

'Book Building': An Alternative Mechanism for Pricing of Public Issues

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Abstract

In India, companies may increase their required capital with the help of capital market by way of an initial public offer (IPO). It is a method of selling of securities to the public in the primary capital market. In this method, offer of selling can be made through the 'Fixed Price Method' or 'Book Building Method'. Book Building Method was introduced in India in 1995. At this outset key words (like ASBA, ESCROW, QIBs etc.) related with this alternative and popular method of raising funds has been discussed in detail. Guidelines and process according to the provisions and regulations described by the SEBI has also been incorporated in this research study. A comparative analysis regarding merits and demerits of Book Building Process has been presented properly. To manage problems related with this alternative method, some considerable and effective suggestions have also been submitted at the end.]

INTRODUCTION:

In the present corporate world, there are two kinds of issue of securities - 'Fixed price issue' and 'Book built issue'. Fixed price is declared in the offer document/ application form and it is fixed by the issuer companies at the time of offer of securities. On the other hand, such price is fixed by the process of Book Building. Now a days, this process is also known as an innovative, most useful and prompt system of marketing securities.

In the process of Book Building, the issuer company discloses a 'Price Band' / 'Floor Price'. Investors may make bids for shares at various price levels within the price band disclosed by the issuer company. Based on bids received from the investors at various price levels / real demands, the lead merchant banker appointed by the issuer company arrives at the price at which the shares can be issued. The book building process is undertaken before making a public offer to determine investor appetite for a share at a particular price and it also helps to determine the number of shares to be issued.

In the opinion of capital managing players, the book building system is an innovative and pioneering technique of promotion of securities and it is most realistic, speedy and competent method of managing jumbo/ mega public issues of securities.

In India, the system of book building was introduced by SEBI in October, 1995. To regulate the system of book building, the SEBI has issued various guidelines. According to the SEBI guidelines, "Book Building means a process undertaken by which a demand for the securities proposed to be issued by

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a body corporate is elicited and built up and the price for such securities is assessed for the determined of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document."

Thus, it can be stated that Book Building Process of Securities is a mechanism, where the book for the offer (IPO or FPO) is open during the period in which the bids are collected from investors at various prices, which are within the price band specified by the issuer company. The issue price is fixed after the bid closure based on the demand generated in the process. Bids can be revised by the bidders before the book closes. Allocation of securities is made to the successful bidders and the rest bidders get refund orders. Notable that no incentive, whether in cash or kind shall be paid to the investors who have become entitle for allotment of securities.

The main purpose of book building process is to decide the maximum market price for securities and demand level from highest quality and potential investors to adjust pricing and allocation and distribution of securities. During the price fixing process of book building, all the applications received till the last dates are analyzed and a cut-off price / final offer price is arrived based on demand of shares at different price levels. This cut-off price is the equilibrium / balanced price or the highest price at which all the shares on offer can be sold efficiently. If the price quoted by an investor is less than the cut-off price, he will not get allotment. On the other hand, if price quoted by an investor is higher than the final price, the amount more than the final price is refunded, if he gets allotment. If the allotment is not made, full money is refunded within fifteen days after the final allotment. For example: an issuer company gives the price range of Rs 800 to 1100. When bidding for the securities, investors must decide at which price they would like to bid for the securities, viz. - Rs.800, Rs. 900, Rs 1000 or Rs 1100. They can bid for securities at any price within this range. Based on the market forces of demand and supply of the securities, the final price will be fixed. Here, the lowest price - Rs 800 is known as the 'Floor Price' and the highest price - Rs. 1100 is known as 'Cap Price'.

Objectives of the Study: The main purpose of this study is to analyze the procedural pattern of Book Building Process. Moreover, to assess the advantages and disadvantages of this method in the context of present-day capital raising environment is another objective of the study.

Methodology of the Study : All the facts and findings of this research work is based on secondary data. To collect the relevant information, guidelines related with Book Building issued by the SEBI, published reports of the MCA and SEBI, Notifications for IPOs published by different companies and other important annual reports have been consulted during the study.

Important Key Terms Used in the Book Building Process

- **Order Book** - It is an 'Electronic Book' which shows the demand for the securities of the issuer company at various price levels.
- **Floor Price** - It is the minimum offer price below which bids cannot be entered. It is fixed by the issuer company with the consultation of Book Running lead manager.

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- **Retail Individual Investor** - An investor who is applying for securities worth up to Rs. 2,00,000 only.
- **Cut-Off Price Option** - It is available for only retail individual investors. Such investors are required to tick the cut-off option which indicates their willingness to subscribe the securities at any price discovered within the price band.
- **Price Band** - It is a band of price within which investors can make bid. The spread between the floor price and the cap of the price band shall not be more than 20%
- **Lead Merchant Banker** - Such manager is appointed by the issuer company. The company can appoint more than one Lead Merchant Banker.
- **Book Running Lead Manager (BRLM)** - In case of more than one Lead Merchant Banker, one of them is nominated as Book Running lead Manager. The name of such nominated BRLM is mentioned in the offer document of the issuer company.
- **Syndicate Members** - These are intermediaries registered with the SEBI and appointed by the BRLM of the issuer company to enter the bids of investors. They also carry on the activities of underwriting.
- **Bidding Period** - It is decided and announced by the issuer company which shall be of at least 3 working days and not more than 7 working days. If the price band is revised by the issuer company, the bidding period may be extended to a maximum of 10 working days.
- **Compliance Officer** The issuer company appoints a Compliance Officer with a view to directly liaise with the SEBI about the compliance with the various laws, rules and regulations of the Companies Act, 2013, the Securities Contracts (Regulations) Act, 1956 and guidelines of the SEBI.
- **Application Supported by Blocked Amount (ASBA)** - It is an alternate system provided by the banks for investors to make the payment for IPO/FPO. The system of ASBA does not require investors to furnish demand drafts or cheques that were earlier needed when applying for buying of securities. According to this system, funds of applicants of IPOs/ FPOS is blocked in their respective bank accounts and release the funds to the issuer company from such blocked account only after the allotment to the extent of allotment made.
- **Escrow Account** - It is an account to which an account holder makes periodic deposits, and authorizes the banks to withdraw funds to pay for certain obligations. Such type of account is used by the investors of securities or real estates.
- **Qualified Institutional Buyers (QIBs)** - According to the SEBI, Scheduled Commercial Banks, Public Financial Institutions, Foreign Institutional Investors (FIIs), Multilateral and Bilateral Development Financial Institutions, Mutual Fund and Venture Capital Funds, Alternative Investment Funds, State Industrial Development Corporations, Provident Fund & Pension Fund with minimum corpus of Rs. 25 crore, National Investment Fund (set up by the

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Gov. of India), Insurance Companies (registered with IRDA,) Insurance Funds (set up by the Department of Posts), Insurance Funds (set up by the Army/Navy/ Air Force of the India). etc. are treated as QIBs in India.

Process of Book Building - The following are the main steps used in process of the book building :

- ✓ The issuer company who is planning an offer through book building process shall appoint a Lead Merchant Banker. He is known as Book Running Lead Manager (BRLM). In case of more than one lead merchant banker for an issue offer, one of them is nominated as BRLM. Notable that a BRLM can act also as the Lead Book Runner.
- ✓ After that the BRLM appoints other principal intermediaries involved in the book building process such as Syndicate members, Registrar to the issue, brokers etc. The syndicate members can carry on activities of an Underwriter. The brokers shall accept the bids and collect the money from clients for every order placed.
- ✓ It is very important that the issuer company shall ensure the compliance with disclosure requirements and pre- issue obligations described in the SEBI guidelines. For this purpose, a 'Compliance Officer' is appointed by the issuer company. Generally, the Company Secretary is appointed as the Compliance Officer with a view to directly liaise with the SEBI as well as about the compliance with the various set of laws, rules, policies, regulations and directions of the SEBI and investors complaints related issues.
- ✓ A 'Post-Issue Lead Merchant Banker' is also appointed by the issuer company. He is overall responsible for allotment of securities. He maintains a close coordination with the Registrar to the Issue, Compliance Officer and other intermediaries.
- ✓ If the issuer company is making an offer of hundred percent / seventy five percent securities to the public, an underwriting agreement is essential between syndicate members & book runner and the issuer company.
- ✓ A 'Red Herring Prospectus' which is also known as 'Draft Prospectus' should be filed with the SEBI by Lead Merchant Banker.
- ✓ After that the issuer company shall enter into an agreement with one or more Stock Exchange/s having the system of On- Line Offer of Securities. The company may also apply for listing of its securities other than such stock exchange/s.
- ✓ On the next stage, the copy of 'Draft Prospectus' will be circulated to the institutional buyers by the book runner. The copy of the 'Draft Prospectus' will also be circulated by the book runner to the eligible intermediaries who can perform the duties of an underwriter. After that the issuer company will supply the 'Standard Bidding Forms' to the brokers having serial number, date & time of issuance etc.,
- ✓ On the next stage, the time for bidding should be announced by the company which shall be of at least 3 working days and not more than 7 days. If the price band is revised, the maximum time may be extended up to 10 working days.

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- ✓ If the price band / floor price is not declared in the 'Draft Prospectus', the company is liable to announce the price band / floor price of securities at this stage. After that an "Electronic Order Book" having all the information about the demand for the securities at various prices will be prepared by the BRLM. If this book shows full or over subscription of the offer, the BRLM may declare closer of the offer after 3rd working day of the opening of the offer. In case of under subscription, he may extend the bidding period according to the norms specified by the SEBI.
- ✓ A "Record Book" should be maintained by the syndicate members which indicates the orders received from institutional investors.
- ✓ On the next stage, the issue price based on the bids received is determined by the issuer company and the BRLM. After price determination, the number of securities to be issued shall be decided. At this stage, an intimation regarding the number of securities is also given to all successful bidders who become entitled for allotment of securities.
- ✓ After that the "Final Prospectus" having all the information regarding offer / issue of securities shall be filed with the Registrar of Companies.
- ✓ The allotment of securities shall be made on fair and proper proportionate basis. within a specified category viz.- QIBs, HNIs, RIs, etc.
- ✓ After the finalization of basis of allotment of securities, the Registrar to the Issue shall prepare an 'Allotment List' having the important information like names of eligible allottees, number of shares, amount due on allotment, amount to be refunded etc.

Guidelines Issued by the SEBI:

- The Compliance Officer appointed by the issuer company is under the duty to ensure fulfillment of all rules, guidelines, laws, regulations and provisions described by the SEBI.
- The Lead Book Runner is responsible for overall system of book building and he may appoint some intermediaries who are registered with the Board of Directors of the issuer company.
- The Book Runner/s and the issuer company shall determine the 'Issue Price' based on the bids received through the Syndicate Members. Once the final price which is also known as 'Cut-off Price' is determined all those bidders whose bids have been found to be successful shall become entitled for allotment of securities. The information regarding the entitlement shall be intimated immediately to the investors.
- On determination of the price, the number of securities to be offered shall be calculated (issue size divided by pre-determined issue price).
- If the issuer company is making an issue of securities of 100 percent of the Net Offer to the public, the offer shall be of Rs. 25 crores or above.
- Total size of the issue shall be mentioned in the draft prospectus.

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- The board of directors within 21 days of the receipt of the draft prospectus may suggest modification to it.
- The allotment of securities shall be made on proportionate basis within the specified categories subject to a minimum allotment of shares being equal to the minimum application size as fixed by the issuer company.
- In case of over subscription of the issue, the proportionate allotments of securities shall be subject to the reservation for retail individual investors.
- In case of ASBA (Applications Supported by Blocked Amount) investors, Syndicate Members may accept and upload the details of such applications in 'Electronic Book'.
- After collection of applications and cheques, all the cheques are sent for collection of funds to the 'ESCROW ACCOUNT'. It is also notable that no cheques are received by the ABSA investors; there subscription is transferred directly in the escrow account.
- The fund balance of Escrow account cannot be used for any purpose until the completion of allotment process.
- After finalization and approval of the allotment, the Lead Merchant Banker issues an advertisement on behalf of Issuer Company giving all information of the process.
- The advertisement shall be published in at least one English National daily newspaper with wide circulation and one Hindi National daily newspaper and a regional language daily newspaper with wide circulation at the place where the registered office of the issuer company is situated.
- There shall be a Standard Bidding Form to ensure uniformity in bidding system and it is also important that such bidding form before being issued to the bidder shall be serially numbered at the bidding centers and date and time stamped.
- The bidding form shall be issued in duplicate signed by the investor and countersigned by the syndicate member, with one form for the investor and the other for the syndicate member/ book runner.
- Individual as well as institutional investors shall place their bids only through the Syndicate Members who shall have the right to vet the bids. These investors shall have the right to revise their bids.
- At the end of each day of the bidding period the demand shall be shown graphically on the terminals for information of the syndicate members as well as the investors.
- The price band can be revised and if it is revised, the bidding period shall be extended for a further period of 3 days, subject to the total bidding period not exceeding 13 days.

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- At least 15% of the issue size shall be reserved for allocation to individual investors applying up to 10 tradable lots through the syndicate members.
- At least 10% of the issue size offered to the public through the prospectus shall be reserved for allocation to individual investors who had not participated in the bidding process or have not received intimation for entitlement of securities.
- The offer shall remain open for subscription from the public for a period of at least 3 working days after completing all the requirements of advertisement and dispatch of issue material to all the stock exchanges.
- A 'Final Book' of demand showing the result of the allocation process shall be maintained by the book runner/s.
- 'Records of the Book Building Prices' shall be maintained by the Book Runner/s and other associated intermediaries.

Merits and Demerits of Book Building Technique

MERITS	DEMERITS
<ul style="list-style-type: none"> • Price of securities is determined in a more realistic way based on optimal demand. • Flexibility to increase or decrease the size of issue is possible. • Immediate allotment and listing of placement portion of securities. • There are no uncertainties relating to the fate of the issue involved. • The issuer company saves the paper work, lead time, brokerage commission etc. • The issuer company can select the potential and qualitative investors. • Investors need not lockup huge- amounts of capital with the issuer company, because the payment is made at the end of process. • This system helps in evaluating the intrinsic worth of the security being offered and the company's credibility. 	<ul style="list-style-type: none"> • It is suitable for mega issues only. • as Sometimes, there is a possibility of price rigging on listing promoters may try to bailout syndicate members. • Matured market conditions are essential for the success of whole process of book building. • Fundamentally and vitally soundness of the issuer company is also essential. • Insufficient knowledge of investors regarding indigenous and global market trend is also an important hurdle. • In case of smaller companies, the cost of complying with regulatory requirements may be very high.

CONCLUSION:

Book Building is a process used to discover the optimal price during an IPO. The final price is set

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based on demand. The issue price is finalized based on overall demand. Although this method offers several advantages but users of this method also face so many problems. To manage the problems, process should be transparent, digitalized and efficient. Additionally, investor participation should be improved, bidding period should be extended for high-demand issues, record-keeping system should be developed based on efficient technologies etc.

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