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IPO Underpricing Determinants: Empirical Evidence from Companies Going Public in the Indonesian Capital Market

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Abstract
Background: Initial Public Offering (IPO) pricing remains a critical issue in capital markets, particularly in emerging economies where information asymmetry and market uncertainty influence initial returns. Understanding the determinants of initial return is essential for both investors and issuing firms.
Objective: This study aims to analyze the factors influencing initial return among companies conducting IPOs on the Indonesia Stock Exchange during the period 2018–2025.
Methods: A quantitative approach was employed using multiple linear regression analysis. The sample consists of IPO firms that met the criteria of complete financial data and stock price availability. The variables examined include firm size, underwriter reputation, return on assets, financial leverage, and earnings per share.
Results: The findings reveal that all variables jointly influence initial return. However, partially, only firm size shows a significant negative effect, indicating that larger firms tend to experience lower levels of uncertainty, leading to smaller initial returns. Other variables, including financial performance indicators and underwriter reputation, do not demonstrate a significant individual effect.
Conclusion: This study contributes to the capital market literature by highlighting the dominant role of firm size in IPO pricing within emerging markets and provides insights for investors and issuers in making strategic investment decisions.

Keywords: Initial Public Offering (IPO); Initial Return; Firm Size; Underwriter Reputation; Financial Performance.

JEL Classification: G12, G14, G24

Introduction

The capital market plays a vital role in mobilizing funds from surplus capital holders to companies in need of fresh financing. Through this mechanism, companies can obtain capital for business expansion, working capital additions, and capital structure improvements through the issuance of new shares (Koptyug et al., 2020; Njenga et al., 2025). The initial public offering (IPO) serves as the primary gateway for companies to transform into public entities whose shares can be owned by the general public (Munshi et al., 2022). Beyond its function as a financing instrument, the capital market also serves as an investment vehicle for the public to allocate capital across various long-term financial instruments. A healthy and well-functioning capital market ultimately supports sustainable national economic growth and stability.

A frequently observed phenomenon in IPO markets is the emergence of significant early gains known as initial return. This condition arises from underpricing, a situation in which the offering price is set below the closing price on the first day of secondary market trading (Bian et al., 2024; Mahalakshmi et al., 2024). Investors strongly anticipate a positive initial return as

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compensation for the investment risk they assume in the primary market (Koptyug et al., 2020). However, from the perspective of the issuer or company owner, excessive underpricing is generally unwanted as it can lead to a wealth transfer to investors. Therefore, setting an appropriate offering price represents a major challenge for issuers and underwriters throughout the process of going public.

This study was conducted to analyze the various factors influencing a company's initial return during the observation period from 2018 to 2025. The selection of this period is critical because the dynamics of the Indonesian capital market have been substantially shaped by a series of significant economic and political events. In 2020, the capital market confronted a severe global economic crisis, which was subsequently followed by renewed optimism following the 2024 presidential election. Further turbulence emerged during the global political crisis in the Euro region in 2022 and amid broader global political uncertainty. This sequence of events generated highly dynamic fluctuations in the stock price index, directly affecting the willingness of companies to conduct initial public offerings.

The primary motivation of this study stems from the inconsistency found in prior research findings regarding the factors that influence initial return. Some researchers have found that firm size and auditor reputation exert a significant influence on initial return. Conversely, other studies indicate that financial ratios such as return on assets (ROA) and financial leverage do not consistently produce the same impact. This gap in findings necessitates re-examination using more current data and a broader sample scope. This study aims to fill that gap by evaluating the influence of firm-level micro variables and the reputation of capital market supporting institutions.

The primary objective of this study is to empirically examine the influence of firm size, underwriter reputation, ROA, financial leverage, and earnings per share (EPS) on initial return. The researchers seek to determine whether the financial information contained in the prospectus genuinely constitutes the primary consideration for investors in making investment decisions. Firm size is used as a proxy for uncertainty, as larger companies are generally perceived to carry lower risk due to their greater public visibility. Additionally, underwriter reputation is examined given its critical role in price determination and market confidence building. Profitability and solvency ratios are included to assess the extent to which an issuer's operational performance influences price perception among market participants.

The research methodology applied in this study employs a quantitative approach using a multiple linear regression model to test hypotheses both simultaneously and partially. The study population encompasses all companies that conducted an IPO on the Indonesia Stock Exchange over the eight-year observation period. Through purposive sampling, 145 companies were selected as the research sample based on criteria of complete financial reporting and the presence of the initial return phenomenon. Various classical assumption tests were conducted, including normality, multicollinearity, and autocorrelation tests, to ensure that the regression model produced is valid and reliable. The secondary data used were obtained from the official website of the Indonesia Stock Exchange and other trusted financial data sources to maintain the accuracy of the analytical results.

The findings of this study offer important theoretical and practical contributions to the development of capital market literature in Indonesia. The analysis reveals that although all examined factors jointly exert a significant influence, firm size remains the most dominant predictor of initial return levels. These findings indicate that investors tend to view the stability of a company's assets as a safety signal before committing to invest in an initial public offering. This article is structured to be accessible rather than overly technical, enabling readers from both academic and practitioner backgrounds to appreciate the important contribution of each variable examined. Through a comprehensive understanding of the drivers of initial return, it is expected that investors will be better equipped to optimize early gains and manage investment risk more prudently during IPOs.

Literature Review

The phenomenon of initial return in initial public offerings has long been a central concern in capital market literature, as it reflects imperfections in the initial stock pricing process. Numerous studies associate initial return with information asymmetry among issuers, underwriters, and investors, whereby the company's internal information is not fully absorbed by the market at the time of the IPO (Fei, 2021). Under such conditions, investors tend to rely on observable signals to assess the risk and prospects of the company. The literature indicates that company characteristics and financial information serve as uncertainty reduction mechanisms in the evaluation process of initial shares. Therefore, understanding the factors that influence initial return is essential for explaining market behavior in the early stages of stock trading.

Firm size is frequently regarded as an indicator of the level of transparency and operational stability of IPO companies. Larger companies generally have broader access to information and higher levels of disclosure, resulting in relatively lower information risk for investors (Young et al., 2020). Several studies find that larger firms tend to experience lower levels of initial return because uncertainty regarding company value can be minimized from the outset of the offering. However, other empirical findings present mixed results, particularly in emerging markets where information efficiency remains limited. These divergent outcomes suggest that the relationship between firm size and initial return is contextual in nature. Based on this reasoning, firm size is expected to have an influence on initial return among companies conducting an in IPOs.

In addition to internal company characteristics, the reputation of the underwriter is also considered an important signal in the IPO process. Underwriter with a high reputation is assumed to possess superior screening and valuation capabilities regarding issuer quality, thereby reducing the risk of offering failure and mispricing (Chen et al., 2020). Several studies indicate that underwriter reputation is associated with lower levels of underpricing due to greater investor confidence in the quality of information disclosed. However, in certain cases, underwriter reputation does not always emerge as the dominant factor in investment decisions, particularly when investors direct greater attention toward the company's financial performance. This inconsistency in findings underscores the need for further empirical testing. Accordingly, underwriter reputation is hypothesized to have an influence on initial return in IPOs.

Pre-IPO financial performance is frequently used by investors as the basis for assessing a company's future prospects. Return on asset (ROA) reflects a company's ability to generate profit from its assets and is commonly perceived as an indicator of managerial efficiency (Kayakus et al., 2023). Theoretically, companies with high ROA are expected to carry lower risk, thereby reducing the need for compensation through initial return. However, several studies find that pre-IPO earnings information may be subject to earnings management practices, thereby undermining the credibility of ROA as a performance signal. This condition renders the effect of ROA on initial return inconsistent at best. Therefore, ROA is expected to be related to initial return, yet the direction and magnitude of this relationship still require empirical substantiation.

A company's financing structure also commands investor attention when assessing the risk of investing in initial shares. Financial leverage describes the proportion of debt in a company's capital structure, where a high level of leverage is frequently associated with greater financial risk (Aripin & Abdulmumuni, 2020). In the context of an IPO, companies with high leverage may be perceived as having greater uncertainty, prompting investors to demand compensation in the form of initial return that is higher in value. However, there is also a perspective that leverage may reflect managerial discipline in the use of funds, and is therefore not always perceived negatively by the market. This divergence in viewpoints has led to varying results in prior research. Accordingly, financial leverage is hypothesized to exert an influence on initial return in IPOs.

Earnings per share (EPS) information is frequently used by investors as an indicator of potential future returns. A high EPS is generally interpreted as a positive signal regarding a company's capacity to generate profit for shareholders (Frecka, 2015). In signaling theory, companies with favorable EPS are expected to exhibit lower levels of uncertainty, such that the initial return that materializes tends to be smaller. However, in IPO practice, investors frequently question the reliability of EPS due to the possibility of earnings manipulation prior to the public offering. This skepticism means that EPS does not always serve as the primary basis for determining the initial stock price. Therefore, the relationship between EPS and initial return still requires further empirical examination.

Research Methods

This study employs a quantitative approach with a causal research design to examine the factors influencing initial return among companies conducting an Initial Public Offering (IPO) on the Indonesia Stock Exchange. The research population encompasses all companies that conducted an IPO during the observation period from 2018 to 2025, with the unit of analysis being the issuing company. The sampling technique used is purposive sampling, with the criterion of complete availability of financial data and stock price information throughout the research period. Based on these criteria, a sample of IPO companies was obtained that were deemed suitable for empirical analysis. This approach was selected because it enables the testing of causal relationships between variables using measurable and verifiable historical data (Chu et al., 2025).

Research data were collected using a documentation method, drawing on secondary data sourced from company financial statements, IPO prospectuses, and official publications of the Indonesia Stock Exchange. Information on the initial offering price and the first-day closing price was used to calculate initial return, while financial data were obtained from annual financial reports issued prior to the IPO. The use of secondary data is considered appropriate because all research variables are objective in nature and can be observed directly from official sources. This method also enhances data reliability by minimizing the potential for respondent bias. All data used have been publicly disclosed and are accessible for research replication purposes.

Variable measurement in this study is based on definitions and indicators commonly used in capital market literature. Initial return is measured as the difference between the closing price on the first day of secondary market trading and the initial offering price, relative to the initial offering price (McGuinness, 2016). Firm size is proxied by the natural logarithm of total assets, while underwriter reputation is measured using a dummy variable based on the underwriter ranking. Financial performance is represented by return on assets, financial leverage, and earnings per share, all calculated from pre-IPO financial statements. All variable measurements are designed to ensure construct validity and consistency with prior research, so that analytical results can be compared and empirically replicated.

Results

The results of multiple regression testing indicate that the research model is statistically significant, with an F value of 3.145 and a significance level of 0.011, which is below $\alpha = 0.05$. The coefficient of determination (R^2) value of 0.100 indicates that the variables of firm size, underwriter, return on asset, financial leverage, and earning per share collectively explain 10% of the variation in initial return, while the remaining 90% is attributable to other factors outside the model. The correlation coefficient (R) of 0.317 indicates a relatively weak relationship between the independent variables and initial return. These results indicate that although the model is significant, the explanatory power of the independent variables over initial return remains limited. Nonetheless, the regression model is deemed appropriate for further analysis.

Table 1
Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,317[a]	0,1	0,068	1,50531	1,539

a. Predictors: (Constant), EarningPerShare, ReputasiUnderwriter, FinancialLeverage, ReturnOnAsset, Firm Size
b. Dependent Variable: InitialReturn

On a partial basis, firm size is proven to have a significant negative effect on initial return with a regression coefficient of -22.182, a t value of -2.363, and a significance level of 0.020. This finding indicates that an increase in firm size tends to reduce the level of initial return at the time of the IPO. Underwriter underwriter reputation has a regression coefficient of -0.455, a t value of -1.691, and a significance level of 0.093, thus indicating no significant effect on initial return. This result suggests that underwriter reputation has not yet become the primary determining factor in the formation of initial return in the primary market. Accordingly, only firm size is proven to be statistically significant in the partial model.

Financial performance variables show insignificant results with respect to initial return. Return on asset has a regression coefficient of 0.040, a t value of 0.826, and a significance level of 0.410, indicating no significant effect. Financial leverage has a regression coefficient of 0.066, a t value of 0.629, and a significance level of 0.530, indicating a positive but insignificant effect on initial return. Meanwhile, earning per share has a regression coefficient of -0.274, a t value of -0.928, and a significance level of 0.355, which also indicates no significant effect. Overall, these results suggest that pre-IPO financial performance information has not been fully reflected by the market in the formation of initial return.

Tabel 2
Analisis Regresi Berganda

Variabel	B (Unstandardized)	Std. Error	Beta (Standardized)	t	Sig.
Firm Size	-22.182	9.389	-0.218	-2.363	0.020
Underwriter Reputation	-0.455	0.269	-140.000	-1.691	0.093
Return onAsset	0.040	0.049	0.072	0.826	0.410
Financial Leverage	0.066	0.104	0.055	0.629	0.530
Earning PerShare	-0.274	0.295	-0.081	-0.928	0.355

a. Dependent Variable: InitialReturn.

Discussion

The research results indicate that simultaneously, firm size, underwriter, return on asset, financial leverage, and earning per share significantly influence initial return, as reflected in an F value of 3.145 with a significance level of 0.011. This finding indicates that the combination of company characteristics and financial information remains a key basis for investor consideration when evaluating shares at the time of an IPO. Nevertheless, the coefficient of determination of 10% indicates that the model's capacity to explain the variation in initial return remains relatively limited. This condition suggests that the formation of initial return is influenced by numerous other factors beyond those examined in this study. These results are consistent with the view that primary markets in developing countries remain subject to uncertainty and non-financial factors.

Firm size is proven to have a significant negative effect on initial return with a regression coefficient of -22.182 and a significance level of 0.020. This finding suggests that larger companies tend to experience lower initial return because the level of information asymmetry faced by investors is relatively smaller. More complete and transparent information in larger companies reduces the need for investors to demand risk compensation through underpricing. This result is consistent with previous research stating that firm size serves as a signal of company quality and stability in the primary market. Thus, firm size is an important factor in explaining the variation in initial return IPO.

Underwriter reputation is not proven to have a significant effect on initial return, as indicated by a significance value of 0.093. This finding suggests that the presence of a highly reputable underwriter does not necessarily reduce stock price uncertainty at the time of an IPO. Investors tend to place greater focus on the company's fundamental conditions than on the reputation of the intermediary. This result reflects that the function of the underwriter as a quality signal provider has not yet been fully effective in the context of the Indonesian capital market. These findings support the results of previous studies that found the effect of underwriter reputation to be inconsistent with respect to initial return.

The return on asset variable does not show a significant effect on initial return, with a significance value of 0.410. This result indicates that short-term profitability information prior to the IPO has not yet become a primary consideration for investors in determining the initial stock price. Investors may question the credibility of pre-IPO earnings due to the potential for earnings management. This condition renders ROA less effective as a signal of company quality in the early stages of stock trading. This finding reinforces the view that historical earnings information does not always reflect a company's post-IPO performance.

Financial leverage has a positive but insignificant effect on initial return, with a significance value of 0.530. This finding suggests that a company's debt level has not been consistently interpreted by the market as a risk indicator at the time of an IPO. Although high leverage may heighten risk perception, investors do not always translate this into demands for initial return that is correspondingly higher. This indicates that capital structure information has not yet emerged as a strong signal in the initial stock pricing process. Accordingly, the role of financial leverage in explaining initial return remains limited in scope.

Earnings per share (EPS) also does not demonstrate a significant effect on initial return, with a significance value of 0.355. This result indicates that investors have not fully relied on EPS as an indicator of company prospects at the time of an IPO. Earnings volatility and the potential for earnings manipulation prior to the public offering render EPS less effective as a primary basis for initial stock valuation. Investors tend to exercise greater caution when using EPS information and often combine it with other indicators. This finding confirms that earnings per share information has not yet become a dominant factor in the formation of initial return di pasar perdana.

Conclusions

This study aims to analyze the factors influencing initial return among companies conducting an Initial Public Offering on the Indonesia Stock Exchange. The results indicate that simultaneously, firm size, underwriter reputation, return on assets, financial leverage, and earnings per share have a significant effect on initial return, suggesting that the combination of company characteristics and financial information remains a consideration for investors in early investment decision making. However, on a partial basis, only firm size is proven to have a significant negative effect on initial return, while the other variables do not demonstrate a significant influence. These findings indicate that the level of transparency and the scale of the company play a more dominant role in reducing stock price uncertainty at the time of an IPO. Meanwhile, financial performance information and intermediary reputation have not yet fully emerged as strong signals in the formation of initial return. Overall, the research results confirm that the behavior of initial stock price determination in the Indonesian capital market continues to be influenced by information limitations and contextual market factors.

Limitations

This study has several limitations that should be considered when interpreting the research findings. First, the relatively low coefficient of determination indicates that the variables of firm size, underwriter, return on asset, financial leverage, and earning per share are only capable of explaining a small proportion of the variation in initial return, indicating that other factors outside the model continue to influence the formation of initial return. Second, the study relies on secondary data and focuses on pre-IPO financial information, and therefore does not fully capture non-financial factors that may potentially influence investor decisions. Third, the observation period being limited to IPO companies within a specific timeframe means that the findings may be contextual in nature and sensitive to the market conditions prevailing during that period. Furthermore, the use of a quantitative approach based on historical data limits the study's ability to capture the dynamics of investor behavior in greater depth. Therefore, the findings of this study should be understood within the context of the methodology and scope applied in this research.

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