E. European Impact

SPACs and Sustainability in the Investment Market After the COVID-19 Pandemic

ESCP Impact Paper No 2021-32-EN

Hamed Ghiaie & Federico Ressico
ESCP Business School

ESCP RESEARCH INSTITUTE OF MANAGEMENT (ERIM)

ESCP Impact Paper No.2021-32-EN

SPACs and Sustainability in the Investment Market After the COVID-19 Pandemic

Hamed Ghiaie
ESCP Business School

Federico Ressico
Normura, London

Abstract

This article summarises an in-depth analysis performed by the authors on the Italian investment market on sustainability. The article addresses two main questions: i) can Special Purpose Acquisition Companies (SPACs) be an effective alternative to more traditional listing methods in a market dominated by SMEs and so boost sustainability, in particular after the COVID-19 outbreak? ii) what are the main characteristics that the parties involved (promoters, investors, target companies) need to be aware of and need to consider to maximise sustainable aspects of the market and their respective interests.

Keywords: SPACs, SMEs, Italian Market, Covid-19

SPACs and Sustainablity in the Investment Market After the COVID-19 Pandemic

The COVID-19 pandemic outbreak has triggered one of the most severe recessions in nearly a century and has affected the whole global economy, including sustainable development of both large corporations and small and medium-sized enterprises (SMEs). Only in Italy GDP decreased by 4.7% in the first quarter of 2020 and the Bank of Italy's estimation shows a drop by 9.0% on average in 2020. The effect on SMEs has been particularly severe, mainly due to the higher level of vulnerability and the lower resilience associated with their size and their weak financial structure, with leverage of Italian SMEs more than 6 percentage points higher than in other European countries and bank loans accounting for 64% of the total financial debt of Italian SMEs.

In this context of economic crisis, this article answers two of the above major questions by both qualitative and quantitative analyses. We propose some policies which enhance sustainable values in the current economic situation of Italy, considering that the largest number of existing papers are focused mainly on US Special Purpose Acquisition Companies (SPACs) with only a few of them having analysed the European context while no deep analyses have been performed on the Italian context.

SPACs can help SMEs which have a dominant presence in various markets around the world to start a forward-looking revival process. SPACs are listed investment vehicles that came out of the US during the Eighties without any previous operation. The main aim of these investment vehicles is to raise funds on the equity capital market through an Initial Public Offering (IPO) in order to invest the collected capital within a 2-year deadline in one (or more) transaction with one (or more) identified target company (business combination) that indirectly goes public after the successful completion of the process.

The qualitative analysis performed in order to address the first question demonstrates that SPACs can be an effective alternative to traditional listing methods in the Italian market, even more so after the COVID-19 outbreak, considering their ability to address the main needs that SMEs currently have and could have in the future. SPACs help SMEs to get listed on the Stock Exchange (without facing the typical disadvantages of the traditional IPO process) even in recessionary periods (Cumming D., Haß L.H. & Schweizer D, 2014) such as the one caused by the recent pandemic and consequently start the internationalisation process that is extremely useful for these companies in the post-pandemic period, obtaining more visibility at both national and international level. Being listed on the Stock Exchange, SMEs can also raise capital from other financing sources other than bank debt (bank lending), therefore starting to build a more solid and diversified financial structure (Fumagalli M., 2014). Lastly, SMEs can also benefit from the expertise and excellent reputation of SPAC's promoters in fields such as entrepreneurship and finance to assess and overcome the issues caused by COVID-19 (Berger, R., 2008).

The quantitative analysis provides supporting evidence for the finding of the qualitative research. The dataset is composed of 19 SPACs that until now have successfully completed business combinations in the Italian market. The initial dataset is composed of the 24 SPACs that have successfully completed business combinations from 2011 to 2019 in Italy (5 transactions have been eliminated from the dataset for comparability reasons). The data concerning SPACs and target companies have been collected by the companies' Financial Statements and counterchecked with the data reported by Eikon Thomson Reuters and Bloomberg. From the analysis and the comparison of four linear regression models, a statistically significant negative correlation between the company's operational performance post business combination and the size of the company has been proved (SIZE t+1 variable). Therefore, this finding is a crucial piece of supporting evidence to demonstrate that SPACs can be an effective alternative listing method in the Italian market, considering that numerous SMEs operating in the Italian market can improve their operational

performance after completing the business combination with the SPAC (Gigante G., Conso A., 2019).
Four linear regression models are implemented in order to address the second question and the analysis identifies two different variables (in addition to the SIZE t+1 variable used to support the qualitative evidence of the first answer) that need to be considered by the parties involved in the SPAC's process. Promoters, investors and target companies can understand how to maximise their respective interests being aware of and considering the effect that these two variables have on the target operational performance post business combination. Firstly, a statistically significant positive correlation is observed between the company's operational performance post business combination and the capital collected during the SPAC's IPO (IPO SIZE variable). Secondly, there is a statistically significant negative correlation between the company's operational performance post business combination and the time it took for promoters to complete the business combination after the SPAC's IPO (TIME TO ACQUISITION variable). Supporting evidence for this second finding is found also through the qualitative analysis: when the expiration of the 2-year deadline is approaching, conflicts of interest can arise and promoters can be pushed to conclude the business combination at any cost, selecting even the least suitable companies as potential targets only to avoid the loss of their initial investment (capital at risk).
By analysing the previous results from a more tangible perspective, it is possible to identify, for each party involved, which considerations should be made to maximise their respective interests.
As a result, we propose that SPACs' promoters should consider three main factors in order to maximise their interests. Firstly, they should find a target company having the characteristics of a SME with a high growth potential (SIZE t+1 variable). Secondly, SPACs' promoters should leverage their name, network and track-record in the financial sector in order to attract a large number of investors and consequently to raise a large amount of capital during the SPAC IPO (IPO SIZE variable). Thirdly, SPACs' promoters should be effective and efficient in scouting and screening the market in order to identify a suitable target long before the expiration of the 2-year deadline, without being influenced by potential conflicts of interest that would lead them to conclude the business combination at any cost, selecting even the least suitable companies as potential targets only to avoid the loss of their initial investment (TIME TO ACQUISITION variable).
In addition, our results indicate that SPACs' investors should consider three main factors to maximize their interests. First, in order to decide whether to vote for or against the proposed business combination, SPACs' investors should evaluate the size of the proposed target company (Gigante G., Conso A., 2019). Investors should vote in favour of the business combination if the proposed target has the characteristics of a SME with a high growth potential (SIZE t+1 variable). Second, SPACs' investors should consider the amount of capital that the promoters have been able to raise during the SPAC's IPO in order to evaluate the quality of the management team. If a considerable amount has been collected, the management team can be considered efficient (IPO SIZE variable). Third, SPACs' investors should evaluate the time it took for promoters to select the proposed target company in order to understand whether there may have been conflicts of interest in selecting the target company. The target company should be proposed to SPACs' investors long before the expiration of the 2-year deadline in order to prevent promoters from having potential conflicts of interest that would lead them to conclude the business combination at any cost, selecting even the least suitable companies as potential targets only to avoid the loss of their initial investment (TIME TO ACQUISITION variable).
Our findings illustrate that target companies should consider two main factors to maximise their interests. Firstly, target companies should critically evaluate their size and their growth potential in order to assess if their performance could be improved after the business combination. If the company has the characteristics of a SME with a high growth potential, concluding a business combination with a SPAC could be a good solution in order to increase the operational performance (SIZE t+1 variable). Secondly, target companies should

consider the exact moment in which they receive the business combination proposal. If the proposal is received close to the expiration of the 2-year deadline, the business combination should not allow the target company to increase its performance because SPAC's promoters are probably trying to select a target company at any cost only as a fall-back plan, so as not to lose their initial investment (TIME TO ACQUISITION variable).

Conclusion

This article outlines that SPACs can be an effective alternative to traditional listing methods on the Italian market, even more so after the COVID-19 pandemic, by offering the identification and analysis of the characteristics that the parties involved need to consider in order to maximise their interests. In addition, this article provides a solid basis for the future development of SPACs on the Italian market by demonstrating to the financial community how SPACs could contribute to the sustainable renewal of the Italian financial culture as well as the revival of SMEs after the unexpected events of global magnitude.

References

Berger, R. (2008), "SPACs: An alternative way to access the public markets", Journal of Applied Corporate Finance, Vol. 20(3), p. 68-75

Boyer C. & Baigent G. (2008), "SPACs as alternative investments: An Examination of Performance and Factors that Drive Prices", The Journal of Private Equity, Vol. 11, p. 8-15

Cumming D., Haß L.H. & Schweizer D, (2014), "The fast track IPO–Success factors for taking firms public with SPACs", Journal of Banking and Finance, Vol. 47, p. 198- 213

Dimitrova L. (2012), "Perverse Incentives of Special Purpose Acquisition Companies, the Poor Man's Private Equity Funds", Journal of Accounting & Economics, Vol. 63(1)

Fumagalli M. (2014), Lo sviluppo della SPAC (Special Purpose Acquisition Company) in Italia. Un nuovo modo di fare private equity e di quotare le imprese in Borsa, Egea

Gigante G., Conso A. (2019), Le SPAC in Italia: Stato di un fenomeno in evoluzione, Egea

Heyman D. (2007), "From Blank check to SPAC: The regulator's response to the market, and the market's response to the regulation", Entrepreneurial Business Law Journal, Vol. 2(1), p. 531-552

Ignatyeva E., et al. (2013), "Analyzing European SPACs", The Journal of Private Equity, Vol. 17(1), p. 64-79

Jenkinson T., Sousa M. (2009), "Why SPAC Investors Should Listen to the Market", SSRN Electronic Journal

Lakicevic M. & Vulanovic M. (2013), "A story on SPACs", Managerial Finance, Vol. 39(4)

Riemer D. (2007), "Special Purpose Acquisition Companies: SPAC and SPAN, or Blank Check Redux?", Washington University Law Review, Vol. 85(4), p. 930-967

Rodrigues U., Stegemoller M. (2013), "Exit, voice, and reputation: The evolution of SPACs", Delaware Journal of Corporate Law, Vol. 37, p. 849-929

Tran A. (2010), "Blank check acquisitions", Available at SSRN: https://ssrn.com/abstract=2070274 or http://dx.doi.org/10.2139/ssrn.2070274