

# **A Literature Analysis in Proposing Maqasid Framework in the Product Development Stages of Islamic Banks<sup>1</sup>**

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## **Abstract**

Literature on new service development (NSD) reveals varying prevalence of inconsistent practices. In the Islamic banking product development process, the NSD has not been given much attention. The uniqueness of Islamic banking activities in its products is that it requires special requirement when dealing with financial innovation activity. In general, Shari'ah is the framework, which affects the overall process in product innovation. The neutral status of product innovation stages has promoted a number of eminent scholars to view the process in light of the Shari'ah perspective. The frameworks developed by previous financial innovationist in mainstream industry however did not give due attention to it since more focus is given to the Shari'ah framework itself. Hence, the purpose of this literature study is to summarise and evaluate the stages revealed in the literatures and to propose a framework based on *Maqasid al-Shari'ah* so that it can be utilised in the NSD processes of Islamic banks.

Key words: New Service Development (NSD); New Product Development (NPD); Financial Innovation; Maqasid al-Shari'ah Framework, Islamic banks

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<sup>1</sup> The paper is selected as one of the 24 finalists and presented in the Forum Riset Ekonomi dan Keuangan Syariah, organized by The Indonesian Association of Islamic Economist and Universitas Islam Negeri Syarif Hidayatullah Jakarta on 13<sup>th</sup>-14<sup>th</sup> December 2014.

## Introduction

The importance of a product development is in its contribution towards the overall success and development of a product-oriented company. New Product development (NPD) is defined as a process that “involves transformation of a market opportunity into a product available for sale” (Krishnan and Ulrich 2001). There have been a number of literature studies on product development like in Raphaël (2005), Krishnan and Ulrich (2001), Balachandra and Friar (1997), Griffin and Hauser (1996), Brown and Eisenhardt (1995), Cusumano and Nobeoka (1992). Some conceptual and empirical studies found that developing a successful new product is utmost important and critical (Raphaël 2005);(Baker, Hart, and Hart 2007);(Brown and Eisenhardt 1995);(George and Paulina 2000);(Hassan 2008); (Tzokas, Hultink, and Hart 2004). Compared to a tangible product innovation, service innovation or intangible product innovation is less sophisticated albeit complicated (Raphaël 2005). New service development (NSD) deals with subjective and intangible ideas that need imagination and keen perception. Such characteristics of service product like intangibility, inseparability (simultaneity), heterogeneity and perishability (Johne and Storey 1998); (Lievens and Moenaert 2000, 2001) should be considered important when innovation of service product takes place. Although it does not involve large machineries and high cost, its intangible characteristics make the innovation process more complex and obscure (Johne and Storey 1998). The importance and intensity of the NPD and NSD processes were reported by Cooper and Scott J (1996) where almost 50 percent of new financial service product fails during the launching stage. This explains why more effort is necessary when dealing with this crucial stage of development.

In the banking sector, developing a new product is somewhat different from manufacturing industry that demands high cost and innovations of tangible products. Financial Innovation aims at producing products that are characterised as intangible, service-based blueprint which involves several processes (Shostack 1982). Ahmed (2011b, 12) adds that in-depth and proper planning are thus essential for the process of developing the product’s blueprint and its delivery infrastructure. Hence, it is suggested that providing a cost-effective new product throughout the overall processes will enhance the financial performance of the bank (Saubert 2005). It is vital then to understand the product development process and its recommended

practices to achieve the said objective. In the area of financial business-related literatures, studies on financial innovation are still at its infant stage (Lievens and Moenaert 2001, 2000). The authors indicate that the literature development on financial innovation which began in the 1980's has made and contributed substantial division towards the study. Consequently, they have identified three streams known as 1) "definition of success of new financial service", 2) "activities undertaken during new financial service development" and 3) "antecedent role of organisational variables on new financial service success".

This present study limits its scope to only the literatures related to the stages of financial service development which is also referred as a model or process of developing new financial product. This also means that the study does not cover other issues of NSD or NPD unless these are indirectly related to the research. The study is structured based on the way the literatures were observed where it is based on the following objectives of the study; firstly on the different models used in the stages or processes of financial innovation; secondly on the financial innovation process for Islamic banking and financial industry; thirdly is the comparison between financial innovation and Shari'ah Compliance Process of Islamic banks; and finally, on the literatures that promote directly or indirectly the inclusion of *Maqasid al-Shari'ah* when developing new banking and financial products. In the conclusion, a proposed model of a new financial innovation for Islamic banking is offered.

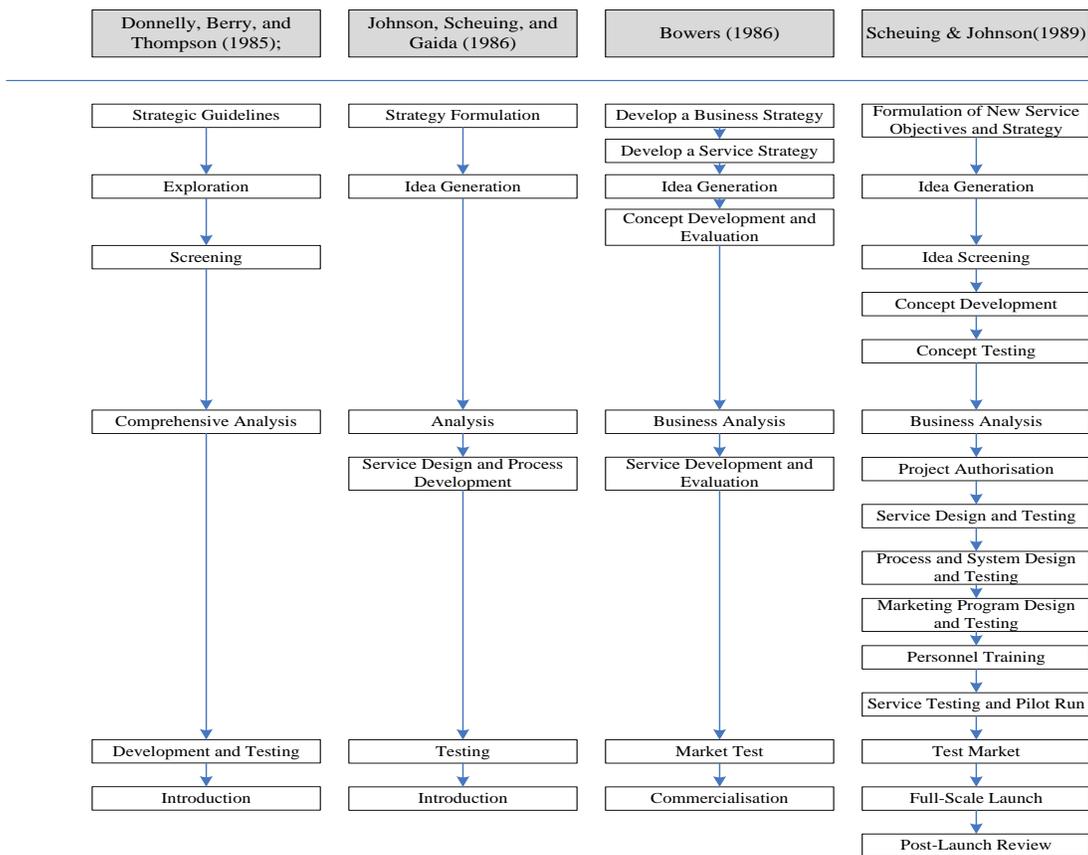
### **Stages or Processes of NSD: Some Different Models**

In the financial sector, the branch below service innovation is financial innovation. In early development of financial innovation process, most of the models cling over tangible product development model like in Cooper's model. However, due to the specific needs of service industry particularly in the financial services, some modifications have been made to the earlier models.

The early models that evolved in the service sector have been dominantly proposed by Bowers (1986); Donnelly, Berry, and Thompson (1985); Johnson, Scheuing, and Gaida (1986) as cited in Raphaël (2005). These three models however according to Raphaël (2005) are the composition of Cooper's Model. Scheuing and Johnson (1989) in a more in-depth and different

approach proposed a model specific for service industry by observing two aspects of inquiry lacking in the industry known as structures and processes of the services. The model is known as the normative model of new service development which is the result of an in-depth survey covering 400 members from the Financial Institutions Marketing. The quality of the model compared to the other models is firstly its consideration of the complexity of service design, secondly is the inclusion of many iterative steps required in service development, and thirdly its concern over the key influences; i.e. within the firm and the environment, during the service development process (Scheuing and Johnson 1989). The comparison of these four earlier models is shown in Figure 1.

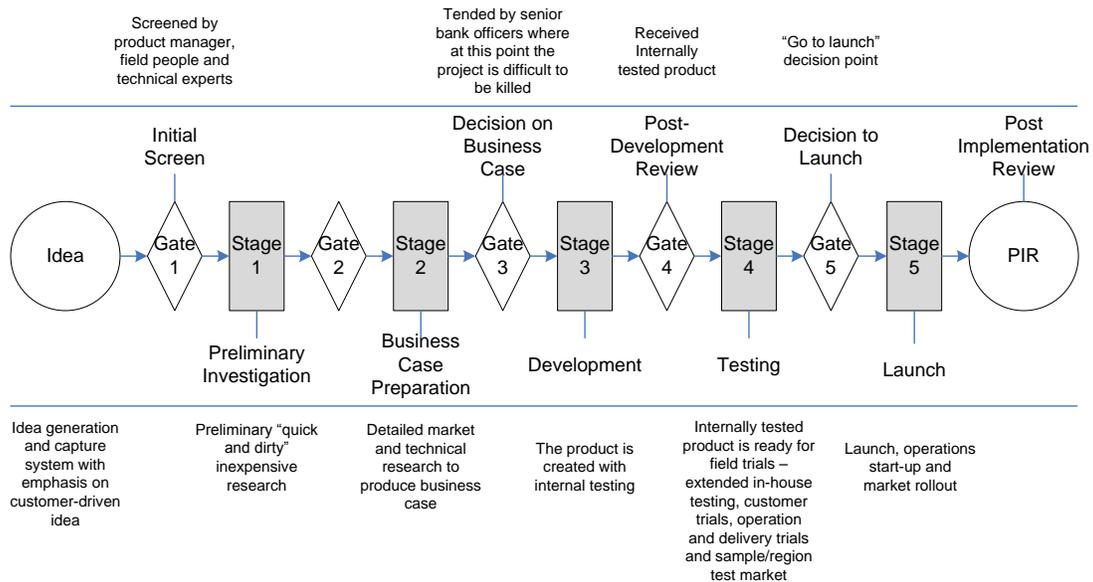
Figure 1: Early New Service Development Model



Source: Adapted from Scheuing and Johnson (1989) and Raphaël (2005)

In a later development, Cooper and Scott J (1996) proposed the stage-gate process in their investigations of over 600 financial new products' launches which were made to achieve three objectives; to study the success and failure factors, to identify the distinguishing factors of top performers, and to focus on best practices in financial institutions. As shown in Figure 2, the business banking division in the Royal Bank of Canada has benefited from the model and the bank's new product process.

Figure 2: The Stage-gate Process of Royal Bank of Canada



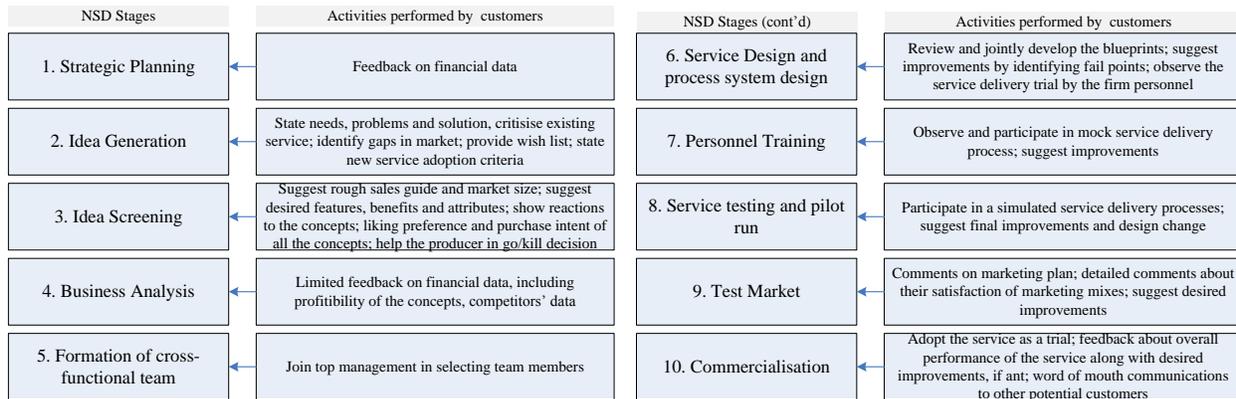
Source: Adapted from Cooper and Scott J (1996)

The problem with the above model is that it does not pay exclusive attention to financial service product development. Even though the object of the study is financial services sectors, the coalition of service innovation and tangible product development models are still obvious especially when the processes are shown in the proposed stages. Moreover, the models' innovators are influenced from their prior knowledge and understanding of NPD for tangible products.

In more recent studies, Ian and Chad (2002); Ozdemir, Trott, and Hoecht (2007) are found to give extra focus on NSD models in financial services which view the process in

different perspectives. Ian and Chad (2002) put emphasis on customer-oriented service development model in financial services as shown in Figure 3.

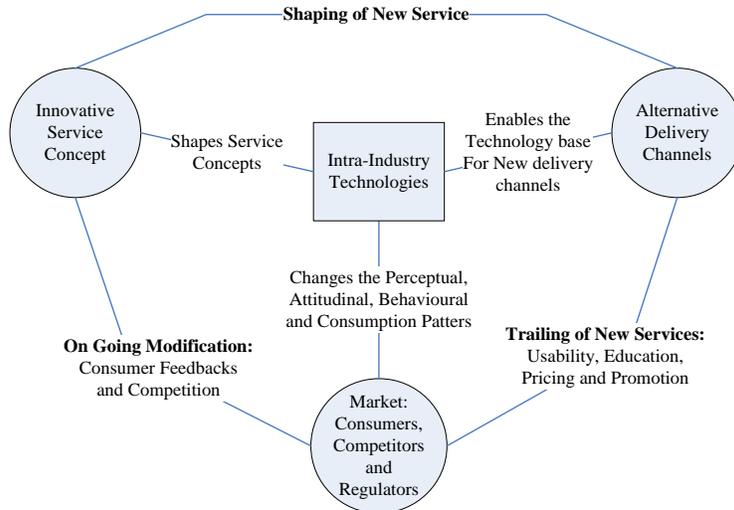
Figure 3: Customers' Input NSD Model



Source: Ian and Chad (2002)

Ozdemir, Trott, and Hoecht (2007) on the other hand proposed a conceptual framework of financial service development in retail banking sector by giving emphasis on two important concepts namely consumer and technology. Both studies made significant contributions towards the importance of customers' input directly and is indirectly involved in NSD or NFD processes. However, the former study still maintains the sequential and linear type model in showing the different stages involved in NSD. On an opposite approach, Ozdemir, Trott, and Hoecht (2007), has breached the tradition of PD linear model invented by Booz, Allen and Hamilton. The model which is more cross-functional and inter-dependent believes that the central of innovation in retail banking is the technology as shown in Figure 4.

Figure 4: Conceptual Framework for New Service Development in Retail Banking



Source: Ozdemir, Trott, and Hoecht (2007)

It is however acknowledged that the contributions of previous literatures on NPD, NSD and financial innovation have proliferated ideas and guidelines in designing NPD models for other specific areas. Whilst some processes are compatible with most kinds of product or service development process, others are only specific for certain industry only. In the financial sector, particularly the Islamic banking industry, special approach should be given to it since it deals with important issues of legality or illegality of a product known as Shari’ah Compliance of a product. This will be further explained in the following sub-chapters.

## **Financial Innovation of Islamic Banking and Financial Industry**

Islamic banking product development<sup>2</sup> activities fall under service and financial development. The uniqueness of Islamic banking is manifested in its products. Moreover, this unique quality requires special approach when dealing with financial innovation activity. Shari'ah requirements are the framework that all financial innovations in Islamic banking and financial sectors should observe which can thus affect its overall process in product innovation. The neutral status of product innovation stages have encouraged a number of scholars to view the process from the Shari'ah perspective as apparent in researches by Mohd Daud (2008); Lahsasna (2010); Zaharuddin (2010); Ahmed (2011b) ; Lahsasna and Hassan (2011); Al-Suwailem and Hassan (2011); Al-Suwailem (2007). However, attention towards these processes was not developed in the models by previous financial innovationists in the mainstream industry. Instead, the focus was given only to the Shari'ah framework.

In drawing a comparison between financial innovation and other similar terms, Mohd Daud (2008) provides a general guideline for product development based on Shari'ah views. His major discussions on the methodology of ijihad and the wisdom behind differences of opinions have shed light on the process of developing Shari'ah compliance products. The author also interchangeably uses the word "product enhancement" with "product innovation" to show the dynamic ijihad process in Muamalat activities. The author also clarifies these two terms that is mostly related to PD process:

Product development is essentially an exercise to create a new product or instrument to meet a specific requirement, be it the customer's, regulator's, industry's or all of the factors. Product enhancement is to add more value to an existing product so that it becomes more viable and appealing

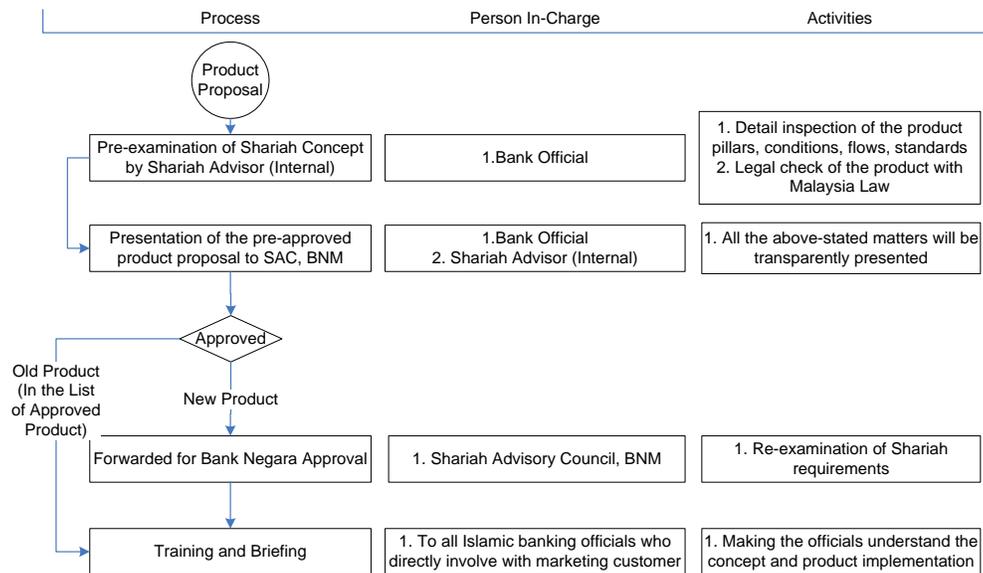
Mohd Daud (2008, p. 124)

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<sup>2</sup> This study uses the term "new product development", "new service development" and "new financial service development" interchangeably. In this sub-chapter, any of the terms used refers to the process of new financial service development.

In a study by Zaharuddin (2010), he focuses on halal authorisation process of Islamic banking. Through his research on Shari’ah compliant product development processes, he illustrates the process in a form of a chart (see Figure 5). The process begins with the “product proposal” stage that is similar to the “idea generation” stage by Cooper. It is apparent that after the first stage, the rest of the processes are only related to Shari’ah practices and have not revealed the overall model of PD in Islamic banking. The stages reveal the importance of Shari’ah compliant activities in ensuring the product’s approval both from at the banks’ level and at the higher level of Bank Negara Malaysia (BNM). The process ends with “training and briefing” which is an important stage despite having no mention in almost all conventional PD models. This stage is only found in Odzemir et al. model in which they use the term “education” under the process of “trailing of new services”.

Figure 5: Shari’ah Compliant Product Development Processes

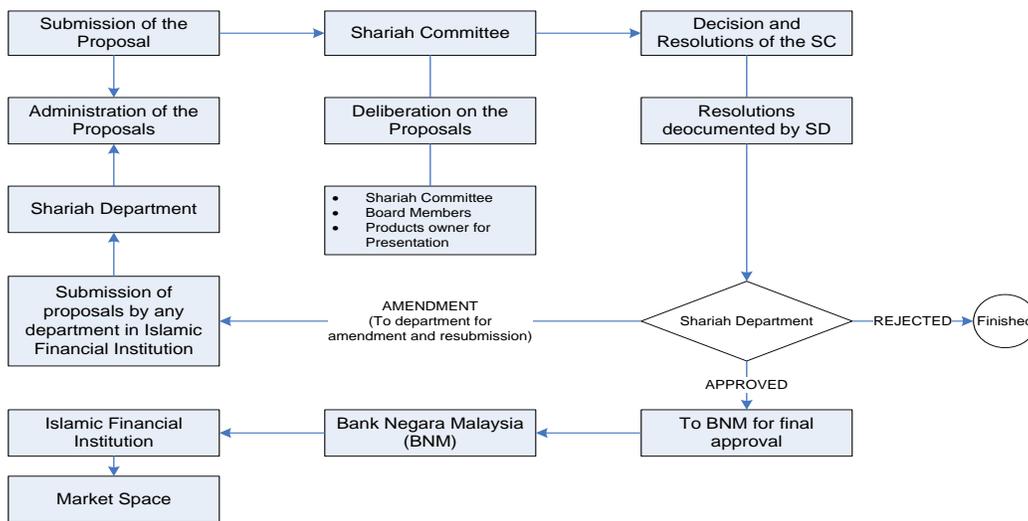


Source: Zaharuddin (2010)

Lahsasna (2010) and Lahsasna and Hassan (2011) have likewise discussed thoroughly the Shari’ah compliance requirements of Islamic banking product with its practical model of product development flow. The process is mainly based on the operation of Islamic banks in Malaysia as well as the regulatory framework developed by BNM. The authors listed eight stages related to

PD as shown in the following Figure 6. Similar to Zaharuddin (2010), the process shown is more like a process map which shows the connection between the processes rather than a process model. It also has benefited the Shari’ah compliance requirement that is the basis of Islamic financial innovation. The process framework in Figure 6 that shows the interconnected process has been further elaborated in a more extensive process that represents the actual model. The authors have deliberated nine stages of PD processes in the form of managerial level of the PD activity. The stages also provide an indicative department or section of the bank dealing with activities in PD processes.

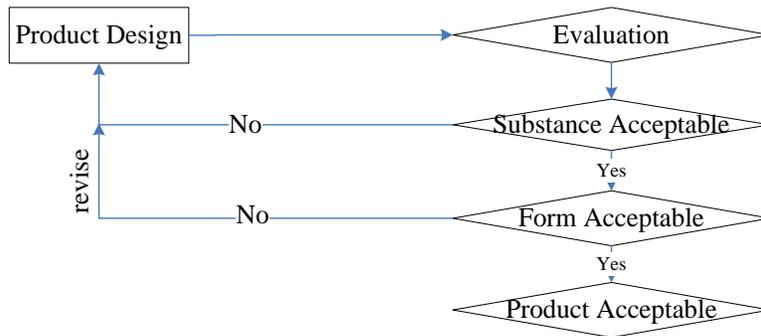
Figure 6: Shari’ah Compliance Product Process Approval and Model



Source: Lahsasna (2010) and Lahsasna and Hassan (2011)

In a more simple and direct process, Al-Suwailem and Hassan (2011); Al-Suwailem (2007) propose a model for evaluating Islamic banking product based on the issue of form and its substance. According to them, the consistency principle in financial engineering must be fully observed which will thus lead to the means conforming towards the ends. The authors added that fiqhi maxims of “actions are based on objectives” and “meanings supersede letters” should be observed in dealing with Islamic banking product innovation as illustrated in Figure 7. However, the process is too general and does not entail detailed assessment of every stage.

Figure 7: Process of Product Evaluation

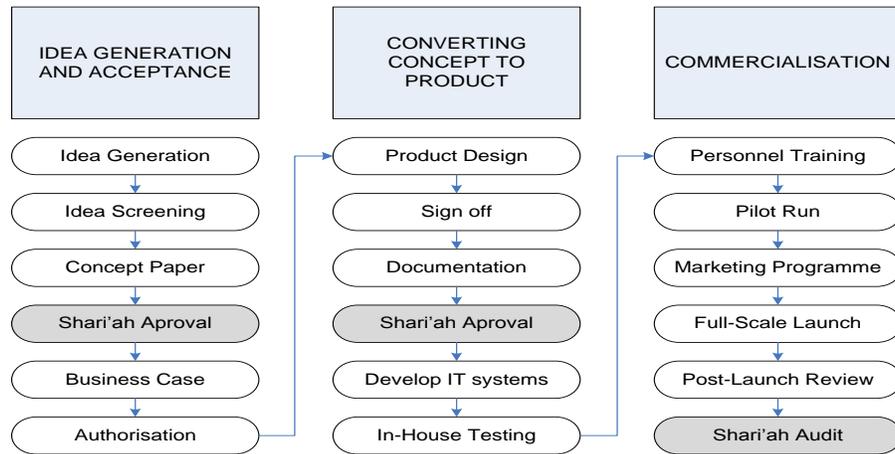


Source: Al-Suwailem (2007); Al-Suwailem and Hassan (2011)

All the models illustrated above have had significant contributions in PD activity in Islamic banking. It is however notably observed from the literatures (Lahsasna 2010); Zaharuddin (2010); Lahsasna and Hassan (2011) and Mohd Daud (2008)) that well-developed and widely accepted model of product development in the conventional financial sector has not been used in any of the models in Islamic banking and finance as per discussion. In Al-Suwailem (2007); Al-Suwailem and Hassan (2011) as well, the model proposed only cover a specific aim of the product (i.e. whether the product complies in its substance or both substance and form) rather than the overall process of PD.

From the missing referred model in Islamic banking product development, a study by Ahmed (2011b) opted to fill in the research gap by adapting the conventional PD model to Islamic financial product. Ahmed (2011b) proposes a model that identifies three broad phases in product development cycle known as idea generation and acceptance; converting concept into product and commercialization. Each phase then sub-divides into six steps in the following Figure 8.

Figure 8: The Product Development Cycle

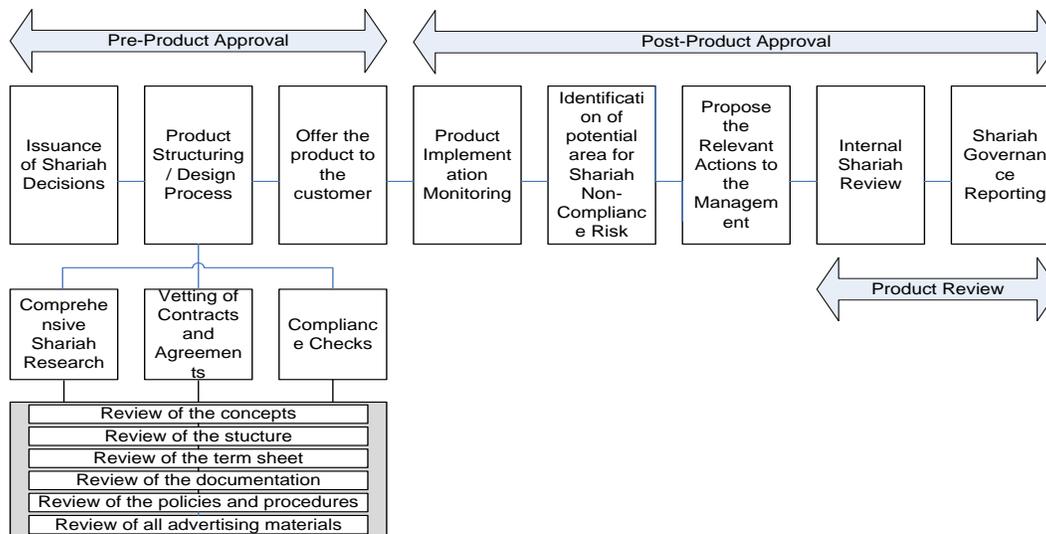


Source: Ahmed (2011b, p. 108)

It is observed in the above model that the Shari'ah approval is the gatekeeper for the process that carries throughout all the levels within the three main stages; “Idea Generation and Acceptance”, “Converting Concept to Product” and “Commercialisation”. The adaptation model of Cooper, 1994 with some modification in terms of Shari'ah requirements have provided a bright possibility for PD modeling in this field.

In Malaysia particularly, as mentioned in the above discussion by Lahsasna (2010); Lahsasna and Hassan (2011), financial product development environment is mainly based on the guidelines prepared by Bank Negara Malaysia (BNM) as the regulator. At the end of 2010, a special standard for governing Islamic Financial Institution has been issued known as the “Shari'ah Governance Framework (SGF) for Islamic Financial Institutions” (SGF, BNM). The standard has created an avenue for Islamic banking and financial institutions to promote better governance system that fully embodies the Shari'ah. The PD framework in the standard clearly indicates product development stages that consists of the following items prescribed in Figure 9.

Figure 9: The Pre-Product Approval Process of Shari'ah Governance Framework for Islamic Financial Institutions, Bank Negara Malaysia (BNM)



Source: Bank Negara Malaysia (BNM) (2011b)

This newly endorsed framework has highlighted among others the importance of strict Shari'ah observance towards product development process (Bank Negara Malaysia (BNM) 2011b). A comprehensive process in product development shows its important contribution to the overall operation and performance of the bank. The process, which falls under Shari'ah Compliance & Research Functions in the framework, underlines Shari'ah review functions as one of its important task in maintaining Shari'ah observance of the institution. It is also mentioned in the framework that the review process involves the following scope:

The scope shall cover the IFI's overall business operations, including the end to-end product development process, which start from product structuring to product offering.

(Bank Negara Malaysia (BNM) 2011b)

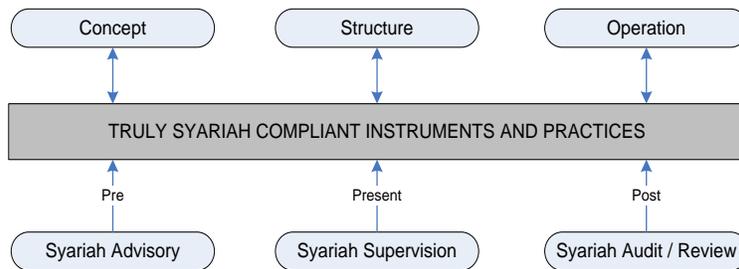
Hence, the process integrates two main processes namely as Pre-product Approval and Post Product Approval that fall under the job-scope of Shari'ah review process. These require thorough research in order to ensure all the elements of non-compliance are eliminated and strictly monitored as stated in SGF, BNM:

Product development covers both pre-product approval (i.e. process of product structuring and developing prior to introduction to the market) and post-product

approval process (i.e. process after the product has been offered to the customers and transactions have been carried out). (Bank Negara Malaysia (BNM) 2011b)

In addition, another guideline has been issued by the regulator known as “Guidelines on Introduction of New Products by (Bank Negara Malaysia (BNM) 2011a). It provides comprehensive guidelines to all new products for compliance observation. However, the framework is very technical and the process model for developing a new product has not been clearly stated in the guideline. In response to the above regulatory framework, Rusni (2012) has simplified the process into the following model as shown in Figure 10. This model can be a referred model when dealing with PD processes in Islamic banking. Moreover, as it is regulated by the central bank, the industry has to comply with this framework and work within their capacity.

Figure 10: PD Model of SGF

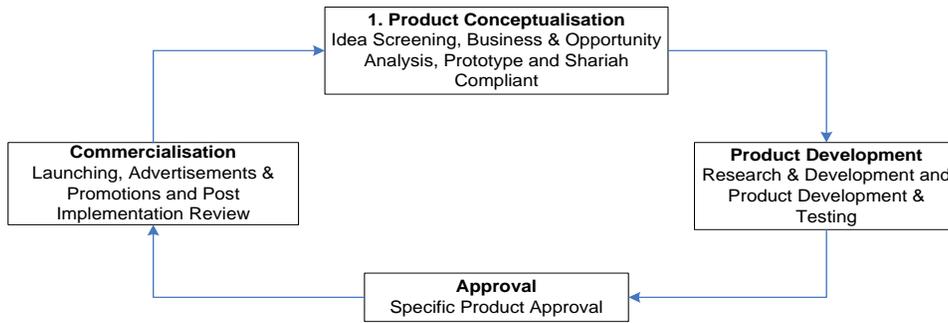


Source: Rusni (2012)

In the practice of Islamic bank for instance, Wan Ismail (2011)<sup>3</sup> lists four processes of PD with three lines of defense in terms of Shari’ah Compliance defense. The following Figure 11 shows the processes that have been in practice by the first full-fledged Islamic bank in Malaysia; Bank Islam Malaysia Berhad (BIMB). The processes involved officials including PD Committee, Shari’ah Committee and Risk Committee with contributions from the Board of Director representing the top management group.

<sup>3</sup> Wan Ismail Wan Yusoh (Dato') is the General Manager Strategic Relations of Bank Islam Malaysia Berhad (BIMB)

Figure 11: PD Process: BIMB Model



Source: Wan Ismail (2011)

It is observed that the well-known financial PD model has not been extensively used in Islamic banking and financial industry. The scarce literatures also show little attention given to this field despite its important roles in determining the success and failure of all innovative products especially with regards to new products. In the context of Malaysia, a standard guideline by its regulator has given a huge impact for the PD processes, thus promoting towards better governance in PD. However, to be in the international and global league, well accepted PD model might be one of the factors that will promote such objectives as proven in many literatures where good PD model contributes towards the success of a product ((Bas, Ron, and Edwin 2011); (Chris and Frank 2010); (Cooper and Scott J 1996); (Edgett and Jones 1991); (Froehle and Roth 2007); (Heiko et al. 2008); (Henning, Dagmar, and Miguel 2009); (Ian 2010, 2006); (Mohammadali and Audhesh 2008); (Ozdemir, Trott, and Hoecht 2007)). The following Figure 12 summarises the literatures of model or product development process of Islamic banking and financial activities.

Figure 12: The NPD Models of Islamic Banking and Financial Activities

SOURCES OF FRAMEWORK		STAGES IN THE MODEL									
		Idea/Concept Evaluation Stage			Product Evaluation Stage				Product Launch	Post Evaluation Stage	
Gene	Screening	Shari'ah Evaluation	Business Analysis	Development	Shari'ah Evaluation	Testing	System design	Shari'ah Approval	Commercialisation/Launching	Product Review/Shari'ah Audit	
1	Mohd Daud (2008)	X			X			X			

2	Lahsasna (2010)	X	X	X		X			X	X	X
3	Zaharuddin (2010)			X		X			X		
4	Ahmed (2011b)	X	X	X	X	X	X	X	X	X	X
5	Lahsasna and Hassan (2011)	X	X	X		X			X	X	X
6	Bank Negara Malaysia (BNM) (2011a, 2011b)	X	X	X	X	X			X	X	X
7	Wan Ismail (2011)	X	X	X	X	X	X		X	X	X
8	Rusni (2012)	X	X	X		X	X	X	X	X	X

### **Comparing NSD to Shari'ah Compliance Process of Islamic Banks**

Fatwa management or ijtiḥad is an important tool of legalising banking and financial products in Islam. As discussed in the previous section, the process or model of PD in Islamic banking in this chapter has shown significant contribution toward fatwa management of Islamic banking. Most of the models presented by the previous literatures especially the Shari'ah-driven literatures highlight the fatwa or ijtiḥad process more than the PD overall process as seen in Mohd Daud (2008) and Zaharuddin (2010). This sub-chapter will not focus on the ijtiḥad and fatwa practices in Muamalat and Islamic banking and financial issues. Rather, it aims at exploring emerging issues of fatwa and ijtiḥad management in dealing with PD process.

Generally, fatwa and ijtiḥad management in Islamic banking is applied when the product is to be approved, has been approved and after approval. The process varies depending on the country; however the idea is almost similar. In Malaysia for instance, Lahsasna and Hassan (2011) report two layers of approval, labeling the layers as “the first layer internal product process” and “the second layer external product process”. Rusni (2012) however depicts three layers of Shari'ah approval named as Shari'ah advisory, Shari'ah supervisory and Shari'ah review/audit. Both are similar in context but with different interpretation. In addition ; Lahsasna and Hassan (2011) adds comprehensive fatwa management of Islamic banking that lead towards product development. It is observed that besides adhering to primary and secondary sources of Islamic Laws, the fatwa process also takes into account mainstream and minority opinions, common regulatory standards, moderation with justice and fairness, Maqasid al-Shariah and others Lahsasna (2010)

Apart from the different managerial levels in relation to Shari'ah observance, ijthihad management also faces difficulty in dealing with fragmented Shari'ah opinions. The issue of harmonisation and fatwa-respectful is a never-ending subject in fiqh including Islamic banking and financial activities. The dynamic nature of fiqh (Islamic jurisprudence) is deemed unique in international Islamic banking development. However, its dynamism may lead to confusion if there is lack of understanding of the fatwa and ijthihad management (Muda and Abdullaah 2007). Thus, in Islamic banking particularly, some literatures argue whether harmonisation is a requirement or otherwise will only become a hurdle. Khan (2007) is of the opinion that process standardisation is more viable than harmonisation. Some opine that multiplicity of ijthihad from one country to another may hinder the development of Islamic banking (Benaissa, Parekh, & Weigand, 2005 in Hassan and Lewis (2007). Al-Suwailem and Hassan (2011) however suggest that the hurdle can be converted into strength for Islamic banks to develop a variety of products that are fully based on Shari'ah. The power of innovation and creativity will thus be developed due to the differences in providing ijthihad. Moreover, to appreciate the innovation environment, the authors suggest for specialised institutions in dealing with different types of product, hence product focus and variation can be produced in an innovative and creative manner (Al-Suwailem and Hassan 2011).

In relation to the top management contribution for PD positive environment, Ahmed (2011b) finds that there is a strong relationship between strategic planning that is approved by top managerial level and PD motivation. This is true especially in relation to Shari'ah-based products that are associated with observing the market-based product that contributes to the survival of all segments of users ranging from deficits, surplus units and underprivileged poor group of customer. Thus, further exploration in this area is suggested to foster more innovation atmosphere in the Islamic banking and financial industry.

Most of the above literatures found that the nature of fiqh muamalat as a branch of Shari'ah should be left as it is. Any endeavour for harmonisation or standardisation also should be given respect and support. However, if the fatwa divergence leads to a bigger problem, effort to make the society understand and contemplate the technical solution is recommendable. Hence, the issues of conflicting resolution, contradicting views of scholars and other issues will not be the focus of the study since the focus is the objectives and not the means. The objectives here

might refer to many interpretations; make it *maslahah* of the society, survival of the industry, profitability of the institution and many others that will be further refined in the research methodology section.

In dealing with the new financial service development model for Islamic bank, the important element of Shari'ah compliance should not be taken as a limitation but more to future challenge of the industry players and researchers to integrate both the financial innovation models and the Shari'ah requirement, which is the objective of this study.

### **Promoting *Maqasid al-Shari'ah* in New Products Development.**

Islamic banking is built upon Shari'ah ruling and the final aim of Shari'ah is presented in a framework known as *Maqasid al-Shari'ah*. Many literatures have related the issue of Maqasid observation in PD process like in Ahmed (2011a); Al-Suwailem (2007); Al-Suwailem and Hassan (2011); Lahsasna and Hassan (2011); Muda and Abdullaah (2007).

From a managerial view, assigning the observance towards *Maqasid al-Shari'ah* during fatwa and *ijtihad* management in PD process (Lahsasna, 2010) will promote towards Maqasid-driven product. Similarly, Muda and Abdullaah (2007) promote the doctrine of *maslahah* in dealing with PD process particularly when society's interest is part of the objectives. In dealing with the process, product owner must firstly categorise the product into its prioritisation according to the range of customers (Muda & Abdullaah, 2007).

To be a Maqasid-driven product, besides firstly being wholly observant to the Shari'ah requirements, customer satisfaction should be one of the objectives of Islamic banking. Many literatures like in Ahmed (2011a, 2011b) suggest that products in Islamic banks should be customer-oriented product. The customer, besides being the main client of the bank, also acts as one of the sources for product innovative ideas (Gainor 2000). Considering the customers' needs in innovating customer-driven product is an acknowledgement to them as important stakeholders which is supported by conventional model of NSD found in Ian and Chad (2002) and Ozdemir, Trott, and Hoecht (2007).

Product innovation bases should prevail over the concept of *maslahah* or public interest (Al-Suwailem, 2007; Al-Suwailem & Hassan, 2011; Muda & Abdullaah, 2007). Besides the

fulfilment of customer's necessity, *maslahah* also connotes wider coverage that includes all stakeholders and society as a whole. Thus, the *maslahah* of the other stakeholders also are within the doctrine of *Maqasid al-Shari'ah* when developing a product. However, most literatures give emphases on the *maslahah* of the customer compared to the other contributors of the bank, like the developers and the banks' officers. Moreover, the many available literatures promote *Maqasid al-Shari'ah* from a conceptual approach rather than an operational one especially in dealing with product innovation or financial innovation of Islamic banking products. The literatures like in Mohamad Akram Laldin and Hafas (2012a, 2012b); Md Som and Ashraf (2012); Zaharuddin (2012); Aidi Izham and Abdul Shukor (2012 ); Al-Shubaily (2011); Saiful Azhar (2011); Al-Ayashi (2011); Vejzagic and Smolo (2011); Asyraf Wajdi and Bouheraoua (2011); Bouheraoua (2011); Al-Mubarak and Osmani (2010); Mohamad Akram Laldin and Hafas (2012a, 2012b); Mohamad Akram Laldin (2011a, 2011b, 2010, 2008); Ezry Fahmy and Zusuff (2010); Bashir and Sobri (2008);Asyraf Wajdi and Bouheraoua (2011); Asyraf Wajdi and Abozaid (2007); Asyraf Wajdi and Nurdianawati Irwani (2007 ); Kahf (2006) provide general review and observation towards *Maqasid al-Shari'ah* in Islamic banking and financial activities. Some other literatures observe specific area of Islamic banking and financial activity like the investment activity, *takaful*, performance and others like in Dangulbi et al. (2012); Ahmed (2011c); Engku Rabiah Adawiah (2011); Asyraf Wajdi (2010); Rafidah et al. (2011); Asyraf Wajdi (2009b); Asyraf Wajdi (2009a); Mydin and Saidumasudu (2009). There are also literatures that empirically applied *Maqasid al-Shari'ah* in their study like in Muhamad Nafik and Imron (2011); Mustafa (2011); Mustafa and Fauziah (2010); Mustafa (2009); Shaukat (2009); Mustafa, Dzuljastri, and Fauziah (2008). Hence, *Maqasid al-Shari'ah* has been widely written in many literatures promoting its observance in the general operation of Islamic banks. However, special focus of the study to financial innovation process has not been given in any of those studies. Only one study recently carried by Ahmed (2011a) that highlights the theory *Maqasid al-Shari'ah* in product development process of Islamic financial product. The issue on how to observe *Maqasid al-Shari'ah* as reflected in the product development process of Islamic bank is still a research gap that necessitates further exploration.

## **Research Methodology Applied in Developing the Proposed Framework**

The framework development is staggered in a few stages of qualitative data analysis; 1) Content analysis of the existing literatures and expert interview data are used to review selected important literatures and data on theories of *Maqasid al-Shari'ah* and selected PD models; 2) Inductive approach of analyzing the data to develop a structured framework as suggested by Thomas (2006) and; 3) Sekaran's Behavioral Operationalization Method to break down the conceptual and abstract item into observable behaviours according to Sekaran (2003).

### **Proposed New Financial Innovation Framework based on Maqasid al-Shari'ah**

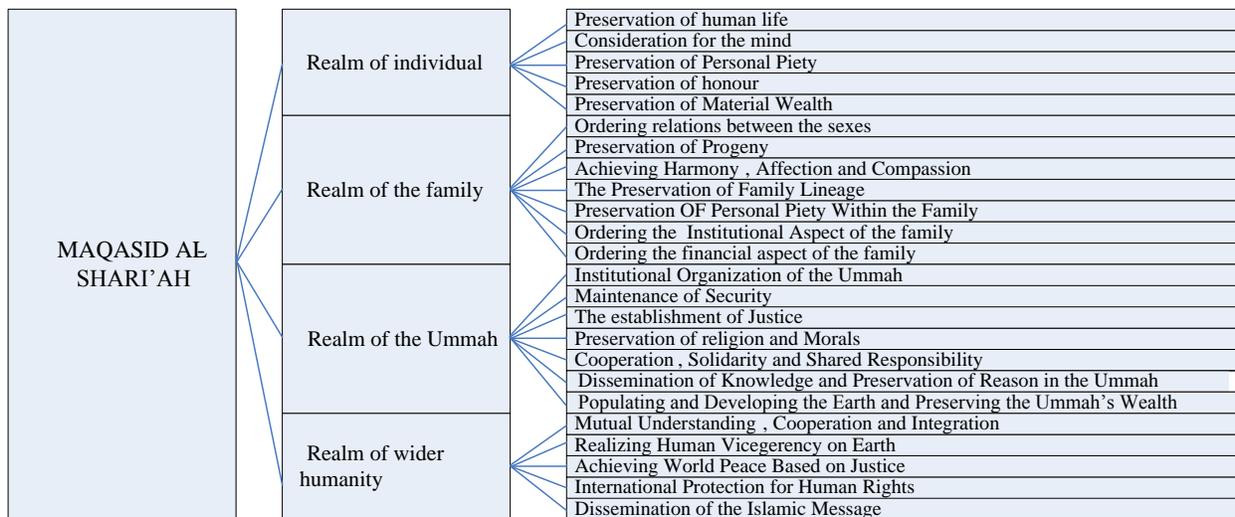
Due to the existing gap in the literatures, the study aims at proposing a new product development framework based on the theory of *Maqasid al-Shari'ah* (the objectives of Islamic law). The explanation of the proposed framework is divided into three; the selected Maqasid theory with modification, the selected product development model and the proposed financial product development framework based on *Maqasid al-Shari'ah*. The framework is subject to modification and improvement.

Back in prophetic reign, the origin of *Maqasid al-Shari'ah* is from Al-Quran itself when it was first revealed. "Knowledge", "wisdom" and "intellect" are among the terms associated to the word "iqra". The objective of human's creation is indirectly prompted by the Al-Qur'an that stated about worshipping Allah as the Creator and searching His wisdom, and seeking to understand about Him and His creations. *Maqasid al-Shari'ah* is the religion itself which controls the whole dimension of life. The formal usage of the word "*Maqasid al-Shari'ah*" has not been established until Imam al-Harmayn (Al-Juwayni) mentioned it in his book, Al-Burhan (Al-Yubi 2008) which he pointed the usage of rational thought in giving reason (*ta'lil*) for new legal rulings (Attia 2010). Other big names associated to the theory are Imam al-Shatibi and Ibn Ashur. All of them had significantly developed the theory and expand its understanding. The term *Maqasid al-Shari'ah* has been used interchangeably with other terms like *al-Niyyah*, spirit of law, *hikmah* (wisdom), philosophy of Islamic law and *'illah* (reason). All these terms connote

the conceptual and functional dimension of the theory. In the latest and contemporary movement, many other expansions to the theory have been done.

In the study, comprehensive theory of *Maqasid al-Shari'ah* by Attia (2010, 2008) will be the guided theory. The reason for choosing Attia's classification of *Maqasid al-Shari'ah* is due to its suitability and comprehensiveness to be applied in today's' current banking phenomena. The Attia's theory will cover the issue of "for whom" the product is developed since it divides the realms into four entities of the ummah. Most importantly, it still maintains Al-Ghazali's theory of *Maqasid al-Shari'ah* that refereed in many literatures when dealing with Islamic banking activity. The extended Al-Ghazali's Maqasid theory of Attia offers a division of the human development into four realms; realm of individual, realm of family, realm of ummah and realm of wider humanity instead of five essential Maqasid purported by Al-Ghazali. In each realm, twenty four intents have been established as shown in the following Figure 13. The author suggests practical implication for the twenty four intents that makes the theory more practical compared to the other conceptual-based theory.

Figure 13: Al-Maqasid Theory of Gamal Eldin Attia



Source: Attia (2010)

The newly proposed framework however has modified grouping the four realms into two main realms for more practical observation in the industry especially in product development process named as the realm of individual and family; and the realm of ummah and wider

humanity. Besides, not all intents will be observed and the selection is based on the observation of PD activity in Islamic banks and also based on review of literatures and data from experts' interviews.

The gap in the literatures has shown that limited studies have been conducted in modeling new financial innovation of Islamic banking and financial product. Moreover, the literatures also revealed that the stages in developing Islamic banking product in Malaysia represent the Shari'ah compliance process map and interconnections between the processes rather than a framework. The Shari'ah compliance process also has not linked the stages to any PD model developed and tested previously. The study hence proposes framework to develop a new financial innovation of Islamic banking and financial product.

To better understand non-standardised practice of Islamic banks in developing new product or enhancing existing product, general stages have been taken from the literatures. Thus, the observed process and elements will be the backbone of the conceptual framework of the study. The observed process is mainly adapted from PD Model of Ahmed (2011a) and experience of Bank Islam Malaysia Berhad (BIMB) presented by Wan Ismail (2011). Ahmed's PD model of Islamic bank is chosen due to its comprehensive coverage of stages of concept stage development mentioned in almost all literatures. Additionally, Wan Ismail's (2011) explanation of PD stages experienced BIMB is a real guideline in the real setting of an Islamic bank. Three main stages under "idea generation" (or also known as "product conceptualisation" stage) like idea generation, screening and Shari'ah evaluation are mentioned in a number of literatures while the idea generation stage is mentioned in almost all PD literatures; both Islamic and conventional bank. Another main stage of "concept product conversion" or "product development" stage moreover includes product design or research, documentation and testing. Finally, the stage of commercialisation as stated in most of the PD models will be also observed since Maqasid-related activity also should be involved there. Shari'ah approval of the product will not be one of the stages as presented by Wan Ismail. Instead, it will be the "stage-gate" for all the three stages; product conceptualisation, product development and product commercialisation. Hence, the gate will function as Shari'ah screening for each stage replicating the screening process used in the model of Cooper and Scott J (1996).

Looking at the current development in Islamic banking activity, the newly proposed *Maqasid al-Shari'ah* framework for product development will fully benefit the SGF of BNM that was endorsed in the end of 2010. Moreover, this proposed framework will only involve pre-product approval as referred by Ahmed (2011a); product conceptualization, converting concept to product and product commercialisation but not the overall product development coverage as stated in the specific ruling for product development stated in rule number 6 of Appendix 7 of SGF, BNM that:

Product development covers both pre-product approval (i.e. process of product structuring and developing prior to introduction to the market) and post-product approval process (i.e. process after the product has been offered to the customers and transactions have been carried out).

Based on interview sessions with officers of Islamic banks in Malaysia regarding their knowledge of the Islamic banking practices in Malaysia, they seem to be unaware of the process that was proposed by Ahmed (2011a) as in their statement:

“We do implement some processes in product development process but there was no referred standard or model practiced, we work in an ad-hoc team known as product development committee”

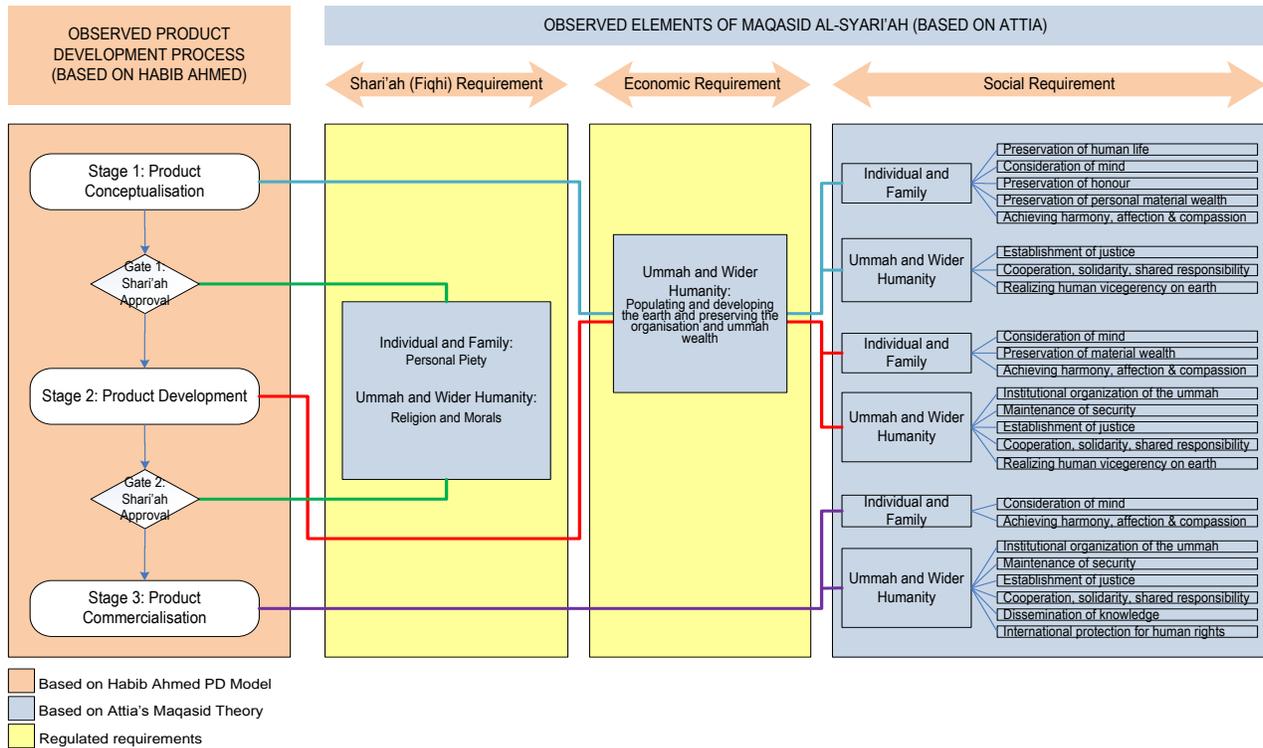
The phenomenon gives clear evidence on the limitation of the current practice of product development activity in Islamic banks in Malaysia. Moreover, the newly endorsed SGF, BNM provides better opportunity for the proposed framework to be observed in the real field hence promoting a positive environment in inculcating standardised new product development procedure in Islamic banking industry. In a series of interviews with experts of Islamic banks, it is understood that in the current development of PD process requirements in Islamic bank as follows:

“BNM in its document on guideline of new product development of Islamic banks has made clear guidelines in developing a new product that requires Islamic banks to mobilize resources for research agenda mainly in ensuring a new product is fully compliant to Shari'ah and also profitable to the bank”

The current research is an attempt to combine the need for proper model in developing new Islamic banking product with the current issue raised by many scholars on the product that lacks

its Maqasid elements. The following Figure 14 illustrates the proposed general framework of the study.

Figure 14: Proposed General *Maqasid al-Shari'ah* Framework of the Study



The above framework is constructed based on Habib Ahmed’s model of product development with the inclusion of observed elements in the process with Attia’s theory of Maqasid al-Shari’ah. The three division of the requirement into three; Shari’ah (fiqhi requirement), economic requirement and social requirement is based on Ahmed’s proposal on categorizing Islamic banking product. Attia’s suggestions of the intents in the realms are divided according to the stages of product development and its appropriateness to the nature of the stages based on interview with experts in Islamic bank. A number of modifications have been done on the framework based on comments and suggestions during experts’ interviews sessions. The framework is still subject to modification and improvement.

## Conclusion

Most of the literatures place emphasis on the importance of product development in various sectors including in the manufacturing, service and financial sectors. However, the focus of these studies was more on tangible product innovation than service innovation. Additionally, for the service sector, financial product innovation has become an object of research only recently. This study thus is an effort to fill the gap in the literature where it mostly pays attention on the conventional financial/service innovation rather than the Islamic one. Despite the importance of PD as reported in many literatures as being the contributing factors for the success of a product, it is observed that innovativeness is new in the banking industry specifically in Islamic banking. Interestingly, the success factors of new products are always linked to the way the NPD model(s) is/are executed in the company (Baker, Hart, and Hart 2007). However, the model of Islamic financial innovation has not been extensively explored by many literatures as supported by Al-Suwailem and Hassan (2011), thus causing this field to be scant and lacking. Even though the financial innovation model proposed by Ahmed (2011a) gives little attention to the Shari'ah issues, the *Maqasid al-Shari'ah* element has not been injected expansively. Also, the theory that has been the central of the activity and assumes to be the main theoretical reference when dealing with today's dynamic financial innovation also has been limitedly explored. The gap in this area is wide as strongly mentioned by Al-Suwailem and Hassan (2011)<sup>4</sup>:

Although scholars as well as bankers increasingly talk about financial engineering and further development within the industry in order to ensure future growth and profitability, a consolidated body of relevant literatures documenting various aspects of Shari'ah-compliant financial innovation and its process of implementation is noticeably lacking.

Moreover, in dealing with Islamic banking financial innovation, the issue of non-standardised or nonexistence of standardised process has restrained the industry to innovate more Shari'ah-based product (those that fulfill the specific requirements). Besides, the contention over

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<sup>4</sup> Sami Al-Suwailem (Dr.) is the Deputy Director of Islamic Research and Training Institute and M. Kabir Hassan (Dr.) is the Professor of Department of Economics and Finance, University of New Orleans, Louisiana, USA

Shari'ah-based, Shari'ah-compliant and customer-oriented products causes the Shari'ah-oriented innovation to decelerate. Hence, there is a gap in the literature assessing the PD processes of Islamic banks despite its important function and impact. Also, with its speedy development and its growing demand, there is a need to invite an in-depth understanding of the product development stages of Islamic banking products.

The study hence brings another dimension in reviewing the existing and particularly the current literatures of Islamic banking development. Product innovation literatures in Islamic banking activities are undeniably limited in number, either in journal articles or in conference proceedings. The available literatures only give attention to conventional banks. Moreover the service development literatures cover overall service industries with limited focus on financial industries especially the Islamic banking and financial industries. Extension and further exploration is suggested in the said area to promote better service for the society.

Note: The authors humbly thank all the experts for the interview sessions (consist of a number of SAC BNM, SC Islamic Banks, Researchers ISRA, Islamic Banking Officers, and all parties) for their ideas, contribution, time and commitment.

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