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Spacs and other fads of high finance

A particular organisational innovation of the past has been resurrected recently, namely, the special purpose acquisition company (Spac)

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The metamorphosis of the world of finance resembles the magical world of Gabriel García Márquez. In his *One Hundred Years of Solitude*, Marquez narrates the story of Gypsies bringing miracles and magic to his fictional hometown of Macondo. When two such miracles — the magnifying glass and the alchemy kit — were applied by José Arcadio Buendía, the lead character in the novel, the results on the ground were devastating.

In the world of finance, what is more disturbing is the speed at which such miracles are being churned out. The *jugalbandi* between finance and technology, though at times jarring, is causing this ever-accelerating pace. Further, there are more Gypsies in the modern world of finance and they appear more frequently in our global Macondo. They bring shinier and shinier products and processes; never allowing us the siesta of the splendid isolation of the old world.

They have come a long way in creating different forms of entities. However, shadow banks, collective investment schemes and bankruptcy-remote special

purpose vehicles are becoming passé. Lending apps, Metaverse entities, and new products — cryptos and other digital currencies, and non-fungible tokens (NFTs) — are instead conquering the world of finance.
Some of them, particularly environmental, social and governance products, are fast emerging as the green avatars of the old collateralised debt obligations (CDOs). Owning a "digital monkey" or digital Mona Lisa enhances human welfare considerably more than their natural/original versions in this new world!
New-age Gypsies as innovators are working really hard and fast to create different variants of such products with different shades of grey. While no sensible person can find fault with innovation and its role in socio-economic progress, all innovations cannot be allowed to be unleashed upon humanity. Innovations can be double-edged swords, like atomic energy. They can have considerable negative spillover effects or externalities like in the case of the CDOs. Some are amenable to regulation, while others may not be. Therefore, it is essential to have a meaningful judgement of the impact of an innovation, whether it is an entity, product or process, before throwing it open to the public.
A particular organisational innovation of the past has been resurrected recently, namely, the special purpose acquisition company (Spac). They are on the upswing, particularly in the US in recent years, though the US Securities and Exchange Commission has lately cast some doubts on their usefulness. They have generated considerable interest in other financial jurisdictions, including India, which reportedly is considering recognising them and allowing their initial public offerings (IPOs). Even before we have come out of the shock of the new-age tech IPOs.
Spacs, otherwise known as "blank cheque companies", mobilise public funds through IPOs with the purpose of acquiring a target company, which is yet to be identified. They mobilise public funds even when they don't have the faintest idea of the company to be acquired, leave aside disclosing the details of such a company. Spacs, by definition, are shell companies. The Ministry of Corporate Affairs, Serious Fraud Investigation Office and the Securities and Exchange Board of India have been fighting the menace of shell companies for years. Given the susceptibility of shell companies to manipulation, extreme caution is called for in promoting such companies and enabling them to raise public resources.
It is often difficult to ascertain or grasp the full impact of a financial product, process or entity, in advance, on different stakeholders in the market. Coupled with the high degree of financial illiteracy and information asymmetry that pervades Indian financial markets, many investors are handicapped when it comes to

making informed decisions. Despite considerable efforts by the regulators and other authorities in raising financial awareness and information dissemination over the decades, the awareness regarding sophisticated entities and products is extremely low.

The Indian market is, therefore, a fertile ground for innovative structures, regulated and unregulated, which have collected large amounts of money from the public by offering lucrative deals but ended up shaking investor confidence. Enabling shell companies to mobilise public funds could create yet another structure to lose money. While some of those who push innovations may be well-meaning, many do not have the right intentions or the ability in managing such innovations.

After all, the securities market exists for capital allocation. Instead of aiding resource allocation, Spacs could hold up capital in search of opportunity. They may even fold up a huge amount of capital. Evidence, Enjoy Technology, a retail start-up in the US that has filed for bankruptcy within a year of going public via Spac merger. Several companies of its ilk are now facing delisting due to low share prices.

While Spacs as an example is a problem, suppressing all innovations and discarding them straightaway is not an option for the modern economy. The solution to this dilemma is to develop regulatory capabilities to decipher each innovation in terms of its full implications and to channelise it productively. With product suitability for different classes/categories of investors becoming significant in this context, the ability to process the pros and cons of innovations and to make them socially and economically productive needs innovative regulatory approaches beyond the “regulatory sandbox” models. It needs regulatory intention and capacity to quickly carry out two types of ex ante impact assessment: Entity/product/process impact and regulatory impact (cost-benefit). While developing regulatory capacity may take time, it is often argued that innovations cannot wait and need to be left alone to do their miracles. Pending a definitive answer to this dilemma, the world is vulnerable to the avalanches that free-flowing innovations unleash in their wake.

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