Executive Summary

Special Purpose Acquisition Companies (SPACs) are companies that do not have any operating activities. They raise funds through an initial public offering (IPO) with the sole purpose of identifying a private operating company (target company) to merge with. The funds raised in the IPO are used to finance the business combination (de-SPAC) between the SPAC and the target company. In recent years, SPACs have become increasingly popular as an alternative for private companies to go public, representing a significant share of U.S. initial public offerings. However, the rising popularity led to a bubble in the SPAC market, and the market eventually collapsed, leading to increased SPAC liquidations and a decline in new SPAC filings. Macroeconomic factors and restrictive regulatory changes caused the collapse.

This thesis aims to comprehensively examine the current state of SPACs compared to traditional IPOs, taking a closer look at the proposed rules for SPACs by the U.S. Securities and Exchange Commission (SEC) and their impact. It analyzes professionals' comments on these proposed regulatory changes. It considers the perspectives of current academic literature to offer an outlook on SPACs as an investment vehicle and a tool for going public. The thesis concludes by outlining an investment recommendation for public investors based on critiques and inputs from professionals.

One of the main criticisms of SPACs is their high costs. During the SPAC craze in 2020 and 2021, sponsors were compensated generously, while public investors incurred huge losses. This was possible due to the SPAC sponsor’s compensation structure. SPAC sponsors are compensated with founder shares (promote). They acquire those founder shares for considerably less than the SPAC's actual share price. This dilutes the public shareholders and represents most of the SPAC's costs. Furthermore, the sponsor's compensation structure creates agency costs at the expense of investors, inducing sponsors to complete the deal under all circumstances, even if it is a value-destroying deal that negatively affects the investors' welfare. The SEC has raised concerns about the transparency of the compensation structure of SPACs.

Professionals and academic research suggest an improved compensation structure that aligns the SPAC's incentives with non-redeeming shareholders' interests. Their arguments have been analyzed, and the most critical points outlined. The compensation structure should be contingent on the deal's outcome. It should align the sponsor's incentives with the investor's interests. An improved structure will lead to the attraction of long-term investors.

SPACs have surged in markets characterized by an optimistic sentiment and with generous lenders. Clarity regarding SPACs' regulation and future structure is expected to newly awake interest in creating SPACs, as well as for private companies interested in going public through de-SPAC transactions. De-SPAC transactions will remain relevant, especially for immature and capital-intensive companies going public.

In conclusion, while SPACs offer early-stage private companies the opportunity to go public and for investors to invest in these companies, they also come with significant risks and costs. Despite the SEC's regulatory approach to protecting investors, SPACs are still considered a speculative investment. When investing in SPACs, investors are advised to do their due diligence on the sponsor team and the target company.