SPACs: a promising IPO alternative

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If you have not heard of special purpose acquisition companies (SPACs) in the past few months, you are probably missing out on a spectacular capital market phenomenon. A SPAC is a publicly listed shell company exclusively set up for acquiring a private company with cash raised from the market. SPACs, also known as 'blank check companies', seek to combine with private businesses to utilise the cash capital and benefit from quick public listing for the operating entity without undergoing the laborious initial public offering (IPO) process. If the SPAC finds a target company within two years, the target company is merged with the SPAC in exchange for the pool of funds in the trust account.

As a process, a SPAC acquisition is covered in two stages. Firstly, the target company merges into the SPAC and shares of all the investors get transferred to it. Secondly, the investors get shares of the SPAC in exchange of old shares through a share swap.

SPAC could be a safe option for choppy markets and the outbreak of the COVID-19 pandemic has played a key role in its popularity. While traditional IPOs are expensive and involve time-consuming registrations and disclosures, SPACs encompass fewer parties and negotiations, and apparently offer a more flexible and faster route for private equity majors and venture capital funds. SPACs are set up by sponsors that go to the public market to raise cash via IPOs. The sponsors are incentivised by a 'promote' structure, whereby they are eligible to get their returns in the event of a successful merger with an operating business. This creates a profit motive for the sponsors, who utilise their expertise and networks to craft an attractive merger transaction and the resultant 'pop' in listing price is beneficial for all the participants. Some of the world's largest asset managers and some specialist SPAC teams have emerged as sponsors in the current SPAC wave.

SPAC is not just another short-term phenomenon. In 2020 alone, USD83 billon were raised by 248 SPAC IPOs with an average size of USD335 million. These were record-breaking numbers, which exceeded the 2019 figures of SPAC IPOs by more than four times and the amount raised was greater than six times[1]. However, what followed during January and February 2021 dwarfed all of 2020 with USD60.7 billion being raised via 189 SPAC IPOs. In Q1 of 2021, deals driven by SPACs already stand at USD166 billion[2].
The SPAC action is centred largely in the U.S. though other jurisdictions such as the U.K., Singapore and Gujarat International Finance Tec-City (GIFT City) in India are also seeking to develop a regulatory framework for SPAC floatation.

SPACs in India

In India, there have been instances of a SPAC associating with an Indian business, thereby providing it liquidity and a public market listing globally. Indian regulations have not yet permitted the formation of a SPAC to list on Indian markets. However, GIFT City has just released a set of rules and might be the first to experiment in this space.

As a privately negotiated deal, a SPAC merger involves a set price and is, therefore, less vulnerable to an unforeseen period of market turmoil. In addition, Indian businesses have not really tapped into this vast flow of capital. The reasons for these lie in the Indian tax and regulatory framework, which needs to introduce specific enabling provisions in this regard. Given the mature and large IPO market of India, and with the requisite checks and balances, the regulators could evaluate permitting SPAC listings in the country. Without clarity on taxation, disclosures, reporting and exchange control aspects, one could easily run afoul of the law-triggering costs and adverse consequences. Immediate attention to the following areas could provide relief:

- Allowing exemption from Indian taxes on the combination transaction itself and continuity of historical tax attributes (cost, period of holding, treaty relief, etc.)
- Permitting Indian founders and employees to hold shares of the merged listed entity and freely trade-in shares/repatriate cash
- Providing relaxation from the rigours of Press Note 3 (2020)[3], in cases where there is no increase in the shareholding of parties belonging to the neighbouring countries
- Giving clarity on reporting and disclosure requirements to the Indian authorities

In May 2020, the Finance Minister of India made a related announcement on issuing the proposed guidelines that would permit Indian companies to directly list on overseas capital markets. However, at the time of writing this article, the guidelines have not yet been announced. While one awaits those, SPAC-led transactions are set to dominate headlines in the remaining three quarters of 2021. Expect several unicorns and emerging companies to dominate merger transactions with SPACs.

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[1] The Market Minute: Will SPACs Outpace Traditional IPOs This Year, Crunchbase, February 2021
[2] The $166 billion of SPAC deals in the 1st quarter exceeds all of 2020, Business Insider, March 2021
[3] Press Note 3, Department for Promotion of Industry and internal Trade, accessed on 19 March 2020