODOLOGY

### Introduction

Time series analysis of the data was done in the study using the EViews Econometric package. Techniques for time series analysis were employed to examine the variables. These techniques include Multiple linear regression model and its assumptions.

### Data source

Secondary data from the UNDP website, the IMF, the annual reports of Indonesia's 11 Islamic banks, and the World Bank for the years 2013–2023 were used in this study.

**Table 1:** The Islamic Banks used in this study

BANKS
PT. Bank Muamalat Indonesia
PT. Maybank Syariah Indonesia
PT. Bank Central Asia Syariah
PT. Bank Mega Syariah
PT. Bank Rakyat Indonesia Syariah
PT. Bank Panin Syariah
PT. Bank Syariah Bukopin

PT. Bank Negara Indonesia Syariah

PT. Bank Syariah Mandiri

PT. Bank Victoria Syariah

## Variable's description

### Dependent Variable

Islamic Bank Performance: Compared to traditional perspectives on evaluating financial institutions' performance, which primarily rely on financial and economic measures, a performance perspective in accordance with Maqasid As-Shariah is multifaceted and encompasses a broader range of objectives with the aim of augmenting and maintaining the welfare of individuals and communities Bedoui, H. E., & Mansour, W. (2015). As a result, in order to gauge the success of Islamic banks, the study employed Maqasid, a shariah index that Abu Zaharah described, as a proxy. The goals of sharia, as determined by Abu Zaharah, are educating people), preserving justice, and increasing wealth, as stated in Mohammed, M. O., Tarique, K. M., & Islam, R. (2015). These objectives are elaborated in the sharia Maqasid index. The following are the dimensions, elements, and ratios apply to each objective:

**Table 2:** The dimensions, elements and ratio of each objective

No	Objectives	Dimension	Element	Ratio
1	Educate individuals ( <i>tahdhib al-fard</i> )	D1. Progress of knowledge	E1. Education grant	R1. Education grants / total costs
			E2. Research	R2. Research costs / total costs
		D2. Increased expertise	E3. Training	R3. Training costs / total costs
		D3. Increased awareness of Islamic banks	E4. Publication or promotion	R4. Publication or promotion costs / total costs
2	Uphold justice ( <i>iqamah al-adl</i> )	D4. Fair return	E5. Fair return	R5. Net income / total income
		D5. Affordable services & products	E6. Distribution function	R6. <i>Mudharabah</i> & <i>musyarakah</i> / total financing
		D6. Removal of negative elements (injustice)	E7. Products without interest	R7. Interest-free income / total income
3	Increasing Welfare ( <i>jaib al-maslahah</i> )	D7. Bank profitability	E8. Profit ratio	R8. Net income / total assets
		D8. Distribution of income and welfare	E9. Income transfer	R9. <i>Zakat</i> paid / net income
		D9. Investment in the real sector	E10. Real sector investment ratio	R10. Total real sector / total financing

Source: Mohammed, Razak & Taib (2008)



Using the simple additive weighting method, each of these above objectives is developed to become the Maqasid shariah index.

### Simple additive weighting

It's one technique for resolving multi-attribute decision problems. The system attempted to find a weighted total of how well each alternative performed across all alternative criteria. As a result, Maqasid As-Shariah indicator obtained by adding up all of the ratios and applying the weight assigned by the global shariah expert. For this reason, in order to maximize the outcomes of measuring each of these ratios, the model will be verified and weighted for each objective and component. Below is a summary of the average weights assigned to each goal and element:

**Table 3:** The variable weight and element weight according to Mohamed, Razak & Talib (2008).

No	Objectives	Variable Weight	Element	Element Weight
1	Educate individuals ( <i>tahdhib al-fard</i> )	0.30	E1. Education grant	0.24
			E2. Research	0.27
			E3. Training	0.26
			E4. Publication	0.23
			Total	1
2	Uphold justice ( <i>iqamah al-adi</i> )	0.41	E1. Fair return	0.30
			E2. Distribution function	0.32
			E3. Products without interest	0.38
			Total	1
3	Increasing Welfare ( <i>jaib al-maslahah</i> )	0.29	E1. Profit ratio	0.33
			E2. Income transfer	0.30
			E3. Real sector investment ratio	0.37
			Total	1

Source: Mohammed, Razak & Taib (2008)

The following are the formular for SAW to calculate Maqasid As-Shariah:

For performance indicator 1: educate individual

$$IK1 = W_1^1 (E_1 \times R_1 + E_2 \times R_2 + E_3 \times R_3 + E_4 \times R_4)$$

For performance indicator 2: uphold just

$$IK2 = W_2^2 \times E_5 \times R_5$$

For performance indicator 2: increasing welfare

$$IK3 = W_3^3 (E_6 \times R_6 + E_7 \times R_7 + E_8 \times R_8)$$

Where, W- show variable weight, E- represent the weight for element and R represent ratio. Therefore, the three performance indicators combined yield the final results.

### Independent Variables

**Table 4:** Independent variables used in this study and the source of their data:

<i>Variables</i>	<i>Data source</i>
<b>Human Development Index</b>	UNDP website
<b>Growth Domestic Product</b>	World Bank
<b>Political civil liberties index</b>	World Bank
<b>Financial development index</b>	IMF

### Multiple Linear Regression Model

Since the response variable is a continuous variable and there are multiple independent variables, this study employed this model to analyse the impact of human development index, growth domestic product, political civil liberties index and financial development index on Islamic Bank performance. This model makes assumptions that must be met in order to produce meaningful results, including linearity, multicollinearity, heteroskedasticity, and normality.

### Formular for the model

Islamic Bank performance (MSI) =  $\beta_0 + \beta_1$  human development index +  $\beta_2$  growth domestic product +  $\beta_3$  political civil liberties index +  $\beta_4$  financial development index +  $\epsilon_0$ .

Where by:  $\beta_0, \beta_1, \beta_2, \beta_3,$  and  $\beta_4$  are regression coefficients

## RESULTS, DISCUSSION AND CONCLUSION

### Assumptions

#### 1. Linearity

Ramsey Reset test used to check the linearity of the data. Table 5 shows that the data are linear in parameters since the p-value is 0.3378, which is greater than 0.05, implying that the null hypothesis of linearity is accepted at the 5% level of significance.

**Table 5:** The Linearity Assumption Output

	Value	df	Probability
t-statistic	1.087899	4	0.3378
F-statistic	1.183524	(1, 4)	0.3378
Likelihood ratio	2.591907	1	0.1074

#### 2. Multicollinearity

Table 6 displays the results for the multicollinearity assumption; as the VIF value is less than 10 and the tolerance score is 0.2, the assumption was met, indicating that there was no multicollinearity in the data.

**Table 6:** The VIF Value

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
GDP	1.29E-06	9.848472	1.882619
HDI	0.211421	15742.25	2.841150
POLITICAL_CIVIL_L...	0.006270	548.0594	2.757952
FINANCIAL_DEVEL...	0.424546	8173.043	2.295082
C	0.118148	17741.73	NA

### 3. Heteroskedasticity

Heteroskedasticity is tested using the Breusch Pagan Godfrey test, where the null hypothesis states that there is no heteroscedasticity. The null hypothesis is accepted because the p-value of 0.1945 indicates that the variance of the residuals is not heteroskedastic and is greater than the 0.05 level of significance.

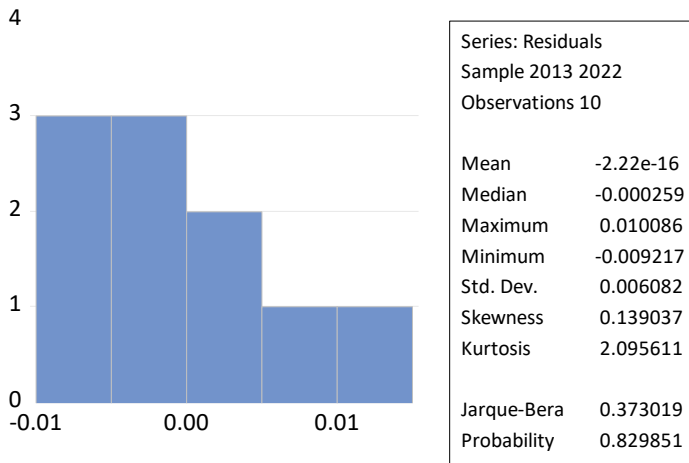
**Table 7:** The Heteroskedasticity Output

Heteroskedasticity Test: Breusch-Pagan-Godfrey  
Null hypothesis: Homoskedasticity

F-statistic	1.925095	Prob. F(4,5)	0.2447
Obs*R-squared	6.063110	Prob. Chi-Square(4)	0.1945
Scaled explained SS	0.830351	Prob. Chi-Square(4)	0.9343

### 4. Normality

The diagram below shows that the p-value is 0.82985, which is greater than 0.05, indicating that the assumption that the data are normally distributed was accepted at the 5% level of significance, implying that the assumption was met.



**Figure 2:** Output Diagram of this study

## Model output and discussion

### 1. Impact of human development Index on Islamic Bank performance

The human development index has a coefficient value of 2.034, which means that for every unity increase in the human development index, Islamic bank performance increases by 2.034 units, assuming all other variables in the model remain constant. Since the human development index measures a variety of variables such as education, health, and income, this implying that a more developed society with higher levels of education, better healthcare, and increased income may provide a favourable environment for Islamic banks to thrive and perform well. However, this result is in contrast to the research conducted by Arman. M., et al., (2021), revealed that human development index is negatively affect Maqasid performance of Islamic Banks.

### 2. Impact of Growth domestic product on Islamic Bank performance

Table 4 below show that there is a statistically significant positive link between GDP and Islamic bank performance, as the coefficient value for GDP is 0.00296 and the p value is 0.047, which is less than 0.05 at 5%. As a result, the study concludes that a unity increase in GDP will have a 0.00296 impact on Islamic Bank performance. This study relates with the study conducted by Abdul Hamzah Shaikh & Siew Chun Hong, (2015) observed that GDP has significant

and positive impact on financial performance of Islamic banks. However, this study is in contrast with the study conducted by Mergaliyev. A. et al. (2021).

### 3. Impact of political civil liberties index on Islamic Bank performance

The table 4 below show that the coefficient value of the political civil liberties index is 0.2699, implying that any unity increase in the political civil liberties index will boost Islamic Bank performance by 0.2699 units. This effect is statistically significant at 5% because the p-value is 0.0191, which is less than 0.05. Furthermore, this finding shows that any environment that promotes political civil rights may improve Islamic banks' ethical conduct and performance. For example, political liberties can encourage greater stakeholder engagement and participation in decision-making processes, as when individuals have the freedom to express their opinions and participate in the democratic process, Islamic banks may be more responsive to stakeholder needs and preferences, potentially leading to improved performance. This study is in contrast with the study conducted by Mergaliyev A. et al. (2021).

### 4. Impact of Financial development Index on Islamic Bank performance

The coefficient value of financial development index is -0.5406 this reveals that there is negative relationship between financial development index and Islamic Bank performance. But this relationship between financial development index and Islamic Bank performance is insignificant since the p- value is 0.444 which is higher than 0.05 at 5% level of significant. This study is in line to the study conducted by Mergaliyev A. et al., (2021).

**Table 8:** The Model Output

Variables	Coefficients	P-value
GDP	0.002968	0.0476
HDI	2.03446	0.0069
Financial_Development_Index	-0.5406	0.4444
Political_civil_lib_index	0.2699	0.0291

## CONCLUSION

This study used the Maqasid As-Shariah index to investigate the factors that influence Islamic bank performance. The study concludes that the main determinants of Islamic bank performance using Maqasid As-Shariah in Indonesia are GDP, political civil liberties index, and human development index, thus all variables have significant effect on Islamic Bank performance at 5% level of significance. However, this study found that the financial development index was insignificant, making it an unimportant component to examine Islamic Bank performance using Maqasid as Shariah in Indonesia. Also, the report recommends that banks should match their business plans to the nations' economic expansion, for example, by making investments in industries that generate a sizable portion of the GDP or by offering financial services that promote economic growth. Additionally, the study indicated that banks should support initiatives that uphold democratic values like accountability, transparency, and involvement in the decision-making process in order to advocate for policies that support civil liberties. Moreover, it is advised that Islamic banks fund social welfare, health, and education initiatives that advance human development. This not only advances the nation's general development but also fosters the growth of a clientele that is financially literate. Therefore, for the future research should identify additional potential determinants of Islamic bank performance, as this study did not address all factors that could affect Islamic bank performance.

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