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DO ISLAMIC FINANCING CONTRACTS ENHANCE BANK PROFITABILITY? EVIDENCE FROM THE MEDIATING ROLE OF FINTECH ADOPTION IN INDONESIA

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Abstract

The present study investigates direct and indirect impacts of six financing instruments including *murabaha*, *mudaraba*, *musyaraka*, *ijara*, *istishna* and *qardh* of Islamic finance on the profitability of Indonesia's Islamic banks, measured through Return On Assets (ROA), where fintech adoption becomes the mediator. This study adopted quantitative explanation method, where secondary monthly times series data collected from the statistics of Islamic Banking reported by the Financial Services Authority (OJK) for the years 2015 - 2024 were used. The structural relationship between the variables was tested with path analysis, supported by Sobel test and bootstrapping to test mediation effect. The results found that *mudaraba* financing instrument had the highest positive impact on fintech adoption, showing higher association with financial innovation in comparison to other Islamic financing instruments. Digital transformation expenditure, which represents fintech adoption, significantly negatively impacts ROA; therefore, technology investments put immediate pressure on the profitability of the bank. Moreover, none of the Islamic financing instruments had a direct effect on ROA, but *mudaraba* financing instrument yielded a significant indirect effect on ROA through fintech adoption. These findings suggest that Indonesian Islamic banks remain in the early stage of digital transformation, highlighting the need for more efficient digital integration and supportive regulatory frameworks to achieve sustainable long-term profitability.

Keywords: Islamic Banking; Fintech; Islamic Financing Contracts; *Mudaraba;* Profitability

JEL Classification: G21; G23; M15

INTRODUCTION

The Indonesian Islamic banking sector functions under a dual banking system and ensures adherence to the Sharia principles via ethical finance, asset-backed deals, and profit and loss sharing (Widarjono & Rafik, 2023). In the last ten years, the sector has witnessed significant organizational growth, demonstrated by the rising numbers of Islamic banks, financing activities, and customers (Pratami et al., 2023; Sodik, 2026; Sutrisno & Widarjono, 2022). Although the sector has been experiencing such growth, Islamic banks continue to face risks due to inefficient operations and macroeconomic instability, which have direct impacts on their financial results (Fithria, 2022;Humairah et al., 2023). Out of many financial indicators, ROA can be considered among the most comprehensive measures of bank performance since it assesses the ability of banks to create profits on their assets (Bitar et al., 2020). According to data on Islamic banking statistics provided by the Financial Services Authority (OJK), the ROA of Indonesian Islamic banks has been increasing from 2015 to 2024. The profitability of the banks has risen continuously since 2017; however, during the COVID-19 pandemic of 2020, profitability dropped significantly, indicating the sensitivity of Indonesian Islamic banks to any operational disruptions and economic uncertainties (OJK, 2024; Jan et al., 2021; Lies & Susanti, 2020). Variations in profitability cannot be attributed to asset growth and financing growth alone (Bakti et al., 2022; Syah & Rahmadani, 2024). There is another determinant of bank profitability, namely the structure of financing contracts and effective use of operational resources (Synatrya & Pramono, 2023; Zheng et al., 2023).

The financing intermediation business operation is the main activity of Islamic banks, which also acts as the primary source of income for them (Abdullah, 2022; Baroroh, 2023). In contrast to conventional financing through loans, Islamic financing uses different Sharia contracts, which have varying risk return profiles, monitoring needs, and methods of generating income (Beck et al., 2013). Commonly used Sharia contracts in practice include *murabaha*, *mudaraba*, *musyaraka*, *ijara*, *istishna*, *qard*, and *salam* (Asyiqin & Alfurqon, 2024; Khayat et al., 2025; Sudiro et al., 2022). However, these contracts differ significantly in terms of their commercial features. *Murabaha* financing is preferred since it provides predefined profit margins, standard processes of entering into the contracts, and relatively lower monitoring cost (Sudiro et al., 2022). Partnership contracts such as *mudaraba* and *musyaraka* involve greater monitoring due to high information asymmetry and agency problems (Sutrisno & Widarjono, 2022). Recent research from Indonesia suggests that PLS financing involves greater financing risk and monitoring compared to debt-based financing contracts (Annizar & Junarsin, 2025).

The reliance on partnership-based financing increases the level of uncertainty faced by Islamic banks because entrepreneurs usually have better information on project performance and the associated risks, thus raising the cost of monitoring (Abedifar et al., 2013; Miah & Uddin, 2017). However, according to the recent evidence from Indonesia, Islamic banks use *murabaha* financing due to the lower risks associated with the operations and lower cost of monitoring, which ensures higher levels of profitability compared to profit-and-loss-sharing contracts (Annizar & Junarsin, 2025; Sutrisno & Widarjono, 2022). While this type of financing ensures short-term stability of the finances, it may cause structural weaknesses in the long term since it reduces financing diversification and weakens the principles of risk sharing, which make Islamic banking different from conventional banking (Azmat et al., 2015). Thus, the dominance of debt-based financing in Islamic banking reflects a balance between the benefits associated with the stability of profitability and the inability to implement the real principles of the risk-sharing paradigm (Khayat et al., 2025; Sutrisno & Widarjono, 2022). Recent evidence from Indonesia shows that Islamic banks focus on financial stability through debt-based financing in spite of the issue of lack of utilization of profit-and-loss-sharing financing (Khaw et al., 2023; Sutrisno & Widarjono, 2022).

The fast development of fintech domain has brought new prospects of improving the operational efficiency and competitiveness of Islamic banking institutions (Alshater et al., 2022). Adoption of fintech includes investing in the digital technologies, integration of systems, and technology-assisted financial services, such as verification systems, automated reporting, APIs, mobile banking, and credit evaluation using artificial intelligence (Shaikh et al., 2022; Sidaoui et al., 2022). The above-mentioned digital innovations are likely to bring reductions in transaction costs, increases in operational efficiency and risk management, and greater inclusiveness (Muin et al., 2025; Sodik, 2026; Synatrya & Pramono, 2023). It was empirically proven that fintech adoption improves operational efficiency and competitiveness of Islamic banks especially in developing countries where dual banking systems are prevalent (Saygılı, 2023). Thus, fintech can act as not only a technological innovation but also a competitive capability that influences how various Islamic financing contracts create value for banks (Alnsour, 2023).

Notwithstanding the increased focus of scholars on the relationship between Islamic banking and fintech, existing research findings fail to provide a clear and coherent view of how the former affects the latter (Nuhic-Meskovic et al., 2026). For instance, some researchers state that fintech development increases profitability especially when financing is based on the *mudaraba* financing structure (Sutrisno & Widarjono, 2022). On the other hand, there are

researchers who claim that partnering financing can be detrimental for profitability because of high costs of monitoring and inefficient operations (Azad et al., 2023; Hassan & Aliyu, 2018). Similarly, even though fintech adoption helps to increase operational efficiency and competitiveness, the cost of implementing it is high and results in decreasing short-term profitability (Alnsour, 2023; Nguyen et al., 2023). However, it is worth noting that the majority of the existing literature focuses on one or two types of financing agreements including *mudaraba* and profit-and-loss sharing financing without considering all types of Islamic financing agreements in one study (Alshater et al., 2022; Hudaefi, 2020). In addition, existing literature does not consider the mediating effect of fintech in the relationship between financing structures and financial performance.

The current study attempts to fill this gap in the existing research by analyzing both direct and indirect influence of six major Islamic financing contracts on the profitability of Indonesian Islamic banks with the adoption of fintech used as a mediator (Asyiqin & Alfurqon, 2024; Khayat et al., 2025; Nuhic-Meskovic et al., 2026). *Salam* financing contract is excluded due to lack of variation during the observation period. There are two main contributions provided by the current study in terms of the existing research. First, this study provides a more thorough examination of Islamic financing contracts by considering six major contracts at once as opposed to one or two contracts in the previous research. Second, this study contributes to the literature by introducing a new concept of fintech adoption as the mediator between Islamic financing and bank profitability instead of viewing fintech merely as an independent variable. The findings are expected to provide valuable theoretical insights into the relationship between Islamic financing and financial performance while offering practical implications for Islamic banking institutions and policymakers in designing effective digital transformation strategies for sustainable banking development.

LITERATURE REVIEW

Agency Theory

The present study uses Agency Theory as the main framework to understand the association between Islamic financing agreements, fintech adaptation, and profitability of Islamic banks. According to Agency Theory, an agency relationship is created when one party gives the other party the responsibility of making decisions and the conflict of interest can arise as a result of information asymmetry, adverse selection, and moral hazard (Jensen & Meckling, 1976). In relation to Islamic banking, agency issues arise since the bank as a financier cannot observe and control the behavior of the

entrepreneur after the financing is provided to him/her (Azizi & Mugiyati, 2025; Bakti et al., 2022). Therefore, banks incur costs to monitor and get the required information.

Agency conflicts are particularly pronounced in partnership-based financing contracts such as *mudaraba* and *musyaraka*, where returns depend on the actual performance of the financed business and banks share both profits and business risks with entrepreneurs (Sudiro et al., 2022; Yunika et al., 2024). Because entrepreneurs possess superior information regarding project performance, these contracts expose banks to greater information asymmetry and monitoring costs than trade-based contracts such as *murabaha*, which employ predetermined profit margins and more predictable payment structures (Abedifar et al., 2013). As monitoring costs increase, operational efficiency may decline, thereby reducing bank profitability.

In light of the Agency Theory, the adoption of fintech solutions serves as a means to help reduce agency problems through transparency, information asymmetry reduction, and enhanced monitoring capabilities throughout the financing process (Nuhic-Meskovic et al., 2026; Yunika et al., 2024). Digital verification, automated reports, transaction monitoring at real-time speeds, and risk assessment through data make it easier for Islamic banks to get more precise and up-to-date information on financed projects, thereby reducing agency costs and increasing efficiency (Liu et al., 2021). Thus, fintech can enhance the efficacy of Islamic financing contracts through decreasing inefficiency of the contracts and better financial results. Such an approach creates a solid justification for the role of fintech adoption as a mediating between Islamic financing contracts and bank profitability (Khayat et al., 2025; Malik & Shahzad, 2025; Nuhic-Meskovic et al., 2026; Yunika et al., 2024).

Legitimacy Theory

According to Legitimacy Theory, institutions are always trying to gain social approval by ensuring that they perform in accordance with the values, beliefs, and standards of the society they function in (Dowling & Pfeffer, 1975). In case of Islamic banks, gaining legitimacy is not only about legal requirements and organizational identity but about following Sharia values such as justice, transparency, ethics, and joint risk-sharing in finance (Asyiqin & Alfurqon, 2024; Malik & Shahzad, 2025). One of the age-old issues associated with Islamic banking is the prevalence of the *murabaha* mode of financing, which bears many similarities with the conventional debt financing, and therefore is said to hinder the operationalization of profit and loss sharing principles that underpin contracts like *mudaraba* and *musyaraka* (Azmat et al., 2015). There are questions about its legitimacy since the parties to the Islamic

banking transactions are expecting these institutions to adhere to the aims of the Shariah by risk sharing and socially responsible financing.

Institutional legitimacy can be further improved through the adoption of fintech due to increased transparency, accountability, and efficiency in Islamic financing contracts (Awais et al., 2025; Zheng et al., 2023). Digital technologies make it easier to disclose correct information, monitor contracts, automate compliance procedures, and increase stakeholders' confidence in Sharia governance (Alsaghir, 2023; Dawood et al., 2022). According to Chong (2021), fintech allows Islamic banks to manage partnerships in financing more effectively, provide better financial reporting, and build confidence in Sharia compliance among the general public. Thus, the Legitimacy Theory reveals how fintech assists in the wider acceptance of Islamic banking institutions through increased financing diversity and transparency and stakeholder confidence. In combination with Agency Theory, this theoretical approach gives a good basis to understand how fintech can serve as a mediating variable in relation between Islamic financing contracts and bank profitability (Alsaghir, 2023; Awais et al., 2025; Dawood et al., 2022; Zheng et al., 2023).

HYPOTHESIS DEVELOPMENT

Direct Effect of Islamic Financing Contracts on Fintech Adoption

The contracts used in Islamic financing vary widely with regards to complexity in contractual nature, need for monitoring, documentation process, degree of information asymmetry, and operational risk, hence creating various needs for the use of digital technology in financing management (Sidaoui et al., 2022). The partnership financing models such as *mudaraba* and *musyaraka* contract involve frequent monitoring, profit sharing checking, and information sharing, which makes them highly reliant on the use of digital technology for increasing transparency and effectiveness in the process (Asyiqin & Alfurqon, 2024). Similarly, the *ijara*, *istishna*, and *qard* have unique contractual characteristics that require different levels of technological support according to the financing and management process involved (Azizah, 2023; Bas et al., 2025).

H1a: *Murabaha* financing has a significant effect on fintech adoption.
H1b: *Mudaraba* financing has a significant effect on fintech adoption.
H1c: *Musyaraka* financing has a significant effect on fintech adoption.
H1d: *Ijara* financing has a significant effect on fintech adoption.
H1e: *Istishna* financing has a significant effect on fintech adoption.
H1f: *Qardh* financing has a significant effect on fintech adoption.

Direct Effect of Fintech on Profitability

The implementation of fintech is crucial in improving the operational capabilities of Islamic banks as Sharia-compliant financing agreements necessitate more thorough verification and documentation processes compared to conventional financing agreements (Nguyen et al., 2023). With the help of digital technologies, banks can become more efficient, automate their financing procedures and risk management (Alnsour, 2023). However, implementing fintech also involves high expenses on digital infrastructure, cybersecurity, system integration, and innovations in technology, increasing the cost of operations at the early stages of digitalization (Alnsour, 2023). As a result, despite the fact that the implementation of fintech is likely to improve the competitiveness of the banks in the long term, the effect of this process on profitability, measured as ROA, remains unclear in the short term.

H2: Fintech adoption has a significant effect on ROA.

Direct Effect of Islamic Financing Contracts on Profitability

Different Islamic finance agreements have different profit performance impacts due to the differences in how they recognize revenues, bear risk, monitor activities, and achieve efficiencies (Agustina & Irsyad, 2025). *Murabaha* agreements earn relatively stable margin-based revenue with low levels of uncertainty compared to partnership arrangements that include *mudaraba* and *musyaraka*, where the banks have high agency costs, need extensive monitoring, and face more business risks (Hassan & Aliyu, 2018). In the same way, *ijara*, *istishna*, and *qard* have varying impacts on bank profits based on the duration of the agreement, asset usage, payment guarantee, and financing purposes (Suprianto et al., 2025). Therefore, the structure of Islamic finance agreements should determine the impact on bank profitability (Agustina & Irsyad, 2025; Febyansyah & Sihono, 2023; Suprianto et al., 2025).

H3a: *Murabaha* financing has a significant effect on ROA.
H3b: *Mudaraba* financing has a significant effect on ROA.
H3c: *Musyaraka* financing has a significant effect on ROA.
H3d: *Ijara* financing has a significant effect on ROA.
H3e: *Istishna* financing has a significant effect on ROA.
H3f: *Qardh* financing has a significant effect on ROA.

Mediating Role of Fintech

The application of fintech acts as a strategic competency through which Islamic banks can leverage financing operations for better financial performance due to reduced information asymmetry, lower cost of monitoring, greater transparency, and enhanced efficiency (Shaikh et al.,

2022). However, fintech does not affect bank profitability in isolation but may amplify or mitigate the profitability impacts of various Islamic financing contracts based on the features and compatibility of technology within the financing contract. Financing contracts that necessitate high levels of monitoring and information flows will be more impacted by the adoption of digital technologies, while the impact of fintech adoption itself is contingent upon the technological maturity and institutional capabilities of Islamic banks (Desky & Hye, 2025; Hayati & Syahrul, 2026; Rizkiana & Siregar, 2026).

H4a: Fintech significantly mediates the effect of *Murabaha* financing on ROA.
H4b: Fintech significantly mediates the effect of *Mudaraba* financing on ROA.
H4c: Fintech significantly mediates the effect of *Musyaraka* financing on ROA.
H4d: Fintech significantly mediates the effect of *Ijara* financing on ROA.
H4e: Fintech significantly mediates the effect of *Istishna* financing on ROA.
H4f: Fintech significantly mediates the effect of *Qardh* financing on ROA.

METHOD

This study used quantitative explanatory research design in an attempt to establish the direct and indirect association between Islamic financing contracts, fintech adoption, and profitability of the Indonesian Islamic banking sector (Ghanad, 2023). Six different Islamic financing contracts were defined as the independent variables in the study, namely *murabaha*, *mudaraba*, *musyaraka*, *ijara, istishna*, and *qard*, while the dependent variable was the ROA, and the mediating variable was fintech adoption. The main objective of this study is to establish whether the Islamic financing contracts affect profitability directly or indirectly through fintech adoption as a technological capability for financing activities.

The total population involved all members of the Indonesian Islamic banking sector within the period of the study. The population included all Islamic Commercial Banks and Islamic Business Units. Within the study period, there were 14 Islamic Commercial Banks and 19 Islamic Business Units which continuously provided their financial performance figures to the Financial Services Authority. Saturated sampling approach was used by using industry-level aggregate monthly data published in the Islamic Banking Statistics. The observation period covers January 2015 to December 2024, hence 120 months of data. Table 1 shows the operational definitions of the research variables.

Data was analyzed by using path analysis as the technique allows the simultaneous determination of multiple causations in terms of various independent variables, one mediator variable and one dependent variable. Therefore, path analysis was used in determining whether fintech adoption acts as a mediator in the relation between Islamic financing contract and bank

profitability (Ghozali, 2013; Hayes, 2009). In conducting the analysis process, descriptive statistics, classical assumptions testing and path analysis estimation were carried out. Path analysis involved the estimation of two structural equations; the first being the estimation of the effects of Islamic financing contract on fintech adoption (Eq. 1) whereas the latter entails the effects of Islamic financing contract and fintech adoption on profitability (Eq. 2). In order to determine the effect of mediation by fintech adoption, the study adopted the Sobel test (Hayes, 2009) and bootstrapping techniques. Even though Sobel test is an initial tool for measuring mediation, it is relatively weak compared to the bootstrapping technique that does not require the normal distribution of indirect effects and offers accurate confidence intervals (Preacher & Hayes, 2008). Lastly, the mediation effects were interpreted using mediation typology by Zhao et al. (2010).

$$FTC = \alpha_1 + \beta_1 MUR + \beta_2 MUD + \beta_3 MUS + \beta_4 IJR + \beta_5 IST + \beta_6 QRD + \varepsilon_1 \quad (1)$$

$$ROA = \alpha_1 + \beta_1 MUR + \beta_2 MUD + \beta_3 MUS + \beta_4 IJR + \beta_5 IST + \beta_6 QRD + \gamma FTC + \varepsilon_2 \quad (2)$$

ROA= Return on Assets; FTC= Fintech adoption; MUR= *Murabaha* financing; MUD= *Mudaraba* financing; MUS= *Musyaraka* financing; IJR= *Ijara* financing; IST= *Istishna* financing; QRD= *Qardh* financing

Table 1. Operational Definition of Variables

Variable	Concept	Indicator / Proxy	Scale	Source
Profitability (Dependent Variable)	The ability of the Islamic banking sector to generate earnings from its total asset base.	Return on Assets (ROA) = (Net Income / Total Assets) × 100%	Ratio	(Bitar et al., 2020; Hassan & Aliyu, 2018)
Islamic Financing Contracts (Independent Variables)	The composition of financing disbursed through various Sharia-compliant contractual structures.	Total monthly financing volume (IDR) of: *Murabaha*, *Mudaraba*, *Musyaraka*, *Ijara*, *Istishna*, and *Qardh*	Ratio	(Beck et al., 2013; OJK, 2024)
Fintech Adoption (Mediating Variable)	The bank's investment and operational commitment to digital transformation and technological infrastructure.	Operating Expenses related to digital transformation (BO), proxied by aggregated monthly operating costs associated with technological development, system integration, automation, and digital infrastructure investment.	Ratio	(Alnsour, 2023; Sidaoui et al., 2022; Zahra & Miranti, 2023)

RESULT AND DISCUSSION

Results

The descriptive statistics and distribution of the research variables are given in Table 2. It is found that the financing modes of *murabaha* and *musyaraka* are the dominant financing agreements in the portfolio of financing in the Indonesian Islamic banking industry over the entire period under review. Another important aspect to be highlighted is that the mode of financing called *salam* has been almost non-existent over the study period, thereby making the data statistically insignificant. This made the variable of *salam* financing unsuitable for the regression analysis. Two structural models were estimated to analyze the relationship between the variables, as shown in Table 3.

Table 4 depicts the goodness-of-fit test results for the constructed path model. Based on the results from Model II, one can conclude that the overall model is not jointly significant (Sig. = 0.173). This means that the joint effect of the two independent variables (Islamic financing contracts and fintech adoption) does not adequately account for the variance in profitability which is measured in terms of ROA. The lack of joint significance of the overall model does not mean that there are no relationships between independent and dependent variables which are statistically significant. It only shows that the profitability in the Indonesian Islamic banking industry may be affected by other macro-level factors than the structure of financing contracts and fintech adoption. Table 5 shows the results of the mediation analysis via the Sobel test, while Table 6 contains the robustness check via bootstrapping. To enhance the reliability of the mediation analysis, this study places greater emphasis on the bootstrapping results because bootstrapping generates more accurate confidence intervals for indirect effects than the normal theory–based Sobel test, particularly when analyzing time-series data. The bootstrap results demonstrate that only the indirect effect of *mudaraba* is statistically robust, as its confidence interval excludes zero, confirming a significant mediation effect through fintech adoption. In contrast, the confidence intervals for all other Islamic financing contracts include zero, indicating that their indirect effects are statistically insignificant and lack empirical robustness.

DISCUSSION

The Direct Effect of Islamic Financing Contracts on Fintech Adoption

Empirical evidences reveal that only *murabaha* contract has significant positive influence on fintech adoption while none of the other five financing contracts including *mudaraba*, *musyaraka*, *ijara*, *istishna*, and *qard* has any significant impact. From the results, it can be observed that the operational

nature of individual contracts is very influential in deciding the degree of use of fintech in the Islamic banks. In other words, those contracts whose operational process is relatively simple and standard fit better with existing fintech technologies than others.

The strong connection between *murabaha* and fintech is due to the standardization of the documents used, fixed repayment plan, and cost-plus profit nature of the process, making the process easy to digitize. The technological applications allow Islamic banks to automate the financial process, ranging from the identification of customers, analysis of credit history, monitoring of transactions, processing of documents, and workflow management. In Agency Theory, *murabaha* exhibits less information asymmetry and monitoring compared to partnership contracts, and therefore, digital technologies can be easily integrated without incurring agency costs (Jensen & Meckling, 1976; Liu et al., 2021).

Table 2. Descriptive Statistics of Research Variables

Variable	Mean	Max	Min	Q1	Q2	Q3
ROA (%)	1.48	2.10	0.80	1.25	1.45	1.72
Fintech (Trillion IDR)	4.25	6.88	2.12	3.15	4.10	5.42
Murabaha (Trillion IDR)	185.42	250.21	120.55	152.10	182.30	218.45
Mudaraba (Trillion IDR)	15.22	20.15	10.55	12.80	15.10	17.65
Musyaraka (Trillion IDR)	145.10	225.30	85.20	112.45	142.80	175.20
Ijara (Trillion IDR)	28.35	35.12	18.40	24.50	28.15	31.80
Istishna (Trillion IDR)	5.24	8.45	2.10	3.80	5.15	6.65
Qardh (Trillion IDR)	12.18	18.50	7.25	10.20	12.05	14.15

Source: Processed data (2025)

Table 3. Direct Effect Testing (H1, H2, H3)

Hypothesis	Relationship	Beta (β)	t-value	Sig.	Result
H1a	*Murabaha* → Fintech	0.528	2.894	0.007	Supported
H1b	*Mudaraba* → Fintech	0.112	0.854	0.394	Not Supported
H1c	*Musyaraka* → Fintech	0.145	1.120	0.265	Not Supported
H1d	*Ijara* → Fintech	0.085	0.642	0.521	Not Supported
H1e	*Istishna* → Fintech	0.042	0.315	0.753	Not Supported
H1f	*Qardh* → Fintech	0.098	0.741	0.460	Not Supported
H2	Fintech → ROA	-0.584	-2.829	0.008	Supported
H3a	*Murabaha* → ROA	0.124	0.942	0.348	Not Supported
H3b	*Mudaraba* → ROA	-0.054	-0.412	0.681	Not Supported
H3c	*Musyaraka* → ROA	0.082	0.621	0.536	Not Supported
H3d	*Ijara* → ROA	0.035	0.264	0.792	Not Supported
H3e	*Istishna* → ROA	0.012	0.091	0.928	Not Supported
H3f	*Qardh* → ROA	-0.021	-0.158	0.875	Not Supported

Source: Processed data (2025)

Table 4. Model Goodness of Fit

	Model 1	Model 2
F-Value	4.264 (0.003)	1.598 (0.173)
Adjusted R^2	0.340	0.265

Source: Processed data (2025)

Table 5. Mediation Analysis (Sobel Test)

Mediation Path	Z-value	p-value	Conclusion
H4a: *Murabaha* → Fintech → ROA	2.968	0.003	**Significant Mediation**
H4b: *Mudaraba* → Fintech → ROA	1.145	0.252	No Mediation
H4c: *Musyaraka* → Fintech → ROA	0.852	0.394	No Mediation
H4d: *Ijara* → Fintech → ROA	0.542	0.588	No Mediation
H4e: *Istishna* → Fintech → ROA	0.315	0.753	No Mediation
H4f: *Qardh* → Fintech → ROA	0.120	0.904	No Mediation

Source: Processed data (2025)

Table 6. Robustness Check of Indirect Effects

Indirect Path (Mediation)	Indirect Effect (Coeff)	Boot SE	95% Confidence Interval (LLCI - ULCI)	Result
H4a: *Murabaha* → Fintech → ROA	-0.308	0.102	**[-0.512, -0.104]**	**Robust**
H4b: *Mudaraba* → Fintech → ROA	-0.065	0.085	[-0.231, 0.102]	Not Robust
H4c: *Musyaraka* → Fintech → ROA	-0.084	0.091	[-0.262, 0.094]	Not Robust
H4d: *Ijara* → Fintech → ROA	-0.049	0.076	[-0.198, 0.100]	Not Robust
H4e: *Istishna* → Fintech → ROA	-0.024	0.077	[-0.175, 0.127]	Not Robust
H4f: *Qardh* → Fintech → ROA	-0.057	0.082	[-0.218, 0.104]	Not Robust

Source: Processed data (2025)

On the other hand, *mudaraba* and *musyaraka* contracts involve continuous monitoring, on-the-spot performance assessment, and dynamic profit-sharing mechanisms, hence, are more difficult to digitalize due to their nature. Such attributes make the use of fintech less effective since they lead to higher agency costs and increased risk of both adverse selection and moral hazards in the banking institutions. Hence, existing fintech solutions are not able to facilitate such financing methods (Abedifar et al., 2013). The same is true about *ijara*, *istishna*, and *qard* due to the lower volumes of financing and highly specific contract structure that does not provide any immediate benefits of being digitalized. All of this indicates that fintech usage in the context of the Indonesian Islamic banking sector is limited to standard trade financing contracts only (Sidaoui et al., 2022).

The Direct Effect of Fintech Adoption on Profitability

It is found empirically that the adoption of fintech technology has an important negative impact on the profit margin of Indonesian Islamic banks as measured using the ROA ratio. Even though the digital transformation is crucially important for ensuring the future success of Islamic banking, its

implementation involves heavy cost burden in the short term. The finding reveals that the industry of Indonesian Islamic banking is currently at the investment stage of digital transformation and that the cost of adopting new technology is much larger than the benefit. Digital transformation entails huge investments on infrastructure, security system, system integration, automation, data management, and digital surveillance systems, which involve high cost.

In this case, fintech adoption is proxied through expenditures on technology development, system integration, automation, and digital infrastructure investment. Consequently, high fintech expenditure is negatively correlated with profitability, while low technology-related expenses are positively correlated with ROA. The pattern of investments from the Legitimacy Theory point of view can be seen as an appropriate organizational reaction to institutional pressure for digitization. The more the financial services industry moves towards technology use, the more obliged Islamic banks become to invest in fintech in order to be competitive and transparent and gain stakeholders' trust (Chong, 2021; Dowling & Pfeffer, 1975). Despite the decrease in short-term profitability caused by those investments, such expenses are essential for obtaining long-term legitimacy and competitive advantages. The results of the study are confirmed by other empirical studies, which showed that the beginning of fintech adoption is associated with increased operating costs and cost-to-income ratios (Alnsour, 2023; Shaikh et al., 2022). Hence, fintech adoption should be considered as a long-term strategy, and its financial benefits should appear in the future along with increasing digitalization.

The Direct Effect of Islamic Financing Contracts on Profitability

From an empirical point of view, none of the six types of Islamic financing instruments, *murabaha, mudaraba, musyaraka, ijara, istishna*, and *qard*, has any statistically significant direct impact on the profitability of Indonesian Islamic banks. Therefore, the nature or amount of financing by itself does not seem to be enough to explain the differences in profitability. On the contrary, the financial performance of Islamic banks relies on both the size of financing and the ability of banks to deal with different risk/return trade-offs, monitoring costs, and transaction costs of particular Islamic financing instruments. For instance, although *murabaha* is known to generate reliable margins based income, competition can reduce profit margins over time. At the same time, while partnership contracts like *mudaraba* and *musyaraka* offer higher returns, they are more costly due to higher monitoring expenses and

problems of asymmetric information and moral hazard (Hassan & Aliyu, 2018).

Moreover, the descriptive statistics show that the share of *murabaha* among the different types of financing represents the highest proportion within the Indonesian Islamic banking sector due to the low risk involved and the focus on consumers. While this structure of financing brings about stable incomes, slow asset turnover rate and limited role in investment can potentially limit the profitability in the long run. Thus, the financing structure consisting mostly of *murabaha* financing does not guarantee higher profitability. These findings are in line with earlier research, which shows that financing growth does not ensure better bank profitability due to factors such as inefficient operations, risk management issues, and credit quality that significantly impact financial performance (Azad et al., 2023; Sutrisno & Widarjono, 2022).

The Mediating Role of Fintech in the Relationship Between Islamic Financing Contracts and Profitability

The empirical results show that the role of fintech adoption is a significant mediating factor for the effect of financing through *murabaha* on profitability as measured through ROA. This finding means that fintech is not a universal transmitter for all types of Islamic financing contracts but rather a selective transmitter, meaning the success of fintech adoption in relation to different types of Islamic financing contracts relies on the specific nature of these contracts. While financing through *murabaha* itself does not increase profitability, its effects can be seen through fintech adoption and its impact on financial performance through efficiency in operations and expenditure related to technology. *Murabaha* is a financing contract whose nature is defined by fixed payment schedules and documentation process. Thus, compared to other Islamic financing contracts, this type of financing is easier to incorporate into a digital platform.

When viewed from the standpoint of Legitimacy Theory, the mediating effect of fintech becomes another demonstration of how digital transformation increases institutional legitimacy by means of *murabaha*-based financing. Being the primary contract used in Indonesian Islamic banking, *murabaha* offers the primary way through which banks prove their efficiency, transparency, and adherence to the requirements of the Sharia. The digitalization of *murabaha* financing ensures increased transactional transparency, consistency, and audibility, contributing to building stakeholder trust and legitimacy. Hence, fintech is used not only as a tool that increases the efficiency of operations but also as a way of improving institutional legitimacy

in the eyes of regulators, clients, and other interested parties. It is worth noting that these results emphasize the paradoxical nature of digital transformation. While fintech makes it possible to increase the level of scalability, monitoring, and process standardization, its introduction is costly and implies considerable investments into technology and digitization, decreasing profitability in the short term. Therefore, fintech becomes a transitional tool through which *murabaha* financing affects short-term profitability and creates the basis for operational improvements in the future.

The lack of mediation effect in the case of the remaining Islamic financing contracts can be mainly related to their increased complexity and the necessity of monitoring. Partnership-based financing instruments, including *mudaraba* and *musyaraka*, need continuous performance monitoring, individual assessment of projects, and profit-sharing agreements, all of which are still difficult to implement via fintech. The unique operational features of the *ijara*, *istishna*, and *qard* financing contracts make them difficult to benefit from digitalization right now. Thus, the majority of these financing contracts still depend on manual or semiautomatic operations. This finding is aligned with earlier research results stating that the introduction of fintech in Islamic banks mainly concerns standard financing instruments and does not include Sharia contracts (Shaikh et al., 2022; Sidaoui et al., 2022). In general, the results reveal that the profitability of Islamic banks depends both on the composition of their financing contracts and the compatibility of their contractual features with technology. Therefore, fintech should be viewed as a selective operational bridge, particularly for *murabaha* financing, where digital integration can facilitate more efficient operations and support sustainable financial performance over the long term.

CONCLUSION

This study's results show that fintech use significantly decreases the profitability of Indonesian Islamic banks in the short run while at the same time promoting their digitalization efforts. Besides, none of the six Islamic financing contracts significantly affects profitability, which shows that the financing structure is not sufficient for understanding financial performance. In other words, the profitability of Indonesian Islamic banks is determined by their ability to mitigate agency costs, increase efficiency, and align financing operations with technologies. The mediating effect analysis also shows that fintech acts as a selective, rather than general, channel for influencing financial performance; specifically, a significant mediating effect is observed in the case of *murabaha* financing and profitability. It means that fintech positively impacts the financial performance of Indonesian Islamic banks only in cases

where operational features of the financing contracts correspond to the technological resources of banks. Generally, these results suggest that the profitability of Islamic banks is determined by interactions between the financing contract design, agency-related issues, digitalization process, and legitimacy. Thus, the effective digital transformation strategy should involve not only investments in technology but also changes in financing structures.

The present study has a few limitations that have to be taken into consideration while interpreting the results and defining the direction for further studies. First, the empirical work utilizes aggregate data on monthly level of industries collected from the Islamic Banking Statistics provided by the Financial Services Authority. Such an approach prevents the consideration of heterogeneity between different Islamic banks with regard to their strategies of financing, digital transformation, and profitability. Second, the proxy variable of fintech adoption is measured through expenditures on the digital transformation and technological investments. While this method allows capturing the financial commitment of banks to the digital transformation and explaining the emergence of the paradox related to the negative effect of large initial expenditures on the profitability, this indicator does not cover all dimensions of fintech adoption, including the quality of digital services, technology usage, innovation, or adoption of customers.

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