

**Strategic Framework for New Product Development in Islamic Banks of Pakistan: A  
Comprehensive Analysis of the Islamic Banking Landscape**

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**Abstract**

Islamic financial industry is at the verge of maturity, to keep it alive it needs new and timely products for its customers. The purpose of this research is to develop a framework which describes new product creation within Islamic banks of Pakistan. The present study uses qualitative method to explore the product development process in Islamic banks of Pakistan by collecting data through unstructured interviews from individuals related to the field of product development. Findings of this research shows induction of 4 steps to the product development process in case of Pakistan such as State Bank's approval and Management's review after in-house testing, legal department and Operations Shari'ah review. With the induction of these steps this framework can be adopted by the Islamic banks of Pakistan. Finally, it is recommended that Islamic banks should foster an environment of Shari'ah based product creation to achieve Maqasid al-Shari'ah and reduce the documentation process to gain and retain customers. State bank should devise a separate Islamic PR department to deal with Islamic banks only, provide protection and ease to Islamic banks in documentation process and produce guidelines for Islamic banks separately.

**Keywords:** *Product development process; Islamic banks in Pakistan; Qualitative research; Unstructured interviews; Maqasidal-Shari'ah.*

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## **Introduction**

The swift development of Islamic finance has proven highly lucrative for international financial sector. According to (Rabbani et al., 2021) Islamic finance stands continually expanding domain within financial realm. Fundamentally, Islamic finance seeks to apply principles of Islamic religious doctrine to economic endeavors, thereby fostering societal welfare, as outlined in Maqasid al-Shari'ah. Typically structured around asset-based contracts, Islamic finance mandates adherence to Shariah principles, prohibiting practices such as Riba (interest), Gharrar (uncertainty), Maisr (gambling), and other activities deemed impermissible in Islam. These prohibitions, rooted in the Quran and Hadith, are strictly enforced within financial institutions (Rabbani et al., 2021).

Currently, Islamic financial market faces the challenge to keep up the momentum and achieve sustainable growth. The Islamic market is still seen as significantly below its full potential in terms of asset base and annual turnover. Due to the small selection of instrument, the market lacks broad appeal. It is evident that new instruments are needed to improve liquidity, managing risk and creating a secondary market. However, developing new instruments is a delicate and complex process that calls for interdisciplinary approach and a thorough grasp of Islamic law (Harahap, Risfandy, & Futri, 2023). The banking services industry, like all other industries, needs new products to be competitive. Customers want new and differentiated products compared to their rivals in the industry. In this regard, a bank needs new products to develop and remain competitive (Al Ali, 2021). To meet the economic and shari'ah needs Islamic banks must develop new products. Islamic banks operate in a highly competitive financial environment, both within the Islamic banking industry and with the conventional banking industry. Liquidity and risk management are the main concerns of an Islamic banking institutions, for which an Islamic banking institution continually innovate new ideas and products to meet their short-term and long-term needs. Procedure for the development of financial product is an important tool in Islamic

banks. Islam encourages trade and partnership, this has brought deficiency in Islamic financial markets in liquidity (Shirazi, Kuanova, Ryskulov, & Mukusheva, 2022).

Many of the Islamic banking products are reengineered from the conventional products. Product development is one of the major areas where Islamic banks lack their own financial reengineering (I. Ahmed, Usman, Farooq, & Usman, 2022). Research also argues that Islamic finance may have some products like conventional, but some Islamic products are differing and difference in Islamic products and conventional products is artificial in nature. There is a clear difference between the operations and outcomes of Islamic and conventional products (Ahmad, Lensink, & Mueller, 2020). However, the Islamic financial industry can grow by offering new products or entering new markets. Entering new markets with existing products is relatively easier than creating new products even in the existing markets. Despite the success it has achieved Islamic financial industry lacks innovation in product development which is the main driver for the existence of any industry. Islamic financial industry needs to introduce new products which are different than the conventional products to achieve Maqasid al-Shari'ah than merely achieving economic goals for the industry. Everybody involved in the Islamic financial sector, including practitioners, academics, scholars of Shari'ah, and other stakeholders, must collaborate in the field of product development in order to expand the application of Islamic banking in order to achieve this goal.

Nevertheless, a prevailing trend among the population is that the product development process is primarily utilised to duplicate traditional products into Shari'ah compatible alternatives. This perspective is endorsed by other academics. (Ahmad et al., 2020) contends that Islamic financial institutions often reproduce mainstream items using Shari'ah contracts, which are deemed unacceptable. Major sukuk bonds are replications of conventional bonds. Islamic financial operations are not merely just to refrain from charging interest. This is just the tip of the iceberg, that the Islamic products should be concerned about the well-being of the society to achieve maqasid al-Shari'ah.

Every product experiences a lifecycle with four main stages: introduction, growth, maturity, and decline. To remain competitive, firms must launch new products as existing ones reach maturity, avoiding the decline phase. Islamic financial institutions are now transitioning from growth to maturity. Creating new Islamic financial products is challenging because they must

adhere to both Shari'ah and general financial regulations. These institutions need to continuously innovate by developing a structured guide and refining their product development processes. This proactive approach will ensure sustained growth and market relevance. The aim of this paper is to develop a framework which best describes the new product development process within Islamic banks of Pakistan. For this purpose, this study explores the current practices of Product development process in Islamic Banks of Pakistan using unstructured interviews collection tool of primary data with intent to provide a comprehensive framework for the development of new products in Islamic banks of Pakistan.

### **Literature Review**

The 1980s was an era of financial innovation. Urge for liquidity and risk management led to the innovations in finance (Amdnagh, Jerry, & Bennani, 2022). Islamic finance is a new entry to the world of finance, its principles of operations differ from the conventional finance. It differs since it is compliant/bounded by Islamic Shari'ah law, it includes certain prohibitions of practices that are lawful in conventional banking, such as interests on loans etc. This emphasizes the necessity of creating services and financial products that are suitable for the industry (H. Ahmed, 2015). By developing new capabilities and knowledge Islamic financial institutions can achieve competitive edge via strategic creativity (H. Ahmed, 2015). Products offered by Islamic institutions have been criticized by Islamic scholars for not being in line with the spirit of the Islamic law. The Islamic total return swap is a copy of conventional swap (H. Ahmed, 2015). Many conventional financial products are copied by the Islamic financial institutions uses the Shari'ah contract but are not acceptable. Usmani (2007) puts major sukuk bonds as replication of conventional bonds. This has led to the negative perceptions about the Islamic financial industry. The three main challenges industry is facing are broadening the purview of its financial operations, preserving excellence in service delivery and capitalizing on profitable advancements in the financial markets (Zaporowska & Szczepański, 2024).

Islamic banks have successfully applied Shari'ah principles in Islamic products such as Musharakah, Mudaraba, Istisna and Murabaha. Many successful products have been innovated in Islamic finance like "Sukuk" an Islamic bond, "Commerce International Merchant Bankers Berhad

Islamic's Profit rate swap” and “Shari’ah-compliant interest rate Swap” Bai-Salam and Bai-Muajjal for futures trading. Takaful an Islamic mutual insurance has been successfully introduced in the market. Globalization and technological innovations are making the markets evolve with time to provide better services to the customers. In the constantly changing and dynamic environment of industry, innovation is seen as the firm's response (Shinkafi & Ali, 2018)

To remain competitive in the market Islamic financial institutions needs to develop and offer innovative products and services (Hassan, Rabbani, & Ali, 2020). The way Islamic banks operate differs from that of mainstream banks as Islamic banks are more tended towards investment than credit and loan provision. There are two ways to develop new financial products: reverse engineering and innovation. The former entails developing new products out of the existing conventional products by finding the closest substitute to basic Islamic instruments and making it Shari’ah compliant. The latter approach to developing Islamic products is more complex and challenging but provides the best results, is about the application of Shari’ah principles to design and innovate new products. The facts that make it more difficult to innovate new products in developing countries is the absence of efficient markets, regulatory laws and information symmetry which are the basic settings for Islamic finance to flourish.

### **Factors Affecting Product Development**

Miles and Snow (2003) gives three organizational problems and how the firm adapts to resolve these problems. The three problems are entrepreneurial, engineering, and administrative. The entrepreneurial problem is the identification of the market where the product will be used. The engineering problem is the formation of the product by providing sufficient material. The administrative problem is the timely delivery of the product to the desired market by creating efficient processes and procedures.

Ansoff (1965) gives four strategies for the market and product development. Market development, product development, market penetration and diversification. In market development, a firm explores a new market for the existing products while in product development it develops new products for the existing market. However, in market penetration a firm seeks to increase market share by selling the same product in bulk in the existing market. In diversification, a firm produces new products for new markets.

There is another classification of how a firm strategically approaches product development which is given by (Miles & Snow, 2003). These are prospectors, analyzers, defenders, and reactors. Prospectors are always in search of new market opportunities and to produce new products. Analyzers, however, operate in two different dimensions. One stable and the other evolving. In a stable market, analyzers do not introduce new products. While in the evolving market, they look up to prospectors and new products are developed for the market. Defenders are niche marketers, and they remain confined to their market segment alone with relatively low change in the product. Reactors react slowly to their market and often slowly develop new products for their market.

Ahmed (2011) has defined two major factors which influence financial product innovation, which are the institutional environment and organizational aspects of a firm. The institutional environment is further broken down into factors such as international and national. The international factors are the increase in globalization, risk and technological innovations. The national factors are the laws and regulations of the country. The second major category is organizational aspects which are further integrated into strategic directions set by the firm such as growth, market conditions and future business prospects. The growth potential in the market, rules and regulations and the bank's approach to innovation will determine their product development systems. Product development is a complex procedure which involves interaction from various departments of the firm. Successful product development requires appointing responsibilities and duties to different departments of the firm. In the efficient development of products, organizational design and resources available to the firm performs a significant role (Ahmed, 2011). The essential unit involved in new instrument creation in Islamic banks is Shari'ah department. The role of the Shari'ah board is to check whether the product is according to the Shari'ah rules or not. Apart from this the Shari'ah department helps Islamic banks in various stages of the product development process (Ahmed, 2011).

Product development depends on the organizational structure of the firm, but it cannot be done without its fuel, which is resources and their availability. A firm needs capital, human and technological resources to develop a new product. A large firm can work on development of different products simultaneously compared to a smaller one (Ahmed, 2011). Smith and Reinertsen (1998) argue that a core team, if created for the development of the product, will be more efficient, which will reduce the time-consumed and resources. The core team can be composed in case of

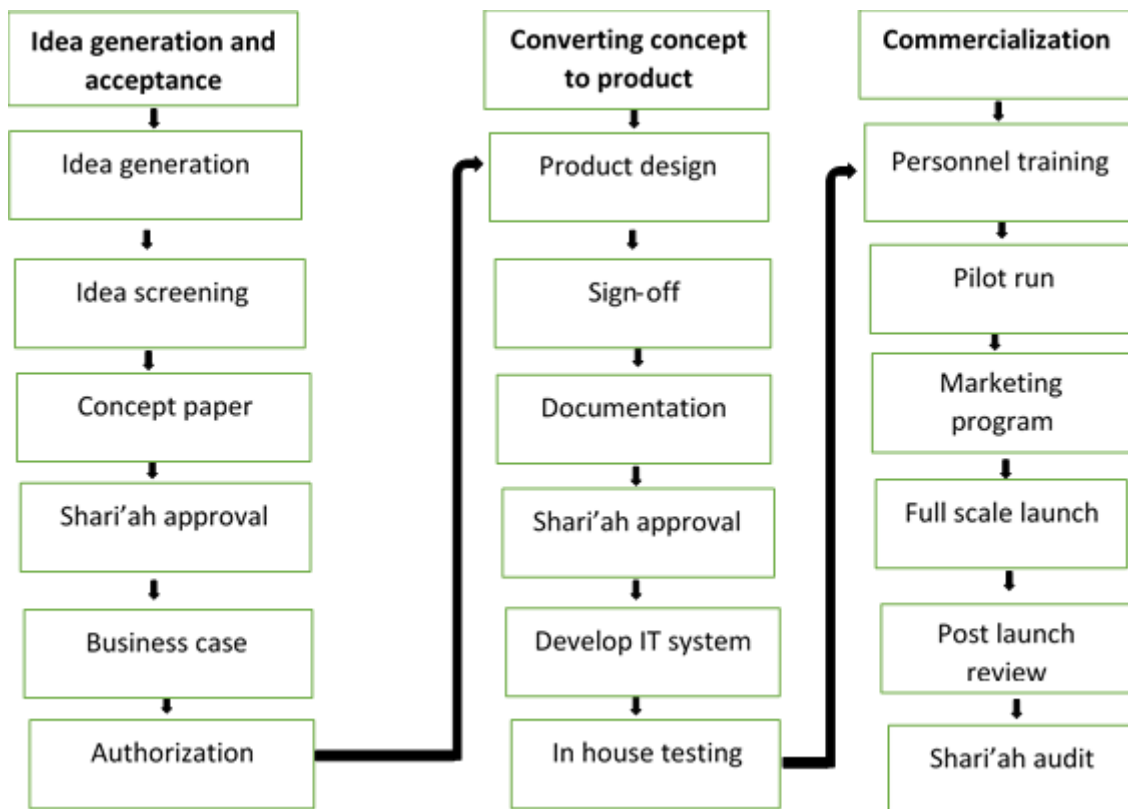
Islamic banks by bringing members from Shari'ah department, Product development, risk management and relative business unit (Ahmed, 2011).

After the strategy of innovation is incorporated into core strategies of business, it needs to identify segments of markets to entertain and produce products accordingly (Ahmed, 2011). This entails developing annual goals and operational plans for the business. Ahmed (2011) argues that there will be difference between the strategies of Islamic banks and conventional banks. As conventional banks are more profit oriented, and their goal is to maximize profit (Reinertsen, 1997). While Islamic banks also operates for profit but only offers products which are within the principles of Shari'ah.

### **Theoretical Framework**

Theoretical framework of this study is based on the 3-stage model given by Habib Ahmed (2011:108) in his book. The 3 stages are further divided into 18 steps. The model gives details about the procedure which is followed in development of a product in Islamic Banks. As applied to this study, this model will be used to identify the procedure undertaken by Islamic Banks in Pakistan. The 18 steps process is shown in figure 1.

Figure 1:



Source Ahmed (2011:108)

### Research Methodology

The present study is descriptive in nature and describes the process of product development in Islamic banking industry of Pakistan. The study uses qualitative research approach to study product development using Ahmed (2011:108) model as a base, to study whether the same model can be applicable in the Islamic banking industry of Pakistan. To clearly understand the product development process in Islamic banking industry of Pakistan, there is a need to get in depth information about the procedure. Thus, qualitative techniques such as interviewing will help in better understanding the product development procedure in the Islamic Banks of Pakistan. Qualitative research is based on “researcher’s immersion in the phenomenon to be studied, gathering data which provide a detailed description of events, situations and interaction between people and things, [thus] providing depth and detail” (Cooper et al., 2006:146). To help gather the data needed for the research it is vital to select the most appropriate data collection technique. Data collection can be described as the means of collecting information which helps in answering



research questions (Creswell and Clark, 2007). The characteristic of this study is descriptive research design. Therefore, primary data is collected through unstructured in-depth interviews to develop a model suitable for the Islamic banking industry of Pakistan. The aim of this study is to explore the product development process in Islamic banks of Pakistan through qualitative study. Propositions are declarative statements which can either be true or false (Cooper and Schindler, 2014). The propositions are detailed below:

*P1: Islamic banks usually develop new products to meet market demand.*

*P2: A specialized product development unit operates in Islamic banks of Pakistan.*

*P3: New products are developed by following a recognized process of product development in Islamic banking of Pakistan.*

*P4: Conventional products are used as basis for the development of financial products by Islamic banks in Pakistan.*

*P5: During development of the product Shari'ah approval stages are handled with great care in Islamic banks of Pakistan.*

*P6: Shari'ah audit of new product is carried out after a specific period set by the Shari'ah board in Islamic banks of Pakistan.*

*P7: Lack of Shari'ah advisors in Pakistan is the biggest barrier to developing products in Islamic banks.*

*P8: Shari'ah compliance is a major risk during development of new products.*

### **Sampling and Data Collection**

The sample for the unstructured interviews was selected based on snowball sampling technique. Identifying the personnel involved in the process of product development at different stages. The sample consisted of personnel from three major banks in Pakistan and a research scholar to give more validity to the findings of the research due to contextual differences and different roles played by each interviewee within different context (Yin, 2003). Moreover, interviews were taken from members of Shari'ah board, product development team member, Islamic research scholar and Shari'ah compliant member to bring diversity to the research by looking at different angles of the product development process in the industry. Four in-depth

interviews were conducted for the collection of primary data in this to study the development of financial services in Islamic banks of Pakistan. In this study the data collected through unstructured interviews was recorded and was transcribed using verbatim transcription as suggested by (Poland, 1995). After transcription the data was compared with the model of Ahmed (2011).

### **Data Analysis**

The qualitative data gathered through interviews is analyzed using thematic analysis. Thematic analysis consists of identifying themes and analyzing and reporting it from the data (Castleberry & Nolen, 2018). The analysis of qualitative data consists of compiling, disassembling, reassembling, interpreting and concluding to find answers the research questions (Yin, 2015). In the first step of compiling the transcription of data is carried out. Transcription of data is carried out using verbatim transcription (Poland, 1995). After data is transcribed it is grouped into different groups based on coding using themes, concepts or ideas (Austin & Sutton, 2014). In the next step themes are created based on the codes or categories. A theme in data capture important information related to research questions (Braun & Clarke, 2006). Data is then interpreted from the themes and codes generated in relation to each other. Identifying and labeling themes is interpretation. Raw data collected through interviews forms codes which forms themes and are identified in interpretation. Conclusion is the response to the purpose or research questions of the study which is then drawn based on the interpretation of data (Yin, 2015).

### **Data Analysis: Discussing Propositions with The Primary Data**

The research propositions are studied individually with the data collected through the unstructured interviews conducted with the industry specialists. The discussion about the propositions with the help of data collected is as follows:

*P1: Islamic banks usually develop new products to meet market demand.*

This proposition stands true as interviewees ISA, SCM, and PDTM have asserted that their banks produce products when there is demand from the customer but not when there is no demand in the market and just go for an idea generation to developing the product which might grow

demand slowly at a later stage. The product is produced when there is certainty of the product in the market.

*P2: A specialized product development unit operates in Islamic banks of Pakistan.*

This proposition is true in case of Islamic banks and false in case of conventional banks with Islamic services as interviewee ISA said their bank doesn't have a specialized product development department and the procedure is operated by the marketing department to ascertain the market demand by conducting predevelopment stage of the product. However, interviewee SCM and PDTM both said their banks had a specialized product development department dedicated to producing new products into the market as per demand of the market.

*P3: New products are developed by following a recognized product development process in Islamic banks of Pakistan.*

This proposition is true because the views of all the interviewees are the same on this. According to them product development starts from recognizing the demand from the market. The product development team initially surveys the market for the data, which is then analyzed with bank policies and State bank guidelines to see whether it is suitable for the bank or not. After that it is developed according to the pro forma launched by the State bank for the development of a new product which must be followed.

*P4: Conventional products are used as basis for developing Islamic financial products by Islamic banks in Pakistan.*

This proposition stands true in case of conventional banks with Islamic services but stands false in case of Islamic banks, as interviewees had difference of opinion regarding the matter, interviewee ISA said that we develop product according to the need of customer and customer comes with an already made up mind about conventional products and to meet their demands mostly conventional products are used as basis for the development of new Islamic products. But interviewee SCM and PDTM said their banks were developing products on Shari'ah compliance basis and conventional products are not used as basis for the development of Islamic financial products.

*P5: During development of the product Shari'ah approval stages are handled with great care in Islamic banks of Pakistan.*

This is true in case of all the Islamic banks as all the interviewees agreed upon this by asserting from the very start the need for Shari'ah compliance of the financial products and how much important it was for them to remain Shari'ah compliant. Various reviews are taken by the resident Shari'ah board member before initial Shari'ah approval.

*P6: Shari'ah audit of new product is carried out after a specific period set by the Shari'ah board in Islamic banks of Pakistan.*

True, all the interviewees said that their banks have a compulsory internal Shari'ah audit at least once a year of every branch a condition made compulsory by State bank of Pakistan. External Shari'ah audit is carried out by selecting branches not case wise.

*P7: Lack of Shari'ah advisors in Pakistan is the biggest barrier to product development in Islamic banks.*

True, all the interviewees had the opinion that the main hurdle to development of new products is lack of quality product developers with command both over Shari'ah and business matters who can create products on Shari'ah basis with the mindset of achieving maqasid al-Shari'ah and not with the mindset of conventional product developer.

*P8: Shari'ah compliance is the main risk during development of new products.*

True, this has been pointed out by all the interviewees that Shari'ah compliance is the key risk while developing new products in Islamic banks of Pakistan. This risk has not only been addressed at the start of the product development stage but also post launch Shari'ah operations reviews are done just to make sure that the product is Shari'ah compliant with the passage of time as new regulations are formed.

### **Discussing Product Development Process in Islamic Banks of Pakistan**

Primary data collected through Unstructured interviews is analyzed and summarized to discuss the product development process in Pakistan keeping in view the product development model presented by Ahmed (2011). The steps and phases induced to the model in case of Islamic banking industry of Pakistan is discussed only.

### **Idea Generation and Acceptance**

This is the initial phase of a new product's development in Pakistan's Islamic banks. It consists of six steps which are Idea generation, Idea Screening, Concept paper, Shari'ah approval, Business Case and Authorization.

### **Idea Generation**

This entails the process of generating new ideas for the product to be developed by the bank (Ahmed, 2011). In case of Pakistan mostly the new ideas generated for the new products are market demand based. The product development department carries out market analysis of the product and produces a working paper which details any advantages or disadvantages the product might have.

*“We look for a product which meets a demand in the market and the structure of it be that of conventional bank or not or a private sector e.g. there are shops of car Ijara, house Ijara, Murabaha transactions in the society. So, in the first phase the demand of the customer and the source available in the market are analyzed. After analysis proposal is formed which contains information about the market, structure of product and how it is operating in the market under certain terms and conditions.”*

*Internal Shari'ah Advisor*

In Pakistani market the idea generation of product is need based, instead of being Prospectors and develop new and innovative products, industries are more likely analyzers and reactors in the market, reacting to the trends. So is the case in Islamic banks of Pakistan.

*“There is a need from the business side that we need this product for our customers in the market to fulfill their needs. For example, take credit card there is a small number of Islamic credit cards in the market. So, a need for the development of Islamic credit card emerges in the market which must be addressed by the bank.”*

*Shari'ah Compliance Department Member*

The above discussion shows that the Islamic banks in Pakistan are developing new products according to the need and demand of the market.

### **Idea Screening**

Idea screening includes rejecting ideas and selecting the most suitable idea for the bank based on the strategies, structure and policies of the bank. And keeping in mind the regulations enforced by the regulator whether they are in line with it or not.

*“The terms and conditions of a product are analyzed on two points, one based on bank policies by comparing those terms and conditions with bank policies whether they can be met by the bank policies or not. Secondly, according to the state bank guidelines whether they allow it or not.*

*And then an idea best suitable for the bank is selected and processed on.”*

*Internal Shari’ah Advisor*

The process of idea screening is very rigorous; it is the initial approval of the product from the developing team itself. They must analyze the industry rules and regulations, the product idea is analyzed based on risk, profit and loss terms, they must analyze the structure and model of the product’s idea to make an appropriate decision.

*“The process consists of multiple analysis of bank policies, State bank regulations, risk analysis and operations of the product. Then an idea is selected for further process.”*

*Product development team member*

Also, the idea screening process is dependent upon the need and demand of the bank as well. They cannot approve a product’s proposal which cannot help them in achieving the long-term goals and strategies of the bank.

*“It depends upon the need of the bank to produce products in the market according to market demand. Where there is need in the market you must produce that product.”*

*Shari’ah Compliance Department Member*

Although Islamic banks in Pakistan produces products according to the needs and demands from the customers. However, they also produce products which are not needed by the customers, but the product development team acknowledges the urge for a new product and an idea is developed which is processed in the screening step.

*“There are two types, producing a new and innovative product and producing what is needed.*

*Where you will have to produce your own ideas, you will have to go through the internal Shari’ah advisor and Shari’ah board that we want to launch this product in the market? And*

*based on their evaluation a final judgement is made whether to pursue the idea or trash it. And the other is we launch a product knowing that it will create demand in the market.”*

*Research Scholar*

These comments and discussion indicate the importance of Idea screening in the process of product development.

### **Initial Shari’ah Approval**

When an idea is generated, and product development teams work on the development of working paper or concept paper after idea screening it is referred to the management’s approval but that is the case in other businesses or conventional banks. In Islamic banks the initial approval is taken from Shari’ah board for Shari’ah compliance of a product.

*“The concept of the product must be approved by Shari’ah at the earliest stage whether to pursue it or not. Procedure is a later part before approval. The initial step is to approve concept paper. If the Shari’ah board disagree on the Shari’ah compliance then no further steps are taken and the concept is dropped. First, it must present the concept paper to Shari’ah board that we want to develop this product and then the other phases will start after approval.”*

*Shari’ah Compliance Department Member*

The Shari’ah board is responsible for the initial approval of the product, it must decide whether the product is Shari’ah compliant or not after analyzing all the documents of the product.

*“The role of Shari’ah board as per the instructions of State Bank of Pakistan is that the Shari’ah board is supposed to approve all the documents whether related to product development or operations procedure or any other shall be approved by Shari’ah board.”*

*Internal Shari’ah Advisor*

Shari’ah board approval is mandatory in product development procedure of Islamic banks of Pakistan. This step is one of the major differences between activities of Islamic and Conventional banks.

### **Converting Concept into Product.**

Conversion of the concept into the product is the next stage of product development process in Islamic banks of Pakistan. This stage consists of four steps mainly product design, sign off, documentation and legal department's comments.

### **Documentation**

Documentation starts with the first step of idea generation; documents are prepared at each step of the product development process. Product development teams organize the data collected from the market which is further analyzed and put forward to the Research department.

*“The documents regarding the new product which will be produced are sent to the research department for the initial development of the documentation, by doing a market survey and collecting all the details about the product. The research department also suggests 3-4 alternatives to the product. Those documents are then passed to the Risk department for risk analysis to check the best possible alternative for the bank. The risk department comments as to which one is more suitable for the bank. Then it comes back to the initial team which overlooks the comments of risk department and then forwards it to the operations department to see if it is possible operationally whether it is easy or difficult.”*

*Research Scholar*

The process of documentation is important in every bank as they must keep a record of each entry made to make the banking business clearer and more attractive. In Islamic banks documentation is not only important because bank must produce documents for every transaction made but the fact that the structure of the product is formulated in the documents of the product.

*“Documents are the building blocks of new product development in Islamic banks. As the Islamic product's structure is formulated in the documents.”*

*Shari'ah Compliance Department Member*

Documents are the backbone of the banking industry which is needed at every stage. Islamic banks in Pakistan also must deliver on this subject with full enclosure.



### **Legal Department**

The step after documentation is the legal department. All the documents which are formulated during the process of product development are sent to the legal department. The legal department is responsible for analyzing the validity of the documents by checking their documents under the prism of laws and regulations of regulator, local and State laws.

*“The step as after operations department comments, it mostly goes to the legal department to check the legal documents and provide their inputs on them. The legal department is responsible to overlook all the legal clauses in the document and to comment when they deem necessary if a clause is not in the interest of the bank.”*

*Internal Shari’ah Advisor*

This step is carried out in the product development process before Shari’ah approval, so that there could be no ambiguity in the document regarding any laws.

*“The role of the legal department in the sense of the Islamic banks as the products are to be seen from both legal and Shari’ah point of view. So, the legal department must present their point of view of the product before going for the Shari’ah approval.”*

*Shari’ah Compliance Department Member*

The legal department must see every aspect of the document and make sure it doesn’t violate any of the bank’s policies, the regulations imposed by the regulator and State laws.

### **Approval**

The third stage in the product development process is the approval stage. In this stage two major approval are sought, approval from the Shari’ah board and approval from the State bank of Pakistan.

### **Shari’ah Approval**

Shari’ah approval is mandatory in the process of product development in Islamic banks all over the world. Shari’ah approval is divided into two stages, an initial Shari’ah approval and final Shari’ah approval. Initial Shari’ah approval is taken right after the development of a concept paper

so that no more resources are wasted if the product is not Shari'ah compliant. Final Shari'ah approval is taken from the Shari'ah board after making all the documents necessary and developing a structure for the product.

*“After the complete documentation of the product is performed manual SOPs are made which are then approved by the Shari'ah board. Shari'ah approval is at two stages. One is at the concept paper stage, and one is when the product is finalized. A fatwa or Shari'ah certificate is brought before the Shari'ah board with all deliberations which is then approved by Shari'ah board which is called Shari'ah approval. Shari'ah certificate is signed by Shari'ah board.”*

*Shari'ah Compliance Department Member*

Resident Shari'ah board members present all the documents of product to the Shari'ah board for approval. If there is any confusion it is the responsibility of RSBM to address it before the Shari'ah board for approval of the product.

*“The approval of Shari'ah board is sought after getting all the documents in place and presented before the Shari'ah board by the resident shari'ah board member for approval.”*

*Research Scholar*

Shari'ah board must be informed of each detail of the product so that there would be no confusion in issuance of fatwa.

*“After legal department's comments the best alternative is selected and is presented to the Shari'ah board for approval with all the details, that this is the existing procedure, this is the market procedure and bank procedure and the difference between them. At the end it goes to Shari'ah board which approves or disapproves the product on Shari'ah basis.”*

*Internal Shari'ah Advisor*

Shari'ah board's approval is very important in product development process, the investors and customers who doesn't have knowledge of Shari'ah looks to the fatwa issued for the product as they believe Shari'ah board have studied the product and is free of any Shari'ah compliant issues.

### **State Bank Approval**

The next step in the approval stage is regulator's approval or in this case the approval of State bank of Pakistan is required. This is a mandatory step in the approval stage without the approval from the State bank, the bank cannot launch the product. The process for the approval is same as the approval from the Shari'ah board as the bank must submit all the documents related to the product to the State bank with the fatwa issued by the Shari'ah board as well.

*“When the bank gets Shari'ah approval from the Shari'ah board, the next step is to approve the product from the State bank for which they submit documents of the product to the State bank for approval. In the last stage it is sent to the state bank for approval that we are launching this product.”*

*Product Development Team Member*

The process of approval from SBP is explained in the circular issued by the SBP for the approval of a new product. They have a designed pro forma for this process which requires all the documents from the bank. The SBP analyzes the documents and contacts the bank if they have any queries regarding the product. The condition for approval of any product is that if SBP do not come up with any queries within 30 working days of the submission of documents then the product is considered as approved.

*“After approval from the Shari'ah board everything must be submitted to the State bank. When the State bank approves it then the bank starts its activities. State Bank has some requirements for the new product. The State bank has already issued a pro forma for the new product approval. It has a specific circular for the introduction of new product requirements. The documents are submitted to the State bank which has an already designed pro forma with all the required information about the product. After receiving the information, they decide whether to approve or disapprove. General condition of State bank is if they do not reply with any queries regarding the product within 30 days then it is considered as approved.”*

*Internal Shari'ah Advisor*

State bank of Pakistan is the regulator of banking industry in Pakistan which also includes Islamic banks of Pakistan. As it is the requirement of SBP to submit documents of new product to

SBP for approval for all the banks, Islamic banks must also submit their documents of new products to SBP for approval.

### **Developing Systems.**

The next stage in product development procedure in Islamic banks of Pakistan is developing systems according to the need of the product. This stage includes three steps which are developing the IT system, In-house testing and management approval or product review.

### **In-House Testing**

In-house testing is carried out after the product is finalized. It is launched on a test basis in a selected branch of the bank and one or two employees of the bank are trained to handle the customers. The purpose of in-house testing is to find any issues which might arise in the product once it is launched.

*“After the approval stage the product is run on a test basis, the bank does not launch it openly in the market. We select a particular branch and select two to three customers and train personnel accordingly as to how to present this product, what are the terms and conditions of this product, advantages and disadvantages of this product and system wise how entries are made. After training a task is given to pilot test the product for 2 or 3 months. Testing is limited on both sides’ customer wise as well as amount of product.”*

*Internal Shari’ah Advisor*

In-house testing is carried out to check for the risks associated with Shari’ah, market risk, operations risk or accounting risk. These are the key points which are kept in mind while reviewing the product at the in-house testing stage. The product is checked for any Shari’ah compliance issues which might arise later. Many products are launched for 2 to 3 months after getting Shari’ah approval which are only limited for the bank employees.

*“Testing is done risk wise as to what type of Shari’ah risks are there, Will the product remain Shari’ah compliant or not? Some products are launched at pilot stage by taking initial approval from Shari’ah board and launch the product for two to three months and after that it will be launched formally. Or some products not in corporate but in consumer we launch it for our*

*employees at the start. And only the bank employees have access to that product and is reviewed after two to three months how it is going and what type of issues are arising in it.”*

*Shari’ah Compliance Department Member*

In-house testing is essential for the bank as it helps the bank in assessing the profit and loss of the product to the bank, it saves resources which might be wasted if the product incurs problems after launching. Then the bank will have to pull the product back and all the resources in developing and launching the product will be wasted.

### **Management Approval or Product Review**

In the developing systems stage, the next step after in-house testing is to review the product or approve it from the management. The review of the product is put forth to the management by the employee who was responsible for handling the product during in-house testing step. The queries of management are answered by the same employee and if the management deem it wise, they approve it.

*“After the testing is done the trained personnel responsible for handling the product are going to brief the management about any issues that arose during the process. After the briefing management decides if they should offer it publicly or not or should go for checking the product again.”*

*Internal Shari’ah Advisor*

Management’s approval comes right before the Commercialization stage, and as the product is about to launch it is reviewed once more by the management and any issues which have been detected during the in-house testing will be addressed accordingly.

*“After completion of pilot step, a review is done and approval from the management is sought. The management approval is sought right after the pilot testing is done while addressing the issues which might have aroused during the pilot testing.”*

*Shari’ah Compliance Department Member*

Management's one last look at the product before launching it publicly adds more scrutiny to the process of product development. This step ensures that the bank is putting its resources in the best possible way for generation of profit and achieving maqasid al-Shari'ah.

### **Commercialization**

The 5<sup>th</sup> stage in the product development process of Islamic banks is Commercialization. This stage includes 3 steps which are Personnel training, Marketing program and Full-scale launch.

#### **Personnel Training**

Personnel at banks are trained according to the product to deal with any issues and queries related to the product on the customer's side. Personnel are trained in different phases and in each branch of the bank to ensure quality is delivered to the customers.

*"The personnel training is carried out after the management approval for the development of the product. The personnel training is carried out in phases for each branch."*

*Internal Shari'ah Advisor*

Training of personnel is carried out by the Shari'ah compliance department of the bank. This is mandatory by the State bank of Pakistan's framework to ensure that the trained personnel also have the knowledge to handle queries related to the Shari'ah aspect of the product.

*"According to the framework of State bank training of personnel according to the new product is the responsibility of Shari'ah compliance department. Any new product that is launched in the market, the concerned people are trained by the Shari'ah compliance department."*

*Shari'ah Compliance Department Member*

Personnel training is important for the bank to deliver on its promises to the customers and ensure quality service to the best of their efforts to the society. Trained personnel are also good for the image of the bank and retention of customers.

### **Review**

This is the 6<sup>th</sup> and last stage of new product development in Islamic banks of Pakistan. In this stage 3 steps are included which are Post launch review, Shari'ah audit and Operations Shari'ah review. These steps are carried out after successfully launching the product in the market.

#### **Post Launch Review**

Launching of a new product in a Shari'ah market is a risky business. Soon after a new Islamic product is launched in a market, reviews over it starts instantly because it needs to be Shari'ah compliant in every aspect. The newly launched product is reviewed annually, semi-annually, quarterly or monthly depending on when the need is felt to inculcate the theories/fatwa with their emergence in the need of time.

*“Repeated review over the newly launched product is an ongoing process and the requirement of the State Bank of Pakistan. As to ensure that the product operates as a fully shari'ah compliant and is fully equipped with the newly emerged shari'ah fatwas in the need of time and to fulfil the legal limitations of the State Bank of Pakistan.”*

*Internal Shari'ah Advisor*

Many banks have a time frame of at least six months to review their products. The products are reviewed based on their possible Shari'ah compliance issues and operations issues.

*“New products are mostly under review after at least six months. These reviews are based upon the operations of the product and riskiness of the product.”*

*Product development team member*

Review of a product is decided by Shari'ah board and Shari'ah compliance department as per guidelines of State bank of Pakistan. They are responsible for deciding the time frame of each review and how long after the launch date of a product these reviews should start. These reviews depend heavily on the factor of riskiness of a product, riskier products are reviewed as late as possible in a month or a quarter while less risky products are reviewed semi-annually and annually.

*“The Shari'ah board and Shari'ah compliance department decide how much later after the launch date the reviews will start. When the product is launched it depends upon the riskiness of the product, if it is riskier, it is reviewed monthly or quarterly, if less risky than either semi-*

*annually or annually. Product review is done branch wise, and others are done department wise.”*

*Shari’ah Compliance Department Member*

Every time one or two products are under review for their riskiness, Shari’ah compliance issues and operation problems.

### **Shari’ah Audit**

Internal Shari’ah audit of the product and branch is carried out by the Resident Shari’ah Board Member of the bank. RSBM is responsible for selection of product, branch and department of the bank to be audited.

*“Internal Shari’ah audit is the responsibility of internal Shari’ah audit department. They have to decide how, when, which product and which department or section of the bank we have to review. Is it going to be branch wise, product wise or department wise, all this is the responsibility of the internal Shari’ah audit department.”*

*Internal Shari’ah Advisor*

Shari’ah audit of a bank’s operations is carried out in two steps or by two different entities. One is internal Shari’ah audit which is the responsibility of RSBM to carry out the audit and the other one is external Shari’ah audit which is carried out by certified auditors. The process of Shari’ah audit entails that the internal Shari’ah audit must be carried out of each branch and product once a year. While external Shari’ah audit is based on selection of branches which are selected by the external auditors.

*“Shari’ah audit is carried out at two stages internal and external Shari’ah audit. Internal Shari’ah audit is compulsory of every branch once a year. External Shari’ah audit is done on selection basis they do not take cases. But for internal Shari’ah audit it is must that they visit one branch once a year.”*

*Shari’ah Compliance Department Member*



For a clear and clean banking operations specially in Islamic banking, Shari'ah audit is carried out by the bank and auditors once a year just like any other business. The important thing about Shari'ah audit is that it enables the business to filter the Shari'ah non-compliant products and make them Shari'ah compliant again.

### **Operations Shari'ah Review**

Operations Shari'ah review of the product entails a process of reviewing the operations of Islamic products and reviewing them for non-compliance Shari'ah issues.

*“Shari'ah review is also performed of the operations of the product to check their operations Shari'ah compliance. In this step we do selected branches, and the effort is to cover 70-80% branches a year.”*

*Internal Shari'ah Advisor*

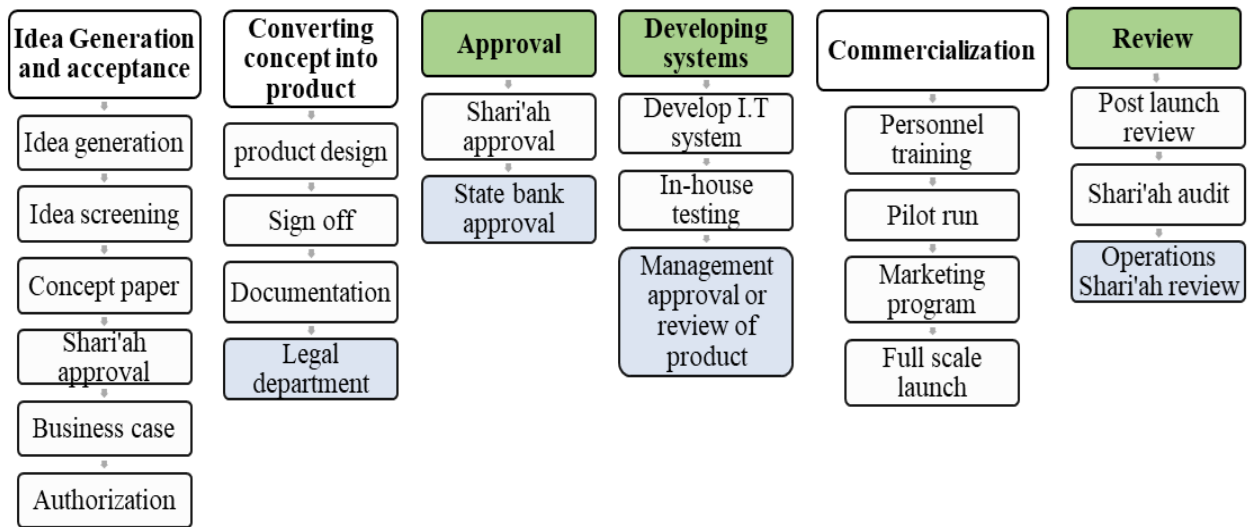
These Operations Shari'ah reviews enables the Islamic banks to carry out necessary steps to make sure that the product runs smoothly in the market. This is the responsibility of the internal Shari'ah department and each year 70-80% of the branches of a bank are reviewed for operations of Shari'ah to make sure they remain Shari'ah compliant.

### **Discussing Pre And Post Empirical Frameworks.**

The framework given by Ahmed (2011) for the development of new products in Islamic banks consists of 3 major stages and each step consists of six steps and in total it is 18 steps. The post empirical framework for new product development in Islamic banks of Pakistan, developed during the analysis of the data collected from industry officials in Islamic banks of Pakistan suggests that there are six major stages during product development and in total the process completes in 22 steps. The stages induced by the researchers after analysis of the data includes Approval stage in which approval from State bank and Shari'ah board is required, the next stage added by the researchers is Developing systems in which the bank develops I.T systems, in-house testing of the product and management's approval is carried out. The other stage induced is the review stage in which there are steps of Review, Shari'ah audit and Operations Shari'ah review. There are four steps in general added to the product development framework which are Legal

department’s review of the documentation, State bank approval, Management’s approval or product review and Operations Shari’ah review. There are six major stages in the post empirical framework compared to three major stages in pre-empirical framework. There are 22 steps in total for the completion of a product development process in the post empirical framework while pre-empirical framework had only 18 steps to be completed. Post empirical framework is given below, the stages and steps added are highlighted with light green and light blue coloring of the boxes.

**Post Empirical Framework**



**Conclusion & Recommendation**

**Conclusion**

Islamic banking industry in Pakistan is still in its developing stage. There are a lot of challenges faced by Islamic banks while developing new products. Consumers still misunderstands the operations of Islamic banks same as conventional banks. The biggest challenge that Islamic banks faces is in the Information technology department. Banking software is expensive and are initially developed for conventional banks and to use them for Islamic banking operations becomes a challenge as the essence of Islamic banking products is on the operations of the product not the end result. The aim of the study is to explore the current market practices undertaken by Islamic banks of Pakistan to create new products and to examine whether the model of Ahmed, (2011) is

applicable in Islamic banks of Pakistan. The model given by Ahmed, (2011) is a comprehensive model covering all aspects of new product development process. This model is applicable in the Islamic banking industry of Pakistan but with induction of small steps, such as legal department after documentation, management's approval or review of product, State bank's approval for development of new products and Operations Shari'ah review. It can be carried out simultaneously with Shari'ah audit or before and after Shari'ah audit. The main purpose of Shari'ah review is to review the operations of new products to meet Shari'ah compliance. With the induction of these steps the model will become a more comprehensive model acceptable to the Islamic banking industry of Pakistan. By adopting this model, the Islamic banks in Pakistan will be able to produce timely and efficient products through a structured process meeting the demands of the market.

### **Recommendations**

(i) State bank of Pakistan should devise a separate Islamic PR department to deal with Islamic banks only, it should also perform advisory functions in transactions between Islamic banks and customers to help flourish the industry and provide protection and ease to Islamic banks in documentation process.

(ii) Islamic banks should foster an environment of Shari'ah based product creation to achieve Maqasid al-Shari'ah and reduce the documentation process to gain and retain customers.

### **Limitations and Future Research**

Future research can be done on the comparison of the product development process and the success of the product produced through it. Also, future researchers can opt for financial reengineering process in Islamic banks of Pakistan and their success rate in Pakistan.

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