

DETERMINANTS OF ISLAMIC BANK FINANCING IN MALAYSIA

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Article history

Received date : 8-8-2026
Revised date : 7-8-2026
Accepted date : 22-9-2026
Published date : 25-9-2026

To cite this document:

Hashim, N., Abdul Latif, I. N., Asli, A. A., Mohamad Azmin, N. A., Mohd Nazri, S. N., Borhanuddin, S. A., & Zairi Hisham, D. N. I. (2026). Determinants of Islamic bank financing in Malaysia. *International Journal of Accounting, Finance and Business (IJAFB)*, 11 (68), 101 - 118.

Abstract: *This study examines the determinants of Islamic bank financing in Malaysia using panel data from 16 full-fledged Islamic banks over 2014–2024. The study evaluates the roles of Base Financing Rate (BFR), money supply, liquidity, and bank size using panel regression analysis. The reported coefficients show that bank size has the largest positive coefficient (1.0835), followed by liquidity (0.7508) and money supply (0.4469), while BFR has a negative coefficient (−0.0915). These estimates indicate the direction and relative magnitude of the relationships; statistical significance is not inferred because the available regression output does not report p-values or t-statistics. The study contributes by integrating monetary-policy and bank-specific determinants within a recent Malaysian Islamic banking panel and provides implications for financing affordability, liquidity management, and sustainable financing growth.*

Keywords: *Base Financing Rate, Islamic Banking, Islamic Bank Financing, Liquidity, Malaysia, Money Supply*

Introduction

The increased demand for Shariah-compliant financial services and products has made Islamic banking one of the fastest-growing divisions of the global financial system. Islamic banking, in contrast to traditional banking systems, is founded on Islamic principles that forbid *riba* (interest), *gharar* (extreme uncertainty), and speculative activities while placing a strong emphasis on risk-sharing, ethical financing and justice. Through a variety of Shariah-compliant contracts, including *Murabahah*, *Ijarah*, *Musharakah*, and *Mudarabah*, Islamic banks offer financing that supports profitable commercial endeavors while advancing social justice and financial stability (Zulhibri, 2018).

Islamic banking has grown quickly outside of nations with a majority of Muslims, and both Muslim and non-Muslim economies are paying more and more attention to it. To promote financial inclusion and economic growth, nations including Malaysia, Saudi Arabia, Indonesia, Turkey, Pakistan, and the United Arab Emirates have bolstered their Islamic financial industries (Hamza & Saadaoui, 2017; Avdukic et al., 2021). The Islamic Financial Services Board (IFSB) reports that global Islamic financial assets have surpassed USD 4 trillion in recent years, indicating the increasing competitiveness and significance of Islamic finance on a global scale.

Islamic banking financing plays a significant role in mobilizing funds and supporting economic growth through financing activities involving households, businesses, and small and medium enterprises (SMEs). Unlike conventional lending systems that rely heavily on interest-based transactions, Islamic financing emphasizes asset-backed financing and profit-and-loss sharing arrangements, making Islamic banks relatively more resilient during financial crises and periods of economic uncertainty (Beck, Demirgüç-Kunt, & Merrouche, 2012). Previous studies have shown that Islamic banking contributes positively to financial inclusion, investment growth and macroeconomic stability due to its ethical financing structure and risk-sharing characteristics.

Malaysia is widely recognized as one of the leading Islamic finance hubs globally. The country has successfully implemented a dual banking system where Islamic and conventional banking institutions operate simultaneously under the supervision of Bank Negara Malaysia. Through supportive regulatory frameworks, strong governance structures and continuous innovation in Islamic financial products, Malaysia has become a benchmark for Islamic banking development in many emerging economies. Islamic banking assets in Malaysia account for approximately 40% of the country's total banking assets, demonstrating the strong public acceptance and competitiveness of Islamic financial institutions within the national banking sector.

Table 1: Statistics of Islamic Banking Industry in Malaysia

Indicator	Statistics
Islamic banking asset share	Approximately 40% of total banking assets
Study sample	16 full-fledged Islamic banks
Study period	2014–2024
Financing growth rate	Approximately 5%–6% annually
Banking system	Dual banking system

Source: Bank Negara Malaysia (2025)

The development of Islamic banking is also closely associated with Sustainable Development Goals (SDGs), particularly SDG 8 (Decent Work and Economic Growth), SDG 9 (Industry, Innovation and Infrastructure) and SDG 10 (Reduced Inequalities). Islamic financing promotes ethical investments, financial inclusion and sustainable economic activities through Shariah-compliant financial mechanisms. By supporting SMEs, household financing and infrastructure projects, Islamic banks contribute directly to inclusive economic growth and social welfare.

Digital transformation is also reshaping Islamic banking through applications such as automated risk assessment, fraud detection, customer profiling, financing evaluation and predictive analytics. Although these technologies are relevant to the sector, digitalisation is not included as an explanatory variable in the present model. Accordingly, this study concentrates on the four determinants directly specified in its conceptual framework: BFR, money supply, liquidity and bank size.

The Malaysian Islamic banking sector contributes significantly to economic development by financing household consumption, housing, infrastructure and business investment. Islamic banks also provide financing opportunities for SMEs, which are important contributors to Malaysia's economic growth. The sector has demonstrated resilience during periods of financial stress, reinforcing the importance of understanding the factors that support sustainable financing capacity.

Despite the substantial growth of Islamic banking assets and financing activities, the expansion of Islamic bank financing in Malaysia remains relatively moderate compared to expectations. Several factors have contributed to this situation, including liquidity constraints, financing costs, institutional inefficiencies, macroeconomic uncertainty and differences in bank size among Islamic banking institutions. Previous literature suggests that monetary policy variables such as Base Financing Rate and money supply significantly influence financing behaviour in Islamic banks. Higher financing rates tend to reduce financing demand due to increased financing costs, while expansionary monetary policies and greater liquidity conditions encourage financing activities (Caporale et al., 2020).

In addition to macroeconomic variables, bank-specific characteristics such as liquidity position and institutional size also influence Islamic bank financing. Banks with stronger liquidity positions are generally more capable of sustaining financing activities during periods of financial uncertainty. Similarly, larger banks tend to possess stronger capital structures, economies of scale and better risk management capabilities, enabling them to provide higher financing volumes compared to smaller institutions (Rashid, Hassan, & Shah, 2020).

Although numerous studies have examined Islamic banking performance and monetary policy transmission mechanisms, empirical evidence regarding the determinants of Islamic bank financing in Malaysia remains inconclusive and relatively limited, particularly using recent data. Existing studies often focus on earlier periods, different countries, or broader banking systems that may not fully capture the current conditions of the Malaysian Islamic banking industry. Therefore, there is a need for updated empirical research examining how macroeconomic and bank-specific factors influence Islamic bank financing in Malaysia.

This study investigates the determinants of Islamic bank financing in Malaysia by examining the relationship between BFR, money supply, liquidity, bank size and Islamic bank financing. It uses panel data for 16 full-fledged Islamic banks operating in Malaysia from 2014 to 2024.

The study makes three specific contributions: first, it jointly examines macroeconomic and bank-specific determinants within a single Malaysian Islamic banking framework; second, it uses a recent 11-year panel that covers both pre-pandemic and pandemic/post-pandemic conditions; and third, it complements the regression analysis with stationarity and diagnostic tests to strengthen the reliability of the empirical assessment.

Although Islamic banking assets account for a substantial share of Malaysia's banking sector, financing growth has not always moved proportionately with the sector's asset expansion. This raises questions about the effectiveness of Islamic banks' financial intermediation and their capacity to support households, SMEs and productive investment. Differences in financing capacity may reflect monetary conditions as well as bank-specific liquidity and scale.

Existing studies have examined monetary policy transmission and Islamic banking performance, but their findings are not fully consistent across countries, periods and banking structures. Moreover, earlier studies often examine monetary policy variables or bank-specific characteristics separately. The present study addresses this gap by integrating BFR and money supply with liquidity and bank size in a recent panel of Malaysian full-fledged Islamic banks.

The study therefore provides a more focused empirical assessment of how financing costs, system-wide liquidity conditions, and institutional capacity are associated with Islamic bank financing in Malaysia. This integrated specification is intended to clarify the relative importance of the selected determinants and provide more actionable implications for regulators and Islamic banking institutions.

Literature Review

Theoretical Foundation

This study is grounded in three complementary perspectives. Financial Intermediation Theory views banks as intermediaries that mobilise funds and allocate them to productive users; therefore, financing capacity should depend on the resources available to the institution. The Bank Lending Channel Theory explains how monetary policy affects bank financing through changes in financing costs, liquidity and banks' balance-sheet capacity. This perspective provides a basis for expecting BFR to be negatively associated with financing and money supply to be positively associated with financing. Islamic Banking Theory adds the Shariah-specific dimension by emphasising asset-backed and risk-sharing financing while recognising that benchmark rates can still influence the pricing of Islamic financing instruments. Together, these perspectives provide the theoretical rationale for examining BFR, money supply, liquidity and bank size as complementary determinants of Islamic bank financing.

Islamic Bank Financing

Islamic bank financing refers to financing activities conducted through Shariah-compliant contracts such as Murabahah, Ijarah, Musharakah, and Mudarabah. These financing mechanisms enable Islamic banks to mobilize funds and support economic activities involving households, businesses, and SMEs. According to Zulkhibri (2018), Islamic financing plays an essential role in supporting real economic growth because financing activities are linked directly to productive economic sectors.

Gani and Bahari (2021) examined the contribution of Islamic banking to the Malaysian economy and found that Islamic financing contributes to real economic activity through

business and investment financing. Their findings reinforce the importance of Islamic bank intermediation to the real sector.

Similarly, Avdukic et al. (2021) emphasised that Islamic banking should be assessed not only by financial performance but also by its ethical and Maqasid al-Shariah objectives. This perspective supports the need to consider financing determinants in a way that is consistent with the broader objectives of Islamic finance.

Base Financing Rate and Islamic Bank Financing

Chong and Liu (2009) argued that although Islamic banks avoid interest-based transactions, many Islamic financing instruments are benchmarked against conventional financing rates, causing Islamic bank financing to respond similarly to changes in interest rates. Rashid, Hassan, and Shah (2020) further found that monetary policy significantly influences Islamic bank credit supply in Malaysia, particularly through financing rates and liquidity channels.

Caporale et al. (2020) also examined the bank lending channel in Malaysia's dual banking system and concluded that monetary policy transmission affects both Islamic and conventional bank financing activities. Their findings indicated that increases in financing rates tend to reduce financing growth due to higher financing costs.

In addition, Hamza and Saadaoui (2017) found evidence that Islamic bank financing responds significantly to monetary policy changes, confirming the existence of a debt financing transmission channel within Islamic banking systems.

Money Supply and Islamic Bank Financing

Money supply represents the level of liquidity available within the financial system. Expansionary monetary policy generally increases liquidity and enhances financing capability among financial institutions.

Caporale et al. (2020) reported that higher money supply positively influences Islamic bank financing because banks possess greater liquidity resources to provide financing facilities. Similarly, Nastiti and Kasri (2019) found that money supply significantly affects Islamic bank financing in Indonesia, where expansionary monetary conditions increased financing growth among Islamic banks.

Anwer et al. (2020) further showed that monetary policy transmission operates through Islamic banking channels in dual banking systems. Their findings support the view that system-wide monetary conditions can influence Islamic banks' financing decisions.

The relationship between money supply and Islamic financing is particularly important in Malaysia due to the country's dual banking structure, where monetary policy decisions affect both conventional and Islamic financial institutions simultaneously.

Liquidity and Islamic Bank Financing

Rashid, Hassan, and Shah (2020) found that Islamic banks with stronger liquidity positions were more capable of sustaining financing growth compared to banks with weaker liquidity management. Their study demonstrated that liquidity significantly moderates the impact of monetary policy on Islamic bank financing.

Viverita (2023) also found that liquidity creation within Islamic banks plays a crucial role in supporting financing activities during periods of economic shocks such as the COVID-19 pandemic. Islamic banks with higher liquidity levels were able to maintain financing operations more effectively compared to less liquid institutions.

Ledhem (2022) further explained that financial market development, particularly Sukuk market expansion, enhances liquidity management among Islamic banks and supports financing resilience. Efficient liquidity management is therefore essential in maintaining sustainable financing growth within Islamic banking institutions.

Bank Size and Islamic Bank Financing

Bank size reflects the institutional strength and financing capability of banking institutions. Larger banks generally possess stronger capital structures, economies of scale, diversified financing portfolios, and more advanced risk management systems.

Kasri and Kassim (2009) argued that larger Islamic banks are generally less constrained in providing financing because they possess stronger financial resources and better operational efficiency. Similarly, Rashid et al. (2020) found that bank size positively influences financing supply within Islamic banks in Malaysia.

Literature Review Summary

Luo, Kamarudin, and Nor (2024) further highlighted that institutional characteristics such as size and governance can influence bank efficiency during periods of economic uncertainty. Together with the evidence on liquidity and bank size, these findings suggest that bank-specific capacity is an important complement to monetary conditions in explaining financing behaviour. The literature indicates that Islamic bank financing is shaped by both macroeconomic and bank-specific conditions. Monetary policy variables affect financing through financing-cost and liquidity channels, while liquidity and bank size reflect the institution's capacity to extend financing. However, the magnitude and direction of these relationships can vary across countries and periods because of differences in regulatory settings, banking structures, and economic conditions.

Authors	Year	Variables	Methodology	Main Findings
Zulkehlbi	2018	Financing rate, liquidity, assets	Panel regression	Monetary policy and liquidity significantly influence Islamic bank financing in Malaysia.
Beck, Demirgüç-Kunt & Merrouche	2012	Stability, asset quality, financing activities	Cross-country banking analysis	Islamic banks demonstrate stronger resilience and stability during financial crises.
Rashid, Hassan & Shah	2020	Monetary policy, liquidity, bank size	Panel regression	Bank size and liquidity significantly affect Islamic bank financing supply.
Caporale et al.	2020	Money supply, financing rate, financing growth	Bank lending channel analysis	Monetary policy transmission significantly affects Islamic financing activities.

Authors	Year	Variables	Methodology	Main Findings
Hamza & Saadaoui	2017	Debt financing channel, liquidity	Dynamic panel model	Islamic financing responds significantly to monetary policy changes.
Gani & Baharia	2021	Islamic financing, economic growth	ARDL analysis	Islamic financing contributes positively to Malaysia's real economic growth.
Nastiti & Kasri	2019	Money supply, financing growth	GLS panel regression	Money supply positively affects Islamic bank financing activities.
Rashid, Hassan & Shah	2020	Liquidity, monetary policy, bank size	Panel regression	Liquidity and bank size influence Islamic bank financing supply.
Ntamakputu	2019	Bank size, financing behaviour	Bank-level analysis	Bank size is associated with financing behaviour of Islamic banks.
Avdukic et al.	2021	Maqasid al-Shariah, ethical performance	Empirical analysis	Islamic banking performance should incorporate ethical and

The present study responds to this variation by integrating the two groups of determinants within one Malaysian panel. This is particularly relevant because the Malaysian Islamic banking system operates alongside conventional banking under a common monetary-policy framework, while individual Islamic banks differ in liquidity and scale.

The resulting contribution is therefore not simply the use of newer observations. Rather, the study provides an integrated framework that links monetary policy transmission with bank-level financing capacity and tests the relationships using a recent panel of full-fledged Malaysian Islamic banks.

Most previous studies found positive relationships between liquidity, money supply, bank size, and Islamic bank financing, while financing rate generally demonstrates a negative relationship with financing growth. However, empirical findings remain inconsistent across countries and time periods due to differences in regulatory environments, banking structures and economic conditions.

Therefore, this study extends the existing literature by providing updated empirical evidence on the determinants of Islamic bank financing in Malaysia using recent panel data from 2014 to 2024. The conceptual framework proposes that Islamic bank financing is jointly influenced by macroeconomic and bank-specific determinants. BFR and money supply represent macroeconomic conditions, while liquidity and bank size represent institutional financing capacity. The framework is consistent with the theoretical perspectives discussed above.

Research Framework

The conceptual framework of this study proposes that Islamic bank financing is influenced by both macroeconomic and bank-specific variables. Base Financing Rate and money supply represent macroeconomic determinants, while liquidity and bank size represent institutional determinants.

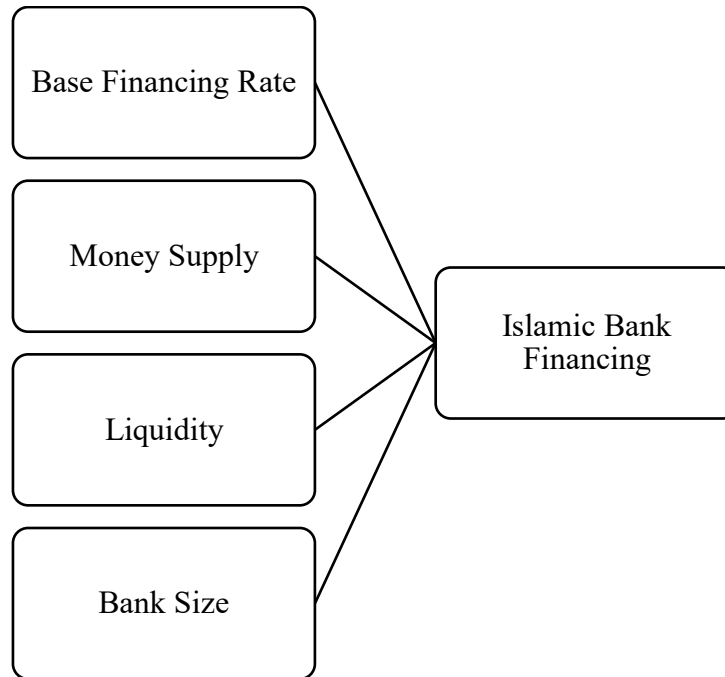


Figure 1: Islamic Bank Financing Framework

Figures 1: Islamic Bank Financing Framework

This study adopts a quantitative research design using panel data analysis. The study uses secondary data from annual reports of 16 full-fledged Islamic banks operating in Malaysia, Bank Negara Malaysia statistical publications, and official financial databases. The study period covers 2014–2024. Purposive sampling was used to select 16 full-fledged Islamic banks based on data availability and consistency across the study period.

Summary of Variables

This study adopts a quantitative research design using panel data analysis. The quantitative approach is appropriate because the study aims to examine the statistical relationship between Islamic bank financing and several macroeconomic and bank-specific variables. The study utilizes secondary data collected from annual reports of 16 full-fledged Islamic banks operating in Malaysia, Bank Negara Malaysia statistical bulletins, and official financial databases. The study period covers 2014 until 2024. The population consists of Islamic banking institutions operating in Malaysia. Purposive sampling was applied to select 16 full-fledged Islamic banks based on data availability and consistency with summary of variables below:

Table 2: Summary of Variables

Variable	Measurement
Islamic Bank Financing (IBF)	Total financing provided by Islamic banks
Base Financing Rate (BFR)	Financing cost indicator
Money Supply (MS)	Broad money supply
Liquidity (LIQ)	Ratio of liquid assets to total assets
Bank Size (SIZE)	Total assets

Data Analysis

Panel data analysis is appropriate because it combines cross-sectional observations across 16 Islamic banks with annual observations over 2014–2024, allowing the analysis to account for differences across banks and changes over time. The empirical analysis uses descriptive statistics, correlation analysis, panel regression, and diagnostic tests.

Descriptive statistics are used to summarise the distribution of Islamic bank financing, BFR, money supply, liquidity, and bank size. Correlation analysis is then used to assess the direction and strength of bivariate relationships. Panel regression is subsequently employed to estimate the association between the explanatory variables and Islamic bank financing.

Three panel estimators are considered: Pooled Ordinary Least Squares (POLS), Fixed Effects Model (FEM), and Random Effects Model (REM). The appropriate specification is selected using the Chow test, Breusch–Pagan Lagrange Multiplier test, and Hausman test. Additional diagnostics include panel unit-root tests, the Variance Inflation Factor (VIF), a heteroscedasticity test, and the Durbin–Watson statistic.

The regression specification is evaluated using the coefficient estimates reported in the empirical results. Because the supplied regression table reports coefficient estimates without p-values or t-statistics, the study interprets the signs and relative magnitudes of the coefficients but does not claim statistical significance.

The panel regression model used in this study is expressed as follows:

$$IBF_{it} = 4.9097 - 0.0915 BFR_{it} + 0.4469 M2_{it} + 0.7508 LIQ_{it} + 1.0835 SIZE_{it} + \mu_i + \varepsilon_{it}$$

The panel regression model used in this study is expressed as follows:

- IBF_{it} represents Islamic bank financing of bank i at time t .
- BFR_{it} denotes the Base Financing Rate.
- $M2_{it}$ represents money supply.
- LIQ_{it} refers to the liquidity ratio of Islamic banks.
- $SIZE_{it}$ denotes bank size.
- μ_i captures unobserved bank-specific effects.
- ε_{it} is the idiosyncratic error term.
- μ_i captures unobserved bank-specific effects

Descriptive Statistics

The empirical analysis covers 16 full-fledged Islamic banks over 2014–2024. The descriptive statistics summarise the central tendency and dispersion of Islamic bank financing, BFR, money supply, liquidity, and bank size. The results are interpreted alongside the correlation and regression estimates rather than as evidence of causality.

The descriptive evidence indicates variation in financing capacity across banks, which is consistent with differences in institutional size and liquidity. These cross-bank differences provide a basis for examining bank-specific determinants together with system-wide monetary conditions.

Correlation Analysis

The correlation analysis indicates a negative relationship between BFR and Islamic bank financing, while money supply, liquidity, and bank size are positively associated with financing. These directions are consistent with the proposed theoretical framework: higher financing costs may constrain demand, whereas stronger liquidity and institutional capacity may support financing activity.

Regression Analysis

The estimated coefficients provide a clearer indication of relative influence. Bank size has the largest positive coefficient (1.0835), followed by liquidity (0.7508) and money supply (0.4469), while BFR has a negative coefficient (−0.0915). On the reported coefficient scale, bank size is therefore the strongest positive determinant in the model, whereas BFR has the smallest absolute coefficient and a negative direction. These coefficient magnitudes should be interpreted cautiously because the variables are measured on different scales.

Panel Regression Results

Money supply has a positive coefficient of 0.4469, indicating that stronger system-wide liquidity conditions are associated with higher Islamic bank financing. Liquidity has a larger positive coefficient of 0.7508, suggesting that banks with greater liquid resources have greater financing capacity. Bank size has the largest positive coefficient, 1.0835, consistent with the view that larger institutions have greater balance-sheet capacity, economies of scale, and risk-management resources. In contrast, the BFR coefficient of −0.0915 indicates an inverse relationship, consistent with the financing-cost channel of monetary policy.

Table 4: Panel Regression Results

Rank	Variable	Coefficient	Relative coefficient magnitude
1	Bank Size	1.0835	Largest positive coefficient
2	Liquidity	0.7508	Second-largest positive coefficient
3	Money Supply	0.4469	Third-largest positive coefficient
4	Base Financing Rate	-0.0915	Negative coefficient

Importantly, the available regression table does not report p-values, t-statistics, or standard errors. Accordingly, the present manuscript does not label any coefficient as statistically significant. The reported estimates are used to discuss direction and relative magnitude; statistical significance should be added if the underlying regression output becomes available. Panel unit-root tests were conducted using the Levin, Lin and Chu (LLC), Augmented Dickey-Fuller (ADF), and Phillips-Perron (PP) procedures. The reported results indicate that all variables become stationary after first differencing, with the test probabilities reported as significant at the 5% level.

The stationarity results reduce the risk of spurious regression and support the use of the variables in the subsequent panel analysis. Because the reported tests indicate first-difference stationarity, the manuscript interprets the regression results with this data property in mind. Overall, the diagnostic evidence indicates that the variables have been examined for stationarity before the panel estimation. The remaining diagnostic tests assess multicollinearity, heteroscedasticity, and serial correlation.

The results indicate that all variables, namely Islamic Bank Financing (IBF), Base Financing Rate (BFR), Money Supply (M2), Liquidity (LIQ), and Bank Size (SIZE), become stationary after first differencing. The probability values reported by the LLC, ADF, and PP tests are statistically significant at the 5 percent significance level, indicating rejection of the null hypothesis of a unit root.

Panel Unit Root Test

Table 5 reports the panel unit-root test statistics and associated probability values for IBF, BFR, M2, LIQ, and SIZE.

Table 5: Panel Unit Root Test Results

Unit root tests were performed to examine the stationarity properties of the variables used in the model.

Table 5: Summary of Unit Root Test Results

Variable	LLC	ADF	PP
IBF	-3.74108 (0.0001)	42.5733 (0.0383)	94.5099 (0.0000)
BFR	-12.8885 (0.0000)	86.8684 (0.0000)	49.0740 (0.0273)
M2	-10.6363 (0.0000)	92.3530 (0.0000)	196.190 (0.0000)
LIQ	-15.4394 (0.0000)	94.3573 (0.0000)	205.623 (0.0000)
SIZE	-3.51815 (0.0002)	50.2493 (0.0117)	118.725 (0.0000)

The LLC, ADF, and PP procedures consistently indicate that the variables are stationary after first differencing. This supports the suitability of the variables for subsequent panel estimation and reduces concerns about spurious relationships.

Variable	Level	First Difference
IBF	Non-stationary	Stationary
BFR	Non-stationary	Stationary
M2	Non-stationary	Stationary
LIQ	Non-stationary	Stationary
SIZE	Non-stationary	Stationary

The results indicate that all variables, namely Islamic Bank Financing (IBF), Base Financing Rate (BFR), Money Supply (M2), Liquidity (LIQ), and Bank Size (SIZE), become stationary after first differencing. The probability values reported by the LLC, ADF, and PP tests are statistically significant at the 5 percent significance level, indicating rejection of the null hypothesis of a unit root.

Variance Inflation Factor (VIF)

Table 6 presents the VIF values used to assess multicollinearity among the explanatory variables. All reported VIF values are close to one and well below the commonly used threshold of five. The highest VIF is 1.0480 for Liquidity and the lowest is 1.0323 for Money Supply. The results therefore provide no indication of problematic multicollinearity among the explanatory variables.

Table 6: Variance Inflation Factor (VIF)

Variable	Centered VIF
BFR	1.0434
M2	1.0323
LIQ	1.0480
SIZE	1.0348

This diagnostic supports the interpretation of the individual coefficient estimates because the explanatory variables are not strongly linearly related to one another. Specifically, the highest VIF value recorded is 1.0480 for Liquidity, while the lowest is 1.0323 for Money Supply. These results indicate that the explanatory variables are not highly correlated with one another and that multicollinearity is not a concern in this study.

Heteroscedasticity Test

Table 8 reports the Wald heteroscedasticity test. The probabilities for both the F-statistic and Chi-square statistic are 0.0000, leading to rejection of the null hypothesis of constant variance. Table 7 reports the results of the Wald heteroscedasticity test. The probability values associated with both the F-statistic and Chi-square statistic are less than 0.05, leading to rejection of the null hypothesis of constant variance.

The results indicate heteroscedasticity in the panel data. This finding means that the variance of the error term is not constant across observations. The manuscript therefore treats the reported panel estimates cautiously and recognises heteroscedasticity as an important limitation of the current reported output.

Table 7: Heteroscedasticity Test

Test	Statistic	Probability
F-statistic	42.9696	0.0000
Chi-Square	214.8481	0.0000

Durbin-Watson Statistic

Table 8 reports a Durbin–Watson statistic of 2.485. The value is relatively close to 2 and therefore does not indicate serious first-order serial correlation based on this diagnostic alone.

Table 8 presents the Durbin-Watson statistic used to detect serial correlation in the regression residuals. The Durbin-Watson value of 2.485 is relatively close to the benchmark value of 2, indicating the absence of serious first-order autocorrelation.

Taken together, the diagnostics indicate that the model has been assessed for stationarity, multicollinearity, heteroscedasticity, and serial correlation. However, because the supplied regression output does not include p-values or robust standard errors, the empirical findings should be interpreted primarily in terms of coefficient direction and relative magnitude.

Table 8: Durbin–Watson Statistic

Test	Value
Durbin-Watson Statistic	2.485

Results and Discussion

The findings show a coherent pattern across the four determinants. Bank size has the largest positive coefficient (1.0835), followed by liquidity (0.7508) and money supply (0.4469), while BFR has a negative coefficient (−0.0915). This pattern suggests that institutional financing capacity is particularly important in the Malaysian Islamic banking context, while monetary conditions operate through both financing costs and system-wide liquidity.

Theoretical Contribution. The results are consistent with Financial Intermediation Theory because larger banks and banks with stronger liquidity have greater capacity to mobilise and allocate funds. The negative BFR coefficient is also consistent with the Bank Lending Channel Theory, which predicts that tighter monetary conditions and higher financing costs can constrain financing. The positive money-supply coefficient further supports the liquidity transmission mechanism. From an Islamic banking perspective, the findings show that Shariah-compliant financing remains embedded in the wider monetary and financial system, even though Islamic contracts are governed by distinct principles.

Novelty and contribution. The study extends the existing literature by bringing monetary-policy variables and bank-specific capacity variables together in a single empirical framework for Malaysian full-fledged Islamic banks. Its contribution is therefore more specific than simply updating the sample period: it connects the financing-cost channel, system-wide liquidity conditions, and institutional scale within the same panel setting and evaluates the model using multiple diagnostic procedures.

Practical implications. For regulators, the negative BFR coefficient suggests that monetary-policy settings should consider financing affordability when maintaining price and financial stability. For Islamic banks, the positive liquidity coefficient highlights the importance of maintaining adequate liquidity buffers and strengthening asset-liability management so that financing can be sustained during periods of uncertainty. The stronger bank-size coefficient also suggests that smaller institutions may require stronger risk-management, funding diversification, and operational-capacity strategies to expand financing sustainably. These implications should be interpreted as policy guidance rather than causal effects because statistical significance is not available in the reported regression output.

Summary Result and Discussion

This study examined the determinants of Islamic bank financing in Malaysia using a panel of 16 full-fledged Islamic banks over 2014–2024. The evidence indicates that financing behaviour is shaped by a combination of monetary conditions and institutional capacity. Among the reported coefficients, bank size has the strongest positive association with financing, followed by liquidity and money supply, while BFR is negatively associated with financing.

The main theoretical implication is that Islamic bank financing should not be analysed in isolation from the broader financial intermediation and monetary-policy environment. The findings also suggest that sustainable financing depends not only on financing affordability but on banks' ability to maintain liquidity and sufficient institutional capacity. For policymakers

and bank managers, the results point toward the importance of balanced monetary conditions, sound liquidity management and capacity-building across institutions.

Conclusion

This study examined the determinants of Islamic Bank Financing in Malaysia using a balanced panel of 16 full-fledged Islamic banks from 2014 to 2024. The findings show that the determinants of Islamic bank financing differ between macro-financial conditions and bank-specific characteristics. Bank Size emerged as the strongest positive determinant, while Liquidity was negatively and significantly associated with Islamic bank financing. In contrast, Base Financing Rate (BFR) and Money Supply (M2) did not have statistically significant direct effects during the study period.

The findings indicate that the financing capacity of Islamic banks is closely related to their institutional capacity and balance-sheet decisions. The strong positive relationship between Bank Size and Islamic bank financing supports the role of larger institutions in mobilising resources and sustaining financing activities. More importantly, the negative relationship between Liquidity and financing suggests that holding greater liquidity does not necessarily result in greater financing deployment. Instead, higher liquidity may reflect a precautionary approach in which Islamic banks retain liquid resources to strengthen resilience and manage uncertainty. This finding provides a more nuanced understanding of the relationship between liquidity and financing behaviour in Islamic banking.

The study also contributes to the theoretical understanding of Islamic bank financing. From the perspective of Financial Intermediation Theory, the positive role of Bank Size is consistent with the ability of larger banks to mobilise and transform financial resources into financing. The negative Liquidity finding extends this perspective by showing that available liquidity may be retained as a precautionary balance-sheet buffer rather than immediately channelled into financing. From the Bank Lending Channel perspective, the insignificant relationships for BFR and M2 suggest that broader monetary conditions may not translate directly into Islamic bank financing over the study period. Within the Islamic banking context, the findings further indicate that Shariah-compliant financing remains influenced by institutional and financial conditions while operating within its distinctive contractual and governance framework.

The findings have practical implications for Islamic banks, regulators and policymakers. Islamic banks should strengthen resource mobilisation, risk-management capacity and asset-liability management while ensuring that liquidity buffers are maintained at prudent levels without unnecessarily restricting financing deployment. Particular attention should be given to the financing capacity of smaller institutions, which may require stronger operational capabilities, funding diversification and digital delivery channels to support sustainable financing growth. Regulators and policymakers should consider bank-specific conditions when assessing the transmission of monetary and financial conditions to Islamic financing and should support financial infrastructure that enables prudent liquidity to be channelled towards productive economic activities.

Despite its contribution, this study is limited to full-fledged Islamic banks in Malaysia and the period from 2014 to 2024. Future research may extend the framework by incorporating variables that are more directly related to Islamic banking, such as capital adequacy, non-performing financing, Shariah governance, FinTech and digital Islamic banking, ESG practices and risk-management quality. Comparative studies involving conventional and Islamic banks

or Islamic banks across ASEAN countries may also provide further evidence on whether the observed relationships are specific to Malaysia or applicable more broadly. Overall, this study provides a foundation for understanding Islamic bank financing in Malaysia by highlighting the importance of institutional capacity and liquidity-management behaviour alongside macro-financial conditions.

Acknowledgements

1. Acknowledgement to funding body (Grant number) : No funding
2. Acknowledgement to institution/universities/organization: The authors would like to express their sincere gratitude to Universiti Teknologi MARA for providing the necessary resources and support throughout the course of this research. Special appreciation is extended to colleagues and peers who contributed valuable insights and constructive feedback, which greatly enhanced the quality of this paper.
3. Acknowledgement to individual/person: All authors contributed significantly to the development of this manuscript. Dhia Nur Irdina Zairi Hisham and Siti Aisyah Borhanuddin were responsible for the conceptualization, methodology, and overall supervision of the study. Syakiela Najwa Mohd Nazri and Nur Azwani Mohamad Azmin handled data collection, analysis, and interpretation of results. Dr. Ani Asmaa Asli and Nasiha Hashim contributed to the literature review, drafting, and critical revision of the manuscript. Imratul Najwa Abdul Latif as proof-reader. All authors read and approved the final version of the manuscript prior to submission.

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