Special Purpose Acquisition Companies and Indian Start-Up Ecosystem

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ABSTRACT

The commercial boardrooms of Wall Street and the American business media have been talking about Special Purpose Acquisition Companies ("SPACs") in their day-to-day affairs. lately, they've become the apple of the eye of America's commercial sphere and have garnered a lot of attention. The SPACs, however in actuality since the 1990s, have taken the US request by storm. In the first quarter of 2021, nearly USD 96 billion was invested, which surpassed the total capital raised through SPACs in 2020 amounting to USD 80 billion. As of 13th March 2022, SPACs have raised USD 9.6 billion[257]. They've stamped their ascendance in Wall Street as in 2020 they reckoned for 50 of the recently publicly listed US realities.

It has become a new buzzword in the vocabulary of every prospective investor and they're starting to engage with these companies in order to gain a better return on investment and application of the finances for essential measures. Investor sanguinity is vital for any company to flourish and their harmonious belief is the key to a company's success. SPACs give the investors an occasion to diversify their investment in a range of diligence offering them better terms than a traditional IPO.

India's hunt to become a global profitable superpower has accelerated in the once decade. The Indian capital requests are flourishing, investor confidence is at its peak and the policy measures are seductive for increased foreign investment and employment generation. The rise in India's Purchasing Power Parity (PPP)[258], accelerating GDP growth and structure capabilities have made India a safe and secure profitable haven. One of the crucial contributors to this growth is the start-up ecosystem. Over time, their increased presence and enhanced capabilities, have steered India to significant growth prospects and SPACs can encourage and boost further entrepreneurs to come up with further similar start-ups by enabling access to

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[257] SPAC INSIDER, https://spacinsider.com/stats/ (last visited Mar. 22, 2025).

[258] Purchasing Power Parity is the measurement of prices in different countries that uses the prices of specific goods to compare the absolute purchasing power of the countries' currencies.

capital. The author attempts to understand how SPACs can impact the Indian start-up ecosystem by looking into the openings it offers and how SPACs can prove to be an important determinant of the success of start-ups in India. The author throws light into the nonsupervisory and duty considerations girding the SPACs and also the future of SPACs in getting the most popular asset class of India Inc.

Keywords: SPACs, sponsors, investors, targets, swapping, start-ups.

INTRODUCTION

SPACs have become a new sensation among the investor clerisy. Their exponential rise in the US market space and the economic benefits they offer to prospective investors as well as incipient companies has made them centre of attention and, as a result, they're attracting huge investments. Ever since the onset of the pandemic, SPACs have been trending in the commercial world. The volatility and query in the capital markets weren't the only reason for their rejuvenescence. There have been significant advancements in participation in the SPAC ecosystem, the size of the issue and its track record.

They've allowed the investors to drift down from the conventional approach and engage in distinct backing openings that are feasible and offer stiff competition to Venture Capital, Private Equity, direct listings and the traditional IPO process. energy is one of the reasons why the growth of SPACs has been exponential. Investors not only engage with these SPACs for the reason of better return on investment but also because of the investment avenues that it offers. The kaleidoscopic arena of start-ups and companies that are invested with the capital raised by these SPACs direct investments in such a way that it energizes invention and growth. India, being a forthcoming global start-up mecca, can yield the benefits that SPACs offer. The forthcoming companies that are enthusiastic about venturing into the waters of the public market can engage with these SPACs and get a better sapience into the prospects that the request offers.

The pandemic has given space to numerous inventions and because of this reason, we've seen the start-up ecosystem grow exponentially in our country. Numerous of these have become unicorns and have also tested the waters of the capital requests. While the traditional IPO process has been a favoured mode of public funding, the growing number of SPACs consisting of people who have distinguished experience in this sphere can disrupt the sundries of funding. Still, the life of SPACs isn't a bed of roses, and especially in India, where investors are primarily concerned about the safety of their investments and get swayed by adversities that arise from the slightest of swings, it's necessary to develop a converse around the overall functioning of SPACs so that they would be in a better position to decide where their finances should be pumped.

RESEARCH METHODOLOGY

In the course of research for preparing the research paper, various sources of literature have been referred to, especially the business law reviews. An analysis of the existing literature on the subject has been initially referred and that has then been coupled with statistical data available on various business and finance websites and news portals. Further, the regulatory considerations have been examined through the existing statutes, rules, regulations, notifications and press releases. Certain suggestions have been recommended based on the existing status quo of SPACs and a conclusion has been arrived at after careful consideration of all the aspects herein mentioned in this research paper.

WHAT ARE SPACs?

SPACs are principally publicly traded corporations that have a two-year life span and are formed simply to effect a merger or an amalgamation with a private corporation to enable it to go public.[259] The main players involved in SPACs are public equity investors who help the SPACs disrupt the market and raise capital through IPO. The SPACs can catalyse the investments made in such a way that the time that a conventional IPO consumes is abridged and also the target companies, for whom the capital is being raised primarily, are offered better terms than what the conventional IPO would offer. These corporations don't have any corporate operation and because of this very reason, they're frequently called “blank-cheque companies” or shell companies.

Though they're formed to effect a merger or an amalgamation with a private company, they primarily don't have any specific target company in their sight which they would acquire and merge with. They directly knock on the doors of the public market and seek to raise capital

[259] Max H. Bazerman & Paresh Patel, *SPACs: What You Need to Know*, HARV. BUS. REV., July–Aug. 2021.

through public offering without relating an acquisition target. Subsequently, when they've raised capital through an IPO and PIPE[260], this capital is kept in an escrow account and, in future, when they seek to acquire any target company, this capital is employed for the same.

Still, if the SPAC, which raises capital through public offering doesn't identify any target company for acquisition within two years from the date of raising such capital, that particular SPAC gets delisted from the stock exchange and the capital is returned to the investors. Thus, the stakes that are involved in a SPAC sale are generally high and it's anticipated that they would live up to the prospects of the investors who have entrusted them their capital.

STAKEHOLDERS IN A SPAC TRANSACTION

A SPAC sale generally involves three groups whose interests are kept under consideration during the commission of a public offering and the ensuing merger or acquisition of a private company. The three vital stakeholder groups are thus sponsors, investors and targets ("target companies"). Each group has its vested interest in a SPAC transaction and their outlooks, requirements and interests differ from the other groups. They complement the subsistence of each other in a SPAC and ensure that functional effectiveness is achieved and there's a minimal quantum of disturbance in the commission of a SPAC transaction. Let us get acquainted with the modus operandi of these stakeholders who ensure effectuation of a SPAC transaction -

1. Sponsors: The sponsors constitute the first group that brings a SPAC into subsistence. A sponsor may be an individual or a team that has proficiency in a particular line of business and has a well-known stewardship team that has experience in Mergers and Acquisitions and also the know-how of the market forces to effectively raise capital through public offering. They're the ones who invest their capital into a SPAC in the form of non-refundable investments which are in turn paid to corporate counsels, accountants, underwriters and bankers to cover the operational charges. Since they finance a SPAC in its pre-IPO stage, they generally hold roughly a 20-25 per cent stake in it which is an admixture of shares and warrants. Their significance can be understood by the fact that the capital that's drawn from the sponsors is generally around 7-7.5 per cent of the IPO in the form of a private placement. It's peremptory for the sponsors to ensure that the SPAC identifies a target company and acquires it within the

[260] Private investment in public equity (PIPE) is the buying of shares of publicly traded stock at a price below the current market value (CMV) per share.

two-year time frame. Otherwise, the SPAC will get delisted and dissolved and investors' capital will be returned to them. Therefore, the stakes are high for the sponsors in the event of failure of a SPAC as it would not only affect their loss of capital but also the proficiency, time and labour that they invest in it. Even after raising capital through a public offering, if the sponsors are of the opinion that fresh funding needs to be attained, they may choose other alternate sources of finance.

They may also resort to funding the SPAC transaction through a PIPE and purchase shares of a publicly traded stock below the subsisting market value. A significant point to be looked at is that, in case a SPAC succeeds, the sponsors are in a position to earn 20 per cent of the capital raised from investors through the shares of the combined entity. Nonetheless, the responsibility of attracting a cult of successful and promising investors, exploring the intricacies of the market, identifying a target company, guaranteeing the attainability of alternate sources of finance, and persuading the target company of the pecuniary as well as strategic implications of the merger is immense. What further makes their purpose vital is their capability to effectively negotiate the terms involved in a SPAC transaction more competitively and ensure that all the investors align with the idea and have utmost belief in the scheme that's sought to be achieved through the public offering and the ensuing merger.

They also have a responsibility towards the SPAC as well as the target company and they've to chaperone both of them in such a way that there's no sense of hostility or scepticism regarding the sustenance of the proposed merger. With enhancing competition and the proliferation of SPACs, the road to a successful path for sponsors is a delicate one to step on. The sponsors find themselves, at times, in extremely precarious situations where the task of identifying the targets and attaining the confidence of investors becomes a humongous task. Therefore, there's a necessity to bridge the gap between the idea of executing a SPAC transaction and the final goal they seek to attain. This can only be possible if there's a strong foundation upon which the entire arrangement idea is predicated and this requires synchronization between all the stakeholders involved in a transaction.

2. Investors: Investors are the soul of any SPAC. Without their investment, the survival of a SPAC would not be possible at all. The majority of investments that a SPAC receives are primarily from institutional investors which frequently involve hedge funds[261] that are especially constituted for investment in a particular sector. The maiden investors in a SPAC display an interest in being a part of the SPAC transaction before the SPAC identifies a target company and in progression of this, they buy the shares of the company. Just like the sponsors, the Investors are amenable to two classes of securities in the form of common stock and warrants which come along with a condition that enables them to buy the shares of the combination once the acquisition is completed post-IPO allotment at a specified price.

The risk of the SPAC, is, therefore, determined by the quantum of warrants it issues to its early investors. Thus, the manner in which the securities are to be offered to the investors must be done in an impeccable way as the number of warrants issued would be directly commensurable to the risk that's involved in a SPAC transaction. Not all investors remain in the sojourn of a SPAC and many times it happens that because of differences in the perspectives of investors and sponsors, the former pull out of the deal. Nevertheless, they get to keep their warrants which assures that their investment is returned to them with interest. Generally, the sponsors assiduously engage with the investors and ensure that their interests will be rightly taken care of in future as well when they merge with the target company. To convince them to stay, the SPACs resort to offering certain fiscal benefits that may keep them engaged with the company. The sponsors try to accommodate the varied interests of the investors and ensure that there are a variety of options available at the disposal of the investors in terms of return on investment, risk management and investment timeline. The ultimate objective of investors is properly taken into consideration and their interests are respected.

3. Targets: The companies who are new players in the commercial world and are willing to test the waters of the equity market look at kaleidoscopic options for achieving that. This can be in the form of pursuing a conventional IPO route, a direct IPO listing, conducting a sell-off to a Private Equity concern, or raising funds from myriad sources including institutional investors, hedge funds, and the Private Equity concerns. However, the regulatory demands encompassing such sources of finance coupled with mediocrity valuations and high dilutions may be some of the obstacles that a company needs to deal with. Here's where the role of SPACs comes into the picture. They can indeed be a more feasible source of funding than the late-round ones mentioned above. In practice, it's generally seen that the majority of the

[261] Hedge funds pool investors' money and invest the money in an effort to make a positive return.

companies that are identified as targets by SPACs are start-ups and these have come into commencement after going through the Venture Capital process. SPACs can enable them to gain access to increased funding and liquidity as they offer them a variety of investment options and ensure that there are fewer regulatory demands, added certainty and clarity regarding the entire SPAC transaction, and lower dilution of capital which in turn ensures that the public equity that's raised has comparatively improved valuation than other funding techniques. They simplify the process through which a nascent company can raise additional capital for the expansion of its business operations and the improvement of its goodwill.

SPACs AND THE INDIAN LANDSCAPE

Innovation and excellence are the two forces that have been driving the Indian economy past the challenges over the last decade. There has been a genesis of new business lines, synergistic alliances, and specialized proficiency. All these aspects have been complemented by changes in the outlook of the subsisting business models through disruption in the business economics. There has been a constant rise in the efficacy of processes due to the development of the technological landscape and logistical support. However, we will understand how these aspects have proven to be beneficial in their survival and also in value creation.

If we look at the Indian start-ups and their exponential growth over the last fifteen years. It's because of this harmonious approach that Indian start-ups have been competent to understand the global sentiment and have therefore ventured into numerous areas that were antecedently unexplored. The ever-expanding number of Indian start-ups in the fields of e-commerce, FinTech, healthcare and logistics over the last decade has made India a favourable destination for investment.

Since the notion of SPAC has not gained a prominent place in the Indian business discourse, an evaluation of its benefits can forsooth help the upcoming and nascent companies. A SPAC would not only enable these start-ups to gain access to growth capital but it would also ensure that they're identified on the global platform and their presence is felt in the global markets. In this age of globalization, it's extremely important that products and innovations transcend beyond national boundaries, and this can only be assured when there are subsist intermediaries who can make that occur. These intermediaries are the sponsors and investors. Indian start-ups can gain access to the public market by merging with a SPAC and refrain from the tedious and time-consuming ones of getting listed via a traditional IPO. Generally, the people who are responsible for giving birth to a start-up are the ones who don't have significant exposure to the global markets and as a result, their business models and methodologies have a limited reach and are only suitable to cater to the domestic population.

Through a SPAC, the start-ups can get an opportunity to interact with sponsors with distinct proficiencies who have experience in different disciplines and they can guide these companies on how to leave their mark in the global market. Therefore, if a start-up is truly willing to go beyond the silhouettes of established domestic boundaries, it's necessary that subsisting operation bandwidth is expanded and room is made for people with global knowledge.

The sponsors can also prove to be advantageous for start-ups in engaging reliable investors who believe in the idea of their business and can gamble on them for their expansion. In the present times, when the capital markets are extremely unpredictable and disrupting any business or technology, the consistent influx of capital is warranted, SPACs by engaging favourable institutional investors, hedge funds, private equity investors, etc. can allow a company to pursue its growth aspirations without being hindered by the dearth of capital. Still, not every merger with a SPAC can prove to be useful if not done at the right time and in the right manner. Therefore, before opting for an Indian or overseas listing, a start-up must ensure that the entire pre-IPO exercise is gone through and that there's a proper organisation of the commercial and legal structure, compliance with governance norms and effective due diligence of financials as well. This will help them tap into the opportunities at the perfect time.

REGULATORY CONTOURS SURROUNDING SPACs

Presently, there are no subsisting regulatory considerations for SPACs in India. However, the Company Law Committee, which submitted its recommendations for incorporating a fresh set of measures and bringing amendments to the subsisting Companies Act, 2013 in 2019, has recommended the introduction of several provisions that will enable SPACs to get listed on a domestic or transnational exchange. However, this has been held up because of regulatory and technical aspects. The Securities and Exchange Board of India (hereinafter referred to as "SEBI") is now examining the possibility of introducing a regulatory framework for SPACs in India. Indian companies cannot get directly listed on a foreign stock exchange. The only available options for financing are the American Depository Receipts (ADRs) and the Global Depository Receipts (GDRs) which can be listed in the overseas markets.

SEBI, in 2018, constituted a high-level committee to examine the possibility of allowing Indian companies to get listed on the foreign equity markets and gain larger access to foreign capital.[262] In the progression of this, an amendment was made to Section 23 of the Companies Act, 2013[263]. This amendment enabled Indian companies to get listed on foreign exchanges of certain permitted jurisdictions. However, a holistic framework is the need of the hour and it's required that there's consensus in the approach of the Government as well as the regulatory bodies to lay down a holistic framework for the foreign listing of Indian companies. This could mark a turning point in India’s commercial landscape as Indian companies will get exposure to the global market and attain global visibility.

Let us now understand the business combination options that are available at the disposal of Indian companies. There can be two possible situations when an Indian company is assessing a merger with a SPAC. initially, if an Indian company is proposing a merger with a foreign company (e.g., SPAC), then it can ask its resident as well as non-resident shareholders to sell their shares to the foreign company, and in return, they would be issued ordinary shares of the foreign company. However, all the selling shareholders would then hold a stake in the foreign company and accordingly, the Indian company will become its subsidiary, If this arrangement is brought into motion. However, this exercise might necessitate prior approval from the RBI under the Foreign Exchange Management Act (hereinafter referred to as “FEMA”), especially for the shareholders who are Indian residents. Compliance with the FEMA regulations and seeking prior approval from the RBI, enables the resident shareholders to be exempted from FEMA Overseas Direct Investment (hereinafter referred to as “ODI”) Regulations and Liberalized Remittance Scheme (hereinafter referred to as “LRS”[264]). The other category of companies are the ones whose headquarters are stationed overseas. In this case, if the procedure of share-swapping is espoused, it may prove to be challenging for the resident shareholders to

[262] MINISTRY OF FINANCE, SEBI, REPORT OF THE EXPERT COMMITTEE FOR LISTING OF EQUITY SHARES OF COMPANIES INCORPORATED IN INDIA ON FOREIGN STOCK EXCHANGES AND OF COMPANIES INCORPORATED OUTSIDE INDIA ON INDIAN STOCK EXCHANGE (Dec. 4, 2018), https://www.sebi.gov.in/reports/reports/dec-2018/report-of-the-expert-committee-for-listing-of-equity-shares-of-companies-incorporated-in-india-on-foreign-stock-exchanges-and-of-companies-incorporated-outside-india-on-indian-stock-exchange_41219.html.
[263] Companies (Amendment) Act, 2020, No. 29, Acts of Parliament, 2020 (India).
[264] Under FEMA, remittance through LRS is limited to USD 250,000/- per financial year.

sell their shares to the SPAC as regulatory approval may also be needed for choosing for the said medium.

When we're deliberating along the lines of regulatory considerations, we also need to understand the legal framework that an Indian company needs to comply with when opting for a merger or reverse merger. The Foreign Exchange Management (Cross Border Merger) Regulations, 2018 and Section 234 of the Companies Act, 2013 regulate the transactions involving the merger or reverse merger of an Indian company with a SPAC. It's thus important for an Indian company to understand the intricacies involved in the transaction and also understand the legal implications of such a merger or reverse merger. It's important to understand that the identity of an Indian company shall be determined by the 'branch office' of the merged entity where effective business operations shall be carried out.

TAX CONTOURS SURROUNDING SPACs

The tax implications by which a SPAC transaction would be bound arise from the Income Tax Act, of 1961. Tax consideration exists for every stakeholder that's part of a SPAC transaction – shareholders/investors, SPACs, targets and sponsors. For the shareholders, when the process of De-SPACing, i.e., when the shareholders of an Indian target entity swap their shares with a SPAC or when the merger between the SPAC and the target company takes place, it constitutes a 'transfer of shares' on which capital gains tax may be applicable.

This will be in excess of the fair market value which is over the cost of acquisition incurred by the selling shareholders. This may vary between 10-40 per cent plus applicable surcharge and cess. Consequently, a SPAC is also obliged to comply with the tax obligation, whether on account of a merger or a swap of shares. For the Indian target companies, the change in ownership becomes an important factor in deciding the tax implication. However, it'll have an effect on its unabsorbed tax losses If the voting rights of the shareholders change by more than 49 per cent. It'll result in the lapse of the unabsorbed tax losses and the same cannot be carried forward. The tax implications for a SPAC sponsor depend upon the date and timing of De-SPACing and also upon the conversion of shares from one class to the other. Considering both aspects, tax shall be valued as per the indirect transfer rules.

SUGGESTIONS

After careful consideration of the subject matter available on SPACs and their existing commercial viability, the following are some of the suggestions that may be taken into consideration by the Indian regulatory authorities to better accommodate the working of SPACs:

1. Establish a clear regulatory framework for SPACs: Currently, there is no specific regulatory framework for SPACs in India. This has led to uncertainty and confusion among potential SPAC sponsors and investors. The Securities and Exchange Board of India (SEBI) should develop a clear and comprehensive set of rules for SPACs, including requirements for sponsor disclosure, investor protections, and business combination timelines.

2. Allow SPACs to list on domestic exchanges: Currently, Indian SPACs are only able to list on foreign exchanges. This has limited the attractiveness of SPACs to Indian investors and has made it more difficult for Indian companies to be acquired by SPACs. SEBI should allow SPACs to list on Indian exchanges, which would provide a more attractive option for both investors and companies.

3. Relax disclosure requirements for SPACs: SPACs are typically shell companies with no operating history. This makes it difficult for investors to assess the risks and potential returns of a SPAC investment. However, excessive disclosure requirements could deter potential SPAC sponsors and investors. SEBI should strike a balance between protecting investors and allowing SPACs to operate efficiently.

CONCLUSION

The future of SPACs in India looks to be majestic. Since the Government and the regulatory bodies are now being proactive and exploring the possibilities of accommodating SPACs within the domestic culture, it gives the companies, especially the start-ups, to explore the options of going global with their business model. The pandemic has tutored the commercial sector on how the inflow of capital can become an indispensable element of a business and this task, though looks to be a doddle, is a gigantic one given the current global economic landscape. It's here where the SPACs can exercise their influence and pool the like-minded sponsors and investors who truly believe in the idea of entrepreneurship and are willing to place their bets on the success of a nascent company. Understanding the ambitions and motivations of the multiple parties involved in a SPAC transaction is extremely important, and this is what needs to be assimilated by every party in mind who's privy to a SPAC. There should be a consistent effort for value creation that would not only attract investors to invest in a company's prospects but would also allow the targets to contend with the global players. All the workstreams must be managed effectively to ensure that a SPAC cruises through adversities effortlessly. Since venturing into the waters of the equity market is in itself a critical process, using it to maximize a company's success prospects is another. Thus, cohesion between all the stakeholders is extremely necessary throughout a SPAC sale.