Discussion of

SPACs

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Outline

- Big picture summary
- Implications for
  - Markets (efficiency)
  - Regulation
  - Policy

Big picture summary

- A timely, interesting, and thorough empirical paper
- Key findings
  - SPAC IPO investors face little downside risk
  - Vast majority of SPAC IPO investors exit (redeem shares) before the deSPAC merger, and more so when merger prospects are unattractive
  - deSPACs' performance is poor, -15.6% over one year, -15.4% over three years
    - But public cash weighted one-year return is -4% and -9.9% over three years – redemptions are very high in bad SPACs
    - Underwriter reputation matters a lot
  - Warrants perform extremely well – puzzling; 44 and 53% over one and three years, but driven in part by 2020 average return of 168%!!
    - Weighted performance is not too stellar
  - Sponsors do well, but risk losing their entire investment in 15% of the SPACs that fail to consummate a merger and earn modest returns in bad deals
  - Costs of a SPAC are greater than traditional IPOs using post-merger equity is the base, and high if cash delivered in a SPAC is the base

Reconciling evidence with market efficiency

- SPAC returns – no downside risk, a feature of the SPACs
- Negative performance of deSPACs
  - Similar to IPO and post-merger firm returns
    - A long-standing puzzle in the profession
    - Why isn't deSPAC abnormal performance measured relative to IPOs or mergers? – might still look bad, but not by as much
  - Most SPAC and deSPAC investors and institutional, sophisticated investors.
    - Projections for deSPAC mergers cannot explain the over-pricing of deSPACs
    - How/why do institutional investors get tempted into investing in losing strategies for decades on?
      - Is it a slow learning process?
      - Agency problem?
      - Or do skewed distributions create the impression of poor performance?

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Reconciling evidence with market efficiency

- Sponsors do well
  - Sponsors' take looks similar to private equity
  - Is it too rich? Or are we under-estimating the compensation for the risk taken, financing arranged, and other services sponsors provide?
    - About 15% of SPACs never consummate a post-SPAC merger – sponsors' investment is wiped out. (Is this accounted for in measuring sponsors' performance?)
  - What is the friction preventing the apparent excessive reward being competed away?
    - Slow learning? Certain recent developments in SPAC contracts offer hope and they suggest a slow decay of fees as witnessed in the active and passive mutual funds industry

Regulatory implications

- Investor protection and efficient markets
  - Most investors in SPACs and deSPACs are institutional
  - SPAC IPO investors have little downside exposure and their net investment at the end of two years is small
  - Performance of deSPACs is similar to IPOs and post-merger security performance – they all lose.
    - Problem with markets or with models?
- Capital formation
  - Even though net SPAC investment has been small due to redemptions, combined with PIPE and sponsor investments, SPACs have resulted in a meaningful amount of capital formation, especially recently
- Sponsors' take seems excessive despite that the SPACs market is teeming with sponsors, but a concern is that sponsors' compensation is not well understood
  - Would more transparent disclosures help? Recall that investors are institutional

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Policy implications

- SPACs offer an alternate route to accessing capital in public markets for private companies
  - Besides capital, these companies benefit from sponsors' knowledge of markets and industry
- Post-merger performance suggests targets are over-, not under-valued – same as mergers without SPACs
- SPAC investors do not face downside exposure
- Institutional, not retail investors are the norm for deSPAC investors
  - Performance measurement models suggest they lose, on average
- Plenty of competition among SPAC sponsors
- Is there a sound economic rationale for choking off this market?

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