

Islamic Financial Product Development: Shariah Analysis

Prof. Dr. Muhamad Muda

Faculty of Economic & Muamalat
Islamic Science University of Malaysia (USIM)
Bandar Baru Nilai
71800 Nilai, Negeri Sembilan
mmuda@admin.kuim.edu.my

Abdullaah Jalil

Faculty of Economic & Muamalat
Islamic Science University of Malaysia (USIM)
Bandar Baru Nilai
71800 Nilai, Negeri Sembilan
abdullaah@admin.kuim.edu.my

ABSTRACT

Islamic banking and financial institutions should be able to foresee the needs of the market and roll out Islamic financial products and services in advance of conventional products to ensure constant growth and competitiveness of Islamic banking and financial products. However, Islamic banking and financial products and services tended to duplicate the conventional ones, resulting in these products losing value and causing some confusion in their interpretation. Hence, it is essential for the Islamic financial institutions to move beyond the adaptation of conventional products and stimulate new ideas that will help the Islamic banking and financial industry flourish. The subject of Islamic financial product development covers various aspects of studies. However, this study aims to analyze the Shariah aspect of Islamic financial product development and discuss the issues arise in the process based on secondary resources. The output of this study should contribute to the advancement of procedure for Islamic financial product development, particularly from the Shariah aspect, as it is the most imperative tool for the Islamic financial institutions to meet their increasing concern about profitability, liquidity, assets value, risk management as well as product acceptability. The study proves that fiqh muamalat discipline provides ample spaces for developing Islamic product development, an area in which Islamic financial institutions should focus their resources.

Keywords: Product development, Shariah analysis

INTRODUCTION

The banking and financial services industry is highly competitive and an inferior product will be discarded by the customers. The product offered must be sound in all regards in order to protect and enhance the reputations of those institutions that associate their name with it. Moreover, new generation of well-informed consumers demanding differentiated and sophisticated products. In the light of the facts, banking and financial institutions should focus their resources and talents on serving the customer in order to ensure continuous presence in the market. Hence, product development is an integral part component in the quest to serve the customer (Gainor, 2000).

THE IMPERATIVE OF ISLAMIC FINANCIAL PRODUCT DEVELOPMENT

It is clear that in the rapidly changing financial environment in which the Islamic banks are operating, it is vital that every player of this sector attempts to ensure both its short-term competitive and long-term strategic presence. Islamic banking institutions as well as Islamic banking consultants need to be continually innovative and create new ideas and new products. Procedure for financial product and service development is the most imperative tool in order to meet their increasing concern about liquidity and risk management so as to ensure the value of the assets created by them as well as sustained growth and profitability for the business (Noman, n.d.).

Product development is an important area in which Islamic banking and financial institutions should focus their resources. There is already a pool of Islamic banking institutions and consultants in the Malaysian market but the study on how the institutions carry out their product development process is still in absence. Hence, this article is a preliminary review dedicated to analyze the Shariah aspects of Islamic financial product development and issues surrounding the area in the Malaysian context. It is hoped that more studies will be undertaken on the topic in the future.

Malaysia has opted to have a dual financial system that consists of Islamic and conventional financial systems. The dual financial system has proved to be viable as more competitive and sophisticated Islamic financial products have been introduced into the Islamic banking industry and gained popularity and even preference amongst the customers. In other words, the Islamic banking products in a dual financial system tend to be wider in range, bigger in number and more sophisticated compared to their counterparts in a single Islamic system¹ (Bakar, n.d.).

It is observed that much of the Islamic products are introduced into the market place by adapting and reengineering the conventional products – following the success of the conventional products (Gainor, 2000). This is a considerable innovation and value-added put by the Islamic financial institutions but it may bring about skepticism on the substance of the products and criticism on the institutions and system if this reengineering process is substantially practiced.

¹ Such in Pakistan, Sudan and Iran.

Islamic banking and financial institutions should be able to foresee the needs of the market and roll out Islamic financial products and services in advance of conventional products to ensure constant growth and competitiveness of Islamic banking and financial products. However, “*Islamic banking products and services tended to duplicate the conventional ones, resulting in these products losing value and causing some confusion in their interpretation*” (Business, 2005). Hence, it is essential for the Islamic banks to move beyond the adaptation of conventional products and stimulate new ideas that will help the Islamic banking and financial industry flourish.

ASPECTS OF ISLAMIC FINANCIAL PRODUCT DEVELOPMENT

The standard product development process comprises of five main stages i.e. market intelligence, resources allocation, team selection, marketing and distribution, and research and development (Khan, 2002). The product development is a comprehensive process and should involve committed and competent people with various backgrounds. Gainor (2000) suggests that the Islamic financial product development team may include Shariah scholar, Islamic financial advisor, asset manager, custodian and registrar of administrative services, lawyer, directors, distributor/selling agents/marketing group, customer and project coordinator. The authors have recognized seven main aspects that should be observed in developing Islamic financial product development. They are:

1. Shariah (Islamic law)
2. (Governing) Law
3. Tax structure
4. Accounting standard
5. Technical system
6. Finance
7. Marketing

However, the core of Islamic financial products is the Shariah compliance. The Shariah scholars are responsible in giving fatwa on the product with the underlying supporting evidences to the Islamic investors. The product must be Islamically acceptable and economically viable in all aspects. This illustrates the criticality of Shariah analysis which must be carried out in order to ensure the marketability of the end-product. Hence, the Shariah scholars must be involved in the whole process from beginning and not only at the end of the process (Gainor, 2000). They must be adequately informed to clear doubts, if any, surrounding the product.

IJTIHAD AS A MEAN OF ISLAMIC FINANCIAL PRODUCT DEVELOPMENT

The term *ijtihad* refers primarily to the “utmost effort by the *mujtahid* (competent Shariah scholar) to derive Shariah rulings on matters from the sources of Shariah” and the past scholarly interpretations of Islamic jurists on the Shariah sources. In carrying out the *ijtihad*, the *mujtahid* should have specific method of *ijtihad* which is recognized in the Islamic jurisprudence discipline. Based on the definition, it is observed that *ijtihad* is not an upfront process rather it is later stage after the existence of matters to be the subject of *ijtihad*. However, the involvement of Shariah scholars at the end of the Islamic financial

product development has slow down the introduction of Islamic banking products and services, in some cases by between six months and a year compared to conventional products, as the fatwa or religious decrees issued by Shariah scholars pertaining the products are carried out late (Business, 2005). This fact indicates that the positioning of Shariah scholars in Islamic financial product development process should be changed to upfront position and they must play active role in documenting the necessary information on the product. The approach of *al-tafri'* (projecting matters before their existence and issuing decrees on them) as practiced by some previous Islamic jurists may be adopted in the Islamic financial product development process.

The responsibility of being Shariah scholars is very serious by all means. In issuing the decrees, they have to interpret the word of God and actions and deeds of the Prophet Muhammad in their effort to prescribe the solutions to govern the activities of Islamic financial institutions. This is a formidable duty as the integrity of the interpretation of the sources of Islamic law must be upheld. Among the criteria for a Shariah scholar is mastery of the Arabic language, sciences of Hadith and Quran, and the various skills of legal reasoning (*ijtihad*) (Business, 2005).

SALIENT FEATURES OF FIQH MUAMALAT: THE BASIS FOR ISLAMIC FINANCIAL PRODUCT DEVELOPMENT

The nature of Islamic financial product development is based on the nature of fiqh muamalat (Islamic commercial jurisprudence) itself. The area of fiqh muamalat differs from the fiqh ibadat from the perspective of Islamic jurisprudence in several ways. Qal’ahji (2000) outlines the main salient features of fiqh muamalat vis-a-vis fiqh ibadat (See Table 1).

Table 1: Salient Features of Fiqh Muamalat vis-à-vis Fiqh Ibadat

Salient Features of	
Fiqh Muamalat	Fiqh Ibadat
The primary ruling is permissibility except where the Shariah prohibition states.	The primary ruling is impermissibility except where the Shariah permission states.
Fatwa or verdict in based on the easiest/most appropriate (al-aysar) opinion.	Fatwa or verdict is based on the most cautious (al-ahwath) opinion.
Legal rulings are based on rational reasoning (illah aqliyyah)	Legal rulings cannot be based on rational reasoning (it is a submissive action).
Specific Quranic and Sunnah resources are few and general in nature; hence the rational thinking can be applied extensively.	Specific Quranic and Sunnah resources are many and detailed in nature; hence it cannot be developed extensively by rationalization.

These features of fiqh muamalat imply that the commercial practices (products and institutions) are very much given to the community to decide and construct as long as they do not contradict with the Shariah principles. The Shariah has opened the doors of

creativity and innovation broadly to Muslim ummah to develop their economic activities in fulfilling their needs under the light of divine guidance. With this understanding in mind, it can be derived that the area of Islamic financial product development is dynamic, adaptable, accommodating and flexible in nature where the Muslim ummah could play energetic role to a great extent.

Another significant point that can be derived from these features is the existence of ample rooms for applying the concept of *maslahah* and the doctrine of Shariah objectives. Since *fiqh muamalat* (Islamic commercial law) should safeguard the interest of the community as long as they do not violate any Shariah principles, the people who are involved in the Islamic financial product development process could categorize the products into the categories of *maslahah* and Shariah objectives. The products that satisfy the essential level of *maslahah* and Shariah objectives should get preference over other products. Table 2 illustrates the relationship between the *maslahah* and Shariah objectives in brief. However, the in-depth discussion of these concepts and their application are not within the scope of this article.

Table 2: The relationship between the *maslahah* concept and Shariah objectives

Main Categories		Categories of Maslahah				
		Beneath the <i>Maslahah</i>	Necessities	Conveniences	Refinements	Beyond the <i>Maslahah</i>
Five essential elements of Man that Shariah seeks to preserve, improve and adorn	Essential Elements of Man					
	Religion	Unacceptable	1 st	6 th	11 th	Unacceptable
	Life		2 nd	7 th	12 th	
	Mind		3 rd	8 th	13 th	
	Offspring		4 th	9 th	14 th	
Wealth	5 th		10 th	15 th		

THE STARTING POINT OF SHARIAH ANALYSIS FOR PRODUCT DEVELOPMENT: AVOIDANCE OF THE INVALIDATING AND DEFECTING FACTORS

Having the understanding that the commercial contracts are permissible except where the Shariah prohibition states, the Islamic jurists have recognized factors that invalidate and defect the commercial contracts through their thorough analysis of Shariah sources. Invalidating factors refers to the factors that violate the fundamentals and conditions of the commercial contract. Hence, an invalid commercial contract is “in effect not

concluded and the exchange of ownership does not result”. Defecting factors refers to the factors that violate the characteristics of the fundamentals. Hence, a defective commercial contract is “one that fundamentally legally sound, but has a violating forbidden characteristics” (al-Zuhayli, 1997). The authors summarize the main invalidating and defecting factors as available in the fiqh literatures in the following points:

- i. Al-Riba’ (الربا): Interest & usury
- ii. Al-Gharar (الغزر): Uncertainty
- iii. Al-Jahalah (الجهالة): Ignorance
- iv. Al-Ghalat (الغلط): Mistake
- v. Al-‘Ayb (العيب): Flaw; Defect
- vi. Al-Maysir (الميسر) & Al-Qimar/Al-Muqamarah (القمار/المقامرة): Gambling/ Fortune-based game
- vii. Al-Ghabn (الغبن): Unjustifiable/unreasonable price
- viii. Al-I’anah ala al-Munkar (الإعانة على المنكر): Helping on unlawful purposes
- ix. Intihak Al-Hurmah al-Shar’iyyah (انتهاك الحرمة الشرعية): Violation of Shariah sanctity
- x. Al-Hilah (الحيلة): Legal device
- xi. Al-Dharar (الضرر): Harm; Impairment
- xii. Al-Zulm (الظلم): Injustice; Unfairness; Oppression
- xiii. Al-Shuruth al-Mufsidah (الشروط المفسدة): Corrupting Conditions
- xiv. Al-Najsh (النجش): Artificial price hiking
- xv. Al-IKrah (الإكراه): Coercion; Compulsion

However, the Islamic jurists are of different opinions in discussing the details of these factors and their effect on the commercial contracts. A detailed study of these factors may give an upfront guideline to the Islamic financial product development team. Most of the fiqh literatures discuss these factors in relation to the pillars of contract and its conditions.

Prof. Dr. Wahbah al-Zuhayli (1997) has summarized all of these factors into four main categories based on the causes of invalidity and defect i.e.

- i. Ineligibility of contracting party
- ii. Non-compliance of the contract language
- iii. Non-compliance of the objects of sale
- iv. Non-compliance of description (*wasf*), condition (*sharth*) and legal prohibition

Prof. Dr. M Uthman Syubayr, a well-known Islamic scholar, has categorized these factors into four categories based on the illegal purposes of the commercial contracts i.e.:

- v. Illegality of subject matter
- vi. Helping unlawful (*haram*) activities
- vii. Oppression and taking others’ property unrightfully
- viii. Violating the Islamic brotherhood (*Ukhwah Islamiyyah*)

From the authors’ humble observation of these factors; they can be categorized into four main categories:

- i. Al-Riba (الربا)

- ii. Al-Gharar & Al-Jahalah (الغرر والجهالة)
- iii. Al-Zulm & Al-Dharar (الظلم والضرر)
- iv. Intihak al-Hurmah al-Shar'iyah (انتهاك الحرمة الشرعية): Violation of the Shariah sanctity

The discussion of these factors and their effect on the commercial contracts is not within the scope of this article.

THE APPLICATION OF SHARIAH CONCEPTS: AN ANALYSIS ON ISLAMIC BONDS AND ISLAMIC BANKING SYSTEM

This section analyze the Shariah concepts applied in the Malaysian Islamic financial system focusing on the Shariah concepts of Malaysian Islamic Bonds and Financing by the Malaysian Islamic Banking System.

Shariah Concepts of Islamic Bonds

Islamic bonds can be categorized – based on their underlying Shariah principles - into five major categories. They are:

- (i) Loan-based bonds i.e. *Al-Qardh al-Hasan* (benevolent loan)-based bonds. This type of bond does not provide a financial return to its holders except the loan principal. Hence, it is totally not attractive to the investors. The Malaysian government firstly introduced this type of bond in order to facilitate the management of Islamic assets in the initial development stage of Malaysian Islamic banking system. However, this was only a temporary step and this type of bonds does not prevail anymore².
- (ii) Sale-based bonds i.e. *Murabahah*³, *BBA (Al-Bai' Bithaman Ajil)*⁴, *Istisna'*⁵, and *al-Wafa'*⁶. This theoretically reveals that the underlying relationship between the bonds issuers and bondholders is a relationship between sellers and purchasers. Most of these sale-based bonds – not all - however render to the concept of *Bai' al-'Inah*⁷ in practice. Through the

² Petronas Dagangan Berhad issued two IDS based on the concept of *al-qardh al-hasan* with detachable warrants in the forms of transferable subscription rights (TSRs) to the investors in 1994 and 1995. However, both have been criticized for possible non-compliance with the Syariah principles (Engku Ali, 2004).

³ *Murabahah* refers to the sale of goods at a price which includes a profit margin agreed upon by both parties. Such a sale contract is valid provided that the price, other costs and the seller's profit margin are all stated at the time of the sale agreement. The *Murabahah* facility involves the purchase of assets by the financiers and the immediate sale of those assets back to the issuer with a mark-up agreed upon by both parties (Ismail, 2002).

⁴ *BBA* contract refers to the sale of goods on a deferred payment basis. In the *BBA* facility, the issuer sells the assets to the financiers who immediately sell it back to the issuer with higher price (Ismail, 2002).

⁵ *Istisna'* refers to a contract of acquisition of goods by specification or order, where the price is usually paid progressively in accordance with job completion progress (Ismail, 2002).

⁶ *Bai' al-Wafa'* is a sale with a condition that when the seller pays back the price of goods sold, the buyer returns the good to the seller (SC, 2002).

⁷ *Bai' al-'Inah* is defined as a type of sale whereby the seller sells his assets to the buyer at an agreed selling price to be paid by the buyer at a later date. Thereafter, the buyer immediately sells back the assets to the seller at a cash price, lower than the agreed selling price (SC, 2002).

operation of *Bai' al-'Inah*, the debt is created for the creditors on the debtors. Hence, these *Bai' al-'Inah*-based bonds are debt-based securities in nature. The sale of debt securities in the secondary market involve another controversial concept in Islamic jurisprudence i.e. *Bai' al-Dayn* (Sale of debt).

- (iii) Lease-based bonds i.e. *Ijarah* (Lease) and *Intifa'* (Sub-lease). The *Ijarah* concept construes the bond issuers and bondholders as lessee and lessors respectively. This means that the holders of *Ijarah* bonds are the beneficial owner of the leased asset and lease charge. They shall receive the rental payments during the lease period and their principal at the end of the lease contract after the asset is sold at the original price (i.e. the face value of the bond issue) (LOFSA, 2002; SC, 2004). *Intifa'* bonds (*Sukuk*) come into the picture when sub-lease contract is involved.
- (iv) Equity-based bonds i.e. *Musyarakah* (Profit-and-loss sharing) and *Mudarabah* (Profit-sharing). The relationship between *Musyarakah* bond (*Sukuk*) issuers and bondholders is a partner-to-partner relationship. In the other hand, *Mudarabah* bonds (*Sukuk*) conceptualize the relationship between bond issuers and bondholders as a relationship between entrepreneurs (*mudarib*) and capital providers (*rabb al-mal*). However, these two equity-based bonds are more risky in nature from the investors' viewpoint.
- (v) Mixed or hybrid bonds i.e. a combination of the previously stated contracts. Islamic Development Bank issued such type of Islamic bonds named as *Sukuk al-Istithmar* (Investment *Sukuk*) – worth USD400 millions - in July 2003. It is a combination of three contracts namely, *ijarah*, *murabahah* and *istisna'*, involving real assets and debt-based assets. It was contemplated that the *Ijarah* assets should constitute more than 50% of the portfolio at all times (Engku Ali, 2004).

“*Sukuk*” is the plural of “*sakk*” which means a document or certificate, which evidences the undivided pro-rata ownership of underlying assets (SC, 2004). In many circumstances, *Sukuk* is wrongly defined and translated as Islamic bonds. In fact, sale-based bonds – in most situations - could not be named as “*Sukuk*” as they represent the value of debt – not real asset - owned by the bondholders. The right term for debt-based Islamic bonds is “*sanadat al-dayn*”. “*Sanadat*” or “*sanadat al-dayn*” are certificates represent the promise by the issuer to pay back the debt to investors (creditors) based on a pre-agreed date of settlement. Hence, sale-based bonds are rightly named as Islamic Debt Securities. However, Islamic sale-based bonds involve two controversial contracts that are hardly accepted by the Middle-east scholars and investors - where there are a substantial numbers of potential investors with a lot of funds – i.e. *Bai' al-'Inah* and *Bai' al-Dayn*. However, the jurisprudential discussion of these two contracts is not within the scope of this paper. It is enough to note that these two concepts are rejected by most Middle-East scholars and jurists.

In 2005, 71.4% of the approved bonds by SC are Shariah-compliant. There were also six equity-based Islamic bonds introduced based on the concept of *Musharakah* (5) and

Mudharabah (1) (See Table 2 for details). It is a new milestone in the Malaysian Islamic capital market as well as Islamic financial product development area. Prior to 2005, it seems that the Shariah concepts for Islamic bonds are not fully utilized in the Malaysian Islamic capital market as it is today. More studies on the features and uniqueness of the Shariah concepts for Islamic bonds and their relations to profitability, liquidity, assets value and risk management should be carried out to facilitate the process of Islamic financial product development in fulfilling the market's needs.

Table 2: Shariah Concepts for the Approved Islamic Bonds in 2005

No.	Shariah Concept	Percentage
1	Bai' Bithaman Ajil (BBA)	36.3
2	Murabahah	33.5
3	Istisna'	14.5
4	Musyarakah	12.6
5	Ijarah	2.9
6	Mudharabah	0.2
	Total	100.00

Source: SC Annual Report 2005

Shariah Concepts of Financing in the Malaysian Islamic Banking System

Similarly with the above analysis, it can be seen that the Shariah concepts for financing in the Malaysian Islamic banking system can be categorized into five categories i.e. loan-based, sale-based, lease-based, equity-based and hybrid. However, the percentage of the equity-based financing is too small compared to the other types of financing. This is in fact contradict to the fact that Islamic concepts of profit and loss sharing (PLS) i.e. *musharakah* and *mudharabah* dominate the theoretical literatures on Islamic banking and finance during its early stage of development several years ago. However, the actual up-to-date practice of Islamic banks, investment companies, and investment funds seems to base their financing very much on the mark-up, commissioned manufacturing, or on leasing bases. According to the International Association of Islamic Banks, profit and loss sharing instruments only covered less than 20 percent of investments made by Islamic banks worldwide (Dar & Presley, 2000).

In the Malaysian scenario for example, *musharakah* and *mudarabah* financings constitute only 0.3% out of total Islamic financing totaling RM 9.5 billion as at end-2005. *BBA*-based (deferred payment sale) financing remains overriding, constituting 40.7% of total financing while *ijarah*-based (leasing) financing constituted 31.6% (BNM, 2005). This is shown in Table 3. With due acknowledgement to the current practices of Islamic banking and financial institutions, there are various constraints around them for adopting *musharakah* and *mudarabah* as their preferable modes of financing.

Table 3: Major Shariah Concepts for Financing as at end-2005 in the Malaysian Islamic Banking System

No.	Shariah Concept	Percentage
1	Bai' Bithaman Ajil (BBA)	40.7
2	Ijarah	31.6
3	Murabahah	6.9
4	Musyarakah & Mudharabah	0.3
5	Istisna'	0.9
6	Others	19.6
	Total	100.00

Source: BNM Annual Report 2005

MAIN SHARIAH ISSUES IN ISLAMIC FINANCIAL PRODUCT DEVELOPMENT

There are several main Shariah issues that should be observed and discussed to set the future direction of the Islamic financial product development area. The main Shariah issues are:

1. Heavy Reliance on the Fixed Mode of Islamic Concepts
2. The Underutilization on Islamic Partnership Concepts
3. The Practice of Legal Device
4. Harmonization of Opinions

Heavy Reliance on the Fixed-Return Mode of Islamic Concepts

Islamic financing products were perceived to be necessarily fixed-return mode of financings even though the actual fact is otherwise. This is due to the heavy reliance of Islamic financial institutions on this type of financing mode at the onset of Islamic banking system. The excessive utilization of the fixed return modes has characterized the Islamic financial institutions as inflexible and inadaptible to the volatile cost of funds. Eventually, the Islamic financial products may be large in number and limited in their variety. This further limits the ability of Islamic financial institutions to match between their assets and liabilities as most of their liabilities are comprised of floating rate instruments. It is not the question of whether the fixed-mode of Islamic financing is superior, equal or inferior to the unfixed-mode of Islamic financing, but what is more important is the wise and profitable use and management of funds.

The downside of heavy reliance on fixed-mode of Islamic financing is the loss of comparative advantage in the long run for the Islamic financial institutions. Eventually, they would 'lose their distinctive features and tend to resemble conventional banks' (Errico and Farahbaksh 1998). Hence, Islamic scholars have warned that if this trend of relying on fixed-return modes continue, Islamic financial institutions would lose ground against conventional financial institutions as they are also offering products with similar, if not the same, characteristics. In order to gain competitive advantage and product differentiation, Islamic financial institutions had better evolve mechanisms for successful application of variable returns modes (Tag El-Din 1999).

The Underutilization on Islamic Partnership Concept

Heavy reliance on the fixed-mode of Islamic concepts has led to the underutilization of Islamic partnership contracts. It observed in the past experiences that most of the Islamic financial products are developed on the sale-based and lease-based Islamic concepts. The focus on these two concepts in the area of Islamic financial product development does not represent the optimum use of Shariah concepts in product development. There are several modes of Islamic partnership contracts in the area of *fiqh muamalat*.

In general, partnership in Islamic jurisprudence (*fiqh*) is of two types: holding and contract partnerships. A holding partnership refers to the joint ownership by two or more persons of an asset by 'optional' or 'compulsory' means of inheritance or wills or joint purchase or other circumstances. In the other hand, a contract partnership refers to a 'joint commercial enterprise' or mutual agreement by two or more persons to contribute to the capital of the partnership and share in its profit or loss. (AAOFI, 1998; Usmani, 2002). Partnership projects for commercial purposes basically can be further divided into two major categories i.e. trading and agricultural partnerships, and can take place in several forms. The divisions can be illustrated by the following points (Al-Masri, 1999; Nyazee, 2002):

- 1) Agricultural Partnerships (*Al-Sharikat Al-Zira'iyyah*). This category has three forms:
 - a. *Muzara'ah* (Share-cropping): It is a type of agricultural partnership with land contributed by one party and work by another. The land is cultivated and the yield is shared between them.
 - b. *Musaqah* (Share-watering): It is a type of agricultural partnership whereby the trees and land are contributed by one party and their care (watering) is undertaken by another with their fruit being divided between the parties.
 - c. *Mugharasah* (Share-planting): It is a type of agricultural partnership where the land and plants are contributed by one party and the work of planting is provided by another party with a portion of plants being given to him.
- 2) Trading Partnerships (*Al-Sharikat Al-Tijariyyah*). This type of partnership is different from the previous one as the partners share the profit, neither crops nor plants, between them. This can be further divided into two categories. This category has two forms:
 - a. *Mudarabah*: It is a type of trading partnership in which capital is contributed by the capital provider (*rabb al-mal*) and labour from the entrepreneur (*mudarib*). The profit is shared between them. In case of loss, it is born by the capital provider. The entrepreneur only suffers from the fruitless efforts.
 - b. *Shirkah*: It is a profit and loss sharing partnership and takes three major forms.
 - i. *Shirkat al-Amwal*: It is a partnership in which participation is based on the contribution of capital by all partners.

- ii. *Shirkat al-Abdan*: It is a partnership in which participation by the partners is based on labour or skill.
- iii. *Shirkat al-Wujuh*: It is a partnership based on the credit-worthiness of the partners. The ratio of loss is based on the liability borne whereby the ratio of profit could be based on either the liability borne by each partner or mutual agreement between them.

These three types of trading partnerships could be based on either '*inan* or *mufawadah* partnership.

A *mufawadah* partnership is based on *wakalah* (agency) and *kafalah* (surety) that entails full commitment from the partners. To achieve this purpose, all partners should maintain equality in capital, labour, liability and legal capacity. It declares each partner to be an agent of and surety for the other. In an '*inan* partnership, the equality of legal capacity and contribution by each partner is not necessary (Nyazee, 2002).

Having discussed the Islamic partnership concepts, it is clearly observed that these concepts could be referred in developing Islamic financial products. However, the reasons for underutilization of Islamic partnership concept in the Islamic financial product development could be summarized in the following points (Dar & Presley, 2000)

1. Islamic partnership contracts are inherently vulnerable to agency problems as clients (entrepreneurs) have disincentives to put in effort and have incentives to report less profit as compared to the self-financing owner-manager.
2. Islamic partnership contracts require well-defined property rights to function efficiently.
3. Islamic partnership contracts are relatively more risky.
4. The restrictive role of shareholders (investors) in management and, hence, the dichotomous financial structure of Islamic partnership contracts make them non-participatory in nature, which allows a sleeping partnership.
5. Equity financing is not feasible for funding short-term projects due to the ensuing high degree of risk (i.e., the time diversification effect of equity).
6. Unfair treatment in taxation.
7. Secondary markets for trading in Islamic financial instruments, particularly *Mudharabah* and *Musharakah*, are non-existent.

It is a challenging task for the Islamic financial product development group to develop equity-based Islamic financial products taking into considerations all of the factors above. However, equity-based financial products, particularly *Mudharabah* or *Musharakah* or both (*Mudharabah Mushtarakah*), is one of the unique value of Islamic financial products and some of the Islamic economists give the preference to these concepts over others. From the authors' viewpoint, these concepts could contribute to the variety of Islamic financial products and in some conditions; they will be more attractive to the customers.

The Practice of Legal Device

The practice and existence of *bay' al-'inah* (which is considered as circumvention of *riba'*) has roused several issues in the Islamic banking and finance industry even though this type of sale is legal according to a few opinions of Islamic jurists. The issue of substance over form in the development of Islamic financial system has taken a lot of time and spaces for discussion. Some misunderstandings have taken place when the public believe that the Islamic financial products are distinctive in term of the contractual aspect only while their spirits are identical to the conventional ones.

The Islamic financial product development group has to reconsider the use of legal device or the option of controversial juristic opinions as the impacts are quite severe. It is not only about the acceptance and the marketability of the products, but the real issue is bigger than that. The practice of legal device has worsened the perception of the public towards the Islamic banking and finance industry and depreciated the genuine value of Islamic financial products. Hence, this is a matter to avoid for the future Islamic financial product development.

Harmonization of Opinions

One of the natures of *fiqh muamalat* discipline is the availability of several opinions of Islamic jurists pertaining to an issue. This nature is seen as an advantage rather than as an obstacle in the area of Islamic financial product development. However, in the real world practice, it does not mean that the Islamic financial product development group could choose any juristic opinion to construct their products. The selection of juristic opinion in this case should take into consideration the juristic standing of the customers. It is vital to ensure the acceptance and marketability of the Islamic financial products.

The past experiences have shown that some of the Malaysian Islamic financial products cannot be sold and accepted in the Middle East countries due to the different juristic opinions. Even though that the Malaysian Islamic financial issuers have their juristic proofs to support their standing in such cases, it is the customers who will decide whether the product will be successful or not. Hence, a pilot study has to be conducted by the Islamic financial product development group to evaluate the acceptance of Islamic jurists, particularly from the Middle East countries, on their products before their introduction into the market.

Harmonization of juristic opinions is also crucial to avoid confusion amongst the Muslim investors. One way to achieve that is to develop Islamic financial products based on the Shariah concepts that are well-accepted. The Islamic financial product development group should observe this point carefully. Those who are in the position of authority should promote this harmonization process by giving incentives and lifting up the barriers. This development can be observed clearly in the Malaysian Islamic capital marker in the recent years.

CONCLUSIONS AND RECOMMENDATIONS

Islamic financial product development is a dynamic area which requires a pool of experts with various backgrounds to come up with products that satisfy the needs of the customers and represent the value of Islamic banking and finance. Hence, it is essential for the Islamic financial institutions to move beyond the adaptation of conventional products and stimulate new ideas that will help the Islamic banking and financial industry flourish. Perhaps, the Shariah aspect is the most unique area of Islamic financial product development which should be attended from the beginning until the end of the process. The core of the issue is the creation and innovation of the Islamically acceptable and economically viable products that receive acceptance at the global scale. Malaysian Islamic banking and financial institutions have much to offer in regard to the Islamic financial product development processes as they have developed sophisticated and various financial products. Islamic banking institutions in Malaysia have introduced similar facilities offered by their conventional counterparts that are based on selected Shariah concepts. Their extensive experience in the industry should be put forward for discussion, comparison and analysis. The outcome could accelerate the process of Islamic financial product development and could help the practitioners to come up with more preferable financial products to both customers and players.

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