

Factors Affecting Initial Return in Companies That Conduct Initial Public Offering (IPO) on Indonesia Stock Exchange

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Abstract

Corporate firms that need more funding can have more corporate action firms called IPO. The IPO public initials (initial public initials) is the first public offering of shares or corporate bonds to the public or public. The IPO companies' performance is reflected in massive initials return. The company samples on this study totaled 204 companies during the 2014-2019 period. The analysis technique used in this research is linear regression with section cross data. Testing models using f-test and hypothetical testing using t-test. Research shows that variable profitability, the size of the enterprise and the age of the company reflect the initials return. Leverage does not affect an initial return.

Keywords: Leverage, Profitability, Corporate Size and Longevity, Initials Return, Underpricing, Initials Public Offering (IPO).

I. Introduction

The company's funding needs are getting higher. The company is required to be able to find outside sources of funding to meet its funding needs. But not all financial institutions can meet the needs of corporate funds in a large amount. One way to find source funding is to do a corporate action called Go Public. This go public activity is often referred to as Initial Public Offering or IPO. An IPO (Initial Public Offering) is a first-time public offering of shares or corporate bonds to the general public or the public.

The phenomenon of IPO companies influenced by the alignment of the economic situation in Indonesia will result in the increase and decrease of IPO companies in Indonesia every year. IPO companies in Indonesia until 2019 recorded 688 issuers (<https://m.cnnindonesia.com/2019>). Here are the developments of companies that conduct IPO corporate action from year to year:



Figure 1. Development of IPO on Indonesia Stock Exchange 2005 - 2019

Source: investor.id

The rising IPO trend proves that more and more companies are needing a source of funding from the capital markets. As a corporate action for a company, an IPO can shape the company's share price, making the company's value more measurable (Liu et al., 2013).

The IPO share offer is an opportunity for investors to make high returns because for the first time the company's shares will gain market value reflecting expectations for the company's future growth. The high demand for IPO shares caused the share price to rise, so investors who invested would benefit. This condition will cause the initial share price to be lower than the price that occurred at the time the IPO shares began trading on the secondary market or so-called underpricing.

Several theories have been put forward that underpricing an IPO is an event in the capital markets. Underpricing companies IPOs are often required of companies for different reasons. If the share price at the time of the IPO is set lower than the expected valuation for new shares, then investors who buy shares at the time of the IPO get a positive initial rate of return on the first trading day after listing (Wong et al., 2017).

The level of underpricing or initial return that occurred in Indonesia during the research period from 2013 - 2019 on the Indonesia Stock Exchange is shown in the table as follows:

Table 1. Underpricing IPO Stock Developments for Period 2014 – 2019 on Indonesia Stock Exchange

Years	Number of Issuers	Number of Underpricing Issuers	Percentage of Underpricing Issuers
2014	23	20	86,96%
2015	18	16	88,89%
2016	15	14	93,33%
2017	37	34	91,89%
2018	58	54	93,10%
2019	55	51	94,44%

Source: e-bursa.com (data processed)

Table 1 shows in Indonesia the company that conducted the IPO from 2014 – 2019 the majority experienced underpricing. In addition, the development of companies that conduct IPOs in the Indonesian capital market is experiencing a worrying trend. Based on the research results of "Global IPO Trends Report: Q2 2019" in 2018 the Indonesia Stock Exchange ranked 10th out of the total number of initial public offerings of global shares (<https://ekonomi.okezone.com/2019>).

The increase in IPO company trend is influenced by several factors consisting of internal and external factors. Internal factors in which the company is in a desire to achieve its vision and mission with great capital financial needs therefore conduct an IPO. The external side is the dynamic of macro state in IHGS Indonesia.

Many investors make very high profits at the time the company conducts an IPO. Unfortunately, this IPO moment is often used by most large investors or institutions to speculate and carry out stock frying actions. This will certainly adversely affect the market performance of the companies that conduct IPOs. Such investor behavior will also impact other investors who participate (herding behaviour) without conducting a fundamental analysis of the shares it will buy. Social interactions like this will influence investors' decisions in conducting transactions (Nofsinger, 2016). Investors should make the company's fundamental information (especially IPO companies) as the basis for consideration in making

investments. Some of the fundamental information that investors can see is Leverage, Profitability, Company Size and Company Age.

In the study by Haymans Manurung & Cardo Manurung (2019) said that since Ibbotson (1975) published his research, the initial return of a company that first traded on the stock market became popular. However, Manurung (2013) stated that empirical IPO research (Initial Public Offering) had been conducted before Ibbotson published his papers such as Reilly and Hatfield (1969), Stoll and Curley (1970), Brown (1970), Shaw (1971), McDonald and Fisher (1972), and Logue (1973).

The strategic role of IPO in creating the value of the company and the discovery of empirical gaps from various studies, encouraged analysis of factors affecting the initial return of IPO companies in Indonesia. Therefore, the authors are interested in conducting research with the title: Factors That Affect Initial Return in Companies That Conduct Initial Public Offering (IPO) on Indonesia Stock Exchange in 2014-2019.

II. Literature Review

There are two phenomena that occur in the share price after the IPO namely underpricing and overpricing. The underpricing phenomenon is an event where the company's share price soars on the first day of trading on the secondary market. Underpricing is often associated with initial returns that will be received by investors or shareholders. While overpricing is an event where the share price decreases on the first day of trading on the secondary market. Initial Return is a profit earned by shareholders due to the difference in the share price purchased in the initial market with the selling price in the secondary market (Manurung, 2013). Initial return is calculated by formula:

$$IR = \frac{\text{Closing Price}_t}{(\text{IPO Price}_t - \text{IPO Price}_{t-1})}$$

There are many factors that affect the initial return. These factors can come from both internal and external. In this study used internal factors as variables that affect initial return, consisting of leverage, profitability, size of company and age of the company.

2.2 Leverage Affects Initial Return

The leverage of companies in this study was measured by the Debt to Total Asset Ratio (DAR). According to Brigham et al. (2011), DAR is a ratio that measures the percentage of funds provided by creditors. The debt to asset ratio (DAR) formula is as follows:

$$DAR = \frac{\text{Total Debt}}{\text{Total Asset}}$$

Leverage is a fundamental aspect that investors will consider in investing in IPO shares (KIM et al., 1993). Investors can perceive the information of high debt levels showing the company has a favorable investment prospect that will provide a profit in the future, thus impacting the increase in initial return as found in the study. On the other hand, investors can also perceive high levels of debt as the situation of the company has a high business risk that will threaten the sustainability of the company so as to impact the decline of the initial return. This is in line with research by Trisnarningsih (2017), Hermuningsih (2014) and Ahmad et al. (2014) which stated that the higher leverage the lower the initial return. Based on the explanation, the first hypothesis of this study is:

H₁: Leverage affects the initial return of IPO companies

2.2 Leverage Affects Initial Return

In this study, profitability was measured by Net Profit Margin (NPM). According to Cashmere (2014) said that Net Profit Margin is the ratio used to measure the bank's ability to generate net income from its core operating activities. NPM is calculated with the following formula:

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Operating Income}}$$

The higher the level of profitability, the higher the likelihood that investors will earn income. This will certainly be good news for investors who will increase interest in IPO stocks, and will increase initial returns. The results of the study showed the effect of profitability on underpricing is Purwanti & Siregar (2018) and Ayuwardani & Isroah (2018). On the other hand, some investors perceive the increase in profitability does not guarantee that high dividend income will result in a decrease in initial return of Maya (2013), Witjaksono (2012), and Ardiansyah (2003). Based on the explanation, the second hypothesis of this study is:

H₂: Profitability affects initial return of IPO companies

2.3 Effect of Company Size on Initial Return

The Size of the Company is a scale where it can be classified as a small large company in various ways (Yoga, 2010). The company size formula is as follows:

$$\text{SIZE} = \text{Ln Total Assets}$$

The size of the company can increase underpricing (Kim et al., 1995). Information in the form of company size can be used as a proxy level of stock uncertainty because large-scale companies tend to be better known to the public, so information about the prospects of large-scale companies is easier for investors to obtain than small-scale companies, thus reducing the level of uncertainty about the company's prospects going forward. This can help investors predict the risks that may occur if they invest in the company. Thus, the larger the size of a company, the lower the level of uncertainty, which will ultimately affect the initial return (Mezhoud & Boubaker, 2011). The effect of the company's size on underpricing was also examined by Wong et al. (2017), Bansal & Khanna (2012) and Hermuningsih (2014). Based on the explanation, the third hypothesis of this study is:

H₃: The size of the Company affects the initial return of IPO Companies

2.4 Effect of The Company's Age on Initial Return

The age of the Company is the length of time the company operates since it was established based on the deed of establishment up to the time the company made an initial public offering or IPO (Trisnawati, 2007). The lifespan of the issuer company, which shows how long the company is able to survive and is proof that the company is able to compete and can take business opportunities that exist in the economy. The increase in the lifespan of the company will have an impact on the increase in initial return (Durkan, 2002; Christy, 1996). Companies that operate longer have a greater likelihood of providing more and broader corporate information than companies that have just been established. Thus the longer a company's lifespan, it will reduce the asymmetry information and reduce the risk of uncertainty that ultimately affects the initial return (Mezhoud & Boubaker, 2011). In contrast,

the results of the study of Yolana & Martani (2005) and Beatty & Ritter (1986) stated that the company will become more inefficient over time, resulting in a decrease in initial return (Bansal & Khanna, 2012). Based on the explanation, the fourth hypothesis of this study is:

H₄: The age of the Company affects the initial return of IPO Companies

III. Method

The research methodology used in this study is a descriptive and verifiative method with this type of expansive research using a quantitative approach. In this study researchers took secondary data. There were 204 companies that conducted IPOs in 2014 to 2019, with the following details:

Table 2. Number of IPO Companies on the IDX in 2014 - 2019

Years	Number of Issuers
2014	23
2015	17
2016	15
2017	36
2018	58
2019	55
Total	204

Source: e-bursa.com (data processed)

The data collection in this study is a library technique and documentation technique by tracing historical data from the website:

- (1) www.idx.co.id
- (2) www.ojk.co.id
- (3) www.e-bursa.com

Analyze data using cross sections with multiple regression models. The regression models in this study are as follows:

$$IR = a + \beta_1 DAR + \beta_2 NPM + \beta_3 SIZE + \beta_4 AGE + e$$

The analysis techniques in this study use descriptive statistical analysis and inference statistics that include:

- (1) Test classic assumptions: normality test, heteroscedasticities, multicollinearity, and autocorrelation
- (2) Determination coefficient, model testing using F test, and hypothesis testing with t test

IV. Results and Discussion

4.1 Results

Before processing the data to test the regression model, previously tested classic assumptions as a condition for BLUE (Best Linear Unbiased Estimators) data.

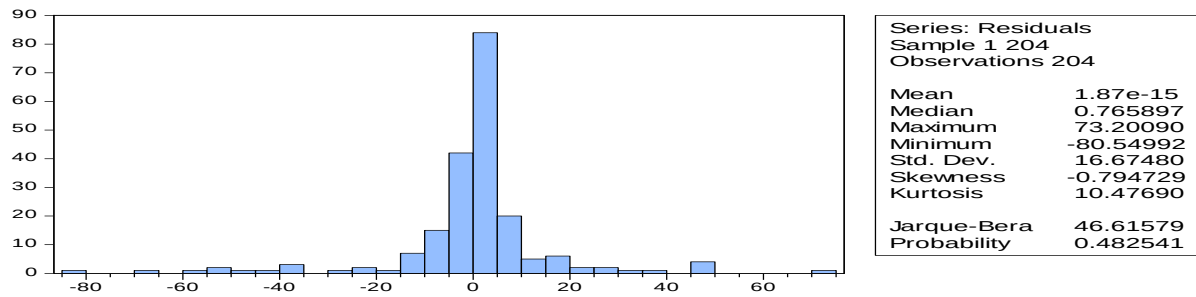


Figure 2. Normality Test Result
Source: Data processed with eviews10

From testing the classical assumptions, it can be concluded that the research data is normally distributed, proven by a value of probability > 0.05 ($0.482541 > 0.05$). It can be seen leverage, profitability firm size, firm age and initial return are normally distributed.

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.969249	Prob. F(4,199)	0.4254
Obs*R-squared	3.898456	Prob. Chi-Square(4)	0.4199
Scaled explained SS	17.57821	Prob. Chi-Square(4)	0.0015

Table 3. Heteroscedasticity Test Result
Source: data processed with eviews10

Based on Heteroscedasticity test result in Table 3 resulted that the data is free from heteroscedastic problems with a value of Chi-Square $0.4199 > 0.05$.

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	1.906790	Prob. F(2,197)	0.1513
Obs*R-squared	3.874091	Prob. Chi-Square(2)	0.1441

Table 4. Autocorrelation Test Result
Source: data processed with eviews10

Based on Autocorrelation test result in Table 4 resulted that the data is free from autocorrelation problems with a prob. Chi-Square $0.1441 > 0.05$.

Variance Inflation Factors
Date: 09/29/20 Time: 11:18
Sample: 1 204
Included observations: 204

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
DAR	10.86625	2.507365	1.085640
NPM	5.814404	1.047008	1.016072
SIZE	0.173262	89.46123	1.052660
AGE__BULAN_	3.91E-05	2.601392	1.068345
C	127.4430	91.66043	NA

Table 5. Multicollinearity Test Result
Source: data processed with eviews10

Based on multicollinearity test result in Table 5 resulted that the data is free from multicollinearity problems as evidenced by the data $VIF = 1$ or the value of VIF produced by each independent variable is smaller or equal to 10.

Dependent Variable: INITIAL_RETURN
Method: Least Squares
Date: 09/29/20 Time: 11:04
Sample: 1 204
Included observations: 204

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DAR	-2.569564	3.296400	-0.779506	0.4366
NPM	1.280709	2.411308	2.531126	0.0049
SIZE	-0.704832	0.416247	-1.693300	0.0420
AGE__BULAN_ C	0.005956	0.006252	2.952639	0.0019
	-17.51073	11.28907	-1.551123	0.1225
R-squared	0.825297	Mean dependent var	-1.334044	
Adjusted R-squared	0.681115	S.D. dependent var	16.88980	
S.E. of regression	0.184155	Akaike info criterion	8.509780	
Sum squared resid	56443.95	Schwarz criterion	8.591107	
Log likelihood	-862.9976	Hannan-Quinn criter.	8.542678	
F-statistic	3.291186	Durbin-Watson stat	2.051989	
Prob(F-statistic)	0.001773			

Table 6. Regression Results
Source: Data processed with eviews10

Based on Table 6, the regression model in this study is as follows:

$$IR = -17.51073 - 2.569564DAR + 1.280709NPM - 0.704832SIZE + 0.005956AGE + e$$

While the R^2 value of 0.825297 means that the variables of leverage, profitability firm size, and firm age are able to explain the rise and fall of initial return by 82,53% while the remaining 17,47% is influenced by other variables not included into the research model.

For testing the model used F statistical test. In the table above, F test can be seen that the F value of 3.291186 with a significant value of 0.001773, it can be concluded that the variable of leverage, profitability firm size, and firm age have a significant against the initial return or the model used is correct.

Partial testing is carried out t-test which shows the results that the variable profitability firm size, and firm age have a significant influence on initial return, with a probability-t value of 0.0049; 0.0420; and 0.0019 (probability value < 0.05). While, leverage variable does not have an influence on profitability because a probability value $0.4366 > 0.05$.

4.2 Discussion

Leverage Affects Initial Return

The test results showed that leverage variables had no effect on initial returns. This indicates that the small amount of leverage of the company will not affect the amount of initial return earned by the IPO company. This result is in accordance with the results of the study of Ayuwardani & Isroah (2018) which states that leverage has no significant effect on the initial return. The small amount of corporate debt will increase the company's capital, but it does not affect investors in investing in IPO shares. Investors do not see the capital structure of the company in deciding the investment so the value of the company's IPO company is not changed. This is in keeping with the theory that Modigliani and Miller put forward in their irrelevant theory.

The Effect of Profitability on Intial Return

The test results showed that variable profitability affects initial returns with positive relationship direction. This indicates that the high profitability of the company will increase the initial return. These results are in accordance with the results of the study by Purwanti & Siregar (2018), and Ayuwardani & Isroah (2018). The high level of profitability of the

company is certainly a good news for investors, according to prospect theory. This will affect the level of investment that investors make towards the shares of companies that have just made an IPO and will increase the IPO share price in secondary markets. Thus, the price in the prime market will be smaller than the price in the secondary market which leads to underpricing.

The Effect of the Company's Size on Initial Return

The test results showed that the company size variable had an effect on the initial return with a negative relationship direction. This indicates that the larger the size of the company will decrease the initial return. These results are in accordance with the results of the study.

Large-sized companies have better prospects than small-scale companies, reducing the level of uncertainty for companies in the future. However, small-scale companies still have great growth opportunities. This has been researched by De Bie & De Haan (2007) which shows that small-scale companies are higher in growth than large-scale companies. Thus, the larger the size of a company, the more reluctant investors are to buy their shares, so the share price on the secondary market will be smaller than the price in the initial market which will ultimately affect the initial return. These results are in accordance with research of Wong et al. (2017), Hermuningsih (2014), Bansal & Khanna (2012) which states that the size of the company affects the initial return.

The Effect of the Company's Age on Initial Return

The test results showed that the company's age variables had an effect on the initial return with a positive relationship direction. This indicates that the longer the company stands it will increase the initial return. These results are in accordance with the results of the study by Mezhoud & Boubaker (2011), Durkan (2002) and Christy (1996). The longer the company operates the higher the flying hours and the company's experience in running its operations. The longer the company operates shows the company is able to survive and is proof that the company is able to compete and can take business opportunities in the economy. The increase in the lifespan of the company will have an impact on the increase in initial return due to the higher level of investor confidence in the company so that it will influence investor investment decisions in the secondary market.

IV. Conclusion

Based on the results of the above data processing, it can be seen that the profitability, size of the company and the age of the company affect the initial return of the company IPO on the Indonesia Stock Exchange in 2014-2019. But variable leverage has no effect on initial return. The results of this study provide advice to the company, investors and researchers further. (1) The Company should pay attention to matters that can increase the confidence of older investors who have actively purchased shares in the primary market (2) Investors should be able to see the prospect of companies that have just gone public in the capital market, missal by looking at the company's ability to generate profit, the ability of the company to survive or survive and the certainty of the company in the future, because it is important for investors in the long term (not only short-term at the time of IPO) , (3) For researchers are further expected to add variables e.g. IPO company industry characteristics, market reaction, underwriter reputation, auditor reputation, IPO corporate business risk, and others.

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