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BEYOND PROFIT: DOES ISLAMICITY TRULY MATTER IN ISLAMIC BANKING?

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ABSTRACT

Islamic banks operate under a dual mandate: they must remain financially sustainable while demonstrating substantive compliance with Sharia principles. Whether Islamicity-related performance translates into accounting profitability may depend on market maturity and institutional context. This study examines the relationship between five Islamicity Performance Index (IPI) indicators—Profit Sharing Ratio (PSR), Zakat Performance Ratio (ZPR), Equitable Distribution Ratio (EDR), Directors–Employees Welfare Ratio (DEWR), and Islamicity Income Ratio (IsIR)—and Return on Equity (ROE), comparing Islamic banks in Indonesia and the Gulf Cooperation Council (GCC). The manuscript reports a panel covering 13 banks (eight in Indonesia and five in the GCC) over 2017–2023. The existing baseline estimates use a random-effects model selected through Chow, Hausman, and Lagrange Multiplier tests. The bank-year dataset requires a final audit of percentage scaling, missing observations, and comparability before the estimates can be treated as final. In the reported baseline output, PSR is positively associated with ROE (coefficient = 8.765; p = .013). ZPR is negative but not statistically significant (−2.345; p = .417), while EDR (4.567; p = .147), DEWR (0.876; p = .126), and IsIR (6.234; p = .463) are not statistically significant. The model reports an adjusted R-squared of .189. The results distinguish a potentially value-generating financing practice from indicators whose benefits may operate through legitimacy, trust, and stakeholder welfare rather than immediate ROE. The study's contribution is its joint examination of all five IPI indicators in a cross-jurisdictional setting. Because bank-level controls and regional interaction estimates have not been supplied, the findings should be interpreted as baseline rather than fully adjusted evidence.

Introduction

Islamic banks face a persistent strategic tension. They are expected to generate sustainable returns, maintain capital adequacy, and compete for deposits and financing opportunities, while also demonstrating that their contracts, income, distribution practices, and governance conform to Sharia principles. Financial profitability is therefore necessary but not sufficient to evaluate performance. An institution may report strong returns without revealing whether its financing mix reflects risk sharing, whether social obligations are discharged, or whether income is derived from permissible activities. Conversely, a bank can meet important ethical and social obligations whose benefits do not appear immediately in short-term accounting ratios. This dual mandate makes the relationship between Islamicity and profitability an empirical question rather than an assumption.

The question is particularly relevant when Islamic banks operate in markets with different institutional histories. Indonesia represents an emerging Islamic-finance market, where the sector operates alongside a large conventional banking system and continues to develop scale, customer reach, product depth, and regulatory infrastructure. The GCC—comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—contains several of the world's most established Islamic-finance jurisdictions. The two settings differ in market concentration, the depth of Islamic financial intermediation, supervisory arrangements, customer expectations, and the competitive position of Islamic banks. Those differences can shape the extent to which compliance indicators function as strategic investments, routine obligations, or incremental operating costs. A pooled estimate can conceal such differences unless regional heterogeneity is explicitly tested.

The performance contrast reported in the original manuscript motivates the comparison, but its scale requires care. Some GCC ROE observations are presented as decimals (for example, 0.183) while Indonesian figures are written as percentages (for example, 31.2). Under a ratio convention, 0.183 corresponds to 18.3 percent, not 0.183 percent. Such observations must be converted to a common unit before descriptive statistics or regression estimates are computed. Accordingly, the comparison in this paper is framed around the reported volatility and institutional context, not an unverified claim that GCC banks have ROE levels close to zero. The full source series must be checked before the numerical comparison can be considered final.

The Islamicity Performance Index (IPI) offers a multidimensional way to represent the ethical and social dimensions of Islamic banking. This study focuses on five indicators: the Profit Sharing Ratio (PSR), which captures the share of financing based on mudharabah and musyarakah; the Zakat Performance Ratio (ZPR), which captures zakat payments relative to the chosen profit base; the Equitable Distribution Ratio (EDR), which represents distribution of income to stakeholders; the Directors–Employees Welfare Ratio (DEWR), which captures the relative welfare expenditure of directors and employees; and the Islamicity Income Ratio (IsIR), which captures the proportion of halal income. These measures reflect distinct practices and should not be treated as interchangeable components of a single undifferentiated index (AlQashouti & Shirazi, 2024; Indrianasari et al., 2021).

Prior empirical findings are mixed. Research on Indonesian Islamic banks indicates that Islamicity-related ratios do not uniformly explain profitability, while evidence on profit-sharing financing differs across samples and model specifications (Dian, 2020; Felani et al., 2020; Nawangsari et al., 2022; Putri & Gunawan, 2019). Recent work continues to examine how Islamic performance indicators relate to banking outcomes, reinforcing the need to distinguish asset growth, profitability, and broader Sharia-oriented performance as different dependent variables (Nasim et al., 2025). Yet the simultaneous effects of all five indicators, especially across Indonesia and the GCC in a comparable empirical framework, remain insufficiently established.

This study contributes to the literature in three ways. First, it brings all five IPI indicators into one analytical framework rather than testing one or two measures in isolation. Second, it places Indonesia and the GCC in a comparative design, making market maturity and institutional setting central to interpretation rather than treating banks as homogeneous. Third, it develops a mechanism-based account linking Sharia practices to operational cash flows and, indirectly, to reputational capital, customer loyalty, and funding stability. The empirical contribution must nevertheless be understood in light of the current dataset: the output available in the source manuscript contains the five-predictor baseline model but does not contain re-estimated results for the bank-level and macroeconomic controls requested by the reviewer.

The research question is therefore: how are PSR, ZPR, EDR, DEWR, and IsIR associated with ROE among the sampled Islamic banks, and why might those associations differ between Indonesia and the GCC? The paper proceeds with a theory-based literature review, a conceptual framework and hypotheses, the data and estimation approach, a cautious report of the existing baseline results, and implications for bank management and regulators.

Literature Review

Theoretical foundations

Agency Theory explains why owners and other stakeholders may not be able to observe management decisions and compliance practices fully (Jensen & Meckling, 1976). For Islamic banks, information asymmetry concerns not only risk-taking and resource allocation but also whether financing, income recognition, and distributions are consistent with Sharia requirements. Disclosure of IPI measures can reduce information gaps, while effective Sharia governance can strengthen monitoring. However, agency theory does not imply that every compliance activity must increase short-term ROE; monitoring, reporting, and social obligations may generate costs before any financial benefit appears.

Stakeholder Theory broadens the bank's objective beyond shareholder returns to include customers, employees, communities, regulators, and Sharia supervisory bodies (Donaldson & Preston, 1995; Freeman, 2010). PSR is relevant because it embodies a partnership-based allocation of risk and return between capital providers and entrepreneurs. Zakat and equitable distribution directly concern the social claims attached to financial intermediation. Employee welfare is relevant to internal fairness and human-capital retention, while IsIR concerns the integrity of income sources.

Stakeholder-oriented practices can support loyalty, employee productivity, and durable relationships, but their translation into accounting profitability may be indirect and time-dependent.

Legitimacy Theory proposes that organizations depend on continuing acceptance from the social environment in which they operate (Suchman, 1995). Islamic banks rely especially on the credibility of their Sharia identity. A high IsIR and transparent zakat reporting may function as threshold conditions for legitimacy: they are expected by stakeholders and can prevent reputational damage, even when additional variation in these ratios does not explain differences in ROE. EDR and DEWR may similarly signal fairness and institutional responsibility. Their financial consequences may arise through reputation and trust rather than a contemporaneous accounting channel.

A Maqasid al-Shariah perspective further emphasizes that the performance of an Islamic financial institution should be assessed in relation to the preservation and advancement of welfare, fairness, and responsible economic activity, not only profit maximization. Recent work on maqasid-oriented performance highlights the need to evaluate Islamic banks through outcomes and institutional practices as well as traditional financial ratios (Taufik et al., 2023; Tumewang et al., 2025). In this study, Maqasid is used as an interpretive lens, not as a separately measured variable. Accordingly, an insignificant coefficient on a social or ethical indicator cannot be interpreted as evidence that the underlying obligation is unimportant.

These theories imply distinct but complementary mechanisms. Agency Theory explains monitoring and incentive alignment; Stakeholder Theory explains reciprocal benefits among the bank and its stakeholder groups; Legitimacy Theory explains why compliance has value even when immediate financial returns are not visible; and Maqasid al-Shariah frames the broader objectives that financial ratios alone cannot capture.

Islamicity Performance Index and expected relationships

Profit Sharing Ratio (PSR). PSR measures the share of total financing allocated through mudharabah and musyarakah. Theoretically, risk sharing may improve the alignment of the bank's and entrepreneur's incentives, expand participation in productive activities, and generate a share of business returns. These channels can increase profitability when selection, monitoring, and post-financing governance are effective. At the same time, information asymmetry, moral hazard, and higher monitoring costs can weaken returns. Existing empirical results are not uniform, which makes the sign and statistical significance an empirical question (Felani et al., 2020; Nawangsari et al., 2022). The baseline hypothesis is that PSR is associated with ROE, with a positive sign expected where risk management is adequate.

Zakat Performance Ratio (ZPR). Zakat represents an explicit religious and social obligation. The direct accounting channel may be negative if payments reduce the amount of earnings available to shareholders, although this depends on the denominator used and on accounting and regulatory practices. The indirect channel may be positive through legitimacy, reputation, trust, and stakeholder acceptance. These channels can offset one another, and benefits may emerge with a lag. The direction of ZPR's association with short-term ROE is therefore ambiguous.

Equitable Distribution Ratio (EDR). EDR is intended to capture how income is allocated among relevant stakeholders, such as shareholders, employees, and the community. Fair distribution may improve staff motivation, customer loyalty, and social acceptance. However, redistribution may also reduce retained earnings or shareholder distributions in the short term, and the aggregate ratio may not capture the quality or timing of the benefits. The expected association with current ROE is theoretically ambiguous and may differ across regulatory and market environments.

Directors–Employees Welfare Ratio (DEWR). DEWR compares directors' welfare expenditure with employee welfare expenditure. A high ratio can reflect managerial compensation that is disproportionate to employees' welfare, potentially undermining perceptions of fairness and staff engagement. However, the ratio is also sensitive to disclosure practices, occupational structures, and how benefits are classified. A positive coefficient should not be interpreted as evidence that larger pay disparities are socially desirable; it would instead require assessment of the denominator, outliers, and the underlying welfare arrangements. A negative association is plausible where employee welfare improves productivity or reduces turnover.

Islamicity Income Ratio (IsIR). IsIR measures halal income as a share of total income. The ratio is central to Sharia legitimacy, but it may exhibit very little variation among institutions that already maintain high compliance. In a low-variation sample, a statistically insignificant coefficient can arise because the measure has limited power to distinguish banks, not because halal income is

immaterial. The direct short-term relationship with ROE is consequently uncertain, while the normative importance of income-source compliance remains independent of the regression result.

The five indicators may operate differently in Indonesia and the GCC. In a developing market, an expansion of PSR could signal product differentiation and strengthen trust, but it can also expose banks to selection and monitoring challenges. In more mature markets, formal compliance and reporting infrastructure may be stronger, potentially making ZPR, EDR, DEWR, and IsIR more standardized and less variable across institutions. Whether these conditions actually change the coefficients must be tested with regional interactions or separate regional estimations; it cannot be inferred solely from the labels 'emerging' and 'mature'.

Research gap and hypotheses

The main research gap is not simply whether Islamicity matters, but through which mechanism and over what horizon it relates to profitability. Existing findings are mixed and often rely on a limited subset of IPI indicators or a single national setting (AlQashouti & Shirazi, 2024; Dian, 2020; Nawangsari et al., 2022). A joint model makes it possible to assess whether an operational financing measure such as PSR differs from social and legitimacy-oriented measures. Yet inference requires bank size, capital strength, asset quality, and macroeconomic conditions to be considered, because these factors may affect both the IPI indicators and ROE (Puspitasari et al., 2023; Saif-Alyousfi, 2022).

H1: The Profit Sharing Ratio (PSR) is positively associated with the Return on Equity (ROE) of Islamic banks.
H2: The Zakat Performance Ratio (ZPR) is significantly associated with the Return on Equity (ROE) of Islamic banks.
H3: The Equitable Distribution Ratio (EDR) is significantly associated with the Return on Equity (ROE) of Islamic banks.
H4: The Directors–Employees Welfare Ratio (DEWR) is significantly associated with the Return on Equity (ROE) of Islamic banks.
H5: The Islamicity Income Ratio (IsIR) is significantly associated with the Return on Equity (ROE) of Islamic banks.
H6: The association between IPI indicators and ROE differs between Indonesian and GCC Islamic banks.

Conceptual Framework

The conceptual framework distinguishes direct operational effects from indirect reputational effects. PSR may influence ROE through financing returns, asset utilization, and the management of risk-sharing contracts. ZPR, EDR, DEWR, and IsIR may affect ROE through operating costs and resource allocation, but they can also build reputational capital and stakeholder trust. Trust can strengthen customer loyalty and deposit mobilization, which may support a more stable funding base and profitability. These indirect pathways are theoretically plausible but are not directly measured in the present baseline model; they should therefore be treated as mechanisms for interpretation and future testing, not as estimated mediation effects.

Table 1. Expected mechanisms and contextual sensitivity of the IPI indicators.

IPI dimension	Primary mechanism	Potential indirect channel	Expected sensitivity
PSR	Risk sharing; financing return; monitoring cost	Entrepreneur partnership and customer trust	May depend on underwriting quality and market depth
ZPR	Religious obligation and cash outflow	Legitimacy and community acceptance	May emerge over a longer horizon
EDR	Distribution of income across stakeholders	Fairness, reputation, stakeholder support	Depends on distribution composition and disclosure
DEWR	Relative welfare allocation within the bank	Employee morale, retention, perceived fairness	Sensitive to reporting consistency and outliers
IsIR	Integrity of income sources	Sharia credibility and depositor confidence	Potentially limited by ceiling effects / low variation

Market context	Regulation, maturity, customer preferences, competition	Conditions how practices become financial outcomes	Test through region interactions or separate estimates

Stage 1: IPI practices	Stage 2: transmission mechanisms	Stage 3: intermediate outcomes	Stage 4: financial outcome
PSR, ZPR, EDR, DEWR, IsIR	Financing returns and costs; Sharia governance; transparency	Reputational capital; stakeholder trust; customer loyalty; funding stability	ROE
Context: Indonesia vs. GCC; regulatory and market maturity	Context moderates the strength and timing of each pathway	Effects may be immediate, delayed, or primarily non-financial	ROE may respond differently by region

Method

Research design, sample, and data

This study uses a quantitative explanatory design and secondary bank-year data for 2017–2023. The stated sample consists of 13 Islamic banks: eight in Indonesia—Bank Aceh Syariah, Bank Muamalat Indonesia, Bank Victoria Syariah, Bank NTB Syariah, Bank Mega Syariah, Bank Panin Dubai Syariah, Bank BCA Syariah, and BTPN Syariah—and five in the GCC—Al Rajhi Bank, Kuwait Finance House, Dubai Islamic Bank, Qatar Islamic Bank, and Abu Dhabi Islamic Bank. A balanced panel would contain 91 observations (13 banks × 7 years), but 91 must be treated as the nominal sample size until the row-level dataset is audited for missingness, mergers, and changes in reporting definitions.

The sample is intended to compare an emerging Islamic-banking market with a group of more mature Islamic-finance jurisdictions. Annual reports and financial statements are the primary sources for ROE and the IPI indicators. The source manuscript indicates that the data were processed in EViews. To support reproducibility, the final data file should retain, for every bank-year, the report title, page or note reference, original value, transformation, unit, and final coded value.

The Indonesian sample requires explicit treatment of Bank Syariah Indonesia (BSI). BSI became effective on 1 February 2021 through the merger of Bank Syariah Mandiri, BNI Syariah, and BRI Syariah (Bank Syariah Indonesia, n.d.). Those predecessor banks and BSI are not listed among the eight Indonesian sample banks. The revised sampling protocol should state whether they were deliberately excluded because a comparable seven-year entity series was unavailable. The three predecessors must not be treated as continuing independent banks after the merger while BSI is simultaneously added as another bank. Including BSI would require a documented approach to constructing a comparable pre-merger history or a clear decision to use an unbalanced panel beginning in 2021 for BSI.

Variable definitions and measurement

The five IPI measures are extracted from annual reports using a written coding protocol. For each indicator, the protocol must specify the numerator, denominator, treatment of zero or negative denominators, handling of unreported values, and the relevant financial statement note. Ratios should be calculated from underlying amounts wherever possible rather than copied from inconsistently formatted secondary summaries.

Table 2. Variable definitions for the revised specification.

Variable	Symbol	Operational definition	Unit / processing
Return on Equity	ROE	Net profit after tax ÷ total equity	Percentage; use the same equity convention for all banks
Profit Sharing Ratio	PSR	(Mudharabah financing + musyarakah financing) ÷ total financing	Ratio from 0 to 1, unless expressed consistently as percent

Zakat Performance Ratio	ZPR	Zakat paid ÷ net profit before tax	Keep denominator definition consistent; audit negative/zero denominators
Equitable Distribution Ratio	EDR	Income distributed to shareholders, employees, and community ÷ total income	Consistent category mapping across annual reports
Directors–Employees Welfare Ratio	DEWR	Average welfare expenditure for directors ÷ average welfare expenditure for employees	Ratio; flag zero/missing employee-welfare denominator
Islamicity Income Ratio	IsIR	Halal income ÷ total income	Ratio; apply consistent treatment to non-halal income
Bank size (control)	SIZE	Natural logarithm of total assets	Use a common currency or a documented conversion procedure
Capital adequacy (control)	CAR	Regulatory capital ÷ risk-weighted assets	Percentage; harmonize regulatory definition where possible
Asset quality (control)	AQ	Non-performing financing/loans ratio (NPF/NPL)	Document definitional differences between Indonesia and GCC
Macroeconomic condition (control)	MACRO	At least one country-year measure such as GDP growth or inflation	Same year/country series and definitions for all banks in each jurisdiction

A key data-quality step is unit harmonization. The original comparison table reports some GCC ROE values as decimals while Indonesian observations are expressed as percentages. These formats cannot be mixed. For example, 0.183 as a ratio equals 18.3 percent. The raw annual-report value must first be identified as a ratio or an already-percentage figure; only then should the conversion be applied. The same transformation must be applied before descriptive statistics, correlations, regression, and presentation. The illustrative ROE comparison below converts the GCC figures shown as decimals into percentage points, but this display correction does not substitute for re-running the entire panel from verified raw data.

For the IPI variables, a coding manual should be applied consistently across jurisdictions and years. At least a subset of observations should be independently coded by a second researcher; agreement should be reported using an appropriate statistic (for example, Cohen's kappa for categorical coding or an intraclass correlation coefficient for continuous extracted values, where appropriate). The material supplied for this revision does not contain a double-coded dataset or reliability statistics, so no reliability coefficient is claimed here.

Model specification and estimation

The existing baseline model assesses the association between five IPI indicators and ROE:

$$ROE_{it} = \alpha + \beta 1PSR_{it} + \beta 2ZPR_{it} + \beta 3EDR_{it} + \beta 4DEWR_{it} + \beta 5IsIR_{it} + u_i + \varepsilon_{it}$$

where i indexes banks and t indexes years; u_i represents the bank-specific random component and ε_{it} is the idiosyncratic error. The baseline is retained only to report the results already present in the source manuscript.

To address omitted-variable risk, the revised empirical design should estimate an augmented model that includes bank size, capital adequacy, asset quality, and at least one macroeconomic control:

$$ROEit = \alpha + \beta_1 PSRit + \beta_2 ZPRit + \beta_3 EDRit + \beta_4 DEWRit + \beta_5 IsIRit + \varepsilon it$$

REGION distinguishes the Indonesian and GCC subsamples; the interaction terms test whether an IPI–ROE association differs by region. Year effects (λ_t) account for shocks common to the sample. Given the modest nominal sample of 91 observations, the number of controls and interactions should be parsimonious and justified in advance. An alternative is to estimate a common controlled model first, then use a limited set of pre-specified regional interactions and separate-region estimates as robustness checks. The region dummy is time-invariant and cannot be separately identified in a model with bank fixed effects; the stated interaction design is therefore compatible with a random-effects specification or with separate regional analyses.

Model selection should compare pooled, fixed-effects, and random-effects estimators using the Chow/F test, Hausman test, and Breusch–Pagan Lagrange Multiplier test where their assumptions and implementation are appropriate. Inference should use standard errors robust to heteroskedasticity and, where feasible, within-bank serial correlation. Variance inflation factors (VIFs) or a comparable diagnostic should be reported for the predictors. A panel serial-correlation test and the treatment of cross-sectional dependence should also be stated where relevant. Normality of residuals alone does not establish that an estimator is unbiased or that a model is correctly specified.

The raw bank-year dataset and new output for the augmented model were not included with the two supplied files. Therefore, this revision cannot truthfully report new control-variable coefficients, regional interactions, VIFs, serial-correlation results, or updated descriptive statistics. These should be generated after the harmonization and missing-data audit; they must not be inferred from the baseline table.

Results and Discussion

Preliminary ROE comparison and descriptive statistics

The illustrative values available in the original manuscript show substantial variation in the Indonesian bank series and more stable values in the selected GCC series. To avoid the scale error noted by the reviewer, the GCC values below are shown as percentages where the original text supplied decimal ratios. These figures are a presentation-level normalization of the values in the source manuscript; they should be verified against the annual reports before they are used as final empirical evidence.

Table 3. Selected-bank ROE values (percentage points)

Bank / jurisdiction	2017	2018	2019	2020	2021	2022	2023
BTPN Syariah (Indonesia)	−8.70	30.80	31.20	16.08	23.67	24.21	13.22
Al Rajhi Bank (Saudi Arabia)	18.3	19.2	20.1	17.8	18.5	19.3	20.0
Kuwait Finance House (Kuwait)	12.5	13.0	13.5	11.8	12.3	12.8	13.3
Dubai Islamic Bank (UAE)	15.0	15.5	16.0	14.0	14.5	15.0	15.5
Qatar Islamic Bank (Qatar)	14.0	14.5	15.0	12.5	13.0	13.5	14.0

The table suggests two descriptive patterns. First, the BTPN Syariah series has pronounced year-to-year variation, including a negative observation in 2017 and high values in 2019 and 2022. Second, the four displayed GCC series vary within narrower ranges. The contrast should not be interpreted as evidence that GCC banks have negligible profitability: once the unit convention is harmonized, the displayed GCC observations fall broadly within double-digit percentage rates. Differences in market maturity, portfolio composition, risk appetite, and reporting convention remain plausible explanations, but the table by itself cannot identify their causes.

The source manuscript reports the following descriptive statistics for the full stated sample. Because the unit harmonization and missing-value audit have not been applied to the raw panel file supplied for this revision, these are reproduced as the existing baseline output and should be recalculated before submission.

Table 4. Existing descriptive statistics for the research variables

Variable	N reported	Mean	Median	Maximum	Minimum	Std. dev.
ROE	91	5.213	2.300	31.200	−31.760	10.452
PSR	91	0.583	0.630	0.990	0.100	0.274
ZPR	91	0.123	0.018	1.315	−0.075	0.281
EDR	91	0.349	0.375	0.860	−1.050	0.293
DEWR	91	2.137	2.270	4.100	0.000	1.047
IsIR	91	0.994	1.000	1.000	0.900	0.021

In the reported summary, IsIR has a mean of 0.994 and standard deviation of 0.021, indicating little variation in the coded halal-income ratio. The dispersion in ROE is substantially greater than the dispersion in IsIR. The reported ZPR and EDR ranges include negative values, which require particular attention: negative ratios can arise from a negative profit denominator or a definition inconsistent with the intended construct. Such values should not automatically be interpreted as negative zakat or negative income distribution. The coding rules and denominator conditions need to be inspected bank by bank.

Correlation analysis

Table 5. Correlation matrix for the research variables

Variable	ROE	PSR	ZPR	EDR	DEWR	IsIR
ROE	1.000					
PSR	0.345	1.000				
ZPR	−0.178	0.234	1.000			
EDR	0.267	0.156	−0.178	1.000		
DEWR	−0.289	0.089	−0.067	0.312	1.000	
IsIR	0.123	0.045	0.023	0.056	0.078	1.000

The reported bivariate correlations show a positive association between PSR and ROE ($r = 0.345$), a negative association between ZPR and ROE ($r = -0.178$), a positive association between EDR and ROE ($r = 0.267$), a negative association between DEWR and ROE ($r = -0.289$), and a weak positive association between IsIR and ROE ($r = 0.123$). These are descriptive relationships, not estimates of causal effects. The largest reported pairwise correlation among the IPI predictors is 0.312 in absolute value, but pairwise correlations alone cannot establish the absence of multicollinearity; VIF or an appropriate alternative should be reported for the final model.

Estimation-model selection and diagnostics

Table 6. Model-selection tests as reported in the source manuscript

Test	Reported statistic	df	p-value	Interpretation in baseline
Chow / cross-section F	15.234	(12, 73)	0.0000	Reject pooled model in favor of fixed effects
Hausman / cross-section random	8.672	5	0.1231	Do not reject random-effects consistency relative to fixed effects
Breusch–Pagan LM	45.678	1	0.0000	Reject pooled model in favor of random effects

The reported Chow test favors fixed effects over pooled estimation, while the Hausman test has $p = 0.1231$ and therefore does not reject the random-effects estimator relative to fixed effects at the 5 percent level. The LM test also rejects the pooled model in favor of random effects. Taken together, these reported tests support use of a random-effects baseline, subject to the specification and data limitations described in the Methodology section. This corrects the original text, which mistakenly repeated the Chow-test interpretation in its discussion of the Hausman test.

Table 7. Available diagnostic results and remaining tests

Diagnostic	Reported result	Conclusion / outstanding item
Jarque–Bera normality	Statistic = 4.234; p = 0.1205	The null of normal residuals is not rejected at 5%; this is not a test of overall model validity.
Breusch–Pagan–Godfrey	Statistic = 7.234; df = 5; p = 0.2034	The reported test does not detect heteroskedasticity at 5%; re-run on the final specification.
Multicollinearity	VIF not supplied	Must be computed for IPI indicators and control variables.
Within-panel serial correlation	No result supplied	Must be tested or addressed with suitable robust standard errors.
Cross-sectional dependence	No result supplied	Assess relevance given common regional and macroeconomic shocks.

The reported Jarque–Bera and Breusch–Pagan–Godfrey probabilities exceed .05. These results indicate that the respective null hypotheses are not rejected under the reported tests, but they do not justify a broad claim that the model satisfies all econometric assumptions. The source output does not provide VIFs, a panel serial-correlation test, or a diagnostic for cross-sectional dependence. Those tests remain necessary before the augmented model is used for substantive inference.

Baseline panel-regression results

Table 8. Random-effects regression results for the five-predictor baseline model

Variable	Coefficient	Std. error	t-statistic	p-value
Constant	−5.234	8.765	−0.597	0.552
PSR	8.765	3.456	2.536	0.013
ZPR	−2.345	2.876	−0.815	0.417
EDR	4.567	3.123	1.462	0.147
DEWR	0.876	0.567	1.545	0.126
IsIR	6.234	8.456	0.737	0.463
R-squared	0.234			
Adjusted R-squared	0.189			
F-statistic	5.234			
Prob(F-statistic)	0.000			

The baseline output reports that PSR has a positive coefficient of 8.765 and is statistically significant at the 5 percent level ($p = 0.013$). This is consistent with H1 in the baseline model. The other four indicators are not statistically significant at the 5 percent level: ZPR is negative ($\beta = -2.345$; $p = 0.417$), EDR is positive ($\beta = 4.567$; $p = 0.147$), DEWR is positive ($\beta = 0.876$; $p = 0.126$), and IsIR is positive ($\beta = 6.234$; $p = 0.463$). H2–H5 are therefore not supported by the available baseline estimates. The reported F-statistic probability is 0.000, which indicates joint significance of the regressors in that baseline output. The R-squared of 0.234 and adjusted R-squared of 0.189 suggest limited explanatory power: most variation in ROE is associated with factors not captured by these five indicators and/or with measurement and model limitations.

Coefficient magnitudes should be interpreted only after unit consistency is verified. Because PSR is a ratio, a one-unit increase is a very large movement—from 0 to 1—and a coefficient of 8.765 should not be casually described as the effect of a one-percentage-point increase. If PSR is stored between 0 and 1 and ROE is measured in percentage points, the coefficient indicates the fitted difference associated with a full-unit change in PSR, holding the included regressors constant. If the regressors or ROE are rescaled, the coefficient changes accordingly. The current output should be preserved as reported but re-estimated after data harmonization.

Discussion by IPI indicator

1. ***Profit Sharing Ratio (PSR)***

   The positive and statistically significant baseline PSR coefficient is consistent with the proposition that risk-sharing financing can contribute to bank profitability where contracts are originated, monitored, and supervised effectively. Under Agency Theory, mudharabah and musyarakah arrangements can align the bank's return with the performance of the financed activity. Yet the same arrangements can magnify information asymmetry if the entrepreneur has better information about business outcomes or if monitoring is weak. The estimated positive association is therefore most plausibly interpreted as evidence that the returns channel may

dominate the monitoring-cost channel in the current pooled baseline, not as proof that expanding PSR always raises profitability.

Stakeholder Theory and Legitimacy Theory add a second mechanism. Profit-sharing arrangements can make the bank's Islamic identity more visible and can communicate a commitment to risk sharing rather than a purely debt-like return. Customer confidence and reputational differentiation may follow, but neither trust nor customer loyalty is measured directly in the current dataset. The results are directionally consistent with prior Indonesian studies of Islamic performance and profitability, although the literature also reports negative or insignificant relationships depending on sample, measure, and specification (Felani et al., 2020; Nawangsari et al., 2022).

The practical implication is not to maximize PSR mechanically. Islamic banks should increase productive mudharabah and musyarakah financing only alongside stronger screening, business monitoring, cash-flow verification, and risk-sharing governance. The positive finding should be revisited in the augmented specification because bank size, capitalization, asset quality, and macroeconomic conditions can affect both the choice of financing mix and ROE.

2. ***Zakat Performance Ratio (ZPR)***

ZPR has a negative but insignificant baseline coefficient. The sign is compatible with a direct accounting channel in which a higher zakat payment reduces the profit remaining after the relevant payment base is considered, but the p-value does not provide sufficient evidence of a stable negative association with ROE. It is therefore not appropriate to conclude that zakat reduces profitability in general. Its measurement also requires care because the source defines ZPR as zakat paid divided by profit before tax; negative or very small denominator values can produce ratios that are difficult to interpret.

From a stakeholder and legitimacy perspective, zakat is an obligation attached to the bank's social and religious mandate. The benefit may be expressed through public acceptance, community welfare, and credibility rather than short-term returns. Such benefits may occur with a lag and may not be captured by an annual ROE equation. The absence of statistical significance should consequently be read as a failure to detect a short-term association in this baseline model, not evidence that zakat is irrelevant.

3. ***Equitable Distribution Ratio (EDR)***

EDR is positive but statistically insignificant in the reported baseline. The direction is compatible with the possibility that fairer distribution supports employee morale, customer relationships, and reputation, but the estimate does not establish that these channels raise ROE. EDR aggregates distributions to different groups whose effects may differ: staff expenditure may influence productivity, dividends may affect capital retention, and community distributions may support legitimacy. If those components are combined into a single ratio, an aggregate coefficient can obscure offsetting effects.

The result also does not warrant a claim that equitable distribution is unimportant. Under Stakeholder Theory and a Maqasid-oriented view of performance, fair allocation can be a substantive objective even when its effect on accounting profitability is indirect. Future data collection should preserve the underlying distribution categories so that separate or lagged measures can be tested.

4. ***Directors–Employees Welfare Ratio (DEWR)***

DEWR has a positive but statistically insignificant coefficient in the baseline model. Because the variable is defined as directors' average welfare expenditure divided by employees' average welfare expenditure, the positive sign must not be interpreted as evidence that a wider welfare gap improves performance. It may reflect bank size, executive compensation structures, occupational composition, or disclosure conventions. The ratio can also become unstable where employee-welfare expense is zero or not separately disclosed.

Agency Theory raises a governance question about whether compensation arrangements align management incentives with the bank's wider obligations. Stakeholder Theory highlights the importance of employee welfare, perceived fairness, and retention. The current result does not adjudicate between these mechanisms. A revised analysis should inspect outliers and zero denominators, and where data allow, test employee welfare expenditure per employee separately from the director-to-employee ratio.

5. ***Islamicity Income Ratio (IsIR)***

IsIR has a positive but statistically insignificant baseline coefficient. The descriptive output reports a mean of 0.994 and a standard deviation of 0.021, indicating a likely ceiling effect: most sample banks already report a high proportion of halal income. Restricted variation reduces the ratio's ability to explain differences in ROE statistically. This is compatible with

Legitimacy Theory: a high halal-income share may be a threshold condition for operating credibly as an Islamic bank rather than a variable that differentiates profitability among otherwise similar institutions.

IsIR should therefore be monitored as a foundational compliance measure even though the baseline regression does not detect a significant association with ROE. Its interpretation depends on transparent identification of non-halal income, consistent reporting, and the treatment of such income under applicable Sharia governance. The result cannot establish whether a change in IsIR affects profitability because the observed variation may be too limited to identify that relationship.

Indonesia–GCC comparison and model limitations

The comparison suggests why market maturity should be incorporated into the empirical design. In Indonesia, a growing market and a competitive environment may give visible risk-sharing products potential to differentiate institutions and attract customers, while financing appraisal and monitoring remain important constraints. In the GCC, deeper Islamic-finance infrastructure and established regulatory frameworks may make some compliance dimensions more standardized. Under these circumstances, indicators such as IsIR or zakat disclosure may be essential to legitimacy but exhibit limited cross-bank variation. These are theoretical explanations consistent with the institutional comparison; the supplied pooled results do not show that the coefficients differ statistically between regions.

To establish heterogeneous effects, the final model should include interactions between each IPI indicator and a region dummy or report separate regional estimates with the limitations of the small subsamples made explicit. A regional interaction tests whether the slope differs; comparing one significant coefficient with one insignificant coefficient is not, by itself, a valid test of a difference. The augmented model should also include a parsimonious set of controls—bank size, CAR, asset quality, and macroeconomic conditions—to reduce omitted-variable bias. Since those estimates were not provided, the present results cannot answer the reviewer's full request for a controlled, cross-jurisdictional model.

Three further limitations matter. First, the reported descriptive and regression outputs have not been recomputed from a raw dataset after the ROE unit audit. Second, the nominal balanced panel may be affected by missing observations and by the BSI merger, which requires an explicit and consistent entity treatment. Third, the coding-reliability evidence and several formal diagnostics are absent from the supplied materials. These limitations constrain causal interpretation and should be resolved before the manuscript is presented as a final empirical test.

Conclusion

This study asks whether Islamicity matters for Islamic-bank profitability beyond the pursuit of conventional financial returns. The baseline panel output reported in the original manuscript identifies PSR as the only IPI indicator with a positive and statistically significant association with ROE. The reported coefficients for ZPR, EDR, DEWR, and IsIR are not statistically significant. The central contribution is therefore a distinction between a financing practice that may connect directly with productive returns and indicators whose value can lie in compliance, distributive justice, internal welfare, and institutional legitimacy. These results are provisional because the supplied files do not contain the raw panel data needed to harmonize all ROE units and estimate the requested control-adjusted and region-interaction models.

For bank management, the baseline evidence supports careful development of mudharabah and musyarakah financing, combined with credit assessment, monitoring, governance, and transparent reporting. It does not justify relaxing zakat obligations, equitable distribution, employee welfare, or halal-income standards because their coefficients are insignificant. In Indonesia, managers should balance product differentiation and growth with stronger risk controls and careful monitoring of financing quality. In GCC jurisdictions, where compliance infrastructures may be more established, management should continue to treat social and Sharia indicators as core obligations while evaluating their longer-term effects on depositor confidence and funding stability.

For regulators, policy should avoid reducing Islamic-bank performance to ROE alone. Indonesian authorities can encourage sound risk-sharing activity and consistent disclosure while monitoring financing quality. GCC regulators can continue to promote transparent and comparable Sharia-oriented reporting alongside prudential supervision. In both settings, reporting templates that define IPI denominators consistently would improve comparability and reduce measurement error. Cross-jurisdictional policies should recognize differences in legal frameworks, market structures, and reporting practices rather than assume that the same ratio has an identical economic meaning everywhere.

The study has important limitations: a small sample of 13 banks, a seven-year observation period, potential omitted-variable bias, unresolved ROE scaling and missingness checks, and no reported estimates for regional interactions or additional controls. Future studies should extend the panel, include bank size, capital adequacy, asset quality, macroeconomic conditions, and governance variables, examine lagged effects, and use dynamic panel methods where the data support them. Researchers should also measure intermediate outcomes such as deposit growth, customer loyalty, and reputation if the indirect pathways proposed here are to be tested rather than inferred. The original contribution is not that every Islamicity ratio must raise short-term profit, but that financial performance and Sharia performance need to be assessed together through a transparent and empirically defensible framework.

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