HIDING IN PLAIN SIGHT

CAMOUFLAGE IN THE CORPORATE GOVERNANCE OF IPOS

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The undersigned, appointed by the Dean of the Graduate School, have examined the dissertation entitled:

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CAMOUFLAGE IN THE CORPORATE GOVERNANCE OF IPOS

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and hereby certify that, in their opinion, it is worthy of acceptance.

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I dedicate this dissertation to Margaret, my miracle girl.

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1 Introduction

An IPO's bylaws and charter are vitally important because without them the firm does not exist (Del. Code Ann. § 102(a)). This fact alone distinguishes these documents from many other corporate governance mechanisms such as the markets for corporate control or the capital markets (Gillan, Hartzel and Starks (2006))[1]. However, bylaws and charters possess another unusual feature: they are among the few governance mechanisms created by the firm itself (Gillan (2006))[2]. Therefore an agency conflict can emerge when the founders write the bylaws and charter to favor their own interests over that of the shareholders (Jensen and Meckling (1976), Jensen and Smith (1985)). IPO founders can entrench themselves by crafting bylaws and charters that appear to favor the investor, when in practice they do the opposite. This is what I call corporate camouflage – *the opportunistic design of corporate documents to optimize managerial utility and to deter shareholder scrutiny.*

I focus on IPOs because their bylaws and charters have not yet been altered by shareholders and/or by market pressures. Seasoned firms, on the other hand, often yield to pressure to remove provisions placed by founders (Bebchuk (2003)). Thus the charters and bylaws of seasoned firms have been 'contaminated' by many stakeholders, whereas the charters and bylaws of IPOs have been formed primarily by the founders or their

[1]A firm's bylaws and charters are an important corporate governance mechanism. Gillan, Hartzel and Starks (2006) provide evidence that bylaws and charters can substitute for other forms of corporate governance such as the markets for corporate control. Specifically, where the markets for corporate control are stronger, the bylaws and charters tend to have fewer governance provisions and the board is weaker. Likewise, where the market for corporate control is weaker, the charters/bylaws tend to have a greater number of restrictive provisions to control the potentially more powerful board.

[2] Other 'firm' created governance mechanisms do exist, such as the board of directors. However, an argument can be made that even the board is not created by the firm because board members are elected, and re-elected, at annual meetings by the shareholders or their proxies. Thus in theory the structure of the board is determined by stakeholders other than the firm.

agents. This provides a unique opportunity to study how founders can camouflage bylaws and charters to further their own interests over those of other stakeholders.

Despite the great importance and relevance of bylaws and charters to corporate finance, most of the literature on this corporate governance mechanism is authored by lawyers, not financial economists. Thus financial economists must look to the legal literature for guidance on how the ex post construction[3] of these contracts impacts firm value. Gompers, Ishii and Metrick (2003) provide evidence that the mere existence of certain provisions in the bylaws and charters influences stock price. Bebchuk and Cohen (2005) look at one specific provision, staggered boards, and provide evidence that not only is existence important, but where this provision is placed is also important. Thus they provide limited evidence that 'how' the bylaws and charter are written impacts firm value. In their 2009 paper, Bebchuck, Cohen and Ferrel expand their focus and show that six of the 24 provisions identified by Gompers, Isshii and Metrick (2003) matter in corporate governance. However, this paper fails to address the issue of provision placement that they touched upon in their 2005 paper. Nevertheless, placement is an important factor in the construction of bylaws and charters. It is on construction that courts of laws make ex post adjudications as to shareholder rights and privileges.

This lack of attention to the ex ante design of bylaws and charters is one-sided. Whereas finance academics and investors pay little attention to these issues, managers appear to have a greater appreciation of their importance. Facebook is an example of this. At the time of this writing, Facebook is undergoing the IPO process. In a recent Wall Street Journal interview, Facebook revealed that they have spent over a year

[3] Construction is an expansive term particularly when the document is being examined beyond it's four corners. For the purposes of this section, construction of a contract concerns only two points: the first is the examination of what is placed in the contract, and the second is the examination of where it is placed in the contract.

generating “top-secret” drafts of their IPO prospectus, “crafting dummy scripts” for quarterly earnings calls, and addressing imaginary questions from analysts. Facebook admits that the reason it is doing this is to enable it to “resist shareholders' short-term desires”[4]. To accomplish this, Facebook has enlisted experienced venture capitalists to lay “a foundation that would make it very difficult for future investors to strip Mr. Zuckerberg of his equity or his control.”[5] This foundation is being built upon the bylaws and charter of Facebook. Reuters reports that Facebook's “bylaws go against shareholder-friendly corporate governance practices put in place in the United States after years of investor activism.”[6] Facebook's bylaws and charter permit Mr. Zuckerberg to "control all matters submitted to stockholders for vote, as well as the overall management and direction of our company."[7] This 'should' concern shareholders, and this 'should' lower firm value. Nevertheless, as I pointed out earlier, shareholders pay little attention to the design of bylaws and charters, and Reuters expects that Zuckerberg's onerous creations will have little to no impact on Facebook's offer proceeds (“the value of Facebook may be slightly lower”).

I submit that the only solid foundation upon which an IPO such as Facebook can build a structure strong enough to resist shareholder desires, is upon the contracts that govern the relationship between Facebook and the shareholders, that is, the bylaws and charters. I show in this dissertation, that through carefully crafted camouflage, that IPO founders are able to design bylaws and charters in such a way so as to enable them to

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[4] Raice, Shayndi (2011, December 22). Facebook's Goal: to Be a Blue Chip. *Wall Street Journal*. Retrieved January 24, 2012 from http://online.wsj.com

[5] Rusli, Evelyn (2011, April 7). Founders Now Take the Money and Maintain Control. *The New York Times*. Retrieved January 24, 2012 from http://dealbook.nytimes.com

[6] Oreskovic and McBride (2012, February 2). Facebook's Zukerberg to keep an iron grip after IPO. *Reuters*. Retrieved Feb 10, 2012 from http:/mobile.reuters.com

[7] *id*

resist the “short term desires” of their shareholders, and to continue the consumption of private benefits that they enjoyed prior to IPO.

My measure of camouflage is based on the premise that humans communicate value relevant information by *how* they say something, not only by *what* they say. In a study of the relationship between future firm performance and the qualitative information in managers' quarterly conference calls, Mayew and Venkatachalam (2012) observe that “it is not what you say that matters but the manner in which you say it”. That phrase could be cast into the context of bylaws and charters: “it is not what the bylaws and charters say that matters but the manner in which they say it.” This statement is too strong for me to advocate. However, I do propose that it is important *how* the bylaws and charter of an IPO are written, i.e., I submit that it is a mistake to focus solely on what is written without also considering how it is written.

To quantify *how* bylaws and charter are written, I model my camouflage index after how humans read. It accounts for nuances of word choice, sentence structure and paragraph placement. I propose that these three dimensions of writing, taken as whole, add incremental information to a written message. This Information is above and beyond that in the words and sentences taken out of the context of the writing as a whole. I then examine the behavior of this index across the bylaws and charters of my sample firms. This approach permits me to make several important contributions to the literature regarding IPOs and corporate governance.

My first contribution is to show a strong positive relationship between the use of camouflage and potential agency conflicts in the new public company. I show that the bylaw/charter provisions which provide managers with greater opportunity for

consumption of private benefits, are also those provisions which are most highly camouflaged. Thus I provide evidence supporting my agency-conflict hypothesis that managers camouflage those provisions which offer them the greatest ability to become entrenched and to enjoy private benefits of control.

My second contribution is to show an inverse relationship between the level of scrutiny experienced by an IPO and the use of camouflage. Scrutiny occurs when entities external to the firm examine it closely, such as that examination coming from regulatory oversight, bank monitoring and analyst coverage. In this paper I test scrutiny's impact on camouflage from the perspective of analysts, the market, and the SEC. The results are consistent with my expectations: as the number of analysts increases, firms use less camouflage; as market and industry scrutiny increases, firms use less camouflage; and lastly, as SEC regulators apply greater scrutiny, firms use less camouflage.

My last contribution is to show that camouflage helps to explain certain IPO pricing phenomena such as underpricing, offer proceeds, and institutional flipping. I provide evidence that camouflage can be used to reduce underpricing and to increase offer proceeds. I show that camouflage contributes to our understanding of flipping by providing evidence that my camouflage measure helps to identify which firms the institutional investor is likely flip.

In summary, my findings provide insight into how IPO founders prepare to manage post-IPO shareholder conflicts, and how they attempt to entrench themselves against shareholder demands. I argue that my camouflage measure can help determine the extent to which management has secured future private consumption. This index can help to explain decisions about IPO underpricing and the offer proceeds realized.

2 An Overview of Bylaws and Charters

Bylaws and charters govern the firm similarly to how the American constitution and the federal statutes govern the United States of America. The corporate charter is the fundamental source of authority supporting the existence of the firm, just as the American constitution is the underlying legal authority granting existence to the United States of America (Kahan and Rock (2003), Bebchuk et al (2009)). Bylaws are created by the power vested from the charter, just as statutes vest authority from the constitution. Furthermore, the power or authority in a bylaw/statute may not exceed that power or authority granted to the charter/constitution by the founders who penned it, else the bylaw/statute will be declared unconstitutional by a court of law. Lastly, I point out that bylaws, like statutes, are relatively easy to change, whereas the charter, like the constitution, is difficult to change.

2.1 Bylaws and Charters Defined and Compared

Formally defined, a firm's charter (articles of incorporation) is that "document that sets forth the basic terms of a corporation's existence, including the number and classes of shares and the purposes and duration of the corporation" (Black's Law Dictionary (1999)). Likewise, bylaws are those "rule[s] or administrative provision[s] adopted by an association or corporation for its internal governance" (Black's Law Dictionary (1999)).

In theory, the roles of the bylaws and charters are clearly delineated, but in practice the separation between the two becomes ambiguous. The corporate charter *should* dictate strategic direction, whereas the bylaws *should* provide tactical guidelines. For example, as it pertains to the board, the charter should detail the responsibilities and authority of the board, while the bylaws should define the daily conduct and procedures of the board

and its sub-committees. However, in practice the bylaws and charters overlap significantly because no entity exists to enforce consistency in their architecture. It is clear that the charter must define the basic terms of the firm's existence, but other than those few provisions, the firm may choose whether to place additional provisions in the charter, in the bylaws[8], or not at all (thus relying on default law). Nevertheless, some authors prescribe lists of items that 'should' appear in the bylaws, such as items pertaining to shareholder meetings, officer elections, committee duties, etc (Robert (2000)). However, any of these items may just as easily go into the charter (Del. Code Ann. § 102(b)(1)) and most legal scholars fail to find any theory that explains "the full pattern of what can and cannot be included in the bylaws" (McDonnel (2008)).

Despite the fact that the proper location to place a provision is ambiguous, it is nevertheless very important. Provision placement is important because charters are very difficult for shareholders to amend which means that the shareholders have little control over them (Bebchuk (1989)). In contrast, bylaws are easily amended by the shareholders. However, they are less binding than charters. Many legal scholars view them as "the rough equivalent of New Year's resolutions….easy to change whenever you need them to. Therefore, they are never a constraint on the board."[9] Thus, I propose that one factor which IPO founders consider in the design of the bylaws and charters, is whether to place a given governance provision in the bylaws or in the charter. I propose that they will place provisions in the charter which they don't want amended, and they will place provisions in the bylaws which, if amended, have minor consequences on managerial perquisite consumption.

[8] Delaware code states that the bylaws may contain any provision, not inconsistent with law, or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees. Section 109(b) of the Delaware Code.
[9] Robert Daines, *email message to the author*, May 19, 2010

2.2 The Role of Managerial Discretion in the crafting the Bylaws and Charters

IPO founders have very broad discretion in selecting and crafting the rules that will govern the firm post IPO. Until now, I have only discussed the rules contained in the bylaws and the charter. However, the firm is also bound by rules external to it, extending beyond its bylaws and charter. These include default rules defined by the firm's state of incorporation.

The IPO founder has considerable discretion over all three sources of controlling law: bylaws, charter, and state default rules. It chooses state default rules simply by selecting its state of incorporation. Furthermore, once a state of incorporation is selected, the firm may override many of the state's default rules by writing new versions of them and including the new versions in its bylaws or charter[10]. The firm chooses most of the content in its charter, which usually starts as a *de minimis* template[11]. The content placed into the bylaws is entirely discretionary. In fact, any provision placed in the bylaws may alternatively be placed in the charter (Del. Code Ann. § 102(b)(1)), alleviating the need for bylaws entirely. Likewise, the charter can remain *de minimis*, and the corporation can rely entirely on the default law of its state of incorporation. So why does a firm place provisions in its bylaws if alternatively they can be placed in the charter, and why does a firm craft over-riding rules which it places into the charter when default law can suffice? I hypothesize that placement and 'rule-crafting' are used by firms to camouflage the bylaws and charter of the IPO. I develop my support for this in section 3 of this paper.

[10] Many of the state's default rules do not apply if the firm "opts-out" by overriding them in its bylaws or charter (McDonnell (2008))

[11] The minimum required by law in most states is only that needed to identify the corporation and its key agents, e.g. 'name of the corporation', 'contact person', 'address of office', etc (Del. Code Ann. § 102(a))

2.3 Creating and Amending Bylaws: Who, What, When, Where and How

The authority to amend bylaws is important to shareholders, because without it they are effectively disenfranchised. Delaware default law permits shareholders to amend the bylaws during shareholder meetings (Del. Code Ann. § 211), by simple majority (Del. Code Ann. § 216), and by advance notice of the proposed changes to the bylaws (Del. Code Ann. § 222). The directors have no such right under default law, because by default they lose the power to amend the bylaws once the firm incorporates. However, this does not happen in practice because § 109 permits the founders to confer the power to change the bylaws upon themselves. Most firms do this. Where the directors have granted themselves authority to amend, adopt, and repeal bylaws, they or the shareholders may unilaterally change the bylaws insofar as such changes are not inconsistent with the articles of incorporation or the laws of the state of incorporation (Del. Code Ann. § 109(a)). These changes may entail any matter "relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees" (Del. Code Ann. § 109(b)).

In practice, Delaware's protection of the shareholders' franchise to adopt, amend or repeal bylaws is meaningless. This is because, when the shareholders amend a bylaw in a way that the directors do not like, the directors often quickly repeal the amendment. The shareholders must then engage an expensive contest or proxy solicitation which almost invariably fails. Thus the power to adopt, amend or repeal the bylaws is in practice vested solely in the directors, and not to the shareholders (Kahan and Rock (2007)). This leads me to my observation that bylaws are mere New Years resolutions which the board may discard whenever they become too constraining.

3 A Theory of Camouflage

Camouflage occurs when someone deliberately disguises something to make it appear different than it really is. The dictionary defines camouflage as a “behavior or artifice designed to deceive or hide”, or a “concealment by means of disguise” (Merriman-Webster (2010)). A firm can employ artifice in the design of its bylaws and charters to disguise, hide, or conceal benefit to future managers. When done skillfully, the benefit which eventually accrues to management, may in the short run, appear to accrue to the shareholder. In this section I develop my theory regarding the use of camouflage and describe the methodology I use to measure it.

3.1 Use of Camouflage in Business

Managers have long known that they can profit by concealing information from shareholders by using artifice to make a bad thing look good. This phenomenon has been documented in both the accounting literature and the finance literature. Examples of it in the accounting literature include 'earnings management', 'income smoothing', and 'creative accounting'. All of these practices have a common theme: management acts opportunistically to deceptively increase investors assessment of true firm value (Stolowy and Breton (2004)). In their theoretical study on earnings management, Degeorge et al (1999) show that earnings that fall just short of threshold are managed upwards and that “all” earnings that are far away from threshold will be reigned in. 'Income smoothing' is closely related to 'earnings management' and both are viewed as attempts by management to “fool” investors (see Brav and Gompers (1997)). Creative accounting is another form

of camouflage. Some researchers call it “the art of computing profits” (Lignon (1989)) or “the art of presenting the balance sheet” (Gounin (1991)).[12]

Similar to accounting practices, the finance literature reports that firms opportunistically use artifice to deceive shareholders, that is, they profit from the use of 'camouflage'. In the current corporate finance literature, 'camouflage' often occurs in the debate over executive remuneration. Ideally, managerial compensation is set by a board of directors to maximize shareholder value. However, the directors and management might not always operate at arm's length, and the manager might have considerable influence over their own compensation. This leads to situations where managers are paid without having to perform, i.e. maximize shareholder value (Jensen and Murphy (1990)), which can lead to shareholder outrage. However powerful managers can camouflage extraction of rents to mitigate the detrimental career consequences of shareholder outrage (Bebchuk and Fried (2004)). Managers can be compensated in other ways as well, such as in the payment of stock options. This compensation vehicle is also exploited to camouflage wealth transfers to executives (Hall and Murphy (2003)).

3.2 The Construction of Camouflage

3.2.1 Overview of the Camouflage Construct

Maggio (2001) contends that written communication is a function of words, sentences and paragraphs. She shows that the careful selection of words, the arrangement or words in sentences, and the placement of sentences in paragraphs convey meaning far

[12] In many cases camouflage is used by management to increase their remuneration. Managers accomplish this by arbitraging information asymmetries (Dye (1988), Scott (1997)). However, these practices are not necessarily illegal because actions are only illegal if they break a law. Thus fabricating false invoices is illegal (fraud), whereas interpreting consignment sales is only error (Stolowy and Breton (2004)). To be fair I must point out that in some cases other stakeholders benefit from managerial camouflage, including existing shareholders and/or the market. Existing shareholders may benefit from camouflage because they wish their holdings to be valued highly, particularly as new shareholders buy into the firm. Therefore camouflage can facilitate a wealth transfer between new shareholders to the existing shareholders because camouflage artificially inflates share value (Schipper (1989)).

beyond the literal meaning of any discrete component of that writing. Thus, she submits that there are three dimensions to any written document – words, sentences and paragraphs – and that these three dimensions can be carefully crafted and joined so as to incrementally increase the persuasiveness of the writing.

Using these three dimensions of a written document, I model the human reading process within the context of my research question. First I analyze the words of my sample documents using the tone libraries created by Loughran and McDonald (2011). I next analyze sentence construction using the Gunning Fog index (Li (2008)). Lastly I expand the work of Bebchuk et al (2005) and analyze the placement of all the provisions in my sample. I then combine these three measures into one, with the expectation that the combined three will provide incremental information over and above that provided by the individual measures taken in isolation.

My three camouflage measures map onto Maggio's writing dimensions, as well as onto the constructs used by linguists. In Figure 1 I diagram this. Specifically, in the lay perspective, tone maps to words, obfuscation maps to sentences, and placement maps to paragraphs. In the linguistic context, tone maps to semantics, obfuscation maps to syntax, and placement maps to rhetoric. I discuss this mapping in the following section.

3.2.2 Theoretical Support for the Camouflage Construct

I develop a camouflage model based on the three dimensions of a written document (see Figure 1). I find support for this model in the finance, accounting and legal literature. Researchers in the finance literature show that 'tone' can modify and condition meaning (Loughran and McDonald (2009), Tetlock et al (2008. 2007, and Demers and Vega (2010)). The accounting literature shows that 'obfuscation' can be used to make a

sentence difficult to comprehend (Li(2008), Nelson and Pritchard (2007), Schrand and Walther (2000), Flesch (1948)). Legal researchers have shown that 'placement' can be opportunistically used to position sentences and paragraphs within a writing. This positioning can weaken or strengthen the enforceability of the writing (Coates (2000), Kahan and Rock (2003)).

I propose that these three dimensions map onto writing primitives (see Figure 1). Specifically, when someone reads, he or she first reads the words. I use tone to measure meaning on the word level. When the reader encounters a sentence delimiter, he or she mentally pauses to consider how the arrangement of words in the sentence conveys meaning beyond the words themselves. My obfuscation measure analyzes sentence structure for meaning beyond the words themselves. Lastly, when a reader comes to the end of a paragraph, he or she considers how the sentences are arranged in the paragraph, and the paragraph in the writing, as an additional way in which the writer communicates information. I manually determine the placement of every provision in my sample. I do this because provision placement signals information to those who understand the difference between bylaws and charters.

I find support in the theoretical linguistics literature for mapping tone, obfuscation and placement, onto the human reading process (see Figure 1). Specifically, tone maps to semantics, obfuscation maps to syntax, and placement maps to rhetoric. Fowler (1980) describes words as the basic units of meaning supporting the *semantics* of the writing. He states that the writer should carefully choose words “that fit your purpose and express your meaning accurately and clearly”. He also states that writers should remove “words that don't make your meaning more exact.” Fowler warns about the difference between

the denotation and the connotation of words. For example, the words 'shack' and 'home' both refer to buildings in which people live, however home has the positive connotation and communicates the positive tone. Therefore, the selection of the specific words in a writing, communicates the 'tone' of the writing.

Fowler (1980) uses the term *syntax* to describe the ordering of words into sentences. Specifically, syntax describes the “relation among words and the means by which these relations are indicated”. He recommends that a good writer avoid unnecessarily wordy or complex sentences, unnecessary repetition, and empty words. He says that sentences which exhibit these shortcomings are obfuscated.

Lastly, Fowler (1980) uses the term rhetoric to describe the placement of ideas in a writing. He states that rhetoric is the “arranging ideas ... in a writing so as to achieve the writer's purpose in addressing his or her audience.” In other words, sentence order and organization is the writer's tool to “draw a reader to his or her pre-selected conclusion.”

In summary, I create a measure of camouflage which analyzes writing in a way similar to how people read. I contend that when people read, that they first read words, then they read sentences, and lastly they read paragraphs. Writers such as Maggio (2001) recognize this, but this idea has not been applied in the finance literature. My camouflage measure accomplishes this. It measures the incremental information provided by the combined constructs of words, sentences and paragraphs.

3.2.3 The Tone Component of Camouflage

The first component of camouflage is 'tone'. I use tone to measure the semantics of my sample documents. However, tone does not attempt to measure the explicit semantics

of a documents, rather it measures the latent semantics of a documents. The term latent semantics implies that there is hidden meaning in the choice of words selected by the author of the document. Hidden meaning which transcends the literal meaning of the words themselves is what I refer to as 'tone'. Mayew and Venkatachalam (2012) show that tone can “convey considerable information over and above the literal meaning” of the words themselves. Davis, Piger and Sedor (2010), Demers and Vega (2010), and Mayew and Venkatachalam (2012) find that tone is incrementally useful to the quantitative information provided by the manager.

Different types of tone have emerged in the finance literature over the last decade. For example, Loughran and McDonald (2011) measure *commitment*, Cicon, Clark, Ferris and Jayaraman (2010) measure *synergy*, Demers and Vega (2009) measure *optimism* and *certainty*, Larcker and Zakolyukina (2010) measure *deceptivity*. Brockman and Cicon (2012) provide evidence that *certainty* (and *optimism*) is inversely related to idiosyncratic volatility during the announcement period and that it is correlated with returns in a 60 day post-announcement window. Larcker and Zakolyukina (2010) find that CEOs involved in financial statement manipulation “use fewer self-references, more third person plural and more impersonal pronouns, fewer extreme negative emotions words, more extreme positive emotions words [and] fewer certainty words” during their annual conference calls.

3.2.4 The Obfuscation Component of Camouflage

3.2.4.1 Obfuscation Defined

I define obfuscation[13] as "the use of an obscure, confusing, or bewildering writing style", and/or the use of a writing style that is "evasive, unclear, or confusing" (Merriam-Webster (2010)). Much of the literature uses the Gunning Fog Index to quantify obfuscation. The fog index analyzes a segment of text by average words per sentence, and average syllables per word. It returns a value indicating the grade level required to read and understand the text. For example, an index score of 12 implies that the analyzed text was written to a high-school seniors reading level. Therefore, if an eight grader attempted to read that text, they would find it opaque and confusing.

Researchers such as Courtis (1995) use the Gunning Fog index to show that firms employ obfuscation to conceal weak firm characteristics from market scrutiny. Anderson, Duru, and Reeb (2009) develop a quantitative opacity index to gauge the relative opacity between founder-held firms and widely-dispersed-ownership firms. They provide evidence that 'disclosure related opacity' has a particularly large negative impact on firm performance especially in founder/heir controlled firms. Therefore I expect that founders taking their firms public will attempt to use opacity in bylaws and charters to "extract firm resources to their private benefit" (Andersen et al (2009)).

Nelson and Pritchard (2007) look at softer measures of opacity than do Andersen et al (2009). They analyze annual reports filed with the SEC and (1) count the number of 'cautionary' words used, (2) the number of words used in each 'risk factor', (3) how often the cautionary language is updated, and (4) the readability of the language based on the

[13] The terms Opacity, Readability and Obfuscation are used interchangeably in the literature. I also use all three words, as context best dictates. This is usually determined by the choice of word used by the authors of the paper I am discussing.

'Gunning Fog Index'. Their findings show that firms with higher litigation risk use more precise and clear language, and that this language persists even after the litigation risk diminishes.

Li (2008) also uses the Gunning Fog Index to analyze annual report readability and earnings persistence. He finds that firms with lower earnings file reports that are harder to read and that firms with higher earnings file reports that are easier to read. This finding supports his "management obfuscation hypothesis" which is that when firm performance is bad, that mangers have incentive to 'obfuscate' reports.

The Gunning Fog index is used by other researchers as well. Dempsey, Harrison, Luchtenberg and Seiler (2009) use the Gunning Fog Index to show that capital markets respond to the level of opacity in REIT annual reports. They find that "managers may opportunistically choose the linguistic characteristics of their corporate disclosures to influence investor sentiment". Lehavy, Li and Merkley (2009) use the Gunning Fog Index to examine EDGAR 10-K filings. They find that analyst following, and the informativeness of their reports, is negatively correlated to the level of obfuscation in the filing.

3.2.4.2 The Obfuscation Component of Camouflage

Consistent with Courtis (1995), Lehavy, Li and Merkley (2009) and Li (2008), I use the Gunning Fog Index as my measure of obfuscation. The index is defined below:

$$Obfuscation = \beta_1 \frac{number\ of\ words}{number\ of\ sentences} + \beta_2 \frac{number\ of\ syllables}{number\ of\ words} \tag{1}$$

where

(number of words)/(number of sentences) = calculates the average sentence length in the passage where longer sentences make for more difficult reading,
(number of syllables)/(number of words) = calculates the number of syllables per word where words with more syllables are harder to understand.
β_1 = an empirically determined Gunning coefficient
β_2 = an empirically determined Gunning coefficient

The two beta coefficients, β_1 and β_2, are empirically determined by Robert Gunning such that the index returns the grade level (obfuscation level) required to read the analyzed text[14]. Users of the Fog Index do not re-estimate the Gunning coefficients (Li (2008), Dempsey, Harrison, Luchtenberg and Seiler (2009), Lehavy, Li and Merkley (2009)) because without the proper coefficients, the index becomes biased to the 'number of words' over the 'number of sentences' ratio. This results in the index losing its power to return a balanced reading grade level. I follow the literature and retain the values of these coefficients in my study as well.

3.2.5 The Placement Component of Camouflage

"Placement is important, absolutely important"[15]. Firms do indeed have broad discretion over provision placement, because as noted previously, "the bylaws may contain any provision, not inconsistent with law, ...", and alternatively, "any provision that may be contained in the bylaws may be included in the charter". Thus the question surfaces: why do firms put some provisions in the charter while other firms put the same provisions in the bylaws?

I propose that the decision of where to place a provision, is based on two fundamental facts: (1) it is nearly impossible for shareholders to change an unfavorable charter provision because doing so requires board approval, and (2) founders can easily

[14] Their values were empirically estimated at 0.40 and 40.0, respectively. They were set such that when the Gunning index is applied to a passage of text, the reading level of that text is return. For example if the index produces a score of 12, then the passage is written to the reading level of a U.S. high school senior (12th grade).
[15] Robert Daines, *telephone conversation with author*, July 22, 2010

change bylaws, often unilaterally without shareholder consent (Kahan and Rock (2003)). Thus I hypothesize that if founders wish to embed a provision favorable to their own interests, they will bury it in the charter. On the other hand, if founders wish to parade a provision as favorable to shareholders, but which they can change at a future date, they will place it in the bylaws.

Most legal scholars agree that it is "difficult if not impossible" for shareholders to change the corporate charter (Coates (2001)). The reason that shareholders find it 'impossible' to amend the charter is statutory. Under Delaware law, the shareholders must gain board approval of any such proposal (Del. Code Ann. § 242). Furthermore, to make shareholder action even more difficult, Delaware law states that "the board of directors or governing body may abandon such proposed amendment without further action by the stockholders" (*id.*).

Bylaws, on the other hand, may be easily and unilaterally changed by the founders. The reason for this is also statutory. Delaware code states that "any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors" (Del. Code Ann. § 109). The code also provides that such action "shall not divest" the shareholders of their rights to amend the bylaws to (*id.*). Thus in theory, both the shareholders and the board have equal authority over bylaw amendments. However in practice the law favors the board, because after the shareholders amend the bylaws, the board can simply undo any such amendment without shareholder consent. The directors can act more quickly than shareholders, and with less personal cost. Thus in reality, it is the directors who have unilateral control of the bylaws, and it is a "myth" that the shareholders have any "franchise" over the board (Bebchuk (2007)).

I propose that founders and their legal agents carefully consider placement when they design their bylaws and charters. If a provision is particularly favorable to the founders interests, then camouflaging founders are more likely to place it in the charter, particularly since the courts are less willing to invalidate a firm's charter (Barzuza (2009)). If, however, a provision is favorable to investor interests but might be disadvantageous to the founders, then camouflaging founders will be more likely to put it in the bylaws. In such a situation, these same founders are able to unilaterally remove it at some future date.

3.3 Estimating Governance

I create two different, but related, camouflage indices for use in my analyses. The first is constructed at the individual provision level, while the second is constructed at the firm level. I use the provision level index in the first part of my results section to test my agency related hypotheses. I use the second index, the firm level index, later in my results section to test the explanatory power of camouflage on the performance and behavior of IPOs.

3.3.1 The Provision Level Camouflage Index

To create the provision level camouflage index, I convert the three components of camouflage into 'camouflage measures', and then sum across these measures to create a camouflage score for each provision in my sample. This conversion reflects a standardization of each camouflage component so that they can be meaningfully combined to provide an overall measure of camouflage in individual provisions. I choose an additive index because it is widely used in the literature (Aggarwal et al (2010), Bebchuk et al (2009), Gompers et al (2003)) and does not require theoretically complex

weighting schemes. The camouflage score for an individual provision is estimated as follows:

$$CP_{i,j} = T_{i,j} + O_{i,j} + P_{i,j} \tag{2}$$

where:

$CP_{i,j}$ = the camouflage score for provision i of firm j,
$T_{i,j}$ = the tone measure for provision i of firm j,
$O_{i,j}$ = the obfuscation measure for provision i of firm j,
$P_{i,j}$ = the placement measure for provision i of firm j.

Therefore, the provision level camouflage index is the sum of the tone, obfuscation and placement measures. I derive the measures by first computing the median value of each component across my sample of provisions. Where an individual provision's component scores higher than median, that provision receives a '1', otherwise the provision receives a '0'. See the footnote below for a detailed explanation[16].

3.3.2 Firm Level Camouflage Measure

The firm level index combines all the provision level camouflage measures for each of the sample firms to create a single camouflage measure. I create the firm level camouflage index by summing the camouflage scores across all the individual provisions. A firm's overall camouflage index value is thus constructed as:

[16] The first component of camouflage is tone. For those provisions, for which I can identify placement, I compute tone scores. I then standardize each score by comparing it to all the other tone scores for this provision. Where this score is above the median score (stronger tone) I assign it a 1. Where this score is below the median score (weaker tone) I assign it a 0. Where the provision does not occur in either, then no provision i score is computed for company j.

The second component of camouflage is obfuscation. For those provisions for which I can identify placement, I compute obfuscation scores. I then standardize each score by comparing it to all the other obfuscation scores for this provision. Where this score is above the median score (more obfuscated) I assign it a 1. Where this score is below the median score (less obfuscated) I assign it a 0.

The third component of camouflage is placement. For company j, I search its bylaws and charter for provision i. When provision i appears in the charter, the placement measure is assigned a '0'. When provision i appears in the bylaws, the placement measure is assigned a '1'.

$$CF_j = \frac{\sum_{i=1}^{N_j} CP_{i,j}}{N_j} \tag{3}$$

where:

CF_j = the camouflage index of firm j,
$CP_{i,j}$ = the camouflage index for provision i of firm j,
N_j = the total number of provisions found in firm-j's bylaws and charter.

4 Hypothesis Development

The amount of camouflage that a firm uses is driven by at least three factors. First among these factors is which provisions, when camouflaged more, increase the agency conflicts between management and shareholders. Second is the amount of scrutiny that the firm is under. Lastly, is the payoff that the firm receives when it camouflages successfully.

An agency conflict can arise in a provision when it is written to grant managers greater consumption of private benefits, at the expense of the shareholder. I hypothesize that camouflage is used more heavily in those provisions that managers can craft to further entrench themselves, and to secure for themselves greater private benefits.

Another factor that drives the use of camouflage is the amount of scrutiny that the firm is under. Scrutiny may come from analysts, bank monitors, and/or regulators. Scrutiny may be tied to the level of IPO activity in the industry. Scrutiny may also vary over time, with some periods experiencing more scrutiny than others. I hypothesize that a firm that is under more scrutiny will camouflage less.

The third factor that I investigate is driven by the potential payoff to the firm. I hypothesize that firms will use camouflage to 'fool' investors into paying too much for the issue. When this fools investors during the book-building process, then the offer price is inflated. When it fools the market in general, then underpricing is increased. However, not all investors are equally fooled. Institutional investors are known to profit by flipping issues which later under-perform. I hypothesize that institutional investors see through camouflage and thus know which IPOs will under-price more than others. They are willing to pay more during the book-building process because they know that larger

profits will emerge when they flip the issue on the first day of trading. In the sections that follow, I develop my hypotheses around these three factors.

4.1 Provision Type and the Use of Camouflage

I contend that camouflage will be greater in those provisions which can be crafted to increase the potential for the consumption of private benefits by the entrepreneur. Based on their general objective and orientation, I classify these common provisions into four categories. These categories are Board, Mergers and Acquisitions, Procedural, and Voting.

The first category is 'board' and includes those provisions which address the rights and privileges of the directors. Most of these provisions have been shown to be related to agency problems: board entrenchment (Bebchuk, Coehn and Ferrell (2004)), indemnification of the board from legal expenses stemming from their (mis)conduct (Black, Cheffins, and Klausner (2006)), limitations of directors liability for breaches of the duty of care (*id*), and permitting the board to consider constituencies other than the shareholder even when such considerations are detrimental to the shareholder (Bebchuk, Cohen and Ferrell (2009)). All of these cited studies indicate considerable agency issues associated with the specific provisions. Therefore I hypothesize that these provisions are more likely to be camouflaged by entrepreneurs.

The second classification of provisions is 'mergers and acquisitions' (M&A) and focuses on those that are triggered in the event of a take-over. These provisions include those which permit the board to increase the 'fair' price of a merger, trigger poison pills which can greatly increase the costs of acquisition, and/or require super-majority votes when shareholders oppose owner initiatives. Kahan and Rock (2003) show that these

provisions give boards the power to distort shareholder choice during corporate mergers and acquisitions. This distortion can be increased through the use of camouflage, thus I hypothesize that camouflage will be greater in the M&A provisions.

The third category is 'voting' and focuses on how voting rights are allocated within the firm. Bebchuk (2006) notes that the ability of the shareholder to vote, i.e. to replace members of the board, is central to corporate governance because exercise of this right enables the shareholders to protect their investment in the firm. Included in the voting provisions are those which grant shareholders secrecy in voting (confidential voting), those which permit shareholders cumulative voting rights, and those which regulate shareholders' ability to amend charters or bylaws. Because these provisions grant the shareholders considerable control over the board, and because they control complicated and nuanced issues, I hypothesize that they will tend to be more camouflaged. The camouflage will serve to make the voting provisions appear to grant the shareholder a greater franchise than they really have.

The fourth type of provision is 'procedural' and describes how governance operates within the firm. This category includes provisions which set notice requirements for nominations (advanced notice) and those which govern the calling of special meetings and or written consent. Cremers and Ferrel (2010) find that these provisions tend to control very specific and concise issues in the firm which are of great interest to shareholders. For example, the right to nominate a director is very fundamental to shareholder interests, and most shareholders would expect that right to be clearly delineated. On the other hand, a shareholder would expect nuance and detail in the procedures used to classify a board. Thus I hypothesize that procedural provisions will

be camouflaged less than board provisions. A similar argument applies to M&A and voting provisions. For example, most shareholders would expect a fair-price (M&A) provision to be detailed and lengthy, but that a (procedural) provision granting the right to written consent would be straightforward (either you have it or you don't). Thus I hypothesize that procedural provisions will be the least camouflaged of my four categories.

4.2 Scrutiny and Camouflage

An important factor in the distribution of camouflage is the level of scrutiny[17] that the IPO is under. Scrutiny affects the distribution of camouflage because it increases the likelihood that the camouflage will be discovered. The consequences of discovery include negative market reaction and subsequent stock price drop, SEC action, civil penalties and/or criminal penalties. All of these consequences reduce the benefit received by camouflage below that benefit gained by camouflage. Thus I hypothesize that when scrutiny is higher that firms will use less camouflage.

Scrutiny is "the act of examining something closely. A prolonged and intense look"[18], a "searching study, inquiry, or inspection."[19] IPOs come under scrutiny from many different entities. Regulatory scrutiny comes from state and federal governments (Loughran and Ritter (2004)). Secondary-market scrutiny comes from investors paying for their own information production (Ljungqvist and Wilhelm (2003)). Political scrutiny is common, particularly following industry disasters, or economic downturns (Hall

[17] An alternative factor may be coaching. Law firms are known to coach entrepreneurs. Thus, cross-sectional differences may be due to the law firm chosen by the entrepreneur. Coaching is out of the scope of this paper, but I control for it with dummies for law firms.

[18] Scrutiny. (2010). Princeton Online Dictionary. Retrieved August 2, 2010, from http://wordnetweb.princeton.edu/perl/webwn?s=scrutiny

[19] scrutiny. (2010). In *Merriam-Webster Online Dictionary*. Retrieved August 2, 2010, from http://www.merriam-webster.com/dictionary/scrutiny

(1993)). Judicial scrutiny determines how closely a court of law will examine the issues in a case (Kahan and Rock (2003)). Scrutiny can come from banks and creditors who require disclosure for the firm to issue debt (Jensen and Smith (1985)). Scrutiny can come from analysts, underwriters and venture capitalists.

Regardless of the origin of scrutiny, it has the effect of making it difficult for the IPO to camouflage unfavorable bylaw and charter provisions. Thus I hypothesize that where scrutiny is low, more camouflage is used, and alternatively where scrutiny is high, less camouflage is employed.

4.2.1 Camouflage and Industry Scrutiny

I hypothesize that the use of camouflage is not homogeneous across industry groupings. In industries where there are higher levels of federal and state scrutiny I expect decreased use of camouflage. Examples of such industries include the financial services industry, the health care industry and industries in which more firms compete (Brau et al (2003)). For firms in these industries, it will be more difficult to successfully use camouflage because greater governmental oversight and reporting requirements will expose camouflage more quickly than in other industries.

In contrast to highly regulated industries, I hypothesize that hi-tech industries, internet industries, and emerging industries use more camouflage. Stoughton et al (2001) finds that product quality is uncertain in these industries and that investors lack information as to the industry's competitive dynamics. These factors also make it more difficult for regulators to assess and evaluate corporate disclosures in these industries. All of these factors contribute to an opaque information environment which the entrepreneur can fill with camouflaged information.

4.2.2 Camouflage and Industry Leverage

I hypothesize that firms in highly leveraged industries will use less camouflage. This is because these firms are subject to the ongoing scrutiny of banks and other lenders (Harris and Raviv (1990, 1991)). Thus, the monitoring of creditors will provide scrutiny for these industries. Such monitoring will tend to defeat managerial efforts to camouflage their firms' governance structure.

4.2.3 IPOs Camouflage Less in Periods of Low IPO Activity

IPOs often occur in clusters within industries. If a new "pioneer firm" goes public after a lull in IPOs, then the industry often experiences a subsequent wave of other private firms going public as well. This is IPO clustering. When a pioneer firm enters the market, the information environment is stale. Thus, the pioneer firm must provide information to the market about industry prospects and investment opportunities, information which the market does not demand from subsequent IPOs (Benninga et al (2005)). Factors which reduce information demand include information spillover, analyst fatigue and overly optimistic investors (Baker and Wurgler (2004), Loughran and Ritter (2000)). Therefore later IPOs are under less scrutiny. This leads to my hypothesis that firms IPOing within a cluster are more likely to camouflage their charters and bylaws than firms IPOing leading the wave.

4.2.4 Time Series Patterns in the Use of Camouflage

The next set of hypotheses test the distribution of camouflage over time. Comparable to my cross sectional hypotheses, here I again propose that scrutiny is critical. Specifically I propose, that in time periods of lower scrutiny, that camouflage

will be used more, and that in time periods of greater scrutiny, camouflage occurs less often.

4.2.4.1 Decreasing Scrutiny in the 1980s and 1990s

The 1980s and 1990s are decades marked by progressive deregulation and a gradual reduction in governmental oversight. During this period, deregulation spread across all industries including the airline, energy, and telecommunications industries. The financial industry also experienced deregulation including the *Depository Institutions Deregulation and Monetary Control Act* (1980), the *Garn-St. Germain Depository Institutions Act* (1982), the *Financial Institutions Reform and Recovery Act* (1989), *Riegle-Neal Interstate Banking and Branching Efficiency Act* (1994), the *Gramm-Leach-Bliley Act* (1999) which repealed the Glass-Steagall Act, and the *Commodity Futures Modernization Act* (2000) which prevented regulation of, among other things, credit default swaps. This new era of lowered scrutiny set the stage for risky behavior by all market participants.

The deregulated market conditions of the late 1990s increased competition in the market for new issues. This caused a realignment of venture capitalists' objectives which led them to exit the new IPO firm more quickly (Loughran and Ritter (2004)) than they had prior to 1990. The underwriter's objective function also encourages a short term business model because they reward venture capitalists, who give them business, by subsequently granting them shares in other IPOs (Loughran and Ritter (2004)). This practice, known as spinning, further exacerbates venture capitalist short-termism and hence the subsequent increase in camouflage.

4.2.4.2 Camouflage Occurs Less in Time Periods of Greater Scrutiny

I hypothesize that camouflage is used less in the earlier part of my sample because scrutiny was greater in the early 1980s and gradually decreased throughout the mid 1980s and early 1990s. However, scrutiny can come from other sources, not just the government. In the 1980s additional scrutiny came from the investment bankers themselves. Prior to the 1990s, investment banks retained ownership in IPOs for long periods after issue. They took concentrated equity positions and continued to serve on the boards of the young firms. Barry et al (1990) state that, in effect, they served the role of 'diligent monitor' for these new firms.

I additionally hypothesize that the use of camouflage decreases after the dot-com crash of 2000. This was primarily driven by the introduction of regulation such as SOX and Plain English requirements. The SEC Plain English Disclosure Rules require the use of short sentences, concrete everyday language, tabular presentation of complex material, reduced legal and technical jargon, etc. The plain English rules became effective late 1998. However, there were many prospectuses and company filings that were written prior to 1998 that remained in effect afterwards. Thus I expect the impact of the plain English rule to grow slowly over time. SOX became effective in 2002, which covers the last part of my sample. Thus I hypothesize that the delayed effect of the plain English rules, and the passage of SOX, reduce the use of camouflage for the last half of my sample period.

4.3 IPO Activity and Camouflage

I hypothesize that camouflage can be used to increase offer proceeds and to decrease underpricing, to implement profitable flipping strategies, and to explain long

term under-performance[20]. When camouflage is used to increase offer proceeds and/or decrease underpricing, then camouflage decreases the risk premium paid to investors purchasing the IPO's equity. This premium is the difference between a low offer price and a high market price. Many investors expect this profit on the first trading day as compensation for buying the security in the face of asymmetric information (Baron (1982), Rock (1986)). Camouflage wrongfully reduces this compensation by decreasing the difference between offer price and market price.

Camouflage can also be used to implement profitable flipping strategies and to explain under performance. Flipping occurs when institutions offload IPOs which eventually under perform those that they retain. Thus institutions who understand camouflage can arbitrage this information to transfer wealth from the market to themselves. Lastly, I hypothesize that in the long run, camouflaged IPOs under perform those that are not. Thus, investors who buy into the IPO early, gradually see their wealth depleted as incremental market corrections reduce the value of their investment.

4.3.1 Camouflage's Effect on Offer Proceeds and Underpricing

Year after year, underpricing leaves billions of dollars on the table (Ljungqvist (2004), Ibbotson (1975), Logue (1973))[21]. These billions do not escape the attention of founders who wish to capture them in the form of offer proceeds. I propose that some

[20] The first two, offer proceeds and underpricing are closely related, however they are clearly distinguishable. Offer proceeds are determined by the offer price which is set prior to IPO by the underwriter during the book-building process. Provided that the new issue is not undersubscribed, offer-proceeds are not a surprise on opening day. Thus, offer proceeds is an ex ante quantity determined by the underwriter. Underpricing is different because it is an ex post value determined by the market after trading commences. During this period, investors who bought in during the road show have the opportunity to sell their allocations. Investors who have prescient knowledge that the offer will underprice and/or underperform may arbitrage their allocation at this time. This is called flipping. Institutional investors are particularly adept at flipping and are known to use the practice profitably. 'Long run under-performance' occurs when an IPO under-performs similar firms in its industry. Under the efficient market hypothesis this should not occur because the IPO should have been priced correctly and should subsequently perform as other similar firms in the industry.

[21] Most IPOs underprice between 12% and 40%. IPOs regularly exceed this amount. For example, in 1999 'TheGlobe.com' offered its equity at $9. It shot up to $97 and ended the day trading at $63.

founders use camouflage to claim a larger portion than is otherwise justified. To explain how this occurs, I borrow two theories from the underpricing literature: agency conflict and informational cascades (behavioral).

4.3.1.1 Agency Conflicts

Ritter (2004) argues that underpricing rewards investors for buying IPO new issue in the face of asymmetrical information. Thus the difference between the offer and market price represents compensation to the investor for buying equity in the face of this asymmetry. On the other hand, the entrepreneur knows that the higher the offer price, the higher the offer proceeds[22]. Thus, some entrepreneurs attempt to wrongfully increase the offer price, so as to increase offer proceeds.

When camouflage is used to deceptively inflate offer price, then wealth is wrongfully transferred from the shareholder to the entrepreneur. Jensen and Smith (1985) would call this an agency problem. Easterbrook and Fischel (1991) might disagree. They argue that agency problems should not exist at the IPO stage because such problems reduce the price that the market will pay for the issue. However, many recent scholars such as Field and Karpoff (2002) side with Jensen and find that agency conflicts do indeed exist "even at the IPO stage". Many agency-based explanations for underpricing appear in the literature (Baron (1982), Muscarella and Vetsuypens (1989), Brennan and Franks (1997), Stoughton and Zechner (1998), Habib and Ljungqvist (2001), Ritter and Welch (2002)). The common thread in these explanations is that agency issues arise when (1) founders wish to maximize private benefits, (2) founders use some mechanism to achieve this, and (3) shareholder wealth is wrongfully depleted.

[22] Obviously, if the price is too high, not all of the issue will sell and thus offer proceeds will be less than expected. Thus managers seek a price which does not decrease demand below an optimal profit level.

An example of this is the agency issues which arise when founders wish to maximize the private benefits associated with entrenchment (Daines and Klausner (2001)). Founders can use camouflage as the mechanism to maximize these benefits. As an illustration, suppose an IPO's bylaws/charter contains two provisions, one that favors the shareholders and one that favors the founders. However, they place the shareholder-friendly provision in the bylaws, and the founder-friendly provision in the charter. The result is a bylaw/charter structure which is camouflaged to appear balanced, but in practice is more favorable to the founders. Thus the security sells at a higher price because the camouflage makes it appear more shareholder friendly that it really is. This results in a wrongful wealth transfer from the principals (investors) to the agents (founders) because camouflage increases offer proceeds which benefit the founders. Thus, I hypothesize that agency conflicts will cause some IPOs to camouflage their bylaws and charter, to permit managers to more fully enjoy their private benefits.

4.3.1.2 Behavioral Explanations

Informational cascades occur when people make decisions based on their observations of the decisions made by others, even if they have information that would suggest an alternative decision. In financial markets, informational cascades often materialize when investors make their buying decisions sequentially (Ritter and Welch (2002), Welch (1992)). When this occurs, the buying decisions of later investors are conditioned on the buying decisions of earlier investors, even if the later investors have information that the earlier investors lacked. In the case of IPOs, this can lead to the common situation where later investors only buy IPO shares which are 'hot' (Ritter and Welch (2002)). Amihud, Hauser, and Kirsh (2001) find that, because later investors rely

on the buying activity of earlier investors, IPOs have been found to be either under-subscribed or hugely over-subscribed, with very few IPO offerings lying between these two extremes.

Firms can use camouflage to condition the buying decisions made by investors in the informational cascades cycle. I propose that this happens through the following sequence of events. First, the founder chooses to go public and works with an underwriter to build demand and to determine share price. At this point the bylaws and charter are not yet complete. Second, the initial price is set through the book-building process. Third the bylaws and charters are finalized. Fourth the IPO goes public. And finally, fifth, subsequent investors come on board and make buying decisions conditioned on those of the earlier investors, even where the later investors have unfavorable information about the IPO (Ljungqvist (2004) such as the apparent use of camouflage in the bylaws and charter.

The first step occurs when the founder chooses to go public with the desire to maximize offer proceeds. The founder knows that later investors will cascade on the decisions of earlier investors so the founder intentionally delays finalization of the bylaws and charters. The earlier investors make their pricing decisions based on draft bylaws/charter which portray the IPO's governance in a better light than it will be at issue.

The second step occurs when the underwriter sets the issue price via the book-building process. This price includes information in the bylaws/charters as they exist at that time. The founders do not use camouflage at that time because they risk discovery due to the heightened scrutiny of the informed investors involved in bookbuilding.

Instead they delay using camouflage to a later time when it is less likely to be discovered by the cascading investors.

The third step occurs as the bylaws/charter are finalized. The founder will use camouflage at this point to make it look as if the finalized bylaws/charter are comparable to the preliminary ones. For example, the founder may move a shareholder-friendly provision from the charter and place it into the bylaws. Furthermore, at this late stage the cascading investor is likely to "disregard their own information", even where that information is negative, and follow the lead of the earlier investors (Ljungqvist (2004)). Thus the camouflage is more likely to succeed.

The fourth step and fifth step occurs as the IPO issues and later investors buy in. However, this buy-in is conditioned on the decisions of the earlier investors who price the IPO based on the un-camouflaged bylaws/charter. The finalized (and camouflaged) charters are less likely to be a factor in the buying decisions of the later investors.

4.3.2 Institutional Flipping

Flipping is defined as the immediate resale of IPO shares to the secondary market. Aggarwal (2002) and Fishe (2002) show that institutions are able to execute profitable flipping strategies. I propose that these institutions use a flipping strategy which identifies those IPOs which will eventually underperform and quickly offloads them, such as IPOs that have carefully hidden unfavorable provisions in their bylaws/charters.

Camouflaging unfavorable provisions in bylaws/charters often succeeds because, in general, the "market has difficulties disentangling carefully hidden warning signals" (Ritter and Welch (2002)). Thus company founders are often able to "fool" individual

investors with camouflage (Brav and Gompers (1997)). However, institutional investors are not so easily tricked and they "appear to possess and use superior information [because] they flip issues that subsequently underperform the market" (Krigma, Shaw and Womack (2002)). This uncanny ability can only mean that somehow "institutions succeed in identifying IPOs that are being overvalued when trading commences" (Ritter and Welch (2002)).

Overvalued IPOs, in the context of this paper, are IPOs with heavily camouflaged bylaws and charters. Founders accomplish this by writing bylaws and charters in such a way that they appear to favor shareholder interests when in fact they do not. In practice these bylaws and charters secure managerial perquisite consumption and/or fortify managerial entrenchment. If such bylaws/charters are not camouflaged, the market discounts the firm. However, because they are camouflaged, the discount is not applied and the issue price is artificially high. Thus I contend that camouflaged firms are over-valued and hence flipped by institutional investor.

I contend that institutions are better able to identify overvalued IPOs because they are more likely to see through camouflaged bylaws and charters. Furthermore, institutional investors know that in the long-run, the market will reduce the price of the camouflaged IPOs, and that those IPOs will subsequently perform worse than non-camouflaged IPOs. Therefore they unload (flip) the camouflaged IPO issue immediately, well before the IPO begins underperforming comparable firms in the industry.

Thus I hypothesize that institutions will flip IPOs that exhibit greater camouflage and retain those which exhibit less camouflage. Later, I expect that the flipped and camouflaged IPOs will underperform the retained, and less camouflaged IPOs.

4.3.3 Camouflage and Long-run Performance

I hypothesize that IPOs which employ more camouflage will subsequently exhibit lower long-run performance. This happens because camouflage initially inflates the value of the corporate governance of the firm. Subsequently investors pay too much for the firm. Eventually the true value of the camouflaged firm becomes apparent, and the market adjusts the firm's price downwards. This camouflage related downward adjustment incrementally explains the under-performance of the IPO.

The bylaws and charter of a firm affect firm value. Bebchuk and Cohen (2005) provide evidence that the bylaws and charters of an organization can be designed to increase or decrease firm value. Specifically they find that the provisions which entrench the board reduce firm value. Other researchers also provide evidence of the impact that bylaws and charters have on firm value. Faleye (2004) provides evidence which supports the findings of Bebchuk and Cohen (2005). Comment and Schwert (1995) show how poison pills impact firm performance. Garvey and Hanka (1999) look at the impact that antitakover provisions in general have on firm value. This research stream provides strong evidence that corporate governance impacts firm value, and more specifically, that the mechanism of bylaws and charters impact firm value.

This discussion leads to my hypothesis that those firms which camouflage more ultimately suffer a negative valuation due to the eventual exposure of the camouflage. This occurs because governance is valued in the market. Thus, I hypothesize that, because the market values governance, that the revelation of poor governance (when camouflage is revealed) will result in an adverse price movement.

5 Data, Summary Statistics, and Document Parsing

5.1 Data Sample

I create my sample using data from the SDC Platinum, SEC EDGAR, and the RiskMetrics databases. I access market data, trading data, and firm fundamentals from CRSP, CompuStat and TAQ. I begin by downloading SDC data for all IPOs between the years 1995 to 2005 which yields a sample of 4,448 firms. SDC does not archive bylaw/charter information, but EDGAR does. Thus, I crosscheck each firm to verify that it has filings on EDGAR. If I cannot find EDGAR filings for the firm, I drop it because I have no other way of retrieving its bylaws. I further filter using the criteria specified by Ritter (2008):

- Have an offer price in excess of $5
- Are listed on NYSE, AMEX, or the NASDAQ exchanges
- Exclude firms which are ADRs, Unit Offerings, Closed-end Funds, REITs, Partnerships, Banks or S&Ls

At this point the sample size is 2,838. I further limit my sample to only those IPOs found on RiskMetrics. This is important because I use RiskMetrics to guide my manual search/reading of corporate bylaws and charters. RiskMetrics annually flags which provisions occur in an IPO, by year. These flags guide my search of the IPO's bylaws and charter. This procedure results in a final sample of 435 IPOs.

Table 1 provides descriptive statistics of the sample. Panel A shows the distribution of the sample by issue year. The largest number of IPOs occur in 1996, at a count of 85. The smallest number occur in 2004, at a count of 1. The years 2003, 2004, 2005 experience a precipitous decline in IPO filings, which is consistent with previous

empirical findings (Gao, Ritter and Zhu (2011)). These authors explain this decline in the context of economies of scope. That is, in the modern economy, firms find it more profitable to sell themselves to an existing firm, rather than to issue equity via the IPO process. Panel B shows the distribution of my sample by industry[23]. The largest industry is Business Equipment (152 IPOs) and the smallest are Consumer Durables (3) and Utilities (2).

5.2 Annual Distribution of Camouflage

Table 2 shows the time-series usage of camouflage over the sample period[24]. The trend statistic in the last row shows how the level of camouflage has changed over time. I estimate this trend statistic by evaluating the following regression:

$$LHS = \alpha + \beta * Year + \epsilon \tag{4}$$

where *LHS* is the year's mean level of camouflage, and *Year* is the observation year of the sample. The coefficient β of the regression is the trend statistic. For example, the leftmost β in Panel A shows that for each 1 year increase of time in my sample, that the mean use of aggregate camouflage increased by 0.037 units. I do not include years 2003, 2004 or 2005 in my regression because the sample size in those years is too small to compute meaningful statistics[25].

Panel A shows a significant upward trend in the use of aggregate camouflage. In 1995, the mean use of camouflage was 1.417. Camouflage then increased on average 0.037 units per year until in 2002 its mean level was 1.703 units. The statistical

[23] I base this table on the Fama French twelve industry classifications available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/ftp/Industry_Definitions.zip.

[24] Panel A shows aggregate camouflage, Panel B tone camouflage, Panel C, obfuscation camouflage, and Panel D shows placement camouflage.

[25] For example, the sample size in 2004 is one observation. It is not meaningful to interpret a mean, median, maximum, minimum or standard deviation for one observation.

significance of this trend in the increase of aggregate camouflage is better than 1%. The median use of camouflage, and the minimum use of camouflage also increased over the sample period, with a trend of 0.036 and 0.166 respectively. Both of these trends are statistically significant. Lastly, there is also a significant decrease in the standard deviation of the use of camouflage, of -0.027 per year. This means that over time that firms are becoming more consistent in their use of aggregate camouflage.

The components of camouflage are analyzed in Panels B, C and D. Panel B provides evidence supporting the findings in Panel A. Specifically, the use of the tone component of camouflage increased by 0.014 units per year from 1995 to 2002. The standard deviation in the use of tone camouflage shows a negative slope of -0014. This means that over time that firms are becoming alike in their use of tone camouflage. Panel C shows no significant increase in the use of obfuscation, but it does show a decrease in the standard deviation of the use of obfuscation camouflage, similar to the other panels. Panel D shows that the mean use of placement camouflage is increasing over time by 0.017 units per year, with a change in standard deviation similar to the other three panels.

Overall, Table 2 provides broad evidence that firms are increasing their use of camouflage over time. In the aggregate, the use camouflage increases over the sample period. Of the three components of camouflage, tone shows the strongest increase, closely tracking aggregate camouflage. Obfuscation camouflage shows no overall change, but the standard deviation in the use of camouflage is similar to the other three panels. This means firms are becoming more similar in the how they use aggregate camouflage, and the components of camouflage.

5.3 Camouflage and Endongeneity

In this section I discuss the causal relationships between camouflage and those variables used to explain it, as well as those variables explained by it. I argue that endongeneity does not bias the results of my tests. The primary reason for this is that the relevant explanatory variables are predetermined prior to measurement of the explained variable.

In the first part of this paper, I test various determinants of camouflage, all of which are determined prior to the creation of camouflage (see Figure 2). In Table 13, I test Herfindahl Index and Industry Analyst Followings. Both of these occur at the industry level and are predetermined by factors exogenous to the firm. In Table 18, I test Days to Last IPO and Antecedent Offer Proceeds. The current IPO cannot possible influence the offer proceeds, or date of IPO, of IPOs that occurred up to a year prior to its IPO, thus these factors are also predetermined relative to camouflage. In Table 22, I test SEC activity levels. Specifically, I look for levels of enforcement that are greater/lesser than in prior years. The new level of activity is public knowledge months or years prior to the firms IPO, thus the activity levels are predetermined relative to the current IPO. In Table 10, I test agency conflict. Agency conflicts emerge early in the IPO, not later. It is these agency conflicts that result in camouflage being created. Thus agency-conflicts are determined prior to camouflage creation. Lastly, I test debt in Table 18. I measure debt prior to camouflage creation, not after it. Thus, this factor must also be predetermined prior to camouflage.

In the latter part of this paper I test camouflages impact on various IPO pricing and performance phenomena (see Figure 2). This includes underpricing (Table 24), offer

proceeds (Table 25), flipping (Table 27) and longrun performance (Table 28). In all cases these phenomena occur after IPO, and in all cases camouflage is created prior to IPO. Thus camouflage in these cases is predetermined with regards to the tested phenomena.

In summary, in this section I argue that endongeneity does not bias my tests of the relationships between camouflage and various IPO variables. In the first part of my paper, endongeneity does not exist because the variables are determined prior to, or exogenously to, the creation of camouflage. In the latter part of my paper, camouflage is clearly predetermined relative to the explained variables. Thus I maintain that endongeneity does not bias the results of these tests.

5.4 Common Variables Used Throughout the Empirical Section

I use a certain set of variables throughout many of the univariate and multivariate analyses in this paper. Thus I define them here and I tabulate their summary statistics. They are listed in Table 3. 'IPO Proceeds' is the gross proceeds of the IPO (total shares offered * offer price) measured in millions of dollars (Habib and Ljungqvist (1998)). 'Pre-offer Price Change' is the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price (Hanley (1993)). 'Number of Amendments' is the number of times the S1 document was amended (Ange and Brau (2003)). 'Secondary Shares Offered' is the percent of secondary shares in the IPO (Leland and Pyle (1977)). 'Underwriter Prestige' is the lead underwriter rank for the year prior to IPO (Carter and Manaster (1990))[26]. 'Venture Capital Backing Dummy' is a binary variable indicating the presence of venture capital backing prior to the IPO (Brav and Gompers (1997)). 'Auditor Prestige' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm (Michaely and Shaw (1995)). 'Average Prior Three Month Underpricing' is the average percent of underpricing (Ljungqvist (2007))[27]. 'Three-week Prior Market Return' is the percent return on the market (value weighed NYSE/AMEX/NASDAQ) three weeks (15 trading days) prior to IPO (Loughran and Ritter (2002)). 'First-day Return Mispricing', is the percent change in price from the IPO price to the closing price on the first day of trading.

Table 3 reports that the average IPO experience 33.5% underpricing. The statistics on my four offering characteristic variables show that my sample firms float an

[26] data from Jay Ritter http://bear.warrington.ufl.edu/ritter/ipodata.htm
[27] data from Jay Ritter http://bear.warrington.ufl.edu/ritter/ipodata.htm

average $177.4 million offering, adjust the pre-offer price range up 9%, have 3.5 amendments prior to issue and sell 13.8% of the issue as secondary shares. The three third-party certification variables show an average underwriter prestige of 4.55 (on a range of 0 to 9), 42.53 with venture capital backing, and 84.37% with a prestigious auditor[28]. The final set of variables, market conditions, show that the prior three-month average underpricing was nearly 30% and that the three-week prior market return average was 1.08%.

5.5 Document Parsing

I obtain my sample of charters and bylaws from the exhibit 3 filings in EDGAR. There are a total of 7,614 filings with an average document length of 22 pages. RiskMetrics lists 31 possible provisions in each filing. To perform my analysis, I need to locate every possible provision in each document. I then copy them to a database for subsequent textual analysis.

To make the parsing process manageable, I create several software tools to manage the textual files, to locate the provisions in them, and to extract the provisions. I create a database manager which groups all the filings by ticker symbol and sorts them by date. I begin by selecting a file and then popping it open. I read enough of the filing to identify and mark it as a Bylaw, a Charter or an 'Other' document. I then compare the document date of the filing and the issue-date of the IPO to select the Bylaw and Charter that occur closest in time before the issue-date. For example, Agilent Technologies issued on 1999-11-17. EDGAR lists six Exhibit 3 filings for Agilent. Two of them occurred prior to IPO issue-date, on 1999-08-16. I popped these files open and identified them as being a

[28] Big Six for the period (1995-1998), Big Five for the period (1998-2001), Big Four for the period (2002-2005)

'Charter' and as being a 'Bylaws'. I identified the remaining files but do not use them as part of this study.

I create a provision-parser tool to parse provisions out of each of the filings that I identified earlier. For Agilent, these are the two filings that appeared on 1999-08-16. The provision parser is opened once for each of these two filings. The provision summary panel of the provision-parser links the filing to the RiskMetrics database and informs me which provisions are listed on RiskMetrics (highlighted in green) for this IPO. Knowing which provision I must find makes parsing the files much easier. I can pop up the actual filing in a customized editor. The customized editor is passed a list of keywords for each provision type in the top panel. It highlights these words in each filing and permits me to quickly jump to word groups that are likely candidates for the types of provision highlighted in green in the top panel.

To facilitate locating and extraction of provisions, I develop keywords specific to each provision type. Examples of these keywords appear in Table 4. I generated this list by reading a subset of bylaws and charters. I observed that, for a given provision, specific sets of words and phrases emerged which were commonly associated with that provision. For example, the words and phrases that were used in provisions defining classified boards were “board three; director classified class office; number election term; classes of directors; class I class II class II”. The words and phrases that used in provision defining advance notice requirements were “nominations business properly brought annual; properly submit business stockholder; stockholder notice delivered; timely notice”. I then used these words and phrases to quickly locate the associated provision in my sample of bylaws and charters.

6 Empirical Results

6.1 Use of Camouflage Across Charter Provisions

In this section I analyze the distribution of camouflage across provision categories and types. I submit that the use of camouflage will vary across provisions because some provisions permit greater agency conflict, and when designed to do so, they will be camouflaged so as to mask that agency conflict. Thus, I hypothesize that the use of camouflage is more extensive in provisions that emphasize board duties, owner's authority over mergers and acquisitions, and voting rights because they provide managers with a greater ability to consume private benefits of control. I further hypothesize that camouflage is less common among procedural provisions because they offer managers less opportunity to expropriate wealth or consume private benefits[29].

6.1.1 The Relationship between Provision Category and Camouflage

To begin my empirical analysis, I must first categorize the provisions found in the bylaws and charters of my sample of IPOs. There are 16 distinct provision types in my sample. I group these provisions into the four categories defined in section 4.1 of this paper. I determine to which category a provision belongs by reading its definition[30]. The results of this categorization appear in Table 5. Panel A (Board Provisions) lists the four provision types which have most to do with board structure, board duties and responsibilities, and board rights and privileges. Panel B (Mergers and Acquisitions) contains the three provisions types which come into play during mergers and acquisitions. Panel C (Procedural Provisions) lists procedures governing director nomination, implementation of poison pills, requirements to call special meetings, and

[29] See section 4.1 Provision Type and the Use of Camouflage
[30] The source of the definition is RiskMetrics, unless otherwise indicated in the text of the definition

procedures to act by written consent. Panel D (Voting Provisions) list provisions concerning the voting rights and powers of the shareholders.

In Panel A of Table 6, I provide an overview of the use of camouflage across the various provisions. In the aggregate-camouflage column of Panel A, I report that the means for the board (1.866), the M&A (1.969) and the voting (1.656) provisions are higher than those for the procedural (1.269) provision. This finding is consistent with my hypothesis that the use of aggregate camouflage is greater in provisions which provide managers with greater opportunities to consume private benefits.

In the three rightmost columns of Panel A, I report scores for the components of camouflage. These scores are somewhat less consistent with my hypothesis. In the tone column I report that the mean use of camouflage is less among M&A provision (.383) than among procedural provisions (.420). My hypothesis predicts the opposite result. I show later, however, that this difference is not statistically significant. On the other hand, the differences in the use of camouflage between voting and procedural (.813 vs .420) and board and procedural (.720 and .420) are as hypothesized.

For the obfuscation component, the greatest amount of camouflage is used by the M&A provisions (.609). Surprisingly obfuscation camouflage is widely used within the procedural provisions (.501). Camouflage is used least in the voting (.325) and board (.392) provisions.

In the final column, placement, I find additional support for my hypothesis. Placement camouflage is distributed very similarly to aggregate camouflage with M&A strongest at 0.977, board second strongest at 0.746, the voting score is 0.519 and procedural is the weakest at 0.348. In the aggregate, Panel A provides evidence that

agency considerations influence the use of camouflage across provisions. That is, I find, in general, that camouflage is used more extensively among those provisions which offer the greatest potential for self-dealing or private benefits to managers. Next, in panels B through E, I analyze a series of pairwise differences between provision categories.

In Panel B, I examine the pairwise differences in the use of aggregate camouflage across provision categories. The values in this panel, as is true for all subsequent panels in this table, report t-statistics constructed as the difference of means between a row variable and a corresponding column variable. I observe that the use of aggregate camouflage occurs significantly more among those three provisions which provide entrepreneurs with the greatest potential for consumption of private benefits of control (board, M&A, and voting) and least in procedural provisions which, as noted earlier, provide the least opportunity for managers to expropriate shareholder wealth. Specifically, Panel B reports that the three provision categories 'board', 'M&A', and 'voting' are all statistically greater than that of the procedural classification (10.694 (<1%), 15.644 (<1%), and 5.041 (<1%), respectively).

In Panel C, I examine the pairwise differences in the use of tone camouflage across the different provision categories. I find evidence which corroborates the findings in Panel B. The significance of the difference in means between board and procedural, and voting and procedural are very strong and positive, with t-statistics of 9.85 and 11.07, respectively. This corroborates the aggregate camouflage findings in Panel B. The t-statistic between M&A and procedural is insignificant.

In Panel D, I examine the pairwise differences in the use of obfuscation across the four provision categories. Panel D reports that the obfuscation component of camouflage

is significantly less in board vs procedural (-3.255) and voting vs. procedural (-4.288). Nevertheless, the t-statistic for the difference of means between M&A and procedural is positive and significant at 3.899. This is consistent with my hypothesis that agency issues impact the decision to camouflage.

Lastly, in Panel E, I examine the placement component of camouflage and the extent of its use across provision categories. The t-statistics for 'board-procedural' is 13.014. The t-statistic for 'M&A-procedural' is even larger with a value of 34.948. The t-statistic for 'voting-procedural' is also significant at 3.974. These results corroborate the those of Panels B and D.

Taken together, the five panels in Table 6 support my hypothesis that camouflage is used more heavily in those provisions that provide managers with greater opportunity to enjoy private benefits of control (M&A, board and voting), and less heavily in those that do not (procedural). I provide evidence that M&A and board provisions are significantly more camouflaged than procedural provisions. I show that voting provisions also use more camouflage, but less significantly than M&A or board. In spite of the importance of voting provisions for managerial control, entrepreneurs might use less camouflage in these provisions to avoid the shareholder outrage likely to occur if the entrepreneur was discovered degrading the shareholder voting franchise. If shareholders uncovered such egregious attempts, subsequent reprisal would out likely exceed any benefit gained by the camouflage.

6.1.2 The Relationship between Provision Type and Camouflage

In this section I analyze the relationship between camouflage and the individual provisions. This section is similar to the previous section, with the difference that in the

previous section I examined the relationship between camouflage and provision *categories*. In this section I discard the categorical groupings and drop down to the level of the individual provision. Thus, in this section my analysis is of a finer granularity. I report the results of this analysis in Table 7.

In Panel A I sort provisions in descending use of aggregate camouflage. I compute the F-statistic for the difference of means in each camouflage column. Panel A shows that the procedural provisions use less aggregate camouflage (LSPMT (0.85), LWCSNT (1.80), and ADVNR (1.16)). These provisions are all in the bottom third of the list. Alternatively, all of the M&A provisions are in the upper half of the sorted list (BLANKCHECK (1.94), FAIRPRICE (2.45), PPILL (1.96) and SUPERMAJOR (2.41)).

In Panel B I sort provisions in descending order by tone camouflage. The tone scores of the M&A provisions (BLANKCHECK (.36), FAIRPRICE (.64), PPILL (.38), SUPERMAJOR (.82)) are generally higher than those of procedural (LSPMT (.23), LWCSNT (.67), and ADVNR (.36)). The voting provisions are also generally higher than procedural with SECRETBALLOT, CONFVOTE and CUMVOTE all being higher than ADVNR or LSPMT. The remaining two voting provisions LACHTR and LABYLW are higher than the procedural provisions LWCSNT.

In Panel C I sort provisions in descending order by obfuscation camouflage. M&A provisions score generally higher (BLANKCHECK (.59), FAIRPRICE (1.00), PPILL (.61), and SUPERMAJOR (.71)) than the procedural scores (LSPMT (.22), LWCSNT (.43), and ADVNR (.77)). Two of the four board provisions are higher than any procedural provision, and the remaining two board provisions are higher than at least one

other procedural provision. The voting provisions tend to have less tone camouflage than the procedural provisions, which was observed in Table 7.

In Panel D I sort provisions by the use of placement camouflage. The placement scores show very high segregation with all the M&A scores (BLANKCHECK (.99), FAIRPRICE (.82), PPILL (.97), SUPERMAJOR (.88)) being higher than any procedural scores (LSPMT (.39), LWCSNT (.70), and ADVNR (.03)). Board is strong. The scores of two board provisions (DUTIESNF and CBOARD) are higher than any procedural score. The remaining board provisions are each higher than at least one other procedural provision. Every voting provision is higher than at least one other procedural provision.

I close this section by summarizing its findings. I provide evidence that camouflage is distributed across provision categories and types in an informative manner. Camouflage is most common in those provision categories in which agency conflicts are greatest (board, M&A, and voting). Likewise it is least in that category in which agency is least of an issue: procedural. Camouflage is somewhat weaker in voting provisions, but it is still significantly greater than in procedural. This may be due to the greater attention that shareholders pay to voting provisions and the desire of the entrepreneur to avoid investor backlash on this issue.

6.1.3 The Relationship Between the Agency Index Score and Camouflage

In this section I further refine my testing of the relationship between camouflage and agency conflicts. In a previous section I grouped provisions into categories, however, in this section I create an agency-conflict index and use it to assign each provision an agency conflict score. I then use this score in univariate and multivariate tests of the relationship between agency-conflicts and camouflage. The agency conflict

score provides greater objectivity in my analyses. I hypothesize a positive correlation between the agency conflict score and the use of camouflage. That is, as the agency conflict score increases, so too will the use of camouflage.

I create my agency conflict index based on three dimensions drawn from the corporate finance literature. These three dimensions are shareholder power, managerial power, and transparency. In the next few paragraphs I describe in detail how I use these dimensions to create the agency index score for each provision. For convenience, I provide here a brief overview of the procedure. First, every provision is assigned a value of -1, 0, or +1, for each of the three dimensions. Then, these three values, for each dimension, are summed for each provision to create the provision's agency index score. This score can range from -3 to 3. A low agency index score means that agency problems are minimal, whereas a high agency index score raises a red flag signaling that the potential for agency conflicts is large.

The shareholder power dimension is based on the premise that shareholders use their franchise to discipline managers and to force change (Bebchuck (2005)). There are multiple ways that shareholders accomplish this, including nominating directors to sit on the board, placing items on the annual meeting agenda, and amending bylaws and/or the charter. Where a provision favors the shareholder franchise, i.e. it has the effect of empowering shareholders, I assign the *weakens*[31] shareholders dimension a value of -1. If the provision weakens shareholder power, I assign it a value of 1. Where the provisions neither increases nor decreases shareholder power, I assign it a value of 0.

[31] For consistency in the agency conflict index, I cast the shareholder power score to negative numbers. Thus it can be meaningfully summed with the other dimensions which increase as agency conflicts increase. Therefore an assignment of -1 to *weakens* shareholders is the same as saying it strengthens shareholders by +1.

The managerial power dimension finds support in the literature which shows that managers pursue their own interests at shareholder expense (Jensen and Meckling (1976)). Managers might do this by classifying the board to entrench their membership, by requiring shareholder super-majority votes to oppose their discretion, or by limiting shareholder ability to act with written consent. Where a provision empowers managers I assign a value of 1 to this dimension. If the provision has the opposite effect, I assign a -1. Where the provision neither empowers nor weakens managers, I assign a 0.

Lastly, the transparency dimension is based on the premise that managers working in an opaque environment have greater opportunity to consume private benefits at shareholder expense (Andres and Theissen (2008)). An example of such a provision might be DIRLIAB (Director Liability). This provision shields directors from violations of the duty of care but not for intentional misconduct or knowing violations of the law. Under this provision, directors would tend to limit publication of information about his/her actions which might later show that they acted 'knowingly'. I assign a 1 to the 'reduces transparency' dimension if the provision tends to discourage publication of information. I assign a -1 if the provision has the opposite effect. Otherwise I assign a 0.

6.1.3.1 Agency Conflict Scoring Across Provisions

In Table 8 I evaluate the provisions as to their potential for agency conflict. The first two columns of each panel of the table provide the type identifier of the provision (the Type column) and a description of the provision (the Description column). In the next three columns I assign a -1, 0, or 1 to each dimension, based on the provision's impact on shareholder rights, managerial empowerment and transparency.

6.1.3.2 Board Provisions

In Panel A I analyze the various board related provisions. The first provision is CBOARD (Classified Board). This provision weakens shareholder control because once the board is classified, the provision prevents the shareholders from easily replacing the directors. The directors see just the opposite effect, and are empowered as they become more entrenched. Thus I assign a 1 to both the 'Weakens Shareholder' dimension and to the 'Empowers Managers' dimension. I assign a 0 to 'Reduces Transparency' because this provision would not tend to make the manager publish more or less.

Next I assess the DIRIND (Director Indemnification) provision. I assign a 1 to both the 'Weakens Shareholders' dimension and to the 'Empowers Managers' dimension. Shareholders are weakened and managers empowered because this provision grants company resources to the managers to defend themselves from shareholder civil actions stemming from managerial [mis]conduct. This provision does not increase or decrease managerial incentives to reveal or conceal information. Therefore I assign a 0 to the 'Reduces Transparency' dimension.

I assess the DIRLIAB (Director Liability) provision. I assign a 1 to both 'Weakens Shareholders' and 'Strengthens Managers' because this provision shields managers from breaches of the duty of care to the shareholder. I assign a 1 to the 'Reduces Transparency' dimension because under this clause, directors are shielded from 'intentional' and/or 'knowing' violations of law. Thus managers have incentive to hide the motivation for their actions, i.e., not to reveal that they knew or understood that their actions were incorrect. They accomplish this via opaque behavior, in other words, withholding material information.

Finally I score DUTIESNF (Duties Non-financial) as weakening shareholder control and empowering managers. This provision grants considerable managerial discretion in the decision to serve constituencies other than the shareholder. Managers can cloak self-serving decisions in the guise of third party rights in order to optimize their consumption of private benefits of control. I also score this as decreasing transparency, because managers have an incentive to withhold information about a decision contrary to shareholder interests. Instead, managers might favor publishing information which justifies serving third-party interests, and downplaying information that serves shareholders.

6.1.3.3 Merger and Acquisition Provisions

In Panel B, I analyze the M&A provisions. I assign a 1 to all the dimensions of FAIRPRICE (Fair Price). I assign a 1 to 'Weakens Shareholders' because the end result of this provision is to increase expense and thus reduce the wealth of the parent company shareholders, or to make the acquisition so expensive that it does not happen at all even if the shareholders wish it to happen. I assign a 1 to 'Empowers Managers' because authority to set the fair-price is exclusively vested in the board. I assign a 1 to 'Reduces Transparency' because managers have the option of not enforcing this provision. If their real motive is to secure private benefits of control, they will default to enforce without explanation, that is without revealing additional information.

Next I score the PPILL (Poison Pill) provision. Poison pills are typically not written until they are needed, only the authority to write one appears in the bylaws or charter. Therefore, by default the shareholders are neither weakened nor strengthened. For this reason I assign a 0 in the 'Weakens Shareholders' dimension. On the other hand,

when and to what extent a poison pill is implemented is completely within the discretion of management. Once written, these provisions can be as accommodating or as onerous as management wishes and management can craft a pill tailored to meet whatever need they have. Therefore I assign a 1 to the 'Empowers Managers' dimension. I assign a 0 to the 'Reduces Transparency' dimension because the information motivating the writing of a poison pill is usually public knowledge, and once it is written, the poison pill is published to all concerned parties.

Finally I score the SUPERMAJOR (Supermajority Requirement) provision. The voting percentages set by this provision usually far exceed those that can be expected to happen at any meeting of the shareholders. Therefore shareholders realize little chance of obtaining the minimum percentage of votes required by these provisions. Alternatively, these restrictions do not apply to the board, and the board can pass resolutions based upon a simple majority. For these reasons I assign a 1 to both the 'Weakens Shareholders' dimension and to the 'Empowers Managers' dimension. I assign a 0 to the 'Reduces Transparency' dimension because with this provision in place the publishing or hiding of information becomes irrelevant. This is because, even if the shareholders have relevant information, it is very unlikely that they can act on it.

6.1.3.4 Procedural Provisions

Next I score the provisions in Panel C, the procedural provisions. I start with ADVNR (Advance Notice Required). This provision can be used to weaken shareholder power by limiting the time that they have to nominate new directors and/or to place their own items on the annual meeting agenda. This provision is not written to strengthen the board's ability to nominate and/or to place issues on the agenda. Rather it is usually

written with the purpose of thwarting shareholder democracy. Therefore I assign a 0 to the 'Empowers Managers' dimension and a 1 to the 'Weakens Shareholders' dimension. On the other hand, I assign a -1 to the 'Reduces Transparency' dimension. Given that the advance notice requirements limit shareholder response time, the board has an incentive to publish information which supports their initiatives, knowing that shareholder will not have time to counter. This protects the board from future shareholder claims of opacity.

Next I score the BLANKCHECK (Blank Check) provision. This provision initially does not limit or empower shareholders. In addition, once written it usually does not dilute the shareholder ownership interest. Therefore I assign a 0 to the 'Empowers Shareholders' dimension. In the context of the board, things are different. The board uses this provision most often to delay a take over. This grants the board considerable power to delay or defeat a takeover, thus I assign a 1 to the 'Empowers Managers' dimension. I assign a 0 to the 'Reduces Transparency' column because the board has sole discretion in invoking this provision, usually on publicly available information, and once invoked, the provision itself becomes public information.

LPSMT (Limitation on Special Meetings) is next in Panel C. The only dimension that I assign a 1 to, is to the 'Weakens Shareholders' dimension. I do this because this provision is targeted primarily at the shareholders and does not apply to the board. Therefore it does not directly affect the board's powers, and consequently, I assign a 0 to the 'Empowers Managers' dimension. In addition, it makes transparency issues less of a concern because the shareholder has reduced power to act on information even if they have it. Therefore I assign a 0 to the 'Reduces Transparency' dimension.

Lastly, I score the LWCNST (Limitation on Written Consent) provision. It reduces shareholder power by eliminating one avenue that the shareholder has to counter the board: acting in writing in lieu of waiting for the annual meeting. Therefore I assign a 1 to the 'Weakens Shareholders' dimension. On the other hand, taken by itself, it does not obviate the power of shareholders to call a special meeting to act on negative information. For this reason the board has incentive to hide information that may prompt a special meeting, so I assign a 1 in the 'Reduces Transparency' dimension. I assign a 0 to the 'Empowers Managers' dimension because this provision targets the shareholders and does not increase/decrease managers rights or powers.

6.1.3.5 Voting Provisions

In the final panel, I score the provisions in Panel D, Voting Provisions. CONFVOTE (Confidential Voting) clearly favors shareholders at the board's expense. Under this provision the shareholder can nominate new directors and/or place items on the agenda without fear of board reprisal. Therefore I assign a -1 to both the 'Weakens Shareholders' dimension and the 'Empowers Managers' dimension. On the other hand, I assign a 1 to the 'Reduces Transparency' dimension. Given the increase in power to shareholders that this provision provides, the board is more likely to reduce information flow about its decisions and plans.

CUMVOTE (Cumulative Voting) is the next provision in Panel D. It primarily increases shareholder power over nominations, and decreases the board's power over resisting ouster by the shareholder. Therefore I assign a -1 to both the 'Weakens Shareholders' dimension and to the 'Empowers Managers' dimension. Because this

provision has little impact on agenda items, or on information related to agenda items, I assign a 0 to the 'Reduces Transparency' dimension.

The LABYLW (Limit Ability to Amend Bylaws) provision appears next in Panel D. This provision drastically reduces the shareholder's ability to counter board initiatives. With this provision in place, the board may unilaterally change the bylaws as it chooses. This grants great power to the board and seriously weakens the shareholder, in fact it may essentially remove all shareholder power depending on what the board decides to place in the bylaws. Therefore I assign a 1 to both the 'Weakens Shareholders' and to the 'Empowers Manager' column. In the 'Reduces Transparency' column, I assign a -1. I do this because with this clause in place, the shareholder is virtually powerless to act against unfavorable information. Therefore the board will publish more freely to avoid legal challenges, which is the only power that the shareholders may have left.

The LACHTR (Limit Ability to Amend Charter) provision is different from the LABYLW provision. The charter is usually created prior to IPO at which time its content is solely determined by management. Its contents usually don't change much after IPO. However, the bylaws can evolve after IPO. As such, management can (pre-IPO) unilaterally craft the charter to greatly increase its own power, but to limit shareholder power. Therefore I assign a 1 to both the 'Weakens Shareholders' dimension and to the 'Empowers Manager' dimension. However, after IPO the decision to amend the charter is bilateral, i.e., management has to approve any changes proposed by the shareholders. Regardless of the information available to the shareholder, they cannot use it to amend the charter without management approval. Thus information transparency is not really an

issue, and transparency is neither increased nor decreased by this provision. Therefore I assign a 0 to the 'Reduces Transparency' dimension.

The last provision is the SECRETBALLOT (Secret Ballot) provision. Bebchuk, Cohen and Ferrell (2009) observe that Gompers defines this provision and the CONFVOTE provision identically. For this reason many authors do not distinguish between the two and treat them as identical (Bebchuk et al (2009)). However, in some years the IRRC uses the term 'secret ballot' and in other years it uses the term 'confidential voting', but it never uses the same term in the same year. This implies that the IRRC may be distinguishing between the two. Therefore, in order to control for nuances in the IRRC use of this provision, I follow the IRRC and label it as 'secret ballot' in those years that the IRRC does, and label it as 'confidential voting' in those years that the IRRC does. Refer to 'Confidential Voting', above, for details on how I scored this provision.

In summary, Table 8 estimates the potential for agency-conflict for each provision type in my sample. The provisions that have the highest agency-conflict score are the Board provisions at an average of 2.50. M&A provisions have the second highest score at an average of 2. Procedural follow with an average agency-conflict score of 1. The provisions with the lowest average score are Voting at 0.20. These findings closely track the camouflage scores of the previous section where Board and M&A provisions had more camouflage than Voting or procedural. This provides support for my hypothesis that as the potential severity of agency conflict increases, so too does the use of camouflage.

6.1.3.6 Camouflage and Agency Conflict Within a Provision

In this section I use the agency index to closely examine the relationship between agency and the use of camouflage. In Table 9, I evaluate the relationship between the potential for agency conflict and camouflage at the provision level. In Panel A, I create groups of provisions based on their aggregate agency score. I do this by sorting provisions by their agency-conflict score in descending order. The first group are those provisions with an agency-conflict score of 3, the second group are those provisions with an agency-conflict score of 2, the third group are those provisions with an agency-conflict score of 1, and the fourth group are those provisions with an agency-conflict score of 0 or less. In the last row, I compute the F-statistic for the simultaneous difference in means between the four groups. In Panels B through E, I test the significance of the difference between groups on their use of camouflage. The tests compare each row to each column (row minus column).

Panel A shows that those provisions with a higher agency-conflict score also tend to have a higher aggregate camouflage score. DIRLIAB, FAIRPRICE and DUTIESNF all have an agency-conflict score of 3. This coincides closely with the rank order by camouflage in panel A of Table 7 where DIRLIAB is ranked highest and FAIRPRICE is ranked third highest. In Table 7 Panel A, LACHTR is ranked second, but in panel A of Table 9 it is ranked fourth. This pattern follows throughout the rest of panel A Table 9 all the way to the bottom of the panel, where SECRETBALLOT, CONFVOTE, and CUMVOTE are ranked lowest. This ranking is generally repeated in panel A Table 7 where CONFVOTE and SECRETBALLOT also rank the lowest, and CUMVOTE is the fourth lowest. Finally, I note that F-statistic is highly significant.

In Panels B through E, I examine the pairwise differences in the use of camouflage across the provision groups. In Panel B I test for differences in the use of aggregate camouflage. This panel, as in the subsequent panels, report t-statistics constructed as the difference of means between a row and a corresponding column variable. I observe that the use of aggregate camouflage occurs significantly more for those provisions with greater agency-conflict scores. Specifically, the t-statistic between provisions with an agency-conflict score of 2 versus those with an agency-conflict score of 3 is -3.584. This finding occurs for all pairwise comparison in Panel B: the t-statistic between scores of 1 and 3 is -5.586, between 0 and 3 is -9.983, between 2 and 1 is -4.561, between 2 and 0 is -13.898, and between 1 and 0 is -10.142. Therefore, Panel B provides support for my hypothesis that aggregate camouflage is used more extensively in provisions where the agency risk is higher.

In Panel C, I examine the relationship between tone and the provision's potential for agency conflict. Most of the pairwise comparisons in this panel corroborate the findings of panel B. Generally, all the t-statistics are negative, as my hypothesis predicts. Therefore this panel provides further evidence consistent with my hypothesis that the use of tone camouflage increases as agency risk is greater.

In Panel D, I examine the relationship between obfuscation and the potential for agency conflict. The results in this panel provide mixed support for my hypothesis. Only half the t-statistics take the expected negative sign, the other half take a positive sign. However, all the t-statistics which appear in the first column take the expected negative sign, thus, this column provides consistent support for my hypothesis that the use of obfuscation camouflage increases as the agency risk increases. Therefore this panel

provides weak evidence that those provisions with higher agency conflict scores use significantly more obfuscation camouflage than provisions with lesser agency-conflict scores

Finally, Panel E examines the use of placement camouflage across provisions. Specifically, all the t-statistics except one are of the expected sign. In the single case where the sign is not as hypothesized, the t-statistic is insignificant. Therefore, this panel provides evidence of a positive relationship between the use of camouflage and the potential for agency conflict within a provision.

In summary, Table 9 supports my hypothesis that there is a relationship between the potential for agency conflict and the use of camouflage. As the potential for agency conflicts increase, so too does the use of camouflage. Panel A supports this because it shows a similar ranking of provisions by camouflage score and by agency-conflict score. Panels B through E support this because the t-statistic, of the difference of means between the group with lower agency-conflict scores and the group with higher agency conflict scores, is generally negative. Therefore the findings in Table 9 provide robust support for my agency/camouflage relationship hypothesis.

The last analysis of this section is a multivariate analysis of the relationship between camouflage and the agency-conflict score. In Table 10 I evaluate the following specification:

(5)

where *CamouflageMeasure* is one of aggregate camouflage, tone, obfuscation, or placement. *AgencyConflict* is my agency-conflict score. The specification includes four

control variables. The first of these, *TotalAmountFiled* (Habib and Ljungqvist (1998)) controls for the greater monitoring that larger firms are under (Jensen and Smith (1985)). Such greater monitoring will tend to reduce the firms opportunity to successfully camouflage. The next three control variables are shown to provide validity to the IPO which results in greater liquidity and an increase in quality. *AuditorPrestige* (Michaely and Shaw (1995)) is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm. *UnderwriterPrestige* (Carter and Manaster (1990)) is the lead underwriter rank. *VentureCapitalBacking* (Brav and Gompers (1997)) is a dummy variable indicating the presence of venture capital backing prior to IPO. Finally I control for industry fixed effects using the Fama-French industry classifications (Benveniste, Ljungvist,Wilhelm and Yu (2003)).

In the first column of Table 10, I test the relationship between the use of aggregate camouflage and my agency conflict score. Table 10 shows a positive relationship between agency conflict and aggregate camouflage where a 1 unit increase in agency conflict results in 0.336 unit increase in camouflage. This relationship is statistically significant at the 1% level. This finding is consistent with my hypothesis that as agency conflicts increase, so to does the level of camouflage.

I then test the three components of camouflage, tone, obfuscation and placement. In the case of tone and placement the coefficient takes the hypothesized sign and is statistically significant. Overall these findings provide further support for the positive relationship between the potential for agency conflict, originating from within a provision, and the use of camouflage.

6.1.4 Summary of the Charter Provisions Analysis

In this section, I test whether the use of camouflage differs across provision types. I also introduce an agency-conflict measure for the potential of agency conflict within a provision. I then evaluate its relationship to camouflage. I find evidence supporting my hypothesis that camouflage is used more heavily in those provisions that provide managers with greater ability to consume private benefits of control (i.e. those provisions which increase the potential for agency conflicts.)

In Table 6 and Table 7, I provide evidence that camouflage is used more heavily in those provisions that managers use to increase consumption of private benefits. In Table 6, I group provisions into Board, M&A, Procedural and Voting categories. I provide evidence that the Board, M&A and Voting provisions are more heavily camouflaged than are the Procedural provisions. In Table 7, I analyzed the provisions individually. I continue to find that those provisions which provide managers the opportunity to consume greater private benefits, are also those provisions which exhibit greater camouflage.

In Table 8 and Table 9, I develop my agency-conflict index to more clearly examine differences in the use of camouflage across provisions. This univariate analysis provides evidence that camouflage is used more heavily in those provisions which increase the risk of agency-conflicts. In Table 10, I evaluate a multivariate model which corroborates the univariate findings. This model introduces control variables which have been shown to explain the extent of agency-conflicts. The multivariate analysis is consistent with my hypothesis that camouflage is used more extensively in those provisions that have greater potential agency conflicts.

6.2 Scrutiny and Camouflage

I hypothesize that scrutiny is a deterrent to the use of camouflage because scrutiny exposes camouflage. I note earlier that scrutiny is "the act of examining something closely", a "searching study, inquiry, or inspection." Camouflage, on the other hand, is a tool used by founders to wrongfully transfer wealth from the shareholder to themselves. Therefore, when scrutiny exposes camouflage, it reveals the underlying wrongful wealth transfer, i.e. expropriation. The consequence of wrongful actions is punishment. Thus, rather than risk punishment in the face of greater scrutiny, founders camouflage less.

6.2.1 Scrutiny and the Industry Distribution of Camouflage

In this section, I analyze the impact of scrutiny on the distribution of camouflage across industries. I hypothesize that camouflage occurs less in industries that are subject to higher levels of scrutiny. I test a number of proxies for scrutiny. In my univariate analysis, I only report those that are significant. However, in my multivariate analysis I report all tested proxies.

6.2.1.1 Industry Competition and Scrutiny

I hypothesize that IPOs entering highly concentrated industries are able to camouflage more because less scrutiny is focused on them. The larger firms are under greater scrutiny because, as the industry becomes more concentrated, the largest firm(s) begin to assume the characteristics of a monopoly. Monopolies attract the attention of regulators, analysts, courts, etc. An IPO, almost by definition, is small. These small firms do not attract the same level of attention as the larger existing firms. Therefore they are under less scrutiny and therefore have greater opportunity to profit from camouflage.

I use the Herfindahl index as a measure of industry concentration. I hypothesize that firms which go public in industries with high Herfindahl scores will use higher levels of camouflage than firms which go public in industries with low Herfindahl scores. Consistent with the industrial organization literature, I use the following definition of the Herfindahl index to measure industry concentration.

$$HerfindahlIndex_j = \sum_{i=1}^{N} PctMarketShare_{j,i}^2 \tag{6}$$

where *HerfindahlIndex* is the industry concentration for industry *j* based on one digit SIC code, and *PctMarketShare* is the market share of firm *i* in that industry.

In Table 11, I test the univariate relationship between camouflage and industry concentration. I sort my sample of IPOs into three groups. The 'More Concentrated' group contains those IPOs entering industries with Herfindahl scores in the upper 75th percentile. The 'Less Concentrated' group represents those IPOs entering industries with Herfindahl scores in the lower 25th percentile. In the 'Average Concentration' group are those IPOs entering industries between the upper 75th percentile and the lower 25th percentile. I conduct t-tests for differences in the mean level of camouflage used in the 75th and 25th percentile groups.

Table 11 shows that IPOs which occur in highly concentrated industries tend to camouflage more. The aggregate level of camouflage used by IPOs is greater for more concentrated industries (1.703) than for less concentrated industries (1.488). This difference is statistically significant with a p-value of less than 1%. Differences in the use of Tone and Placement camouflage are similarly significant. These initial results suggest that IPOs going public in highly concentrated industries do indeed camouflage

more. This supports my hypothesis that, in industries dominated by a few larger firms, smaller IPOs are under less scrutiny and thus camouflage more.

6.2.1.2 Analyst Scrutiny and Camouflage

Next, I test the relation between the use of camouflage and the scrutiny provided by industry analysts. Researchers show that analysts monitor a firm's management and that they increase the efficiency by which firm specific information enters the market (Jensen and Meckling (1976), Moyer, Chatfield and Sisneros (1989)). I hypothesize that both of these functions tend to reduce the use of camouflage. Specifically, as the level of monitoring increases, the use of camouflage will decrease. Furthermore, as firm specific information enters the market, the firm becomes more transparent, the risk that camouflage will be exposed increases, and the cost of exposure increases relative to the benefit of using the camouflage. Thus I hypothesize that as more analysts monitor the firm, that the level of camouflage used by that firm will decrease.

I report the results of industry adjusted analyst scrutiny on the use of camouflage in Table 12. I sort my sample of IPOs into three groups. The 'More Analysts' group contains those IPOs with high analyst followings (75th percentile). In the 'Less Analysts' group are those IPOs with low analyst followings (25th percentile). The 'Average Analysts' group represents those IPOs with analyst followings between the 75th percentile and the 25th percentiles. I conduct t-tests for the differences in the mean use of camouflage between the 75th and 25th percentile groups. In the first column I test for differences in aggregate camouflage between firms with high industry adjusted analyst followings[32] (75th percentile) and firms with low industry adjusted analyst followings (25th

[32] I use the IBES database to download analyst followings for each IPO in my sample.

percentile). In the next three columns I estimate the same tests for the individual components of camouflage: tone, obfuscation and placement.

Table 12 provides evidence that analyst scrutiny influences the firm's use of camouflage. The first column of Table 12 reports that aggregate camouflage is lower for firms with higher analyst coverage (1.587), and greater for firms with lower analyst coverage (1.661). However, this result has a p-value of only 0.31. The second column corroborates the economic results of the first column and adds statistical significance. The second column reports that the tone component of camouflage, in IPOs with more industry adjusted analyst followings, is lower (0.459) than in firms with less industry adjusted analyst followings (0.529). This result is significant at 4.8%. Neither obfuscation, nor placement camouflage is economically or statistically significant. Therefore, these findings provide limited support for my hypothesis that as more analysts focus scrutiny on an IPO, that less camouflage is used.

6.2.1.3 Multivariate Test of Scrutiny and Camouflage

In this section, I estimate a multivariate model of the relationship between camouflage and my measure of industry scrutiny. I include the following explanatory variables in my model: Herfindahl index, analyst following, and relative size of the IPO to that of the Industry. I also include indicator variables for the types of industries which are known to be under higher scrutiny, including High Tech (Ciccone and Rocco (2011), Health Industries (Fama French (2011)), Energy, Telecom and Utilities.

Table 13 contains the results from my multivariate analysis. It reports that the coefficients, on the Herfindahl index and on analyst followings, are statistically significant and assume the anticipated signs. Specifically, when the industry is more

concentrated, IPOs use 1.5358 more units of aggregate camouflage. In addition, for each additional analyst following the firm, founders reduce aggregate camouflage by -0.0186 units. These results provide support for my hypothesis that IPOs under more scrutiny use less camouflage and that those under less scrutiny use more.

6.2.2 Leverage and the Use of Camouflage

I hypothesize that IPOs in highly leveraged industries will camouflage less due to the monitoring activity of the debt holders (Harris and Raviv (1990, 1991)). This monitoring subjects the IPOs to greater scrutiny and tempers managerial efforts to camouflage their firm's governance structure. I test multiple measures of debt including debt at beginning of year, debt at end of year, debt due in 2nd year, debt due in 3rd year, debt due in 4th year, debt due in 5th year, long-term debt issuance, long-term debt reduction, long-term debt change, convertible debt, subordinated debt, debentures, total long term debt, total debt in current liabilities, long-term debt due in one year, notes, notes payable - short-term borrowings, short-term debt - decrease (increase). I standardize all measures by the market capitalization of the IPO and by average industry market capitalization. I only report results on two measures (long term debt and short term debt) because all measures of debt return similar results.

In Table 14 I test the relationship between debt (long term and short term) and camouflage. In each panel I test for differences in the use of camouflage between IPOs that have a high amount of debt (75th percentile) compared to those that have a low amount of debt (25th percentile). In the next three columns I perform the same test on the three components of camouflage. I standardize all measures of debt by both the market capitalization of the IPO and the average industry market capitalization.

Panel A reports the results for long term debt while Panel B contains the results for short term debt. The test statistic between the upper 75th percentile and the lower 25th percentile sub-samples is insignificant in all cases. Thus, Table 14 implies that neither long-term debt nor short-term debt influence the amount of camouflage used by the firm. Therefore, this table does not provide evidence that monitoring performed by bond holders reduces camouflage.

In Table 15 I evaluate the relation between debt and camouflage with a multivariate model. My independent variables capture various measures of monitoring. First, I include debt which represents monitoring provided by all debt holders, including banks and bond holders. *AuditorPrestige* is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm. *UnderwriterPrestige* is the lead underwriter rank. *VentureCapitalBacking* is a dummy variable indicating the presence of venture capital backing prior to IPO. Finally I control for industry fixed effects using the Fama-French industry classifications.

Table 15 reports that the coefficients on debt have the hypothesized sign, but lack statistical significance. Long Term Debt has a negative coefficient of -0.00144. This means, that when long term debt increases by $1 million, there is a corresponding decrease in the use of camouflage of -0.00144 units. However the statistical significance on this result has a p-value of .52 which renders the results insignificant. Short term debt yields similar results, with short term debt also being insignificant. Therefore, the multivariate analysis in Table 15 agrees with the univariate analysis in Table 14. I find that neither long term debt nor short term debt influence the use of camouflage.

In summary, this section evaluates the relationship between debt and aggregate camouflage. I report results for long term, and short term debt. The coefficients from the multivariate analysis take the hypothesized sign, but are statistically insignificant. In unreported results I also evaluate debt at beginning of year, debt at end of year, debt due in 2nd year, debt due in 3rd year, debt due in 4th year, debt due in 5th year, long-term debt issuance, long-term debt reduction, long-term debt change, convertible debt, subordinated debt, debentures, total long term debt, total debt in current liabilities, long-term debt due in one year, notes, notes payable - short-term borrowings, short-term debt - decrease (increase). None of these measures of debt yield statistically significant results.

I offer an explanation why debt and camouflage may not be related. During the IPO process the founder focuses on issuing equity while issuance of debt is of secondary or tertiary concern. The founders expect to earn many times more in offer-proceeds, than they do by selling new debt. In fact, I propose that is likely that the founder uses the proceeds of debt issuance during this period as a means of increasing offer proceeds, i.e., the founder is leveraging debt to maximize proceeds. Thus, if the lender increases the lending rate, because the lender observes greater camouflage, this increased rate is of minor consequence to the founder. Increasing offer proceeds still takes precedence. The founder may view an increased lending rate as a small cost to pay ... if it leads to a greater offer proceeds benefit.

6.2.3 IPO Activity

In this section I evaluate the relationship between camouflage and the timing of an IPO relative to other IPOs. I hypothesize that isolated IPOs tend to camouflage less. This happens because IPOs that stand alone are under greater scrutiny than those

occurring in clusters. IPOs which stand alone, bear the entire burden of information production (Benninga et al (2005)). On the other hand, those that occur in clusters benefit from information spillover, analyst fatigue and overly optimistic investors (Baker and Wurgler (2004), Loughran and Ritter (2000)). I test two measures of IPO activity: 'Days to Last IPO' and 'Antecedent IPO Proceeds'.

The 'Days to Last IPO' measure is the number of days since the last IPO occurred within the industry. I contend that as the number of days between IPOs increase, that individual IPOs become more visible and are subject to greater scrutiny. Therefore, as 'Days to Last IPO' grow larger, the IPO becomes more isolated, it comes under greater scrutiny, and it tends to use less camouflage.

'Antecedent IPO Proceeds' is the total offer proceeds earned by all other IPOs within the industry over the last year, relative to the current IPO offer proceeds. If this value is large and positive, then more proceeds were earned by the previous IPOs, than by this IPO. If this value is near zero, then the proceeds earned by previous IPOs are about equal to proceeds earned by this IPO. If this value is large and negative, then this IPO is earning proceeds in excess of all previous IPOs.

I hypothesize that as Antecedent IPO Proceeds increase, more scrutiny is focused on the previous IPOs. Specifically, a large positive Antecedent IPO Proceeds implies that the previous IPOs were of greater interest to the market than the current IPO. Thus the previous IPOs bore a greater information production burden. Consequently, the information production burden is less on this IPO. Therefore this IPO is under less scrutiny. Thus it will camouflage more.

6.2.3.1 Univariate Analysis

In Table 16 I present summary statistics for the timing and clustering of the IPOs in my sample. I sort the sample by industry because IPOs tend to cluster within industries, and increased IPO activity in one industry is not necessarily correlated with increased IPO activity in another industry (Benninga et al (2005)). I find that Business Equipment has the greatest number of IPOs (152) and the shortest mean and median days between IPOs (20.45 days and 7 days respectively). The longest mean days between IPOs occurs in the Chemical industry at 359.4 days. Health-care has the longest actual time between IPOs of 1106 days. The 'mean' and 'median' days between IPOs generally move opposite to the 'Number of IPOs' statistic. For example, Business Equipment has the largest number of IPOs (152), but it also has the smallest value in the mean and median columns, 152 and 20.45 respectively. Seven separate industries have multiple IPOs occurring on the same day.

In Table 17 I test the relationship between IPO activity and the use of camouflage. I sort results into three groups by 'Days to Last IPO' or by 'Antecedent Offer Proceeds'. The first group contains those IPOs in the upper 75th percentile, the last group contains those IPOs in the lower 25th percentile, and the middle group contains the remaining IPOs. I conduct t-tests between the average amounts of camouflage between the 75th and 25th percentile groups. In Panel A, I test the Days to Last IPO measure and find that as the number of days to the last IPO increase, that the use of camouflage decreases. In Panel B, I test 'Antecedent IPO Proceeds'. Panel B reports that those IPOs, which have an above average antecedent proceeds in the industry, use more camouflage. However, as with Panel A, the test statistic is insignificant.

In summary, my univariate analysis is suggestive of a relationship between camouflage and IPO activity. Both panels of Table 17 provide evidence supportive of my hypothesis. Panel A shows the predicted negative relationship between Days to Last IPO and camouflage. Panel B shows the predicted positive relationship between Antecedent IPO Proceeds and camouflage. However, the evidence in both panels lacks statistical significance. Thus they provide suggestive, but not definitive, support for my hypotheses.

6.2.3.2 Multivariate Analysis

In this section I estimate a multivariate model of the relationship between camouflage and prior IPO activity. I create a model which includes camouflage as the dependent variable, either one of my two measures of IPO activity as the primary explanatory variable, two control variables, and select dummies to control for industry fixed effects. The dependent variable is *aggregate camouflage*, *tone*, *obfuscation*, or *placement*. The primary explanatory variable is either of my measures of IPO Activity: *Days to Last IPO* or *Antecedent IPO Proceeds*. The two control variables in my model are: Mean Days to Last IPO, and Proceeds (of this IPO). I select Mean Days to Last IPO (in that industry) to account for industry timing effects with the Days to Last IPO variable. For similar reasons I select Proceeds (of this IPO), but as a control for Proceeds Before Industry. I use the Fama-French industry classifications to control for industry fixed effects.

In Panel A, the 'Days to Last IPO' variable is significant and negative for both aggregate camouflage and obfuscation camouflage. Both coefficients have similar economic significance. However, the coefficient on obfuscation camouflage has very

strong statistical significance. Taken together the results, for both aggregate camouflage and obfuscation camouflage, provide evidence supporting my hypothesis that as an IPO becomes more isolated in time, it will tend to use less camouflage because of greater scrutiny.

In Panel B, 'Antecedent Offer Proceeds' is significant and positive for both aggregate camouflage and for placement camouflage. Both coefficients take the expected sign. Statistically, the coefficient on aggregate camouflage is significant at 5%, while the coefficient on placement camouflage is very strong at better than 1% significance. Thus, Panel B corroborates the evidence in Panel A. Together they support my hypothesis that as firms come under more (less) scrutiny, that the subsequently camouflage less (more).

This section provides limited evidence that IPO activity is correlated meaningfully to the use of camouflage. This occurs in two ways. First, when the IPO is isolated in numbers (separated from the herd), it is under greater scrutiny, and thus camouflages less. On the other hand, when many firms are IPOing together, less scrutiny will/can be placed on any given firm. Thus these firms camouflage more. Second, when the IPO is earning less offer proceeds than its industry peers, it tends to camouflage more. This occurs because scrutiny tends to be focused on the firms generating higher proceeds. Thus, when an IPO with low (high) offer proceeds issues, it is under less (more) scrutiny, and has greater (lesser) opportunity to successfully camouflage.

6.2.4 Time Series Patterns in the Use of Camouflage

I hypothesize that during time periods of greater market scrutiny that firms camouflage less, and likewise, I contend that in time periods of lesser market scrutiny that firms camouflage more. This occurs because scrutiny increases the likelihood that

camouflage will be discovered. If the camouflage is discovered, the firm will be punished. This punishment may come in the form of a downgrade from an analyst, or in the form of civil punishments issuing from an SEC initiated adjudication. Thus, to avoid the greater likelihood of punishment, which is inherent to greater scrutiny, the firm will camouflage less.

In this section I use SEC activity as a proxy for scrutiny. I choose the SEC because its mission is to regulate the stock market and to protect the vast number of small investors who find it unprofitable to monitor the firms in which they hold only a small ownership interest. The SEC was created in 1934 in direct reaction to the stock market crash of 1929. It's regulatory authority is founded on seven congressional acts: the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Sarbanes-Oxley Act of 2002 and the Credit Rating Agency Reform Act of 2006. These acts give the SEC broad reaching regulatory powers. In fact, it is the largest and most powerful regulator in the United States. As such, it is the ideal regulatory entity to study in this section.

I hypothesize that in periods of greater SEC activity, that the SEC focuses increased scrutiny on the market, that this greater scrutiny is observed by IPOs going public, and that these IPOs subsequently use less camouflage for fear of discovery and punishment by the SEC. I use two measures of SEC activity: SEC budget excess and SEC Enforcement activity excess[33].

[33] In unreported tests, I also examine staffing changes (number of full time employees) but find no significance is this factor.

I use SEC budget excess[34] as a proxy for SEC scrutiny because I hypothesize that in periods when the SEC budget is greater than expected, that the SEC is able to direct greater scrutiny on the market. This occurs because the SEC's primary mission is the oversight, regulation, enforcement, and prosecution of publicly traded firms. If follows that when the SEC has more budget resources, that it will use this budget to pursue its primary mission. It also follows, that because the SEC budget is determined the year prior to the current year, and that it is published at the beginning of the current year, that firms are on notice of the greater (lesser) budget and will subsequently camouflage less (more).

I use SEC Enforcement[35] activity excess[36] as a proxy for SEC scrutiny because I hypothesize that in periods when the SEC initiates more enforcement actions, that it focuses more scrutiny on the market. The SEC has discretion about how to use it's resources. Specifically, it can choose if will initiate new enforcement cases, or if it will focus on the cases that are already open. I hypothesize that when the SEC chooses to initiate more new cases than expected, that it is focusing more scrutiny on the market than was expected.

I hand collect SEC activity data from the SEC Annual Performance and Accountability Reports which are on the SEC website. I download all reports spanning the years 1934 through 2005. From these reports I create Table 19. This table shows that

[34] SEC budget excess is the unexpected increase in SEC budget for the current year. I compute this unexpected increase by observing trends in the historical SEC budgets. I use the trend to estimate current SEC budget. The budget excess is that amount by which the actual budget exceeds my estimated budget.

[35] In unreported tests I separate cases into 'Civil Actions' and 'Administrative Procedures'. I find no material significance between the two.

[36] SEC Enforcement activity excess is the unexpected increase in initiation of SEC enforcement cases for the current year. I compute this unexpected increase by observing trends in historical SEC enforcement initiations. I use the trend to estimate the number of enforcement actions that the SEC should initiate this year. The enforcement activity excess is that amount by which the actual number of new enforcement cases exceeds my estimated number.

the SEC budget generally increases in time with the exception of a drop in 1997 of 2.7%. The largest increase occurs in 2004, an increase of 36.08% over the previous year. The number of staff generally increases over time. The total number of enforcement actions initiated is not as monotonic as the staff and budget values.

6.2.4.1 SEC Budget Excess

Budget excess is the difference in inflation adjusted dollars between the actual SEC Budget and the expected SEC Budget[37]. I compute SEC budget excess using a linear trend model. First I regress the SEC budget over a 20 year period from 1984 to 2005[38]:

$$SecBudget_i = \alpha + \beta \cdot Year_i + \varepsilon \tag{7}$$

I then compute the residuals as follows:

$$BudgetExcess_i = SecBudget_i - (\hat{\alpha} + \hat{\beta} \cdot Year_i) \tag{8}$$

I use these residuals as a measure of SEC budget excess. I sort my sample by budget excess and create three groups: those IPOs with budget excess in the upper 75th percentile, those in the lower 25th percentile, and those lying between the 75th and the 25th percentiles[39]. I conduct t-tests for the differences in the use of mean camouflage between the 75th and 25th percentile groups.

[37] One might question why current budget should influence current camouflage. This is a reasonable question because there should be a lag between budget allocation and its influence on firms choosing to camouflage. If there is no lag, and the two happen concurrently, then causation comes into question. However, I maintain that there is indeed a lag because the current years budget was proposed and approved in the previous years annual report. This public report put IPO founders on notice last year, that the SEC has a greater budget this year, and thus may increase scrutiny in the months ahead.

[38] I also test a 'rolling' estimate period in which I compute beta and alpha for the five years (and for 10 years) previous to each year in the sample. Thus in year 2000 I would compute alpha and beta over years 1995 through 1999 (1990 through 1999). The results do not substantially differ from those reported for a fixed estimation period.

[39] The number of IPOs in each group is as follows: Upper 75th percentile group: 108 observations, Lower 25th percentile group: 109 observations, Middle group: 218 observations.

In Table 20, I test the relationship between camouflage and SEC budget excess. The first column of Table 20 reports a significant decrease in aggregate camouflage when the SEC Budget is greater than expected, from an average of 1.625 to an average of 1.508. The second column reports a much stronger decrease in the tone component of camouflage, from an average of .518 to an average of .445. I conjecture that the tone component is strongest because my tone component is partly based on Loughran & McDonalds (2011) litigiousness word list. It may be that an increase in the use of legal words raises red flags with the SEC's lawyers and legal staff. Thus they focus more attention on these firms.

6.2.4.2 Enforcement Activity Excess

Next, I test Enforcement Activity as a proxy for SEC scrutiny. For the purpose of this paper, an 'enforcement activity' occurs when the SEC initiates a new investigation into possible violations of securities laws. When this action is initiated in federal court, it is called a 'civil action'. When this action is initiated before an administrative law judge, it is called an 'administrative procedure'. Prosecuting federal cases is more expensive for all parties involved, however, the defendant typically fairs better in this setting. On the other hand, even though administrative actions can be shorter and less expensive, these proceedings are known to favor the SEC and to put the defendant at a disadvantage.

In this section, I test civil actions and administrative action combined because their aggregate measure has the greatest explanatory power over camouflage. Inspection of the last two columns of Table 19 shows that the SEC tends to increase the later while decreasing the former, and vice versa. For example, in 1995 the SEC decreased Civil actions by -15.28% but increased Administrative actions by 8.96%. In the subsequent

year, 1996, the SEC increased Civil actions by -9.28% but decreased Administrative procedures by 17.47%. This alternating pattern generally repeats throughout the sample with the exception of years 2001, 2002, and 2003 in which the SEC increased Administrative actions three years in a row. As a proxy of scrutiny, I test Administrative Actions, Civil Actions, and Enforcement Actions (the aggregate of admin and civil) separately. Only aggregate Enforcement Actions are significant. I suspect that the Administrative and Civil actions are not seperately significant because of the alternating pattern described above.

Enforcement activity excess is the difference between the total number of cases actually initiated by the SEC and the number expected to be initiated by the SEC. I hypothesize that the SEC focuses greater scrutiny on the market in those years when it initiates a greater number of cases than expected. I compute SEC activity excess using a linear trend model. I first regress SEC enforcement activity over a 20 year period from 1984 to 2005[40]:

$$SecTotalCases_i = \alpha + \beta \cdot Year_i + \varepsilon \tag{9}$$

I then compute the residuals as follows:

$$ActivityExcess_i = secTotalCases_i - (\hat{\alpha} + \hat{\beta} \cdot Year_i) \tag{10}$$

I use these residuals as a measure of SEC activity excess. I sort my sample by activity excess and create three groups: those IPOs with activity excess in the upper 75th percentile, those in the lower 25th percentile, and those lying between the upper 75th and

[40] I also test a 'rolling' estimate period in which I compute beta and alpha for the five years (and for 10 years) previous to each year in the sample. Thus in year 2000 I would compute alpha and beta over years 1995 through 1999 (1990 through 1999). The results do not substantially differ from those reported for a fixed estimation period.

the lower 25th percentiles[41]. I conduct t-tests for the differences in the mean use of camouflage between the 75th and 25th percentile groups.

In Table 21, I evaluate the relationship between camouflage and SEC enforcement activity excess. The first column reports a significant decrease in aggregate camouflage when SEC Enforcement Activity is greater than expected, from an average of 1.625 to an average of 1.417. The last column reports a significant decrease in the placement component of camouflage when SEC Enforcement Activity is greater than expected, from an average of .608 to an average of .460. The tone and obfuscation components of camouflage are not significant. These two findings support my hypothesis that firms use less camouflage in the face of greater scrutiny.

6.2.4.3 The Multivariate Impact of SEC Scrutiny on Camouflage

I conclude this section with an analysis of the incremental impact of SEC scrutiny on an IPO's use of camouflage in the presence of other factors. These other factors, i.e. measures of scrutiny, are Underwriter Prestige, Auditor Prestige, and Venture Capital Backing. These entities have all been shown to serve as monitors for the firm (Carter, Dark, and Singh (1998), Brav and Gompers (1997), and Michaely and Shaw (1995) respectively) and thus increase the level of scrutiny that the firm is under. SEC scrutiny is incremental to all three of these because the SEC is an independent agency operating at arms length from the IPO. Neither the underwriter, the auditor, nor the venture capitalist is truly independent of the firm. The underwriter and the auditor are chosen by the firm and paid by the firm. This clearly presents potential conflicts of interest. Unlike the underwriter and the auditor, the venture capitalist selects which firm it will fund, but once

[41] The number of IPOs in each group is as follows: Upper 75th percentile group: 108 observations, Lower 25th percentile group: 109 observations, Middle group: 218 observations.

that choice is made, then their financial interests become intertwined. This again presents potential conflicts of interest. In contrast to the former three, the SEC remains independent, and at arms length, from the firm throughout the prosecution process. Thus it adds a level of independent monitoring to the firm that the former three cannot provide.

I report the results of my incremental analysis in Table 22. In the first column, I examine budget excess. The coefficient on budget excess is negative and statistically significant which supports my hypothesis that as budget excess increases, the use of camouflage decreases. The value of the coefficient is -0.0029. The economic interpretation of this value is that for every $1 million increase in SEC budget that camouflage decreases by -0.0029 units.

In the second column of Table 22, I examine Enforcement activity excess. The coefficient on this explanatory variable is also negative and significant. This finding corroborates that of budget excess (column 1) and provides further evidence supporting my hypothesis of the relationship between SEC activity and the use of camouflage. In this case the value of the coefficient is -0.0008. The economic meaning is that for each additional case initiated by the SEC, that camouflage drops by -0.0008 units. This finding provides evidence supporting my hypothesis that SEC scrutiny is incremental to that provided by the underwriter, auditor and venture capitalist.

I close this section with a summary of its findings. I provide evidence supporting my hypothesis that firms camouflage less during periods of higher scrutiny, and camouflage more during periods of lower scrutiny. I create two measures of SEC scrutiny which are SEC budget excess and SEC enforcement activity excess. Both of

these measures are correlated with camouflage and provide evidence supporting my hypothesis that scrutiny impacts the levels of camouflage used by the firm.

6.3 Camouflage and Offer-proceeds, Under-pricing, Flipping and Long-run Performance

In this chapter, I analyze the relationship between camouflage and IPO pricing behavior. This behavior includes underpricing, relative offer proceeds, flipping and long-run performance. Anomalies such as underpricing and long-run performance have been of great interest to academics and practitioners since the seminal work of Stoll and Curley (1970) and Logue (1973). Flipping has been a profitable trading strategy of institutional investors for many years, but the market in general has not been able to replicate the institutional trader's success (Aggarwal (2002), Fishe (2002)). I provide evidence that camouflage incrementally explains these anomalies.

6.3.1 Camouflage's Effect on Offer Proceeds and Underpricing

In this section I test the relationship between camouflage and offer proceeds, and between camouflage and underpricing. I test both because, even though they are related, they represent different aspects of the IPO process. Specifically, offer-proceeds represent an ex-ante value that is determined prior to issue, whereas underpricing is an ex-post value determined after issue. In addition, the former is determined by the underwriter and the founders, while the latter is determined by the market.

I begin with a univariate analysis of the relation between camouflage and offer proceeds/underpricing. In Panel A (Panel B) of Table 23, I sort firms into three groups. The 'Underpricing is Higher that Average' (Offer Proceeds are Higher than Average) group contains those IPOs which underprice (earn offer proceeds) in the upper 75th

percentile. The 'Underpricing is Lower than Average' (Offer Proceed are Lower than Average) group contains those IPOs which underprice (earn offer proceeds) in the lower 25th percentile. The 'Average Underpricing' (Average Offer Proceeds) group contains those IPOs which underprice (earn offer proceeds) between the two other groups. I conduct t-tests on the difference of mean underpricing (offer proceeds) between the upper and lower groups. The statistical significance of the tests are reported as 'Test Statistic'. I find no economic or statistical significance in Panel A, underpricing. In Panel B, Offer Proceeds has a significant t-stat in the 'Obfuscation' measure of camouflage. The above-average 'Offer Proceeds' group uses more camouflage (.549) than the below-average group (.461). This is statistically significant at 3.1%. These results provide weak evidence that firms use camouflage to increase offer proceeds, and little evidence that underpricing and camouflage are related.

In Table 24 and Table 25 I test the impact of camouflage on underpricing and on offer proceeds in a multivariate analysis. I develop a model drawn from the IPO literature with variables used to explain underpricing and offer proceeds. The model is as follows:

(11)

where *LHS* is either underpricing (Table 24) or offer proceeds (Table 25). *CamoMeasure* is aggregate camouflage, tone, obfuscation or placement. The other variables can logically be divided into three groups: offering characteristics, third-party certification, and market conditions.

The 'Offering Characteristics' variables are as follows. *TotalAmountFiled* is the amount filed, in millions of dollars (Habib and Ljungqvist (1998)). Hanley (1993) uses '*PreOfferPriceChange*' to control for the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price. I borrow from Ang and Brau (2003) the variable *NumberAmendments*, which is the number of times the S-1 document is amended. Finally, *SecondarySharesOffered* is the percent of secondary shares in the IPO (Leland and Pyle (1977)).

The next set of regressors represent 'Third-Party Certification'. *UnderwriterPrestige* is the lead underwriter rank for the year prior to IPO (Carter, Dark, and Singh (1998)). Brav and Gompers (1997) use *VentureCapitalBacking* to indicate the presence of VC backing prior to the IPO. Finally, '*AuditorPrestige*' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm (Michaely and Shaw (1995)),

Lastly I include a set of 'Market Conditions' variables to control for IPO market activity. *AveragePriorThreeMonth-Underpricing* is the average percent of underpricing of IPOs in the prior three months (Ljungqvist (2007)). *ThreeWeekPriorMarket-Return* is the percent return on the market (value weighted) three weeks (15 trading days) prior to IPO (Loughran and Ritter (2002)).

In Table 24 I estimate the relation between camouflage and underpricing. The common IPO control variables all take the expected signs and significance. My camouflage variables are negative and significant for both aggregate camouflage (Model 1) and tone camouflage (Model 2). In Model 1, as IPO founders increase the use of aggregate camouflage by 1 unit, there is a corresponding 0.11% decrease in underpricing.

This finding provides evidence supporting my hypothesis that IPO founders use camouflage to reduce the billions of dollars that IPOs leave on the table each year (underpricing).

Model 2 corroborates this finding and focuses attention on the tone component of camouflage. Specifically, as IPO founders increase the use of tone camouflage by one unit, there is a corresponding decrease in underpricing by 0.22%. This is both economically and statistically stronger than the results in Model 1. Models 3 and 4 (obfuscation and placement camouflage) are neither economically nor statistically significant. Overall, the findings in this table provide evidence supporting my theory that firms use camouflage to decrease underpricing.

In Table 25 I test the relation between camouflage and relative offer proceeds. In this table, both Aggregate Camouflage (Model 1) and Obfuscation camouflage (Model 3) are significant and positive. In Model 1, as Aggregate Camouflage increases by one unit, there is a corresponding increase in the log of Offer Proceeds of .1943. In Model 3, as Obfuscation camouflage increases by 1 unit, the log of Offer Proceeds increases by .879. Neither Model 2 nor Model 4 (tone and placement camouflage) are significant. Overall, the findings in this table provide evidence supporting my hypothesis that firms use camouflage to increase offer proceeds.

In summary, this section provides evidence that offer proceeds, and underpricing, are incrementally related to the use of camouflage. Specifically, I find in Table 24 that as the use of aggregate camouflage increases, offer proceeds also increase. This relation holds for tone camouflage as well. This finding supports my hypothesis that founders use camouflage to increase offer proceeds. Likewise in Table 25, I find that as camouflage

increases, underpricing decreases. This relation holds for obfuscation camouflage as well. This finding provides evidence supporting my hypothesis that founders use camouflage to minimize underpricing.

6.3.2 Camouflage and Flipping

I now test the relation between camouflage and flipping. Flipping is the immediate sale of IPO allocations back to the market on the first day of trading. Krigman, Shaw and Womack (1999) formally define flipping as the ratio of first-day sell-signed block trade dollar volume to the total dollar volume traded on the first day. Flipping is a very profitable trading strategy implemented by many institutional traders (Aggarwal (2002) and Fishe (2002)). However, in general the market is unable to replicate these strategies (Ritter and Welch (2002)). In this section I show that camouflage incrementally explains this institutional trading strategy.

6.3.2.1 Identifying Institutional Flippers

Identifying institutional trades, and if that trade represents a 'flip', is difficult. First day trading activity is available on WRDS as part of the TAQ dataset. However, TAQ only provides trading volume, price, and time. It provides neither trade direction (buy or sell) nor the identity of the originator of the trade. I need both of these missing variables: direction and identity. Direction (and volume) flags the trade as a flip, and identity establishes if it is an institutional trade.

To identify institutional flipping, I follow Lee and Ready (1991). They formulate a 'tick test' algorithm which permits a researcher to infer trade direction. Essentially this test observes the change in equity prices throughout the trading day and compares each

new price to the preceding price[42]. If the price is higher than the previous trade, the test tags it as an 'uptick'. If it is lower the test tags it as 'downtick'. Where the price has not changed, but the previous price was an uptick, then the test tags it as a 'zero-uptick'. Finally, if the price has not changed, but the previous price was a downtick, the test tags it as a 'zero-downtick'. Finally, the algorithm classifies a trade as a 'sell' if it is either a downtick or a zero-downtick.

Next I follow Krigman, Shaw and Womack (1999)[43] to infer identity. KSW define large trades (institutional traders) as transactions of 10,000 shares or more. I use the KSW definition of flipping: flipping is the ratio of first-day sell-signed block trade dollar volume to the total dollar volume traded on the first day.

6.3.2.2 Empirical Evidence of the Relation between Camouflage and Flipping

I hypothesize that my measure of camouflage is correlated to institutional flipping. I note earlier that institutional traders "appear to possess and use superior information [because] they flip issues that subsequently underperform the market" (Krigman, Shaw and Womack (2002)). Ritter and Welch (2002) show that many "institutions succeed in identifying IPOs that are being overvalued when trading commences". In this section I provide empirical evidence that suggests that institutions detect camouflage prior to IPO and use it post IPO as a factor in their profitable flipping strategies.

[42] I download the TAQ intraday trading data for my sample from the WRDS TAQ database. This is a total of 1,710,016 trades and a total share volume of 2,844,958,461 shares. Only 3% of these trades are 'block' trades, i.e., trades by institutions. However, the impact of institutional trading is substantial, because institutional traders account for 1,718,308,825 of all shares traded, or 60.4%.

[43] In a conversation with Jay Ritter (Oct 2011, University of Missouri), he commented that institutional traders are more often trading in smaller and smaller blocks. He said that identifying institutional traders by block size is problematic today. However, he said that this problem only begins to emerge in 2004 and it takes to about 2009 for it to get serious enough to abandon KSW. Because my sample extends from 1995 to 2005, KSW is still relevant and applicable.

In Table 26 I investigate the univariate relation between flipping and the use of camouflage. In this table I sort my sample of IPOs into three groups by percent volume of shares flipped by institutions, on the first day of trading. The 'Above Average Flipping' group contains those IPOs whose percent volume of shares flipped by institutions was in the upper 75th percentile. The 'Below Average Flipping' group contains those IPOs whose percent volume of shares flipped by institutions was in the lower 25th percentile. The 'Average Amount of Flipping' group contains the residual firms. I conduct t-tests on the difference of mean underpricing (offer proceeds) between the upper and lower groups.

Table 26 shows that those IPOs which experience above average flipping volume on the first day of trading used significantly more camouflage in the design of their bylaws and charters than those that are flipped less frequently. Specifically, aggregate camouflage is 1.629 units in those IPOs that were flipped more and only 1.507 units in those IPOs that were flipped less. This evidence is corroborated by obfuscation camouflage which finds that those IPOs that were flipped more used 0.552 units of obfuscation camouflage compared to only 0.416 units for those that were flipped less. This finding is significant at better than 1%. Tone and placement camouflage are neither economically nor statistically significant. Overall, these results support my hypothesis that camouflage is an ex-ante predictor of flipping.

Next I evaluate flipping in a multivariate framework. Krigman, Shaw and Womack (1999) develop an ex-ante multivariate model which they use to explain flipping behavior. I modify their model by introducing camouflage as an explanatory variable. I use the modified model to show that camouflage incrementally explains flipping:

$$Flipping = \alpha + \beta_1 \cdot CamoMeasure + \beta_2 UnderwriterRank + \beta_3 \cdot \ln(MktCap) + \beta_4 \cdot ExanteReturn + \epsilon \quad (12)$$

In this model, *Flipping* is the percentage of sell-signed dollar volume executed in trades of 10,000 shares or more on the first day of trading. *CamoMeasure* is aggregate camouflage, tone camouflage, obfuscation camouflage or placement camouflage. *UnderwriterRank* is a ranking of underwriters based on equity capital. *ln(MktCap)* is the natural logarithm of the IPOs market capitalization at the time of IPO. *ExanteReturn* is the percentage change from the offer price to the opening trade price.

The results of my multivariate analysis of the relation between camouflage and flipping appear in Table 27. The coefficient on *UnderwriterRank, ln(MktCap)* and *ExanteReturn* variables are similar in magnitude, sign and significance to those of the KSW variables. More importantly, the coefficient on the camouflage measure takes on the sign and significance that I expect. In Model 1, the aggregate measure of camouflage is positive and significant. This indicates that institutional traders flip 3.46% more frequently as camouflage increases by one unit. In Model 3, the obfuscation component of camouflage is positive and significant. This indicates that institutional traders flip 10.81% more frequently for each unit increase in obfuscation. Neither tone nor placement camouflage are economically or statistically significant. Overall this table provides evidence supporting my hypothesis that institutions flip those IPOs which are more heavily camouflaged.

6.3.2.3 Summary of the Relation between Camouflage and Flipping

In summary, this section provides evidence that camouflage is meaningfully correlated to the institutional trading strategy known as flipping. Specifically, I show that

as the level of camouflage used by an IPO increases, that institutions are more likely to flip the IPO on the first day of trading. This implies that institutions are not 'fooled' by camouflage. Rather they see through camouflage and know when the firm is overpriced, and know that it will subsequently under-perform. Thus they quickly offload the IPO, take their profits, and leave.

6.3.3 Camouflage and Long Run Performance

In this section I examine the relation between camouflage and long run performance. I hypothesize that those firms which use more camouflage also underperform in the long run. This occurs because camouflage initially inflates the true value of the corporate governance in these firms (Bebchuk and Cohen (2005)). I then presume that in the long run, camouflage is unveiled, the true corporate governance of the firm is revealed, and the market makes a value adjustment. Many factors can contribute to the eventual unveiling of camouflage, including the increase in analyst coverage that usually follows IPO, the behavior of insiders who increase perquisite consumption, and the greater scrutiny the firm comes under as it grows in size.

In Table 28 I test the univariate relationship between long run performance and camouflage. I measure long run performance as the buy and hold average return (BHR) over the periods of 6 months, 9 months, 1 year, 2 years and 3 years. For each period I sort firms by BHR and sort them into three groups. The 'Above Average Performance' group contains those firms with buy-and-hold returns in the upper 75th percentile of my sample. The 'Below Average Performance' group is made up of those firms with a BHR in the lower 25th percentile of my sample. Lastly, the 'Average Performance' group is

composed of the residual firms. I conduct t-tests on the difference of mean BHR between the upper and lower groups.

Table 28 Fails to provide evidence supporting my hypothesis that camouflage and long run performance are related. This finding emerges from the fact that no period in the table is economically or statistically significant. Before I explain this lack of results, I present the results in Table 29 because they are substantially similar to the results inTable 28.

In Table 29 I evaluate the relationship between camouflage and long run performance within a multivariate specification. I modify the Brau et al (2012) model for this purpose by introducing my camouflage measure as an explanatory variable:

$$\begin{aligned} BHR_{1yr} = \alpha + \beta_1 \cdot CamoMeasure + \beta_2 \cdot TotalAmountFiled + \beta_3 \cdot PreOfferPriceChange + \\ \beta_4 \cdot NumberAmendments + \beta_5 \cdot SecondarySharesOffered + \beta_6 \cdot UnderwriterPrestige + \\ \beta_8 \cdot VentureCapitalBacking + \beta_9 \cdot AuditorPrestige + \\ \beta_{10} \cdot AveragePriorThreeMonthUnderpricing + \beta_{11} \cdot ThreeWeekPriorMarketReturn + \\ \sum \beta_i \cdot FamaFrenchIndustry + \sum \beta_j \cdot YearFixedEffects + \epsilon \end{aligned}$$

where *CamoMeasure* takes one of four values: aggregate camouflage, tone, obfuscation or placement. Please see Table 3 for a description of the control variables in this model. I control for industry fixed effects using the Fama French industry classifications. I control for year fixed effects.

The results in Table 29 are similar to the results in Table 28, that is neither table provides evidence supporting my camouflage/long run performance hypothesis. I test all five periods (6 months, 9 months, 1 year, 2 years, and 3 years) but I only report results for period '1 Year' because the other four periods are substantially identical. These multivariate results agree with my earlier univariate results: I fail to find evidence

supporting a relationship between camouflage and long run performance. I offer this explanation for the paucity of results in Table 28 and in Table 29: the camouflage is not 'eventually' revealed. My hypothesis is premised on the assumption that the camouflage effect is short term. I assume that as time passes that factors will combine to reveal the camouflage to the market. These factors include increased number of analysts following the firm, the increase in firm size, and misbehavior of insiders. It is possible that these factors don't generally have a revelatory effect on camouflage. This may be reasonable, because if the camouflage was robust enough to survive the heightened scrutiny of the IPO process, then it may be robust enough to remain undetected for years afterwards.

In summary, in this section it test for a relationship between long run performance and camouflage. My first test is a univariate analysis between the buy and hold returns of the IPO over different time periods, and the use of camouflage. My second test is a multivariate analysis using a specification drawn from the literature. Neither test provides evidence supporting a relationship between long run performance and camouflage. I offer an explanation that this occurs because camouflage may continue to be effective in the long run, i.e., it is not discovered by the market. If this is the case then it does not impact long run performance.

7 Conclusion

In this paper I show that managers opportunistically inflate the observable quality of governance in an IPO. They do to increase the opportunity to consume private benefits of control. I facilitate this by creating a camouflage index and then applying it to the bylaws and charters of 435 IPOs. I estimate provision level and firm level camouflage and evaluate the relationship between it and various characteristics of the

firm. My findings provide evidence supporting my hypotheses that managers profit from the use of camouflage.

I begin by analyzing the firms' bylaw and charter on a provision level basis. I group the provision into four categories, board, mergers and acquisitions, procedural, and voting. I make two major findings concerning individual charter provisions. The first is that camouflage is meaningfully distributed across provisions and across provision categories. The second is that there is a strong and positive relationship between the potential for agency conflicts and the use of camouflage.

Next I analyze how scrutiny impacts the use of camouflage across industries. I proxy scrutiny with the Herfindahl index, and with analyst coverage. I provide evidence that IPOs entering industries that are more concentrated (higher Herfindahl index) tend to use more camouflage. I also provide evidence that IPOs with greater analyst followings use less camouflage. Together these findings provide support for my hypothesis that IPOs under more scrutiny use less camouflage and that those under less scrutiny use more.

I look at how IPO activity and camouflage are related. I test two measures of IPO activity. The first is days to last IPO and the second is antecedent IPO proceeds. When testing the former measure, I hypothesize that when IPOs occur alone that they use less camouflage and that when they occur in clusters that they use more. When testing the latter I hypothesize that when IPO proceeds for previous IPOs are larger, that current and future IPOs will tend to camouflage more in hopes of maximizing their proceeds. I find evidence supporting both of these hypotheses and thus provide evidence that the use of camouflage and IPO activity are correlated.

I investigate how camouflage varies over time as levels of scrutiny vary over time. I find evidence supporting my hypothesis that firms camouflage less during periods of higher scrutiny and that they camouflage more during periods of greater. I create two measures of SEC scrutiny which are SEC budget excess and SEC enforcement activity excess. Both of these measures are correlated with camouflage and provide evidence supporting my time period scrutiny hypotheses.

My next major finding in this paper is that offer proceeds, and underpricing, are meaningfully related to the use of camouflage. As the use of camouflage increases, offer proceeds also increase. This finding supports my hypothesis that founders use camouflage to increase offer proceeds. Likewise, as camouflage increase, underpricing decreases. This finding provides evidence supporting my hypothesis that founders use camouflage to minimize money left on the table, that is, to minimize underpricing.

Lastly I look at flipping of IPOs by institutional traders. The literature has long shown that institutional traders execute profitable flipping strategies. Indeed, they "appear to possess and use superior information" because they are able to identify those IPOs which will underperform in the long run, and flip them on the first day of trading. I hypothesize that Institutional traders can see through the camouflage which fools the rest of the market. My findings support this hypothesis and I show a correlation between the use of camouflage and flipping, that is, more highly camouflage IPOs are more often flipped by institutional traders.

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TABLES

Table 1: Descriptive Statistics

This table provides descriptive statistics of my sample of IPOs between 1995 and 2005. Panel A shows a distribution of my sample by the year of issue. Panel B shows a distribution by industry. I use the Fama French twelve industry classifications available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/ftp/Industry_Definitions.zip.

Panel A: Distribution by Year

Year	Number	Percent of Sample
1995	52	12.0%
1996	85	19.5%
1997	62	14.3%
1998	58	13.3%
1999	73	16.8%
2000	44	10.1%
2001	30	6.9%
2002	25	5.7%
2003	3	0.7%
2004	1	0.2%
2005	2	0.5%
Total	435	100%

Panel B: Distribution by Industry

Industry	Number	Percent of Sample
Business Equipment -- Computers, Software, and Ele...	152	34.9%
Chemicals and Allied Products	5	1.1%
Consumer Durables -- Cars, TVs, Furniture, Househo...	3	0.7%
Consumer NonDurables -- Food, Tobacco, Textiles, A...	13	3.0%
Finance	44	10.1%
Healthcare, Medical Equipment, and Drugs	49	11.3%
Manufacturing -- Machinery, Trucks, Planes, Off Fu...	23	5.3%
Oil, Gas, and Coal Extraction and Products	12	2.8%
Other -- Mines, Constr, BldMt, Trans, Hotels, Bus ...	65	14.9%
Telephone and Television Transmission	23	5.3%
Utilities	2	0.5%
Wholesale, Retail, and Some Services (Laundries, R...	44	10.1%
Total	435	100%

Table 2: Annual Distribution of Camouflage

This table shows the time-series patterns in camouflage over the period of my sample. Each panel shows the change in mean, median, maximum, minimum and standard deviation of the four camouflage measures over time. The final row in the panel shows the time trend of the use of camouflage, trend is the beta coefficient and significance of the following regression.

$$LHS = \alpha + \beta * Year + \epsilon$$

Where LHS takes the value of 'Mean', 'Median', 'Maximum', 'Minimum', and 'Standard Deviation' and Year takes on the values of 1995 to 2002

Panel A: Annual Distribution of Aggregate Camouflage

Year	Mean	Median	Maximum	Minimum	Standard Deviation	Number of Firms
1995	1.417	1.333	3.000	0.000	0.642	52
1996	1.581	1.556	3.000	0.000	0.560	85
1997	1.549	1.500	3.000	0.333	0.454	62
1998	1.605	1.600	3.000	0.667	0.504	58
1999	1.543	1.500	2.750	0.750	0.447	73
2000	1.663	1.586	3.000	0.667	0.468	44
2001	1.741	1.667	3.000	1.167	0.391	30
2002	1.703	1.667	2.600	1.000	0.443	25
2003	1.417	1.333	1.667	1.250	0.180	3
2004	1.500	1.500	1.500	1.500	0.000	1
2005	1.464	1.464	1.500	1.429	0.036	2
Trend	0.037 ***	0.036 **	-0.036	0.166 ***	-0.027 **	

Panel B: Annual Distribution of Tone Camouflage

Year	Mean	Median	Maximum	Minimum	Standard Deviation	Number of Firms
1995	0.435	0.464	1.000	0.000	0.366	52
1996	0.458	0.500	1.000	0.000	0.302	85
1997	0.461	0.464	1.000	0.000	0.269	62
1998	0.480	0.500	1.000	0.000	0.295	58
1999	0.498	0.500	1.000	0.000	0.263	73
2000	0.573	0.600	1.000	0.000	0.269	44
2001	0.506	0.500	1.000	0.000	0.235	30
2002	0.520	0.500	1.000	0.000	0.246	25
2003	0.194	0.250	0.333	0.000	0.142	3
2004	0.500	0.500	0.500	0.500	0.000	1
2005	0.679	0.679	0.857	0.500	0.179	2
Trend	0.014 **	0.008	0.000	0.000	-0.014 ***	

Panel C: Annual Distribution of Obfuscation Camouflage

Year	Mean	Median	Maximum	Minimum	Standard Deviation	Number of Firms
1995	0.522	0.500	1.000	0.000	0.347	52
1996	0.501	0.500	1.000	0.000	0.312	85
1997	0.475	0.500	1.000	0.000	0.288	62
1998	0.489	0.500	1.000	0.000	0.320	58
1999	0.463	0.500	1.000	0.000	0.308	73
2000	0.487	0.500	1.000	0.000	0.268	44
2001	0.591	0.612	1.000	0.000	0.274	30
2002	0.527	0.500	1.000	0.000	0.251	25
2003	0.556	0.500	1.000	0.167	0.342	3
2004	0.333	0.333	0.333	0.333	0.000	1
2005	0.393	0.393	0.500	0.286	0.107	2
Trend	0.006	0.007	0.000	0.000	-0.011 ***	

Panel D: Annual Distribution of Placement Camouflage

Year	Mean	Median	Maximum	Minimum	Standard Deviation	Number of Firms
1995	0.46	0.500	1.000	0.000	0.422	52
1996	0.622	0.667	1.000	0.000	0.315	85
1997	0.613	0.667	1.000	0.000	0.275	62
1998	0.636	0.667	1.000	0.000	0.258	58
1999	0.582	0.600	1.000	0.000	0.265	73
2000	0.603	0.600	1.000	0.000	0.238	44
2001	0.644	0.667	1.000	0.167	0.198	30
2002	0.656	0.667	1.000	0.000	0.229	25
2003	0.667	0.667	0.833	0.500	0.136	3
2004	0.667	0.667	0.667	0.667	0.000	1
2005	0.393	0.393	0.500	0.286	0.107	2
Trend	0.017 *	0.011	0.000	0.010	-0.024 ***	

Table 3: Issue Characteristics of Sample IPOs

The variables in this table are used throughout many of the univariate and multivariate analyses in this paper. Thus I define them here and I tabulate their summary statistics. 'First-day Return Mispricing' is the percent change in price from the IPO price t the closing price on the first day of trading, 'IPO Proceeds' is the gross proceeds of the IPO (total shares offered * offer price) measured in millions of dollars, 'Pre-offer Price Change' is the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price, 'Number of Amendments' is the number of times the S1 document was amended, 'Secondary Shares Offered' is the the percent of secondary shares in the IPO, 'Underwriter Prestige' is the lead underwriter rank for the year prior to IPO (data from Jay Ritter http://bear.warrington.ufl.edu/ritter/ipodata.htm), 'Venture Capital Backing Dummy' is a binary variable indicating the presence of venture capital backing prior to the IPO, 'Auditor Prestige' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, 'Average Prior Three Month Underpricing' is the average percent of underpricing (data from Jay Ritter http://bear.warrington.ufl.edu/ritter/ipodata.htm), and 'Three-week Prior Market Return' is the percent return on the market (value weighed NYSE/AMEX/NASDAQ) three weeks (15 trading days) prior to IPO.

Variable	Mean	Standard Deviation	Median	Minimum	Maximum
First-day Return Mispricing (%)	33.52%	62.50%	16.67%	-99.82%	525.00%
Offering Characteristics					
IPO Proceeds ($ millons)	177.4	395.2	68.1	7.6	3979.1
Pre-offer Price Change (%)	9.0%	28.2%	6.7%	-65.7%	220.0%
Number of Amendments	3.47	1.84	3.00	0.00	10.00
Secondary Shares Offered (%)	13.8%	27.0%	0.0%	0.0%	100.0%
Third Party Certification					
Underwriter Prestige	4.55	4.34	6.51	0.00	9.10
Venture Capital Backing Dummy	42.53%	49.50%	-	-	-
Big-six Auditor Dummy	84.37%	36.36%	-	-	-
Market Conditions					
Average Prior Three Month Underpricing (%)	29.98%	25.56%	18.67%	-1.30%	105.77%
Three-week Prior Market Return (%)	1.08%	3.79%	1.49%	-10.85%	10.84%

Table 4: Representative Provisions and their Associated Key Words

This table lists representative samples of the key words used to identify sample provisions

Provision Example	Category	Key Words
Classified Board	Board	board three; director classified class office; number election term; classes of directors; class I class II class II
Poison Pill	Mergers and Acquisitions	issue rights; restricting transfer rights; voiding rights; deny holder; merger consolidation; protective provisions; 100 times aggregate amount; events deemed liquidation.
Advance Notice Requirements	Procedural	nominations business properly brought annual; properly submit business stockholder; stockholder notice delivered; timely notice
Confidential Voting	Voting	judges of election; receive votes or ballots; count and tabulate votes; determine results of election; inspector determine share; appoint

Table 5: Provision Definition and Categorization

This table lists each distinct provision type found in my sample. A definition of each provision is provided. The provisions are sorted into four different categories. Panel A (Board Provisions) lists the four provision types which have most to do with board structure, board powers and authority, and board rights and privileges. Panel B (Mergers and Acquisitions) contains the three provisions types which come into play during mergers and acquisitions. Panel C (Procedural Provisions) lists procedures governing director nomination, implementation of poison pills, requirements to call special meetings, and procedures to act by written consent. Panel D (Voting Provisions) concern the voting rights and powers of the shareholders.

Panel A: Board Provisions

Type	Description
CBOARD	A Classified Board (or "staggered" board) is one in which the directors are placed into different classes and serve overlapping terms. Since only part of the board can be replaced each year, an outsider who gains control of a corporation may have to wait a few years before being able to gain control of the board. This slow replacement makes a classified board a crucial component of the Delay group of provisions, and one of the few provisions that clearly retains some deterrent value in modern takeover battles [Daines and Klausner 2001].
DIRIND	Director Indemnification uses the bylaws, charter, or both to indemnify officers and directors from certain legal expenses and judgments resulting from lawsuits pertaining to their conduct. Some firms have both this "Indemnification" in their bylaws or charter and additional indemnification "Contracts". The cost of such protection can be used as a market measure of the quality of corporate governance [Core 1997 and 2000].
DIRLIAB	Limitations on director Liability are charter amendments that limit directors' personal liability to the extent allowed by state law. They often eliminate personal liability for breaches of the duty of care, but not for breaches of the duty of loyalty or for acts of intentional misconduct or knowing violation of the law.
DUTIESNF	Directors' Duties provisions allow directors to consider constituencies other than shareholders when considering a merger. These constituencies may include, for example, employees, host communities, or suppliers. This provision provides boards of directors with a legal basis for rejecting a takeover that would have been beneficial to shareholders.

Panel B: Merger and Acquisition Provisions

Type	Description
FAIRPRICE	Fair-Price provisions limit the range of prices a bidder can pay in two-tier offers. They typically require a bidder to pay to all shareholders the highest price paid to any during a specified period of time before the commencement of a tender offer, and do not apply if the deal is approved by the board of directors or a supermajority of the target's shareholders. The goal of this provision is to prevent pressure on the target's shareholders to tender their shares in the front end of a two-tiered tender offer, and they have the result of making such an acquisition more Expensive.
BLANKCHECK	Blank Check preferred stock is stock over which the board of directors has broad authority to determine voting, dividend, conversion, and other rights. While it can be used to enable a company to meet changing financial needs, its most important use is to implement poison pills or to prevent takeover by placing this stock with friendly investors. Because of this role, blank check preferred stock is a crucial part of a "delay" strategy.
PPILL	Poison Pills provide their holders with special rights in the case of a triggering event such as a hostile takeover bid. If a deal is approved by the board of directors, the poison pill can be revoked, but if the deal is not approved and the bidder proceeds, the pill is triggered. Typical poison pills give the holders of the target's stock other than the bidder the right to purchase stock in the target or the bidder's company at a steep discount, making the target unattractive or diluting the acquirer's voting power. Poison pills are a crucial component of the "delay" strategy.
SUPERMAJOR	Supermajority requirements for approval of mergers are charter provisions that establish voting requirements for mergers or other business combinations that are higher than the threshold requirements of state law. They are typically 66.7, 75, or 85 percent, and often exceed attendance at the annual meeting.

Panel C: Procedural Provisions

Type	Description
ADVNR	These limits generally take the form of advance notice requirements (often 60 days and sometimes as many as 130 days) for shareholders to make board nominations or to place an item on the agenda of a shareholders meeting.
LPSMT	Special Meeting limitations either increase the level of shareholder support required to call a special meeting beyond that specified by state law or eliminate the ability to call one entirely. Such provisions add extra time to proxy fights, since bidders must wait until the regularly scheduled annual meeting to replace board members or dismantle takeover defenses.
LWCNST	Limitations on action by Written Consent can take the form of the establishment of majority thresholds beyond the level of state law, the requirement of unanimous consent, or the elimination of the right to take action by written consent. Such requirements add extra time to many proxy fights, since bidders must wait until the regularly scheduled annual meeting to replace board members or dismantle takeover defenses.

Panel D: Voting Provisions

Type	Description
CONFVOTE	Under a Secret Ballot (also called confidential voting), either an independent third party or employees sworn to secrecy are used to count proxy votes, and the management usually agrees not to look at individual proxy cards. This can help eliminate potential conflicts of interest for fiduciaries voting shares on behalf of others, and can reduce pressure by management on shareholder-employees or shareholder-partners. Cumulative Voting (see above) and Secret Ballots are the only two provisions whose presence is coded as an increase in shareholder rights, with an additional point to the Governance Index if the provision is absent.
CUMVOTE	Cumulative Voting allows a shareholder to allocate his total votes in any manner desired, where the total number of votes is the product of the number of shares owned and the number of directors to be elected. By allowing them to concentrate their votes, this practice helps minority shareholders to elect directors. Cumulative Voting and Secret Ballot (see below) are the only two provisions whose presence is coded as an increase in shareholder rights, with an additional point to the Governance Index if the provision is absent.
LABYLW	Limit Shareholder Ability to Amend Bylaws
LACHTR	Limit Shareholder Ability to Amend Charter

Table 6: The Relationship between Provision Category and Camouflage

This table analyzes the relationship between provision type and camouflage. I sort provisions into 'Board', 'M&A', 'Procedural', and 'Voting' categories. In Panel A I show the average camouflage in each provision as well as the average camouflage across categories. I do this for aggregate camouflage as wells as for the components of camouflage: tone, obfuscation and placement. In Panels B through E, I conduct difference of means test between each provision category for aggregate camouflage as well as for the components of camouflage. These panels report t-statistics constructed as the difference of means between a row variable and a corresponding column variable. I report test results as t-statistics and indicate significance where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. The camouflage types are defined as follows: CBOARD – classified board, DIRIND – director indemnification, DIRLIAB – director liability, DUTIES NF – duties non financial, BLANKCHECK – blank check, FAIRPRICE – fair price, PPILL – poison pill, SUPERMAJOR – super majority required, ADVNR – advanced notice required, LSPSMT – limit ability to call sepcial meeting, LWCNST – limit ability to act by special consent, CONFOTE – confidential voting, CUMVOTE – cumulative voting, LABYLW – limit ability to amend bylaws, LACHTR – limit ability to amend charter, SECRETBALLOT – secret ballot.

Panel A: Average Camouflage Across Provision Categories

Category	Type	Count	Percent	Aggregate Camouflage	Tone	Obfuscation	Placement
BOARD	CBOARD	255	14.32%	1.824	0.741	0.333	0.749
	DIRIND	10	0.56%	2.200	1.000	0.800	0.400
	DIRLIAB	11	0.62%	2.545	1.000	0.909	0.636
	DUTIESNF	15	0.84%	1.867	0.133	0.733	1.000
	Averages			1.866	0.729	0.392	0.746
	Totals	291	16.34%				
M&A	BLANKCHECK	380	21.34%	1.939	0.358	0.595	0.987
	FAIR PRICE	11	0.62%	2.455	0.636	1.000	0.818
	PPILL	114	6.40%	1.956	0.377	0.605	0.974
	SUPERMAJOR	17	0.95%	2.412	0.824	0.706	0.882
	Averages			1.969	0.383	0.609	0.977
	Totals	522	29.31%				
PROCEDURAL							
	ADVNR	317	17.80%	1.161	0.363	0.770	0.028
	LSPMT	238	13.36%	0.849	0.231	0.223	0.395
	LWCNST	253	14.21%	1.798	0.668	0.427	0.704
	Averages			1.269	0.420	0.501	0.348
	Totals	808	45.37%				
VOTING	CONFVOTE	13	0.73%	0.692	0.4615	0	0.2308
	CUMVOTE	11	0.62%	1.000	0.4545	0.0909	0.4545
	LABYLW	115	6.46%	1.887	0.9217	0.4087	0.5565
	LACHTR	6	0.34%	2.500	1	0.5	1
	SECRET BALLOT	13	0.73%	0.769	0.5385	0	0.2308
	Averages			1.656	0.813	0.325	0.519
	Totals	158	8.87%				

Panel B: Difference of Means for Aggregate Camouflage

	M&A	Voting	Procedural
Board	-1.871*	2.514**	10.694***
M&A		4.095***	15.644***
Voting			5.041***

Panel C: Difference of Means for Tone Camouflage

	M&A	Voting	Procedural
Board	10.249***	-2.074**	9.851***
M&A		-11.427***	-1.325
Voting			11.070***

Panel D: Difference of Means for Obfuscation Camouflage

	M&A	Voting	Procedural
Board	-6.081***	1.423	-3.255***
M&A		6.631***	3.899***
Voting			-4.288***

Panel E: Difference of Means for Placement Camouflage

	M&A	Voting	Procedural
Board	-8.761***	4.812***	13.014***
M&A		11.409***	34.948***
Voting			3.974***

Table 7: Comparative Use of Camouflage by Individual Provision Type

This table is similar to Table 6 except I sort by individual provision without regard for category. It lists provisions in order of aggregate camouflage score, from most aggregate camouflage to least aggregate camouflage. I compute the F-statistic for the difference of means in each camouflage column. Significance of the F-statistic is indicated where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. In Panel B I sort provisions by tone, in Panel C I sort provisions by obfuscation and in Panel D I sort provisions by placement.

Panel A: Provisions sorted by Aggregate Camouflage

Provision Type	Provision Category	Aggregate Camouflage	Tone	Obfuscation	Placement
DIRLIAB	board	2.55	1.00	0.91	0.64
LACHTR	voting	2.50	1.00	0.50	1.00
FAIR PRICE	mna	2.45	0.64	1.00	0.82
SUPERMAJOR	mna	2.41	0.82	0.71	0.88
DIRIND	board	2.20	1.00	0.80	0.40
PPILL	mna	1.96	0.38	0.61	0.97
BLANKCHECK	mna	1.94	0.36	0.59	0.99
LABYLW	voting	1.89	0.92	0.41	0.56
DUTIESNF	board	1.87	0.13	0.73	1.00
CBOARD	board	1.82	0.74	0.33	0.75
LWCNST	procedural	1.80	0.67	0.43	0.70
ADVNR	procedural	1.16	0.36	0.77	0.03
CUMVOTE	voting	1.00	0.45	0.09	0.45
LSPMT	procedural	0.85	0.23	0.22	0.39
SECRET BALLOT	voting	0.77	0.54	0.00	0.23
CONFVOTE	voting	0.69	0.46	0.00	0.23
F-Statistic for Simultaneous Test of Means		38.14***	28.08***	22.25***	109.93***

Panel B: Provisions sorted by the Tone component of Camouflage

Provision Type	Provision Category	Tone
LACHTR	voting	1
DIRLIAB	board	1
DIRIND	board	1
LABYLW	voting	0.92
SUPERMAJOR	mna	0.82
CBOARD	board	0.74
LWCNST	procedural	0.67
FAIR PRICE	mna	0.64
SECRET BALLOT	voting	0.54
CONFVOTE	voting	0.46
CUMVOTE	voting	0.45
PPILL	mna	0.38
ADVNR	procedural	0.36
BLANKCHECK	mna	0.36
LSPMT	procedural	0.23
DUTIESNF	board	0.13

Panel C: Provisions sorted by the Obfuscation component of Camouflage

Provision Type	Provision Category	Obfuscation
FAIR PRICE	mna	1
DIRLIAB	board	0.91
DIRIND	board	0.8
ADVNR	procedural	0.77
DUTIESNF	board	0.73
SUPERMAJOR	mna	0.71
PPILL	mna	0.61
BLANKCHECK	mna	0.59
LACHTR	voting	0.5
LWCNST	procedural	0.43
LABYLW	voting	0.41
CBOARD	board	0.33
LSPMT	procedural	0.22
CUMVOTE	voting	0.09
CONFVOTE	voting	0
SECRET BALLOT	voting	0

Panel D: Provisions sorted by the Placement component of Camouflage

Provision Type	Provision Category	Placement
LACHTR	voting	1
DUTIESNF	board	1
BLANKCHECK	mna	0.99
PPILL	mna	0.97
SUPERMAJOR	mna	0.88
FAIR PRICE	mna	0.82
CBOARD	board	0.75
LWCNST	procedural	0.7
DIRLIAB	board	0.64
LABYLW	voting	0.56
CUMVOTE	voting	0.45
DIRIND	board	0.4
LSPMT	procedural	0.39
CONFVOTE	voting	0.23
SECRET BALLOT	voting	0.23
ADVNR	procedural	0.03

Table 8: Distribution of Agency Conflict Index across Provisions

In this table I estimate the potential for agency-conflict in each provision. The first two columns of each panel of the table provides the type identifier of the provision (the Type column) and a description of the provision (the Description column). In the next three columns I assign a -1, 0, or 1 to each dimension, based on the provisions impact on shareholder rights, managerial empowerment and transparency. In the 'Weakens Shareholders' column, I assign a 1 if the provision weakens shareholder control rights, I assign a -1 if it does the opposite, and I assign a zero if it does not impact shareholder control rights. In the 'Empowers Managers' column, I assign a 1 if the provision increases founders' power to maintain private benefits of control, I assign a -1 if it reduces founders' power, and I assign a zero if it does not impact founders' power. In the 'Reduces Transparency' column, I assign a 1 if the provision tends to encourage founders to withhold information, I assign a -1 if it tends to encourage managers to publish information, and I assign a 0 if it does not impact managers decisions to publish, or to withhold. In the last column, I sum the previous three columns to arrive at the agency-conflict score. In the last row of each panel I show the average agency conflict score for that panel, as well as the average for each dimension of agency. Panel A lists the Board Provisions, Panel B lists the M&A provisions, Panel C lists the Procedural provisions, and Panel D lists the Voting provisions.

Panel A: Board Provisions

Type	Description	Weakens Shareholders	Empowers Management	Reduces Transparency	Agency Score
CBOARD	A Classified Board (or "staggered" board) is one in which the directors are placed into different classes and serve overlapping terms. Since only part of the board can be replaced each year, an outsider who gains control of a corporation may have to wait a few years before being able to gain control of the board. This slow replacement makes a classified board a crucial component of the Delay group of provisions, and one of the few provisions that clearly retains some deterrent value in modern takeover battles [Daines and Klausner 2001].	1	1	0	2
DIRIND	Director Indemnification uses the bylaws, charter, or both to indemnify officers and directors from certain legal expenses and judgments resulting from lawsuits pertaining to their conduct. Some firms have both this "Indemnification" in their bylaws or charter and additional indemnification "Contracts". The cost of such protection can be used as a market measure of the quality of corporate governance [Core 1997 and 2000].	1	1	0	2
DIRLIAB	Limitations on director Liability are charter amendments that limit directors' personal liability to the extent allowed by state law. They often eliminate personal liability for breaches of the duty of care, but not for breaches of the duty of loyalty or for acts of intentional misconduct or knowing violation of the law.	1	1	1	3
DUTIESNF	Directors' Duties provisions allow directors to consider constituencies other than shareholders. These constituencies may include, for example, employees, host communities, or suppliers. This provision provides boards of directors with a legal basis for rejecting a takeover that would have been beneficial to shareholders.	1	1	1	3
Average Score		1.00	1.00	0.50	2.50

Panel B: Mergers and Acquisitions Provisions

Type	Description	Weakens Shareholders	Empowers Management	Reduces Transparency	Agency Score
FAIRPRICE	Fair-Price provisions limit the range of prices a bidder can pay in two-tier offers. They typically require a bidder to pay to all shareholders the highest price paid to any during a specified period of time before the commencement of a tender offer, and do not apply if the deal is approved by the board of directors or a supermajority of the target's shareholders. The goal of this provision is to prevent pressure on the target's shareholders to tender their shares in the front end of a two-tiered tender offer, and they have the result of making such an acquisition more Expensive.	1	1	1	3
PPILL	Poison Pills provide their holders with special rights in the case of a triggering event such as a hostile takeover bid. If a deal is approved by the board of directors, the poison pill can be revoked, but if the deal is not approved and the bidder proceeds, the pill is triggered. Typical poison pills give the holders of the target's stock other than the bidder the right to purchase stock in the target or the bidder's company at a steep discount, making the target unattractive or diluting the acquirer's voting power. Poison pills are a crucial component of the "delay" strategy	0	1	0	1
SUPERMAJOR	Supermajority requirements for approval of mergers are charter provisions that establish voting requirements for mergers or other business combinations that are higher than the threshold requirements of state law. They are typically 66.7, 75, or 85 percent, and often exceed attendance at the annual meeting.	1	1	0	2
Average Score		0.67	1.00	0.33	2.00

Panel C: Procedural Provisions

Type	Description	Weakens Shareholders	Empowers Management	Reduces Transparency	Agency Score
ADVNR	These limits generally take the form of advance notice requirements (often 60 days and sometimes as many as 130 days) for shareholders to make board nominations or to place an item on the agenda of a shareholders meeting.	1	0	-1	0
BLANKCHECK	Blank Check preferred stock is stock over which the board of directors has broad authority to determine voting, dividend, conversion, and other rights. While it can be used to enable a company to meet changing financial needs, its most important use is to implement poison pills or to prevent takeover by placing this stock with friendly investors. Because of this role, blank check preferred stock is a crucial part of a "delay" strategy.	0	1	0	1
LPSMT	Special Meeting limitations either increase the level of shareholder support required to call a special meeting beyond that specified by state law or eliminate the ability to call one entirely. Such provisions add extra time to proxy fights, since bidders must wait until the regularly scheduled annual meeting to replace board members or dismantle takeover defenses.	1	0	0	1
LWCNST	Limitations on action by Written Consent can take the form of the establishment of majority thresholds beyond the level of state law, the requirement of unanimous consent, or the elimination of the right to take action by written consent. Such requirements add extra time to many proxy fights, since bidders must wait until the regularly scheduled annual meeting to replace board members or dismantle takeover defenses.	1	0	1	2
Average Score		0.75	0.25	0.00	1.00

Panel D: Voting Provisions

Type	Description	Weakens Shareholders	Empowers Management	Reduces Transparency	Agency Score
CONFVOTE	Under a Secret Ballot (also called confidential voting), either an independent third party or employees sworn to secrecy are used to count proxy votes, and the management usually agrees not to look at individual proxy cards. This can help eliminate potential conflicts of interest for fiduciaries voting shares on behalf of others, and can reduce pressure by management on shareholder-employees or shareholder-partners. Cumulative Voting (see above) and Secret Ballots are the only two provisions whose presence is coded as an increase in shareholder rights, with an additional point to the Governance Index if the provision is absent.	-1	-1	1	-1
CUMVOTE	Cumulative Voting allows a shareholder to allocate his total votes in any manner desired, where the total number of votes is the product of the number of shares owned and the number of directors to be elected. By allowing them to concentrate their votes, this practice helps minority shareholders to elect directors. Cumulative Voting and Secret Ballot (see below) are the only two provisions whose presence is coded as an increase in shareholder rights, with an additional point to the Governance Index if the provision is absent.	-1	-1	0	-2
LABYLW	Limit Shareholder Ability to Amend Bylaws	1	1	-1	1
LACHTR	Limit Shareholder Ability to Amend Charter	1	1	0	2
SECRETBALLOT	IRRC uses the term 'Secret Ballot' and 'Confidential Voting' to describe essentially the same arrangement However, in some years the IRRC uses the one term, and in other years the other term. I follow IRRC and mark this provision as Secret Ballot in the same years that IRRC does, and as Confidential Voting in those yeas that IRRC does likewise.	1	0	0	1
Average Score		0.20	0.00	0.00	0.20

Table 9: Provision Level Agency-Conflict and Camouflage

In this table I evaluate the relationship between agency and camouflage. In Panel A I sort the provisions by their average agency-conflict score in descending order. In the last row I compute the F-statistic for the difference of means between the four agency groups where the first group are those provisions with an agency-conflict score of 3, the second group are those provisions with an agency-conflict score of 2, the third group are those provisions with an agency-conflict score of 1, and the fourth group are those provisions with an agency-conflict score of 0 or less. In Panels B through E, I test the significance between each agency group's camouflage, and the components of camouflage. These panels report t-statistics constructed as the difference of means between a row variable and a corresponding column variable. I report test results as t-statistics and indicate significance where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

Panel A: Provision sorted by their agency-conflict score

Provision Type	Agency Score	Aggregate Camouflage	Tone	Obfuscation	Placement
GROUP 1					
DIRLIAB	3	2.55 (3.0)	1.00 (1.0)	0.91 (1.0)	0.64 (1.0)
FAIR PRICE	3	2.45 (3.0)	0.64 (1.0)	1.00 (1.0)	0.82 (1.0)
DUTIESNF	3	1.87 (2.0)	0.13 (0.0)	0.73 (1.0)	1.00 (1.0)
GROUP 2					
LACHTR	2	2.50 (2.5)	1.00 (1.0)	0.50 (0.5)	1.00 (1.0)
SUPERMAJOR	2	2.41 (2.0)	0.82 (1.0)	0.71 (1.0)	0.88 (1.0)
DIRIND	2	2.20 (2.0)	1.00 (1.0)	0.80 (1.0)	0.40 (0.0)
CBOARD	2	1.82 (2.0)	0.74 (1.0)	0.33 (0.0)	0.75 (1.0)
LWCNST	2	1.80 (2.0)	0.67 (1.0)	0.43 (0.0)	0.70 (1.0)
GROUP 3					
PPILL	1	1.96 (2.0)	0.38 (0.0)	0.61 (1.0)	0.97 (1.0)
BLANKCHECK	1	1.94 (2.0)	0.36 (0.0)	0.59 (1.0)	0.99 (1.0)
LABYLW	1	1.89 (2.0)	0.92 (1.0)	0.41 (0.0)	0.56 (1.0)
UNEQVOTE	1	1.50 (1.5)	0.00 (0.0)	0.50 (0.5)	1.00 (1.0)
LSPMT	1	0.85 (1.0)	0.23 (0.0)	0.22 (0.0)	0.40 (0.0)
GROUP 4					
ADVNR	0	1.16 (1.0)	0.36 (0.0)	0.77 (1.0)	0.03 (0.0)
SECRET BALLOT	0	0.77 (1.0)	0.54 (1.0)	0.00 (0.0)	0.23 (0.0)
CONFVOTE	-1	0.69 (1.0)	0.46 (0.0)	0.00 (0.0)	0.23 (0.0)
CUMVOTE	-2	1.00 (1.0)	0.45 (0.0)	0.09 (0.0)	0.45 (0.0)
FStat for Simultaneous Test of Means		165.76***	103.43***	22.58***	359.05***

Panel B: T-tests for the use of Aggregate Camouflage

	Score = 3	Score = 2	Score = 1
Score = 2	-3.584***		
Score = 1	-5.586***	-4.561***	
Score <= 0	-9.983***	-13.898***	-10.142***

Panel C: T-tests for the use of Tone Camouflage

	Score = 3	Score = 2	Score = 1
Score = 2	2.071**		
Score = 1	-1.653	-12.340***	
Score <= 0	-1.895*	-10.589***	-0.805

Panel D: T-tests for the use of Obfuscation Camouflage

	Score = 3	Score = 2	Score = 1
Score = 2	-7.664***		
Score = 1	-6.697***	2.473**	
Score <= 0	-2.784***	9.046***	7.534***

Panel E: T-tests for the use of Placement Camouflage

	Score = 3	Score = 2	Score = 1
Score = 2	-1.703*		
Score = 1	-1.218	1.353	
Score <= 0	-12.471***	-29.532***	-36.842***

Table 10: The Relationship between Agency-Conflict and Camouflage

This table evaluates the relationship between the agency-conflict score and camouflage in a multivariate context. The specification which I evaluate is defined below:

$$CamouflageMeasure = \alpha + \beta_1 \cdot AgencyConflict + \beta_2 \cdot AuditorPrestige + \beta_3 \cdot UnderWriterPrestige + \beta_4 \cdot VentureCapitalBacking + \beta_5 \cdot TotalAmountFiled + \sum \beta_j \cdot FamaFrenchIndustry + \varepsilon$$

where *CamouflageMeasure* is one of aggregate camouflage, tone, obfuscation, or placement and *AgencyConflict* is my agency-conflict score. I include a number of control variables including *AuditorPrestige* which is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *UnderwriterPrestige* which is the lead underwriter rank, *VentureCapitalBacking* which is a dummy variable indicating the presence of venture capital backing prior to IPO, and *TotalAmountFiled* for the total dollar amount filed. Lastly I control for industry fixed effects using the *FamaFrenchIndustry* classifications. I report test results as t-statistics and indicate significance where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Camouflage	Tone	Obfuscation	Placement
Agency Conflict Score	0.3360 ***	0.1473 ***	-0.0657 ***	0.2545 ***
Controls				
Auditor Prestige	-0.0597	-0.0279	-0.0031	-0.0286
Underwriter Prestige	-0.001	-0.0016	0.0004	0.0002
Venture Capital Backing	-0.0029	-0.0118	-0.0242	0.0331
Total Amount Filed (log)	0.0621 **	0.0168	0.0507 ***	-0.0053
Industry Fixed Effects	yes	yes	yes	yes
R^2	0.101	0.071	0.033	0.179
df	1424	1424	1424	1424

Table 11: Industry Concentration (Herfindahl Index)

This table tests the relationship between industry concentration and camouflage. I use the Herfindahl index to measure industry concentration. I sort results into three groups. In the 'More Concentrated' group are those IPOs entering industries with Herfindahl scores in the upper 75th percentiles. In the 'Less Concentrated' group are those IPOs entering industries with Herfindahl scores in the lower 25th percentile. In the 'Average Concentration' group are those IPOs entering industries between the upper 75th percentile and the lower 25th percentile. I conduct t-tests on the mean camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

Herfindahl Index	Aggregate Camouflage	Tone	Obfuscation	Placement
More Concentrated	1.703	0.517	0.531	0.656
Average Concentration	1.578	0.483	0.497	0.597
Less Concentrated	1.488	0.429	0.492	0.567
Test Statistic	0.002***	0.026**	0.338	0.024**

Table 12: Analyst Followings

In this table I test the relationship between analyst scrutiny and camouflage. I use IBES to determine the industry adjusted number of analysts watching the IPO. I sort results into three groups. In the 'More Analysts' group are those IPOs with high analyst followings (75th percentile). In the 'Less Analysts' group are those IPOs with low analyst followings (25th percentile). In the 'Average Concentration' group are those IPOs with analyst followings between the upper 75th percentile and the lower 25th percentile. I conduct t-tests for the differences of mean camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Aggregate Camouflage	Tone	Obfuscation	Placement
More Analysts	1.587	0.459	0.524	0.603
Average Analysts	1.623	0.498	0.524	0.601
Less Analysts	1.661	0.539	0.523	0.598
Test Statistic	0.31	0.048**	0.978	0.901

Table 13: The Relationship between Camouflage and Industry Scrutiny

This table reports the relationship between camouflage and various measures of industry specific scrutiny. I test this relationship with the following model:

$$Camouflage = \alpha + \beta_1 \cdot HerfindahlIndex + \beta_2 \cdot AnalystFollowing + \beta_3 \cdot RelativeSize + \beta_5 \cdot HighTech + \beta_6 \cdot HealthCare + \beta_7 \cdot Energy + \beta_8 \cdot Telecom + \beta_9 \cdot Utilities + \varepsilon$$

where *Camouflage* is one of aggregate camouflage, tone, obfuscation or placement, *Herfindahl* is a measure of industry concentration, *AnalystFollowing* is the IBES industry adjusted number of analysts covering the IPO, *RelativeSize* the ratio of the IPOs market capitalization of the IPO to that of the entire industry, and the remaining variables are control dummies set to 1 respectively. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Aggregate Camouflage	Tone	Obfuscation	Placement
Herfindahl Index	1.5358 **	0.5887	0.6717 *	0.2753
Analyst Following	-0.0186 **	-0.0126 **	-0.0042	-0.0018
Relative Size	0.0048	0.0009	0.0025	0.0014
High Tech	0.0213	0.0272	0.0063	-0.0122
Health Care	0.0219	0.0702	-0.0297	-0.0187
Energy	0.0129	0.0071	-0.0504	0.0563
Telecom	-0.1093	-0.0918	-0.1296 *	0.1120 *
Utilities	-0.1616	0.2492	-0.3407	-0.07

Table 14: Leverage and the Use of Camouflage

In this table I evaluate the relationship between debt and camouflage. In each panel I test for differences in the use of aggregate camouflage between IPOs that have a high amount of debt (75th percentile) compared to those that have a low amount of debt (25th percentile). In the next three columns I run the same test on the components of camouflage. I standardize all measures of debt by the market capitalization of the IPO and by average industry market capitalization. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

Panel A: Long Term Debt	Aggregate Camouflage	Tone	Obfuscation	Placement
Above Average Long Term Debt	1.608	0.482	0.528	0.598
Average Long Term Debt	1.580	0.495	0.495	0.590
Below Average Long Term Debt	1.555	0.507	0.465	0.584
Test Statistic	0.475	0.532	0.139	0.740

Panel B: Short Term Debt	Aggregate Camouflage	Tone	Obfuscation	Placement
Above Average Short Term Debt	1.589	0.461	0.525	0.603
Average Short Term Debt	1.598	0.491	0.499	0.608
Below Average Short Term Debt	1.601	0.503	0.489	0.609
Test Statistic	0.858	0.238	0.337	0.878

Table 15: Multivariate Analysis of Camouflage and Financial Leverage

This table evaluates the relationship between debt and camouflage in a multivariate context. The specification is below:

where *Debt* is one of short term debt or long term debt. I include a number of control variables including *AuditorPrestige* which is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *UnderwriterPrestige* which is the lead underwriter rank, *VentureCapitalBacking* which is a dummy variable indicating the presence of venture capital backing prior to IPO. Lastly I control for industry fixed effects using the *FamaFrenchIndustry* classifications. I report test results as t-statistics and indicate significance where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2
Long Term Debt	-0.00144 (0.51689)	
Short Term Debt		-0.03978 (0.72146)
Underwriter Prestige	0.0009	0.001
Auditor Prestige	-0.0261	-0.0269
Venture Capital Backing	0.0046	0.0061
Industry Fixed Effects	yes	yes
R^2	0.026	0.025
df	352	352

Table 16: Sample Summary Issuance Statistics by Industry

This table provides descriptive statistics of the clustering and timing of the IPOs in my sample. I sort the sample by industry. *Number of IPOs* is the IPO count for each industry. *Mean (Median) Days Between IPOs* are the average number of days between an IPO for each industry. *Standard Deviation* is the standard deviation in the number of days between IPOs. *Min (Max) Days Between IPOs* is the minimum (maximum) number of days between IPOs for each industry. *25th (75th) Percentile* are the relevant number of days from this IPO to the previous one.

Industry	Number of IPOs	Mean Days Between IPOs	Median Days Between IPOs	Standard Deviation	Min Days Between IPOs	25th Percentile	75th Percentile	Max Days Between IPOs
Business Equipment	152	20.45	7	44.06	0	3	21	433
Chemicals	5	359.4	254	303.97	196	196	622	725
Durable Goods	3	69.67	55	78.04	55	28	105	154
Energy	12	205.67	130	202.96	1	63	343	669
Healthcare	49	76.57	35	160.36	1	10	99	1106
Manufacturing	23	118.83	83	131.86	0	19	187	443
Money	44	64.41	46	79.85	0	14	72	408
Non-Durable Goods	13	143.77	131	131.60	9	42	182	465
Other	65	43.11	26	48.97	0	12	64	239
Shops	44	76.68	54	104.69	0	12	90	610
Telecom	23	155.26	71	261.39	0	27	117	1049
Utilities	2	164	164	231.93	328	82	246	328
Total Sample	435	66.31	22	124.97	0	6	73.5	1106

Table 17: IPO Activity and the Use of Camouflage

In this table I test the relationship between IPO activity and camouflage. I test two measures of IPO activity: Antecedent IPO Proceeds, and Days to Last IPO. 'Antecedent IPO Proceeds' is the average proceeds for all the IPOs which occurred in the same industry over the last year. This factor essentially weights IPO activity by offer proceeds. Days to last IPO is the number of days to the last IPO which occurred in the same industry. I sort results into three percentiles, the upper 75th percentiles, the lower 25th percentile, and those lying between. I conduct t-tests between the average amounts of camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

Panel A: Days to Last IPO

	Camouflage	Tone	Obfuscation	Placement
More Days to Last IPO	1.586	0.464	0.473	0.648
Average Number of Days to Last IPO	1.604	0.483	0.498	0.624
Less Days to Last IPO	1.623	0.501	0.522	0.601
Test Statistic	0.577	0.365	0.25	0.242

Panel B: Antecedent IPO Proceeds

	Camouflage	Tone	Obfuscation	Placement
Antecedent IPOs - Above Average Proceeds	1.639	0.466	0.513	0.66
Antecedent IPOs - Average Proceeds	1.625	0.491	0.505	0.629
Antecedent IPOs - Below Average Proceeds	1.612	0.516	0.497	0.598
Test Statistic	0.696	0.203	0.701	0.113

Table 18: Multivariate Analysis of IPO Activity and Camouflage

This table evaluates the relationship between camouflage and IPO activity in a multivariate setting. I run the following model:

$$LHS = \alpha + \beta_1 \cdot IpoActivity + \beta_2 \cdot MeanDaysToLastIPO + \beta_3 \cdot Proceeds + \sum \beta_i \cdot FamaFrenchIndustry$$

where *LHS* is one of aggregate camouflage, tone, obfuscation, or placement. I test two different measures of IPO Activity. In Panel A I test *Days to Last IPO* and in Panel B I test *Antecedent IPO Proceeds*. I control for Mean Days to Last IPO in that industry and for the proceeds of the IPO. I also control for industry fixed effects. I report significance as follows: '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

Panel A: Days to Last IPO

	Aggregate Camouflage	Tone	Obfuscation	Placement
Days to Last IPO	-0.0009 *	-0.0003	-0.0008 ***	0.0002
Mean Days to Last IPO	0.0010	0.0000	0.0001 **	0.0000
Proceeds	0.1530 **	0.0440	0.1050 ***	0.0040
Industry Fixed Effects	yes	yes	yes	yes
R^2	0.032	0.038	0.057	0.021
df	420	420	420	420

Panel B: Antecedent Offer Proceeds

	Aggregate Camouflage	Tone	Obfuscation	Placement
Antecedent Offer Proceeds	0.0043 **	-0.0001	0.0009	0.0035 ***
Mean Days to Last IPO	0.0000	0.0000	0.0000	0.0000
Proceeds	0.1490 **	0.0430	0.1020 ***	0.0050
Industry Fixed Effects	yes	yes	yes	yes
R^2	0.034	0.036	0.038	0.041
df	420	420	420	420

Table 19: Annual Distribution of SEC Enforcement Activity Level

This table shows the statistical distribution of characteristics of the SEC. The percent change follows in parentheses (% change). The SEC Budget is inflation adjusted to 1995 dollars. Total Number of Enforcement Actions are the total number of new enforcement actions initiated in that year. The last two columns of this table decompose the Enforcement Actions into Civil Actions or Administrative Procedures.

Year	SEC Budget	Number of Staff	Total Number of Enforcement Actions	Total Number of Civil Actions	Administrative Procedures
1995	269150 (3.6%)	2825 (-3.91%)	486 (-2.21%)	194 (-15.28%)	292 (8.96%)
1996	292239 (8.58%)	3039 (7.58%)	453 (-6.79%)	212 (9.28%)	241 (-17.47%)
1997	284359 (-2.7%)	3039 (0%)	489 (7.95%)	203 (-4.25%)	286 (18.67%)
1998	287262 (1.02%)	3039 (0%)	477 (-2.45%)	229 (12.81%)	248 (-13.29%)
1999	291070 (1.33%)	3039 (0%)	525 (10.06%)	227 (-0.87%)	298 (20.16%)
2000	316833 (8.85%)	3101 (2.04%)	503 (-4.19%)	259 (14.1%)	244 (-18.12%)
2001	329175 (3.9%)	3235 (4.32%)	485 (-3.58%)	236 (-8.88%)	249 (2.05%)
2002	357726 (8.67%)	3285 (1.55%)	598 (23.3%)	317 (34.32%)	281 (12.85%)
2003	424495 (18.66%)	3353 (2.07%)	678 (13.38%)	313 (-1.26%)	365 (29.89%)
2004	577638 (36.08%)	4009 (19.56%)	639 (-5.75%)	375 (19.81%)	264 (-27.67%)
2005	636735 (10.23%)	4090 (2.02%)	629 (-1.56%)	335 (-10.67%)	294 (11.36%)

Table 20: SEC Budget and the Use of Camouflage

In this table I test the relationship between SEC budget excess and the use of camouflage. budget excess is the difference in dollars between the actual SEC Budget and the expected SEC Budget. I sort results into three groups, the upper 75th percentile, the lower 25th percentile, and those lying between. The number of IPOs in each group is as follows: Upper 75th percentile group: 108 observations, Lower 25th percentile group: 109 observations, Middle group: 218 observations. I conduct t-tests between the average amounts of camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage.

	Aggregate Camouflage	Tone	Obfuscation	Placement
SEC Budget More than Expected	1.508	0.445	0.505	0.557
Expected SEC Budget	1.571	0.481	0.495	0.595
SEC Budget Less than Exepected	1.625	0.518	0.500	0.608
Test Statistic	0.053*	0.035**	0.871	0.162

Table 21: SEC Enforcement Activity and the Use of Camouflage

In this table I test the univariate relationship between SEC activity excess and the use of camouflage. Activity excess is the difference between the total number of cases actually initiated by the SEC and the number expected to be initiated by the SEC. I sort results into three groups, the upper 75th percentile, the lower 25th percentile, and those lying between. The number of IPOs in each group is as follows: Upper 75th percentile group: 108 observations, Lower 25th percentile group: 109 observations, Middle group: 218 observations. I conduct t-tests between the average amounts of camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage, in the last column I test agency.

	Aggregate Camouflage	Tone	Obfuscation	Placement
SEC Initiated More Cases than Expected	1.417	0.435	0.522	0.460
Expected Number of SEC Cases Intiated	1.571	0.481	0.495	0.595
SEC Initiated Fewer Cases than Expected	1.625	0.518	0.500	0.608
Test Statistic	0.033**	0.135	0.669	0.020**

Table 22: The Incremental Impact of SEC Scrutiny on Camouflage

This table evaluates a multivariate model of the incremental economic impact of SEC Scrutiny on camouflage and its components. I estimate the following model:

$$camouflage = \alpha + \beta_1 \cdot ScrutinyProxy + \beta_2 \cdot UnderwriterPrestige + \beta_3 \cdot AuditorPrestige + \beta_4 \cdot VentureCapitalBacking + \sum \beta_i \cdot FamaFrenchIndustry + \epsilon$$

where *ScrutinyProxy* is one of my two proxies for SEC Scrutiny, *Camouflage* is my aggregate camouflage measure, *UnderwriterPrestige* is the lead underwriter rank for the year prior to IPO, '*AuditorPrestige*' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *VentureCapitalBacking* indicates the presence of VC backing prior to the IPO. I control for industry fixed effects. I tabulate significance as follows: '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2
Budget Surprise	-0.0029 **	
Enforcement Activity Surprise		-0.0008 **
Underwriter Prestige	-0.0045	-0.0045
Auditor Prestige	-0.0119	-0.0119
Venture Capital Backing	0.0049	0.0049
Industry Fixed Effects	yes	yes

Table 23: The Influence of Camouflage on Offer Proceeds and Underpricing

This table tests the relationships between camouflage and underpricing, and between camouflage and offer proceeds. I sort results into three groups, the upper 75th percentile, the lower 25th percentile, and those lying between. I conduct t-tests between the average amounts of camouflage between the 75th and 25th percentile groups. The significance of these tests are reported in the 'test statistic' row where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage.

Panel A: Underpricing and Camouflage

	Aggregate	Tone	Obfuscation	Placement
Underpricing is Higher than Average	1.612	0.494	0.493	0.625
Average Underpricing	1.536	0.463	0.484	0.589
Underpricing is Lower than Average	1.615	0.508	0.524	0.584
Test Statistic	0.967	0.73	0.449	0.3

Panel B: Offer Proceeds and Camouflage

	Aggregate	Tone	Obfuscation	Placement
Offer Proceeds are Higher than Average	1.613	0.477	0.549	0.587
Average Offer Proceeds	1.594	0.491	0.49	0.613
Offer Proceeds are Lower than Average	1.511	0.474	0.461	0.576
Test Statistic	0.139	0.934	0.031**	0.785

Table 24: Camouflage and Underpricing

In this table I evaluate four multivariate models testing the effect of camouflage and its components on underpricing. The basic model is as follows:

$$\begin{aligned} Underpricing = {} & \alpha + \beta_1 \cdot CamoMeasure + \beta_2 \cdot TotalAmountFiled + \beta_3 \cdot PreOfferPriceChange + \beta_4 \cdot NumberAme \\ & \beta_5 \cdot SecondarySharesOffered + \beta_6 \cdot UnderwriterPrestige + \beta_7 \cdot VentureCapitalBacking + \\ & \beta_8 \cdot AuditorPrestige + \beta_9 \cdot AveragePriorThreeMonthUnderpricing \\ & \beta_{10} \cdot ThreeWeekPriorMarketReturn + \sum \beta_i \cdot FamaFrenchIndustry + \sum \beta_j \cdot YearFixedEffects + \end{aligned}$$

where *CamoMeasure* takes one of four values: aggregate camouflage, tone, obfuscation or placement, *TotalAmountFiled* is the amount filed, in millions of dollars,'*PreOfferPriceChange*' is the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price, *NumberAmendments* is the number of times the S-1 document was amended, *SecondarySharesOffered* is the percent of secondary shares in the IPO, *UnderwriterPrestige* is the lead underwriter rank for the year prior to IPO, *VentureCapitalBacking* indicates the presence of VC backing prior to the IPO, '*AuditorPrestige*' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *AveragePriorThreeMonth-Underpricing* is the average percent of underpricing of IPOs in the prior three months, and *ThreeWeekPriorMarket-Return* is the percent return on the market (value weighted) three weeks (15 trading days) prior to IPO. I control for industry fixed effects using the Fama French industry classifications. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2	Model 3	Model 4
Aggregate Camouflage	-0.0011 *			
Tone		-0.0022 **		
Obfuscation			-0.0004	
Placement				-0.0007
Total Amount Filed (log)	0.0416	-0.0100	-0.0230	-0.0391
Pre-offer Price Change	0.0137 ***	0.0137 ***	0.0136 ***	0.0136 ***
Number of Amendments	-0.0003	-0.0003	-0.0003	-0.0003
Secondary Shares Offered (%)	0.0001	-0.0001	-0.0001	-0.0001
Underwriter Prestige	0.0000	-0.0001	0.0000	0.0000
Venture Capital Backing	0.0022 ***	0.0022 ***	0.0022 ***	0.0022 ***
Auditor Prestige	0.0007	0.0008	0.0008	0.0007
Average Prior Three-month Underpricing (%)	-0.0055 **	-0.0052 *	-0.0051 *	-0.0053 **
Three-week Prior Market Return (%)	-0.0130	-0.0145 *	-0.0134	-0.0131
Industry Fixed Effects	yes	yes	yes	yes
Year Fixed Effects	yes	yes	yes	yes
R^2	0.5380	0.5390	0.5320	0.5330

Table 25: Camouflage and Relative Offer Proceeds

In this panel I evaluate four multivariate models testing the effect of camouflage and its components on offer proceeds. The model I evaluate is defined below:

where *CamoMeasure* takes one of four values: aggregate camouflage, tone, obfuscation or placement, *TotalAmountFiled* is the amount filed, in millions of dollars, '*PreOfferPriceChange*' is the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price, *NumberAmendments* is the number of times the S-1 document was amended, *SecondarySharesOffered* is the percent of secondary shares in the IPO, *UnderwriterPrestige* is the lead underwriter rank for the year prior to IPO, *VentureCapitalBacking* indicates the presence of VC backing prior to the IPO, '*AuditorPrestige*' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *AveragePriorThreeMonth-Underpricing* is the average percent of underpricing of IPOs in the prior three months, and *ThreeWeekPriorMarket-Return* is the percent return on the market (value weighted) three weeks (15 trading days) prior to IPO. I control for industry fixed effects using the Fama French industry classifications. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2	Model 3	Model 4
Aggregate Camouflage	0.1943 **			
Tone		0.1966		
Obfuscation			0.3792 **	
Placement				0.001
Pre-offer Price Change	0.4571 **	0.4634 **	0.4657 **	0.4717 **
Number of Amendments	0.0521	0.0525	0.0506	0.0512
Secondary Shares Offered (%)	0.6926 ***	0.7294 ***	0.6661 ***	0.7379 ***
Underwriter Prestige	-0.0081	-0.0077	-0.01	-0.0086
Venture Capital Backing	-0.4733 ***	-0.4790 ***	-0.4586 ***	-0.4752 ***
Auditor Prestige	0.0858	0.0784	0.0791	0.0788
Average Prior Three-month Underpricing (%)	1.1433 ***	1.0901 **	1.0596 **	1.0852 **
Three-week Prior Market Return (%)	0.09	0.243	0.063	0.1491
Industry Fixed Effects	yes	yes	yes	yes
Year Fixed Effects	yes	yes	yes	yes
R^2	0.447	0.442	0.449	0.439

Table 26: Camouflage and IPO Flipping

In this table I test the relationships between camouflage and flipping. In this table I sort my sample of IPOs into three groups by percent volume of shares flipped by institutions, on the first day of trading. The 'Above Average Flipping' group contains those IPOs whose percent volume of shares flipped by institutions was in the upper 75th percentile. The 'Below Average Flipping' group contains those IPOs whose percent volume of shares flipped by institutions was in the lower 25th percentile. The 'Average Amount of Flipping' group contains the residual firms. I conduct t-tests on the difference of mean underpricing (offer proceeds) between the upper and lower groups. The statistical significance of the tests are reported as 'Test Statistic'. where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance. In the first column I test aggregate camouflage, in the next three columns I run the same test on the components of camouflage.

	Aggregate Camouflage	Tone	Obfuscation	Placement
Above Average Flipping	1.628	0.459	0.552	0.617
Average Amount of Flipping	1.568	0.488	0.484	0.596
Below Average Flipping	1.507	0.516	0.416	0.575
Test Statistic	0.084*	0.142	0.001***	0.276

Table 27: Camouflage as an Ex-Ante Predictor of Flipping

This table evaluates camouflage as an ex-ante predictor of flipping. I evaluate the following model:

$$Flipping = \alpha + \beta_1 \cdot CamoMeasure + \beta_2 UnderwriterRank + \beta_3 \cdot \ln(MktCap) + \beta_4 \cdot ExanteReturn + \epsilon$$

where flipping is defined as the percent of the issue immediately sold back to the underwriter or to the market (Krigman, Shaw and Womack (1999)), C*amoMeasure* takes one of four values: aggregate camouflage, tone, obfuscation or placement. *UnderwriterRank* is the lead underwriter rank for the year prior to IPO, *ln(MktCap)* is the natural logarithm of the IPOs market capitalization at the time of IPO, and *ExanteReturn* is the percentage change from the offer price to the opening trade price. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2	Model 3	Model 4
Aggregate Camouflage	0.0346 *			
Tone		-0.03		
Obfuscation			0.1081 ***	
Placement				0.0169
Underwriter Rank	0.0011	0.001	0.001	0.001
LN(Market Cap)	0.0051	0.0060 *	0.005	0.0057
Ex-ante Return	-0.1249 ***	-0.1254 ***	-0.1270 ***	-0.1249 ***
R^2	0.101	0.095	0.121	0.094
df	416	416	416	416

Table 28: The Relationship Between Camouflage and Long Run Performance

I test the relationship between long run performance and aggregate camouflage. In the columns I test periods 6 months, 9 months, 1 year, 2 years and 3 years. For each period I sort firms by BHR and sort them into three groups. The 'Above Average Performance' group contains those firms with buy-and-hold returns in the upper 75th percentile of my sample. The 'Below Average Performance' group is made up of those firms with a BHR in the lower 25th percentile of my sample. Lastly, the 'Average Performance' group is composed of the residual firms. I conduct t-tests on the difference of mean BHR between the upper and lower groups. The significance of these tests are reported in the 'test statistic' row where '*' is 10% significance, '**' is 5% significance and '***' is 1% significance

	6 Month	9 Month	1 Year	2 Year	3 Year
Above Average Performance	1.637	1.606	1.625	1.629	1.587
Average Performance	1.622	1.584	1.593	1.572	1.535
Below Average Performance	1.607	1.562	1.56	1.515	1.482
Test Statistic	0.639	0.493	0.332	0.133	0.17

Table 29: Camouflage and Long Run Performance

This table estimates four multivariate models testing the relationship between long run performance and camouflage.

$$BHR_{1yr} = \alpha + \beta_1 \cdot CamoMeasure + \beta_2 \cdot TotalAmountFiled + \beta_3 \cdot PreOfferPriceChange + \beta_4 \cdot NumberAmendments + \beta_5 \cdot SecondarySharesOffered + \beta_6 \cdot UnderwriterPrestige + \beta_8 \cdot VentureCapitalBacking + \beta_9 \cdot AuditorPrestige + \beta_{10} \cdot AveragePriorThreeMonthUnderpricing + \beta_{11} \cdot ThreeWeekPriorMarketReturn + \sum \beta_i \cdot FamaFrenchIndustry + \sum \beta_j \cdot YearFixedEffects + \epsilon$$

where *CamoMeasure* takes one of four values: aggregate camouflage, tone, obfuscation or placement, *TotalAmountFiled* is the amount filed, in millions of dollars, *PriorActivity* is a measure of clustering over the previous year, '*PreOfferPriceChange*' is the partial adjustment percentage difference between the midrange filing price in the original S1 and the final offer price, *NumberAmendments* is the number of times the S-1 document was amended, *SecondarySharesOffered* is the percent of secondary shares in the IPO, *UnderwriterPrestige* is the lead underwriter rank for the year prior to IPO, *VentureCapitalBacking* indicates the presence of VC backing prior to the IPO, '*AuditorPrestige*' is a binary variable indicating the presence of a Big Six (1995-1998), Big Five (1998-2001), or Big Four (2002-2005) accounting firm, *AveragePriorThreeMonth-Underpricing* is the average percent of underpricing of IPOs in the prior three months, and *ThreeWeekPriorMarket-Return* is the percent return on the market (value weighted) three weeks (15 trading days) prior to IPO. I control for industry fixed effects using the Fama French industry classifications. I control for year fixed effects. '*' is 10% significance, '**' is 5% significance and '***' is 1% significance.

	Model 1	Model 2	Model 3	Model 4
Aggregate Camouflage	0.106			
Tone		-0.0007		
Obfuscation			0.1312	
Placement				0.1826
Total Amount Filed (log)	0.0941 ***	0.0973 ***	0.0958 ***	0.0964 ***
Pre-offer Price Change	-0.5925 **	-0.5849 **	-0.5870 **	-0.5895 **
Number of Amendments	-0.0363	-0.0357	-0.0365	-0.0353
Secondary Shares Offered (%)	-0.0835	-0.0675	-0.0868	-0.0692
Underwriter Prestige	-0.0149	-0.0149	-0.0154	-0.0145
Venture Capital Backing	0.3914 ***	0.3904 ***	0.3972 ***	0.3885 ***
Auditor Prestige	0.0642	0.0679	0.0601	0.0625
Average Prior Three-month Underpricing (%)	-1.6580 ***	-1.7028 ***	-1.7118 ***	-1.6434 ***
Three-week Prior Market Return (%)	1.6016	1.6163	1.5626	1.5805
Industry Fixed Effects	yes	yes	yes	yes
Year Fixed Effects	yes	yes	yes	yes
R^2	0.15	0.15	0.15	0.15

FIGURES

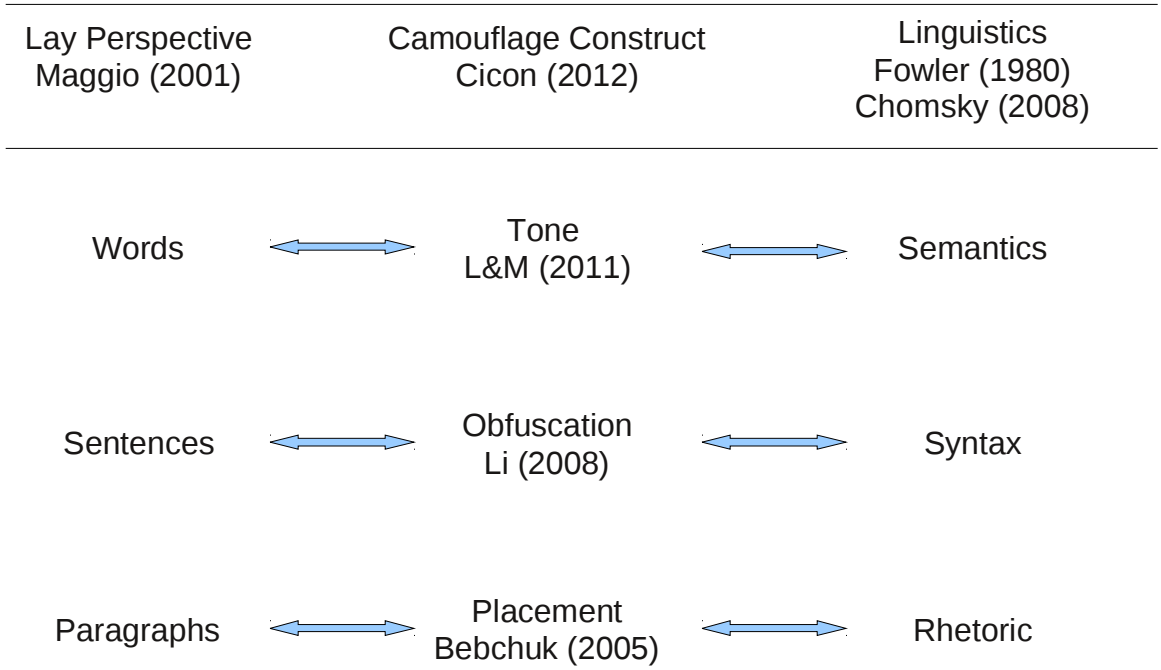

Figure 1: Camouflage Construct

This figure shows how camouflage maps to the lay interpretation of how people write, as well as to the formal linguistics constructs of writing. Specifically, in the lay perspective, tone maps to words, obfuscation maps to sentences, and placement maps to paragraphs. In the linguistic context, tone maps to semantics, obfuscation maps to syntax, and placement maps to rhetoric.

	Explains Camouflage				Explained by Camouflage
Table 10	Agency Conflict	⇨	Camouflage		
Table 13	Herfindahl Index Analyst Followings	⇨	Camouflage		
Table 15	Debt	⇨	Camouflage		
Table 18	Days to Last IPO Anttecedent Offer Proceeds	⇨	Camouflage Camouflage		
Table 22	Budget Surprise Enforcement Surprise	⇨	Camouflage		
Table 24			Camouflage	⇨	Underpricing
Table 25			Camouflage	⇨	Offer Proceeds
Table 27			Camouflage	⇨	Flipping
Table 28			Camouflage	⇨	Long-run Performance

Figure 2: Camouflage, Causality and Endongeneity

In Figure 2, I depict causality in those tables which evaluate the multivariate relationship between camouflage and the relevant factors in the table's specification. In the first column I list the tables which might potentially suffer from endongeneity. In the second and sixth columns I list the factors which I test where the second column lists those which are used to explain camouflage and the sixth column lists those which are explained by camouflage. In columns 3 and 5, I use an arrow to denote the direction of causality.

VITA

James Cicon was born November 8, 1961 in Taylor, Pennsylvania. He joined the military at age 17 and served honorably in the U.S. Regular Army for 4 1/2 years until his discharge in 1983. He served a proselyting mission for the Church of Jesus Christ of Latter Day Saints from 1983 to 1985. He received a degree in Electrical and Computer Engineering from Brigham Young University in 1990. He practiced as an engineer for 13 years until he returned to academia in 1983. He worked for a number of companies including Hewlett Packard Corporation and Fluke Corporation as 'senior staff engineer'. He received a JD and an MBA from the University of Missouri in 2007. He received his PhD from the University of Missouri in 2012.