

# **Analysis of Factors Influencing IPO Underpricing on Companies Listed in Indonesia Stock Exchange**

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## **Abstract**

This study aims to determine the factors influencing the level of IPO Underpricing on companies listed on the Indonesian stock exchange from 2015 to 2017. Variables examined include Return on asset, firm age, financial leverage, number of shares offered, and auditor reputation. This research is carried out by analyzing multiple regression with a 5% significance level. Observation and literature study with purposive sampling is used as the data collection method. The study concluded that ROA and the number of shares offered show a significant positive effect on underpricing. Firm age, financial leverage, and auditor reputation do not significantly influence underpricing.

## **Keywords**

Auditor Reputation, Financial Leverage, Firm Age, Number of Shares Offered, ROA, Underpricing.

## **1. Introduction**

Economic development supported by the advancement of communication and technology has created very tight competition in almost every business sector. Many companies compete with each other to expand their scope of business. To survive, a company must continue to grow and make a new development. Many business owners think of doing global expansion in line with global economic development that keeps growing up.

Stock issuance in the capital market has become an alternative for companies to get additional funds for business expansion. The additional capital will be used for the development of the business operation. Not only for companies, but the capital market has also become one of the alternatives for the investor in investing in various types of businesses. This has also become the investor's opportunity to get a bigger initial return, the result that the investor got from the investment, from the investing activities.

The initial public offering is the term used for a process when a company first sells its stock to the public in the primary market and becomes a publicly traded company. According to the law of the Republic of Indonesia, Act. No 8 the year 1995 about the Capital Market, the definition of going public is the activity of offering shares by the issuer company to the public based on the procedure set by the law of Capital Market.

Once a company decides to go public, the company must sell its shares in the primary market at a price that has been determined by the help of the underwriter. This activity is called Initial Public Offering (IPO). Then, after being traded in the primary market, the issuer's shares will be traded in the secondary market. The price of the shares is formed by the supply and demand of the investors.

Besides the advantages of going public, IPO also raises a problem for the issuer. When a company prepares to go public, the problem faced is determining the first price. The issuer wants to set a high price to gain a high return from the initial offering, but on the other side, the high price of shares will lessen the investor's interest in buying the

shares. Many investors are not interested in buying high priced shares because high priced shares have more risk than shares with a lower price. The company will not get high returns if only a few investors are interested in investing in its shares. The effect of initial Return can raise the underpricing phenomena.

Underpricing occurs when the stock price in the primary market is lower than the stock price on the first day of trading in the secondary market (Martani, Sinaga, & Syahroza, 2012). Otherwise, if the stock price of IPO is higher than the stock price on the first day in the secondary market, then it is called overpricing. Underpricing can be disadvantageous for the issuer because they will not get the maximum profit from the offering.

Underpricing is the phenomenon that often happens in companies performing IPO. Only a few companies have experienced overpricing in IPO. Based on the data from Indonesia Stock Exchange, from 67 companies that performed initial public offerings from 2015 until 2017, only five companies experienced overpricing.

The factors affecting underpricing may come from the behaviour of the issuer in determining the price. How the issuer and its underwriter determine the price can be from many calculations and considerations. The price determination could cause information asymmetry between the issuer, underwriter, and investors (Safitri, 2013). The party with more information will benefit from the IPO, whereas the party with less information about the market will be disadvantageous.

The underpricing phenomenon of first publicly traded shares becomes an interesting topic to analyze because there are inconsistencies in the result of previous research. Many researchers have analyzed this topic before, such as the research done by (Yoga, 2010) showing that ROA as the independent variable has a significant negative effect. Meanwhile, research by (Purwanto & Mahyani, 2016) shows that ROA does not significantly affect underpricing. This topic also had been researched by many international researchers, such as (Agathee, Sannasee, & Brooks, 2012), using the data from the Stock Exchange of Mauritius from 1989 until 2010, and found that the offering size does not significantly affect underpricing. This result is inconsistent with the findings of (Clarkson & Simunic, 1994).

Because of the inconsistencies in previous research results, this research analyzes the factors that affect underpricing based on the problems mentioned as follows:

1. Does Return on Asset (ROA) affect the level of underpricing?
2. Does the number of shares offer affects the level of underpricing?
3. Does the age of the firm affect the level of underpricing?
4. Does the financial leverage affect the level of underpricing?
5. Does the reputation of the auditor affect the level of underpricing?

Information asymmetry is when information is not well balanced, mostly among the issuers and investors. According to (Katti & Phani, 2016), information asymmetry is why many studies about underpricing are conducted. The literature establishes information asymmetry into two different interfaces. The first one is between issuer and underwriter, and the other is between various investor classes. The issuer and underwriter determine the offering price. The degree of underpricing occurred due to how the underwriter determines the offering price, wherein the underwriter plays a significant role and has more information as the price setter. The degree of underpricing also occurred due to informed and uninformed investors.

### 1.1 Previous Studies

Research by (Kim, Krlnsky, & Lee, 1993) and (Permadi & Yasa, 2017) indicates that the ROA variable has a significant negative effect on the level of underpricing. A significant negative effect indicates an inverse correlation between ROA and underpricing level. ROA and underpricing level move in opposite directions as the lower ROA will increase the underpricing level, and the higher ROA will decrease the underpricing level.

Age of the firm and underpricing show a significant positive effect in research conducted by (Islam, Ali, & Ahmad, 2010). A positive relationship is where the firm age and underpricing level move in tandem. An increase in age affects the increase of underpricing and vice versa.

(Mahatidana & Yunita, 2017) finds a significant negative result from the relationship of auditor reputation and underpricing level. He argues that a more reputable auditor will likely reduce the degree of underpricing. Auditors are considered to have complete information about the condition of financial condition, so auditors who have a high reputation will give information in accordance with the condition of the company.

## 2. Research Method

The population of this study is the companies listed on the Indonesia Stock Exchange that performed IPO from 2015 until 2017. This research will be conducted based on secondary data obtained from the official website of the Indonesia Stock Exchange and the companies' official websites. The secondary data used in this research are the Return on Asset, number of shares offered, the age of the firm, financial leverage, and auditor reputation.

The type of data used in this research is quantitative research using secondary data taken from an Indonesian listed company that performed IPO from 2015 until 2017. The data was taken from the companies' prospectus and annual reports, which disclose the number of shares issued, financial ratio, firm age, and auditors. Those prospectus and annual reports can be found on the companies' official website, [www.e-bursa.com](http://www.e-bursa.com), and the Indonesia Stock Exchange website ([www.idx.co.id](http://www.idx.co.id)). The data of the IPO date was taken from IDX's official website and also available in the prospectus. The author also retrieves data from the related literature review, published journals, previous research, and textbook to gain theories that support the study. All the literature reviews can be found on the internet, official website, and library.

The population used in this study is from all Indonesian companies that performed initial public offerings from 2015 until 2017, with 67 companies. The technique used to determine the samples is purposive sampling, a non-probability sample. Purposive sampling is a technique in which the author relies on certain characteristics when choosing population members to participate in the study. The criteria used in determining the samples are:

1. Samples must be the companies that performed an initial public offering (IPO) from 2015 until 2017.
2. Samples must be the companies that experienced IPO underpricing from 2015 until 2017.
3. Samples must have complete and reliable IPO data and financial reports.
4. Closing price information is available.

This study uses secondary data. Thus, the method of collecting data is by documentation from reliable source. The data such as IPO price, first day closing price in the secondary market, net profit, total assets, total liabilities, and the auditor information are gained from the annual financial report and companies' prospectus. The IPO date, offering price, and the number of shares offered are obtained from the companies' prospectus. The closing price in the secondary market is available on [e-bursa.com](http://e-bursa.com).

To analyze the effect of independent variables on dependent variables, then multiple regression is used in this study. Multiple regression is chosen for this study because this technique can determine the relative influence of one or more predictor variables on the criterion values. Multiple regression could determine the effect of more than one independent variable on a particular dependent variable. Multiple regression is also capable of identifying outliers or anomalies.

SPSS Statistic 25 is used as the statistical software that helps transform data into statistical output. Before multiple regression is tested, the test towards assumptions of multiple regression models must be completed first. The assumptions are normality, multicollinearity, autocorrelation, and heteroskedasticity.

There are two types of variables used in this study: the independent and dependent variables. There are five independent variables used in this study: Return of Asset (ROA), the age of the firm, financial leverage, offering size, and reputation of the auditor. The dependent variable is underpricing rate.

The dependent variable in this study is the level of IPO underpricing (X). According to (Purwanto, Agustiningsih, Insani, & Wahyono, 2014), underpricing is measured by the level of initial Return. The level of underpricing can be calculated by deducting the closing price (closing price) on the first day in the secondary market with the initial offering price (offering price) and divided by the initial offering price. The closing price of the first day of IPO is used because the market conditions on the first day are more unbiased to determine the fair value of the company's IPO transactions (Cotter, Goyen, & Hegarty, 2005). Then underpricing will be formulated as follows:

$$\text{Underpricing} = \frac{\text{closing price} - \text{offering price}}{\text{offering price}} \times 100\%$$

The independent variables used in this paper are Return of asset (ROA), offering size, the age of the firm, financial

leverage, and auditor's reputation.

## 2.1 Return on Asset

Return on asset (ROA) ratio provides information to potential investors about the profitability of the IPO companies. According to [12], this profitability variable is calculated by dividing the net income after tax by total assets owned by the company in the year last before the company is listed. Formulated as follows:

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

## 2.2 Firm Age

The age of the companies can be measured by the difference between the IPO year and the establishment year. The year of establishment and year of initial public offering can be conducted from the prospectus. (Handayani, 2008) stated that the age of the issuer company shows how long a company can survive and becomes evidence that the company can compete in the industry.

## 2.3 Financial Leverage

This variable measures how the debt finances many company assets. According to (Purwanto & Mahyani, 2016), financial leverage can be measured by comparing the total liabilities with total assets of the latest year before IPO. The greater ratio shows the great amount of debt relative to assets.

$$\text{Financial Leverage} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

## 2.4 Offering Size

Offering size is measured by the number of shares a company offered in conducting the IPO. How much a company offers its shares can be seen in the prospectus. This variable uses the natural logarithm (ln).

## 2.5 Auditor Reputation

Auditor reputation uses a dummy variable in which 0 and 1 are applied in a certain condition. The auditor's reputation is measured by seeing whether the auditor is the auditor from a prestigious audit firm or not. According to (Prastica, 2012), prestigious auditors are affiliated with the Big Four audit firm, and the others will be categorized as non-prestigious auditors. The Big Four audit firm is as follows:

1. Deloitte Touche Tohmatsu;
2. PricewaterhouseCoopers;
3. Ernst & Young;
4. KPMG.

Auditor reputation will be scored 1 if the company used the Big Four audit firm. Otherwise, 0 is applied if the condition is not met.

## 3. Result and Discussion

The total variables used in this research include 1 dependent variable and 5 independent variables, as discussed in the previous chapter. The samples of 58 companies from the observation period of 2015 until 2017 are utilized to calculate the descriptive statistic. The following table describes the result of the descriptive statistic calculated using SPSS 25 (table 1).

Table 1. Descriptive Statistics

	N	Min	Max	Mean	Std. Deviation
Underpricing	58	.0132	.7000	.379839	.2719340
ROA	58	-	.2104	.051925	.0653708

		.0620			
AGE	58	2	46	17.64	12.811
FINLEV	58	.0029	.9089	.528311	.2615972
SIZE	58	2217	1054443	104616354	162568009
		4000	6000	7.12	7.359
AUDIT	58	0	1	.07	.256
Valid N (listwise)	58				

Source: SPSS 25.

### 3.1 Normality Test

The normality test is run with the Kolmogorov – Smirnov test, as shown in the table below. The asymptotic significance is 0.2, which is more than 0.05. Thus, it can be concluded that the data is normally distributed (table 2).

Table 2. One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		58
Normal Parameters <sup>a,b</sup>	Mean	.0000000
	Std. Deviation	.22962155
Most Extreme Differences	Absolute	.099
	Positive	.060
	Negative	-.099
Test Statistic		.099
Asymp. Sig. (2-tailed)		.200 <sup>c,d</sup>
a. Test distribution is Normal.		
b. Calculated from data.		
c. Lilliefors Significance Correction.		
d. This is a lower bound of the true significance.		

Source: SPSS 25

### 3.2 Multicollinearity Test

Multicollinearity is assumed not to exist in the multiple regressions. According to (Sujarweni, 2016), if the result of VIF is between 1-10, then there is no multicollinearity occurred for this regression model. Below is the result of the multicollinearity test (table 3):

Table 3. Multicollinearity Test Result

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	1.746	.620		2.815	.007		
	ROA	-1.465	.499	-.352	-2.936	.005	.953	1.050
	AGE	-.005	.003	-.219	-1.791	.079	.913	1.095
	FINLEV	-.136	.073	-.224	-1.864	.068	.951	1.051
	SIZE	-.062	.030	-.248	-2.061	.044	.948	1.055
	AUDIT	-.241	.130	-.227	-1.860	.069	.922	1.085
a. Dependent Variable: Underpricing								

Source: SPSS 25

### 3.3 Autocorrelation Test

The autocorrelation test is used to determine whether there is any deviation in the variables used for the study. The *dw* value can be seen from the Durbin-Watson column. The upper value (*du*) can be found in the Durbin-Watson table. The *du* or upper value of 5 variables and 58 samples is 1.767. Meanwhile, the table above shows the *dw* value

of 2.125. The  $dw$  value is greater than  $du = 1.767$ , and the  $dw$  is less than  $4-du$  ( $4 - 1.767$ ), which means there is no autocorrelation in the regression model (Table 4)

Table 4. Autocorrelation Test Result

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.536 <sup>a</sup>	.287	.218	.240407714291026	2.125
a. Predictors: (Constant), AUDIT, SIZE, FINLEV, ROA, AGE					
b. Dependent Variable: Underpricing					

Source: SPSS 25

### 3.4 Heteroscedasticity Test

Heteroscedasticity also can be done by Glejser Test. The Glejser test aims to regress the absolute value of the residual with independent variables. If the significance value between independent variables with absolute residual is more than 0.05, then there is no problem with heteroscedasticity (Table 5).

Table 5. Glejser Test Result

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.168	.291		.576	.567
	ROA	-.125	.234	-.072	-.531	.597
	AGE	.001	.001	.163	1.181	.243
	FINLEV	.011	.034	.043	.320	.750
	SIZE	.001	.014	.010	.077	.939
	AUDIT	-.094	.061	-.212	-1.543	.129
a. Dependent Variable: ABS RES						

Source: SPSS 25

### 3.5 Hypothesis Testing

The t-test statistic is used to know how big the influence of each independent variable is on the dependent variable. In this study, the level significant used is 5% or 0.05.

Table 6. t-test Result

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.746	.620		2.815	.007
	ROA	-1.465	.499	-.352	-2.936	.005
	AGE	-.005	.003	-.219	-1.791	.079
	FINLEV	-.136	.073	-.224	-1.864	.068
	SIZE	-.062	.030	-.248	-2.061	.044
	AUDIT	-.241	.130	-.227	-1.860	.069
a. Dependent Variable: Underpricing						

Source: SPSS 25

Based on the table above, the influence of the independent variables on the dependent variables is described as follows:

In this study, the ROA affects the Underpricing level (Y), which is why the t-test result of this variable is less than 0.05 ( $0.005 < 0.05$ ). The decrease and increase in ROA of the issuer will influence the underpricing rate. The coefficient of -1.465 in table 6 indicates ROA has a significant negative effect on underpricing level. The significant negative effect shows an inverse correlation between ROA and underpricing level. ROA and underpricing level move

in opposite directions as the lower ROA will increase the underpricing level, and the higher ROA will decrease the underpricing level.

The significant negative influence of ROA on underpricing level might happen for various reasons. One of the causes is that investors have more interest in companies with high Return on Asset. ROA itself is the financial ratio that shows the percentage of profit a company earned in a year with the overall asset and resources. The higher the ROA, the more effective a company uses its assets to gain profit. The high level of ROA also becomes a piece of evidence that the company can manage the capital efficiently, which results in future income. This phenomenon will reduce the uncertainty of future events and decrease the risk of investment. The lower level of uncertainty will reduce the underpricing level as it affects the decision making of the investors. Thus, the significant negative result shows an inverse relationship between two variables as the higher the ROA, the lesser the underpricing and vice versa.

### **3.6 The Influence of Firm Age towards Underpricing**

According to the t-test, firm age has no significant influence on underpricing. The result can be seen in the table above. The significant value is 0.079, and the coefficient of -0.005. Therefore, the significance value of firm age is greater than the significance level of 0.05 ( $0.079 > 0.05$ ). Therefore, according to the decision criteria,  $H_0$  cannot be rejected, and it means that the firm age does not significantly influence the underpricing level of IPO companies listed on the Indonesia Stock Exchange (IDX) within the period 2015 to 2017.

The age of the companies is not influencing the level of underpricing because investors do not concern about how long a company has been established. The older companies do not reduce the uncertainty of initial Returns. The older companies cannot ensure the good prospect of the issues. Also, younger companies do not necessarily show a bad prospect of the issues. The age of the companies cannot be the evidence that older companies can reduce the risk of future investment as the firm age cannot be the proxy of firm quality. Younger companies are not always riskier than older companies. Investors are more interested in analyzing the financial factors rather than the company's age. Due to that reason, age is not becoming the factor determining the degree of Return. Companies of any age can experience unhealthy financial conditions or even have the possibility of bankruptcy. Thus, the company's age is not the consideration of investors in assessing the value of issues.

### **3.7 The Influence of Financial Leverage towards Underpricing**

According to the t-test, financial leverage has no significant influence. The influence shown in Table 6 has a significance value of 0.068 and a coefficient of -0.136. The significance value of financial leverage is greater than the significance level of 0.05 ( $0.068 > 0.05$ ). Therefore,  $H_0$  is not rejected, and  $H_1$  is rejected according to the criteria.

The result shows that financial leverage does not significantly influence the underpricing level in IPO companies listed on Indonesia Stock Exchange (IDX) from 2015 to 2017.

Financial leverage does not significantly influence underpricing because investors are not concerned about the level of leverage. Leverage can be both good and bad. It depends on the investment made by the company. If used successfully, leverage can be very advantageous for the company as they can use the fund from the debt to buy more assets to improve production and profit. On the other hand, financial leverage also comes with the risk of loss and bankruptcy if not well managed by the management. Thus, based on the research result, financial leverage is not a consideration for investors to invest in a company, and investors do not seem to view financial leverage as a relevant factor in determining the company's future.

### **3.8 The Influence of Number of Shares Offered towards Underpricing**

Based on the regression carried out in this study, it can be concluded that the number of shares offered in IPO has a significant negative influence on underpricing. The conclusion is made by looking at the coefficient of -0.062 and the significance level of 0.044. The significance value is lower than 0.05 ( $0.044 < 0.05$ ), so it can be concluded that the number of shares issues significantly influences the level of underpricing. The coefficient of -0.062 shows the negative direction from this variable towards underpricing. The significant negative effect shows an inverse correlation between the number of shares offered and the underpricing level. The number of shares offered and underpricing level move in opposite directions as the smaller the offering size will increase the underpricing level, and the larger the offering size will decrease the underpricing level.

A large number of shares sold to the secondary market will affect the decision of the investor to purchase the shares

of the company or not. The more shares sold to the public, the higher the number of shares purchased by investors or potential investors. The more the number of shares purchased by investors, the higher the capital coming in for corporate funding. A company with a high amount of capital will have enough resources to reach its goal and develop the company, reducing the risk of investing. The lower level of risk and uncertainty will decrease the underpricing level. Thus, the significant negative result shows an inverse relationship between the two variables as the higher the offering size, the lesser the underpricing and vice versa.

### 3.9 The Influence of Auditor Reputation towards Underpricing

According to the t-test, the auditor's reputation has no significant influence on the level of underpricing. The result can be seen in Table 6. Auditor reputation has a coefficient of -0.241 and a significance level of 0.069. Therefore, the significance value of auditor reputation is greater than the significance level of 0.05 ( $0.069 > 0.05$ ). Thus, according to the decision criteria,  $H_0$  is not rejected, and the alternative hypothesis  $H_1$  is rejected. The result also indicates that the auditor's reputation does not influence the underpricing level in companies in 58 sampled companies that conducted IPO listed on Indonesia Stock Exchange (IDX) within the period 2015 to 2017.

The selection of auditors by the companies is not always because of the audit firm's reputation but also because of the audit cost. From the t-test result, the auditor's reputation does not influence the underpricing. This finding proves that the more reputable auditor does not reduce the uncertainty of future investment among the investors. The potential investment risk still exists within all companies, no matter who the auditor is. Therefore, investors do not perceive that the big four auditors could give better information than other auditors (table 7).

Table 7. R-squared Test Result

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.536 <sup>a</sup>	.287	.218	.240407714291
a. Predictors: (Constant), AUDIT, SIZE, FINLEV, ROA, AGE				
b. Dependent Variable: Underpricing				

Source: SPSS 25

Based on the result shown in the table above, the value of the adjusted R square is equivalent to 0.218, which is also equivalent to 21.8%. This result is closer to 0 rather than 1. This means that the independent variables included in the model, such as ROA, the age of the firm, financial leverage, number of shares offered, and auditor reputation, contribute to the variation of Initial Return (Y) by the amount of 21.8%. The remaining 78.2% is determined by other variables not identified in this study (table 8).

Table 8. F-test Result

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.210	5	.242	4.186	.003 <sup>b</sup>
	Residual	3.005	52	.058		
	Total	4.215	57			
a. Dependent Variable: Underpricing						
b. Predictors: (Constant), AUDIT, SIZE, FINLEV, ROA, AGE						

Source: SPSS 25

Table 8 shows the result of the F-test that has been done using SPSS 25. The result from the simultaneous test shows the value of F equal to 4.186 with test significance equal to 0.003. The value of significance is less than 0.05 ( $0.003 < 0.05$ ). Thus, the underpricing level can be explained simultaneously and significantly by the variance of Return on Asset, the age of the firm, financial leverage, number of shares offered, and auditor reputation variables.

## 4. Conclusion

Based on the hypothesis testing, the conclusion of this research is as follow:

1. Partially, only ROA and the number of shares offered have a significant negative influence on the level of underpricing. Company age, financial leverage, and auditor reputation do not influence the level of underpricing.



2. The ability of all variables to explain the underpricing level is 21.8%. The remaining 78.2% is determined by other variables not identified in this study. This result is obtained from the R-squared test conducted in the previous chapter. The result shows the adjusted R-squared of 0.218 or 21.8%, as shown in Table 7

3. Return on the asset, the age of the firm, financial leverage, numbers of shares issued, and auditor reputation simultaneously affect underpricing of companies that conducted IPO from 2015 to 2017. This result can be seen from F-test in table 8. The test result shows that the significance value of the F-test is less than 0.05 ( $0.003 < 0.05$ ). This research has provided a deeper knowledge for the researcher of the capital market, especially related to initial public offerings in Indonesia. The advice given to researchers is to expand the range of the observation, such as using stock exchanges from other countries or other financial or non-financial variables not mentioned in this study.

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