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The *i*SPAC

Tasawar Nawaz[1]

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Abstract
Special purpose acquisition companies (SPACs) are one of the most celebrated investment vehicles in recent years. Relative to traditional IPOs, SPACs are much more cash-strapped and speculative. Resultantly, the scope for SPACs remains sparse for certain segments of the financial system notwithstanding the SPAC euphoria surrounding the financial markets: one notable exception is Islamic banking and finance. The Islamic banking business model is based upon the ethical ontologies and epistemologies – informed by the divine sources of *Quran* and *Sunnah: the Shariah* – operating with the mandate to promote socio-economic justice through a fair redistribution of wealth while embargoing speculative trading or investments and adopting a risk-sharing model between economic agents. Unsurprisingly, – owing to the speculative nature of SPACs – the Islamic finance industry remains reluctant to participate in the SPAC-mania despite the frenzy engulfing global securities markets. This work addresses the misaligned incentives inherent in a conventional SPAC structure and proposes alternative SPAC structure terms i.e., the *i*SPAC, which potentially mitigates the noted misaligned incentives and offers less dilutive SPAC terms to shareholders. Specifically, *i*SPAC structure terms address the issues of speculation (*gharar*), information asymmetry, and transparency in the pre-IPO phase, which may lead to adverse selection and moral hazard. Equally, the proposed structure reconciles post-IPO operational and investment-related risks such as the treatment of proceeds, interest rate (*riba*), opportunity costs, and management costs in consort with unethical behavior i.e. cashing-out opportunities that may lead to uneven redistribution of wealth thereby, widening the socio-economic voids in the society.

Keywords Special purpose acquisition companies (SPACs) · Speculation · Islamic banking business model · The *i*SPAC

JEL Classification D53 · G10 · G15 · G20 · Z12

✉ Tasawar Nawaz
t.nawaz@hud.ac.uk

[1] Huddersfield Business School, University of Huddersfield, Huddersfield HD1 3DH, UK

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1 Introduction

Traditionally companies go public via the initial public offering (IPO) to satisfy their financial capital and liquidity needs. Public listing is an expensive and lengthy process that is subject to several regulations set by the country's regulatory bodies and the markets. Thus, not all privately held companies can afford or qualify for a public listing status. A few non-conventional methods of going public have emerged in the recent past (Blankespoor et al. 2022). Reverse merger in which a privately held firm assumes the current reporting status of another publicly traded company thereby getting public swiftly and inexpensively is one of the popular routes to access the financial markets (Bayar et al. 2020; Chatterjee et al. 2016; Floros and Sapp 2011; Pavabutr 2019).

Blank check companies also referred to as special purpose acquisition companies (SPACs) have emerged as one of the fastest ways of going public (Blomkvist and Vulanovic 2020; Gahng et al. 2023). By design, SPACs have no commercial activities other than targeting private companies with specific characteristics to acquire–a shortcut to get listed in the stock market via acquisition i.e., reverse merger (Lee et al. 2015). That is, SPACs are non-income-generating vehicles that strive to raise capital via an IPO to acquire an income-generating business or assets (Lee et al. 2019). SPACs are participatory vehicles, often structured to pool funds to finance a merger or acquisition opportunity within a set timeframe, usually within twenty-four months (Kim et al. 2020).[1] From a niche part of the equities markets (Cumming et al. 2014; Kolb and Tykvova 2016), SPACs have grown to become a popular alternative route to public markets (Blomkvist and Vulanovic 2020; Gahng et al. 2023; Haniffa et al. 2022).

While economies around the world were faced with socio-politico-economic uncertainties, the COVID-19 Pandemic of 2020–2022 accelerated the long-looming socio-economic malaise. The crisis brought the world to a standstill and dried up the equities markets around the world. It equally made the financial markets more volatile, consequently, forcing the economic agents to look for alternative routes to satisfy their financial capital needs. SPACs offered the imminent, interim, solution. As a result, economic agents across the markets rode the SPAC tides during the Pandemic, which in 2020 made up one in five dollars raised via an IPO in the US (Henderson and Platt 2020).

Despite the unneglectable euphoria surrounding the capital markets in the recent past, the scope for SPACs remains sparse for certain segments of the financial system such as the Islamic banking and finance industry. While Islamic banking and finance institutions are active in the financial markets in offering financial solutions, using a wide range of equity and debt-based financial instruments (Stubing 2020), they have been reluctant to tap into the SPAC mania (Nawaz and Virk 2022). The main reason behind the reluctance to adopt SPACs as a financial vehicle is their speculative nature. SPACs are highly speculative investment vehicles and as such they are much more cash-strapped and speculative compared to traditional IPOs (Lee et al. 2015). Therefore, SPACs are highly prone to default risk. Speculation is not allowed under the principles upon which the Islamic banking business model is built. Precisely, the Islamic banking business model is based on the religious business ethics informed by the Islamic jurisprudence, also known as the *Shariah law*, under which any establishment offering *Shariah*-compliant financial services must

[1] The timeframe is subject to the jurisdiction of the host country. For example, the timeframe from receiving the proceeds to acquisition is two years in the US while it is three years in South Korea and one year in Malaysia, to cite a few.

adhere to the following covenants: (i) eschewing interest (*riba*), (ii) evading speculative trading or investments (*gharar*), excessive risk taking–in their investment and financing dealings, and (iii) involving in the risk-sharing of the proceeds and revenues of the borrower (Nawaz 2019).

While these principles promote ethical and inclusive financial solutions, they hinder the incumbent institutions from mimicking any disruptive/innovative–speculative–financial instruments such as the SPACs, unless they are declared *halal* (permissible) or *Shariah*-compliant. However, the Islamic finance industry cannot turn a blind eye to the latest developments in the global finance industry. To maintain their relevance in the larger financial system and to be competitive in sustaining the growth trends while satisfying the needs of their clientele, Islamic financial institutions must offer an alternative solution to swiftly raising financial capital as does the SPACs do.

Despite the significance of SPACs in the conventional finance industry and the need for a *Shariah*-compliant SPAC for those who are wedged with the Islamic way of banking and finance, no study to date has projected an alternative SPAC structure that appeases the *Shariah* principles. A few noted exceptions are Haniffa et al. (2022) and Nawaz and Virk (2022) who provide an alternative view of traditional SPAC terms but do not propose alternative SPAC terms. The present study fills this chasm by designing and proposing a *Shariah*-compliant or Islamic-SPAC: the *i*SPAC.

In addressing the misalignments inherent in a typical SPAC, the study divides the SPAC construct and lifecycle into two phases: the pre-IPO and the post-IPO phase. The former has inherent issues of speculation, information asymmetry, and transparency which may lead to adverse selection and moral hazard. The latter is mainly concerned with the operational and investment-related risks such as the treatment of proceeds, interest rate, opportunity costs, and management costs in consort with unethical behavior such as cashing-out opportunities that can lead to uneven redistribution of wealth thereby, widening the socio-economic voids in the society. The study then addresses these misalignments and proposes an alternative SPAC structure i.e., an *i*SPAC that is less dilutive for the shareholders.

The remainder of the paper is structured as follows. The next section discusses the structural terms of a traditional SPAC and trends in the SPAC market. Section 3 puts the Islamic banking and finance industry at a glance. Section 4 discusses the design and structural terms of the proposed *i*SPAC, and Sect. 5 concludes the paper.

2 Special purpose acquisition company – SPAC

2.1 Structural terms of a conventional SPAC

The SPACs market is largely dominated by experienced executives who possess financial expertise and first-hand industry experience in dealing with the financial markets. Most of the SPACs are founded by these executives, who are also known as the "SPAC sponsors". SPAC sponsors make a private placement for a nominal fee of 25,000 US dollars, also known as the promote, which is normally worth 20% of redeemable shares i.e. SPAC's equity (Cumming et al. 2014). Besides, SPAC sponsors typically maintain 3% of total SPAC funds to obtain derivative securities (e.g., warrants or rights) in exchange. Warrants carry the right to buy shares in the company at a predetermined price once the SPAC successfully acquires a target. If the SPAC fails to acquire a target business within the given timeframe, SPAC funds are liquidated, and the sponsors lose their invested funds (Kolb

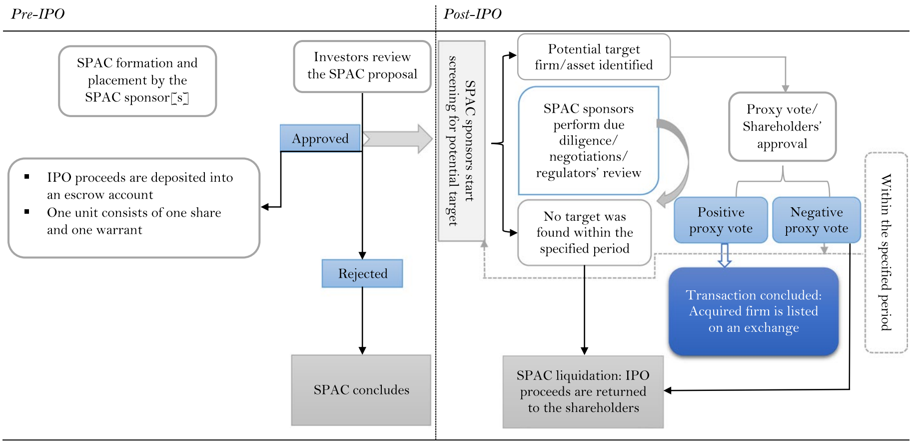

Fig. 1 Conventional SPAC Structure Terms

and Tykvova 2016). The SPAC sponsors are tasked with identifying a target business or assets within a specified period and are compensated with an allocation of equity (Banerjee and Szydlowski 2024).

An IPO of the SPAC follows the private placement, during which the majority of the funds are raised that are necessary for a potential acquisition. The SPAC IPOs commonly raise capital by issuing units, which consist of redeemable shares and derivative securities such as warrants (Banerjee and Szydlowski 2024). The proceeds are deposited into an escrow account where they earn interest until a target is acquired and can only be released if the SPAC acquires a company within the agreed-upon timeframe or in the case of liquidation. This is the intersection between the pre-IPO and post-IPO phases as illustrated in Fig. 1. The former concludes with initial fundraising in a private placement whereas the latter phase begins with SPAC listing. Figure 1 further illustrates the structural construct of a typical conventional SPAC.

Following the SPAC listing, the SPAC sponsors start screening for a target and once an appropriate acquisition target is found, sponsors perform extensive due diligence, negotiate the acquisition structure, and fulfil the regulatory requirements to conclude the SPAC acquisition. After a successful acquisition, SPACs typically list on one of the major stock exchanges. If the SPAC sponsors do not succeed in finding a target in the agreed timeframe or the SPAC shareholders do not approve the recommended target, the SPAC is liquidated and the proceeds with accrued interest from the trust account are distributed among the shareholders (Rodrigues and Stegemoller 2014).

2.2 The SPAC market: evolution and current trends

SPACs were launched in the US in the early 1990s. In tracing the SPAC roots and relative developments, Cumming et al. (2014) explains that SPACs remained unpopular until 2003 when a new generation of SPACs emerged: the first spike in SPACs floatation was witnessed during the financial crisis of 2007 during which 66 SPACs went public, accounting for 22% of all the IPOs while in 2008 SPAC IPOs accounted for 36% of the total issues in the US (Kolb and Tykvova 2016). Besides their popularity in the US markets, SPACs have surged into other international financial markets as well (Kim et al.

Table 1 SPAC IPO trend analysis

Table 1 presents the SPAC IPO trend analysis. Panel A presents SPAC IPO flotation from 2003 to 2023 whereas Panel B tracks the SPAC status by year of IPO from 2009 to 2023

	Panel A: SPAC IPOs 2003–2023		Panel B: SPAC Status by year 2009–2023	
Year	No of SPAC IPOs	Gross proceeds (in US$ billions)	Completed	Liquidated
2003	1	0.242	–	–
2004	12	0.403	–	–
2005	28	0.75	–	–
2006	37	0.908	–	–
2007	66	1.832	–	–
2008	17	2.26	–	–
2009	1	0.036	1	0
2010	7	0.4965	3	4
2011	15	1.08	12	3
2012	9	0.4905	6	3
2013	10	1.45	8	2
2014	12	1.74	8	4
2015	20	3.90	17	3
2016	13	3.50	11	2
2017	34	10.05	31	3
2018	46	10.75	44	2
2019	59	13.60	56	3
2020	248	83.04	178	62
2021	613	162.53	180	266
2022	86	13.42	14	12
2023	31	3.84	1	0
Total	1365	316.32	570	359

Source: Special Purpose Acquisition Company (SPAC)|SPACInsider

2020). A year-by-year summary of SPAC floatation and SPAC status is illustrated in Panel A and Panel B of Table 1, respectively. According to these figures, the year 2021 saw the highest number of SPAC IPOs during which 613 SPACs were floated into the market raising a record-breaking 162.53 billion US dollars, compared to 248 SPACs floated in 2020, which fetched over 83 billion US dollars. This corresponds to 63% of the total number of IPOs in 2021, accounting for approximately 48% percent of the proceeds of all IPO transactions over the same period.

The SPAC-boom belies mixed signals. A closer look at SPACs' status, in Panel B of Table 1, suggests that about one-third of the SPAC IPOs were unable to find a suitable target and were liquidated. While the record-breaking SPAC IPOs were floated in 2021, SPAC liquidation is the highest for the same: 266 out of 613 SPACs were liquidated. Relatedly, Blankespoor et al. (2022) assert that only 35% of SPAC mergers with observable post-merger revenue, meet or beat their projections. This would explain the declining trends in SPAC IPOs, observed for the latest year, 2023, which to a larger degree can also be attributed to the market recovery after the COVID-19 Pandemic and the normalization of trading at a global level.

3 The Islamic banking and finance industry at a glance

Before proposing the *i*SPAC terms, it is imperative to put the Islamic banking and finance industry at a glance to trace the core of financial engineering in the Islamic banking business model as well as to illustrate the growth and development trends in the Islamic finance industry and the challenges faced by the industry.

A great deal of research has been conducted debating the similarities and differences between the Islamic and conventional banking business model (see, Beck et al. 2013; Johnes et al. 2014) as well as drawing a comparative analysis between *fully-fledged* Islamic banks vs. Islamic *Shariah-windows* (e.g., Nawaz 2019). According to the Islamic Finance Outlook Report 2023, the Islamic finance industry manages assets of over 2.2 trillion US dollars, which is expected to grow to 4.94 trillion US dollars by 2025 (Standard Chartered 2023). The report further estimates that the Islamic finance industry is expected to grow at a double-digit rate. The expected growth is largely driven by sustainable Sukuk (the Islamic bond): S&P (2024), forecasts the global Sukuk issuance to reach up to 170 billion US dollars in 2024.

Sukuk is one of the most commonly traded financial securities in the Islamic financial markets. Despite the criticism,[2] Sukuks were approved by the *Shariah* scholars as *Shariah*-compliant hence, are considered *halal* securities, and are supported by the regulators, the industry, and the investors. By construct, a Sukuk is backed by an underlying tangible asset or assets whereas a conventional bond merely indicates a debt obligation but no ownership. Additionally, the par value of a Sukuk is determined by the market value of the underlying assets whereas conventional bonds are based on issuers' creditworthiness, coupon rate, maturity, credit rating, etc. Furthermore, the performance or value of the underlying assets does not affect bondholders' income stream as the coupon rate makes fixed periodic payments. With Sukuk, any increase or decrease in the value of the underlying assets will have direct implications on investors' income stream. Thus, conventional bond is a simple sale of debt whereas Sukuk is more akin to an equity-like contract that offers proportionate ownership in the underlying assets.

Islamic financial markets remain active in raising capital via public offering: debt or equity. The first notable IPO in the recent past is the green Sukuk issued by the Islamic Development Bank (IDB), to fund its initiative, "the Sustainable Finance Framework". The IPO raised a record 1 billion Euros in proceeds. Interestingly, Standard Chartered Saadiq took the lead over fully-fledged Islamic banks by underwriting the IPO thereby adding a strong testament to its credentials in the Islamic financial markets as well as becoming the best Sukuk bank of 2019 (Stubing 2020).

The second major IPO is Aramco. The company went public in December 2019, raising a record 26 billion US dollars initially and a further over 3 billion US dollars, as the issue was oversubscribed, amounting to 29.4 billion US dollars of total proceeds against 1.5% of the company equity. The syndicate was dominated by Islamic banks in which Al Ahli

[2] For details see, *"The Sukuk and their contemporary applications"* (2007) by Muhammad Taqi Usmani (Usmani 2007), chairperson of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) *Shariah* board.

and Samba Bank handled the book running for Aramco's IPO along with HSBC Holdings Plc while other Islamic banks were tasked to oversee the IPO. The success of the IPO was largely conditioned by the steady cash flow streams of the petrodollar.

The active participation by the fully-fledged Islamic banks and Islamic *Shariah* windows in raising capital suggests a certain trend in the *Shariah*-complaint business is emerging in which religious scholars, regulatory institutions, financial intermediaries, investors, and governments are yielding on the use of certain financial instruments to raise capital. The contention here is that the Islamic finance industry, despite receiving the double-digit growth of the recent past, falls far behind its conventional rivals when it comes to product/service innovation. Any disruptive innovation in conventional finance such as the SPACs sends out waves across the finance sector, including for the Islamic finance industry. This raises the propensity to adopt such disruptive financial instruments when businesses are faced with the challenges of raising additional capital to finance their operations in the desiccated financial markets and at a time when investors are edging at the end of their tether in the pursuit of a prolific investment opportunity. Such anxiety will arguably lead the economic agents on each end of the spectrum towards short-termism, which tends to hurt the market and the economy at large in the long run. That is the case for SPACs, in focus. Jolted market liquidity forced investors during the financial crisis to look for alternative routes, which transformed the SPAC market (Cumming et al. 2014). Markets and investors faced similar conditions during the recent Pandemic, hence, the rise of SPAC IPOs.

Systematic risk is persistent and unpredictable. Markets and institutions operate under these uncertain economic environments. There is no exception for the Islamic banking and finance institutions. To remain competitive and relevant to the larger financial system, these institutions must be equipped with an arsenal of financial instruments to swiftly adapt to the fast-changing economic environment. Offering *Shariah*-compliant business solutions is the core business of the Islamic finance industry. This shall not become an excuse to shy away from innovative financial instruments or vehicles as has been the case for SPACs. Islamic finance industry shall robustly engage in developing innovative financial solutions to cater to a larger market and be disruptive. The proposed *i*SPAC is an effort to encourage the industry to take a walk in that direction.

4 The *i*SPAC

As the paper makes a case in the above discussion, conventional SPACs are speculative, therefore, they are not considered by the Islamic finance industry. The following text explicitly discusses the misaligned incentives inherent in a typical SPAC structure in proposing alternative SPAC structure terms i.e., an *i*SPAC, which potentially mitigates those misaligned incentives thereby making the *i*SPAC less dilutive to shareholders. Furthermore, the proposed *i*SPAC is informed by the underlying principles upon which Islamic banking and finance are built, therefore, the *i*SPAC shall be considered under *Shariah* law.

4.1 The *i*SPAC: structural terms

In terms of structure and construct, a *Shariah*-compliant SPAC, or an Islamic SPAC (hereafter, *i*SPAC) is not significantly different from a conventional SPAC. The notion behind an *i*SPAC is to eliminate the manipulative properties of a typical SPAC to make the vehicle more ethical and complacent for wider segments of finance. Figure 2 depicts the construct

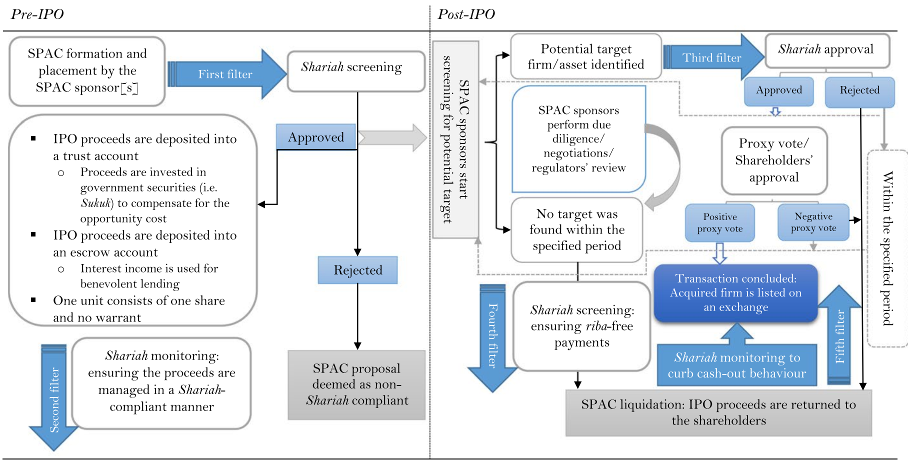

Fig. 2 The *i*SPAC Structure Terms

and life cycle of an *i*SPAC. Borrowing from the ethical ontologies and epistemologies upon which the Islamic banking business model is founded, five ethical-compliance checks or *Shariah* filters are proposed during the life cycle of an *i*SPAC. Essentially, two filters are applied in the pre-IPO phase whereas three filters are applied in the post-IPO phase to address the issues of speculation, information asymmetry, transparency, treatment of costs, proceeds, and interest, and to curb unethical behavior such as cash-out opportunities.

4.1.1 Speculation, information asymmetry, and transparency

Blank check companies or SPACs are highly speculative investment vehicles. Speculation is embedded in the very design of a SPAC as recognized by the Securities and Exchange Commission (SEC 2005), which defines a blank check company or a SPAC as "a developmental stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person", suggesting that the investors are financing the unknown. In a typical SPAC, investors are not informed about the nature or segment i.e., industry of the target business ahead of the SPAC IPO, which makes the blank check IPO highly ambiguous.

A closely related issue in the pre-IPO phase is the lack of transparency in SPACs. Generally, in founding a SPAC, the sponsors occasionally have at least one acquisition target in mind however, the target company is not disclosed to the investors during the IPO process hence, the term "blank check company". In more simple terms, IPO investors do not know which business they would ultimately end up investing in. Since the SPAC sponsors withhold the target company information from the IPO investors, such a "blank or blind" investment arrangement gives rise to uncertainty, which is a violation of the ethical principles in general and *Shariah* principles underpinning the Islamic banking business model, in particular. Arguably, such high levels of information asymmetry can potentially lead to adverse selection that can effectively cause moral hazard or even an economic crisis.

Shariah law, which guides Islamic economics, emphasizes the elimination of contractual ambiguity in all financial contracts and transactions and strongly prohibits speculation or *gharar*. *Gharar* (also referred to as deception or risk/hazard) in Iqbal and Mirakhor (2011, p. 68) is "a situation when either party to a contract has information regarding some element of the subject of the contract, which is withheld from the other party, and/or the subject of the contract is something over which neither party has control." *Gharar* is prohibited under *Shariah* law to protect the weak from exploitation, speculation, or uncertainty–caused by the lack of clarity regarding the subject matter or the price in a contract or exchange–and to achieve better levels of transparency and fairness. The basic construct and objective of a traditional SPAC do not offer this, therefore, in its current structural terms, the vehicle is not permissible under *Shariah* law, unless certain covenants are introduced to amend the SPAC terms, eliminating the speculative properties. The proposed *i*SPAC addresses these omissions.

As per the proposed *i*SPAC structure terms, illustrated in Fig. 2, the first pre-IPO *Shariah* filter is applied at the formation stage when the SPAC sponsors make the private placement. Since the private placement is made in the private equity market to high-net-worth individuals or private investors, the *Shariah* screening must be performed by the equity providers at this preliminary stage and must not be left at the behest of SPAC sponsors. Private equity providers should either maintain an in-house *Shariah* board or committee or they shall hire the services of freelance *Shariah* scholars on a deal-to-deal basis. The core purpose is to have the investment proposals screened for their *Shariah* compatibility, regardless of whether the *Shariah* board construct is on an in-house or ad hoc basis. Procedurally, the SPAC proposal shall undergo a *Shariah* review with two possible outcomes: (a) if the initial *Shariah* scrutiny renders the opportunity as non-*Shariah* compliant, the process shall conclude and (b) if the proposal is approved as *Shariah*-compliant, funds shall be raised in a private placement and the SPAC sponsors shall proceed to the next stage.

Importantly, to eliminate speculation, mitigate information asymmetry, and enhance transparency, the *i*SPAC dictates that the SPAC founder identifies the target business or assets for acquisition at the time of private placement. In the absence of an identified target, at its minimum, the SPAC sponsor must identify the target industry or the economic segment to the potential investors. Investors then invoke due diligence for that particular industry to ensure the business is ethical and permissible under *Shariah* law. For instance, *Shariah* prohibits sponsoring certain economic segments or businesses such as armaments, pornography, alcohol, etc. Such an early-stage disclosure would potentially help investors avoid investing in illicit businesses. The first filter thus ensures the proposed SPAC has an identified target or a potential business segment that is not involved in illicit business activities and hence, is not speculative. While transparency would equally help the SPAC sponsors attract investments, essentially, making their SPAC a success.

4.1.2 Treatment of SPAC proceeds

The second prominent issue in the pre-IPO phase is the management and treatment of SPAC proceeds. By convention, SPAC proceeds are deposited into an interest-bearing trust account until the target company is acquired. This is pure interest (*riba* in Arabic terms) earning, which violates the fundamental principles upon which the Islamic banking business model is based. Particularly, the current structure allows the SPAC issuer to hold the proceeds for up to two years. If the issuers fail to find a target business for investment, money is returned to the investors/shareholders. Thus, the proceeds are not managed in a *Shariah*-compliant manner.

The second *Shariah* filter is thus directed imminently to ensure the IPO proceeds are managed in a *Shariah*-compliant manner. Also, at this stage, SPAC sponsors and equity providers agree on the terms in treating the *Shariah* screening-related costs. Continuous *Shariah* screening shall be maintained to ensure that funds are managed in a *Shariah*-compliant fashion. As noted above, in conventional SPAC, IPO proceeds are deposited into an escrow account where they earn interest until a target is acquired. However, funds raised under *i*SPAC terms shall be deposited into a non-interest-bearing trust account as depicted in the *i*SPAC structure, to avoid *riba*-based earnings.

To compensate the investors for the opportunity cost, the proceeds shall be invested in *Shariah*-compliant government securities such as the Sukuk (the Islamic bond). Since government-issued Sukuks are considered low risk and offer steady returns, which might not be as high as the interest earned from an escrow account, however, the return shall mitigate the opportunity costs to a certain degree.

Under special circumstances, where an interest-free deposit facility is not available or the opportunity to invest in government-issued debt securities i.e., Sukuk, the IPO proceeds may be deposited into an escrow account. However, the interest income incurred during the deposit period shall be received in a separate account and must not be treated as income because making money from money is pure *riba*, which is not permissible under *Shariah* law. Instead, interest income shall be used for charitable purposes using Islamic finance instruments such as the *Qard-e-Hasanah* (benevolence loan) or any other charitable purposes.

4.1.3 SPAC management costs

The post-IPO phase begins as the SPAC sponsors secure funds and start screening for a potential target. Once a potential target is identified, the SPAC sponsors must submit the acquisition case for *Shariah* approval before it is presented for the proxy vote to the shareholders' approval. At this stage, *Shariah* due diligence shall be carried out to ensure the potential target is not in a restricted business under *Shariah*. If the potential target receives *Shariah* approval, the case shall be forwarded for shareholders' approval. A positive proxy vote would conclude the transaction. The target business is subsequently acquired and listed on a stock exchange. However, if the potential target is not deemed as *Shariah* compliant, it shall not be presented for a proxy vote and the SPAC sponsors shall carry on their search for a potential target within the specified time frame. The same mechanism applies to the negative proxy vote. However, if the SPAC sponsors fail to find a target within the specified time, the SPAC shall be liquidated, and proceeds shall be returned to the investors. This is when the fourth *Shariah* filter is applied to ensure no interest payments are being made to the investors i.e., *no money is made on money*. Similarly, the *Shariah* screening shall ensure that the costs related to the process are distributed fairly: as per the pre-agreed terms between the SPAC sponsors and the investors.

In a traditional SPAC, the sponsors bear all the operating expenses of the SPACs if they fail to find the target business/assets. In some instances, SPAC founders use part of the interest income as working capital. Fair treatment shall be given to the agents i.e., SPAC sponsors or managers shall be compensated for the time and effort they have put in, from SPAC formation to SPAC liquidation. The participatory contracts of *Mudarabah* and *Musharakah* provide a solid footing for fair treatment in terms of cost. Under these contracts, either the principal provides funds i.e., working capital to the agents or shares the management costs by pooling up capital. Moreover, under conventional SPAC terms, SPAC sponsors are not paid for their services until a target is acquired. Under *i*SPAC terms, agents must be incentivized for their efforts as per the pre-agreed-upon terms between the SPAC sponsors and the equity shareholders. Such an arrangement would potentially align the stakes of agents with those of the shareholders, thereby, facilitating founders' share structure.

4.1.4 SPAC sponsors' promote

As discussed earlier, SPAC founders make a private placement for a nominal fee of 25,000 US dollars, which is normally worth 20% of the SPAC's equity (Cumming et al. 2014). SPAC founders maintain up to 25 percent equity at the pre-IPO price when accounting for the warrants (Kolb and Tykvova 2016). Thus, SPACs can be extremely lucrative for the SPAC sponsors who usually take a healthy chunk of equity at a nominal value. Aliaj et al. (2020) estimate that promotes for the four SPAC sponsors are now worth a combined value of almost 2 billion US dollars across the 10 deals carried out in 2019–2020. Likewise, Gahng et al. (2023) report an annualized average return of 23.9% for investors who buy shares at the SPAC IPO and redeem optimally before the merger.

The *i*SPAC offers a plausible solution. While the conventional SPAC units usually consist of one share and one warrant, under the proposed *i*SPAC structure, one unit would consist of one share and no warrant. However, if the regulations must dictate issuing shares, and warrants, the sponsor shall be allowed to buy warrants at their fair value rather than at the pre-IPO value. Additionally, the warrants should only be transferrable or exercisable after a certain period. For example, if the sponsor agrees to find a target within two years after raising SPAC, the time limit on transferring warrants should be similar i.e., two years after the floatation. The condition applies to all warrants held by either sponsors or investors. Such covenant will serve two objectives: first, the equity stakes are redistributed on a fair value and second, the sponsors and investors show a firm commitment towards the SPAC. The *i*SPAC structure terms are not to discourage sponsors' equity stake – quite the opposite. The emphasis is on fair treatment of costs and equity ownership on a fair value while curbing the cash-out opportunities, typically practiced by the SPAC sponsors in the post-IPO phase.

4.1.5 Cash-out opportunities

A successful acquisition concludes the SPAC with a listing on one of the major stock exchanges (Rodrigues and Stegemoller 2014). However, the successful SPAC acquisition may fuel the *"cash-out"* motives among equity holders, including the SPAC sponsors. The redemption option means that a SPAC can be shorn of sufficient cash to complete deals. SPAC sponsors, therefore, heavily rely on committed investors, institutional investors, block-holders, and private equity holders including venture capitalists. The fifth and final filter comes into effect to curb the cash-out behavior.

The existing equity holders may exercise their right to short their positions thereby, cashing out of the company using the SPAC acquisition as an exit route. The cash-out route violates the *Shariah* guidance about financial matters because they do unjust to the new equity holders. For instance, if the company acquired through the SPAC fails or its share value declines after the IPO début, the new equity holders bear losses while those who cashed out earn high profits. Therefore, it is unjust on the part of the initial/private equity holders to cash out soon after the IPO floatation. The cash-out exercise would equally result in an unfair redistribution of wealth and that goes against the principles upon which the Islamic banking business module is based.

Since cash-out motives cannot be determined in advance, the bindings proposed in the *i*SPAC terms potentially hinder existing equity holders from an immediate sale of ownership. As discussed in the earlier sub-section, the *i*SPAC structure ensures firm commitment from the sponsors and the initial equity shareholders. Under the *i*SPAC terms, investors still afford the arbitrage opportunities, however, the sale is time constraint and must be conducted at fair value. Equally, these constraints mitigate the financial capital risk a sponsor may face if too many shareholders opt for cash-out opportunities, leaving the SPAC with less financial capital available to acquire a target (Henderson and Platt 2020).

An *i*SPAC must comply with all five *Shariah* filters along with the covenants discussed above, to be considered as a *Shariah* compliant SPAC. Furthermore, after a successful floatation, the *i*SPAC managers must maintain an in-house *Shariah* board or committee to ensure the *Shariah* compatibility of the business. Besides, an internal *Shariah* audit shall be conducted regularly, and the business shall submit a *Shariah* compliance report, the same as any other *Shariah*-compliant entity.

5 Concluding remarks

This paper addresses variations inherent in a typical special purpose acquisition company or a SPAC and proposes an alternative SPAC structure i.e., an *i*SPAC that is less dilutive for the shareholders. The proposed structural construct of an *i*SPAC is less dilutive to investors/shareholders relative to a conventional founder share structure. Particularly, the treatment of sponsor's promote i.e., equity and warrants redemption framework for shareholders offers greater alignment between the SPAC sponsor and the investors. These features while mitigating the speculative properties of conventional SPAC, *Shariah* monitoring across five stages during the lifecycle of an *i*SPAC, make the proposed structure more suitable for other segments of the finance industry such as Islamic banking and finance, which largely remain excluded from the SPAC market.

The glut of blank check IPOs in the recent past has attracted a broader set of sponsors, investors, and target companies that have considered them when raising equity capital. The noted volume, popularity, and acceptance imply that SPACs may become a mainstay of the equity capital markets, especially during periods of economic downturns. Islamic banking and finance institutions compete head-to-head with their conventional rivals in many markets around the world and to remain attractive for and relevant to the market, these institutions must draw near with the latest developments i.e., financial innovation in the field of finance.

The proposed *i*SPAC offers an intuitive alternative *Shariah*-compliant investment vehicle for the Islamic finance industry. The academic rigor presented in this paper has strong relevance to the *Shariah*-compliant industry, which includes Islamic financial markets, Islamic banking and finance institutions, Islamic finance regulatory bodies, *Shariah* scholars, and investors, and shall guide and supplement the ongoing financial innovation within the sector.

Declarations

Conflict of interest There is no conflict of interest with any individual or organization.

Ethical approval The manuscript fully comply with the ethical standards set by the journal.

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