REVISITING THEORY OF UNDERPRICING AT INITIAL PUBLIC OFFERING IN INDONESIA

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ABSTRACT

This research aims to proof the existing theory of underpricing phenomenon at Initial Public Offering (IPO). The one of many theory has been used to explain it phenomenon is asymmetry information. The results of this research found that theory of asymmetry information explained underpricing phenomenon weakly. By using many proxies variable represented asymmetry information theory, there was only financial leverage affected on underpricing phenomenon. This research's result will reopen the discussion of explained theory in IPO phenomenon.

Keywords : IPO, Underpricing, Asymmetry Information

INTRODUCTION

Initial Public Offering (IPO) is one of many equity financing mechanism. In Indonesia, the development of IPO is fascinating as will be illustrated in Picture 1.0.

Picture 1.0 shows the increasing of stock emission's value from a first half period in 2010 to second half period in 2010, approximately 495,4 billion. The increasing of emission value was continuous in the first-half period in 2011. According to the data from Table 1.0, it also implied that companies in Indonesia interested in equity financing to reach capital for their business. Thereby it has been a good news for the development of a capital market industry. As we have known, the growth of capital market industry gave more efficient in capital distribution. Therefore could support Indonesian's economic growth as a whole.

Picture 2.0 shows the firm's IPO activity in Indonesia from 1995 to 2007. From it picture the IPO activity in Indonesia is up and down, but at the last three years, IPO activity in Indonesia has a positive trend. It strengthened the argument which told the companies in Indonesia interested in equity financing.

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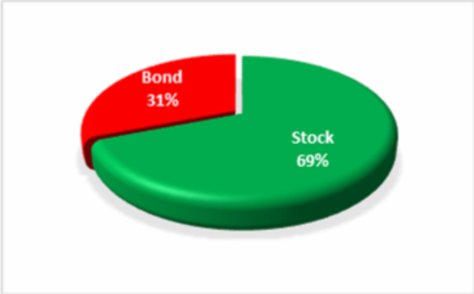
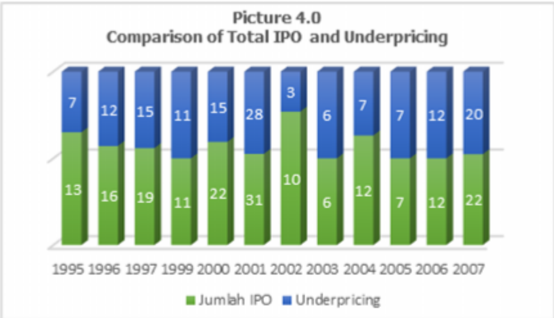
Picture 3.0
Emission's Graphic Value



Picture 3.0 shows the comparison between bond and stock emission at the end of 2010. According to it picture the stock emission is 54,37 trillion or 38% greater than bond emission. The huge of stock emission in Indonesia attracted many scholars to study the phenomenon in IPO activity and its complexities. Many researchers said that one of the many phenomena at IPO is underpricing (F Bramsich et al, 2011; Husnan and Triaryati, 2004; Michaely and Shaw, 1994; Dong, Michel and Pandes, 2011; Su and Bangassa, 2011; Kim, Krinsky and Lee, 1995; Gasbarro, Bundo and Zumwalt, 2003). Underpricing is the phenomenon if stock price at IPO lower than first-day trading's price (Husnan and Triaryati, 2004). Many theories have explained it such as asymmetry information (Rock, 1986), and signaling theory (Allen, and Faulhaber, 1989;Brau and Fawcett, 1996), both of them have the same perspective in which told that underpricing occurred because uncertainty was inherently in IPO. In asymmetry information, an investor has no more information about IPO's firm. Limited information availability caused the emergence of risk. Therefore, from the perspective of asymmetry information underpricing was compensated to investor due to carried on the effect that has occurred in its process. In the other said, from the perspective of the firm underpricing was an indirect cost that brought down the value of the stock from its intrinsic value. Hence from the perspective of signaling theory, firms attempted to reduce the risk of uncertainty by giving any signals to the investor such as publishing a prospectus, hiring underwriter (Brau and Fawcett, 1996). Most of IPO in Indonesia are underpriced, picture 4.0 showed the data of underpricing in Indonesia.


Picture 4.0
Comparison of Total IPO and Underpricing

According to picture 4.0 underpricing occurred more than 50% every IPO in Indonesia. That is the main reason why many scholars interested in this issues, included in this research will test the theory of asymmetry information to explain that phenomenon by using many signals as proxies.

LITERATURE REVIEW

As we have known that firms ought to hire underwriter to prove its stocks at initial public offering process. In the context of market information at the initial public offering, an underwriter in the better position than firms. Sometimes underwriter not only responsible to the firms but they also responsible to their clients who want to buy stocks through themselves. In the perspective of the firm, underwriter should be set at a high price, however, in the perspective of their clients (investor) low price is a good price for them. In a while from the perspective of an underwriter, initial public offering process is risk activity. Therefore, underwriter suggests to minimizing the price of IPOs stocks.

Since many investors have not been interested in high-risk stocks, the higher reputation of underwriter inclined to avoid high-risk emission (Husnan and Triaryati, 2004). Because of not sell well of IPOs stocks will be able to break the reputation of underwriters. Many researchers showed a negative relation between the reputation of underwriter and underpricing (Husnan and Triaryati, 2004; Michaely and Shaw, 1994; Chen and Mohan, 2002; Chen, Su and Bangassa, 2011; Bromsich et al, 2011; Dong, Michel and Pandes, 2011). Therefore this research proposes hypothesis :

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H_1 : Underwriter reputation negatively related to underpricing

Beside the underwriter reputation, the prospectus of the firm is the next signal was given out by firms. The information that was available in prospectus such as retained equity. Retained equity is the proportion of stocks that was held by an insider and not sell at the process of initial public offering. Most of the firm have inclined to share loss to outside investor. In other words, retained equity implied the confidence of inside investor regarded the prospect of the firm in the future (Daily, Certo, and Dalton, 2005). And what it more, retained equity represents the extent of ownership concentration. Daily, Certo, and Dalton (2005) said that most of the retained stocks owned by the owner of the firm. Thereafter, more and more high retained stocks represent the tight control by the owner to the process of firm's operationalization. Thus, it can minimalize asymmetry information in firms. As was explained in this articles in which underpricing is compensation mechanism for the existing of asymmetry information, Su (2004) said that retained equity negatively related to underpricing. Therefore, next hypothesis is :

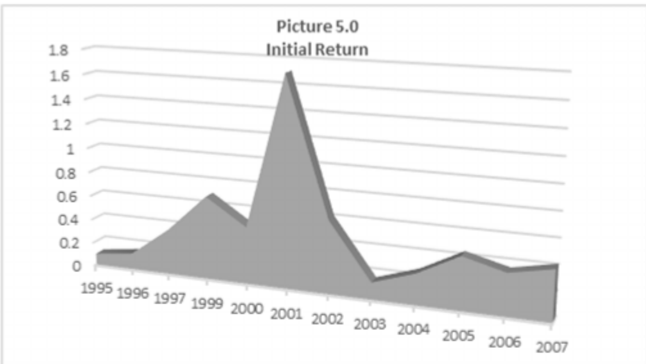
H_2 : Retained equity negatively related to underpricing

The other information that was available in a prospectus of the firm is a financial ratio. Gasbarro, Budo, and Zumwalt (2003) used financial ratio to predict the extent of underpricing. Nam, Arthurs, Nielsen, Mousa and Liu (2008) explained that financial reports will give an advantage, such as minimalize asymmetry information. In my case, more profitable firm will announce financial condition of the firm as soon as possible. Conversely, the less profitable firm will delay their financial announcement to outside investor. As said previously that advantage of financial reports or announcements is to minimize asymmetry information between investor and firm. Gasbarro, Bundo, and Zumwalt (2004) said that profitability negatively related to underpricing. In the other case, financial leverage represents the extent of firm's risk. Without high of return, many investors are reluctant to invest their funds in riskier stocks. Kim, Pukthuantong-Le, and Walker (2007) said that financial leverage positively related to underpricing in the high-tech firm. And also Cogliati, Paleari, and Vismara (2011) said that financial leverage positively related to underpricing. Therefore, the next hypothesis are :

H_3 : Profitability negatively related to underpricing
H_4 : Financial leverage positively related to underpricing

RESEARCH METHOD

This research used secondary data of 189 firms which was IPO in 1995 to 2007. Sampel of this research included 139 firms which have underpricing or positive initial return at IPO at those year. Picture 5.0 graph the rate of underpricing, the average of underpricing in Indonesia are 46 %, in other said investor who bought stock at IPO got 46% initial return.



To find what and how the proxies of asymmetry information works, in this research use multiple regression analysis as following below

$IRi = \alpha + \beta_1.Dum_{time} + \beta_2.Dum_{rep} + \beta_3.Dum_{tipe} + \beta_4.Retain_i + \beta_5.ROA_i + \beta_6.FL_i + \beta_7.Size_i + \varepsilon_i$

IR is positive initial return as a proxy of underpricing, *DumRep* is a dummy variable of underwriter reputation (1 : reputable underwriter, 0 : non- reputable underwriter), *Retain* is retained stocks which hold by insider shareholders, *ROA* is return on asset, *FL* is financial leverage, and *Size* is firm's market capitalization as a control variable. This research model use many dummy variable to capture the detail effect of many different condition e.g. dummy type refer to the type of the firm (1: financial firms, 2: non- financial firms), dummy time refer to the time of IPO (1: after 1998, 0: before 1998).

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RESULT

Table 1.0 shows the result of multiple regression analysis, as we have looked at those result there are just one variable which have significant impact on underpricing. Financial leverage negatively related on underpricing and it was different from hypothesis of this research.

Table 1.0

(Constant)	0,32
	(0,28)
Time	0,51***
	(2,43)
Type	-0,22
	(-1,22)
Rep	-0,00
	(-0,02)
ROA	-0,42
	(-1,53)
FL	-0,55***
	(-2,62)
Retain	0,98*
	(1,53)
Size	-0,02
	(-0,48)

***significant level 5%
**significant level 10%
*significant level 15%

The previous hypothesis said that firms which have greater financial leverage would have greater in risk, thereby investor would get a positive initial return as a compensation of holding risk. But then, the empirical research said conversely. The explanation of this result departs from agency theory. Firms which greater in financial leverage have good in corporate governance by greater controlling mechanism it means lower in agency conflict. The Investor who bought stocks from firms which had less in agency conflict would be carried on riskless, thereby they got less return. Table 1.0 also showed the significant level of dummy of time, it meant initial return or underpricing after 1998 greater than before 1998. This result was extremely contradictive with the real condition if we used the theory of asymmetry information for explaining. The time after 1998, reformation era was closely analogous with openness information era. And in the opposite, the time before 1998, Orde Baru era was like closeness era in which the distribution of information was extremely limited. In the other said, the time before 1998 should be given greater initial return than the time after 1998 due to greater in asymmetry information.

Discussion

The result of this research said that asymmetry information is weak to explain the phenomenon of underpricing at IPO. Table 1.0 showed that there was just one proxy had a significant impact on underpricing. Future research many scholars may be could use other theory for explaining the underpricing phenomenon e.g. behavioral finance theory. The negative significant level of financial leverage affected on initial return could make many scholars look at the details effect of how financing decision had affected on shareholder wealth. Many scholars could introduce non-linearity relation between financial leverage and shareholder wealth.

The issues on IPO phenomenon are not only in underpricing, why and how underpricing affect to their long-run performances are so important. That is to say, we can examine many factors affected to underpricing by used the outcome which was raised by underpricing itself.

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