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Determinants of financing in Indonesian Islamic banking

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ARTICLE INFO	ABSTRACT
	This study aims to analyze the factors that affect the distribution of financing in Islamic commercial banks in Indonesia for the period 2015–2023 with quarterly panel data on 34 Islamic commercial banks. This study applies the dynamic panel regression method with the GMM system. The results show that market power, as measured by the Lerner Index, has a significant negative effect, indicating that a less competitive market structure is suppressing financing expansion. Internal factors such as profits and bank size have a positive effect, while capital adequacy reduces financing disbursement. In profit-sharing financing (PLS), risk-based variables such as NPF and profitability have a significant negative influence, while bank size and economic conditions have a positive effect. Non-profit sharing (Non-PLS) financing is more sensitive to operational efficiency, financing risks, and macroeconomic conditions. The COVID-19 pandemic has been proven to reduce financing in all categories, especially PLS, which have higher risks. Overall, the results of the study confirm that the financing behavior of Islamic banks in Indonesia is influenced by a combination of market dynamics, the fundamental strength of banks, risk quality, and macroeconomic conditions, with significant differences between profit-sharing and non-profit-based financing.

Introduction

Islamic banking in Indonesia has a strategic role in strengthening a fair and sustainable national financial system. As an Islamic value-based intermediary institution, Islamic commercial banks not only function as profit-oriented institutions, but also as real economic development instruments that channel public funds to the productive sector (Ardana & Nurmalia, 2025). Through financing activities, Islamic banks contribute to business growth, job creation, and poverty alleviation, as well as become the driving force for halal economic transformation. Therefore, understanding the factors that affect the distribution of Islamic commercial bank financing is crucial, both from an academic and policy perspective.

The financing performance of Islamic banks is greatly influenced by market structure, efficiency, profitability, risk, and macroeconomic conditions (Meslier et al., 2020). In the context of market structure, one of the commonly used measures to assess the level of competition of banks is the Lerner Index, which reflects the market power of a bank in determining the markup of its marginal costs (Šeho et al., 2024). A high value of the Lerner Index indicates that a bank has great market power and faces relatively weak competition, while a low value indicates a more competitive market. This market structure has the potential to influence banks' financing behavior, whether they tend to expand or hold back financing expansion.

Several key theories can explain the relationship between market forces and bank financing. According to the Structure–Conduct–Performance (SCP) theory, when the banking market is more concentrated and competition decreases (as reflected in the Lerner Index), banks can set higher profit margins and tend to be cautious in distributing financing to maintain profitability (Widarjono et al.,

2020). Conversely, in a competitive market, pressure to maintain market share encourages banks to channel financing more aggressively. Meanwhile, the Efficient Structure Hypothesis (ESH) argues that the relationship between market forces and financing is not determined solely of market structure, but by the efficiency of banks. Efficient banks can reduce costs and expand financing without relying on market forces.

In practice, Islamic banks face a dilemma between maintaining profitability and fulfilling their social functions. As a sharia-based financial institution, Islamic commercial banks operate on the principle of fairness and balance (*al-'adl wa al-mizan*), which demands prudence in financing while encouraging an active role in supporting the real sector. Therefore, financing decisions are not only determined by commercial considerations but also by Sharia principles and macroeconomic conditions.

In addition to market power, internal factors of banks also play an important role in determining financing capacity and strategies. A bank's profitability, measured through Return on Assets (ROA), reflects the bank's ability to generate profits from its assets. The higher the ROA, the greater the bank's ability to expand financing. The size of a bank describes the scale of the economy and the capacity of the intermediary, while the adequacy of capital indicates the bank's ability to bear the risks of financing activities. On the other hand, operational efficiency and asset quality are limiting factors for financing expansion. High CIR and NPF often reduce banks' ability and willingness to channel funds more widely.

In terms of external factors, macroeconomic conditions, as reflected in Gross Domestic Product (GDP), also have a significant effect on financing. Rising GDP boosts economic activity and demand for real sector financing, while an economic slowdown tends to suppress financing expansion. Furthermore, the COVID-19 pandemic period has provided a significant shock to the banking industry, including Islamic banks. Mobility restrictions, a decline in people's incomes, and increased credit risk have led to financing contractions in many banks. Therefore, including the COVID-19 dummy variable is important to capture the impact of the crisis on the financing behavior of Islamic banks.

Although a lot of research on Islamic banking financing has been conducted, some gaps have not been studied in depth, especially in the context of Islamic commercial banks in Indonesia. First, there is a lack of research linking the Lerner Index to Sharia financing. Most studies on the Lerner Index focus on the profitability, efficiency, or stability of banking, not on financing behavior. In fact, market strength is an important determinant in explaining the variation in interbank financing distribution. Second, the lack of integration between micro and macro factors in a single empirical model. Many studies separate the internal determinants of banks and macro variables, even though the interaction of the two can affect the direction and volume of financing. The context of the COVID-19 pandemic has not been extensively researched empirically in Sharia financing. The pandemic has caused fundamental changes in the financing behavior and risk management of Islamic banks, but empirical studies measuring their impact on financing are still limited.

This research offers a significant scientific and practical contribution to the Islamic banking literature in Indonesia through the following aspects of novelty. First, it focuses on the relationship between market forces (Lerner Index) and Islamic bank financing. This study is one of the first studies to explicitly examine how the level of competition in the Islamic banking industry affects the behavior of financing distribution. Second, this study uses an integrative approach between micro-bank and macroeconomic variables. The empirical model combines the bank's internal and external factors simultaneously to explain the dynamics of financing more comprehensively. Third, This work investigates the empirical analysis in the context of the COVID-19 pandemic. By including the COVID dummy, this study can evaluate changes in the financing behavior of Islamic commercial banks during the crisis period, thereby providing insight into the resilience of the Islamic financial system. Fourth, Islamic bank financing consists of profit-sharing and non-profit-sharing financing. These two types of financing are different in risk, where the risk-sharing financing is higher (Ibrahim & Rizvi, 2018). This research also separates between profit-sharing financing and non-profit-sharing financing.

Literature Review

Several researchers have analyzed the determinants of financing in Islamic banks. Ibrahim (2016) showed that macroeconomic fluctuations greatly influence Islamic bank financing in Malaysia. Šeho et al. (2020) analyzed determinants of non-profit sharing financing in 17 Islamic banks in 13 countries in

the period 2003-2017. The results show that bank size has a positive effect on profit-sharing financing. In addition, conventional bank interest rates have a negative effect on profit-sharing financing.

Risfandy et al. (2020) documented that profit-sharing financing was influenced by market competition, bank size, and bank fundamentals in banking in Indonesia in the 2009-2014 period. Profit-sharing financing will be offered more if the market is very competitive, and vice versa, if the market is not competitive, banks will distribute more non-profit-sharing financing. In addition, bank assets, profits and stability have a positive impact on profit-sharing financing.

Widarjono and Misanam, (2023) analyzed Murabaha Financing in Indonesian banking using symmetric (ARDL) and asymmetric (NARDL) approaches in the period 2010 to 2021 using monthly data. The ARDL method indicates that the price of murabahah financing has a negative effect on murabahah financing. This means that the price of murabahah financing rises, then murabahah financing will decrease and vice versa. However, in the NARDL approach, the cost of murabahah financing asymmetrically affects murabahah financing. The increase in the price of murabahah financing will decrease murabahah financing, but when the price falls, it does not decrease murabahah financing.

Misanam and Widarjono (2023)analyzed the influence of market concentration, bank characteristics and macroeconomic conditions on Islamic bank financing in the 2015-2020 period using quarterly data. The results show that Islamic bank financing is persistent. Market concentration increases Islamic bank financing. In addition, profits, bank size and financing loss provision have a positive effect, but CAR and operating inefficiency have a negative effect on Islamic bank financing. Furthermore, Islamic bank financing is also greatly influenced by high economic growth.

Widarjono et al. (2025) examined non-profit sharing financing, such as mudharabah, in banking in Indonesia in the period 2015-2020 with quarterly data. The results of the study show that competition and bank fundamentals strongly determine non-profit sharing financing. Meanwhile, bank and asset stability have a negative effect on non-profit sharing financing. These findings show that the more stable and larger Islamic banks are, the more profit-sharing financing increases. In addition, this study also shows that CAR has a positive effect on non-profit sharing financing.

Methods

Research Design

The study used panel data to analyze Islamic bank financing in Indonesia. This panel data regression approach was chosen because it is able to combine individual bank dimensions (cross-section) and time (time series) so that it can capture the dynamics of the heterogeneous behavior of Islamic commercial banks in Indonesia in a certain period of time. This study aims to analyze the influence of competition, bank fundamentals and macroeconomic conditions on Islamic commercial bank financing in Indonesia. This study applies the dynamic panel regression estimation method to overcome potential endogeneity problems in the model. The dynamic panel estimation method uses the Generalized Method of Moments (GMM) method (Arellano & Bond, 1991); (Blundell & Bond, 1998).

Research Data

The data of this study are secondary data sourced from the Financial Services Authority and the Central Bureau of Statistics. Financial data of Islamic banks is obtained negatively, including financial ratio reports and profit and loss reports from each Islamic bank, which are available on the Financial Services Authority website. Macroeconomic data is the Gross Domestic Product (GDP) obtained from the Central Statistics Agency for COVID-19 pandemic data, starting in the second quarter of 2020 to the fourth quarter of 2021. The research period lasted for 6 years, from 2015 to 2023, using quarterly data. The banks studied are all 34 Islamic banks in Indonesia, consisting of 12 Islamic commercial banks (ICBs) and 22 Islamic bank windows (IBW).

Variable Measurement

The dependent variable in this study is Islamic Bank Financing. Islamic bank financing is divided into total financing, profit-sharing financing (PLS) and non-profit-sharing financing (Non PLS). This Financing Distribution is carried out in order to see in more detail the factors that affect the types of

Financing in Islamic banks. The types of financing in Islamic banks are different, so they need to be analyzed separately.

The competition variables in this study were measured using the Lerner Index (Risfandy et al., 2022). This Lerner index represents the level of a bank's ability to set a price above its costs. The higher the value of the Lerner Index, the greater the power of the bank and the more uncompetitive the market becomes. On the other hand, the lower the value of the Lerner Index, the more it indicates that the market is increasingly competitive as the strength of banks weakens (Trinugroho et al., 2018). The Lerner Index is calculated using the formula:

$$\text{Lerner} = \frac{(P-MC)}{P} \tag{1}$$

where P is the output price that is proxied by the operating income per asset, and MC is the marginal cost calculated through the translog cost function approach (Widarjono et al., 2025). A Lerner value close to zero indicates a competitive market, while a higher value indicates greater market strength. The translog cost function is as follows:

$$LTC_{it} = \theta_0 + \sum_{m=1}^{2} \theta_1 Lw_{m,it} + 0.5 \sum_{m=1}^{2}\sum_{n=1}^{2} \rho_{mn} Lw_{m,it}Lw_{n,it} + \sigma_1 LTA_{it} + 0.5\sigma_2(LTA_{it})^2 +$$
$$\sum_{m=1}^{2} \sigma_{2m}LTA_{it} LV_{m,it} + \epsilon_{it} \tag{2}$$

Total cost (TC) is the total cost. TA is the total assets. V1 is the ratio of deposits to total deposits. V2 is another ratio of costs to fixed assets. L represents the natural logarithm. MC is obtained from equation (2) through derivatives to the total assets as follows (Khattak et al., 2022):

$$MC_{it} = \frac{TC_{it}}{LAsset_{it}}\left(\sigma_1 + \sigma_2 LAsset_{it} + \sum_{k=1}^{2} \sigma_{2k}Lv_{k,it}\right) \tag{3}$$

The fundamental variables of the bank consist of profit, size, capital, operating efficiency, and financing risk. Return on assets (ROA) measures a bank's profitability. ROA reflects the bank in optimizing the value of assets to make a profit (Rita & Sugiarti, 2025). Assets in logarithm form measure bank size. The size of a bank reflects the economic capacity and scale of the financial institution's operations (Hendri et al., 2025). Capital Adequacy Ratio (CAR) measures the balance of a bank's capital. The Capital Adequacy Ratio shows the level of capital adequacy of banks to the risk of their assets (Widarjono & Misanam, 2024) Operating efficiency is measured by the Cost to Income Ratio (CIR). CIR indicates the efficiency of the operation. The lower the CIR, the more efficient the bank is in its operations, and vice versa, the more inefficient (Putri & Misbah, 2025). Credit risk is measured by Non-Performing Financing (NPF). NPF is the ratio of non-performing financing to total financing. NPF represents the quality of Financing (Fitrah & Widarjono, 2024). Gross Domestic Product (GDP) represents macroeconomic conditions in Indonesia. Its value is expressed in natural logarithms. COVID-19: a dummy variable that is valued at 1 for the pandemic period, starting in the second quarter of 2020 to the fourth quarter of 2021 and 0 for the period before and after the pandemic. COVID was included in this study to capture the external impact of the pandemic shock on Islamic bank financing.

Model Specifications

To capture the dynamics of Islamic bank financing in Indonesia, the research model employs dynamic panel data regression. The dynamic equation regression model is as follows:

$$LTFIN_{it} = \emptyset_0 + \emptyset_1 LTFIN_{it-1} + \emptyset_2 Lerner_{it} + \emptyset_3 Lasset_{it} + \emptyset_4 ROA_{it} + \emptyset_5 CAR_{it} + \emptyset_6 CIR_{it} + \emptyset_7 NPF_{it} +$$
$$\emptyset_8 LGDP_{it} + \emptyset_9 COVID_{it} + e_{it} \tag{4}$$

TFIN is total financing, Lerner is the Lerner Index, assets are total assets, ROA is returns on assets, CAR is capital adequacy ratio, CIR is cost to income ratio, NPF is non-performing financing, GDP is Gross Domestic Product and COVID is the COVID-19 pandemic. TFIN and Asset are expressed in the form of natural logarithms.

Profit-sharing financing (PLS) and non-profit-sharing financing (NPLS) are different in practice. PLS financing is based on profit sharing, while NPLS financing is based on debt financing, so these two types of financing differ in their management (Widarjono, et al., 2025). Furthermore, to capture the differences in financing behavior in Islamic banks, this study separately analyzes PLS financing. The dynamic panel equation model is as follows:

$$\text{LPLS}_{it} = \emptyset_0 + \emptyset_1 \text{LPLS}_{it-1} + \emptyset_2 \text{Lerner}_{it} + \emptyset_3 \text{Lasset}_{it} + \emptyset_4 \text{ROA}_{it} + \emptyset_5 \text{CAR}_{it} + \emptyset_6 \text{CIR}_{it} + \emptyset_7 \text{NPF}_{it} +$$
$$\emptyset_8 \text{LGDP}_{it} + \emptyset_9 \text{COVID}_{it} + e_{it} \tag{5}$$

PLS is profit-sharing financing and is denominated in the form of natural logarithms. Meanwhile, the NPLS Financing equation model dynamic panel equation model is as follows:

$$\text{LNPLS}_{it} = \emptyset_0 + \emptyset_1 \text{LNPLS}_{it-1} + \emptyset_2 \text{Lerner}_{it} + \emptyset_3 \text{Lasset}_{it} + \emptyset_4 \text{ROA}_{it} + \emptyset_5 \text{CAR}_{it} + \emptyset_6 \text{CIR}_{it} + \emptyset_7 \text{NPF}_{it} +$$
$$\emptyset_8 \text{LGDP}_{it} + \emptyset_9 \text{COVID}_{it} + e_{it} \tag{6}$$

NPLS is a non profit-loss financing and is issued in the form of natural logarithms.

This study uses the GMM method to estimate equations (4)-(6). Because the model includes a lag of the dependent variable as one of the independent variables, the Fixed Effects (FE) estimation method with the OLS method will result in biased and inconsistent estimates. To address this condition, the study applied the Generalized Method of Moments (GMM) designed to address unfettered endogeny in a static panel model.

There are several advantages of the GMM Method. First, the GMM method can address the issue of endogeneity, especially when the profitability of the bank itself may influence independent variables such as the Lerner Index or CIR. Second, GMM is able to overcome the bias of simultaneity and heteroscedasticity because the instruments used are derived from the lag values of endogenous variables. In this study, the GMM System was used, which combined equations in the first difference equation and in the level equation to produce a more efficient estimator than the Difference GMM (Blundell & Bond, 1998). The GMM system is also more appropriate when dependent variables are persistent, such as bank financing, which usually shows consistency over time. Therefore, this study employs the two-step system GMM.

Results and Discussion

Summary of statistics

Table 1 presents a statistical summary of mean values, standard deviations, and minimum–maximum range of Sharia Banks in Indonesia. Total Financing (TFin) has an average value of 13.21 trillion with a standard deviation of 27.22. The very wide range (0.41 to 239.69) reflects a significant difference in the scale of financing between large and small Islamic banks. The high variation is in accordance with the composition of the sample, which includes Islamic commercial banks (ICBs) and Islamic bank windows (IBWs) with vastly different financing capacities.

Table 1. Summary of statistics

Variable	Mean	Std. dev.	Min	Max
TFin	13.2140	27.2259	0.4152	239.6926
Lerner	0.3924	0.8729	-4.2964	5.4348
Asset	19.0570	38.9595	0.7676	353.6241
ROA	0.0219	0.0259	-0.0672	0.3700
CAR	0.2455	0.1013	0.0213	1.4927
CIR	0.8177	0.2710	0.0567	2.6158
NPF	0.0307	0.0288	0.0001	0.2229
GDP	2797.2900	169.6826	2498.6980	3139.1610
COVID	0.1693	0.3752	0.0000	1.0000

The Lerner Index has an average of 0.39, but the standard deviation reaches 0.87, as well as a negative minimum value (-4.29) and a maximum of 5.43. This extreme range of values indicates a large degree of heterogeneity in the structure of the Islamic banking market. A negative value indicates that some banks are pricing below marginal fees, while a high value indicates great market power. Assets as a bank size have an average of 19.05 with a large standard deviation (38.95) and a range of 0.76 to 353.62. This large variation illustrates a striking difference in the size of Islamic banks, which is consistent with the duality of ICBs and IBWs. ROA shows an average value of 2.19%, with a minimum value of -6.72%, which illustrates the existence of banks that have suffered losses. However, the maximum value is 37%, indicating that some banks have very high profitability. The average CAR is 24.55%, well above the regulator's minimum requirements. This shows that, in general, Islamic banks are in a strong capital

condition. However, the maximum value of CAR reached 149%, indicating that some banks have very conservative capital structures. The CIR has an average value of 0.81, which indicates a relatively low level of operational efficiency, as a higher value indicates that the bank is increasingly inefficient. The average NPF was 3.07% with considerable variation (0.01% to 22.29%). This indicates that the quality of financing between Islamic banks varies greatly, from very good to very problematic.

Table 2 shows the value of the correlation coefficient between independent variables. In general, the correlation coefficient is less than ± 0.5, which varies from -0.4856 to 0.3377. A correlation coefficient value below ± 0.5 indicates that there is no problem with multicollinearity in the model.

Table 2. Correlation

	TFin	Lerner	Asset	ROA	CAR	CIR	NPF	GDP
Tfin	1							
Lerner	0.0525	1						
Asset	0.9803	0.0961	1					
ROA	-0.0854	0.0703	-0.0943	1				
CAR	-0.1281	0.1320	-0.0730	0.2713	1			
CIR	0.0988	0.0050	0.1059	-0.4856	-0.1114	1		
NPF	-0.0308	-0.1276	-0.0545	-0.2875	-0.2359	0.3377	1	
GDP	0.0800	0.2118	0.1307	0.0355	0.2642	-0.0470	-0.1702	1
COVID	0.0004	-0.1201	-0.0014	-0.0549	-0.0466	0.0548	0.0466	-0.3215

Total Financing

Table 3 presents the results of estimating factors that affect the total Islamic bank financing in Indonesia. The results of the GMM estimation show that the lag of financing (TFin(-1)) has a positive and significant effect on all models. These findings indicate that Islamic bank financing is persistent. The current amount of financing is heavily influenced by the previous period's financing. This is consistent with the intermediation character of banks that tend to maintain the stability of the financing portfolio over time. The lag of the dependent variable as an independent variable is positively significant, implying that the dynamic panel regression is more applicable than the static panel regression.

Table 3. Total Financing

Variable	Coefficient	Prob	Coefficient	Prob	Coefficient	Prob
TFin (-1)	0.8033***	0.0000	0.7883***	0.0000	0.7865***	0.0000
Lerner	-0.0096***	0.0000	-0.0095***	0.0000	-0.0110***	0.0000
ROA	0.3319***	0.0000	0.3465***	0.0000	0.2191***	0.0000
Asset	0.2017***	0.0000	0.2163***	0.0000	0.3190***	0.0010
CAR	-0.1147***	0.0000	-0.1174***	0.0010	-0.1099***	0.0010
CIR	-0.0030	0.8440	-0.0045	0.7880	-0.0046	0.7830
NPF	-0.0421	0.7420	-0.0393	0.7790	-0.0377	0.7910
GDP	-	-	-0.0546*	0.0620	-0.1597***	0.0000
COVID	-	-			-0.0361***	0.0000
Cons.	-0.1119	0.0120	0.6974	0.0930	2.2457	0.0000
Banks	34		34		34	
Obs.	768		768		768	
Inst.	30		31		32	
AR(1)	0.036		0.035		0.035	
AR(2)	0.352		0.364		0.361	
Hansen	0.221		0.25		0.252	

***, *** and * significant at 1%, 5% and 10%

The Lerner Index has a negative and significant effect on total financing. When market forces increase (the market is less competitive), Islamic banks tend to reduce financing expansion. These findings support the SCP theory, where banks with strong market positions choose conservative behavior to maintain profit margins, so the distribution of financing tends to decline.

In terms of internal factors, ROA and bank size have a significant positive effect. A high ROA indicates the bank's ability to generate profits so that it has a greater capacity to expand financing.

Larger banks also have better resources and economies of scale, thus encouraging increased financing. On the other hand, CAR has a significant negative effect. The high CAR shows the bank's prudent attitude in restraining financing expansion to maintain capital adequacy. The CIR and NPF variables are not significant, indicating that operational efficiency and financing quality did not have a direct influence on total financing in the dynamic model.

For external variables, GDP and COVID-19 have a negative effect. The economic weakening and the pandemic period have reduced the real sector's ability to absorb financing, so Islamic banks have reduced the volume of financing they distribute.

PLS Financing

Table 4 presents the results of the estimated factors affecting PLS Financing of Islamic banks in Indonesia. Based on Table 4, lag of PLS Financing, PLS(-1) is positive with a coefficient value: 0.7976 – 0.8102 and significant at 1%. This shows that PLS financing is very persistent. If PLS financing increases in the previous period, then the financing of the next period also increases. This illustrates that PLS is a long-term relationship.

Table 4. PLS Financing

	PLS Financing					
Variable	Coefficient	Prob	Coefficient	Prob	Coefficient	Prob
PLS(-1)	0.7976***	0.0000	0.7983***	0.0000	0.8102***	0.0000
Lerner	0.0036	0.5620	0.0023	0.6920	0.0002	0.9780
ROA	-4.5875***	0.0000	-4.8033***	0.0000	-4.4468***	0.0000
Lasset	0.1891***	0.0000	0.1837***	0.0000	0.1783***	0.0000
CAR	-0.1830*	0.0870	-0.1925*	0.0570	-0.1797**	0.0410
CIR	-0.0174	0.5300	-0.0158	0.5700	-0.0246	0.4070
NPF	-1.3888***	0.0000	-1.3084***	0.0000	-1.3581***	0.0000
GDP	-	-	0.2517***	0.0010	0.1167	0.2010
COVID	-	-	-	-	-0.0144**	0.0150
Cons.	0.1566**	0.0300	-3.5053***	0.0010	-1.5786	0.2130
Banks	34		34		34	
Obs.	768		768		768	
Inst.	30		31		32	
AR(-1)	0.254		0.253		0.254	
AR(-2)	0.309		0.309		0.309	
Hansen	0.179		0.207		0.224	

***, *** and * significant at 1%, 5% and 10%

Lerner is not significant across all models, with Prob values of 0.5620–0.9780. On market power, banks have no effect on the distribution of PLS financing. This means that banks do not increase or decrease PLS based on the level of competition in the industry. PLS is more influenced by internal risks and factors, not market structure.

The bank's profitability ROA is a negative and significant at 1% (prob <0.001), ranging from -4.5875 to -4.8033. This means that when profitability increases, banks reduce PLS financing. In this case, PLS is riskier and requires high costs. Banks maintain profits by choosing safer financing or Non-PLS financing. Profitability encourages Islamic banks to be conservative towards profit-sharing-based financing.

Lasset is a positive and significant at 1% (p < 0.01). This means that larger banks will be able to distribute PLS financing. This is because an Islamic bank (IB) has a stronger monitoring capacity, human resources, a more effective risk management system, and a stronger capital base to bear PLS risks.

CAR is a negative and significant. This is because banks that have large capital tend to be more careful in distributing PLS. Because PLS is high risk, banks with high CAR may prefer safer financing so as to reduce the portion of PLS.

CIR is a negative but is not significant. This means that CIR has a negative and insignificant effect on the distribution of PLS financing. This shows that the level of bank operational efficiency measured through the Cost to Income Ratio has no influence on the distribution of PLS financing. CIR

efficiently increases or decreases, because it does not directly affect the decision of Islamic banks to increase or decrease profit-sharing-based financing.

NPF is a negative and significant. NPF has a negative coefficient and is significant at the level of 1% across all models. This means that NPF has a negative effect on the distribution of PLS financing. This shows that the higher the level of non-performing financing faced by Islamic banks, the lower the bank's ability or willingness to distribute PLS-based financing. The large coefficient shows that the influence of financing risk on PLS is very strong and consistent.

GDP shows a positive coefficient of 0.2517 and is significant at 1% level in Model 2. This means that higher economic growth is driving an increase in the distribution of PLS-based financing to Islamic banks. Improved economic conditions create more stable business prospects and reduce the risk of business failure, enabling banks to be more willing to distribute PLS, which is indeed sensitive to risk.

COVID is a negative coefficient of -0.0144 and significant at 5%. This shows that during the COVID-19 pandemic, Islamic banks reduced the amount of Profit and Loss Sharing (PLS)-based financing. The pandemic has created high economic uncertainty, declining real sector performance, increasing risk of business failure, and increased potential for moral hazard. Because PLS contracts are very sensitive to business risks, pandemic conditions have made banks more cautious in distributing PLS financing. Thus, the COVID variable has been proven to have a significant decreasing effect on PLS financing.

Non-PLS Financing

Furthermore, Table 5 shows the estimated results for non-profit sharing financing (NPLS). The results showed that NPLS(-1) had a positive and significant coefficient in all models. This shows that NPLS financing is very persistent. In other words, the amount of financing in the previous period is a strong determinant of financing in the current period. The large coefficient shows that Islamic banks tend to maintain the level of NPLS financing disbursement over time.

Table 5. Non-PLS Financing

Variable	NPLS Financing					
	Coefficient	Prob	Coefficient	Prob	Coefficient	Prob
NPLS(-1)	0.7896***	0.0000	0.8004***	0.0000	0.7862***	0.0000
Lerner	-0.0474***	0.0010	-0.0347**	0.0180	-0.0348**	0.0250
Lasset	0.1930***	0.0000	0.1916***	0.0000	0.2083***	0.0000
ROA	3.0336***	0.0000	2.7333***	0.0000	2.7871***	0.0000
CAR	-0.0768	0.5180	-0.0657	0.5460	-0.0654	0.5740
CIR	-0.1371***	0.0020	-0.1505***	0.0000	-0.1567***	0.0000
NPF	2.2711***	0.0000	2.0159***	0.0000	2.1481***	0.0000
GDP	-	-	-0.3749***	0.0000	-0.5780***	0.0000
COVID	-	-	-	-	-0.0615***	0.0000
Cons	-0.0231	0.8800	5.4371***	0.0000	8.4101***	0.0000
Banks	34		34		34	
Obs.	768		768		768	
Inst.	30		31		32	
AR (1)	0.038		0.039		0.040	
AR (2)	0.066		0.070		0.075	
Hansen	0.144		0.142		0.157	

***, *** and * significant at 1%, 5% and 10%

Lerner is a negative and significant. This means that if the Lerner index increases by 0.0010, the NPLS decreases by -0.0474. That is, the greater the market power of Islamic banks, the smaller the risk of non-performing financing (NPLS). Market power banks (Lerner Index) have a stable and significant effect in lowering NPLS. These findings support the theory of the "franchise value hypothesis, which is that Islamic banks with high market power will be more cautious and maintain financing risks.

Lasset, which represents bank size through the logarithm of total assets, shows a positive and significant coefficient at the level of 1% in the model with values of 0.1930, 0.1916, and 0.2083, respectively. This means that the larger the size of the bank, the greater the ability and tendency of Islamic banks to distribute non profit-sharing financing (NPLS). The positive coefficient shows that the growth in the size of the bank is directly correlated with the increase in NPLS financing capacity.

Economically, banks with larger assets generally enjoy higher economic scale, a stronger capital structure, and a better ability to diversify risk. Sharia commercial banks also tend to have more complex risk management infrastructure and more competent human resources to conduct project screening and monitoring, which is an important element in profit-sharing contracts that have a higher level of uncertainty. Large-scale banks have more stable liquidity strength, so they are better able to bear the risks inherent in mudharabah and musharakah financing. With stronger operational capacity, large banks tend to be more confident to expand the portion of NPLS financing, which theoretically does not require more intensive supervision.

ROA has a positive and significant coefficient at a significance level of 1%, amounting to 3.0336, 2.7333, and 2.7871, respectively. The positive coefficient indicates that any increase in ROA will be followed by an increase in NPLS financing, which means that Islamic banks with better financial performance tend to be more aggressive in expanding their non partnership-oriented financing portfolios. This explains that more profitable banks have stronger capital capacity, liquidity, and risk management, so they are better able to bear the inherent risks in non profit-sharing-based contracts. Increased profitability also reflects operational efficiency and better asset quality, so banks are in a more stable position to take exposure to financing that has a higher level of return certainty than profit-loss sharing financing. Thus, these findings support the view that the fundamental strength of banks contributes positively to the courage of Islamic banks in enlarging the composition of NPLS financing. The ROA coefficient in all models shows that profitability is the main determinant in NPLS financing disbursement behavior. These results confirm that the higher the bank's financial performance, the greater the tendency of Islamic banks to allocate financing to non profit-sharing-based sectors.

The CAR has a negative but insignificant coefficient across the model, with coefficient values of –0.0768, –0.0657, and –0.0654, with probability values well above the general significance level (p > 0.10). This explains that the level of capital adequacy of banks does not have a significant influence on the distribution of non profit-sharing-based financing (NPLS) in Islamic banks. The negative coefficient value indicates an increasing relationship with bank capital, so the distribution of NPLS financing decreases. This means that the decision of Islamic banks in distributing PLS financing is not determined by the amount of available capital, but by other factors such as profitability, asset quality, credit risk, and the size of the bank which is proven to be more dominant in the model. CAR is not a major determinant in NPLS financing growth, and other internal factors of banks play a greater role in determining Islamic banks' preference for partnership-based financing disbursements.

CIR shows negative and significant coefficients at 1% levels across the model, of –0.1371, –0.1505, and –0.1567, respectively, with probability values of 0.0020, 0.0000, and 0.0000. This means that when the CIR increases, the distribution of non profit-sharing financing (PLS) decreases. The negative coefficient shows that cost inefficiencies play a role as a factor that limits the ability of Islamic banks to expand their NPLS financing portfolio. As the burden of operational costs increases, Islamic banks tend to avoid aggressive financing.

NPF has positive, significant coefficients of 2.2711, 2.0159, and 2.1481, with p-values of 0.0000 in all three. This means that NPF has a positive effect. This reflects that credit risk has a *contagion effect*, where the increase in non-performing financing in one segment can affect another. NPF is one of the most influential variables in determining the direction of financing distribution of Islamic banks, so that NPF control is a strategic priority for Islamic banks to maintain the stability and health of their portfolios.

GDP has a negative coefficient of –0.3749 and –0.5780, and is significant at the level of 1% level, with p-values of 0.0000 in both models. This means that it has a negative and significant effect on Non-PLS financing. This is that economic growth is increasing and correlates with the decrease in the distribution of non profit-sharing financing (NPLS) in Islamic banks. When economic conditions are improving, Islamic banks do not increase the distribution of NPLS financing, which is a fixed cost, but tend to switch to financing contracts that are based on profit-loss sharing, such as murabahah or mudharabah.

COVID has a negative coefficient of -0.0615 and a significant value at the level of 1% (p = 0.0000). This means that COVID has a negative relationship and has a significant effect on profitability and economic growth. This shows that the increase in COVID is associated with a decrease in the dependent variable by -0.0615. On the External Shock Theory that disrupts social, economic, or health

systems. These shocks usually decrease output, productivity, service quality, or performance of other variables. These negative impacts correspond to uncertainty theory, productivity disorder theory, and growth theory.

Conclusion

The results of GMM estimation show that the total financing of Islamic banks' financing is continuous, with a positive financing lag in all models. The less competitive market structure is seen from the high Lerner Index, which suppresses financing expansion, in line with the prediction of the Structure-Conduct-Performance (SCP) theory. Internal bank factors, such as profitability and bank size, positively affect financing, while the level of capital adequacy suppresses expansion. In this case, there is a prudent bank in maintaining capital stability. Operational efficiency and financing risk had no significant effect. The economic growth and the COVID-19 pandemic have a negative impact on the financing distribution capacity of Islamic banks. Thus, overall, financing is influenced by a combination of internal factors of Islamic banks, market structure, and pressure on macro conditions.

Some important implications of this research can be highlighted. Strong bank fundamentals significantly influence the amount of bank financing. First, bank profits must be continuously improved to enable continued financing growth. Second, Islamic banks must improve their operational efficiency. Third, Islamic banks must manage their non-performing loans effectively.

There are several weaknesses in this research. First, this study did not include recent data, therefore, future research should incorporate more recent data. Second, this study requires a robustness test to demonstrate the consistency of the results using a static panel regression approach.

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