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Risk Disclosure in IPO Prospectuses: A Descriptive Study in the Indonesian Capital Market

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Abstract

This study aims to describe risk disclosure in the IPO prospectuses of companies listed on the Indonesia Stock Exchange during the 2021-2023 period. Using a quantitative approach with a descriptive design, this study analyzes four risk categories: primary risk, business risk, general risk, and investor risk. Data were collected using a documentation technique using purposive sampling, covering 176 companies that published complete information in their prospectuses.

The results show that principal risk disclosure is the lowest, while general risk disclosure is the highest. Variation in risk disclosure between companies, as measured by standard deviation, indicates that general risk is the most heterogeneous, while investor risk is the most homogeneous, indicating consistency in disclosure between companies. These findings indicate an imbalance in the depth of information, particularly related to principal and general risks. Based on signaling theory, it is recommended that IPO companies improve the transparency of risk disclosure to provide more complete information to investors. Future research can explore the relationship between risk disclosure and IPO stock performance..

Keywords:
Primary risk, Business risk, General risk, Investor risk; Disclosure; IPO Prospectus

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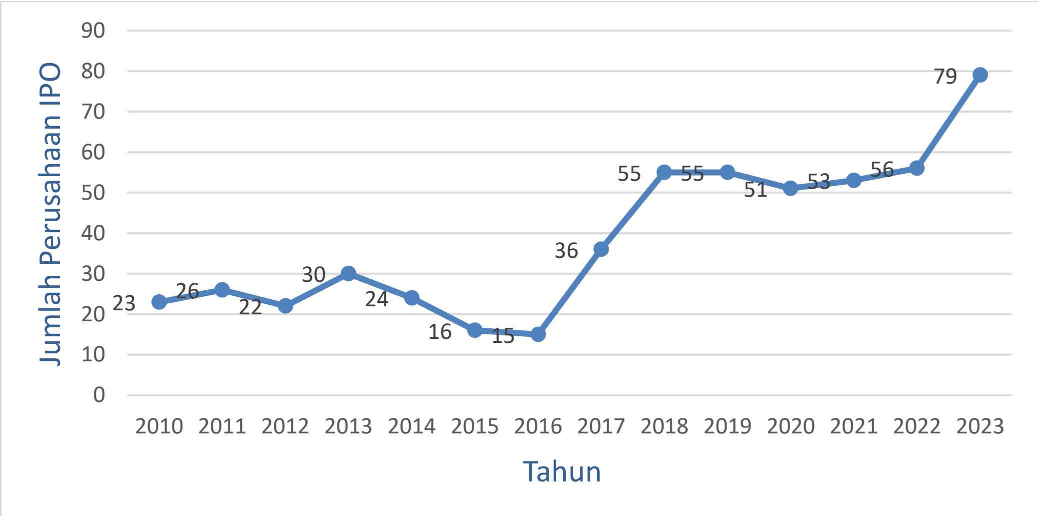
INTRODUCTION

An initial public offering (IPO) occurs when a security is sold to the public for the first time (Ritter, 1998). In the capital market, an IPO is a primary means for companies to raise funding. IPOs have become an increasingly popular method in Indonesia to raise capital and expand operations. There has been an increasing trend in the number of companies conducting IPOs in Indonesia since 2010, particularly since 2017. Despite a decline in 2020, the number of IPO companies increased again in 2023, reaching 79 companies. This indicates growing interest in companies seeking funding from the capital market through IPOs.

Figure 1. Number of Companies Conducting IPOs in Indonesia by Year



Source: IDX

A common phenomenon surrounding IPOs, occurring in many countries and studied by numerous researchers worldwide, including Indonesia, is short-term underpricing and long-term underperformance (Ritter, 1991; Loughran & Ritter, 1995; Shen et al., 2014; Barry & Mihov, 2015). Underpricing, or positive initial return (IR), occurs when the initial offering (IPO) price is below the secondary market price that occurs after the initial market closes. Underperformance occurs because the initial return generated cannot be maintained over the long term.

Various approaches have been taken to explain the complexity of the stock underpricing phenomenon, but none have fully explained the phenomenon that occurs in many capital markets worldwide. Previous research still requires further exploration and discussion to explain the phenomenon of stock underpricing. Understanding the phenomenon of stock underpricing in Indonesia is crucial for stakeholders involved in the IPO process and will ultimately facilitate more informed decision-making in the future..

Researchers have attempted to analyze and understand the causes of underpricing and its implications for investors and issuers. Various theories and influencing factors have been tested to understand the phenomenon of stock underpricing. Research results have shown mixed findings. Information asymmetry is one theory that attempts to explain the positive initial return. Information asymmetry leads to underpricing of IPO shares. This information asymmetry between issuers and the market encourages issuers to send various signals about the company's condition, one of which is underpricing shares.

The transition from a private company to a public company causes potential investors, who are relatively unfamiliar with the company, to seek a variety of information to inform their investment decisions. On the other hand, companies strive to provide relevant information regarding the company's condition to the market. The Indonesian government supports the transparency of information that must be disclosed by public companies, one of which is through POJK No. 8/POJK.04/2017 concerning the Form and Content of Prospectuses and Abbreviated Prospectuses for Public Offerings of Equity Securities. Referring to POJK No. 8/POJK.04/2017, companies (issuers) are required to disclose information about risks in their IPO prospects. This risk disclosure will reduce information asymmetry between the company and potential investors. Disclosure of the issuer's risk profile and the implementation of risk mitigation strategies and measures enables investors to make a more informed assessment of a company's investment potential and reduce information asymmetry using signals from the prospectus. Intransparent risk disclosure can influence investor perceptions of the feasibility and potential risks of an investment.

LITERATURE REVIEW

Initial Public Offering

An Initial Public Offering (IPO) is the process by which a private company first offers its shares to the public for trading on the capital market. IPO is an important financing strategy for companies to access public capital. Companies' motivations for conducting an IPO vary widely. Several researchers explain the motivations for companies conducting an IPO based on agency theory (Jensen Mecking, 1976), signaling theory (Myers & Majluf, 1984), and capital market theory. In an IPO, companies often offer shares at a low price compared to their actual market value. This can signal to investors that the company has growth potential and good prospects. The underpricing phenomenon also occurs in IPOs in Indonesia.

Information Asymmetry

Information asymmetry is an imbalance of information, a condition in which one party has more information than another. For example, company management has more information than investors in the capital market. The level of information asymmetry varies depending on the amount of information. In a perfect market, all parties have the same information about the returns of risky assets. However, in practice, agents can have different information because they have access to different sources of information or differ in their ability to process information from the same sources.

Signal Theory

Spence (1973) explains that signal theory involves information owners sending signals to recipients, who use them to inform their decision-making. In capital markets, issuers use signals to convey management actions aimed at meeting the interests of company owners. These signals can take the form of financial reports, annual reports, and company activities that demonstrate positive actions to enhance company value. For companies undergoing an Initial Public Offering (IPO), signals are often conveyed through the IPO prospectus. In this study, signals refer to factors related to the IPO process that may influence stock underpricing. Previous research has explored key market signals that help reduce stock underpricing during an IPO.

Risk Disclosure Regulations

Risk disclosure regulations for public companies are crucial for increasing transparency and protecting investors. Risk disclosure regulations have been implemented in many countries. The United States government, through the Securities and Exchange Commission (SEC), has established rules requiring companies to disclose material risks that could impact financial performance. Meanwhile, in Indonesia, the Financial Services Authority (OJK) has implemented similar regulations through POJK No. 8/POJK.04/2017 concerning the Form and Content of Prospectuses and Abbreviated Prospectuses for Public Offerings of Equity Securities, which requires companies to disclose the risks they face in their annual reports. Adequate risk disclosure can boost investor confidence and encourage better investment decisions. Therefore, these regulations play a crucial role in maintaining market stability and protecting the interests of all stakeholders.

There are several risks that issuers must disclose, as stated in Article 22 of POJK No. 8/POJK.04/2017, including:

A. **primary risks** that have a significant impact on the Issuer's business continuity;

B. **material business risks**, both directly and indirectly, that could affect the Issuer's business results and financial condition, arising from at least the following:
   1. competition;
   2. investments or corporate actions;

3. the Issuer's failure to comply with applicable laws and regulations in its industry;
4. technological changes;
5. resource scarcity; and
6. raw material supply;

C. general risks, arising from at least the following:

1. macroeconomic or global conditions;
2. changes in foreign exchange rates;
3. compliance with applicable laws and regulations related to the Issuer's business;
4. lawsuits or claims;
5. government policies; and
6. provisions of other countries or international regulations;

D. risks to investors;

RESEARCH METHOD

This study uses a quantitative approach with a descriptive design and secondary data collected through documentation techniques by accessing the IPO prospectuses of 176 companies conducting IPOs on the Indonesia Stock Exchange during the 2021-2023 period. The study population includes all companies conducting IPOs during that period, with the sample selected using a purposive sampling technique based on two criteria: companies conducting IPOs during the 2021-2023 period and those that publish complete information in the IPO prospectus. The research variable is risk disclosure, which is divided into four categories: primari risk, business risk, genaral risk, investor risk. Data analysis was conducted descriptively to describe the types of risks disclosed and the level of depth of information provided in the IPO prospectus.

FINDINGS AND DISCUSSION

Findings

Description

The description of the research variables is shown in tablefollowing table:

Table 1. Descriptive of Research Variables

	N	Minimum	Maximum	Mean	Std. Deviation
Risk_Primary	176	0,00	1,00	0,0530	0,13695
Risk_Business	176	0,00	0,73	0,2985	0,14863
Risk_General	176	0,00	1,00	0,5199	0,20874
Risk_Investor	176	0,13	0,88	0,4169	0,09784

Source: processing statistical data, 2024

Based on the table above, the average value of primary risk disclosures in IPO prospectuses is very low (0.0530), with a relatively small standard deviation (0.13695), indicating that most companies provide limited or insignificant disclosure of primary risks. Disclosure of primary risks tends to be rarely highlighted in the prospectus.

The average business risk disclosure is 0.2985, which is higher than the primary risk disclosure. This indicates that companies disclose business risks more frequently, although some still provide no information related to business risks at all. The larger standard deviation of Risk_Primary indicates higher variation in business risk disclosure across companies.

General risk disclosure has a mean of 0.5199, meaning that half of IPO companies disclose general risks in their prospectuses, with relatively moderate variation (standard deviation 0.20874). This suggests that most companies provide more general risk disclosures, covering external factors such as economic conditions or regulations that may affect their performance.

The average investor risk disclosure is 0.4169, indicating that nearly half of the companies provide risk disclosure related to investors. The relatively low standard deviation (0.09784) indicates that investor risk disclosure tends to be uniform across most companies.

Discussion

Based on the calculations above, it can be concluded that risk disclosure in IPO prospectuses in Indonesia shows significant variation. Disclosure of primary risks (Risk_Primary) is very low, possibly reflecting a lack of attention to risks that directly impact a company's viability. Business risks (Risk_Business) are disclosed more frequently, but still vary across companies.

General risks (Risk_General) are disclosed more frequently, with a higher average disclosure rate than primary and business risks. This may indicate that companies tend to focus more on more easily identified external risks, such as economic conditions or regulatory changes. Risks directly related to investors (Risk_Investor) also receive significant attention, although with less variation than other risks.

Based on these findings, it is recommended that companies planning an IPO provide more comprehensive and transparent risk disclosures, particularly regarding key risks and business risks that could directly impact the company's performance. Increasing the depth of these risk disclosures will provide more useful information for investors in making more informed investment decisions.

Furthermore, companies should provide a clearer picture of internal risks that could impact the company's operations after the IPO, as well as highlighting risks to investors that will help them understand the potential impact on their share value.

CONCLUSIONS

This study reveals that risk disclosures in the IPO prospectuses of companies listed on the Indonesia Stock Exchange during the 2021-2023 period show significant variation across companies. In general, disclosure of internal risks (Risk_Primary) tends to be low, with most companies not providing in-depth information on the primary risks that could impact their viability. Conversely, disclosures of business risks (Risk_Business) and general risks (Risk_General) are more common, with higher averages, indicating that companies tend to focus more on external factors affecting their performance. Disclosure of investor-related risks (Risk_Investor) also receives considerable attention, although they are more consistent across companies.

These findings indicate that despite the implementation of risk disclosures, there are still disparities in the depth of information provided to investors, particularly regarding internal and business risks. Therefore, IPO companies are advised to improve the transparency and depth of risk disclosures to provide more complete and accurate information for investors to make better investment decisions.

LIMITATION & FURTHER RESEARCH

Limitation

This study has several limitations, including:

Sample Limitations: This study only covers companies listed on the Indonesia Stock Exchange during the 2021-2023 period, so the findings may not reflect the overall state of risk disclosure in the Indonesian capital market.

Descriptive Approach: This study only describes the data without conducting further analysis on the effect of risk disclosure on stock returns or investment decisions.

Further Research

Future research could expand on this topic by examining the relationship between risk disclosure and IPO stock performance, such as initial stock returns, to assess the extent to which risk disclosure impacts investor perceptions and investment outcomes. Research could also compare risk disclosure across companies in other countries or examine factors influencing risk disclosure, such as company characteristics, market conditions, and local regulations.

AUTHOR CONTRIBUTION

Author: Harlina Meidiaswati contributed to conceptualisation, research design, primary data collection, and initial drafting of the manuscript. **Nunik Dwi Kusumawati** contributed to data collection, methodological development, and empirical analysis. **Rasyidi Faiz Akbar** contributed to conceptualisation refinement, advanced data analysis, methodological validation, supervision, and critical revision of the manuscript. **Nugroho Sasikirono** contributed to editing, formatting, layout preparation, and final manuscript polishing.

Declaration of interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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