BOOK-BUILDING IN INDIA : AN EVALUATION

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Book-building, a method of pricing the issues of securities, was introduced in India in 1995 as an alternative to free pricing. An attempt is made in the present paper to evaluate this concept in the context of the hapennings in the Indian Capital Market in recent years.

INTRODUCTION

The success of an issue of securities depends, to a large extent, on the price at which it is made. Whether the issue is at par or premium or discount, one can expect it's over or even full subscription only when the issue price is taken to be fair and reasonable by the prospective investors. An issue at discount may be fully subscribed, but it provides company costly funds. A premium issue promises cheap funds but reduces chances for full subscription. Thus, issue pricing is an important question and calls for considerable expertise on the part of issuers and promoters of any company. The problem could be still more serious if the organisation is a new company. The following approaches for pricing new issues have been in use the world over:-

- **Historical price based pricing**- The securities are issued at a price at which any security of the same company has been previously or currently traded. As per this method the issue price is fixed near to the market value of the share.
- **Net AssetValue [NAV] based pricing**- The issue price is fixed on basis of NAV of company. The NAV is calculated on the basis of assets and liabilities figures appearing in the balance sheet of the company.
- **Reference pricing** - The price is determined in comparison with other similar companies. The shares are issued at a price at which the share of some other same company is valued.
- **Tender pricing** - This method is also known as book-building and has been widely used in developed stock markets for issue of securities more importantly Global Depository Receipts.

The concept of book-building is explained in detail below.

BOOK-BUILDING

Book-Building is a method in which the investors are invited to offer bids for the securities in issue. On the basis of these bids the issue price is fixed. Thus, this method is also known as bid-determined pricing. Book-Building is a professional fee based service rendered by merchant bankers. It is a method of private placement or wholesale of securities. The securities are first placed with big financial institutions and then these financial institutions go for retail

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sale of securities to the public.

PROCESS OF BOOK-BUILDING

A Company willing to use book-building method for pricing it's issue, generally proceeds as follows-

- The company appoints merchant banker(s) to act as book-runner(s) or book running lead manager.
- The book-runner(s) invites institutional and big investors like commercial banks, mutual funds, insurance companies etc. to offer bids for the company's shares in issue. The bids are to be offered within a specified price range or banked.
- The book-runner(s) records the bids received in a separate book. This particular step is known as book-building. The book-runner(s) builds up the book by recording the bids.
- On the basis of these bids the best price is selected.
- In case the price determined is too low, the company can postpone or cancel the issue.

The determination of price is based on functioning of market forces of demand and supply. The demand for shares is obtained from the bids received. The supply is the number of shares in issue. The investors can offer single or multiple bids. They can offer to buy different number of shares at different prices. The total number of shares demanded at every price is calculated. The highest price at which the issue is fully subscribed is selected.

To illustrate, if the total number of shares in issue is 50,000, bids are received from three investors A, B and C. Their demand schedule is as follows:-

	No. of Shares Demanded			
Price (Rs.)	*A*	*B*	*C*	*Total*
100	15000	17000	8000	40000
90	18000	19000	13000	50000
80	20000	20000	15000	55000
70	24000	21000	15000	60000

The demand is equal to supply at Rs.90. Issue price, therefore, would be Rs.90 and A, B and C will get 18000, 19000 and 13000 shares respectively.

REGULATION OF BOOK-BUILDING

Book-Building was allowed by the Securities and Exchange Board of India (SEBI) with issue of detailed guidelines on 12.10.95. The major guidelines for regulation of book-building, in brief, are-

- 100% book-building is allowed for issues of minimum size of Rs.100 crores.
- A maximum of 75% of the issue is meant for private placement (firm allotment) and minimum of 25% is reserved for offer to public.
- To company has to offer 10% of issue to public through prospectus so as to enable small investors who could not participate in bidding. 15% of the issue is reserved for investors applying upto 10 tradeable lots.
- Bidding is allowed only for private placement portion. The price determined through book-building shall be applicable to offer to public portion also.

- Underwriting is compulsory for offer to public portion.
- The issue is to be made through electronically linked transparent systems like National Stock Exchange (NSE) and Over the Counter Exchange of India (OTCEI) etc.

EVALUATION OF BOOK-BUILDING

Book-Building has become an important method of pricing the issues because of the benefits offered by it:

- The biggest advantage of book-building is that it enables the investors to play an active role in issue pricing by offering bids. It helps to almost eliminate the scope for price rigging and manipulations by the issuers.
- It is an economical method of raising funds being a private placement method.
- The market demand for shares is assessed well before the issue is launched and as such chances for under subscription/failure of the issue can be avoided.
- Also, the price fixed by market forces of demand and supply is relatively stable.

Thus, this method appears to be very sound, theoretically, but it has certain illusionary aspects, like:

- It claims to be economical, but, in fact, it is costly from general investors' point of view, as they purchase shares from financial institutions who sell them at a profit.
- The company prescribes a price band within which the bids are to be offered. If the price fixed through book-building does not come according to company's expectations, the issue can be postponed or even cancelled. Thus, the company issuing shares indirectly dictates the issue pricing process, giving least freedom to investors to fix the price.
- The congruence of offeror and offeree at same price is often difficult as offeror is willing to get maximum possible whereas offeree tries to give the minimum possible price

THE INDIAN CONTEXT

Earlier the Controller of Capital Issues (CCI) was the sole authority to clear the pricing of new issues. In 1992, the office of CCI was abolished considering it to be inefficient to regulate the stock market and the SEBI was formed. SEBI gave relatively more freedom to companies in pricing their issues. Even this free or deregulated pricing process was not successful to help New Issue Market grow and prosper as it gave maximum scope for price manipulations and rigging operations by issuers.

In 1995, book-building was allowed as an alternative method of pricing the issue to enable the investors to participate directly in pricing process. For the first time in April 1996, the Industrial Credit and Investment Corporation of India (ICICI) took the initiative to use this method to issue Rs.1000 crore bonds. After ICICI, several bond issues have been made. Table-1 gives a brief account of major issues made through book-building.

Besides the aforesaid, some of the companies, such as, Indian Petroleum Corporation Ltd., HUDCO, HAL and Hindalco Industries Ltd., have also used book-

Table-1

Timing of issue	*Name of Company*	*Amount of Issue (Crores)*	*Nature of Securitites*
April, 1996	ICICI	Rs.1000	Bonds
Nov., 1997	Power Finance Corporation	Rs.100	Bonds
Nov., 1997	ICICI	Rs.200	Prefernce Shares
Nov., 1997	Nuclear Power Finance Corporation	Rs.150	Bonds
Dec., 1997	Maharashtra State Electricity Board	Rs.150	Bonds
March, 1998	Indian Oil Corporation	Rs.300	Debt.
May, 1998	Nirmal Ltd.	Rs.100	Debt.
Nov. 1999	HCL Technologies Ltd.	Rs.700	Equity

Source: CMIE-Monthly Economic Review

building concept to fix the coupon rate on their bonds issues.

From the above table, book-building, appears to be gaining popularity for debt issues to fix coupon rates. For equity issues, Nirma Ltd. made the first attempt to use this method in 1997, but, this issue could not materialise for sluggish stock market conditions. In Nov.1999, HCL Technology Ltd., for the first time, floated Rs.700 crores equity issue through book-building. In more than four years of it's existence, just one equity issue has been successfully made through book-building upto the end of 31st December, 1999. Cadila Healthcare Limited has also invited bids for 1,33,97,400 equity shares of Rs.5 each through book-building. Bid closed on 16th February, 2000. Indicative price band was Rs.300 to Rs.350 per share. The issue was oversubcribed by more than seven times at Rs.250 per shares. The company decided to price it at Rs.250 per share of Rs.5 each. This indicates slow growth of the concept in India. There have been number of reasons for this:

- The most important reason has been the underdeveloped state of the Indian Capital Market. The infrastructure, information and communication systems are not much developed to handle the bidding process adequately. The NSE, OTCEI and On Line Trading systems are still far below the international standards in terms of their efficiency.
- The Indian Capital Market, which is driven more by sentiments of investors than the financial prospects of the companies, is not matured enough to absorb the international concept effectively.
- The method has been lacking proper understanding among market players. Most of the concerned people are unaware of it's benefits.
- Some of the regulatory guidelines issued by SEBI are also responsible for slow progress of book-building in India like the requirement of Rs.100 crore as minimum issue size for use of the method restricts small companies to avail benefits of book-building.

CONCLUSION

In about five years of it's existence, Book-Building has made a good position for the debt market. The method would be used widely for pricing the equity issues if the stock market recovers significantly from it's underdeveloped state. With globalisation of the Indian Capital Market and coming up of international securities like Global Depository Receipts, book-building is likely to become a success for the Indian economy.

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