



The Theory of Product Innovation and Its Application in Islamic Banking

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Abstract

The success of banking institution depends on continuous innovation and improvement of the product offering to increase profitability and marketability. Product innovation is also one of the important aspects for Islamic banking institution, but it requires attention in observing *Shariah* requirements. This article will analyze the principles of innovation and development and its application in Islamic banking product. The analysis is based on qualitative research approach where reference will be made to primary and secondary sources gathered through library research. The discussion will study several literature on the concept of product innovation and analyze the applicable *Shariah* principles in the aspect of innovation of Islamic banking product. From the study, it is concluded that the general concept of product innovation in conventional banking can be applied in the context of Islamic banking. This is because Islamic banking is still within the framework of banking which is also subject to similar commercial aspects but with the requirement to uphold *Shariah* principles. Product innovation in Islamic banking involves the role of creativity and the concept of reform in *Shariah* as well as the approach in the construction of *Shariah* ruling. Therefore, continuous product innovation is significant for Islamic banking institution to remain competitive with other financial institutions in the industry.

Keywords: product innovation, Islamic banking product, Shariah principle, islah, tajdid

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1. Introduction

Commercial banking institutions like the rest of the financial industry around the world are undergoing drastic changes. With these rapid market changes, most commercial banks are increasingly relying on innovation and development capability to increase profitability and marketability to remain competitive (Stephan, 1995; Dereli, 2015; Nnodim et al., 2020). The success of a product also depends on the strategy and process of innovation and development of the product itself. Therefore, continuous improvement throughout the life cycle of a product can help to extend and build a stronger brand (Murray, 2009; Nugroho and Harjanti, 2020). In the context of product development, building innovation programs and new product development is the most effective strategy for increasing productivity and profitability (Avlonitis, 2001; Dereli, 2015; Nnodim et al., 2020).

Product development and innovation is also an important aspect for Islamic banking. However, the flexibility in Islamic banking products should be understood in the context of *Shariah* principles and frameworks. In this regard, this article will analyze the principles of innovation and development in the context of Islamic banking product. The discussion will refer to several views on the concept of innovation and product development and analyze on the *Shariah* principles underlying the development of Islamic banking products. This refers to the role of creativity and the concept of reform in *Shariah* as well as ethics and approach in the construction of ruling in the activities of *mu'amalat* (Islamic commercial) for the purpose of the development of Islamic banking products.

2. Literature Review

2.1 Product and service

Product refers to goods, services and so forth produced or offered by an institution (DBP, 2007). According to Junarsin (2010), a service is different from product in some aspects. Service has no physical value so it cannot be stored where the results of a service are not uniformed and the quality depends largely on the employee who delivers the service. Alam (2003) stated that new product refers to either products or services. These two terms are used interchangeably to refer to products offered by banks.

For product in Islamic banking context, it is a banking product that is governed by divine guidance in line with Islamic ethos and values (Ab. Ghani, 1999; Iqbal and Quitia, 2017). It is based on a banking system that offers banking products based on Islamic economic principles in a *Shariah*-compliant banking arena (Ab Majid, 1994). In other words, it is a direct involvement with financial and banking practices based on *Shariah* and *fiqh* (Islamic jurisprudence) methods (Ab. Ghani, 1999; Dusuki, 2012). This means that all operations and products offered by banks whether deposit or financing are conducted in accordance with *Shariah* law. Therefore, even though Islamic banking is bound by *Shariah*, it still offers the same products and services as conventional banking offers such as deposits, credit facilities as well as fund transfers which creates banker-customer relationship through multiple *Shariah*-compliant contractual relationships with varying risk characteristics. (Ibrahim, 1997; Abu Bakar et al., 2019). The use of these principles also includes other bank transactions such as letter of guarantee, letter of credit, remittance, foreign exchange, etc. (Haron, 1996).

The main principle in Islamic banking products is profit and loss sharing based on contracts of *Muḍarabah* (profit-loss sharing) or *Musharakah* (partnership). Nevertheless, in practice, the widely used principles are commutative contracts such as *Bai' Bithaman Ajil* (deferred sale), *Murabahah* (sales with mark-up-profit), *Ijarah* (lease) and *Ijarah Thumma al-Bay'* (lease ends with sale) (BIMB, 1989; Lee, 2019). Therefore, if conventional banking products reflects the relationship of lender-borrower based on loan contracts with interest charging, in Islamic banking product, the relationship between bank and customer forms either 'seller-buyer', 'lessor-lessee' or 'financier-entrepreneur' relationship (Wan Ahmad, 2006).

Therefore, the conversion of conventional bank products into *Shariah*-based products not only replaces the contract underlies the product but it also uses mechanism that meets *Shariah* requirements. This is because the establishment of conventional banks is merely to maximize profits and not based on religious principles whereas Islamic banking is not only meant for profit maximization but also emphasized on religious factors guided by Islamic economics which operate based on *fiqh mu'amalat* (Islamic commercial law) in every banking transactions (Borhan, 2000; Abu Bakar et al., 2020).

2.2 Innovation and product development

Innovation refers to something that is newly introduced such as methods, systems, etc. Innovation is also be associated with development. There is also a view that the terms 'product innovation' and 'product development' share similar meaning. This is because both terms lead to similar processes, objectives and results. Development is defined as a process or effort to develop something (DBP, 2007). Alam (2003) stated in his study that most respondents comprising bank officers used the term 'innovation' which refers to 'development of new products or services'. In fact, Avlonitis (2001) states that any form of development and invention of new products, services or processes can be categorized as a form of innovation.

From the literature references and studies, there are various views and categorizations applied to the term product innovation and development. Among the earliest literature refers to studies conducted by Booz et al. (1982). Innovation of product refers to something that is newly introduced in the world and also to the customer. It brings new challenge to the company and adds to the company's existing product line. As for innovation to the existing product, it will provide improvements and changes to the original product. Product development also enables repositioning of strategies and targets for new market segments. Moreover, product development can lead to reduction and cost savings (Booz et al., 1982). However, Junarsin (2010) views that although new product and service can open up for new opportunities, the impact on profit and sales is very moderate. Nonetheless, if a new product differs from various angles and is difficult for other competitors to emulate, then it can lead to competitive advantages.

Kleinschmidt and Cooper (1991) categorized product innovation into three levels of innovation that also shares similar classification as Booz et al. (1982):

- a. Highly innovative product includes product that is new to the world as well as the institution itself;
- b. Moderate innovation product is new product to the existing product line but are not new to the world;
- c. Low innovation product involves modification of existing product, cost reduction and product restructuring to achieve market targets.

Ulrich and Eppinger (2004) classified product innovation and development into four major groups that share similar aspects as Kleinschmidt and Cooper (1991).

- a. Product that fundamentally require radical changes from product and production assets, technology and require an attempt to compete with new and unfamiliar markets.
- b. New product built on a new platform to form a new a group of products for the existing market.
- c. Update on existing product and platform to improve and enhance the level of competition with new product offering.
- d. Improvements to existing products by making modification or addition of new feature to remain competitive.

According to Bergfors and Larsson (2009), product innovation leads to a desire-driven development to improve the performance of existing product. The objective of product innovation is either to build new products or improve the existing product and its quality. This view is consistent as set out in the Oslo Manual issued by the Organization for Economic Co-operation and Development (OECD). It states that innovation refers to new product and process or combinations of both which significantly improved the previous product offered to potential consumers (OECD, 2018).

In terms of factors that drive and lead to product innovation, it will be implemented according to market demand and eventually customer-driven (Bergfors and Larsson, 2009). This view is similar to Murray's view where successful innovation is when customer is regarded as the main driver (customer driven). An effective innovation is one that understands what, why and what are the latest customer's needs which will lead to experiences in improving processes and shaping new thing for the future. This is because innovation constantly changes as well as attitude and behavior of customers according to circumstances and times (Murray, 2009).

There are also researchers who consider the aspect of technology as a factor that leads to product innovation. According to Ali, the pioneer in product innovation is the result of technological advancement. However, there are also researchers that include technological reform with other forms of innovation (Ali, 1994). Veryzer (1998) suggested to classify innovation into four forms based on the level of novelty of product innovation that provides unique feature and benefit to the customer. This also includes to what extend technological change are used to create those benefits. The four forms of innovation according to Veryzer are:

- a. Continuous innovation i.e., product that is developed based on technology and the original product capabilities.
- b. Technologically discontinuous innovation i.e., product that is different from the original and existing technology capabilities.
- c. Commercially discontinuous innovation i.e., product that is considered as new by the customer.
- d. Technologically and commercially discontinuous innovation i.e., product that involves significant technology advancement that will give new benefit to customer.

In the context of financial industry, Llewellyn states that economic factor is the main factor that led to product innovation. In addition, innovation consist of four forms namely "defensive" which is introduced in response to policies introduced by authorities, "aggressive" i.e., innovation that is performed to meet market conditions with the aim of generating profit, "responsive" i.e., innovation to meet customers' needs; and "protective" that refers to innovation designed to address problems with current product (Llewellyn, 1992). Martivoy and Mention (2016) consider innovation in financial product based on the criteria objective for innovation to be carried out, degree of novelty, driving factors in innovating and objects for development.

Avlonitis (2001) classify the concept of innovation in the context of financial industry to six main forms. It includes something new to the market, something new to the service offered by company, new delivery process, service modification, addition of new service and reorganization of services. Frame and White (2001) explain product innovation in financial sector is represented in several forms such as new product (e.g., flexible profit

rate), new service (electronic banking), new production process (credit scoring system) and new organizational approach (enhancement in electronic transfer approach).

2.3 Product innovation in the context of Islamic banking

Based on the foregoing literature, although the understanding and explanation refer to the general concept of product innovation and development in banking or finance, it can still be applied in the context of Islamic banking. This is because Islamic banking is still within the framework of banking and financial industry which is also subject to similar commercial aspects. In the context of Islamic banking, [Ahmed \(2011\)](#) explained that the importance of Islamic banking product development involves on how an institution wants to position itself in the future market. Institution that considers and understands current market changes will be more relevant in the future. The institution will place innovation as an important component of its mission and strategic goals. This is because product development is driven by development strategies, future business and market condition. Product development system is determined based on the legal environment, market growth potential and the bank's orientation towards innovation.

Therefore, based on the theory related to product innovation as described earlier, there are three interconnected terms in the subject of this discussion namely product development, financial engineering and innovation. According to [Hassan and Lahsasna \(2011\)](#), all these terms lead to a goal of change and invention. Financial engineering and innovation play an important role for Islamic banking in attracting international investors and industry players globally. Thus, innovation and product development together with financial engineering can build niche market, expand new market and create business opportunities. Moreover, it allows Islamic banking institution to offer more products covering diverse customer segments and options to the market ([Ahmed, 2011](#); [Alhasadi and Ilhusadi, 2018](#)).

Creation is understood as the focus of human thought on change to the original creation that has practical used. Creations are usually patented but patenting is not necessarily a creation. Innovation is practical to bring creation to expansion through creative thinking, investment and marketing. Therefore, the fundamental to innovation typically requires creation. Innovation is a change in the thought process in implementing something or it forms something new such as an instrument or tool that gives advantages. It can be understood as a revolution in thinking and a change in the way of thinking, processes and organizations ([Hassan and Lahsasna, 2011](#)).

Innovation is a key player in the Islamic economy especially involving the structuring and design of new product categories or increasing productivity in the banking sector. The strong relationship between innovation and financial engineering and product development forms the appropriate instrument that reflects the maturity of Islamic banking products in the market. Suwailem and Hassan are of the view that product development is a broad term covering various techniques and issues when offering new products and modifications of the existing products. Financial engineering specifically refers to product development activities involving financial instruments. In other words, financial engineering involves designing and positioning value for financial products that offer a combination of profit-risk as well as increasing profit to institution. In addition, it involves the application of analytical on financial problems especially involving pricing and structuring of financial instruments such as derivative products ([Suwailem and Hassan, 2011](#)).

In comparing between product development and innovation in conventional and Islamic banking, the nature of new product in conventional banking industry is more to product enhancement rather than product development. This is because, in conventional banking, deposit and loan products are based on loan contract as expressly stated in the court case of *Foley v Hill*.¹ From the court case, the bank-customer relationship is merely as borrower and lender. Conventional banking is more likely to embed new feature on the existing product and claim it as a new product. This is true as a new product in the market but from the underlying contract point of view, the product remains the same which is based on the principle of loan contract. However, this cannot be compared in Islamic banking as each new product may have a different set of new *Shariah*-compliant contract. Otherwise, it is also just a product enhancement ([Bakar, 2008](#)).

Product enhancement is to improve and add value to the existing product so that it can be more attractive and competitive in the market. It does not change the original concept of the product but rather offer new features

¹ *Foley v Hill* (1848) 2 HL Case 28, 9 ER 1002.

for the product purpose. On the other hand, product development involves the development of product based on the existing product to a new structure and perspective in banking environment. This is because, although the existing product still meets the prescribed regulations, it is unable to meet the requirements of contemporary banking business. In other words, it requires a new *Shariah*-compliant contract to enable it to evolve for Islamic banking institution to continue to engage in financial activities (Bakar, 2008).

Based on the above literature discussion, there are various definitions in classifying innovation and development of new product. Each opinion can lead to the same objective of building a new banking product to meet the needs of customers and eventually derive profit to the banking institution. Therefore, based on the analysis, it can be summarized that apart from generating profit, innovation or development of Islamic banking products is a form of activity or financial engineering to create a new product or instrument involving the following aspects and criteria:

1. It is implemented to meet specific requirements. This includes meeting the needs of customer, authorities, industry, regulation, technology or due to all such factors.
2. It aims to achieve diversification or uniqueness in any aspect covering the structure, mechanisms, operations as well as the selection of underlying *Shariah* contracts without affecting the aspects of risk management. This is because each institution has different level of risk assessment which requires its own risk management plan depending on the features and structure of the product.
3. It requires various disciplines of knowledge covering *Shariah* theory, finance, economics and operational practices to achieve the ultimate goal. The main thing for Islamic banking products is to put ethics as well as *Shariah* principles including the construction of the *Shariah* law in *mu'amalat* (Islamic commercial) as the underlying pillar in the product development process.

The continuous innovation and development of product is important for Islamic banking institution to remain competitive with other financial institutions in the industry. This is pertinent especially for country adopting dual banking system such as in Malaysia that offers both the conventional and Islamic banking products in tandem which also contributes to the overall banking system and economy.

3. *Shariah* Principles in Islamic Banking Product Innovation and Development

In this subtopic, the discussion will examine the *Shariah* principles underlying the development of Islamic banking product. This refers to the role of creativity and the concept of reform (*islah*) in *Shariah* as well as the ethics and *fiqh* approach in the construction of Islamic law for the purpose of developing Islamic banking product.

3.1 *The relation of creativity, islah and tajdid in innovation*

Islam recognizes human as *khalifah* (ruler) on earth that puts every human being with the creativity and power to administer the world as mandated by Allah. The responsibility as *khalifah* is explained further by the trust offered by Allah and accepted by man to become *khalifah* in the world (Ab. Majid, 1994). Allah states in the *al-Qur'an*:

"And [mention, O Muhammad], when your Lord said to the angels, "Indeed, I will make upon the earth a successive authority." They said, "Will You place upon it one who causes corruption therein and sheds blood, while we declare Your praise and sanctify You?" Allah said, "Indeed, I know that which you do not know." (al-Baqarah, 30).

As a *khalifah* to administer the land, *Shariah* provides a comprehensive set of rules as a guide and reference for every aspect of life including commercial transactions such as banking and finance. Although the rule has obstacles in certain aspects, it does not hinder and limit creativity. In fact, there is evidence of studies that show that creativity is optimized from tribulations and obstacles (Suwailem and Hassan, 2011). Silber (1983) noted that barriers and constraints are the main contributors to innovation in finance which also contributes to the improved economic performance and welfare.

Although creativity is encouraged in the framework of Islam, it should not be misused to avoid achieving the objectives set by *Shariah*. If the result of innovation in banking products involved in matters contrary to Islam,

it is considered inappropriate and unacceptable. In general, Islam teaches and guides the right way for creativity and innovation. In principle, the human being is always asked to think for the truth and see the development of nature as a lesson. Allah commands the mankind to always think and see the history of mankind as stated in the statement of Allah below:

"...Travel through the land and observe how was the end of the criminals (sinners)."
(*al-Naml*, 69).

In the framework of Islamic thought, creativity is understood as the gift of Allah and that power is used in order to carry out the obligations (*taklif*) that are entrusted to mankind. *Taklif* is found in the understanding of *islah* (reformation). Its objectives are contained in the understanding of *ijtihad* (personal judgement) and the method of *ijtihad* is based on the actual understanding. This form of understanding leads to what is considered to be progress according to Islam (Ahmah, 2011).

With knowledge and creativity, it leads to a thought and recommendation to implement reformation (*islah*) and renewal or revival (*tajdid*) on matters that are originally not *Shariah*-compliant. This covers aspects of the modern world such as economics and commercial banking transactions. Islam is a religion of reformation (*islah*) that comes to improve and restore the condition of mankind. In the *al-Qur'an*, there are many commandments to perform *islah* as stated in the statement of Allah below:

"O children of Adam, if there come to you messengers from among you relating to you My verses, then whoever fears Allah and reforms - there will be no fear concerning them, nor will they grieve." (*al-A'araf*, 35)

"... So fear Allah and amend that which is between you and obey Allah and His Messenger, if you should be believers." (*al-Anfal*, 1)

Those who perform *islah* will be rewarded by Allah as mentioned in *al-A'araf*, 170. In addition, as long as there are people who has the effort to perform *islah* to improve their life, Allah will not destroy the group as stated in *al-Hud*, 117. This shows the importance of continuous efforts to ensure the well-being of the community.

"But those who hold fast to the Book and establish prayer - indeed, We will not allow to be lost the reward of the reformers." (*al-A'araf*, 170)

"And your Lord would not have destroyed the cities unjustly while their people were reformers." (*al-Hud*, 117)

The understanding of *islah* is closely related to the understanding of *tajdid* which is often described in the context of the current debate as renewal (or revival). These two understandings are inseparable i.e., not all reforms are valid and applicable. Only reforms that bring good to the public (*maslahah*) are acceptable and this means that a revivalist (*mujaddid*) must also at the same time be a reformer (*muslih*) (Ahmah, 2011).

Thus, to ensure that there is no end and retention of the Islamic law, the scholars have outlined *Usul al-Fiqh* (principles of *fiqh*) as well as the *fiqh* maxim so that each issue surrounding humankind can be resolved systematically. Their efforts are an interpretation of *fiqh* which is in fact part of the demands of *tajdid*. All that can only be done with a hard effort in understanding the fact of religion and wisdom contained in it which is considered as *ijtihad*.

Islah and *tajdid* is an effort to organize the good thus eliminates the damage to mankind, both for the life in the world and the hereafter. The goal to achieve by this effort is called *maslahah* (good) and the one that must be avoided or eliminated is *mafsadah* (harm) (Ahmad, 2011). *Tajdid* in religion does not mean to replace Islam with another religion or change it. Religious reform means reforming based on any new problems that arise by applying the correct *Shariah* ruling of the problem. Therefore, reform does not mean improving any verse from *al-Qur'an* or *Hadith*.

Based on the discussion, in the context of innovation and development of Islamic banking product, the command to make reform is the result of creativity and the role of knowledge to drive innovative thinking. More precisely, the process of blending knowledge and creativity will produce new concepts and approaches to explore new innovative solutions in accordance with *Shariah*. For that reason, the process of innovation of Islamic banking product requires diverse expertise and creativity to form a combination of ideas that can produce the desired reforms and changes. Innovation, *Syariah* expertise and modern contemporary knowledge in financial engineering will provide greater balance between creativity and compliance with standard norms in *Shariah*.

3.2 Ethics and principles of *Shariah* in *mu'amalat*

In Islam, it is not sufficient for Muslims to obey the five pillars of Islam² alone as every Muslim must also comply with the Islamic code of ethics. Therefore, every business and transaction must be based on Islamic faith and *halal* matters. Every Muslim should differentiate between ethical matters which are *halal* or *haram* and unethical which is fair and unfair as well as good and bad intentions. In Islam, ethic is not only limited to business practice and daily transaction. In Islam, ethic is divided into two dimensions, firstly ethic to Allah. Every Muslim should believe in Allah who needs to be worshipped. Second is ethic to other parties. Muslim should ensure ethical relationship with other parties (Abuznaid, 2009; Laldin, 2020).

Islamic ethic is based on rational method and revelation (*wahyu*). Revelation provides truth while rational leads to an understanding of belief. Therefore, Islamic ethic is based on *tauhid* (unification or oneness of Allah) which shows the unique relationship between Allah and man, among human and human with the environment (Abuznaid, 2009). Islam emphasizes the ethical rules as outlined in the *al-Qur'an*, *Sunnah* and *Ijma'* as the main source of law. This rule serves as a guide and code of Islamic ethic relating to daily life which includes in *mu'amalat*.

There are a number of ethical and rules in *mu'amalat* without it can cause contracts to be considered void. In terms of ethic in the context of banking, although in Islam, the term bank does not exist, but this does not mean that banking institution is not recognized in Islam. The principle is not new because it has been explained in general in the *al-Qur'an*³ and *Hadith* more than 1400 years ago through the ban of *riba* (interest) (Abdul Ghani, 1997).

Among the other Islamic principle to be adhered to are prohibition of any form of *gharar* (uncertainty), *maysir* (gambling), focus on *halal* activities and commodities and upholding the concept of justice. In addition, there is also view that outlines seven main principles and concepts of Islamic banking system which are Allah as the absolute owner, man as *khalifah*, profit sharing, elimination of *riba*, integration of moral values, being positive towards the economy and paying *zakat* (Abdul Kader, 2001).

Islam has provided a general guide regarding permissible transaction although it is not specific to the Islamic banking operation and practice. With the prohibition of *riba*, it initiates the idea to enable Islamic banking to grow over time to bring reforms in more dynamic and structured banking products. Islam prohibits all forms of *riba* because it involves elements of exploitation of wealth which can lead to economic instability (Haron et al., 2013; Gani, 2020). In the *al-Qur'an*, Allah says:

“O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers.” (al-Baqarah, 278).

Besides that, another important principle that governs economic activity is justice where *mu'amalat* transaction must be fair and equitable. In the *al-Qur'an*, Allah says:

“O you who have believed, be persistently standing firm for Allah, witnesses in justice, and do not let the hatred of a people prevent you from being just. Be just; that is nearer to righteousness. And fear Allah; indeed, Allah is acquainted with what you do.” (al-Maidah, 8).

In addition, Islam also emphasizes specific regulations in the activities of *mu'amalat*. There are many verses

² The declaration of faith (*shahada*), prayer (*salah*), alms-giving (*zakat*), fasting (*sawm*) and pilgrimage (*hajj*).

³ See the ban of *riba* in *al-Rum*, 39, *al-Nisa'*, 160-161, *al-Imran*, 130, and *al-Baqarah*, 275-281.

in the *al-Qur'an* that prohibit taking property wrongfully and illegally. Allah states in the *al-Qur'an*:

“Believers! Do not devour one another's possessions wrongfully; rather than that, let there be trading by mutual consent. You shall not kill yourselves. Surely Allah is ever compassionate to you.” (*al-Nisa'*, 29)

Islam also underlines the importance of fulfilling and complying with contractual agreements. Islam teaches the principles of truth, integrity and trust in every transaction. There is a statement of Allah in the *al-Qur'an* as stated below which emphasizes the moral obligation to fulfill every agreement in the contract.

“O you who have believed, fulfill [all] contracts.” (*al-Ma'idah*, 1)

Based on the above deliberation, the principle of justice involves the concept of rights, equality, balance and simplicity. It involves the right (*huquq*) to enjoy equal opportunities and not to exploit the rights of other parties. At the macro level, the goal is to achieve social justice. The Islamic banking principles aim to achieve fairness in the economy through the distribution of wealth and efficient use of resources including meeting the basic needs of society and social development. At the micro level, the principle of justice involves individual transactions. The requirements of economic transactions require a balance of rights and opportunities and cannot be carried out without agreement with the contracting parties. Therefore, unfair activities and transactions and exploitation are not allowed (Laldin and Furqani, 2013).

On that basis, there are many views and discussions that stress that Islamic banking should involve the social aspects as the main objective and not focus on maximizing profit. Moreover, the selection of *Shariah* contract plays a role in highlighting the social characteristics and values found in a product. Although the above discussions demonstrate the emphasis of *Shariah* principles on justice, social values and so on, it does not mean that Islamic banking does not meet the requirements set by *Shariah* simply because it puts profit as one of its goals. It should be viewed from holistic perspective including from the aspects of policies and regulations made by authorities based on the principle of *Siyasah al-Syar'iyah* (i.e., rules related to policies and approaches taken to manage and organize the national policy to meet *Shariah* requirements) which also emphasizes the need to safeguard the interest of consumers, society and economy. Furthermore, even the bank's interest should also be taken into account in order to avoid exploitation and invite "moral hazard" from customer if the bank acts as charitable organization. Therefore, every regulation that needs to be complied by Islamic banking institution should have already covered all those aspects to ensure innovation and product development achieves its objectives and safeguards the interests of all parties. The question now is whether the regulations drafted and issued by regulator really reflect the principles of *Shariah* and several Islamic banking models based on views from Islamic economist. Perhaps future research can be undertaken to investigate this matter.

3.3 Constructing *hukm* (ruling) in *mu'amalat* matters

In the context of constructing *hukm* in *mu'amalat*, generally the concept of *mu'amalat* is broadly encompassed the question of family, criminal, judicial, inheritance, commercial and government. That is why Islamic banking transaction falls under the category of *mu'amalat al-maliyyah* (commercial dealing). In order to determine the ruling in that context, it is different from *'ibadah* (worship). *'Ibadah* is a form of human relationship with Allah while *mu'amalat* refers to human relationships including contracts or transactions with each other. Therefore, any form of *'ibadah* must have its own *dalil* (authentic reasoning) on its sanctioning while *mu'amalat* is generally acceptable unless there is specific *dalil* that prohibits it (Che Abdullah, 2006).

This principle is based on the view that economic interaction is aimed at achieving human desires and choices. From the economic context, this principle is the basis for innovation. It allows imagination and creativity as long as it does not bring more harm than good. In product innovation, as long as there is no clear prohibition, it is not necessary to prove its permissibility as this is the general rule imposed by *Shariah* (Suwailem and Hassan, 2011). Therefore, if there is a new view in the problem of *mu'amalat* and *Syariah* does not bring any common or specific *dalil* which prohibits it, then the ruling of the matter remains permissible. This is also in accordance with the following Islamic legal maxim:

"The origin of the law in *mu'amalat* is permissible unless there is evidence that prohibits it." (al-Shafi'i, al-Um).

In addition, in carrying out any transaction, each party in a contract is free to place any conditions as long as it complies with *Shariah* requirement. This is in accordance with the statement of Allah and the Islamic legal maxim which states:

"O you who have believed, fulfill [all] contracts." (al-Ma'idah, 1).

"The original ruling in the contract is that both the contracting parties agree, and the effect of the contract is based on the rights and responsibilities they have agreed to in the contract" (al-Zarqa', 1989).

In addition, the aspects in *mu'amalat* are among the things that rapidly change continuously based on the change of place and time. Allah does not prescribe the detailed ruling in *mu'amalat* context. Allah only provides the general principles which cover various aspects to make room for reform and modernization efforts, provided that it does not lead to things that are prohibited by *Shariah*. The system of *mu'amalat* is always ready to accept changes in accordance with the transition of life as well as the cultural reality (*'urf*) provided that it is still within the scope of *Shariah*.

However, in order to innovate and develop *Shariah*-compliant banking product and instrument, it is not only necessary to adopt the classical transactions such as *Mudharabah*, *Musharakah* and so on. It involves the development and innovation of a completely new form of transaction based on the current needs of market and customer without violating *Shariah*-prescribed principles. Therefore, Islam sets out a number of fundamentals and important sources to interpret every ruling to reflect the modern financial transaction (Che Abdullah, 2006).

3.4 Source of *mu'amalat* ruling

The approach in constructing *hukm* (ruling) in *mu'amalat* particularly in banking aspect must refer to but not limited to the sources of *Shariah* and *manhaj* (methodology). The main sources used as references are based on any rulings contained in the *al-Qur'an*, *Hadith* and *Ijma'* (scholars' consensus). Apart from these main sources, the fundamental thing that derives the approach of each ruling is to meet the objectives and rationale of *Shariah* or referred to as *Maqasid Syari'ah* (objectives of *Shariah*). A comprehensive and thorough assessment of particular issues is aimed at safeguarding the public interest in all aspects of life. *Maqasid Shariah* is to promote the well-being of all human beings including preserving religion (*din*), life (*nafs*), intellect (*'aql*), descendants (*nasl*) and property (*mal*). Therefore, in the context of Islamic banking, the products offered should give priority to preserving these five components in order to meet the needs of the public interest.

Another applicable principle is based on analogies (*Qiyas*) which provides the space for scholars and practitioners to apply the laws contained in the *al-Qur'an* and *Hadith* as well as *Ijma'* to new cases or issues by applying the principle of *ratio decidendi* (*'illah*) for the original case to the new case because both have the same cause. Besides the above principles, there are also techniques and other secondary sources to be considered such as *maslahah*, *istihsan*, *istishab*, *dhari'ah* and *'urf*. These techniques and methodologies have played great role in the past and will continue to make significant contributions in modern and future commercial innovation (Bakar, 2008).

In terms of the administration and policy of a country to safeguard the interests of society and the country, it depends on understanding and approach in the context of *Siyasah al-Syar'iyah*. Matters involving economic management or known as *Siyasah al-Syar'iyah al-Iqtisadiyah* are part of *Siyasah al-Syar'iyah* branch. It includes and based on the same principle of *maslahah* (public interest) which is the responsibility of each leader. This concept is important especially for regulator and authorities to regulate every transaction, financial and economic activity of a country. This includes building a legal framework and enforcing comprehensive regulatory and governance oversight based on continuous policies issuance.

Among other approaches that should be considered is reference to *fatwa* (ruling made by jurist) specific to particular *mazhab* (school of thought) or jurists which are contemporary in nature. The purpose of referring to this *fatwa* is to obtain justification and authority to strengthen the permissibility of a product which can be implemented in modern Islamic banking. However, point to note that it is not necessary to adopt conservative and safe approach by accepting stringent *fatwa* only. The reason is because the ruling in *mu'amalat* is *murunah*

(flexible) because the majority of rulings are related to *maslahah* (public interest) and when there are changes in public interest, then the ruling will also change. This is very significant because in the financial and banking aspects, the changes and innovations in this sector are very rapid and increasingly complicated (Bakar, 2008).

Based on the above discussions, each application of principles and sources used and considered by the jurists will form *Shariah* rules which have been arranged and categorized according to the topic of the problem as a result of the interpretation of the jurist. The interpretation process is referred to as *ijtihad* (interpretation by jurist in solving issue). *Ijtihad* in *mu'amalat* is not an easy thing to do (Che Abdullah, 2006). By only observing the transaction or structure of modern banking product and then compared to the ruling found in the classical book is still not worth saying *ijtihad*. The reason is because the ruling produced in the past is the result of analysis and research that was done in view of the needs of that time. Although the process of *ijtihad* is difficult, it does not deny the importance of *ijtihad* to be performed today. In the current context of Islamic banking, the Islamic banking institution must appoint *Shariah* scholars to enable the *ijtihad* process to be carried out. In conducting *ijtihad* based on all the considerations and main sources of *Shariah* as described above, the scholar should also apply certain *manhaj* (methodologies) such as *ta'wil* (contextual meaning), *istiqra'* (induction) or *talfiq* (integration).

4. Conclusion

Based on the discussion in this paper, innovation and development of banking product is very important aspects to ensure the continuity of a banking institution including Islamic banking. Products that constantly innovate according to current trends and the needs of society can facilitate not only in terms of generating profit but also to meet social value to the society and the economy of the country in general. Islamic banking also needs to innovate to ensure the continuity of product development and at the same time complies with *Shariah* requirements. In general, the concept of product innovation aims to build a new product to meet the needs of its customers and maximize profit for the institution. For Islamic banking products it also shares the same objective, but the innovation of Islamic banking products not only involves various disciplines covering financial and economic theory to ensure the productivity and its development in the market. The main aspect that sets it apart is that each innovation must meet *Shariah* requirements and at the same time in line with the needs of the market in view of the transformation in technology and lifestyle.

As stated earlier, the main principle in *mu'amalat* transaction is that any form of transaction is permissible unless there is clear evidence that prohibits it. In the context of constructing *Shariah* ruling and innovation of modern Islamic banking product, it is very unwelcome if Islamic banking practitioners including *Shariah* scholars and regulators only focus in seeking *Shariah* ruling that allows particular banking product or instrument. Innovation and developing Islamic banking products are essential as long as they meet *Shariah*-prescribed principles and are evaluated by *Shariah* scholars based on authoritative sources and references in the construction of ruling.

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