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Unraveling Malaysia's Dominance: A Porter's Diamond Analysis of the Islamic Financial Ecosystem

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ABSTRACT :

The 2023 Islamic Finance Development Indicator (IFDI) report reveals a significant *academic anxiety*: Malaysia's dominant score of 103 starkly contrasts with Indonesia's 58, creating a 45-point gap despite Indonesia's demographic advantages. This research *purpose* is to dissect the factors behind Malaysia's superior national competitive advantage by applying Porter's Diamond Model. The study uses a quantitative descriptive *method* via a single case study of Malaysia. It analyzes secondary time-series (2014-2023) and cross-sectional (2023) data from Statista, mapping them to Porter's pillars. Data analysis techniques include Trend Analysis, CAGR, and Composition Analysis. The *results* demonstrate that Malaysia's excellence is systemic. (X1) "Factor Conditions" are proven by massive asset growth (CAGR 10.63%) reaching 1018.00 Billion USD. (X2) "Demand Conditions" are confirmed by mature domestic savings growth (CAGR 9.71%). (X3) "Related and Supporting Industries" are uniquely structured, with a dominant (63.02%) household financing sector providing stability that supports the entire ecosystem. This 'Diamond' is strongly shaped by state rivalry and strategic government regulation.

ABSTRAK :

Laporan Indikator Pengembangan Keuangan Islam (IFDI) 2023 mengungkapkan kekhawatiran akademis yang signifikan: skor dominan Malaysia sebesar 103 sangat kontras dengan skor 58 di Indonesia, menciptakan kesenjangan 45 poin meskipun Indonesia memiliki keunggulan demografis. Tujuan penelitian ini adalah untuk menganalisis faktor-faktor di balik keunggulan kompetitif nasional Malaysia yang superior dengan menerapkan Model Berlian Porter. Penelitian ini menggunakan metode deskriptif kuantitatif melalui studi kasus tunggal di Malaysia. Penelitian ini menganalisis data sekunder deret waktu (2014-2023) dan data lintas sektor (2023) dari Statista, dan memetakannya ke pilar-pilar Porter. Teknik analisis data meliputi Analisis Tren, CAGR, dan Analisis Komposisi. Hasilnya menunjukkan bahwa keunggulan Malaysia bersifat sistemik. (X1) "Kondisi Faktor" dibuktikan dengan pertumbuhan aset yang masif (CAGR 10,63%) mencapai 1.018,00 Miliar USD. (X2) "Kondisi Permintaan" dikonfirmasi oleh pertumbuhan tabungan domestik yang matang (CAGR 9,71%). (X3) "Industri Terkait dan Pendukung" memiliki struktur yang unik, dengan sektor pembiayaan rumah tangga yang dominan (63,02%) memberikan stabilitas yang mendukung seluruh ekosistem. 'Berlian' ini dibentuk secara kuat oleh persaingan antar negara dan regulasi pemerintah yang strategis.

Key words: *Islamic Finance, Malaysia, Porter's Diamond Model, Competitive Advantage, IFDI*

INTRODUCTION

The global Islamic finance industry has demonstrated significant growth and strong resilience, making it a crucial pillar of the international economic ecosystem [1]. However, this development has not been uniform across all regions, creating a complex and diverse market maturity landscape. In particular, Southeast Asia has become the epicenter of growth, but with varying degrees of success across countries [2,3]. The 2023 Islamic Finance Development Indicator (IFDI) report, which provides a comprehensive benchmark for market progress, highlights this disparity and presents significant academic concerns[4]. The report ranks Malaysia as the undisputed global leader with an IFDI score of 103, far surpassing other countries. In contrast, Indonesia, despite having the world's largest Muslim population, ranks third with a score of 58.

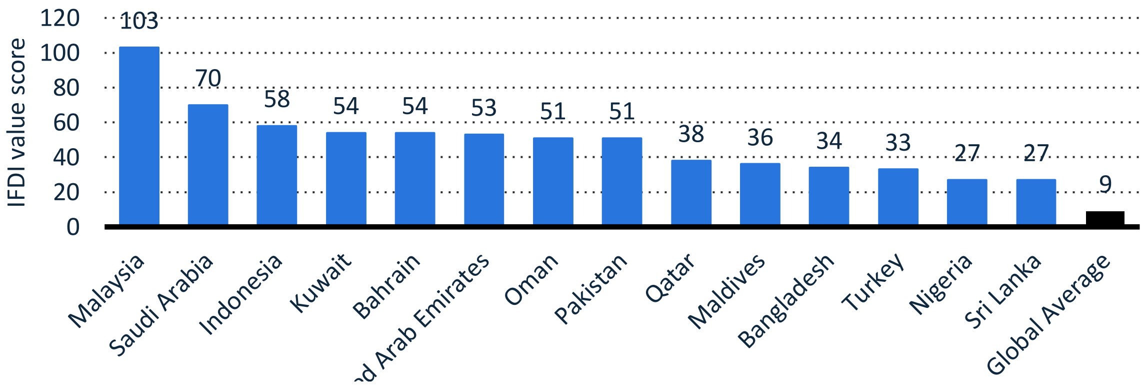

Figure 1 Data IFDI 2023 . Sourcer: Statista.com

The striking 45-point score gap between these two leading ASEAN countries presents a critical research issue. This difference raises fundamental questions about the comprehensive factors contributing to Malaysia's absolute competitive advantage. This significant gap forms the primary problem and academic impetus for the research presented in this article.

In response to the dominance of the Malaysian Islamic financial market, several previous studies have attempted to identify the determinants of success in this industry[4]. Most of the existing literature tends to focus on comparative analysis of financial performance at the institutional (micro) level, such as banking efficiency, profitability, and stability [2,56]. These studies have successfully identified key variables such as capitalization, liquidity, and operational efficiency as important determinants of bank performance. Furthermore, other research has explored macroeconomic factors, confirming that GDP growth and regulatory stability positively contribute to the growth of Islamic financial assets [7].

While previous studies have provided important insights, existing analyses tend to be partial or fragmented. Existing research often focuses on a single aspect (e.g., micro-efficiency) or a specific macro-factor, without providing a holistic framework to comprehensively explain national competitive advantage[8,9]. To explain the phenomenon of systemic market dominance as demonstrated by Malaysia, a more integrated analytical model is needed. The Diamond Model, introduced by Porter (1990)[10], offers such a framework. This theory enables a systemic analysis of national competitive advantage by examining the dynamic interactions between four key determinants: (1) Factor Conditions; (2) Demand Conditions; (3) Related and Supporting Industries; and (4) Firm Strategy, Structure, and Rivalry [11]. To date, the application of Porter's

Diamond Model to specifically dissect the factors behind the high 2023 IFDI score has been very limited, creating a clear analytical gap.

Based on the researcher's observation of the prevailing literature, a distinct analytical dichotomy persists. While previous studies have provided critical insights, they predominantly operate in isolation[12,13]. **Observations indicate** that existing research tends to focus either heavily on micro-institutional efficiency or solely on macroeconomic variables like GDP and inflation[14–16]. The researcher observes a lack of connectivity between these two poles; there is a scarcity of studies that integrate these micro and macro elements into a unified framework to explain national competitiveness. Consequently, the comprehensive 'ecosystem' factors that drive a country's absolute dominance—as seen in Malaysia—remain largely unexplained by the current fragmented literature

To strengthen this analysis, it is important to refer to recent Indonesian scholarship that links Islamic economic behavior with organizational and consumer dynamics. Cahyono [17]shows that leadership and organizational climate rooted in Islamic values have a direct impact on employee satisfaction and performance, which implies that institutional quality is a key enabler for the success of Islamic-based programs. At the same time, [18] demonstrate that financial literacy, perceived convenience, and risk perception—when moderated by an Islamic lifestyle—significantly influence Muslim consumers' adoption of financial products, indicating that demand in Muslim societies is increasingly sophisticated and value-driven. These two findings support the argument of this paper that Malaysia's strong IFDI position is not only the result of macro-structural readiness, but also of socio-behavioral factors in Muslim communities that positively respond to well-designed Islamic financial offerings[19–21].

The urgency of this research lies in its potential to deconstruct the 'black box' of Malaysia's systemic success. Practically, this study offers significant utility for key stakeholders. For regulators and policymakers, the findings provide a strategic blueprint on how to engineer a competitive ecosystem through 'created advantage' rather than relying on demographics. For Islamic banking practitioners, this analysis highlights the strategic necessity of capturing the household sector as a fundamental stability buffer.

Therefore, to fill this analytical gap, this study offers novelty by specifically applying Porter's Diamond Model framework to analyze the 2023 IFDI data. While other studies have identified Malaysia's success factors through a case study approach [22–24], this study focuses on mapping the most recent quantitative data (2014-2023) into Porter's three key pillars to provide a more systemic explanation. This approach aligns with the need for a more holistic strategic framework in understanding the Islamic financial ecosystem [25]. Therefore, the purpose of this study is to analyze the national competitive advantage factors that explain Malaysia's superior 2023 IFDI score, through a quantitative-descriptive investigation of (X1) Factor Conditions, (X2) Demand Conditions, and (X3) Related and Supporting Industries.

Methods

This research employs a case study methodology focused solely on Malaysia. In accordance with the INCOILS template's requirement to include a "scientific rationale," the case study design was chosen due to its high relevance in analyzing the Malaysian Islamic financial market leadership phenomenon in depth and context [22]. The research approach used was descriptive quantitative. This approach was chosen for its ability to build a rich theoretical understanding of real-world phenomena by analyzing quantitative data descriptively [26]. The purpose of this design is not to seek general causality, but rather to provide an operational and systematic explanation of the factors explaining one specific case, namely Malaysia's 2023 IFDI score.

The data used in this study is secondary data. All research data is sourced from the premium business statistics database, Statista, to ensure data validity and reliability. The data collection technique used is a documentation study. The use of secondary data sourced from verified databases is standard practice in quantitative financial research to ensure the objectivity and accuracy of findings [27]. Operational data for the research variables were mapped according to Porter's Diamond Model framework, consisting of: (Y) IFDI Score 2023 (statistic_id1090847) as the dependent variable; (X1) Total assets of Islamic banks in Malaysia 2014-2023 (statistic_id1420924) as a proxy for Factor Conditions; (X2) Total savings deposits in Islamic banks in Malaysia 2014-2023 (statistic_id1422560) as a proxy for Demand Conditions; and (X3) Financing by Islamic banks in Malaysia 2023, by sector (statistic_id1422186) as a proxy for Related and Supporting Industries.

Data analysis techniques were adjusted according to the type of data obtained for each variable (time-series vs. cross-sectional). For the 10-year time-series data on variables X1 (Total Assets) and X2 (Total Savings), the analysis technique used was Trend Analysis. The use of trend analysis is standard practice in quantitative descriptive research to evaluate long-term performance and momentum [28]. This data was visualized using line charts, and then the Compound Annual Growth Rate (CAGR) was calculated to summarize the average annual growth. Meanwhile, for the cross-sectional data on variable X3 (Financing by sector), the analysis technique used was Composition Analysis. This proportional descriptive analysis is used to identify the relative share of each sector, which is presented visually through bar charts or pie charts [29].

Result

This section presents research findings obtained from secondary data processing. The findings are presented systematically based on three independent variables representing the pillars of Porter's Diamond Model.

Subsection 1: Factor Condition (X1) – Absolute Scale of Industry

Analysis of variable X1, proxied by total Islamic banking assets, indicates the development of a massive and consistent industrial foundation. Data for the last 10 years (2014-2023) are presented in Table 1.

Tabel 1. Total Aset Bank Syariah Malaysia (2014-2023)

Tahun	Total Aset (Milyar USD)
2014	410.24
2015	461.77
2016	511.68
2017	582.20
2018	693.39
2019	754.72
2020	812.38
2021	893.31
2022	967.75
2023	1018

This asset growth trend is visualized in Chart 1. The analysis shows that total assets grew steadily from 410.24 Billion USD in 2014 to 1018.00 Billion USD in 2023. This solid growth reflects an impressive compound annual growth rate (CAGR) of 10.63% over nine years. This proves that Malaysia's "Factor Condition" (X1) is not only statically large, but also growing exponentially.

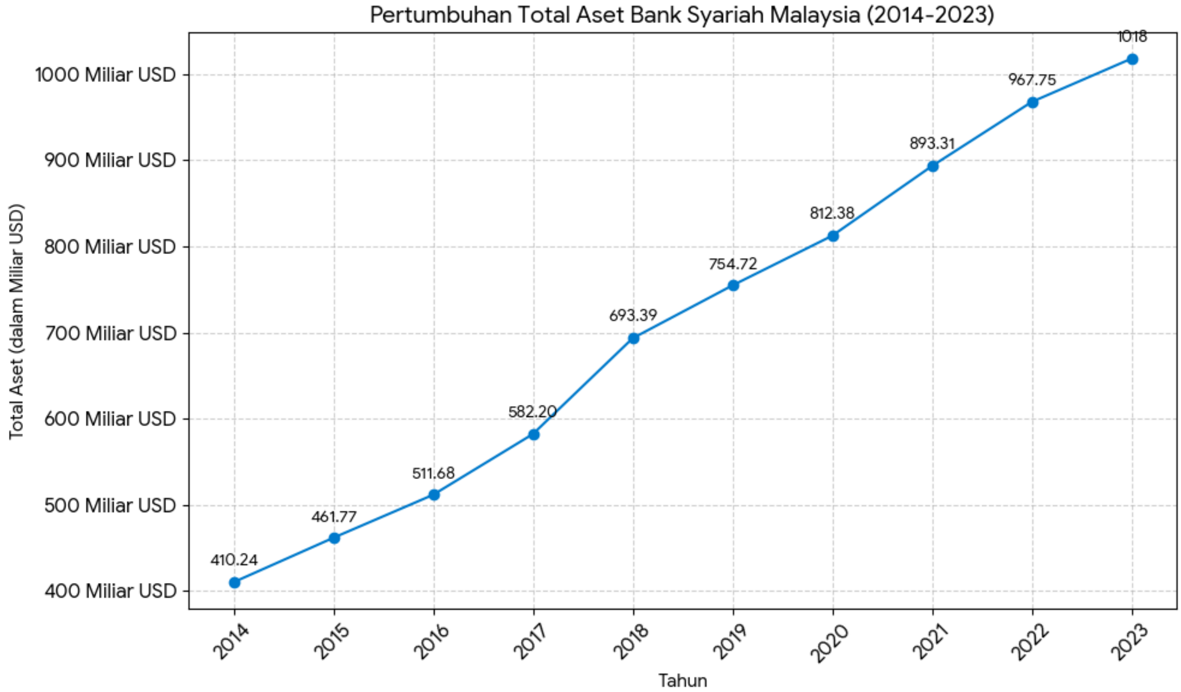

Figure 2 Tren Pertumbuhan Total Aset Bank Syariah Malaysia (2014-2023)

The visualization in Figure 2 reveals more than just linear growth; it demonstrates significant industrial **resilience**. It is noteworthy that even during the global economic contraction caused by the COVID-19 pandemic (2020-2021), the asset curve maintained a positive upward trajectory. From a Porter's Diamond perspective, this massive accumulation of capital—growing at a double-digit CAGR of 10.63% —signifies that Malaysia has successfully transitioned from basic factor conditions to **advanced factor conditions**. This immense asset base acts as a critical 'shock absorber' for the ecosystem and creates a high barrier to entry for regional competitors, solidifying Malaysia's position as a mature Islamic finance hub

Subsection 2: Demand Conditions (X2) – Domestic Market Penetration

Analysis of variable X2, proxied by total savings deposits in Islamic banks, measures the strength of domestic "demand conditions." The data in Table 2 shows a consistent increase in public confidence and demand.

Tabel 2. Total Simpanan di Bank Syariah Malaysia (2014-2023)

Tahun	Total Simpanan (Milyar USD)
2014	32.02
2015	33.99
2016	36.08
2017	38.15
2018	41.15
2019	42.23
2020	59.53
2021	72.73
2022	71.02

2023	73.71

As seen in Chart 2, total deposits grew from USD 32.02 billion (2014) to USD 73.71 billion (2023), with a CAGR of 9.71%. An interesting finding is the sharp growth spurt between 2019 and 2021, indicating a drastic increase in public savings. This demonstrates the "Demand Conditions" (X2) that are not only strong but also mature.

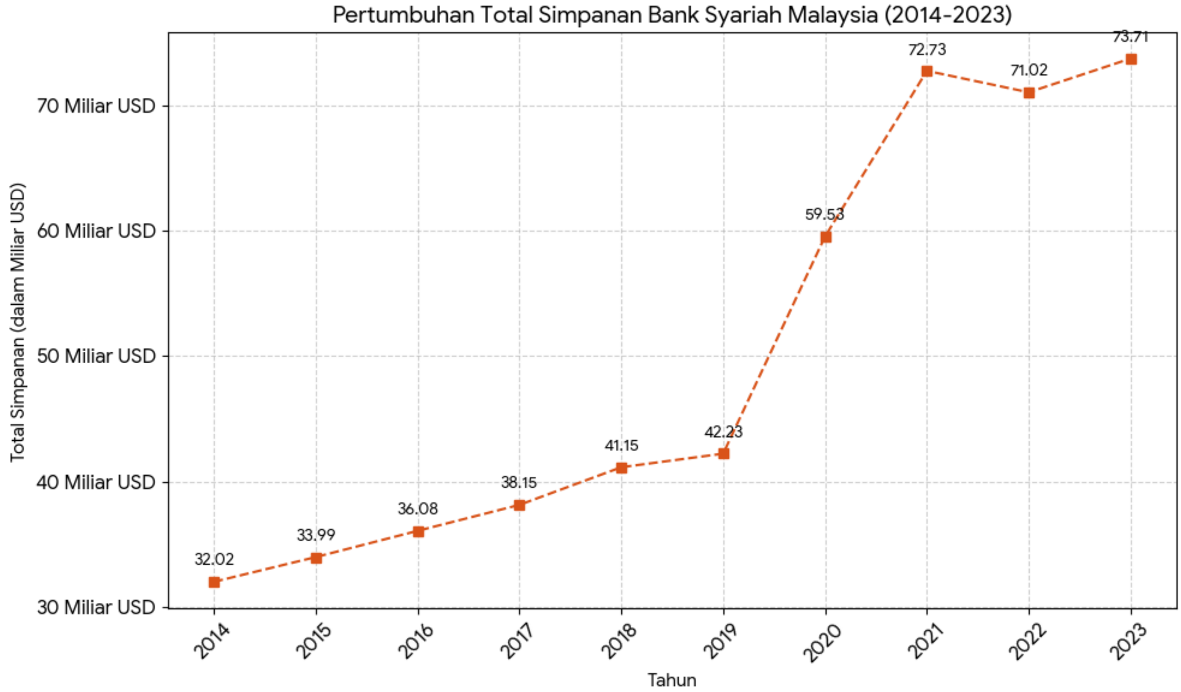

Figure 3Tren Pertumbuhan Total Simpanan Bank Syariah Malaysia (2014-2023)

Figure 3 illustrates a profound shift in market behavior, particularly the sharp vertical surge in deposits observed between 2019 and 2021. This steep slope indicates a 'flight to safety' phenomenon where domestic consumers actively prioritized Islamic banks during periods of uncertainty. In the context of Porter's **Demand Conditions**, this data confirms the existence of a sophisticated and demanding local market. The 9.71% annual growth rate suggests that the demand for Sharia-compliant instruments is no longer latent but has become a dominant preference. This strong domestic pressure compels Malaysian Islamic banks to continuously innovate and improve service standards to retain this highly aware customer base

Subsection 3: Related and Supporting Industries (X3) – Financing Composition

Variable X3 analysis measures the role of Islamic banks as a "Supporting Industry" by analyzing their financing allocation per sector in 2023. Of the total financing of 888.92 Billion MYR, the sectoral distribution is presented in Table 3.

Tabel 3. Komposisi Pembiayaan Bank Syariah Malaysia per Sektor (2023)

Sektor	**Jumlah Pembiayaan (Milyar MYR)**	**Presentase**
Household sector	560.17	63.02%
Finance, insurance, real estate...	100.63	11.32%
Wholesale and retail trade..	50.40	5.67%
Construction	43.95	4.94%
Manufacturing	37.45	4.21%

Education, health, and others	20.71	2.33%
Agriculture, forestry, and fishing	19.32	2.17%
Transportation and storage	13.91	1.56%
Information and communication	11.65	1.31%
Electricity, gas, steam...	11.05	1.24%
Other sector	10.78	1.21%
Accomodation and food service...	3.86	0.43%
Mining and quarrying	3.15	0.35%
Water supply, sewage...	1.89	0.21%

A key finding from the composition analysis (Chart 3) is the absolute dominance of the "Household sector," which accounts for 63.02% of the total financing portfolio. The next largest supporting business sectors are "Finance, insurance, real estate, and business activities" (11.32%) and "Wholesale and retail trade" (5.67%).

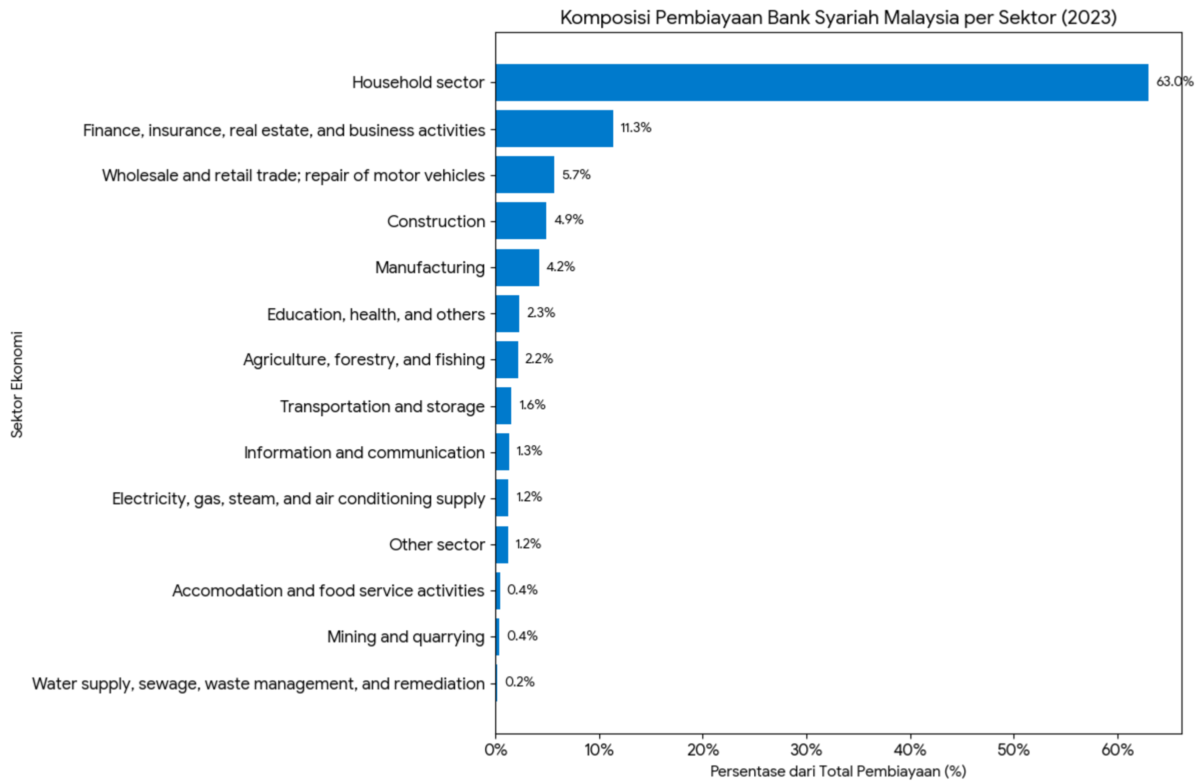

Figure 4. Komposisi Pembiayaan Bank Syariah Malaysia per Sektor (2023)

The absolute dominance of the Household sector (63.02%) shown in Figure 4 provides a critical strategic insight. While a heavy reliance on retail financing is often viewed as conservative, in this ecosystem, it functions as a **fundamental stability anchor**. By securing a steady stream of low-risk income from the household sector, Malaysian Islamic banks generate the necessary liquidity and profitability buffers to support other 'Related and Supporting Industries.' Effectively, the stability derived from the retail sector subsidizes the banks' capacity to venture into more volatile but productive sectors such as Construction (4.94%) and Manufacturing (4.21%). Thus, this composition reflects a deliberate structural strategy to balance portfolio risk across the entire national ecosystem

Discussion

This section discusses the quantitative findings presented in the Results section and interprets them systematically using Porter's Diamond Model framework. These findings not only confirm Malaysia's competitive advantage but also provide a structured explanation of why it was achieved.

Subsection 1: X1 as Evidence of Superior "Factor Conditions"

The first finding reveals that Malaysian Islamic banking assets (X1) grew exponentially at a CAGR of 10.63%, reaching USD 1 trillion by 2023. **When juxtaposed with existing theory**, this provides empirical validation for Porter's first pillar: the creation of "Advanced Factor Conditions." Unlike basic factors such as natural resources which are inherited, this massive capital accumulation represents a created advantage. **This finding aligns with and extends the research of Hassan, Khan, and Paltrinieri (2020)**[7], who argued that asset scale is a critical macro-determinant for stability. However, while Hassan et al. focused on stability, this study **contrasts** that perspective by highlighting that such asset accumulation also serves as a strategic *barrier to entry* for regional competitors, effectively solidifying Malaysia's hegemony in the ASEAN market.

Subsection 2: X2 as a Reflection of Mature "Demand Conditions"

The second finding shows total deposits (X2) growing at a CAGR of 9.71%, reflecting Porter's "Demand Conditions." **This result corroborates the earlier work of Thaker and Thaker (2021)**, who identified public awareness as a key driver of Malaysian Islamic finance. However, **this study goes further by synthesizing these findings with recent behavioral literature.** Drawing on **Qhairunisa and Cahyono (2024)**[18], who demonstrated that financial adoption is significantly moderated by an "Islamic lifestyle" and risk perception, we argue that the surge in Malaysian deposits is not merely transactional. It represents a sophistication of demand where consumers actively choose Sharia-compliant products as a value-based lifestyle choice, creating a "demand-pull" effect that forces banks to innovate—a dynamic predicted by Porter's theory but rarely quantified in previous descriptive studies.

Subsection 3: X3 and Interpretation of the "Related and Supporting Industries" Pillar

The third finding, showing a 63.02% dominance of the "Household sector" in financing, presents an interesting anomaly **when compared to standard industrial theories**. Typically, strong "Supporting Industries" are associated with manufacturing or B2B supply chains. **However, this study interprets this structure through the lens of Wasiuzzaman and Nurdin (2019)**[29], who highlighted the importance of sectoral risk profiles. By securing a stable, low-risk revenue stream from the retail sector, Islamic banks effectively build a financial buffer. **This finding offers a new perspective**: in the context of the Malaysian ecosystem, the household sector acts as a supporting "liquidity engine." This contrasts with the assumption that Islamic finance must be heavily corporate-driven; instead, the retail stability acts as a prerequisite that enables banks to fund more volatile productive sectors (Construction and Manufacturing) without compromising systemic health.

Subsection 4: Model Synthesis – The Role of "Rivalry" and "Government"

Finally, findings X1, X2, and X3 must be synthesized through the lens of Porter's external factors: Rivalry and Government. **This study supports the strategic framework proposed by Khattak and Al-Hunnayan (2023)**, who emphasize that a sustainable ecosystem requires a regulator that actively integrates legal infrastructure with market incentives. Malaysia's leadership is a classic example of "Created Advantage" engineered by the government (BNM). Furthermore, **referencing the organizational insights of Cahyono (2024)**[17] regarding the impact of leadership values on performance, we can infer that the "Government" factor in Malaysia has succeeded in instilling a high-quality institutional climate. This creates a unique ecosystem where intense domestic rivalry drives efficiency, yet is balanced by a strong regulatory safety net—a combination that explains the 45-point IFDI gap with Indonesia.

Conclusion

This study concludes that Malaysia's absolute competitive advantage, reflected in its superior IFDI 2023 (Y) score, can be comprehensively explained through Porter's Diamond Model framework. Quantitative-descriptive findings prove that this success is not the result of a single factor, but rather a dynamic interaction of key pillars. This advantage is built on the foundation of (X1) superior "Factor Conditions", evidenced by the massive scale of industrial assets (1018.00 Billion USD) and a growth of 10.63% CAGR over a decade. This is supported by (X2) mature and sophisticated domestic "Demand Conditions", as evidenced by the consistent growth of public deposits (9.71% CAGR). In addition, (X3) unique "Related and Supporting Industries", where the dominance of the retail sector (63.02%) creates stable profitability, enabling Islamic banking to support other productive sectors. Reflections from this research suggest that this entire "Diamond" was not formed naturally, but rather the result of intense domestic rivalry and the active role of regulators as strategic facilitators, which collectively created a mature and difficult-to-replicate Islamic financial ecosystem.

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