

FRAUD RISK IMPLICATIONS OF CELEBRITY SPACS

by

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Declaration of Authorship

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Abstract

The 2012 Jumpstart Our Businesses Act (JOBS) was passed arguably to facilitate greater access to capital by startup firms and to lower the costs of being public in an effort to make American listings more competitive with low cost exchanges abroad, such as London's Alternative Investment Market (AIM). However, the JOBS Act established a number of exemptions for a new class of firms called Emerging Growth Act (EGC) companies, which lowered the governance and disclosure requirements. This opportunity for firms to access the public capital markets at low cost spawned a resurgence of vehicles known as Special Purpose Acquisition Companies (SPACs), whose only purpose in going public is to raise capital to do an acquisition that yields a formerly private company going public through a Reverse Takeover (RT). As all post-JOBS Act SPACs are incorporated as EGCs, they pose an additional fraud risk to the public, yet very little academic research has addressed this issue. In this thesis, I examine three research questions related specifically to celebrity SPACs. First, using a proprietary, hand collected data set consisting of Celebrity SPACs from 2015 to 2021, I examine the characteristics of post-JOBS Act Celebrity SPACs in terms of their underpricing, post IPO returns, institutional structures, and acquisition patterns. Secondly, I examine the governance characteristics of sample Celebrity SPACs. Third, I link the features of Celebrity SPACs to Fraud Diamond Theory risk factors. I anticipate that my findings will be of interest to regulators, practitioners, the academic literature on alternative investments, and to auditors.

Search Terms: Special Purpose Acquisition Companies (SPACs), Fraud Diamond Theory, Emerging Growth Companies, Jumpstart Our Businesses Act, Initial Public Offering

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1. Introduction

Special Purpose Acquisition Companies (hereafter, SPACs) are vehicles used to raise capital through an Initial Public Offering (IPO) for the purpose of later conducting an acquisition of a privately held entity, which will merge through the SPAC to survive as a publicly traded company. These vehicles have traditionally been associated with low quality transactions (in vernacular terms, “shady”) where an Initial Public Offering (IPO) is undesirable due to the extensive oversight and disclosure that they require. SPACs are not new. The literature documents several aspects of SPAC risk and return features and governance characteristics (Ignatyeva, Rauch, and Wahrenburg (2013).

What is new is that in the United States, a new regulatory regime has facilitated a proliferation of SPAC transactions with very different governance profiles from past SPACs. Over half of all new listings in 2020 and 2021 have been SPACs. The new regulatory setting arose in 2012 when the United States Congress passed the Jumpstart Our Business Startups (JOBS) Act for the stated purpose of lowering the costs of access to capital in the public capital markets to startup firms. In doing so, it hoped to generate listings of growth companies in the technology sector, and to make American exchanges more competitive with foreign exchanges for small cap companies, such as London’s Alternative Investment Market (AIM).

The genesis of the JOBS Act was to reverse some of the costlier provisions of the Sarbanes-Oxley (SOX) Act of 2002. For example, in its governance provisions, SOX required board restructuring, more extensive disclosures of executive compensation, and an external audit of internal controls. Some companies moved to the OTCBB to avoid these requirements, others went private (Rosenthal, Gleason, and Madura, 2011), and many new listings chose the AIM, where the costs of being public were lower. While the JOBS Act succeeded in generating new listings for US exchanges, it did so at the cost of transparency, disclosure, and governance. Just as SOX led to firms that should not have been public going private (Gleason, Rosenthal, and Wiggins 2005), JOBS has facilitated firms going public that possibly shouldn’t, including many recent SPACs. In particular, while the post JOBS Act SPAC wave began in 2020, a 2021 trend was the evolution of the “Celebrity SPAC”.

Most celebrities are not experts in capital markets theory. While some eventually end up taking control of their private wealth and even venturing into brand sponsorship, merchandising, sports team ownership, and non-fungible transactions (NFTs), it has not traditionally been the norm entertainers and athletes run their own investment companies or launch startups. Recently, however, the popular press has described an explosion in the participation of celebrity athletes, musicians, actors, philanthropists, and influencers in the establishment of, or acquisitions related to, SPACs. We refer to these transactions - where a celebrity uses their reputational capital to promote business interests involving a SPAC transaction, such as acting as a sponsor, executive, board member, or investor in a SPAC or a company targeted for acquisition by a SPAC, as a “Celebrity SPAC”.

A recent example of what can go wrong with a celebrity SPAC is a transaction involving former president Donald Trump and an opaque Chinese SPAC, Digital World Acquisition Company. As an act of outrage against Twitter for his ban, Trump sought to establish his own social media vehicle, TRUTH Social, which would compete against established social media such as Facebook and Twitter, offering a conservative perspective. In order to operationalize the plan, to raise funding, Trump’s privately held company, Trump Media & Technology Group, would need to raise sufficient capital through an exchange listing. The Digital World SPAC could help Trump achieve this objective as quickly as possible, without the oversight of the IPO process, through a reverse merger with Trump Media and Technology Group, and the investors in the associated PIPE would not need to be disclosed to the public (Mangan, 2021a). However, as publicly noted by Elizabeth Warren, securities law governing SPACs is clear that the SPAC enter into conversations with any potential target until after the IPO has been completed; accordingly, the transaction is currently under investigation by the FINRA and the Securities and Exchange Commission (SEC) (Mangan, 2021b).

While other Celebrity SPACs may not yet be under SEC investigation, it appears that even with the aggressive marketing offered by a celebrity participant has not necessarily translated into strong market performance. For instance, the Parent Company, of which Jay-Z is the Chief Visionary Officer, which is the surviving product of the acquisition of his marijuana business Caliva and the Subversive Capital Acquisition Corporation SPAC, had lost 84% of its post acquisition value by December

21, 2021 (Lipschultz, 2021). As Jim Cramer, host of CNBC's stated: "These newer SPACs increasingly feel like an inside joke for the super-rich and a way for celebrities to monetize their reputations," Cramer said earlier this month. "Believe me, you don't want to invest in someone else's inside joke." (Egan, 2021)

SEC Chair Gary Gensler seeks to slow the madness with SPACs, arguing for greater oversight and regulation over SPAC marketing practices and disclosure practices (Franck, 2021).

There are several reasons why the existing literature on SPACs is incomplete, and I intend to address this in my thesis. First, no paper to date has explored the current wave of Celebrity SPACs. Secondly, the Celebrity SPACs have occurred after the implementation of the (JOBS) Act of 2012. The JOBS Act allowed for the creation of new structures, Emerging Growth Companies (EGCs) with much more limited governance and disclosure attributes than what was required after the Sarbanes-Oxley Act (SOX). Third, the post JOBS Act Celebrity SPACs have been much more heavily marketed towards retail investors, than pre-JOBS Act SPACs, and have an oddly intense emphasis on attracting visibility through social media, almost like multilevel marketing firms (MLMs); retail investors are less informed relative to institutional investors, and more prone to rely on expert thinking and celebrity endorsements. Third, the majority of post-JOBS Act SPACs are incorporated in offshore jurisdictions, with weaker rules on governance and transparency. Fourth, SPACs are, at present, spawning in high numbers; over half of all Initial Public Offerings in 2020 were SPACs, and they exhibit a peculiar pattern of external governance features in terms of serial sponsors, investment bank underwriters, and auditors (including audit firms that might not participate in PCAOB peer review) prior to their IPOs. Fifth, post JOBS Act Celebrity SPACs enable a privately held firm to go public by acquiring the SPAC through a reverse takeover (RT) in a process known as de-SPACing, rather than through an IPO which provides much more extensive oversight of the surviving public firm than an RT.

In the analysis, I address three research questions. First, what features of Fraud Diamond factors apply to post-JOBS Act Celebrity SPACs that should be highlighted by stakeholders and regulatory authorities? Second, what are the central institutional characteristics of post JOBS Act Celebrity SPACs, including their choice of targets? Third, what are the risk and return implications of SPAC IPOs?

2. Literature Review

2.1 SPACs

Referred to as the “poor man’s private equity” (Dimitrova, 2016), SPACs are investment vehicles that go public through an IPO for the exclusive purpose of conducting an acquisition. The reputational capital of the SPAC relies on the expertise and experience of the top management team, the sponsor, amassed to conduct the SPAC IPO and subsequent merger.

Berger (2008) argues that SPACs operate under the SEC’s “blank check” rules, which allow an issuer to raise money without disclosing information about its target. Accordingly, legally, every SPAC prospectus must state that the sponsors do not have a specific acquisition target under consideration and have not had any conversations with anyone about a potential transaction. The SPAC raises capital through the traditional IPO process, similar to what an operating firm would do. As soon as the SPAC collects the funds, it embarks on a journey to find a target to acquire.

The process normally starts with a sponsor who is usually a high-profile investor, experienced businessman or fund manager who creates a SPAC and purchases warrants to cover underwriting fees. The sponsor reputation is important, given that the public is investing in a vehicle without knowing what the ultimate acquisition of the SPAC will entail. Initially the SPAC is a shell company. SPACs are a tool private companies can use to become public without the usual regulatory scrutiny.

The sponsor gets around 20% of the SPAC’s value in exchange for a fee. The SPAC goes public, and retail investors may purchase shares. The proceeds from this IPO are deposited until a target for the reverse merger-like process (the “de-SPACing”) is identified. The sponsor typically has 2 years in order to find an appropriate target company or they would lose “the promote” which is 20% of the SPAC value raised in the IPO which they were granted in the first stage. In addition, they would lose the value of the warrants they had purchased. Sponsors do not receive salaries and do not receive a management fee.

Ignatyeva, Rauch, and Wahrenburg (2013) assess a sample of nineteen European SPACs, citing the looser regulatory oversight of these vehicles going public in Europe in terms of deal sourcing and governance, given that there does not appear to be a focus on pursuing European targets. They note that the listing of choice for many European SPACs is the Alternative Investment Market (AIM), potentially due to its low listing requirements.

Relatively little academic work has focused on SPACs, and even less in the post-JOBS Act environment. Bazerman and Patel (2021) highlight that SPACS have existed in different forms for years but have witnessed an unprecedented boom in popularity from 2019 onwards. Fifty-nine SPACS were initiated in 2019 shaping a \$13 billion-dollar total investment value. In 2020, 247 SPACS were established with a \$80 billion total investment value shaping more than half of newly listed public companies in the US. As of December 2021, approximately 693 SPACs have been created with a corresponding proceeds value of approximately \$188 billion.

2.2 JOBS Act and Emerging Growth Companies (EGCs)

The Jumpstart Our Business Startups (JOBS) Act was passed in April 2012 in order to help loosen regulatory requirements imposed on small businesses that aim to raise funds in the US. The JOBS Act relaxed disclosure and compliance requirements for small firms wishing to go public through an IPO. It also reduced the level of disclosures required in the first 5 years after which a firm goes public.

Chaplinsky et al. (2017) mention that “Title I of the Act permits “emerging growth companies” (EGCs)—generally, firms with less than \$1 billion in revenues in their most recently completed fiscal year—to phase in the public reporting and compliance obligations” (“public on-ramp provisions”). The continue to explain that some of the provisions linked to IPO preparation are like, EGCs can decide to seek a pre-filing interest from investors regarding a deal, submit their registration statement with the SEC in complete confidentiality, and limit financial and executive compensation disclosures within their IPO filing. Moreover, EGCs may resume reporting limited executive compensation disclosure post the IPO, and Postpone the outset of Sarbanes-Oxley (SOX) and the Dodd-Frank Act governance requirements Until having spent 5 years as a public company. Therefore, the JOBS Act aims to

minimize the costs of going public. Dambra et al. (2015) estimated that there have been 21 more IPOs created per year as a result of the JOBS Act given market conditions were controlled. This is considered a 25% jump versus pre-JOBS levels.

To lower the costs of being public for small firms, and to lure back new listings from exchanges such as the Alternative Investment Market (AIM) in London, EGCs benefit from lowered disclosure requirements. In the IPO Prospectus (the S-1 Filing), the EGC is required to provide only two years of audited financial statements. At the time of the IPO the EGC must provide an additional year of audited financial data. In contrast, non-EGCs under the Sarbanes Oxley Act must provide five years of audited financial statement information. Accordingly, the majority of EGCs availed themselves of this leniency in disclosure (PWC, n.d.)

For the first five years following the IPO, EGCs are not required to have an external audit of internal controls previously required by SOX Section 404(b) (although management must still assess internal controls and disclose the findings in the annual report). The Management Discussion and Analysis (MD&A) only is required to cover the present accounting period. EGCs are allowed to defer adoption of new accounting principles for the first five years post-IPO (Deloitte, 2013).

In addition to the disclosure requirements, the governance requirements are also lighter for EGCs than for non EGCs. They are not required to provide detailed executive compensation data; only aggregate compensation for the top five highest paid members of the management team must be disclosed. Non-US EGCs are allowed to follow the corporate governance requirements of the country of incorporation. Many are incorporated in offshore secrecy jurisdictions, such as the Cayman Islands, Bermuda, and the British Virgin Islands, which have minimal minority stakeholder protection and meager requirements for corporate governance. They do not need to follow US-GAAP, and they do not need to report in USD. An example of the disclosures related to the Digital World IPO is as follows:

The Company is an “emerging growth company,” as defined in Section 2(a) of the Securities Act, as modified by the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), and it may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being

required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in its periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved.

Further, Section 102(b)(1) of the JOBS Act exempts emerging growth companies from being required to comply with new or revised financial accounting standards until private companies (that is, those that have not had a Securities Act registration statement declared effective or do not have a class of securities registered under the Exchange Act) are required to comply with the new or revised financial accounting standards. The JOBS Act provides that a company can elect to opt out of the extended transition period and comply with the requirements that apply to non-emerging growth companies but any such election to opt out is irrevocable. The Company has elected not to opt out of such extended transition period which means that when a standard is issued or revised and it has different application dates for public or private companies, the Company, as an emerging growth company, can adopt the new or revised standard at the time private companies adopt the new or revised standard. This may make comparison of the Company's financial statements with another public company which is neither an emerging growth company nor an emerging growth company which has opted out of using the extended transition period difficult or impossible because of the potential differences in accounting standards used. (Digital World Acquisition Corp. S-1/A, 2020)

From the Forest Road Acquisition Corp II S-1 filing:

We are an “emerging growth company,” as defined in Section 2(a) of the Securities Act of 1933, as amended (the “Securities Act”), as modified by the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). As such, we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a non-binding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. If some investors find our securities less attractive as a result, there may be a less active trading market for our securities and the prices of our securities may be more volatile.

In addition, Section 107 of the JOBS Act also provides that an “emerging growth company” can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an “emerging growth company” can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We intend to take advantage of the benefits of this extended transition period. (Forest Road Acquisition Corp II, 2021)

Given the ability to raise large amounts of capital with relatively low oversight, based on the characteristics of SPAC sponsors and underwriters, with often little more than a general idea of the sector in which the SPAC intends to pursue an acquisition, it is not difficult to see a potential for fraud risk arising from SPACs. Further, the nature of the transaction and embedded contractual claims lend themselves to a moral hazard problem: the sponsor makes a relatively small investment in the SPAC at the time of the formation of the SPAC, and once the SPAC goes public, they are able to obtain a significant ownership stake in the company following the IPO. The value of this ownership stake is not based on the value of the shares in the public market for the stock when the shares begin trading; they are attached to warrants held by the SPAC sponsor. This gives the SPAC sponsor access to the potential upside return should the SPAC stock perform well in the market following the IPO for very little investment and with nothing to lose except their initial stake in the SPAC, even if the SPAC is unable to complete an acquisition within the time period specified. While the evidence is limited regarding the underpricing and aftermarket performance of SPACs, preliminary research suggests that the wave of SPACs has not performed well on a market adjusted basis. Even if the SPAC does complete the required acquisition, the contractual claims in SPAC deals could yield other undesirable outcomes; in October 27, 2021, The CFA Institute noted that “the way in which the SPAC structure mitigates “deal risk” would potentially result in mergers for companies completely unfit for public markets” (Schacht, 2021).

There are multiple reasons why SPACs are risky. The compensation and regulatory practices in the IPO market and the SPAC market are both very different. Bai et al. (2021), explain how these differences impact the motives of the intermediaries that help firms become publicly listed. SPACs enjoy lenient regulatory supervision. In addition, SPAC sponsors get compensated in equity rather than a fixed amount like

investment banks in an IPO. Consequently, this encourages investment banks to help safer companies to go public rather than the risky ones. This is not to mention that litigation costs discourage investment banks from taking risky firms public. SPACs are not threatened by litigation costs because they are required to abide by merger laws rather than public offering laws. Therefore, Bai et al. (2021), prove that big, safe firms tend to opt for the IPO option and smaller risky companies tend to go public using SPACs.

Another reason why SPACs are risky is because as Bai et al. (2021) explains, firms that have potential but are risky will definitely prefer to go public through a SPAC because it will be more profitable. If they choose the IPO route, their riskiness will lead to higher costs.

Furthermore, on the 22nd of September 2021, Senators Elizabeth Warren, Sherrod Brown, Tina Smith and Chris Van Hollen sent a group of individuals that have created SPACs a formal letter expressing their concern regarding the operation of these SPACs. Gary Gensler the Chair of the SEC and Robert Cook the President and CEO of the Financial Industry Regulatory Authority received carbon copies of this communication. In the letter, the senators quote the Bloomberg article “The SPAC Man Method: Inside the Billionaire Rush for Riches”, a number of times to channel their concerns. In this Bloomberg article Perlberg (2021) criticizes SPAC sponsors and accuses them of using SPACs as a tool to expand their fortune and net worth by saying “ they’ve employed a range of maneuvers — some of them downright astonishing to the uninitiated — to win even when investors lose.”. The article gives examples of three SPAC sponsors who practiced questionable behaviors and were consequently part of the group of SPAC sponsors who were addressed in the senators’ letter. One of the examples Perlberg (2021) discusses was related to Michael Klein the Founder and Managing Partner of M. Klein & Associates. Klein hired his own investment bank to offer his SPACs consulting services. In simple words, he was paying himself fees.

What makes SPACs even riskier is that the corporate structure of SPACs and the environment of the SPAC community does not encourage good corporate governance practices. Anderson et al. (2021), writes that due to the short life span of SPACs their governance practices are usually less systemized than regular corporations. He compares the structures and practices of SPAC boards and corporate

boards and highlights that SPAC boards are only required to have three independent directors whereas a corporate board would need to have 8 to 10.

Klausner and Ohlrogge (2021) explain how the structure of SPACs causes a conflict of interest between the sponsors and the shareholders. In a scenario where a SPAC identifies a value creating merger, both the sponsors and the shareholders would benefit and both parties would not hesitate to support the transaction. However, if the SPAC sponsor does not find a value creating transaction to pursue, they may still support a transaction that causes a loss to the shareholders because the sponsor would still be able to profit from the transaction. Whilst the shareholders may prefer to liquidate the SPAC and redeem their shares, the sponsor would not prefer that because the sponsor would lose their initial investment and would not be able to make any profit.

Therefore, the sponsor may try to beautify the deal as much as possible so that the shareholders vote in favor of a beautified loss-making deal. In many cases, this can lead to breach of duty and a class action lawsuit. Klausner and Ohlrogge (2021) continue to explain that ideally, a sponsor should appoint perfectly independent directors as members of the SPAC board and should compensate them in a manner that aligns the directors' interests with the public shareholders' interests. The governance of a SPAC should be set up in a manner that neutralizes the conflicts. However, in reality, numerous sponsors assign directors as board members who are compensated in a way where the directors' interests are aligned with the sponsor's interests rather than the shareholders' interests.

Taken together, the literature suggests that SPACs in general, are not considered a safe investment. This is because at the time of the IPO, the investors do not know what they will end up owning. They are just trusting the sponsor. Egan (2021) describes this by mentioning what the Yale Law School professor, Jonathan Macey has to say, "It's a sign that markets are ruled by emotion, rather than rationality". He continues to say "'With a SPAC, it's like you have a captain and the captain is telling you he will buy a ship and then figure out where it will go.'" Some in the media described a huge SPAC bubble forming in 2020. According to spacanalytics.com, there were more SPACs in 2020 than all the SPACs created since 2008. And it was not only fund managers and finance enthusiasts that were interested in SPACs.

2.3 Celebrity SPACs

The formation and IPOs of EGC SPACs have spawned since 2019, and an interesting phenomenon began to appear in the popular press and retail circles: the participation of publicly well known individuals in the sponsorship of or investment in SPACs. In March 2021, Reuters also commented on this SPAC mania by mentioning that many celebrities have been attracted to SPACs including high profile athletes, musicians, influencers, politicians, and news commentators, ranging from Jay-Z (American rapper and producer) to former basketball player Dr. Shaquille O’Neal to Martha Stewart (media personality) who have either sponsored their own SPAC or hopped onto the boards of other SPACs. For example, Jay-Z’s cannabis company was taken public through a SPAC transaction with Subversive Capital Acquisition Corporation. The SPAC prospectuses demonstrate the roles that celebrities play in the SPACs. From the Forest Road Acq Corp II S-1 filing:

“Shaquille “Shaq” O’Neal will serve as a strategic advisor as of the effective date of the registration statement. Mr. O’Neal is an American athlete, investor, and entrepreneur, and is regarded as one of the greatest players in NBA history. Mr. O’Neal was elected to both the Naismith Memorial Basketball Hall of Fame and FIBA Hall of Fame. Beyond basketball, Mr. O’Neal has a keen eye for investing in successful ventures, having invested in Google prior to its initial public offering and Ring prior to its sale to Amazon. Mr. O’Neal owns many leading franchises, including Auntie Anne’s and Papa John’s Pizza, as well as several restaurants in Las Vegas. Mr. O’Neal moved into e-sports by assuming the role of General Manager of the Kings Guard (NBA 2K League), an e-sports team associated with the Sacramento Kings, in which he owns a minority stake. Mr. O’Neal serves on the board of directors of Papa John’s Pizza, as a national spokesperson for the non-profit Boys & Girls Clubs of America, and as a global spokesperson for Krispy Kreme. Mr. O’Neal has served as a strategic advisor of FRX I since November 2020. Mr. O’Neal has exceptional experience in the sports and entertainment landscape, assuming the roles of player, media personality, owner, and operator.” (Forest Road Acq Corp II, 2021). From the Slam Corp. S-1:

Alex Rodriguez founded A-Rod Corp in 2003, purchasing a duplex apartment building on the theory that investing his MLB earnings wisely would protect him from the kinds of financial struggles that afflict too many professional athletes. While best known during his baseball career as one of the world’s

greatest athletes (a 14-time MLB All-Star and a 2009 World Series Champion with the New York Yankees), Mr. Rodriguez now leads a team of experts who aim to build high-growth businesses and enhance the value of more than 30 companies in the A-Rod Corp portfolio. Mr. Rodriguez invests in world-class startups and partners with leading global companies in a variety of industries. While he racked up extraordinary statistics on the field, Mr. Rodriguez simultaneously assembled an impressive team at A-Rod Corp, bought apartment units across the southeastern United States, and built a fully integrated real estate and development company. Following his success in real estate, Mr. Rodriguez has invested in a variety of sectors where he has expertise, including sports, wellness, media and entertainment and technology. He looks for long-term opportunities to not only provide financial capital but also employ his operational expertise and unique global perspective. Mr. Rodriguez is an Emmy Award-winning MLB analyst for Fox Sports and ESPN. Mr. Rodriguez has been a judge and investor on ABC's Shark Tank, mentored financially distressed ex-athletes on CNBC's Back in the Game, and currently co-hosts the podcast The Corp with Barstool Sports' Dan Katz, interviewing chief executive officers, entrepreneurs and sports legends. Committed to creating opportunities for young people to succeed, Mr. Rodriguez serves on the Board of Directors of the Boys and Girls Clubs of Miami-Dade and the Boards of Trustees of the University of Miami and The Paley Center for Media. (Slam Corp, 2021)

Celebrity affiliation with SPACs could potentially be useful in several ways, and the marketing literature related to celebrity endorsement of brands provides some insights into the potential benefits. The marketing literature offers some insights into the role of celebrities in branding consumer products. McCracken (1989) defines a celebrity endorser as: "any individual who enjoys public recognition and who uses this recognition on behalf of a consumer good by appearing with it in an advertisement". Celebrity endorsement can lead to greater purchase intention, greater cash flow expectations, greater perceived favorability), especially for unfamiliar brands. On the other hand, it is costly to get a celebrity to endorse a consumer product (less so with SPACs) and celebrity overexposure can be damaging.

Brands endorsed by trustworthy and globally recognized celebrities are viewed as more credible than those endorsed by attractive celebrities and those with expertise in globalized industries where trust is important, such as airlines (Wang-Close and Scheinbaum, 2018). Agnihotri and Bhattacharya (2018) find that "Niche celebrities create more abnormal returns than mainstream celebrities." Roy and Mishra (2018) find that "celebrities from more glamorous professions, such as film actors, are perceived differently than celebrities from performance-oriented professions, such as

sports.” Celebrity likeability is also important (Tantiseneepong et al., 2012) as is a perceived “match”, or congruency, between the celebrity and the product (Till and Busler, 1998), and raises consumer intention to buy a product. In the SPAC context, celebrities can employ their network to find targets and investors, as indicated by the following statement from the Slam Corp S-1 filing:

Our selection process will leverage Mr. Rodriguez’s extraordinarily powerful network and personal influence, as well as our Founding Partners’ ecosystem of management teams at public and private companies, entrepreneurs, investment bankers, private equity and venture capital fund sponsors, attorneys and consultants. We will deploy a proactive, thematic sourcing strategy that identifies companies where we believe the combination of our operating experience, network, investment capital and capital markets expertise can be catalysts to transform and accelerate the target business’s growth and performance. (Slam Corp, 2021)

However, in some cases, a celebrity can be detrimental. Bad publicity regarding a celebrity can also be damaging to the public perception of the brand the celebrity endorses, especially for new or unfamiliar products (Kim and Sung, 2013). Celebrity involvement in SPAC transactions has yielded failure that is amplified by the media and could potentially damage the reputational capital of sponsors and target management. SPAC acquisitions that go bad yield losses for SPAC sponsors because the SPAC has a limited amount of time to conduct an acquisition or it must dissolve, returning investors’ money. A recent example is Fast Acquisition, which reached a deal to acquire media personality Tilman Feritta’s Fertitta Entertainment in 2021. Feritta’s attempted withdrawal from the acquisition agreement led to a high profile feud in the media between himself and Fast Acquisition CFO Garrett Schreiber (Maze, 2021). Fertitta ultimately paid \$33 million in fines to exit the transaction with Fast Acquisitions to cover the expenses associated with the \$6.6 billion acquisition and to replenish Fast’s working capital (Ruggless, 2021).

Another potential problem with Celebrity SPACs is that they have been aggressively marketed through social media to less informed retail investors. In addition, in February of 2001, raising the profile of SPACs to the subset of retail investors who are also fans of rap music, rapper and cannabis enthusiast Cassius Cuvée released a song and video describing the attributes of SPAC transactions called SPAC Dream. The video was tweeted by Bill Ackman and quickly obtained over 80,000 views on Youtube.

Fueled by Twitter influencers SPACInsider, SPACTiger and SPACzilla, the use of social media by SPAC analysts to reach the investing public, Cuvée also invests in SPACs as well as options and warrants related to SPACs, and SPAC Dream raised awareness of these social media influencers. Based on these social media personalities as well as others, such as Bill SPACman and SPACdaddy, SPACs became some of the most actively traded assets by retail investors through Robinhood (Ramukar, 2021). Analysts such as SPACZilla focus on “analysis” of the SPACs that tend to be most visible in the media, with a disproportionate emphasis on SPACs associated with celebrities and retweet content reiterating the “power” of retail investors.

To stem what they perceived to be heightened retail interest in SPAC investments, on the 10th of March 2021, the SEC issued an investor alert regarding celebrity SPACs “celebrity involvement in a SPAC does not mean that the investment in a particular SPAC or SPACs generally is appropriate for all investors. Celebrities, like anyone else, can be lured into participating in a risky investment or may be better able to sustain the risk of loss. It is never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment.”

2.4 The Fraud Diamond Theory

Cressey’s (1956) Fraud Triangle posits that the necessary and sufficient conditions for fraud to occur are (1) a non-shareable pressure, (2) an opportunity, and (3) the chance to rationalize away the cognitive dissonance most people experience when they act in a way that is not lawful. The Fraud Triangle Theory, while still widely employed in the auditing and forensic accounting literature, has been recently modified by the Fraud Diamond Theory, which incorporates a fourth factor, skill.

A conflagration of factors related to post-JOBS Act SPACs generates substantial fraud risk. First, the JOBS Act enables SPACs to incorporate offshore in jurisdictions characterized by weak governance, while following the country of incorporation’s governance standards. This would have been impossible following the 2002 Sarbanes Oxley Act until JOBS removed these controls for EGCs. Secondly, the heavy recruitment of retail investors weakens the base of informed investors who would act as monitors of SPAC management. Several stylized facts characterizing post JOBS Act SPACs also encourage weak oversight, including serial sponsors and common boutique investment banks and auditors. The de-SPACing process also generates fraud

risk. While the SPAC does an IPO (on the basis of weak governance and limited transparency permitted following the JOBS Act), the private firm the SPAC takes public through the merger is subject to less oversight than if it went public through an IPO. Gleason, Rosenthal, and Wiggins (2005) document a high level of securities litigation surrounding RTs, highlighting the increased fraud risk.

3. Data and Methods

3.1 Data

In order to obtain the sample of Celebrity SPACs, we began by obtaining all post JOBS Act SPACs. We access the Audit Analytics database, searching on all IPOs from 2012 to 2021 and matching on SIC “blank check” to obtain SPACs, as well as corresponding data on ticker symbol, state of incorporation, nation of incorporation, headquarters nation, IPO date, and EGC status. We then used Lexis-Nexus and media searches to identify Celebrity SPACs. The Celebrity SPACs were then matched against the Audit Analytics database to ensure that all were EGCs. Data was then matched against the subscription database SPAC Research Database (Spacresearch.com) and Crunchbase (a subscription dataset on startups and IPOs) in order to obtain information on the transaction features, sponsors, investors, underwriter, target industry, status, and target (if any). Additional data was obtained from S-1 filings. Stock price data was obtained from CRSP. Our final sample of unique Celebrity SPACs is 61.

To test our hypotheses, we also obtained a control sample of non-Celebrity SPAC transactions. These control SPACs were matched on named target sector of the SPAC and IPO month, both of which were obtained from a subscription to www.Spacresearch.com and Crunchbase.

3.2 Methodology

The research questions in this thesis require a mixed methods approach (i.e., both qualitative and quantitative.) My first research question, following Ignatyeva, Rauch, and Wahrenburg (2013), is to summarize the key institutional features of Celebrity SPACs.

My second research question involves identifying the fraud diamond factors and linking them to the characteristics of Celebrity SPACs. This type of investigation requires a qualitative technique.

To examine the second and third research questions, regarding the risk and return of Celebrity SPACs, we use quantitative analysis. A measure of the perceived riskiness of an IPO is the first day return, or underpricing (Rock, 1986), which is calculated as the difference between the opening price and the end-of-day price the first trading day (Daily et al., 2003). We will be looking at the 1- month, 6-month and 12 month returns of the SPACS in the sample. Underpricing and is a commonly used proxy for the information asymmetry, or perceived riskiness of the issue (Rock, 1986). Underpricing is also a signal of the quality of the IPO firm (Franklin and Faulhaber, 1989); only high quality IPO firms will ultimately recoup the underpricing loss to insiders through strong aftermarket returns. Therefore, we will examine the returns of these SPACs from it's earliest stage (1 month) and see if there is any come back in the following months. We will also examine the SPACs' performance throughout these months and stages.

Following Barber and Lyon (1997), post-IPO returns are calculated follows:

We compute the buy-and-hold return (BHR_i) for each Celebrity SPAC i over period T (i.e., for one month, three months, and six months following the IPO date) as:

$$BHR(T)_{i(\tau_1, \tau_2)} = \prod_{t=\tau_1}^{\tau_2} (1+R_{i,t})$$

where R_{it} is the return of Celebrity SPAC i on trading day t .

We also calculate $BHR(T)_j$ for each control SPAC as:

$$\prod_{t=\tau_1}^{\tau_2} (1+R_{j,t})$$

Where R_{jt} is the return on control SPAC j on trading day t .

If the Celebrity SPAC return mirrors the control SPAC, the abnormal return is zero, and the Celebrity SPAC performs as expected. However, if the Celebrity SPAC average return deviates significantly from the average control SPAC returns, then the

Celebrity SPAC has either under or outperformed the control SPAC sample. Therefore, our measure of aftermarket performance, the buy-and-hold abnormal returns (BHARs) for each SPAC, is defined as:

$$\text{BHAR}(T)_{i(\tau_1, \tau_2)} = \prod_{t=\tau_1}^T (1+R_{i,t}) - \prod_{t=\tau_1}^T (1+R_{j,t})$$

Where $T = 1$ month, 3 months, and 6 months, respectively.

So, for example, if a Celebrity SPAC had a 5 percent buy-and-hold return over the 1 month following the IPO and the control SPAC had a 2 percent abnormal buy-and-hold return over the 1 month post IPO, then the Celebrity SPAC's buy-and-hold 1 month abnormal return would be a positive 3 percent.

We then use t-tests for differences in means non-parametric tests to examine whether Celebrity SPACs exhibit significantly greater underpricing and post IPO returns.

We then test for differences in underpricing and post-IPO performance by segmenting the sample based on celebrity characteristics and fraud diamond risk factor

$$\text{Underpricing}_i = \text{Fraud Diamond Factors, other factors, visibility, etc...}$$

4. Results

4.1 Quantitative Results

Set out below are the descriptive statistics of the sample collected in order to carry the quantitative analysis to address my research questions, regarding the risk and return of Celebrity SPACs. Table 1 below provides the details of the sample used.

Table 1: Sample characteristics and results

	N	Minimum	Maximum	Mean	Std. Deviation
Instagram Followers	58	0	103,000,000	5,138,508	15,394,924
Fame Source (Politics)	58	0	1	12.0%	32.9%
Fame Source (Sports)	58	0	1	59.0%	49.7%
Fame Source (Business)	58	0	1	22.0%	42.1%
Capital Raised (\$)	58	75,000,000	1,380,000,000	344,794,655	254,671,084
SPACs with Closed Deals	20	0	1	40.0%	50.3%
High Quality Underwriter	53	0	1	57.0%	50.0%
Big4 (Underwriter and/or Auditor)	58	0	0	0.0%	0.0%
Offshore Incorporated	57	0	1	26.0%	44.4%
BHR (1 month)	37	-48.9%	10.1%	-2.3%	10.7%
BHR (3 months)	37	-93.3%	34.0%	-3.3%	18.0%
BHR (6 months)	36	-98.7%	79.5%	-1.1%	23.6%
BHR (9 months)	36	-99.5%	140.9%	0.5%	30.6%
BHR (12 months)	36	-98.5%	222.7%	3.1%	41.9%

The sample used comprised of 58 US based SPACs of which approximately 60% were associated with athletes. The majority of the remaining SPACs related to businesspersons or politicians. More than a quarter of the SPACs in this sample were incorporated in offshore countries like the Cayman Islands or the British Virgin Islands. The remainder were all incorporated in the state of Delaware. Approximately 40% of the SPACs had closed deals and the remaining 60% were involved in live deals or were in a pre-deal stage.

Only 37 SPACs had enough data publicly available to calculate the 1-month and the 3-month buy and hold return. Furthermore, only 36 SPACs had enough data publicly available to calculate the 6, 9 and 12-month buy and hold return.

Three Regressions were generated using the following independent variables:

- Fame Source (Politics)
- Fame Source (Sports)
- Fame Source (Business)
- High Quality Underwriter
- Offshore Incorporated

The three dependent variables used for the 3 regressions were the following:

- 1-month buy and hold return
- 6-month buy and hold return
- 12-month buy and hold return

The results were as shown in Table 2, 3, and 4:

Table 2: 1-month buy and hold return regression results

BHR1 Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-0.04	0.07		-0.566	0.576
	Source of Fame (Politics)	-0.073	0.075	-0.254	-0.975	0.338
	Source of Fame (Sports)	-0.019	0.076	-0.087	-0.252	0.803
	Source of Fame (Business)	0.021	0.074	0.084	0.282	0.78
	High Quality UW	0.023	0.05	0.105	0.463	0.647
	Offshore Incorporation	0.059	0.06	0.249	0.982	0.334
Dependent Variable: BHR1						

Table 3: 6-month buy and hold return regression results

BHR6 Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.003	0.165		0.016	0.987
	Source of Fame (Politics)	-0.098	0.176	-0.156	-0.559	0.581
	Source of Fame (Sports)	-0.033	0.178	-0.068	-0.186	0.854
	Source of Fame (Business)	0.06	0.174	0.11	0.345	0.733
	High Quality UW	-0.014	0.118	-0.029	-0.118	0.907
	Offshore Incorporation	0.038	0.141	0.072	0.27	0.789
Dependent Variable: BHR6						

Table 4: 12-month buy and hold return regression results

BHR12 Coefficients						
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
1	(Constant)	0.059	0.293		0.201	0.842
	Source of Fame (Politics)	0	0.313	0	0.001	0.999
	Source of Fame (Sports)	0.079	0.317	0.091	0.248	0.806
	Source of Fame (Business)	0.019	0.31	0.02	0.063	0.95
	High Quality UW	-0.109	0.211	-0.125	-0.515	0.611
	Offshore Incorporation	-0.036	0.251	-0.038	-0.143	0.887
Dependent Variable: BHR12						

The results in the tables above prove that none of the t tests are significant therefore the variables do not significantly predict the return or riskiness of the SPACs. Nevertheless, we can see from the descriptive statistics that the mean of the performance of the SPACs is not great either. All the calculated buy and hold returns were negative except for the 9-month and the 12-month buy and hold returns which were still at a low 0.5% and 3.1% respectively. Compared to the average risk-free rate or treasury rates that float between 2.5% and 3% SPACs can be considered a really bad investment that can yield negative returns and in the best-case scenario no returns at all. The high standard deviations of the buy and hold returns also indicate the unpredictability of the returns.

4.2 Qualitative Results

As referred to previously in section 2 (d) Cressey's (1956) Fraud Triangle posits that the necessary and sufficient conditions for fraud to occur are (1) a non-shareable pressure, (2) an opportunity, and (3) the chance to rationalize away the cognitive dissonance most people experience when they act in a way that is not lawful. We also mentioned that The Fraud Triangle Theory, while still widely employed in the auditing and forensic accounting literature, has been recently modified by the Fraud Diamond Theory, which incorporates a fourth factor, skill.

After having analyzed the characteristics of the 58 SPACs, several alarming links were identified between these SPACs' characteristics and the Fraud Diamond Theory. These links can demonstrate the fraud risk implications of celebrity SPACs.

First, the JOBS Act enables SPACs to incorporate offshore in jurisdictions characterized by weak governance, while following the country of incorporation's governance standards. As per Table 1 we note that more than a quarter of the SPACs in this sample were incorporated in offshore countries like the Cayman Islands or the British Virgin Islands. This would have been impossible following the 2002 Sarbanes Oxley Act until JOBS removed these controls for EGCs. Linking this to the Fraud Diamond Theory, this would represent the "opportunity" element. These SPACs now have the opportunity to operate with weak governance.

Secondly, the heavy recruitment of retail investors weakens the base of informed investors who would act as monitors of SPAC management. Famous SPAC sponsors are usually chosen to promote for SPACs in order to attract retail investors from their fandom who are less informed than professional investors. According to Table 1, 59% of the SPACs sample had sponsors who were famous athletes and sports people. The fan base of these athletes may trust an investment simply because the sponsor is someone they are familiar with. It gives more credibility to the investment. This link to the 'rationalization' element of the Fraud Diamond Theory.

Third, we see in Table 1 that only 57.0% SPACs had a high-quality underwriter, and none included one of the Big 4 as an auditor or underwriter. We also mentioned previously that more than a quarter of the SPACs in this sample were incorporated in offshore countries like the Cayman Islands or the British Virgin Islands. All these factors. All these factors provide an "incentive" for fraud since it provides the "opportunity" to commit fraud with lower risk of being caught. In addition, the non-shareable pressure element which can be considered the "incentive" element is difficult to link to any of the SPACs characteristics because this will be unique to each individual seeking to commit fraud and at the end of the day it is something "non-shareable". A non-shareable financial pressure could be having to steal in order to purchase drugs. This is something any person would be reluctant to admit to anyone.

Fourth, the final element of the Fraud Diamond Theory is "skill". This is basically the skill of being able to get away with fraud and the ability to maintain the "lie" without being caught. This thesis will hopefully bring the world one step closer to uncovering the characteristics of these worrying SPACs that are spreading at an

alarming rate in the economy. This analysis and these findings will hopefully be of interest to regulators.

5. Conclusion

In conclusion, we have defined SPACs, Special Purpose Acquisition Companies, as vehicles used to raise capital through an Initial Public Offering (IPO) for the purpose of later conducting an acquisition of a privately held entity, which will merge through the SPAC to survive as a publicly traded company. The JOBS Act established a number of exemptions for a new class of firms called Emerging Growth Act (EGC) companies which lowered the governance and disclosure requirements. We examined the characteristics and governance features of a sample of 58 post-JOBS Act Celebrity SPACs. Furthermore, we linked the features of Celebrity SPACs to Fraud Diamond Theory risk factors. The analysis conducted and the regressions results indicate that the fame source, having a high-quality underwriter and being incorporated offshore do not significantly predict the return or riskiness of the SPACs. However, the descriptive statistics show that the mean of the performance of the SPACs is not as good as one expects. Compared to the average risk-free rate or treasury rates that float between 2.5% and 3% SPACs can be considered a really bad investment that can yield negative returns and in the best-case scenario no returns at all. The high standard deviations of the buy and hold returns signal the unpredictability of the returns. I anticipate that my findings will be of interest to regulators, practitioners, the academic literature on alternative investments, and to auditors. Investors should be cautious when it comes to investing in SPACs.

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