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REVISITING THE SPEED OF CAPITAL STRUCTURE ADJUSTMENT IN ISLAMIC FIRMS: A SYSTEMATIC LITERATURE REVIEW AND RESEARCH AGENDA

Euis Bandawaty[1], Woro Anglia Banda Sutomo[2]*, Sanjoyo[3]

Universitas Islam As-Asyafi'iyah[1]
Universitas Islam As-Asyafi'iyah[2]
Universitas Islam As-Asyafi'iyah[3]
*euisbandawaty.feb@uia.ac.id

Abstract

This study systematically reviews the development of research on the Speed of Adjustment (SOA) within the context of Islamic finance, with a focus on identifying the dominant determinants and analytical models employed in empirical investigations. The review was conducted using a Systematic Literature Review (SLR) approach guided by the PRISMA 2020 protocol, covering 22 Scopus-indexed articles published between 2015 and 2025. The findings reveal an upward trend in publication activity beginning in 2018, with notable peaks in 2019 and 2025. Internal factors such as profitability, firm size, growth, asset tangibility, and liquidity emerge as the primary determinants of SOA, whereas macroeconomic stability, regulatory strength, and Shariah compliance strengthen the capital adjustment mechanism. The most frequently applied analytical models include the Partial Adjustment Model (PAM) and System-GMM, followed by VECM and Fixed Effect Panel Regression, although methodological diagnostic reporting remains inconsistent across studies. The synthesis further indicates that SOA research on Shariah-compliant firms is still evolving, leaving substantial space for conceptual, empirical, and methodological expansion. Future research may focus on comparative analyses between Shariah-compliant and conventional firms, the integration of ESG factors, and the development of an Islamic Dynamic Capital Adjustment Model grounded in maqasid al-shariah principles. Methodologically, subsequent studies are encouraged to employ Panel Quantile Regression or Bayesian Dynamic Panel Models and to incorporate bibliometric analysis and big data analytics to enhance scientific validity and research novelty.

Keywords:
Speed of Adjustment, Islamic finance, Systematic Literature Review.

Introduction

Capital structure is a strategic choice that shapes a firm's value and financial resilience. Traditional frameworks such as the Trade-Off, Pecking Order, and Market Timing theories suggest that firms aim for an optimal capital structure to reduce capital costs and enhance value. Yet in reality, firms do not reach this optimum

immediately. They adjust their leverage gradually, a process captured by the Speed of Adjustment (SOA). The speed reflects how efficiently managers respond to internal conditions and shifts in the financial environment. As noted by (Mukherjee & Wang, 2013), SOA measures how quickly firms close the gap between their actual leverage and the optimal target. In this study, SOA is used to assess how effectively firms realign their existing capital structure toward the desired level. The concept is grounded in the Dynamic Trade-Off Theory, which argues that firms adjust incrementally due to adjustment costs and various financial or informational constraints.

Although theories and models of SOA are well established in conventional finance, research on SOA within Islamic finance remains limited. The Islamic financial system has distinct features—such as the prohibition of riba, the use of profit-and-loss sharing, and its focus on ethical and productive activities—that directly shape firms' financing choices, capital adjustment behavior, and the speed at which they reach their optimal capital structure. As noted by (Khan & Bhatti, 2008)), these core principles reshape risk management and capital decisions because asset-based and profit-sharing contracts naturally restrict excessive leverage and encourage stronger financial discipline. This means that SOA in Islamic finance involves not only financial considerations but also ethical commitments and Sharia compliance.

Growing Islamic financial sectors in OIC countries have increased academic interest in dynamic analyses, yet empirical studies on SOA remain fragmented. Existing works often rely on different periods and models, resulting in varied conclusions about the factors that drive capital adjustment speed. This aligns with (Hassan & Aliyu, 2018) , who observed limited methodological integration between conventional theories and Sharia principles, and with (Rahman & Rahim, 2020), who emphasized the need for dynamic Islamic finance research to better explain institutional responses to macroeconomic and regulatory changes while upholding non-riba and distributive justice principles. Hence, a systematic review of SOA in Islamic finance is needed to close this gap and strengthen its theoretical and empirical foundations. Furthermore, shifts in global economic conditions over the past decade—such as financial crises, energy price volatility, and the COVID-19 pandemic—have influenced capital adjustment behavior across financial systems. These developments are particularly relevant for Islamic finance, which has shown relative resilience due to its avoidance of speculation and reliance on asset-backed financing.

(Rizvi & Naqvi, 2021) showed that Islamic banks remained more stable during the COVID-19 crisis than conventional banks, largely due to their lower exposure to risky assets and their conservative financing approach. However, (Alqahtani & Mayes, 2018) noted that despite this resilience, the limited variety of financial instruments and high adjustment costs can slow down the capital structure adjustment process. This raises an important question about how efficiently Islamic financial institutions can adjust their capital structures while fully adhering to Sharia requirements. As interest in capital structure dynamics has grown, recent empirical studies have examined both internal and external determinants of SOA within

Islamic finance. According to (Gungoraydinoglu & Oztekin, 2017) , internal characteristics such as profitability and firm size significantly speed up capital adjustment, especially for firms with better financing access. (Ullah & Khan, 2020) added that external conditions, including macroeconomic volatility and global monetary shifts, influence how quickly Islamic institutions can reach their optimal leverage levels. In addition, (Abdul Rahman & Saad, 2022) argued that stronger Sharia compliance and Islamic ethical governance enhance financial discipline and improve adjustment efficiency. However, evidence across countries and time periods remains inconsistent, highlighting the need for a systematic review to establish a clearer and more coherent understanding of these relationships.

Methodologically, research on the Speed of Adjustment (SOA) in Islamic finance has undergone significant development in recent years. A variety of models have been employed—ranging from the Partial Adjustment Model (PAM) and the Dynamic Trade-Off Model (DTO) in the early 2010s to more sophisticated dynamic panel approaches such as the Generalized Method of Moments (GMM), Vector Error Correction Model (VECM), and Fixed Effect Model (FEM) in more recent studies. According to (Al - Muharrami & Matthews, 2021) , the GMM approach provides more accurate estimations as it accounts for adjustment delays arising from Sharia-related constraints and asset-based financing structures. Similarly, (Arouri & Maghyereh, 2023) highlighted the importance of dynamic approaches such as System-GMM and VECM in analyzing the simultaneous interactions between leverage, profitability, and Sharia compliance. Consequently, the literature on SOA in Islamic finance has evolved toward more dynamic, context-sensitive, and empirically grounded approaches, reflecting the growing sophistication and methodological rigor in this area of research.

Based on the foregoing background, this study employs a Systematic Literature Review (SLR) approach to obtain a deeper and more comprehensive understanding of the Speed of Adjustment (SOA) phenomenon within the context of Islamic finance. Through the SLR method, this research seeks to synthesize empirical findings from various Scopus-indexed international studies in order to address three key research questions, namely:

1. What are the publication trends of studies on the Speed of Adjustment in Islamic finance over time?
2. What internal and external factors dynamically influence the Speed of Adjustment in Islamic finance?
3. What analytical models have been employed to investigate the Speed of Adjustment within the Islamic finance context?

By addressing these three research questions, this study is expected to provide academic contributions in two main aspects. First, it offers a systematic mapping of the literature on the Speed of Adjustment (SOA) in Islamic finance over time. Second, it provides a stronger conceptual and methodological understanding of the determinants and relevant models that explain the speed of capital structure adjustment under Sharia principles.From a practical perspective, the findings of this study are also expected to serve as a foundation for policymakers and Islamic

finance practitioners in designing capital structure management strategies that are efficient, stable, and fully compliant with Sharia principles.

Theoretical Framework

Research on the Speed of Adjustment (SOA) within the context of Islamic finance is rooted in the dynamic capital structure theories extensively developed in corporate finance literature. The principal theoretical foundations underpinning this study are the Dynamic Trade-Off Theory (DTO) and the Partial Adjustment Model (PAM), which posit that firms cannot instantaneously attain their optimal capital structure due to adjustment costs, information asymmetry, and external financing constraints (Flannery & Rangan, 2006; Byoun, 2008; Dang & Garret, 2015) . Within this framework, the SOA represents the rate at which firms correct the deviation between actual and target leverage toward their long-term equilibrium (Mukherjee & Wang, 2013).

However, the application of dynamic capital structure theories within an Islamic financial system requires conceptual refinement to accommodate the distinctive features of Shariah principles—namely, the prohibition of riba (interest), the principle of profit and loss sharing, and the avoidance of gharar (excessive uncertainty gharar (Khan & Bhatti, 2008; Iqbal & Mirakhor, 2017) . These characteristics fundamentally reshape financing behavior and capital structure decisions, as Islamic firms tend to rely more heavily on internal funds and asset-backed financing rather than interest-bearing debt. Consequently, capital structure adjustment among Islamic financial institutions tends to occur more gradually, yet with greater stability and ethical discipline, compared to their conventional counterparts (Alnori, 2019; Dhaoui & Bacha, 2020).

Complementarily, the Pecking Order Theory provides an additional theoretical basis for explaining the financing preferences of Islamic financial institutions. According to this theory, firms prioritize internal financing before seeking external sources, aligning with the limited availability of non-interest-based instruments and the principle of prudence inherent in Islamic finance (Ambarsari & Hermanto, 2017; Al-Kayed, Zain, & Duasa, 2014) . Accordingly, the positive relationship between profitability and SOA can be interpreted as a reflection of managerial prudence and adherence to Shariah values through the prioritization of internal funds.

From a macroeconomic perspective, the Dynamic Macroeconomic Framework offers insights into the influence of external factors—such as energy price volatility, economic policy uncertainty, and global monetary transmission—on the SOA. Prior studies indicate that these macro-level variables may either accelerate or decelerate adjustment speed, depending on market conditions and macroeconomic stability ((Mongi, 2019 ; Guizani, 2023; Hasan & Dridi, 2021) . Within Islamic finance, these effects are moderated by the principles of prudence and avoidance of excessive risk, leading to a more gradual but stability-oriented adjustment process over the long term.

Furthermore, Corporate Governance Theory and the Shariah Governance Framework constitute integral components of this study's theoretical foundation. Ethical governance practices and oversight by the Shariah Supervisory Board (SSB)

strengthen financial discipline, mitigate non-compliance risk, and enhance the efficiency of capital structure adjustments (Abdul Rahman & Saad, 2022; Al-Homaidi, Tabash, & Ahmad, 2022; Lewis & Hassan, 2024). Consequently, the degree of Shariah compliance functions not only as a moderating variable in the adjustment process but also as an embodiment of the integration between financial efficiency and moral responsibility in Islamic finance systems.

From a methodological standpoint, the above theories have been operationalized through a variety of dynamic empirical models designed to estimate SOA, including PAM, DTO, System-GMM, Vector Error Correction Model (VECM), and Fixed Effects Model (FEM) (Al - Muharrami & Matthews, 2021; Arouri & Maghyereh, Capital Structure Dynamics in Islamic Financial Institutions: Evidence from a Dynamic System Approach., 2023; Akbar, 2025) . Among these methods, GMM and VECM are especially valuable because they can model simultaneous interactions among variables and differentiate short-term adjustments from long-term equilibrium paths in capital structure decisions. In essence, the study's theoretical foundation combines four key perspectives:

- Dynamic Capital Structure Theory – explains the process of adjustment toward optimal leverage;
- Pecking Order Theory – elucidates financing preferences based on internal profitability and prudence;
- Shariah Governance Theory – emphasizes the role of ethical discipline and normative compliance; and
- Dynamic Macroeconomic Framework – highlights the impact of global external factors on the financial dynamics of Islamic institutions.

Integration of these four perspectives provides a comprehensive conceptual foundation for understanding the determinants and dynamics of the SOA in Islamic finance, while underscoring its fundamental differences from conventional financial systems.

Method

This study employs the Systematic Literature Review (SLR) method, a scientific approach that relies on comprehensive searches across multiple databases to collect and synthesize relevant research findings within a specific field. According to (Banda Sutomo & Turmudi, 2025) , the purpose of SLR is to integrate various empirical evidences to address specific research questions through a structured process of study identification, data extraction, and the analysis and synthesis of findings, thereby providing a comprehensive understanding of the topic under investigation. The implementation of SLR requires a well-defined research protocol to ensure that the process is conducted systematically, transparently, and consistently, thus enhancing the credibility of the results. In this study, the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines are adopted as the primary reference, as they ensure uniformity and clarity in reporting. As explained by (Panic , Leoncini, Belvis, Ricciardi, & Boccia, 2013) , PRISMA was developed as an improvement of the QUORUM statement to align

with advancements in reporting methods for both systematic reviews and meta-analyses, encompassing observational as well as experimental studies. The data analysis in this study was conducted using a descriptive approach.

A critical element of the SLR process involves establishing eligibility criteria to determine which studies are appropriate for inclusion in the analysis. To ensure the relevance and quality of the reviewed literature, articles were selected based on predefined inclusion and exclusion criteria. The detailed inclusion and exclusion parameters applied in this study are presented in Table 1.

Tabel 1. Inclusion and Exclusion Criteria

No	Inclusion Criteria	Exclusion Criteria
1	Research articles published in Scopus-indexed journals	Research articles not published in Scopus-indexed journals
2	Research articles that are not part of Islamic finance studies	Research articles that are part of Islamic finance studies
3	Studies discussing the speed of adjustment	Studies not discussing the speed of adjustment
4	Studies published between 2010 and 2025	Studies published before 2010
5	Articles that are accessible	Articles with restricted (closed) access
6	Articles written in English	Articles not written in English

The data for this Systematic Literature Review (SLR) were obtained through searches conducted using the Publish or Perish software, which aggregates academic publications from multiple databases. The literature included in this study consists of peer-reviewed journal articles indexed in Scopus, ensuring high academic quality and global relevance. The search covered the publication period from 2015 to 2025 and applied a Boolean keyword search technique, which combines multiple terms using logical operators such as AND and OR to improve both accuracy and comprehensiveness. The Boolean combination used in this study was ("speed of adjustment" OR "capital structure adjustment") AND ("Islamic finance" OR "Sharia compliance" OR "target leverage" OR "Shariah"). Based on this search strategy, a total of 124 Scopus-indexed journal articles were initially identified.

The subsequent step involved a systematic screening process to evaluate the retrieved studies and ensure their consistency, accuracy, and relevance to the research objectives. This process aimed to guarantee that the literature reviewed was reflective, objective, and aligned with the main focus of the study, namely the Speed of Adjustment (SOA) within the context of Islamic finance. The selection and screening procedures were conducted following the PRISMA protocol, which provides a transparent and standardized framework to guide systematic reviews. The PRISMA flow diagram illustrating the identification, screening, eligibility, and inclusion stages is presented in Figure 1.

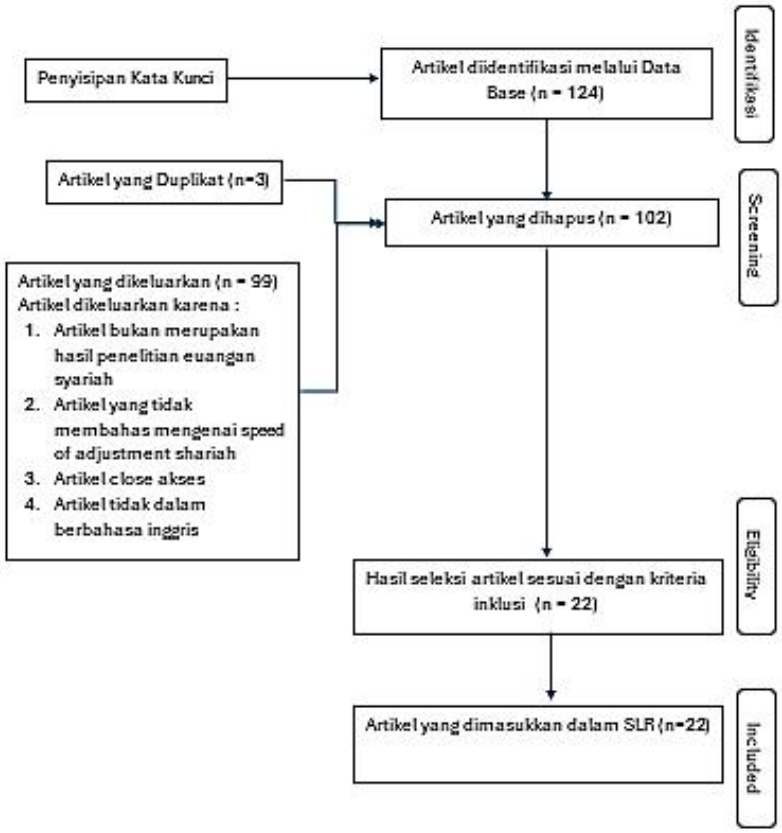

Figure 1. PRISMA Flow Diagram

As illustrated in Figure 1, the identification stage yielded a total of 124 articles retrieved from Scopus-indexed journals. During the screening phase, several records were identified as duplicates, while others were excluded for not meeting the predefined inclusion criteria of this study. Consequently, 102 articles were eliminated from further consideration. Following the screening process, 22 articles remained and were subjected to the eligibility assessment stage. The evaluation confirmed that all 22 articles met the established quality and relevance standards. Therefore, these 22 studies were deemed eligible and included in the final synthesis and analysis of this review.

Results

The summary of the coding results for data extraction from the articles included in this SLR comprises the authors' names, article titles, year of publication, and journal names. A consolidated summary of the extracted data is presented in Table 2.

Tabel 2. Ringkasan Hasil Data Pengodean

Author	Tittle	Journal
A. Mongi	The global influence of oil futures-prices on Dow Jones Islamic stock indexes: Do energy-volatility's structural breaks matter?	International Journal of Emerging Markets
B. Chaklader	Testing dynamic trade-off theory of capital structure: An empirical study for the textiles industry in India and China	Afro Asian Journal of Finance and Accounting
B. Ghose	Dynamic Capital Structure Adjustments and Business Group Affiliations: Indian Evidence	Business Perspectives and Research
B. Nieto	Corporate Stock and Bond Return Correlations and Dynamic Adjustments of Capital Structure	Journal of Business Finance and Accounting
C.F. Baum	Capital structure adjustments: Do macroeconomic and business risks matter?	Empirical Economics
C.T. Nguyen	Corporate capital structure adjustments: Evidence from Vietnam stock exchange market	Journal of Asian Finance Economics and Business
D. Dufour	The influence of cash flow on the speed of adjustment to the optimal capital structure	Research in International Business and Finance
F. Alnori	Capital structure and speed of adjustment in non-financial firms: Does sharia compliance matter? Evidence from Saudi Arabia	Emerging Markets Review
H.I. Hussain	The impact of sharia compliance on the adjustment to target debt maturity of Malaysian firms	European Research Studies Journal
H.I. Hussain	Capital structure speed of adjustment and Shari'ah compliance: Empirical evidence from Malaysia	Journal of Engineering and Applied Sciences
N.A.M. Arif	The impact of interest rate changes on the islamic foreign exchange forward in the Malaysian derivative market	Jurnal Pengurusan

A. Bugshan	Shariah compliance and corporate cash holdings	Research in International Business and Finance
H.I. Hussain	Asymmetric capital structure speed of adjustment, equity mispricing and Shari'ah compliance of Malaysian firms	International Review of Economics and Finance
M. Guizani	Economic policy uncertainty, geopolitical risk and cash holdings: evidence from Saudi Arabia	Arab Gulf Journal of Scientific Research
R. Rehan	Inspecting sector-specific capital structure determinants: The case of Malaysian Shariah firms	International Journal of Applied Economics Finance and Accounting
A. Bugshan	Does being Shariah-compliant affect capital structure decision: evidence from emerging markets	Journal of Islamic Accounting and Business Research
A. Bugshan	Corporate net working capital: evidence from Shariah compliance	International Journal of Emerging Markets
D. Grau-Vera	Time-varying risk aversion and capital Structure: An overlooked effect	International Review of Economics and Finance
M. Alsharif	How do the capital structure and adjustment speed of Islamic banks differ from those of conventional banks? Evidence from the GCC region	Humanities and Social Sciences Communications
M.A. Salami	Evaluation of non-performing financing of non-oil sectors: a case of Bahraini Islamic banks	International Journal of Accounting Auditing and Performance Evaluation
R. Rehan	Inspecting sector-specific capital structure determinants: The case of Malaysian Shariah firms	International Journal of Applied Economics Finance and Accounting
S. Akbar	Capital structure and speed of adjustment of shariah-compliant firms: does the shariah screening criteria influence the results?	Journal of Islamic Accounting and Business Research

1. Trends in Research Publications on the Speed of Adjustment in Islamic Finance

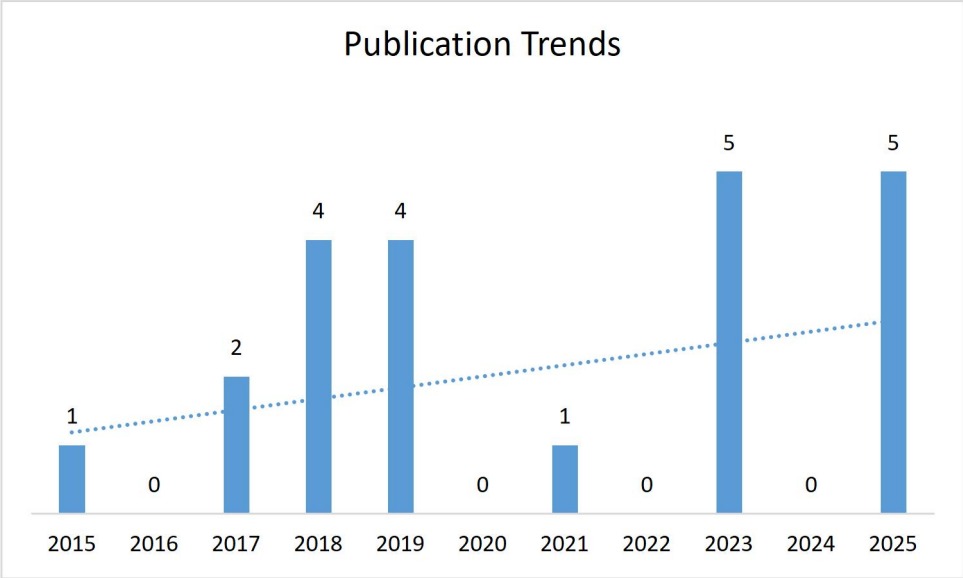

Figure 2. Trends in Publications on Speed of Adjustment in Islamic Finance

Figure 2 illustrates the development of research publications addressing the Speed of Adjustment (SOA) within the context of Islamic finance over the period 2015–2025. Overall, the number of publications exhibits annual fluctuations with an irregular pattern; however, the general trend demonstrates a gradual upward trajectory, as indicated by the rising trend line.

During the initial period (2015–2017), research on this topic was relatively scarce, with only one to two articles published annually. A notable surge occurred in 2018 and 2019, with four publications per year, reflecting a growing scholarly interest in SOA within Islamic finance. This momentum declined sharply during the 2020–2022 period, when publication output dropped significantly, with some years recording no related studies. Nevertheless, a substantial rebound was observed in 2023 and 2025, each registering five publications, suggesting a renewed academic focus on this topic in recent years.

The linear trend line reinforces the indication that, despite interannual volatility, the overall trajectory of research development continues to rise. This pattern implies that the topic of SOA in Islamic finance has increasingly attracted scholarly attention and is likely to remain a promising and evolving area of academic inquiry in the coming years.

2. Dynamic Identification of Factors Influencing the Speed of Adjustment (SOA)

Based on the synthesis of 22 international articles published between 2015 and 2025, research on the Speed of Adjustment within Islamic finance reflects a complex and multidimensional landscape. Overall, the factors shaping the pace of capital structure adjustment stem not only from firms' internal attributes but also from external conditions and the inherent requirements of Sharia compliance in the Islamic financial system.

a. Internal Factors Influencing SOA in Islamic Finance

1) Profitability

Profitability emerges as the most consistently significant determinant affecting SOA. Studies by (Ghose, 2018), (Alnori, 2019), and (Bugshan, 2025) indicate that firms with higher profitability tend to adjust their capital structures more rapidly toward their target leverage. This occurs because strong earnings expand internal funding capacity, thereby reducing dependence on external financing. In the Islamic finance context, the limited availability of interest-based instruments further amplifies firms' reliance on internal funds.

2) Firm Size

(Rehan, 2023) and (Akbar, 2025) find that larger firms exhibit faster adjustment speeds due to broader access to Sharia-compliant financing instruments such as sukuk and Islamic equities. In contrast, smaller firms face liquidity constraints and higher adjustment costs (Nabila, 2023) further emphasizes that firm size is positively associated with access to external financing sources, which in turn accelerates capital structure adjustment.

3) Liquidity and Tangibility

Findings from (Dufour, 2018) and (Rehan, 2023)) show that firms with higher asset tangibility and stronger liquidity are better positioned to adjust toward their target leverage. Tangible assets serve as collateral for profit-and-loss-sharing contracts, while higher liquidity enhances a firm's ability to rebalance without incurring substantial transaction costs.

4) Cash Flow

(Dufour, 2018) reports that corporate cash flow significantly affects adjustment speed in both the short and long run. Firms with positive cash flows are able to adjust their capital structures more swiftly, whereas negative cash flows tend to slow the adjustment process.

b. External Factors Influencing SOA in Islamic Finance

1) Energy Prices and Global Market Conditions

The literature indicates that energy price volatility and global market dynamics are positively correlated with the speed of capital structure adjustment, particularly for Islamic financial institutions that are closely linked to commodity-based sectors. Studies by (Mongi, 2019) and (Nguyen , 2019) reveal that rising energy prices enhance asset values and revenues for financial institutions operating in energy-producing countries, such as those in the GCC region, thereby accelerating adjustment toward the desired capital structure. Conversely, declining energy prices weaken this adjustment capability.

2) Economic Policy Uncertainty (EPU)

The SLR findings also show that economic policy uncertainty serves as an external factor that slows the adjustment speed of capital structures. (Guizani, 2023) finds that heightened EPU encourages Islamic financial institutions to adopt more cautious investment and financing decisions. In the Islamic financial system, the principle of avoiding excessive uncertainty (gharar) leads firms to delay capital

structure adjustment during periods of policy fluctuation or macroeconomic instability.

3) Monetary Factors and Global Interest Rates

The reviewed studies suggest that although Islamic finance prohibits interest (riba), movements in global interest rates still exert indirect effects. Arif (2019) reports that fluctuations in international benchmark rates influence exchange rates and cross-border capital flows, thereby affecting financing costs for Islamic financial institutions.

c. Shariah Compliance and Corporate Governance Factors Influencing SOA in Islamic Finance

1) Shariah Compliance

The SLR findings indicate that the degree of Shariah compliance significantly shapes the dynamics of adjustment speed. Studies by (Alnori, 2019) and (Hussain , 2023) suggest that higher levels of Shariah compliance tend to slow SOA in the short term due to limitations in non-interest-based financing instruments. However, over the long term, such compliance contributes to a more stable capital structure and a lower risk of financial distress.

2) Corporate Governance

Based on the synthesized SLR evidence, studies by (Bugshan , 2021) and (Bugshan, 2025) find that board structure, director independence, and institutional ownership exert significant effects on SOA. Strong governance mechanisms enhance the efficiency of capital structure adjustment by improving oversight of financing decisions.

3. Identification of Dynamic Models and Estimation Approaches in the Speed of Adjustment (SOA) within Islamic Finance

a. Dynamic Data Analysis Models

The literature synthesis indicates that SOA is inherently dynamic (time-varying) and influenced by macroeconomic conditions, monetary policy, and corporate governance. Various studies employ models such as PAM, ARDL, and VECM to analyze short- and long-run relationships among variables, revealing clear differences in adjustment speeds between conventional and Islamic firms.

a) Dominance of the Partial Adjustment Model and Dynamic Trade-Off Model

The systematic review of studies published over the last twenty years indicates that the Partial Adjustment Model (PAM) and the Dynamic Trade-Off Model (DTO) are the dominant frameworks used to analyze SOA in Islamic finance. Both approaches are rooted in Dynamic Capital Structure Theory, which argues that firms cannot immediately attain their optimal capital structure because of adjustment costs, information asymmetry, and limited access to external funding. Several works included in this SLR, such as those by (Nguyen , 2019), (Alnori, 2019) and (Dufour, 2018), consistently employ these models to estimate the speed at which firms move toward their target leverage, whether in Shariah-compliant or conventional settings.

b) Cointegration and Error Correction Models (VECM)

The systematic review further shows that, in efforts to capture long-term capital structure dynamics, recent studies have shifted toward cointegration-based approaches, particularly the Vector Error Correction Model (VECM) and the Johansen Cointegration Test. (Salami, 2023) empirically applies these methods to identify cointegrating relationships among key financial variables such as leverage, profitability, asset growth, and firm size. The VECM framework is used to estimate adjustment speeds toward long-run equilibrium following short-term deviations. The findings reveal that the error correction process for Islamic firms proceeds more gradually compared to their conventional counterparts. This suggests that the Islamic financial system tends to prioritize long-term stability, consistent with its principles of prudence and avoidance of uncertainty (gharar). Moreover, the use of VECM allows researchers to distinguish between short-run adjustments and long-run convergence toward equilibrium, offering deeper insight into the mechanisms of capital structure adjustment in a system grounded in ethical values and asset-backed financing.

b. Dynamic Parameter Estimation Models

a) Generalized Method of Moments (GMM)

The systematic review reveals a significant methodological shift in SOA research within Islamic finance, moving from static models toward dynamic panel approaches using the Generalized Method of Moments (GMM). This approach is widely adopted in recent studies such as (Hussain , 2023) , (Rehan, 2023) dan (Bugshan, 2025) , due to its ability to address endogeneity and unobserved heterogeneity, both of which are common challenges in financial panel data analysis. (Hussain , 2023) employs a two-stage approach to estimate SOA target leverage using a distance-to-target variable. (Rehan, 2023) applies the system-GMM estimator to examine sectoral differences in adjustment speeds. Meanwhile, (Bugshan, 2025) integrates internal instruments to mitigate simultaneity bias arising from the reciprocal relationship between financing decisions and firm performance.

Overall, these findings indicate that dynamic panel models estimated using GMM provide more robust and efficient estimates, offering a more accurate depiction of capital structure adjustment behavior in Islamic financial institutions operating within complex macroeconomic environments and Shariah-based principles.

b) Fixed Effect Model (FEM) and Comparative Analysis

The systematic review also shows that the Fixed Effect Model (FEM) plays an important role in SOA analysis, particularly in comparative studies between Shariah-compliant and conventional firms. (Akbar, 2025) applies FEM combined with the F-test to control for unobserved heterogeneity at the firm level, allowing temporal variation to be separated from cross-sectional variation. This approach produces more reliable estimates that are free from time-invariant individual biases. Empirical findings indicate that Shariah-compliant firms exhibit slower adjustment speeds compared with their conventional counterparts. This condition is attributed

to financing constraints stemming from the limited availability of non-interest-based financial instruments, as well as a strategic preference for long-term capital structure stability aligned with prudential principles in Islamic finance.

Discussion

1. Analysis of Publication Trends in Speed of Adjustment Research within Islamic Finance

The upward trend in publications illustrated in Figure 2 reflects the evolving trajectory of scholarly work on the Speed of Adjustment in Islamic finance. Fluctuations in publication volume indicate that research in this field is dynamic and shaped by contemporary academic debates and developments in the global Islamic economic landscape. The surge in publications during 2018–2019 marks the early phase of conceptual exploration of SOA within the Shariah context, a period when researchers began paying closer attention to the efficiency of capital structure adjustments and dividend policies grounded in Islamic principles. This trend also signifies growing interest in dynamic capital structure studies within Islamic finance, in line with the expansion of Shariah-compliant financial instruments and the need for financial theories aligned with Islamic ethical values.

Meanwhile, the sharp decline observed between 2020 and 2022, particularly the significant drop to just one publication in 2021, was likely influenced by the COVID-19 pandemic, which disrupted research and publication activities across many fields, including Islamic finance. Nevertheless, this decline was temporary; by 2023, the number of publications rose markedly to five articles. This surge signals a post-pandemic revival of research, where SOA issues regained prominence in analyses of the resilience and adaptability of Islamic financial institutions during periods of economic turbulence. This pattern aligns with the view of (Raainaa & Zahrurrijal, 2024) , who argue that the pandemic prompted scholars to re-evaluate the effectiveness of capital structure adjustment mechanisms under conditions of heightened uncertainty. Additionally, (Rahman , Rahiman, Meero , & Amin, 2023) emphasize that the post-pandemic period represents a crucial moment for advancing research on how Islamic financial institutions strengthen their adjustment processes toward optimal capital structures as a form of adaptation to external shocks. Thus, the observed publication dynamics reflect not only quantitative fluctuations but also a shift toward more crisis-responsive and recovery-oriented research perspectives.

The renewed increase in publications during 2023 and 2025 represents a strong phase of academic resurgence. This demonstrates that researchers are increasingly adopting more diverse and sophisticated approaches to SOA analysis, such as employing dynamic models like the Generalized Method of Moments (GMM) and the Vector Error Correction Model (VECM) to explain financial adjustment behavior in Islamic financial institutions. These findings correspond with (Arouri & Maghyereh, 2023) , who highlight that dynamic approaches offer a more comprehensive depiction of the simultaneous interactions among leverage,

profitability, and Shariah compliance in the post-pandemic environment. Furthermore, recent studies such as (Bugshan, 2025) show that the rising publication trend reflects a shift in research focus toward integrating global macroeconomic factors with Shariah-based financing structures in SOA analysis. Hence, the upward trajectory of publications not only indicates quantitative growth but also represents increasing methodological sophistication and deeper conceptual development in modern Islamic finance scholarship.

Conceptually, the rising trend suggests that SOA research in Islamic finance has evolved from an exploratory stage toward more theoretically grounded and empirically robust inquiry. This progression opens avenues for more focused future research, such as comparative analyses with conventional institutions or examinations of factors affecting adjustment speed within the contexts of Shariah governance and sustainable finance. This study also notes that the dataset includes publications only up to September 2025, indicating that additional studies are likely to appear by the end of the year.

2. Dynamic Analysis of the Determinants of SOA in Islamic Finance

a. Internal Factors Influencing SOA in Islamic Finance

The synthesis of findings indicates that the dynamics of the Speed of Adjustment (SOA) in Islamic finance are shaped by internal and external factors, as well as governance and Shariah compliance considerations. These findings underscore that Islamic financial institutions exhibit more stable yet less responsive adjustment behavior compared to their conventional counterparts. Theoretically, the positive relationship between profitability and adjustment speed affirms the relevance of the pecking order theory within the Shariah framework. However, the absence of interest-based instruments forces the adjustment mechanism to rely more heavily on earnings management efficiency, supporting the view of (Ambarsari & Hermanto, 2017) that highly profitable firms tend to maintain lower leverage due to their preference for internal financing. In the Islamic finance setting, profitability functions not only as a financial metric but also as an indicator of an institution's ability to maintain sustainability and prudence in halal financing (Al-Kayed, Zain, & Duasa, 2014) . Thus, ethical dimensions are deeply embedded in the process of capital adjustment.

Firm size also plays a pivotal role in determining adjustment speed because it reflects institutional capacity and reputation within Islamic financial markets. Larger firms enjoy stronger reputations and higher market trust, enabling them to access instruments such as sukuk more efficiently. This aligns with (Omri, 2022) , who argues that economies of scale and public confidence enhance the ability of Islamic institutions to adjust their capital structures more effectively. Similarly, (Nabila, 2023) emphasizes that firm size is positively correlated with access to external financing sources, which in turn accelerates the capital structure adjustment process.

Liquidity and tangibility further highlight the importance of real asset strength in supporting the stability of the Islamic financial system. Tangible assets serve not only as collateral in profit-sharing–based financing but also reflect the asset-backed

principle that is fundamental to Islamic finance. This is supported by (Givari, Yantiana, Rusmita, & Noviarty, 2024), who find that firms with high tangible assets possess greater financial flexibility because such assets can be pledged as collateral to obtain new financing, thereby accelerating capital structure adjustment. Accordingly, tangibility and liquidity operate as essential foundations that reinforce resilience and efficiency in the adjustment process of Islamic financial institutions.

Cash flow also emerges as a central determinant of SOA in both conventional and Islamic finance. This finding is consistent with (Flannery & Rangan, 2006), who argue that stable cash flows significantly accelerate convergence toward optimal capital structure. Firms with stable cash flows can rely more on internal financing and reduce dependence on external funds. In the Islamic finance context, (Abedifar, Molyneux, & Tarazi, 2013) similarly show that Islamic financial institutions capable of managing cash flows efficiently tend to maintain stronger capital stability and adjust more swiftly to economic changes without violating Shariah principles. Cash flow therefore functions not only as a short-term liquidity indicator but also as a signal of adaptive capacity and financial resilience in maintaining a balanced capital structure aligned with Islamic ethical values. Managerial efficiency in cash flow management thus becomes a key driver of a sustainable, ethically grounded speed of adjustment in Islamic finance.

b. External Factors Influencing SOA in Islamic Finance

Overall, the results of this SLR indicate that the dynamics of SOA in Islamic finance are influenced not only by internal financial variables but also by external pressures and the normative values that characterize the Islamic financial system. External factors such as energy prices, economic policies, and global interest rates demonstrate that Islamic financial institutions remain integrated into the global financial system despite operating under an interest-free framework. This is reinforced by (Hammoudeh, Arouri, & Nguyen, 2021), who find that fluctuations in global oil prices significantly affect Islamic financial stability through commodity price transmission mechanisms and exposure to real assets. Moreover, (Alqahtani & Mayes, 2018) show that Islamic financial institutions in the GCC region possess higher shock absorption capacity compared to conventional banks due to their equity-based asset structures and profit-sharing principles. These findings highlight the asymmetric nature of SOA in responding to external shocks and the central role of energy factors in mediating the capital adjustment process of Islamic financial institutions.

Economic policy uncertainty (EPU) also moderates the speed of adjustment. The Shariah principle of avoiding gharar requires stability and prudence, leading Islamic institutions to delay adjustment processes until policy risks subside. This is consistent with (Baker, Bloom, & Davis, 2022), who find that increases in the EPU index significantly slow firms' adjustment toward target leverage in both conventional and Islamic sectors due to rising capital costs and unpredictable policy risks. Furthermore, (Narayan & Bannigidadmath, 2023) show that global policy uncertainty exerts spillover effects on the stability of Islamic finance, particularly in emerging markets that are sensitive to international capital flows. Thus, EPU

emerges as a key macroeconomic determinant that moderates the relationship between financing policies, capital structure, and adjustment rates in the Islamic finance sector. This indicates that ethical dimensions within Shariah extend the adjustment horizon yet contribute to long-term stability.

The influence of global monetary factors further indicates that the Islamic financial system is not entirely insulated from the dynamics of conventional global monetary policy. Rising global interest rates encourage investors to shift portfolios toward fixed-income conventional assets, reducing liquidity and capital inflows into Islamic financial markets. This finding aligns with (Hasan & Dridi, 2021), who argue that the transmission of global monetary policy through exchange rates and capital flows may constrain the adjustment capacity of Islamic finance, especially in countries with dual financial systems. Meanwhile, (Srairi, 2022) finds that Islamic financial institutions in the Middle East exhibit lower sensitivity to interest rate fluctuations than conventional banks, yet they remain affected through changes in market asset values and export financing. Additionally, (El Massah & Al-Sayed, 2023) highlight that although Shariah principles offer direct protection from interest risk, global monetary policy transmission can still slow capital structure adjustment through liquidity pressures and increased external funding costs. This demonstrates the systemic interconnectedness between global conventional and Islamic financial markets, where international monetary shocks continue to shape the SOA dynamics of Islamic financial institutions through exchange-rate channels, capital flows, and liquidity conditions.

c. Shariah Compliance and Corporate Governance Factors

Shariah compliance and corporate governance exert a substantial influence on the stability and efficiency of the speed of adjustment (SOA). Over the long term, strong adherence to Shariah principles contributes to a more stable capital structure and a lower risk of financial distress. Similar findings are reported by (Alam & Rizvi, 2021), who argue that Shariah compliance enhances financial discipline through strengthened transparency and ethics-based governance, thereby reducing leverage volatility. Furthermore, (Hanif & Hassan, 2022) emphasize that a high level of Shariah compliance can function as a stabilizing mechanism by lowering firms' sensitivity to external fluctuations and enhancing their financial resilience against macroeconomic shocks. In addition, (Abdul Rahman & Saad, 2023) find that the implementation of a strong Shariah Supervisory Board (SSB) accelerates long-term capital structure adjustment by promoting efficiency in equity-based and profit-sharing financing. These insights underscore that SOA in Islamic finance is not merely a financial mechanism, but rather a reflection of the integration between moral principles, governance quality, and long-term sustainability.

A relatively slower adjustment speed reflects prudence and normative compliance, whereas the resulting long-term stability demonstrates the resilience and sustainability of the Islamic finance system in navigating global economic dynamics. Strong governance mechanisms enhance oversight of financing decisions and improve efficiency in the process of capital structure adjustment. Consistent with

this view, (Al-Homaidi, Tabash, & Ahmad, 2022) show that the Shariah Supervisory Board plays a critical role in maintaining a balance between Shariah compliance and financial efficiency, thereby indirectly accelerating the adjustment toward an optimal capital structure. Moreover, (Lewis & Hassan, 2024) find that the application of accountability principles and Shariah governance within the board structure encourages more cautious yet efficient financing decisions, strengthening the link between normative compliance and long-term financial stability. Thus, corporate governance in the context of Islamic finance serves not only as a managerial control mechanism but also as an ethical framework that integrates moral objectives with economic efficiency.

3. Dynamic Analytical Models and SOA Estimation Models in Islamic Finance

a. Dynamic Data Analysis Models

This section highlights the theoretical formulation and analytical framework rooted in the concepts of the Partial Adjustment Model, the Dynamic Trade-Off Model, and cointegration approaches designed to capture long-run relationships.

a) Dominance of the Partial Adjustment Model and Dynamic Trade-Off Model

The dominance of the Partial Adjustment Model (PAM) and the Dynamic Trade-Off Model (DTO) in the literature reflects a methodological tendency among researchers to adopt approaches capable of capturing the gradual and dynamic nature of capital structure adjustment. Several studies identified in the SLR, including those by (Nguyen , 2019), (Alnori, 2019) and (Dufour, 2018), consistently apply these models to estimate the speed of adjustment (SOA) toward target capital structure among firms operating in both Islamic and conventional financial systems. In general, the model formulation follows the frameworks developed by (Byoun, 2008) and (Dang & Garret, 2015)). This indicates that scholars in Islamic finance perceive convergence toward an optimal capital structure not as an instantaneous mechanism but as an adaptive process shaped by firms' internal and external conditions.

In the Islamic finance context, a lower SOA compared to conventional firms should not be interpreted as inefficiency; instead, it reflects managerial prudence in maintaining strict adherence to Shariah principles. The adjustment process toward an optimal structure tends to be slower and more gradual, as explained by (Dhaoui & Bacha, 2020) , who link this phenomenon to financing constraints, higher transaction costs, and dependence on profit- and loss-sharing contracts. Furthermore, (Abdul Rahman, Bacha, & Saad, 2023) assert that the slower adjustment reflects the commitment of Islamic financial institutions to avoid non-compliance risk and ensure that financing and investment decisions align with maqasid al-shariah.

The dominance of PAM and DTO thus illustrates an academic effort to balance financial efficiency with normative integrity in capital structure analysis. These approaches enable a more comprehensive understanding that incorporates both financial determinants and ethical considerations underlying Islamic finance. Accordingly, this SLR concludes that the prevalence of PAM and DTO is not merely a methodological preference but also signals an evolving conceptual paradigm in

understanding capital structure adjustment among Islamic financial institutions, which is oriented toward stability, ethics, and distributive fairness.

b) Cointegration and Error-Correction Models (VECM)

Cointegration approaches such as the Vector Error Correction Model (VECM) represent an important methodological advancement in SOA research within Islamic finance. Unlike partial or conventional dynamic models, VECM captures both long-run equilibrium relationships and short-run dynamics among financial variables. This is particularly relevant because Islamic finance exhibits structural stability influenced by the prohibition of speculation (maysir), excessive uncertainty (gharar), and its foundation in asset-backed financing.

Thus, slower adjustment is not indicative of inefficiency but reflects a commitment to sustainability and ethical balance in capital structure decisions. Consistent with (Salami, 2023), SOA in Islamic systems is shaped not only by economic factors such as adjustment costs and target leverage, but also by normative dimensions involving prudence, distributive justice, and systemic stability. Moreover, the application of VECM creates opportunities to integrate additional dynamic models such as the Autoregressive Distributed Lag (ARDL) model and the Error Correction Mechanism (ECM) to assess the long-run stability of capital structure within Islamic financial frameworks. This approach expands SOA analysis from a narrow focus on adjustment speed to a holistic understanding of the interaction between financial mechanisms and Islamic values.

In this context, the structural characteristics of Islamic finance—including asset-backed contracts and prohibitions against maysir and gharar—generate capital structures that tend to be stable but respond more gradually to external shocks such as energy price fluctuations, economic policy uncertainty, and global liquidity shifts, as noted by (Iqbal & Mirakhor, 2017).

b. Dynamic Parameter Estimation Models

a) Generalized Method of Moments (GMM)

The shift toward dynamic panel models using the Generalized Method of Moments (GMM) represents a significant methodological and paradigmatic development in SOA research within the Islamic finance sector. This approach enhances the empirical validity of findings and broadens theoretical insights into structural adjustment mechanisms under an Islamic financial framework. By accounting for intertemporal dynamics and controlling for firm-specific effects, GMM provides a more realistic analytical structure for understanding the behavior of Islamic financial institutions shaped by Shariah compliance, non-ribawi financing constraints, and sensitivity to macroeconomic and Islamic monetary conditions.

Given its ability to control dynamic interdependencies and unobservable heterogeneity, the GMM estimator yields more robust and efficient results compared to conventional partial-adjustment models, as noted by (Blundell & Bond, 1998) . Moreover, GMM enables deeper exploration of interactions among religious factors, corporate governance, and market liquidity, as highlighted by (Baltagi, 2021) .Thus,

the adoption of GMM reflects not merely a technical innovation but a conceptual shift toward a holistic, empirically grounded understanding of capital structure dynamics within an ethical and justice-based Islamic framework. This methodological evolution reinforces the growing academic relevance of Islamic finance in the global research landscape.

b) Fixed Effect Model (FEM) and Comparative Estimation Analysis

The use of the Fixed Effect Model (FEM) in SOA analysis demonstrates methodological rigor in distinguishing systematic differences between financial regimes, particularly between Shariah-compliant and non-compliant firms. Unlike the Random Effect Model (REM), which assumes homogeneity among entities, FEM isolates firm-specific characteristics, producing estimates that more accurately reflect the actual conditions of Islamic financial institutions. Findings by (Akbar, 2025),which show slower SOA among Shariah-compliant firms, can be interpreted as evidence of prudential behavior, reflecting managerial caution in maintaining Shariah compliance and avoiding non-compliance risk. This aligns with (Hasan & Dridi, 2023) , who emphasize that long-term stability and sustainability are central features of Islamic financial governance in the face of market volatility and economic uncertainty.

Consequently, FEM serves not only as a statistical tool but also as an analytical framework that strengthens understanding of the interaction between financial efficiency and Shariah-based normative values. This approach enriches the literature with more robust comparative evidence, demonstrating that capital structure adjustment dynamics in Islamic finance are shaped not solely by market pressures but also by a commitment to moral stability and the sustainability of an ethics-based financial system.

Conclusion

The findings of this Systematic Literature Review, based on 22 Scopus-indexed articles, indicate that research on the Speed of Adjustment (SOA) in Islamic finance has undergone significant development since 2018, with a noticeable upward trend in the post-pandemic period. The determinants of SOA are multidimensional, encompassing internal factors (profitability, firm size, liquidity, and cash flow), external factors (energy prices, policy uncertainty, and global monetary conditions), as well as governance and Shariah compliance, which collectively enhance long-term stability. Methodologically, the literature reveals a shift from partial-adjustment models (PAM, DTO) toward more sophisticated dynamic approaches such as GMM and VECM, which offer stronger explanatory power for both short- and long-term adjustment dynamics. Overall, Islamic financial institutions exhibit a slower yet more stable speed of capital structure adjustment, reflecting managerial prudence, adherence to Shariah principles, and an orientation toward sustainability and economic justice consistent with the objectives of maqasid al-shariah.

Future Research Directions

The synthesis of the literature indicates that research on the Speed of Adjustment (SOA) in Shariah-compliant firms remains in a developmental phase, leaving substantial room for conceptual, empirical, and methodological advancement. Accordingly, future studies should be oriented toward three main directions. First, subsequent research is encouraged to extend SLRs using a comparative approach between Shariah-compliant and non-Shariah firms in order to identify fundamental differences in capital structure adjustment speeds. Such cross-system analysis is crucial for understanding the institutional, regulatory, and managerial behavior factors that uniquely shape Islamic financial systems, particularly within dual financial frameworks such as those in Indonesia and Malaysia. Second, integrating Environmental, Social, and Governance (ESG) dimensions may provide additional explanatory power for variations in adjustment speed by influencing the cost of capital, reputation, and decision-making efficiency. Third, the development of dynamic capital structure models grounded in Islamic principles, or an Islamic Dynamic Capital Adjustment Model, warrants exploration as a potential theoretical foundation that accommodates core features of Islamic finance, including the prohibition of interest, profit-and-loss sharing mechanisms, and maqasid al-shariah values, while remaining consistent with modern trade-off theory. From a methodological standpoint, future research is advised to expand the use of advanced econometric techniques such as Panel Quantile Regression (PQR), Bayesian Dynamic Panel Models (BDPM), or System GMM to test the robustness of findings and account for firm-level heterogeneity. Moreover, integrating empirical approaches with bibliometric analysis and big data analytics may enrich the mapping of global research trends and strengthen the theoretical underpinnings of Islamic finance scholarship.

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