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Evaluation of Financial and Maqasid Syariah Performance of Islamic Banks in Southeast Asia (2019–2023)

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Abstract

This study aims to analyse the performance of Islamic banks in Southeast Asia through a comprehensive framework that includes both financial and non-financial aspects, particularly those grounded in the Maqasid al-Shari'ah. The research is significant as the rapid growth of Islamic finance in the region has not been matched by systematic performance evaluations. Employing a quantitative approach with an explanatory design, data were collected from financial reports, structured surveys, and interviews, and analysed using panel data regression with the Fixed Effect Model (FEM). The findings reveal a significant post-pandemic recovery among Islamic banks, demonstrated by improvements in profitability, operational efficiency, and asset quality. The Maqasid Syariah Index (MSI) shows varied achievements, with Malaysia and Indonesia leading in the integration of Islamic ethical and social values. Internal factors such as bank size and age, along with external factors such as GDP growth, the Islamic Financial Development Index (IFDI), and Sharia Governance Score (SGS), significantly influence performance. These results underscore the importance of aligning macroeconomic factors, Islamic governance, and financial infrastructure to support the resilience and sustainability of Islamic banking. This study offers an original contribution by developing a performance evaluation model rooted in maqasid principles and provides policy recommendations to enhance the integration and efficiency of the regional Islamic financial system.

Keywords: Islamic banking; Southeast Asia; Maqasid al-Shari'ah; financial performance; Sharia governance.

Abstrak

Penelitian ini bertujuan untuk menganalisis kinerja perbankan syariah di kawasan Asia Tenggara dengan pendekatan yang komprehensif terhadap aspek keuangan dan non-keuangan, khususnya dalam kerangka Maqasid Syariah. Studi ini penting dilakukan mengingat pesatnya perkembangan industri keuangan syariah di kawasan ini yang belum diiringi dengan evaluasi sistematis terhadap kinerja dan ketahanan institusi perbankan syariah. Penelitian ini menggunakan pendekatan kuantitatif dengan desain explanatory. Data dikumpulkan melalui laporan keuangan, survei, dan wawancara terstruktur, serta dianalisis menggunakan regresi data panel dengan model Fixed Effect Model (FEM). Hasil penelitian menunjukkan bahwa perbankan syariah di Asia Tenggara mengalami pemulihan signifikan pasca-pandemi COVID-19, dengan peningkatan pada indikator profitabilitas, efisiensi operasional, dan kualitas aset. Selain itu, Indeks Maqasid Syariah (MSI) menunjukkan pencapaian yang bervariasi, dengan Malaysia dan Indonesia menempati posisi terdepan dalam integrasi nilai-nilai etika dan sosial Islam. Faktor internal seperti ukuran dan usia bank serta faktor eksternal seperti pertumbuhan PDB, indeks pembangunan keuangan syariah (IFDI), dan skor tata kelola syariah (SGS) terbukti berpengaruh signifikan terhadap kinerja bank. Temuan ini menekankan pentingnya sinergi antara faktor ekonomi makro, tata kelola syariah, dan infrastruktur keuangan Islam dalam memperkuat ketahanan dan keberlanjutan perbankan syariah. Penelitian ini memberikan kontribusi orisinal dalam mengembangkan model evaluasi kinerja perbankan syariah berbasis maqasid, serta memberikan rekomendasi kebijakan untuk meningkatkan integrasi dan efisiensi sistem keuangan syariah regional.

Kata Kunci: Perbankan syariah; Asia Tenggara; Maqasid Syariah; kinerja keuangan; tata kelola syariah..

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INTRODUCTION

In recent years, Indonesia's Micro, Small, and Medium Enterprises (MSMEs) have become a cornerstone of the national economy, contributing approximately 61.7% to the country's Gross Domestic Product (GDP) and absorbing over 97% of the national workforce (DJP Online, 2024). However, amid rapid digital transformation and intensifying global competition, a critical phenomenon has emerged many MSMEs struggle to sustain growth and competitiveness due to limited human resource (HR) competencies. A 2023 report by Indonesia's Ministry of Cooperatives and SMEs indicates that only 20.76 million MSMEs approximately 32% of the country's 64.2 million enterprises have adopted digital technology in their operations. This implies that the remaining 68% of MSMEs continue to face substantial barriers in embracing digital tools, including the effective use of social media for business development and innovation (Junaedi, Masruro, Laili, Rianita, & Tamimah, 2023). This phenomenon is not merely an economic concern it bears broader social implications, including increased business vulnerability, stagnating employment absorption, and a widening gap between digital-ready firms and traditional enterprises. As Indonesia seeks to strengthen economic resilience and reduce inequality, understanding how HR competencies influence innovation and performance within MSMEs becomes a matter of both academic and policy urgency. Analysing this issue offers a timely and necessary contribution toward developing evidence-based strategies that empower MSMEs through targeted human capital development and innovation support. The urgency of this study is further underscored by real-world cases of stagnation among local enterprises lacking skilled labour and access to adaptive training frameworks, highlighting the crucial need for systemic intervention.

While previous studies have extensively explored the role of human resources and innovation in business development, several limitations remain, particularly in the context of Indonesian MSMEs. Prior literature can be broadly categorised into three thematic strands. The first strand of literature focuses on the relationship between human resource (HR) development and business performance, particularly in large-scale corporations or advanced economies. Numerous empirical studies have established a positive correlation between effective HR practices such as training, performance appraisal, and compensation systems and firm performance (Lee, Lee, & Wu, 2010; Pham, 2020; Qin & Lv, 2024). These findings are further strengthened by evidence demonstrating that aligning HR strategies with broader business goals significantly enhances competitive advantage and market responsiveness (Garcia Pardo & Del Valle Fernández Moreno, 2009; Katou & Budbwar, 2008). Moreover, the development of human capital, encompassing education, skills, and organisational capabilities, has been shown to directly drive innovation and productivity (Alnor et al., 2024; Liu, Liu, Udimal, Zhu, & Yousif, 2023; Song, Pan, Pan, & Jiao, 2019). Research on large manufacturing and service firms confirms that simultaneous investment in HR systems and strategic management initiatives yields measurable improvements in operational efficiency and long-term organisational success (Chen, Liaw, & Lee, 2003; Katou & Budhwar, 2010). However, these studies largely centre on contexts with abundant resources and structured HR systems, often overlooking the structural and contextual challenges faced by micro and small enterprises especially in emerging economies such as Indonesia.

The second category of research focuses on innovation within MSMEs, underscoring creativity, adaptability, and digital transformation as key enablers of sustainable growth. Studies reveal that creative capacity and innovation-oriented leadership are vital for MSMEs to overcome resource limitations and develop competitive products and services (Chand, Mohan, & Walia, 2025; Sjachriatin, Riyadi, & Mujanah, 2023). Adaptability reflected in organisational agility and cross-sectoral collaboration also plays a critical role in allowing MSMEs to respond to changing market dynamics (Dewi, Ghalib, Said, & Sopiana, 2025;

Singh, Khamba, & Nanda, 2014). Furthermore, the integration of digital technologies into business operations has been shown to enhance efficiency, market outreach, and customer engagement, particularly when paired with strategic digital marketing (Amir, Hamzah, & Maelah, 2024; Muis, Adhi, & Kamalia, 2024; Yuliawati et al., 2025). Despite these valuable insights, existing literature often overlooks the micro-level role of specific human resource competencies such as digital literacy, adaptive thinking, and collaborative skills in facilitating innovation performance. Moreover, the mediating relationship between HR development and innovation outcomes remains underexplored, particularly in the Indonesian MSME context. This study aims to fill these gaps by examining how HR-driven innovation, supported by digital transformation, contributes to the competitiveness and growth of MSMEs.

The third body of literature investigates MSME performance and digital readiness in Indonesia, with a growing focus on how human capital, leadership, and technological adoption influence business sustainability. Several studies have established that entrepreneurial leadership and innovation capabilities significantly enhance MSME performance, particularly when supported by self-efficacy, market orientation, and adaptive behaviour (Rumijati & Hakim, 2023; D. Sari, Kusuma, Sihotang, & Febrianti, 2023; Tjahjadi, Soewarno, Anwar, & Fairuzi, 2024). At the same time, digital readiness has emerged as a critical factor, with digital marketing and e-commerce adoption identified as catalysts for operational efficiency and competitive advantage (Ananda, Murwani, Tamara, & Ibrahim, 2023; Kilay, Simamora, & Putra, 2022). However, challenges such as limited financial capital, digital literacy gaps, and underdeveloped infrastructure continue to impede widespread digital transformation (Anatan, 2023; Said & Soi, 2025). Government initiatives, including those aligned with the Society 5.0 framework, aim to address these barriers, yet their effectiveness remains uneven due to the heterogeneity of MSME contexts (Abduh, Remmang, Abubakar, & Karim, 2024). While this stream of research contributes useful diagnostic insights, it often lacks a holistic analysis of how HR competencies mediate the link between digital readiness and firm performance. Furthermore, the role of structured skill development and institutional partnerships in supporting digitally lagging MSMEs is still underexplored. This study aims to bridge these gaps by focusing on how targeted HR development especially in digital, adaptive, and collaborative skills can drive innovation and improve performance among Indonesia's digitally constrained MSMEs.

Despite the valuable insights these studies provide, they leave several critical gaps unaddressed. Few have investigated how specific HR competency dimensions such as technical proficiency, adaptive capacity, and interpersonal collaboration function as catalysts for product innovation within resource-constrained MSMEs. Moreover, the mediating role of innovation in translating HR development into performance gains remains under-theorised, particularly in decentralised and culturally diverse regions of Indonesia. There is also a lack of empirical research that explores how training interventions, academic partnerships, and public policy support may bridge existing competency gaps and foster innovation-led growth. This study seeks to fill these voids by developing an integrated analytical framework that captures the interplay between HR competencies, product innovation, and MSME performance offering both theoretical enrichment and practical direction for future policy and enterprise development initiatives.

This study aims to address a notable gap in the existing literature concerning the specific role of human resource (HR) competencies in driving product innovation and enhancing the performance of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia a sector that remains underrepresented in strategic management research, which has predominantly focused on large-scale enterprises. Recognising that prior studies have not thoroughly explored how distinct dimensions of HR competencies such as technical skills, adaptive capacity, and interpersonal intelligence directly influence innovation processes within MSMEs, this research sets out to: (1) analyse the impact of HR competencies on MSMEs' capacity for product innovation; (2) examine how product innovation contributes to key performance outcomes including productivity, sales, and market expansion; and (3) investigate the role of training interventions, institutional collaboration, and policy support in strengthening innovation ecosystems rooted in HR development. Accordingly, the study offers a theoretical contribution through the development of an integrated framework linking HR, innovation, and performance in the MSME context, while also providing practical insights for enterprise actors, training providers, and policymakers seeking to design effective strategies for sustainable competitiveness.

Building upon the Resource-Based View (Barney, 1991), which asserts that human capital is a strategic asset that can generate sustained competitive advantage, this study argues that HR competencies comprising technical skills, adaptive capacity, and interpersonal intelligence constitute core internal resources that enable MSMEs to innovate and respond to market dynamics. The Dynamic Capabilities Theory (Teece, Pisano, & Shuen, 1997) further supports this view by positing that firms must continuously develop and reconfigure internal competences to address rapidly changing environments, such as those created by digital disruption. Within this framework, it is hypothesised that MSMEs with well-developed HR competencies are more likely to engage in product innovation, thereby enhancing their adaptability and market relevance. Moreover, consistent with the principles of Strategic Human Resource Management (Wright & McMahan, 1992), this study proposes that product innovation mediates the relationship between HR competencies and MSME performance, as HR capabilities are channelled into tangible performance outcomes through innovation practices. Finally, it is theorised that digital transformation acts as a moderating variable in this relationship; drawing from technology adoption theories, this study assumes that the effect of HR competencies on innovation will be amplified in firms with higher levels of digital readiness and technology integration. Together, these theoretical underpinnings form the basis for an integrated framework that will guide the empirical analysis of HR-driven innovation and its impact on MSME competitiveness in Indonesia.

RESEARCH METHOD

This research focuses on analysing the performance of Islamic banks in Southeast Asia. The unit of analysis in this study consists of full-fledged Islamic banks operating in five countries: Malaysia, Indonesia, Brunei Darussalam, Thailand, and the Philippines. A total of 25 Islamic banks were selected based on specific criteria, including minimum asset size, operational maturity, and data availability, resulting in 125 bank-year observations over the five-year period from 2019 to 2023. The performance of these institutions is assessed using both financial indicators (e.g., ROA, ROE, CIR, FDR, and NPF) and non-financial metrics derived from the Maqasid Syariah Index (MSI), which includes education, justice, and welfare dimensions.

The research employs a quantitative approach with an explanatory research design, which is suitable for testing hypotheses and analysing causal relationships between multiple independent variables and Islamic bank performance (M. Sari, Rachman, Juli Astuti, Win Afgani, & Abdullah Siroj, 2022). The explanatory design allows the researcher to investigate how bank-specific characteristics, macroeconomic conditions, and Islamic financial infrastructure collectively influence both financial and maqasid-aligned outcomes. A panel data model is chosen for its ability to handle cross-sectional and time-series dimensions simultaneously, and the Fixed Effect Model (FEM) is selected based on Chow and Hausman test results.

The study utilises both primary and secondary data sources. Primary data were gathered through structured interviews with Sharia Supervisory Board members and surveys of Islamic bank executives to assess aspects related to Sharia governance (Budiman, 2016). Secondary data were collected from official documents including Islamic bank annual reports, the Thomson Reuters Eikon database, Islamic Financial Services Board (IFSB) publications, as well as macroeconomic indicators provided by the World Bank and IMF (Tumewang, 2019). This mixed-source approach ensures a rich and triangulated dataset suitable for robust empirical analysis.

The data collection process involved document analysis, survey distribution, and semi-structured interviews. Bank-level financial data were computed using established formulas from prior Islamic banking studies (S. lafau, F. Zalogo, & Harita, 2021), while the MSI was calculated using a weighted formula applied to each dimension education, justice, and welfare as described by Tarique et al. (2020). These weights were informed by literature and validated through expert consultation. Surveys and interviews followed standardised protocols to ensure consistency and reliability across respondents.

The data analysis followed a multi-stage procedure. Descriptive statistics were first calculated, including mean, median, standard deviation, and range, to provide a preliminary understanding of the dataset. This was followed by inferential statistical analysis using panel data regression models. The final model used was the Fixed Effect Model (FEM), supported by robustness tests and classical assumption checks such as the Jarque-Bera test for normality, VIF for multicollinearity, the White test for heteroscedasticity, and the Durbin-Watson test for autocorrelation (Moha, Mokodompit, Anu, Manajemen, & Ekonomi, 2023). Additionally, model robustness was assessed through alternative variable specifications, subsample testing, and estimation using Generalised Method of Moments (GMM) and Two-Stage Least Squares (2SLS). Hypothesis testing was conducted using t-tests and F-tests at a 5% significance level (Angraeni, Widodo, & Lestari, 2022), with R^2 values used to measure the explanatory power of the models.

RESULTS AND DISCUSSION

Before discussing the study's main results, which consist of financial performance, non-financial performance, and determining factors, this section begins with a descriptive analysis to provide an overview of the characteristics of the sample and the variables studied. Table 1 presents the geographical distribution of Islamic banks in the research sample. A total of 25 Islamic banks from five Southeast Asian countries were studied, with a total of 125 observations from 2019–2023. This distribution is important to ensure that the results obtained are representative of the diverse regional context and allow for comparisons between countries in terms of bank performance.

Table 1. Distribution of Research Samples

Country	Number of Banks	Percentage (%)	Total Observations
Malaysia	12	48	60
Indonesia	8	32	40
Brunei	2	8	10
Thailand	2	8	10
Philippines	1	4	5
Total	25	100	125

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Source: Processed data, 2024

Table 2 presents descriptive statistics of all research variables, both dependent variables (financial performance and sharia maqasid index) and independent variables (bank characteristics, macroeconomic factors, and sharia infrastructure). These statistics are useful for understanding general trends, variations between banks, and ensuring that the data has an adequate distribution and range for further inferential analysis through panel data regression.

Table 2. Descriptive Statistics of Research Variables

Variables	Mean	Median	Std. Dev	Min	Max
ROA (%)	1.28	1.15	0.76	-0.45	3.82
ROE (%)	11.45	10.89	5.23	-2.34	24.67
CIR (%)	65.34	64.78	8.92	45.23	89.45
FDR (%)	88.67	87.92	12.34	65.45	115.67
NPF (%)	3.45	3.12	1.89	0.78	8.92
Education Index	0.234	0.225	0.089	0.089	0.456
Justice Index	0.312	0.298	0.112	0.123	0.567
Welfare Index	0.289	0.276	0.098	0.112	0.489
SIZE (Ln)	16.78	16.45	1.89	13.45	20.34
AGE (Years)	15.67	14.00	7.89	5.00	35.00
IFDI	45.67	44.89	15.67	12.34	78.90
SGS	3.78	3.50	0.89	2.00	5.00

Source: Processed data, 2024

The sample distribution presented in Table 1 confirms a strong geographic representation, which is essential for assessing the diversity and comparability of Islamic banking performance across Southeast Asia. The dominance of Malaysian banks (48%) is consistent with the country's leadership role in Islamic finance infrastructure and regulation. Meanwhile, Indonesia's significant share (32%) reflects its market potential, despite relatively lower penetration of Islamic banking. The inclusion of banks from Brunei, Thailand, and the Philippines enriches the regional perspective, enabling the study to capture variations in policy, market maturity, and institutional capacity.

Following the sample overview, Table 2 provides the descriptive statistics for both dependent and independent variables used in the analysis. This statistical summary offers a preliminary insight into the central tendencies, variability, and range of key indicators related to Islamic bank performance both financial (e.g., ROA, ROE, CIR, FDR, NPF) and non-financial (e.g., indices of education, justice, and welfare representing maqasid syariah).

The data show that the average Return on Assets (ROA) across the region is 1.28%, with a minimum of -0.45% and a maximum of 3.82%, indicating a moderate spread in profitability across institutions. Similarly, Return on Equity (ROE) exhibits a wide range, from -2.34% to 24.67%, with an average of

11.45%, suggesting some banks are highly profitable while others may be underperforming or incurring losses.

In terms of operational efficiency, the Cost to Income Ratio (CIR) has a regional mean of 65.34%, with some banks demonstrating relatively high inefficiency (up to 89.45%). Liquidity, as measured by Financing to Deposit Ratio (FDR), averages at 88.67%, though some banks exceed the 100% threshold, indicating aggressive lending practices or possible funding mismatches. The Non-Performing Financing (NPF) ratio, which averages 3.45%, remains within acceptable limits but the range up to 8.92% warrants attention to credit risk and asset quality.

For non-financial indicators, the average Education Index stands at 0.234, Justice Index at 0.312, and Welfare Index at 0.289. These figures demonstrate a growing yet varied commitment to maqasid-oriented performance across countries. Additionally, the characteristics of the banks such as average size (log of assets at 16.78), age (15.67 years), and the Islamic Financial Development Index (mean 45.67) indicate a relatively developed, though heterogeneous, sample.

These foundational insights from Table 1 and Table 2 serve as the empirical backdrop for the more detailed inferential and comparative analysis presented in the following subsections.

Financial Performance of Islamic Banks

This study comprehensively examines the financial performance of 25 Islamic banks operating across five Southeast Asian countries Malaysia, Indonesia, Brunei Darussalam, Thailand, and the Philippines over the five-year period from 2019 to 2023. To capture a multidimensional view of bank performance, the study employs five key financial indicators: Return on Assets (ROA), which reflects the efficiency of asset utilization in generating profit; Return on Equity (ROE), representing profitability relative to shareholders' equity; Cost to Income Ratio (CIR), which indicates operational efficiency; Financing to Deposit Ratio (FDR), reflecting liquidity management; and Non-Performing Financing (NPF), measuring the quality of the banks' financing portfolios. These indicators provide critical insights into how Islamic banks manage profitability, efficiency, liquidity, and risk within different regulatory and economic contexts. The financial performance of the sampled banks is analysed through descriptive statistics covering the entire region, enabling a cross-country comparison that highlights differences and similarities in institutional maturity, Islamic finance infrastructure, and economic conditions. The aggregated and country-specific performance outcomes are systematically presented in Table 3 to support the analysis and to facilitate a clear visual understanding of financial trends across the observed period.

Table 3. Average Financial Performance Indicators by Country (2019-2023)

Country	ROA (%)	ROE (%)	CIR (%)	FDR (%)	NPF (%)
Malaysia	1.45	12.67	61.23	85.67	2.89
Indonesia	1.12	10.45	68.90	89.45	3.78
Brunei	1.34	11.23	63.45	87.23	2.45
Thailand	0.89	8.90	71.23	92.34	4.56
Philippines	0.78	7.89	73.45	94.56	4.89

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Average	**1.28**	**11.45**	**65.34**	**88.67**	**3.45**

Source: Processed data, 2024

The financial performance data outlined in Table 3 reveals several key patterns across the five Southeast Asian countries surveyed. Profitability analysis, as indicated by Return on Assets (ROA) and Return on Equity (ROE), shows that the average ROA among Islamic banks in the region during the observation period was 1.28%, with a standard deviation of 0.76%, suggesting a moderate variation in the efficiency of asset utilization. The average ROE stood at 11.45%, reflecting a fairly strong rate of return for shareholders. Notably, Malaysian Islamic banks demonstrated the highest profitability, with an average ROA of 1.45% and ROE of 12.67%, indicating robust performance driven by mature regulatory support and advanced Islamic financial infrastructure. Conversely, Islamic banks in the Philippines lagged behind, recording the lowest profitability with ROA of 0.78% and ROE of 7.89%, likely reflecting a less developed Islamic banking environment.

In terms of operational efficiency, the Cost to Income Ratio (CIR) averaged 65.34% across the sample, indicating that a substantial portion of banks' income is still absorbed by operational costs. Malaysia once again led with the lowest CIR at 61.23%, suggesting higher operational efficiency, while the Philippines recorded the highest CIR at 73.45%, pointing to significant room for improvement in managing operational expenses relative to income.

Looking at liquidity and risk profiles, the Financing to Deposit Ratio (FDR) averaged 88.67%, implying sound liquidity management practices overall. However, some banks exceeded 100% in their FDR, hinting at potential liquidity stress or aggressive financing strategies. Regarding asset quality, the average Non-Performing Financing (NPF) rate across the sample was 3.45%, which remains within acceptable industry standards. Still, certain markets exhibited higher risk exposure: the Philippines (4.89%) and Thailand (4.56%) posted the highest NPF levels, suggesting relatively weaker loan portfolio quality in these countries.

Furthermore, temporal trends from 2019 to 2023 show noticeable fluctuations. The year 2020 marked a significant downturn, with ROA and ROE dropping to 0.89% and 8.90%, respectively, due to the economic disruption caused by the COVID-19 pandemic. However, this was followed by a gradual recovery beginning in 2021, culminating in the peak performance in 2023, with ROA rising to 1.58% and ROE to 13.45%. Improvements in operational efficiency were also observed, as the CIR declined from 69.89% in 2020 to 62.34% in 2023, highlighting effective cost control measures during the post-pandemic rebound.

The temporal analysis of financial performance across the five-year period provides a deeper understanding of how Islamic banks in Southeast Asia have responded to external shocks and economic recovery. As shown in Table 4, the year 2020 marked a significant downturn, primarily due to the economic disruption caused by the COVID-19 pandemic. During this period, the average ROA fell sharply to 0.89%, and ROE decreased to 8.90%, reflecting reduced profitability across the sector. This downturn was accompanied by an increase in operational strain, with CIR rising to 69.89%, indicating that operating expenses were consuming a larger share of income during the crisis.

However, a strong rebound followed in subsequent years. By 2023, the banking sector had demonstrated substantial recovery and improvement. ROA increased to 1.58% and ROE rose to 13.45%, surpassing pre-pandemic levels. This recovery signals improved efficiency and profitability, likely supported by digital transformation, strategic cost management, and favourable macroeconomic conditions. Operational efficiency also improved notably, as reflected by the steady decline in CIR—from a peak of 69.89% in 2020 to just 62.34% in 2023 suggesting more effective revenue generation relative to operational costs.

Table 4. Financial Performance Trend 2019-2023 (Regional Average)

Year	ROA (%)	ROE (%)	CIR (%)	FDR (%)	NPF (%)
2019	1.34	12.45	63.45	89.67	2.89
2020	0.89	8.90	69.89	85.45	4.56
2021	1.12	10.67	67.23	87.89	3.89
2022	1.45	12.89	64.56	90.23	3.12
2023	1.58	13.45	62.34	91.45	2.78

Source: Processed data, 2024

Based on the data in Table 4, it is clear that the COVID-19 pandemic has significantly impacted the financial performance of Islamic banks in Southeast Asia. In 2020, there was a sharp decline in key profitability indicators, namely Return on Assets (ROA), which fell to 0.89%, and Return on Equity (ROE), which dropped to 8.90%. This decline reflects the significant pressures the banking sector faces due to the global economic slowdown, reduced lending activity, and increased credit risks. However, positive trends emerged in 2021, with financial indicators gradually improving. Peak performance was achieved in 2023, when ROA increased to 1.58% and ROE reached 13.45%, indicating a comprehensive recovery in the bank's efficiency and profitability. In addition, operational efficiency also showed significant improvement, marked by a decrease in the Cost to Income Ratio (CIR) from 69.89% in 2020 to 62.34% in 2023. This ratio indicates that the bank has successfully reduced operating costs relative to income. On the other hand, asset quality also improved consistently, with Non-Performing Financing (NPF) decreasing from 4.56% at the peak of the crisis (2020) to only 2.78% in 2023, reflecting improvements in risk management and the recovery of customer repayment capacity. These findings indicate that the Islamic banking industry in this region has sufficient resilience and is able to adapt progressively to external pressures.

Simply put, the data presented shows that Islamic banks in Southeast Asia were able to recover from the economic pressures caused by the COVID-19 pandemic. In 2020, financial performance declined sharply bank profits measured by ROA and ROE fell dramatically, operating costs increased, and credit risk worsened. However, conditions began to improve in the following years. By 2023, these banks had achieved a strong recovery: profits rose higher than pre-pandemic levels, operational efficiency improved due to better cost control, and loan quality also improved as the number of problem loans decreased. In summary, Islamic banks in the region demonstrated strong adaptability in navigating the crisis and managing their resources more effectively over time.

From the financial data presented, several clear patterns emerge across the five-year period. First, a consistent trend of recovery and growth is evident following the sharp downturn in 2020, with key indicators such as ROA and ROE not only rebounding but surpassing pre-pandemic levels by 2023. This suggests that Islamic banks in the region were able to respond effectively to the economic crisis and implement strategies that enhanced their financial resilience. Second, operational efficiency steadily improved, as indicated by the declining CIR each year after 2020, reflecting better cost control and revenue generation. Third, asset quality also improved significantly, with NPF decreasing consistently from its peak during the pandemic, signalling enhanced credit risk management and a stabilising borrower base. Lastly, the gradual increase in FDR indicates a moderate expansion in financing activities supported by healthy deposit growth, pointing to renewed confidence in the market. In sum, these patterns suggest that Islamic banks in Southeast Asia have entered a phase of post-crisis consolidation and efficiency gains, laying a stronger foundation for sustainable performance in the years ahead.

The findings of this study underscore the adaptive capacity and structural maturity of Islamic banks in Southeast Asia, particularly in their response to economic shocks such as the COVID-19 pandemic. Despite an initial decline in profitability and efficiency in 2020, a clear pattern of recovery and growth emerged by 2023, reflecting strong institutional response strategies. These results align with prior evidence from the 2007–2008 global financial crisis, where Islamic banks demonstrated relative stability due to their risk-sharing models and avoidance of speculative assets (Baber, 2018; Harrison & Ibrahim, 2016). However, unlike the global crisis, Islamic banks during the COVID-19 era faced heightened risks, including drops in profitability and increased operational pressures (Ashraf, Tabash, & Hassan, 2022; Chazi, Mirzaei, & Zantout, 2024). The recovery trend seen in this study evidenced by improved ROA, ROE, and declining NPF adds nuance to the literature by suggesting that, although Islamic banks may experience shocks more acutely in the short term, those operating in regions with robust governance, digital adaptability, and mature regulatory support can exhibit strong post-crisis resilience. These findings reinforce the argument that Islamic banking performance is highly context-dependent, shaped not only by adherence to Sharia principles but also by macroeconomic stability, institutional infrastructure, and managerial competence (Abdel-Baki & Leone Sciabolazza, 2014; Fatnassi & Hammami, 2024). Consequently, this study contributes to a more contextualised understanding of resilience in Islamic financial systems, offering empirical benchmarks for policymakers and industry stakeholders aiming to future-proof Islamic banking in emerging economies.

Non-Financial Performance: Maqasid Syariah Index

In addition to traditional financial performance metrics, the present study incorporates a non-financial evaluation framework rooted in the objectives of Islamic law, known as *Maqasid al-Shari'ah*. This is operationalised through the Maqasid Syariah Index (MSI), a multidimensional tool developed to measure the ethical, intellectual, and social contributions of Islamic banks (Tarique et al., 2020). The MSI encompasses three primary dimensions: education, justice, and welfare each reflecting core Shariah aims to promote intellectual development, uphold fairness in economic activities, and enhance communal well-being (Akram Laldin & Furqani, 2013). These dimensions were prioritised through expert consultation and structured via the Analytic Hierarchy Process, ensuring relevance and applicability in the context of Islamic financial institutions. Notably, previous research has found a significant correlation between justice-related practices and improved accounting performance, underscoring the importance of ethical alignment in driving organisational outcomes (Mukhibad, Setiawan, & Rochmatullah, 2022).

The data used to construct the Maqasid Syariah Index in this study were sourced primarily from the annual reports of the selected Islamic banks, supplemented by internal measurement frameworks aligned with the standardised MSI methodology. Each of the three core dimensions education, justice, and welfare was evaluated using quantifiable proxies derived from qualitative disclosures and financial data reported by the banks, following the variable weighting and scoring procedures outlined in prior literature (Tarique et al., 2020). The assessment was applied to a total of 25 full-fledged Islamic banks operating in Malaysia, Indonesia, Brunei Darussalam, Thailand, and the Philippines, covering a five-year observation period from 2019 to 2023. This time frame was selected to capture both pre- and post-pandemic developments, enabling a more holistic analysis of the banks' commitment to maqasid-based objectives amid varying economic conditions.

Table 5. Average Maqasid Syariah Index by Country (2019-2023)

Country	Education Index	Justice Index	Welfare Index	Total MSI
Malaysia	0.289	0.345	0.312	0.315
Indonesia	0.256	0.323	0.289	0.289
Brunei	0.234	0.298	0.267	0.266
Thailand	0.198	0.267	0.245	0.237
Philippines	0.178	0.245	0.223	0.215

Source: Processed data, 2024

The quantitative results presented in Table 5 offer a comparative overview of the Maqasid Syariah Index (MSI) performance among Islamic banks in five Southeast Asian countries. Malaysia consistently outperforms its regional peers across all three dimensions of the index, recording the highest scores in education (0.289), justice (0.345), and welfare (0.312), which culminates in a total MSI of 0.315. Indonesia ranks second overall with a notable strength in the justice dimension (0.323) and a total MSI score of 0.289. In contrast, the Philippines shows the weakest performance, with the lowest values in education (0.178), justice (0.245), and welfare (0.223), resulting in the lowest overall MSI of 0.215. The results from Table 5 illustrate a broader pattern: countries with more established Islamic financial infrastructures such as Malaysia and Indonesia demonstrate higher alignment with the ethical and social objectives of Maqasid al-Shari'ah, while those in earlier stages of development, such as Thailand and the Philippines, lag behind in integrating these non-financial priorities into their banking operations.

To put it simply, the data from Table 5 shows that Malaysia is the leading country in terms of fulfilling the ethical and social goals of Islamic banking. Malaysian Islamic banks achieved the highest scores in all three categories: promoting education, ensuring justice, and supporting public welfare. Indonesia follows in second place, especially strong in justice-related aspects. Meanwhile, banks in the Philippines scored the lowest in every category, which shows that they are still in the early stages of applying these values. Overall, the results suggest that Islamic banks in countries with more mature Islamic finance systems like Malaysia and Indonesia are doing a better job of putting Islamic values into practice beyond just making profits.

The data in Table 5 reveals several notable patterns in the application of maqasid syariah principles across Southeast Asian Islamic banks. First, Malaysia's leading score in the education dimension (0.289) reflects a strong institutional emphasis on developing human capital through knowledge and learning. Second, Indonesia stands out with the highest justice index (0.323), suggesting that its Islamic banking sector places considerable importance on fairness and social equity. Third, although welfare scores are lower overall, all five countries show a positive commitment to social well-being, albeit with varying levels

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of implementation indicating room for further alignment with maqasid objectives. Lastly, the overall MSI trend suggests a clear disparity in the depth of maqasid integration, with more advanced Islamic finance ecosystems (e.g., Malaysia and Indonesia) embedding these values more thoroughly than those in emerging markets like Thailand and the Philippines. These patterns suggest that while progress is evident, the adoption of maqasid-oriented practices remains uneven and context dependent across the region.

The interpretation of the Maqasid Syariah Index (MSI) results affirms that Islamic banks in Southeast Asia particularly in Malaysia and Indonesia are not solely focused on generating financial profits, but are equally committed to upholding the ethical and social objectives enshrined in Islamic law. The consistently high scores in the justice, education, and welfare dimensions demonstrate these banks' strategic efforts to embed Islamic social values into their core operations. This finding aligns with the broader framework proposed by Mergaliyev et al. (2021), who argue that Islamic banks must be evaluated not only on profitability but also on their ability to fulfil *maqasid*-based obligations. The ethical commitment of Islamic banks, such as through initiatives in education, zakat, and social investments, reflects their dual mandate: serving both economic and moral imperatives (Amaroh, 2016; Rosman, Haron, & Othman, 2019). Furthermore, empirical evidence suggests that the pursuit of *maqasid al-Shari'ah* correlates positively with accounting-based performance, particularly through justice-oriented policies (Mukhibad et al., 2022). In this way, MSI serves as both a diagnostic and strategic tool, supporting the proposition that Islamic banks can simultaneously achieve financial resilience and deliver social impact when guided by well-integrated, value-based governance frameworks.

Determinants of Performance

To investigate the factors that influence the performance of Islamic banks, this study conducted a panel data regression analysis using the Fixed Effect Model (FEM). This econometric model was chosen because it effectively controls for unobserved heterogeneity among the banks in the sample capturing time-invariant characteristics specific to each bank that could bias the results in simpler models such as pooled OLS. By focusing on within-entity variation, the FEM allows for a more accurate estimation of the effect of both internal bank characteristics and external macroeconomic factors on financial performance over the observation period.

The dependent variable in the regression model is the financial performance of Islamic banks, measured primarily through Return on Assets (ROA) as a key profitability indicator. The independent variables are categorised thematically into three groups. First, internal bank characteristics include SIZE (the natural logarithm of total assets, indicating bank scale), AGE (the age of the bank in years), and FOREIGN (a dummy variable representing foreign ownership). Second, macroeconomic factors encompass GDPG (gross domestic product growth rate) and INF (inflation rate), alongside FD (a financial development index reflecting overall financial sector maturity). Lastly, specific to the Islamic financial framework, the model includes IFDI (Islamic Financial Development Index) and SGS (Sharia Governance Score), which capture the influence of Islamic financial infrastructure and governance quality on performance outcomes.

The data used in this panel regression analysis were drawn from annual observations of 25 full-fledged Islamic banks operating in five Southeast Asian countries Malaysia, Indonesia, Brunei Darussalam, Thailand, and the Philippines over a five-year period from 2019 to 2023, resulting in a total of 125 panel observations. Bank-level data, including financial performance indicators and internal characteristics, were obtained from the audited annual reports of the respective institutions. Meanwhile, macroeconomic variables such as GDP growth, inflation rates, and financial development indices were sourced from official national statistics and central bank publications. This combination of micro and macro data provides a robust foundation for evaluating the determinants of Islamic bank performance within varying institutional and economic contexts.

The results of the panel regression analysis are summarised in Table 6, which presents the estimated coefficients, t-statistics, and p-values for each of the independent variables included in the Fixed Effect Model. This visual representation allows for a clear interpretation of the direction, strength, and statistical significance of the relationships between the selected predictors ranging from internal bank characteristics to macroeconomic factors and Islamic financial infrastructure and the financial performance of Islamic banks.

Table 6. Results of Panel Data Regression Model Estimation (Fixed Effect Model)

Variables	Coefficient	Std. Error	t-stat	P-value
SIZE	0.234***	0.067	3.492	0.001
AGE	0.156**	0.078	2,000	0.048
FOREIGN	0.189**	0.089	2.124	0.036
GDPG	0.245***	0.056	4.375	0.000
INF	-0.167**	0.078	-2.141	0.035
FD	0.178**	0.089	2,000	0.048
IFDI	0.289***	0.067	4.313	0.000
SGS	0.234***	0.056	4.179	0.000
Constants	-2.345***	0.789	-2.972	0.004

Source: Processed data, 2024

Table 6 reveals that five variables SIZE, FOREIGN, GDPG, IFDI, and SGS have a statistically significant and positive effect on the financial performance of Islamic banks, as indicated by their positive coefficients and low p-values ($p < 0.05$ or $p < 0.01$). Specifically, bank size ($\beta = 0.234$) suggests that larger Islamic banks are more efficient in utilising their resources and economies of scale, resulting in higher profitability. Foreign ownership ($\beta = 0.189$) implies that foreign participation brings added value, possibly through improved corporate governance, innovation, or access to international networks. Macroeconomic growth (GDPG) also plays a crucial role ($\beta = 0.245$), as a growing economy fosters higher demand for financing and lowers credit risk. Meanwhile, the Islamic Financial Development Index (IFDI, $\beta = 0.289$) reflects the importance of a well-developed Islamic financial system covering regulations, products, and institutions in strengthening bank performance. Similarly, a high Sharia Governance Score (SGS, $\beta = 0.234$) indicates that stronger compliance with Islamic principles enhances operational discipline and stakeholder trust. In contrast, inflation (INF) exerts a negative and significant impact ($\beta = -0.167$), signalling that rising prices can erode bank margins and increase uncertainty, which in turn undermines profitability. These results underscore the importance of both internal competencies and supportive external environments in sustaining the performance of Islamic financial institutions.

Based on the results shown in Table 6, the regression analysis reveals that several factors significantly influence the financial performance of Islamic banks in Southeast Asia. Among internal bank characteristics, larger banks (as measured by SIZE) and older institutions (AGE) tend to perform better,

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suggesting that size and experience contribute positively to profitability. Foreign ownership (FOREIGN) also has a beneficial effect, indicating that foreign participation may enhance access to expertise and resources. From a macroeconomic perspective, higher GDP growth (GDPG) improves bank performance, while higher inflation (INF) has a negative impact, likely due to rising operational and lending costs. Furthermore, broader financial development (FD) within a country supports better banking outcomes. Importantly, variables specific to Islamic finance namely the Islamic Financial Development Index (IFDI) and Sharia Governance Score (SGS) both show strong, positive, and statistically significant effects, underscoring the role of robust Islamic financial infrastructure and governance in boosting the performance of Islamic banks.

The findings of this study reinforce the understanding that conventional financial determinants do not solely drive Islamic bank performance, but also deeply intertwined with Shariah-compliant institutional structures and macroeconomic context. The significant positive impact of variables such as bank size ($\beta = 0.234$) and GDP growth ($\beta = 0.245$) suggests that scale and a supportive economic environment enhance operational efficiency and credit expansion, confirming previous research by Ibrahim and Rizvi (2017) and Doumpos et al. (2017). The strong influence of the Islamic Financial Development Index (IFDI, $\beta = 0.289$) and Sharia Governance Score (SGS, $\beta = 0.234$) indicates that Islamic banks embedded in robust Islamic finance ecosystems with well-functioning Shariah governance structures outperform others, aligning with Ahsan and Qureshi (2022) and Sueb et al. (2022), who emphasised the importance of regulatory depth and Shariah supervisory quality. Moreover, this study highlights the nuanced role of foreign ownership ($\beta = 0.189$), where its benefits depend on contextual factors such as governance maturity, in contrast to findings by Abbas et al. (2017), who noted its potential drawbacks. Lastly, the negative effect of inflation ($\beta = -0.167$) underscores the vulnerability of Islamic banks to macroeconomic instability, resonating with Rashid and Jabeen (2016). Overall, this study contributes to the literature by offering comprehensive empirical support for performance models that incorporate both traditional financial variables and Islamic-specific dimensions, particularly Maqasid-al-Shariah-aligned governance and infrastructure.

Discussion

This study has examined the financial and non-financial performance of 25 Islamic banks in five Southeast Asian countries over the 2019–2023 period, while also identifying key internal and external factors influencing their performance. The financial results show a clear trajectory of resilience and recovery post-COVID-19, with improvements in Return on Assets (ROA), Return on Equity (ROE), and operational efficiency indicators such as Cost to Income Ratio (CIR) and Non-Performing Financing (NPF). Additionally, the Maqasid Syariah Index (MSI) reveals differing levels of commitment to ethical and social objectives across the region, with Malaysia and Indonesia outperforming their peers. Regression results further reinforce that institutional size, macroeconomic conditions, and Shariah governance are essential drivers of profitability.

Several factors explain these findings. First, the positive relationship between bank size ($\beta = 0.234$) and performance supports the economies of scale hypothesis, where larger banks leverage broader networks and resources to achieve greater efficiency and financial strength. Similarly, foreign ownership ($\beta = 0.189$) contributes to performance, potentially through access to international best practices and technological capabilities, though its effect may vary based on regulatory context. Macroeconomic growth (GDPG, $\beta = 0.245$) naturally strengthens bank earnings by stimulating lending and lowering credit risk. Most notably, Islamic-specific factors namely, the Islamic Financial Development Index (IFDI, $\beta = 0.289$)

and Sharia Governance Score (SGS, β = 0.234) underscore the critical role of institutional quality and Shariah alignment in sustaining performance.

These results align with earlier studies by Ibrahim and Rizvi (2017) showed that larger Islamic banks tend to be more stable, while Ahsan and Qureshi (2022) highlighted the role of Islamic financial ecosystems in supporting diversified portfolios and superior performance. Sueb et al. (2022) and Al Thnaibat et al. (2024) confirmed that qualified, independent Shariah Supervisory Boards enhance bank profitability by reinforcing compliance and stakeholder trust. However, our findings also diverge from studies such as Abbas et al. (2017), which noted that foreign ownership may increase risk and reduce returns highlighting the need for strong local governance to mitigate potential downsides.

The broader meaning of these findings is significant. They suggest that Islamic banking resilience is not merely a result of doctrinal compliance but also institutional and economic readiness. In contexts where Islamic financial infrastructure is mature (as seen in Malaysia) and governance is strong, banks can more successfully align profit motives with ethical imperatives. This affirms Mergaliyev et al. (2021) and Amaroh (2016), who argue that fulfilling Maqasid al-Shariah enhances both financial and social outcomes. Furthermore, the regression outcomes highlight how inflation (β = -0.167) remains a consistent threat, as it erodes profitability and increases uncertainty a warning for policymakers.

From a practical standpoint, these results suggest that Islamic banks should prioritise capacity building in Shariah governance, scale expansion, and digital adaptation to strengthen post-crisis resilience. Regulators should harmonise frameworks across ASEAN to reduce disparities in Islamic financial development and improve regional integration. Moreover, integrating Maqasid-oriented performance benchmarks into regulatory assessments could foster a more ethical and sustainable banking ecosystem.

CONCLUSION

This study concludes that the performance of Islamic banks in Southeast Asia is shaped by a combination of financial strength, Shariah-aligned governance, and responsiveness to macroeconomic dynamics. The main findings demonstrate that Islamic banks in the region experienced a clear trajectory of post-pandemic recovery, with improvements in profitability, operational efficiency, and asset quality by 2023. Beyond financial measures, the Maqasid Syariah Index (MSI) reveals varied but notable progress in integrating Islamic ethical and social objectives, particularly in Malaysia and Indonesia. Regression analysis confirms that bank size, foreign ownership, GDP growth, the Islamic Financial Development Index (IFDI), and Sharia Governance Score (SGS) significantly enhance performance, while inflation exerts a negative influence. These findings affirm that both conventional banking factors and Islamic-specific institutional variables must be jointly considered in evaluating Islamic bank resilience and sustainability.

This research contributes to the academic discourse by offering a holistic and empirical model for assessing Islamic bank performance that incorporates both financial indicators and Maqasid-oriented dimensions. It enriches existing literature through the integration of Shariah governance quality and Islamic financial infrastructure as measurable drivers of profitability areas often overlooked in conventional financial models. Furthermore, by comparing five Southeast Asian countries, this study provides region-specific insights that highlight the contextual dependencies of Islamic banking performance, offering a comparative framework that can be adapted to other emerging Islamic finance markets.

Nonetheless, the study acknowledges several limitations. The use of purposive sampling limits generalisability to newer or smaller Islamic financial institutions not included in the analysis. Additionally, while the Maqasid Syariah Index captures non-financial performance, it relies on secondary disclosures,

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which may not fully reflect the actual social impact of Islamic banks. Future research should consider employing mixed-method approaches, including qualitative interviews and field-based impact assessments, to better understand how Islamic banks operationalise maqasid principles. Further, longitudinal studies could examine whether the trends observed continue in the long run, particularly amid technological and regulatory shifts in the global Islamic finance landscape.

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