CHAPTER I
INTRODUCTION

1.1 Background

A firm undertake an Initial Public Offer (IPO) moves the firm from the private to the public domain. Attention to IPO firm research is important for a variety of reasons such as IPO research can help inform critical issue either the investor or the firm to develop. One of important topic on the IPO is the different between the price at which the firm’s stock was initially offered and the stock’s closing price on the first day of trading. The different frequently is quite significant and most likely the offering price is lower than the first day of trading or underprice. The topic of underpricing has been attracting economic financial analyst to study the phenomenon. The most dramatic underpricing in the US market as mentioned by Body, Kane & Marcus in “Investments” seventh editions (2008) occur in December 1999 when share in VA Linux were sold in an IPO at $30 per-share and close on the first day of trading at $239.25 (equivalent to 698% first day return). Using IDX data, Some research in Indonesian Stock Exchange has found underpricing in Indonesian stock market IPO also. For example the IPO of PT Ryane Adibusana Tbk. (RYAN) on 17 Oct 2001 was having underpricing 480% from offering price Rp. 100 to first day closing price Rp 580. This significant underprice provide attractive capital gain to the investor, but for the IPO firm this underpricing is seen as leaving huge money on the table, its loss opportunity to maximize the fund from IPO.
It has been many research regarding underpricing and the correlation with either issuer performance or capital market issue. Some of the research made by Khaled Abdou and Mehdet F. Dicle (“Do Risk Factors matter in IPO Valuation? - 2007) and Tim Studi BAPEPAM-LK (“Studi Pengkajian Informasi dalam Prospektus Berdasarkan Industri Dikaitkan dengan Pendekatan Risiko-2007) also Rogier Deumes (The Information Content of Risk Factor Disclosure in IPO Prospectuses – 2007) were focusing in the Risk Factor disclose in IPO prospectus. As many people believe “hi risk, hi return”, is it right? Many investor want discount price for the company that is consider riskier. This research is trying to assess the correlation between the Risk Factors in the IPO prospectus and the underpricing in Indonesian Stock Exchange (IDX). Mainly to answer whether the disclose information in prospectus is valuable enough for the investor to consider.

1.2 Problem Identification

The IPO company has to prepare the prospectus which is required by the regulatory agencies domestically and internationally, as regulated in BAPEPAM regulation No. IX.C.2 about the content and the format of the prospectus. According to this regulation the prospectus is a tools to inform the potential investor and it is intended to protect the investor from IPO abuse. The question remain is it that important? Does it include information that affect the stock price after issuance? If so, what type of information? Are investors widely affected by all of the information in the prospectus, especially the risk factors cited?
BAPEPAM-LK has formed team to study the information in the prospectus particularly regarding the Firm Risk of the specific industry. It very obvious that the underlying regulation about risk discloser is very broad. The study suggested that the IPO firm has to disclose also specific risk related to its industry. Some IPO company disclose very limited firm risk, but some put so many firm risk in the prospectus although it is general risk. Hence it is needed to answer the question above. Explained by Davis (in Khaled Abdou-2007); an incident that confirms that the prospectus is seen as an important investment guide, is the fine imposed on an investment banker for failure of sending the prospectus to potential investors. NYSE (New York Stock Exchange) has fined Morgan Stanley $19 million, which was considered a very high amount. This fine was imposed because of the failure of sending the prospectus as well as other operational and supervisory deficiencies. That is very huge fine for such standard report (prospectus). It is still remain a question whether the investor will change the decision when receiving the prospectus.

The risk cited in BMRI (PT Bank Mandiri) is 38 risk factor and return the underpricing 26%, also the ITMG (PT Indo Tambang Raya Megah) disclose 40 risk factor at its IPO and return 40% underpricing. In other hands, the GEMA (PT Gema Grahasarana) with 5 risk factors disclose in the IPO has initial return -24% (overpricing), which mean the offer price is high enough compare to its should be. Does this phenomenon also explain the important of the risk factor expose in the IPO? Probably if this is very significant, then the same case with Morgan Stanley may be happened in IDX.
The IPO offer price is determined by the underwriter and the issuing firm after the road show and communication with analyst and potential investor. Meanwhile the secondary market will be based on market mechanism (the price will be compare to other industry and economic condition of the firm and regional/world wide). Hence the equilibrium price should be obtain to set the offer price. The investor want to get big investment gain, the underwriter has to keep its reputation and avoid loss, meanwhile the issuing firm want to optimize the money from the IPO. The more risk disclose in the IPO prospectus can be perceived the firm transparency, but for the investor it could be seen as high risk company (so they want discount price on IPO). Common understanding that high risk high return, is it true?

1.3 Purpose of Research

This study is intended to enrich the previous research regarding underpricing particularly the information disclose in IPO prospectus of companies at Indonesian Stock Exchange (IDX). Hopefully the result can answers some curiosity regarding the IPO underpricing phenomenon in IDX, such as:

a. Does underpricing occur significantly in IDX?

b. Whether Risk Factor disclose in the prospectus has significant correlation with the underpricing and which risk factor should be considered when valuing the IPO?

c. Do financial leverage, profitability, firm age, Company size and Auditor reputation also has significant correlation with the underpricing of IPO at
Indonesian Stock Exchange (IDX)?

Of course, this research need further review and update since there are many parameter affect the underpricing and the IPO company at IDX is not as much as US company going public. During 2001-2007 in IDX there are only 112 company meanwhile in US capital markets hundreds company going public yearly. This limitation will make the analysis not perfect, but at least it can be used as other literatures regarding the underpricing analysis. Personally, this research has enrich the author knowledge regarding the IPO and more curios to know further about the investment method.

1.4 Research Scope and Assumption

In this study, the data from Indonesian Stock Exchange (IDX) published by PT Jasatama Teguh Jaya Buana were used, for period 2001-2007. There 112 companies going public during this period. We use underpricing as the dependent variable in multiple regression meanwhile the independent variable are the dummy number of risk factor, financial leverage, profitability, dummy number auditor reputation, company size and company age. Although there other factor affect the underpricing, but this research scope only cover those items. The initial return or the return obtain from the selling of the IPO share at the secondary market on the first say trading sometime does not positive (higher than the offering price), in this research we do not filter to only the positive initial return but also include the negative initial
return. It is very common in economic financial term, the initial return is consider similar to underpricing terminology (Catherine M. Daily – 2003).

It is assumptive consideration that the risk factors disclose in the prospectus are important items for the IPO company in IDX. Although seemingly the risk disclose in the prospectus are most likely opportunity rather than the risk (even too general or avoidable such as the inefficient operation). Other assumption in this research are using the Gross Proceed as indicator of company size.

1.5 Thesis Structure

Following the standard report for thesis research issued by Binus Business School, this thesis is set in the following order:

Chapter I - INTRODUCTIONS

This chapter is explaining the background of the research and what happen in IDX in relation with underpricing. The big picture of the research objective are described to have the reader understand why the topic is interest.

Chapter II – THEORETICAL FOUNDATIONS (LITERATURE REVIEW)

Some theory are used as the basis to assess the underpricing and the risk factor correlation. Including the previous similar research has been conducted.

Chapter III – RESEARCH METHODOLOGY

This chapter is explaining how the data was collected and how to filter it. The data prospectus & transaction regarding IPO company in Indonesia was taken from IDX.
In this chapter those data were compile to the quantitative format that can be processed by the statistic’s software.

Chapter IV - SAMPLE CHARACTERISTICS AND EMPIRICAL FINDING

Underlying research questions were assessed in this chapter. The hypothesis result were explain base on sample analysis. The result from statistic’s software was compare to the underlying theory used in the research.

Chapter – V CONCLUSIONS & FUTURE RESEARCH

The final chapter of this study, present the summary of the research, discuss the conclusions related to the finding an doffer future research needed.