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Firm Characteristics, Underwriter Reputation, Auditor Reputation and Underpricing

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Abstract
This study aimed to examine the effect of firm characteristics, underwriter reputation, and the auditor reputation to underpricing. The level of underpricing measured by initial return. Firm characteristics that proxied by profitability, firm size, firm age, allocations IPO funds for investment and the type of industry. The results of this study indicate that only the auditor's reputation negatively affect underpricing and six other variables such as profitability, firm size, firm age, the allocation of IPO funds for investment, industry type and underwriter reputation does not affect the level of underpricing. Auditors prestigious will be reflected in the financial statements of a company that is more accurate and reliable, so it will be assessed positively by investors and underpricing will be lower.
Keywords: Firm characteristics, underwriter reputation, auditor reputation, underpricing

1. Introduction

Underpricing phenomenon can occur when a company doing an IPO in the primary market. Underpricing occurs when the stock price at the time of IPO is lower than the share price in the secondary market (Ljungqvist, 2006:6). Underpricing is a global phenomenon, it is evidenced by previous investigators who conduct research on the world capital markets as Bildik and Yilmaz (2006) in Istanbul Stock Exchange, Yong (2011) in Kuala Lumpur Stock Exchange, Islam et al. (2010) in Chittagong Stock Exchange, Martani et al. (2012) in Jakarta Stock Exchange and Hoque and Musa (2002) in Dhaka Stock Exchange.

Underpricing can lead to the transfer of wealth from the company's IPO to investors (Beatty, 1989). Investors will receive early returns of transactions carried out while the company will not get additional funds because the price of the IPO shares purchased cheaper than the market price (Aini, 2013). According to Ang (1997) stated that the amount of funds received by the company's IPO is the multiplication of the number of shares offered at the IPO price per share. The higher the level of underpricing then the funds will be obtained the company at the IPO will be lower (Ang, 1997).

The data in this study indicate that the level of underpricing is experienced by IPO companies in the Indonesia Stock Exchange at the period 2005-2009, every year is always above 61%. In 2006 the company experienced underpricing of 100%, which means that all the company's IPO in experienced underpricing. The high underpricing by issuers need to be minimized, so that issuers can obtain a reasonable price IPO and raise some funds sufficient to fund the company's activities (Gumanti, 2002)

This study focuses on the factors that can minimize underpricing conditions. Factors that can affect the lower underpricing has been carried out by previous researchers (Carter and Manaster, 1990; Fernando et al., 1999; Bildik and Yilmaz, 2006; Islam et al., 2010; Risqi and Harto, 2013; Junaeni and Agustian, 2013; Martani et al., 2012 and Aini, 2013). Kurniawan (2007) and Arman (2012) proved that profitability (which is proxied by ROA and ROE) negatively affect the level of underpricing, which means that the higher the profitability of the company will lower underpricing. Size large companies can minimize underpricing Fernando et al. (1999); Bildik and Yilmaz (2006); Kristiantari (2012) and Martani et al. (2012) found that the greater the size of the company then underpricing can be minimized. The research results of Arman (2012), shows that firm age negatively affect of underpricing which mean is the longer of firm age so the level of underpricing will be lower. Bildik and Yilmaz (2006) and Kristiantari (2012) found that the company allocate of IPO funds for investment could negatively affect underpricing, it shows that by allocating of IPO funds for investment so the level of IPO underpricing can be minimized.

The results of the study of Islam et al. (2010) conducted in Chittagong Stock Exchange proves that this type of industry negatively affect of underpricing. Prestigious auditors reputation can minimize underpricing are consistent with the research (Aini, 2013 and Safitri, 2013). Caster and Manaster (1990), found that underwriter reputation proves that negatively affect the level of underpricing, the research results are consistent with the results of studies Fernando et al. (1999); Bildik and Yilmaz (2006); Junaeni and Agustian (2013); Risqi and Harto (2013); Kristiantari (2012) and Safitri (2013) which showed that the better the underwriter reputation so the level of underpricing will be lower.

This study focuses on the factors that can minimize underpricing. Firm characteristics (profitability, firm size, firm age, the allocation of IPO funds for investment and industry types), underwriter reputation and the auditor reputation is the dependent variable in this study is used to affect of underpricing. This study uses 81 sample IPO company listed on the Indonesia Stock Exchange. The results of this study indicate that the auditor's reputation proved negative effect on underpricing.

This paper organizes into four sectiond: introduction, literature review, discussion and conclusion.

1. Literatur Review

1.1 Underpricing Theory

Underpricing theories to explain the causes of the underpricing. Ritter (1998:13) argues that underpricing theories into seven theories that include, the winner's curse hypothesis is a condition in which the number of informed investors participate in a condition that can lead to underpricing issuer create conditions underpriced as self-protection in order to sell the stock. Second, the market feedback hypothesis is a condition where underwriters provide returns to investors by creating underpricing as investors have helped in setting stock prices IPO (Ritter, 1998:13).

Third, the bandwagon hypothesis is a condition where the informed investors and uninformed investors will scramble to obtain information and underprice be deliberately created by the firm to attract investors. Fourth, investment banker monopsony power hypothesis is a condition where investment banker (underwriter) do to minimize the risk of underwriting by assuring the client (company IPO) that underpricing is a common condition at the time of the IPO (Ritter, 1998:13).

Fifth, the lawsuit avoidance hypothesis is a condition in which underwriters and issuers to maintain and avoid legal action in the future if there is a decrease in company's performance after the IPO. Sixth, the signaling hypothesis is a condition in which the company deliberately created the underpricing as a signal that investors are interested in buying the company's stock. The last, the ownership dispersion hypothesis is a condition in which the issuer intentionally degrading the IPO price to attract minority shareholders as minority shareholders more difficult to increase liquidity and to oppose management policies (Ritter, 1998:13).

Ljungqvist (2006:2) also argues that underpricing theories grouped into four theoretical models which are asymmetric information, control theories, behavioral theories and institutional theories. Asymmetric information models assume that one of these parties knows more than the others, and that the resulting information frictions give rise to underpricing in equilibrium. Control theories argue that underpricing helps shape the shareholder base so as to reduce intervention by outside shareholders once the company is public. Then, behavioral theories assume the presence of 'irrational' investors who bid up the price of IPO shares beyond true value. Finally, institutional theories focus on three features of the marketplace seperti litigation, banks price stabilizing activities once trading starts, and taxes (Ljungqvist, 2006:2).

1.2 Signaling Theory

Signaling theory explains how the company should present the information to the capital markets (Bini et al., (2011). The concept of signaling by asymmetric information is closely related, asymmetric theory argues that the parties relating to the company does not have the same information about the firm's prospects and risks (Hanafi, 2013:314). The existence of asymmetric information between companies and external parties (investors) can lead to underpricing (Ljungqvist, 2006:2). At the time of the IPO the company will publish a prospectus that point to reduce the asymmetric information to external parties. Information about the firm characteristics, underwriter reputation and auditor reputation are provided in the prospectus.

Hartono (2005) revealed that a good quality firm will deliberately give a signal to the market with the aim to differentiate the market are of good quality and quality company otherwise.

Signaling theory in this study is used to describe the relationship between firm characteristics, underwriter reputation and the auditor reputation on the level of underpricing. High profitability, firm size is large, long life, the allocation of IPO proceeds for investment, industry types, use a good reputation underwriters and prestigious auditors are expected to rated positively by investors and underpricing will be lower.

1.3 Life Cycle Stage

Mulford and Comiskey (2005:27) revealed about enterprise life cycle theory where a company has operating cash flow characteristics depend on the stage of the company life cycle. Companies can have a negative or positive cash flow and low or high, it depends on the stage that will be experienced by the company (Juniarti and Limanjaya, 2005). Life stage companies by Mulford and Comiskey (2005:27), there are four stages namely strart-up, growth, maturity or decline stage of its life cycle.

According to Anthony and Ramesh (1992) the company has specific characteristics and different at each stage. The first stage, start-up is the stage where the company has a low initial sales volume, the company's funds is also largely proceeds from the loan and the company does not distribute dividends to investors. Second, the growth stage of the company has increased sales, profits, liquidity, and increasing the ratio of equity to debt, and companies have started paying a dividend to investors. Third, the mature stage companies experiencing high peak sales levels, capable of generating greater cash flow and able to pay high dividends to investors. And the last stage of decline, the company experienced limited growth opportunities, a decrease in revenue and stop paying dividends to investors.

Life cycle theory in this study is used to explain the relationship between firm age with underpricing.

1.4 Karakteristik perusahaan, reputasi underwriter, reputasi auditor terhadap underpricing

Firm Characteristics in this study consisted of profitability, firm size, firm age, the allocation of IPO funds for investment and industry types. Kurniawan (2007) found that profitability (measured by ROE) negative effect on underpricing and Arman (2012) showed that the profitability (measured by ROA) negative effect of underpricing. Profitability in this study is proxied by ROE as used by (Martani et al., 2012), (Risqi and Harto, 2013), (Susilowari and Turyanto, 2011) and (Kurniawan, 2007). According to Brigham and Houston (2006:109) ROE is a ratio that measures the return on investment of common shareholders.

Firm size in this study was calculated by the natural logarithm of the total assets of the company when the last period before an IPO as used by (Martani et al., 2012), (Islam et al., 2010) and (Safitri, 2013). Fernando et al. (1999), Bildik and Yilmaz (2006), Martani et al. (2012) and Arman (2012) showed that the firm size is negative effect of underpricing.

Arman (2012) and How et al. (1995) found that firm age negatively affect of underpricing. Long-lived companies have the possibility to provide more information and wider than the newly established company so that it can minimize asymmetric information and underpricing will be lower (How et al., 1995). Firm age in this study was calculated from the establishment of the company (as per deed of incorporation) until the year the company made an IPO on the Indonesia Stock Exchange as done by Aini (2013), Arman (2012) and Kristiantari (2012) in their study.

Plan allocation of IPO funds to investments is one of the information submitted by the company prospectus in the form of a percentage. Bildik and Yilmiz (2006) found that the allocation of IPO funds for investment affect to underpricing. The calculation the allocation of IPO funds for investment in this study was calculated by dividing the IPO funds for investment with total IPO funds and multiplied by the percent as used (Aini, 2013).

Indonesia Stock Exchange through ICMD (Indonesian capital market directory) classifies some industrial sectors into two types of industries including are the manufacturing and non-manufacturing industries (Junaeni and Agustian, 2013). This study distinguish type of industry in the two industries that have been classified by IDX through ICMD. The use of this type of industry in research as an independent variable aims to see whether investors distinguish the type of industry in investment decisions so that affect the level of underpricing. The results of the study of Islam et al, (2010) conducted in Chittagong stock exchange industry proves that this type of negative effect on the level of underpricing.

Underwriter is the underwriting in order to qualify IPO. The tasks and responsibilities of an underwriter that intersect with the underwriter position as parties to an IPO, according to Hadi (2013:22) is organized and responsible for activities in go public accordance with the schedule set forth in the prospectus, responsible upon payment of the public offering to the issuer (company) in accordance with the contract and submit a report that has been required by Bapepam-LK.

Underwriter reputation is a dummy variable in this study to provide a scale of 1 to reputable underwriters and a scale of 0 to otherwise reputable underwriters. Standard underwriter reputation measurement in this study is based on ranking the big five underwriters total trading value contained in IDX fact Book as is done by (Aini, 2013), (Martani et al., 2012) and (Safitri, 2013) in their study. Carter and Manaster (1990), Fernando et al. (1999), Bildik and Yilmaz (2006), Kristiantari (2012), Arman (2012) and Risqi and Harto (2013) (using the big ten) prove that the underwriter's reputation negatively affect the level of underpricing.

The auditor may be called by the public accounting profession is one of the capital market support. The role of the auditor is to determine whether such a decent company to go public or not (Martani et al., 2012). Aini (2013) and Safitri (2013) found that auditor reputation negatively affect of underpricing. Auditor reputation is a dummy variable in this study by using a scale of 1 to prestigious reputable auditors and a scale of 0 to otherwise reputable auditors.

Standards reputable auditor or prestigious auditors measured by belonging to the Indonesian public accounting firm affiliated with the big four KAP including the KAP Tanudireja, Wibisana & Partners (PwC), KAP Osman Bing Satria & Partners (Deloitte), Purwantono, Suherman & Surja (EY), KAP Siddhartha & Widjaja (KPMG) and in 2013 the KAP Tanudireja, Wibisana & Partners (PwC) is changed by KAP Haryanto Sahari (PwC).

Standar auditor yang bereputasi baik atau prestigious diukur berdasarkan auditor yang tergolong ke dalam kantor akuntan publik Indonesia yang berafiliasi dengan *big four* KAP diantaranya KAP Tanudireja, Wibisana & Rekan (PwC), KAP Osman Bing Satrio & Rekan (Deloitte), KAP Purwantono, Suherman & Surja (EY), KAP Siddhartha & Widjaja (KPMG) and tahun 2013 KAP Tanudireja, Wibisana & Rekan (PwC) digantikan oleh KAP Haryanto Sahari (PwC). Martani et al. (2012) and Risqi and Harto (2013) using the same measurement standards in their research.

Underpricing in this study was measured by the initial return (IR). Initial return is estimated as the percentage difference between the price at the which the IPO shares were sold to investors (the offer price) and the price at the which the shares subsequently trade in the secondary market (Ljungqvist, 2006:6). Initial return can be calculated by the formula closing stock price on the secondary market deductible to the IPO stock price, then divided by the IPO stock price and multiplied by the percent, it as used by (Martani et al., 2012) and (Aini, 2013).

Signaling theory argues that how the company should present the information for the capital markets to reduce asymmetric information (Bini et al., 2011), because of asymmetric information can lead to underpricing (Ljungqvist, 2006:2). *A*t the time of IPO the company will publish a prospectus that is useful to reduce the presence of asymmetric information to external parties. Information about profitability, firm size, firm age, the allocation of IPO funds for investment, type of industry, the use of services of underwriters and auditors are also presented in the company's prospectus.

Information about increase in profitability can be a positive signal of the investors, because it shows that the company can make a profit in the future so that there is certainty of return obtained by investors who would then be lower underpricing (Santoso, 2013).

Large size of the company will show that the company can with stand the uncertainty because of the amount of assets owned by the company can be used mainly as collateral for investment so that IPO's company will be assessed positively from investors and then the level of underpricing will be lower (Arman, 2012).

Firm age can also provide a positive signal for the company cause of investors assume that the long-lived companies have more experience and experience in the face of competition that would lower underpricing (Arman, 2012). IPO funds used for investment will be considered by the issuer (company) as a positive signal because of potential investors will imply that the company will increase its production capacity so that it can be used as collateral for investors that investment will be lower underpricing (Kristiantasri, 2012).

The use of highly reputable auditor will give a positive signal of investors because of the company will be interpreted by investors that the company has an accurate and transparent information to the financial statements of company so that underpricing conditions can be minimized (Santoso, 2013).

The use of a good reputation underwriters according to Arman (2012) can reduce the uncertainty in the future so that it will give a positive signal to the company that underpricing will be lower.

2. Discussion

The sample in this study using the 81 companies which an IPO on the Indonesia Stock Exchange. The sampling technique using purposive sampling method and methods of analysis using multiple regression models. The results of this study indicate that only the auditor's reputation negatively affect of underpricing. Safitri (2013) argues that the company's financial statements are audited by prestigious auditors will obtain a positive signal to the market, especially investors in making decisions for the use of this high-quality auditors will provide information about the prospects of his client companies (issuers) with more carefully and accurately.

This study supports the signaling theory, because the information about the use of prestigious reputable auditors at the IPO can give positive signals from investors that the low level of underpricing. These findings support the results of research conducted by Johson (2011) and Safitri (2013) which states that there is a negative effect between auditor reputation on the level of underpricing.

This research shows that profitability is proxied by ROE no effect on underpricing. Profitability does not affect the level of underpricing shows that the information about profitability's company submitted through prospectus can not give any signal to investors that no impact assessment of the underpricing.

Second, the data in this study have much value range between the value of lowest and highest profitability so may cause the results in this study becomes insignificant. This finding is consistent with research Risqi and Harto (2013), Susilowati Turyanto (2011), Johson (2011), as well as Martani et al. (2012) which states that the profitability (ROE) does not affect the level of underpricing.

Firm size found no effect on underpricing. These findings do not support the signaling theory because the information about large and small companies can not give any signal to the investors' assessment so that it does not impact to the level of underpricing. The results of this study also indicate that the data size of the company at least in this study experienced only by 2%, while underpricing the data size of the largest companies experienced underpricing level is much higher (50%). According to Aini (2013) investors do not assess the large and the small size of the company in investment decision but investors better assess the company's performance with how companies can manage company assets efficiently and effectively. These findings support the results of research Safitri (2013) and Aini (2013) which states that there is no influence of firm size on the level of underpricing.

Other results in this study indicate that there is no influence between firm age with underpricing. First, Mulford and Comiskey (2005:27) revealed that a company has different characteristics at each stage of the life cycle experienced by the company and any company that does not experience the same age in through the stage. This is supported by the data of this study in which companies are under five years old have characteristics (profitability) are different so that firm age can not be used as a basis for valuation of investments.

Second, company's performance more assessed by investors in their investment decisions than the firm age. According to Aini (2013) argues that the company's performance is quite good if the company can minimize costs and maximize profits. These findings support the results of research conducted by (Kristiantari, 2012), (Martani et al., 2012) and (Safitri, 2013). These findings are inconsistent with the theory signaling as long and at least information about the age of the company can not get any signal from investors that have no effect of underpricing.

The results of this study indicate that allocation of IPO funds for investment no effect of underpricing. This finding is consistent with the results of research conducted by Aini (2013) who found that the allocation of IPO funds for investment does not affect underpricing, it is because investors can better assess macroeconomic factors such as inflation events. According to Aini (2013) argues that high inflation may cause the Bank Indonesia's policy to raise interest rates so as to result in investors shift their investment funds from the capital market to the money market (Aini, 2013).

These findings are not consistent with the signaling theory because the information about allocation of IPO funds for investment no effect of underpricing and it shows that investors do not assess the percentage IPO funds for investment in the investment decision-making.

Industry types have no effect on underpricing, it shows that investors are not distinguish type of industry in their investment decisions so as not to affect the underpricing.

These findings are not consistent with the signaling theory due to the manufacturing and non-manufacturing companies, they can not give any signal to the level of underpricing. Yolana and Martani (2005) revealed that the type of industry which does not affect the underpricing can also be caused investors suspect that investment risk can occur in all types of industries and opportunities for profit can also be shared by all types of industries. This finding supports the research done by Aini (2013) who found that there is no influence between allocation of IPO funds for investment with underpricing.

The findings of the last indicates that underwriter reputation has no effect on underpricing. This research consistent with result of Johson (2011), Martani et al. (2012) and Aini (2013) found that underwriter reputation no effect on underpricing. Not influential underwriter reputation on underpricing can be caused due to underwriter reputation measurement standards in this study uses only the top 5 of the 50 most active underwriters in total trading value so that the standard measurement underwriters in this study considered too little and cause no significant results.

The second reason, the possibility of investors assume that reputable underwriters have not been able to determine a reasonable stock price (real) at the time of the IPO (Kristiantari, 2012).

3. Conclusion

Use of a prestigious reputable auditors at the time of the IPO can cause low level of underpricing so losses suffered by the company at the time of the IPO is not too large because the initial returns are accepted investors are not too big. The results showed that of the seven independent variables used in this study include the firm characteristics (profitability, firm size, firm age, the allocation of IPO funds for investment and industry types), underwriter reputation and reputation of the auditor, only auditor reputation which proved negative effect on underpricing while the other six variable no effect on underpricing. The better of the of an auditor reputation used at the time of IPO, it will minimize underpricing conditions. Audited financial statements by prestigious reputable auditors will get a positive signal of investors when making investment decisions because of the use of this high-quality auditors will provide information about the prospects of his client companies (issuers) more carefully and accurately so that the fraud on the financial statements that may be made by the company's IPO at the time can be minimized

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