

Capital Market: Structure and Emerging Trends

Part-6

Topic: Book Building and Buy-back of Shares

1.1 Meaning of Book Building

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 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".

Book Building is basically a process used in Initial Public Offer (IPO) for efficient price discovery. It is a mechanism where, during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date.

Hence, Book Building may be defined as a process used by companies raising capital through Initial Public Offers (IPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

As per SEBI guidelines, an issuer company can issue securities to the public through prospectus in the following manner:

- 100% of the net offer to the public through book building process
- 75% of the net offer to the public through book building process and 25% at the price determined through book building. The Fixed Price portion is conducted like a normal public issue after the Book Built portion, during which the issue price is determined.

The concept of Book Building is relatively new in India. However it is a common practice in most developed countries.

1.2 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 is not decided 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.

1.3 Book Building Process

The detailed process of book building is as follows:

1. **Appointment of Investment Banker:** The first step starts with appointing the lead investment banker. The lead investment banker conducts due diligence. They propose the size of the capital issue that must be conducted by the company. Then they also propose a price band for the shares to be sold. If the management agrees with the propositions of the investment banker, the prospectus is issued with the price range as suggested by the investment banker. The lower end of the price range is known as the floor price whereas the higher end is known as the ceiling price. The final price at which securities are indeed offered for sale after the entire book building process is called the cut-off price.
2. **Collecting Bids:** Investors in the market are requested to bid to buy the shares. They are requested to bid the number of shares that they are willing to buy at varying price levels. These bids along with the application money are supposed to be submitted to the investment bankers. It must be noted that it is not a single investment banker who is engaged in the collection of bids. Rather, the lead investment banker can appoint sub-agents to tap into their network especially for receiving the bids from a larger group of individuals.
3. **Price Discovery:** Once all the bids have been aggregated by the lead investment banker, they begin the process of price discovery. The final price chosen is simply the weighted average of all the bids that have been received by the investment banker. This price is declared as the cut-off price. For any issue which has received substantial publicity and which is being anticipated by the public, the ceiling price is usually the cut-off price.
4. **Publicizing:** In the interest of transparency, stock exchanges all over the world require that companies make public the details of the bids that were received by them. It is the lead investment banker's duty to run advertisements containing the details of the bids received for the purchase of shares for a given period of time (let's say a week). The regulators in many markets are also entitled to physically verify the bid applications if they wish to.

5. **Settlement:** Lastly, the application amount received from the various bidders has to be adjusted and shares have to be allotted. For instance, if a bidder has bid a lower price than the cut-off price then a call letter has to be sent asking for the balance money to be paid. On the other hand, if a bidder has bid a higher price than the cut-off, a refund cheque needs to be processed for them. The settlement process ensures that only the cut-off amount is collected from the investors in lieu of the shares sold to them.

1.4 SEBI GUIDELINES FOR BOOK BUILDING

An issuer company proposing to issue capital through book building shall comply with the following guidelines:

A) 75% Book Building Process

- i. The option of book-building shall be available to all body corporate which are otherwise eligible to make an issue of capital to the public.
- ii. The issue of securities through book-building process shall be separately identified / indicated as 'placement portion category', in the prospectus.
- iii. (a) The securities available to the public shall be separately identified as 'net offer to the public'.

(b) The requirement of minimum 25% of the securities to be offered to the public shall also be applicable.
- iv. In case the book-building option is availed of, underwriting shall be mandatory to the extent of the net offer to the public.
- v. One of the lead merchant banker to the issue shall be nominated by the issuer company as a Book Runner and his name shall be mentioned in the prospectus.
- vi. The copy of the draft prospectus filed with the Board may be circulated by the Book Runner to the institutional buyers who are eligible for firm allotment and to the intermediaries eligible to act as underwriters inviting offers for subscribing to the securities.
- vii. The draft prospectus to be circulated shall indicate the price band within which the securities are being offered for subscription.
- viii. On receipt of the information, the Book Runner and the issuer company shall determine the price at which the securities shall be offered to the public.
- ix. On determination of the issue price within two day, thereafter the prospectus shall be filed with the Registrar of Company.

- x. The issuer company shall open two different accounts for collection of application moneys, one for the private placement portion and the other for the public subscription.
- xi. To ensure that the securities allotted under private placement portion and public portion are pari passu in all respects, the issuer company may have one date of allotment which shall be the deemed date of allotment for the issue of securities through book building process.
- xii. The Book Runner and other intermediaries associated with the book building process shall maintain records of the book building process.

B) 100% BOOK BUILDING PROCESS

In an issue of securities to the public through a prospectus option for 100% Book Building shall be available to any issuer company subject to the following:

1. The minimum capital to be raised must be Rs 25 crores.
2. Reservation or firm allotment to promoters can be made only according to the guidelines of the SEBI i.e. to permanent employees of the issuer company, and in the case of new companies, to the permanent employees of the promoting company.
3. Allotment can also be made either on a competitive basis or on firm allotment basis to the shareholders of the promoting companies in the case of a new company, or to the shareholders of group companies in the case of existing companies.
4. Eligible merchant bankers shall be appointed as the lead book runners and their names shall be mentioned in the draft prospectus to be filed with the SEBI.
5. The Lead Merchant Banker shall act as the Lead Book Runner and the other eligible Merchant Banker(s), so appointed by the Issuer, shall be termed as Co-Book Runner(s).
6. The primary responsibility of building the book shall be that of the Lead Book Runner.
7. The Book Runner(s) may appoint those intermediaries who are registered with the Board and who are permitted to carry on activity as an Underwriter as syndicate members.
8. The draft prospectus containing all the disclosures such as price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with the Board.
9. The issuer company shall after receiving the final observations if any on the offer document from the Board make an advertisement in an English National daily with wide circulation, one Hindi National newspaper and a

Regional language newspaper with wide circulation at the place where the registered office of the Issuer Company is situated.

10. The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the syndicate members.
11. Once the final price (cut-off price) is determined all those bidders whose bids have been found to be successful (i.e. at and above the final price or cut-off price) shall become entitled for allotment of securities.
12. The final prospectus containing all disclosures as per these Guidelines including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.

2.1 Buy Back of Shares: Meaning

Buy-Back is a corporate action in which a company buys back its shares from the existing shareholders usually at a price higher than market price. When it buys back, the number of shares outstanding in the market reduces.

A buyback allows companies to invest in themselves. By reducing the number of shares outstanding on the market, buybacks increase the proportion of shares a company owns. The reduction in share capital due to buy back also strengthens the promoter's control and enhances the equity value for shareholders. Buybacks can be carried out in two ways:

- Shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain time frame and at a premium to the current market price. This premium compensates investors for tendering their shares rather than holding on to them.
- Companies buy back shares on the open market over an extended period of time.

2.2 Reasons/Advantages for Buy-Back:

- To improve earnings per share;
- To improve return on capital, return on net worth and to enhance the long-term shareholder value;
- To provide an additional exit route to shareholders when shares are undervalued or are thinly traded;
- To enhance consolidation of stake in the company;
- To prevent unwelcome takeover bids;
- To return surplus cash to shareholders;
- To achieve optimum capital structure;
- To support share price during periods of sluggish market conditions;
- To service the equity more efficiently.

- It is an alternative mode of reduction in capital without requiring approval of the Court/CLB (NCLT).

2.3 Provision of Buyback under Companies Act 2013

Section 68 of Companies Act deals with Buyback of Shares by company. This section corresponds to section 77A (Power of company to purchase its own securities) of the 1956 Act with no changes except that the definition of free reserve has been modified and the penalty provisions has been enhanced. Unlike the provisions of section 67 which prohibits a company to buy-back its own shares unless reduction of capital is effected, this section dilutes this general prohibition and allows a company whether public or private, to purchase its own shares or other specified securities out of following sources according to section 68(1) of Companies Act 2013:

- a) Its free reserves; or
- b) The securities premium account; or
- c) The proceeds of any shares or other specified securities.

However, buy-back of any kind of shares or securities shall not be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Section 68(2) conditions for Buy-back:

No company shall purchase its own shares or other specified securities unless the following conditions are fulfilled [sub-section (2)].

- a) Its Articles permit the buy-back ;
- b) A special resolution has been passed at a general meeting of the company authorizing the buy-back where the buy-back is 25% or less of the aggregate of paid-up capital and free reserves of the company. Board resolution would authorize the buyback where the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company, a Board resolution would authorize such buy-back ;
- c) the buyback is 25% or less of the aggregate of paid-up capital and free reserves of the company ; Provided that in respect of the buy-back of equity shares in any financial year, the reference to 25% in this clause shall be construed with respect to its total paid-up equity capital in that financial year ;
- d) Debt-Equity ratio 2:1 :the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves.
- e) Fully paid up shares: all the shares or other specified securities for buy-back are fully paid-up;
- f) The buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by SEBI.

g) The buyback in respect of shares or other specified securities not listed on any recognized stock exchange is in accordance Companies (Share Capital and Debentures) Rules, 2014.

2.4 SEBI Guidelines for Buyback of Shares

- A company may buy-back its shares by any one of the following methods:
 - a. from the existing share holders on a proportionate basis through the tender offer;
 - b. from the open market through—
 - i. Book building method
 - ii. Stock exchange;
 - c. from odd-lot holders
- Every buy-back shall be completed within a period of one year from the date of passing of the special resolution at general meeting, or the resolution passed by the board of directors of the company, as the case may be.
- Where the buy-back is from open market either through the stock exchange or through book building, the resolution of board of directors/ shareholders resolution shall specify the maximum price at which the buy-back shall be made.
- The price for buy back of shares can also be at discount to Market Price/ Book value of shares.
- Companies are not permitted to buy-back their own shares through negotiated deals, spot transactions or private arrangements.
- Promoters shall not be permitted to tender their shares if the company opts to buy back shares through the stock market route.
- The promoter would be required to declare up front the pre and post buy back holding in the company so as to leave no room for manipulation.
- An offer for buy back shall not remain for more than 30 days except in the case of purchases via stock exchanges.
- Shares bought back will have to be extinguished within seven days of the purchase in the presence of registrar or merchant banker or the statutory auditor.
- The verification of shares received in buy back has to be completed within 15 days of the closure of offer and payments made within 7 days.
- SEBI has placed the onus of a company complying with its regulations on the merchant bank. This is why association of a merchant banker in every offer has been made essential.