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The Rise of SPAC in the Indian Context

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What Is a Special Purpose Acquisition Company (SPAC)?

A Special Purpose Acquisition Company (SPAC) is a company with no commercial operations and which is formed primarily to raise capital through an initial public offering (IPO) with the intention of acquiring an existing company. SPACs have been around for decades and are also known as "blank check companies,". In recent times, SPACs have become much more popular; have attracted big-name underwriters and investors and have raised a record amount of IPO investment in the year 2019. To give an example of USA, till August 2020, more than 50 SPACs were formed which had raised approximately 21.5 billion dollars in investment.

KEY TAKEAWAYS

- A special purpose acquisition company is generally formed to raise money through an IPO (Initial Public Offering) to buy another company
- Typically, at the time of their IPOs, SPACs may not have any existing business operations or they might not have even stated targets for proposed acquisition
- Anyone from Private Equity funds to the general public can be Investors in SPACs
- SPACs have to return their funds to the respective investors if they do not complete their proposed acquisition in two years

HOW AN SPAC WORKS

SPACs are typically formed by individual or group of investors, or sponsors, who have expertise in a particular business sector or industry, with the intention of pursuing acquisition deals in that area. During the IPO process, an SPAC and the founders sometimes have at least one acquisition target in mind, but they refrain from identifying that target so that they can avoid extensive disclosures. This is why they are generally referred to as Blank Check Companies. IPO investors have no idea in which company they will end up investing in. SPACs seek help from underwriters and institutional investors before offering shares to the public.

An interest-bearing trust account is used to place in the money SPACs raise in an IPO. These funds can only be used to complete an acquisition or to return the money to investors if the SPAC is liquidated. A SPAC is granted two years to complete a deal or else it faces liquidation. Some of the interest earned from the trust can be used as the SPAC's working capital in certain cases. After an acquisition, a SPAC is usually listed on one of the major stock exchanges.

MECHANICS

SPACs trade as units and/or as separate common shares and warrants on stock exchanges such AS Nasdaq and New York Stock Exchange. Distinguishing the SPAC from a blank check company formed under SEC Rule 419, once the public offering has been declared effective by the SEC. Usually, units are denoted with the letter "u" (for unit) appended to the ticker symbol of SPAC shares.

Investors get a flexible exit strategy by trading liquidity of the SPAC's securities. Moreover, the public currency helps enhancing the position of the SPAC while negotiating a business combination with a potential merger or acquisition target. In order to get an accurate picture of the SPAC's performance, the common share price must be added to the trading price of the warrants.

As per the market convention, 85% to 100% of the proceeds raised in the IPO for the SPAC are held in trust to be used for the merger or acquisition at a later date. A SPAC's trust account can only be used to fund a shareholder-approved business combination or to return capital to public shareholders at a charter extension or business combination approval meeting. An increase in 100% and above is currently seen in the gross proceeds held in trust pending consummation of a business combination.

As mentioned earlier, SPACs have their own liquidation window to complete a merger or an acquisition failing which it is forced to dissolve and return the assets in the trust to the public stockholders. In practice, SPAC sponsors generally tend to extend the life of a SPAC by making a contribution to the trust account and thereby entice shareholders to vote in favour of a charter amendment which in turn delays the liquidation date.

Additionally, the target of the acquisition must have a fair market value which is more than or equal to 80% of the SPAC's net assets when the acquisition has happened. In earlier times, SPAC structures needed to have a positive shareholder vote by 80% of the SPAC's public shareholders for a consummated transaction.

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However, current SPAC provisions do not require a shareholder vote for the transaction to be consummated unless as follows:

Type of transaction & Shareholder approved required	
Purchase of assets	No
Purchase of stock of target not involving a merger with the company	No
Merger of target with a subsidiary of the company	No
Merger of the company with a target	Yes

ADVANTAGES OF A SPAC

For the owners of smaller companies, which are often private equity funds, selling to a SPAC can be an attractive option. First, selling to a SPAC can add up to 20% to the sale price compared to a typical private equity deal. Further, being acquired by a SPAC offers business owners a faster IPO process under the guidance of a more experienced partner, which also results in less worries about the swings in broader market sentiment.

THE INDIAN PERSPECTIVE REGARDING SPACS

Capital markets across the globe are embracing several new and innovative initiatives and so is India. Very progressive, creative and promising steps have been taken with the announcements in the previous Union Budget regarding One Securities Markets Code, trading in gold and corporate bond markets. Special Purpose Acquisition Company (SPAC) could also be considered in the same spirit as an alternative methodology for initial public offers (IPOs).

With all required checks and balances, our regulators should consider allowing SPAC listing in India given India's large and mature IPO market. There may be some scepticism around the risks associated with a new product and it very understandable. The framework would evolve over time but it is important to make a beginning in a restricted way. Recently, our markets and regulators have exhibited openness towards new

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ideas and products, and SPAC could well be the next new thing for our emerging and dynamic market.

SPAC'S AND THE OPPORTUNITY FOR TECH COMPANIES

The SPAC structure has decent number of advantages for technology companies of India. The existing process for a traditional IPO with respect to registrations, detailed financial disclosures and scrutiny can be very taxing and an extensive exercise for tech companies. Moreover, high investment banking fees and far-reaching road shows in an attempt to convince a reasonably large and diverse group of investors which can be replaced by submitting less tedious financial projections and the ease of negotiating a fixed price with one party, all executable in a far shorter time frame.

One more benefit of SPAC is that it is a product that can help in unstable times such as the COVID-19 pandemic, which can empower companies to raise capital to propel growth despite market turbulence. Technology firms can avoid the risk of being exposed to volatile markets and uncertain valuations, but still see a huge payday as is the case through an IPO. An example of this was Opendoor raising over $1 billion through a SPAC sponsored by legendary Silicon Valley investor Chamath Palihapitiya and institutional investors including BlackRock. This is in spite of posting a net loss of $118 million for the first half of 2020, down year on year amid the macro environment.

ECO-SYSTEM TROUBLES

For Indian tech companies, not only are the advantages of the SPAC structure highlighted but further compounded if we consider the business case of listing outside India more generally.

Firstly, the dynamics within the Indian investment community and that of the International technology eco-system are very different. Historically, Indian investors have looked at a company's ability to make profits and pay dividends. On the contrary, most technology companies will not have this approach and instead adopt the more conventional model of this IT sector in trading off cash burn and profits for growth. In the areas of R&D and innovating new products and services, such structural facets are likely to place international competition at an advantage.

The Second thing, and perhaps most critical is the listing norms and regulations affecting Indian tech companies, one of which being that most will tend to fail to satisfy the profitability and track record criteria of the main exchanges. Most funding agreements between late-stage start-ups and VCs have a clause that

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mandates a future public listing. Although SEBI and the other regulators have attempted to address these issues by launching a number of initiatives such as the BSE Startup platform, it remains to be seen how effective these will be. Another initiative was to amend the limit on Differential Voting Rights (DVR's) from 26 percent to 74 percent, thus allowing founders a greater say on keyboard decisions and retaining more control even if they have a minority stake. A key change in the law was the removal of the earlier requirements of distributable profits for three years before a company was eligible to issue shares with DVRs.

A further key issue is India's taxation laws. Ecommerce giant Flipkart for instance is registered in Singapore with the Indian business that generates its $21 billion valuation structured as a subsidiary. Other Indian tech stars such as OYO, InMobi, Lenskart and Curefit also have such "flipped structures" by registering in overseas jurisdictions such as Singapore, UK, and Mauritius thus allowing better access to foreign capital and also preferential tax treatment, avoiding punitive rates for any sale or purchase of equity between investors.