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*RESEARCH ARTICLE*

# THE COMPANY CHARACTERISTICS, *INITIAL RETURN* AND LONG TERM PERFORMANCE STOCK *INITIAL PUBLIC OFFERINGS* LISTING IN INDONESIA STOCK EXCHANGE.

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## *Abstract*

This study examines and analyzes the characteristic information and initial returns of the IPOs associated with the long-term performance of post-IPO shares in the Indonesian capital market. The observations include initial return, firm size, age of company, offering size, reputation of underwriter, profitability of influence on long-term performance of post-IPO shares. This study was conducted data 2004-2013, with 157 companies IPO in Indonesia capital market. The test is done by using multiple linear regression. The results of this study indicate initial return, firm characteristics consisting of firm size, company age, and size of offer, underwriter reputation, and return on equity all have no significant effect on long-term performance of post-IPO stock with 12 month cumulative abnormal return. The age of the company negatively affects the cumulative abnormal return 24 months and the initial return has a negative effect of cumulative abnormal return of 36 months. With the measurement of buy and hold abnormal return 12 months initial return, firm size negatively affects the measurement of buy and hold abnormal 24 months and 36 months.



## Introduction:-

Phenomena research that happened in IPO, among others is *underperformance*, which explains that the performance of companies conducting IPO, within 1 to 5 years tend to *underperformance* compared with non-IPO companies whose characteristics are the same. Ritter (1991) argues that long-term underperformed IPO performance is due to investors who are very optimistic that investors want to buy IPO shares at high prices. In the long term the stock price will be corrected to the actual value so the return becomes low This causes the IPO's stock performance to undergo underperformance in the long term Using a sample of 1526 in US companies that made an initial public offering between 1975 and 1984, Ritter (1991) found that the average return over three years after IPO was significantly lower than the market average. By using *Cumulative abnormal return* measurement method, *it was* found that the performance of one, two and three consecutive years after IPO underperformance was 10.23%, 16.89% and 29.13%.

Controversy over the long-term performance of public offerings continues. Many studies reveal *underperformance* after an IPO. This phenomenon occurs in many countries, both in developed and developing capital markets including in Indonesia. Long-term performance of post-IPO stocks both underperformance and over performance

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occurred in some countries. As it is known that the highest underperformance occurred in Brazil, (Anggarwal, 1993) of 47%, followed by Australia at 46.5% (Lee, 1996). The lowest underperformance occurred in Singapore of 2.7% (Dawson, 1987).

In Indonesia, all have underperformance ranging from 9.8% to 47.5% (Pujiharto, 2003; Martani, 2004; Suroso, 2005; Manurung, 2006).The highest outperformance in Malaysia is almost 42% (Ahmad, 2007). Uniquely all research in Malaysia shows outperformance. The Swedish capital market experienced the lowest outperformance of 1.2% (Loughran, 1994). By analyzing the characteristics of the IPO Company, the potential investor will know the correlation with the abnormal return of the short-term company stock and will be able to predict the prospect of the company in the future and the investor will be interested to buy the securities issued by the issuer.

Society as an investor who invests because of his desire to earn profit or yield in the future, whereas various theories say the long-term performance of IPO shares is low. Information on the characteristics of the companies used in this study to examine the effects on the long-term performance of post-IPO stocks include firm size, age of company, *offering size* , reputation of underwriter, and profitability (Brav and Gompers, 1997; Ritter, 1991; Carter, Dark and Sigh, 1998, Jain and Now, 1994; Darmetko, 2009; Miller, 2000; Seitibraimov, 2012).

This study intends to reveal the effect of *initial return* and firm characteristics with the long-term performance of post IPO shares using *cumulative* measurement of *abnormal return* and *buy and hold abnormal return* with maturity of 12 months, 24 months and 36 months.

**Theory Review And Hypotheses:-**

Long-term performance of post-IPO shares compared to non-IPO shares of companies of the same size and industry, IPO shares show lower performance, Ritter (1991) .The Company's operating performance decreased significantly after IPO, Jain and Kini (1994). The measure of operational performance used is the operating return on assets. When operational performance cannot be maintained then the stock price will fall. Ibbotson (1975) from his research findings that the IPO stock performance is generally positive for the first year period, negative for the next three years, and positive after the fifth year.

The result of Chahine (2002) study found that IPO shares provide negative profit in the period of one year to five years after trading in secondary market. Despite the underperformance and over performance in several countries, the highest *underperformance* in Brazil was 47%, followed by Australia with 46.5%.The lowest underperformance occurred in Singapore at 2.7%. While on the BEI, all experienced underperformance which ranged from 9.8% to 47.5%. The highest outperformance in Malaysia amounted nearly 42%. Uniquely all research in Malaysia shows outperformance. The Swedish capital market experienced the lowest outperformance of 1.2%.

Here are some theories or hypotheses about *underpricing* and long-term performance of low stock (underperformance).

**The *Divergence of Opinions* Hypothesis:-**

Houge et al. (2001) found that the divergent opinion between Investor affected to long run underperformance which is more large, the divergence opinion between IPO who optimistic and pessimistic led to post-IPO stock price patterns (Miller, 1977).According to Ritter (1991), in addressing IPO investors can be classified as optimistic investors and pessimistic investors. An optimistic investor who acts as a buyer at the time of the IPO. If there is a lot of uncertainty about the IPO assessment then investors are optimistic that it will be much higher than the pessimistic investor. As time passes and information increases, the differences of opinion between optimistic and pessimistic investors will narrow, and consequently the market price will fall.

**Hypothesis of *windows of opportunity:-***

Ritter (1991) states that the low long-term performance of IPO shares usually occurs in companies that are published in high volume in the year of publication. The concept of *windows of opportunity* explains that the decline in stock performance is due to the opportunist attitude of managers who take advantage of market error opportunities but in the long run the market will know its mistakes and make corrections towards the true lower value.

**Impresario Hypothesis:-**
Shiller (1990), explain that investment bankers *(the impresarios)* deliberately set the price of shares of companies that will go public with the low price *(underprice)* to attract investors to happen *excess demand* .With the *excess demand* there will be some investors who do not successfully buy IPO shares in the primary market, allegedly will buy IPO shares in early trading on the secondary market at a high price. *Long run underperformance* is the result of stock selling activity with high *initial returns* according to Chahine (2002).This conclusion is certainly based on the assumption that high stock prices in early trading will be corrected down in the long term. Impressive prime pricing *(impressive*) investors will increase initial returns and will lead to lower post-IPO stock performance, (Chahine, 2002).

**Conceptual Framework and Hypothesis:-**
This research will try to examine from the point of view of characteristic information, *initial return* of IPO Company that is associated with long-term performance of post-IPO shares in Indonesia capital market. Observations to be conducted include the effect of *initial return*, firm size, age of company, *offering size*, reputation of underwriter, and profitability on long-term performance of post-IPO shares.

**The Influence of *Initial Return* on Long-term Performance of Post-IPO Shares:-**
Ritter (1991) found that firms with the highest *underpricing* (over 23.7%) had long-term performance of the worst stocks. Ritter (1991) conducted a study of the effect of *initial return* with long-term performance post IPO. How (2000) conducted a study of the relationship between *initial return* and long-term post-IPO performance in Australia. How (2000) conducted this research in 1979-1990 with a sample of 130 companies with a period of 12 months, 24 months and 36 months .By measuring long-term performance post IPO using CAR and BHR. How (2000) found an *underpricing* average of 107.13% and has a significant relationship explaining the long-term performance of post-IPO stocks with a 36 month measurement period .Based on the above it can be formulated hypothesis as follows:
$H_1$: *Initial Return* negatively affects the Long-term Performance of Post-IPO Shares

**Influence of Company Size on Long-Term Performance of Post-IPO Shares:-**
Company size (Ritter, 1984; Miller, 2000), is a proxy for the difficulty of assessing a company is the size of the company. The size of the company that can be used is the book value of equity, annual sales or some combination of both, and the size used is total sales. For a small company there will be a lot of uncertainty about the price of the stock, a more established company is easier to conduct stock price valuations. Loughrun and Ritter (1995), Bravo and Gompers (1997) found that firms with low sales had long-term post-IPO stock performance declining. Miller (2000) also explained that IPO companies with low sales will have long-term post-IPO performance decline. Based on the above it can be formulated hypothesis as follows:
$H_2$: The size of the company positively affects the Long-term Performance of Post-IPO Shares

**Influence of Company's Age on Long-Term Performance of Post-IPO Shares:-**
The age of the company is a proxy for corporate IPO risk or the future uncertainty of the company. Ritter (1991) documented the long-term performance of IPO companies under the age of *underperformance* and this is consistent with an explanation of excessive optimism from investors. Thus there is a positive relationship between IPO company's age and long-term performance of IPO shares. Miller (2000) says companies with a history of young operations will have long-term post-IPO performance decline. Yu (2006) firm age has a significant influence on long-term performance is decreased. Based on the above it can be formulated hypothesis as follows:
$H_3$: The age of the firm positively influences the Long-term Performance of Post-IPO Shares

**The Effect of *Offering Size* on Long-Term Performance of Post-IPO Shares:-**
Offering size can be used as a proxy for predicting the future difficulty of a company. Yu (2006) found that the largest *underperformance* for the smallest IPO (based on market value).The size of the IPO's small share offerings will be increasingly difficult to predict future hardships, this raises disagreements and is most speculative. The size of the small IPO offerings makes it easier for institutional shareholders to control prices, and other investors will bear a higher risk. Based on the above it can be formulated hypothesis as follows:
$H_4$ : Offering Size positively affects the Long-term Performance of Post-IPO Shares

**The Influence of Reputation of Underwriters to Long toward Performance of Post-IPO Shares.:-**
Carter, Dark and Singh (1998), Brav and Gomper (1997) suggest that *underwriter* reputation is associated with long-term performance of IPOs. The *underwriter's* reputation reflects the quality of information available, and the IPO borne by *underwriters* whose low reputations have greater divergence of opinion. *Underwriter with a good reputation refrains from IPOs whose futures are uncertain or whose returns are unpredictable.* The higher the reputation of the underwriter will have a positive relationship with the long-term performance of IPO shares. Based on the above it can be formulated hypothesis as follows:
$H_5$: Reputation of underwriters positively affects the Long-term Performance of Post-IPO Shares

**The Effect of Profitability on Long-term Performance of Post-IPO Shares:-**
Various literature found a negative relationship profitability of the company before *going public* with long-term performance. The company's operating performance declined significantly after IPO (Jain and Kini, 1994). Ritter (1991) also stated that the decline in performance is due to managers who take advantage of market error and in the long run will know the error and make corrections to the true value. Darmetko (2009) states that the long-term performance of post-IPO and operating performance before going public are negatively related. When operating performance cannot be maintained, then the stock price will fall. In the next turn post-IPO share performance will decrease. Based on the above it can be formulated hypothesis as follows:
$H_6$: Profitability negatively affects the Long-term Performance of Post-IPO Shares.

**Research Methods:-**
**Research design:-**
This research uses *explanatory research* design .According Faisal (1992), *explanatory research* aims to analyze the relationships between variables and explain the influence between variables through hypothesis testing.

**Samples and Sampling Techniques:-**
The sample in this study is determined by *purposive sampling*, the samples taken must meet certain criteria. The criteria used are companies that conduct an IPO from January 1, 2004 - December 31, 2013. The Company is not delisting from BEI within 3 years after listing on IDX.

**Types and Sources of the Data:-**
The type of data used in this study is secondary data. The data in this study were obtained from the Indonesia Stock Exchange Gallery of Muhammadiyah Gresik University, *Indonesia Capital Market Directory*, the capital market website, Bapepam - LK, Bank Indonesia and other supporting publications.

**Research variable:-**
Research Variables consist of independent variable and dependent variable. The independent variables in this study consisted of *initial return* ($X_{1)}$, the size of the company ($X_{2)}$, the age of the company (X 3), *offering size* ($X_{4)}$, the reputation of underwriters ($X_{5)}$ and profitability ($X_{6)}$ and performance long-term stock of IPO (Y) as the dependent variable.

**Operational Definition of Variables:-**
**Initial Return ($X_1$ ):-**
*Initial Return* is the return on the first day on the secondary market measured by the difference between the closing stock prices on the first day on the secondary market with the initial offer price divided by the initial offer price. The equations used for the initial return according to Kunz and Anggarwal (1994) are

$$IR_{it} = \frac{Pt1-Pt0}{Pt0}\ x\ 100\%$$

$IR_{it}$ = Initial Return of stock i period t
$Pt_0$ = the initial offer price
$Pt_1$ = closing price on the first day on the secondary market

**Company Size ($X_2$ ):-**
Company size Company size is the size of the company measured by the total number of sales in a year, taken from the IPO's profit and loss for the period ended 31 December of the year before the IPO is executed, thus the size of the company is calculated as follows:

$UK_i$ = Ln (Sales company IPO $_i$)
$UK_i$ = Company size for stock i
Company sales IPO i = Company sales for shares i in one year is the value of stock offer at the time of IPO.

**Company Age ($X_3$ ):-**
The Company's age is the starting age of the company based on the deed of establishment until the time the company makes an initial public offering. The age of a company is measured by the number of years.

Age of company = Year of company IPO - year of company standing

**Offering Size ($X_4$ ):-**
*Offering size* is the number of stock quotes at the IPO. *Offering size is* measured by the offering price of the shares at the IPO multiplied by the number of shares issued compared to the market capitalization.

$$Offering\ Size_i = \frac{HPi \times JLSi}{TKP}$$

With :
*Offering Size* $_i$ = Number of Offering of Shares i at the IPO
$HP_i$ = Price Offer Price i
$JLS_i$ = Number of Shares i issued
TKP = Total Market Capitalization

**Reputation of Underwriters ($X_5$):-**
The underwriter's reputation is the rating of underwriters whose measurements are *dummy* variables. For a reputable underwriter using a scale of 1 and 0 for underwriters who do not have a high reputation. The underwriting reputation of the underwriters is based on the frequency of the underwriter as the company conducts an IPO within a year. Guarantor emission which has a high reputation is the underwriter which is above the average frequency wore underwriters in a year while the frequency is below the average frequency categorized as underwriters who do not have a high reputation. Average is calculated by:

$$\text{Average frequency} = \frac{\sum \text{frekuwensi}}{\sum \text{penjamin emisi}}$$

Σ frequency = Number of underwriting frequencies make a guarantee within a year
Σ Underwriters = Total underwriters conducting underwriting within a year

**Profitability ($X_6$ ):-**
Profitability is the ability of a company to generate profits in the future or the ability of the company to generate profits that can be obtained shareholders. Measurement of company profitability is used *return on equity* (ROE), which equation is:

$$ROE_{i,t-1} = \frac{EAT_{i,t-1}}{TE_{i,t-1}}$$

$ROE_{i,t-1}$ = *Return on equity* share i at IPO-1
$EAT_{i,t-1}$ = Earning After Tax of share i at the time of IPO-1
$TE_{i,t-1}$ = Total equity of share i at the time of IPO-1

**Long Term Performance of IPO Shares (Y):-**
The long-term performance of post-IPO shares is the result obtained by investors that reflect the company's market performance. The benchmark of long-term stock performance post IPO used two measurements are:

**Cumulative Abnormal Return ( CAR ):-**
Ritter (1991) used a *cumulative abnormal return* to measure the long-term performance of stocks with average stock returns corrected with market returns.

$$CAR_i - \sum_{t=1}^{i} AR_{it}$$

And,

$CAR_i$ = cumulative return of stock i corrected with market return on month 1 to t.Ritter (1991) mentions as *cumulative adjusted after market performance.*
$AR_{it} = R_{it} - E(R_{it})$
$AR_{it}$ = abnormal return with *market adjusted* stock *return* i month t
$R_{it}$ = return of stock i in month t
$E(R_{it})$ = Expectation of stock return i in month t by using market return in this case using JCI.

**Buy and Hold Abnormal Return (BHAR):-**
*Buy and hold abnormal return* is an advantage for buying and holding shares for a certain period of time, Jain and Kini (1994), Loughrun and Ritter (1995), Brav and Gompers (1997), Jakobsen and Sorensen (1994), Chahine (2002) and Barber and Lyon (1997).The use of *buy and hold abnormal return* on the grounds, this study considers the benefits of investment in stock IPO from time to time in the short term is not an investment activity but speculation activities outside of the discussion of research. This study sets the benefits of buying IPO shares in early trading and reselling within 12 months, 24 months and 36 months later. *Buy and hold return abnormal return,* this variable is formulated according to the formula:

$$BHAR_{i,t} = \prod_{t=1}^{T}[1 + R_{i,t}] - \prod_{t=1}^{T}[1 + E(R_{i,t})]$$

And,

$BHAR_{i,t}$ = *Buy and hold abnormal return* securities period i t, shares purchased at closing price on the first day of listing and held for 12 months, 24 months and 36 months.
$R_{i,t}$ = *Return of* securities i in period t
T = Number of months (12, 24 and 36)
$E(R_{i,t})$ = *Expected return* securities i t period by using *market adjusted model* in this case using JCI.

The use of these two measurements, CAR and BHAR, as the various studies reveal that the long-term performance of the IPO depends on the measurement method used and the reliability of the statistical conclusions are different from each other, so both used by Barber and Lyon (1997), Wang (2010) .

**Model Analysis:-**
To test the hypothesis that has been developed in this study used multiple linear regression model. The model used to answer hypotheses 1, 2 , 3, 4, 5, 6 used 1 and 2 as follows:

(1) $CAR_i = \alpha_1 + \beta_1 IR_i + \beta_2 UK_i + \beta_3 AGE_i + \beta_4 OFFSIZE_i + \beta_5 REP_i + \beta_6 ROE_i + \varepsilon_1$
(2) $BHAR_i = \alpha_1 + \beta_1 IR_i + \beta_4 UK_i + \beta_3 AGE_i + \beta_4 OFFSIZE_i + \beta_5 REP_i + \beta_6 ROE_i + \varepsilon_1$
And
CARi = Cumulative Abnormal Return of stock i
$BHAR_i$ = *Buy and Hold Abnormal Return of* stock i
$IR_i$ = *Initial Return* shares i
$UK_i$ = Size of stock company i
$AGE_i$ = Age of stock company i
$OFFSIZE_i$ = *Offering* stock i
$REP_i$ = Reputation *underwriter* shares i
$ROE_i$ = Profitability of stock i

**Data Analysis Techniques:-**
1. Data analysis techniques that are used to answer the problems that exist in this research is to use multiple linear regression model test with the help of SPSS application. The steps of analysis conducted in this research are:

2. Calculates the long-term performance of post-IPO shares with CAR and BHAR methods for 12 months, 24 months and 36 months
3. Calculates the *initial return* , the size of the company, the age of the company, the *offering size* , the reputation of the underwriter and calculates the profitability of the company
4. Regressing between independent variables to the dependent variable .Registers *initial return* , firm size, age of company, *offering size* , reputation of underwriter and *return on equity* on long-term performance of post-IPO shares (CAR and BHAR).Regression is done with a period of 12 months, 24 months and 36 months.
5. To test the significance of each regression coefficient value with a *level of significance of* 5% and 10%.

## Results:-

***Initial Return* Testing, Company Characteristics with *Cumulative Abnormal Return:-***

Tests on the hypothesis that IR, UK, AGE, OFFSIZE, REP and ROE variables have an effect on the long-term performance of post-IPO shares with measurement of CAR12, CAR24 and CAR36.From table 4.4 found all independent variables have no significant effect with CAR12 being with CAR24 variable of company age only having significant negative effect with 5% significance level. The effect of independent variables on CAR36 occurs on *initial Return* variable which has significant negative effect.

The conclusion is that only the hypothesis that the *initial return* is negative is accepted or proven to negatively affect the long-term performance of post-IPO shares (CAR36).

**Initial Return Testing, Company Characteristics with *Buy and Hold Abnormal Return:-***

Tests on the hypothesis that the IR, UK, AGE, OFFSIZE, REP and ROE variables have an effect on the long-term performance of post-IPO shares with the measurement of BHAR12, BHAR24 and BHAR36. From table 4.5 found all independent variables have no significant effect with BHAR12 being with BHAR24 *initial return* variable has significant negative effect with significance level of 10% and firm size has significant negative effect with 5% significance level.Next variable affecting BHAR36 is the variable *initial return* significant negative effect with the level of significance of 10% and firm size has a significant negative effect with 5% significance level.

The conclusion is that only the hypothesis that *initial returns* negatively affect BHAR24, BHAR36 received.

***Initial Return* , Corporate Characteristics Its Effect on Long Term Performance of Post-IPO Shares (CAR):-**

The findings of this study indicate that the company's age negatively affects the long-term performance of post-IPO shares (CAR24) and *initial return* negatively affect the long-term performance of post-IPO shares (CAR36).The results of this study suggest that the increasing age of the company will be followed by declining long-term performance of post-IPO shares (CAR24). The results of the study on the age of the company contradict the divergence theory of opinion, Miller (2000) said companies with a history of surgery are still young will have long-term performance post-IPO decline. Similarly, Yu (2006), the age of young companies has a significant effect on long-term performance that decreases.

Negative influence of company age is possible due to investors behaving irrationally. One of them is *herding* behavior , where market participants have a tendency to follow the behavior of other investors regardless of the age of the company.

The result of *initial return* study had a significant negative effect on the long term performance of post-IPO shares (CAR36), the result of this study means that the increase of *initial return* will be followed by decreasing long-term performance of post-IPO shares (CAR36).The results of this study support the results of research Yu (2006), Darmetko (2009), Miller (2000). According to Gao (2006) and Wang (2010), pricing in early trading on the secondary market reflects investors' valuation of available information, as time goes by and information increases so dissent will narrow, resulting in falling market prices and long-term post-stock performance The IPO will decrease. Firm size, firm age, *underwriter* reputation and *return on equity* have no significant effect.

***Initial Return*, Corporate Characteristics Its Effect on Long Term Performance of Post-IPO Shares (BHAR):-**

The findings of this study show that *initial return* negatively affects the long-term performance of post-IPO shares (BHAR24) and firm size negatively affect the long-term performance of post-IPO shares (BHAR24).The results of this study indicate that the increase of *initial return* will be followed by declining long-term performance of post-IPO shares (BHAR24) and the larger the size of the company, the long-term performance of post-IPO shares

(BHAR24) will decrease further. The *initial return* will be followed by a decline in long-term performance of post-IPO shares (CAR24 ).The results of this study support the results of research Yu (2006), Darmetko (2009), Miller (2000).

The results of the study for firm size had a significant negative effect on the long-term performance of post-IPO shares, in contrast to the results of a study from Ritter (1984), Miller (2000). For a small company there will be a lot of uncertainty about the price of the stock, a more established company is easier to conduct stock price valuations. Loughrun and Ritter (1995), Bravo and Gompers (1997) found that firms with low sales had long-term post-IPO stock performance declining. Miller (2000) also explained that IPO companies with low sales will have long-term post-IPO performance decline. The size of the firm negatively affects the long-term performance of post-IPO shares, an explanation that can be given, among others, is that the characteristics of the firm can explain the long-term performance of stocks, Fama and French (1988).

The results of the research for long-term performance of post-IPO shares (BHAR24) and (BHAR36) consistently *initial return* , firm size affect the long-term performance of post-IPO shares. U the firm's nuts, offer size, *underwriter* reputation and *return on equity* have no significant effect.

## Conclusions:-

Based on the analysis of the study and hypothesis testing and discussion presented in the previous chapter, it can be deduced, *Initial return* , company characteristics consisting of firm size, company age, offer size, *underwriter* reputation , *return on equity* all have no significant effect on long-term performance stock post IPO with *cumulative* measurement *abnormal return* 12bulan. The age of the company negatively affects the cumulative abnormal return 24 months and the *initial return* has a negative effect of *cumulative abnormal return of* 36 months.

*Initial return* , company characteristics consisting of firm size, company age, offer size, *underwriter* reputation , *return on equity are* all insignificant effect on long-term performance of stock post IPO with measurement of *buy and hold abnormal return* 12bulan.*Initial return* , firm size negatively affects the measurement of *abnormal buy and hold* 24 months and 36 months.

On long-term performance measurement by using *cumulative abnormal return is* only company age, *initial return* which has significant negative if significant effect. On measurement of *buy and hold abnormal return* which has significant negative effect is *initial return* variable and firm size. This gives the meaning that the *initial return* variable and the characteristics of the company that the investor is concerned in performing IPO stock transactions are firm size and *initial return* .

Period of research conducted in 2004-2013, in that period the condition of the Indonesian capital market in *bullish* and *bearish* conditions .It is better for the next research to make the difference of market condition so that clear the influence of *initial return* , the characteristics of the company on the long-term performance of post-IPO shares in *bullish* and *bearish* conditions. For investors of IPO shares, it is expected to pay attention to the characteristics of other IPO companies, not only company size, , *initial return* .

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