

DETERMINANTS OF ISLAMIC BANKING FINANCIAL PERFORMANCE: THE ROLE OF ASSETS AND INTERMEDIATION IN PALESTINE

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Abstract

The Islamic banking sector in Palestine faces complex challenges due to the prolonged conflict, which has significantly impacted the stability of the domestic economy and financial system. Despite extreme geopolitical pressure, Islamic banks in the region have demonstrated robust operational resilience and stability through robust asset management and optimization of their intermediation function based on Islamic Sharia principles. This study analyzes the influence of total assets, total investment, and total financing on the financial performance (income) of Palestinian Islamic Banks during the 2015–2024 period. Using a quantitative approach with multiple linear regression (OLS) based on 120 monthly observations, this study estimates two test models: a baseline model and a model with control variables (deposits and stock prices). The partial analysis results indicate that total assets and total financing have a positive and significant influence on financial performance in both models, confirming their role as risk absorbers and primary sources of bank income in conflict zones. Meanwhile, total investment has a significant influence in the opposite direction, namely negative in the baseline model due to short-term volatility and becoming positive after the inclusion of control variables. Simultaneously, these three main variables significantly influenced financial performance, with an R-squared value of 32.52% in the baseline model, which then increased to 61.76% in the control model. In conclusion, asset size, investment effectiveness, and financing quality are the main foundational pillars determining the resilience and continuity of Islamic banking operations amidst Palestinian geopolitics.

Keywords: Assets, Investment, Financing, Financial Performance, Islamic Banking, Palestine

A. INTRODUCTION

The development of global Islamic finance has shown impressive growth in recent decades. The Islamic finance industry continues to demonstrate resilience and adaptability in the face of various global economic challenges (Alisic et al., 2024; Shah et al., 2020). The Islamic financial model is built on the principles of Islamic law that emphasize the values of justice, blessings, and economic sustainability (Azzahra et al., 2025; Inne Risnaningsi, 2020). The Islamic financial system has begun to be widely implemented in various sectors of modern life, including banking, along with the development of the concept of *mu'amalat maliyyah* (Abasimel, 2023).

The Middle East, with countries such as Saudi Arabia, the United Arab Emirates, Kuwait, Qatar, and Bahrain, has become a hub for the development of global Islamic banking (Rahman et al., 2023). Total Islamic banking assets in the GCC region are reported to exceed USD 1.5 trillion by 2023, indicating that the region accounts for more than 50% of the global assets of the Islamic finance industry (Yusop et al., 2025). The development of Islamic banking in the Middle East also demonstrates its increasingly significant role in promoting financial inclusion in predominantly Muslim regions (Zamer, 2018). Although the level of financial inclusion remains below the global average, the presence of Islamic banks can serve as an alternative strategy for communities that reject *riba*-based financial services (Khmous & Besim, 2020).

Palestine presents a unique case in the context of Islamic banking in conflict zones, where the sector has managed to maintain stability and even record positive growth amidst political and economic turmoil (Risfandy & Prwatiwi, 2022). The Palestine Islamic Bank (PIB), the first Islamic financial institution established in the West Bank and Gaza Strip, has a market capitalization of approximately USD 115 million and annual revenues reaching USD 63.6 million (Shihadeh, 2021). Despite structural challenges facing Palestine due to the conflict, the Palestinian banking sector continues to demonstrate a high level of resilience, underscoring the importance of access to financial services in improving banking performance (Ayusaleha & Laila, 2022).

Total assets are all resources under a company's control as a result of past events and that have the potential to generate future economic benefits (Rosita et al., 2022). The greater the total assets, the greater the institution's ability to improve financial performance and operational efficiency (Kendo & Tchakounte, 2022). In the context of Islamic banking intermediation, total investments allocated to *sukuk* instruments, Islamic stocks, and *halal* commodities must be strategically managed through portfolio diversification to stabilize returns and minimize risk (Mahadewi, 2024). Furthermore, financing is the core business of Islamic banks and a primary source of income through *murabahah*, *musharakah*, *mudaraba*, and *ijarah* contracts. Therefore,

portfolio quality and credit risk management are crucial for the institution's profitability and stability (Akram & Rahman, 2018).

Although extensive research has been conducted on the financial performance of Islamic banking, most previous major studies have focused on geopolitically stable regions and used standard profitability indicators such as Return on Assets (ROA) or Return on Equity (ROE) (Hassan & Bashir, 2018; Sudarsono & Ash Shiddiqi, 2022). There is a significant research gap, with limited empirical literature examining how the interaction between total assets, total investment, and total financing simultaneously impacts the financial resilience of Islamic banks operating under extreme long-term geopolitical pressures, such as in Palestine. Furthermore, there are inconsistent findings (empirical gaps) regarding the effect of Islamic investments on bank profitability; some studies suggest a positive impact through profit sharing (Safiullah, 2021), while others in restrictive regions indicate that sukuk regulatory challenges often depress bank earnings in the short term (Awwad et al., 2024). Therefore, the main novelty of this study lies in the contextualization of extreme conflict areas using comprehensive monthly time series data for a decade (2015–2024). Unlike conventional research, this study conceptualizes financial performance using total revenue as the primary indicator. The use of revenue as a performance proxy is considered more relevant in the context of conflict areas, as it provides a more stable measure and reflects the bank's capacity to maintain operational activities amidst the economy (Hakimi et al., 2025). Furthermore, the integrated control variables of deposits and stock price movements provide a more robust estimation model in capturing the dynamics of intermediation in vulnerable zones.

B. LITERATURE REVIEW

Financial Intermediation Theory

Financial Intermediation Theory explains that banks act as intermediary institutions that channel funds from parties with excess funds to parties that need funds (Konstantakopoulou, 2023). In the context of Islamic banking, this theory emphasizes that the intermediation function carried out through asset management, investments, and financing is the core financial activity that determines bank performance (Yumanita, 2005). The more effective this intermediation function is, the greater the potential for increased revenue and the stability of Islamic banking institutions (Sukmana & Suryaningtyas, 2016).

Uncertainty and Risk Theory

The Theory of Uncertainty and Risk distinguishes between measurable risk and unpredictable uncertainty in the process of economic and financial decision-making (Al-Banna et al., 2024). In the context of Palestine, which is in a state of conflict and economic instability,

Islamic banks with larger total assets have a better ability to absorb risk and maintain income stability (Irziqat et al., 2025). Large assets act as a buffer against external shocks, allowing banks to sustain operations even in the face of geopolitical uncertainty (Anis & Hamdi, 2022).

Total Assets and Financial Performance

Total assets are all forms of economic resources owned or controlled by a company, both tangible and intangible, which can provide economic benefits in the present or future (Mudrikah & Imsar, 2023). Framita et al., (2022) indicate that the size of total assets has a significant impact on the financial performance of banks, especially in increasing the bank's capacity to provide financing. The larger the total assets owned, the stronger the bank's capacity to carry out its intermediation function, bear risks, and provide financing to the public (Ragil et al., 2024). Beck et al., (2013) (Mulato, 2019) also emphasize that bank size is always a main determinant of financial performance, particularly in countries with unstable economic and political conditions.

Total Investment and Financial Performance

Investment in Islamic banking generally refers to productive financing based on Sharia contracts, aimed at supporting the real sector through profit-sharing mechanisms (Mulato, 2019). Safiullah, (2021); Ubaidillah & Astuti, (2020) show that total investment has a positive and complex effect on the financial performance of Islamic banks. Investment through mudharabah and musyarakah contracts has been proven to increase bank revenue compared to consumer financing. However, in the context of Palestine, investment faces obstacles in the form of regulations that are not yet supportive and a lack of interest from local investors to optimally absorb sukuk instruments (Awwad et al., 2024).

Total Financing and Financial Performance

Financing is the core business of Islamic banks and the main source of income through murabahah, musyarakah, mudharabah, and ijarah contracts. Portfolio quality, sector diversification, and credit risk management greatly determine the profitability and stability of the institution (Akram & Rahman, 2018). A high non-performing financing (NPF) ratio has the potential to erode core capital and trigger systemic risk, which becomes increasingly critical in the context of the Palestine conflict (Kuswahariani et al., 2020). Penelitian oleh A'laa & Sahliyah, (2025) shows that total financing has a significant effect on the financial performance of Islamic banks, both through increased margin income and fee-based income.

Research Hypotheses

Based on the theoretical and empirical studies that have been presented, the research hypotheses are formulated as follows:

H1: Total Assets have a significant effect on the financial performance of Islamic banks in Palestine.

H2: Total Investments have a significant effect on the financial performance of Islamic banks in Palestine.

H3: Total Financing has a significant effect on the financial performance of Islamic banks in Palestine.

H4: Total Assets, Total Investments, and Total Financing simultaneously have a significant effect on the financial performance of Islamic banks in Palestine.

C. RESEARCH METHODOLOGY

Types and Approaches of Research

This research is a quantitative study with a case study approach aimed at testing the effect of independent variables on dependent variables (Ramadhani & Suharto, 2023). A quantitative approach was chosen because the data used is numerical and the analysis is conducted using statistical methods based on multiple linear regression (Putri Primawanti & Ali, 2022). Data analysis is conducted using the Ordinary Least Squares (OLS) method with time series data from the specified research period (Leppink, 2017).

Research Objects and Units of Analysis

The research object is Islamic banks operating in Palestine that have published financial reports for the period 2015 - 2024. The selection of Palestine Islamic Bank as the single unit of analysis is based on academic and empirical considerations that the bank is the only full-service Islamic commercial bank operating in Palestine and meets all the data eligibility criteria required in time-series-based quantitative research (Hasyim et al., 2024). The operational characteristics of the bank, which is located in an area of extreme geopolitical conflict, make Palestine Islamic Bank relevant to be studied in analyzing the relationship between intermediation function and financial performance.

Data and Data Sources

This study uses secondary data in the form of monthly financial reports of Palestine Islamic Bank during the period from January 2015 to December 2024, resulting in 120 observations. The data sources were obtained from the bank's official website, the international financial platform investing.com, and publications from the Palestinian financial authority (Siregar et al., 2022). The data were processed using Microsoft Excel and EViews for regression analysis purposes.

Operational Definition of Variables

The dependent variable in this study is financial performance, measured through the bank's revenue. Revenue is chosen as a proxy for performance because it is more relevant in describing the sustainability of the bank's operations in conflict areas compared to other profitability indicators such as ROA or ROE, which are prone to distortion due to fluctuations in non-operational costs (Hassan & Bashir, 2018).

Independent variables consist of: (1) Total Assets (X1), which are all economic resources owned by the bank, calculated as the sum of current assets and non-current assets (Budiang et al., 2017); (2) Total Investment (X2), which is the portion of funds channeled through Sharia-based investment instruments such as sukuk and equity participation (Adiwinata et al., 2017); dan (3) which is all financing disbursed through Sharia contracts to customers in need of funds (Mudrikah & Imsar, 2023). As control variables, deposits and stock prices are used to obtain more robust estimates.

Table 1. Operational Definitions of Variables

No	Variable	Operational Definition	Indicator	Scale
1	Total Assets (X1)	All economic resources owned by the bank	Total Assets = Current Assets + Non-Current Assets	Ratio
2	Total Investment (X2)	Funds placed in Sharia investment instruments	Total investment in sukuk, Sharia stocks, and halal commodities	Ratio
3	Total Financing (X3)	Funds channeled through Sharia contracts to customers	Total murabahah, mudharabah, musyarakah, ijarah financing	Ratio
4	Kinerja Keuangan (Y)	The bank's ability to generate income from operational activities Revenue	(Revenue)	Ratio

Source: Data processed by the researcher, 2026

Data Analysis Method

Data analysis was conducted using multiple linear regression (OLS) with two models. Model 1 uses the main variables (assets, investments, financing), while Model 2 adds control variables in the form of deposits and stock prices. Before hypothesis testing, a classical assumption test was conducted including normality test (Jarque-Bera), multicollinearity (VIF), heteroscedasticity (White Test), and autocorrelation (Breusch-Godfrey LM Test). Hypothesis testing was conducted through T-Test (partial), F-Test (simultaneous), and coefficient of determination (R^2) (Ghozali, 2016).

D. RESULTS AND DISCUSSION

General Overview of the Research Object

Palestine Islamic Bank was established in 1997 with the aim of providing financial services in accordance with sharia provisions and supporting the development of the Palestinian community's economy. The bank conducts banking activities free from elements of *riba*, *gharar*, and *maysir*, and implements principles of justice and partnership through profit-sharing mechanisms. The main financing products offered include *murabahah*, *mudharabah*, *musyarakah*, and *ijarah*. During the period 2015 - 2024, Palestine Islamic Bank's total assets grew by more than 43%, from around USD 5.80 billion in 2020 to USD 7.12 billion in 2024, with a CAGR of approximately 7.01% (Framita et al., 2022).

Descriptive Statistics

The results of the descriptive statistical analysis of 120 observations from the period January 2015 - December 2024 are presented in Table 2 below:

Table 2. Descriptive Statistics of Research Variables

Variabel	N	Mean	Minimum	Maximum
Total Assett (X1)	120	1.125000	0.690000	1.560000
Total Invesment (X2)	120	0.285000	0.190000	0.390000
Total Financing (X3)	120	21906.58	19028.00	23200.00
Revenue/Performance (Y)	120	1880.700	1244.000	2298.000
Deposits* (Kontrol)	120	2113.450	1100.000	2296.000
Stocks* (Kontrol)	120	1379.717	724.0000	2200.000

Source: Data processed by the researcher, 2026

Note: * = Variabel Control

The asset variable has an average value of 1.125 with relatively stable variation across observation periods. The investment variable has a mean of 0.285 with a not very wide range, indicating stability in the level of investment. The financing variable shows an average of 21,906.58, with the minimum and maximum differences reflecting the dynamics of intermediation activities (Shella et al., 2025). Income variable as a proxy for financial performance shows an average of 1,880.70, with variations reflecting differences in banks' operational performance in generating income from financing and investment activities.

Classical Assumption Test

Table 3. Results of Classical Assumption Test

Test	Model 1	Model 2	Description
Normality (JB Prob.)	0.367317	0.294223	Normal (> 0.05)
Multicollinearity (VIF Maks.)	3.312826	6.066795	Free (< 10)

Heteroskedasticity (Prob. Chi ²)	0.4582	0.0532	Homoscedastic (> 0.05)
Autocorrelation (Prob. F)	0.9568	0.8811	Free of autocorrelation (> 0.05)

Source: Data processed by the researcher, 2026

Based on the results of the classical assumption tests, all OLS assumptions were met. The Jarque-Bera normality test showed probability values of 0.367 and 0.294 for Model 1 and Model 2, both above 0.05, indicating that the data are normally distributed. VIF values for all variables were below 10, indicating no multicollinearity symptoms. The White test showed Chi² probabilities of 0.458 and 0.053, both above 0.05, indicating no heteroskedasticity. The Breusch-Godfrey test showed F Prob. values of 0.957 and 0.881, confirming freedom from autocorrelation (Sureiman & Mangera, 2020).

Multiple Linear Regression Results

Table 4. Partial T-Test Results

Variable	Model 1 (Koef.)	Prob.	Model 2 (Koef.)	Prob.	Description
Total Assets (X1)	Positive	< 0.05	Positive	< 0.05	Significant (H1 Diterima)
Total Investment (X2)	Negative	< 0.05	Positive	< 0.05	Significant (H2 Diterima)
Total Financing (X3)	Positive	< 0.05	Positive	< 0.05	Significant (H3 Diterima)
Deposits (Kontrol)	-	-	Positive	< 0.05	Significant
Stocks (Kontrol)	-	-	Positive	< 0.05	Significant

Source: Data processed by the researcher, 2026

Table 5. Simultaneous F-Test and Coefficient of Determination Results

Indicator	Model 1	Model 2
F-statistic	18.63707	36.82644
Prob(F-statistic)	0.000000	0.000000
R-squared	0.325233 (32,52%)	0.617619 (61,76%)
Adjusted R-squared	0.307782 (30,78%)	0.600848 (60,08%)

Source: Data processed by the researcher, 2026

DISCUSSION

The Effect of Total Assets on Financial Performance

The results of the study indicate that total assets have a positive and significant influence on the financial performance of Palestinian Islamic Banks, both in Model 1 and Model 2. This result is consistent with the findings (A'laa & Sahliyah, 2025; Silvia, 2017; Widarjono, 2021; Yaseen & Widarjono, 2024) which state that assets not only represent the scale of operations but also

reflect the bank's capacity to manage third-party funds effectively in accordance with Sharia principles. In the context of Islamic banking in Palestine, assets serve as a basis for financing the bank's expansion and operational capacity (Hasyim et al., 2024). Abugamea, (2021) explains that the size of Islamic bank assets is one of the fundamental factors in improving financial performance in Palestine. Facts on the ground confirm this condition, where strong asset ownership is a primary survival mechanism for financial institutions amidst escalating conflicts that often paralyze macroeconomic activity. In real terms, the Palestinian Islamic Bank's meteoric growth in total assets, reaching USD 7.12 billion by 2024, reflects its ability to mitigate risks in a region with high geopolitical uncertainty. Its substantial assets act as a buffer, ensuring that in the event of political or military turmoil, the bank maintains a solid capital structure and liquidity to maintain its operations. Furthermore, this substantial asset base psychologically fosters public confidence among the Palestinian public, attracting investors to invest their third-party funds (TPF) without fear of liquidation risk, ultimately driving more productive intermediation and sustainably increasing operating income.

Theoretically, this finding aligns with the Financial Intermediation Theory, which explains that total assets reflect the Islamic bank's ability to collect funds from the public and distribute them productively through financing or investment according to Sharia principles (Konstantakopoulou, 2023). The larger the assets owned, the broader the bank's ability to carry out intermediation functions, thus potentially increasing income (Saleem & Masood, 2023). It is also relevant to the Uncertainty and Risk Theory, as an Islamic bank with larger total assets has a better capacity to absorb geopolitical risks and maintain income stability in conflict areas. This finding is further supported by Amalia & Diana, (2022); Aryo Jasmiko et al., (2024); Dermawan et al., (2021); Fauziyah et al., (2024) who found that greater asset capacity provides more room for Islamic banks to perform intermediation functions and generate income.

The Effect of Total Investment on Financial Performance

The research results show that total investment has a significant effect on financial performance, but with different directions between Model 1 and Model 2. In Model 1, investment has a negative and significant effect, indicating that in the short term, an increase in investment tends to suppress bank income because investment returns are volatile and not immediate. This phenomenon is consistent with the findings of Grozdi et al., (2020) which showed the occurrence of overinvestment in the short term. However, in Model 2, after controlling for the fund-raising factor, investment has a positive and significant effect on income, in line with Safiullah, (2021);

Ubaidillah & Astuti, (2020) who found that profit-sharing based productive investment is able to increase Islamic bank income.

This condition can be explained by the unique context of Palestine, where the issuance of sukuk is hindered by regulations that are not yet supportive, incomplete legislation, and a lack of interest from local investors (Awwad et al., 2024). Athari et al., (2023) in a cross-country study in the MENA region, found that the diversification of Sharia-compliant instruments and sukuk investment plays a positive role in maintaining the performance of Islamic banks during crises, provided there is adequate internal capacity to manage the portfolio selectively. Thus, the impact of investment on financial performance is highly dependent on the quality of management and the operational environment of the bank (Basyariah et al., 2021).

The Effect of Total Financing on Financial Performance

Total financing is proven to have a positive and significant effect on the financial performance of Palestine Islamic Bank in both models, making it the most robust variable among the independent variables in this study. This finding is consistent with research by A'laa & Sahliyah, (2025); Syah & Rahmadani, (2024); Wibisono & Wahyuni, (2019) which shows that total financing has a significant effect on the financial performance of Islamic banks through increased margin income and fee-based income. Financing is a major determinant of Islamic bank income through profit-sharing mechanisms, murabahah margins, and ujah from various Islamic financing contracts.

Nevertheless, the direction and strength of the total financing impact very much depend on the quality of financing management, economic stability, as well as other internal and external factors (Rahmawati, 2023). Shah et al., (2020) found that Palestinian Islamic banks recorded higher NPFs due to repeated shocks from conflict, while Hasyim et al., (2024) emphasized that geopolitical risks increase volatility and weaken financing stability. Therefore, strengthening risk governance and diversifying financing sectors becomes the key to the resilience of Islamic banks in Palestine (Kuswahariani et al., 2020). Financing from an Islamic perspective is a tangible implementation of the principles of ta'awun and partnership, where the relationship between the bank and customers involves risk-sharing, not merely a creditor-debtor relationship.

Simultaneous Influence and Model Robustness

The F-test results show an F-statistic of 18.637 with $\text{Prob}(F\text{-statistic}) = 0.0000$ in Model 1, and an F-statistic of 36.826 with $\text{Prob}(F\text{-statistic}) = 0.0000$ in Model 2. This confirms that total assets, total investment, and total financing together have a significant effect on the financial

performance of Palestine Islamic Bank (H4 accepted). The ability of these three variables to explain variations in financial performance reaches 32.52% in Model 1 and increases to 61.76% in Model 2 after the addition of control variables, in line with, Al Khatib et al., (2024) who stated that internal bank variables are able to explain most of the variations in the profitability of Islamic banks in developing countries.

The coefficient values of the main variables remain consistent in direction and significance even after the inclusion of control variables. This indicates that the regression model is robust and that the relationship between assets, investment, and financing with income is not driven by omitted variable bias. These findings support Financial Intermediation Theory, which explains that banks function as intermediaries that efficiently allocate funds from surplus units to deficit units through the management of assets, investments, and financing (Konstantakopoulou, 2023). Overall, the results provide important implications for Islamic bank management in Palestine. Under highly uncertain geopolitical conditions, banks should prioritize the expansion of productive assets that directly generate financing returns and investment margins in accordance with Sharia principles.

E. CONSLUSION

Based on the analysis, this study concludes that partial total assets and total financing have a positive and significant influence on the financial performance of Palestinian Islamic Banks. A large asset size proves to be a fundamental pillar that serves as a buffer against geopolitical risks, while financing activities act as a primary engine in generating bank revenues amidst conflict zones. On the other hand, total investment shows a complex influence; this variable has a negative effect in the base model due to short-term volatility, but changes to a positive one after the inclusion of control variables such as deposits and stock prices. Simultaneously, the three main variables total assets, total investment, and total financing are proven to have a significant influence on the financial performance of Islamic banking in Palestine. The joint contribution of these variables is able to explain 32.52% of the variation in bank revenues in the base model, and jumps to 61.76% after the application of control variables. Thus, strong integration between asset size management, investment effectiveness, and financing portfolio quality is a key pillar in maintaining the resilience, stability, and operational continuity of Islamic financial institutions under extreme economic pressure.

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