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Stock Underpricing Phenomenon and Influencing Factors

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Abstract

The excessive discrepancy between the main market's both the secondary market's share price and share price is known as underpricing. This research seeks to ascertain how debt affects covenant, business size, and industry type on the undervaluation of stocks of businesses that are listed on the Indonesia Stock Exchange. The author employs a quantitative research approach and an associative technique. The data was collected using the documentation approach. The study object consists of companies that list from 2019 to 2022 on the Indonesian Stock Exchange. The sample strategy employed was non-probability purposive sampling. In all, 190 companies met the sample's standards. According to the investigation's findings, the kind of industry has a positive impact on stock underpricing. However, for businesses that conduct IPOs on the Indonesian Stock Exchange, it seems that stock underpricing is unaffected by the company's size or debt-to-equity ratio. This finding emphasizes the importance of considering investment decision-making strategies based on a deep understanding of industry factors rather than relying solely on firm size or financial structure.

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1. Introduction

A company is established with two primary aims: firstly, to maintain the business in a sustainable manner and, secondly, to facilitate its growth. As the business expands, the company will require significant additional financial resources. Frequently, internal sources of capital, including equity and retained earnings, prove inadequate to finance this process, necessitating the acquisition of external funding (Alhadab, 2016). There are two principal categories of external funding: equity and debt. Equity may be raised by selling company shares to the public. Debt can be obtained through the process of borrowing from creditors or the issuing of debt securities. A company that elects to issue new shares and sell them to the general public is often referred to as a "going public" entity (Castilho et al., 2019). In the process of becoming a publicly-held company, the company will initially offer shares to the general public, after then, it will be exchanged on the secondary market. The main marketplace is the initial point of sale for companies' first-time issuance of shares to the general public. The secondary market, in turn, comprises an exchange or market where securities are traded between investors subsequent to the initial offering (Dou et al., 2023; Geng & Tan, 2021). Those who have purchased shares in the primary market may subsequently sell them in the secondary market.

In accordance with the initial offering process, the company in question is required to present a complete and comprehensive overview of the aforementioned company (Kongkaew et al., 2021). Information related to the company may be provided by the aforementioned company via a prospectus. Numerous details about the company's operating and financial situation are included in the prospectus. Information derived from the prospectus can be classified according to whether it is financial or non-financial data pertaining to the company (Sieradzki & Zasępa, 2016). A prospectus containing comprehensive information allows investors to obtain more complete data. Such information will inform the decisions of investors while they are making their investments.

In the preliminary stages of offering shares on the open market, the share price at which it is offered is a significant consideration for the company. The pricing of shares at a value below their closing price on the secondary market is a cause of underpricing. It is not uncommon for underpricing to occur during the initial offering process (Siwach et al., 2023). The phenomenon of underpricing presents an advantage for investors, as it allows them to realise an early return. Conversely, the company suffers a loss, as it fails to obtain the maximum additional capital. Conversely, should the offered share price prove high, the funds that the company will receive will be substantial, resulting in investors losing the initial return (Solovjova et al., 2022). There are several elements that affect the degree of stock underpricing, such as the company's size, industry, and ratio of debt to equity.

Although the phenomenon of underpricing is advantageous for short-term investors seeking rapid capital gains, it presents a number of challenges for organisations embarking on initial public offerings (IPOs) (Sreenu et al., 2022). For corporations, underpricing signifies a considerable forfeiture of prospective capital that could otherwise be deployed for expansion, innovation, or debt reduction. When shares are initially undervalued, the funds procured

through the IPO are, in effect, diminished, curtailing the resources attainable to accomplish strategic objectives (Tutuncu, 2020). Consequently, companies are compelled to meticulously consider the benefits of attracting investors through reduced initial prices against the long-term costs associated with underpricing.
The one of the leverage ratios is the debt-to-equity ratio. The company's capacity to fulfill all of its financial commitments is evaluated using this ratio, including both in the near and far future ones (Cao et al., 2023; Khatib et al., 2024). By comparing the entire liabilities and the total capital possessed by the business, the ratio of debt to capital or debt to equity is calculated. An elevated proportion of debt to equity is indicative of elevated financial risk for the company in question (Yanti & Pratiwi, 2021). Such financial constraints are a consequence of the company's obligation to discharge both principal debt and interest expenses. One potential cause of an initially mispriced share price is a high debt-to-equity ratio.

Among other things, a firm's size is referred to as its "company size" based on its assets and revenues. The magnitude of a company may be determined by looking at its total revenue and asset worth. The entire assets possessed by the business prior to its initial offering are used in this study to ascertain the company's size. This data can be sourced from the company prospectus. It is generally observed that companies which are of a considerable magnitude are more likely to demonstrate favourable and promising prospects in the future. Consequently, firms of considerable scale tend to establish share prices that are unduly elevated (Karpowicz, 2020).

An enterprise's industry classification serves to define its business operations. There are two principal categories of industry: manufacturing and non-manufacturing. Manufacturing companies are those that oversee the processing of raw materials into finished goods intended for sale. Conversely, non-manufacturing companies are those that do not engage in the process of managing goods for sale. This encompasses trading companies, service companies, and other similar entities. The level of risk and market conditions vary between different types of industry, including both manufacturing and non-manufacturing. The disparate risk profiles and market conditions that characterise different industrial sectors result in varying profit margins and, consequently, divergent levels of stock underpricing (Augustine et al., 2023)

The purpose of this study is to identify the variables that affect underpricing during a business's initial public offering (IPO) on the Indonesian stock exchange by taking into account the debt ratio, industry type, and company size. In the context of Indonesia's emerging capital markets, this study offers strategic insights that help investors, businesses, and regulators manage and comprehend the dynamics of stock prices during initial public offerings (IPOs). The classification of businesses into manufacturing and non-manufacturing categories, which can give a general idea of whether manufacturing firms are a contributing cause to underpricing in the age of economic globalization, is what makes this study innovative.

2. Literature Review

Debt to Equity Ratio and Stock Underpricing

Signaling theory was initially introduced by Spence's Job Market Signalling. According to Spence (1973: 358) the transmitter (the entity with the knowledge) sends cues or indications to the recipient as useful information. Investors utilize relevant information to choose firms to invest in to increase returns. The company requires funds to operate and grow.The capital market brings together money-needy and money-rich people. Article 1, Paragraph 13 of Law No. 8 of 1995 on the Capital Market defines the capital market as "an activity involving the public offering and trading of securities, public companies issuing securities, and securities-related institutions and professions. The capital market's two main roles affect a nation's economy (Baydaş et al., 2024) . First, it helps businesses raise financing from investor communities. The capital market provides money for firm development, expansion, and operational cash. Second, the capital market allows wealthy people to invest in bonds, equities, and mutual funds (Suryani & Fernando, 2024; Zolotoy et al., 2021).

Among the leverage ratios is the debt to equity ratio. According to Sujarweni, (2019), the leverage or solvency ratio serves as an indicator of a company's capacity to fulfill all of its short- and long-term commitments. The debt to equity ratio is "the composition of the company's equity given to pay debt," according Muhani et al., (2020) Stated differently, it refers to the degree to which debt may be paid off using equity. Compared to a high low debt-to-equity ratio, a corporation with a low debt-to-equity ratio has a lower financial risk profile. When the debt-to-equity ratio is high, investors will become less interested in the business. This is because the business must make the principle and interest payments needed to pay off the debt. Results from earlier studies by Kusumawati, (2019) support this conclusion, showing that a high the debt-to-equity ratio is beneficial for underpricing.
H1: Debt to Equity Ratio has a positive effect on Stock Underpricing.

Company Size and Stock Underpricing

A company's size is a gauge of its scope, which may be calculated according to a number of different criteria, including total assets, total capital, total sales revenue, the number of employees, and so on. An examination of the total assets available to a corporation might provide insight into its size. Theoretically, a company's size increases with the amount of assets it owns. Large companies are more likely to exhibit favourable performance and corporate governance outcomes. A company of considerable magnitude is indicative of an inherently low level of risk. It is anticipated that a company with a high economic scale will be capable of enduring for an extended period of time. This is due to the fact that large companies are able to draw on sufficient resources and possess advanced technologies, enabling them to compete more effectively and expand in the face of existing business complexity. Investors typically favour investment in large-scale companies, given their expectation that such entities will be able to generate a return on capital invested and offer more attractive and promising returns. It is anticipated that companies with a substantial size will have more favourable prospects in the future. A large-scale company is perceived as having minimal risk, which ultimately influences the pricing strategy at the initial offering stage. It is observed that companies with large sizes tend to set share prices that are above the equilibrium price. This may result in a minor degree of underpricing of shares. Thus, it

may be said that stock underpricing is negatively impacted by firm size. These findings are in line with other research showing that underpricing is negatively impacted by firm size Ariyanti & Isynuwardhana (2023).
H2: Company Size has a negative effect on Stock Underpricing.

Industry Type and Stock Underpricing
Velez Osorio, (2024) defines industry as "a collection of companies that produce and sell similar products in the same market," thereby distinguishing between a market and an industry. An industry type is a classification of companies based on the sector in which the company operates. It is a defining feature of the business and is used for the purposes of classification and analysis. Typically, industry types can be identified by their production processes. There are two principal categories of industry: manufacturing and non-manufacturing. The analysis of industry type is a crucial element of the investment process. Such an analysis can assist in the estimation of potential investment opportunities, taking into account the inherent risks and market conditions associated with different industry types. The measurement of industry type variables employs the use of dummy variables. The determination employs a scale of 1 for manufacturing companies and 0 for non-manufacturing companies. The analysis of industry type is a pivotal phase in the process of stock investment. The related analysis enables the estimation of investment opportunities in industries characterised by a specific level of risk, as well as the calculation of returns that will provide benefits to the investor. The influence and risk associated with each type of industry vary considerably in relation to investor decisions. Consequently, the level of stock underpricing will vary according to the type of industry in question. Thus, it is evident that stock underpricing is influenced by the type of industry. This conclusion is in line with the findings of the study by Ariyanti & Isynuwardhana (2023) which show that underpricing is negatively impacted by the industry type.
H3: Industry Type has a negative effect on Stock Underpricing

3. Research Methods
In this study, the authors used an associative research approach. Associative research is defined as research conducted to determine whether independent and dependent variables influence each other. Companies that completed initial public offerings (IPOs) on the Indonesia Stock Exchange and provided extensive datasets to researchers are the subjects of the study. 219 businesses that went public became the research population, consisting of those traded on the Indonesia Stock Exchange between 2019 and 2022. The sample was selected using a non-probability sampling technique called purposive sampling. The sampling criteria are companies that conducted an initial public offering in the research year, totaling 219 companies, then companies that did not experience underpricing, totaling 25 companies, and companies not including the banking industry, totaling 4 companies, resulting in 190 companies identified as meeting the necessary criteria. The results will then be used as the research sample. Secondary data is used in this research. The term "secondary data" refers to information that does not come directly from the intended source, but rather from intermediaries, whether individuals, organizations, businesses, or other entities. Secondary data is obtained in the form of prospectuses published by companies as well as

the closing prices of secondary market stocks. The following websites offer access to the data: www.idx.co.id and www.idnfinancials.com. The author will proceed with additional data processing. For the Statistical Package for the Social Sciences (SPSS) version 26 software, the author used it to analyze the data. This is an overview of the formulae utilised in the study variables, consolidated into a single table.

Table 1. Variable Measurement

Variabel	Measurements	Sources
Initial Return	$\frac{\text{Closing Price} - \text{Offering Price}}{\text{Offering Price}}$	Suresha B et al. (2023)
Debt to Equity Ratio	$\frac{\text{Total Debt}}{\text{Equity}}$	Sani et al. (2024)
Firm Size	Logaritma Natural (Total Asset)	Shubita et al. (2024)
Industry Type	Dummy 1 = Manufacturing Companies 0 = Non-Manufacturing Companies	From the Author

Source: Suresha B et al. (2023), Sani et al. (2024), Shubita et al. (2024), Author data

4. Result

Descriptive Statistical Analysis

The findings of a descriptive statistical study of businesses that went public on the Indonesia Stock Exchange from 2019 to 2022 are displayed in the following section:

Table 2. Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
DER	190	.0022	71.2945	2.345549	6.9413048
Size	190	20.4734	32.6297	26.426852	1.6833296
Initial Return	190	.0051	.7000	.355519	.2038841
Valid N (listwise)	190				

Source: Output SPSS versi 26, 2023.

As evidenced in Table 2, Primarily, the Debt-to-Equity Ratio (DER) elucidates the magnitude of financial leverage or risk that a company assumes by comparing its total debt to its equity. The DER values vary considerably, from a low of 0.0022 to a maximum of 71.2945, which reflects a significant degree of diversity among companies in their approach to debt management. An average DER of 2.3455 indicates a relatively balanced debt structure among companies. However, the high standard deviation of 6.9413 demonstrates that this balance varies significantly across the sample, with some companies exhibiting a high degree of financial risk due to their reliance on debt. This variability suggests that while some

companies maintain conservative financial structures, others may resort to leveraging debt to finance their growth or operations, which could impact investor perceptions during IPOs.

Company size, as measured by total assets, reflects the operational scale of the companies in question. A larger asset base is generally indicative of greater stability and resources, which may render larger companies more attractive to investors. In this study, the range of company sizes is from 20.4734 to 32.6297, with a mean size of 26.4269 and a moderate standard deviation of 1.6833. This indicates that the majority of companies are of a moderate size, with only a few outliers that are either extremely large or small. The moderate dispersion in size reflects the fact that while some companies have substantial resources, others may be smaller or newly established, which could affect their appeal in the public market and the likelihood of underpricing during their IPO.

Ultimately, the Initial Return metric, defined as the discrepancy between the IPO price and the closing price on the inaugural trading day, gauges the immediate market response to the IPO. The observed initial return ranges from a minimum of 0.0051 to a maximum of 0.7000, with an average of 0.3555 and a standard deviation of 0.2039. This variation indicates a trend of underpricing, whereby the initial share price is frequently set below the secondary market price. An initial return with a positive value can be seen as a benefit for investors who purchase shares at the initial price. Nevertheless, this also means that the issuing company misses the opportunity to raise as much capital as possible during the IPO process. The considerable variability in initial returns suggests that investor enthusiasm and demand may fluctuate considerably between different companies, potentially influenced by factors such as perceived growth potential, industry sector or market conditions.

Table 3. Frequency Distribution Industry Type

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0	129	67.9	67.9	67.9
	1	61	32.1	32.1	100.0
	Total	190	100.0	100.0	

Source: Output SPSS versi 26, 2023.

As evidenced in Table 3, A Frequency Distribution table for the Industry Type variable is provided for the purpose of offering an analytical breakdown of the sample companies in accordance with their industry classification, thereby distinguishing between the manufacturing and non-manufacturing sectors. This categorisation is pivotal for elucidating the potential discrepancies in IPOs performance and underpricing trends on the basis of industrial classification, given that disparate sectors are frequently exposed to disparate levels of risk, growth potential and investor demand.

In the table, industry types are indicated by a dummy variable. Companies classified as manufacturing are assigned a value of "1," while non-manufacturing companies are assigned a value of "0." The results demonstrate that of the total 190 companies included in the sample, 129 are classified as non-manufacturing (67.9%), while the remaining 61 companies are part of the manufacturing sector (32.1%). This distribution demonstrates a greater prevalence of

non-manufacturing companies within the sample, which may be indicative of the overall composition of companies going public on the Indonesia Stock Exchange or of industry-specific trends in IPO activity.

The preponderance of non-manufacturing companies in the sample indicates that sectors such as services, trade, and other non-manufacturing businesses may be more active in seeking public funding. The market conditions and capital needs of non-manufacturing companies may differ from those of manufacturing companies, which could influence their pricing strategies during IPOs. Conversely, manufacturing companies, representing a smaller proportion of the sample, are frequently associated with elevated capital requirements and growth potential, rendering them attractive to investors seeking long-term returns. The discrepancy in industry composition may influence the extent of underpricing, as investor perceptions and expectations are frequently influenced by the specific industry in question.

Classical Assumption Test

The classical assumption test is a prerequisite test used for analyzing research data with the Ordinary Least Squares (OLS) method. A set of statistical tests known as the "classical assumption test" are intended to ascertain if the regression model's data satisfies the basic presumptions required for accurate analytical outcomes. The normality, multicollinearity, heteroscedasticity, and autocorrelation tests are among the traditional assumption tests used in this investigation. These tests' findings have led to the conclusion that the residual values are normally distributed, that this study does not have any difficulties with multicollinearity, heteroscedasticity, or autocorrelation, and that further studies may go forward. The following summary is given in Table 4 of the findings from the traditional assumption test:

Table 4. Recapitulation of Classical Assumption Test Results

	Normality test	Multicollinearity Test		Heteroscedasticity Test	Autocorrelation Test
	Asymp. Sig. (2-tailed)	Tolerance	VIF	Sig.	Asymp. Sig. (2-tailed)
DER	.073c	.987	1.013	.067	.509
Size		.917	1.091	.180	
Type of Industry		.928	1.077	.954	

Source: Output SPSS versi 26, 2023.

Multiple Linear Regression Analysis

Multiple linear regression analysis is a statistical technique used to ascertain the relationship between one dependent variable and two or more independent variables. The results of the multiple linear regression analysis are shown as follows in Table 5:

Table 5. Test Results Multiple Linear Regression Analysis

Model		B	t	Sig.	R	Adjusted R Square	F	Sig.
1	Constant)	.229	5.284	.000	.264	.044	2.732	.047
	DER	.001	1.863	.065				
	Size	-.005	-1.422	.158				
	Type of Industry	.025	2.094	.039				

Source: Output SPSS versi 26, 2023.

The following regression equation is produced by the examination of multiple linear regressions utilizing the data in Table 5:

$$\text{Stock} = 0{,}229 + 0{,}001_{\text{ Debt to Equity Ratio}} - 0{,}005_{\text{ Size}} + 0{,}025_{\text{ Type of Industry}}$$

Table 5 demonstrates that the correlation coefficient (R) is 0.264, falling between 0.10 to 0.29. This suggests that the factors and the stock underpricing variable do not significantly correlate of firm size, industry type, and debt to equity ratio. 4.4%, or 0.044, is the Adjusted R Square value. This figure displays the debt to equity ratio, business size, and industry type may account for 4.4% of the stock underpricing variable, with additional factors beyond the scope of this study accounting for the remaining 95.6%.

With a significance threshold of 0.047, the F-value is 2.732 according to Table 5 This test indicates that the F-table value is 2.68. These findings demonstrate that the ratio of debt to equity, firm size, and industry type all have a simultaneous impact on the stock underpricing variable in this regression model.

The t-value of 1.863 for the variable representing the debt to equity ratio is less than the t-table value of 1.98118 (1.863 < 1.98118), according to Table 5. Furthermore, there is no relationship between stock underpricing and the debt to equity ratio variable, as indicated by 0.065, the significance value, is more than 0.05. The first theory in this study is rejected as a result of this results. The findings are consistent with those of Djashan (2018) and Andari & Saryadi (2020), who also came to the conclusion that underpricing is unaffected by the ratio of debt to equity variable. Investors are not given a signal by a company's ratio of debt to equity. As a result, when making investment selections, investors often focus less on the ratio of debt to equity in the business's prospectus. Rather, they place greater emphasis on the business's performance, management's capacity to manage debt, and its prospects for the future. A high ratio of debt to equity is not always a sign of subpar management or bad performance.

The t-value of -1.422 for company size is greater than the t-table value of -1.98118 (-1.422 > -1.98118), according to Table 5. Furthermore, the greater than 0.05 significance value of 0.158 indicates that the business size variable has no bearing on stock underpricing. Consequently, the study's second hypothesis is disproved.

This result is in line with the research that was done. By Djashan (2018) and Nurcahyani & Harianti (2021), which also concluded that company size does not influence stock underpricing. Information about a company's size does not serve as a clue to help investors decide what to buy. This is due to the fact that a company's size does not necessarily impact its performance or management effectiveness. Although company size, measured by total assets, can provide an indication of how large and financially robust a company is, The performance of the business is not entirely reflected in it.

Table 5 indicates that the t-value for industry type is 2.094, which exceeds the t-table value of the 1.98118 (2.094 > 1.98118). Additionally, the significance value is 0.039, which has a positive regression coefficient of 0.025 and is smaller than 0.05. This suggests that the industry type variable has an effect on stock underpricing. Furthermore, the positive regression coefficient of 0.025 suggests a positive relationship. Therefore, this study's third hypothesis is disproved.

These findings contradict those of Andari & Saryadi (2020) and Pahlevi (2014)which indicated that industry type does not affect stock underpricing. Industry type serves as a favorable signal for investors when making investment decisions, with manufacturing companies being particularly attractive. The manufacturing sector plays a significant role in economic development, contributing substantially to national economic goals, particularly through a large share in the gross domestic product. Manufacturing companies are considered to have promising future prospects, both in the near and far future, enhancing their appeal to investors.

5. Conclution and Suggestion

The findings indicate that industry type significantly impacts stock underpricing. Companies classified within manufacturing sectors tend to exhibit a greater degree of underpricing compared to their non-manufacturing counterparts. This pattern can be attributed to the positive perception of manufacturing firms by investors, as they are often seen as growth-oriented and contributing to economic development. As a result, shares of manufacturing companies are more attractive to investors, which fuels demand and creates an opportunity for underpricing at the IPO stage.

On the other hand, the study found no significant relationship between stock underpricing and either the debt-to-equity ratio or company size. This is noteworthy because these factors are often considered indicators of a company's financial stability and operational scale. The debt-to-equity ratio, typically associated with financial risk, did not play a substantial role in influencing underpricing. This suggests that investors may not rely heavily on this metric in

IPO pricing decisions, instead focusing on other aspects like company growth potential or industry outlook. Similarly, the size of the company, measured by assets, also did not have a meaningful impact on underpricing. This may be due to the fact that large company size alone does not guarantee better performance or profitability, thereby not serving as a strong indicator for IPO pricing.

Given these findings, it becomes clear that the type of industry plays a central role in driving investor expectations and decisions in Indonesia's IPO market. Manufacturing companies, due to their perceived growth potential and contribution to GDP, tend to attract more interest, leading to a higher degree of underpricing. In contrast, indicators of financial structure and scale, like debt levels and asset size, do not provide significant signals for underpricing. For companies planning IPOs, understanding the influence of industry type can be crucial for strategic pricing decisions. The theoretical implications underscore that non-financial variables, such as industry type, are crucial in influencing IPO pricing, particularly in emerging markets like Indonesia. These results offer guidance for companies preparing for an IPO to factor in their industry's characteristics when devising pricing strategies and communicating with investors. Additionally, they aid investors and underwriters in making more informed decisions regarding the risks and opportunities inherent in the industry sector. From a policy standpoint, these findings prompt regulators to formulate more tailored regulations according to industry attributes, improve information transparency, and bolster market education to reduce information asymmetry and enhance the efficiency and protection of the capital market for all stakeholders. The study suggests future research should delve into other financial and non-financial factors to gain a fuller picture of the determinants of stock underpricing. Extending the research period and including additional variables may shed more light on the complex dynamics at play in IPO pricing. By broadening the scope of analysis, future studies can provide valuable insights for companies aiming to maximize capital raised in IPOs while minimizing underpricing.

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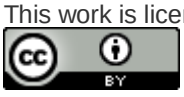

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