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# Effect of Institutional Ownership and Audit Committee to Underpricing in Indonesian Stock Exchange

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**ABSTRACT:** Underpricing is a phenomenon that remains unresolved. Between 2015 and 2022, 83 percent of companies listed on the Indonesia Stock Exchange (IDX) experienced underpricing. Information asymmetry is often cited as the primary reason for underpricing during the Initial Public Offering (IPO) process. The audit committee and institutional ownership are crucial indicators in reducing information asymmetry between issuers, underwriters, and investors. This study aims to examine the consistency of the application of the audit committee and institutional ownership in influencing underpricing, using a sample of 304 companies that experienced underpricing between 2015 and 2022.

**KEYWORDS:** Underpricing, Information Asymmetry, Signaling Theory, Institutional Ownership, Audit Commitee

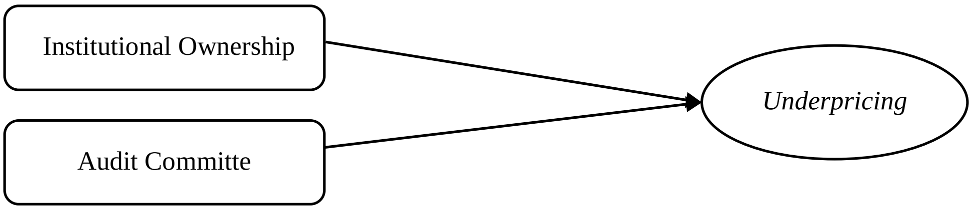
## I. INTRODUCTION

An IPO (Initial Public Offering) is an alternative for companies to raise capital by issuing shares in the capital market. However, during this process, underpricing often emerges as a phenomenon that remains a mystery. This phenomenon has been documented by numerous previous researchers who found underpricing occurring in almost every IPO event worldwide. An IPO (Initial Public Offering) is an alternative for companies to raise capital by issuing shares in the capital market. However, during this process, underpricing often emerges as a phenomenon that remains a mystery. This phenomenon has been documented by numerous previous researchers who found underpricing occurring in almost every IPO event worldwide (Dhamija & Arora, 2017; Mehmood et al., 2021; Rathnayake et al., 2019; Soesetio, Siswanto, et al., 2022; Soongswang, 2017; Xu et al., 2017). Underpricing is defined as the occurrence of a lower price due to the first public offering being priced below market value (Hartono, 2015). The average percentage of IPO companies in Indonesia that experienced underpricing between 2015 and 2022 was around 87 percent, meaning that approximately 304 out of 468 IPO companies experienced underpricing (data processed in 2023).

Institutional ownership within a company's ownership structure has a significant impact on the effectiveness of corporate governance. It is generally believed that institutional investors, such as banks and insurance companies, can enhance corporate performance through their expertise and financial resources (Teti & Montefusco, 2022). When institutional investors own a portion of a company's shares, the monitoring system becomes more developed (Shleifer & Vishny, 1986; Velury & Jenkins, 2006), leading to better overall corporate governance (Gillan & Starks, 2003). Several studies have found a positive influence of institutional ownership on underpricing, such as the research conducted by (Lin & Chuang, 2011). However, different findings were reported by (Darmadi & Gunawan, 2013 and Sasongko & Juliarto, 2014) who found a negative correlation between institutional ownership and underpricing. Conversely, (Rustami & Yuyetta, 2017) found that institutional ownership had no effect on the level of underpricing.

The audit committee has the authority to access records or information related to employees, funds, assets, and other company resources that are relevant to its duties. The audit committee plays a central role in the corporate governance structure, particularly in the design of high-quality financial reports. A well-functioning audit committee must meet specific criteria to create more optimal corporate governance. Additionally, the audit committee is a component of the corporate governance structure that signals investors about the quality of the company and the information contained in the prospectus. The audit committee plays a crucial role in determining and defining the credibility, quality, and quantity of financial and non-financial information reported (Beasley & Salterio, 2001; Mitchell Van der Zahn et al., 2008). (Tran et al., 2021) explained that the presence of an audit committee significantly influences the reduction of underpricing during IPOs. On the other hand, (Hidayat & Kusumastuti, 2014) found no significant correlation between these two variables.

Based on the literature review and previous research, the relationship between variables in the research model can be described in a conceptual framework.




Hypothesis is a temporary estimate of the problem being faced. Hypothesis has a function as a guide to the course of a research that allows us to find answers. The hypothesis developed in this study is:
H1: Institutional ownership has a significant effect on Underpricing
H2: Audit committee has a significant effect on Underpricing

## II. LITERATURE REVIEW

### *1. Underpricing*

Underpricing during an IPO is a common phenomenon that can be detrimental to the company. (Hartono, 2015) defines underpricing as a phenomenon where the offering price to the public during the initial offering is lower than the market price. This results in the emergence of an initial return that investors receive. According to (Hartono, 2015) , the initial return is the return obtained from assets during the initial offering, starting from the time they are purchased in the primary market until they are first listed in the secondary market. The initial return represents the positive profit shareholders gain due to the difference between the price at which shares are purchased in the primary market and the price at which they are sold in the secondary market (Nadia & Daud, 2017).

### *2. Information Asymmetry*

Information asymmetry refers to a situation where one party in a transaction possesses more or better information than the other party (Diantini, 2015) Information asymmetry among IPO participants, including managers, underwriters, and investors, leads to higher levels of underpricing (Teti & Montefusco, 2022). (Cook & Officer, 1996) state that if there is no information asymmetry between managers and investors, the initial price will match the market price, thus eliminating underpricing. Information asymmetry can occur between issuers, underwriters, and investors (Fabrizio & de Lorenzo, 2001). The first type identified is between issuers and investors. Ibbotson & Jaffe (1975) argue that issuing companies decide to lower the initial price to "make a good impression on investors.
The second type of information asymmetry is between informed and uninformed investors, known as the winner's curse theory introduced by (Rock, 1986). According to the winner's curse, underpricing is a method to reduce information asymmetry among investors (Teti & Montefusco, 2022). Lastly, there is information asymmetry between underwriters and issuers. (Baron & Holmström, 1980) hypothesize that underwriters possess more information than the company. With the information they have, underwriters tend to set a lower price to attract investor interest and reduce the risk borne by the underwriter.

### *3. Signaling Theory*

Signaling theory according to (Brigham & Houston, 2018) refers to actions taken by a company's management to provide guidance to investors on how management assesses the company's prospects. Signaling theory emphasizes the importance of information generated by the company in the investment decisions of external parties. Accurate and timely information is essential for investors in the capital market as an analytical tool for making investment decisions (Novalia & Nindito, 2016). All actions and events within the company become information used by both internal and external parties in decision-making (Zhou et al., 2020). According to (Ritter & Welch, 2002), issuing companies can minimize ex-ante uncertainty by providing signals that reduce the amount of information asymmetry surrounding the company's listing. Signaling theory can address information asymmetry during an IPO, as it essentially involves eliminating information imbalances between parties (Spence, 2002; Zhou et al., 2020). During an IPO, the company, as the signaling party, disseminates a prospectus that helps reduce information asymmetry with potential investors as the signal receivers.

### *4. Corporate Governance*

Corporate governance is described as the policies and processes adopted by companies to reduce agency problems by considering the differences between owners and managers (Hakimah et al., 2019). Good corporate governance is defined as a system of sound corporate governance to manage and control companies in creating added value for all stakeholders. Corporate governance governs the relationships between key stakeholders within a company, influencing agency conflicts between shareholders and management and conflicts of interest among different types of shareholders (Teti & Montefusco, 2022). According to (Dirman, 2020), the implementation of corporate governance is considered capable of enhancing management oversight, promoting effective decision-making, preventing opportunistic behavior that does not align with the company's interests, and reducing information asymmetry between management, shareholders, and creditors. Corporate governance can act as a signaling tool for external investors, reducing information asymmetry between issuers and potential buyers during an IPO (Teti & Montefusco, 2022). Companies with good corporate governance will not only reduce agency conflicts but also information asymmetry (Maurya & Singh, 2018).

### *5. Institutional Ownership*

Institutional ownership refers to the proportion of shares owned by institutional owners such as insurance companies, banks, investment companies, and other institutional investors (Teti & Montefusco, 2022). Institutional ownership represents the shareholding by an institution that has a significant interest in its investment. A commonly used mechanism for monitoring managers is through large outside shareholders, usually financial institutions such as investment banking, insurance companies, pension funds, mutual funds, and banks (Arifin, 2005), referring to institutional parties. Monitoring by institutional investors will encourage more optimal oversight of management performance. A high percentage of institutional ownership indicates control over the company and can reduce agency costs. Agency theory suggests that it is difficult to trust that management will always act in the best interest of shareholders, necessitating monitoring by shareholders to reduce agency conflicts.

### *6. Audit Committee*

The audit committee is a committee under the board of commissioners, consisting of at least one independent commissioner and independent professionals from outside the company, responsible for helping the auditor maintain independence from management (Yolanda et al., 2019). The audit committee has the authority to access records or information about employees, funds, assets, and other resources related to its duties. The audit committee plays an important role in the corporate governance structure in terms of preparing quality financial reports. A well-functioning audit committee must have certain characteristics to create better corporate governance. Additionally, the audit committee is a component of the corporate governance structure that provides signals to investors about the quality of the company and the information contained in the prospectus. The audit committee plays a crucial role in determining and defining the credibility, quality, and quantity of financial and non-financial information reported (Beasley & Salterio, 2001; Mitchell Van der Zahn et al., 2008)

## III. RESEARCH METHODOLOGY

### 1. *Scope of the Research*

The scope of this research is financial management, particularly in the field of capital markets, focusing on the relationship between institutional ownership and the audit committee on the phenomenon of underpricing during IPOs on the Indonesia Stock Exchange (IDX).

**Table 1: Variables Measurement**

| Variables | Description | Measurement |
|---|---|---|
| **Dependent variable** | | |
| Underpricing (UDP) | Measures the difference between the initial price and the closing price | (First day trading price – IPO price) / IPO price |
| **Independent variables** | | |
| Institutional ownership (INS) | Measures the ratio of shares owned by institutional investors to the number of outstanding shares | (Institutional shares / Listed shares) x 100% |
| Audit Committee (AC) | Audit committee shows the number of audit committees in a company at the time of the IPO. | ($\Sigma$ Commitee Audit) |

**Source:** Data Processed, 2023

***2. Types and Sources of Data***

The type of data used in this research is quantitative data, while the sources of data are secondary, obtained from IPO prospectuses available on the Indonesia Stock Exchange website (www.idx.co.id) and The Indonesian Capital Market Institute website (www.ticmi.co.id), as well as closing prices on the first day of secondary market trading obtained from the Yahoo Finance website (https://finance.yahoo.com).

***3. Population***

The population studied in this research consists of issuers or companies that conducted an Initial Public Offering (IPO) over seven years, during the observation period from 2015 to 2022, with a total of 343 companies.

***4. Sample***

The sample is a subset of the population. The sampling method used in this research is purposive sampling, a technique that involves selecting samples based on specific criteria. The following are the samples obtained using the purposive sampling method, with the criteria listed below.

| **No** | **Sample Criteria** | **Number of Samples** |
|---|---|---|
| 1 | Companies that conducted IPOs in 2015-2022 | 343 companies |
| 2 | IPO companies with complete offering price and closing price data | 343 companies |
| 3 | Companies that experienced underpricing | 304 companies |
| 4 | Companies that published a complete prospectus during the 2015-2022 IPO period | 304 companies |
| | Final Sample Count | 304 companies |

Based on these criteria, the sample studied in this research consists of 304 companies. The regression equation used in this research is as follows:

$$UDP_i = \alpha + \beta_1 INS_i + \beta_2 AC_i + \varepsilon$$

***5. Hypothesis Testing***

Hypothesis testing in this research is conducted using partial tests, which involve testing individual partial regression coefficients to determine whether independent variables (X) individually affect the dependent variable (Y) with a maximum significance level of 10% (0.10). Hypothesis testing is performed using SPSS 22 software as the basis for decision-making, based on the rejection or acceptance of the hypothesis. The criteria used in the partial test include:

- If the probability > 0.10, then h0 is accepted, meaning there is no significant effect of X on Y.
- If the probability ≤ 0.10, then h0 is rejected, meaning there is a significant effect of X on Y.

**IV. RESEARCH RESULT AND DISCUSSION**

***I. Descriptive Analysis***

Data description can be interpreted as a description of the results of research that has been conducted from each variable studied. This study consists of dependent variables represented by Underpricing (UDP), independent variables represented by institutional ownership (INS), audit committee (AC) The data used in this study were obtained from the official prospectus report issued by the issuer company before conducting an Initial Public Offering (IPO) which has been published on the official website of the Indonesia Stock Exchange (IDX), The Indonesian Capital Market Institute (ticmi) and on the company's official website. In detail, the descriptive results of each variable can be described as follows.

| *Variables* | *N* | *Minimum* | *Maximum* | *Mean* | *Std. Deviation* |
|---|---|---|---|---|---|
| UDP | 304 | .00 | 3.13 | .4243 | .32512 |
| INS | 304 | .00 | .99 | .5551 | .29464 |
| AC | 304 | .00 | 4.00 | 2.9803 | .34412 |

***a. Underpricing***

Underpricing shows the positive initial return ratio received by investors due to the positive difference between the closing price on the first day of secondary market trading and the price when the shares were first offered on the primary market. Based on table, the average underpricing value is 0.4243 or 42,4%, which means that the average closing price of IPO companies in 2015-2022 on the first day of secondary market trading increased by 42.4% compared to the price when the shares were first offered on the primary market. The minimum value is 0.003 and the maximum value is 3,13. The minimum value of 0.003 or 0.3% is owned by the company Golden Plantation Tbk which IPO in 2014 and the maximum value of 3.125 or 312.5% is owned by the company PT. Arkadia Digital Media Tbk which IPO in 2018.

***b. Institutional Ownership***

Institutional ownership is a structure of share ownership by institutions with an indicator comparing the number of institutional shares to the number of shares outstanding. Based on table, the average value of institutional ownership is 0.5551, which means that in IPO companies in 2015-2022, an average of 55.51% of their shares are owned by institutions. The minimum value is 0.000 and the maximum value is 0.990. The minimum value of 0.000 indicates that the company's shares are not owned by institutions. During this period, as many as 49 companies did not have institutional shareholders in their share capital structure. Meanwhile, the value of 0.990 or around 99% of the shares are owned by institutional parties, namely the company PT MAP Boga Adiperkasa Tbk which IPO in 2017.

***c. Institutional Ownership***

The audit committee shows the number of audit committees in the company at the time of the IPO. Based on table, the average value of the audit committee is 2.9803, which means that in companies IPO in 2015-2022, on average they have 3 audit committees. The minimum value is 0 and the maximum value is 4. The minimum value of 0 indicates that the company does not have an audit committee until the IPO prospectus is issued. During this period, 63 companies did not have an audit committee. While the value of 5 indicates that the company has 4 audit committees, namely the company Bank Yudha Bakti Tbk, Dafam Property Indonesia Tbk, Bank Tabungan Pensiunan Nasional Syariah, Bank BRI Syariah, Bank Net Indonesia Syariah.

***II. Classical Assumption Tests***

***1. Normality Test***

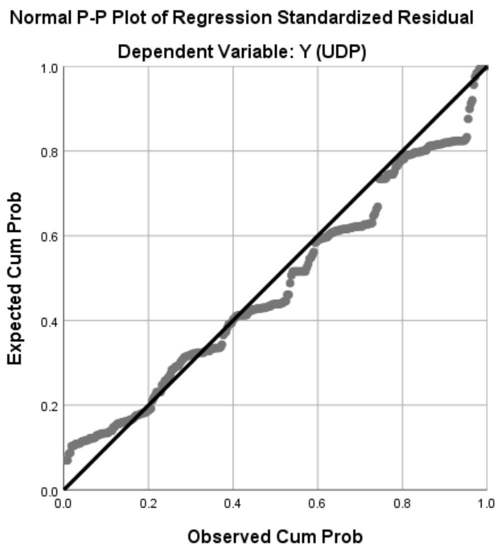
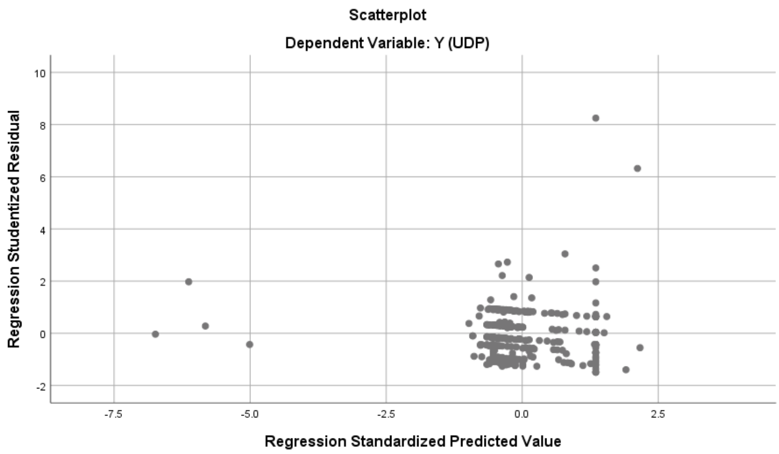



**Figure 2. Normality Test Result**

The assumption that data are normally distributed is one of the important assumptions in regression research. The purpose of this normality test is to examine whether the independent and dependent variables are normally distributed. (Ghozali, 2016) suggests that normality of data can be detected by observing the distribution of points along the diagonal axis in a graph. If the data points are distributed around the diagonal line and follow its direction, this indicates that the data are normally distributed.

### 2. *Heteroscedasticity Test*




Based on Figure 3, it can be observed that the distribution of points is irregular, with no clear pattern, and they are spread above and below the zero value on the Y-axis. This suggests that heteroscedasticity is not present in the regression model.

### 3. *Multicollinearity Test*

**Table 4. Multicollinearity Test Result**

| Variable | Collinearity Statistics | |
|---|---|---|
| | Tolerance | VIF |
| INS | .993 | 1.008 |
| AC | .993 | 1.008 |

A regression model is free from multicollinearity if the VIF (Variance Inflation Factors) values of each independent variable are less than 5, and the tolerance values are close to 1. The VIF results are shown in Table 12. Based on the VIF calculation results, each independent variable has a VIF value smaller than 5, indicating that the regression model does not suffer from multicollinearity.

***Hypothesis Testing***

This study was conducted to examine the influence of independent variables (X) on the dependent variable (Y) and control variables when added, by testing companies that conducted Initial Public Offerings (IPOs) during the 2015-2022 period, involving 304 companies.

**Table 5. Multiple Regression Analysis Result**

| *Variables* | | *Unstandardized Coefficients* | *Standardized Coefficients Beta* | t | Sig. |
|---|---|---|---|---|---|
| (*Constant*) | ,169 | ,163 | | 1,037 | ,044 |
| INS | -,110 | ,063 | -,100 | -1,739 | ,083 |
| AC | ,106 | ,054 | ,112 | 1,961 | ,051 |

In Model 1, it can be seen that INS has a significance level of 0.083 ≤ 0.10, meaning that INS significantly affects underpricing with a negative coefficient of -1.10. AC has a significance level of 0.051 ≤ 0.10, meaning that AC significantly affects underpricing with a positive coefficient of 1.06.

***The Effect of Institutional Ownership on Underpricing***

Based on Table 10, it can be concluded that institutional ownership significantly affects underpricing with a significance level of α ≤ 10%. Thus, the hypothesis stating that institutional ownership significantly influences underpricing is supported.

***The Effect of the Audit Committee on Underpricing***

Based on Table 10, it can be concluded that the audit committee significantly affects underpricing with a significance level of α ≤ 5%. Thus, the hypothesis stating that the audit committee significantly influences underpricing is supported.

***Discussion***

***The Effect of Institutional Ownership on Underpricing***

Institutional ownership consistently and significantly affects underpricing. These results also support previous studies by (Darmadi & Gunawan, 2013; Sasongko & Juliarto, 2014) which found a negative correlation between institutional ownership and underpricing. However, these findings are contrary to the study by (Rustami & Yuyetta, 2017), which found that institutional ownership does not affect the level of underpricing. The presence of institutional investors in the company's ownership structure has a broader impact on the effectiveness of corporate governance. It is generally believed that institutional investors, such as banks and insurance companies, can enhance corporate performance through their expertise and financial resources (Teti & Montefusco, 2022). When institutional investors hold a portion of the company's shares, the monitoring system becomes more developed (Shleifer & Vishny, 1986; Velury & Jenkins, 2006), leading to better overall corporate governance (Gillan & Starks, 2003). The implementation of good corporate governance during the IPO process provides positive signals to investors, encouraging them to invest, as good corporate governance will minimize the risk of agency conflicts in the future. Companies with good corporate governance will not only reduce agency conflicts but also information asymmetry (Maurya & Singh, 2018). Therefore, corporate governance can negatively impact the level of underpricing during an IPO.

***The Effect of the Audit Committee on Underpricing***

The audit committee consistently and positively affects underpricing. These results contrast with previous studies by (Tran et al., 2021), which found a negative correlation between the audit committee and underpricing, and with the earlier study by (Hidayat & Kusumastuti, 2014), which found no significant correlation between the two variables. The audit committee has the authority to access records or information about employees, funds, assets, and other resources related to its duties. The audit committee plays an important role in the corporate governance structure, especially in the preparation of quality financial reports. In the case of IPO companies from 2015 to 2022 that experienced underpricing, 63 companies did not have an audit committee when the IPO prospectus was published. (Tran et al., 2021) explained that the presence of an audit committee significantly influences the reduction of underpricing levels during IPOs. The absence of an audit committee certainly affects the quality of financial reports in the prospectus published by the company. As a result, information asymmetry between the underwriter and the issuer increases, leading the underwriter to set the IPO price below its actual value to reduce the risk borne, ultimately causing the company to experience underpricing.

## V. CONCLUSION AND RECOMMENDATIONS

***Conclusion***

Institutional ownership consistently and significantly affects underpricing. The findings of this study indicate that an increase in institutional shareholders can enhance oversight, minimize information asymmetry, and reduce underpricing. The audit committee consistently and positively influences underpricing. The findings of this study show that during the research period, several companies did not have an audit committee, which affected the quality of financial reports and ultimately impacted information asymmetry and the determination of IPO prices.

***Recommendations***

1. ***For Companies Considering an IPO:***
    - Companies should focus on strengthening their corporate governance structures, particularly by ensuring the presence and effective functioning of an audit committee. This will help reduce information asymmetry and minimize the risk of underpricing during the IPO process.
    - Institutional investors should be encouraged to take a more active role in the ownership structure, as their involvement can lead to better corporate governance and reduce the chances of underpricing.
2. ***For Investors:***
    - Investors should consider the presence of an audit committee and the level of institutional ownership as important factors when evaluating the potential of an IPO. A company with strong corporate governance is less likely to experience underpricing, providing a more secure investment opportunity.
3. ***For Future Research:***
    - Future studies could explore other variables that may influence underpricing, such as managerial ownership or the presence of independent commissioners, to provide a more comprehensive understanding of the factors affecting IPO pricing.
    - Researchers may also consider examining the impact of different industry sectors on underpricing, as the dynamics of underpricing may vary across different industries.

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