# The Effect Of Underwriter Reputation, Profitability And Leverage On Underpricing Shares At Initial Public Offering

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**ABSTRACT**

This study aims to test empirically the effect of Underwriter's Reputation, Profitability and Leverage on Underpricing Shares at Initial Public Offering. This analysis uses independent variables, namely underwriter reputation, ROA as a measure of profitability and DER as a measure of leverage. Then, the dependent variable used is Underpricing. The object of this research is publicly traded companies listed on the Indonesia Stock Exchange (IDX) that conducted IPO's from 2014 to 2018. During the observation period, there were 147 companies that made Initial Public Offerings which could be used as the research population.

Based on the purposive sampling method as a sampling technique, 61 companies were obtained as research samples with an observation period from 2014 - 2018. The type of data used is secondary data obtained from the websites of each company. The analysis tool used in this study is multiple linear regression analysis with the SPSS 16 program. The results of this study indicate that the Underwriter's Reputation has a positive effect on Underpricing. Profitability has a positive effect on Underpricing, and Leverage has a positive effect on Underpricing.

**Keywords:** Underpricing; Underwriter's reputation; Profitability and Leverage.

## 1. Introduction

A company has the goal of getting a profit or profit which is used to increase the owner's wealth and increase the company's growth. Therefore, along with the development and growth in achieving goals, the company made additional capital and changed the form of the company from an individual company to a public company ( going public ). Public offering or going public is the activity of offering shares or other securities by an issuer or company, to sell shares or securities to the public based on the Capital Market Law ( www.idx.co.id ). IPO is a way for developing companies to get additional funds in the context of financing or business development such as debt repayment, business expansion, and to strengthen the company's capital structure (Purwanto and Bambang, 2019). In order for the funds obtained from the IPO to be as expected, the shares offered at the IPO must be maximally absorbed by investors.

There are several reasons for the company to conduct an IPO, namely the company does not want to add new debt and to expand its business. Then, to replace part of the debt into equity obtained from the initial offering. The stock price at the time of conducting an IPO is often the difference with the price of the same shares on the stock exchange. According to Manurung (2013), if the stock price at the time of conducting the IPO is lower than the stock price on the secondary market, then there will be underpricing. Conversely, if the stock price at the time of the IPO is higher than the stock price on the stock exchange, what will happen is overpricing. Underpricing is an interesting thing to observe because this phenomenon is often found in the core of public offerings (IPO). The underpricing phenomenon occurs in most capital markets in the world, including Indonesia. Underpricing may occur because of the asymmetry of information that can occur between the investor informed by the uninformed.

Some study evidence shows that underpricing that occurs in the primary market is a common symptom in every capital market in the world. The phenomenon of falling stock prices that have been made by a number of researchers like Reber and Fong (2006) in the capital markets of Singapore, and Ahmad-Zaluki, Campbell, and Goodacre (2007) in the Malaysian capital market. Research from Dinnul and Fernando (2019) states that initial public offerings to private companies and state-owned companies (BUMN) are usually underpriced. There are 149 companies that conducted IPOs on the Indonesia Stock Exchange from 2014 to 2018. A total of 136 companies experienced underpricing of selling shares in the primary market.

The underpricing phenomenon is actually very detrimental to the prospective listed company because the company cannot obtain maximum funds, but it benefits investors. Meanwhile, the overpricing condition can benefit the prospective listed companies, this is actually detrimental to investors because they do not get an initial return. Initial return is the rate of return obtained by investors during a certain period from the time the shares are purchased on the primary market with the closing price on the first day. The issuer and underwriter have an important role in determining the initial share price.

The underwriter is the party that guarantees the sale of shares issued by the issuer and the party who together with the issuer determines the share price in the primary market. Companies that are the first to make a stock offering to the capital market will usually face problems in determining the price in the primary market. The share price in the initial offering is determined based on an agreement between the issuing company and the underwriter.

Underwriters will use the information they have to get an optimal agreement with the issuer, namely by minimizing the risk of having to buy unsold shares by underpricing (Arfandy, 2013). So the company must receive a cheap price for its initial share offering. Therefore, the reputation of an underwriter as an underwriter will affect the level of underpricing. According to Kusumawati and Azhar (2019), the reputation of an underwriter is an important consideration for investors to buy shares of a company. If the underwriters belong to the type of full commitment then he is at risk of having to buy all shares not sold.

The relationship between underwriter's reputation and underpricing can be explained that using the services of a reputable underwriter can minimize the level of underpricing at the closing of the stock price of the company that is conducting an initial public offering. Although basically, a company can issue its Securities without using an underwriter. In the process of going public before shares are traded on the stock exchange, first the shares of the company that will go public are sold on the primary market which is commonly called an IPO.

The research examining the relationship between underwriter's reputation and underpricing was conducted by Riyadi, R. (2014) that the underwriter's reputation variable has a significant effect on the level of underpricing. This is because underwriting underwriters with high reputation will reduce the risk of uncertainty. Underwriters with high reputations are more willing to give high prices as a consequence of the quality of their underwriting, so the underpricing rate is low. The same research conducted by Rejeki RS (2015) shows that underwriting underwriters with high reputation will reduce the risk of uncertainty.

Information asymmetry between informed and uninformed investors causes problems because uninformed investors are more likely to accept allocations of poor quality company shares. The component used to measure financial performance is the profitability ratio using Return On Assets (ROA). ROA is a ratio that can be used to measure the issuer's ability to earn profits with the assets owned by the company.

The relationship between return on asset and underpricing can be explained that the performance of a company is usually measured based on the level of profit, while return on assets plays an important role in assessing company performance. Companies with high ROA levels show the company's ability to generate profits in the future, this is often used as a basis for investment decisions and as a consideration for buying shares. The high return on company assets will reduce IPO uncertainty, thereby reducing the level of underpricing.

The research conducted by Prastica (2012) proves that return on assets (ROA) has a significant effect on the level of underpricing of shares of companies conducting Initial Public Offering (IPO) on the Indonesia Stock Exchange. This research is supported by the results of Riyadi's (2014) research which shows that companies that have high profitability or ROA will be more attractive to investors than companies that have low profitability (ROA). Research conducted by Kurniawan (2014) shows that Return On Assets has a significant effect on underpricing.

Apart from the profitability ratio, the leverage ratio can also be an analytical tool for financial performance. Leverage is also considered as a variable in this study, because theoretically leverage shows the risk of a company, so it will have an impact on the uncertainty of stock prices. Leverage is an indicator that shows how much the company is able to pay its obligations with the equity it has. Leverage occurs when a company uses a source of funds which creates a fixed burden (Sujarweni, 2017). Leverage is the use of funds with fixed expenses in the hope that it will provide a large additional profit than fixed expenses so that it will increase shareholder profits, thus a strong reason for using fixed expense funds is to increase the income available to shareholders (Hidayati and Dedik, 2020).

The relationship between Debt to equity ratio and underpricing can be explained that a company that has a low Debt to equity ratio will minimize the occurrence of underpricing . The debt ratio (DER) is a good measure of a company's financial strength. Debt to Equity Ratio (DER) describes a company's ability to pay off its obligations with equity (Rastiti & Stephanus, 2015). Debt to Equity Ratio (DER), or debt-to-equity ratio, is the ratio between debt and equity in company funding and shows the ability of capital to meet its obligations or how much the company is financed by creditors compared to equity (Sujarweni, 2017).

Research related to testing the effect of the leverage variable on underpricing has been carried out by Astuti and Syahyunan, ( 2014) which showed that the debt to equity ratio (DER) has a significant positive effect on underpricing. A similar study was also conducted by Linazah (2015) which stated that leverage has a significant effect on underpricing . So the purpose of this study is to examine the effect of underwriter's reputation, profitability and financial leverage on underpricing.

## 2. Literature Review

### *2.1 Capital Market*

Capital markets are often found in various countries, because capital markets carry out economic and financial functions. In carrying out its economic function, the capital market provides facilities to transfer funds from parties who have excess funds (lenders) to parties who need funds (borrowers). From the lender's side, he hopes to get a return from the funds placed, while from the borrower side who gets the funds, it can be used to increase production which in time can increase profits.

### *2.2 Initial Public Offering (IPO)*

Offering company shares to the public for the first time is known as the Initial Public Offering. IPO is a process that must be carried out by a company that will list its shares on the stock exchange. When conducting an IPO, the issuer does not sell shares to the public on the stock exchange. However, the issuer sells shares through underwriters and selling agents. The IPO share price is determined jointly by the issuer and the underwriter. The price set tends to be underpricing.

### *2.3 UNDERPRICING*

Underpricing is a condition in which the offering price of a security is below the market price (Humaira, 2013). Underpricing occurs when the share price at the time of the initial offering is lower when traded on the secondary market (Wirwan, 2007). So, underpricing is the positive difference between the stock price in the secondary market and the share price in the primary market or during the IPO. This difference is known as the initial return (IR) or positive return for investors. Undepricing can be seen as a condition in which on average, the market price of a go-public company , usually in a matter of days or weeks is higher than its initial offering.

### *2.4 Signaling Theory*

Information is an important element for investors and business people because information essentially provides information, notes or descriptions for the past, present and future conditions for the survival of a company and how the market effects. Complete, relevant, accurate and timely information is needed by investors in the capital market as an analytical tool for making investment decisions.

### *2.5 Information Asymmetry*

Information asymmetry occurs when one party to a transaction has more information than the other party. According to Mamduh (2004), information asymmetry is a condition where there is an imbalance in getting information between management as an information provider and shareholders and stakeholders or users of information.

*2.6 Underwriter*

According to Suyatmin and Sujadi (2006), a company can basically issue its securities to certain investors without using an underwriter. However, because the process is so complex and requires very specific knowledge, it can be said that companies cannot enter the capital market without the assistance of an underwriter.

*2.7 Profitability Ratios*

Profitability ratios are ratios that provide information about the company's ability to generate profits using a number of investments or invested capital. This ratio is a broad assessment criterion and is considered the most valid to be used as an indicator of management effectiveness and a control tool for management as well as a tool for making company profit projections.

*2.8 Leverage Ratio*

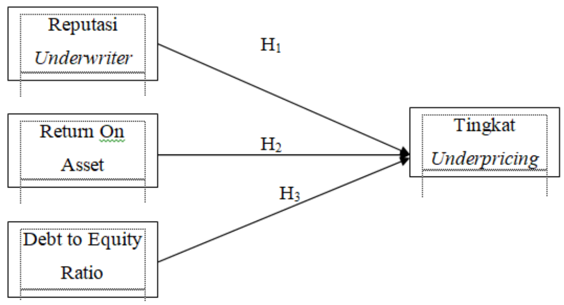
Leverage ratio is usually used to describe a condition or ability of a company to use assets or funds that have fixed expenses to increase the level of income for company owners. Financial assets can be measured by looking at the amount of assets the company financed by debt.

*2.9 Research Accomplished*

As previous research that supports this research is according Lismawati and Munawaroh (2015) study concluded that Financial leverage companies positive effect on the level of underpricing shares on offer public equity prime in Indonesia Stock Exchange. According to Riyadi, R (2013) the results of the research are as follows underwriter's reputation variable has a significant effect on underpricing. The profitability variable (ROA) has a significant effect on underpricing. In addition, research according to Purwanto and Cahyaningrum (2019) shows that the underwriter's reputation simultaneously affects IPO underpricing.

*2.10 Hypotheses and Research Models*

Figure 2.1 Research Model




The hypotheses in this study are as follows:

1. $H_1$ : The better the underwriter's reputation , the lower the underpricing level of the stock.
2. $H_2$ : The higher the level of profitability, the lower the level of underpricing shares.
3. $H_3$ : The higher the level of the leverage ratio, the lower the level of stock underpricing.

## 3. Research Methodology

*3.1 Types of Research*

This research is classified as a causal associative research. According to Sugiyono (2013: 11), associative research is research that seeks to find a relationship or influence between one variable and another. Meanwhile, a casual relationship is a relationship that is causal, such as the independent variable affecting the dependent variable.

*3.2 Population and Sample*

The population taken in this study were companies that did IPO which were listed on the Indonesia Stock Exchange during the 2014-2018 period. Meanwhile, the sampling in this study used a purposive sampling method. The criteria in use are p ompany listing in BEI period January 1, 2014 until December 31, 2018 and the activities I nitial Public Offering (IPO). The company has financial reports that include data on the underwriter's reputation, profitability such as ROA and Leverage such as DER (total debt and equity). Company is experiencing underpricing when Initial Public Offering (IPO). The company is not overpriced and prices are fixed.

*3.3 Data Collection Methods*

The data collection method in this research is documentation. Documentation is data collection by recording documents related to this research. The data used in this study are financial reports, data on opening and closing prices for IPOs, and the reputation of the underwriters obtained from various editions of the Fact Book, www.e-bursa.com in companies that publish in 2014-2018.

## 4. Advanced Research Result n

*4.1 Descriptive Statistics*

Table 4.1 Descriptive Statistics

| | N | Minimum | Maximum | Mean | | Std. Deviation |
|---|---|---|---|---|---|---|
| | Statistics | Statistics | Statistics | Statistics | Std. Error | Statistics |
| UP | 61 | .101 | .988 | .48526 | .037024 | .289165 |
| UND | 61 | .000 | .001 | .00057 | .000064 | .000499 |
| ROA | 61 | .101 | .890 | .29831 | .026013 | .203164 |
| DER | 61 | .034 | .989 | .41957 | .036539 | .285377 |
| Valid N (listwise) | 61 | | | | | |

According to the table 4.1 shows that of 61 samples of data, with a description of the data is described as follows the variabel Reputation of Underwriters were measured using dummy showed an average Reputation Underwriter of companies sampled in this study was 0.00057 with the lowest value ( minimum) of 0.000 and the highest value (maximum) of 0.001. Values of standard deviation or standard deviation Reputation of Underwriters amounted to of 0.000499 less than the average (mean). This means that the Reputation Underwriter (UND) variable data is spread normally.

Variable Profitability as measured using the Return On Asset (ROA) shows the average value of 0.29831 with low or minimum value of 0.101 and the high or maximum value of 0.890. Standard Deviation value amounted to of 0.203164 smaller than the average value, it means that the variable Return On Asset scattered normal. For variable Leverage as measured by Debt to Equity Ratio DER showed an average value of 0.41957 with a minimum value of 0.034 and the value of maximum of 0.989. Standard Deviation value amounted to of 0.285377 less than the mean, mean DER variable data are normally distributed .

*4.2 Classic Assumption Test*

4.2.1 Normality Test

Table 4.2 Test Kolmogorov-Smirnov

| Model | Kolmogorov-Smirnov Z | Asymp. Sig. (2-tailed) | Criteria | Conclusion |
|---|---|---|---|---|
| Unstandardized Residual | 0 .681 | 0 .742 | P> 0.05 | Test distribution is Normal. |

According to the table 4.2 above, test results of the Kolmogorov-Smirnov test showed significant values for 0.742 (0.742> 0.05) so that it can be concluded that the normally distributed data and regression model worthy to wear.

4.2.2 Multicollinearity Test

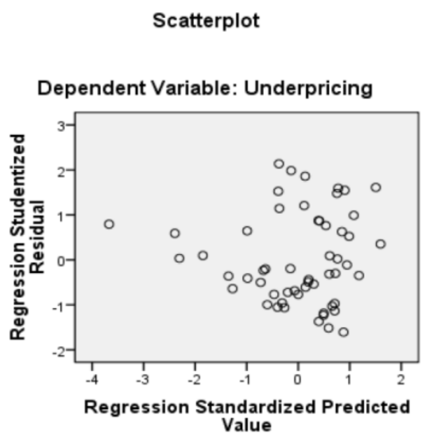
Table 4.3 Multicollinearity Test Results and Linear Regression Test Results

| Variable | Coefficient | T Count | Sig | Tolerance | VIF | Information |
|---|---|---|---|---|---|---|
| (Constant) | 0.712 | 9.514 | 0.000 | | | |
| Underwriter | 131.944 | 2.010 | 0.049 | 0.869 | 1.150 | Multicollinearity and Influence Free |
| ROA | - 0.498 | -3.080 | 0.003 | 0.862 | 1.160 | Multicollinearity and Influence Free |
| DER | - 0.366 | -3.185 | 0.002 | 0.864 | 1.157 | Multicollinearity and Influence Free |
| Adjusted R Square | | | 0.332 | | | |

From table 4. 3 it can be seen that the reputation of underwriter, profitability, laverage showing that the value of tolerance> 0.10 and VIF (Variance Inflation Factor) <10. So we can conclude that the independent variable is not the case multikolinearitas research.

4.2.3 Heteroscedasticity Test

Figure 4.1 Heteroscedasticity Test




Based on the figure 4.1 it appears that the data are scattered randomly and does not form a specific pattern to the point - the point spread above and below the axis x = 0 and on the right and left y-axis = 0, so there is no heteroscedasticity.

*4.3 Regression Analysis*

Based on table 4.3, the regression equation can be obtained as follows:

$$Y = 0.712 + 131.944\,Underwriter - 0.498\,\mathrm{ROA} - 0.366\,\mathrm{DER} + e \qquad (1)$$

This equation can be interpreted as follows, the constant regression coefficient shows a number of 0.712, which means that if the Underwriter , ROA and DER variables are considered constant or have a value of 0, then the firm value will be 0.712. Regression coefficient of 131.944 has the meaning j ika reputation of underwriters increased by 1 unit, then the variable underpricing will be increased by 131.944 significantly.

Koefisien regression of ROA - 0.498 which means that if the return on assets increased by 1 unit, then the value of the underpricing will decrease 0.498 units. Koefisien regression debt to equity ratio amounted to - 0.366 which means that if the debt to equity ratio increased by 1 unit and other variables held constant, then the variable underpricing will increase by 0.366 units.

*4.4 Test The coefficient of determination ($R^2$)*

Based on SPSS output in Table 4.3 shows that the results adjusted $R^2$ of 0.332. This means that 33.2% of the underpricing level can be explained by underwriter's reputation, return on assets and debt to equity ratio. While the remaining 66.8% is explained by factors other than the model such as EPS, company size and share offering percentage.

*4.5 Test Statistics t*

From ta bell 4.3 it can be seen that the variable reputation underwriter has a t value of 2.010 with a significance level of 0.049. This means that the underwriter's reputation variable has a significant positive effect on the level of underpricing, because the level of significance is less than 0.05 (0.049 <0.05) then $H_{01}$ is rejected and $H_{a1}$ is accepted.

According to the table 4.3 it can be seen that the profitability variable has a t value of -3.080 with a significance level of 0.003, which means that proxy variable profitability with ROA positive and significant impact on the level of underpricing , because the significance level lower than 0.05 (0.003 <0.05) then $H_{02}$ is rejected and $H_{a2}$ is accepted.

According to the table 4.3 it can be seen that the variable financial leverage has a t value of -3.185 with a significance level of 0.002, which means variable financial leverage proxied by DER positive and significant impact on the level of underpricing , because the significance level lower than 0.05 (0.002 < 0.05) then $H_{03}$ is rejected and $H_{a3}$ is accepted.

## 5. Discussion

This study found that there was a positive relationship between underwriter's reputation, profitability, and financial leverage on underpricing. The results of this study are in line with the results of research conducted by Riyadi, R. (2014) which states that the underwriter's reputation has a significant positive effect on the level of underpricing. Research conducted by Kurniawan (2014) and Riyadi, R. (2014) shows that Return on Assets has a significant effect on underpricing. A similar study was also conducted by Linazah (2015) which stated that leverage has a significant effect on underpricing.

## 6. Conclusion

This study aims to examine the effect of underwriter's reputation , profitability and financial leverage on the underpricing of shares at the initial public offering (IPO) in Indonesia Stock Exchange for the period 2014-2018. Then, conclusion obtained the variable reputation underwriter significant effect on underpricing. This is indicated by a significance value <0.05. Thus, the underwriter's reputation can be used as a signal to reduce the uncertainty that the information contained in the prospectus cannot reveal and provide a signal that the private information from the issuer regarding the company's future prospects is not misleading.

The profitability variable (ROA) has a significant effect on underpricing. This is evidenced by the significance value <0.05. The results of this study indicate that companies that have high profitability (ROA) will be more attractive to investors than companies that have low profitability (ROA). Financial leverage (DER) effect terhada p underpricing type in a initial public offering (IPO). It is shown from the significant value of 0.002 is less than 0.05. So, the hypothesis put forward is accepted. Leverage shows the amount of asset value of a company that is financed by its debts. The higher the value of this ratio, the higher the risk of underpricing. This is because the company will tend to set the initial offering price at a low price to attract investors to buy the company's shares.

Limitations of this study is v ariabel used in this study is limited, while there are many other variables that affect the underpricing . In addition, the p eriod used in this study is relatively little that is of year 20 14 -20 18 in this case may affect the estimation of measurement.

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