

## FINANCIAL RATIO AND INITIAL RETURN ON COMPANIES IN INDONESIA

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**Abstract:** The development of various types of businesses in Indonesia began to emerge in the era of globalization, causing business competition to be increasingly fierce. This study aims to analyze the effect of the oversubscriptio ratio, underwriter reputation, firm size, and leverage on initial return. The independent variables of this study are oversubscriptio, underwriter reputation, firm size, and leverage while the dependent variable is initial return. The sample in this study is a publicly listed company that has an initial public offering (IPO) listed on the Indonesia Stock Exchange in 2015-2021 with a total of 133 companies as samples. The research method uses multiple linear regression. The results of the study found that the oversubscriptio ratio, underwriter reputation, and firm size had a significant effect on initial return, while leverage had no effect on initial return. Investors do not only pay attention to the financial aspects of the company, but also pay attention to non-financial aspects.

**Keywords:** Initial Return, Oversubscription Ratio, Underwriter Reputation, Company Size, Leverage

**Abstrak:** Perkembangan berbagai jenis usaha di Indonesia mulai bermunculan di era globalisasi menyebabkan persaingan usaha semakin ketat. Penelitian ini bertujuan untuk menganalisis pengaruh rasio oversubscription, reputasi underwriter, firm size, dan leverage terhadap initial return. Variabel bebas penelitian ini adalah oversubscription, reputasi underwriter, firm size, dan leverage sedangkan variabel terikatnya adalah initial return. Sampel dalam penelitian ini adalah perusahaan publik yang melakukan initial public offering (IPO) yang terdaftar di Bursa Efek Indonesia tahun 2015-2021 dengan jumlah sampel sebanyak 133 perusahaan. Metode penelitian menggunakan regresi linier berganda. Hasil penelitian menemukan bahwa rasio oversubscription, reputasi underwriter, dan firm size berpengaruh signifikan terhadap initial return, sedangkan leverage tidak berpengaruh terhadap initial return. Investor tidak hanya memperhatikan aspek keuangan perusahaan, tetapi juga memperhatikan aspek non keuangan.

**Kata kunci:** Pengembalian Awal, Rasio Oversubscription, Reputasi Underwriter, Ukuran Perusahaan, Leverage

## INTRODUCTION

The development of business in Indonesia is progressing rapidly every year along with the number of types of businesses that have begun to emerge, causing increasingly fierce business competition. Therefore, with the development of business and competition between business actors, every company needs to continue to improve its strategy and performance to maintain the existence of its company in the eyes of the public (Bawa et al., 2019; Fowowe, 2017). In general, companies aim to develop their business and earn as much profit as possible (Ozturkkal, 2015). Companies are no longer satisfied with achieving their business goals if they only move on a small scale but a large scale. For this reason, the need for additional company funds is a problem that will never disappear from all its operational activities (Hermawan & Mulyawan, 2014).

To meet these problems, companies can get them from internal or external sources. However, the company's internal sources of funds from retained earnings are often insufficient (Boussaidi & Dridi, 2020). Thus, the company will look for other sources of funds, namely external companies that come from bank debt, issuance of debt securities, and financing in the form of shares (Alaabed & Masih, 2016; Grundy & Verwijmeren, 2020). If the choice falls on financing, that is, an investment in the form of shares, then the company will become a public company and part of the capital market in Indonesia.

Initially, companies going public will go through an initial public offering process, generally known as an initial public offering (IPO). At this time, the company, as the party conducting the initial public offering, will offer its shares in the primary market for the first time. Then, the company's shares that have been issued in a public offering in the primary market will be traded on the secondary market. This IPO activity is carried out through 8 periods: the quiet period, the order period, the allotment period, the distribution of share certificates, refunds, listing on the IDX, and the composite stock price index (JCI) and closing.

Investors who wish to invest in an IPO company will order in advance. After the order period ends, the company will make an allotment and distribute its shares in a balanced manner according to the investor's order. At the IPO stage, the company will obtain additional funds, which it can use to finance its activities, including funding, operations, expansion, and capital structure improvement (Amini et al., 2020; Li et al., 2016).

The number of companies conducting IPOs on the Indonesia stock exchange (IDX) continues to increase, and the IDX stated that since the privatization of the stock exchange 26 years ago, the number of companies conducting IPOs in 2018 has recorded the highest number of companies reaching 56 companies. This number is also the highest in ASEAN, as in 2019 and 2020. Meanwhile, in 2020 the number of companies carrying out IPOs decreased to 51. This could be due to disrupted business conditions due to the COVID-19 pandemic, so some companies delayed the IPO implementation process.

There were 285 companies in 2015-2021 that carried out IPOs. Of the 285 companies, as many as 263 companies experienced underpricing, while 20 others experienced overpricing and two with stable value. In Indonesia, cases of underpricing can be said to be relatively high. Based on IDX data, the percentage of companies with underpricing values exceeding 80% of the total number of companies carrying out IPOs, with an average percentage above 20% and the highest percentage reaching 70% of 26 companies. It is known from the data at the time of the IPO that the company tends to experience more underpricing than overpricing and is stable every year.

The underpricing data above shows a large percentage gap between other companies. A total of 5 companies experienced an underpricing rate of less than 2%, while the other 137 experienced an underpricing rate of more than 40%, with the highest rate being 70%. Meanwhile, most companies experiencing overpricing experienced varying levels of overpricing, from 0.57% to 35.71%. More in-depth research on IPO companies' underpricing or initial return with this phenomenon is needed.

Initial returns have been of great interest to researchers for decades. Several researchers have analyzed the factor that might affect the initial return: the oversubscription ratio. The oversubscription ratio is a phenomenon that arises as a public response to a share offered by the company. The oversubscription ratio reflects the value of the excess demand for shares of the number offered by the company in the primary market. This ratio is identical to an indicator of a company's success in implementing an IPO.

Leow & Lau (2020) and Siew et al. (2015) found that the oversubscription ratio affected initial return. However, research on the oversubscription ratio on initial returns in Indonesia is still relatively small. No recent research exists so the authors will re-examine these factors using objects on the IDX. The company prospectus is the primary information presented in

implementing the IPO. Prospectus information is used to make it easier for investors to decide whether or not to invest in a stock. The prospectus contains essential company information, such as financial or non-financial information. Furthermore, most researchers use the information obtained from the company's prospectus to analyze the phenomenon of initial return (Yildirim & Gökalp, 2016).

One of the non-financial information available in the prospectus is the underwriter used by the company to assist in the public offering process. The reputation of the underwriter used by the company is a factor that can be analyzed as a factor that is likely to affect the initial return. In their research, Kuncoro & Suryaputri (2019) showed an influence between underwriter reputation and initial return. However, this research does not align with Kusumawati & Fitriyani (2019) and Wiguna & Yadnyana (2015), which show no influence between underwriter reputation and initial return.

The results of other studies regarding initial return and the factors that influence it still produce different findings. Wiguna & Yadnyana (2015) research shows an influence between company size and leverage with the initial return. In contrast to Nuryasinta & Haryanto (2017), which found no proven effect between leverage and initial return. Likewise, research by Morina & Rahim (2020) states that there is no effect between company size and initial return.

Due to the differences in the findings of previous studies regarding the factors that influence the initial return, it is exciting to conduct another research with a research gap, namely the use of the latest variables, different research objects, and the latest research period. By doing this research, researchers can find findings that will correctly answer and state that the factors used in this study can affect the initial return.

In this study, the author will focus on the oversubscription ratio, underwriter reputation, company size, and leverage. The year period that the researcher uses is the latest, namely 2015-2021. The observation year was chosen because of the development of the Indonesian capital market, wherein from 2015 to 2018, the number of companies conducting IPOs on the Exchange increased. In 2018 the number of companies conducting IPOs was the highest number since the privatization of the IDX. At the same time, many events are happening in Indonesia and the world that is likely to affect the Indonesian capital market, including the trade war between the US and China, rising US interest rates, the Asian Games sports event, and the 2019 general election, and the COVID-19 pandemic.

## LITERATURE REVIEW

Generally, the problem that is often experienced by companies when carrying out an IPO is determining the share price in the primary market. Determining the share price is essential for a company because it involves the interests of several different parties. The share price listed in the initial offering is the result of the provisions of several parties, namely between the party conducting the public offering (the company) and the underwriter (the underwriter) (Tajuddin et al., 2017).

Two possible phenomena can occur in stocks during the initial public offering (IPO). The first is overpricing, when the closing stock price in the secondary market is lower than in the primary market. The second is underpricing, when the closing stock price in the secondary market is higher than in the primary market. These phenomena can occur due to several factors, one of which is the information asymmetry factor.

Information asymmetry is a condition where there is an information gap between the underwriter and the company. The difference in information between the company and the underwriter is due to more information about the market that the underwriter has known compared to the company (Dick-Nielsen et al., 2021; Humphery-jenner et al., 2018; Kusumawati & Fitriyani, 2019). Thus, with more knowledge and a desire to minimize the level of risk that he will bear as the guarantor, the underwriter will lower the company's share price in the primary market (Boeh & Dunbar, 2016; Nikolova et al., 2020).

Information gaps can also exist among investors. There are two types of investors in the market (Aggarwal et al., 2022; Hellmann & Thiele, 2022). The first investor is an investor who has more information than others (informed investors). The second investor is an investor who has less information about the market than others (uninformed investors). Informed investors will only buy shares if the shares are attractive and will provide benefits to them.

In contrast, uninformed investors will buy shares randomly, whether the shares are profitable or not (Campello & Graham, 2013). Companies must issue a prospectus used as a means of information for potential investors before the initial public offering begins to minimize information asymmetry. In addition, the company can use a reputable underwriter. Using a reputable underwriter, especially a reputable one, hopes investors will receive positive information or signs about the company (Chang & Hong, 2019).

Underpricing conditions will harm the company. In general, the company, as the party issuing the shares, does not want to underprice because the capital received by the company during the public offering is not optimal. On the other hand, investors benefit by obtaining an initial return. The profit received by investors when buying IPO shares and selling them at closing on the first day of shares traded on the secondary market is the initial return. The profit is calculated based on the difference in share prices, namely between the closing price on the secondary market (closing price) on the first day and the price on the primary market (offering price) (Moya-martínez et al., 2014; Wu et al., 2012).

## **METHOD**

This study uses data measuring underwriter reputation, company size, and leverage from the Indonesian stock exchange from 2015 to 2021. The data source oversubscription ratio is obtained from several online editors that contain information about an excess demand for a stock of an IPO company for the period 2015 to 2021 with 133 companies. Meanwhile, to meet the initial return data needs, the data source is obtained from the stock summary menu published on the official website of the Indonesian stock exchange.

The data that has been collected will be analyzed to determine whether there is an effect of an independent variable on the dependent variable, either partially or simultaneously. The following is a descriptive analysis of initial return data, oversubscription ratio, underwriter reputation, company size, and leverage. Descriptive statistics aim to describe and describe data so that it can be analyzed as it is without having to create generally accepted conclusions. Descriptive analysis was included in the study, namely the maximum value, minimum value, mean, and standard deviation.

After conducting a descriptive analysis, the next step is testing the classical assumptions, which is an important thing that must be done in a study because before proceeding to test regression analysis, the data used must meet this test first. The classical assumption test consists of several stages: the normality test. The primary purpose of this normality test is to determine whether the dependent variable and the independent variable in a regression model have a standard or abnormal distribution.

Second, the multicollinearity test determines whether or not there is a data correlation in each independent variable in the regression model. It is said that the regression model is called

good if there is no correlation between the independent variables. The third is the Autocorrelation test which functions to check whether the data continuously interferes with each other from one observation to another. Fourth, the Heteroscedasticity test determines whether there is an inequality of variance from the residuals of observation to another observation in a regression model. The regression model is said to be good in this test if it does not experience heteroscedasticity.

After testing the classical assumptions, the next step is to analyze the data using multiple regression, which was chosen because, in this study, the time dimension was cross-sectional, with all companies conducting IPOs in a certain period, namely 2015-2021. The purpose of this analysis is to know thoroughly about the effect of the research variables, namely the influence of the independent variable (free) on the dependent variable (bound) both partially and simultaneously. Where IR is the initial return, OVR is oversubscription ratio, RU is underwriter reputation, TA is the firm size, DER is leverage,  $\alpha$  is constant,  $\beta$  is regression coefficient, and e is the error term.

$$IR = \alpha + \beta_1 OVR_t + \beta_2 RU_t + \beta_3 TA_t + \beta_4 DER_t + e$$

## RESULTS

This analysis is calculated to determine the maximum, minimum, mean, and standard deviation values of a sample. Initial return (IR) variables, oversubscription ratio (OVR), underwriter reputation (RU), company size calculated using total assets (TA), and leverage calculated using debt to equity ratio (DER). IPO companies' lowest initial return value from 2015 to 2021. The initial return value with a ratio scale of 133 sample companies has a minimum value of 0.0045 from PT Sarimelati Kencana Tbk (PZZA) in 2018. The maximum value is 0.7 from PT Terregra Asia Energy Tbk (TGRA), PT Megapower Makmur Tbk (MPOW), PT Malacca Trust Wuwungan Insurance Tbk (MTWI), and PT Asuransi Jiwa Syariah Jasa Mitra Abadi Tbk (JMAS) in 2017, PT Jaya Trishindo Tbk (HELI), PT Batavia Prosperindo Trans Tbk (BPTR), PT Arkadia Digital Media Tbk (DIGI), and PT Natura City Developments Tbk (CITY) in 2018, PT DMS Propertindo Tbk (KOTA), PT Fuji Finance Indonesia Tbk (FUJI), and PT Repower Asia Indonesia Tbk (REAL) in 2019, PT Perintis Triniti Properti Tbk (TRIN), PT Era Mandiri Cemerlang Tbk (ikan), and PT Esta Multi Usaha Tbk (ESTA) in 2020. The standard deviation of the initial return obtained is 0.236602, and the average is 0.433279 or 43.33% of the stock

price. In other words, when estimating the initial share price, the company and the underwriter set it lower than the estimate set by the investor.

Table 1. Descriptive Statistics

	<b>IR</b>	<b>OVR</b>	<b>RU</b>	<b>TA</b>	<b>DER</b>
Mean	0.433279	20.67120	0.187970	26.72342	3.405148
Median	0.496000	3.000000	0.000000	26.6110	1.52400
Maximum	0.700000	500.0000	1.000000	31.08200	78.42300
Minimum	0.004500	1.000000	0.000000	23.32800	0.002000
Std. Dev	0.236602	62.11418	0.392165	1.527966	8.853578
Observations	133	133	133	133	133

The oversubscription ratio with a ratio scale with a minimum value of 1 was obtained from PT MNC Studios International Tbk (2018), indicating that the excess demand experienced by the company was only one time. The maximum value of 500 from PT Kapuas Prima Coal Tbk indicates that investors are very interested in the company's IPO shares so that they are oversubscribed by 500 times. The mean oversubscription ratio of 133 companies that conducted an IPO was 20.6712, with a standard deviation of 62.11418.

The reputation of the underwriter (RU) uses a dummy with a measurement based on a nominal scale. There is a minimum value of 0 and a maximum value of 1. The mean underwriter reputation is 0.18797, which indicates that more companies use underwriters with low reputations than underwriters with high reputations, with a standard deviation of 0.392165. Of the 133 companies that conducted IPOs, only 25 companies used high-reputation underwriters to assist in IPO activities, while 108 other companies chose to use low-reputation underwriters.

The size of the company that shows the size of an IPO company is calculated using the ratio scale of each company's total assets (TA). The maximum value of the size of the company indicates that the total number of company assets it owns is vast, so it can automatically be said that the company is included in a large-scale company. The minimum value of 23.328 was obtained from PT Arkadia Digital Media Tbk, and the maximum value of 31.082 was obtained from PT Bank BRI Syariah Tbk. Total assets are 26.72342, with a standard deviation of 1.527966.



Leverage using the debt to equity ratio (DER) with a ratio scale. There is a minimum score of 0.002 obtained from PT Fuji Finance Indonesia Tbk and a maximum value of 78.423 obtained from PT Satria Antaran Prima Tbk. The company's leverage ratio before the IPO showed an average of 3.405 and a standard deviation of 8.853. These results indicate that from the sample of 133 companies before the IPO, the average debt value was 340.51% compared to the company's total equity or capital.

Table 2. Diagnostic Test

Investigation	Indicator	Variable	Value	Probability
Normality test	Jarque-Bera		3.898	0.142
		OVR	1.027	
Multicollinearity test	Variance Inflation Factor	RU	1.047	
		TA	1.051	
		DER	1.009	
Autocorrelation Test	Durbin-Watson		1.627	0.095
Heteroscedasticity test	Breusch-Pagan		2.782	

The results of the data normality test using Jarque-Bera found a probability value in the research regression model of 0.142 where this value is greater than the 0.05 significance level, so it can be said that the regression model is feasible to use because the data is normally distributed. The results of the multicollinearity test using the Variance Inflation Factor (VIF) found that all variables had a value of less than 10 (<10), so the regression model did not have a multicollinearity problem.

Table 3. Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob
C	1.287985	0.328119	3.925363	0.0001
OVR	0.000702	0.000298	2.354604	0.0201*
RU	-0.224829	0.047688	-4.714593	0.0000*
TA	-0.031014	0.012266	-2.528501	0.0127*
DER	0.000542	0.002074	0.261512	0.7941

\*Significant at 5%

The autocorrelation test aims to determine whether there is a correlation between the errors that appear in the data based on time in the regression model. The study's results using Durbin-Watson obtained a value of 1,627 between -2 to +2, so there is no autocorrelation in the regression model. The heteroscedasticity test aims to test whether there has been inequality of variance from the residuals of one observation to another in the research regression model. The test results using Breusch-Pagan found a probability value of 0.095, where the value is higher than 0.05, so the regression model has homoscedasticity.

#### *Effect of Oversubscription Ratio on Initial Return*

The oversubscription ratio has a coefficient value of 0.000702 and a probability value of 0.0201, so the oversubscription ratio affects the initial return in a positive direction. These results illustrate that investors consider the oversubscription ratio in their investment decisions. The oversubscription ratio measures how much excess demand for shares of several shares is offered in the primary market (Leow & Lau, 2020). The higher the oversubscription ratio in companies carrying out IPOs, the more investors have high confidence in the company's shares. In other words, the demand for shares will also increase. Increased demand will enable investors to get a high initial return because the stock price will increase when offered in the secondary market (Jussani et al., 2018).

The excess demand for shares over the number of shares the company offers to investors in the primary market is called oversubscription. An oversubscription is an event that is often encountered in IPO activities. Oversubscription in an IPO company will only occur when potential investors feel interested in the company because the company has the opportunity to increase shareholder (investor) income, be it a significant increase in share price or an increase in dividend rates in the future (Driver et al., 2020; Leow & Lau, 2020).

#### *Underwriter's Reputation Affects Initial Return*

The study results illustrate that investors consider the underwriter's reputation in their investment decisions. Underwriters are one of the essential parties in the IPO process. Investors tend to be attracted to highly reputable underwriters. Companies that use quality or reputable underwriters have more certainty about their shares and company in the future than companies

that use low reputation underwriters. The underwriter's reputation has a coefficient value of -0.224829 and a probability value of 0.0000, which is smaller than 0.05, so the underwriter's reputation affects the initial return negatively. Therefore, it will cause underwriters and companies to decide to set a higher offering price for IPO shares due to the influence of the quality of the guarantee so that the level of underpricing will decrease and investors are likely to get a low initial return.

The underwriter is the party who will assist the company in conducting the initial public offering process. Companies can use underwriters according to their individual choices and considerations. The underwriter's reputation will usually be divided into two: good and bad (Humphery-jenner et al., 2018). The quality or reputable underwriters have more confidence in the success of the stock offering. If the company uses a reputable underwriter, the level of investor uncertainty about the stock and the company in the future will be reduced (Boeh & Dunbar, 2016; Chang & Hong, 2019). This situation makes underwriters and companies decide to set a higher stock offering price, causing the level of underpricing to decrease and allowing investors to get a lower initial return.

#### *Effect of Firm Size on Initial Return*

The size of the company has a coefficient value of -0.031014 and a probability value of 0.0127, so the size of the company affects the initial return in a negative direction. Investors consider the size of the company in their investment decisions. Company size shows how big or small a company in which this research is measured by the total assets of the last period of the company prospectus. In general, large companies have the same asset value. Large companies tend to be more attractive to investors because they have more certainty about their shares and companies in the future than small companies. This situation will cause underwriters and companies to set a higher stock offering price so that the level of underpricing will decrease and affect the lower initial return that investors will receive.

Company size shows the size of a company, both large and small, as measured by total assets. Large-scale companies have low investment risk values to attract investors' attention to make investment transactions in the company's shares (Fernandez-Perez et al., 2017; Kannadhasan, 2015). In general, information and the condition of a company will be widely available and easier to obtain if the company is a large-scale company and inversely

proportional to small-scale companies (Atidhira & Yustina, 2017; Kariyawasam, 2019). In addition, it will minimize investor uncertainty about stocks and companies in the future. This situation makes the underwriters and companies decide to set a higher share offering price which causes the level of underpricing to decrease and affects the lower initial return that investors will receive (Boeh & Dunbar, 2016).

### *Effect of Leverage on Initial Return*

These results illustrate that investors do not consider the debt to equity ratio (DER) in their investment decisions. DER is the ratio that the company uses to determine and at the same time measure the company's ability to pay all of its obligations or all of its debts using available capital. The leverage ratio has a coefficient value of 0.000542 and a probability value of 0.7941, so leverage does not affect the initial return. However, it is possible that investors will not use leverage as a factor to consider in investing in IPO shares because they do not know the company's DER value and what risks investors may face due to this ratio in the future.

The Debt to Equity Ratio (DER) has a function to measure its ability to fulfill all its obligations using equity (capital) (Amanda, 2019; Arribaat et al., 2021). The high value of DER illustrates the company's risk, which is also increasing and will increase the level of investor uncertainty about the stock and the company in the future (Amanda, 2019; Ferris et al., 2018). This situation will make underwriters and companies decide to set a lower stock offering price, cause the level of underpricing to increase, and allow investors to get a high initial return. In addition, it makes investors avoid investing in these stocks.

## **CONCLUSION**

This study aims to analyze the effect of the oversubscription ratio (OVR), underwriter reputation (RU), firm size (TA), and leverage (DER) on the initial returns of companies conducting IPOs on the Indonesia Stock Exchange for the 2015-2021 period. The study's results reveal that the oversubscription ratio, underwriter reputation, and company size affect the initial return, while leverage does not affect the initial return.

The findings of this study can provide an overview in making an investment decision in IPO company shares. Then, investors should not only pay attention to the financial aspects of the company but also have to pay attention to non-financial aspects, such as the

oversubscription ratio and the underwriter's reputation in the investment decision-making process.

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