INTERNAL AND EXTERNAL FACTORS INFLUENCING EQUITY-BASED FINANCING IN ISLAMIC BANKING: PANEL DATA EVIDENCE FROM INDONESIA

Irena Paramita Pramono[1*], Farah Aida Ahmad Nadzri[2], Mohamad Hanif Abu Hassan[3], Mohd Taufik Mohd Suffian[4]

[1]*Accounting Department Economic and Business Faculty, Universitas Islam Bandung, Indonesia*
[2,4] *Accounting Research Institute, Universiti Teknologi MARA, Shah Alam, Malaysia*
[3] *School of Business Management, College of Business, Universiti Utara Malaysia, Malaysia*

Email: [1*]irena.paramita@unisba.ac.id, [2]aidanadzri@uitm.edu.my, [3]hanifab@uum.edu.my, [4]taufik815@uitm.edu.my

Received: 31 December 2025
Accepted: 20 January 2026

ABSTRACT

Data reveals significant differences in the allocation of mudharabah and musharakah financing within Islamic banks. The importance of equity financing from Islamic banks to the community highlights the urgent need for a comprehensive understanding of the internal and external factors influencing equity financing in Islamic institutions. This study aims to examine the determinants affecting the distribution of equity financing by Islamic banks. This study attempts to analyze the determinants affecting the distribution of equity financing by Islamic banks. A total of 14 banks were selected as samples due to their complete data. Consequently, the collected annual data for seven years, from 2018 to 2024. This study identifies that internal factors influencing the distribution of mudharabah financing include the Capital Adequacy Ratio (CAR), Third Party Funds (TPF), and Non-Performing Financing (NPF), while external factors do not alter this distribution. In contrast, the allocation of musharakah financing is governed exclusively by the Bank Indonesia (BI) interest rate, with no internal factors influencing it. This conclusion suggests that Islamic banks increase mudharabah financing allocation by lowering CAR, increasing TPF, and reducing NPF. A decrease in CAR often indicates an increased capacity for investment financing. An increase in TPF will motivate Islamic banks to expand their mudharabah funding. Furthermore, efficient management of NPF will further motivate Islamic banks to improve their mudharabah financing.

Keywords: Islamic banking, Mudharabah , Musyarakah, Financing

1.0 INTRODUCTION

Indonesia is one of ten nations that have adopted a dual banking system, offering both conventional and Sharia financing options, alongside Malaysia, Egypt, Pakistan, Saudi Arabia, Kuwait, the UAE, Turkey, Bangladesh, and Sudan. The funding offered by Islamic banks has a positive influence on economic growth across all sectors and significantly contributes to the creation of employment opportunities (Setiawan, 2019). Sharia financial institutions are not limited to Sharia banks. They also include a diverse range of institutions such as Bank Perkreditan Rakyat Syariah (BPRS), Pegadaian Syariah, Sharia multi finance, Sharia venture capital (Komite Nasional Ekonomi dan Keuangan Syariah, 2020).

It is important to recognize that Islamic Financial Institutions (IFI) is different from traditional financial institutions in financing disbursement activities. Financing activities in conventional financial institutions are only carried out through loan financing or debt. However, financing activities at IFI can also be carried out through the principle of buying and selling,

the principle of ijarah[1], and the principle of syirkah[2] or profit-loss sharing. Equity financing in Islamic financial institutions, usually conducted through Musharakah and Mudarabah aqad, which a fundamental aspect of Islamic finance that complies with Shariah principles by prioritizing risk sharing and prohibiting Riba. This financing method has attracted academic attention due to its dual function in enhancing financial inclusion and promoting stability during economic instability (Othman et al., 2023). Empirical data indicate that while equity financing can enhance bank stability in times of financial difficulty, the complexities of risk-sharing arrangements, together with challenges like asymmetric knowledge and insufficient regulatory monitoring, remain as significant obstacles (Othman et al., 2023).

As discussed in the previous section, IFI differ from traditional financial institutions. There are three different types of contracts: buying and selling, equity based financing, and leasing. Equity financing is based on mudharabah aqad and musyarakah aqad. Another financing method, utilizing purchasing and selling contracts, could be classified as debt financing due to its more assured returns to the IFI. This includes murabahah, qardh, istisna, ijarah, salam, and other financing arrangements aqad. Based on its contract or aqad, Table 1 below presents the latest data about the composition of financing in Islamic Banks and Islamic microfinance institutions. Data indicates that musyarakah contracts predominate in Islamic banks, with 48.93% of the total financing, which is quite the opposite of the mudharabah contract, which only has a portion of 2.16% of the total financing. Meanwhile, debt financing using murabahah aqad dominates the financing in the Islamic Bank of Indonesia with 47.42% of the total financing. However, a different trend is happened in Islamic microfinance institutions, where murabahah aqad is 70% of the total contract value. In comparison, mudharabah and musyarakah comprise less than 13% of the overall contract value.

Based on the data in Table 1, there is a significant disparity in the distribution of mudharabah and musyarakah financing in the Islamic Bank. In theory, a mudharabah aqad is a financial arrangement between a fund owner (shahibul maal) and a fund manager (mudharib) to engage in certain business operations in compliance with sharia. The operational outcomes are allocated between the two parties based on a predetermined ratio, and in the event of a loss, the capital owner bears the responsibility for the loss. IFIs possess funds in modern financial activities, which they allocate as productive capital. On the contrary, customer work as fund manager in their business activities. Meanwhile, a musyarakah aqad is a collaborative contract when two or more fund or asset owners finance or invest in a firm, in compliance to sharia principles. The allocation of business outcomes between the two parties is according on this mutual agreement. In the case of a loss, it is allocated according to the agreement or the percentage of the capital provided. In a musyarakah aqad, the fund management and the Islamic Financial Institution collaborate as business partners, supplying capital or products to engage in company activities. In practice, the musyarakah aqad cannot function independently and must be executed in a hybrid multi-contract framework, even though the Prophet prohibited the practice of executing two contracts within a single transaction (Purnomo et al., 2024). The significance of equity financing from Islamic banks to the society, highlights the pressing necessity for a comprehensive understanding of the internal and external dynamics affecting equity financing in Islamic institutions. Therefore, this study tries to investigate the factors influencing equity funding allocation by Islamic banks.

[1] Ijarah: Ijarah is a contractual agreement that involves the transfer of the rights to use specific assets for a specified duration in return for rent

[2] Syirkah is a business model characterised by a partnership structure, wherein risks and earnings are shared among partners

Table 1. Sharia Financing Based on Aqad

Aqad	Sharia Bank (in Billion Rp and % with total financing)			Sharia Microfinance (in Billion Rp and % with total financing)		
	2020	2021	2022	2020	2021	2022
Mudharabah	11,854	10,185	10,376	4.96	6.79	14.11
	3.09%	2.48%	2.11%	2.57%	3.04%	5.67%
Musyarakah	174,919	187,485	223,680	18.00	21.02	19.03
	45.56%	45.74%	45.51%	9.34%	9.41%	7.65%
Murabahah	174,301	190,884	233,046	135.54	158.67	175.09
	45.40%	46.57%	47.42%	70.31%	71.05%	70.40%
Qardh	11,872	11,920	13,438	-	-	-
	3.09%	2.91%	2.73%	-	-	-
Istishna	2,364	2,496	3,013	-	-	-
	0.62%	0.61%	0.61%	-	-	-
Ijarah	8,635	6,908	7,937	-	-	-
	2.25%	1.69%	1.61%	-	-	-
Salam	-	-	-	0.05	-	-
	-	-	-	0.03%	-	-
Other financing	-	-	-	34.22	36.83	40.49
	-	-	-	17.75%	16.49%	16.28%
Total Financing	383,945	409,878	491,490	192.77	223.31	248.72

Source: Otoritas Jasa Keuangan [OJK], 2023

2.0 LITERATURE REVIEW

2.1 Islamic Bank - Mudharabah and Musyarakah Financing

Equity financing, which is also referred to as "Profit Loss Sharing" (PLS) financing in Islamic finance, is different from debt financing. Equity financing is a unique form of financing that is exclusively available to IFIs and is not accessible at traditional financial institutions. Equity financing, which is also known as PLS, is a critical component of equity financing in Islamic finance. PLS is a spirit of Islamic financing that emphasizes the equitable distribution of profits and losses between the investor and the business owner. Equity financing is in line with the principles of Islamic finance, as it forbids the payment of interest and promotes risk-sharing, both of which are prohibited by Islamic law (Sharia). It facilitates a more equitable distribution of wealth and encourages investment in productive activities.

Equity financing is more closely aligned with the principles of Islamic finance, as indicated by the literature (Abdul-Rahman et al., 2014). Previous research has also indicated that equity financing by IFIs offers numerous benefits. According to prior research, PLS financing also mitigates credit risk (Farihana & Rahman, 2021). Additionally, equity financing is more advantageous for the lower middle class(Yusof et al., 2009). Equity microfinance fosters closer relationships, offering the knowledge and guidance necessary to ensure business success, unlike debt-based financing which only facilitates financial inclusion for SMEs (Ayayi, 2012). Islamic financial intermediaries can invest in SMEs with higher risk returns over an extended period of time through the use of musyarakah and mudharabah (Huda, 2012).

Mudharabah and musyarakah aqad are the two types of equity financing that are employed in the practice of IFIs in Indonesia. A mudharabah contract is a financing/investment agreement between a fund owner (shahibul maal) and a fund manager (mudharib) to pursue specific business activities in accordance with sharia. The results of operations are shared between the two parties in accordance with a predetermined ratio, and if a loss occurs, the capital owner is responsible for the loss. Funds are owned by IFIs in contemporary financial activities, who provide them as productive capital. Meanwhile, customers serve as fund managers in their operations. In contrast, a musyarakah contract is a mutual agreement that involves the financing or investment of funds from two or more proprietors of funds and/or assets to manage a specific business in accordance with sharia. The distribution of business results between the two parties is based on this mutual agreement. In the event of a loss, the loss is allocated in accordance with the agreement or the proportion of the capital provided. In a musyarakah contract, the fund manager and the IFI work together as business partners, providing funds or products to conduct commercial business activities.

2.2 Internal and External Factors

Numerous previous studies have investigated the determinants of Islamic bank financing, including profit-sharing contracts such as mudharabah and musyarakah. These determinants can be categorized into internal factors, which originate within the Islamic bank, and external factors, which are influenced by the macroeconomic environment and regulatory policies.

2.2.1 Internal Factors

Internal factors are bank specific measurements that show financial health, operational efficiency, and risk management, which are directly controlled by management. These factors influence the ability of Islamic banks to expand or restrict financing, particularly mudharabah and musyarakah contracts. The CAR measures capital strength compared to risk weighted assets, indicating a bank's ability to absorb losses. While a higher CAR ensures stability, it may lead to conservative financing policies (Morshed, 2024). The Cost to Income Ratio (CIR) evaluates operational efficiency; a lower CIR signals better cost management and encourages financing, whereas high costs limit financing capacity (Ayinuola & Gumel, 2023)

TPF is fund customer deposits, are the primary financing for Islamic banks. A larger deposit base improves liquidity, positively influencing profit-sharing financing (Ernayani, 2024; Sartono et al., 2023; Zubir et al., 2023). The NPF ratio reflects credit risk; high NPF prevents banks from disbursing profit sharing financing (Riyadi et al., 2021; Riza Salman, 2023). The Return on Assets (ROA) indicates profitability; higher ROA enhances financing capacity (Singh et al., 2024). Finally, bank size (total assets) reflects financial strength and market influence, with larger banks more capable of providing financing (Singh et al., 2024). These internal factors determine the capacity, efficiency, and how much the risk of Islamic banks willing to take in distributing equity financing.

2.2.2 External Factors

External factors are consisting of macroeconomic and regulatory conditions that influence Islamic bank financing but are beyond the direct control of bank management. These factors influence the overall demand and supply of financing. The main external factors identified are as follows:

The BI rate, set by Bank Indonesia, serves as a benchmark for monetary policy. Although Islamic banks do not engage in interest based transactions, the BI rate indirectly affects them by influencing market liquidity and the cost of funds. A higher BI rate can attract deposits, increasing funds available for financing. Septiatin (2022) reported a positive relationship between the BI rate and Islamic bank financing.

GDP growth measures the overall economic activity and a country's health. Strong economic growth increases investment, increase consumption, and also stimulating demand for financing. Most studies, such as Singh and Chaudhary (2024) found a positive relationship between GDP growth and financing. However, Ehigiamusoe and Samsurijan (2021) suggested a negative influence, arguing that during periods of strong economic growth, businesses might rely more on internal funding rather than external financing.

2.3 Principal Agent Theory

The Principal Agent Theory comes from the important work of Jensen and Meckling (1976), helps us understand conflicts that happen when one person (the principal) gives another person (the agent) the power to make decisions. This relationship is fundamentally caused by asymmetry information and conflict of interests. The agent, who is supposed to work on behalf of the principal, usually knows more about what they are doing and how the task is really going than the principal does. This phenomenon causes two main problems: moral hazard, where the agent might do things that are good for them instead good for the principal after the contract is signed, and adverse selection, when the principal cannot fully appraise the agent's quality before the contract is signed. To reduce these risks, principals pay a lot of money for things like monitoring, bonding, and residual loss fees. In traditional corporate finance, this framework explains the relationship dynamics between shareholders (principals) and managers (agents). However, its application to Islamic banking uncovers a more complicated,the principal agent theory is explaining the industry's prudent attitude towards equity financing (Chapra & Ahmed, 2002). Because of this, PLS financing is not as appealing to institutions as debt like instruments like Murabaha, which shift business risk to the client and make it easier for the bank to keep an eye on things (Ariffin et al., 2009).

This approach directly influences the choice and anticipated impact of internal bank specific factors in this investigation. It predicts that a bank's willingness to do equity financing depends on how well it can handle and absorb these higher agency expenses. For example, a higher CAR could mean that the company is ready for any losses from PLS initiatives, but it could also mean that the company is being cautious and avoiding high agency cost items. An increase in NPF also means that the portfolio has more credit risk and problems with related institutions, which may make people less reluctant to accept risk-sharing contracts. On the other hand, an increase in TPF means that more money is available for PLS, but it also means that the bank has more duty to depositors. Consequently, the Principal Agent Framework asserts that the underdevelopment of equity financing is a logical, micro economic reaction to significant information asymmetries. It establishes the theoretical basis for positing that internal factor indicative of a bank's financial stability, risk management, and governance are the principal determinants of its allocation to Mudharabah finance, as demonstrated by the findings of this study.

2.4 Past Studies and Hypothesis Development

Several previous research addresses the same topic. Based on the previous studies, these factors can be classified into internal and external categories. Internal factors pertain to elements arising from within the Islamic banking institution, whilst external factors stem from outside the institution, including the macroeconomic conditions of Indonesia during that period.

Internal factors such as the CAR used as predictor by (Misanam & Widarjono, 2024; Riza Salman, 2023; Winarsih & Asokawati,2019). The CAR evaluates the capital of an Islamic bank. It is the proportion of equity to risk weighted assets. A high CAR signifies enhanced capital capacity to withstand losses from credit, market, or operational risks, enhanced resilience in confronting economic crises or market volatility, and enhanced business expansion potential due to compliance with regulatory obligations within a secure margin. According to Misanam and Widarjono (2024), CAR negatively affect financing, however the Islamic Financing observed is general Islamic Financing and do not specify with profit sharing financing.

Meanwhile, Riza Salman (2023) and Winarsih and Asokawati (2019) conclude that CAR has no significant effect on profit sharing financing, both using a data panel of 11 Sharia banks. Therefore, the hypothesis for this research is:
$H1_a$: CAR significantly affects the mudharabah financing
$H1_b$: CAR significantly affects the musyarakah financing

Another internal factor mentioned is operational cost efficiency, which is measured in this research by using CIR (Cost to Income Ratio). The CIR quantifies a bank's operational efficiency by relating total operational expenses to total operational revenue. Therefore, a lower CIR indicates greater efficiency in a bank's expense management relative to income generation. CIR as a predictor mentioned in the study by Misanam and Widarjono (2024) and Riyadi et al. (2021). Misanam and Widarjono (2024) mentioned the CIR adversely affects finance; elevated efficiency motivates banks to augment financing, whilst diminished efficiency curtails it. This phenomenon also occurs in profit-sharing financing, where efficiency exerts a markedly adverse impact on profit-sharing arrangements (Riyadi et al., 2021). Therefore, the hypothesis for this research is:
$H2_a$: CIR significantly affects the mudharabah financing
$H2_b$: CIR significantly affects the musyarakah financing

The third internal factor in this study is Third Party Funds. TPF are deposits that banks collect from customers (individuals, corporations, or institutions). These deposits are subsequently utilized by the bank for operational activities and credit/financing distribution. In the past research by Hafizh et al. (2020) using time series data analysis, third party funds positively affect profit sharing financing. Riyadi et al. (2021) utilized mudharabah deposits as predictors, which favorably influenced profit sharing financing. This result was similarly articulated by Riza Salman (2023) and Winarsih and Asokawati (2019) who employed panel data in his analysis. Therefore, the hypothesis for this research is:
$H3_a$: TPF significantly affects the mudharabah financing
$H3_b$: TPF significantly affects the musyarakah financing

The risk of problematic financing is among the most prevalent concerns faced in the banking sector, including in Islamic banks. This risk is typically quantified by the NPF ratio, which assesses the proportion of problematic financing to the total financing of Islamic banks. In contrast to NPL in traditional banks, NPF includes all Islamic financing agreements. Several studies use NPF as the predictor, including Riyadi et al. (2021) and Winarsih and Asokawati (2019) which stated that NPF negatively affects profit-sharing financing. This contrasts with the conclusion derived from Riza Salman (2023) which asserts that NPF does not influence profit sharing financing. The distinction arises from the differing samples utilized; Riyadi et al. (2021) and Winarsih and Asokawati (2019) study employed annual data from 11 Islamic general banks, whereas Riza Salman (2023) analyzed financial reports from Islamic banks and Islamic business units. Therefore, the hypothesis for this research is:
$H4_a$: NPF significantly affects the mudharabah financing
$H4_b$: NPF significantly affects the musyarakah financing

Profitability assesses a bank's capacity to create earnings from its operations, and the commonly used measurement is Return on Assets (ROA). ROA assesses the efficiency with which a bank transforms assets into earnings, calculated by dividing net income by total assets. Misanam and Widarjono (2024) conclude that ROA is significantly positive to Islamic bank financing. Meanwhile, Winarsih and Asokawati (2019) come to a different conclusion, which is that ROA did not significantly affect profit sharing financing. Therefore, the hypothesis for this research is:

$H5_a$: ROA significantly affects the mudharabah financing
$H5_b$: ROA significantly affects the musyarakah financing

Business size denotes the magnitude of a company's operations, quantifiable by assets, revenue, personnel count, market capitalization, or geographic reach. The size of a business influences its strategy, regulatory compliance, competitive positioning, and financial accessibility. Business size can be based on assets, revenue, or even market capitalization. Research by Misanam and Widarjono (2024) which discusses bank size as a predictor, using total assets as the measurement. This concludes that bank size has a positive effect to Islamic financing in Islamic banks. Therefore, the hypothesis for this research is:
$H6_a$: Total asset significantly affects the mudharabah financing
$H6_b$: Total asset significantly affects the musyarakah financing

In addition to internal variables, external factors also affect the decision making of Islamic banks regarding the distribution of finance, particularly profit sharing financing. One of the predictors is the central bank rate of BI. BI rate is a benchmark interest rate established BI, utilized as a monetary policy tool to regulate inflation, uphold exchange rate stability, and stimulate economic growth. The BI Rate significantly impacts lending interest rates, hence influencing the total volume of loans issued by banks. An elevation in the BI Rate generally results in a rise in bank lending rates. This link is underpinned by factors including operating expenses, the cost of capital, and inflation, which are determinants of banking interest rates. Based on past research, BI rate is concluded to also have a positive effect on the Islamic bank financing (Hafizh et al., 2020). Therefore, the hypothesis for this research is:
$H7_a$: BI rate significantly affects the mudharabah financing
$H7_b$: BI rate significantly affects the musyarakah financing

Gross Domestic Product (GDP) represents the aggregate value of all products and services generated by a nation within a specified timeframe. GDP Growth measures the percentage variation in GDP between successive periods, often annually or quarterly. Economic growth usually elevates the demand for bank credit as enterprises pursue financing for expansion and consumers intend to acquire products and services. Numerous studies indicate a strong association between economic growth and banking loan activity, such as research by Hafizh et al. (2020) and Misanam and Widarjono (2024). However, several studies have different conclusions, where GDP has a negative effect on total bank credit (Bashir & Ibrahim, 2020). Therefore, the hypothesis for this research is:
$H8_a$: GDP significantly affects the mudharabah financing
$H8_b$: GDP significantly affects the musyarakah financing

In figure below, presented the research framework of this study:

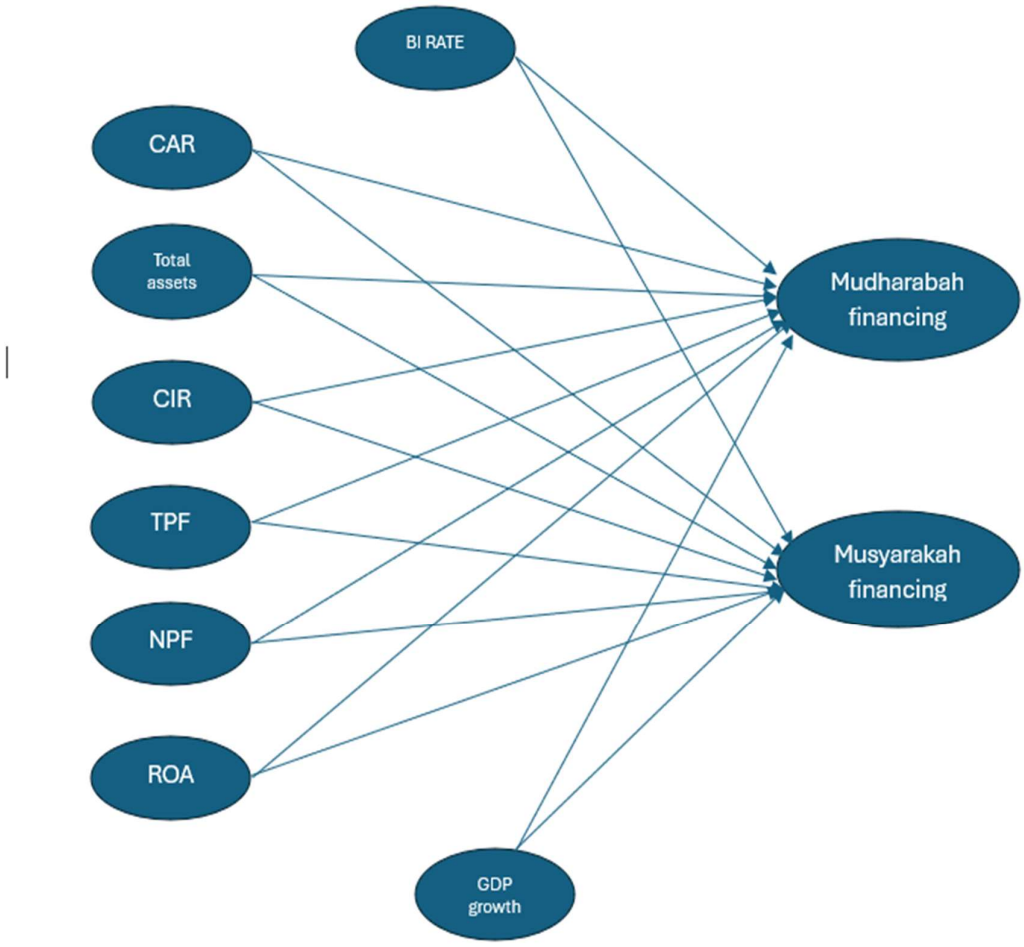

Fig 1. *Research Framework*

3.0 Research Methodology

This chapter discusses the collection data type and process, data analysis, and research instruments to answer the research questions. The purpose of this study is to examine the determinants of equity financing distribution by Sharia banks, therefore quantitative study that involves analysis of numerical data using a deductive approach is used in this research (Noor, 2010). It commences with the identification of broad problem areas, the formulation of problems, the formulation of hypotheses, the determination of measurements, data collection, data analysis, and data interpretation (Sekaran & Bougie, 2016) . We identify the formulation of hypotheses by reviewing past studies and research on a similar research topic and area. This concluded that there are 8 significant predictors based on the past research.

At the end of 2024, 14 Islamic commercial banks in Indonesia are registered with the Indonesian Financial Services Authority. The 14 banks were selected as examples based on data completeness. To ascertain the sample size, G*Power was employed, utilizing statistical multiple regression analysis with 8 predictors, an error rate of 0.05, and a one-tailed hypothesis, it is established that the least requisite sample size is 89, so the annual data collected spans 7 years, specifically from 2018 to 2024.

Based on the time horizon, this study uses panel data, a combination of time series and cross-sectional data. Panel data regression analysis is used in this study to investigate the relationship between dependent and independent variables across entities and over time, utilizing a quantitative research methodology, allows for more robust estimates. Before performing research data analysis, a diagnostic experiment was undertaken to ascertain the appropriate model for usage, specifically determining the applicability of the Fixed Effects Model (FEM), Common Effect Model (CEM), or Random Effect Model (REM). The Hausman Test, F Test, and Breusch Pagan LM Test were employed in this analysis. Upon determining the model, an evaluation of the classical assumptions was conducted, specifically the tests for autocorrelation, heteroscedasticity, and multicollinearity. Additionally, the Interpretation of Results involved analysing the Coefficients, which indicate the marginal impact of predictors on the dependent variable; R squared, which reflects the cumulative impacts of all predictors; and P values, which denote the statistical significance of the predictors.

Here is the formula used in this research:

Equation 1:

$$ln_{mudharabah} = c + \beta 1\ car + \beta 2\ ln_{asset} + \ \beta 3\ cir + \ \beta 4\ + \beta 5\ npf + \ \beta 6\ roa + \ \beta 7\ bi_{rate} + \beta 8\ gdp\_growth$$

Equation 2:

$$ln_{musyaraka} = c + \beta 1\ car + \beta 2\ ln_{asset} + \ \beta 3\ cir + \ \beta 4\ + \beta 5\ npf + \ \beta 6\ roa + \ \beta 7\ bi_{rate} + \beta 8\ gdp\_growth$$

4.0 RESEARCH RESULT

Based on the diagnostic experiment to conduct the Hausman test, F test, and the Breusch Pagan test, the Fixed Effect Model was chosen as the analysis model. This happened because in equations 1 and 2, both pass the Chow test and the Hausman test, which has criteria significance probability less than 0.05 (Table 2).

Table 2. Criteria for regression model selection

Formula	Chow test	Hausman test	The Lagrange Multiplier (LM) test	Selected Model
Equation 1	Prob = 0.000 (FEM)	Prob = 0.0003 (FEM)	Prob = 0.000 (REM)	FEM
Equation 2	Prob = 0.000 (FEM)	Prob = 0.0023 (FEM)	Prob = 0.000 (REM)	FEM

Source: Processed

After deciding the model that will be used in decision making, we evaluate the model fit of each equation. Based on the ANOVA test, both models (equations 1 & 2) are statistically significant (Prob F statistics < 0.05) and explain a large portion of the variance in the dependent variable (R^2> 0.9), according to Hair et al. (2011) an R squared of more than 0.75 shows that the models are strong.

Table 3. Goodness of Fit

Formula	R^2	F statistics	Prob (F statistics)
Equation 1	0.91	17.92280	0.000000
Equation 2	0.93	27.02430	0.000000

Source: Processed

A. Regression Result Equation 1

This table below presents the regression coefficients, standard errors, t statistics, p values (Prob.), and hypothesis testing decisions for each independent variable in a regression model. Based on p value, the independent variables from internal factors that does not impact the mudharabah financing are Ln_assets, CIR, and ROA (the p value > 0.05) which are not significant at 95% confidence level. Meanwhile both external factors, BI Rate and GDP growth do not impact the mudharabah financing (the p value > 0.05) which are not significant at 95% confidence level. The significant variables are all internal factors such as CAR, Ln_TPF, and NPF, showed from the p value which less than 0.05. CAR and NPF have negative effect to mudharabah financing which shows from the coefficient -3.85 and -28,67. Meanwhile, Ln_TPF has positive effect to mudharabah financing which shows from the coefficient 1.77.

Table 4. Regression Result of Equation 1

Variables	Coefficient	Std. error	t statistics	Prob.	Decision
C	-25.33259	17.87626	-1.417108	0.1658	Hypothesis rejected
CAR	-3.856093	0.934549	-4.126154	0.0002	Hypothesis accepted
Ln_Assets	0.002390	0.137840	0.017340	0.9863	Hypothesis rejected
CIR	0.840838	0.763781	1.100890	0.2789	Hypothesis rejected
Ln_TPF	1.771767	0.606353	2.922005	0.0062	Hypothesis accepted
NPF	-28.67325	10.29612	-2.784860	0.0088	Hypothesis accepted
ROA	0.564574	1.683311	0.335395	0.7395	Hypothesis rejected
BI_Rate	-16.84208	13.98355	-1.204421	0.2370	Hypothesis rejected
GDP_Growth	-4.265947	7.060564	-0.604194	0.5498	Hypothesis rejected

Source: Processed

B. Regression Result Equation 2

In the table below, the result of regression showed that the independent variables from internal factors does not impact the musyarakah financing (the p value > 0.05) which are not significant at 95% confidence level. Meanwhile for external factors, only BI Rate impact the musyarakah financing (the p value < 0.05) which are significant at 95% confidence level. The significant variables or BI rate have positive significant effect to the musyakah financing which shows from the positive coefficient 21.85727.

Table 5. Regression Result of Equation 2

Variables	Coefficient	Std. error	t statistics	Prob.	Decision
C	-0.338040	13.05421	-0.025895	0.9795	Hypothesis rejected
CAR	0.371367	0.680545	0.545690	0.5882	Hypothesis rejected
Ln_Assets	0.067394	0.099065	0.680305	0.5000	Hypothesis rejected
CIR	-0.005469	0.510291	-0.010717	0.9915	Hypothesis rejected
Ln_TPF	0.847681	0.442064	1.917553	0.0620	Hypothesis rejected

NPF	11.67805	7.338679	1.591301	0.1190	Hypothesis rejected
ROA	-0.509551	1.201399	-0.424131	0.6736	Hypothesis rejected
BI_Rate	21.85727	9.248833	2.363246	0.0228	Hypothesis accepted
GDP_Growth	2.358413	3.904461	0.604030	0.5491	Hypothesis rejected

Source: Processed

5.0 DISCUSSION AND CONCLUSION

We can infer from the studies above that a significant amount of the variance in the dependent variable can be explained by each model. Although mudharabah and musyarakah both refer to equity finance, they each have unique characteristics that affect how their funds are distributed. The distribution of mudharabah finance is primarily influenced by internal considerations, including the CAR, TPF, and NPF. CAR and NPF statistically have a negative effect on mudharabah financing, meanwhile, TPF is positively influence mudharabah financing in Islamic bank. This outcome is consistent with the findings of the study by Misanam Widarjono (2024), Riza Salman (2023), and (Winarsih & Asokawati, 2019). The CAR signifies the bank's tendency to maintain high capital reserves, which may lead to a more conservative approach in financing, ultimately restricting the available funds for mudharabah contracts. Mudharabah financing is also negatively affected by NPF. This conclusion is in accordance with previous research (Riyadi et al., 2021; Winarsih & Asokawati, 2019). This phenomenon happened because NPF can negatively impact a bank's liquidity and profitability, banks typically take more cautious financing decisions as NPF rates rise to reduce capital risks, it also includes mudharabah financing in Islamic banks. TPF in this research has a positive impact on mudharabah financing, this result is consistent with past research by Hafizh et al. (2020) which uses time series data analysis, Riyadi et al. (2021), also by Riza Salman (2023) and Winarsih and Asokawati (2019) which used panel data analysis. The larger the third party funds owned by an Islamic bank, the greater the possibility of it distributing its mudharabah financing. Following Islamic finance principles, the increased capital permits more investment options, reduces operational risks associated with financing, and eventually improves profitability and sustainability.

In musyarakah finance, internal factors do not influence the decision to allocate funds; however, external factors, particularly the BI Rate, significantly impact the decision to distribute musyarakah financing. This result is in accordance with the research result by Hafizh (2020). The importance of the BI Interest Rate is in its function as a standard for determining the overall cost of money across the financial system, which then impact lending rates in Islamic banking. This interest rate sets the benchmark for banks to evaluate the feasibility and profitability of lending, including musyarakah financing. Variations in this interest rate significantly impact the marketing of financial products, changes in customer demand, and the risk assessment of financial institutions.

One important element of equity financing is its ability to enhance the stability and profitability of Islamic institutions. Dao et al. argue that equity financing allows investors and banks to share risks and rewards, resulting in a more balanced risk profile and greater stability (2023). Equity financing, particularly through profit-sharing mechanisms such as Mudharabah and Musyarakah, provides a framework that inherently supports socio economic development, which is a base of the Sustainable Development Goals (SDGs). This study shows that Islamic banks can improve the distribution of mudharabah financing by lowering the CAR, increasing the TPF, and reducing the NPF. A decrease in CAR often indicates an increased capacity for investment financing. An increase in the TPF will motivate Islamic banks to increase their mudharabah financing. Furthermore, professional NPF management will further encourage Islamic banks to improve their mudharabah financing operations. However, for musharakah financing, external factors, particularly central bank interest rates, significantly influence this

type of distribution; thus, it is expected that internal considerations will play a more prominent role in the decision making process for allocating musharakah financing.

ACKNOWLEDGMENTS

We would like to express our deepest gratitude to the Accounting Research Institute (ARI) Universiti Teknologi MARA (UiTM) for their support and resources that made this research possible. Our heartfelt thanks also go to our research supervisor and collaborators for their invaluable guidance, constructive feedback, and continuous encouragement throughout this research.

REFERENCES

Abdul-Rahman, A., Abdul Latif, R., Muda, R., & Abdullah, M. A. (2014). Failure and potential of profit-loss sharing contracts: A perspective of New Institutional, Economic (NIE) Theory. *Pacific Basin Finance Journal*, *28*, 136–151. https://doi.org/10.1016/j.pacfin.2014.01.004

Ayayi, A. G. (2012). Micro-credit and Micro-equity: The David and the Goliath of Micro-Enterprise Financing. *Economic Papers*, *31*(2), 244–254. https://doi.org/10.1111/j.1759-3441.2011.00144.x

Ayinuola, F. T., & Gumel, B. I. (2023). The impact of cost-to-income ratio on bank performance in Nigeria. *International Journal of Multidisciplinary and Current Educational Research (IJMCER)*, *5*(2), 125–137. www.ijmcer.com

Bashir, M. S., & Ibrahim, A. A. A. (2020). Effects of macroeconomic variables on bank credit in Saudi Arabia: An ARDL Bounds Testing Approach to Cointegration. *Asian Journal of Economics, Business, and Accounting*, *2*(19), 1–12. https://doi.org/10.9734/AJEBA/2020/v19i230298

Dao, M. D., Pham, A. M., & Nguyen, N. A. (2023). Equity Financing and performance of islamic commercial banks in Kuala Lumpur, Malaysia. *Journal of Finance and Accounting*, *7*(4), 11–20. https://doi.org/10.53819/81018102t5196

Ehigiamusoe, K. U., & Samsurijan, M. S. (2021). What matters for finance-growth nexus? A critical survey of macroeconomic stability, institutions, financial and economic development. *International Journal of Finance & Economics*, *26*(4), 5302–5320.

Ernayani, R. (2024). Factor affecting profit distribution management in islamic commercial banks: Moderation of return on assets. *JAS (Jurnal Akuntansi Syariah)*, *8*(2), 295–315. https://doi.org/10.46367/jas.v8i2.2152

Farihana, S., & Rahman, M. S. (2021). Can profit and loss sharing (PLS) financing instruments reduce the credit risk of Islamic banks? *Empirical Economics*, *61*(3), 1397–1414. https://doi.org/10.1007/s00181-020-01912-5

Fianto, B. A. (2018). Equity financing and debt-based financing: Evidence from Islamic microfinance institutions in Indonesia. *Pacific Basin Finance Journal*, *52*, 163–172. https://doi.org/10.1016/j.pacfin.2017.09.010

Hafizh, M., Hidayah, N., & Silalahi, P. R. (2020). Macroeconomics And profit sharing financing in islamic banking in indonesia: The third parties fund as intervening. *Jurnal Akuntansi Dan Keuangan Islam*, *8*(2), 131–147. https://doi.org/10.35836/jakis.v8i2.183

Hair, J. F., Ringle, C. M., & Sarstedt, M. (2011). PLS-SEM: Indeed, a silver bullet. *Journal of Marketing Theory and Practice*, *19*(2), 139–152. https://doi.org/10.2753/MTP1069-6679190202

Horobet, A., Curea, S. C., Smedoiu Popoviciu, A., Botoroga, C.-A., Belascu, L., & Dumitrescu, D. G. (2021). Solvency risk and corporate performance: A case study on european retailers. *Journal of Risk and Financial Management*, *14*(11), 536. https://doi.org/10.3390/jrfm14110536

Huda, A. N. (2012). The development of islamic financing scheme for smes in a developing country: The Indonesian case. *Procedia - Social and Behavioral Sciences*, *52*, 179–186. https://doi.org/10.1016/j.sbspro.2012.09.454

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Manageri behavior, agency costs and ownership structure. *Journal of Financial Economics* (4). Harvard University Press. http://ssrn.com/abstract=94043Electroniccopyavailableat:http://ssrn.com/abstract=94043http://hupress.harvard.edu/catalog/JENTHF.html

Komite Nasional Ekonomi dan Keuangan Syariah (KNEKS). (2020). *Direktori Pembiayaan Syariah untuk UMKM*.

Korkmaz, E., Durukan, M. B., & Cagli, E. C. (2018). Does sentiment affect capital structure decisions. *Pressacademia*, *7*(4), 340–345. https://doi.org/10.17261/pressacademia.2018.994

Lyu, B., & Chen, H. (2022). Effect of founder control on equity financing and corporate performance-based on moderation of radical strategy. *SAGE Open*, *12*(2). https://doi.org/10.1177/21582440221085013

Misanam, M., & Widarjono, A. (2024). Market concentration, bank characteristics, macroeconomic conditions, and Indonesian Islamic bank financing. *Muqtasid: Jurnal Ekonomi Dan Perbankan Syariah*, *14*(2), 165–184. https://doi.org/10.18326/muqtasid.v14i2.165-184

Morshed, A. (2024). Strategic working capital management in Polish SMEs: Navigating risk and reward for enhanced financial performance. *Investment Management and Financial Innovations*, *21*(2), 253–264. https://doi.org/10.21511/imfi.21(2).2024.20

Noor, N. M. (2010). *Writing Research and Thesis proposals: guidelines and examples*. Pusat Penerbitan Universiti Teknologi Mara.

Othman, N., Abdul-Majid, M., & Abdul-Rahman, A. (2023). Equity financing and Islamic bank stability: evidence from Malaysia and Indonesia. *International Journal of Islamic and Middle Eastern Finance and Management*, *16*(6), 1248–1268. https://doi.org/10.1108/IMEFM-03-2022-0106

Otoritas Jasa Keuangan (OJK). (2022). *Laporan Perkembangan Keuangan Syariah Indonesia 2022*.

Piva, E., & Rossi-Lamastra, C. (2018). Human capital signals and entrepreneurs' success in equity crowdfunding. *Small Business Economics*, *51*(3), 667–686. https://doi.org/10.1007/s11187-017-9950-y

Purnomo, B. S., Nasim, A., Hairul, M., Haji Besar, A., & Suryadi, E. (2024). Mudharabah and Musyarakah Financing in Indonesian Islamic Banking Practices: Is It Equity or Debt Financing? *The International Journal of Islamic Civilization Studies*, *7*(1), 14–22. https://doi.org/10.47076/jkpis.v7i1.232

Rahman, A. R. A. (2007). Islamic banking and finance: between ideals and realities. *IIUM Journal of Economics and Management*, *15*, 123–141.

Riyadi, S., Iqbal, M., Pangastuti, A. A., & Muditomo, A. (2021). Optimization of profit-sharing financing at islamic banking in Indonesia. *Jurnal Keuangan dan Perbankan*, *25*(2). https://doi.org/10.26905/jkdp.v25i2.5212

Salman, K. R. (2023). The determinants of profit-loss sharing financing of Islamic banks in Indonesia. Muqtasid: J*urnal Ekonomi dan Perbankan Syariah, 13*(2), 95–111.https://doi.org/10.18326/muqtasid.v13i2.95-111

Sartono, S., Sapta, A. E., & Pratama, I. R. (2023). Factors influencing third-party funds of Islamic bank: a case study in Indonesia. *E-Academia Journal*, *12*(2), 105–118.

Sekaran, U., & Bougie, R. (2016). *Research methods for business: A skill building approach*. John Wiley & Sons.

Septiatin, A. (2022). Influence of third party funds, bi rate, inflation on market share in islamic banking. *Jurnal Ilmu Ekonomi Dan Keislaman*, *10*, 1–16. www.ojk.go.id

Setiawan, I. (2019). The role of islamic banking in the development of economic sectors in Indonesia. *International Journal of Applied Business Research*, *1*(02), 88–99. https://doi.org/10.35313/ijabr.v1i02.70

Singh, R., Gupta, C. P., & Chaudhary, P. (2024). Defining Return on Assets (ROA) in empirical corporate finance research: A critical review. *Empirical Economics Letters*, *23*(1). https://doi.org/10.5281/zenodo.10901886

Winarsih, W., & Asokawati, W. (2019). Determinant of implementation profit sharing financing in islamic banking. *International Journal of Islamic Business Ethics*, *4*(1), 582. https://doi.org/10.30659/ijibe.4.1.582-594

Yusof, E., Fahmy, E., & Kamal, A. (2009). Islamic finance: Debt versus equity financing in the light of Maqasid al-Shari'ah (MPRA Paper No. 20722*). Munich Personal RePEc Archive. https://mpra.ub.uni-muenchen.de/20722/*

Zubir, A. N., Abu Hassan, M. H., Khordin, N., Zainudin, S. N. A., Mohamad Yunus, F., & Syed Shaharuddin, S. S. (2023). Impact of profitability elements on the food and beverage industry in Malaysia. *Social and Management Research Journal (SMRJ)*, *20*(2), 137–151.