

FINANCIAL PRODUCT DEVELOPMENT PROCESS

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King Fahd National Library Cataloging-in-Publication Data

Islamic Development Bank
Financial product development process./ Islamic
Development Bank – Jeddah, 2016

ISBN: 9960-32-324-2

1-Product management	2-Process	I-Title
658.57 dc	1437/7794	

L.D. no. 1437/7794
ISBN: 9960-32-324-2

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Note

For easy reference and understanding, the following terms are used for the abbreviations and technical terms.

	Description	Mentioned as
MC IFM	Member Country Islamic Financial Market	Clients
IFI	Islamic Financial Industry/Institutions	industry
IFPI / PI	Islamic Financial Product Idea	product idea
PIM	Product Idea Map	idea map
PIPP	Product Idea Project Portfolio	project portfolio
FPDC	Financial Product Development Center	the Center
FPD	Financial Product Development	product development
FPDP	Financial Product Development Process	the Process
IFP(s)	Islamic Financial Product(s) [Also, IDBG's modes of finance]	product(s)

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FOREWORD

The IDB Vision 1440H (2020) emphasizes the role of IDB in leading and supporting the Islamic financial industry. One of the most important initiatives in this endeavor is to “invest in a strong research and development facility to develop new financial products”¹.

An important step in that direction was the establishment of the Financial Product Development Center (FPDC) in early 1432H, to act as a focal point for product innovation across IDBG and build upon the pioneering role of the IDB Group in promoting and expanding the Islamic financial industry.

The Center has since embarked on various initiatives for new product development, including:

1. Developing a Business Process for new product development.
2. Building capacity of product developers within IDBG.
3. Designing new financial products.

The Center has developed a framework for the Financial Product Development Process (FPDP), described in this document. The document outlines the main steps and functions of each step in the process of new product development. The goal is to streamline product development efforts and optimize coordination between various stakeholders to facilitate the creation of new Islamic financial products.

As product development is a relatively new area in Islamic finance, we hope that the feedback for this framework document from within the IDB Group, and other stakeholders of the Islamic financial industry, will greatly help improve and enhance the proposed framework.

The ultimate objective of product development is to enable the Islamic financial industry to systematically create new financial instruments that meet Shari’ah objectives and at the same time serve the needs of Member countries. This can be achieved by innovating credible and efficient instruments for financing development and creating wealth. In this manner, the Islamic financial industry will be able to better contribute to the stability and prosperity of the world economy.

Dr. Abdul Aziz Al-Hinai

Vice President, Finance
Islamic Development Bank

¹ Vision 1440H, Islamic Development Bank, Safar 1427H, March 2006, p. 32.

ACKNOWLEDGEMENT

This document was first drafted by Mr. Rolf Michael Bergman, who was advising IsDB for the process for developing new financial products in IsDB.

Br. Mohsin Sharif, of the Financial Product Development Center, extensively reviewed the original draft and brought it into its final shape for publishing.

1 Introduction

The Financial Product Development Center was established in response to the IDBG Vision 1440 H and the IDBG Strategy. One of its main roles is to set up, develop, and implement a Group-wide Financial Product Development Process to facilitate new product development and ensure the leading role of IDBG in the Islamic financial industry. It will undertake this activity in close collaboration with all relevant departments and entities of IDBG.

This document provides a framework that describes the essential steps of the process and how the process will function. Furthermore, it describes the major activities of each process step and the consequent results as well as the resulting responsibilities. This is crucial to guarantee successful development and subsequent launching of new products.

In addition, the document provides information about the necessary organizational units, their roles and responsibilities as well as the required control mechanisms to enable the process to achieve its objectives, in accordance with the IDBG Strategy.

This includes, particularly, the creation of consistent control mechanisms like product portfolio, business segment matrix, product life cycle management including trend analysis, and above all structured knowledge about the financial needs of IDBG's Clients, that consequently provide information that facilitates the development of new and sustainable Shari'ah compliant products.

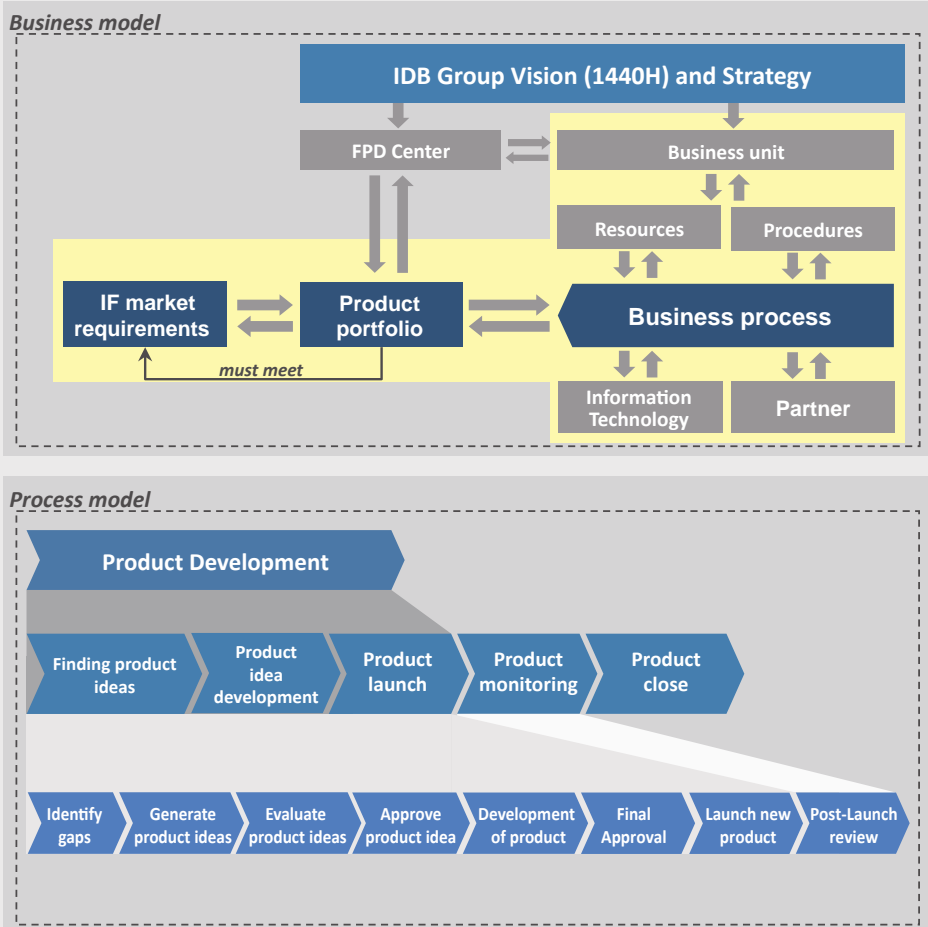
Besides the launch of the process, an open and integrated Group-wide teamwork of participants, combined with the creation and the implementation of transparent and consistent planning and controlling processes will be crucial for successful product development.

2 Design of the Financial Product Development Process

2.1 Modeling Framework

A field-proven modeling framework is adopted as the basis for the design of a new process. This consists of a “business model” and a “process model” for a product development process customized for the IDB Group.

Modeling framework



Legend: IF = Islamic Financial
FPD = Financial Product Development

Figure 1: Modeling Framework

2.2 Business Model

The business model shows the main components that play a significant role in the accomplishment of the IDBG's mission. One of the main components is the product portfolio that IDBG offers to its Clients. To be successfully aligned with the needs of the Clients, the product portfolio must meet the requirements of the Clients, failing which the strategic business plan and product goals will not be realized.

Directly connected to the product portfolio is the business process that generates the products. The business process needs resources like offices, infrastructure, specialists, etc. as well as specific procedures for an efficient and lean operation and management of the business process. Other important components are information technology (IT) for a proper business process support as well as business partners who bring a specific service or support for the business process. The business model at IDBG is shown in Figure 2.

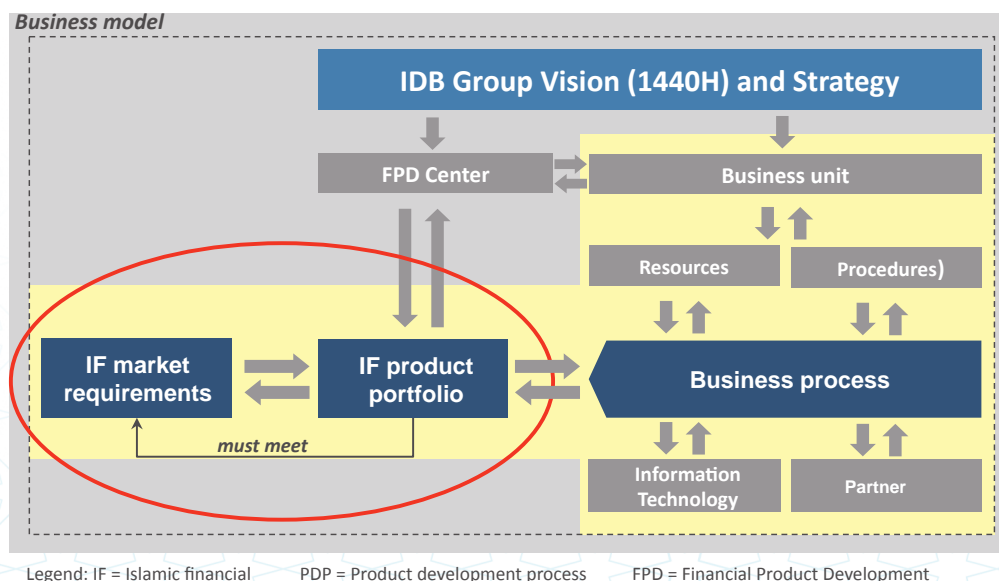


Figure 2: Business Model

IDBG's success is majorly determined by its ability to meet the needs and requirements of its Clients and satisfy the demand as well as enhance the product portfolio of IDBG. (Area marked red in Figure 2 and detailed in Figures 3 and 4).

Based on the business model, the relationship of the market demand and the IDBG product spectrum that is documented in its product portfolio is shown in Figure 3.

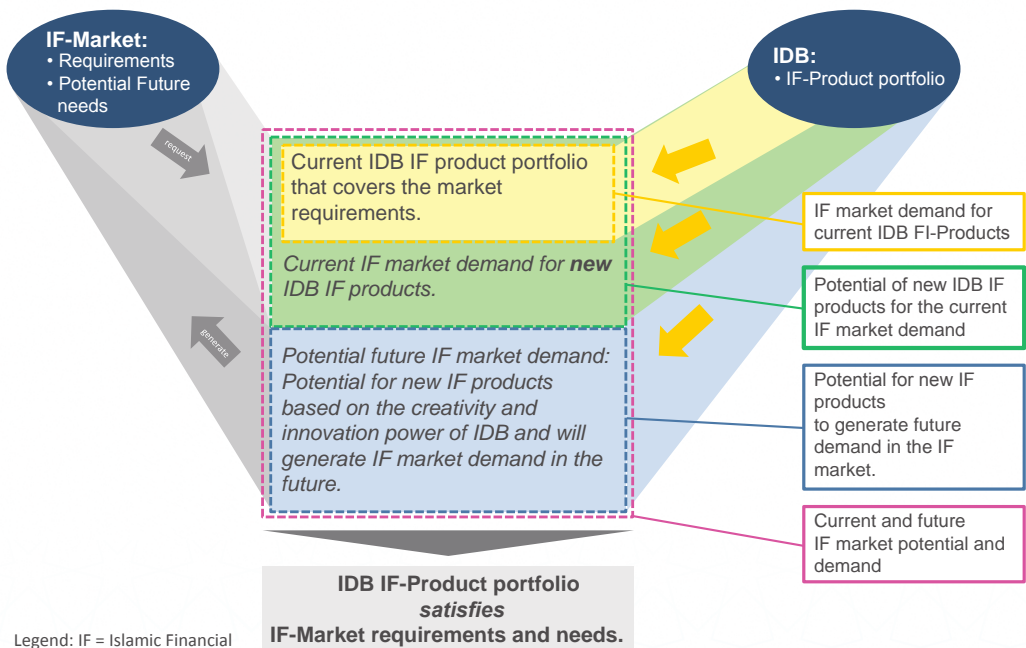


Figure 3: Relationship between IF market and IDBG's Product Portfolio

To secure IDBG's leading role in the industry, it is of paramount importance that future trends be identified at early stages, through regular interactions, surveys and studies of both the Islamic as well as the conventional financial industry. This will effectively drive IDBG's product portfolio towards sustainable Shariah-compliant innovation.

Of note is the increasing importance and popularity of Islamic financial products in non-Muslim countries. The principles of these products include avoidance of speculation business and that no business is allowed without a real flow of goods and services. This will be the most effective way that will result in sustainable and ethical business development, while at the same time minimizing the risks involved. Hence,

these will assert themselves in the market of such products for rational reasons. Consequently, IDBG will have to be at hand to cater to such demand with innovation in this area, to maintain its position as a leader in the industry.

The product spectrum of IDBG (yellow, green and blue in Figure 3) shows the subsets of products, both current and future, offered by IDBG. The corresponding Product-Market matrix is presented in Figure 4.

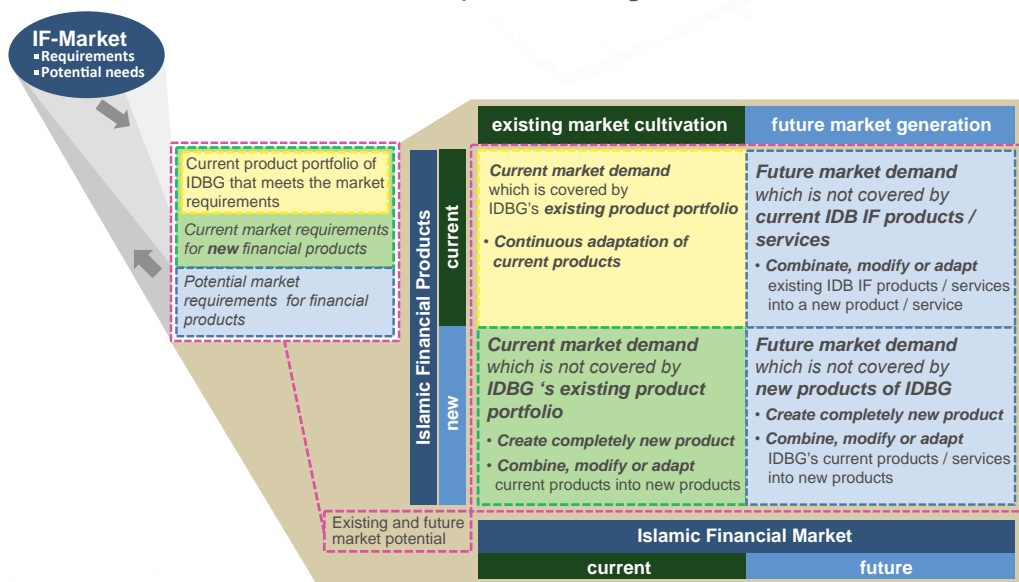


Figure 4: Product-Market Matrix for IDBG

Studies will be conducted to explore future trends of the market and subsequently propose relevant strategies for IDBG to adapt and lead the industry.

Products also require effective business processes. These business processes consist of:

- human resources with specific skills and knowledge;
- procedures and regulations for the operative handling of resources;
- partners i.e. investors, syndication partners or vendors/suppliers; and
- IT support

The optimal cooperation and coordination of these factors as shown in Figure 5 will influence both the effectiveness and efficiency of IDBG in generating new products. This will enable IDBG to focus on the right products, and complement them with an efficient business process along with the use of requisite resources, procedures, IT support and business partners.

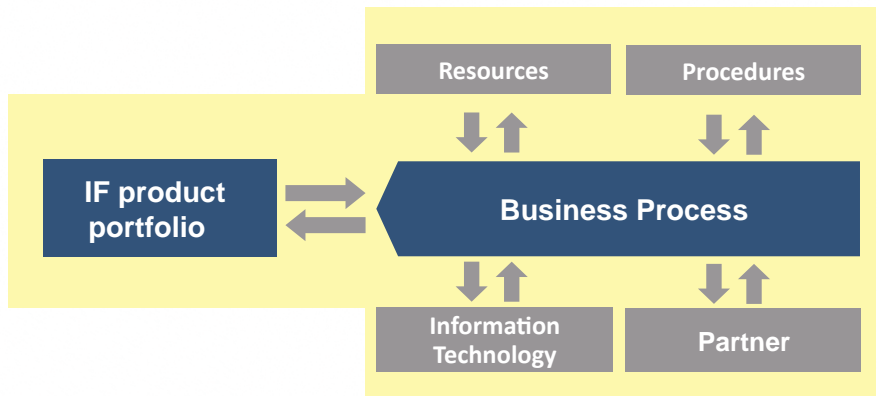


Figure 5: Product's relation to the Business Process

2.3 Process model

The process model (Figure 6) shows the path of product development.

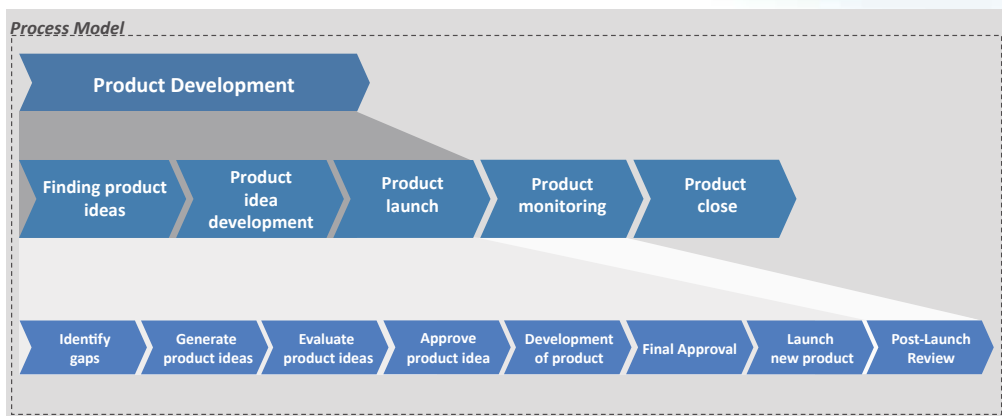


Figure 6: Process model (PM)

It starts with the identification of the gaps, followed by generating new ideas for products that can potentially fill those gaps. These ideas are then evaluated and initial approval is obtained for subsequent development of the most feasible ideas. A project portfolio then assists in the development of the product, which is launched after obtaining final approval from the relevant authorities. Post-launch review of the product facilitates the monitoring function by transmitting information regarding performance and potential ideas for the future.

2.4 Planning and Steering Instruments

It is very important that gaps between the market requirements and the existing product portfolio of IDBG be identified (see also Figure 3), as they are crucial for stimulating development of new products.

To identify gaps, IDBG can use both internal and external sources to obtain information on the needs of the Clients and the extent to which the current products serve them. An unmet need represents a gap that needs to be filled by a new product.

The development of a new product takes place within the framework of the 'Source and Gate model' (Figure 6). This model consists of various sources of ideas and the gates they pass through for eventual development. The gates are

decision points where the ideas are screened and evaluated to proceed to the next stage of product development. This is a direct result of the viability of the idea at any particular stage in the process. The model depicts the path of the ideas for products that make their way through the gates in the idea funnel, to being developed alongside each other in the project portfolio towards the final launch.

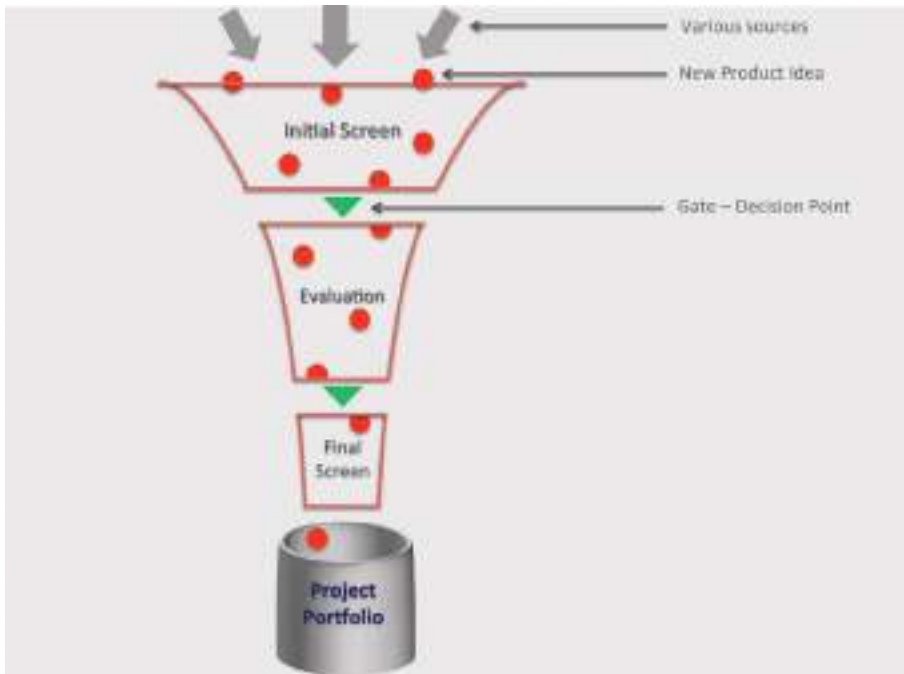


Figure 7: Basic Source and Gate Model (SGM)

The ideas are sourced from various players in the market through regular monitoring and research. Next, they go through the 'gates' in the 'idea funnel' where they are reviewed for:

- a. Shariah permissibility,
- b. Strategic alignment,
- c. Economic impact
- d. Operational feasibility, and
- e. Financial viability

The source and gate model of the Process is presented in Figure 8.

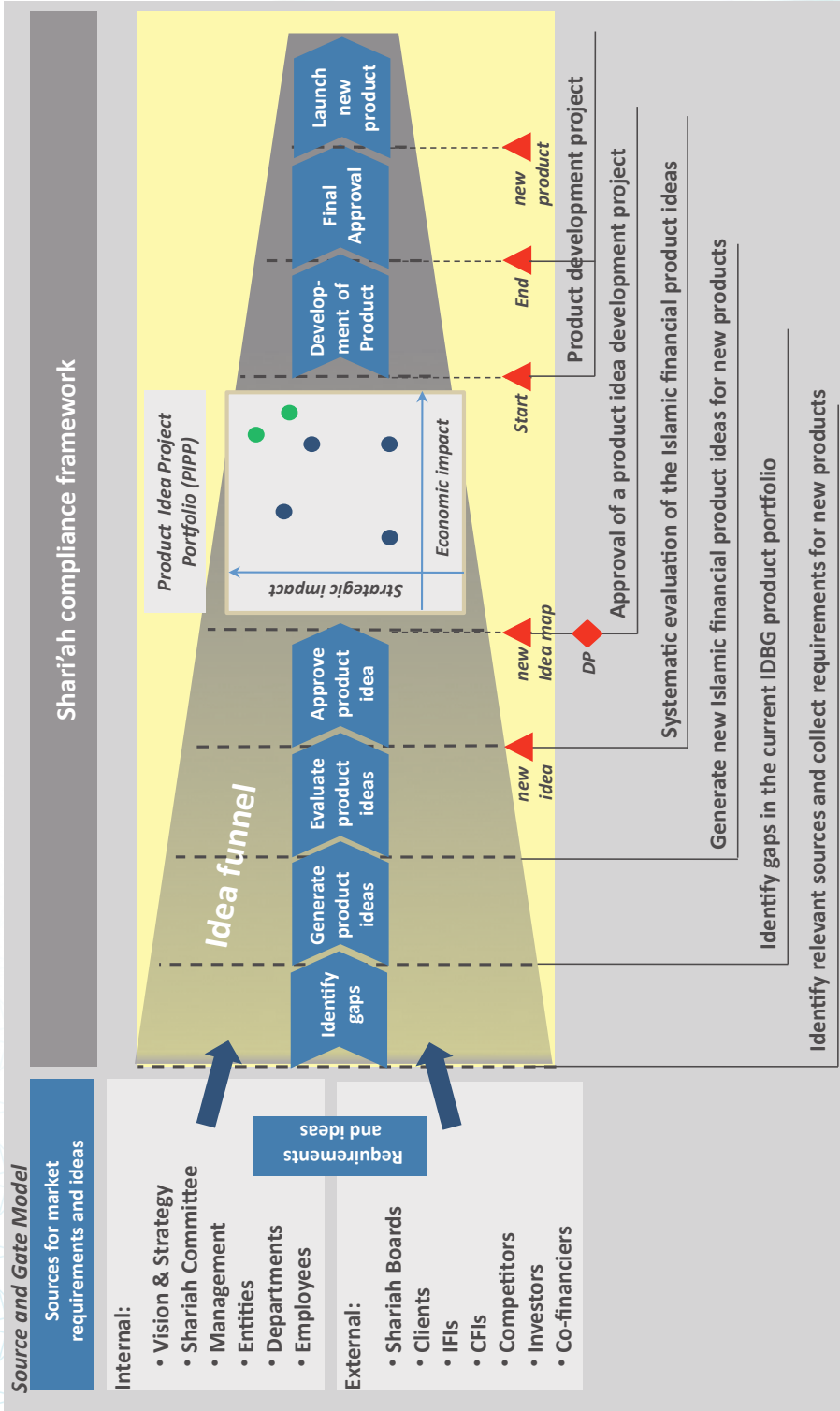


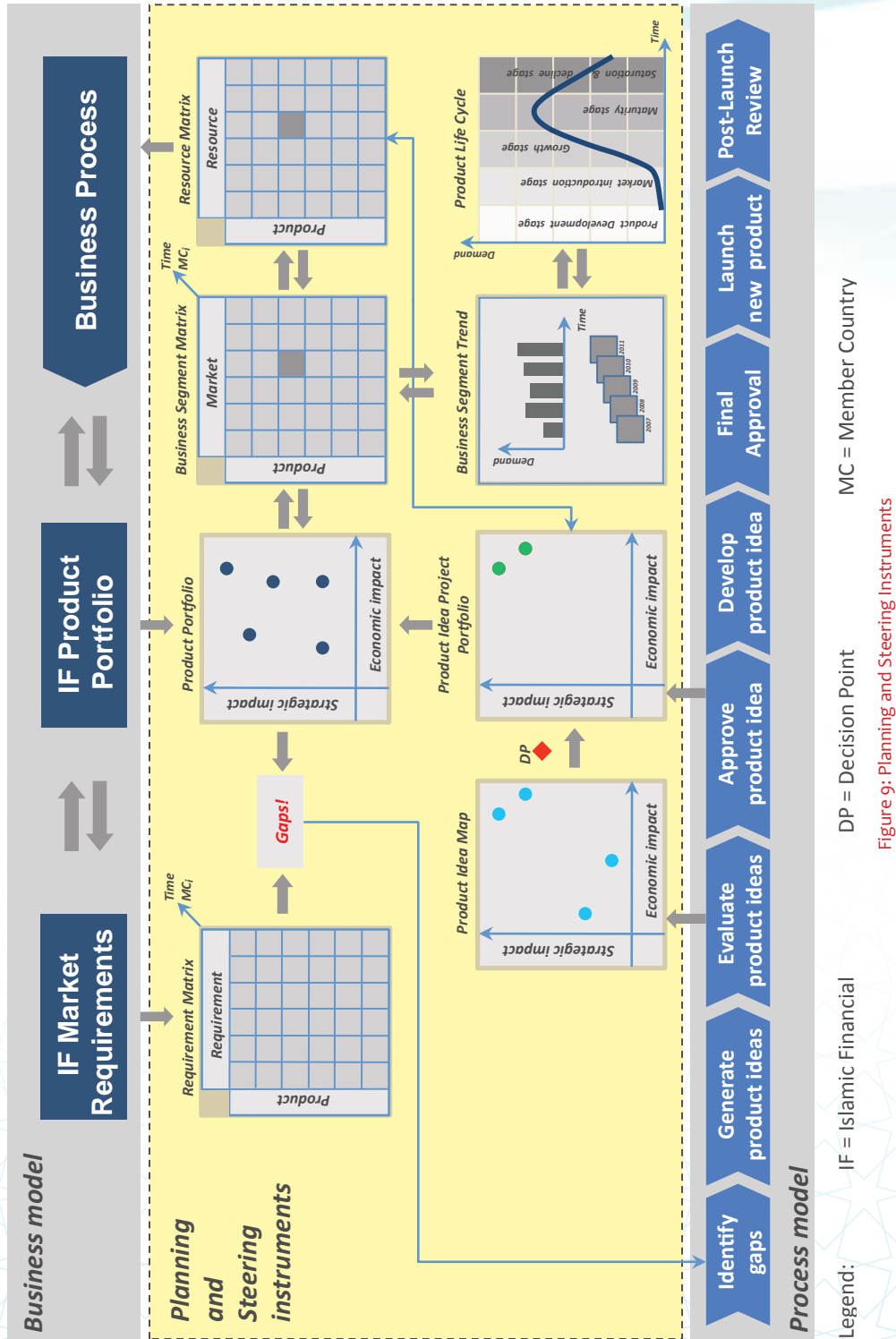
Figure 8: Source and Gate Model (SGM) of the Process

This results in the project portfolio where the ideas are sorted and arranged according to the relative strategic and economic impacts, for further development. The project portfolio, hence, facilitates efficient project management for the development of the ideas into products.

The Process passes through various levels including the systematic and structured assessment of previously identified product ideas followed by the approval for developing a new product as a project, including resource planning i.e. staff, budget, timeline, etc.

The gaps are to be identified by different departments and entities of IDBG in collaboration with the Center. Various ideas are generated through direct feedback from the Clients, their different requirements as well as discussions within the departments and entities within IDBG and different players in the industry.

The interaction between the business model on one side and the process model on the other side will result in the control and planning mechanisms that will be required to ensure creation and control of the process (yellow field in Figure 9).



As mentioned previously, the success majorly depends on IDBG's capability to react to new market requirements swiftly and adequately. Those requirements may imply minor modifications in existing products at best. However, they may also lead to completely new products. This will present the starting point of for identifying new product ideas within IDBG. At the same time, it can be assumed that a number of product ideas compete with each other for reaching the state of realization. Hence, a consistent evaluation and approval scheme is crucial. All product ideas have to pass through the previously established scheme to ensure a reasonable ranking, choice and approval for a product development project. Important control mechanisms are the product idea map (PIM), the product idea project portfolio (PIPP) and the product portfolio (PP).

2.4.1 Requirement Matrix

The Requirement Matrix includes the Clients' requirements versus the current as well as new products that are not yet available in IDBG's product portfolio. A requirement matrix for each client is developed and the resulting matrices are then aggregated in one overall Requirement Matrix. In this matrix, the requirements with a high number of inquiries and demand will be identified.

Regular surveys of Clients and explorations of future trends (as mentioned in Section 2.2) will be complementing the study of the relationship between the market and IDBG's product portfolio (see Figure 3). These are crucial to pursue an overarching vision of the requirements of the Clients amidst the current as well as future market trends and conditions. Techniques like these will subsequently facilitate the creation of matrices with the gathered information of the requirements. The resulting aggregated matrix will enhance IDBG's efficiency in identifying the right product ideas that can be developed into products that fill the gaps and effectively cater to the needs of the Clients.

2.4.2 Product Portfolio

The Product Portfolio shows the current IDBG products with its strategic and economic impact for IDBG. It shows how to evaluate the strategic and economic impact for any single IDBG product, either existing or in-development. (Detailed in Figure 11)

2.4.3 Business Segment Matrix

The Business Segment Matrix depicts the products of IDBG against various sectors in which these products are used. Table 1 shows a sample matrix for selected sectors and products.

Product \ Sector	Agriculture	Education	Energy
Installment Sale	312.70	581.70	1565.10
Istisna'a	1963.70	849.70	1596.10
Leasing	94.60	122.80	4986.90

Table 1: IDB approvals (US\$ millions) – Inception until 1433H (selected sectors and products)

The Business Segment Matrix serves as the planning and control tool to ensure that IDBG's strategic objectives are paramount in consideration. Furthermore, there has to be a link to the dynamic development of the individual business segments, showing the trend within the segment and the product life cycle status. This information is relevant for both elimination of non-feasible products from the product portfolio in a timely manner, as well as for initiating the development of new products soon enough.

The Business Segment Matrix is the basic instrument for getting an overview of the whole business at IDBG and its future development. It is an important instrument for steering IDBG in an effective way and detecting future directions at an early stage.

2.4.4 Business Segment Trend

The Business Segment Trend is derived from and is a graphical representation of the Business Segment Matrix over a period of time. It is also an important input for the product life cycle management.

2.4.5 Product Life Cycle

The Product Life Cycle corresponds with the business segment trend. It shows the maturity level of IDBG's products. It is also an instrument for triggering new products at the right time in case the life of an existing product ends.

2.4.6 Resources Matrix

The Resources Matrix includes an overview of all relevant resources like employees, skills, IT support, and business partner etc. that are required to generate the new products. It allows a quick check of the allocation of critical resources related to the Business Segment Matrix and Product Portfolio of IDBG. It is also a basic instrument for an efficient resource management at IDBG.

2.4.7 Product Idea Map

The idea map identifies product ideas based on a set of attributes and properties of financial products (see Figure 9). This set of attributes ultimately defines how each product idea is ranked based on its strategic and economic impact at IDBG. It is also the decision-making basis to set up the project portfolio.

2.4.8 Product Idea Project Portfolio

The project portfolio is based on the idea map and includes all product ideas with their description and the extent of necessary resources required, like budget, timeline, business partners, IT support and employees with special skills, etc. to develop the idea into a proper new product. It is also the basis of decisions about product development projects that are to be started, implemented or executed. The project portfolio is also used as a central monitoring instrument for all running product development projects.

3 IDBG's Financial Product Development Process

The design of the IDBG's Process is based on the Modeling framework that was outlined and described in the previous section. The Process is shown in Figure 10.



Figure 10: The Financial Product Development Process

3.1 Identify current and future market requirements

This is the starting point of any product development. It is of primary importance for IDBG to identify potential sources of information regarding the Clients' needs. This allows for systematic learning of these needs and generation of ideas to modify existing products or develop new products.

After having identified the sources of information, it has to be determined how the information obtained from these sources can be structured and extracted in a timely manner and how that can be transmitted to the Center.

For example, potential sources are IDBG's member countries. In these countries, the market requirements and/or the product ideas as well as the expected demand and the Clients' needs can be identified. In addition, other relevant client-sectors for IDBG, like private-sector clients of ICD and ITFC can also be defined.

Therefore, the requirements of the Clients have to be defined and documented periodically in a structured and coordinated manner. The Center is responsible for the consistent assimilation of the data. The representatives and/or country officers of the member countries assume the role of local market researchers and are responsible for gathering market data. The structure and templates for that should be consistent with all other planning and steering instruments at IDBG.

The Center keeps an overview of market requirements and the product ideas coming from the different Clients, which will constantly help to recognize the

frequency of certain demands/requirements, and therefore possibly identify a potentially huge demand regarding development of new products or modifying the existing products.

These are important prerequisites for subsequent procedures of evaluation and approval of the requirements and/or products ideas.

For other relevant external sources, i.e. the industry, investors, regulators, etc. (see Figure 8) similar standardized procedures for gathering relevant information have to be established.

The quality of decision-making for development of new products as well as the probability of success will substantially improve as increasingly relevant sources of information on market needs are considered.

Pre-requisites for this process step:

- Determining a standardized structure for gathering, documenting, aggregating and transmitting information in a timely manner,
- Determining relevant information to gather, and
- Determining the relevant sources for gathering information.

Major results of this process step are:

- Requirement matrix of each Client
- The aggregated Requirement Matrix
- Estimated demand and benefits of satisfying Clients' needs
- Financial, economic, legal and Shari'ah requirements of the Clients, and
- Comparative analysis of other Islamic financial Institutions and their product portfolios (based on market research)

3.2 Identify gaps in existing IDBG products

Based upon the market requirements and the planned projects in a Member Country as well as the information originating from other relevant sources as defined in 3.1, the concerned department as well as the Center can identify the gaps in the existing product portfolio of IDBG. To ensure consistency, standardized templates will be used to document structured descriptions of the gaps that are identified.

Major results of this process step are:

- Identification of gaps in the current product portfolio at IDBG
- Structured description of the gaps on a standardized template

3.3 Generate new product ideas – Prepare the Concept Paper

Based upon the gaps identified, various techniques can be used to generate product ideas that might help fill these gaps. Workshops bringing together experts from different relevant fields, both internal as well as external, can be very useful to generate ideas to fill the gaps. Other techniques of idea generation will have to be developed as well.

The ideas are described in the Concept Paper, which is the first look of any idea. The Concept Paper outlines, briefly:

- The gap (to be filled by the idea),
- Description of the idea,
- Justification of the proposal, and
- Expected outcomes.

For a clearer understanding of the product, a Product Template is also developed. It outlines the structure of the proposed product, showing the roles of the parties involved as well as the deliverables. Table 2 shows a sample format.

Product Name –				
Steps	Step 1		Step 2	
Description				
No.	1	2	1	2
Parties				
Actions				
Deliverables				

Table 2: Product Template

Essential results of this process step are:

- New product ideas to fill the identified gaps,
- Concept Paper, and
- Product Template.

3.4 Evaluate new product ideas – Develop the Business Case

The product ideas, after being generated and described, now have to pass through an evaluation test, which will ensure that only product ideas that are in the best interest of IDBG and its Clients are cultivated in detail (in the business case) and put forward for subsequent development and approval.

To enable this, an evaluation scheme with clearly defined views and evaluation criteria as well as weighting criteria has to be developed. The development of such a scheme will be coordinated, defined, developed, documented and advanced by the Center, with involvement of all participants.

Methodically a progressive portfolio technique will be applied. This enables various views on the product idea based on the aligned criteria. It also allows aggregating a product idea in a portfolio according to its priority. In the priority portfolio, the individual product idea is presented according to its strategic and economic relevance for IDBG. The portfolio serves as a central decision basis for further approval. It also shows the relative positioning of competing product ideas. The complexity of the progressive portfolio is critically influenced by the number of different views as well as by the number of relevant evaluation and weighting criteria per view. The schematic construction of a progressive portfolio is illustrated in Figure 11.

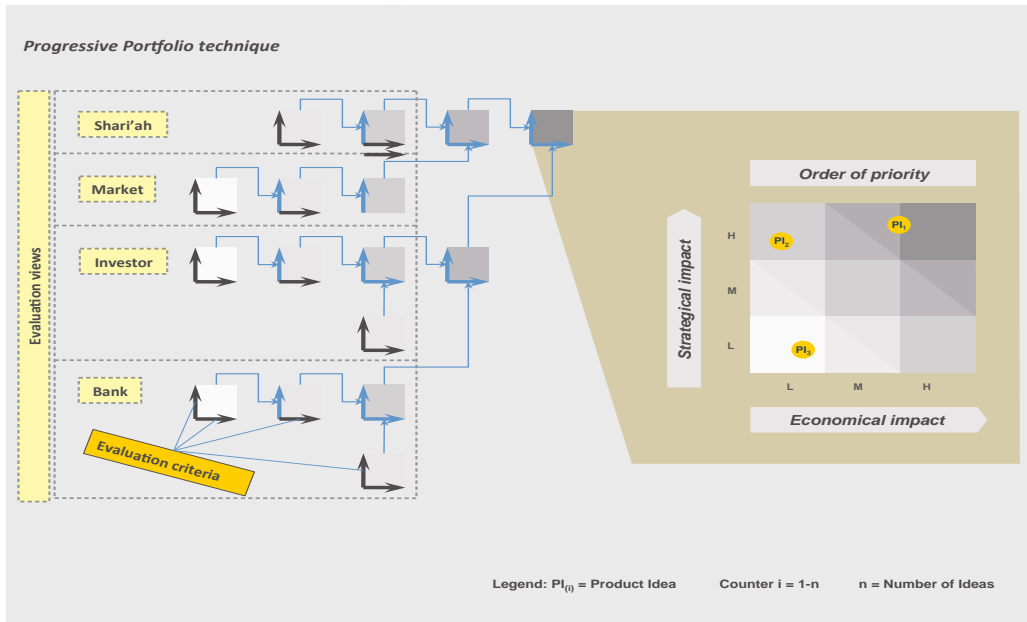


Figure 11: Progressive Portfolio technique

Product evaluation is based on various criteria analyzed from different perspectives i.e. Shari'ah, client, investors, and IDBG. The black arrows in Figure 11 represent the specific evaluation criteria. For example, the market view can include the following: Market growth, share and volume for a product idea as well as a competitive position like service, competence, customer orientation, etc. All the criteria for evaluation and their weights will be defined in order to develop a standardized pattern for product idea evaluation. The evaluation of the product ideas leads to only certain ideas being selected for further development and subsequent approval.

For each product, a Product Coordinator is identified and assigned by the concerned department. The Product Coordinator acts as the focal point for the Process and is responsible for preparing the Business Case for the product in close coordination with the Center.

The Business Case should include the following:

- ❖ The rationale and goals of the product
- ❖ The product design, including but not limited to:
 - description of the product idea
 - the Shariah-compliant structural model
 - potential of the product within the market and assumptions made
 - sustainable benefit of the new product for all parties involved.
- ❖ Risks involved
- ❖ Financial engagement, implications and projections

Essential results from this process step are:

- Product Idea Map
- Prioritized product ideas
- Business case for selected product ideas

3.5 Approval of new product ideas

The business case will then be presented to the relevant authorities, starting with the Shari'ah Committee, followed by related departments and units at IDBG. Clearance of the product from the following departments is essential:

- Risk Management
- Finance Control
- Legal
- IT (if necessary)

The Product Coordinator is responsible for following through the approval process of the new product idea.

Essential results from this process step are:

- Project Portfolio
- Sign-off from relevant departments/entities

3.6 Product Development Project

The next step is to develop and finalize the necessary legal documents for the new product, as well as marketing material. This is done by the Product Coordinator in close collaboration with the Legal department.

Essential results of this process step:

- Complete legal documents of the new product
- Marketing & outreach materials

3.7 Final Shariah approval (Documentation & Process flow)

After the development of the product, it has to be presented to the Shariah board for final review and approval. The documentation, contracts and the processes through which the transaction would take place have to be clearly highlighted for the board's consideration.

Following the approval, the product is ready for in-house testing (if required) and adaptation of IT and BP-implementation.

3.8 Adaptation of IT and BP-implementation

During this phase, all the necessary tasks for supporting the new product's operational structure with efficient business processes and suitable IT support are accomplished.

Suitable criteria have to be defined for measuring the performance of the business process of setting up a new product.

Essential results from this process step are:

- Business processes
- IT processes and system support
- Monitoring criteria

3.9 Launch new product

For the launch, all necessary preparations have to be in place, like providing information material, preparing presentations and setting up the appropriate internet presence.

3.10 Post-launch review - Shariah audit and feedback

In-house Shariah audits by the IDB's Shariah Committee on regular basis will ensure monitoring the Shariah-compliance of the approved processes and procedures and the fulfillment of all contractual stipulations by the product team.

Feedback from the Clients will also become a relevant source to identify any gaps that could suggest future improvements in IDBG's offerings and potentially new products as well.

4 The Process at a Glance

Process	Deliverables
Step 1 Identify current and future market requirements	<ul style="list-style-type: none"> • Requirement matrix of each Client • The aggregated Requirement Matrix • Estimated demand and benefits of satisfying Client's needs • Financial, Economic, Legal and Shariah requirements of the Clients • Comparative analysis of other Islamic Financial Institutions and their product portfolios
Step 2 Identify gaps in existing IDBG products	<ul style="list-style-type: none"> • Identification of gaps in the current product portfolio of IDBG • Structured description of the gaps on a standardized template
Step 3 Generate new product ideas	<ul style="list-style-type: none"> • New product ideas to fill the identified gaps • Concept Paper • Product Template
Step 4 Evaluate new product ideas	<ul style="list-style-type: none"> • Product Idea Map • Prioritized product ideas • Business case for selected product ideas
Step 5 Approval of new product ideas	<ul style="list-style-type: none"> • Project portfolio • Sign-off from relevant departments/entities
Step 6 Product Development Project	<ul style="list-style-type: none"> • Complete legal documents of the new product • Marketing & outreach materials
Step 7 Final Shariah approval	<ul style="list-style-type: none"> • Clearance of all documents, contracts and processes of the product by the Shariah Committee
Step 8 Adaptation of IT and BP-implementation	<ul style="list-style-type: none"> • Business processes • IT processes and system support • Monitoring criteria
Step 9 Launch new product	<ul style="list-style-type: none"> • Offer the new product to Clients
Step 10 Post-launch review	<ul style="list-style-type: none"> • In-house Shariah audits • Feedback from Clients for future review of products





The **Financial Product Development Center** was established in Muharram 1432H (December 2010). Its main purpose is to enhance the leadership of the **Islamic Development Bank Group** in the development and promotion of innovative Islamic financial products within the framework of the Maqasid al-Shariah. This is accomplished while further strengthening the financial soundness and relevance of the IDB Group.

The Center is the focal point for the development of new and innovative financial instruments at IDB Group, and for this purpose it also collaborates with various institutions in the Islamic financial industry.

Strategic Objectives

The Center has three major strategic objectives:

1. Developing Business Process for new product development.
2. Building capacity of product developers.
3. Designing new financial products.

These three objectives are summarized by the “3Ps” that the Center works along: Process, People, and Products.

Process



Formulating the Business Process (BP) of developing new products is vital to determine the requisite steps for product development. The BP will be used as a framework for all other activities for product development.

The Center has already completed the general Business Process Matrix for IDB Group, and is working to develop the detailed processes of each step in the BP. The Center is also moving ahead to implement the processes. The steps for this include:

1. Identifying product gaps with respect to the needs of investors and customers, both on the assets side and liabilities side.
2. Developing tools and techniques for generating and evaluating new product ideas.
3. Producing Manuals of Islamic Financial Products.



People

For the process to be effective there has to be a good number of product developers who are equipped with the skills and knowledge needed for product development. This objective is achieved through:

1. Capacity building and training programs.
2. Establish a Product Development Working Group (WG) across IDBG. The WG shall work collectively to:
 - a. Identify gaps within each department or entity.
 - b. Stimulate new idea generation.
 - c. Share information on existing products.
 - d. Coordinate product development process.
3. Organize periodic seminars and conferences by inviting experts and scholars to enrich and enhance developing new products.

Products

With an effective process and the right people, the stage is set for designing new products to fill the gaps between customers' and investors' needs on one hand, and the existing products on the other. Accordingly, the Center carries out the following activities:



1. Carry out periodic surveys of existing Islamic and conventional products.
2. Respond to the needs of the IDB Group entities for new products.
3. Work closely with the Advisory Panel and the Working Group for idea generation and evaluation.
4. Collaborate with the concerned departments and entities for due approval and implementation.
5. Arrange pilot experiments for testing new products.

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