

Dilution Effect in Islamic Finance: The Case of Convertible Sukuk

Authors : Mahfoud Djebbar

Abstract : Stock dilution is a financial phenomenon resulting from the issue of additional shares by a company, or when holders convert their convertibles into new shares (capital increase). This issue and/or conversion enlarge the company's share base that will result in marginal dilution (loss) for existing shareholders, and a benefit to new ones. Dilution issues have already been addressed in mainstream finance, particularly as far as information disclosure is concerned. However, in Islamic finance, stock dilution problems have not been deeply studied and the subject has not received sufficient attention from shariah-compatible firms, investors, and scholars. In this regard, this paper emphasises the forms, the effects of capital dilution on current shareholders as well as the ways and techniques of compensating them. And since the research in this field, in its Islamic perspective, is still in its infancy, the paper tries to analyse the phenomenon theoretically in detail using numerical examples, and expose some case studies of Shariah-compliant issuers of convertible Sukuk and how they compensate their existing shareholders. Finally, this study shows that the Sukuk issuers compensate old shareholders using the right of shuf'ah as a well known and practiced pre-emptive right in Islamic transactions centuries ago, as well as the ways conventional bond issuers use.

Keywords : compensating shareholders, convertible Sukuk, Islamic financial innovation, Shuf'ah

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