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# The Influence of Underwriter and Auditor Reputations, Not to Mention Return on Asset on Initial Public Offering (IPO) Underpricing in Indonesian Stock Exchange

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**Abstract:** AbstractInitial Public Offering (IPO) is the company's activity issuing its share for the first time to the public in order to increase the company's capital. This research is aimed to know the influence of underwriter reputation. Auditor reputation, and Return On Asset (ROA) againts underpricing for period 2012-2016. This research was conducted using multiple regression analysis with 5 percent level of signification. The aim of the research is to know the influence of each variable. Before using multiple regression tet, the author tested the classical first. The result of this research againts the variable is ROA has a significant positive effect on underpricing and other variable that is the underwriter reputation and auditor reputation are not affected againts underpricing.

**Key words:** IPO; underpricing; underwriter reputation; auditor reputation; profitability; return on asset (ROA)

**JEL code:** G1

## 1. Introduction

Company can engage many alternative funding sources to support its grow. According to Darmaji and Fachrudin (2012), internal fund alternatice may take form of using the company's reserve funds, while the external fund alternative can be sourced from creditor in the form of debt, other financings or through the issuance of bond, or equity financing. Should the company decide to offer its shares to public (go public) as one alternative to raise money, this initial share offering is known as go public or Initial Public Offering (IPO). Initial Public Offering (IPO) is a company's activity in issuing its share for the first time to the public in order to increase company's capital. According to Ritter and Welch (2002), in its early business cycle, the company is going private, but when the company is expanding along the time, it can optimize its grow by going public.

The company might find it hard to determine its initial offering price due to the absent of relevant price information. The absent of this relevant price information is calledasymmetric information. Retnowati (2013) said that asymmetric information might occur between issuer and underwriter, or among investors. The company initiating to go public can minimize this asymmetric information by the way of issuance of a prospectus. Prospectus contains detailed information and material facts regarding shares public offering of a company from

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issuer and underwriter, as the financial information and financial statements are useful in determining the share price during IPO.

Underwriter's objective and urge are different from the issuer, issuer will strive to offer higher price, but underwriter will try to keep the share price at a minimum to avoid the risk of unsaleable over the share offered. The unsalable share will be repurchased by underwriter so that underwriter tries to maintain the share at a lower price so the risk remain minimum.

Share prices in the primary market differ from those in the secondary market. According to Darmaji and Fachrudin (2012), Initial Market is a share or others securities offering activity performed by the issuer (the company innitiating to go public) to sell shares or other securities to public under the procedures as set out in the Capital Market Law and its Sub-Ordinate Legislations, while secondary market is a market in which investor can trade its securities after listing on a stock exchange.

If the share price is lower than the price applicable on the secondary market, then underpricing will occur, on the contrary, the overpricing will occur when the primary market sets the price for sale at too high a price than the secondary market does. Investors are expecting the underpricing phenomenon so they can generate an initial return. Initial return is obtained from the difference between share price on the secondary market and the share price on the primary market. Meanwhile, the issuer may incur the wealth losses as the result of underpricing.

Underwriter reputation is the most important thing for underwriter to avoid unsalable share, making the underwriter to repurchase such shares itself. Lestari, Hidayat, and Sulasmiyati (2015) said that Auditors are the parties assessing the feasibility of a financial statements issued by company. Profitability ratio reflects the financial performance of a company. Sound profitability ratio demonstrates an excellent financial performance of the company. The factors such as underwriter and auditor reputations, and profitability, in this case, Return On Asset (ROA), affect the underpricing. With the abundance of information, investors must consider the influencing factor to take a decision to invest their fund.

Based on the above elaboration, researcher wants to conduct a research regarding the analysis of external factor in the form of underwriter and auditor reputations, as well as internal factor which is Return On Asset (ROA). Based on the background, researcher reexamines the influence of underwriter and auditor reputations, and Return On Asset against initial public offering (IPO) underpricing on the Indonesian Stock Exchange.

## 2. Literature Review

### 2.1 Initial Public Offering

2.1.1 IPO Definition

According to Darmadji and Fachrudin (2012), IPO (Initial Public Offering) is a share or others securities offering activity performed by the issuer (the company innitiating to go public) to sell shares or other securities to public under the procedures as set out in the Capital Market Law and its Sub-Ordinate Legislations. The company initiating to go public is driven by its intention to increase the company capital or to reduce its debt. Sugiyanto and Wijaya (2014) argued that the change of company's status becoming go public company is intended to increase the fund as much as possible, so that IPO price is estimated to be high by issuer. IPO is deemed to succeed if the share issued by company is in great demand by investors (oversubscribe) but if the share price in secondary market is higher than in initial market then it is called underpricing. According to J Muna and Yulia (2007), before share offering on the primary market, company will issue a brief prospectus (detailed information on the company) announced in mass media. This prospectus aims to provide the investors with any information regarding the company, for them to forcast the company's future.

2.1.2 IPO Underpricinh

Brealey, Myers and Marcus (2006) stated that underpricing is an activity of issuing securities on the offering price specified below the actual securities value. Underpricing can occur due to asymmetric information. Retnowati (2013) said that asymmetric information may occur between issuer and underwriter, or among the investors. Specifically, asymmetric information may occur between issuer company and underwriter or between investors having information and investors having no information. The companycan minimize this asymmetric information by the way of issuance of a prospectus containing various information regarding the related company. A big uncertainty of issuer company on share price will increase the demand of underwriter service.

Kurniawan (2014) stated that in IPO, issuer wants a high initial share offering price while underwriter and investors want a lower price. This contradicting concer can cause underpricing condition. For the company issuing initial share which undergoes underpricing, the company has lost the opportunity to generate maximum fund and capital. On the other hand, overpricing will enable the company to generate more funds in a lower cost. For investors, underpricing phenomenon is a positive signal that the company has a possibility to provide profits for investors in the future because investors will obtain initial return. Initial return is generated from the difference between the share price on a secondary market and the share price on a primary market.

**2.2 Factors Influencing Underpricing**

2.2.1 Underwriter Reputation

According to Brealey, Myers and Marcus (2006), Underwriter is an investment banking company acting as financial assistant for new share issuer. Normally, it plays three roles namely, giving the company procedural and financial suggestions, then disposing them to public and finally repurchasing its share. Darmadji and Fachrudin (2012) said that the cooperation form between underwriter and issuer takes form of a complete underwriter contract with various rights and obligations among them. Fahmi (2015) stated that the Contract consists of 2 contracts which are, Fahmi (2015) Best effort agent which is the underwriter only in the limitation of a certain sold share and Fahmi (2015) Full Commitment, which is an underwriter who ensures the sale of all share offered. In the event there is unsalable share then underwriter shall purchase it.

2.2.2 Auditor Reputation

Lestari et al. (2015), Auditor is any party assessing the feasibility of a financial statements issued by company. Auditor reputation is very influential for the credibility of financial statements when the company is engaged in IPO. The auditor is indirectly affect the a trust level on any information reflected in the prospectus. Therefore, auditor quality affects IPO success, which is indicated by a lower underpricing.

2.2.3 Profitability (ROA)

According to Lismawati and Munawaroh (2015), Profitability is the company's ability to generate profit which will attract investors to invest their fund in order to expand the company business. Information regarding company's profitability ratio is highly considered by Investors in making a decision to invest their funds. The higher the profitability ratio, the higher investor desire to invest their capital. Company's profitability is calculated with Return On Asset (ROA) to be enjoyed by investors. Retnowati (2013), Return On Asset is a ratio used to calculate company's effectivity in producing profits by utilizing its assets.

**2.3 Hypothesis Development**

2.3.1 The influence of Underwriter Reputation against Underpricing

Underwriter is an underwriter for each company to issue its share in capital market. If a company found not feasible to go public but underwriter states that the company is feasible, the risk to come is that the company will be judged poorly in public so as the underwriter reputation. Then underwriter must pay corresponding to the unsalable share in capital market. The higher underwriter reputation, the lower underpricing level of the company performing IPO since investors believe that a highly reputable underwriter does not guarantee the low quality issuer so it will cause trust in investors.

The research result of Putra and Sudjarni (2017) and Rizqi and Harto (2013) showed that Underwriter reputation has a negative effect on the underpricing. The higher underwriter reputation, the lower underpricing level on the company performing IPO because investors believe that the highly reputable underwriter does not guarantee low quality issuer so it will cause trust in investors. In line with the research, in the research conducted by Murtini (2015), underwriter reputation affects the underpricing and in Khin, Wong W B, and Ting (20150's research in the journal entitled Initial Public Offering (IPO) Underpricing in Malaysian settings said that underwriter reputation affects the underpricing. Johnston and Roten (2015) stated that experience and resource enable reputable underwriters to offer new offering price more accurately therefore, reputable underwriter said that the proper offering price has lower underpricing than IPO borne by non-reputable underwriter.

It means that issuer candidate uses underwriter in determining the share price to be sell in initial market so that the better underwriter's reputation will reduce underpricing level. Contradicting with it, in the research conducted by Pahlevi (2014) and Lestari et, al (2015) showed that Underwiter reputation does not affect the underpricing. It is caused by the Investors who did not consider underwriter used by a reputable issuer so that investors could not estimate the proper or the actual value for IPO company.

H1: Underwriter reputation negatively affect the Underpricing

**2.4 The Influence of Auditor Reputation on Underpricing**

Fahmi (2015), Underwriter auditor is a public accountant firm (KAP) appointed and gives a representation that the company is feasible to go public. Feasibility statement is determined by feasibility factor of financial report and audit result of the company which by law and procedure meeting the requirements to go public. It is also needed in auditor reputation, because if the issuer who is guaranteed its feasibility a problem found in the financial report then auditor and KAP reputation will be bad in public. Therefore, auditor quality also affects IPO success indicated by the lower underpricing. In a research conducted by Lestari et al. (2015) showing that auditor reputation negatively affects the underpricing. It means that auditor reputation affects underpricing level on a primary market.

Martini, Sinaga and Syahroza (2012) stated that the audited financial statements will increase the information reliability for users and reliable financial statements will reduce asymmetric information for users. Users, in this case investors, s can find out the prospect of a company by examining the audited financial statements which are prepared by experienced and reputable auditor, since reputable auditor will conduct a thorough audit before deciding such company is feasible to go public, and the financial statements published reflect a qualified and trusted audit result.

However, in the research of Purwanto, Agustiningsih, Insani and Wahyono (2014) as well as Rizqi and Harto (2013) contested the study done by Lestari et, al (2015), indicating that auditor reputation does not affect the underpricing. Hence, it stated that investors do not consider auditor reputation in assessing issuer performing the IPO.

H2: Auditor reputation has negative effect on underpricing

### 2.5 The Influence of Return On Asset (ROA) on Underpricing

Lismawati and Munawaroh (2015) said that Information regarding company's profitability ratiois a positive signal for investors in making decision. One of the profitability measurement is using Return On Asset (ROA). This ratio shows how and to which extent the company effectively generates profits from company's activity result. Razafindrambinina and Kwan (2013) stated that financial ratio analysis can help investors in making investment decision and predicting the future performance of a company.

The high level of company's profitability will attract more investors which will result in increasing company's share demand. Prastica (2012) stated that the higher company's ROA, the lower underpricing level since investors will assess company's performance better and ready to purchase its initial share with higher price. Purbarangga and Yuyetta (2013) mentioned that High demand causes the share price offering in secondary market increases.

Tian and Liu (2017) argue that the existence of Underpricing in company's IPO and investor's sentiment will positively affect investors in which investors will obtain initial return. Although underpricing is seen from investors' point of view will give profits in the form of initial return but from the issuer's point of view the issuer will obtain not maximum fund, however there is a positive side for issuer which is issuer's share will be enjoyed by investors in the future since issuer guarantees and provides real evidence in the form of initial return for investors so that other investors will be interested in buying the issuer's share. Hence, investors make ROA as the standard to see the prospect of a company.

H3: Return On Asset (ROA) positively affect the Underpricing

## 3. Research Method

### 3.1 Population and Sample

The population in this research was the companies performing IPO listed on Indonesian Stock Exchange. Sample collection was done by using purposive sampling technique, the criteria as the companies performing IPO on IDX during the period of 2012-2016, undergoing underpricing, having financial statements published a year prior to IPO, the sample must contain underwriter's information, name and non-negative ROA data. Based on the sample corresponding to the criteria, there were 58 companies employed as the research samples.

### 3.2 Data and Data Source

This research usedsecondary data consisting of qualitative and quantitative data. Quantitative data included companies name performing IPO, initial price and closing price during secondary market, as well as company's financial report. Whereas the qualitative data included underwriter names data, auditor names. The data can be obtained from www.e-bursa.com, Indonesian Stock Exchange (ww.idx.co.id), and other publications which can help this research.

### 3.3 Operational and Variable Definitions Exist in the Hypothesis

3.3.1 Underpricing

The sample used is companies experienced underpricing, which is positive initial return and its calculation thereof uses this following formula:

$$UP = \frac{\text{closing price} - \text{IPO price}}{\text{IPO price}} \times 100\%$$

3.3.2 Underwriter Reputation

Underwriter reputation in this research used measurement data based on the most active underwriter. This research determined the value of 0 for underwriters who are not classified as the top five group and value of 1 for underwriters who are classified as the top five group. This research was conducted in the period of 5 years from 2012-2016 during the research.

3.3.3 Auditor Reputation

Auditor reputation in this research was measured by using auditor's rank or frequency in performing financial report audit from issuer. Auditor record measurement on company's IPO year, auditor will be given value of 1 in auditor's category included in the top three and 0 value for auditor not included in the top three.

### 3.4 Return On Asset (ROA)

ROA is a profitability ratio used to calculate company's capability in producing benefits or profits. The data for ROA calculation were taken from 1-year prior company performs IPO. ROA formula according to Darmadji and Fachrudin (2012) is as follows:

$$ROA = \frac{\textbf{EAT}}{\textbf{TOTAL ASSET}} \times 100\%$$

### 3.5 Analysis Tool Method

To reveal any effects which might be brought by the independent variables to the dependent variable, researcher used double regression analysis formulated as follows:

$$UP_i = \boldsymbol{\alpha + \beta 1\ RUi + \beta 2 RAi + \beta 3 ROAi}$$

In which:

**UP** = Underpricing of the first day as dependent variable

$\boldsymbol{\alpha}$ = Constant

$\boldsymbol{\beta_1}$, $\boldsymbol{\beta_2}$, $\boldsymbol{\beta_3}$ **=** Regression coefficient of every independent variable

**RU** = Underwriter Reputation

**RA** = Auditor Reputation

**ROA** = Return On Asset

## 4. Data Analysis and Discussion

### 4.1 Descriptive Statistics

Descriptive Statistics is useful to know the average, the highest value, the lowest value and deviation standard on every variable which are underpricing, underwriter reputation, auditor reputation, ROA. The following is a descriptive statistic of this research:

**Table 1 Descriptive Statistics of Research Variable**

| | UP | RU | RA | ROA |
|---|---|---|---|---|
| Mean | 0.272086 | 0.482759 | 0.362069 | 6211.772 |
| Median | 0.149500 | 0.000000 | 0.000000 | 0.058000 |
| Maximum | 0.700000 | 1.000000 | 1.000000 | 210458.4 |
| Minimum | 0.007000 | 0.000000 | 0.000000 | 0.000000 |
| Std. Dev. | 0.240389 | 0.504067 | 0.484796 | 30883.86 |
| Skewness | 0.596908 | 0.069007 | 0.573997 | 5.635424 |
| Kurtosis | 1.834345 | 1.004762 | 1.329472 | 35.64149 |
| Jarque-Bera | 6.727879 | 9.666721 | 9.929001 | 2881.873 |
| Probability | 0.034599 | 0.007960 | 0.006981 | 0.000000 |
| Sum | 15.78100 | 28.00000 | 21.00000 | 360282.8 |
| Sum Sq. Dev. | 3.293865 | 14.48276 | 13.39655 | 5.44E+10 |
| Observations | 58 | 58 | 58 | 58 |

Source: Secondary data processing of researcher

Based on Table 1, underpricing has the average of 0.272086 indicating that the share price on the first closing day is higher than initial market or underpricing occurred. While on the deviation standard, it indicates 0.240389 meaning that the underpricing distribution from 58 companies is in amount of 0.240389. The maximum value shows 0.700000 and the minimum value shows 0.007000. On the underwriter reputation, it was known that the average is in amount of 0.482759. Whereas the deviation standard is 0.504067 meaning that underwriter reputation distribution of 58 companies is in amount of 0.504067 with the highest value of 1.000000 and the lowest value of 0.000000. It was found out that auditor average is in amount of 0.362069, for the highest value of 1.000000 and the lowest value of 0.000000. deviation standard in in amount of 0.484796 which means that auditor reputation distribution value of 58 companies is 0.484796. The average of Return On Asset (ROA) is 6211.772. The deviation standard of Return On Asset (ROA) of 58 companies is 30883.86. While the highest value is 210458.4 and the lowest value is 0.000000. Protech Mitra Perkasa (OASA) has the highest ROA and the lowest ROA is owned by Sri Rejeki Isman (SRIL), Bank Maspion Indonesia (BMAS), Sawit Sumbermas Sarana (SSMS) and Bank Dinar Indonesia (DNAR).

### 4.2 Analysis Result of Double Regression

In the analysis of classic assumption test, it was obtained the result of normality test that the data used is normally distributed. In multicollinearity test, the VIF centered value showed that there is no multicollinearity problem. Autocorrelation test using Durbin-Watson method showed that there is no autocorrelation problem. In heteroscedasticity test result showed that there is no heteroscedasticity problem. Based on the data result tested in this research, double regression analysis is in Table 2.

It was obtained the regression equation as follows:

$$UP = 0.311529 - 0.073519\ RU - 0.045795\ RA + 2.03E\text{-}06\ ROA$$

Based on Table 2, it can be explained that each independent variable influence towards dependent variable is as follows.

**Table 2 Analysis Result of Double Regression**

Dependent Variable: UP

Method: Least Squares

Date: 01/24/18 Time: 15:52

Sample: 1 58

Included observations: 58

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 0.311529 | 0.046278 | 6.731692 | 0.0000 |
| RU | -0.073519 | 0.063660 | -1.154870 | 0.2532 |
| RA | -0.045795 | 0.065840 | -0.695547 | 0.4897 |
| ROA | 2.03E-06 | 1.00E-06 | 2.028026 | 0.0475 |

| | | | |
|---|---|---|---|
| R-squared | 0.123991 | Mean dependent var | 0.272086 |
| Adjusted R-squared | 0.075324 | S.D. dependent var | 0.240389 |
| S.E. of regression | 0.231159 | Akaike info criterion | -0.024953 |
| Sum squared resid | 2.885454 | Schwarz criterion | 0.117147 |
| Log likelihood | 4.723623 | Hannan-Quinn criter. | 0.030398 |
| F-statistic | 2.547738 | Durbin-Watson stat | 1.996852 |
| Prob(F-statistic) | 0.065397 | | |

Source: Secondary data processing of researcher

### 4.3 The Influence of Underwriter Reputation on Underpricing

It was found out on Table 2 that the coefficient is in negative value -0.073519 and the significant value is 0.2532 which is greater than 0.05. Based on the result, then the hypothesis concerning underwriter reputation affects underpricing is “rejected”. From the result, it showed that underwriter reputation does not affect the underwriting. This finding supports the research conducted by Pahlevi (2014) and Lestari et al. (2015) indicating that underwriter reputation does not affect the underpricing. It means that investors do not consider the underwriter of every issuer so that investors cannot estimate the proper or actual value for company’s IPO.

Sugiyanto and Wijaya (2014) stated that underwriter does not affect underpricing might be due to different reference from reputable underwriter which researcher used and regarding investors, they might not reflect the underwriter quality of the company because it might only identify the performance of underwriter briefly. Therefore, investor still cannot identify and separate good and bad company eventhough the issuer has used reputable underwriter. It means that it does not support the research of Putra and Sudjami (2017) as well as Rizqi and Harto (2013) whics stated that underwriter reputation negatively affects underpricing. This result also rejects the research conducted by Murtini (2015) which stated that underwriter reputation affects underpricing and the research of Khin et al. (2015) in his journal of Initial Public Offering (IPO) Underpricing in Malayian setting which stated that Underwriter reputation affects Underpricing.

### 4.4 The Influence of Auditor Reputation on Underpricing

Table 2 shows negative coefficient of -0.045795 and significant value of 0.4897 in which greater than 0.05. Based on the result, then the hypothesis mentioning that auditor reputation affects underpricing is “rejected”. This research does not support the research conducted by Lestari et al. (2015) which stated that auditor reputation negatively affects the Underpricing and supports the research conducted by Purwanto et al. (2014) as well as Rizqi and Harto (2013) which argue that auditor reputation does not significantly affect the underpricing. Auditor reputation which is not affecting underpricing is occurred because investors do not consider auditor reputation in assessing the issuer performing IPO.

According to Lee, Li, Hu, and Lu (2017) said that Compared to the other big IPO markets (various countries), company's financial report registered in IPO market in Indonesia and Chinese Mainland is not reliable enough. Therefore, whether the issuer uses reputable or non-reputable auditor, it is not considered by investors and might be caused by investors' trust in auditor's report result in prospectus is deemed low.

### 4.5 The Influence of Return On Asset (ROA) on Underpricing

The result of table 4.6 shows positive coefficient of 2.03E-06 or 0.00000203 and the profitability value shows 0.0475 which is greater than 0.05. The result of this research regarding the hypothesis of Return On Asset (ROA) has positive effect on underpricing is **"accepted"**, meaning that this research does not support the profitability level showing the result that profitability (ROA) has negative effect on underpricing. And the research of Retnowati (2013) showed that profitability (ROA) does not affect underpricing. This research supports the research conducted by Prastica (2012) which stated that profitability (ROA) has positive effect on underpricing, meaning that if the company generates a high profit, then the shares demand will increase.

Purbrangga and Yuyetta (2013) stated that high demand causes the share price in secondary market increases. The increase of share price in this secondary market is called Underpricing. Tian and Liu (2017) said that the existence of Underpricing in company's IPO and investors' sentiment will positively affect investors in which investors will get initial return. Welch and Ritter (2002) said about the signaling theory in underpricing phenomenon. According to Martani et al. (2012), underpricing IPO is a mechanism to signal the quality of a company, hence company with good quality performs underpricing to its share in order to be success when they are performing share offering in the future.

## 5. Conclusion and Suggestion

### 5.1 Conclusion

From the research analysis conducted, there were 58 companies performing IPO and experienced Underpricing, therefore it can be concluded as follows:

1) Underwriter reputation does not affect the underpricing on initial public offering on Indonesian Stock Exchange. The result showed that investors do not consider underwriter reputation in decision making.
2) Auditor reputation does not affect the underpricing on initial public offering in Indonesian Stock Exchange. The result showed that investors do not consider the auditor used by company in decision making.
3) Return On Asset (ROA) possitively affects underpricing on initial public offering on Indonesian Stock Exchange. The result showed that the higher the profit generated by company, the higher investors' demand. resulting in the increase of share price on the secondary market which also makes the underpricing level high.

### 5.2 Suggestion

Based on the conclusion above, then the suggestions proposed are as follows:

1) For the future researcher, it is suggested to add the variables possibly affecting underpricing.
2) For the future researcher, it is suggested to extent the number of years to conduct the research possibly

affecting the result of underwriter reputation and auditor reputation.

3) For the future researcher, it is suggested to focus more on the sample used to determine industrial type possibly affecting the result obtained to be more accurate.