

# **THE VALUE RELEVANCE OF MANAGEMENT EXPECTATION IN NEW ISSUES**

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## Abstract

This study investigates the value relevance of management expectation in Indonesian new issues. The management expectation is defined as the future accounting numbers (earnings forecast and *proforma* book value of equity) published in the IPO prospectus. In Indonesian market setting, the future accounting numbers disclosure in the IPO prospectus is voluntary. On the other hand, disclosing pre-IPO financial statement is mandatory. This study analyses the impact of voluntary and mandatory disclosure on the firm's value. Using 94 IPO firms that went public during 2000-2008, the results show that the accounting forecast explains more the firm value than the historic earnings. This concludes that the earnings forecast and *proforma* book values of equity are more value relevant than historical pre-IPO earnings and book value of equity. The conclusion provides evidence that voluntary disclosure does have significant impact on the firm equity valuation.

*Keywords:* Value relevance, future accounting numbers, earnings forecast, *proforma* book value of equity, IDX

# THE VALUE RELEVANCE OF MANAGEMENT EXPECTATION IN NEW ISSUES

## Introduction

Undoubtedly, the pricing of new issues is the most puzzling phenomenon in the financial asset pricing. There have been many studies attempting to explain the new issues “mispricing” in the early trading days and its impact in the long run. Ritter and Welch (2002) argue that the asymmetric information is not the primary driver of many IPO phenomena, however, it is still a significant factor in explaining the, so called, IPO anomalies.

In general, there are not many information regarding firms’ activities available to market prior to firms’ IPOs. This creates the asymmetric information in the IPO market, especially during the early trading days. The asymmetric information among the new issues varies. Usually, high profile firms are expected to have less asymmetric information than its counterparts since they most likely have been exposed by the media coverage before their IPOs. To reduce the asymmetric information in the IPO market, the capital market authorities all over the world request firms that want to sell their stocks in the IPO market to provide adequate information through a formal document called the offering prospectus. Although the authorities have set the standard requirement of prospectus information, firms are encouraged to voluntarily disclose other information that could help the market to price the IPO.

There are few information could be categorized as voluntary disclosure to the offering prospectus, one of them is the management earnings forecast. Disclosing management earnings forecast is a way of managers to describe their expectation of the firm’s prospect when the funds sought in the offering is available to the firms. The managers also expect that their expectation could be a credible signal to the market about firms’ real value. In a voluntary disclosure scenario, managers are motivated to disclose the information voluntarily when they believe it will reveal the firms’ real value to the market, which in turn will revise firm’s value upwardly (Lev and Penman, 1990).

Despite considerable research efforts, however, IPO valuations are still largely mysterious. In particular, most of the literature (e.g. Chemmanur, He, and Hu, 2009; Chemmanur and Hu, 2007)

inherently posit that private information contributes substantially to institutions' ability to value and avoid the worst performing firms.

This study examines the value relevance of the management expectation, via management earnings forecast, In Indonesia IPO market. Although studies regarding management earnings forecast have been conducted in several Asian countries, such as Singapore, Thailand, Malaysia, Taiwan, China, and Hong Kong, this study differs to the priors. Most prior studies examine the impact of disclosing management earnings forecast on the IPO valuation. The primary objective of this study is to compare the impact of management earnings forecast (as a voluntary disclosure) on IPO valuation to one of the historical earnings (as a mandatory disclosure). By doing so, this study provides an evidence of the additional information content of management expectation on the firm's future and its superiority (inferiority) to the past firms information.

### **The value relevance of accounting information in IPO**

Many studies documented the evidence of the value relevance of accounting information. Barth, Beaver and Landsman (2001) argue that most of the value relevance studies investigate the relevance and the reliability of the accounting information. They review extensive literature on the value relevance of accounting information. They point out that in opposed to the examination of the relevance of historical accounting numbers; a group of studies investigate the relevance of intangible assets. This group includes studies on the relevance of intangible assets in a setting that permit asset revaluation. In that setting, the intangible assets are observed in estimation, rather than historical numbers. Barth et al (2001) argue that this group of studies reflects the values of the assets as assessed by investors. This finding shows that the market does impound both historical and managers' estimation accounting information into their pricing decision.

Using a sample of 193 IPOs in US market, Klein (1996) investigate the relationship between the IPO prices (at the offer date and at the end of the 1<sup>st</sup> trading day) and various information in the prospectus. She finds that the IPO prices are positively related to the pre-IPO earnings and pre-IPO book value of equity. Further, she notes that the impact of the pre-IPO accounting information is robust and superior to other prospectus information. However, since she uses the

US data which forbid the disclosing the forecast accounting numbers, her research is limited to include only the historical accounting data.

Using a sample of 190 US IPOs, Kim and Ritter (1999) investigate the IPO valuation using comparable industry-median accounting numbers (PE ratio). Using the historical accounting data, they find a low explanatory power of the valuation model. However, using an experimental design, the explanatory power of the model is improved by employing forecasted earnings instead of historical earnings. They conclude that IPO valuation by industry comparables based historical accounting information are of limited value for understanding the IPO pricing on the early trading days.

Aggarwal, Bhagat, and Rangan (2009) observe the impact of accounting information on the IPO prices in various time periods. The time period reflects different state of economics. They find that historical accounting information: earnings and sales are significantly related to the IPO offer price and initial market price, while the historical book value of equity appears to be insignificantly related to the IPO prices.

All studies above are conducted in the tight-legal environment where disclosing the future accounting numbers is forbidden. Using IPO data from Greek market that allows the disclosure of the future accounting numbers, Ghikas, Iriotis, Papadaki, and Walker (2000) investigate the value relevance of accounting information. They find that forecasted earnings disclosed in the prospectus are positively related to the pre IPO earnings. Both earnings are value relevant; however, they find that the forecasted earnings have higher explanatory power on the IPO offer price than the historical earnings.

### **Earnings forecasts as a voluntary disclosure**

Lev and Penman (1990) argue that earnings forecasts are used by managers of “good news” firms to screen themselves out from other firms. In this argument, it could be said that management earnings forecast is used as a signal to the firm value. Trueman (1986) states in the voluntary disclosure setting, the managers would be motivated to release earnings forecasts if such actions leads to higher firm market value. Initially, these premises are utilized to evaluate the performance difference between firms that disclose voluntary disclosure and ones that do not.

Empirical evidence show a strong support to Trueman (1986). In the UK market, Keasey and McGuinees (1991) find that IPOs that disclose earning forecast are differently valued in the market on their initial trading day compared to their counterparts. Disclosing earnings forecast is perceived as a signaling tool that has a positive impact on the firm initial market value. The similar findings are also found in Canada (Clarkson et al, 1992). Hong Kong (Firth, 1998; Keasey and McGuiness, 2008) in which disclosing earnings forecast is voluntary. However, How and Yeo (2001), using the Australia data, find that the act of the forecast is not related to the initial market valuation of IPO firms and their long-run performance.

Firth (1998) finds that earnings forecasts are positively related to the IPO initial market value than to the IPO offer price. If the earnings forecasts have high explanatory power to the IPO initial market value, it could be expected that it provides some explanation to the IPO stylistic fact, underpricing. Unlike the robust findings in the initial market valuation, the empirical evidence on the initial returns is mixed. Using Hong Kong data, Keasey and McGuiness (2008) finds that IPOs that disclose earnings forecast are less underpriced than their counterparts. This implies that disclosing earnings forecast in the IPO forecast could reduce the information assymetry between the managers and the market.

In line with Keasey and McGuiness (2008), Jog and McConomy (2003) find that firms disclosing the earnings forecast experience lower initial returns in the market than the firms do not disclose. Furthermore, they also find that smaller firms that disclose earnings forecast tend to have a lower forecast errors than the big firms. They explain that the smaller forecasting firms might add value when they go through the process of building their forecast. Despite their robust finding and interesting explanation, Brown (2003) argues that the beneficial of volunteering earnings forecast in the prospectus should be examined prior to the listing. He suggests that the evidence of disclosing value added should be observed by the offering price and the assets before the firms went listing.

### **Institutional setting**

Indonesian capital market authority (BAPEPAM-LK) requires the issuers to publish a document, so called, the offering prospectus before they want to sell their shares to the public through the

IPOs. The prospectus contains the mandatory components such as the main information the business entity (the founders, the charter of incorporation, the location, all business activities, significant business risk encountered), the details of the offering activities (the reason for going public, the date of various stages of the IPO process, the names of advisors, the names of responsible officers in producing prospectus, a description of shares that will be offered, ownership structured before and after the IPO), the financial position of the business entity (highlights of major financial measures, full audited financial reports).

In addition to that, the authority allows the issuers to voluntarily disclose any information that could help investors to know the firms better, which in turn, helping investors to price the IPO wisely. In Indonesia market, such voluntary disclosure is varied. For example, the mining firms tend to provide vast information about the related worldwide business risk. Hi-tech firms tend to include the technology trend that could affect the firms' performance. During the research period observed, disclosing earnings forecast is one of the prominent voluntary disclosure in the offering prospectus.

BAPEPAM-LK has a regulation that disclosing earnings forecast should be certified by the appointed auditors in the IPO and the certification statement from the auditor should be included in the prospectus. However, from 94 IPOs included in the research sample, only two prospectuses include the auditors' certification statement.

### **Research sample and data**

The research sample used consists of 94 IPOs that disclose earnings forecast in their prospectus during year 2000 – 2009. It includes all the industries in the Indonesia Stock Exchange (IDX). The prospectuses and IPO prices are collected from the databases provided by BINUS Business School and from the stock exchange (IDX).

The data used in this research includes the historical and forecasted earnings, the percentage of shares retained by the old shareholders, the pre-IPO leverage, the auditors of the IPO, and the IPO prices (offer price and the initial market price).

This research compares the impact of the historical and future accounting numbers on the IPO prices. The historical numbers model will be analyzed using the following research model

$$P0/preBV = \alpha + \beta1preAP/preBV + \beta2Retain + \beta3DR + \beta4DAud + e \quad (1)$$

$$P1/preBV = \alpha + \beta1preAP/preBV + \beta2Retain + \beta3DR + \beta4DAud + e \quad (2)$$

where,

- P0/preBV = the offering price deflated by the pre-IPO book value of equity  
P1/preBV = the closing price of the 1<sup>st</sup> trading day deflated by the pre-IPO book value of equity  
preAP/preBV = the historical (pre-IPO) earnings deflated by the pre-IPO book value of equity  
Retain = the percentage of shares retained by the old shareholders at the IPO  
DR = pre-IPO leverage measured by the debt ratio  
DAud = a dummy variable for auditor reputation. It take a value of 1 when the IPO firms is audited by one of the Big 4 auditors

Since the research focuses on the accounting numbers and BAPEPAM-LK requires the auditor certification of any future accounting numbers disclosed, then further the models include the interactive term between the accounting numbers disclosed and the auditor reputation dummy following the equations below and the description of each variable is as above

$$P0/preBV = \alpha + \beta1preAP/preBV + \beta2Retain + \beta3DR + \beta4DAud + \beta5preAP*Aud + e \quad (3)$$

$$P1/preBV = \alpha + \beta1preAP/preBV + \beta2Retain + \beta3DR + \beta4DAud + \beta5preAP*Aud + e \quad (4)$$

The forecasted accounting numbers are analyzed using similar valuation model with the substitution of the historical numbers. The forecasted earnings are collected from the prospectuses, while the forecasted book value of equity needs additional computation from offering information. Following Kim and Ritter (1999), the following equation is used to compute the forecasted book value of equity,

$$postBVE = preBVE + IPO\ proceeds \quad (5)$$

The IPO proceeds used here is the gross proceeds since there is limited information available regarding the cost of going public in Indonesian IPOs.



Equation 1 to 4 above is used to analyze the value relevance of the forecasted numbers by using the forecasted numbers instead of the historical numbers.

For further analysis, this research examines whether the use of historical and forecasted accounting numbers differs the opinions of the market participants (issuers and investors). This is to check if the analysis could explain the underpricing phenomenon. Therefore another model is employed using the equation below

$$IR = \alpha + \beta_1 preAP/preBV + \beta_2 Retain + \beta_3 DR + \beta_4 DAud + e \quad (6)$$

Where, *IR* is the IPO initial returns, which is computed as the difference between the closing price of the 1<sup>st</sup> trading day and the offer price.

As shown in table 1, the sample shows that historical numbers (P/preBVE, P1/preBV, and preAP/preBVE) shows higher standard deviation and wider range. This shows that prior to the IPO, some firms experienced fluctuated financial conditions. The variations, somehow, become smoother in their forecasted numbers.

Table 1 – Descriptive Statistics

Variable	Mean	Std dev	Min	Max
P0/preBVE	5.4604	7.8902	0.1963	64.7748
P1/preBVE	7.1381	8.0721	0.0474	42.9027
preAP/preBVE	0.1193	0.0948	0.0017	0.4483
P0/postBVE	3.7248	3.8290	0.1901	19.7323
P1/postBVE	5.3227	5.7129	0.0459	33.1331
FP/postBVE	0.1864	0.1730	-0.2190	1.0056
Retain	0.7541	0.1051	0.5000	0.9303
DR	0.5173	0.2530	0.0051	0.9500
Aud	0.4787	0.5022	-	-

The percentage of shared retained by the old shareholders at the IPO, has an average of 75.41%, which is considerably higher than the figures found in other markets. It shows that the firms' founders still become the majority of the public firms in Indonesia. The sample shows relatively moderate leverage at the time of they go public. Almost half of the sample hired Big 4 as their appointed auditors at the IPOs

## **Findings and Discussion**

The results of IPO offering prices are presented in table 2 (panel A and B, respectively) below. The table shows that the offering price models are valid. This shows that accounting information is still relevant in IPO valuation (Aggarwal et al, 2009; Klein, 1996). In term of the model superiority, the model using forecasted accounting numbers (earnings and book value of equity) explains the impact of independent variables better than the model using historical numbers (Kim and Ritter, 1999). This finding shows that the forecasted accounting numbers provide additional information contents to the IPO offering price (Lev and Penman, 1990). This also suggests that managers rely more on the forecasted numbers for the basis to price the IPOs since they want to highlight their expectation on the firms' future of not the past.

Both earnings (preAP and FP) show positive relations to the offering price (P0). Despite of a high coefficient of historical earnings, it shows insignificant relevance to the IPO offer price. On the other side, the forecasted earnings coefficient shows a strong significant relationship. This emphasizes the usefulness of the forecasted earnings as a determinant factor used by the managers to set their offer price.

As discussed in the prior section, the constant of the model could be interpreted as the coefficient of the book value of equity. The model using historical book value of equity shows a big coefficient, however, it lacks the significance. This result confirms the findings from previous research (e.g., Aggarwal et al. 2009). The model using the forecasted numbers shows a significant relationship. Both models show a negative relation between the book value of equity and the IPO offer price. This is not as expected. Since the book value of equity reflects the company size, this result suggests that bigger companies tend to price their IPOs, relatively, lower.

**Table 2 – The regression analysis on the offering price (P0)**

Panel A

Variable	Expected sign	P0/preBV	P0/post BV
		Coefficient (White t-stat)	Coefficient (White t-stat)
Constant	+	-26.2288 (-1.3395)	-3.9450 (-1.986)*
preAP/preBVE		31.2774 (1.1601)	-
FP/postBVE	+	-	11.59219 (3.4863)***
Retain	+	30.0083 (1.7968)*	8.046245 (2.3134)**
DR	-	12.1381 (1.5063)	-0.3517 (-0.3940)
Aud	+	-1.9809 (-1.3657)	-0.8639 (-1.1621)
Adj R-Square		7.28%	33.98%
F-stat		2.8252**	12.6956***

Panel B

Variable	Expected sign	P0/preBV	P0/post BV
		Coefficient (t-stat)	Coefficient (t-stat)
Constant	+	-24.7004 (-1.2406)	-3.9336 (-1.8785)*
preAP/preBVE		29.3194 (1.1378)	-
FP/postBVE	+	-	14.6849 (3.0603)***
Retain	+	28.5768 (1.5889)	7.4451 (2.0249)**
DR	-	-11.2904 (-1.3638)	-0.5873 (-0.5713)
Aud	+	-2.0673 (-1.0051)	0.1011 (0.0834)
Aud*preAP		7.2614 (1.5682)	
Aud*FP		-	-4.6882 (-0.7405)
Adj R-Square		7.7746%	34.30%
F-stat		2.2697**	0.0000***

Note: \* significant at  $\alpha=10\%$ ; \*\*significant at  $\alpha=5\%$ ; \*\*\*significant at  $\alpha=1\%$

The prominent IPO signal (Retain) shows positive and significant coefficients. The magnitude of the Retain coefficient in the historical number model is much higher than one in the forecasted number model. It shows that its impact on the offer price is more sensitive. The leverage (DR) takes negative coefficients as expected, however, they lack of significance. This infers that the managers do not take the leverage into account when they have to determine the IPO price. The leverage used here, is measured using the historical numbers. Again, this shows that historical accounting numbers are less relevant to the IPO pricing.

The impact of auditor reputation (Aud) is shown in panel A and B. Panel A shows that the Auditor reputation does not have a significant impact on the offer price. It is not as expected. Panel B shows that no significant effect of the auditor reputation on the forecasted earnings disclosed in the prospectuses, which in turn the effect is irrelevant to the IPO offer price. This could be explained as the regulation requirement to certify the earnings forecast disclosure is not well-implemented in the practices, therefore, the managers also do not relate the auditors' service to the forecasted earnings.

The discussion of the value relevance on the IPO offer price above reflects the usefulness of forecasted accounting numbers over the historical numbers for the managers. It could be seen from the analysis that the managers use the forecasted accounting numbers to bring forward their expectation of the firms' future. The question now is how the market responds to the management expectation.

Table 3 (panel A and B) shows the impact of historical and forecasted accounting numbers on the initial market price. The initial market price is the closing price of IPO stocks on the 1<sup>st</sup> trading day. Panel A shows that models using historical and forecasted accounting numbers are valid. Similar to the result of the IPO offer price analysis, the forecasted accounting number model has a much higher explanatory power than the historical accounting numbers. It could be inferred that the forecasted numbers do reduce the information asymmetry in the IPO market (Trueman, 1986; Kim and Ritter, 1999). This also implies that investors in IPO market look forward to the firm's future, not the past. As predicted, the IPO initial market models have lower explanatory power than the IPO offer price models. This is understandable as individually, investors could consider different factors in their pricing decisions.

Table 3 – The regression analysis on the first day market price (P1)

Panel A			
Variable	Expected sign	P1/preBVE Coefficient (t-stat)	P1/post BVE Coefficient (t-stat)
Constant	+	-22.0931 (-1.3198)	-4.0956 (-1.0652)
preAP/preBVE	+	25.9476 (1.3591)	
FP/postBVE	+	-	14.0682 (3.7338)***
Retain	+	31.4054 (1.8828)*	11.7500 (2.0744)**
DR	-	-7.5759 (-1.3807)	-1.6467 (-0.8813)
Aud	+	-3.4906 (-1.9647)*	-2.5312 (-2.1617)**
Adj R-Square		6.6288%	24.22%
F-stat		2.6506**	8.4302***

  

Panel B			
Variable	Expected sign	P1/preBVE Coefficient (t-stat)	P1/post BVE Coefficient (t-stat)
Constant	+	-21.3391 (-1.2516)	-4.0489 (-1.1165)
preAP/preBVE	+	25.7530 (1.3333)	
FP/postBVE	+	-	26.6796 (2.9550)***
Retain	+	30.7001 (1.8701)*	9.3396 (1.5929)
DR	-	7.5778 (1.2721)	-2.6210 (-1.5057)
Aud	+	-7.6023 (-2.9194)***	1.1130 (0.5822)
Aud*preAP		-36.2642 (2.1356)**	-
Aud*FP		-	-19.1175 (-1.9350)*
Adj R-Square		5.928%	31.3881%
F-stat		3.0243***	9.5090***

Note: \* significant at  $\alpha=10\%$ ; \*\*significant at  $\alpha=5\%$ ; \*\*\*significant at  $\alpha=1\%$

The explanatory power of the models is more driven by the strong impact of the forecasted earnings on the initial market. The historical earnings appear to be insignificantly related to the initial market price, despite its higher coefficient. The positive coefficient of forecasted earnings means that the higher the forecasted earnings relatively, the higher the IPO initial market price. According to Aggarwal et al (2009), investors perceived the forecasted earnings as a proxy for growth opportunity. The higher forecasted earnings is perceived as greater growth opportunity in the future which if it is realized, it will certainly increase the value of the firm. Therefore, investors put higher valuations to the higher forecasted earnings IPOs. The magnitude of the forecasted earnings is approximately similar to the P/E ratio in the market. This result confirms findings from prior research (e.g. Keasey and McGuinness, 2008). This provides evidence of the usefulness of the forecasted earnings on the IPO pricing.

The coefficients of book value of equity are insignificant on both models. This suggests that the market does not price the firms' assets in place, whether the current net assets nor the future net assets, on their valuation process. This does not confirm other prior studies (e.g., Kim and Ritter, 1999; Keasey and McGuinness, 2008). This, neither, confirms the results of the established stocks in the Indonesia market. There could be two possible explanations to that. Firstly, since the forecasted book value of equity is not disclosed straight away, it does not capture the investors' attention. Secondly, investors do consider the future net asset in their pricing process; however, somehow, it is impounded on the future earnings information (forecasted earnings).

Similar to the offer price analysis, the Retain coefficient is significantly positive related to the initial market price. This shows that it serves as a credible signal to the IPO valuation. The leverage appears to be insignificant related to the initial market price. Since the leverage proxy, DR, uses the historical accounting number, again, it provides evidence of the less relevance of accounting numbers on the IPO pricing.

Interesting result is found in the auditor reputation (Aud). Despite its irrelevance to the IPO offer price, investors still think that it is relevant. However, the sign of the coefficient is not as expected. The auditor reputation appears to be negatively related to the IPO initial market price. It means that firms that hire one of the big 4 auditors tend to be priced lower than their counterparts. This result is opposed to prior research. This finding should not be interpreted in a

negative sense. This could be explained that investors believe in the audit results of the Big 4 auditors, so that they correct their initial price downwardly. Further analysis also shows that the initial returns (IR) of firms hiring Big 4 auditors are substantially and significantly lower than the IR of their counterpart firms<sup>1</sup>.

So far, the analyses show that the forecasted numbers provide additional informational content to the historical numbers. Furthermore, it is shown that the accounting numbers are used by the issuers to price the IPOs, however, their role becomes less informative in the market since individually investors also used other information in their pricing process.

Further analysis will show whether the difference of accounting information relevance could address the issue of IPO underpricing. The result of the IR analysis is shown in table 4 below.

**Table – 5 – The regression analysis on the IPO performance**

Variable	Expected sign	Initial Return (IR)	Initial Return (IR)
		Coefficient (t-stat)	Coefficient (t-stat)
Constant	+	0.7916 (1.4641)	0.7902 (1.648)*
preAP/preBVE	?	0.2334 (0.4593)	-
FP/postBVE	?	-	-0.1399 (-0.5328)
Retain	-	-0.0846 -0.1208	-0.0133 (-0.0195)
DR	+	-0.6971 (-2.5493)**	-0.6682 (-2.4564)**
Aud	-	-0.1038 -0.5059	-0.2117 (-1.6998)*
Adj R-Square		8.06%	8.48%
F-stat		2.6324**	3.1545**

*Note: \* significant at  $\alpha=10\%$ ; \*\*significant at  $\alpha=5\%$ ; \*\*\*significant at  $\alpha =1\%$*

The result show that the research sample is consistently is underpriced. As whole the accounting numbers could explain the underpricing phenomena. However, both historical and forecasted

<sup>1</sup> The means difference test of IR between firms with big 4 auditors and not with big 4 auditors is conducted. The result shows that average of IRs of firms with big 4 Auditors is significantly lower than their counterparts at  $\alpha = 1\%$

earnings fail to provide the significant explanation. This adds to the explanation above that historical earnings is not only less relevant to the IPO valuation, but also does not diverge the opinion of the firms between the issuers and investors. Despite its strong evidence in the valuation, forecasted numbers also do not differ the opinions of the firms between the issuers and investors, since the impact of the forecasted number is similar to both parties. (Ritter and Welch, 2003)

Surprisingly, despite of lack of significant impact on the valuation, the leverage does provide significant explanation to the IPO underpricing although it is not of expected sign. The result shows pre-IPO leverage is negatively related to the IPO underpricing. The more leverage firms obtain prior to IPO, the lower the initial returns. From the information asymmetry theory, it implies that to some degree the leverage certifies the firm's financial condition so that minimize the asymmetry in the market.

The auditor reputation also provides a weak, yet, significant explanation to the underpricing, when forecasted numbers are involved. The valuation result lends the explanation to this. Since valuation analyses show that there is a differ opinion between the issuers and investors, regarding the role of auditor, its difference is reflected in the underpricing. Hiring big 4 auditors, to some degree, certifies the forecasted earnings disclosed in the prospectus. This certification reduces the information asymmetry, which is in turn lowering the degree of the underpricing.

## **Conclusion and limitation**

This research investigates the value relevance of the management expectation via the disclosure of forecasted earnings in the offering prospectus. The result shows that accounting numbers are still important determinant factors used by both, issuers and investors, in valuing the IPO. There is additional informational content provided by the forecasted accounting numbers compared to ones provided by the historical numbers.

The analysis shows that the forecasted earnings are the most robust factor determining the IPO offer and initial market prices. However, since the impact affect issuers and investors in the same



direction and more or less magnitude, the robustness does not alter the opinions of the pricing decisions. This result in forecasted earnings fails to explain the underpricing phenomenon.

Other prominent signals disclosed in the prospectus shows that the percentage shares held by old shareholders are robustly significant in IPO valuations. Pre-IPO leverage appears to be less informative to the IPO prices, but provides significant explanation to the underpricing. Despite lack of evidence of auditors' certification of the forecasted earnings disclosed, investors do consider it in their pricing decisions. The involvement of big 4 auditors regarding the earnings forecast has reduced the information asymmetry in the market.

This conclusion is limited to the firms disclosing forecasted earnings. The findings could be more generalized to the IPO firms in Indonesia if the sample includes non disclosing IPO firms so that results in historical earnings is more meaningful.

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