Accrual-based vs cash-based accounting in affecting underpricing phenomenon: Evidence from emerging country

Yuli Soesetio¹*, Ely Siswanto², Lulu Nurul Istanti³, Subagyo⁴
¹,²,³,⁴ Manajemen, Fakultas Ekonomi dan Bisnis, Universitas Negeri Malang, Indonesia

Abstract
Until now, more than 80 percent of shares are underpriced at every IPO event around the world, making it a phenomenon and a big unsolved puzzle, so it is still interesting and relevant to research, especially in emerging countries. This study aims to reveal the impact of profitability information based on accrual and cash on the phenomenon of underpricing on the Indonesia Stock Exchange (IDX). The sample used was firms that conducted IPOs on the IDX from 1994-2020 that had met the sample criteria of 475 firms using the purposive sampling method. Furthermore, the collected cross-section data were analyzed using ordinary least square (OLS) regression. The study concluded that only accrual-based profitability information consistently affects underpricing. These results also support the argument that the use of the accrual-based is better than the cash-based to predict underpricing. This study implies that IPO firms to pay more attention to, strengthen, and maintain their 'earnings' so that investors are more confident regarding the firm's future business continuity. In addition, investors are more detailed in using information from the prospectuses of large firms.

Keywords: Accrual, Cash, Underpricing, Initial Public Offering, Indonesia Stock Exchange

Introduction
IPO is the most important activity carried out by the firm as an effort to increase funds without interest in the capital market (Badru et al., 2019). In addition, the firm's purpose of conducting an IPO is to gain access to a new and broad sources of funding, carry out mergers or acquisitions of other firms with financing through the issuance of new shares, increase the ability to going concern, improve the firm's image, and improve the welfare of shareholders (Hadi, 2013; Mun & Jang, 2019; Yazdani & Aris, 2015).

However, one of the phenomenon that is still become a big puzzle in the IPO event in around the world is positive initial returns, underpricing (Jamaani & Alidarous, 2019; Mehmood et al., 2021). Through their paper, Loughran et al. (1994) explained that from 54 countries studied, all of these countries showed positive initial returns in every IPO activity on the world stock exchange. Mehmood et al. (2021) through their paper summarize...
The underpricing phenomenon also continues to appear every year on the Indonesia Stock Exchange (IDX). In Table 1, it shows that more than 80 percent of companies that carried out the IPO process at IDX experienced underpricing with an average of 34.75%, which means that the closing price on the first day trading increased by 34.75% from the offering price in the initial market.

One of the causes of underpricing is inequality of various information such as prospectuses that underlie prospect expectations and firm assessments between issuers, underwriters, and investors. Thus, ‘information asymmetry theory’ is one of the theories that answers why in the stock market there is always underpricing during the IPO process that occurs in around the world. In addition, the ‘behavioral theory informational cascade’ also strengthens the previous theory.

Nevertheless, every stock exchange in around the world is constantly trying to reduce information asymmetry by requiring all firms to publish prospectuses before conducting an initial public offering. Detailed and complete prospectus information can be used by investors to obtain information about the risks, developments, and opportunities of a firm in the future.

This study aims to test the impact of financial information analysis, especially profitability and other information presented in the prospectus on the phenomenon of underpricing. In addition, previous studies were limited to only one type of profitability proxy without further exploring the comparison between profitability proxies and various accounting methods. In addition, the use of more complete samples and longer periods is another strength to provide more general and robust results. Thus, the results of this study are expected to add and sharpen the findings from previous literature related to prospectus information especially profitability information on underpricing.

Table 1. IPO Firms and Underpricing in 1994-2020

| Year | IPO | Under-priced Company | % | Underpricing Average (%) |
|------|-----|----------------------|---|--------------------------|
| 1994 | 47  | 26                   | 55%| 15.35%                   |
| 1995 | 23  | 12                   | 52%| 10.78%                   |
| 1996 | 17  | 14                   | 82%| 12.25%                   |
| 1997 | 31  | 23                   | 74%| 16.82%                   |
| 1998 | 6   | 4                    | 67%| 34.47%                   |
| 1999 | 9   | 7                    | 78%| 52.56%                   |
| 2000 | 25  | 17                   | 68%| 68.15%                   |
| 2001 | 31  | 27                   | 87%| 96.06%                   |
| 2002 | 23  | 18                   | 78%| 39.17%                   |
| 2003 | 9   | 5                    | 56%| 13.91%                   |
| 2004 | 12  | 10                   | 83%| 21.93%                   |
| 2005 | 9   | 7                    | 78%| 17.13%                   |
| 2006 | 13  | 12                   | 92%| 37.28%                   |
| 2007 | 22  | 20                   | 91%| 41.16%                   |
| 2008 | 19  | 16                   | 84%| 35.90%                   |
| 2009 | 13  | 8                    | 62%| 21.89%                   |
| 2010 | 23  | 22                   | 96%| 30.53%                   |
| 2011 | 25  | 17                   | 68%| 20.14%                   |
| 2012 | 22  | 20                   | 91%| 30.29%                   |
| 2013 | 30  | 21                   | 70%| 24.31%                   |
| 2014 | 24  | 21                   | 88%| 28.77%                   |
| 2015 | 16  | 14                   | 88%| 29.81%                   |
| 2016 | 15  | 12                   | 80%| 30.94%                   |
| 2017 | 37  | 29                   | 78%| 43.94%                   |
| 2018 | 57  | 54                   | 95%| 66.99%                   |
| 2019 | 55  | 51                   | 93%| 53.80%                   |
| 2020 | 51  | 51                   | 100%| 43.81%                  |

∑ 664 538 81% 34.75%

Source: www.idx.co.id, www.ticmi.co.id, data processed (2022)
dynamics. There are many previous papers that used profitability ratios to test their effect on underpricing such as studies from Abbas et al. (2022); Mayasari et al. (2018); Permatasari & Kusumah (2017); Thoriq et al. (2018); Utomo & Kurniasih (2020), but have not found consistent results. In addition, the use and comparison of various profitability indicators in determining underpricing is still not widely practiced. Therefore, we are interested in researching and concluding more comprehensively the effect of accrual and cash-based profitability information on underpricing.

Profitability is one of the fundamental analyses to analyze the firm's ability to generate both positive and negative profits. In addition, profitability is one of the fundamental analysis proxies to measure and analyze the sustainability of the firm and become a bottom line calculation of the firm's performance (Etale et al., 2021). Measuring profitability either in the past or projecting it in the future is the most important measure of business success (Hofstrand, 2009). Saputra et al. (2019) argued that future profit projections are the financial information that most attracts the attention of investors and concludes that firm size and underwriter reputation are the main factors in predicting future profits more accurately.

In addition to the use of profit, the firm’s ability to generate cash is another indicator to see the performance of a firm. Operating cash flow is one of the indicators to see the firm’s ability to use or generate cash. Operating cash flow is one of the indicators to see the firm’s ability to use or generate cash as well as the main determinant of business success (Febriani et al., 2017). Lumbanraja (2018) found that operating cash flow is positively related to stock price. Foerster et al. (2017); Hou et al. (2011) found that cash flow tends to be better at predicting stock returns than gross profit, operating profit and net profit. Cash activity arising from operating activities is a key and true indicator that firm’s operations are success (Febriani et al., 2017). In addition, accrual accounting requires a subjective assessment, therefore it will be prone to management manipulations (Breale & Myers, 1981; Serly & Lau, 2021).

On the other side, Muniroh & Yuliati (2021) argued that operating cash flow cannot be a key benchmark for a firm’s future success. Profitability using gross profit is the "cleanest" measure of actual profitability (Novy-Marx, 2013). In Statement of Financial Accounting Concepts No. 1 (1978), the Financial Accounting Standards Board (FASB) stated that, cash-based accounting statements provide an incomplete basis for assessing future cash flow prospects than accrual accounting statements because they do not show a relationship between periods (Kwon, 1989; Nguyen & Nguyen, 2020; Pae & Yoon, 2012). Abolhalaje et al. (2012); Abolhallaje et al. (2014) explains that some of the advantages of implementing accrual-based accounting are timely management evaluation, supporting tax planning goals, better resource allocation and accountability and clarity of costs.

Accrual profit is considered relevant in measuring a firm's performance because it avoids distortions of uncertain cash flow variations in performance measurements (Godfrey et al., 2003). Accrual-based accounting is able to improve the decision-making process, encourage better financial management, and improve public accountability (Yusof & Jaafar, 2018). Using the accrual based as a measure of the quality of profit, Bhattacharya et al. (2013) found that poor quality of profits were significantly and incrementally related to higher information asymmetry. Good profit quality comes from a good profitability ratio (Purnamasari & Fachrurrozie, 2020). In other words, the quality of profit measured using the accrual based is negatively related to information asymmetry. Thus, if the firm's profitability is good, the quality of profit owned by the

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firm is also good, it will minimize information asymmetry and underpricing.

H1a: Profitability using accrual-based accounting has a significant negative effect on underpricing

H1b: Profitability using cash-based accounting has a significant negative effect on underpricing

H1c: Profitability using accrual-based accounting is better at predicting underpricing

The larger the firm's assets, the firm has the potential to generate greater profits and minimize the investment risks that will be faced by investors. Large firms are generally better known to the public than small firms. Firms that are better known, tend to disclose more information and the information is more accessible to investors than small firms. This will reduce information asymmetry in large firms so that it will reduce the IPO underpricing. Mayasari et al. (2018); Singgih et al. (2018) proving a significant relationship between the firm size and underpricing. Different result from Morina & Rahim (2020); Thoriq et al. (2018) which states there is no significant effect of the firm size on underpricing.

H2: Firm size has a significant negative effect on underpricing

In the IPO process, an underwriter is one of the capital market institutions that has an important role during the IPO process for a firm. Underwriters act as intermediaries and become suppliers of firm information for investors. According to their experience, underwriters have information about the needs of potential investors in making investment decisions. The underwriter will give consideration or advice to the issuer regarding various information that can reduce the level of information asymmetry and optimize the funds obtained through the IPO process. Thus, the underwriter will give the best effort to sell the shares at a price that meets the quality of the firm. Research from Dhamija & Arora (2017); Razafindrambimina & Kwan (2013); Reutzel & Belsito (2015); Sundarasen et al. (2018) mentioned that the reputation of underwriters has a negative and significant effect on underpricing. However Badru & Ahmad-Zaluki (2018); Thoriq et al. (2018) concluding the reputation of the underwriter has no significant effect on the underpricing.

H3: Underwriter reputation has a significant negative effect on underpricing

The relationship between auditor reputation and underpricing has been researched in numerous studies (Arora & Singh, 2019; Chen et al., 2018; Nazihah et al., 2020). The utilization of reputable capital market institutions, that is, underwriters and auditors give legitimacy to IPO firms because they help in reducing uncertainty about future cash flows and therefore reducing underpricing. Study from Ardiansyah (2004) discloses that investors trust financial statements audited by reputable auditors than non-reputable auditors. Investor confidence helps increase the value of the firm by reducing information asymmetry and uncertainty regarding IPOs (Arora & Singh, 2019). Study from Arif & Isnidya (2010); Gao et al. (2015); Razafindrambimina & Kwan (2013); Sundarasen et al. (2018) shows the result that the auditor's reputation has a negative and significant effect on the initial return. While the results from Arora & Singh (2019); Badru & Ahmad-Zaluki (2018) proving that there is no significant effect of the auditor's reputation on underpricing.

H4: Auditor reputation has a significant negative effect on underpricing

Methods

This paper examines the relationship between the firm’s profitability and initial return on IPO firm. This quantitative
A research paper uses secondary data from the prospectus of firms conducting IPOs for the period 1994-2020 and closing prices of the first day in the secondary market obtained from the IDX, PT Kustodian Sentral Efek Indonesia (KSEI) and The Indonesia Capital Market Institute (TICMI). This period was chosen because cash flows began to be reported in the financial statements in 1994.

The population is 664 firms that conducted IPOs on the IDX for 27 years for the 1994-2020 period. The use of the purposive sampling method obtained a sample of 475 firms with sample criteria, (1) the initial public offering price was lower than the closing price at the beginning of the day in the secondary market or underpriced as many as 538 firms (2) firms that experienced underpricing and IPO prospectuses were accessible as many as 475 firms. The variables used in this research are shown in Table 2.

OLS analysis is used as an analytical tool to answer every hypothesis proposed because it use cross-section data. Regression of each profitability variable to underpricing is carried out alternately and tiered to avoid the presence of multicolinearity (Alin, 2010; Daoud, 2017), because each proxy uses relatively the same data i.e. net profit for accrual based and operating cash flow for cash based. The regression model used:

Table 2. Variable operationalization

| Variables                  | Symbol | Type | Measurement                                                                 |
|----------------------------|--------|------|------------------------------------------------------------------------------|
| **Dependent Variable**     |        |      |                                                                              |
| Underpricing               | UDP    | Ratio| (Price of stock at the end of first trading day – IPO price)/IPO price       |
| **Independent Variables**  |        |      |                                                                              |
| Return on equity           | ROE    | Ratio| EAT/Total equity                                                            |
| Return on asset            | ROA    | Ratio| EAT/Total asset                                                             |
| Earning per share          | EPS    | Ratio| EAT/Listed shares                                                           |
| Cash flow return on equity | CFROE  | Ratio| Operating cash flow/Total equity                                            |
| Cash flow return on asset  | CFROA  | Ratio| Operating cash flow/Total asset                                             |
| **Control Variables**      |        |      |                                                                              |
| Firm Size                  | SIZE   | Ratio| Natural logarithm of total asset                                            |
| Underwriter reputation     | UND    | Dummy| Measured by frequency (1 if firm use top 10 underwriters: 0 otherwise)      |
| Auditor reputation         | AUD    | Dummy| 1 if firm use big four auditors: 0 otherwise                                |

Source: data processed (2022)

\[
\begin{align*}
IR_i &= \alpha_i + \beta_1\text{ROE}_i + \beta_7\text{SIZE}_i + \beta_9\text{UND}_i + \beta_{10}\text{AUD}_i + e_i \quad (1) \\
IR_i &= \alpha_i + \beta_2\text{ROA}_i + \beta_7\text{SIZE}_i + \beta_9\text{UND}_i + \beta_{10}\text{AUD}_i + e_i \quad (2) \\
IR_i &= \alpha_i + \beta_3\text{EPS}_i + \beta_7\text{SIZE}_i + \beta_9\text{UND}_i + \beta_{10}\text{AUD}_i + e_i \quad (3) \\
IR_i &= \alpha_i + \beta_4\text{CFROE}_i + \beta_7\text{SIZE}_i + \beta_9\text{UND}_i + \beta_{10}\text{AUD}_i + e_i \quad (4) \\
IR_i &= \alpha_i + \beta_5\text{CFROA}_i + \beta_7\text{SIZE}_i + \beta_9\text{UND}_i + \beta_{10}\text{AUD}_i + e_i \quad (5)
\end{align*}
\]
Result

Descriptive Statistic Analysis

The data obtained and processed through passing the classical assumption test and regression analysis with the OLS method shown in tables 4 and 5. The descriptive statistics in table 3 show an average of underpricing is 0.414, which means that the firm set the IPO price 41% lower than the closing price of the shares on the first day of trading on the stock exchange so that investors earn profit from the purchase of the IPO shares by the abnormality of the initial IPO pricing firm and raised funds.

Table 3. Descriptive Statistics

| Variable | Obs | Mean  | Std. dev. | Min  | Max  |
|----------|-----|-------|-----------|------|------|
| UDP      | 475 | 0.414 | 0.385     | 0.003| 3.125|
| ROE      | 475 | 0.151 | 0.668     | -10.416| 7.143|
| ROA      | 475 | 0.029 | 0.190     | -3.474| 0.641|
| EPS      | 475 | 25.987| 58.328    | -119.609| 530.968|
| CFROE    | 475 | 0.018 | 2.434     | -45.917| 14.219|
| CFROA    | 475 | 0.022 | 0.230     | -2.972| 2.724|
| SIZE     | 475 | 26.598| 1.698     | 22.288| 33.174|
| UND      | 475 | 0.531 | 0.500     | 0     | 1    |
| AUD      | 475 | 0.225 | 0.418     | 0     | 1    |

Source: data processed (2022)

Different Test

Table 4 shows the results of the different test underpricing and profitability information in large and small firms based on Law no. 20 of 2008 about micro, small and medium enterprises. In small firms, underpricing tends to be greater at 50.4% while in large firms it is only 31.6%. This result explains that small firms provide a greater initial return as a sweetener and compensation for the risks that will be faced by IPO investors that invest in small firms so the process of raising funds through the IPO will take place successfully and potential investors are willing to buy all the shares offered. Thus,
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the underwriter will not suffer loss for the IPO event that is covered due to the enactment of a full commitment agreement that requires the underwriter to purchase the remaining unsold shares at the time of the IPO.

In terms of profitability, large firms tend to have greater profits and cash flow than small firms. This is considering that the financial performance condition of large firms has greater resources so that there is a better chance of profitability performance as shown in table 4, EPS and CFROA. On the contrary, other information related to the firm's financial condition is relatively no different from the conditions before the IPO was held.

Hypothesis Test

Using hierarchical regression analysis shows that return on equity (ROE) has a coefficient of -0.022 with a significance of more than 0.1 which means ROE has no significant effect on underpricing. This result rejects H1a that accrual-based profitability affects underpricing.

Return on asset (ROA) has a coefficient of 0.024 with a significance of more than 0.1 which means ROA has no significant effect on underpricing. This result rejects H1a that accrual-based profitability affects underpricing.

Earning per share (EPS) has a coefficient of -0.001 with a significance of less than 0.05 which means EPS has significant effect on underpricing. This result accept H1a that accrual-based profitability affects underpricing.

Cash flow return on equity (CFROE) has a coefficient of -0.002 with a significance of more than 0.1 which means CFROE has no significant effect on

| Table 5. Regression Result |
|-----------------------------|
| Variable | (1) UDP | (2) UDP | (3) UDP | (4) UDP | (5) UDP |
| ROE | -0.022 | -0.022 | -0.022 | -0.022 | -0.022 |
| | (0.021) | (0.021) | (0.021) | (0.021) | (0.021) |
| ROA | 0.024 | 0.024 | 0.024 | 0.024 | 0.024 |
| | (0.061) | (0.061) | (0.061) | (0.061) | (0.061) |
| EPS | -0.001** | -0.001** | -0.001** | -0.001** | -0.001** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| CFROE | -0.002 | -0.002 | -0.002 | -0.002 | -0.002 |
| | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) |
| CFROA | 0.036 | 0.036 | 0.036 | 0.036 | 0.036 |
| | (0.056) | (0.056) | (0.056) | (0.056) | (0.056) |
| SIZE | -0.053*** | -0.053*** | -0.053*** | -0.053*** | -0.053*** |
| | (0.014) | (0.014) | (0.014) | (0.014) | (0.014) |
| UND | 0.021 | 0.021 | 0.021 | 0.021 | 0.021 |
| | (0.039) | (0.039) | (0.039) | (0.039) | (0.039) |
| AUD | -0.124*** | -0.124*** | -0.124*** | -0.124*** | -0.124*** |
| | (0.039) | (0.040) | (0.040) | (0.040) | (0.040) |
| Constant | 1.849*** | 1.847*** | 1.763*** | 1.832*** | 1.852*** |
| | (0.363) | (0.369) | (0.362) | (0.364) | (0.368) |
| R-squared | 0.090 | 0.089 | 0.097 | 0.089 | 0.089 |

Note: *, **, *** significant at 10%, 5%, 1%
Source: data processed (2022)
underpricing. This result rejects H1b that cash-based profitability affects underpricing.

Cash flow return on asset (CFROA) has a coefficient of 0.036 with a significance of more than 0.1 which means CFROA has no significant effect on underpricing. This result rejects H1b that cash-based profitability affects underpricing.

Of the five profitability variables used, only EPS, which is accrual-based profitability, has a significant effect on underpricing. This result accepts H1c that profitability using accrual-based accounting is better at predicting underpricing than cash-based.

Company size (SIZE) consistently has a significant effect on underpricing with a significance level of less than 0.05. This result accepts H2 that is, the company size affects underpricing.

Underwriter reputation (UND) consistently has no significant effect on underpricing because it has a significance level of more than 0.1. This result rejects H3 that is, underwriter reputation affects underpricing.

Auditor reputation (AUD) consistently has a significant effect on underpricing with a significance level of less than 0.05. This result accepts H4 that is, auditor reputation affects underpricing.

Discussion

The Effect of Profitability using accrual-based on Underpricing

Profitability information is a general and simple measure that is always become the first question in the investor's mind before starting an investment or business. This is natural considering that the firm's goal is to maximize the welfare of shareholders. Well-being will be gained through healthy, sustainable, and profitable business practices in the long term. Therefore, EPS information is the most important profit information and is a special concern available in the prospectus for investors when transacting around the IPO. This is proven, from some of the profitability proxies used, only EPS consistently has a significant negative effect on underpricing. These results support Wijayanto (2010) which states that EPS has a significant negative effect on underpricing.

This result explains that the higher the EPS value, the smaller the underpricing. The high EPS value provides a positive signal for investors so that they are willing to buy initial shares at a high and optimal price, close to the fair value of the firm, cause small underpricing. In addition, it increases investor confidence and trust in the future performance of the firm, thereby reducing information asymmetry and uncertainty regarding the IPO (Arora & Singh, 2019). EPS information is also considered more important than other proxies of profitability based on accruals and cash because it is able to provide a more convincing and relatively simpler picture of the firm's profits which shareholders are entitled to each share owned (Morina & Rahim, 2020). This also makes the high initial pricing and the issuer obtain funds optimally. In the article written by Dechow et al. (1998); Yusof & Jaafar (2018); Zarandi et al. (2013) proves that accrual basis is better in terms of providing reliable, informative, comparable, and comprehensive results than cash basis.

The Effect of Profitability using cash-based on Underpricing

The cash-based profit measures in this study proxied by CFROE and CFROA consistently had no significant effect on underpricing. The measurement of cash-based historical data has become less meaningful and is not a major concern for investors because the power to predict the future firm success is lower than the accrual basis. Accrual gradually improve operating cash flow capabilities in projecting future operating cash flows (Farshadfar et al., 2022). Similarly, the study
from Biswas et al. (2015); Narsa (2011) found that the ability of accrual-based profit information i.e. gross profit and net profit is higher than cash-based in predicting future cash flows. In addition, accrual accounting can reduce timing and matching problems. This result proves that profitability using accrual-based is better than cash-based accounting, especially in predicting underpricing.

The Effect of Firm Size on Underpricing

The results of the regression analysis concluded that firm size information was used by decision makers. Firm size has a negative and significant effect on underpricing. Firms with larger assets have the advantage that they are better known by the public than small firms. Firms that are better known, tend to disclose more information and the information is more accessible to investors than small firms. This will reduce information asymmetry in large firms. This condition makes the firm more confident to offer its shares at a high price then it will minimize the difference between the closing price of the first day in the secondary market and the offering price in the primary market.

The findings of this study strengthen the conclusions of the study from Mayasari et al. (2018); Singgih et al. (2018) which proves the existence of a significant relationship between the firm size and underpricing. Different result from Morina & Rahim (2020) which states there is no significant effect of the firm size on underpricing.

The Effect of Underwriter Reputation on Underpricing

The results of the regression analysis concluded that the underwriter's reputation information was not used by decision makers. The reputation of the underwriter provides a signal for the market to assess the quality of the issuer for good or bad. A good underwriter's reputation is a positive signal for investors in assessing the issuer's shares of good quality (Thoriq et al., 2018). However, there are two conditions for a positive signal that will be effective, that the signal must reach potential investors and be interpreted properly and not easily imitated by low-quality firms. On the contrary, the use of reputable underwriters is relatively easy to imitate by all issuers, so investors cannot distinguish between the quality of good and bad issuers by only looking at underwriters who underwriting IPO shares (Aini, 2013). Through their studies, Albada et al. (2019) explains that most IPO firms use reputable underwriters. This has caused investors to ignore these signals as useful information to identify good investment characteristics.

Albada et al. (2019) concluded that underwriter reputation can reduce the level of information asymmetry in the IPO firm, but it cannot affect the initial return on the IPO firm. These results also support previous research by Thoriq et al. (2018) which proves that there is no significant effect of underwriter reputation on underpricing.

The Effect of Auditor Reputation on Underpricing

The results of the regression analysis concluded that the auditor's reputation information affect the formation of underpricing. The effect of the auditor's reputation variable on the initial return indicates that the better the auditor's reputation, the lower the underpricing rate. This research has successfully proven that reputable auditors are believed by investors to have a greater commitment in maintaining the quality of the audit of issuers' financial statements that they conduct. In other words, financial information that has been audited by reputable auditors is used as a basis for consideration in decision making by investors (Albada et al., 2019). Reputable auditors improve the quality of the firm by proving the fact that the management has good performance and integrity. Studies conducted by Ardiansyah
(2004) discloses that investors trust financial statements audited by reputable auditors than non-reputable auditors. Investor confidence helps increase the value of the firm by reducing information asymmetry and uncertainty regarding IPOs (Arora & Singh, 2019). Hearn (2013) argues that the reputation of auditors can also reduce the level of information asymmetry from listing firms by reducing agency costs, thereby improving the relationship between pre-IPO shareholders and firm managers. These results also support Arif & Isnidya (2010); Razafindramibimina & Kwan (2013) which proves that the auditor reputation has a negative and significant effect on underpricing.

Robustness Check

Furthermore, the robustness check shown in table 6 tests and strengthens the results of the regression analysis in table 5 by splitting the sample based on the size of firms in the category of large firms and small firms based on Law no. 20 of 2008. In large firms, accrual-based profitability information, EPS, has a significant effect on UDP. Nevertheless, these findings were reinforced also when use small firms although only slightly different for ROA information and other control variables. This reinforces the results of previous regressions that accrual-based profitability information is more informational for IPO investors. In addition, these results provide an idea of the type of IPO investors tend

Table 6. Robustness Check – Large Firms and Small Firms

| Variables | Large Firms | Small Firms |
|-----------|-------------|-------------|
|           | **(1)** | **(2)** | **(3)** | **(4)** | **(5)** | **(1)** | **(2)** | **(3)** | **(4)** | **(5)** |
| UDP       | UDP       | UDP        | UDP      | UDP      | UDP      | UDP      | UDP      | UDP      | UDP      | UDP      |
| ROE       | -0.002    | -0.025     |          |          |          |          |          |          |          |          |
|           | (0.032)   | (0.023)    |          |          |          |          |          |          |          |          |
| ROA       | -0.498**  | 0.062      |          |          |          |          |          |          |          |          |
|           | (0.203)   | (0.039)    |          |          |          |          |          |          |          |          |
| EPS       | -0.000**  | -0.001**   |          |          |          |          |          |          |          |          |
|           | (0.000)   | (0.001)    |          |          |          |          |          |          |          |          |
| CFROE     | -0.007    | -0.001     |          |          |          |          |          |          |          |          |
|           | (0.017)   | (0.003)    |          |          |          |          |          |          |          |          |
| CFROA     | -0.043    | 0.119      |          |          |          |          |          |          |          |          |
|           | (0.056)   | (0.072)    |          |          |          |          |          |          |          |          |
| UND       | -0.051    | -0.044     | -0.054** | -0.037   | -0.037   | 0.063    | 0.062    | 0.036    | 0.056    | 0.059    |
|           | (0.031)   | (0.032)    | (0.031)  | (0.035)  | (0.034)  | (0.080)  | (0.080)  | (0.080)  | (0.091)  | (0.091)  |
| AUD       | -0.167*** | -0.150***  | -0.158***| -0.182***| -0.181***| -0.114   | -0.117   | -0.068   | -0.026   | -0.039   |
|           | (0.031)   | (0.031)    | (0.032)  | (0.032)  | (0.033)  | (0.101)  | (0.102)  | (0.102)  | (0.146)  | (0.144)  |
| Constant  | 0.426***  | 0.444***   | 0.438*** | 0.433*** | 0.434*** | 0.502*** | 0.501*** | 0.534*** | 0.520*** | 0.524*** |
|           | (0.025)   | (0.025)    | (0.025)  | (0.026)  | (0.026)  | (0.046)  | (0.046)  | (0.046)  | (0.051)  | (0.051)  |
| R-squared | 0.070     | 0.084      | 0.078    | 0.078    | 0.078    | 0.012    | 0.011    | 0.042    | 0.003    | 0.008    |

Note: *, **, *** significant at 10%, 5%, 1%
Source: data processed (2022)
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to herding and heuristic behavior when making transactions, especially for small firms. Herding behavior shows the tendency of investor behavior to follow the actions of other investors without using and analyzing in depth the fundamental information presented in the prospectus (Luong & Ha, 2011). While heuristic behavior provides an illustration of the decision-making process that uses limited information, relying more on experience and intuition and even not infrequently using the rule of thumb and common sense (Cherry, 2022; Fromlet, 2001). This is proved in the limited use of fundamental information presented in the prospectus influencing underpricing. Only accrual-based profitability information, especially EPS that is considered important by investors, where other accrual-based and cash-based profitability information should theoretically contain information as the financial principle of ‘cash is the king’ also needs to be considered. If a firm does not have cash, business operations will be disrupted (Adebayo et al., 2015; Beck, 1994; DeFranco & Schmidgell, 1998; Keown et al., 2011).

Conclusion

This study aims to test fundamental information of the profitability of firms based on accrual or cash that investors use when trading until the first day of stock trading on the stock exchange after the IPO. The use of ordinary least square analysis was obtained that accounting conservatism is negatively associated with the magnitude of IPO underpricing, especially the accrual basis with the EPS indicator, although other indicators of accrual are also used as consideration of transactions for large firms. These findings prove that accrual profit information is superior and is considered to have information content for IPO investors than cash flow to determine expectations of return value. In addition, the type of investor tends to heuristic and herding behavior.

These results emphasize the firm to prepare and manage firm performance information that reflects real conditions, especially accrual-based information. The limitation of this study is that the use of data is quite limited due to the availability of data that is not fully available and has a large cost. For the next study, the use of profit quality indicators and market conditions as interaction variables will sharpen the results of the disclosure of the underpricing phenomenon and the type of IPO investor.

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