

# SMART

## JOURNAL OF BUSINESS MANAGEMENT STUDIES

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Vol.1

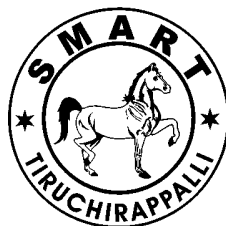
Number. 1

January - June 2005

Rs. 200

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**Chief Editor**



**SCIENTIFIC MANAGEMENT AND ADVANCED RESEARCH TRUST**  
**(SMART)**  
***TIRUCHIRAPPALLI (INDIA)***

## EFFICACIES OF BOOK-BUILDING FOR INITIAL PUBLIC OFFERINGS (IPOS) IN INDIAN CAPITAL MARKET

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The impetus generated under the globalization and liberalization processes, has had a phenomenal effect on the Indian capital market; many structural modifications have been done and a host of new mechanisms and instruments have been developed, mostly conforming to and in line with international practices. A crucial factor to strengthen the investor confidence is, no doubt, the transparency in the pricing policies for the shares floated and related disclosures involved. Of great significance is the introduction of a new mechanism termed '*Book-Building*,' in the scheme of Initial Public Offerings (IPOs) and recognition of the same by SEBI in India in 1995. In international markets, the most active investors are mutual funds and other institutional investors and the entire 100% of issue is allotted through the book-building process. The lead in India was taken by ICICI; it chose book-building in 1996 for its 1000crore bond issue. This was followed by L&T, TISCO & HCL issues; the last got over-subscribed by 27 times and the original price band of Rs.450–540 was revised to 500-580 and finally offered at Rs.580/- Nevertheless, several critical assessments also were churned out. This paper aims to examine whether the high profile advantages of the method have actually been consolidated at the present juncture or a critical review/systemic re-routing is called for. The study reveals that the Book-Building method appears to be evolving over the last decade in our capital markets. In the end, if the issuer company, the lead merchant bankers and the regulators discharge their responsibilities to the best interests of the investors, success through Book-Building would consolidate into a strong capital foundation of our economy.

The impetus generated under the globalization and liberalization processes, has had a phenomenal effect on the Indian capital market. Many structural modifications have been done and a host of new mechanisms and instruments have been developed, mostly conforming to and in line with international practices. As a true growth of this market depends more on the omnipotent primary market, several ways to effectively tap this segment are constantly envisaged by policy makers in the Government. A crucial factor to strengthen the investor confidence is, no doubt, the transparency in the pricing policies for the shares floated and related disclosures involved. Of great significance is the introduction of a new mechanism termed '*Book-Building*,' in the scheme of Initial Public Offerings (IPOs) and recognition of the same by SEBI in India on the recommendations of the Malegam Committee in Oct. 1995. Here it is pertinent to note that the SEBI itself was established in 1992, after abolishing the Capital Issues Control Act, 1947.

### **The What and Why of Book-Building :**

Book-building is a process by which a demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of notice, circular, advertisements, documents or information memoranda or offer documents. This implies-

- It is a transparent and flexible price discovery method for the IPO.
- Price is fixed by the issuer-company *and* the Book Running Lead Manager (BRLM)
- A portion of the issue is reserved for institutional and corporate investors.

The aim is to introduce flexibility in terms of price as well as the number of issues. It is a scientific method through which a consensus price of IPOs may be determined on the basis of feedback received from most informed investors who are institutional investors and corporates like UTI, LIC, ICICI, FIIs etc. The steps involved in Book-Building are listed-

### **Book-Building vis-à-vis Fixed-Price Options:**

- ❖ In fixed price option, allotment of shares is done on a proportional basis, with the resultant uncertainty of allotment discouraging prospective institutional investors.
- ❖ The time taken for completion of process is much less in book building compared to fixed price.
- ❖ In book-building, the share price is fixed on the basis of demand, or at a price greater than or equal to the floor price while in fixed price option, price is fixed first and then offered to public.
- ❖ BRLM assesses demand on a daily basis, unlike in the fixed process at the close of the issue.
- ❖ Fixed-Price issue carries a cost of about 2.3% of the issue price with a risk of failure, if subscription ends up below 90%; in book-building such costs and risks could be avoided.

### **Book-building at the Global Level :**

In international markets, the most active investors are mutual funds and other institutional investors and the entire 100% of issue is allotted through the book-building process. It is also called as '*soft underwriting*' in US since the investment bankers are not obliged to take up the unsold shares, in case of low demand. An average of 75 days is taken to design a prospectus; file it with SEC, NYSE or NASDAQ; talk to select investors; establish a price range; print the prospectus and launch the offer. Trading of securities begins on 16<sup>th</sup> day and payment and delivery of shares are completed by 20<sup>th</sup> day.

<b>Nominate Book Runner</b>
<b>Form Syndicate Of Brokers, Arrangers, Underwriters, Financial Institutions etc.</b>
<b>Submit Draft Offer Document To SEBI Without Mentioning Coupon Rate or Price</b>
<b>Circulate Offer Document Among the Syndicate Members</b>
<b>Ask For Bids on Price and Quality of Securities</b>
<b>Aggregate And Forward All Offers To Book Runner</b>
<b>Run the Book To Maintain a Record Of Subscribers and Their Orders</b>
<b>Consult Issuer; Determine Issue Price as a Weighted Average of the Offers Received</b>
<b>Firm Up Underwriting Commitments</b>
<b>Allot Securities Among Syndicate Members</b>
<b>Securities Issued And Listed</b>
<b>Trading Commences on Exchanges</b>

*Source: Bharat's Manual of Indian Capital Market, 1997.*

#### **Book-building at home :**

The lead in India was taken by ICICI; it chose book-building in 1996 for its 1000crore bond issue. This was followed by 4323crore L&T and 5878crore TISCO issues. A significant landmark was made by HCL in Nov.'99; the issue got over-subscribed by 27 times and the original price band of Rs.450–540 was revised to 500-580 and finally offered at Rs.580/-Nevertheless, several critical assessments also were churned out in the early years of adoption.

#### **Aim of this paper :**

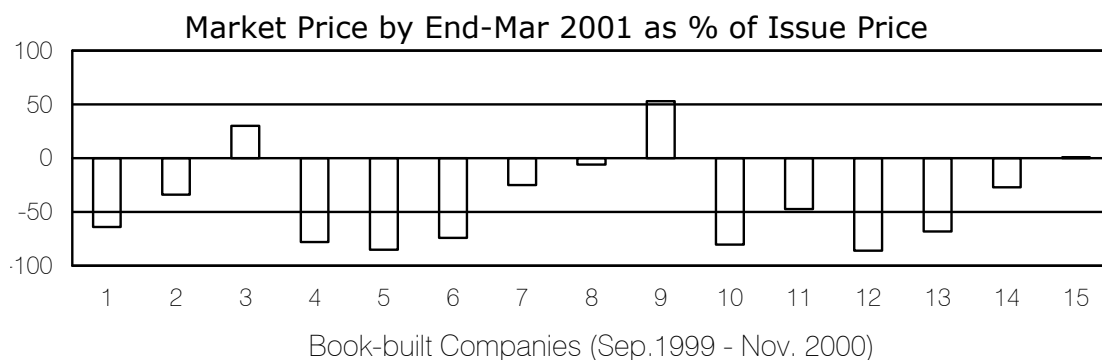
This paper aims to examine whether the high profile advantages of the method have actually been consolidated at the present juncture or a critical review/ systemic re-routing is called for. In the first 4 years since this pricing mechanism was set to roll out in our market between 1996-2000, the much sought after price stability simply did not unfold. But in the next 4 years, culminating in the current year, the process does appear to have established itself extra-ordinarily well. A study published in March 2001 by 'The Financial Express' is worth noting.

Taking to Book-Building route in 1999-2000 there is a projected grim picture because out of the 15 IPO scrips, 12 of them quoted below the 'discovered' price. To contrast the above with the current scenario, the corporate that adopted this system during this calendar year (Jan. 2004 – Sep. 2004) is explored. The market prices as on 30<sup>th</sup> September 2004, were captured; the percentage raise or fall relative to the corresponding offer prices were worked out and included in the tabulation. It is an interesting coincidence that out of the 15 on Book-Building route in 2004, a whopping 12, quote **above** the 'discovered' price.

### Book-Building Issues in 2000-2001

Sl. No.	Name of the issue	Date of Issue	Issue Price (Rs.)	Market Price, as on March 2001 (Rs.)	Market Price to Offer Price
1	Creative Eye	03/11/2000 to 09/11/2000	50	18.0	<i>Down by 64%</i>
2	AZTEC Software & Tech.	12/10/2000 to 18/10/2000	80	52.5	<i>Down by 34%</i>
3	Balaji Telefilms	06/10/2000 to 12/10/2000	130	168.9	<b>Up by 30%</b>
4	Tips Industries	04/09/2000 to 11/09/2000	325	72.7	<i>Down by 78%</i>
5	Pritish Nandy Communications	04/09/2000 to 11/09/2000	155	23.7	<i>Down by 85%</i>
6	MRO TEK	04/09/2000 to 09/09/2000	95	24.3	<i>Down by 74%</i>
7	Hughs Telecom	04/09/2000 to 09/09/2000	12	9.0	<i>Down by 25%</i>
8	Mukta Arts	12/07/2000 to 18/07/2000	165	155.1	<i>Down by 6%</i>
9	Akash Optifibre	12/07/2000 to 18/07/2000	60	91.7	<b>Up by 53%</b>
10	Mascot Systems	10/04/2000 to 18/04/2000	460	94.0	<i>Down by 80%</i>
11	Cadila Healthcare	15/01/2000 to 21/01/2000	250	132.1	<i>Down by 47%</i>
12	Cinevista	15/01/2000 to 21/01/2000	300	42.1	<i>Down by 86%</i>
13	Shree Rama Multi Tech	15/01/2000 to 21/01/2000	120	38.7	<i>Down by 68%</i>
14	HCL Technologies	16/11/1999 to 24/11/1999	580	425.3	<i>Down by 27%</i>
15	Hughes Software Systems	22/09/1999 to 28/09/1999	630	638.4	<b>Up by 1%</b>

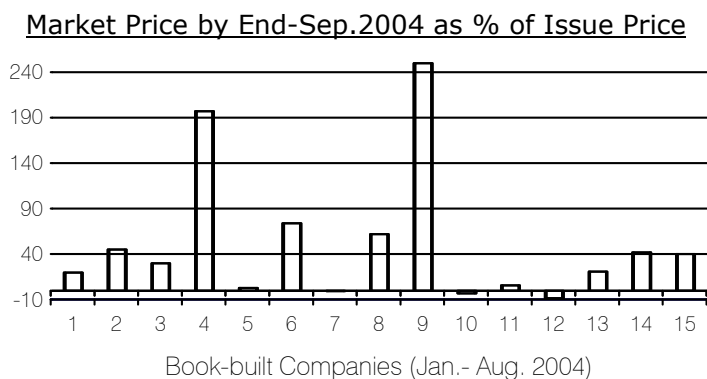
Source : web-site: <http://www.namasthenri.com>



### Book-Building Issues in 2004 (Jan. - August)

Sl. No.	Name of the issue	Date of Issue Closing	Floor Price (Rs.)	Issue Price (Rs.)	Market Price (End-Sep.)	Markert Price to Offer Price
1	Tata Consultancy Services	05/08/2004	775-900	850	1024.0	<b>Up by 20%</b>
2	New Delhi Television	28/04/2004	63-70	70	101.7	<b>Up by 45%</b>
3	Datamatics Technologies	19/04/2004	101-110	110	143.4	<b>Up by 30%</b>
4	Dishman Pharma & Chemicals	07/04/2004	155-175	175	519.5	<b>Up by 197%</b>
5	ICICI Bank	07/04/2004	255-295	280	288.6	<b>Up by 3%</b>
6	Biocon	18/03/2004	270- 315	315	547.2	<b>Up by 74%</b>
7	Oil & Natural Gas Corporation	13/03/2004	680-750	750 & 712.50 R	745	<i>Down by 0.7%</i>
8	Petronet LNG	09/03/2004	13-15	15	24.3	<b>Up by 62%</b>
9	Power Trading Corporation	08/03/2004	14-16	16	57.1	<b>Up by 257%</b>
10	Gas Authority of India	05/03/2004	195	195 & 185.25 R	189.3	<i>Down by 3%</i>
11	Dredging Corporation of India	04/03/2004	385- 400	400 & 380 R	425.0	<b>Up by 6%</b>
12	IBP Co.	01/03/2004	620	620 & 589 R	567.0	<i>Down by 8.5%</i>
13	Indian Petrochemicals Corporation	27/02/2004	170	170 &161.50 R	206.0	<b>Up by 21%</b>
14	CMC	28/02/2004	485	485 & 460.75 R	691.0	<b>Up by 42%</b>
15	Patni Computer Systems	05/02/2004	200-230	230	323.0	<b>Up by 40%</b>

Source : Compiled from web-site of National Stock Exchange; R : for Retail investors.



### **The Green Shoe Option (GSO) :**

This is an option that is expected to go a long way in tightening the loose knots in the system. To smoothen the swings in the price of new shares immediately after listing, Stabilizing Agents (SA) are appointed to buy a new issue for the limited purpose of preventing a decline in price and save the investors from loss. ICICI Bank is the first to use this in India. Guidelines have been framed to utilize this option. (vide SEBI's Circular No.11 Dt. 14.08.2003)

Accordingly, a company desirous of availing the GSO shall, in essence-

- ✓ Pass a resolution in the general meeting, seeking authorization to allot shares to SA.
- ✓ Appoint one of the lead book runners amongst the issue management team as the SA.
- ✓ The complete agreement with SA shall be filed prior to filing of offer document (with SEBI).
- ✓ The agreement between SA and the promoters shall clearly include the maximum shares that can be borrowed but limited to 15 % of the total issue.
- ✓ The mechanism shall be used within 30 days of acquiring trading permission by the exchange.

### **Conclusion**

This study reveals that the Book-Building method appears to have evolved over the last decade in our capital markets. Through the first half of its trial, up to around 2000, vagaries did show up alarmingly; nevertheless, the later half has proved far greater maturity levels in the system- the issuer, institutions and investors. The year also happens to be a typical one involving turbulences on account of electoral switchovers and a global petroleum-war-terrorism related trade fluctuations. In conclusion, if the issuer company, the lead merchant bankers and the regulators discharge their responsibilities to the best interests of the investors, success through Book-Building would consolidate a strong capital foundation of our economy.

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