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Challenges in the Development of Special Purpose Acquisition Companies (SPAC) with specific regard to the Indian Corporate Sector

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ABSTRACT

SPACs (Special Purpose Acquisition Companies) have been rising in significance and prominence all across global capital markets, particularly over the course of past few years. They have existed and been relevant for some time now, but have experienced an exponential increase of late, having a resurgence in several prominent markets, such as the United States. The sustainable energy company ReNew Power utilized the SPAC concept as a major part of their growth plan and consequently found themselves listed on the NASDAQ Stock Exchange. One major effect of this is that it has rendered SPACs a big topic of conversation in India.2 But what is a SPAC? A special purpose acquisition company is a corporation with the objective of raising capital through IPO'S (Initial Public Offerings). They originate as a shell company, with the amount raised being routed through to a trust fund until a target operational firm is identified. Post identification, the respective shareholders are asked for approval, and those who are not interested or piqued in the sale of their shares are afforded the opportunity to redeem them. Post this, the de-SPAC step begins, which deals with the carrying out of the acquisition transaction. The widespread implementation of SPAC with respect to Indian markets is once again being mooted, following the aforementioned ReNew Power's merger with a US-based special purpose acquisition company. Several high-profile companies are investors in SPAC'S, including but not limited to Flipkart and Mahindra & Mahindra. SPAC'S are being used more and more by start-ups to facilitate easier access to stock market. As a result of all these changes being ushered in by the introduction of the SPAC process, India will soon amend it SPAC rules and GoPro SPAC, to better reflect the prevalence and importance of SPAC'S.

Keywords: *Corporate Finance, SPACs, IPOs.*

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I. INTRODUCTION

Special purpose acquisition companies were created to collect and accumulate revenue through Initial Public Offerings (IPO) to facilitate the utilization of these funds to acquire one or more firms selected after the IPO. They are also referred to as Blank Cheque Companies. Their only purpose is to acquire another corporation. The special purpose acquisition companies are constituted of specialized investors who are entrusted with the responsibility of identifying an appropriate target within a period of two years and funneling the funds raised by the IPO to invest in the selected target, with approval from shareholders. If there was no consent/approval the amount raised is returned back to the investors, along with interest. The funds raised through the IPO is the only economic asset these firms possess, as per the norms stipulated by the Securities and Exchange Commission.[2] Once their purpose is completed, the special purpose acquisition companies will reflect the target company's identity. SPAC's have emerged as a very viable alternative pathway for start-ups in our country that find it cumbersome or quite unrealistic to raise capital through the conventional IPO route. SPACs have seen a precipitous rise in usage and relevancy as a result of huge market volatility caused by the Covid-19 pandemic. Multiple firms which were apprehensive of exposing their frailties in a recovering market opted to go through the SPAC route.

II. THE PROCESS BEHIND SPACS

The cornerstone of a SPAC firm fundamentally starts with an original concept or market narrative that such entrepreneurs can offer to investors. New-age entrepreneurs are known for developing novel procedures and systems. Then, this group of businesspeople and investors will file a statement of registration with the Securities and Exchange Commission (SEC) using form S-1 under the Securities Act of 1993. The firm must disclose on this form the kind of security it intends to issue, the total number of shares it will be issuing, the price per share, and any corporate property. These disclosures must be approved by accountants who also assess them.

In order to achieve a merger, or "combination," with a privately held company so that it can go public, a SPAC is a publicly traded corporation with a two-year life span. SPACs, which primarily seek capital from public equity investors, frequently provide their target firms with better conditions than a regular IPO while also having the potential to derisk and speed up the IPO process.

[2] Mugeera Patel, All you need to know about the rising Special Purpose Acquisition Companies (SPAC), iPleaders (June 26, 2021, 11:04AM), https://blog.ipleaders.in/need-know-rising-special-purpose-acquisition- companies-spac/

While this process is ongoing, the SPAC must create any appropriate underwriting agreements (agreements with investment banks or financing institutions) that include a trust account establishment agreement. This trust is where the proceeds from the IPOs are kept. The SEC actively engages in the procedure by doing extensive due diligence on the firm and giving a clearance in accordance with the documents and disclosures offered. After receiving this approval, the management of these companies can start going to conferences, roadshows, exhibitions, and other events where they can successfully market their companies. The key difference is that senior management hires made by the sponsor market their expertise in the sector in which the SPAC will operate rather than a specific company. This generates a buzz in the marketplace that helps them acquire notice and raise more money. After then, they start issuing common stock at a price of $10 per share, which is the SEC's standard base price for the majority of SPAC shares.

The money from such investments is held in trust until the newly formed SPAC firm decides and finds a company to buy, if the SPAC succeeds in connecting with people and investors as a consequence of the management's efforts prior to the share offerings. During this time, one of two things could occur: if the acquisition goes as planned, the value of the trust's shares increases and investors start to show interest in it; if the acquisition does not go as planned, the share's base price stays at the sum that the investor originally paid. Additionally, the SPAC corporation must disband and pay back the initial investment plus interest to the owners if they are unable to find a suitable organization for combining within two years.

Since the 1990s, and even as recently as one year ago, SPACs have significantly improved as an investment alternative. Anyone involved in the SPAC process should keep aware and watchful because there will undoubtedly be more changes in the markets and regulations. This story is developing quickly.

III. Benefits/Advantages of special purpose acquisition companies

- *Conservation of time and improved operational flexibility:* The period required to go public on the domestic market can take anywhere from four months to a year. These timeframes are said to be reduced by SPAC businesses. Additionally, clear covenants in the contract and merger scheme limit any actions that are inconsistent with the regular course of business in conventional IPOs and mergers. SPAC firms do not currently have this type of structure, which would increase flexibility.
- *Increased Access:* In a conventional IPO, the company would have been listed on the regional exchange market; but, in the instance of SPAC, it is listed on the US exchange

market, giving it a better opportunity to draw in investors.

- *Lack of burden of extensive paperwork:* The cost of paperwork and disclosure is one of the most crucial factors to take into account, especially for early-stage start-ups. This expense is kept to a minimum in SPAC enterprises, if not at all. due to the fact that the disclosure requirements are less strict than the thorough screening process often utilized for IPOs.
- *Reduction of risk and volatility:* The value of the company being purchased is decided and negotiated by the sponsor/main investor, not the financing institutions. Instead of rapid swings in market value, this leads to pricing predictability.
- *Tax:* In domestic contexts, some tax duties are viewed as gray areas, adding to the burden on stakeholders. to lessen such responsibilities, improve their company's access to foreign financing, and profit from tax-related favorable status. For instance, Flipkart is registered in Singapore to benefit from such a tax climate. Tech-based companies that are still growing have benefited from this by registering in other nations, including Cure Fit.

IV. Disadvantages of increased prominence of special purpose acquisition companies

- *Ambiguity of investment:* Major investors in such a venture are effectively gambling blindly because the danger is diminished but not completely removed. The sponsor who intended to establish the SPAC firm might learn that they are unable to do so, in which case the funds will be kept in reserve for the following two years, during which time they might be put to greater use.
- *Suspicious Notions:* SPAC is currently seen as a shell company alternative; nevertheless, this comparison is not commonly recognized in many foreign markets, and this type of firm is always looked with mistrust. Since they already have to deal with numerous regulatory issues like GDPR, data sharing, and data protection, companies in the IT sector might not want to deal with this because it would increase their liability.[10]

V. Regulatory framework and legislative structure with regard to SPACs (or lack thereof)

The lack of specific SPAC legislation in India is a serious regulatory flaw. The regulations for SPAC are as follows:

- *Companies Act* - Shell enterprises have been governed by the government since November

2016, when demonetization was announced. In order to avoid any legal ambiguity and pointless litigation, a Parliamentary Committee asked the government to define the phrase "shell corporation" in detail in 2018. The completion of SPAC deals normally takes 18 to 24 months. However, in accordance with Section 248 of the Companies Act 2013, the Registrar of Companies may remove a company's name from the register if it fails to launch commercial operations within 12 months of its incorporation.[3] This would put the promoters and directors of the corporation in a whole host of legal binds. However, this issue can be easily avoided by reviewing the regulations and amending the Companies Act to grant exemptions to SPACs if the reason for their registration has already been made clear to the Registrar of Companies, eliminating any uncertainty that may result from the SPAC's inability to start conducting business within a year of its incorporation.[4]

- *SEBI Regulations* - SPAC is not even acknowledged by the Securities and Exchange Board of India Act. To be eligible for a public listing, a company must have net tangible assets of at least 3 crores rupees over the previous three years, consolidated pre-tax operating profits of at least 15 crores rupees over any three of the previous five years, and net worth of at least 1 crore over the same period.

SPAC's lack of operating earnings and net tangible assets will prevent it from conducting an IPO in India. In the United States, SPAC is becoming more well-liked. The US Securities and Exchange Commission is in charge of regulating every SPAC transaction.

SPAC transactions must adhere to strict SEC filing, reporting, and disclosure standards in order to ensure transparency and integrity. Sponsors and investors now consider SPAC to be a better option than conventional IPOs due to SPAC's highly regulated status in the United States.

Each stock exchange also has its own SPAC laws. For instance, the Australian Securities Exchange allows reverse mergers on a case-by-case basis while the London Stock Exchange mandates that a listed company delist and reapply in the event of a reverse merger with another listed organization. SPAC regulatory standards are actively being promoted in Canada as well.

SPACs are not now bound by any onerous regulatory constraints imposed by Indian law. However, the Securities and Exchange Board of India, India's market regulator, has established a committee of experts to examine the potential introduction of SPAC regulations in India, which may increase the likelihood of start-ups listing domestically.

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[3] Karan Upadhyaya, *SPAC Regulations in India: Identifying regulatory challenges and the way forward*, SSC ONLINE (June 26, 2021, 11:47AM), https://www.scconline.com/blog/post/2021/06/08/spac-regulations-in-india/
[4] *Regulatory Framework for SPAC in India*, Amlegals (Jun 26, 2021 11:27AM), https://amlegals.com/regulatory-framework-for-spac-in-india/#

India has a sizable and developed IPO potential and prospective market, therefore SPAC stands a high chance of being successful there as well. If India considers SPAC listing, flexible legislation covering topics like formation, compliance, and governance will need to be created.

VI. Inherent Risks involved in the execution of the SPAC Concept and possible future changes with regard to SPAC and India

SPACs speed up and simplify the listing process for startups, but they also avoid the time-consuming and expensive listing process, which puts retail investors at great risk. Indian law may prevent listed companies from redeeming their shares because there is no clear structure for SPACs there. Once more, India may borrow a page from the US and amend the laws to permit investors to redeem their own shares or request a return of the money they put in before the target business bought them.

Another significant regulatory obstacle that SPACs must overcome is stamp duty duties. The SPAC listing route is preferred by startups since it is more economical. On the other hand, transactions made through SPAC take the form of reverse mergers, which are subject to substantial stamp charges. The merger plan must therefore be initiated and approved by the tribunals, which presents numerous compliance challenges under the Companies Act of 2013. Promoting the SPAC way of listing might be effective with the potential for a stamp duty exemption for SPAC transactions.

VII. Conclusion

The development of SPAC is being hampered by the present norms and regulations in India. In view of the state of the Indian economy right now, several of these need to be revised. The public's perception that shell firms are primarily used for money laundering needs to be clarified, and that perception needs to change. A special committee needs to be established to look at how SPAC has affected other countries, especially in terms of resurrecting their startup sectors. SPACs require unique legislation since they differ from conventional public corporations. The creation of a SPAC, as well as compliance and governance problems pertaining to its management, board, and shareholders, should be dealt with under a separate chapter of the Companies Act. Once its purchase is complete, a SPAC can rule under standard conditions. Similar to this, all relevant laws and listing requirements call for specific sections or chapters. India's tax system is anti-SPAC in a number of ways as well. For instance, the Indian tax authorities forbid foreign listed SPACs from acquiring Indian start-ups without paying capital gains tax. As a result, the shareholders receive the capital gain. It is crucial to permit SPAC transactions in India. The SPAC and the target organization would be merged under a scheme of amalgamation because both of their headquarters are in India. These kinds of business dealings are tax-free. Additionally, this will guarantee that the involved owners have no tax liabilities.

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