Journal of Accounting and Economics 63 (2017) 99–120

Contents lists available at ScienceDirect

Journal of Accounting and Economics

journal homepage: www.elsevier.com/locate/jae

Perverse incentives of special purpose acquisition companies, the “poor man's private equity funds”

Lora Dimitrova

University of Exeter Business School, Rennes Drive, Exeter EX4 4ST, United Kingdom

ARTICLE INFO

Article history:
Received 22 January 2015
Received in revised form
4 October 2016
Accepted 11 October 2016
Available online 19 October 2016

JEL classification:
G29
G34

Keywords:
SPACs
Private equity
IPOs
Incentives
Contract design

ABSTRACT

Special purpose acquisition companies (SPACs) are an alternative investment, structured as a one-shot private equity (PE) deal. Significant cross-sectional variation exists in SPACs' performance, which can be explained by the strong implicit incentives embedded in contracts. SPAC performance is worse for acquisitions announced near the predetermined two-year deadline, for acquisitions with deferred initial public offering underwriting fees, and for acquisitions with market value close to the required 80% threshold. Also, sponsors' involvement in the merged firm's governance improves long-term performance. This evidence has important implications given SPACs' high popularity in recent years and the new PE industry's trend toward deal-by-deal fund-raising.

Crown Copyright © 2016 Published by Elsevier B.V. All rights reserved.

1. Introduction

Special purpose acquisition companies (SPACs) are blank-check companies that have no operations but go public with the intention of merging with or acquiring a company with the proceeds of the SPAC's initial public offering (IPO) of shares. Since 2003, SPACs have raised more than $31 billion in U.S. markets. They have represented a significant proportion of IPOs, especially in the years leading up to the 2007–2009 financial crisis, reaching more than one-third of U.S. IPO volume in 2007 (see Fig. 1). This paper studies the performance of SPACs and how incentives created by the contractual features of SPACs [some of which bear a strong resemblance to that of private equity (PE)] affect their performance.

I find that, on average, SPACs perform extremely poorly, whether measured by long-run stock abnormal returns or operating performance. The average four-year buy-and-hold return following the SPAC IPO is −51.9%, compared with an average return of 8.5% for all other companies that became public in the year of the SPAC IPO. Moreover, considerable cross-sectional variation exists in the degree to which SPACs destroy value with their acquisitions. I find strong evidence that much of SPAC value destruction through bad acquisitions is a result of certain contractual features that give SPAC managers' incentives to pursue any acquisition over no acquisition. For instance, performance is worse when deals are completed just before the contractually specified deadline for a SPAC acquisition. This finding suggests that, as the deadline approaches, SPAC managers become desperate to do any acquisition, even a bad one, to avoid missing the deadline and having to liquidate the SPAC. Along the same lines, performance is worse if the deal just barely meets the contractually specified

E-mail address: L.Dimitrova@exeter.ac.uk

http://dx.doi.org/10.1016/j.jacceco.2016.10.003
0165-4101/Crown Copyright © 2016 Published by Elsevier B.V. All rights reserved.

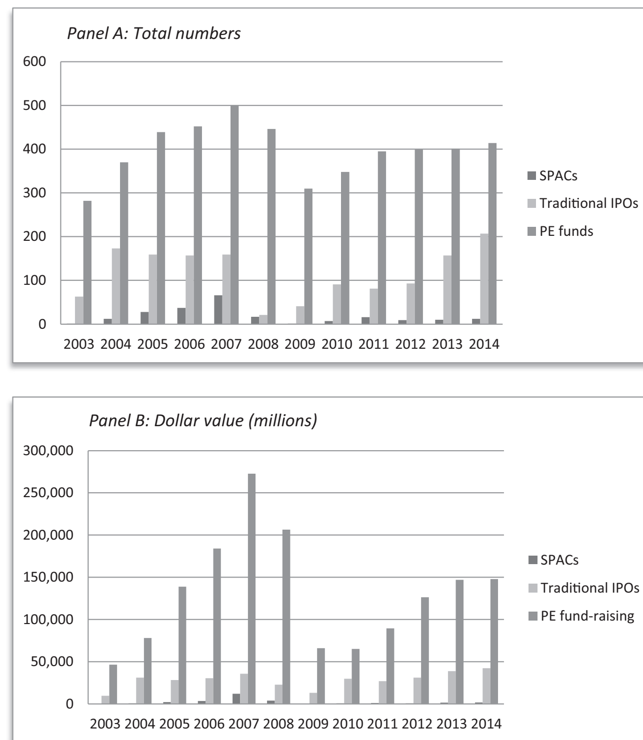

Fig. 1. Volume of SPACs and traditional IPOs.
Panel A shows the total number of special purpose acquisition companies (SPACs), traditional initial public offerings (IPOs), and public equity (PE) funds in the U.S. from 2003 to 2014. Panel B shows the dollar value of all SPACs, traditional IPOs, and PE fund-raising in the U.S. from 2003 to 2014.

minimum transaction value. In addition, I find that performance is worse when SPAC IPO underwriter fees are deferred and paid upon a SPAC's successful merger completion, suggesting that underwriters with an interest in a deal being completed, regardless of its quality, are more likely to pitch bad deals to SPAC sponsors.

I also find that increasing SPAC sponsors' ownership is detrimental to performance and that appointing one of the sponsors as a chairman in the merged company improves it. Finally, evidence from the accounting performance, using measures such as operating margins and return on sales, further confirms that SPAC acquisitions significantly under-perform various benchmarks and that the poor operating performance of SPACs does not appear to be caused by higher leverage and financial distress costs. In summary, while the average investor in SPAC acquisitions incurs large losses in the long run, the perverse incentives of SPACs cause some investors to lose more than others.

My results are important because they provide evidence of the detrimental effects of SPAC structure on sponsors to pursue a bad acquisition instead of no acquisition. The results also relate to the PE industry, as some of the structural features and implicit incentives that affect SPAC performance are some of the most important hallmarks of the traditional private equity contract (Rodrigues and Stegemoller, 2013).[1] Above all, the evidence from this paper is especially relevant given the recent trend in the PE industry toward alternative, more transparent, and more flexible structures of investment. Although the PE industry has survived the 2007–2009 global financial crisis, it is currently undergoing significant changes and increased regulation, in the wake of public demand, media scrutiny, and government pressure. The use of alternative structures and asset classes is becoming more common as limited partners explore options beyond the traditional ten-year blind pool fund. Moreover, the deal-by-deal model of fund-raising (whereby investors are presented investment opportunities and can either opt in or opt out on a case-by-case basis, without having to lock up their money for a ten-year period) was recently selected by investors as one of the most popular forms of tailor-made funds (see Fig. 2).[2] However, while tough fund-raising conditions and market dynamics are likely to stimulate the growth of alternative PE structures, unless these structures are designed to align the interests of managers and investors, they may not always be optimal.

The literature on SPACs is limited compared with the importance of SPAC deals. Researchers have overlooked the richness of empirical data that SPACs' public disclosures offer and the unique form of SPACs (public form of private

[1] For instance, both forms of investment have a finite life: two years for SPACs and typically ten years for a traditional PE. Also, the managerial compensation in both cases is incentive-driven. SPAC managers obtain 20% of the initial equity raised only upon successful merger completion, and PE managers are awarded 20% of the gains only upon successful exit. In addition, while SPAC sponsors are required to spend at least 80% of the money raised on a given target, PE investors are restricted on the amount of fund capital that can be used on a given deal.

[2] For additional discussion and analysis of the recent shifts in the business model of private equity, see Jacobides and Saaverda (2015).

Download English Version:

https://daneshyari.com/en/article/5086589

Download Persian Version:

https://daneshyari.com/article/5086589

Daneshyari.com