Loan Syndication

Loan Syndication is the process where a bunch of banks and lenders fund various fragments of a loan of an individual borrower. Loan Syndication happens when a borrower requires a loan amount which is too big for a single bank to provide. Thus, a bunch of banks come together to form a syndicate and provide the necessary loan amount to the borrower.

Loan syndication is often used in corporate financing. Firms seek corporate loans for a variety of business reasons that include funding for mergers, acquisitions, buyouts, and other capital expenditure projects. These types of capital projects often require large amounts of capital that typically exceed a single lender's resource or underwriting capacity.

Loan syndication allows any one lender to provide a large loan while maintaining a more prudent and manageable credit exposure because the associated risks are shared with other lenders. Each lender's liability is limited to their respective share of the loan interest. Generally speaking, with the exception of collateral requirements, most terms are uniform among lenders. Collateral assignments are generally assigned to different assets of the borrower for each lender. Usually, there is only one loan agreement for the entire syndicate.

The Advantages of Loan Syndication

- Best prices are available for business
- You have the option of reducing your term loans
- The syndicate banks will also share feedback on issues related to your business
- Loan syndication allows the lenders to have a greater visibility of the borrowers in the open market
- Borrowers have the option of choosing among multi currency options, prepayment rights, and risk management techniques.

Book Building

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.

Book building is a price discovery mechanism that is used in the stock markets while pricing securities for the first time. When shares are being offered for sale in an IPO, it can either be done at a fixed price. However, if the company is not sure about the exact price at which to market its shares, it can decide a price range instead of an exact figure. This process of discovering the price by providing the investors with a price range and then asking them to bid on it is called the book building process. It is considered to be one of the most efficient mechanisms of pricing securities in the primary market. This is the preferred method which is recommended by all major stock exchanges and as a result is followed in all major developed countries in the world.

Book building is the process by which an underwriter attempts to determine the price at which an initial public offering (IPO) will be offered. An underwriter, normally an investment bank, builds a book by inviting institutional investors (fund managers) to submit bids for the number of shares and the price(s) they would be willing to pay for them.

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.

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 in 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.

How is the Price Fixed?

All the applications received till the last dates are analyzed and a final offer price, known as the cut off price is arrived at. The final price is the equilibrium price or the highest price at which all the shares on offer can be sold smoothly. If the price quoted by an investor is less than the final price, he will not get allotment.

If price quoted by an investor is higher than the final price, the amount in excess of the final price is refunded if he gets allotment. If the allotment is not made, full money is refunded within 15 days after the final allotment is made. If the investor does not get money or allotment in a month's time, he can demand interest at 15 per cent per annum on the money due.

Methods of book building

There are two methods of book building. They are the:

1. Open book system and

2. Closed book system

Open book system: In this system, the issuers and merchant bankers are required to ensure online display of the demand and bids during the bidding period. The investors can know the movement of the bids during the period in which the bid is kept open.

Closed book system: In this case, the book is not made public. The investors will have to make bids without having any information of the bids submitted by other bidders.