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Book building process & its perspective

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Abstract

Book Building is the process of determining the price at which an Initial Public Offering will be offered. SEBI guidelines, 1995 defined book-building as “a process undertaken by which a demand for the securities proposed to be issued by a body of 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 a notice, circular, advertisement, document or information memoranda or offer document”.

Every business organization needs funds for its business activities. It can raise funds either externally or through internal sources. When the companies want to go for the external sources, they use various means for the same. Two of the most popular means to raise money are Initial Public Offer (IPO) and Follow on Public Offer (FPO). During the IPO or FPO, the company offers its shares to the public either at fixed price or offers a price range, so that the investors can decide on the right price. The method of offering shares by providing a price range is called book building method. This method provides an opportunity to the market to discover price for the securities which are on offer. The paper aim to examine detail Analysis of Book Building Process.

Keywords: Book Building, IPO, Book Building process, listing, etc.

Introduction

In general, the word “Book building” is a method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the’ bids’ received from the prospective shareholders by the lead merchant bankers. According to this method, share prices are determined on the basis of real demand for the shares at various price levels in the market. Book building is a common practice in developed countries and has recently been making inroads into emerging markets as well.

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2. Review of important literature & relevant literature on the study

Malegam Panel 's recommendations

The introduction of book-building in India in 1995 followed the recommendation of an expert committee appointed by SEBI under Y. H. Malegam "to review the (then) existing disclosure requirements in offer documents," two of the terms of reference being "the basis of pricing the issue" and "whether substantial reduction was possible in the time taken for processing applications by SEBI." The committee recommended and SEBI accepted in November 1995 that the book-building route should be open to issuer Companies, subject to certain terms and conditions. Some of the important terms and conditions were:

(a) The option should be available only to issues exceeding Rs. 100 crores;
(b) The issuer companies could either reserve the securities for firm allotment or avail themselves of the book-building process'
(c) Draft prospectus to be submitted to SEBI could exclude information about the offer price;
(d) A book runner to be nominated from among the lead market bankers charged with specific responsibilities and the name submitted to SEB;I and
(e) The requirement of 25 per cent of the securities to be offered to the public will be applicable.

There have been several amendments/revisions to the above guidelines; the first one in December 1996 made available the option of book-building to all body corporate which were otherwise eligible to make an issue of capital to the public, and in case of under subscription, the spill-over from the public portion could be permitted to the placement area and vice-versa. In 1997, the restriction of the facility to 75 per cent of the issue was thought to severely constrain the benefits arising out of price and
demand discovery, and the facility was extended to 100 per cent of the issue, available only if the issue amount was Rs.100 crores and above, compulsorily offering an additional 10 per cent of the issue size to the public through prospectus, and reserving at least 15 per cent of the issue size to individual investors applying up to ten tradable lots. Further, audited financial ratios had to be disclosed, namely, EPS for last three years, P/E, average return on net worth in last three years and net asset value based on last balance sheet.
However, there were no takers for the 100 per cent book-building facility. Based on suggestions made by leading merchant bankers, the following amendments were made to the guidelines in 1999:
i) The issuer may be allowed to disclose either the issue size or the number of securities to be offered to the public;
(ii) Allotment should be in demat mode only; and (iii) reservation of 15 per cent of issue amount for individual investors need not be made. This could be offered to the public at a fixed price. Some of the earliest mega issues through the book-building route were those of Larsen & Toubro, ICICI and Tisco.

3. Statement of the Problem:
Why Book building is essential for mega Issues
Book building is a common practice in developed countries and has recently been making inroads into emerging markets as well. Book Building is essentially process used by companies raising capital through Public Offerings. It is necessary study applicability of Book Building Process in mega issues.
This Research includes the study of Book Building Process with reference to Book Building Process & its Perspective

4. Objectives of the study
1. To study the Concept of Book Building Process.
2. To examine the importance of Book-Building method in issuing shares in secondary market.
3. To estimate and compare immediate and long term performance of the issues made through Book-Building and Fixed Price method.

5. Statement of the Hypotheses
The proposed study is guided by the following hypotheses.
1. Ha: Book-Building is the most practical mechanism for quick and efficient management of mega issues.
2. Ha: Book-Building mechanism is preferred for efficient pricing over Fixed Price method.

6. Methodology
Data is collected from various books, journals, periodicals, websites i.e. Bombay Stock Exchange and publications by various institutions

7. Analysis of Concepts
I) Types Of Investors
There are three kinds of investors in a book-building issue.
1. The retail individual investor (RII)
2. The non-institutional investor (NII)
3. The Qualified Institutional Buyers (QIBs)

II) Types of Public Issues
Fixed Price Issue: When the issuer at the outset decides the issue price and mentions it in the offer document, it is commonly known as fixed price issue.

Book Built Issue: When the price of an issue is discovered on the basis of demand received from the Prospective investors at various price levels, it is called as book built issue.

III) Types of Book-Building
The Companies are bound to adhere to the SEBI's guidelines for book building offers in the following manner:
- 75% book building
- 100% book building

IV) 75% Book-Building Process
Under this process 25 per cent of the issue is to be sold at a fixed price and the balance of
75 per cent through the Book Building process. The process specifies that an issuer company may make an issue of securities to the public through prospectus in the following manner:
100 per cent of the net offer to the public through book building process, or 75 per cent of the net offer to the public through book building process and 25 per cent of the net offer to the public at a price determined through book building process.

8. 100% Book Building Process
The principal intermediaries involved in a book building process are the companies, Book Running Lead Manager (BRLM) and syndicate members are the intermediaries registered with SEBI and eligible to act as underwriters. Syndicate members are appointed by the BRLM. The book building process is undertaken basically to determine investor appetite for a share at a particular price. It is undertaken before making a public offer and it helps determine the issue price and the number of shares to be issued.

The following are the important points in book building process

1. The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.
2. The Issuer specifies the number of securities to be issued and the price band for the bids.
3. The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
4. The syndicate members put the orders into an 'electronic book'. This process is called' bidding' and is similar to open auction.
5. The book normally remains open for a period of 5 days.
6. Bids have to be entered within the specified price band.
7. Bids can be revised by the bidders before the book closes.
8. On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
9. The book runners and the Issuer decide the final price at which the securities shall be issued.
10. Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.
11. Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

9. Book Building vs. Fixed Price Method

The main difference between the book building method and the fixed price method is that in the former, the issue price to not decide initially. The investors have to bid for the shares within the price range given. The issue price is fixed on the basis of demand and supply of the shares. On the other hand, in the fixed price method, the price is decided right at the start. Investors cannot choose the price. They have to buy the shares at the price decided by the company. In the book building method, the demand is known every day during the offer period, but in fixed price method, the demand is known only after the issue closes.

10. Relevance & importance of the study

The SEBI (Disclosure and Investor Protection) Guidelines, 2000, define the term `book-building' in a rather complex language as "a process undertaken 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 determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document."

Interestingly the term used is body corporate, in place of the usual company. The guidelines do not define the term `body corporate' but the Companies Act, 1956 (the Act) explains that body corporate or corporations include a company incorporated outside India. This is as it should be because it will also enable companies incorporated outside India but having shares in companies registered in India to divest through the book-building route. According to the Securities and Exchange Board of India, "the facility of book-building in the capital issuance process would provide the issuer and lead merchant banker the flexibility of price and demand discovery."

In simple terms, book-building is a mechanism by which the issue price is discovered on the basis of bids received from syndicate members/brokers and not by the issuers/merchant bankers. However, it is felt that this system will be more suited for companies that are in existence for some time as past financial data are available for analysis and there will be awareness of the company, etc. (Suresh Krishna, Chartered Secretary, April 2002).

11. SEBI guidelines

In January 2000, SEBI came out with a compendium of guidelines, circulars and instructions to merchant bankers relating to issue of capital, including those on the Book-building mechanism.

The compendium includes a model timeframe for book-building: "After the price has been determined on the basis of bidding, statutory public advertisements for a continuous three days containing, inter alia, the price as well as a table showing the number of securities and the amount payable by an investor, based on the price determined, shall be issued and the interval between the advertisement and issue opening date should be a minimum five days."

The draft prospectus to be circulated has to indicate the price band within which the securities are being offered for subscription. The bids have to be within the price bands. Bidding is permissible only if an electronically-linked transparent facility is used. An issue company can also fix a minimum bid size. An initial bid can be changed before the final rate is determined. Two of the recent mega issues, one by Petro net LNG and the other by Biocon, were both through the 100 per cent book-building route. Prospective bidders were advised to read the red herring prospectus carefully. According to the Act, a red herring prospectus means a prospectus that does not have complete particulars on the price of securities offered and the quantum of securities offered. The Concise Oxford Dictionary gives the meaning of `red herring' as a misleading clue or distraction, so named from the practice of using the scent of red herring (a silvery fish) in training hounds.

The 2000 Amendment to the Act gave legal cloak to the book-building route by allowing circulation of the information memorandum and the red herring prospectus. According to the Act, information the memorandum denotes a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of the issue of such securities are assessed by means of a notice, circular, advertisement or document. Incidentally the working group on the comprehensive Companies Bill, 1997 (since lapsed) had advocated introduction of book-building. It defined the term as "an international practice that refers to collecting orders from investment bankers and large investors based on an indicative price range. In capital markets, with sufficient width and depth, such a pre-issue exercise often allows the issue to get a better idea of the demand and the final offer price of an intended public offer."

12. Conclusion

As per above information it is proved that Analytical study of Book Building Process will be helpful to promote the use of Book building Process in the companies.

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