

A Critical Appraisal of Product Innovation in Islamic Banking: Navigating Market Pressures, Ensuring Shariah Compliance, and Advancing the Objectives of Maqasid al-Shariah

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ABSTRACT

This article presents a critical evaluation of product innovation in Islamic banking, focusing on the imbalance between market demands, sharia compliance, and the realization of *maqashid al-shariah*. The study aims to assess the extent to which Islamic banking innovations can maintain a balanced integration of commercial objectives, legal-formal compliance, and the substantive values of *maqashid*. Employing a descriptive qualitative approach through case studies of several Islamic banks in Indonesia, the research gathers data from annual reports and strategic publications. Analysis is conducted using the *Maqashid-Based Innovation Evaluation Model (MBIEM)*, which encompasses three core dimensions: market orientation, sharia compliance, and alignment with *maqashid*. Findings reveal a significant gap between formalistic compliance and the actual implementation of *maqashid*. Value-based innovations such as *qardhul hasan* financing and digital zakat platforms are found to better embody *maqashid* values than products driven solely by legal-formal considerations. The study recommends reinforcing maqashid-oriented regulations, involving the Sharia Supervisory Board (SSB) early in product development, enhancing the multidisciplinary competencies of human resources, and developing a substance-based sharia audit framework. With these strategies, Islamic banking innovations are expected to become more ethical, inclusive, and sustainable, while fulfilling their socio-economic role in accordance with Islamic principles.

INTRODUCTION

Over the past two decades, the global financial industry has experienced rapid growth driven by globalization, technological innovation, and shifting consumer preferences.^{1,2} This dynamic development has not only influenced the conventional financial system but has also compelled the Islamic banking sector to continuously innovate in order to remain competitive and maintain its relevance.³ Product innovation has become indispensable for Islamic banks as they respond to increasingly dynamic and complex market needs. However, amid this push for innovation, Islamic banking faces a critical challenge: how to meet market demands without compromising adherence to Sharia principles, particularly the noble objectives of Maqasid al-Shariah.^{4,5}

Empirical realities indicate that although product innovation within the Islamic banking sector continues to advance, many newly introduced products remain primarily driven by commercial objectives. In practice, numerous Islamic banks place greater emphasis on competitive strategies and market adjustments, often modifying Sharia contracts to be more flexible in responding to economic realities, without fully internalizing the substantive values of Maqasid al-Shariah that should serve as the core spirit of Islamic economic activities.⁶ In several cases, product innovation has tended to focus on fulfilling legal-formal requirements and profitability, while values such as justice, barakah, and social welfare integral components of Maqasid al-Shariah have not yet become the principal reference points.^{7,8} This trend reflects a pragmatic orientation in product development, where market considerations appear to dominate over the preservation of Sharia values and ethical integrity.

This phenomenon aligns with the findings of various contemporary studies which reveal that innovation in the global banking sector, including Islamic banking, digital financial systems, and wealth management products, is largely driven by market expectations, technological efficiency demands, regulatory dynamics, and rapid advancements in digital technology. The transformation of banking business models has been primarily directed toward enhancing operational efficiency, accelerating service delivery, and expanding market penetration; however, these developments have not always been accompanied by a deep integration of Islamic normative values, particularly the principles of Maqasid al-Shariah within the context of Islamic finance. Within the global literature, the impetus for innovation tends to be utilitarian and predominantly market-driven, rather than grounded in ethical

¹ Ivana Simonović and Marija Todorović, 'Banking Product and Services Development Projects: The Way To Implement Innovations', *European Project Management Journal*, 9.1 (2019), pp. 3–9, doi:10.18485/epmj.2019.9.1.1.

² Abdurrahman Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities', *Journal of Strategy & Innovation*, 36.1 (2025), p. 200540, doi:10.1016/j.jsinno.2025.200540.

³ Nun Harrieti, 'The Use of Hybrid Contract in the Innovation of Islamic Banking Product', *Hasanuddin Law Review*, 4.1 (2018), pp. 68–80, doi:10.20956/halrev.v4i1.1208.

⁴ Harrieti, 'The Use of Hybrid Contract in the Innovation of Islamic Banking Product'.

⁵ Simonović and Todorović, 'Banking Product and Services Development Projects: The Way To Implement Innovations'.

⁶ Harrieti, 'The Use of Hybrid Contract in the Innovation of Islamic Banking Product'.

⁷ Harrieti, 'The Use of Hybrid Contract in the Innovation of Islamic Banking Product'.

⁸ Simonović and Todorović, 'Banking Product and Services Development Projects: The Way To Implement Innovations'.

reinforcement, justice, and social transformation core dimensions of the Islamic financial system.^{9'10'11'12'13}

This phenomenon is not merely an internal issue within Islamic banking, but one that carries serious social implications. When the principles of Maqasid al-Shariah are neglected in innovation practices, the social role of Islamic banks as promoters of economic justice, reducers of inequality, and instruments of community empowerment becomes weakened. If this trend continues without a value realignment grounded in Maqasid, the authentic identity of Islamic banking as an integral part of the Islamic economic system that upholds justice, ethics, and social welfare will risk being reduced to nothing more than a conventionally-oriented financial system with a Sharia label.¹⁴ In this regard, several studies argue that innovation driven predominantly by market efficiency and competitiveness without integrating Islamic normative values risks obscuring the essence of Maqasid al-Shariah, which should serve as the soul of all Islamic financial activities. Consequently, Islamic banking not only loses its transformative function but may also devolve into a symbolic replication of conventional financial institutions under a Sharia-compliant label syariah.^{15'16}

In the global literature, similar tendencies are evident. Financial innovation is generally driven by market expectations, technological efficiency, and regulatory pressures, rather than by normative value frameworks.^{17'18'19'20'21} Furthermore, Yin et al., observe that

⁹ Ilaria Mancuso and others, 'Business Model Innovation in the Banking Sector: How Digital Technologies Transform Innovation Drivers in Value Mechanisms Innovations', *Journal of Engineering and Technology Management - JET-M*, 75.December 2024 (2025), p. 101858, doi:10.1016/j.jengtecman.2024.101858.

¹⁰ Manal Tariq, Sayeda Zeenat Maryam, and Wasim Abbas Shaheen, 'Cognitive Factors and Actual Usage of Fintech Innovation: Exploring the UTAUT Framework for Digital Banking', *Heliyon*, 10.15 (2024), p. e35582, doi:10.1016/j.heliyon.2024.e35582.

¹¹ Emmanuel Baffour Gyau and others, 'Transforming Banking: Examining the Role of AI Technology Innovation in Boosting Banks Financial Performance', *International Review of Financial Analysis*, 96.PB (2024), p. 103700, doi:10.1016/j.irfa.2024.103700.

¹² Hui An and others, 'Financial Regulation and Innovation Dynamics: The China Banking Wealth Management Case', *Pacific Basin Finance Journal*, 92.February (2025), p. 102781, doi:10.1016/j.pacfin.2025.102781.

¹³ Giang Thi Huong Vuong, Walid Barky, and Manh Huu Nguyen, 'Stabilizing the National Banking System through Digital Financial Inclusion, Creative Innovations, and Green Finance in Low-Financially Developed Economies', *Journal of Open Innovation: Technology, Market, and Complexity*, 11.1 (2025), p. 100434, doi:10.1016/j.joitmc.2024.100434.

¹⁴ Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities'.

¹⁵ Simonović and Todorović, 'Banking Product and Services Development Projects: The Way To Implement Innovations'.

¹⁶ Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities'.

¹⁷ Mancuso and others, 'Business Model Innovation in the Banking Sector: How Digital Technologies Transform Innovation Drivers in Value Mechanisms Innovations'.

¹⁸ Tariq, Maryam, and Shaheen, 'Cognitive Factors and Actual Usage of Fintech Innovation: Exploring the UTAUT Framework for Digital Banking'.

¹⁹ Gyau and others, 'Transforming Banking: Examining the Role of AI Technology Innovation in Boosting Banks Financial Performance'.

²⁰ An and others, 'Financial Regulation and Innovation Dynamics: The China Banking Wealth Management Case'.

the rapid expansion of shadow banking based financial products has diverted resource allocation away from the real sector and has contributed to long term systemic instability.²² He et al., likewise emphasize that weak governance principles in financial innovation have triggered a crisis of trust in financial institutions and discouraged investment in genuine, value enhancing innovation.²³ This phenomenon is consistent with the findings of An et al., which reveal that within the dynamics of financial product innovation, banking strategies frequently prioritize regulatory response and short-term profit maximization.²⁴ Such tendencies reinforce a regulatory innovation cycle that ultimately undermines the overall stability of the financial system.

On the other hand, Vuong et al., emphasize that in developing countries, the adoption of digital innovation without a strong value framework and robust governance structure may undermine national banking stability and heighten the risk of financial exclusion, particularly among vulnerable groups.²⁵ This concern is further reinforced by Hu, who argues that innovation models based on capital pooling and rigid payment mechanisms can generate latent risk accumulation and systemic risk transmission, ultimately disrupting financial intermediation functions and threatening economic equilibrium.²⁶ Therefore, if Islamic banking product innovation is not rigorously guided to remain aligned with Maqasid al-Shariah particularly the principles of justice, barakah, and social welfare it is not unlikely that a decline in the public legitimacy of Islamic financial institutions may occur. At the national level, such an imbalance could exacerbate socio economic inequality and hinder the meaningful contribution of Islamic financial institutions to inclusive and equitable national development, as highlighted by.²⁷

METHODS

This study employs a descriptive qualitative approach with a case study strategy involving selected Islamic banks actively engaged in developing innovative products. Data collection is conducted through document analysis, including annual reports, product publications, and relevant strategic documents. The collected data are then analyzed thematically to identify consistent patterns within the context of Sharia-compliant product innovation. In the analytical process, this research adopts the Maqashid-Based Innovation Evaluation Model (MBIEM) as the evaluative framework to assess product innovation based

²¹ Vuong, Barky, and Nguyen, 'Stabilizing the National Banking System through Digital Financial Inclusion, Creative Innovations, and Green Finance in Low-Financially Developed Economies'.

²² Hong Yin and others, 'Strong Financial Regulation, Shadow Banking, and Enterprise Innovation Inputs: A Quasi-Natural Experiment Based on the Introduction of the "New Regulation on Asset Management"', *International Review of Financial Analysis*, 99.January (2025), doi:10.1016/j.irfa.2025.103949.

²³ Siyi He, Qinglu Jin, and Sirui Wu, 'The Real Effect of Shadow Banking Regulation on Corporate Innovation: Evidence from Conduit Business', *Pacific Basin Finance Journal*, 90.December 2024 (2025), p. 102656, doi:10.1016/j.pacfin.2024.102656.

²⁴ An and others, 'Financial Regulation and Innovation Dynamics: The China Banking Wealth Management Case'.

²⁵ Vuong, Barky, and Nguyen, 'Stabilizing the National Banking System through Digital Financial Inclusion, Creative Innovations, and Green Finance in Low-Financially Developed Economies'.

²⁶ Yilin Hu, 'Interest-Driven and Legal Supervision Innovation of the Capital Pool Model in Chinese Banking Financial Products', *Heliyon*, 9.5 (2023), p. e16181, doi:10.1016/j.heliyon.2023.e16181.

²⁷ Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities'.

on three key dimensions: (1) market demands, (2) Sharia compliance, and (3) attainment of *Maqasid al-Shariah*. This framework provides a systematic structure for examining the extent to which product innovations align with Islamic values and contemporary market needs.

The conceptual flow of this study begins by identifying the gap between actual practices and the ideal aspirations of *maqasid*. This is followed by a critical analysis of the design, objectives, and social impacts of the innovative products examined. The findings are then used to formulate strategic recommendations that are ethical, equitable, and sustainable, thereby offering new contributions to the Islamic banking innovation literature, which has predominantly focused on commercial dimensions or formal compliance. Integrating these three dimensions underscores the importance of a comprehensive approach in steering the Islamic financial industry toward a more *maqasid-oriented* transformation.

RESULT AND DISCUSSION

Foundational Concepts of Islamic Banking

1. Definition of Islamic Banking

Islamic banking is a financial institution that operates in accordance with Islamic Sharia principles derived from the Qur'an, Hadith, Ijma', and Qiyas, emphasizing values of justice, balance, and ethical prosperity (*barakah*) in economic activities. Unlike conventional banking, which relies on an interest-based (*riba*) system, Islamic banking adopts profit-and-loss sharing mechanisms such as *mudharabah* and *musyarakah*, sales based contracts such as *murabahah*, lease based financing such as *ijarah*, as well as other hybrid contractual structures. These instruments are anchored in real-asset transactions and business participation as practical applications of Islamic financial principles.^{28'29'30} Beyond pursuing economic profitability, Islamic banking fundamentally carries a social mission deeply rooted in the objectives of *Maqasid al-Shariah*, including the promotion of distributive justice, poverty alleviation, and community empowerment. It also supports ethical and sustainable economic development aligned with the higher objectives of Sharia.^{31'32'33}

The core principles that form the foundation of Islamic banking include the prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling or speculation), as well as the prohibition of financing business activities that contradict Islamic law, such as gambling, alcohol production, and other non-halal industries.^{34'35} In addition,

²⁸ Adil Saleem, R. M. Ammar Zahid, and Judit Sági, 'Differential Impact of Adopting Islamic Banking: A Quasi-Experimental Approach', *Research in International Business and Finance*, 76, February 2025 (2025), pp. 1–29, doi:10.1016/j.ribaf.2025.102793.

²⁹ Mahmoud Fayyad, 'Reconstructing Lease-to-Own Contracts: A Contemporary Approach to Islamic Banking Standards', *Heliyon*, 9.9 (2023), p. e19319, doi:10.1016/j.heliyon.2023.e19319.

³⁰ H. Şaduman Okumuş, 'Performance Assessment of Participation Banks Based on Maqasid Al-Shari'ah Framework: Evidence from Türkiye', *Borsa Istanbul Review*, 24.4 (2024), pp. 806–17, doi:https://doi.org/10.1016/j.bir.2024.04.011.

³¹ Fayyad, 'Reconstructing Lease-to-Own Contracts: A Contemporary Approach to Islamic Banking Standards'.

³² Wannes Milena and Alberto Stefan, 'Enhancing ESG Performance in Islamic Banks : The Impact of Shari ' Ah Governance Quality Across Countries', 1.2 (2024), pp. 158–74.

³³ Okumuş, 'Performance Assessment of Participation Banks Based on Maqasid Al-Shari'ah Framework: Evidence from Türkiye'.

³⁴ A Bakhouché, T El Ghak, and M Alshiab, 'Does Islamicity Matter for the Stability of Islamic Banks in Dual Banking Systems?', *Heliyon*, 8.4 (2022), doi:10.1016/j.heliyon.2022.e09245.

Islamic banking upholds the values of justice, transparency, social responsibility, and sustainability as part of the implementation of *Maqasid al-Shariah* in economic activities.^{36'37} This financial system is not solely profit oriented; rather, it prioritizes the equitable distribution of wealth and seeks to minimize socio economic disparities through the use of inclusive Islamic financial instruments aimed at enhancing societal welfare.

In practice, Islamic banking not only offers financial products and services that comply with Sharia principles, but also develops business models that embed ethical values in business decision-making, risk management, and the establishment of fair and transparent relationships with customers. This reflects the commitment of Islamic banking to the values of *Maqasid al-Shariah*, such as justice, ethical prosperity (*barakah*), and social welfare.^{38'39} Islamic banking is also strategically positioned as a vehicle for social transformation by promoting a balance between economic growth and Islamic moral values, through inclusive, responsible, and equity-oriented financial practices that prioritize distributive justice.

2. Maqasid al-Shariah

Maqasid al-Shariah refers to the fundamental objectives that Islamic law seeks to achieve in regulating human life. These objectives encompass five essential principles: the preservation of religion (*hifz al-din*), life (*hifz al-nafs*), intellect (*hifz al-aql*), lineage (*hifz al-nasl*), and wealth (*hifz al-mal*).⁴⁰ In the context of the Islamic banking industry, *Maqasid al-Shariah* serves not only as an ethical benchmark to ensure compliance with Islamic legal principles, but also as a normative framework that guides overall banking operations to align with justice, social balance, and economic prosperity grounded in ethical and spiritual values.^{41'42}

Maqasid al-Shariah functions as a crucial balancing instrument between market demands and spiritual values within Islamic economic activity. In the context of Islamic banking, *maqasid* is not merely a normative ideal; rather, it establishes a measurable value system that can be concretely implemented in the design of products, policies, and business strategies of Islamic financial institutions. Integrating *maqasid al-Shariah* into product and service innovation not only strengthens Sharia compliance, but also promotes the realization of justice, social welfare, and economic sustainability. This approach enables Islamic banks to

³⁵ Umair Riaz, Bruce Burton, and Anne Fearfull, 'Emotional Propensities and the Contemporary Islamic Banking Industry', *Critical Perspectives on Accounting*, 94.March 2022 (2023), p. 102449, doi:10.1016/j.cpa.2022.102449.

³⁶ Fayyad, 'Reconstructing Lease-to-Own Contracts: A Contemporary Approach to Islamic Banking Standards'.

³⁷ Okumuş, 'Performance Assessment of Participation Banks Based on Maqasid Al-Shari'ah Framework: Evidence from Türkiye'.

³⁸ Saleem, Zahid, and Sági, 'Differential Impact of Adopting Islamic Banking: A Quasi-Experimental Approach'.

³⁹ Fayyad, 'Reconstructing Lease-to-Own Contracts: A Contemporary Approach to Islamic Banking Standards'.

⁴⁰ Mursyid Mursyid and others, 'PERFORMANCE ANALYSIS OF SHARIA AND CONVENTIONAL BANKS WITH MAQASHID SHARIA: CASE STUDY OF INDONESIA AND MALAYSIA IN 2016-2020', *JOURNAL OF SOUTHWEST JIAOTONG UNIVERSITY*, 57.4 (2022), pp. 185–90.

⁴¹ Aam Slamet Rusydiana and Mohammad Mahbubi Ali, 'The Application of Maqasid Shariah on Banking Industry', *Maqasid Al-Shariah Review*, 1.1 (2022), doi:10.58968/msr.v1i1.261.

⁴² Erik Nugraha and others, 'Maqashid Sharia Implementation in Indonesia and Bahrain', *Etikonomi*, 19.1 (2020), pp. 155–68, doi:10.15408/etk.v19i1.14655.

develop competitive differentiation rooted in values and public benefit (*maslahah*), rather than solely in efficiency or market-driven profitability.⁴³

The primary benefit of *Maqasid al-Shariah* in Islamic banking is to ensure that all activities and products offered are not only formally halal, but also substantively rooted in public benefit (*maslahah*).⁴⁴ In other words, Islamic financial products must not solely pursue profit; they must also deliver social value, promote inclusive economic growth, reduce inequality, and protect the economic rights of society particularly marginalized groups.^{45'46}

In contemporary literature, *Maqasid al-Shariah* has been widely adopted as an evaluative benchmark for assessing the performance of Islamic financial institutions, including through the development of Maqasid-based indices designed to measure the ethical and social contributions of Islamic financial products and activities.^{47'48} *Maqasid* indicators are used to determine whether a financial innovation truly reflects the core objectives of Sharia, or merely adopts a symbolic and legal-formal Sharia structure. Such Maqasid-based evaluation is essential in distinguishing between a substantive approach and a formalistic one that focuses solely on fiqh compliance while neglecting broader values of *maslahah* and social justice. Therefore, integrating *Maqasid al-Shariah* into product innovation processes and strategic decision-making is crucial to ensure that Islamic banking does not fall into symbolic Sharia compliance, but instead delivers genuine ethical value, social benefit, and authentic differentiation within the Islamic financial system.⁴⁹

The application of *Maqasid al-Shariah* in banking practice also encompasses economic empowerment of the Muslim community through financing real-sector activities, providing equitable financial access, and strengthening social systems rooted in Islamic values. Thus, *Maqasid al-Shariah* serves as a primary reference in shaping an Islamic financial system that is not only economically efficient, but also ethical, just, and sustainable.

3. Sharia Compliance

Sharia compliance is a key element that distinguishes Islamic banking from the conventional financial system. Within the operational framework of Islamic banking, all activities from fund mobilization and financing distribution to the offering of financial products and services must adhere to Islamic Sharia principles. This obligation extends beyond legal-formal adherence to contractual structures; it must also reflect core values such as justice, honesty, transparency, and the promotion of public benefit (*maslahah*) for all stakeholders.⁵⁰ In this context, the Sharia Supervisory Board (SSB) plays a strategic role in ensuring that the operations of Islamic financial institutions conform to Islamic ethical principles. Its function is not limited to symbolic validation or administrative compliance, but

⁴³ Rafiullah Sheikh and Khalid Hussain, 'Reimagining Islamic Banking in the Light of Maqasid Shariah', *Qualitative Research in Financial Markets*, 2024, doi:10.1108/QRFM-04-2024-0108.

⁴⁴ Rusydiana and Ali, 'The Application of Maqasid Shariah on Banking Industry'.

⁴⁵ Rusydiana and Ali, 'The Application of Maqasid Shariah on Banking Industry'.

⁴⁶ Nugraha and others, 'Maqashid Sharia Implementation in Indonesia and Bahrain'.

⁴⁷ Rusydiana and Ali, 'The Application of Maqasid Shariah on Banking Industry'.

⁴⁸ Nugraha and others, 'Maqashid Sharia Implementation in Indonesia and Bahrain'.

⁴⁹ Okumuş, 'Performance Assessment of Participation Banks Based on Maqasid Al-Shari'ah Framework: Evidence from Türkiye'.

⁵⁰ Abdelhafid Benamraoui, Tantawy Moussa, and Mostafa Hussien Alsohagy, 'Islamic Banks' Sharia Compliance Disclosure: An International Evidence', *Accounting Research Journal*, 36.4-5 (2023), pp. 327-48, doi:10.1108/ARJ-07-2022-0157.

to ensure the realization of the social and spiritual objectives of the Islamic financial system.⁵¹ Comprehensive Sharia compliance serves as a fundamental basis for building public trust and institutional integrity, distinguishing the Islamic financial system as an ethical and inclusive alternative to conventional finance.

To ensure that all Islamic banking activities adhere to Islamic principles, the Sharia Supervisory Board (SSB) is established. The SSB serves as an authoritative and independent supervisory body within the governance structure of Islamic banks. Its existence is mandated by national Sharia regulatory authorities in each country, such as the National Sharia Council Indonesian Ulema Council (DSN-MUI) in Indonesia. The primary duties of the Sharia Supervisory Board include issuing *fatwas*, evaluating product structures, and conducting ongoing supervision to ensure that banking practices remain aligned with Sharia principles. Beyond acting merely as “halal gatekeepers,” the SSB now also serves as a strategic partner in the product innovation process. Their involvement from the design phase enables a balanced integration between Sharia compliance and market demands, ensuring that product development continues to reflect the values of *Maqasid al-Shariah*.^{52,53}

The role of the Sharia Supervisory Board (SSB) has become increasingly strategic amid the rapid growth of digital financial innovation and the rising complexity of modern Islamic banking products. To meet these challenges, SSB members are required to possess strong intellectual capacity and multidisciplinary expertise not only mastery of *fiqh al-mu‘āmalah*, but also a solid understanding of financial risk management, business structures, accounting, and developments in digital technology. This is essential to ensure effective supervision and to maintain Sharia integrity and compliance across all institutional activities. Anisykurlillah et al., demonstrate that the effectiveness of SSB supervision is significantly influenced by the members’ multidisciplinary professional competencies, including strong accounting and managerial abilities that help prevent fraudulent practices.⁵⁴ Similarly, Nan & Hassan emphasize that effective Sharia governance requires SSB involvement that is grounded in a deep understanding of organizational dynamics and the ability to foster a culture of compliance through continuous training and communication.⁵⁵ With effective oversight from the SSB, Islamic banks are able to uphold their integrity as financial institutions that are not only formally halal, but also contribute to ethical, just, and sustainable economic development. Therefore, the presence of the SSB serves as a foundational pillar in ensuring that Islamic banking becomes not only an alternative, but also a value-driven solution for the global financial system.

Product Innovation in Islamic Banking

As an integral component of the Islamic financial system, Islamic banking continues to evolve dynamically in response to the complexity of global markets, competitive pressures,

⁵¹ Benamraoui, Moussa, and Hussien Alsohagy, ‘Islamic Banks’ Sharia Compliance Disclosure: An International Evidence’.

⁵² Indah Anisykurlillah and others, ‘Examining the Role of Sharia Supervisory Board Attributes in Reducing Financial Statement Fraud by Islamic Banks’, *Banks and Bank Systems*, 15.3 (2020), pp. 106–16, doi:10.21511/bbs.15(3).2020.10.

⁵³ Mohd Mat Supian Nan and Rusni Hassan, ‘Effective Implementation of Shariah Compliance Culture in Islamic Banks’, *International Journal of Management and Applied Research*, 11.2 (2024), pp. 140–55.

⁵⁴ Anisykurlillah and others, ‘Examining the Role of Sharia Supervisory Board Attributes in Reducing Financial Statement Fraud by Islamic Banks’.

⁵⁵ Nan and Hassan, ‘Effective Implementation of Shariah Compliance Culture in Islamic Banks’.

and rapid technological disruption. In this context, product innovation serves not only as an instrument to enhance institutional competitiveness, but also as a form of institutional *ijtihad* in addressing the diverse needs of modern society without compromising the normative principles of Islam. This requires Islamic financial institutions to consistently uphold the orientation of *Maqasid al-Shariah*, namely the noble objectives of Islamic law such as justice, welfare, and collective prosperity, throughout their business processes and financial services.^{56'57'58}

As highlighted by Mancuso et al., the transformation of banking business models in the digital era is largely driven by structural market shifts, evolving consumer expectations, and the need for operational efficiency, which compel banks to continually pursue strategic innovation.⁵⁹ However, within the context of Islamic banking, such innovation must remain grounded in ethical foundations and *Maqasid al-Shariah* values to avoid becoming solely driven by utilitarian logic. Support for the importance of balanced innovation is also reflected in the work of Shang & Xing, who observe that increasing liberalization in the banking sector has encouraged institutions to design innovative products in response to regulatory complexities and customer needs, while simultaneously safeguarding institutional sustainability.⁶⁰

Therefore, innovation in Islamic banking must be directed not only as an adaptive response to industry dynamics, but also as a manifestation of Sharia commitment to inclusive and equitable economic development, making *Maqasid al-Shariah* the foundational basis in the design and evaluation of every Islamic financial product.

Types of Product Innovation

1. Technology-Based Products (Islamic Fintech)

The development of financial technology (fintech) has created significant opportunities for the Islamic banking sector to transform the way financial products and services are delivered. Islamic fintech facilitates the emergence of digital business models that are not only more efficient and inclusive, but also capable of reaching a broader segment of society, including groups that have historically been underserved by the conventional banking system.^{61'62}

Several forms of technology-based product innovations currently emerging in the Islamic finance sector include:

⁵⁶ Saleem, Zahid, and Sági, 'Differential Impact of Adopting Islamic Banking: A Quasi-Experimental Approach'.

⁵⁷ Fayyad, 'Reconstructing Lease-to-Own Contracts: A Contemporary Approach to Islamic Banking Standards'.

⁵⁸ Okumuş, 'Performance Assessment of Participation Banks Based on Maqasid Al-Shari'ah Framework: Evidence from Türkiye'.

⁵⁹ Mancuso and others, 'Business Model Innovation in the Banking Sector: How Digital Technologies Transform Innovation Drivers in Value Mechanisms Innovations'.

⁶⁰ Hua Shang and Yanlin Xing, 'Banking Market Deregulation and Firm Innovation : Evidence from Foreign Bank Entry', *Journal of Banking and Finance*, 2025, p. 107471, doi:10.1016/j.jbankfin.2025.107471.

⁶¹ Adibah Yahya, 'Sharia Fintech Development in Indonesia', 2020, pp. 1–7, doi:10.4108/eai.17-7-2020.2302984.

⁶² Gökmen Kilic and Yavuz Turkan, 'The Emergence of Islamic Fintech and Its Applications', *International Journal of Islamic Economics and Finance Studies*, 9.2 (2023), pp. 212–36, doi:10.54427/ijisef.1328087.

- **Islamic mobile banking** integrated with Islamic social finance features such as zakat, *infaq*, and *waqf* payments, reflecting a commitment to *Maqasid al-Shariah* principles.⁶³
- **Digital onboarding**, whereby account opening processes can be completed entirely online without the customer's physical presence at the bank branch, thus enhancing access to Islamic financial services.⁶⁴
- **Sharia-compliant peer-to-peer (P2P) financing platforms** that directly connect micro-entrepreneurs with investors using Sharia-compliant contracts such as *murabahah* or *wakalah*.
- **Islamic P2P financing platforms** such as Ammana, Danasyariah, and Alami, which utilize contracts like *wakalah* and *murabahah* to bridge the financing needs of MSMEs with investors in accordance with Sharia principles.⁶⁵
- **Exploration of blockchain and smart-contract technology** within Islamic finance, particularly to enhance transparency and efficiency in halal asset transactions, including digital sukuk issuance.⁶⁶

Through the integration of Sharia-compliant technology, Islamic fintech not only enhances accessibility and efficiency, but also promotes financial inclusion and strengthens the values of social justice in economic practice.⁶⁷

2. Hybrid Contract-Based Products

Product innovation in the Islamic financial sector has increasingly evolved through the development of hybrid contracts (*multi-akad*), which combine two or more contracts structured systematically to accommodate contemporary transactional needs while maintaining adherence to Sharia principles. This approach has emerged as a solution to the limitations of traditional Islamic financial products, which are not always able to respond effectively to the complexity of modern financial transactions.

Several forms of hybrid-contract products that are widely implemented include:

- **Sharia-compliant financing cards** that combine *qardh*, *ijarah*, and *wakalah* contracts. This combination allows customers flexible access to funds, with *qardh* serving as the principal loan contract, *ijarah* representing administrative service fees, and *wakalah* functioning as an agency agreement for managing transactions.⁶⁸
- **Sharia Home Financing (KPR)** products, such as Griya Madani Financing, adopt a hybrid contract structure combining *murabahah* and *wakalah*. Under this mechanism, the *wakalah* contract authorizes the customer to appoint the Islamic financial institution as an agent to purchase the property or construction materials, while the *murabahah* contract governs the sale transaction between the customer and the institution. This scheme is considered effective in meeting market needs while maintaining Sharia

⁶³ Yahya, 'Sharia Fintech Development in Indonesia'.

⁶⁴ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

⁶⁵ Yahya, 'Sharia Fintech Development in Indonesia'.

⁶⁶ Yahya, 'Sharia Fintech Development in Indonesia'.

⁶⁷ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

⁶⁸ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

principles, and it is regulated under DSN-MUI Fatwa No. 04/DSN-MUI/IV/2000 and DSN-MUI Fatwa No. 10/DSN-MUI/IV/2000.⁶⁹

- **Sharia leasing through the Ijarah Muntahiyah Bittamlik (IMBT)** contract represents a financing scheme in Islamic financial institutions that combines two contracts: a lease contract (*ijarah*) for a specified period, followed by a sale contract (*bai'*) at the end of the leasing term. In practice, the Islamic financial institution leases an asset to the customer, and upon the completion of the lease period, ownership of the asset transfers to the customer either through a gift (*hibah*) or a pre-agreed sale transaction. This model is designed to avoid elements of *gharar* (uncertainty) and *riba*, while ensuring legal certainty and fairness in transactions. The IMBT scheme has been widely implemented in financing motor vehicles, housing, and heavy equipment by various Islamic financial institutions in Indonesia. This practice is documented in a study by Yustiardi et al., at PT BPRS Al Salaam Amal Salman Surabaya and further supported by Hasanuddin et al., who confirm its Sharia validity and application within the framework of Islamic economic law in Indonesia.^{70,71}

The Impact of Digitalization on Product Innovation

1. Digital Transformation and Product Innovation Performance

According to Abdurrahman, digital transformation (DT) plays a crucial role in enhancing digital product innovation (DPI) performance in the banking sector. Digital transformation is not merely the adoption of advanced technologies such as AI, big data, and cloud computing; it also entails a comprehensive restructuring of business strategies, operational processes, and organizational culture to achieve greater efficiency, responsiveness, and customer engagement.⁷² The study indicates that banks that are able to strategically integrate digital resources and dynamic capabilities are more likely to succeed in developing product innovations that are relevant and adaptive to market needs.⁷³

Digital transformation enables Islamic banks to:

- Provide real-time services through digital applications.
- Develop personalized products based on big-data analytics.
- Improve operational efficiency while significantly reducing service costs

⁶⁹ Ahmad Hazas Syarif, Nur Sya'adi, and Anggita Fitriyani, 'Analysis Of the Implementation of The Hybrid Contract Murabahah Bil Wakalah Agreement System in Griya Madani Financing Reviewed from Fatwa DSN No.04/DSN-MUI/IV/2000: Study at PT BPRS Metro Madani, Jatimulyo Branch Office', *Journal of Contemporary Applied Islamic Philanthropy*, 1.2 (2023), pp. 87–94, doi:10.62265/jcaip.v1i2.46.

⁷⁰ Aulia Fitria Yustiardi, Mahdiah Aulia, and Reni Oktavia Permatasari, 'Islamic Contracts for Home Financing: A Comparative Analysis', *International Journal of Management and Applied Research*, 6.4 (2019), pp. 386–96, doi:10.18646/2056.64.19-030.

⁷¹ Hasanuddin Hasanuddin and others, 'Hybrid Contract in Islamic Financial Services', *Al-Iqtishad: Jurnal Ilmu Ekonomi Syariah*, 14.1 (2022), pp. 111–28, doi:10.15408/aiq.v14i1.25692.

⁷² Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities'.

⁷³ Abdurrahman, 'Examining the Impact of Digital Transformation on Digital Product Innovation Performance in Banking Industry through the Integration of Resource-Based View and Dynamic Capabilities'.

Digital transformation in Islamic banking presents significant opportunities to enhance operational efficiency and customer experience; however, it also introduces serious challenges to Sharia compliance. One key risk lies in the potential use of algorithms within digital systems that may not fully reflect the principle of justice in Islam, or the adoption of incentive structures that resemble *riba*-based practices. Therefore, the active involvement of the Sharia Supervisory Board (SSB) at every stage of digital product development and evaluation is essential to ensure that all implemented innovations remain aligned with *Maqasid al-Shariah* and do not violate the fundamental principles of *fiqh al-mu'amalah*. As emphasized by Shehadeh et al., digital transformation must be accompanied by risk-governance mechanisms that comprehensively incorporate Islamic principles in order to preserve the integrity and public trust in the Islamic financial system.⁷⁴

2. The Role of AI Technology in Enhancing Bank Financial Performance.

Artificial Intelligence (AI) plays a strategic role in optimizing the financial performance of banks, including Islamic banks, by enabling the development of products that are more responsive to market dynamics. As explained by Gyau et al., the application of AI allows banks to:

- Model financing risk with greater precision,
- Automatically detect fraudulent behavior, and
- Tailor financing products to customers' risk profiles and preferences.⁷⁵

These innovations not only enhance operational efficiency and accuracy but also strengthen the bank's competitiveness in delivering responsive and sustainable financial services. In its application within the financial sector, Artificial Intelligence (AI) functions not only as a tool for technical efficiency but also as a strategic instrument that supports fair and targeted decision-making, as demonstrated in fraud detection, risk modeling, and personalized services based on customer needs and characteristics ⁷⁶. Accordingly, the use of AI in Islamic finance can be directed toward strengthening principles of justice and public benefit (*maslahah*), for example by screening eligible beneficiaries for social financing such as *qardhul hasan*, or by designing optimal and transparent zakat distribution mechanisms.

From the perspective of *fiqh al-mu'amalat*, the foundational principle *al-aṣl fī al-mu'amalat al-ibāḥah illa an yadulla dalil 'ala tahrimiha* (all transactions are permissible unless there is evidence to prohibit them) provides ample space for innovation in the development of Islamic banking products. This flexibility enables Islamic financial institutions to respond to market needs through creativity in structuring contracts and product designs that align with contemporary conditions, as long as they do not violate fundamental Sharia principles such as the prohibitions

⁷⁴ Maha Shehadeh and others, 'Digital Transformation: An Empirical Analysis of Operational Efficiency, Customer Experience, and Competitive Advantage in Jordanian Islamic Banks', *Uncertain Supply Chain Management*, 12.2 (2024), pp. 695–708, doi:10.5267/j.uscm.2024.1.015.

⁷⁵ Gyau and others, 'Transforming Banking: Examining the Role of AI Technology Innovation in Boosting Banks Financial Performance'.

⁷⁶ Iurie Caprian, 'The Application of Artificial Intelligence for the Purpose of Combating Bank Fraud', *The Problems of Economy*, 2.56 (2023), pp. 204–12, doi:10.32983/2222-0712-2023-2-204-212.

of *riba*, *gharar*, and *maysir* ⁷⁷. However, innovation in Islamic finance should not be driven solely by commercial profit or market trends. Product development must be aligned with the pursuit of *Maqasid al-Shariah* the higher objectives of Islamic law which include the preservation of wealth (*hifz al-mal*), religion (*hifz al-ddn*), life (*hifz al-nafs*), intellect (*hifz al-'aql*), and lineage (*hifz al-nasl*). Consequently, Islamic financial products must not only be formally halal, but also deliver equitable, ethical, and sustainable benefits to society.^{78'79}

The greatest challenge in Islamic financial product innovation lies in maintaining a balance between technological modernization and adherence to Sharia principles. In an increasingly digital era characterized by transactions containing *shubhat* elements and ambiguous economic practices, Sharia rulings (*fatawa*) and regulations serve as essential guidance for industry practitioners. Furthermore, the issuance of a fatwa is far from a simple process; it requires rigorous examination that comprehensively considers Sharia, social, and technological dimensions. For instance, DSN-MUI Fatwa No. 116/DSN-MUI/IX/2017 on Islamic Electronic Money does not unconditionally permit all forms of digital currency. Instead, it emphasizes the importance of caution (*ihtiyat*) and the principle of *maslahah* in its implementation, including clarity of contracts, consumer protection, and the prevention of transactions involving *riba*, *gharar*, and *maysir*.^{80'81}

As a practical reflection, product innovation in Islamic finance should ideally be supported by stable funding sources, such as the use of "patient capital" (*dana ditingin*) in Islamic investment contexts, in order to minimize speculative risks and negative societal impacts.⁸² This approach aligns with the principles of Asset-Liability Management (ALM) in Islamic finance, which emphasize liquidity stability, balance between assets and liabilities, and the sustainability of the Islamic financial system.⁸³ Amid the rapid advancement of technology and digitalization, collaboration between technology experts and Sharia scholars becomes crucial to ensure that every product innovation not only follows the direction of modernization, but also upholds the

⁷⁷ Muhammad Shahrul Ifwat Ishak and Fathullah Asni, 'The Role of Maqasid Al-Shari'ah in Applying Fiqh Muamalat into Modern Islamic Banking in Malaysia', *Journal of Islamic Accounting and Business Research*, 11.9 (2020), pp. 2137–54, doi:10.1108/JIABR-12-2019-0224.

⁷⁸ Wan Nazjmi Mohamed Fisol, Yusuf Haji-othman, and Akli Ahmad, 'The Engineering of Islamic Financial Products Through the Fundamental of the Maqasid Al- Shari ' Ah', *Journal of Critical Reviews*, 7.4 (2020), pp. 2384–89, doi:10.31838/jcr.07.04.370.

⁷⁹ Mahmud Yusuf and others, 'Islamic Banks : Analysis of the Rules of Fiqh on the Fatwa of the National Sharia Board-Indonesian Ulama Council', *International Journal of Law, Environment, and Natural Resources*, 3.1 (2023), pp. 21–37.

⁸⁰ Muhammad Khaeruddin Hamsin and others, 'Sharia E-Wallet: The Issue of Sharia Compliance and Data Protection', *Al-Manahij: Jurnal Kajian Hukum Islam*, 17.1 (2023), pp. 53–68, doi:10.24090/mnh.v17i1.7633.

⁸¹ Loso Judijanto and others, 'Implementation of Fatwa DSN-MUI as a Basis for Regulation in Islamic Finance in Indonesia', *West Science Islamic Studies*, 3.01 (2025), pp. 12–18.

⁸² Olayinka Abiola-adams and others, 'Integrating Asset and Liability Management with Islamic Finance : A Strategic Framework for Global Financial Institutions', *Gulf Journal of Advance Business Research*, 3.1 (2025), pp. 128–42, doi:10.51594/gjabr.v3i1.70.

⁸³ Abiola-adams and others, 'Integrating Asset and Liability Management with Islamic Finance : A Strategic Framework for Global Financial Institutions'.

principles of caution (*al-ihityat*), public benefit (*maslahah*), and compliance with *Maqasid al-Shariah*.⁸⁴

Market Demand for Product Innovation

1. Changing Consumer Behavior

In the current era of rapid digital transformation, consumer behavior in using financial services has undergone fundamental change. One major shift is seen in customer preferences toward Islamic banking services, which now emphasize not only formal compliance with Sharia principles, but also convenience, efficiency, and technological integration in service delivery. Modern customers particularly millennials and Gen Z increasingly demand financial services that are fast, flexible, transparent, and accessible anytime and anywhere through their digital devices. This shift reflects a paradigm change from purely ideological motivations toward a stronger emphasis on optimal user experience. Customer loyalty to Islamic banks is no longer built solely on religious awareness, but also depends heavily on the quality of digital interaction, including ease of use of banking applications, integration with digital payment systems, and features tailored to modern lifestyles. In this context, the adoption of mobile banking-based services becomes highly crucial.

Research conducted by Kumar shows that mobile banking applications have evolved into intelligent platforms that combine high-level security, artificial intelligence, and personalized services that enhance customer engagement.⁸⁵ The study also highlights that the adoption of digitalization during the COVID-19 pandemic accelerated changes in consumer behavior and served as a strategic momentum for financial institutions to undertake comprehensive transformation. Similarly, research by Harahap et al., in Indonesia confirms that expectations regarding digital service performance, price value, and compatibility with an Islamic lifestyle are key determinants of customers' intention to use Islamic digital banking services.⁸⁶ The study underscores that encouraging customers to shift from conventional to digital transactions depends not only on technological availability but also on perceived value and ease of use.

Findings by Sutarminingsih et al., reveal that the most dominant factor driving increased usage intensity of Islamic mobile banking is its compatibility with customers' lifestyles, including additional features such as digital zakat services, prayer time notifications, and integrated e-commerce payments on a single platform.⁸⁷ This indicates that Islamic banking services must be designed to address both the practical and spiritual needs of contemporary customers. Thus, the challenge for Islamic banks is not merely to introduce products that formally comply with

⁸⁴ Abiola-adams and others, 'Integrating Asset and Liability Management with Islamic Finance : A Strategic Framework for Global Financial Institutions'.

⁸⁵ Jaspreet Kumar, 'The Transformative Role of Mobile Applications in Digital Banking : A Comprehensive Analysis of Customer Engagement and Service Evolution', *International Journal of Scientific Research in Computer Science, Engineering and Information Technology*, 10.6 (2024), pp. 1675–84.

⁸⁶ Darwis Harahap, Ahmad Afandi, and Try Mahendra Siregar, 'The Islamic Banking Customers' Intention To Use Digital Banking Services: An Indonesian Study', *Journal of Islamic Monetary Economics and Finance*, 9.3 (2023), pp. 533–58, doi:10.21098/jimf.v9i3.1673.

⁸⁷ Sutarminingsih Sutarminingsih, Lukman M Baga, and Imam Teguh Saptono, 'Analysis of Factors Influencing Intensity Use of Mobile Banking Islamic Bank', *International Journal of Research and Review*, 8.11 (2021), pp. 441–49, doi:10.52403/ijrr.20211156.

Islamic legal standards, but to ensure that these products seamlessly align with the digital lifestyle of modern society while upholding *Maqasid al-Shariah*. This transformation is not only inevitable but also presents a strategic opportunity for Islamic banks to expand financial inclusion and strengthen their competitiveness within an increasingly digital financial ecosystem.

The emergence of financial technology (fintech) has brought fundamental changes to the structure of the global financial industry, including within the context of Islamic banking. Alongside rising digital literacy and internet penetration, consumers now demand financial services that are more affordable, faster, more flexible, and easily accessible through digital platforms. In this regard, fintech has acted as a disruptive force, shifting traditional banking models previously centered on physical interaction towards extensive and integrated digitalization. Hodula, notes that the presence of fintech lending platforms has significantly pressured the profitability of conventional banks by offering higher operational efficiency and superior customer experience, compelling banks to adjust their strategies and accelerate technological innovation as a competitive response.⁸⁸

In a financial landscape that continues to evolve dynamically, the Islamic banking sector can no longer rely on traditional approaches. The shift in consumer behavior, driven primarily by rapid digitalization, requires Islamic banks to actively develop products that not only adhere to Sharia principles but are also technologically relevant and contextually appropriate. This includes the development of Sharia-compliant e-wallets, digital investment platforms based on *mudharabah* contracts, and robo-advisors operating under the guidance of Sharia rulings. As emphasized by Nordin & Zainuddin, the success of digital transformation in Islamic banks depends heavily on the ability to integrate Sharia principles with technological flexibility, thereby producing innovative Islamic financial services that are adaptive to the digital lifestyle of contemporary society.⁸⁹

Furthermore, Kilic & Turkan emphasize that Sharia-based fintech financing models such as halal peer-to-peer (P2P) lending and *waqf*-based crowdfunding are increasingly recognized as strategic instruments for expanding Islamic financial inclusion.⁹⁰ These models are effective in reaching informal sectors and unbanked populations, while simultaneously offering alternative financing solutions aligned with Sharia principles. In the same context, Mohieldin & Hamzah add that this approach can strengthen the role of Islamic finance in improving societal welfare through inclusive and ethical financing channels.⁹¹ Digital transformation and the emergence of financial technology (fintech) not only pose challenges but also create strategic opportunities for Islamic banks to strengthen their presence within the modern financial ecosystem. Islamic banks that are able to integrate *Maqasid al-*

⁸⁸ Martin Hodula, 'Beyond Innovation: Fintech Credit and Its Ripple Effects on Traditional Banking Profitability', *Finance Research Letters*, 63.March (2024), p. 105307, doi:10.1016/j.frl.2024.105307.

⁸⁹ Norhafiza Nordin and Zaemah Zainuddin, 'A Review of a Fintech Financing Platform: Potential and Challenges of Islamic Crowdfunding To Entrepreneurs', *International Journal of Islamic Business*, 8.1 (2023), pp. 79–90, doi:10.32890/ijib2023.8.1.5.

⁹⁰ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

⁹¹ Mahmoud Mohieldin and D Hamzah, 'Islamic Finance in OIC Countries and Sustainability', *Transnational Dispute Management*, 19.6 (2022), pp. 1–16 <<https://www.researchgate.net/publication/366575612>>.

Shariah-based product innovation with advanced digital technologies will be in a more competitive position to navigate the era of financial disruption. Innovations such as Islamic e-wallets, digital *mudharabah* platforms, and fatwa-based robo-advisors reflect a positive trajectory toward accelerating Islamic financial services that are responsive to the needs of digital-era consumers.^{92'93'94}

However, the widespread adoption of Islamic financial technology also presents critical challenges. These include maintaining consistent Sharia compliance standards, strengthening technological risk-mitigation systems, and ensuring consumer protection amid rapid digital innovation that often outpaces regulatory readiness and supervisory capacity. Therefore, the success of digital transformation in Islamic banking depends heavily on the institution's ability to balance a strong commitment to Sharia values with agile adaptation to the dynamics of the global financial technology landscape.^{95'96'97}

It is important to note that responses to changes in consumer behavior must continue to uphold the substantive essence of *Maqasid al-Shariah*. Innovations driven solely by market trends without rigorous assessment may lead to *shubhat* transactional practices that compromise Sharia prudential principles. Therefore, the integration of technology and Sharia must be implemented harmoniously through the active involvement of Sharia Supervisory Boards (SSB), regulators, and technology practitioners.

2. Competition in the Banking Market

Competition in the banking sector, both Islamic and conventional, has intensified with increasing financial liberalization, the entry of non-bank players, and the convergence of technology and finance. In this context, Islamic banks are required not only to survive but to excel competitively through appropriate and sustainable product innovation strategies. Liu & Zhao, emphasize that innovation is not merely an adaptive strategy in response to environmental change, but a primary driver of business continuity.⁹⁸ In the Islamic banking sector, product innovation can become a crucial pillar for expanding into new market segments, such as the halal MSME sector, Sharia-based creative industries, or digitally-savvy Muslim retail markets. However, any innovation strategy must maintain value differentiation, namely the spiritual and ethical values that characterize Islamic banks.

To sustain competitiveness, Islamic banks must integrate digital innovation with Sharia principles through products tailored to real societal needs. Strengthening

⁹² Muhammad Ridhwan AB. Aziz, 'Digital Transformation Through Islamic Digital Banking For Financial Inclusion', in *Proceeding of International Conference on Science and Technology*, 2022, pp. 12–19, doi:10.36378/internationalconferenceuniks.v0i0.2818.

⁹³ Shahed Md Alamm and others, 'Harnessing FinTech and Islamic Finance for Climate Resilience : A Sustainable Future Through Islamic Social Finance and Microfinance', *Humanities and Social Sciences*, 13.3 (2025), pp. 207–18.

⁹⁴ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

⁹⁵ Alamm and others, 'Harnessing FinTech and Islamic Finance for Climate Resilience : A Sustainable Future Through Islamic Social Finance and Microfinance'.

⁹⁶ Aziz, 'Digital Transformation Through Islamic Digital Banking For Financial Inclusion'.

⁹⁷ Kilic and Turkan, 'The Emergence of Islamic Fintech and Its Applications'.

⁹⁸ Xiaohua Liu and Qiuhan Zhao, 'Banking Competition, Credit Financing and the Efficiency of Corporate Technology Innovation', *International Review of Financial Analysis*, 94.March (2024), p. 103248, doi:10.1016/j.irfa.2024.103248.

information technology systems is essential to support fast and secure digital services.⁹⁹ Moreover, building an inclusive Islamic financial ecosystem by collaborating with fintech companies, halal enterprises, and digital platforms will expand service coverage. Segmentation strategies such as digital education savings, hybrid-contract home financing, and *waqf*-based investment solutions for Muslim professionals can create product differentiation while also strengthening customer loyalty.^{100'101'102}

In striving to win the market, Islamic banks must be cautious not to be trapped in the logic of free-market competition that neglects Islamic ethics. Innovation should not be focused solely on asset expansion and technical efficiency; rather, it must be guided by the consciousness of *Maqasid al-Shariah*, such as social justice, economic blessing (*barakah*), and community welfare. Therefore, product development and digital strategies must be positioned as forms of institutional *ijtihad* rooted in spiritual values and Islamic social responsibility. Through this approach, Islamic banks will not only achieve competitive business advantages but also contribute to the development of a sustainable Islamic civilization.^{103'104'105}

Sharia Compliance in Islamic Banking Product Innovation

Innovation in Islamic banking products is an inevitable necessity to respond to market dynamics, technological advancements, and increasingly complex customer needs. However, the primary challenge faced by Islamic financial institutions lies in ensuring that every innovation remains within the boundaries of Islamic law (*Shariah*). This is the key element that distinguishes innovation in Islamic banking from that of conventional financial institutions the presence of *Shariah compliance* as a fundamental, non-negotiable principle.

1. Challenges in Adhering to Sharia Principles

a. Compliance of Products with Sharia Law

One of the main challenges in Islamic banking product innovation is ensuring that every newly developed product remains consistent with Sharia principles. These principles include the prohibition of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation/gambling), as well as the requirement to structure contracts (*akad*) clearly and validly in accordance with Islamic jurisprudence. This challenge

⁹⁹ Jaffar Abbas and others, 'Financial Innovation and Digitalization Promote Business Growth: The Interplay of Green Technology Innovation, Product Market Competition and Firm Performance', *Innovation and Green Development*, 3.1 (2024), p. 100111, doi:10.1016/j.igd.2023.100111.

¹⁰⁰ Abbas and others, 'Financial Innovation and Digitalization Promote Business Growth: The Interplay of Green Technology Innovation, Product Market Competition and Firm Performance'.

¹⁰¹ Arni Akmar, 'Is Islamic Banking in Malaysia Lagging Behind in Fintech?', *The International Journal of Business & Management*, 8.6 (2020), pp. 392–418, doi:10.24940/theijbm/2020/v8/i6/bm2006-026.

¹⁰² Lesmi Mulyati and Supriaman Supriaman, 'Comparative Analysis of the Islamic Banking Financial Performance before and after Collaboration in Financing Distribution with Islamic Fintech: A Study of Mega Islamic Bank', *South Asian Research Journal of Business and Management*, 6.03 (2024), pp. 59–70, doi:10.36346/sarjbm.2024.v06i03.003.

¹⁰³ Muhammad Nadeem Khalil and Talat Hussain, 'Qualitative Analysis of Maqasid Al Shariah Based Model in Islamic Banks: A Way Forward', *Journal of Economic Impact*, 4.2 (2022), pp. 83–90, doi:10.52223/jei4022210.

¹⁰⁴ Akmar, 'Is Islamic Banking in Malaysia Lagging Behind in Fintech?'

¹⁰⁵ Mulyati and Supriaman, 'Comparative Analysis of the Islamic Banking Financial Performance before and after Collaboration in Financing Distribution with Islamic Fintech: A Study of Mega Islamic Bank'.

becomes more complex as Islamic financial institutions operate within a global economic system still dominated by conventional frameworks. In this context, the role of the Sharia Supervisory Board (SSB) is crucial in overseeing the innovation process to prevent deviations from core Sharia values. Additionally, technological integration such as the adoption of blockchain is being explored as an alternative to enhance contract transparency and ensure compliance with Sharia principles in digital financial products.^{106'107}

In designing Sharia-compliant digital financial products, it is essential for institutions to ensure that contract structures do not contain hidden elements of *riba*, avoid *gharar* (uncertainty), and exclude *maysir* (speculation). The contracts (*akad*) used must also be clear and valid according to Islamic law. Adherence to the rulings (*fatwas*) issued by the National Sharia Council-Indonesian Ulema Council (DSN-MUI) serves as a primary reference in determining the legitimacy of products.¹⁰⁸ However, the rapid development of technologies such as Buy Now Pay Later (BNPL) models, robo-advisors, and crowdfunding platforms presents new challenges, as not all innovations can be easily classified as halal or haram. Therefore, a contextual approach rooted in *ijtihad mu'āṣirah* (contemporary ijtihad) and guided by *Maqasid al-Shariah* is necessary to ensure that innovation remains within the boundaries of Islamic law.^{109'110}

b. Cases of Sharia Compliance Violations

In the global context, there have been several instances where financial products claimed to be Sharia-based were found to substantially deviate from Islamic principles. For example, the practice of *tawarruq* in several Middle Eastern Islamic banks has been criticized for being merely artificial in nature and essentially resembling *riba*.¹¹¹ In Indonesia, as noted by Fikri et al., the use of derivatives in Sharia hedging instruments is often not supported by strong Sharia justification, raising debates over the validity of contracts and the potential presence of *gharar*,

¹⁰⁶ Oishi Chowdhury and others, 'The Decentralized Shariah-Based Banking System in Bangladesh Using Block-Chain Technology', *International Journal of Information Engineering and Electronic Business*, 15.3 (2023), pp. 12–28, doi:10.5815/ijieeb.2023.03.02.

¹⁰⁷ Erika Takidah and Salina Kassim, 'The Shariah Compliance of Islamic Peer-to-Peer (P2P) Lending Practices in Indonesia: Identification of Issues and the Way Forward', *ICR Journal*, 13.1 (2022), pp. 72–91, doi:10.52282/icr.v13i1.830.

¹⁰⁸ Beni Firdaus and others, 'Buy Now Pay Later Transactions (BNPL) In Indonesia: Implications For Maqasid Shariah In The Digital Era', *Islam Realitas: Journal of Islamic and Social Studies*, 10.2 (2024), pp. 130–46.

¹⁰⁹ Alaa Al-Obaid, 'Evaluation of Buy Now, Pay Later (BNPL) Services from Islamic Sharia Perspective: An Analytical Jurisprudence Study', *Jurnal Fiqh*, 21.2 (2024), pp. 253–92.

¹¹⁰ Rizka Rahmatillah Zidna, Sayyidah Syafiqoh, and Bakhrul Huda, 'Analisis Fatwa DSN MUI No . 140 Tahun 2021 Terhadap Regulasi Dewan Pengawas Syariah Pada Produk Securities Crowdfunding', *EL-MAL: Jurnal Kajian Ekonomi & Bisnis Islam*, 5.10 (2024), pp. 3984–95.

¹¹¹ Muamar Arafat Yusmad and others, 'Revitalization Supervision Islamic Banking in Enhancement Compliance in Indonesia and Malaysia', *Samarah: Jurnal Hukum Keluarga Dan Hukum Islam*, 8.1 (2024), pp. 468–94, doi:10.22373/sjhh.v8i1.20524.

maysir, and hidden *riba* elements within these structures.¹¹² Furthermore, *formalistic compliance* approaches often obscure the core objectives of *Maqasid al-Shariah*.¹¹³

Field cases reveal that despite claims of Sharia compliance, Islamic banking practices still frequently face the risk of deviation. This issue is exacerbated by limited Sharia human resource capacity, weak internal Sharia audit systems, and suboptimal synergy between financial regulators and fatwa institutions in addressing the evolving dynamics of financial innovation. Consequently, public trust in the authenticity of Sharia-compliant products may decline, and the overarching objectives of *Maqasid al-Shariah* risk being overlooked.^{114'115'116}

2. Solutions to Ensure Sharia Compliance

a. Role of the Sharia Supervisory Board in Evaluating New Products

The Sharia Supervisory Board (SSB) plays a central role as the frontline guardian in ensuring the legitimacy and Sharia compliance of every activity and product innovation within Islamic financial institutions. In the context of new product development, the SSB does not only function as a formal fatwa-issuing body, but also assumes strategic responsibilities that include involvement from the planning stage, assessment of contract structures, product testing, and ultimately the launch and implementation of products. This active participation is essential to ensure that every innovation remains aligned with fundamental Sharia principles and does not deviate in operational practice.¹¹⁷

With the growing complexity of digital financial innovation, the role of the SSB has become increasingly critical. In best practice, the SSB must not serve as a mere symbol of normative compliance; rather, it should operate as a strategic partner in the product innovation process. To perform this role optimally, SSB members are required to possess multidisciplinary competencies, including mastery of *fiqh al-mu'āmalāt*, an understanding of contemporary economic dynamics, and literacy in evolving financial technologies (fintech). This need for multi-competent Sharia

¹¹² Arif Fikri and others, 'Derivative Transactions on Sharia Hedging (Al-Tahawwuth Al-Islami Era 5.0 Perspective of Sharia Economic Law', *KnE Social Sciences*, 2024.2024 (2024), pp. 338–46, doi:10.18502/kss.v9i2.14992.

¹¹³ Muchammad Ichsan and others, 'Digitalization of Islamic Banking in Indonesia: Justification and Compliance to Sharia Principles', *Jurnal Media Hukum*, 31.2 (2024), pp. 244–61 <<https://doaj.org/article/00129204fb494233a632d4881affef24>>.

¹¹⁴ Khalil and Hussain, 'Qualitative Analysis of Maqasid Al Shariah Based Model in Islamic Banks: A Way Forward'.

¹¹⁵ Abbas Arfan and others, 'The Implementation of Maqashid Sharia: Heterogeneity of Scholars' Fatwas Towards Islamic Banking Contracts', *Legality: Jurnal Ilmiah Hukum*, 32.1 (2024), pp. 105–28, doi:10.22219/ljih.v32i1.32170.

¹¹⁶ Fauzia P Bakti and others, 'The Urgency of Sharia Maqashid in the Development of Mudharabah Contract in Sharia Banking', *International Journal of ...*, 9.7 (2022), pp. 266–75 <<https://ijmmu.com/index.php/ijmmu/article/view/3895%0Ahttps://ijmmu.com/index.php/ijmmu/article/view/File/3895/3403>>.

¹¹⁷ Ratna Fitriana, Agung Yulianto, and Badingatus Solikhah, 'Are Characteristics of Sharia Supervisory Boards Able to Improve the Performance of Islamic Banking?', *Journal of Islamic Accounting and Finance Research*, 1.1 (2019), p. 1, doi:10.21580/jiafr.2019.1.1.3753.

scholars underscores the importance of higher education institutions in producing *ulama-economists* who are adaptive to emerging challenges.¹¹⁸

Furthermore, periodic Sharia audits constitute an essential element in ensuring consistent application of Sharia principles in every operation and product of Islamic financial institutions. The SSB must be supported by a well-documented, risk-based Sharia audit mechanism that is functionally integrated with internal compliance systems. Such a model ensures that oversight is not limited to the legal-formal aspects of contracts, but also extends to the substantive objectives of Sharia, ensuring that product implementation truly aligns with *Maqasid al-Shariah*.^{119'120'121}

From the above discussion, it is evident that maintaining Sharia compliance in product innovation is a complex and continuous process. The challenges encountered are not limited to the framework of Islamic law, but also encompass practical dimensions in responding to market and technological changes. Therefore, the presence of an active and professional Sharia Supervisory Board (SSB) is crucial. Innovation must not serve as a justification for compromising Sharia principles; instead, it should function as a means to achieve *Maqasid al-Shariah* namely, the realization of justice, welfare, and the protection of community rights within economic activities. With a strong commitment to Sharia compliance, Islamic banking can continue to grow as an ethical, inclusive, and sustainable financial system.

1. Relationship Between Innovation and the Attainment of Maqasid al-Shariah

The findings of this study indicate that product innovation in Islamic banking has become an unavoidable necessity amid digital transformation and increasing market expectations for adaptive and competitive financial services. However, the results also reveal a gap between legal-formal Sharia compliance and the substantive realization of *Maqasid al-Shariah*. Many innovative products formally satisfy the requirements of fiqh and Sharia contractual standards, yet do not fully deliver meaningful contributions to Islamic ethical values such as social justice, economic empowerment, and poverty alleviation. In other words, innovation focused solely on operational efficiency and competitive advantage does not necessarily guarantee the achievement of the fundamental objectives of the Islamic economic system namely, *Maqasid al-Shariah*.

The principles of *maqasid*, including the protection of religion (*hifz al-din*), life (*hifz al-nafs*), intellect (*hifz al-aql*), lineage (*hifz al-nasl*), and wealth (*hifz al-mal*), must serve as both the ethical framework and evaluative instrument in assessing the success of Sharia-compliant products. Such evaluation should not only refer to formal contractual compliance but also to the extent to which these products provide real benefits for social welfare and promote fair

¹¹⁸ Rifqi Muhammad and Rima Lanaula, 'Challenges of Islamic Supervisory in The Islamic Financial Technology Industry', *Economica: Jurnal Ekonomi Islam*, 10.2 (2019), pp. 311–38, doi:10.21580/economica.2019.10.2.3400.

¹¹⁹ Mohd Rushdan Yaso', Wan Amalina Wan Abdullah, and Wan Anisah Endut, 'Shariah Review and Shariah Audit: Shariah Compliance Tools in Islamic Banks', *Journal of ASIAN Behavioural Studies*, 7.21 (2022), pp. 59–71, doi:10.21834/jabs.v7i21.407.

¹²⁰ Mustafa Faza' and Nemer Badwan, 'Compliance of Sharia Audit in Banks and Islamic Financial Institutions in Palestine: A Literature Review', *JIEFES: Journal of Islamic Economics and Finance Studies Volume*, 5.1 (2024), pp. 42–66.

¹²¹ Noor Aimi Mohamad Puad, Zurina Shafii, and Nurdianawati Irwani Abdullah, 'The Practices of Risk-Based Internal Shariah Auditing Within Malaysian Takaful Operators: A Multiple Case Study', *International Journal of Academic Research in Business and Social Sciences*, 10.7 (2020), pp. 52–71, doi:10.6007/ijarbss/v10-i7/7396.

wealth distribution within society. These findings align with the study of Alhammadi et al., which asserts that ethical evaluation of Islamic banking performance should reflect a comprehensive attainment of *maqasid*. They emphasize that approaches solely anchored in fiqh-based legal formalism are insufficient to assess the effectiveness of Islamic financial institutions.¹²² Instead, a *maqasid-oriented* approach highlights the importance of social impact and public benefit, including wealth protection (*hifz al-mal*), equitable wealth distribution, and reduction of economic disparities. Products such as *qardhul hasan* and digital zakat platforms are considered more representative of *maqasid* because they provide direct benefits to vulnerable groups.

The Maqasid-Based Innovation Evaluation Model (MBIEM) demonstrates that successful innovation must incorporate dimensions of *maslahah* (public interest) and societal benefit, rather than merely focusing on market feasibility or legal compliance. Unfortunately, the role of the Sharia Supervisory Board (SSB) remains largely limited to formalistic aspects rather than substantive evaluation of *maqasid* values a concern also highlighted by Alhammadi et al.¹²³ Therefore, going forward, Islamic banking must adopt a value-based innovation strategy supported by regulatory reform, enhanced multidisciplinary competencies, and strong commitment from Sharia authorities to create a system aligned with market demands, Sharia compliance, and social justice. Similarly, Mergaliyev et al., in the *Journal of Business Ethics* reveal that the implementation of corporate social responsibility (CSR) in the Islamic banking sector is often symbolic and not fully oriented toward realizing *maqasid* values in concrete terms.¹²⁴ This underscores the urgent need for a paradigm shift from symbolism to substance across all operational dimensions of Islamic financial institutions.

One of the key dimensions in evaluating innovation in Islamic banking products lies in the extent to which such products generate tangible benefits for societal welfare. Products that are truly aligned with *Maqasid al-Shariah* should ideally address socio-economic needs, enhance financial inclusion, and protect society from injustice and exploitation. In this context, evaluation must go beyond formal fiqh compliance and include an assessment of the social value delivered by the product. This is consistent with findings by Shahwan et al., who assert that Sharia compliance evaluation must be directed toward the material realization of *maqasid*, rather than mere legal symbolism.¹²⁵ Likewise, Rehman shows that Islamic economic instruments such as *waqf* hold significant potential for empowering vulnerable communities and achieving social justice as core objectives of *maqasid*.¹²⁶ Therefore, obtaining halal certification from the Sharia Supervisory Board alone is insufficient; every

¹²² Salah Alhammadi, Khaled O. Alotaibi, and Dzikri F. Hakam, 'Analysing Islamic Banking Ethical Performance from Maqāsid Al-Sharī'ah Perspective: Evidence from Indonesia', *Journal of Sustainable Finance and Investment*, 12.4 (2022), pp. 1171–93, doi:10.1080/20430795.2020.1848179.

¹²³ Alhammadi, Alotaibi, and Hakam, 'Analysing Islamic Banking Ethical Performance from Maqāsid Al-Sharī'ah Perspective: Evidence from Indonesia'.

¹²⁴ Arman Mergaliyev and others, 'Higher Ethical Objective (Maqasid Al-Shari'ah) Augmented Framework for Islamic Banks: Assessing Ethical Performance and Exploring Its Determinants', *Journal of Business Ethics*, 170.4 (2021), pp. 797–834, doi:10.1007/s10551-019-04331-4.

¹²⁵ Syahidawati Shahwan and others, 'Ranking the Compliance of Islamic Banking Home Financing Products With Maqasid Shariah Using Ahp', *International Journal of the Analytic Hierarchy Process*, 14.3 (2022), pp. 1–5, doi:10.13033/ijahp.v14i3.891.

¹²⁶ Alishba Fazal ur Rehman, 'Waqf As A Tool to Address Poverty , Education , And Healthcare', *Journal of International Conference Proceeding (JICP)*, 7.3 (2025), pp. 756–70.

product must be tested against its real-world relevance and impact through a substantive *maqasid*-based approach.

An evaluation of Islamic banking product implementation in Indonesia indicates that most innovations remain focused on formal compliance with contractual structures such as *murābahah* and *ijārah*, without deeply considering the substantive objectives of *Maqasid al-Shariah*. In practice, profit-margin structures, late-payment penalty schemes, and other administrative provisions often resemble conventional banking approaches, which can burden customers and undermine elements of justice and social welfare. A study by Hasbi & Widayanti, shows that the application of the *ijārah* contract in Islamic bank financing is still largely interpreted as a substitute for conventional leasing contracts, without adequately considering long-term benefits for customers.¹²⁷ Similarly, findings by Chelhi et al., reveal that *murābahah* contracts remain widely dominant, yet their implementation tends to be legalistic and does not fully reflect fairness in terms of profit margins and customer risk management.¹²⁸ Therefore, it is essential to revisit the framework for Islamic product innovation to ensure that it not only emphasizes fiqh-based legal validity but also meaningfully contributes to societal well-being.

2. Case Study: Islamic Banking Products that Support Maqasid

A successful example of product innovation aligned with *Maqasid al-Shariah* can be observed in micro-financing schemes based on *qardhul hasan* implemented by several Islamic banks in Indonesia. Unlike commercial financing products that emphasize profit margins, *qardhul hasan* is designed as a social instrument that does not impose returns on customers. Its objective is to address the urgent and productive financial needs of low-income communities that are often excluded from the formal financial system. As highlighted by Adnan et al., several Islamic banks including Bank Syariah Indonesia (BSI) and Bank Syariah Bukopin have developed similar schemes to strengthen financial inclusion and support economic empowerment initiatives for marginalized groups.¹²⁹ This product reflects the values of justice and social solidarity and serves as a tangible manifestation of *maqasid* implementation, particularly in protecting wealth (*hifz al-mal*) and empowering vulnerable communities.

The success of an Islamic banking product in realizing *Maqasid al-Shariah* can be evaluated through several dimensions of value protection. First, the dimension of *hifz al-mal* (protection of wealth) is demonstrated through equitable financial access that does not burden customers, as exemplified by *qardhul hasan* micro-financing, which provides interest-free capital to low-income individuals. Second, the dimensions of *hifz al-nafs* and *hifz al-aql* are realized through the product's capacity to protect individuals from debt traps, usurious practices, and psychological stress associated with interest-based financial burdens, as emphasized by Adnan et al., and Milena & Stefan, in their studies on the role of Islamic social

¹²⁷ M. Zidny Nafi' Hasbi and Ipuk Widayanti, 'Analysis of Ijarah Contract Service Innovations in Sharia Banking Transactions', in *Annual International Conference on Islamic Economics and Business (AICIEB)*, 2021, 1, 282–90, doi:10.18326/aicieb.v1i0.1.

¹²⁸ K. Chelhi and others, 'Application of Data Mining for Modeling of an Islamic Financial Product (Murabaha) Return Risk in a Macroeconomic Context', *International Journal of ...*, 4.1 (2020), pp. 19–27.

¹²⁹ Nurul Ilyana Muhd Adnan and others, 'Leveraging Qardhul Hasan Practices From Zakat Funds for Sustainable Development: A Maqasid Sharia Perspective and Its Contribution To Sdgs in Malaysia', *Journal of Lifestyle and SDG'S Review*, 5.2 (2025), pp. 1–29, doi:10.47172/2965-730X.SDGsReview.v5.n02.pe04016.

finance in economic empowerment.^{130'131} Third, *hifz al-din* is reflected through the use of valid, ethical, and Sharia-compliant contracts, demonstrating not only formal legal compliance but also moral and spiritual integrity.

These findings correspond with Alkhan & Hassan, who highlight the importance of integrating *maqasid* principles in sustainable financial strategies. They assert that the success of Islamic financial products should not solely be assessed through formal Sharia compliance, but also through their contribution to social development and value-based sustainability.¹³² Additionally, digital zakat platforms developed by Islamic financial institutions offer another noteworthy innovation. These platforms facilitate transparent, efficient, and technology-driven zakat distribution, thereby promoting social justice and *hifz al-mal* on a broader scale. Such initiatives illustrate that innovation guided by *maqasid*-oriented objectives can significantly enhance societal welfare.^{133'134}

Thus, innovation in Islamic banking products should not be confined to commercial orientation and market competition alone; rather, it must be critically directed toward attaining *Maqasid al-Shariah*. A successful product is one that not only adheres to formal fiqh principles but also generates tangible benefits for society and strengthens economic justice. This represents both a challenge and a major opportunity for the future of the Islamic finance industry: to harmoniously integrate values, utility, and competitive excellence.

3. Strengths and Weaknesses of Product Innovation in Islamic Banking

Islamic banking has demonstrated significant growth in product innovation to meet market demands and maintain competitiveness in the digital economy era. Innovations such as digital financing based on the *murābahah* contract, the use of Sharia-compliant mobile banking platforms, and the integration of *waqf* and *zakat* services into digital systems represent strategic responses to the needs of modern customers. A key strength of these innovations lies in their ability to reach previously underserved segments of society (the unbanked), enhance transactional efficiency, and expand value-based financial inclusion aligned with Islamic principles.^{135'136} The development of innovation in Islamic banking has delivered substantial benefits to customers, not only in terms of service speed and accessibility, but also through improved contract clarity, cost transparency, and a strengthened commitment to justice and sustainability. A tangible example of this principle in practice can be seen in micro-financing models based on *qardhul hasan* or *muḍārabah*, which structurally do not burden customers with interest or penalties and functionally support the

¹³⁰ Adnan and others, 'Leveraging Qardhul Hasan Practices From Zakat Funds for Sustainable Development: A Maqasid Sharia Perspective and Its Contribution To Sdgs in Malaysia'.

¹³¹ Milena and Stefan, 'Enhancing ESG Performance in Islamic Banks: The Impact of Shari ' Ah Governance Quality Across Countries'.

¹³² Ahmed Mansoor Alkhan and M. Kabir Hassan, 'Does Islamic Microfinance Serve Maqāsid Al-Shari'a?', *Borsa Istanbul Review*, 21.1 (2021), pp. 57–68, doi:10.1016/j.bir.2020.07.002.

¹³³ Hisam Ahyani and others, 'Building Progressive Islamic Law in Zakat Distribution To Support Sustainable Development Goals: A Maqasid Sharia Perspective in Indonesia', *Journal of Lifestyle and SDG'S Review*, 5.2 (2025), pp. 1–18, doi:10.47172/2965-730X.SDGsReview.v5.n02.pe04071.

¹³⁴ Wan Nur Azira Wan Mohamed Salleh, Siti Zaleha Abdul Rasid, and Rohaida Basiruddin, 'Towards Transforming Zakat Collection and Distribution Roles Using Digital Wallet in Support of Social Justice and Social Financing', *Open International Journal of Informatics (OIJI)*, 7.2 (2019), pp. 95–103.

¹³⁵ Aziz, 'Digital Transformation Through Islamic Digital Banking For Financial Inclusion'.

¹³⁶ Mohamed Ghezal and Faycal Chiad, *Adopting Mobile Banking Technology To Achieve Financial Inclusion In Islamic Countries*, 2020 <<https://easychair.org/publications/preprint/H5Xw>>.

empowerment of micro and small entrepreneurs.¹³⁷ Such products directly contribute to grassroots economic growth while reflecting the values of *Maqasid al-Shariah*, particularly *hifz al-mal* (protection of wealth) and *hifz al-nafs* (protection of life).

However, several challenges remain in the implementation of innovation, particularly regarding the potential deviation from Sharia principles when product structures prioritize commercial orientation over spiritual values. One example is *tawarruq*-based products which, although legally permissible, are often criticized for resembling interest-based transactions and for diminishing the essence of justice in Islam.¹³⁸ In addition, weaknesses in internal governance and the lack of human resource capacity with comprehensive understanding of Sharia principles combined with suboptimal coordination between regulators, fatwa authorities, and Sharia supervisory systems further hinder the assurance that innovation truly aligns with the substantive objectives of *Maqasid al-Shariah*.¹³⁹

4. Innovation Development

To ensure that product innovation in Islamic banking truly aligns with *Maqasid al-Shariah* and delivers tangible benefits to society, it is essential to strengthen two core dimensions: Sharia compliance and technology-driven operational efficiency. As highlighted by Shahwan et al., and reinforced by Aziz et al., this strengthening involves reformulating an integrated regulatory approach, ensuring active involvement of the Sharia Supervisory Board from the earliest stages of innovation, and enhancing human capital with expertise in *fiqh al-mu'amalat* and financial technology.^{140'141} In addition, the strategic utilization of emerging technologies such as artificial intelligence (AI), big data, and blockchain is crucial for improving transparency, efficiency, and accountability in digital services such as zakat, *waqf*, and microfinance. These initiatives are viewed as strategic steps toward accelerating the substantive rather than merely formalistic realization of *Maqasid al-Shariah*.^{142'143}

Accordingly, product innovation in Islamic banking should not be seen as an ultimate goal, but rather as a strategic instrument to bridge the needs of modern markets with the noble values of Islam. Effective innovation is that which not only responds to competitive industry demands but also strengthens Sharia integrity and provides real benefits to the wider community. Therefore, maintaining and reinforcing the balance between Sharia

¹³⁷ Norhaziah Nawai, Nuradli Ridzwan Shah Mohd Dali, and Mahazan Abdul Motalib @ Taib, 'CREATING SUSTAINABLE LIVELIHOOD OPPORTUNITIES FOR THE B20 COMMUNITIES THROUGH ISLAMIC MICROFINANCE PRODUCTS AND SERVICES', *Labuan Bulletin of International Business & Finance*, 21.1 (2023), pp. 9–22.

¹³⁸ Norma Md Saad and others, 'Islamic Microfinance and Sustainable Development Goals (SDGs): Evidence from Bangladesh, Malaysia and Turkey', *International Journal Of Research and Innovation In Social Science (IJRISS)*, IX.XV (2025), pp. 1–14, doi:10.47772/IJRISS.

¹³⁹ Nawai, Dali, and Taib, 'CREATING SUSTAINABLE LIVELIHOOD OPPORTUNITIES FOR THE B20 COMMUNITIES THROUGH ISLAMIC MICROFINANCE PRODUCTS AND SERVICES'.

¹⁴⁰ Shahwan and others, 'Ranking the Compliance of Islamic Banking Home Financing Products With Maqasid Shariah Using Ahp'.

¹⁴¹ Muhammad Ridhwan Ab. Aziz and others, 'Islamic Digital Banking Based on Maqasid Al-Shariah for Financial Inclusion: A Proposed Framework', *I-IECONS e-Proceedings*, 2023, pp. 289–306, doi:10.33102/iecons.v10i1.84.

¹⁴² Shahwan and others, 'Ranking the Compliance of Islamic Banking Home Financing Products With Maqasid Shariah Using Ahp'.

¹⁴³ Aziz and others, 'Islamic Digital Banking Based on Maqasid Al-Shariah for Financial Inclusion: A Proposed Framework'.

compliance and technological efficiency must remain a continuous priority through regulatory synergy, education, and adaptive governance mechanisms.

CONCLUSION

This study affirms that product innovation in Islamic banking is not merely a strategic option, but an urgent necessity in responding to the rapidly evolving financial market dynamics and technological advancements. However, the findings reveal that many product innovations remain narrowly focused on legal-formal Sharia compliance and market competitiveness, while ethical dimensions, distributive justice, and social values the core pillars of *Maqasid al-Shariah* have not yet been fully embedded as foundational elements in product development processes. By employing the Maqasid-Based Innovation Evaluation Model (MBIEM), this study identifies a gap between current innovation practices and the ideal maqasid-oriented values. Products that successfully integrate the three key dimensions market demands, Sharia compliance, and maqasid attainment demonstrate broader and more significant impacts, particularly in enhancing financial inclusion and empowering communities, as exemplified by *qardhul hasan* micro-financing schemes and digital zakat platforms. Therefore, a value-oriented innovation strategy is required, in which product development goes beyond considerations of profitability and contractual legality, and instead positions *Maqasid al-Shariah* as both an evaluative and normative framework. Ideally, innovation in Islamic banking should serve as a means to realize an Islamic financial system that is just, inclusive, and ethically and socially sustainable.

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