Effect of Underwriter's Reputation, Financial Information, and Inflation Rate on Underpricing of Companies during IPO (2016-2020 Period)

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Abstract

Underpricing occurs because of mispriced in the primary market due to an imbalance of information between underwriters and issuers, known as information asymmetry. This research is quantitative research with a descriptive analysis approach. The research design is in the form of conclusive research between the X variable (Underwriter Reputation, Financial Statements, Inflation Rate) and Y (Company Underpricing). Research data in the form of secondary data obtained from various sources. The sample in this study consisted of 75 companies with an observation period of 2016-2020. Testing of research data is carried out with Normality Test, Multicollinearity Test, Autocorrelation Test, Classical Assumption Test, and Hypothesis Testing. The underwriter reputation variable partially has a negative and insignificant effect on the underpricing variable. The Financial Information variable partially has a negative and significant effect on the underpricing variable. The inflation rate variable partially has a negative and insignificant effect on the underpricing variable.

Keywords: Influence, Underwriter’s Reputation, Financial Information, Inflation Rate, Underprices.

A. INTRODUCTION

Companies that will go public usually decide to make initial public offerings (IPOs) in the primary market (Putra & Nababan, 2019). Furthermore, these shares will be traded in the capital market or called the secondary market (Indriani & Marlia, 2015). The initial offering’s stock price is established by an agreement between the issuer company and the underwriter, who is the party in need of funding while the issuer want a high starting price (Carter, Dark & Singh, 1998). On the other side, underwriters attempt to reduce the risks they carry as underwriters. Under this arrangement, the underwriter will purchase shares that are not offered in the primary market (Fadila, Hamzah & Sihombing, 2017). This situation makes the underwriter not willing to buy shares that are not sold. Efforts are being made to negotiate with issuers so that the stakes are not too high in price and even underpriced (Boulton, Smart & Zutter, 2011).

Before the company goes public, the company’s shares must be traded on the primary market before entering the secondary market (Rodoni, Mulazid & Febriyanti, 2018). The issuer determines the price of claims that the company will sell during the IPO by the underwriter; the IPO participation is intended to improve the company’s prospects in the future (Wan-Hussein, 2005). Determining the initial
share price in the primary market is not an easy thing. One of the reasons is the absence of relevant price information; this is because the shares have never been traded before, so it will be challenging to assess and determine a fair IPO price (Bedard, Coulombe & Corteau, 2008). Limited information about what and who companies will go public also makes potential investors be careful and analyze further. In the 2016-2020 period, 167 companies conducted IPOs (in 2016 as many as 13 companies, in 2017 as many as 36 companies, in 2018 as many as 55 companies, in 2019 as many as 40 companies, in 2020 as many as 24 companies.

Factors that cause the underpricing phenomenon during an IPO include the influence of the underwriter’s reputation, macroeconomics, and financial information (Arthurs, Hoskisson, Busenitz & Johnson, 2008). Calculating stock prices during the initial public offering is critical for issuers and underwriters because it is directly related to the amount of funds raised by the issuer and the risks assumed by underwriters (Severini, 2020). The issuer receives the product of the number of shares offered and the price per share (Honjo, 2020). This causes issuers to often determine the initial share price by opening a high price offer so that the income obtained is also high (Setya, Supriyani & Fianto, 2020). The underwriter, as the underwriter, tries to minimize the risk so as not to suffer losses due to the unsold of the shares offered; the underwriter can make an effort to negotiate with the issuer (Nadeem, 2020). This shows a difference of interest between the issuer and the underwriter in determining the IPO share price (Azevedo, Guneý & Leng, 2018). The situation in which primary market stock prices are lower than secondary market stock prices is referred to as the underpricing phenomena (Karimov, 2020). The percentage of the underpricing phenomenon that occurred on the IDX from 2016-2020 is relatively high, where the underpricing rate is consistently above 61%.

Underpricing conditions need to be minimized by issuers so that issuers can obtain a reasonable IPO price and raise sufficient funds to finance the company’s activities; on the other hand; investors will benefit more from underpricing conditions because investors will receive returns on their trades (Lowry, Michaely & Valkova, 2017). This condition will make investors interested in buying underpriced IPO shares in the primary market.

B. LITERATURE REVIEW

The underwriter is a mediator between the issuer and potential investors (Putra & Nababan, 2019). Underwriters who already have an excellent reputation are more trusted to sell and guarantee company shares traded in the primary market (Setya, Supriyani & Fianto, 2020). So the higher the importance of the underwriter, the lower the level of underpricing that will arise. Underwriters or underwriting companies are usually large companies that are experienced in selling emissions, acting as a moderator between the issuer and investors (Putranto & Negoro, 2021). Underwriter reputation is measured by assigning a value of 1 to underwriters who are included

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in the top 10 in the 20 most active brokerage house monthly IDX based on the total trading frequency, and beyond that is 0.

According to Law No. 8 of 1995, the underwriter’s role in the go public process is to enter into a contract with the issuer to undertake a public offering for the benefit of the issuer, with or without the obligation to purchase any remaining unsold securities. As such, the underwriter is a supporting institution that is critical to the issuer’s continued public offering. This is because apart from being an institution that assists issuers in preparing all the necessary documents in the entire process of going public, underwriters also make efforts to make the marketing of the issuer’s initial public offering run successfully. Underwriter reputation has been widely used as an independent variable that explains the causes of underpricing in IPOs. Then the hypothesis that can be drawn is as follows:

H₁: The underwriter’s reputation has a positive and significant effect on the underpricing of companies conducting IPOs in the 2016-2020 period.

Financial information is essential for investors in assessing a company that will go public. Financial information is contained in the financial statements of a company. Financial information consists of ratios having the company’s financial condition. Investors believe that information on financial ratios will be able to help in investing in a company (Mahardika & Ismiyanti, 2021). The ratio analysis is employed in three components, specifically (1) managers; the use of ratios by business managers aids in the study and improvement of business operations, (2) credit analysis, which is analyzing ratios in order to ascertain a business’s ability to repay debts, (3) stock analysis, which aids in determining the company’s efficiency, risk, and growth potential. The financial information used in this study is the Price Earning Ratio (PER) which can describe the appreciation of investors in the market for the profits earned by the company. Then the hypothesis that can be drawn is as follows:

H₂: Financial information has a positive and significant effect on the underpricing of companies conducting IPOs in the 2016-2020 period.

Numerous factors can be evaluated in macroeconomics that are external to the company but have an effect on its growth and decline directly or indirectly; one of these aspects is the inflation rate (Widyawati, Juanda & Andati, 2019). Changes in macroeconomic conditions will have an immediate effect on the company’s success, but will have a gradual effect over time. On the other hand, because investors react more swiftly, macroeconomic issues will have an immediate effect on stock values.

Inflation is a critical economic indicator; the rate of change is constantly kept low and consistent to avoid causing macroeconomic diseases that will eventually result in economic instability (Asir, 2021). Inflation that is both high and unstable demonstrates the general trend of rising prices for goods and services over an extended period of time. As a result of this increase in the price level, people’s
purchasing power decreases; as a result, the goods produced do not sell out, and manufacturers do not raise their investment.

Based on statistical data on the official BI website, in January 2016, inflation was 4.14%, and in December 2016, it was 3.02. In 2017, inflation data for January was 3.49% and stood at 3.61% in December 2017. In 2018, inflation data for January was 3.25% and stood at 3.13% in December 2018. In 2019, inflation data for January was 2.82% and stood at 2.72% in December 2019. In 2020, inflation data for January was 2.68% and stood at 1.68% in December 2020. If investment falls, national income falls, illustrating how economic growth ultimately affects the stability of an economy's activities, especially as a development wheel, including investment activities in the capital market. Then the hypothesis that can be drawn is as follows:

H₃: The inflation rate has a positive and significant effect on the underpricing of companies conducting IPOs in the 2016-2020 period.

C. METHOD

This research is quantitative research with a descriptive analysis approach. The research design is in the form of conclusive research between the X variable (Underwriter Reputation, Financial Statements, Inflation Rate) and Y (Company Underpricing). Research data in the form of secondary data obtained from various sources. The sample in this study consisted of 75 companies with an observation period of 2016-2020. Testing of research data is carried out with Normality Test, Multicollinearity Test, Autocorrelation Test, Classical Assumption Test, and Hypothesis Testing.

D. RESULT AND DISCUSSION

Variable Descriptive Statistics

The sample in this study consisted of 75 companies with an observation period of 2016-2020, 80 companies experiencing underpricing, but 4 of them were excluded from the sample because three companies experienced a negative Return On Equity (ROE), one company required incomplete data and 2 data outliers because the range is too high. After several eliminations, the final sample used in this study amounted to 75 companies.

| Variable           | N  | Mean  | Std. Deviation |
|--------------------|----|-------|----------------|
| Underpricing       | 75 | .337285 | .2849088 |
| Underwriter's Reputation | 75 | .155365 | .1486269 |
| Financial Information | 75 | 3.034060 | .4.2004821 |
| Inflation Rate     | 75 | .061565 | .0205167 |

Source: Data processed
The descriptive test findings indicate that the average amount of undervaluation between 2016 and 2020 is 0.3375, with a standard deviation of 0.2849. The average score for underwriter reputation is 0.1553 with a standard deviation of 0.1486. The average financial information is 3.034 with a standard deviation of 4.20, and the average inflation rate is 0.061 with a standard deviation of 0.020 in the year of observation. The standard deviation is used to express the range or separation of two sets of data. The standard deviation is lower than the average, indicating that the variation of the variable is relatively small and vice versa. In terms of average, 41 companies whose underpricing level is below the standard so that it can be said that the initial public offering process has gone quite well following the expectations of the issuer because if there is high underpricing, it means that the funds obtained by the company are not optimal.

**Coefficient of Determination**

The coefficient of determination test quantifies the extent to which independent variables can explain dependent variables. With the provisions, the Coefficient of Determination Test (R-square) is worth 0-1; the closer the value is to 0, the better. The following table summarizes the results of this study’s coefficient of determination:

| Model | R  | R Square | Adjusted R Square | Std. The error of the Estimate |
|-------|----|----------|-------------------|-----------------------------|
| 1     | .480a | .232     | .175              | .2587101                    |

Source: processed data

From the coefficient of determination test results, the adjusted R Square value shows the number 0.175, which means the underpricing level variable, which can be explained by the Underwriter Reputation, Financial Information, and Inflation Rate variables, are 17.5%. At the same time, the remaining 82.5% is explained by other variables not examined in this study.

**Normality Test**

A normality test is used to examine whether or not the distribution of data in a group of data or variables is normally distributed. The results of this study’s normality test are summarized in Table 3 below:
Table 3. Normality Test Results

|                     | Unstandardized Predicted Value |
|---------------------|-------------------------------|
| N                   | 75                            |
| Normal Parameters   |                               |
| Mean                | 0.3125988                     |
| Std. Deviation      | 0.09551883                    |
| Most Extreme Differences |                           |
| Absolute            | 0.108                         |
| Positive            | 0.065                         |
| Negative            | -0.108                        |
| Test Statistic      |                               |
| Asymp. Sig. (2-tailed) | 0.201                      |

Source: Data processed

The results of the Kolmogorov-Smirnov test indicate the Asymp. value. Sig. (2-tailed) or residual significance of 0.201. Sig. (2-tailed) or residual significance of 0.201. If the value is greater than 0.05, the data is regularly distributed.

**Multicollinearity Test**

The multicollinearity test is used to detect whether there is a correlation between independent variables or within-model independent variables. Multicollinearity has the effect of increasing the number of variables in a sample. The Multicollinearity Test results for this investigation are summarized in Table 3 below:

| Model                                | Collinearity Statistics |
|--------------------------------------|-------------------------|
|                                      | Tolerance | VIF   |
| Underwriter's Reputation (X1)        | .868      | 1.158 |
| Financial Information (X2)           | .939      | 1.065 |
| Inflation Rate (X3)                  | .938      | 1.066 |

Source: Data processed

The multicollinearity test shows that the underwriter reputation, auditor reputation, company age, and percentage of share offerings have a tolerance value of more than 0.1 and a VIF of less than 10. This indicates that there is no multicollinearity in the data of these variables.

**Autocorrelation Test**

The autocorrelation test is used to check whether the variables in the prediction model are correlated. The disturbance's value is no longer expressed in independent pairs but in autocorrelation. The Autocorrelation Test results for this investigation are summarized in Table 4 below:
Table 4. Autocorrelation Test Results

| Model | R   | R Square | Adjusted R Square | Durbin-Watson |
|-------|-----|----------|------------------|---------------|
| 1     | .426a | .183     | .069             | 2.034         |

Source: Data processed

According to the autocorrelation test results in Table 4, the research data has a Durbin-Watson (DW) value of 2.034. When this result is compared to the Durbin-Watson table value with a 5% significance level, 75 samples (n), and 5 independent variables (k), the du value is 1.7814. This indicates that du DW 4 – du, there is no autocorrelation.

**F-test**

The F test is used to compare $F_{count}$ to $F_{table}$: if $F_{count} > F_{table}$, the F test is used ($H_0$ is rejected, $H_a$ is accepted). The model is significant if and only if the significance column (%) $< \text{Alpha}$. Furthermore, if $F_{count} =$ $F_{table}$, the model is not significant. The following table 5 summarizes the results of the F test used in this study:

Table 5. F Test Results

| Model     | Sum of Square | df  | Mean Squares | F           | Sig.  |
|-----------|---------------|-----|--------------|-------------|-------|
| Regression| 1.367         | 6   | .274         | 4.083       | .004  |
| Residual  | 4.552         | 69  | .068         |             |       |
| Total     | 5.918         | 74  |              |             |       |

Source: processed data

The F test results above indicate a significance level of 0.004. Due to the fact that the significance level is less than 0.05, $H_0$ is rejected and $H_1$ is accepted, indicating that the regression model is fit.

**T-test**

The t-test or partial test was used to determine the independent effect of each independent variable on the dependent variable. The following table summarizes the results of the T-test used in this study:

Table 6. T-test result

| Model                        | Standardized Coefficients | t  | Sig.  |
|------------------------------|---------------------------|----|-------|
| (Constant)                   | Beta                      | 3.048 | .005 |
| Underwriter's Reputation     | -.036                     | -.214 | .833 |
| Financial Information        | -.349                     | -2.236 | .033 |
| Inflation Rate               | -.137                     | -.875 | .389 |

Source: Data processed
Table 6 shows that only the auditor’s reputation variable has a significance level smaller than the level of significant (α). The Financial Statements variable, however, has a considerable effect on underpricing.

**Underwriter’s Reputation Variable**

According to the statistical analysis in Table 6, the underwriter reputation variable has a marginally negative and negligible effect on the underpricing variable. This means that H1 is rejected. The underwriter is tasked with bridging the interests of issuers and investors together. Issuers want a maximum initial price for parties who need funds, while investors expect a minimum initial outlay to get maximum capital gains.

Underwriters, on the other hand, expect the issuance of shares to be successful, one of which is marked by the sale of all IPO shares, especially if the agreement scheme with the issuer is Full Commitment, where the underwriter is required to buy shares that are not sold during the IPO. The underwriter’s measures to avoid the issuer’s shares from being sold include negotiating with the issuer to ensure that the share price is not excessive (Asir, 2011). This raises the risk of high underpricing, whether the issuer uses services of an underwriter with a high or low reputation. The importance of the underwriter has an insignificant effect on underpricing.

**Financial Information Variables**

According to the statistical analysis in Table 6, the Financial Information variable has a somewhat negative and statistically significant effect on the underpricing variable. That is, H2 is rejected. A negative coefficient value suggests that the more financial information available, the less underpricing there will be in the initial public offering. This condition makes it very difficult for investors to research the benefits and risks of IPO shares. Information obtained by investors related to the company’s performance that reflects the prospect or value of the company in the future will affect the initial rate of return (Asir, 2018). This information helps investors to determine and decide on a suitable investment in IPO shares.

**Inflation Rate Variable**

The statistical calculations in Table 6 show that the Inflation Rate variable partially has a negative and insignificant effect on the underpricing variable, meaning that H3 is rejected. This indicates that the high or low inflation rate in the macro-economy until the time of the IPO will not significantly affect the level of underpricing.

One of the elements affecting variations in inflation in Indonesia is Bank Indonesia’s reference interest rate, or the BI Rate, which serves as a signal for banks to determine interest rates on savings, deposits, and loans. Changes in the BI Rate will have an effect on a number of macroeconomic indicators, which will be reflected in inflation. The difference in the form of an increase in the BI Rate level attempts to slow economic activity and hence prevent inflation. When the BI Rate rises, lending and deposit rates rise in lockstep. When deposit rates increase, more people deposit their
money in banks, reducing the amount of money in circulation. In terms of credit interest rates, an increase in interest rates will encourage business actors to cut down on investment as the cost of capital continues to rise. This has slowed economic activity and, as a result, inflationary pressures have subsided.

E. CONCLUSION

The underwriter reputation variable partially has a negative and insignificant effect on the underpricing variable. The Financial Information variable partially has a negative and significant effect on the underpricing variable. The inflation rate variable partially has a negative and insignificant effect on the underpricing variable.

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