

[wallstreetmojo.com](https://www.wallstreetmojo.com)

Book Building

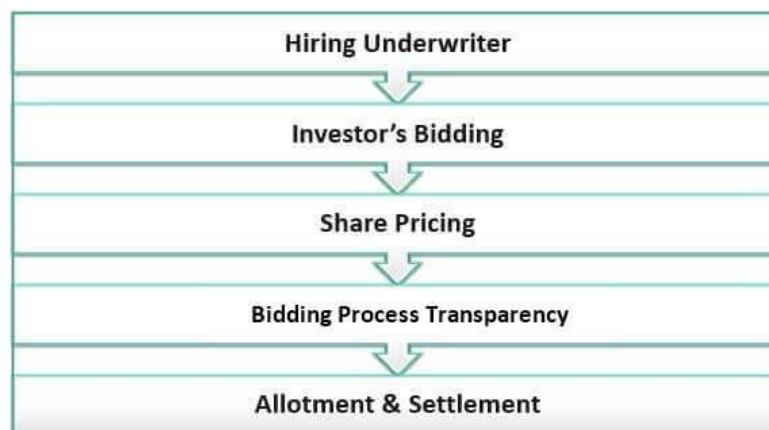
Article by Madhuri Thakur Reviewed by Dheeraj Vaidya, CFA, FRM

Book building is a process that helps companies discover the price of their security when its shares are being offered for sale in an IPO with the help of investment bankers. Major stock exchanges and regulators recommend it because it is the most efficient mechanism to price securities in the market.

How does the Book Building Process Work?

When a company has planned to list its shares on the stock exchanges for the first time via [IPO](#) An initial public offering (IPO) occurs when a private company makes its shares available to the general public for the first time. IPO is a means of raising capital for companies by allowing them to trade their shares on the stock exchange. [read more](#), the company management decides various things to get its share listed on the stock exchange, such as issue size, share price, etc. Firstly, company management must appoint an underwriter to help get through this listing process.

Book Building



Book Building Process



You are free to use this image on your website, templates etc, Please provide us with an attribution link Article Link to be Hyperlinked

For eg:

Source: [Book Building](https://www.wallstreetmojo.com) (wallstreetmojo.com)

Let us see in detail each step involved in the book-building process.

1. Hiring Underwriter

Firstly, the issuing company needs to hire an [Investment bank](#)[Investment banking is a specialized banking stream that facilitates the business entities, government and other organizations in generating capital through debts and equity, reorganization, mergers and acquisition, etc.read more](#) that acts as an [underwriter](#). With the help of issuing company management, the investment bank identifies the size of the issue and determines the price range of the securities. An investment bank drafts the company prospectus, including all the relevant details about the issuing company such as financials, issue size, price range, future growth perspectives, etc. The share price range consists of floor price (lower end of the price range) and ceiling price (upper end of the price range).

2. Investor's Bidding

Investment banks invite investors. Usually, these are high [net-worth](#) individuals and fund managers to submit their bids on the number of shares they are willing to buy at different prices. Sometimes, not a single investment bank underwrites the entire issue. Rather, the lead investment bank is engaged with other investment banks who use their networks to tap many investors for the bidding process.

3. Share Pricing

After the investment bank collects all the bids at different price levels, they evaluate the aggregate demand for the issue from the submitted bid. To price the share of the issue, the underwriter uses the weighted-average method to arrive at the final price of the share. This final price is also known as the 'cut-off price.' If investors have a good response for any issue, the ceiling price is usually a 'cut-off price.'

4. Bidding Process Transparency

Most of [the regulators and the stock exchanges](#)[Stock exchange refers to a market that facilitates the buying and selling of listed securities such as public company stocks, exchange-traded funds, debt instruments, options, etc., as per the standard regulations and guidelines—for instance, NYSE and NASDAQ.read more](#) in the world require companies to make public the details of the bidding process. An underwriter must publicize the details of the bids submitted by the investor to purchase the shares of the issue.

5. Allotment & Settlement

Lastly, the allotment process begins by allocating the shares of the issue to the accepted bidders. Now, as you know, initially, investors had bid for this issue at a different price range, but the settlement process ensures that all allotments happen at the cut-off price of this issue. An investor

who had bid in excess to cut off cost, their excess money is returned, and investors who had bid less than the cut-off price, investment bank ask them to pay the difference amount.

Other Subtypes of Book Building

The following are subtypes of book building: –

#1 – Accelerated Book Building

The companies can use an accelerated book-building process to obtain quick financing from the [capital market](#)A capital market is a place where buyers and sellers interact and trade financial securities such as debentures, stocks, debt instruments, bonds, and derivative instruments such as futures, options, swaps, and exchange-traded funds (ETFs). There are two kinds of markets: primary markets and secondary markets.read more. That can be the case when a company cannot finance its short-term project via debt financing. So, the issuing company contacts several investment banks that can act as underwriters on the evening before the intended placement. Under this process, the offer period is open only for a day or two days, and you have no time for marketing for an issue. So, instead, the underwriter overnight contacts their networks and details the current topic to [institutional investors](#)Institutional investors are entities that pool money from a variety of investors and individuals to create a large sum that is then handed to investment managers who invest it in a variety of assets, shares, and securities. Banks, NBFCs, mutual funds, pension funds, and hedge funds are all examples.read more. If this investor finds this issue interesting, then allotment happens overnight.

#2 – Partial Book Building

As the partial book building says, that issue book is built partially, where the investment banker only invites bids from the selected investors. Based on their bids, they take the weighted average of the prices to finalize the cut-off price. Then other investors, such as [retail investors](#)A retail investor is a non-professional individual investor who tends to invest a small sum in the equities, bonds, mutual funds, exchange-traded funds, and other baskets of securities. They often take the services of online or traditional brokerage firms or advisors for investment decision-making.read more, take this cut-off price as a fixed price. So, the bidding happens with a selected group of investors under the partial book-building process.

Advantages of Book Building

The following are the advantages of the book-building process over a fixed price mechanism: –

- The most efficient way to price the share in the IPO market.
- The share price is finalized by investors' [aggregate demand](#)Aggregate Demand is the overall demand for all the goods and the services in a country and is expressed as the total amount of money which is exchanged for such goods and services. It is a relationship between all the things which are bought within the country with their prices.read more, not by the fixed price set by the company management.

Disadvantages of Book Building

The following are the disadvantages of the book-building process over the fixed-price mechanism: –

- High cost involved in the book-building process compared to the fixed-price mechanism.
- The period is also more in the book booking process than the fixed-price mechanism.

Important Point to Remember

- Book building is a process of discovering the security price offered for sale in an IPO market.
- The security price range consists of ceiling price (upper end of the price) and floor price (lower end).
- The final price at which shares are allocated to investors is known as the 'cut-off price.'

Conclusion

Book building is one of the most efficient mechanisms by which companies, with the help of investment bankers, price their share in IPOs. It is also recommended by all the major stock exchanges and regulators. It also helps investors value the shares by submitting the bids to the underwriter, which is impossible if the company chooses a fixed-price mechanism to price its share.

Recommended Articles

This article has been a guide to book building and its meaning. Here, we discuss how the book-building process works for the company and its advantages and disadvantages. You can learn more from the following articles: –

- [Merchant Bank](#)
- [Box IPO Valuation](#)
- [Share Market](#)
- [Red Herring Prospectus](#)
- 117 Courses
- 25+ Projects
- 600+ Hours
- Full Lifetime Access
- Certificate of Completion

[LEARN MORE >>](#)