

Zakat and Islamic Bank Financial Performance: Do Third Party Funds Play an Important Role?

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ABSTRACT

Research Aims: Using third-party money as a moderating variable, the study intends to investigate how zakat affects Indonesian Islamic banking performance.

Methodology: The research sample consisted of 16 Islamic banks selected using the total sampling method based on the availability of annual financial report data at the financial services authority using smartpls 3.0 and structural equation modeling, the data analysis method was executed.

Research Findings: The findings demonstrate that zakat improves Islamic financial performance. This finding supports the theory that optimal zakat fund collection can increase customer trust in Islamic banks. In addition, third party funds strengthen the connection between financial achievement and zakat. This finding is also consistent with the premise that the allocation of third-party finances and funding is positively impacted by optimal zakat and growing public trust.

Theoretical Contribution: By enhancing knowledge of the impact of zakat and the function of third-party funds in enhancing the financial performance of Islamic banks, this work makes a substantial theoretical contribution.

Research limitation and implication: This study is limited to the sample and use of secondary data, which needs to be considered in interpreting the research findings. The implications of this study are useful for Islamic banks and further researchers to create more thorough research and more efficient tactics.

Keywords: Zakat, Third Party Funds, Financial Performance, Financing to Deposit Ratio

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INTRODUCTION

High financial performance is usually a manager's top priority because it is crucial to the organization and growth of a business. However, this goal is often hampered by various factors, resulting in low company performance (Le et al. 2021). Owners and prospective owners pay close attention to the financial performance of the company's

value because it shows the company's ability to improve the welfare of its owners and has a positive value in improving the company's performance (Dariati et al. 2023; Mustika et al. 2019). Financial performance is one indicator in evaluating the health and sustainability of an institution's finances, including Islamic banking. Islamic banks operate with Islamic finance principles, such as the prohibition of usury, gharar, and may, and apply drafts for results in their operations (Qadri & Bhatti 2025). With the rapid growth in various countries, Islamic banking is increasingly getting attention as a better alternative stable and sustainable compared to banking conventional, especially in the face crisis global economy (Taleb and Khater 2024).

In two years lastly, Islamic banking has shown significant growth, with improvement in global assets reaching more than 2 trillion US dollars in 2023 (IFSB, 2023). However, even though their power holds stronger in a crisis economy compared to banking conventional, Islamic banks still face challenges big in matters of efficiency operational, and diversification of product finance. Besides that, the adoption of digital technology and fintech in industry Islamic banking is still left behind compared to banking conventional, which causes a gap in accessibility and power competitiveness in the global market (Daoud and Kammoun 2024). Therefore, analysis of performance finance in Islamic banking becomes more important to ensure that the industry can keep growing and compete in a way effective in system global finance.

In system Islamic banking, performance in good finance is not only measured by profitability but also by contribution to welfare society, one of them through zakat. Sharia banking is mandatory to pay zakat on the profit net obtained, which is then distributed to eligible groups accepted by Sharia provisions (Iman et al. 2022). With the higher profitability of Islamic banks, increasingly the amount of zakat funds that can be obtained is also collected and distributed, which can have an impact positive to the development economy people. Therefore, zakat payments can also be made to increase the reputation of Islamic banks, strengthen the trust of customers, and create an ecosystem more financially inclusive as well as sustainable (Eid et al. 2023). According to Al-Malkawi and Javaid (2018) since businesses and organizations make money and can effectively serve the objective of boosting social benefits, zakat can be extended beyond individual responsibility to include the duty or obligation of all businesses or organizations to society. The fact that the zakat variable truly displays the amount of money businesses spend on social welfare is another reason to use it. By paying zakat (alms) and sedekah (charitable donations), Muslims are encouraged to take the proper steps to reduce social inequality, redistribute resources, avoid the concentration of wealth in a few hands, and spread the wealth of the wealthy to the less fortunate segments of society (Sawmar and Mohammed 2021).

Research conducted by Hussain (2021) and Sawmar & Mohammed (2021) found that zakat has a role in increasing the reputation of Islamic banks and strengthening the loyalty of customers, who ultimately contribute to improving profitability. Another study by (Hassan 2023) shows that Islamic banking which consistently pays zakat tends to own a level of stability and more finances compared to those who don't. While, research by Noviani et al. (2022) revealed that zakat works as a mechanism of redistribution of wealth that can increase power by the community and support a sustainable growth economy in a way sustainable, which in turn strengthens the position of Islamic banking finance. In

addition, a study conducted by [Schaeublin \(2019\)](#) stated that Islamic banks are active in the payment of zakat and responsibility answers that Islamic social is superior and more competitive in attracting investors and partners business. Findings indicate that zakat is not only is obligation religious but also has an impact positive to the performance of Islamic financial banking in the term long. In addition to zakat, one of the primary factors influencing the performance of financial companies in banking is the Third Party Funds (TPF), including Islamic banking. The fund of the party third reflects the trust public towards the bank, which in turn can increase the bank's capacity in channeling financing and investment. Research by [Amimakmur et al. \(2024\)](#) shows that TPF increase has an effect positive to performance finance. Besides that, a study by [Ekawati et al. \(2021\)](#) revealed that TPF has an influence significant and positive to the performance of finance banks. Thus, the more large party funds the third one is collected and managed optimally, the more strong the power competitiveness and performance of Islamic banking finance in the term long.

Studies about the influence of zakat on performance finance with third-party funds as variable moderation is still arguably limited, in the analysis of performance finance Islamic banking, zakat plays a role as an instrument that can strengthen the stability and reputation institution Islamic finance. However, the magnitude of the impact of zakat on performance finance can be influenced by various factors, one of which is third-party funds (TPF). Third-party funds play a role as a source of the main operational funds of the bank that can moderate the connection between zakat and performance finance. The study by [Ali, Shuib, and Nor \(2023\)](#) The study's findings indicates a strong and positive correlation between Malaysian Islamic banks' financial success as shown by return on equity (ROE) and return on assets (ROA) and the zakat donation. Consequently, the results of the study demonstrate the significance of social elements like zakat in Islamic banks' operations and overall profitability. On the other hand, research by [Novitasari, Aviyanti, and Wan Ismail \(2022\)](#) demonstrated that third-party funds and ROA and ROE are unaffected by the zakat performing ratio. It is impossible to mitigate the effects of third-party investment and intellectual capital on performing companies and neither can the impact of the zakat performing ratio. Therefore, a is needed study more carry on for explore how third-party funds can strengthen or weaken the influence of zakat on performance finance Islamic banking.

Novelty in research will explore more in mechanisms of how third-party funds can function as variable moderation, these challenges include regulatory frameworks such as performance [Noor \(2012\)](#), [Said et al., \(2012\)](#) and [Fadilah \(2013\)](#), trust [Muhammad and Saad \(2016\)](#), [Oladimeji et al. \(2013\)](#) and [Syafei \(2015\)](#), performance finance in study this measured with financing to deposit ratio (FDR) for give a better picture wide about the impact of zakat on probability and efficiency Islamic bank operations. This will done with consider period of further research and using the latest data, so that can catch trend changes in industry-related Islamic banking and the role of zakat with indicators of the amount of zakat available in Islamic banks and TPF in performance finance. Not only evaluate whether third-party funds moderate the connection between zakat and performance finance but also explore mechanism moderation third-third-party funds strengthen or weaken connection in various conditions of economics and regulation.

LITERATURE REVIEW

Theory of Islamic Finance

Islamic finance is a concept based on the financial system of Islamic principles, especially those derived from the Qur'an, Hadith, Ijma', and Qiyas. This theory focuses on the alignment of finance with Islamic values, emphasizing justice, sustainability, and balance between profit and social responsibility. One application of Islamic finance theory is zakat (Wiley and Sons, 2011). Chapra (2000) emphasized that the Islamic financial system is oriented towards social welfare and economic justice. In this theory, zakat is considered a wealth distribution mechanism that can improve social and economic balance. Third-party funds in Islamic banking also act as a means to channel financing based on justice and transparency, which can strengthen the relationship between zakat and financial performance.

Financial Performance

A measure of a company's financial health over a given period is called financial performance and shows how well it manages its assets, liabilities, income, and expenses to meet its objectives (Brigham & Houston, 2019). Numerous metrics, including profitability ratios, liquidity, solvency, and operational efficiency, can be used to assess financial performance (Ali et al. 2023). According to Wamba et al. (2020), Financial performance is a company's effort to make a profit. The company's investor policy is directly impacted by its financial performance. If the business does well, it will add funds and, conversely, be able to draw in new investors.

Zakat

Zakat is one of the main pillars in Islam which functions as an instrument for redistributing wealth to create social and economic balance in society. Zakat is defined as a financial obligation that must be issued by individuals or institutions who have wealth exceeding a certain limit (nisab) to be given to groups who are entitled to receive it, such as the poor, orphans, and other groups in need (Elbanna 2024). In the context of Islamic economics, zakat acts as a tool for poverty alleviation and a mechanism to improve social welfare through a fairer distribution of wealth (Taleb and Khater 2024). Other studies also show that zakat can contribute to financial stability by increasing people's purchasing power and supporting sustainable economic development (Noviani et al. 2022). Zakat helps a country's socioeconomic progress, particularly by improving the standing of asnaf (eight groups mentioned in the Qur'an) (Omar, Wahid, and Nor 2017).

According to Hayeeharasah, Sehvises, and Ropha (2013), the amount and type of zakat during the caliphate largely followed the form of zakat during the time of the Prophet Muhammad. Zakat is crucial for providing financial support to the impoverished and in need. Therefore, Zakat helps to reduce poverty in addition to promoting socioeconomic development. Ag Omar et al. (2021) said Zakat institutions have a dual responsibility, specifically gathering zakat money and allocating it to the rightful recipients. The community's socioeconomic standing can be raised by the appropriate application of zakat (Ayuniyyah et al. 2018; Debnath, Islam, and Mahmud 2013; Firmansyah 2013; Nahar 2018; Romdhoni 2017).

Third-Party Funds

According to [Anggari and Dana \(2020\)](#) and [Sofian, Irfan, and Astuty \(2020\)](#) The public provides third-party funds through time deposits, savings accounts, and current accounts. The bank may also redistribute the nominal value in the form of substantial credit if it is high. Both the bank and the client will gain from the distribution of credit. As a disbursing institution, the bank will get money. [Priyadi et al. \(2021\)](#) further support this viewpoint by asserting that the quantity of third-party funds has a direct bearing on Islamic banks' capacity to disburse funds. Therefore, to maintain operational sustainability and increase profitability, banks need to optimize third-party funds collection, so that they can expand financing and strengthen financial stability.

The bank's operating activities may be financed with these monies. Third-party funds are a crucial metric in the banking system for determining a bank's degree of liquidity and stability ([Sondakh, Tulung, and Karamoy 2021](#)), an essential extra source of funding for the business's operations are third-party funds, which consist of external financial resources such as bonds issued, bank loans, and customer deposits ([Amimakmur et al. 2024; Song, Yu, and Lu 2018](#)). They thereby make it possible to obtain the funds required for investments, product development, market expansion, and infrastructure enhancement, all of which have a favorable effect on financial performance. Third-party funding is essential for growth since it makes it possible to expand operations, produce new products, reach a wider audience, make acquisitions, and make other expenditures. By increasing resources for innovation and development, efficient use promotes growth, enhances financial performance, benefits shareholders, and boosts competitiveness ([Ali et al. 2021; Song et al. 2018](#)).

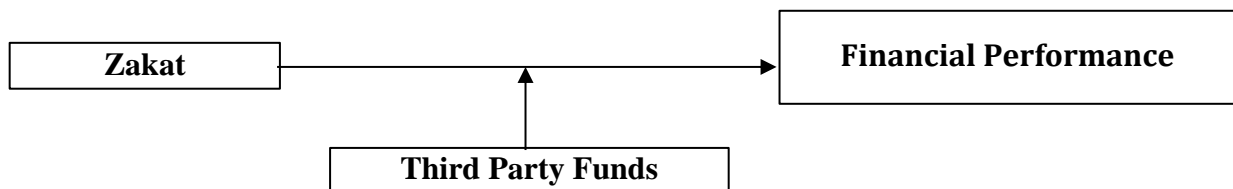


Figure 1. Research Framework

The research framework linking zakat, TPF, and financial performance is explained in Figure 1. Further, this will be explained in the hypothesis section below.

Hypothesis Development

Influence of Zakat on Financial Performance

The financial performance of a business is significantly impacted by zakat, especially in the context of Sharia-based banking and business. Zakat payments not only reflect compliance with Islamic principles, but can also improve a company's reputation, strengthen investor confidence, and encourage customer loyalty, which ultimately contribute to better financial performance ([Ali, Shuib, and Nor 2023](#)). A study conducted by [Bilo and Machado \(2020\)](#) found that companies that consistently pay zakat tend to have more stable profitability due to the redistribution of wealth that improves social welfare and people's purchasing power. In addition, research by [Iman et al. \(2022\)](#) shows that zakat can function as a financial risk mitigation tool, by reducing economic inequality and

increasing the stability of the business sector.

Several previous studies have examined the effect of zakat as a CSR parameter on bank financial performance (Sidik and Reskino 2016; Tuan Ibrahim et al. 2020). This research discovered a strong positive correlation between bank financial performance and zakat following an examination of secondary data from bank yearly reports. As a result, Zakat not only fulfills a religious obligation but also enhances the company's long-term profitability and financial stability. In light of the aforementioned justifications, the first alternative hypothesis put out in this research is:

H1: Zakat significantly improves Islamic banks' financial performance.

The Impact of Third-Party Funds on the Association Between Islamic Bank Financial Performance and Zakat

Current accounts, savings, and time deposits are examples of third-party funds (TPF), which are crucial for boosting banking revenue (Bossone, 2021). Pooya et al. (2020) added that when the amount of funds collected increases, both banks and customers will obtain more optimal benefits. This finding is in line with Hermuningsih (2019), which shows a reciprocal relationship between TPF and banking performance. Furthermore, Amimakmur et al. (2024) and Anggari & Dana 2020 found that one of the primary internal elements influencing how finance is distributed in Islamic banks is TPF. Priyadi et al. (2021) also strengthen this opinion by stating that the amount of TPF directly impacts the ability of Islamic banks to distribute funds. Therefore, to maintain operational sustainability and increase profitability, banks need to optimize the collection of TPF, so that they can expand financing and strengthen financial stability. In light of the aforementioned justifications, the second alternative hypothesis put forth in this research is:

H2: The impact of zakat on Islamic banks' financial performance is moderated by third-party funds.

RESEARCH METHOD

The study uses a approach quantitative with method explanatory research to analyze the influence of zakat on performance finance with third-party funds (TPF) as variable mediation in Islamic banking in Indonesia. The research sample consisted of 16 Islamic banks that corresponded to the population size and were selected using the total sampling method. Total sampling is a sampling technique when all members of the population are used as samples. The variable independent in a study is zakat, which is measured based on the amount of zakat distributed by sharia banks, meanwhile variable dependent is performance finance, which is measured using the financing-to-deposit ratio (FDR). Variables mediation in a study is third-party funds thirdly, which reflects the total funds collected by Islamic banks in the form of savings. Data used is secondary data obtained from the report Finance Annual Islamic Bank and publication from financial services authority. Data analysis techniques are carried out using structural equation modeling (sem) with smartpls.3 for test connection direct and also effect mediation from TPF to the influence of zakat on performance finance Islamic banking. The model's viability was evaluated using the indirect effect, inner weight, and outer weight tests (Hair et al 2014). Research this expected can give an outlook new about how the role of zakat in increasing performance finance Islamic banking and to what extent third-party funds can

strengthen or weaken connections said, so that can become a reference for the development of Islamic banking financial strategies in the future (Hassan 2023).

RESULTS AND DISCUSSIONS

Table 1. Results of Measurement Model Test (Outer Model)

Variables	Weight	T-Statistic	P-Value	Information
Zakat (ZAK)	0,82	7,25	0,000	Significant
Financial Performance (FDR)	0,85	8,12	0,000	Significant
Third Party Funds (TPF)	0,87	8,45	0,000	Significant

Source: Processed Secondary Data, 2025

The validity and reliability of the indicators are tested using the outer model. The analysis's findings indicate that the third-party fund variable has a significant value of > 0,50 and a significant t-statistic value $p < 0,01$; the financial performance variable also has a significant value of > 0,5 and a significant t-statistic value $p < 0,01$; and the zakat indicator exhibits significance as indicated by the t-statistic value p is small from 0,10. These findings show that every indicator is dependable and valid, allowing for additional study. The results of the structural model shown in Figure 1 below serve as an illustration of the bootstrapping test results that were examined using PLS.

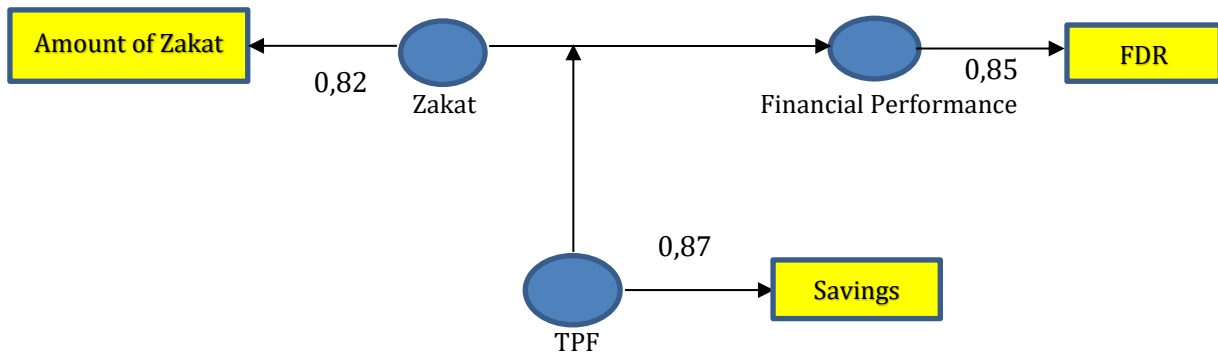


Figure 2. Research Results Framework
Source : PLS 3.0 Data Processing Results

Table 2. Results for Inner Weight

Relationship Between Variables	Original Sample	Sample Mean	T-Statistic	p-value	Information
Zakat → Financial Performance (FDR)	0,45	0,44	3,12	0,003	Significant
TPF → Financial Performance (FDR)	0,39	0,38	2,52	0,012	Significant
Zakat × TPF → Financial Performance (FDR)	0,28	0,27	2,21	0,027	Significant

Source: Processed Secondary Data, 2025

The link between the model's latent variables is tested using the inner model. The analysis's findings demonstrate that the sample mean is the average of the outcomes derived from the bootstrapping method in structural equation modeling (SEM), whereas the original sample represents the original regression coefficients from the SEM model estimation. At the 95% confidence level, the link between the variables in this study is significant, as indicated by the values T-Statistic > 1,96 and p-Value < 0,05. While third-party funds (TPF) as a moderating variable further reinforces the association between

zakat and financial performance, this finding shows that zakat has a considerable impact on financial performance, such that Islamic banks' financial performance improves with increased zakat and third-party money accumulation. The structural model findings shown in Figure 3 below serve as an illustration of the bootstrapping test results that were examined using PLS.

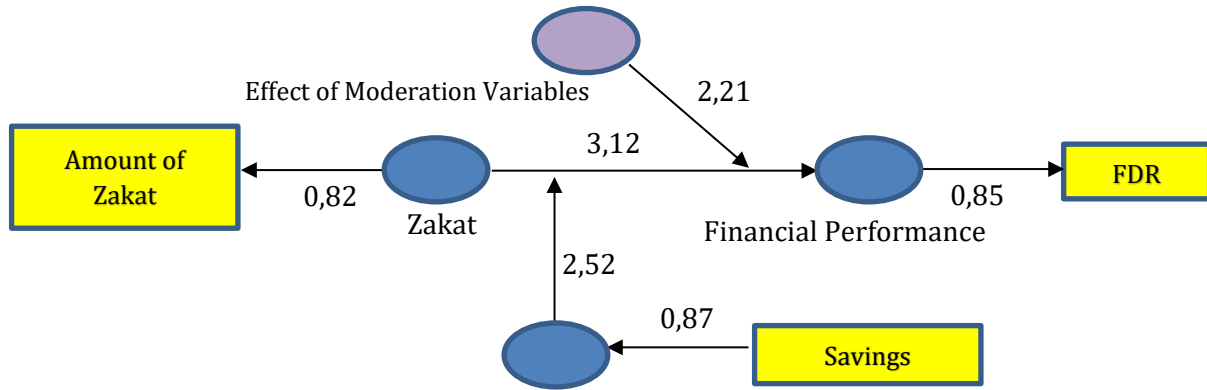


Figure 3. Research Results Framework
 Source: Data Processing Results, 2025

CONCLUSION AND RECOMMENDATION

Based on the study's findings, it can be said that zakat significantly and favorably affects Islamic banks' financial performance as indicated by the FDR ratio. This confirms that optimizing zakat collection can increase customer trust and contribute to the stability and sustainability of Islamic bank finances. In addition, third-party funds (TPF) act as variables that strengthen the relationship between zakat and financial performance, where increasing zakat collection has the potential to encourage TPF growth and financing distribution.

The theoretical contribution provides additional empirical evidence supporting the theory that optimal zakat fund collection increases customer trust in Islamic banks, thus positively impacting their financial performance (determined by the FDR, or financing to deposit ratio.). It strengthens the existing literature by using different performance indicators from previous studies. The significant role of TPF in moderating the connection between financial achievement and zakat. This finding strengthens the understanding of the mechanism of zakat in improving the financial performance of Islamic banks, by showing that increasing public trust and optimizing zakat have a positive impact on third-party funds and subsequently on financing distribution.

Sample limitations and the use of secondary data need to be considered in interpreting the research findings. This restricts the research findings' applicability to Indonesia's entire Islamic bank population. The study's consequences are significant for Islamic banks' financial performance improvement methods. Islamic banks must maximize zakat money collection and distribution, as well as increase customer trust to increase third-party funds and financing distribution. Further research is also recommended to examine the third-party funds moderation mechanism in different economic and regulatory conditions.

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