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BOOK BUILDING METHOD: CONCEPTUAL FRAMEWORK

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Introduction

Capital market can be defined as a market where long-term funds can be raised. They are a part of the broader financial markets, which include forward markets, swap markets etc. Capital markets can be further sub-divided into equity markets and debt markets, where equity and debt are traded respectively. The capital market includes primary market and secondary market. The distinction between primary and secondary market is that in the former, the original fund raiser (the company) raises the funds by way of issuing the securities, whereas in the latter, the securities are traded among the investors/ speculators.

The pricing of an Initial Public Offering (IPO) is an important task for the lead manager and the issuer company. The aim is to price the issue as high as possible but it cannot be so high that the investor loses interest. On the lower side the issue price should not be lower than what the investor is willing to shell out. Equally important is a room for further appreciation in the issue price to entice the investor community.

Recently another method for pricing of IPOs has emerged. It is known as the "Book-Building" method. Under this method, the company determines a price-band, with a lower limit (called the floor) and an upper limit (called the ceiling). Applications are invited for the purchase of the securities. The investor, interested in the security, quotes a price between the floor and the ceiling. Thus the market itself determines the price of the security, based on the demand for the security.

Book Building is a relatively new option to raise ownership (equity) or borrowed funds (debt) through public issues in the capital market in India although it has been in vogue in the international financial market for a longer period. The system of book building has been introduced in India as a result of the steps taken by the SEBI to implement the recommendations of the Malegam Committee. In the book building system, the issuer company ties up with a selected group of individuals and agencies for private placement. The entire exercise is done on wholesale basis whereas in the conventional system, a large number of brokers and underwriters are involved. This new method is called "book-building process" because one of the lead managers builds his order book by forming a syndicate of eligible potential buyers. It is a process by which the issuer company before filling the prospectus build ups and ascertains the demand for the securities being issued and assesses the price at which such securities may be issued and ultimately determines the quantum of securities to be issued.

Definition

SEBI Guidelines defines Book Building as a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and build-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, advertisement, document or information memoranda or offer document.

SEBI Guidelines for Book Building

SEBI (Disclosure and Investor Protection) Guidelines of 2000 contains guidelines for book building under chapter XI, which contains guidelines for 75% book building process, 100% book building process, disclosure requirements, allocation/ allotment procedure and maintenance of books and records. Companies are obliged to follow SEBI guidelines for book building offers.

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Intermediaries of Book Building

Book Building refers to the collection of bids from investors. This is based on an indicative price range, the offer price being fixed after the closing date of the bid. The principle parties/ intermediaries involved in the book building process are:

- i) The issuer company,
- ii) A Book Running Lead Manager who is a Category I Merchant Banker registered with SEBI. The Book Running Lead Manager is also the Lead Merchant Banker.
- iii) Syndicate Members, who are intermediaries registered with SEBI, are permitted to carry on activities because they are appointed by the Book Running Lead Manager.

Process of Book Building

The Book Building process involves the following steps

- a) **Preparation of Draft Prospectus**
The preliminary prospectus, prepared on the prescribed format, contains the all the information

Maintenance of Records

The records of book building are maintained by the book runner and other intermediaries involved in the process. Such records may be inspected by the SEBI.

The entire book building process is given in Chart-I.

Advantages of Book Building

The system will be beneficial both to investors and to the issuer companies. **Minimum Cost**

The cost of public issue is minimized in the book building process. In the traditional system, wide publicity is given to the issue through various methods, e.g. road shows, conferences, media coverage and despatch of bulk stationery.

a) Speed

The book building process results in the faster collection of funds atleast to the extent of private placement. Moreover, the funds collected by the company are accessible quickly.

b) Better Chances of Success of the Issue

In an era of uncertainty, the process improves the chances of the success of the issue since full subscription by the brokers and the underwriters is ensured. The chances of under-subscription or development are also precluded.

c) Realistic Price

In the book building system, the price is decided at a date which is very close to the opening of the issue. It is about one to two weeks before the opening of the issue. As compared to this, under the traditional system, the price is fixed about six weeks before the opening of the issue. Therefore, the price is more realistic in book building.

d) Fair Price of the Issue

The price of the securities, in the case of book building, is determined on the basis of the offers given by different investors. It, therefore, tends to be closer to the real value.

e) Evaluation of Intrinsic Worth

The intrinsic worth of the securities and credibility of the company in the eyes of the public can be evaluated in the book building system.

Limitations of Book Building

Though the book building system has various advantages, there are some serious limitations.

- ❖ Book Building is appropriate for mega issue only. In the case of small issues, the companies can adjust the attributes of the offer according to the preferences of the potential investors. It may not be possible in big issues since the risk returns

Features	Fixed Price Process	Book Building Process
Pricing	Price at which the securities are offered/ allotted is known in advance to the investor	Price at which securities will be offered/ allotted is not known in advance to the investor. Only an indicative price range is known
Demand	Demand for the securities offered is known only after the closure of the issue	Demand for the securities offered can be known everyday as the book is built.
Payment	Payment if made immediately at the time of subscription whereas refund is given only after allocation	Payment only after allocation

preference of the investors cannot be estimated easily.

- ❖ The issuer company should be fundamentally strong and well known to the investors.
- ❖ The book building system works very efficiency in matured market conditions. In such circumstances, the investors are aware of the various parameters affecting the market price of the securities. But such conditions are not commonly found in practice.
- ❖ There is a possibility of price rigging on listing as promoters may try to bale out syndicate members.

Difference between shares offered through book building and offer of shares through normal public issue.

Glossary of Terms Used in Book Building Process

The following are the important terms used in book building process.

❖ Bid

An application to make an offer by a prospective investor to subscribe to equity shares of the company at a designated price during the Bidding Period and it includes all revisions and modifications thereto.

❖ Bid Closing Date

The date after which the Syndicate Members would not accept any bids; any such date shall

be notified through a notice in an English national newspaper, Hindi national newspaper and Regional language newspaper with wide circulation.

❖ **Bid Cum Application Form/Bid Form**

The form in terms of which the bidder shall bid for the equity shares of the company and shall upon allocation of the equity shares by the BRLM and filling of the Offer Document with the ROC, be considered as the application for allotment of the equity shares in terms of the offer document.

❖ **Bid Opening Date**

The date on which the Syndicate Members to the offer would start accepting bids; such date shall be the date notified and communicated through a notice in an English national newspaper, Hindi national newspaper and Regional language newspaper with wide circulation.

❖ **Bidder**

Any prospective investor who makes a bid in terms of this Offer Document.

❖ **Bidding Period**

The period between the Bid Opening Date and the Bid Closing Date inclusive of both days and during which period prospective investors can submit their bids.

❖ **Book Build Portion**

The offer less the Fixed Price Portion.

❖ **BRLM/ Book Runner**

Book Running Lead Manager, who lead manages the issue.

❖ **Brokers to the Fixed Price Portion**

Brokers of all stock exchanges, who have been registered with the respective stock exchange, can act as Brokers.

❖ **CAN**

Confirmation of Allocation Note means the note or advice or intimation for confirmation of shares sent to the bidders who have been allocated shares in the Book Build Portion.

❖ **Escrow Account**

Account opened with the Escrow Collection Bank and in whose favour the bidder will issue cheques in respect of the bid and in which

account the cheques will be deposited by the Syndicate Members.

❖ **Collection Bank(s)**

The banks at which the Escrow Account will be opened and which act as such, in terms of this Offer Document and Escrow Agreement.

❖ **Institutional Bidders/ Investors**

Bidders who are institutions specified in Section 4A of the Act Banks, Mutual Funds or Foreign Institutional Investors registered with SEBI.

❖ **Non- Institutional Bidders**

All bidders who are not institutional bidders are called non- institutional bidders.

❖ **Offer Closing Date for Fixed Price Portion**

It is the date on which the Fixed Price Portion closes for subscription by the public.

❖ **Offer Opening Date**

It is the date on which the Book Built Portion opens for automatic subscription by bidders who have received allocation and have paid at least the offer price for their allocation into the escrow account. This date shall also mean the date on which the Fixed Price Portion opens for subscription to the public.

❖ **Offer Period**

The period between the offer opening date and offer closing date for fixed price portion inclusive of both these dates.

❖ **Offer Price/Issue Price**

The price determined by the company in consultation with the BRLM on the Pricing Date after the Bidding Period and which will be set out in the Final Offer Document to be filled with the ROC at which equity shares of the company would be allotted.

❖ **Pay-in- Period**

For the Book Building Portion, pay-in period means the period commencing on the Bid Opening Date and extending till the Bid Closing Date, during which period the bidders have to pay their maximum bid amount into the Escrow Account during the bidding period, unless such requirement is waived by the Syndicate Members. In case of requirement of payment during the Bidding Period being waived by the Syndicate Members, the closure of the pay-in period for such bidders for payment into the

Escrow Account shall be within two days of the communication of the allocation list to the Syndicate Member by the BRLM.

❖ **Pricing Date**

It is the date on which the company in consultation with the BRLM finalises the offer price.

❖ **Revision Form**

The form used by the bidders to modify the quantity of shares of the bid price in any of the bid options as per their bid Forms and as modified by their subsequent revision form(s), if any.

❖ **Syndicate**

It includes the Book Running Lead manager and Syndicate Members.

❖ **Syndicate Members**

They are collectively the Book Running Lead Manager and the Syndicate Members (as disclosed in the Offer Document) and other persons who are registered with SEBI as underwriters.

❖ **TRS**

Transaction Registration Slip refers to the slip or document registering the bids, issued by the Syndicate Member to the bidder as proof of

registration of the bid upon submission of the Bid Form in terms of this Offer Document

Conclusion

Book Building is the most practical mechanism for quick and efficient management of mega issues. SEBI permits the book-building route to be open to issuer companies. The book-building route is successful in some of the earlier mega issues. Indian Capital Market is rapidly reaching the stage of maturing as a result of book building process.

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