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**Praptono Soeharto  
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Factors Affecting Underpricing in The Company that does IPO in BEI 2004 – 2014

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## **FACTORS AFFECTING UNDERPRICING IN THE COMPANY THAT DOES IPO IN BEI PERIOD 2004-2014**

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### *Abstract*

This study aimed to analyze the factors that influence underpricing on IPO. Variables used in this research is Underwriter Reputation (RU), Auditor Reputation (RA), Company Age (AGE), firm size (SIZE), Financial Leverage (FL), Return on Equity (ROE) and Total Asset Turnover (TATO) , This study uses a quantitative approach with a model of multiple linear regression analysis. This study used a sample of companies that conduct an Initial Public Offering (IPO) in the period 2004 to 2014 that are listed in the Indonesia Stock Exchange. The number of observations used in this study were 204 observations. The results showed that the companies doing IPOs in the period 2004-2014, the variable underwriter reputation, auditor reputation, and return on equity significantly negative effect on underpricing, while variable firm age, firm size, financial leverage, and total asset turnover negative not significantly to underpricing

Keywords: Initial Public Offering (IPO), Underpricing, Indonesia Stock Exchange (IDX).

### *Abstrak*

Penelitian ini bertujuan untuk menganalisis faktor-faktor yang mempengaruhi underpricing pada perusahaan yang melakukan IPO. Variabel yang digunakan dalam penelitian ini adalah Reputasi Underwriter (RU), Reputasi Auditor (RA), Umur Perusahaan (AGE), Ukuran Perusahaan (SIZE), Financial Leverage (FL), Return on Equity (ROE) dan Total Asset Turnover (TATO). Penelitian ini menggunakan pendekatan kuantitatif dengan model analisis regresi linear berganda. Penelitian ini menggunakan sampel perusahaan yang melakukan Initial Public Offering (IPO) pada periode 2004-2014 yang terdaftar di Bursa Efek Indonesia. Jumlah observasi yang digunakan dalam penelitian ini adalah 204 observasi. Hasil penelitian menunjukkan bahwa pada perusahaan yang melakukan IPO pada periode 2004-2014, variabel reputasi underwriter, reputasi auditor, dan return on equity berpengaruh negatif signifikan terhadap underpricing, sedangkan variabel umur perusahaan, ukuran perusahaan, financial leverage, dan total asset turnover berpengaruh negatif tidak signifikan terhadap underpricing.

Kata kunci: Initial Public Offering (IPO), Underpricing, Bursa Efek Indonesia (BEI)

JEL Classification: M48

### **1. Research Background**

How to meet additional capital needs to expand its business, a company can obtain additional capital capital through internal and external sources of funds. Internal sources of corporate funding can come from retained earnings while external sources of funds come from bank loans, bonds, and financing in the form of equities or shares (Purbarangga and Yuyeta, 2013).

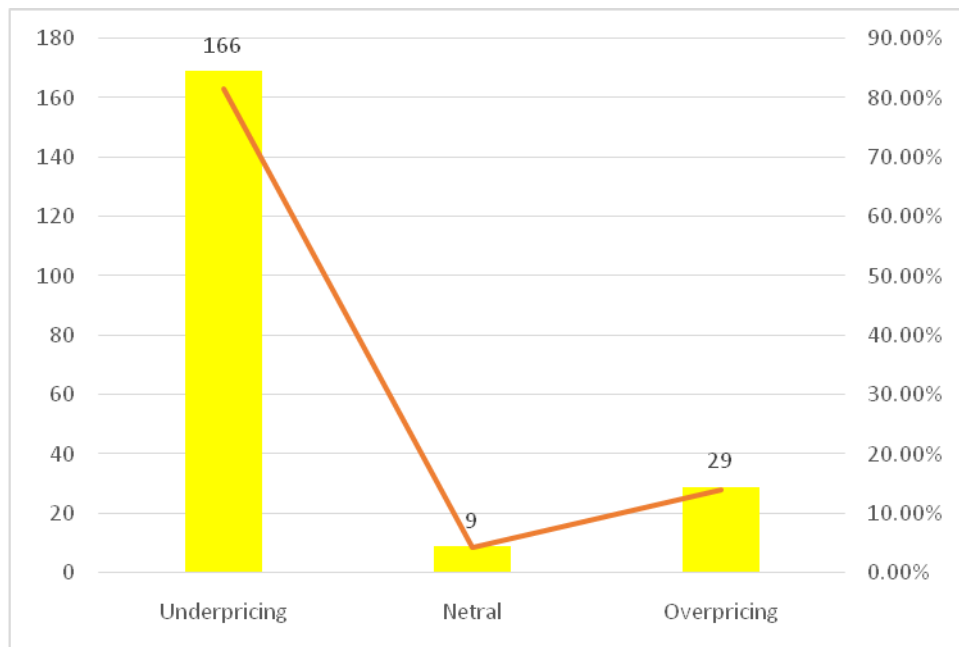
The process of offering part of the company's shares to the public for the first time through the stock exchange is called the Initial Public Offering (IPO) or IPO offer. (Husnan, 2001 in Kurniawan, 2010). The price of shares to be sold by the company at the IPO is determined by an agreement between the issuer and the underwriter, while after the IPO, in the



secondary market the stock price will be determined by the market mechanism of demand and supply (Kristianti, 2013).

If the stock price in the primary market (IPO) is lower than the stock price in the secondary market on the first day, then this indicates an underpricing IPO (Hanafi, 2004 in Kristiantari, 2013). According to Beatty (1989), underpricing conditions will harm the companies that do the IPO, because the funds obtained from the public is not maximum.

The main reason for the price gap is the presence of information asymmetry between IPO publishers and outside investors so that underwriters and auditors become crucial (Li *et al.*, 2005 in Kristiantari, 2012). The underpricing phenomenon can occur because there is asymmetric information between issuer companies and underwriters (Baron models), or between informed and uninformed investors (Rock models). With the existence of underpricing allows investors to get abnormal return in the primary market. In the absence of information asymmetry between the issuer and the investor, the bid price in the primary market will be equal to the price in the secondary market, so there will be no underpricing or overpricing (Cook and Officer, 1996 in Kristiantari 2013).



**Figure 1. Graph of Initial Return of Company Go Public Year 2004 - 2014**

Figure 1 shows the number of companies experiencing underpricing. The total number of companies experiencing underpricing amounted to 166 or 81.37% of all companies with an IPO. This percentage indicates that almost all companies whose IPO experience underpricing conditions.

**1.1 Literature Review**

**1.1.1 Underpricing**

Underpricing is the closing price difference on the first day of the secondary market with the offering price of the primary market, then divided by the offering price (Ratnasari and Hudiwinarsih, 2013). According Jogiyanto (2008, 32), interesting phenomenon that occurs in the IPO process to the public is a phenomenon of low prices (underpricing). Shares are said to be underpricing when the closing price on the first day of the secondary market is higher than the initial market price. The difference between the price of the first day on the secondary market and the price in the primary market is known as the initial return (IR).

### **1.1.2 Reputation Underwriter**

High reputation underwriters have more confidence in the success of stock quotes absorbed by the market because reputable underwriters have better market situation information. Thus, there is a tendency of a highly reputable underwriter to dare to give a high price as a consequence of the quality of the guarantee, so the level of underpricing was low. Underwriter reputation is believed to be an important consideration for investors to buy shares of a company. The higher the reputation of the underwriter, the lower the initial return or underwriter reputation has a negative effect on underpricing (Kristiantari, 2013).

### **1.1.3 Reputation Auditor**

According to Kwan and Razafindrambinina (2013) the auditor's reputation is believed to have an effect on underpricing on the IPO. By using a reputable or professional auditor, the issuer will minimize the opportunity to manipulate information that may mislead investors about the prospects of the company in the future. Thus, this indicates a highly reputable auditor, the company will reduce uncertainty in the future, thus reducing underpricing IPO.

### **1.1.4 Age of Company**

Longer operating companies are more likely to provide more and broader enterprise information than newly established companies. Thus, the age of the firm will reduce the existence of information asymmetry and minimize uncertainty in the market and will ultimately reduce underpricing (Kristiantari, 2013).

### **1.1.5 Size of Company**

Large companies are generally better known to the public than small companies. Since it is better known then the information about big companies is more and more easily obtained by investors than small companies. This will reduce the information asymmetry of large companies that will reduce the underpricing of small firms because the small enterprise information dissemination has not been so much (Kristiantari, 2013). This is consistent with research conducted by Kristiantari (2013) that there is a negative relationship between firm size and underpricing.

### **1.1.6 Financial Leverage**

High financial leverage shows that the company's debt is also large. Companies are more likely to use debt than their own capital for the fulfillment of any company performance has a greater risk. Thus, the higher the financial leverage will make the underpricing become higher as well (Wahyusari, 2013). According to Kurniawan (2012) Nilaidebt ratioyangtinggi will increase the uncertainty of investments to decrease the level of sharethe sharehighdownthe possibility ofthe decline oftheimportant investment managers will be coming. This can be because the company will try to repay the debt first before sharing the profit to the investor. Therefore, high financial leverage is not favored by investors.

### **1.1.7 Return on Equity (ROE)**

According to Kurniawan (2007), the higher ROE value will show that the company is able to generate profit in the future and profit is important information for investors as consideration in investing capital. With high profitability, uncertainty for investors will decrease so that it will reduce underpricing (Kim, et.al., 1995 in Kurniawan, 2007).

### **1.1.8 Total Asset Turnover (TATO)**

Total Asset Turnover indicates efficiency with how the company uses its assets to generate sales (Gitman and Zutter, 2010, 75). Generally, the higher the total asset turnover of a company, the more efficiently the company uses its assets. If the value of TATO is smaller indicates that the assets owned are too large compared to the ability to sell.

High TATO will be assessed by investors to have higher value so that investors dare to buy at higher prices in the primary market. The higher TATO value indicates that uncertainty for

investors is lower so that it will decrease underpricing (Manao and Deswin, 2001 in Sulistyawati, 2006). TATO therefore has a negative effect on underpricing.

### **1.2 Research Hypothesis**

Based on the formulation of problems and propositions that have been described above, it can be formulated hypothesis below:

H1: Suspected there is a negative influence between the underwriter's reputation on underpricing.

H2: Suspected there is a negative influence between the auditor's reputation on underpricing.

H3: Suspected there is a negative influence between the age of firms on underpricing.

H4: Suspected there is a negative influence between firm size on underpricing.

H5: Suspected there is a positive influence between financial leverage to underpricing.

H6: Suspected there is a negative influence between Return on Equity (ROE) against underpricing.

H7: Suspected there is a negative influence between Total Asset Turnover (TATO) on underpricing.

### **1.3 Data Analysis**

Multiple linear regression is a form of regression equation that the dependent variable is influenced by more than one independent variable. Prior to the test, the tested variables are tested first if they meet the classical assumption of multiple regression equations. To test the effect of independent variables on dependent variable, used equation model as follows:

$$IR = \beta_0 + \beta_1.RU + \beta_2.RAU + \beta_3.SIZE + \beta_5.FL + \beta_6.ROE + \beta_7.TATO + e$$

Details:

IR = *Underpricing a stock that conducts an IPO*

RU = Reputation Underwriter (top 5: 1, not top 5: 0)

RA = Auditor Reputation (KAP big 4: 1; Non-KAP big 4: 0)

AGE = Age of Firms

SIZE = Size of Firms

FL = *Financial Leverage*

ROE = *Return on Equity*

TATO = *Total Asset Turnover*

e = *Standard error*

$\beta_0$  = Size of constanta

$\beta_1$ -  $\beta_7$  = The regression coefficient of each independent variable

## **2. Research Method**

This study includes a type of causal research based on its purpose. This study was conducted to prove the causal relationship of the variables studied. The purpose of this research is to know the independent variables that are underwriter reputation, auditor reputation, company age, company size, financial leverage, Return on Equity, and Total Asset Turnover intercept dependent variable that is underpricing at company doing IPO at Indonesia Stock Exchange In 2004-2014.

This study is based on the details, including the type of quantitative research. This research includes quantitative research because this research emphasizes its analysis based on numerical data processed by statistical methods. While based on the technique, this research is an experimental research. This study is an experiment because the data used is experimental data during the year 2004 - 2014. While based on the purpose of this research included in basic / pure research because in this study aims to develop hypotheses through the disclosure of facts.

This research data using secondary data obtained from Indonesia Stock Exchange website that is *www.IDX.com*, *www.ipotnews.com*, and *website www.yahoofinance.com*. The data used is data from the financial statements of each company listed on the Indonesia Stock Exchange in 2004-2014.

This study uses the population of companies conducting IPOs in Indonesia Stock Exchange in 2004 - 2014. The selection of target population in this study has certain criteria, following the criteria for determining the target population:

1. Companies that conduct IPO in 2004-2014
  2. The company never relies.
  3. Have information or availability of data to be used in research.
- From these criteria obtained 204 companies as the target population.

### 3. Result and Discussion

Multiple linear regression is used to determine the relationship of independent variables to the dependent variable either partially or collectively. Multiple linear regression was used in this study because the number of independent variables used in this study is more than one. The independent variables in this research are: underwriter reputation, auditor reputation, company age, firm size, financial leverage, return on equity, and total asset turnover. The results of multiple linear analysis are done by using help from Eviews 8 for Windows program.

**Table 1. Regression Result**

Variable	Coefficient	t-Statistic	Prob.	Hypothesis
C	0,6617	1,662196	0,0981	-
RU	-0,128358	-2,43069	0,016*	Negatif
RA	-0,15787	-3,75942	0,0002*	Negatif
AGE	-0,001316	-0,9542	0,3412	Negatif
SIZE	-0,011051	-0,72983	0,4664	Negatif
FL	-0,01034	-0,11604	0,9077	Positif
ROE	-0,100853	-2,04259	0,0424*	Negatif
TATO	-0,007819	-0,4974	0,6195	Negatif

Source: Appendix 2, processed

Description: RU: Reputation Underwriter; RA: Auditor Reputation; AGE: Age of Company; SIZE: Company Size; FL: Financial Leverage; ROE: Return on Equity; TATO: Total Asset Turnover, \* = Significant with  $\alpha = 5\%$

Looking from Table 1 can be modeled the regression equation as follows:

$$IR = 0,6617 - 0,128358 RU - 0,1587 RA - 0,001316 AGE - 0,011051 SIZE - 0,01034 FL - 0,100853 ROE - 0,007819 TATO - e$$

F test is used to find out whether the independent variable has a significant influence on the dependent variable. This test uses Eviews 8 for Windows which results F-statistics of 5.305044 and significant signifikannya amounted to 0.000014. Since the result of the significance level of 0.000014 is much smaller than 0.05 or 5%, it can be stated that all the variables simultaneously affect the underpricing variables significantly.

Of the seven independent variables, there are three variables that have significant effect on underpricing namely Underwriter Reputation, Auditor Reputation, and Return on Equity. This can be seen from the level of significance for RU of 0.016 smaller than 0.05, RA has a significant level of 0.0002 smaller than 0.05, and ROE has a significant level of 0.0424 smaller than 0.05. While the other four independent variables are AGE, SIZE, FL, and TATO has a significant level above 0.05 means it has no significant effect on underpricing.

#### 3.1 Result of Underwriter Effect on Underpricing Percentage



The underwriter underpricing fair value is 0.016. Means variable. Underwriters are negatively negatively underpricing. These results are consistent with research conducted by Kristiantari (2013), and Razafindrabinina and Kwan (2013) and research with Johnson (2012) and Wahyusari (2013). According to (Kristiantari, 2013) High performing underwriters have more confidence in the success of market-protected offerings because highly reputable underwriters have better market situation information. Thus, there is a tendency for highly reputable underwriters to dare to provide high prices as a consequence of Quality Guarantee, so underpricing was low. Underwriters can be decisive for investors to. The higher the underwriter, the initial return will be the lower the underwriter has a negative effect on underpricing.

### **3.2 Result of Influence of Auditor's Reputation to Underpricing**

In the T test, the auditor's significance value value to underpricing is 0.0002. Thus, the auditor's reputation variable has significant negative effect on underpricing. These results are consistent with Johnson (2012), and Razafindrabinina and Kwan (2013) results and are contrary to research conducted by Kristiantari (2013). According to Kwan and Razafindrabinina (2013) the auditor's reputation is believed to have an effect on underpricing on the IPO. By using a reputable or professional auditor, the issuer will minimize the opportunity to manipulate information that may mislead investors about the prospects of the company in the future. Thus, this indicates a highly reputable auditor, the company will reduce uncertainty in the future, thus reducing underpricing IPO.

### **3.3 Results of Effect of Business Age on Underpricing**

In T test, the significance value of company's age at the underpricing percentage of 0.3412 means that H1 is rejected. This means that the variable age of the company has no significant negative effect on underpricing. The results of this study are in accordance with research conducted by Kristiantari (2013) and Kurniawan (2007) and contrary to the research. This shows that the age of the company is not a benchmark for investors so that the age of the company is not too noticed by investors in making decisions to invest companies that conduct an IPO. According to Kristiantari (2013), in a business world that is identical with competition, the age of the company is not a guarantee that the company has a better performance or prospect than a younger company. Companies of any age are not guaranteed to be free from unhealthy financial conditions and the risk of bankruptcy.

### **3.4 Result of Influence of Company Size on Underpricing**

In T test, the significance value of firm size under underpricing is 0.4664, meaning H1 is rejected. The firm size variable has no significant negative effect on underpricing. This result is in accordance with research results conducted by Kurniawan (2007) and contrary to the results of Kristiantari research (2013). This indicates that the size of the company is not a variable that is too noticed by investors in taking investment decisions in companies that IPO. According Riyadi (2014), companies that have a large size may not be able to produce performance and good prospects in the future compared to smaller companies that berukuran. Large and small companies have the same business prospects prospects. Companies that are able to generate innovations in its business are more viewed by investors have a good prospect in the future. Companies that always innovate can win the business competition is getting tighter even though starting from a small company.

### **3.5 Result of Influence of Financial Leverage to Underpricing Percentage**

In the T test obtained the significance of Financial Leverage against underpricing of 0.9077. With these results, the financial leverage variable has no significant negative effect on underpricing. The results of this study are in accordance with the results of research conducted by Kristiantari (2013) and Razafindrabinina and Kwan (2013) and contrary to Wahyusari (2013). The insignificant effect is due to the pricing of the initial market set by the underwriter.

Based on the efficient market theory, capital markets are efficient because the competition among investment analysts will make the securities market at all times to show the

true price. The true value is nothing but a balance price reflecting all the information available to investors at a given point in time (Gittman and Zuter, 2010, 39). So, the stock price when traded in the secondary market is the actual price of the company. So even if financial leverage affects the firm's value reflected in the stock price on the secondary market on the first day, the price in the primary market is set by the underwriter in accordance with market conditions and the underwriter's reputation in ensuring the emissions of a company. Especially if underwriter underwriter is full commitment, underwriter will pay more attention to market condition try to show that the stock which in its guarantee looks positive in the eyes of investor. Thus, the financial leverage has no significant effect on underpricing.

### **3.6 Result of Influence Return on Equity to Underpricing**

In T test, the significance of Return on Equity on underpricing is 0.0424, H1 is accepted and H0 is rejected. From the results of the variable Return on Equity has a significant negative effect on underpricing. This result is in accordance with the results of research conducted by Kurniawan (2007) and contrary to the results of Johnson's (2012) study. According to Kurniawan (2007), the higher ROE value will show that the company is able to generate profit in the future and profit is important information for investors as consideration in investing capital. With high profitability, uncertainty for investors will decrease so that it will reduce underpricing (Kim, *et al.*, 1995 in Kurniawan, 2007).

### **3.7 Result of Influence of Total Asset Turnover to Underpricing**

In the T test, the percentage value of shares offered to the public on the percentage of underpricing is 0.6195. From these results can be said that the variable total asset turnover has a negative influence is not significant on the percentage of underpricing. This result is in accordance with the results of research conducted by Razafindrambinina and Kwan (2013) and is different from the results of research conducted by Safitri Kurniawan (2007). TATO has no significant effect as investors pay more attention to the company's profitability than total asset turnover. High TATO values do not guarantee that the profitability of firms is higher. Investors prefer firms with high profitability because higher profitability can maximize shareholder value compared to higher TATO. This is supported by descriptive statistic that the highest TATO value is SKYB issuer with value 13,02 with ROE 0,1897 resulting in underpricing 49% while highest ROE is AKKU issuer with value 3,727 and TATO 0,482 produce underpricing equal to 2%. From the above data, it can be concluded that high TATO has no effect on underpricing.

### **3.8 Coefficient of Determination (R<sup>2</sup>)**

Result Coefficient of Determination (R<sup>2</sup>) Seen from adjusted R-squared on testing using Eviews 8 for Windows and the result of 0.159286 (15.9286%). This shows that 15.9286% of underpricing changes can be explained by all variables that exist in the study, while the rest of 84.0714% explained by other variables outside the research variables used.

## **4. Conclusion**

This study aims to prove empirically the influence of some variables suspected to affect underpricing on companies listed on the Stock Exchange in 2004-2014. Target population that is processed in this research is 204 companies that conduct IPO at Indonesia Stock Exchange year 2004-2014 and in accordance with criterion specified in Chapter III. This study used seven independent variables: underwriter reputation, auditor reputation, company age, firm size, financial leverage, return on equity, and total asset turnover.

Based on the results of the tests described in the previous section, obtained the results of the F test that explains that the independent variables and control variables proved to affect the dependent variable significantly. That is, simultaneously or simultaneously the independent variables and control variables significantly influence the underpricing of companies conducting IPOs in BEI in 2004-2014.

Based on the result of T test, from seven independent variables there are three variables that have a significant effect on underpricing, ie underwriter reputation, auditor reputation, and return on equity at significance level  $\alpha = 5\%$ . For the other four independent variables: company age, firm size, financial leverage, and total asset turnover have no significant effect on underpricing.

Based on test of coefficient of determination which have result of equal to 15,9286%, it shows that 15,9286% change of underpricing can be explained by all variables exist in research, while the rest equal to 84,0714% explained by other variable outside research variable used.

Based on the test coefficient of determination that has a result of 18.3568%, it shows that 18.3568% change in underpricing can be explained by all variables in the study, while the remaining 81.6432% explained by other variables outside the research variables used.

The results of the research for underwriter reputation variable have a significant negative effect on underpricing. This indicates that firms using reputable underwriters will have low underpricing. This result is in accordance with the results of research conducted by Kristiantari (2013) and Razafindrabinina and Kwan (2013).

The result of the research for auditor reputation variable has a significant negative effect on underpricing. This explains that firms that use the services of reputable auditors will have low underpricing. This result is in accordance with the results of research conducted by Johnson (2012) and Razafindrabinina and Kwan (2013).

The underpricing phenomenon is favorable for investors in the short term, since stocks that are underpricing in the long run will not necessarily have better performance due to information asymmetry between investors and companies as well as investors and underwriters. So, investors should look at the factors - factors that can cause the asymmetry of information obtained by investors that cause underpricing. The underwriter reputation variable is used by investors as information in investing. Investors will see that a reputable underwriter has better market information. Thus, there is a tendency of a highly reputable underwriter to dare to give a high price as a consequence of the quality of the guarantee, so that the level of underpricing was low.

Auditor reputation variables make information for investors, by using a reputable or professional auditor, the issuer will minimize the opportunity to manipulate information that may mislead investors about the prospects of the company in the future.

In addition, return on equity variables are used as investors as information. To benefit from underpricing, the higher ROE value will show that the company is able to generate future profits and profit is important information for investors as a consideration in investing capital. With high profitability, uncertainty for investors will decrease, thus reducing underpricing.

The results of this study can provide an overview of the factors that can affect underpricing for companies that conduct an IPO. For companies that conduct an IPO, the occurrence of underpricing is not profitable because the funds obtained by the company to be less than the maximum. Because underpricing is not profitable for the company, the company needs to pay attention to the factors that influence underpricing. By knowing the significant factors to underpricing, it is expected that companies conducting IPO can raise funds from society optimally.

So, companies that do IPO need to pay attention to variable underwriter reputation, auditor reputation, and Return on Equity to minimize the occurrence of underpricing. The company will minimize underpricing by selecting experienced and reputable underwriters, using auditor services that also have a good reputation of auditors included in the Big Four KAP, and pay attention to the company's earnings before conducting an IPO because these three factors have influence and are noticed by investors in investing.

Researchers then suggested to consider the period of time, so easy in finding company data. Researchers need to look at more detailed criteria in determining the companies that enter

into the study. Researchers further suggested also to use variable financial and non-financial companies. In addition, researchers should understand the theory of deeper underpricing in order to avoid confusion while doing research.

Investors are advised to buy underpricing stocks in order to make a profit. Investors before buying shares should pay attention to information on underwriter reputation, auditor reputation, and return on equity. In addition, information about company age, firm size, financial leverage, and total asset turnover also need to be understood.

Companies that conduct IPOs are advised to reduce or minimize underpricing, so that funds obtained from the IPO can be maximized. Companies can minimize underpricing by understanding the factors affecting underpricing, which the company needs to understand is the underwriter's reputation, auditor's reputation, and Return on Equity.

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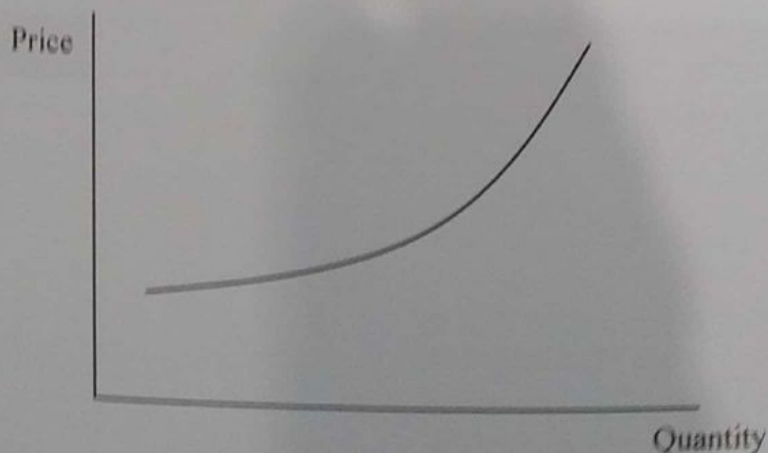
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