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## Article

# How are Islamic banking products developed? Evidence from emerging country

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# How are Islamic banking products developed? Evidence from emerging country

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## ABSTRACT

Sharia product development in Indonesia faces unique challenges in terms of strategy and innovation compared with conventional products. Islamic banking managers must adhere to Sharia principles to maintain customer trust and comply with Islamic law. Compliance with Sharia principles is not only a religious obligation but also the foundation of the business model. This study used qualitative methods, specifically semi-structured interviews, to validate the Sharia product development practices in Indonesia. Seven experts from diverse backgrounds were interviewed, and their responses were thematically analysed using NVivo version 12. The findings confirm that the Sharia supervisory board and Islamic banking management play crucial roles in developing Sharia products. They collaborate to ensure that Sharia products adhere to the principles, meet customer needs, and comply with relevant regulations and standards. This collaboration enables efficient development of Sharia products that align with values and meet market demands. Moreover, their involvement goes beyond their compliance. They also contribute to the ethical and responsible growth of Islamic banking by fostering customer trust and confidence. Their commitment to upholding the core principles of Islamic banking establishes a solid foundation for the sustainable development of Sharia-compliant products in the global market.

## IMPACT STATEMENT

Building strong relationships with clients should be a priority for Islamic banks, achieved through a deep understanding of their unique needs and the provision of personalized solutions. This approach helps to establish trust, loyalty, and long-term relationships with customers. Islamic banks should prioritize ethical and responsible banking practices, including transparency in transactions, adherence to ethical standards, and promotion of social responsibility. Islamic banks must effectively communicate the moral and ethical aspects of their business models to customers. This not only helps build customer trust, but also differentiates Islamic banks from conventional banks, attracting customers who value ethical and responsible banking practices. The success of Islamic banks in the competitive banking sector relies on their ability to strategically position themselves by continually innovating and developing products that meet the needs of their target customers.

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## 1. Introduction

The development of Islamic banking products is important for various reasons. First, it enables Islamic banks to effectively address the financial requirements of Muslim individuals and businesses, while maintaining adherence to their religious beliefs. By providing Sharia-compliant products, Islamic banks can expand their customer base and foster trust in the Muslim community. Second, the advancement

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of Islamic banking products plays a crucial role in promoting the overall growth and stability of the Islamic finance industry (Shahid et al., 2020). As Islamic banking acquires global recognition and popularity, the imperative to remain competitive in the market requires the development of innovative and diverse products. Furthermore, the advancement of Islamic banking products has played a pivotal role in fostering financial inclusion and economic development. Islamic banks can bolster the establishment, service, and growth of SMEs by providing a comprehensive array of products and services. This fosters economic expansion, job generation, and equitable wealth distribution within the community (Mansour, 2020).

In order to achieve this, Islamic banks must actively engage with their clients and present compelling moral justifications for their business practices. It is imperative that Islamic banks effectively showcase the benefits of their innovative financial products, emphasising their strict adherence to Sharia principles and relevance in contemporary business environments (Asutay, 2013). Moreover, Islamic banks are required to accurately identify and comprehensively understand their customers' needs to provide an extensive array of products and services tailored to meet these needs (Mohd Yusof & Wan Jusoh, 2014). Furthermore, Islamic banks should prioritize the establishment and cultivation of robust customer relationships.

One current issue in the development of Sharia-compliant products is the ongoing debate surrounding Sharia scholars' participation in the product development process. Some contend that Sharia scholars must be directly involved in the formulation of financial instruments for a product to be deemed Sharia-compliant. Another concern is the necessity for distinct pricing of Sharia-compliant products. It is argued that these products should possess noticeably different pricing and return characteristics compared with conventional or Sharia-compliant products. Some observers also stress that Sharia-compliant instruments should not utilize conventional interest rates as price benchmarks, thereby calling for the establishment of a Sharia-compliant benchmark linked to real economic activities (Calder, 2020; Jan et al., 2021).

Moreover, there is increasing concern regarding the disconnection of Islamic finance from productive economic activities. Although numerous Islamic financial institutions have asserted their association with the actual economy, the widespread use of complex Sharia-compliant instruments has undermined this correlation. Consequently, there is a demand for a transition towards Sharia-based finance that restores the connection to productive, tangible economic activities (Ahmed, 2014). These issues underscore the ongoing discussions and challenges in the development and definition of Sharia-based products in the Islamic finance industry.

Sharia product development in Indonesia faces great challenges, especially in the development strategy and innovation of new products that are fundamentally different from their counterparts (Zaini & Bin Shuib, 2021). Islamic banks in Indonesia must strictly adhere to Sharia principles when developing their financial products. These banks must maintain the trust and confidence of their customers and adhere to religious guidelines mandated by Islamic law. Compliance with Sharia principles is not merely a religious obligation but also serves as the cornerstone of their business model. By providing Sharia-compliant products and services, Islamic banks cater to the financial requirements of Muslim customers, who seek solutions that align with their religious beliefs. Additionally, Sharia compliance is important not only for Muslim customers, but also for those who prioritize ethical banking practices, regardless of their religious affiliation (Pollard & Samers, 2013). By effectively communicating their adherence to the Sharia principles to stakeholders, Islamic banks can distinguish themselves from conventional banks and attract a broader customer base. This commitment to compliance with Sharia also plays a vital role in shaping the regulatory landscape of Islamic finance. Government authorities and regulatory bodies bear the responsibility of ensuring that Islamic banks remain faithful to Sharia principles to uphold the financial system's integrity (Zaini et al., 2019).

Research on the development of Sharia products in Islamic financial institutions, both banks and non-banks, has been conducted using various approaches. For example, Sharia product development using the theory of the Pyramid of Maslahah (Yumna, 2019), development and regulation of Islamic banking products, with a specific focus on Islamic house financing in Malaysia (Abdul Aris et al., 2013), and research on Sharia product development using the network theory approach, specifically the FORFLOW-Process-Model (FFPM) and Petri-Nets (PN), to model and optimize the product development process

(PDP) in Islamic banks (Chahin et al., 2016). Calder (2020) conducted a study on the evolution and various definitions of the terms 'Sharia-compliant' and 'Sharia-based' within the Islamic finance context. This study delves into the emergence of these terms, their implications, and the debates surrounding their meaning in the Islamic finance industry. Mukhlisin and Suhendri (2018) employ a corporate strategy approach to investigate the Sharia product development strategy in Indonesia. Zulfikar (2020) conducted a study that examined the challenges and opportunities for Islamic banking in Indonesia with a particular focus on product innovation. The study concludes that the main challenges include limitations in human resources and information technology, regulatory support, crisis management, and competition. Ilmi (2023) investigated the significance of product innovation in Islamic financial institutions and the need to harmonize Sharia economic law with relevant laws and regulations. This study also discusses the development of Islamic financial products and transactions within the framework of *ijtihad*.

However, there is limited knowledge regarding the practice of Sharia product development in Indonesian Islamic banking. This study aims to fill this gap by examining the product development practices for Sharia products from the perspective of key actors in Indonesia. Understanding the intricacies of Sharia product development is crucial for gaining a comprehensive view of the Indonesian banking landscape. This study delves into the perspectives of key actors involved in the process, providing a nuanced understanding of the challenges, opportunities, and best practices in Sharia product development. By shedding light on these aspects, this study contributes to the existing body of knowledge and offers valuable insights for practitioners, policymakers, and researchers in the field of Islamic banking in Indonesia.

The main contributors to Sharia product development are management/executive directors and Sharia supervisory boards, who play a vital role in shaping the development of these products. The development of Sharia products in the Islamic banking industry is distinctive as it requires careful consideration of both Sharia principles and economic aspects. Ensuring adherence to these two requirements poses a significant challenge for the development of Sharia products. This study seeks to answer the following question: How do the collaborative efforts of Sharia supervisory boards and Islamic banking management contribute to the development of Sharia-compliant products that are marketable and adhere to regulatory standards? Hence, we hypothesize that effective collaboration and adherence to Sharia principles are crucial for sustainable growth and market acceptance of Islamic banking products to meet the needs and expectations of both Sharia supervisory boards and the management of Islamic banks. This collaboration ensures that Sharia-compliant products are not only marketable, but also adhere to regulatory standards, creating a level of trust and confidence among customers.

This collaboration is important, as it allows for the integration of Sharia principles into the development and design of Islamic banking products, ensuring that they are in line with the ethical and religious values of Islamic finance. The collaboration between Sharia supervisory boards and Islamic banking management allows for a thorough assessment of products to ensure they comply with Sharia principles. This collaboration also facilitates the identification and mitigation of potential risks or issues related to Sharia compliance, helping maintain the integrity of Islamic banking products. Furthermore, effective collaboration between Sharia supervisory boards and Islamic banking management allows for ongoing monitoring and evaluation of Sharia-compliant products. This helps identify and address any deviations or non-compliance in a timely manner, ensuring that the products remain Sharia-compliant throughout their lifecycle.

## 2. Literature review

Product development plays a pivotal role in driving growth and ensuring the success of Islamic banking. Islamic banks can effectively appeal to a broader customer base and satisfy their distinctive financial requirements through the provision of inventive and comprehensive offerings. Islamic banking, a rapidly expanding sector in the finance industry, operates following the principles of Islamic law, also known as Sharia. As such, all financial transactions are conducted in strict adherence to Sharia principles, which prohibit interest-based transactions and encourage ethical and socially responsible investments (Bacha, 2013).

Some strategies that Islamic banks can adopt for product development include the following (Faizi & Shuib, 2021; Pollard & Samers, 2013): (1) conducting market research to gain insights into customer preferences, needs, and pain points. This enables Islamic banks to identify gaps in the market and develop products that address specific customer needs. (2) Creating partnerships and collaborations with fintech companies and technology providers to leverage digital advancements and offer innovative banking solutions. This includes mobile banking apps, online payment platforms, and other digital services that provide convenience and accessibility to customers. (3) Customized financing options are introduced for different customer segments, such as home, car, and business financing, with flexible terms and competitive rates that meet the unique requirements of each customer. (4) Expand the range of investment products and services, including equity-based investments, asset management, and wealth management services, to cater to customers' diverse investment preferences. (5) Promoting financial literacy and education among customers to increase their understanding of Islamic banking principles and the benefits they offer. (6) Developing sustainable and socially responsible investment products that align with Islamic principles such as green energy projects, ethical funds, and microfinance initiatives.

By adopting these strategies, Islamic banks can differentiate themselves in the market, attract and retain customers, and contribute to the growth and development of the banking industry. Hence, Islamic banks must prioritize innovation to remain competitive in the banking sector. By continuously improving and expanding their product offerings, Islamic banks can not only stay ahead of competition but also ensure that they meet the evolving needs of their diverse customer bases. To effectively compete with conventional banks, Islamic banks must continuously innovate and develop products that align with Islamic values while offering unique solutions that differentiate them from their competitors and cater to their target customers' specific needs (Lodhi & Kalim, 2005; Malami, 1992).

In navigating the realm of Islamic banking, the development of Sharia-compliant products is a multifaceted journey marked by several intricate challenges (Ahmed, 2014; Bahari, 2009; Calder, 2020). First, regulatory compliance and securing Sharia endorsements are pivotal hurdles. Each prospective product underwent meticulous scrutiny to ensure strict adherence to the Sharia principles, necessitating approval from the internal Sharia supervisory board. However, this process, which is vital for aligning products with Islamic law, introduces a layer of complexity. The potential for diverse interpretations of Sharia among advisors may lead to product variations, even when rooted in the same contract. Balancing consistency and compliance among these nuanced interpretations is a formidable challenge. Second, pursuing innovation in product offerings adds another layer of complexity. Islamic Financial Institutions (IFIs) strive to introduce novel products to remain competitive. However, given the intricate and diverse nature of these new offerings, this innovation poses a risk of misinterpreting *maqasid sharia*. Striking a delicate balance between adherence to Sharia principles and the imperative to innovate is a tightrope walk that demands vigilant supervision. Third, bridging the gap between intricate Islamic banking products, consumer understanding, and acceptance is a significant challenge. The diverse and complex nature of these products requires a high level of consumer comprehension. Effective communication and education strategies have become imperative to empower consumers with comprehensive insights into the distinctive features and benefits of Islamic banking products, enabling them to make informed choices aligned with their values. Finally, Islamic banking transcends mere compliance with Islamic law, which aspires to contribute to broader economic and social objectives. This introduces a challenge to its own—developing products that not only adhere to Sharia principles but also align with overarching goals, such as risk-sharing, poverty reduction, and socio-economic development. The collaborative and risk-sharing nature of the Islamic banking model demands innovative approaches to product development that can cater to the diverse needs of individual and corporate clients while remaining financially viable and competitive.

Moqbel and Ahmed (2020) argued that these products strictly adhere to Islamic law and meet consumer demand. Some Sharia experts criticize Islamic banking and finance for closely imitating their conventional counterparts, which dilutes Sharia principles. For example, El-Gamal criticizes Islamic financial institutions for being rent-seeking Sharia arbitrageurs, who use tactics to circumvent Islamic law's prohibitions. He suggests that the industry's efforts to comply with Sharia may sometimes result in the creation of products that only superficially meet Sharia requirements (Nagaoka, 2012). Usmani also highlighted that the majority of *sukuk* (Islamic bonds) replicate conventional bonds and do not align



with the spirit of Islamic law. This indicates a challenge in developing genuine Sharia-compliant products that meet the market's financial needs and expectations (Godlewski et al., 2013). Delorenzo also criticizes the Islamic total return swap as unacceptable from a Sharia perspective, further emphasizing the difficulties in ensuring that new financial products conform to Sharia principles (Iqbal, 1999). Moreover, the practice of adding new features to traditional contracts to create financial products raises questions about Sharia compliance, particularly regarding the extent to which the clauses and stipulations of classical contracts should be fulfilled in contemporary financial products. This necessitates a careful evaluation of each condition/stipulation in terms of its essentiality and legal weight from the Sharia perspective, which is a complex and nuanced process. The existence of these challenges underscores the importance of developing a robust framework for assessing the Sharia compliance of Islamic financial contracts and products, ensuring they do not merely mimic conventional finance but genuinely reflect Islamic legal and ethical principles (Moqbel & Ahmed, 2020).

According to Noman (2001), the primary challenge lies in designing enhanced products that provide clients with cost reductions and efficient distribution. This challenge arises because clients now have a wider array of choices, including Sharia-compliant products offered by conventional banks. Consequently, Islamic banks must innovate and adapt in a market where customers seek not only Sharia compliance, but also profitability and efficiency in their banking services. Moreover, competition is intensified by the presence of conventional commercial banks operating Islamic banking units or subsidiaries. Therefore, it is imperative for Islamic banks to differentiate their offerings and retain their customer bases.

Most importantly, Sharia compliance is a fundamental aspect of product development in Islamic banking, ensuring that all products and services adhere to Islamic legal principles. The development of Sharia-compliant products involves a meticulous process of aligning financial transactions with Islamic principles such as the prohibition of interest (*riba*), uncertainty (*gharar*), and gambling (*maysir*). This process is crucial to maintaining the integrity and authenticity of Islamic financial institutions. Hence, Sharia banks ensure compliance with Islamic principles in their products by employing a Sharia advisory board or committee composed of scholars who are well versed in Islamic law. These boards review and approve all products and transactions to ensure they are in line with Islamic principles.

Regular audits and reviews were conducted to maintain transparency and accountability. To be considered compliant, businesses must comply with the basic tenets of Islam such as not engaging in interest-based transactions or alcohol production. Businesses must adhere to specific Sharia principles relating to contracts, which means that businesses using Sharia financing should focus on reducing the harm caused by their products. These activities include, but are not limited to, speculation and gambling. Sharia-compliant businesses are subject to special taxes and regulations and are often seen as more trustworthy and ethical. However, the restrictions placed on businesses by Sharia law can make it challenging to compete in the global marketplace (Hasan, 2011; Khalid, 2020; Mohd Saad et al., 2020). Hence, Sharia banks ensure compliance with Islamic principles in their products by adhering to Sharia standards, employing Sharia advisory boards, conducting regular audits and reviews, and complying with basic tenets of Islam. Aligning products with Sharia principles presents distinctive challenges for Islamic banks, primarily because of the stringent compliance requirements with Islamic law, which emphasize socio-economic justice and prohibits transactions involving *gharar* (uncertainty), *maysir* (gambling), *riba* (interest), *dhzalim* (injustice), and unlawful objects. This necessitates a thorough review by the Sharia Supervisory Board to ensure that all products and operations adhere to these principles (Alam et al., 2022).

Islamic banks must navigate through these challenges by ensuring that all their products and operations are in line with the principles of Sharia law. This involved a rigorous review process overseen by the Sharia Supervisory Board to guarantee compliance with the prohibition of transactions involving uncertainty, gambling, interest, injustice, and unlawful objects. These principles are central to the ethos of Islamic banking and require meticulous adherence to ensure socioeconomic justice and ethical conduct within the framework of Islamic finance. In addition to regulatory compliance, Islamic banks prioritize the establishment of Sharia advisory boards, regular audits, and reviews to maintain the integrity of their products and operations. This unwavering commitment to Islamic principles distinguishes Sharia banks and underscores their dedication to upholding the value of Islamic finance.

### 3. Methodology

This study uses a qualitative approach known as exploratory research to delve deeply into an understudied phenomenon that warrants further exploration. The choice of exploratory research design was driven by the authors' limited understanding of many aspects of the practice of Sharia products in the Islamic banking industry in Indonesia. According to Robson and McCartan (2016), exploratory studies are conducted to determine what is happening, particularly in poorly understood situations. They aim to provide new insights, raise questions, examine phenomena from a new perspective, and challenge ideas and hypotheses for future research. Given that qualitative approaches are more attuned to insiders' perspectives and their understanding of situations, this study involved stakeholders who possessed relevant knowledge and experience of the research topic. Denzin and Lincoln (2017) assert that qualitative research is a distinctive approach that allows for objective, transparent, and accountable understanding and interpretation of current phenomena. Therefore, it encompasses various aspects and specific criteria that adhere to the scientific standards.

In a qualitative study, empirical data encompass personal experiences, introspection, life stories, interviews, artifacts, cultural texts and products, observations, histories, interactional texts, and visuals that depict significant moments, meanings, and challenges in individuals' lives. Bhatti and Sundram (2015) further explained that qualitative research involves the exploration of a problem through a method that employs small, unique samples. This unstructured approach helps researchers to gain an in-depth understanding of the phenomenon being studied. By employing different data-collection techniques, researchers can gather diverse types of information, resulting in reliable findings and offering more effective solutions.

In terms of data triangulation, the author incorporated data from management and the Sharia Supervisory Board. These two data sources are utilized to enhance the reliability and robustness of the subsequent sources employed for analysis. The author also ensured triangulation by incorporating data from various outlets, including books, journal articles, academic studies, websites, and official documents. This multi-faceted approach to data collection helps validate the findings and strengthen the overall credibility of the research. Next, the author will delve into a detailed analysis of the collected data to uncover insights and draw conclusions that will contribute to the existing body of knowledge in the field of Sharia-compliant finance.

The target population for this study consisted of experts on Sharia product development and the Sharia Supervisory Board. The participants were selected using purposive sampling, which entailed choosing individuals who were deemed highly knowledgeable and capable of providing valuable insights for the study. They were selected based on their expertise and proficiency in describing events or aspects related to the study (Sandelowski, 2000). The sample size is not a concern, as Colin Robson (2015) noted that there is no set number of interviews required for flexible design studies. Grbich (2022) state that in a qualitative study, researchers work with a small sample size that they study in-depth. Seven experts from varied backgrounds were selected to participate as interviewees in this study. This sample size was assumed sufficient to achieve the objective of validating the model.

The interviews will be conducted in a semi-structured manner to gather in-depth information regarding Sharia product development. Semi-structured interviews are particularly useful for exploratory research where depth, flexibility, and the ability to uncover new insights are critical. These interviews allowed the researcher to have a set of predetermined questions, while still being able to probe further into specific topics based on the participants' responses. In the context of our study on Sharia-compliant product development in Islamic banking, it is evident that collaborative efforts between Sharia supervisory boards and Islamic banking management are crucial to ensure that products meet both market demands and regulatory standards in accordance with Sharia principles. These collaborative efforts entail regular communication, consultation, and decision making between Sharia supervisory boards and banking management.

The interview is expected to last approximately 60–90 minutes and will follow a set of guidelines and predetermined questions. This question is commonly asked by individuals with limited knowledge of the subject matter. In practice, these guidelines are open to discussion and adaptable to technological advancements in the field. At the time this study was conducted, there were no regulations in Indonesia



mandating ethical clearance for research involving human subjects. Furthermore, our university has not yet established a research ethics committee that is responsible for providing ethical clearance recommendations. Despite this, we submitted a letter of request for willingness to participate as informants, which was approved by the Dean under reference number B/524.1/UN61.8/V2023/FEB, dated May 31, 2023. All informants in this study consented to provide information openly and without any coercion or interventions.

To prioritize personal security, confidentiality, and the quality of information, all key information identities in this research remain undisclosed. Once the data have been collected from the measurement results and it has been verified that the obtained information is sufficient and valid, the subsequent step involves transcribing the data to identify the overall theme or main idea, in line with the objectives of this study. Following this, the data will be coded, allowing the encoded information to not only serve for research analysis and data interpretation but also to interchange ideas and data within the context of this study.

The next step was to categorize the data and display themes based on the coding results. Bandur (2019) divides two ways of displaying themes: inductive from information received from the field, and deductive from previous theories and research. This study used inductive research to understand or apply a major theme based on information obtained from selection information. To obtain data analysis, researchers used the NVivo version 12.

## 4. Result and discussion

### 4.1. Profile of the experts

The general background of the interviewed experts is presented in Table 1. The table provides information on positions and organizations. The seven participants named Experts 1 (E1), Experts 2 (E2), Experts 3 (E3), Experts 4 (E4), Experts 5 (E5), Experts 6 (E6) and Experts 7 (E7).

From Table 1, it can be seen that the experts had mixed and varied backgrounds. They were comprised of five males and two females. In terms of professional expertise, they vary from banking management to Sharia advisors of Islamic banks. The informants are considered a good source of information as they are highly knowledgeable and experienced, thus providing great input for this study. After conducting the interviews, it was evident that the diversity in the backgrounds of the experts significantly contributed to the depth of the insights gathered. The range of perspectives from banking management to Sharia advisors of Islamic banks provided a comprehensive understanding of the subject matter. Additionally, the informants' extensive knowledge and experience proved invaluable in offering nuanced and rich data for this study. Their input not only added depth to the research findings but also ensured a well-rounded analysis of the topic. The presence of diverse perspectives and expertise among the experts played a crucial role in gaining a comprehensive understanding of the subject matter. The conducted interviews yielded rich and nuanced data, ensuring a well-rounded analysis of the topic. Moreover, the informants' extensive knowledge and experience greatly contributed to the depth of the insights gathered. The varied backgrounds of the experts not only enriched the research findings but also provided valuable input for this study.

The development of Sharia-compliant banking products in Indonesia's banking industry is a crucial endeavor to cater to the financial needs of Muslim communities seeking services aligned with the Sharia principles. The process of developing Sharia-compliant products in Indonesian banking involves several stages and procedures, including an in-depth understanding of Sharia concepts, market research,

**Table 1.** Profile of experts.

Code	Experts position	Organization
E1	Head of Sharia product development	Muamalat Indonesia
E2	Head of Sharia product development	BCA Syariah
E3	Head of Sharia product development	BNI Syariah
E4	Head of Sharia product development	BRI Syariah
E5	Head of Sharia product development	Bukopin Syariah
E6	Chairman of Sharia supervisory board	Mega Syariah
E7	Chairman of Sharia supervisory board	Panin Syariah

product design, testing, and marketing. Moreover, this requires the involvement of regulators and Sharia supervisory boards, as these institutions play a central role in supporting the development of Sharia-compliant products in Indonesia. Therefore, the development of Sharia-compliant products is intricately connected to these two entities, particularly in adhering to the rules and regulations established by Sharia provisions as well as fulfilling the positive legal aspects mandated by the state.

## 4.2. Basic concepts, strategies and stages of sharia product development in Indonesia

The important stages of Sharia product development in Islamic banking in Indonesia are as follows:

### 4.2.1. Conducting business feasibility analysis

Market analysis and business feasibility in financial intermediation institutions are closely linked to strategies for assessing and mapping business conditions, while considering the future actions required by banking actors. At this stage, it is important to begin by collecting information on customer needs, potential opportunities, and market requirements. Once the information has been gathered, the next step involves analyzing the collected data to determine community needs, profit potentials, anticipated competition in the industry, and the feasibility of the product idea (i.e. whether the product is truly needed by the community). The analysis results are then presented in the form of proposals, providing a comprehensive overview of the business potential. The initial stage of this report was based on interviews conducted with several banking actors.

≤Files\\E3> – § 1 reference coded [12,73% Coverage]

Reference 1 – 12,73% Coverage

*We analyze market demand, followed by careful consideration of banking needs. The primary and most extensive requirements originate from the community, which we assess from multiple perspectives. Subsequently, we consolidate the results and arrive at a well-founded and valuable conclusion. Following this, we propose a robust leadership proposal accompanied by a comprehensive description of the business's potential. Finally, a meticulously designed product description was developed.*

≤Files\\E4> – § 1 reference coded [2,25% Coverage]

Reference 1 – 2,25% Coverage

*Product development is typically guided by the top management. This means that, during annual meetings, we often have a clear understanding of which products will be launched in the upcoming year. The direction of product development can originate from both management and our team, as well as from the LOP itself.*

≤Files\\E5> – § 1 reference coded [5,75% Coverage]

Reference 1 – 5,75% Coverage

*Some of the products being developed require inclusion in the bank's business plan, which marks the initial stage of development. As a result, we submitted a list of products to be developed in 2021 and 2022 to OJK, the business bank. Two decisions were made regarding one specific product. In this report, we present a case of OJK codification. In the absence of codification for OJK products, we propose applying for a permit, emphasizing that launching should not occur prior to obtaining permission from OJK.*

After the initial stage of proposing new products and developing existing ones, the next crucial step is to delve thoroughly into the intricacies of the writing stage. This will require a comprehensive understanding of the market, competitors, and the specific needs of the target audience. Additionally, the business plan submitted through OJK must be meticulously crafted to demonstrate a clear understanding of the banking sector, including its regulatory framework, risk management strategies, and financial projections. It is also imperative to incorporate a thorough analysis of potential challenges and the corresponding mitigation plans to ensure a robust and resilient business plan. Once the business plan is submitted, it will undergo a comprehensive review process by the OJK to ensure compliance with regulatory standards and alignment with the banking sector's overall objectives. It is essential to anticipate potential areas of scrutiny and proactively address them within a business plan to enhance its credibility and effectiveness.

A key aspect of the writing stage is to integrate a compelling marketing and sales strategy that highlights the unique value propositions of the proposed and existing products. This involves clearly articulating how products address the evolving needs of customers, differentiate them from competitors, and contribute to the overall growth and success of the banking institution. Furthermore, financial projections within the business plan should be supported by in-depth analysis and realistic assumptions to instill confidence in potential investors and stakeholders. This includes detailed information on the sources of revenue, cost structures, and anticipated returns on investment.

#### 4.2.2. Compile product scheme

After the stage of proposing a business proposal to the management is agreed upon, the next step is brandmarking. The results are evident from the interviews with several banking actors.

<Files\\E2> – § 1 reference coded [2,11% Coverage]

Reference 1 – 2,11% Coverage

*In the product development process, our first step is to submit a comprehensive business proposal to the management team, outlining our intention to create a new product. Upon receiving approval from the business proposal, we invited pertinent units involved in the project.*

<Files\\E5> – § 1 reference coded [2,39% Coverage]

Reference 1 – 2,39% Coverage

*The initial step involves formulating a product strategy that aligns with the market demand. Drawing upon our industry expertise, it is imperative to devise a product that effectively addresses these demands or cultivates a product that aligns with management objectives.*

The brand in question conducts a thorough market study and assesses its risks and operations. Based on the findings of this study, a market analysis was conducted to determine the viability of selling or developing this product. If the conclusion is favorable, the product development proceeds. However, if the existing product is deemed unsuitable, it is postponed. Following market analysis, the product was determined to possess significant potential in the current market. With this positive outcome, the decision was made to proceed to the product development phase. The subsequent steps will involve refining product design, conducting feasibility studies, and establishing a marketing strategy for its launch. Additionally, a comprehensive risk analysis was conducted to identify and mitigate potential challenges. This comprehensive approach will not only guarantee the product's success, but also minimize any risks associated with its development and launch.

#### 4.2.3. Opinion of the Syariah supervisory board

If the bank's business proposal has been accepted by the leadership from the initial stage, it is evaluated in terms of compliance with the legal aspects of Sharia during the subsequent stage. The product is not only analyzed based on market needs but also needs to align with Islamic law. Therefore, in this stage, the focus is on assessing what is permissible and what is not. This includes evaluating whether the product is in line with the law, how risks are managed, and whether it meets the requirements of Sharia. The findings are evident from interviews conducted with various banking professionals.

<Files\\E4> – § 1 reference coded [8,27% Coverage]

Reference 1 – 8,27% Coverage

*We sought the opinion of the Sharia supervisory board regarding the eligibility of the products we developed for the fatwas. If a fatwa already existed, we proceeded accordingly. Otherwise, we requested a fatwa from the Sharia Supervisory Board.*

<Files\\E5> – § 1 reference coded [3,53% Coverage]

Reference 1 – 3,53% Coverage

*After soliciting input on compliance aspects and risk management, the collected information will be submitted to the Sharia supervisory board for evaluation of Sharia compliance.*

Suitability is determined based on the Sharia aspects related to the product, which must be communicated to the Sharia supervisory board as a priority. The board's perspective is to assess whether the product aligns with the established aspects of Sharia. This is consistent with the board's responsibility to ensure adherence to Islamic banking principles and values for all offered products and services. Once communication about the product is received, the Sharia supervisory board conducts a thorough evaluation to determine its compliance with Sharia principles. This evaluation includes scrutiny of a product's financial transactions, business activities, and contractual agreements. Moreover, the board evaluates the potential impact on the community and ensures that the product is in line with the ethical and moral standards outlined by Sharia Law. After a comprehensive review, the Sharia supervisory board provided guidance and approval, thus establishing the product's suitability within the Islamic banking framework. This meticulous process reinforces the commitment to upholding Sharia principles and values in all financial offerings in the Islamic banking sector.

#### 4.2.4. Perform risk management

As a business entity, Islamic banking faces risks with the potential to cause losses. These risks should not always be avoided but should be taken care of properly without compromising the results that need to be achieved. Properly managed risks can benefit banking managers by generating profits. Therefore, the actors of the banking sector, and Islamic banking in particular, are required to be able to effectively manage the risks they face. The results are evident from the interviews with several banking actors.

<Files\\E4> – § 1 reference coded [4,01% Coverage]

Reference 1 – 4,01% Coverage

*After obtaining the Sharia perspective, it is important to consider risk and complaint perspectives. In addition to addressing Sharia-related complaints, it is crucial to report any complaints to the appropriate regulatory authorities.*

Risk management in the banking sector aims to proactively identify potential future losses before executing transactions or providing financing. The concept of integrated risk management is expected to generate timely reports for the board of directors, enabling them to assess a bank's comprehensive risk exposure. Apart from identifying potential future losses, risk management in the banking sector involves implementing strategies to mitigate these risks. This includes setting up risk limits, conducting stress tests, and developing contingency plans to address potential adverse events. Furthermore, integrating risk management across the organization helps foster a risk-aware culture and ensures that risk considerations are incorporated into the decision-making processes at all levels of the bank. By adopting a comprehensive and integrated approach to risk management, banks can enhance their ability to navigate uncertainties and maintain stability in constantly evolving market conditions.

#### 4.2.5. Prepare operating activities guide

At this stage, typically following the presentation of a new product, the proposal must conform to the Sharia principles. The subsequent step involved the creation of comprehensive guidelines for operational activities. Usually, these guidelines are prepared by the operations or marketing departments. The findings of the interviews with banking professionals are outlined below.

<Files\\E4> – § 1 reference coded [1,53% Coverage]

Reference 1 – 1,53% Coverage

*As previously mentioned, an analysis of the business encompasses its data, brand marks, and other relevant factors. Subsequently, we propose whether management concurs with the analysis. If management agrees, we proceed to the next stage.*

<Files\\E5> – § 1 reference coded [3,88% Coverage]

Reference 1 – 3,88% Coverage

*If the business review of the product is highly favorable, we request that the operations section prepare comprehensive guidelines for operational activities. If this responsibility falls under the marketing and operations division, it will gather the necessary transactional information.*

#### 4.2.6. Program development by IT team

At this stage, given that all transactions are computerized, product development still relies on the IT team. It is necessary to coordinate and discuss the product that needs to be developed with the IT team. However, if the proposed product is new, the product development division must submit a Business Requirements Definition (BRD) to the IT division to create the program. These findings are evident from interviews conducted with banking stakeholders.

<Files\\E4> – § 1 reference coded [2,07% Coverage]

Reference 1 – 2,07% Coverage

*This stage entails increased discussion and coordination with the IT team regardless of their level of support. If these elements are absent, they can be categorized as business requirements.*

<Files\\E5> – § 1 reference coded [3,62% Coverage]

Reference 1 – 3,62% Coverage

*We collaborated closely with the IT team to develop the program, ensuring that all transactions within Sharia adhered to the IT standards. We specifically requested that the IT team devise a digitalization program for Sharia products.*

#### 4.2.7. Initial testing

Initial testing is commonly conducted to assess the acceptability of a product or application developed by the IT department to a user. This evaluation is typically performed prior to the commencement of the production phase. Upon the successful completion of the initial testing, the product is permitted to proceed to the production phase. The findings obtained from interviews conducted with relevant banking stakeholders further corroborate these outcomes.

<Files\\E5> – § 1 reference coded [3,45% Coverage]

Reference 1 – 3,45% Coverage

*After completion of the program, preliminary testing should be conducted before integrating it into the production machine. The testing phase serves as an internal assessment, allowing users to test various applications within the program. Once user acceptance testing is completed, an announcement is made to notify the stakeholders of the program's integration into the production machine.*

#### 4.2.8. Production process

After the consumer agrees to the initial testing process of the product, the next step is to formally schedule it within the department through a memo. This step is crucial for determining whether the product aligns with the bank's strategy and profitability. If the department approves, the next course of action would be to propose to the management that the product be prepared for launch. The following interviews with key banking stakeholders provide clear evidence of the results.

<Files\\E1> – § 1 reference coded [3,58% Coverage]

Reference 1 – 3,58% Coverage

*The fourth step involves advancing to the subsequent stage, followed by follow-up in the form of a memorandum, typically at the departmental level. At the position level, we determine whether it aligns with the bank's strategy and whether it is financially beneficial for the organization.*

<Files\\E4> – § 1 reference coded [3,86% Coverage]

Reference 1 – 3,86% Coverage

*If all stages have been completed, we propose that the new product be considered ready. Therefore, it is imperative to ensure that everything is ordered.*

#### 4.2.9. Product launching

The product will be launched only after all parties have reached a consensus that the product meets all necessary criteria at this stage. Typically, once all parties are in agreement, the launch proposal is

submitted to management, indicating that the product is prepared for launch. This proposal encompasses a precise launch date, as well as planned marketing activities. The following interviews with key banking stakeholders provide compelling evidence of these outcomes.

<Files\\E3> – § 1 reference coded [1,24% Coverage]

Reference 1 – 1,24% Coverage

*After receiving approval from all the stakeholders, we successfully launched a new product.*

#### **4.2.10. Reporting to the financial services authority**

Reporting to the OJK division occurs once a product has been launched. This indicates that the product was marketed and prepared for further assessment. These findings are apparent from the interviews conducted with the banking stakeholders mentioned below.

<Files\\E2> – § 1 reference coded [1,70% Coverage]

Reference 1 – 1,70% Coverage

*After all preparations have been completed, it is necessary to formally notify the OJK of the product launch and subsequently conduct an evaluation.*

### **4.3. Reasons for the development of sharia products**

According to recent Sharia business statements, the development of Sharia-compliant banking products is not only crucial and advantageous, but also plays a significant role in ensuring customer loyalty and simultaneously becoming the most effective competitive tool for advancing Islamic banking. If Islamic banking fails to possess or incorporate the latest innovations in product development according to the Sharia principles, it will inevitably lag behind competitors in the market. Hence, Islamic banking should prioritize the development of new product models rather than solely focusing on the supply aspect, as changes in supply conditions can lead to the introduction of innovative products.

Some of the reasons for the necessity of developing Sharia-compliant banking products include assessing customer needs to ensure that products meet their requirements. It is essential to ensure that a new product is marketable and aligns with customer preferences. From the Sharia perspective, we can evaluate whether product development adheres to the Sharia principles. Additionally, from a business standpoint, it is crucial to consider the product's potential advantages, such as the ability to generate higher profits by incorporating an improved operating system compared with conventional bank products.

The third reason for the expansion of Islamic banking products is to diversify the portfolio, either by increasing the quantity of products or improving their quality, to provide a comprehensive one-stop service. When developing a new product, it is important to assess the market demand. However, for Sharia products, it is crucial to ensure adherence to Sharia principles. For instance, a product may comply with Sharia rules but not generate profit from a business perspective, or it may be profitable from a business standpoint but violate Sharia principles. Therefore, it is equally important to consider both business and Sharia principles when developing new products.

Bankers must find a delicate equilibrium between adhering to Islamic law and meeting their profit objectives. This balance is crucial in determining the triumph of Islamic banking products in local, national, and international markets. If Islamic banks prioritize profit and pragmatism by merely replicating conventional bank products while disregarding Islamic law, the banking sector will inevitably falter. This deviation from its fundamental principles and purposes leads to failure.

In addition, if what is developed is a new product of innovation that has never existed before,

In addition, if the development is a new, innovative product that has never existed before, it is necessary to engage with customers or the community to explain the nature of the product and the potential opportunities it offers. This is important because customers often fail to recognize the uniqueness of a new product and perceive it as a variation of an existing one. Two parameters can be used to assess the feasibility and viability of new products: (i) novelty and technological similarity to existing products.



Another reason is intense competition between Islamic and conventional banks. Consequently, the products developed by Islamic banks must be fundamentally distinct from those offered by conventional banks. In other words, they must explore areas or features that are not offered by conventional banks. Islamic banking also needs to provide a new model for product development from the supply side because changes in supply conditions can lead to the introduction of innovative products. Consequently, there has always been a strong demand for interest-free banking services, which have become popular alternatives to modern financial services because of the wide range of products offered to customers. The following interviews with key figures in the banking industry provide evidence of this.

<Files\\E1> – § 4 references coded [4,39% Coverage]

Reference 1 – 1,14% Coverage

*The primary determinants should be rooted in customer requirements, encompassing the existence and magnitude of their needs.*

Reference 2 – 0,63% Coverage

*from the point of view of sharia comply or not*

Reference 3 – 1,24% Coverage

*From a business standpoint, we have the capability to do so at the operating system level.*

Reference 4 – 1,39% Coverage

*Regulatory and legal products should become additional factors in product development.*

<Files\\E2> – § 3 references coded [7,97% Coverage]

Reference 1 – 2,45% Coverage

*The primary objective is to enhance portfolio expansion, the purpose of which is to increase product diversity, improve portfolio quality, and further establish a comprehensive one-stop service. This is exemplified by instances in which customers request the provision of services.*

Reference 2 – 2,94% Coverage

*To ensure the successful launch of a product, it must be absorbed effectively by the market. Failure to do so may result in an excess of unsold products, which can be both time-consuming and costly. Therefore, it is crucial to thoroughly understand the potential market before embarking on a product creation process.*

Reference 3 – 2,58% Coverage

*If competition is necessary but not the primary factor, we ensure that our product remains unaffected by competitors' actions. While our competitors focus on their strategies, we remain committed to creating products that specifically address our customers' needs, allowing us to maintain our strategic direction without constantly monitoring our competitors' activities.*

<Files\\E3> – § 4 references coded [5,80% Coverage]

References 1-2 – 2,37% Coverage

*If Sharia compliance is prioritized while considering business opportunities that encompass risk and profit, all of these inquiries must be addressed by the Sharia Supervisory Board.*

References 3-4 – 3,43% Coverage

*At BNI Syariah, we prioritize the alignment of Sharia principles with our business practices. It is essential to ensure that our products not only comply with Sharia requirements, but are also financially viable. We understand that a product may adhere to Sharia principles but lack profitability or be profitable from a business perspective, but fail to meet Sharia compliance.*

<Files\\E4> – § 3 references coded [5,77% Coverage]

Reference 1 – 1,90% Coverage

*We have been mandated by the OJK to increase the development of Islamic banking by over five percent. It is crucial to surpass this threshold by implementing products that set us apart from conventional banking.*

## Reference 2 – 3,42% Coverage

*There are significant concerns regarding the presence of nonconventional products in the market. It is important to highlight that the interest rate offered by a bank is identical to that of a conventional bank. The advantages and features of IMBT are well known and recognized. It is evident that the recent introduction of IMBT has garnered considerable attention as it offers the potential to utilize Murabaha for purchasing goods and IMBT for refinancing purposes.*

## Reference 3 – 0,45% Coverage

*We need to develop products that are not available in conventional markets.*

<Files\\E5> – § 3 references coded [3,98% Coverage]

## References 1-2 – 3,10% Coverage

*The primary reason for recommending this product is its adherence to the Sharia principles. It is imperative to develop a product that fully complies with Sharia guidelines. Additionally, its compatibility with market demands and the overall business aspect further strengthens the case for Sharia-compliant products.*

## Reference 3 – 0,88% Coverage

*The competition between Sharia and conventional banks also drives the need for product development.*

#### 4.4. Sharia product development strategy

Islamic banking has three distinct characteristics: (1) interest-free, (2) multipurpose rather than purely commercial, and (3) justice-oriented. The literature on Islamic banking does not critique 'interest-free' instruments, but rather refers to them as 'Profit loss sharing (PLS).' The interest-free market, or, in modern economic terms, 'zero interest,' promotes efficiency in resource allocation.

As discussed in a previous article, sharia is of utmost importance. Therefore, when developing a product, if it does not align with the principles of Sharia, it will not be pursued even if it is highly profitable from a business perspective. However, product development must strike a balance between the Sharia and business considerations. If a product is projected to yield significant profits but does not meet the Sharia requirements, it must be promptly reviewed or revised to fulfill these requirements. Consequently, Sharia product development strategies must simultaneously address both the Sharia and business aspects.

Islamic banking practitioners must navigate the pressures of adhering to Islamic law and generating profits. Striking a balance between the two is crucial in determining the success of Islamic bank products in the local, national, and international markets. If an Islamic bank focuses solely on profit and pragmatism, developing products that mimic conventional banking without considering Islamic law will ultimately fail as it strays from its purpose and identity. The following interviews with banking practitioners substantiate these findings:

<Files\\E2> – § 1 reference coded [4,11% Coverage]

## Reference 1 – 4,11% Coverage

*The most crucial aspect of Sharia is that a business must adhere to its standards to obtain approval, even if it is profitable. Consequently, the Sharia Supervisory Board at BCA Syariah plays an active role, convening monthly to ensure that all operations are aligned with Sharia principles. This practice is facilitated by the fact that BCA Syariah operates under a unified management system.*

<Files\\E3> – § 1 reference coded [7,93% Coverage]

## Reference 1 – 7,93% Coverage

*As previously discussed, diversity exists within Sharia and business domains. Regardless of the quality of our product offerings, if they do not adhere to the Sharia principles, they should be discontinued. The decision-making process involves evaluating aspects that previously did not meet Sharia requirements and subsequently making improvements to ensure Sharia compliance. If this cannot be achieved, the product should not be introduced, even from a business perspective, to maximize profits for the company.*

<Files\\E4> – § 1 reference coded [3,84% Coverage]

Reference 1 – 3,84% Coverage

*How can we utilize a product that has been claimed to empower and superpower both IMBT and Musyarakah? Considering that Musyarakah has already set a precedent for IMBT, we can further develop IMBT. Hence, the objective was to benefit both parties by making necessary adjustments and conducting thorough reviews. In reality, it is not feasible to accomplish two tasks simultaneously without any grievances or exploiting others. However, implementing this ideal scenario is challenging.*

<Files\\E5> – § 1 reference coded [4,22% Coverage]

Reference 1 – 4,22% Coverage

*Ideally, a comprehensive market survey should be conducted to assess demand and analyze competitors' products. This ensures that the product we launch aligns with the community's needs. Consequently, in my view, Sharia compliance should be ensured to meet the necessary requirements and principles, even if this means that the products may appear slightly more intricate than conventional banking products.*

In this context, Al Madani et al. (2020) proposed that financial products in Islamic finance should be structured around the substance of the investment rather than its legality. This approach is designed to achieve the Maqasid Al-Shari'ah, which ensures that the investments made by Sukuk benefit everyone, including individuals, institutions, societies, and the entire country. This approach is consistent with the principles of Maqasid Al-Shari'ah, which were designed to promote human well-being and sustainable development. By prioritizing substance, Shari'ah supervisory boards can facilitate the transition of Islamic finance towards achieving these broader objectives. In the development of Sharia-compliant financial products, it is of paramount importance for Sharia supervisory boards and Islamic banking management to collaborate effectively and adhere to Sharia principles. This ensures that the products are not only marketable, but also meet regulatory standards. The collaborative efforts of Sharia supervisory boards and Islamic banking management are of critical importance in the development of Sharia-compliant products that are marketable and adhere to regulatory standards. Such collaborative efforts ensure that products are designed in accordance with Sharia principles and address the specific needs and preferences of Muslim consumers. By working in concert, Sharia supervisory boards and Islamic banking management can ensure that products are ethically and morally sound, thereby providing transparency and trust to investors and customers.

#### **4.5. Regulatory support for the implementation of sharia product development**

Islamic banking in Indonesia has a good legal framework that regulates various aspects of its operations. However, some important regulations were too late to be prepared to respond to the rapid growth of the Islamic banking industry, such as the double taxation problem. The collection of double tax on Islamic banking was one of the barriers to the growth of Islamic banking was only abolished in 2009, and effectively took effect on April 1, 2010, through amendments to Law No. 42 (2009) on value added tax. In addition, dispute resolution was not clearly regulated until 2008, when Islamic banking law was issued. Section 55 of the Act states that any dispute arising in Islamic banking transactions and businesses should be resolved in the Sharia Court. However, under a special clause, if both parties are in agreement, the dispute can be taken to another court with the prior consent of the judges.

Based on this evidence, it can be seen that the regulator's support for Islamic banking has not been entirely good or supportive, although most of it is due to the different tax implementations between Islamic and conventional banking. In addition, the process of developing new products requires a rather long process (at least a year). The results are evident from the interviews with the banking actors below.

<Files\\E1> – § 3 references coded [10,07% Coverage]

References 1-2 – 6,20% Coverage

*Regulatory support has not yet been fully established. An illustration of this can be seen in the varying mortgage tax policies of Islamic and conventional banks. The question arises as to whether regulators enforce uniform treatment. The implementation of codification proves to be highly beneficial for banks, as the product is already present in the codification process, requiring only reporting. However, if there is no existing way to create a product, considerable time is still needed to obtain a fatwa. Once a fatwa has been obtained, progress can be made.*

## Reference 3 – 3,87% Coverage

*Regularly conducted seminars also assist management in gaining a comprehensive understanding, particularly regarding the future development of Islamic banks, over the next five years. This enables our company to stay well informed about the five-year planning of the Financial Services Authority (OJK) and align our strategies accordingly.*

<Files\\E2> – § 1 reference coded [3,65% Coverage]

## Reference 1 – 3,65% Coverage

*OJK continues to provide support in the form of IB Vagansa programs held in several cities that have limited awareness, as well as other ceremonial activities. These efforts were intended to support the development of Islamic banking. However, the effectiveness of these initiatives is hindered by their low public acceptance and limited familiarity with Islamic banking.*

<Files\\E3> – § 2 references coded [7,72% Coverage]

## References 1-2 – 7,72% Coverage

*Thus far, we have received substantial assistance from regulatory policies, particularly in the realm of both new and existing product development. While the process is relatively straightforward for existing products, the development of new products requires a time-intensive procedure that typically spans less than a year. Although product codification offers some assistance, the workflow does not differ significantly from that of new product development. In addition, there is a process of familiarizing regulators with new banking products, which is beneficial for us in terms of product development.*

<Files\\E4> – § 2 references coded [4,40% Coverage]

## Reference 1 – 1,70% Coverage

*The higher the level of support is, the more beneficial it is. They frequently organize forums for the exchange of IMBT information among banks, which the OJK facilitates to address any barriers.*

## Reference 2 – 2,70% Coverage

*During the regulatory session, codification exists. This process is straightforward if a product is already coded because no further permission is required.*

<Files\\E5> – § 3 references coded [7,19% Coverage]

## References 1-2 – 1,53% Coverage

*I see Bank Indonesia and OJK as institutions that are supportive, conducive, and commendable in all aspects, including policies, operations, and transactions.*

## Reference 3 – 5,67% Coverage

*The BI Checking process enables banks to access the investment track records of the projects being financed. This record is accessible to all banks. The term 'Sharia Bank' is used because it involves a thorough analysis of financing. The first factor to consider was the characteristics of the individuals involved in the project. This can be assessed using BI checking. The recording process is predominantly online, ensuring that the published data are always up-to-date. This is facilitated by OJK and BI.*

#### **4.6. The strategic role of the sharia supervisory board in the development of sharia products**

In conventional banking, an effective management system can be established by clearly defining the roles, authorities, and relationships between shareholders and the bank management. In Islamic banking, a well-functioning management and supervision structure involves four parties: shareholders (board of commissioners), bank managers, the Sharia supervisory board or the National Sharia Board, and depositors. Each party had distinct interests. Therefore, a robust Islamic banking management system requires clear regulations that outline the rights, powers, and obligations of each party to prevent conflicts of interest. It must also avoid favoring the interests of one party over others and prioritize the achievement of corporate goals that consider all stakeholders.

The Sharia supervisory board ensures that the operational activities of Islamic financial institutions adhere to the Sharia principles. According to the decree of the National Sharia Council No. 3 of 2000, the Sharia supervisory board is an integral part of the respective Sharia financial institution and its

placement is subject to the approval of the National Sharia Board. To enhance the performance of the Sharia supervisory board, it is crucial to enhance knowledge of banking operations and increase involvement in socialization/promotion programs for local residents. Typically, the Sharia supervisory boards are positioned at the level of the board of commissioners in each bank. This was performed to ensure the effectiveness of the guidance provided by the Sharia supervisory board. Hence, the appointment of members of the Sharia supervisory board is usually carried out by a general meeting of shareholders after receiving recommendations from the national Sharia board. Consequently, we observe that the key distinction between Islamic and non-Islamic financial institutions lies in the presence of a Sharia supervisory board in the former.

The Sharia supervisory board must discuss the problems and business transactions faced by Islamic financial institutions and determine whether the transaction follows Sharia. The powers of the Sharia supervisory board are (a) providing Sharia guidelines to the bank for the deployment of funds, distribution of funds, and other bank activities; and (b) making improvements if a product that is run is considered not under Sharia. Sharia supervisory board members consist of Sharia experts who, to some extent, dominate the applicable commercial law and are familiar with business contracts. Sharia supervisory board members are independent in the sense that they are not subordinate to the leadership of the bank they oversee. To ensure the independence of the Sharia supervisory board, the following issues must be considered: (a) Sharia supervisory board members are not bank staff; they are not subject to the administrative powers of the bank; (b) they are elected by the general meeting of shareholders; (c) their honorarium is determined by the general meeting of shareholders; and (d) the Sharia supervisory board has a working system and certain tasks, such as other supervisory bodies. The results are evident from interviews with several Sharia supervisory boards.

<Files\\E6> – § 1 reference coded [7,08% Coverage]

Reference 1 – 7,08% Coverage

*The Sharia supervisory board serves as an integral part of the bank's operations, ensuring compliance with the established guidelines set forth by the Sharia supervisory board. The board convenes meetings several times a month to discuss and evaluate adherence to the Sharia principles. Additionally, a quotation test was conducted, seeking input from the Sharia supervisory board to determine whether a particular practice was compliant with Sharia, and in cases where clarification was required, a request was made to the National Sharia Council. However, if the Sharia supervisory board can provide a definitive opinion, the issue can be promptly resolved. Typically, matter falls into a gray area, necessitating consultation with the Sharia supervisory board. This is particularly common when addressing issues related to halal and haram practices.*

<Files\\E7> – § 5 references coded [79,93% Coverage]

Reference 1 – 24,81% Coverage

*The Sharia Supervisory Board functions as an extension of the National Sharia Council, which operates as a temporary autonomous institution under MUI. Its primary role is to oversee banking operations through the Sharia Supervisory Board. The board must align its activities with the directives provided by the National Sharia Council. Furthermore, the Sharia supervisory board is responsible for overseeing banking products and other financial institutions. This entails ensuring that they comply with Islamic law and the fatwa issued by the National Sharia Council. In cases where a product has not yet received a fatwa from the National Sharia Council, the Sharia supervisory board is authorized to provide Sharia views. However, it is important to note that these views are subject to fatwa. In the event of discrepancies, the fatwa takes precedence over the Sharia. Hence, it is unlikely that a fatwa would be overridden from the perspective of Sharia.*

#### **4.7. The strategic role of the national sharia council and the supervisory board to the Islamic banking management**

Islamic banking is established and developed based on the values and principles of Islamic law, which requires all financial activities to adhere to Sharia principles. Adhering to Sharia principles not only adds value to the administrative process of Islamic banking and other financial institutions but also ensures that Sharia values and principles are significantly applied in the activities of the Islamic industry. To achieve this, it is essential to have Sharia supervisors in all Islamic banking industries. These supervisors

play a crucial role in advising and providing opinions to the chairpersons of Islamic banking, particularly in the day-to-day operations of the financial board.

Compliance with Sharia rules is the foundation of all activities in Islamic banking, as failure to comply with Sharia can have serious consequences for the continuity of Islamic banking activities and overall development of the Islamic financial system. Strengthening an efficient Sharia supervisory system is therefore considered vital for promoting stability in the Islamic banking and finance sectors. To this end, corporate governance on Islamic banking boards should establish constitutional provisions to oversee Sharia compliance in all financial activities. The results of interviews with several banks clearly demonstrate the impact of such measures.

<Files\\E5> – § 1 reference coded [7,08% Coverage]

Reference 1 – 7,08% Coverage

*We commonly characterize the prevailing circumstances as favorable because of the rigorous selection process that each Sharia supervisory board undergoes. The Sharia Supervisory Board serves as an integral component of the National Sharia Council. We consistently engage the expertise of the Sharia supervisory board in addition to ensuring that our product and campaign encompass all aspects. We wholeheartedly endorse all business activities and their impact on the integrity of the Sharia-compliant products offered by banks.*

≤Files\\E1≥ – § 1 reference coded [7,20% Coverage]

Reference 1 – 7,20% Coverage

*If there were matters that lacked clear guidelines, they promptly referred them to the national Sharia board. This demonstrates their regular communication with the national Sharia board regarding the issues that arise in BCA Sharia and how to enhance the growth potential of Islamic banks. Thus, Malaysia can serve as a potential benchmark in this regard. If the Sharia supervisory body consistently exhibits diligence, it will convene monthly meetings. In case of urgent matters, they are always prepared and available to attend.*

≤Files\\E2≥ – § 1 reference coded [7,52% Coverage]

Reference 1 – 7,52% Coverage

*The support of the Sharia supervisory board has proven to be invaluable in our product development efforts. They not only provide guidance and assistance, but also serve as trusted consultants on all matters pertaining to product development. The fatwas issued by the board was particularly beneficial, offering valuable insights and directions. Their active involvement throughout the product development process underscores the importance of having a Sharia supervisory board in place.*

≤Files\\E3≥ – § 1 reference coded [2,13% Coverage]

Reference 1 – 2,13% Coverage

*If I express my opinion, the presence of the Sharia Supervisory Board of the National Sharia Council is truly commendable. Although we are not directly affiliated with the National Sharia Council, valuable input from their board members has proven to be highly beneficial for our own Sharia Supervisory Board.*

## 5. Conclusion

Product development plays a crucial role in the growth and success of Islamic banking. Islamic banks must consistently innovate and develop products that exceed Sharia compliance to attract and retain customers in today's highly competitive environment. In this context, the management of Islamic banking and Sharia supervisory boards is vital for developing Sharia-compliant products. The Sharia supervisory board, also known as the Sharia board, ensures that all financial products and services adhere to the Islamic principles. They reviewed the proposed products, provided guidance on compliance with Sharia, and ensured that the products met the needs of Muslim customers. Furthermore, collaboration between the Sharia supervisory board and the management of Islamic banking is essential for the success of Sharia-compliant products. The management team works closely with the Sharia board to ensure that the products adhere to the Sharia principles and meet customer demands and preferences. This collaboration is integral to maintaining the integrity of Sharia-compliant products and complying with relevant regulations and standards set by Islamic finance authorities. Moreover, the involvement of these entities goes beyond compliance. They also contribute to the ethical and responsible growth of Islamic banking, thereby fostering customers' trust



and confidence. Their commitment to uphold the core principles of Islamic finance establishes a solid foundation for the sustainable development of Sharia-compliant products in the global market.

Building strong relationships with clients should be a priority for Islamic banks, achieved through a deep understanding of their unique needs and provision of personalized solutions. This approach helps to establish trust, loyalty, and long-term relationships with customers. Islamic banks should prioritize ethical and responsible banking practices, including transparency in transactions, adherence to ethical standards, and promotion of social responsibility. It is important for Islamic banks to communicate effectively the moral and ethical aspects of their business models to customers. This not only helps build customer trust but also differentiates Islamic banks from conventional banks, attracting customers who value ethical and responsible banking practices. The success of Islamic banks in the competitive banking sector relies on their ability to strategically position themselves by continually innovating and developing products that meet the needs of their target customers.

Although the findings of this study are valuable, it is crucial to acknowledge that their applicability may differ among Islamic banks in different regions and countries. Factors such as regulatory frameworks, consumer behavior, economic conditions, and cultural influences can significantly affect the operations and performance of Islamic banks. Therefore, further research and analysis is necessary to gain a deeper understanding of how these factors shape the dynamics of Islamic banking in different contexts. Additionally, case studies and comparative analyses across different regions can provide a more comprehensive perspective on the nuances and implications of Islamic banking practices.

### Authors' contributions

All material (from conception until final version) provided by Faizi.

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### Data availability statement

The data that support the findings of this study are available from the corresponding author, upon reasonable request.

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