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Characteristics of special purpose acquisition companies as a new challenge in European markets

Karakteristike kompanija za akvizicije posebne namene kao novog izazova na evropskim tržištima

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Abstract

Special Purpose Acquisition Company (SPAC) is a special type of public listed company available to investors in financial markets, and was formed with the aim of investing in one or more existing operating companies after raising capital. This paper provides an overview of academic and financial literature on SPACs, describes their characteristics, advantages and risks of using SPAC as a form that does not offer services and does not conduct business operations, but is formed only for the purpose of acquisition of target companies. The paper focuses on the analysis of the impact of these forms of short-term investments on private companies, SPAC managers and investors. The paper further examines whether the impact of SPACs on European financial markets can be expected to grow. Authors' findings show that, beside limitations for growth of European SPAC number, there is evident interest among European startup companies to go public through SPACs.
Keywords*: *SPAC, IPO, United States, Europe

Sažetak

Kompanija za akvizicije posebne namene (SPAC) predstavlja posebnu vrstu javno listovanih kompanija koja je dostupna investitorima na finansijskim tržištima, a formirana je sa ciljem da nakon prikupljanja kapitala izvrši ulaganje u jedno ili više postojećih operativnih preduzeća. Ovaj rad daje pregled akademske i finansijske literature o SPAC-ovima, opisuje njihove karakteristike, prednosti i rizike korišćenja SPAC-a kao obrasca koji ne nudi usluge i ne vodi poslovne operacije, već se formira samo sa svrhom akvizicije ciljanih kompanija. Rad se fokusira na analizu uticaja koji imaju ovi oblici kratkoročnih ulaganja na privatne kompanije, menadžere SPAC-a i investitore. Rad se osvrće na budući razvoj SPAC-a u Evropi kao instrumenta korisne promene koji pruža brži put za listovanje kompanija na berzama. Rad dalje ispituje da li se može očekivati rast uticaja SPAC-ova na evropskim finansijskim tržištima. Nalazi autora pokazuju da, pored ograničenja za rast broja SPAC-a u Evropi, postoji evidentan interes među evropskim startap kompanijama da izađu na berzu putem SPAC-a.
Ključne reči*: *SPAC, IPO, Sjedinjene Američke Države, Evropa

1. Introduction

At the start of this century use Special Purpose Acquisition Company (SPAC) raised in popularity as non-traditional way to access public markets in United States (US). These entities exist with the single objective to "to raise equity from investors in an Initial Public Offer (IPO) in order to locate an investment opportunity in an existing and operating, but not publicly listed, company within a specific period of time, usually eighteen to twenty-four months" (Cumming et al., 2014). Unlike other non-conventional methods of going public, such as reverse merger, natural shells or cash shells, SPAC acquisition must be approved by investors via proxy vote, when they determine whether proposed acquisition will be realized (Kolb & Tykvova, 2016; Cumming et al., 2014).

Kolb & Tykvova (2016) emphasize the advantages of SPACs over traditional IPOs, such is their liquidity. SPAC can raise enough funding which enables its independence to the current market trends, and gives the possibility of cashing out shareholders holdings immediately at the SPAC acquisition. Also, SPAC can be formed in short period of time since they don't require review by US Securities and Exchange Commission (Cumming et al., 2014). Further, Kolb & Tykvova (2016) consider need of

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shareholder approval of SPAC acquisition as disadvantage of SPAC, which may give uncertainty to private firms. Cumming et al. (2014) state that this type of reverse merger "may create situation where the purchasers of the newly listed firms will face highly asymmetric information, risk, and uncertainty, because offerings are not conducted at deal consummation". And finally, there is a risk of dilution of investors' holdings, since SPAC managers are entitled to buy and deposit warrants into a trust account before IPO (Lakićević et al, 2013).

In this paper, we present how private operating firms are acquired thorough SPAC, with description of all participants and their role in the process. Through literature review we first investigate benefits of SPAC to stakeholder groups, in order to understand why SPACs, reach popularity after global financial crises at the end of first decade of this century. We focus on analysis of advantages that acquisition of private companies by SPACs have over the traditional IPO. We also examine risks for targeted companies that go public. The aim is to place these specifics in European environment in order to understand the significantly slower development of SPACs in Europe compared to the US market. We further examine literature and research data to show that growth of SPACs in Europe is limited by characteristics of financial markets which differ among European countries, such as regulations and lack of experienced sponsors. Our findings furthermore indicate that SPACs on European markets are chosen by smaller startup companies in high-growth sectors as opportunity to enter public markets, since their risk to succeed in IPO is high. Our research provide support to understanding challenges European SPACs are facing in order to contribute limited literature that addresses SPAC structure, acquisition process and mechanisms.

This paper is structured as follows: in Section 2, we discuss characteristics of SPAS, it shareholders and their role in SPAC life cycle; in Sections 3 and 4, benefits and limitation for participants are presented with focus on private companies; in Section 5, we analyse characteristics of SPACs in Europe and their potential to become important part of European merger and acquisition landscape; in Section 6 we give conclusion.

2. Characteristics of SPAC business combination

SPACs are a novelty in the capital markets. The founders of some SPACs have been participating in the "blank check" markets before 2003. These companies are established with sole purpose to raise capital through an IPO (initial public offering), which is than deposited in an interest-bearing trust account, with the aim of acquiring an existing private company, i.e., to gain a business combination (Harroch, 2020).

The United States Securities and Exchange Commission defines a "blank check" company as a "a development stage company that has no specific business plan, or purpose, or has indicated its business plan is to engage in a merger or acquisition with an unidentified company, other entity, or person". In the continuation of definition, the Commission states that Special Purpose Acquisition Company (SPAC) are created to pool funds to finance the possibility of a merger within a certain time frame. The merger opportunity is usually not identified before the formation of the SPAC.

SPAC is a "shell company" that acquires public status through Initial Public Offering (IPO) units and is specifically established to acquire one or more operating companies within a specified period, usually for two years. Lakićević et al. (2014) explains that funds are raised through the initial public offering are placed in an escrow - a trust account with a credible financial institution and kept there until the founders of SPAC conclude a business combination with a potential target, i.e., a target company. If a suitable target is not found within two years after the IPO, the SPAC is liquidated and the funds from the trust account are returned to the investors (Lakićević et al., 2014). Unlike trading with warrants and shares, which begins after the date by which underwriters exercise overallotment rights, SPACs units can be traded immediately. SPACs emerges as an alternative to the traditional IPO process, besides direct listings. SPACs may also allow the target company's shares to be redeemed from holders as part of a business combination.

According Lakićević et al. (2014), SPAC shares have been listed on the New York Stock Exchange (NYSE) and the National Association of Automated Securities Dealer Quotations (NASDAQ) since 2008. Prior that, SPACs were traded on the American Stock Exchange (AMEX) and unorganized markets (Over the Counter - OTC). Three stakeholder groups - SPAC founders, underwriters and investors, are primarily interested in successful realization of the merger as a final outcome of SPAC (Lakićević et al., 2014).

a) **The SPAC founders**, also called SPAC **sponsors, promoters** or **managers**, are usually former or current executives from different industries, who often possess experience from previous involvement in merger and acquisition activities, but can be individuals of different professions, from all overt the world. Sponsors form SPACs for the sole purpose to use cash previously collected through an IPO for acquiring or merging with other companies. Today, investment companies, hedge funds and private equity funds are often cited as the founders of SPAC, which they see as a way to access public capital markets (Lakićević & Vulanović, 2013).
b) **Underwriters** have multiple roles in the life of SPACs. Lakićević & Vulanović (2013) state that their "frist role is to carefully structure offering of SPAC securities in order to make SPACs attractive to potential investors; second, they represent market makers for SPAC units, shares and warrants and determine when they can be traded; and the third role of is to provide their proprietary knowledge and serve as advisors to all parties involved".
c) **Investors** are the buyers of the largest share in SPAC during the IPO, who provide the highest percentage of cash by purchasing SPAC units. The rest of the cash comes from the purchase of warrants and initial

investments by SPAC sponsors. SPAC investors were informed about cash flow management before the IPO. According Lakićević & Vulanović (2013) “around 96 percent of the funds raised through the IPO are placed in an escrow account with a well-established financial institution”.

Lorne & Bryan (2019, as cited in Schumacher, 2020) state that during the IPO stage, investors buy units “representing one or more shares of common stock and one or more warrants exercisable for one share of common stock at a discount to the offering price.” Investors believe that the SPAC sponsors (founders) are able to find profitable private company to acquire, so they are using deposited assets on escrow account from the SPAC IPO to buy SPAC shares (Schumacher, 2020). If that happens, the share price of SPAC, which is already a publicly listed company, is likely to increase as long as the private company being bought represents a successful investment. Warrants are also offered to investors, which allow them to buy additional shares in the future at a specified, discounted price (Schumacher, 2020). Trading of warrants and common shares begins, on average, four weeks after the IPO.

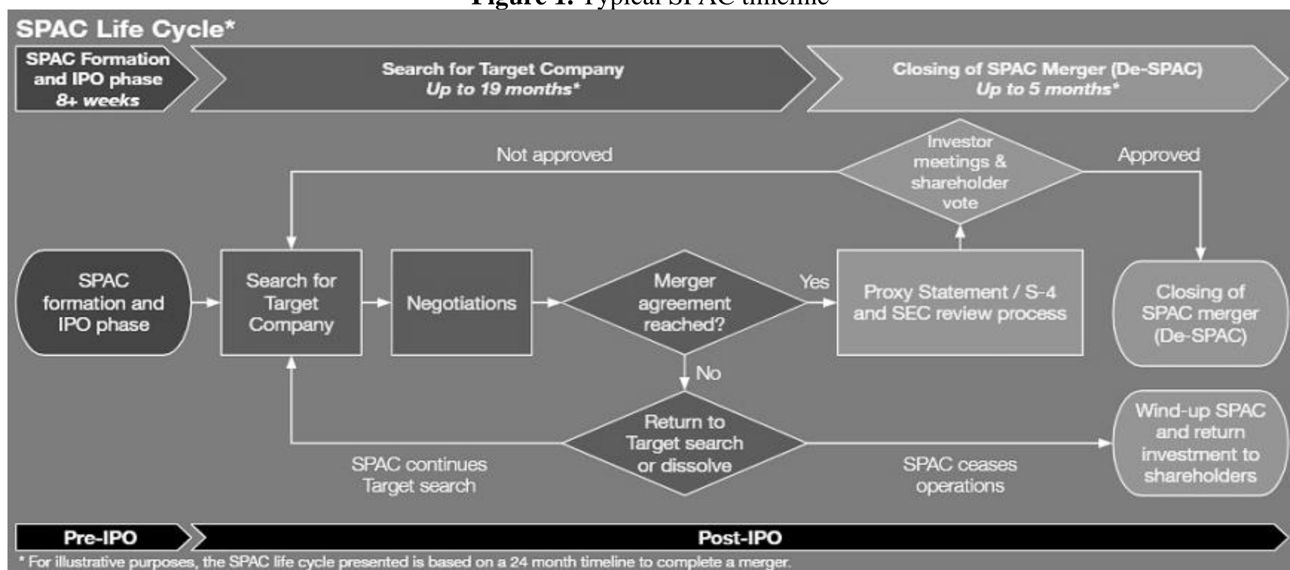
Ninety-five percent of SPAC gross IPO offering proceeds are held in a trust account for the purpose of making the acquisition, while five percent of the gross IPO offerings can be used for operating costs (fees for underwriters, regular administrative and legal costs, office lease costs, securities registration costs and monthly salaries of employees), but not for salaries or commissions for managers (Lorne & Bryan, 2019, as cited in Schumacher, 2020).

Stock exchange rules require that a business combination must be realized with one or more target companies, whose total fair market value is at least eighty percent of the assets held in the SPAC trust account (Harroch, 2020). Typically, target company’s value is two to five times higher than the gross revenue generated by the SPAC through the IPO, so the SPAC raises additional required capital through private investment in public capital (PIPE – Private Investment in Public Equity) (de Heredia et al., 2021). This additional financing through PIPE can be raised from existing or new investors. In some cases, the amount of revenue from PIPE can be significantly higher than the amount of funds in the SPAC trust account, which provides significant certainty for the target company that a business combination will be realized (Harroch, 2020).

De Heredia et al. (2021) states that “once the target has been identified, the business combination approved and the merger closed, the de-SPAC process takes place, where the target company becomes a public listed entity”. Before de-SPAC, this target company must be ready to act as a public company in order to achieve success in future period. SPAC usually takes over a private company through a reverse merger. Existing shareholders become the majority owners of the operating target company, which is now publicly listed, and thus successfully realized the de-SPAC transaction.

As presented in Figure 1, the date of the IPO represents the first day of the public life of the SPAC, but it also determines the last day of the life of the SPAC, since SPAC managers have two years to find the right business combination (Lakićević & Vulanović, 2013). According to Lorne & Bryan (2019, as cited in Schumacher, 2020), the SPAC must be liquidated if the acquisition is not realized within twenty-four months of the IPO, and the investment must be returned to the IPO investors. Further they state that the market value of transaction is considered fair if it is eighty or more percent of the SPAC's net assets. A shareholder has the right to liquidate his investment in SPAC if he does not approve the proposed merger or acquisition. This assures investors right that they will be notified if any merger is proposed, and that, if they don’t approve merger, the entire investment will be returned to them before the deal is concluded (Schumacher, 2020).

Figure 1. Typical SPAC timeline



Source: SPAC overview and lifecycle (2021, March 11). PriceWaterhouseCoopers

SPAC sponsors are aware that this poses a risk to the de-SPAC process. To reduce the risk of shareholders not voting with a business combination, SPACs raise additional funds through PIPE during the acquisition, with existing or new investors subscribing to additional shares. SPAC may also enter into futures contracts at the time of listing, with investors agreeing to purchase the shares, usually at a reduced price, at the close of the takeover process. These forward purchase agreements represent a firm commitment to finance, and these purchased shares cannot be redeemed (Bryans et al., 2020).

SPAC may be dissolved if SPAC managers cannot find a business combination within the time frame which is given, in which case SPAC investors may use their right to withdraw the funds from the escrow account in proportion to shares they hold (Lakićević & Vulanović, 2013). The ultimate reason for SPAC formation is merger, from which all stakeholders expect positive returns. If the founders of SPAC cannot make the merger before the date set by the IPO, they are required to return all proceeds to their investors and liquidate SPAC. If business combination is approved by SPAC shareholders, SPAC managers will use all available funds which are held in escrow accounts for the newly established company (Lakićević & Vulanović, 2013).

3. Benefits of SPAC

For private companies

From the point of view of private companies and their owners, SPAC offers cheaper and faster listing compared to traditional IPOs, and enables listing in periods of instability and high market volatility. Unlike traditional IPO, which comes with 7% underwriter fee and a timeline of one year for completion, underwriter fee for standard SPAC is 2% and fee at completion is 3.5%, and the timeline of a SPAC is usually three to four months (Muskett, 2021). Through SPACs, companies are able acquire at a late-stage growth capital, in addition to private capital or venture capital financing. Harroch (2020) states that "additionally, SPACs offer the opportunity to essentially raise capital through common shares, rather than through preferred shares that may have significant down-side protections and control rights."

But the biggest advantage for target companies is the security of valuation. Traditional IPO implies that the investors set the value of the company. Therefore, the market affects the value to a great extent and issuers are not allowed to give future projections. In the case of SPAC, the value is fixed through a privately agreed acquisition transaction and is agreed between the founders and the target company, and projections provided by target company can be used by sponsors to set value (de Heredia et al., 2021). SPAC provides business combination the ability to present future projections to founders, in order to determine the value of the company, which can help fast-growing but still unprofitable companies present their company to investors.

SPAC can be a good way for small startups, led by an experienced partner, to quickly raise cash without the need for an IPO, and with less concern for changes in the wider market. There is little interest in small business IPOs in the market leaving only a few cash collection options. Selling price of small startups, most often owned by private equity funds, can be larger up to 20% in comparison to a typical private equity agreement (Young, 2022). In addition, many teams that manage these companies are reluctant to hand over some of the control to private equity funds. The traditional investment of private capital in the takeover of a private company often involves the replacement of the board of directors of the acquired company with new management, and further restructuring of the company which is acquired, with the final goal of public listing of the acquired company (Schumacher, 2020). In the case of SPAC, it is more likely that the management of the acquired company will retain control and management, and it will become a publicly listed company after the completion of the SPAC transaction.

For managers (sponsors)

SPAC offers easy access to capital due to fewer regulatory barriers than traditional IPOs, as well as significant profits, making it attractive to sponsors. Although managers do not receive a salary, they usually receive a 20% interest in SPAC shares after the IPO, as compensation for finding and negotiating the takeover of a profitable target company (Heyman, 2007). Sponsors usually purchase the founding shares before submitting the SPAC IPO offer, for which they pay a minimum amount. In the process of acquiring the target company, the founding shares are converted into public shares. When business combination is realized through SPAC, Harroc (2020) states that "sponsor's shares significantly diluted in the combined business". In order to acquire additional shares, sponsors issue founder warrants, which together with founder shares are acting as an incentive to grow the sponsor business and increase the value of the shares (Harroch, 2020). SPAC share prices are likely to rise and become valuable if a merger that is made is considered profitable. This is, without a doubt, a controversial aspect of the growing popularity of SPAC, as sponsors can make huge profits over the profits of ordinary SPAC investors (de Heredia et al., 2021). Second, the management team has at its disposal a portion of the net offer income that is not kept in the trust account, which they can use as the company's working capital to pay insurance costs for directors, clerks, legal and accounting costs, in-depth analysis of future goals and costs, negotiating, structuring and obtaining shareholder approval for the merger (Heyman, 2007). Finally, "sponsor may act as a strategic partner after the de-SPAC process, meaning it may provide the target company with an experienced leadership team to guide it after going public (de Heredia et al., 2021)".

For investors (shareholders)

SPAC is founded and managed by experienced and motivated managers, experts with extensive experience in

the selection of targets and acquisition of unlisted companies, who provide assurance to investors that they will place their money on better terms than the opportunities offered by the markets of listed companies.

The main SPAC advantage is that it provides investors right to return their investments. Since the SPAC takeovers time is limited, investors can return investments if the target company is not acquired within twenty-four months period, and if investors do not personally approve the proposed acquisition they can withdraw their funds deposited in a trust account (Heyman, 2007, as cited in Schumacher, 2020).

Investors occupy a central place in the decision-making system for choosing business combinations, and shareholders who have not approved a business combination have the opportunity to exercise the right to pull back from SPAC. In this way, the investment risk is significantly reduced. SPACs also provide investors with an additional opportunity to make money because, in addition to investing in the initial SPAC, they can purchase additional shares through the warrants after the acquisition of the target (de Heredia et al., 2021). Investors also have the opportunity to make a significant profit from their initial investment if the acquired company is considered profitable and the share price rises as a result.

4. Risks and disadvantages of SPACs

SPAC managers have a set deadline for acquisition, usually twenty-four months, in which investors' cash deposits are tied to SPAC. Managers receive incentives to realize acquisition in a given period of time, and are under constant pressure from investors and must not allow their return on investment if the business combination is not realized during that period. Harroch (2020) states that there is possibility that SPAC sponsors, since they must close the deal, could overpay the target company. Investors can mitigate this risk by returning their shares in case they do not approve proposed business combination. As a compensation, SPAC managers receive a 20 percent stake in SPAC in advance. But if the merger is not realized, managers are not entitled to a refund of these shares, unlike investor rights (Schumacher, 2020). Managers are obliged to spend at least eighty percent of SPAC's funds on the realization of transaction, which could lead them to try to overpay target company, or to mislead investors to approve a bad purchase (Heyman, 2007, as cited in Schumacher, 2020).

SPACs continue to be highly sophisticated and usually large investments, and represent risky investments. SPAC does not own any assets other than the knowledge and experience of management, and the investor is basically betting on management to make a smart purchase decision and negotiate a good deal (Heyman, 2007). It is assumed that an investor would not have invested in SPAC without trusting who the management is and their previous investment success history.

Traditional IPO allows direct interaction between company's management and future shareholders, what ensures continuity of management after IPO. According de Heredia et al. (2021), changes in the management team of the target company may occur in the de-SPAC transaction, where founders and the target company negotiate conditions of transaction. When it takes over a controlling stake of target company, SPAC may requests the removal of certain managers, but the risk for severance pay for fired managers that SPAC is obliged to realize in the future should be taken into account (de Heredia et al., 2021). In this case previous shareholders will lose some control, and SPAC founders will became new shareholders and will gain power for decision-making.

Targeted companies risk investing a lot of time, effort and expense in the SPAC takeover negotiation process, but SPAC shareholders may not approve the agreement and sponsors may not be able to raise adequate funding through PIPE or, more often, it happens that the shareholders of SPAC recover a major part of the funds from the trust account (Harroch, 2020).

5. The emergence of SPACs in Europe

SPACs are not new on European stock exchanges either. Observing the period of the past few years, several SPACs have been implemented in Europe. Most of the takeovers are small value companies. European high-value companies have been taken over by SPACs from other capital markets, mainly in the United States.

SPACs have emerged in Europe as a form of public capital that provides support to startups that have had difficulty raising funds through the conventional IPO process. However, many relatively mature European technology startups are reluctant to become public open joint-stock companies. These companies have been operating for many years and have sound finances, and are not encouraged to bear the additional costs of SPAC. SPACs bear high costs, and usually, 20% of the capital or share in the acquired company goes to SPAC sponsors (Mukherjee & Sen, 2021).

Most often, SPACs choose startups in the high-growth sector as their target merger companies, offering them a faster and cheaper way to market than a traditional initial public offering (IPO). The listings in Europe focus mostly on health, technology and the consumer sector (Denina et al., 2020). SPACs in Europe are finding their place in next-generation technology startups, such as fintech companies and electric vehicle companies, as well as pharmaceutical and biotechnology companies working on new technologies.

Going public through SPAC has several advantages for the founders of European startup companies (Filfilan, 2021):

a) First, unlike an IPO, the founders associate with one SPAC sponsor, instead of having to organize presentations by talking to a lot of investors. This makes the whole process faster, and also allows the

sponsor and the startup (like those from the same sector) to match.

b) Second, funding already exists in SPAC, providing security in the volatile market. Capital market volatility has come to the fore over the past year and the outbreak of a global pandemic has put SPACs in the spotlight because of their potential to enter public markets faster than traditional IPOs.
c) Third, by negotiating with SPAC sponsors, company founders can gain greater certainty in their assessment and have a better chance of telling the story of their organization. This can be especially useful for startups that have a complex structure that requires more explanation for investors.

The growing popularity of SPAC in Europe is the result of several factors, including the availability of low-interest capital, the development of an environment where investors can realize higher returns, and the fast growth of the sector of technology (de Heredia et al., 2021). There was a lack of technology IPOs in Europe because startups used government subsidies, government grants and similar sources of funding in the development phase. These companies have reached the appropriate size and maturity and thus gained the opportunity to apply for financing in the capital market in order to enter the next phase of their development with the help of this capital (de Heredia et al., 2021). This could create more opportunities for listing through SPAC in the future.

Technology companies were among the most sought-after SPAC targets in the United States in 2020 and the first quarter of 2021. Unlike a traditional IPO, SPAC can provide this companies: alternative for faster entering on public markets; time and flexibility for investors to identify the best targets for acquisition; ability to file less paperwork as newly formed companies; and possibility go public in period four to six months, which is much shorter than a regular IPO time of 12 to 18 months (Damyanova, 2021). Also, companies that acquire SPAC can increase their selling price by up to 20% compared to takeovers by private equity.

SPAC, a listed company with the sole purpose of taking over a private company, had more than 248 listings in the United States in 2020, raising 83.3 billion US dollars, surpassing the 2019 record of 13.6 billion US dollars, as well as 67 billion US dollars collected through the traditional IPO in 2020. Already in the first seven months of 2021, SPACs collected 117.6 billion US dollars in the United States through 391 listings. Further numbers regarding US SPACs are presented in Table 1. The dizzying growth of SPAC-related activities and the increase in their number in the United States suggests that part of the market will move to Europe. (PitchBook, 2021)

US SPACs have begun targeting lower-quality US companies and acquiring companies that aren't fully ready to go public, making European businesses attractive for mergers and acquisitions.

Table 1. Key US SPAC statistics from 2009 to August 2021

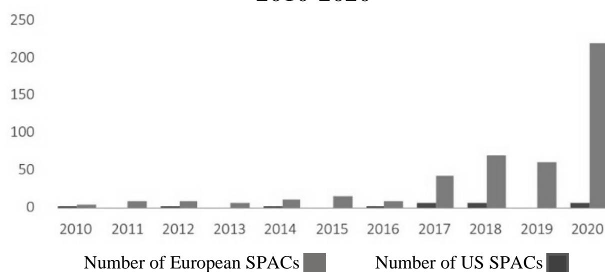
Key US SPAC statistics
865 SPAC IPO-a
309 registered for IPO in 2021.
424 seeks acquisition in 2020 and 2021.
136 announced acquisition targets in 2020 and 2021.
264 completed acquisitions (since 2009)
26 liquidated (since 2009)

Source: Bryans, N., Eastell, A. & Canner, S. (2020, December 15). *US SPAC market makes first moves into Europe*. Baker McKenzie, IFLR.

Europe has been slower to embrace the growing popularity of the SPAC, despite the fact that first US SPAC, which went public in 2003, was followed in 2005 by the IPOs of the first European SPACs (Ignatyeva, 2013). But Europe have the prospect of continuing and sustaining SPAC investments in the future.

Data presented in PitchBook (2021) show that from 2014 to 2020, 19 SPACs were listed in Europe. Only four listings were closed in 2020, compared to more than 220 SPACs in US, as presented in Figure 2. This four SPACs raised 496 million US dollars in 2020. Regardless of this number, Europe records significant growth in 2021 compared to 2020. In the first five months of 2021 alone, there were 12 SPAC listings, whose total value is about 3.9 billion US dollars. In the United States, there were 639 listings in 2020 and 2021, which brought in over 200 billion US dollars (PitchBook, 2021).

Figure 2. Number of European versus US SPACs in 2010-2020



Source: PitchBook (2021, January 14). 2021 European Private Capital Outlook. PitchBook

The value and size of business combinations of European SPACs have also increased in recent years. Data presented by de Heredia et al. (2021) shows that the average amount of these transactions in 2019 was about 75 million US dollars. In 2020, the average value of European SPACs increased to approximately 124 million US dollars, and in the first half of 2021, the average value has increased to about 320 million US dollars. This increase is the result of a greater investor interest in SPACs and an increase in the number of reputable sponsors in newly formed SPACs.

Despite the data presented, there are several reasons to suggest that SPACs will become a significant part of the European merger and acquisition landscape (Bryans et al., 2020):

1) There are large and attractive private companies in Europe. European startups that have reached maturity in the last ten years from the growth phase are still

privately owned by the founders. Some of these companies now have a high value. This provides an opportunity to go public through SPAC, which has the ability to raise significant funds and acquire these companies at high prices. In addition, with the perceived risk of corporate capitalization that is present in the traditional IPO structure, SPAC represents an attractive way to transform these companies into public open companies.

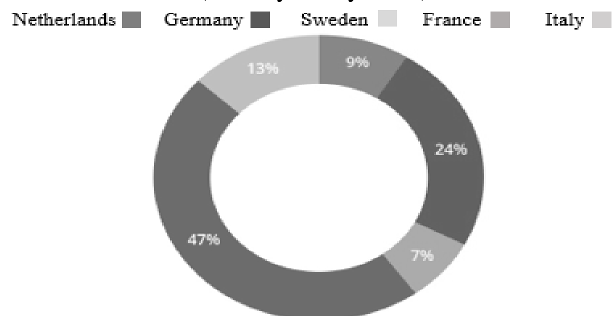
2) Increased competition for company acquisitions in the United States. With a large number of SPACs raising capital in the United States, competition to take on quality US target companies will increase. Therefore, SPAC sponsors can start looking for goals outside the United States and allocate part of the capital in the future to European companies. On the other hand, European sponsors can list SPACs in the United States, where there is an abundance of capital and which they want to raise solely for the purpose of taking over European companies.
3) Lack of the European SPAC market. Although the first European SPACs were formed with headquarters in London, the SPAC market in Europe is still slow to move. That is why European companies still prefer to list on the American stock exchange (especially NASDAQ) than to go public by selling to SPAC.

Despite the growing importance of SPACs in Europe, investors are still wary of investing. Their caution is due to the small number of SPACs in Europe, which did not provide enough evidence that the release of European companies was successful. As the number of SPACs in Europe increased in 2021, the European SPAC listings in the future depend on success of realization of SPACs business combinations and adequate choice of target company which will show the successful performances after the sale (de Heredia et al., 2021).

Distrust of SPACs in Europe was also caused by a small number of sustainable sponsors (Filfilan, 2021). It is expected that SPACs will become an increasingly common type of publicity, and more and more professional sponsorship teams are being formed in Europe to lead SPACs - managers with many years of experience primarily in the high technology sector, as well as sponsorship teams supported by investment companies such as JP Morgan, GoldmanSachs and Deutsche Bank, among many others (de Heredia et al., 2021). Furthermore, deposits in euros in a trust account can be burdened by negative interest rates, which must be covered by either investors or others who invest risk-bearing capital. However, the most important reason for the slow growth of SPACs in Europe is stricter regulations related to investments on European stock exchanges than in the United States. European SPACs are hampered by a less flexible regulatory environment compared to the United States, where investors are usually allowed to monetize their shares if they do not want to support the proposed merger, or the takeover yields poor results. In general, stock exchanges in the United States are more suitable for SPAC, and allow you to keep deposits in a trust account until the acquisition is made, while investors have the opportunity to return the money if they do not like the target company. There is no such possibility in European financial markets. Investors are facing stricter restrictions on the London Stock Exchange. They do not have the opportunity to temporarily trade SPAC shares between the announcement of the deal and the approval of the prospectus, which potentially binds them to a deal they may not be in favour of for an unknown length of time (Almazora, 2020). These rules in the UK market of SPACs prevent investors from prematurely selling their shares and leaving SPAC, i.e. recovering funds if they do not agree with the choice of the target company identified as a new business combination. This regulation reduces the risk for the founders of the target company to leave SPAC without investors, and the financing of the acquisition of the target company is provided. Also, SPACs formed in the UK do not have a target market and provide less protection to investors as they do not give them a chance to vote on the target company they are buying. In the UK, acquisitions by SPAC are usually classified as reverse acquisitions, leading to the suspension of SPAC shares from trading until SPAC is able to issue a prospectus or other relevant offer document or make sufficient information available, including financial information, on targeted companies to meet fairly high regulatory barriers (Bryans, 2020). Stock exchanges in continental Europe have variations of these rules and therefore face the same obstacles.

Despite the challenges facing SPACs in Europe, activities are on the rise in 2021, and Amsterdam is becoming the centre of the European Union's financial business after Brexit. This is confirmed by the fact that in January 2021, Amsterdam surpassed London with 8.6 billion euros in daily stock trading worth 9.2 billion euros, and became the largest European centre for stock trading, moving London from the historical position of the main European capital market (Stafford, 2021). In the Netherlands, there is a regulatory environment similar to the United States, while the regulatory rules in Frankfurt most closely mimic the SPAC structure in the United States. As a result, SPAC investors must approve a business combination and have the freedom to withdraw their money when SPAC publishes a business combination with which they disagree, which is not the case with the London Stock Exchange. On this basis, the Netherlands dominated the volume of SPAC IPOs in the European Union during 2021, as shown in the Figure 3.

Figure 3. Scope of SPAC IPO in the European Union (January - May 2021)

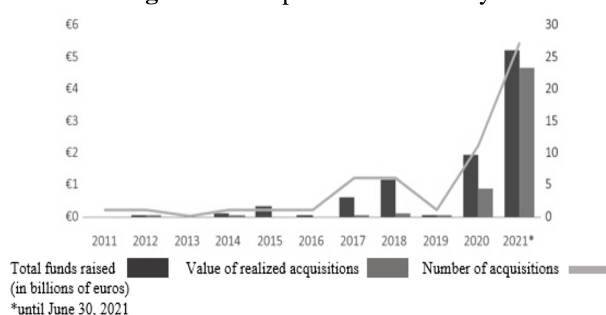


Source: De Heredia, T., Fernandez-Galiano, J. & Garcia, M. (2021). The SPACs boom. *Deloitte Insights.* Deloitte University EMEA CVBA.

As the popularity of the SPAC grows, and European companies continue to opt for the traditional way of listing through IPOs, European stock exchanges and financial regulators are beginning to review their regulations and listing rules. The goal is to make changes that would make them competitive and attract SPACs. For example, it is expected that the rule on the London Stock Exchange, which suspends the sale of SPAC shares after selecting the target company, will be relaxed for investors, whose money can be blocked in that case (Mukherjee & Sen, 2021).

However, possible changes in the rules by regulators in European markets do not guarantee a dramatic increase in the number of SPACs that will soon enter the market in the main markets in Europe (Bucak, 2021).

Figure 4. European SPAC activity



Source: PitchBook (2021, January 14). 2021 European Private Capital Outlook. PitchBook.

Figure 4 shows that in the middle of 2021, there were 27 European SPAC lists, compared to 4 in 2020, and this number is expected to exceed 50 by the end of the year (PitchBook, 2021). As Europe emerges from the pandemic, private companies are likely to seek capital for rapid growth to consolidate fragmented European markets, and these provide a solution to this.

Despite the fact that the regulations for investing in SPACs on European stock exchanges are considered strict by managers, there are regulatory measures in Europe that, if used effectively, together with favourable tax fees, can be convenient for investors and act as significant benefits for European SPACs. First, stock exchanges regulations in the United States do not allow SPACs to have any specific target company under consideration at the time of the IPO, while European SPACs can target a specific company during the IPO phase since Stock Exchanges in European countries do not have these regulations (Ignatyeva, 2013). According Schumacher (2020) “this provides SPAC management with the opportunity to incentivize investors to invest in the SPAC as SPAC managers have the option to discuss with potential investors the companies, they are considering targeting.” Therefore, investors have a clearer perspective of the direction that SPAC follows, but also benefit from the insight into the risk they take when investing.
In addition, US stock exchanges, particularly the NASDAQ and the New York Stock Exchange, require that the fair market value of the target company be at least 80% of the amount of funds entrusted by investors to SPAC in an escrow account so that a qualifying business combination can be realized, SPAC’s investment life cycle was completed (de Heredia et al., 2021). Many European stock exchanges, such as Amsterdam and Frankfurt, are not subject to this regulation, which gives “European SPACs the opportunity to complete multiple smaller acquisitions instead of a single, extremely capital-intensive acquisition (Ignatyeva, 2013)”. The advantages of such regulations are: for SPAC managers, as they provide greater flexibility regarding the type of companies they target; for targeted companies, because a large number of small companies have been given the opportunity to go public, i.e. it gives them the opportunity to become public companies; for investors, because they diversify risk, and it is not the case that large and significant acquisitions are always more successful in terms of operational or stock performance. Interest in SPACs in Europe is therefore growing due to the increasingly accessible regulatory environment and European SPAC in a market with much fewer crowds compared to the United States.

6. Conclusion

Innovations in the capital markets most often occur in the United States, after which they reach Europe, as happened with the SPACs. There is a high probability that interest in SPACs will grow in the coming period, as the European technology ecosystem has become mature and the number of companies considering options for going public is growing. Adjustment of regulations creates a favourable environment that already leads to significant SPAC investments in many European countries. These potentials must be recognized and exploited by European SPAC managers to ensure further growth in SPAC investments in Europe.

The current state of activity of companies with an “empty check” shows an increase in the saturation of financial markets in the United States, which is an opportunity for Europe to catch up. It is certain that the growth of SPAC in Europe will not be the same as in the United States, where there is significantly more investment capital and a larger number of potential sponsors. European capital markets are shallower, less able to absorb larger changes in the movement of new financial instruments, which can lead to problems in finding investors or business combinations. In addition, regulations also differ in European financial markets and restrictions are more intense in some European countries.

Fewer investors, a lack of credible managers, key structural challenges and regulatory constraints continue to limit the development of the European SPAC market. These restrictions direct European sponsors to SPAC markets in the United States, and investors remain cautious in market structures that are still unknown to them and do not provide key information.

On one side, through SPACs, large and small investors are able to become shareholders. On the other, SPACs provide equal opportunities for small European companies to go public like large ones. This is why SPACs are acceptable for European startups as new

sources of funding and because they can provide access to future financing cycles. For small and medium-sized companies, SPAC is a new way of moving to a public open joint-stock company. It is essential to determine which approach to public markets is most suitable for specific company based on characteristics, strengths and weaknesses of the SPAC process. Listing brings with it structured management and processes which are precisely defined and need to be followed in order to meet regulatory requirements. Therefore, startups need to assess whether and to what extent early listing can affect the creativity and business culture of these companies, which are largely their key drivers of success.

European technology companies are accelerating the growth cycle and are increasingly looking for ways to go public, which could increase the number of European SPAC IPOs. On the other hand, the sudden jump in the number of US and the growing number of European SPACs show that there are sponsors with a great reputation, able to raise more money to target larger and more mature companies. This may change the current practice in Europe, where SPACs are considered to be most suitable for small and medium-sized startups. Given that topics regarding European SPACs are relatively unexplored, we call for further research which need to be focused on analysis of performance of companies which went public through SPAC on different European markets. This will provide insights for investors and sponsors to acquire larger companies thorough SPACs in Europe.

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