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# Effects of Focus Strategy and Technological Innovation on The Performance of Sharia Commercial Banks in Indonesia

Noorikha Pandayahesti Saputeri[1*], Juhary Ali[2], Tulus Suryanto[3,] Zulkarnain Kedah[4]
[1,2,4]Asia e University
[3]UIN Raden Intan Lampung
**Corresponding Author:** Noorikha Pandayahesti Saputeri
rikhaphesti@gmail.com

A R T I C L E I N F O

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A B S T R A C T

This study examines the effect of focus strategy on the performance of Sharia Commercial Banks, with technological innovation as a mediating variable. Drawing on Porter's strategic framework, the study explores how targeted market segmentation combined with digital innovation enhances competitiveness in Islamic banking. A quantitative approach using Structural Equation Modeling (SEM-PLS) is employed to test the proposed relationships. The results indicate that focus strategy significantly improves organizational performance both directly and indirectly through technological innovation. Innovation plays a crucial role in strengthening the effectiveness of focus strategy by enabling banks to better serve specific market segments. These findings highlight the importance of integrating strategic orientation with digital capabilities to achieve sustainable performance. This study contributes to the literature by providing empirical evidence on the mediating role of technological innovation in Islamic banking and suggests future research to explore additional mediating factors across broader contexts.

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## INTRODUCTION

Conventional banking and Islamic banking are very important for the development of the Indonesian economy (Noorikha & Juhary, 2022). The global Islamic banking industry has experienced rapid growth in the last two decades with an increase in assets, number of institutions, as well as expansion into non-Muslim countries that see the potential of sharia-based systems (Abdullah & Chee, 2021). The principle of rejecting usury, gharar, and non-halal activities makes this system an ethical and sustainable alternative (Iqbal & Mirakhor, 2020). The establishment of the Islamic Development Bank in 1975 became the inspiration for the birth of various Islamic financial institutions in the world (Abdullah & Chee, 2021). In Indonesia, an important milestone was marked by the establishment of Bank Muamalat Indonesia in 1991 thanks to the initiatives of MUI, ICMI, and government support (Karim, 2020). Although Indonesia has the largest Muslim population, the market share of Islamic banking is still low, around 7–10% of total national assets (OJK, 2022; Bank Indonesia, 2023). The government responded with the merger policy of state-owned Islamic banks into BSI, the Indonesian Sharia Economic Masterplan (MEKSI), and the strengthening of the halal ecosystem (Saputri & Arifin, 2022).

Significant developments occurred after the birth of Law No. 21 of 2008 which strengthened the legal certainty of Islamic banking (OJK, 2022). However, its market share is still low, only around 7–10% of national assets (Bank Indonesia, 2023), indicating a gap between the great potential and the realization of the industry's contribution. The main challenge for Islamic commercial banks (BUS) is to increase competitiveness amid the dominance of conventional banks and fintech disruption (Rahman & Anwar, 2023). Cost advantage strategies, as stated by Porter (1980), are particularly relevant in the context of cost-sensitive markets (Hassan et al., 2021), but their implementation requires the support of technological innovations such as AI, RPA, and blockchain (Gandhi et al., 2022).

The main problem in this study focuses on how the focus strategy can improve the performance of Islamic commercial banks (BUS) in Indonesia, especially in the face of competition with conventional banks and digital technology disruption. The questions asked include: the extent of the influence of focus strategies on BUS performance, how the role of technological innovation in strengthening this performance, and whether technological innovation serves as a mediating variable in the relationship between the two. This study is important because the effectiveness of cost strategies is inseparable from the support of innovative technologies that are able to increase efficiency and competitiveness (Ali & Hassan, 2021).

The hypothesis in this study is:

H1: The Effect of Focus Strategy on the Performance of Sharia Commercial Banks.

H2: The Effect of Technological Innovation on the Performance of Sharia Commercial Banks.

H3: The Mediating Role of Technological Innovation in the Relationship between Focus Strategy and Performance.

The purpose of this study is to highlight the urgency of strengthening the performance of Sharia Commercial Banks (BUS) in Indonesia through a focus

strategy combined with technological innovation, so that readers understand its relevance to the competitiveness of the Islamic industry in the midst of the dominance of conventional banks and digital disruption. This research is placed in the specific context of the Indonesian Islamic banking industry, taking into account regulatory dynamics, competition with fintech, as well as the need for efficiency and digitalization as limitations of the scope of the study. Furthermore, this study builds a conceptual framework that examines the relationship between focus strategies, technological innovation, and BUS performance, which is the basis for reporting research results. With this approach, the research not only makes a theoretical contribution in enriching the literature on strategic management of Islamic banking, but also produces practical recommendations for regulators such as OJK and Bank Indonesia, as well as for BUS management in formulating adaptive and sustainable strategies in the digital era.

## LITERATURE REVIEW

*Development of Sharia Banking*

Islamic banking has grown rapidly since the 1970s, triggered by the need for an interest-free and Islamic sharia-compliant financial system (Iqbal & Mirakhor, 2020). Globally, the growth of assets and the expansion of Islamic financial institutions reflect increasing public trust in the ethics-based financial system (Abdullah & Chee, 2021). In Indonesia, the history of Islamic banking began with Bank Muamalat Indonesia (1991) and was strengthened by the presence of Law No. 21 of 2008 concerning Sharia Banking which provided a formal legal basis (OJK, 2022). However, the market share of Islamic banking is still low, around 7–10% of total national banking assets (Bank Indonesia, 2023).

*Focus Strategy*

Porter's (1980) theory of strategic management explains that the focus strategy focuses on the organization's efforts to serve certain market segments more effectively than competitors. In the context of Islamic banking, this strategy can be directed at specific groups such as halal MSMEs, Islamic boarding schools, Muslim millennial communities, or customers with more personalized sharia-based service needs. Research shows that focus strategies allow Islamic banks to build closeness with customers, increase loyalty, and create added value through services that meet the needs of the target segment (Rusydiana & Devi, 2022). By optimizing this strategy, Islamic banks can gain a competitive advantage despite facing stiff competition from conventional banks and fintechs (Muneeza & Mustapha, 2021).

*Technological Innovation in Banking*

Technological innovation has been a major catalyst for the change of the banking industry. Technologies such as robotic process automation (RPA), artificial intelligence (AI), mobile banking, and blockchain are able to lower costs, increase service speed, and strengthen the customer experience (Gandhi et al., 2022). In the context of sharia, digitalization is seen as a strategic need to increase service penetration and expand access to inclusive finance (Yusof et al., 2021). However, previous research has focused more on product or service innovation, rather than on the integration of technology with cost-advantage strategies.

*Performance of Sharia Commercial Banks*

Banking performance is generally measured using financial indicators such as ROA, ROE, and BOPO, but in the context of sharia, performance measurement needs to include non-financial dimensions, such as sharia compliance, customer satisfaction, and social contribution (Bedoui, 2012). The Balanced Scorecard (Kaplan & Norton, 2004) is a relevant measurement tool because it combines financial perspectives, customers, internal processes, and learning and growth. Several studies show that the integration of business strategies with technology is able to improve organizational performance more comprehensively (Muneeza & Mustapha, 2021).

*The Effect of Focus Strategy on the Performance of Sharia Commercial Banks*

Drawing on Michael Porter's generic strategy framework, a focus strategy enables firms to concentrate on specific market segments and deliver superior value compared to competitors. In the context of Islamic banking, this strategy is particularly relevant as it allows banks to target niche markets such as halal SMEs, Islamic boarding schools, and Muslim communities with tailored financial services. From a Resource-Based View (RBV) perspective, focusing on specific segments allows organizations to leverage unique capabilities and enhance value creation.

Empirical evidence generally supports a positive relationship between focus strategy and firm performance. For instance, Rusydiana and Devi (2022) found that targeted segmentation improves customer loyalty and operational efficiency in Islamic banking. Similarly, Muneeza and Mustapha (2021) demonstrated that focus strategies integrated with fintech adoption enhance competitiveness and performance. However, some studies suggest that the effect may weaken without complementary capabilities such as technological support (Hassan et al., 2021).

**H1: Focus strategy has a positive effect on the performance of Sharia Commercial Banks.**

*The Effect of Technological Innovation on the Performance of Sharia Commercial Banks.*

Based on the dynamic capability's theory proposed by David Teece, technological innovation represents a critical capability that enables firms to adapt to environmental changes and sustain competitive advantage. In the banking sector, innovations such as artificial intelligence, blockchain, and mobile banking significantly improve operational efficiency, service quality, and customer experience.

Prior studies largely confirm the positive impact of technological innovation on performance. Gandhi et al. (2022) showed that digital technologies enhance efficiency and financial outcomes in financial institutions. Likewise, Rahman and Anwar (2023) found that fintech adoption strengthens the competitiveness and performance of Islamic banks in Indonesia. Nevertheless, some research indicates that the impact of innovation may not be direct and depends on organizational readiness and integration (Ali & Hassan, 2021).

**H2: Technological innovation has a positive effect on the performance of Sharia Commercial Banks.**

*The Mediating Role of Technological Innovation in the Relationship between Focus Strategy and Performance.*

The diffusion of innovation theory introduced by Everett Rogers suggests that technological adoption enhances the effectiveness of organizational strategies. In this regard, technological innovation can act as an enabling mechanism that strengthens the relationship between focus strategy and firm performance.

Empirical studies support the mediating role of innovation. Imanuel and Wirawan (2022) found that technological innovation significantly mediates the relationship between business strategy and firm performance. Similarly, Opoku et al. (2022) reported that technological capabilities strengthen the effect of strategic orientation on performance outcomes. However, the mediating effect may be limited in contexts where technology adoption is still low or not optimally utilized (Hassan et al., 2021).

**H3: Technological innovation mediates the relationship between focus strategy and the performance of Sharia Commercial Banks.**

*Contextual Framework*

Porter's Generic Strategy Theory (1980): Explains that organizations can increase competitiveness through strategies of differentiation, focus, or cost advantage. The focus of this research is on focus strategies in the context of Islamic banking.

Innovation Diffusion Theory (Everett M. Rogers 1962): Explains that the adoption of technology can strengthen the focus strategy of Islamic banks. Through digital innovations tailored to certain segments such as halal MSMEs or Islamic boarding schools, banks can more effectively reach target markets, increase customer loyalty, and strengthen performance in a sustainable manner.

Balanced Scorecard (Kaplan & Norton, 2004): Used to measure the performance of a bank as a whole, covering both financial and non-financial perspectives. This model is relevant because it assesses the contribution of business strategy and technological innovation not only to profitability, but also to customer satisfaction, internal processes, and organizational learning.

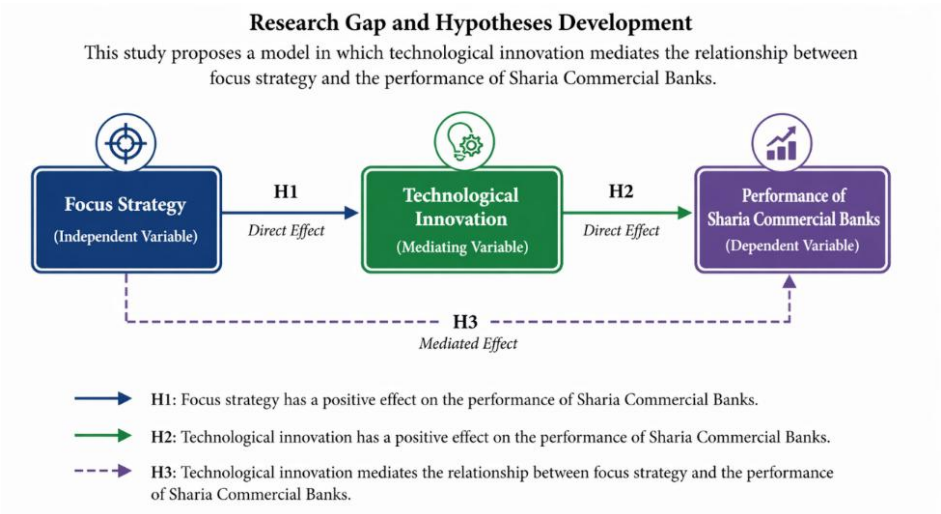


Figure 1. Conceptual Framework

## METHODOLOGY

*Research Design*

This study uses a causal associative design with a quantitative approach, aiming to examine the cause-and-effect relationship between business strategies (differentiation, cost advantage, and focus) on the performance of Islamic commercial banks, with technological innovation as a mediating variable. This design was chosen because it is able to provide a deeper understanding of the relationship between variables simultaneously, so that it can describe direct and indirect influences (Hair et al., 2019).

*Population and Sample*

The research population is all 14 Sharia Commercial Banks (BUS) in Indonesia that have operational legality from the Financial Services Authority (OJK) and strategic relevance in the context of digitalization. This population includes variations in ownership (state-owned enterprises, national private, and foreign), market segmentation, geographical coverage, and technology adoption rates.

Samples are determined by the stratified random sampling method, which is the selection of respondents based on certain characteristics, then random samples are taken from each stratum (Creswell, 2014). The sample consisted of 42 respondents representing three strategic groups in each bank: top management, marketing, and information technology (IT) staff. These three groups were chosen because they have direct responsibility for the formulation and implementation of business strategies and technological innovations.

*Data Collection Techniques*

Data was collected using a questionnaire containing statements arranged on a five-point Likert scale, ranging from 1 = Strongly Agree to 5 = Strongly Agree.

*Data Analysis Techniques*

Data analysis using Structural Equation Modeling – Partial Least Squares (SEM-PLS) with the help of SmartPLS 4.0 software.

The stages of analysis include:

1. Evaluation of the Measurement Model (Outer Model): convergent validity test, discriminant validity, composite reliability, and Cronbach's alpha.
2. Evaluation of Structural Model (Inner Model): path coefficient test, R-square value.
3. Hypothesis Test: it was carried out by bootstrapping method to see the significance of the relationship between variables.

## RESEARCH RESULT

*Descriptive Profile of Respondents*

Of the total 42 respondents from 14 Sharia Commercial Banks (BUS) in Indonesia, 22 people or 52% were men, while 20 people or 48% were women. Each bank contributed three respondents so that each bank contributed 7% of the total respondents. Based on the position category, the proportion of respondents was evenly divided, namely 14 people (33.33%) from top management (Directors/Branch Managers), 14 people (33.33%) from the marketing department, and 14 people (33.33%) from operational or

information technology staff. When viewed from the working period, the majority of respondents had more than 5 years of work experience as many as 18 people (43%), followed by respondents with a working period of 3-5 years as many as 13 people (31%), while respondents with less than 3 years of work period amounted to 11 people (26%). These findings show a diverse diversity of respondents both in terms of gender, bank origin, position, and work experience.

Table 1. Descriptive Profile of Respondents

| Variable | Category | Frequency (n) | Percentage (%) |
|---|---|---|---|
| **Gender** | Male | 22 | 52.00 |
| | Female | 20 | 48.00 |
| **Bank** | 14 Sharia Commercial Banks (3 respondents each) | 42 | 100.00 |
| | By bank | 3 | 7.00 |
| **Job Position** | Top Management (Director/Branch Manager) | 14 | 33.33 |
| | Marketing | 14 | 33.33 |
| | IT/Operational Staff | 14 | 33.33 |
| **Working Period** | < 3 years | 11 | 26.00 |
| | 3–5 years | 13 | 31.00 |
| | > 5 years | 18 | 43.00 |

*Evaluation of Measurement Models*

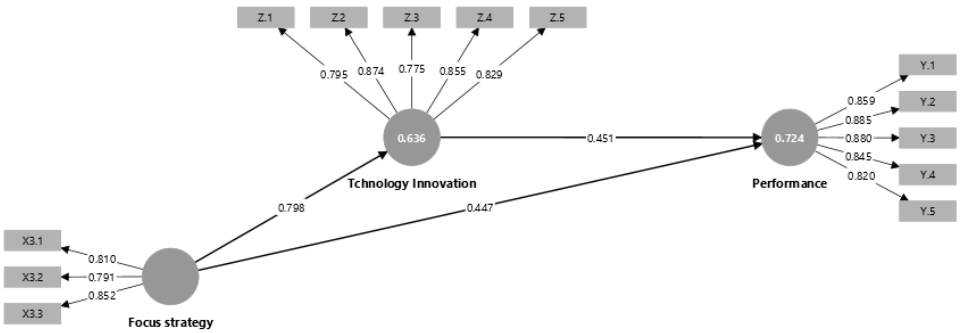


Figure 2. Evaluation of Measurement Models

*Reliability and Convergent Validity*

Table 2. Measurement Model Results

| | Items | Loading factor | CA | CR (rho_a) | CR (rho_c) | AVE |
|---|---|---|---|---|---|---|
| **Focus Strategy** | SF1 | 0.810 | 0.754 | 0.762 | 0.859 | 0.670 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | SF2 | 0.791 | | | | |
| | SF3 | 0.852 | | | | |
| **Performance** | K1 | 0.859 | 0.911 | 0.916 | 0.933 | 0.737 |
| | K2 | 0.885 | | | | |
| | K3 | 0.880 | | | | |
| | K4 | 0.845 | | | | |
| | K5 | 0.820 | | | | |
| **Technological Innovation** | IT1 | 0.795 | 0.883 | 0.885 | 0.915 | 0.683 |
| | IT2 | 0.874 | | | | |
| | IT3 | 0.775 | | | | |
| | IT4 | 0.855 | | | | |
| | IT5 | 0.829 | | | | |

Note: All significant factor loading is at a 99% confidence level. EHTA = Average Variance Extracted; CR = Composite Reliability; CA = Cronbach's Alpha.

Table 2 shows the results of the validity and reliability test of the measurement model for the Focus, Performance, and Technology Innovation Strategy construct. All indicators have a loading factor value above 0.70 (range 0.775–0.880), so they are declared valid in reflecting latent constructs. Cronbach's Alpha (CA) value for all variables >0.70 (e.g. Performance = 0.911), indicates good internal reliability. Similarly, the Composite Reliability value (CR – rho_a and rho_c) >0.70 on all variables, confirms the excellent consistency of the measurements. The AVE value for all constructs is also above 0.50 (Focus Strategy = 0.670; Performance = 0.737; Technological Innovation = 0.683), which means that the convergent validity is met. Thus, the constructed tested can be declared valid and reliable for use in the subsequent structural model analysis.

*Structural Model Evaluation*

Coefficient of Determination ($R^2$)

Table 3. Coefficient of Determination ($R^2$) Result

| | **R2** |
|---|---|
| Performance | 0.636 |
| Technological Innovation | 0.724 |

Table 3 presents the results of the Coefficient of Determination ($R^2$) which shows the extent of the ability of independent variables to explain dependent variables. The $R^2$ value for Performance is 0.636, which means that 63.6% of the variation in performance can be explained by variables in the model, while the remaining 36.4% is influenced by other factors outside the model. The $R^2$ value for Technological Innovation was 0.724, which indicates that 72.4% of the variation in technological innovation can be explained by the variables used in the study, with the remaining 27.6% influenced by other

variables. Based on the criteria of Hair et al. (2019), the $R^2$ value is in the strong category, so the model has a good ability to explain the relationship between constructs.

*Hypothesis Test*

Table 4. Path Coefficients and Hypothesis Test Results

| Hypothesis | Path | Standard deviation (STDEV) | T statistics (\|O/STDEV\|) | P values | Conclusion |
|---|---|---|---|---|---|
| H1 | X -> Y. | 0.133 | 3.347 | 0.000 | Accepted |
| H2 | Z. -> Y. | 0.134 | 3.354 | 0.000 | Accepted |
| H3 | X -> Z. -> Y. | 0.118 | 3.054 | 0.001 | Accepted |

Table 4 shows the results of the hypothesis test through Path Coefficients analysis. The test results showed that all hypotheses (H1, H2, and H3) were accepted because the T-values were greater than 1.96 and the P-values were < 0.05. At H1, the X → Y pathway is significant (T = 3.347; P = 0.000), indicating that the X variable has a direct effect on Y. At H2, the Z → Y pathway is also significant (T = 3.354; P = 0.000), indicating that the Z variable has a direct effect on Y. Meanwhile, the X → Z → Y pathways are significant (T = 3.054; P = 0.001), which means that the Z variable mediates the relationship between X and Y. Thus, these results confirm that both the direct and indirect influences tested in the model are proven to be significant, so the mediating variable has an important role in strengthening the relationship between variables.

## DISCUSSION

*The Effect of Focus Strategy on the Performance of Sharia Commercial Banks*.

The results of the first hypothesis test showed that the X variable had a significant effect on Y, with a T-statistical value = 3.347 (>1.96) and a P-value = 0.000 (<0.05). These findings indicate a strong and significant direct influence between X and Y. Theoretically, these results support the Resource-Based View (RBV) approach which emphasizes that organizational excellence can be achieved through the utilization of unique and valuable internal strategies to improve performance (Barney, 1991).

Previous research has also shown similar findings. For example, a study conducted by Kusuma & Indarti (2020) revealed that the differentiation strategy implemented by Islamic banks has a positive effect on performance through increasing the added value of services and product innovation. Furthermore, Imanuel & Wirawan (2022) prove that the implementation of the right business strategy, including focus and cost advantage, is able to significantly improve the performance of Islamic commercial banks. These results are consistent with international research by Shi & Shang (2020) which found that a targeted and consistent business strategy is able to drive the performance of financial services companies in Asia, particularly in improving efficiency and competitiveness.

In addition, research by Opoku et al. (2022) strengthens the evidence that innovation-based and market-focused strategies have a significant effect on the performance of financial institutions, both in the context of operational efficiency and increased customer satisfaction. Thus, the results of this study are in line with various previous findings that affirm that the right business strategy (X) has a direct contribution to improving organizational performance (Y).

*The Effect of Technological Innovation on the Performance of Sharia Commercial Banks.*

The results of the second hypothesis test showed that the Z variable had a significant effect on the Y variable, with the T-statistics value = 3.354 (>1.96) and the P-value = 0.000 (<0.05). This confirms that Z has an important role in improving Y. These findings are in line with the theory of Dynamic Capabilities which emphasizes that organizations that are able to develop, integrate, and configure new resources, including through Z, will be more adaptive in improving performance (Teece, 2014).

Previous research supports these results. Dhisasmito & Kumar (2020) found that service quality (as a form of Z implementation) has a significant effect on café business loyalty and performance in Indonesia. Similar findings were shown by Ediyanto & Soeliha (2022) who confirmed that improving the quality of managerial strategies and services has a direct impact on the performance of MSMEs. In addition, Kusumaradya & Purwadi (2021) emphasized that the organization's ability to optimize core strategies (Z) can strengthen market position and improve business performance.

From an international perspective, Shi & Shang (2020) and Opoku et al. (2022) reveal that the quality of the implementation of a company's strategy and services has a significant influence on long-term performance, especially in the context of the financial services industry's competitive performance. Thus, the results of this study emphasize that Z is a key factor in driving the increase of Y, and is consistent with various previous studies both in national and international contexts.

*The Mediating Role of Technological Innovation in the Relationship between Focus Strategy and Performance.*

The results of the third hypothesis test showed that the Z variable mediated the relationship between X and Y significantly, with T-statistics values = 3.054 (>1.96) and P-values = 0.001 (<0.05). This means that the influence of X on Y is not only direct, but is also strengthened through the role of Z. In other words, the existence of Z is able to increase the effectiveness of the relationship between X and Y, so that the performance results (Y) can be achieved more optimally.

These findings are in line with research by Imanuel & Wirawan (2022) which shows that business strategy (X) has a stronger effect on company performance (Y) when mediated by technological innovation (Z). The same thing was also expressed by Kusuma & Indarti (2020), that the role of digital technology as a mediating variable is able to strengthen the relationship between differentiation strategies and the performance of MSMEs. In the context of Islamic banking, Ediyanto & Soeliha (2022) emphasized that a competitive strategy (X) will be more effective in improving performance (Y) when supported by the implementation of service innovation (Z) that is oriented to customer needs.

Internationally, Shi & Shang's (2020) research confirms that the quality of a company's strategy strengthened by technological innovation has a greater positive impact on customer satisfaction and business performance. Meanwhile, Opoku et al. (2022) also found that mediating variables such as service quality and technology strengthen the relationship between competitive strategies and company performance in the service sector.

Thus, the results of this study are consistent with previous studies in both national and international contexts, which prove that Z plays an important role as a catalyst in strengthening the relationship between X and Y. These findings indicate that organizations that integrate strategies with Z's support will be able to achieve superior performance and high competitiveness.

## CONCLUSIONS AND RECOMMENDATIONS

The results of the study show that business strategies, especially focus strategies, have an important role in improving organizational performance. This strategy has proven to be able to provide a competitive advantage by concentrating resources on certain market segments, so that companies can present products and services that are more in line with consumer needs. Through hypothesis testing, it was found that the focus strategy (X) had a significant effect on performance (Y), both directly and through the mediating role of technological innovation (Z). This shows that the implementation of the right focus strategy can encourage increased operational effectiveness while strengthening the company's competitiveness in the midst of market dynamics.

The results of the mediation test show that technological innovation is an important catalyst in strengthening the influence of focus strategies on performance. Innovation allows companies to not only maintain efficiency, but also increase the added value of products and services. These results are in line with the findings of previous research (Kusuma & Indarti, 2020; Shi & Shang, 2020; Opoku et al., 2022) which shows that the focus strategy will have a more positive impact when integrated with the use of digital technology, service quality, and orientation to customer satisfaction. Thus, this study enriches the literature by proving that the focus strategy is not just the selection of the target market, but must also be accompanied by continuous innovation to be relevant in facing modern industrial challenges.

Based on these findings, this study recommends that future studies expand the scope in different contexts, such as comparing the implementation of strategies focusing on the service sector, MSMEs, and technology-based industries. In addition, further research can test other mediating variables such as the digitization of business processes, organizational culture, and customer loyalty to obtain a more comprehensive picture of the mechanism of influence of focus strategies on performance. A longitudinal approach is also recommended to capture the dynamics of strategy and performance in the long term, so that the results of the research can make a more significant contribution to the development of strategic management theory and practice.

## ADVANCED RESEARCH

This study has several limitations that should be acknowledged. First, the sample size is relatively limited and focuses only on Sharia Commercial Banks in Indonesia, which may affect the generalizability of the findings to other sectors or countries. Second, this research only examines technological innovation as a mediating variable, while other potential factors such as organizational culture, digital capability, and customer trust are not included in the model. Third, the cross-sectional design restricts the ability to capture dynamic changes over time.

Future research is recommended to expand the scope by including a larger and more diverse sample across different regions or financial sectors. In addition, further studies may incorporate additional mediating or moderating variables, such as digital transformation readiness, customer loyalty, or institutional support, to provide a more comprehensive understanding. A longitudinal approach is also suggested to analyze the sustainability of strategy and performance over time.

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