Do SPAC Combinations Affect Their Peers' Accounting Quality?

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Abstract

We explore whether firms going public through mergers with Special Purpose Acquisition Companies (SPAC combinations) influence the financial reporting quality of their peer firms. Although SPAC combinations provide an efficient alternative to traditional IPO for private firms, recent studies show that SPAC combinations suffer from poor financial reporting quality. We extend this line of research by analyzing the effect of SPAC combinations on their peers. We show that peers of SPAC combinations experience an increase in their financial reporting quality in the subsequent years. This result is in line with SPAC combinations attracting regulatory scrutiny into their peer group. Consistently, we further show that the increase in financial reporting quality is driven by more visible peers of SPAC combinations. Our study provides a new perspective on the debate over the overall effects of SPAC combinations.

Keywords: SPAC, spillover, earnings quality, earnings management, IPO, mergers

1. **Introduction**

U.S. private firms have increasingly preferred merging with Special Purpose Acquisition Companies (SPACs) to form public firms called SPAC combinations. This method of going public is deemed efficient for sponsoring private firms, as compared to the traditional initial public offering (IPO) process. However, recent studies in accounting research, motivated by regulatory concerns over the SPAC combination process, show that SPAC combinations suffer from poor financial reporting quality (Kim, Park, Peterson and Wilson 2022). We join this line of research by asking whether SPAC combinations affect the financial reporting quality of their peers. On one hand, peers of SPAC combinations may increase their earnings management. Recent work documents that SPAC combinations suffer from low financial reporting quality because the accelerated process of going public via a SPAC merger brings about the cost of insufficient time to adopt to new reporting requirements and higher likelihood of internal control deficiencies (Kim, et al. 2022). Moreover, SPAC combinations tend to produce optimistic forecasts that later fail to meet expectations after going public (Blankespoor, Hendricks, Miller and Stockbridge 2021). If peer firms are pressured through SPAC combinations' overly optimistic forecasts, managers of peers are likely to engage in earnings management more to meet the elevated expectation from investors (i.e. *contagion hypothesis*) (Beatty, Liao, Yu 2013; Dhaliwal, Huang, Khurana, Pereira 2014; Kedia, Koh, and Rajgopal 2015; Li 2016). On the other hand, due to a SPAC merger's unique process that allows private firms to circumvent strict monitoring, SEC has paid high attention to SPACs. In 2021 alone, SEC investigated multiple SPAC combinations including Nikola Corporation, Akazoo, Momentus Inc., Trump Media & Technology Group, and Lucid Group; some being charged with fraud and fined millions. Prior research suggests that SEC attention on a firm has a spillover effect on peer firms in the direction that reduces peer firms' risks

(Brown, Tian, Tucker 2018). If this is the case, peer firms are likely to reduce the extent to engage in earnings management (i.e. *scrutiny hypothesis*).

Identifying 304 SPAC combinations and analyzing their peer firms (SPAC peers, hereafter) over the period of 2013-2021, we find higher financial reporting quality in SPAC peers after a SPAC merger in their industry or metropolitan statistical area, consistent with the scrutiny hypothesis. Our results suggest that in the event of a SPAC merger, peer firms decrease their discretionary accruals in subsequent years, indicating a better accounting quality. We show that a new SPAC combination is associated with an increase in financial reporting quality of its industry peers by 0.025 standard deviations from its average levels in the subsequent period. We further show that this increase in financial reporting quality is driven by SPAC peers who are more visible, as measured by high profitability and high market share. This is in line with the notion that more visible peers of SPAC combinations feel more scrutiny in their financial reporting decisions.

SPAC process provides a time-saving option for private firms to go public and raise capital, compared to the traditional IPO process. Another critical advantage for SPAC firms is that they are allowed to disclose forward-looking information to their investors, unlike IPO firms. Due to these appealing features, SPAC mergers have become very popular over the last decade, accounting for roughly half of the total IPO valuation in 2020 (Ramkumar and Farrell, 2021). However, this quick rise of SPAC mergers brought about concerns about their performance. Recent research has focused on several aspects of SPAC combinations to address these concerns. For example, Blankespoor et al. (2022) show that SPAC combinations use inflated revenue and earnings projections, which mostly fail to meet or beat expectations during the post-merger period.

Another concern related to SPAC combinations has to do with the quality of financial statements. Affirming the regulator and auditor warnings about SPAC combinations, Kim et al.

(2022) find that SPAC combinations suffer from lower financial reporting quality, compared to other IPO firms. We join this debate about the effects of SPAC merger process on the financial reporting quality, by examining possible spillover effects from SPAC combinations to their peer firms.

We make several contributions to the literature by increasing our understanding of the large-scale effects of SPAC mergers that have become a prominent type of public financing for companies. First, the increase of SPACs is shaping the current trend for private firms to go public and has drawn attention from the SEC. We provide evidence that continuous attention by SEC mitigates potential negative effects on peer firms' financial reporting quality. Second, studies on SPACs have largely focused on institutional backgrounds and financial performances of SPAC combinations themselves (Berger 2008; Blankespoor et al. 2021; Gahng, Ritter, Zhang 2021). We extend the literature on SPACs by exploring whether and how SPAC combinations affect the financial reporting of their peer firms. While there is concern and evidence that SPAC combinations suffer from poor earnings quality (Kim et al. 2022), we provide a new perspective into this debate by showing that peers of SPAC combinations increase their earnings quality to prepare for the additional scrutiny by regulators. While we do not make any claims on the net benefits of SPAC combinations on the society, the additional piece of evidence we show improves our understanding of overall SPAC merger process. Finally, our study contributes to the literature on earnings management of peer firms. Kedia et al. (2015) and Beatty et al. (2013) show earnings management has a contagion effect on peer firms using SEC or class action lawsuits and accounting fraud, respectively. We use SPAC combinations' entry into the market as an instrument and discuss its impact on peer firms.

2. Motivation and Hypotheses

2.1. SPAC Combinations

SPACs are founded with the purpose of merging with private companies, and they attract investment by marketing on this idea. SPAC investors seek returns from the eventual merger which practically converts SPAC's target firm into a public firm. Typically, SPACs are smaller than their target firms, therefore the merger activity is essentially a reverse merger. Another result of this is SPACs seek additional financing such as PIPEs, on top of the investment from their public shareholders, to facilitate the merger. SPAC investors have the option to redeem their investment with accrued interest before the merger, but if they stay with the firm, they receive discounted ownership shares upon completion of the merger and they can earn substantial profits (Chung and Ramkumar 2021).

On the other hand, private firms which become the target of a SPAC merger also look for the significant benefit from an accelerated process of going public, compared to a traditional IPO (Maurer 2021). SPAC mergers are not subject to a lengthy IPO review process by SEC, and this can save time between 3 to 12 months for private firms to access public capital. Another advantage for private firms is that they can provide their future performance projections during the merger process to attract investment, while IPO firms are not allowed to disclose their future expectations. These mutual benefits for SPAC investors and SPAC targets have made SPAC mergers a leading form of raising capital over the recent years. According to Ramkumar and Farrell (2021), percentage of money raised in initial public offerings that came from SPACs was 49.2% in 2020, as compared to 1.1% in 2010. This figure jumped to a whooping 71.2% in 2021.

SPACs have brought about a variety of concerns centered around their valuations and internal controls, which has naturally alerted the US regulators (Maurer 2021). A bourgeoning

literature in this area has documented the roots of these concerns. For example, there were reports in the business press regarding the overvalued projections of SPAC firms (Brown 2021; Kruppa and Aliaj 2021). Blankespoor et al. (2022) investigate this concern and find that in their sample of SPAC combinations with observable post-merger revenue, only 35% of firms meet or beat their projections. This result grants validity to the concerns. Another concern about SPACs was that time pressures during the SPAC merger process might lead to cutting corners while establishing internal controls of the SPAC combination, which will attract subsequent SEC enforcement actions (Maurer 2021). Kim et al. (2022) validate this concern by showing that SPAC combinations are more likely to restate their financial statements and have internal control weaknesses, as compared to similar IPO firms.

2.2. Spillover effects of Poor Accounting Quality

We follow the lead of Kim et al. (2022) and analyze the effects of SPAC merger activity in financial statements from a broader perspective, by looking at possible spillover effects from SPAC combinations to their peer firms. In other words, we inquire what happens to the financial reporting quality of other firms, when there is a SPAC merger in their industry.

Spillover effects of financial misreporting is well-documented in the literature. Gleason, Jenkins, and Johnson (2008) find that a firm's accounting restatements negatively affect the market value of the firm's peers, pointing to a spillover effect of the negative information. Consistent with this effect, Beatty et al. (2013) document that fraudulent financial reports are associated with higher investment activity by peer firms. Moreover, Kedia et al. (2015) show that accounting restatements are "contagious", such that the peers of restating firms are more likely to begin managing earnings after the public announcement of the restatement. The early evidence on SPAC combinations show that they lack quality in their internal control processes and financial

statements, leading to more frequent restatements (Kim et al. 2022). Therefore, it might be expected that SPAC combinations transmit their low-quality financial statements to their peers in the same industry.

On the other hand, the literature on spillover effects also shows settings where a negative development in a firm has an effect on its peers which can be described as opposite to contagious (i.e. antiseptic). For example, Brown et al. (2018) show that SEC scrutiny on a firm leads to an antiseptic effect on its peers which see a decline in their risks. Donelson, Flam, and Yust (2021) show that peers of firms that face disclosure-related securities litigation start disclosing shorter and more readable information, which in turn leads to lower future litigation incidence. As pointed by Kedia et al. (2015), contagion in misreporting might also be implausible, because observing others' misconduct may lead to one's re-evaluation of their own dishonesty and increasing the ethicality in their decisions. Another force tilting towards such an antiseptic effect may come from the regulatory scrutiny around SPAC mergers. In 2021 alone, SEC investigated multiple SPAC combinations including Nikola Corporation, Akazoo, Momentus Inc., Trump Media & Technology Group, Lucid Group, some charged with fraud and fined millions. Brown et al. (2018) show that SEC attention on a firm has a spillover effect on peer firms in the direction that reduces peer firms' risks. Therefore, it is also possible that increased regulatory scrutiny around SPAC combinations might put their peers under spotlight. As a result, they can pay more attention to their internal controls, leading to an increase in their financial reporting quality.

Evaluating these opposing arguments for contagious and antiseptic effects of SPAC combinations on their peers' financial reporting quality, we do not form a prior expectation about the dominating effect and continue with our empirical inquiry. We form the following null hypothesis.

H_0: SPAC combinations do not have an effect on their peers' financial reporting quality.

3. Sample and Research Design

3.1. SPAC Combinations

We obtain SPAC IPO data from spactrack.net and stockmarketmba.com, and financial information from Compustat. While the earliest SPAC IPO in these datasets begins in 2005, the SPAC combination starts in 2013 as not all SPAC IPOs turn into SPAC combinations. The last SPAC combination date in our sample is December 30, 2021. From 318 SPAC combinations, we drop nine SPAC IPOs with missing merger completion date. Next, to help identify peers, we hand-collect post-merger SPAC firms' information on CIK, industry classification and headquarter locations from the SEC EDGAR. SPAC IPOs are classified by SEC under SIC 6770 Blank Checks and its SIC is later changed to the target's SIC code post-merger. Similarly, the location of headquarters changes mostly from SPAC sponsor's to the target's location post-merger. Hand-collection allows us to ascertain information on post-SPAC combination rather than the blank check SPAC before the merger. We drop three SPAC combinations whose CIK is missing and two SPAC combination whose SIC code is missing or stays 6770, which leave us 304 SPAC combinations. Table 1 details the selection of SPAC combinations.

3.2. Peer Firms

To identify peers (treatment group) and non-peers (control group) of SPAC combination, we adopt two methods used by Kedia et al. (2015) using industry and metropolitan statistical area (MSA). First, peers are defined as firms in the same 3-digit SIC code as SPAC combination. Non-peers are firms in the same 2-digit SIC code, but different 3-digit SIC codes (Beatty et al. 2013). For example, for a SPAC combination in 3-digit SIC code of 734, peers are firms in 3-digit SIC

734 whereas non-peers are firms in 3-digit SIC 730 to 733 and 735 to 739. The intuition is that peers in the same 3-digit SIC code experience more similar operating and financial reporting environments compared to firms in the different 3-digit, but same 2-digit SIC code. We drop financial and utility industries because of their distinctive nature of the operation and financial reporting.

Second, peers are defined as firms in the same geographical area as SPAC combination. Geographical area is measured using MSA obtained from U.S. Census. Non-peers are firms in different MSA from the SPAC combination's MSA. Following prior studies, we concentrate on manufacturing industry (Almazan et al. 2010). The definition of peers based on MSA assumes that firms located in the same area face similar economic pressure and thus exhibit similar accounting practices. Across the two definitions, both peers and non-peers must report sales for the past three years to assure new market entrants along with SPAC combinations are not included the sample.

3.3. Financial Reporting Quality

The primary measure for financial reporting quality is the absolute value of discretionary accruals measured following Dechow and Dichev (2002), McNichols (2002), and Ball and Shivakumar (2006).

$$TA_t = \beta_0 + \beta_1 OCF_{t-1} + \beta_2 OCF_t + \beta_3 OCF_{t+1} + \beta_4 NegOCF_t + \beta_5 OCF_t \times NegOCF_t + \beta_6 \Delta Sales_t + \beta_7 PPE_t + \varepsilon_t \quad (1)$$

TA_t is total accruals calculated as the difference between net income and cash flows from operation (OCF_t). We account for non-linear effect of operating cash flow by including $NegOCF_t$ which equals OCF_t if OCF_t is less than 0. $\Delta Sales_t$ is change in sales from year t-1 to t. PPE_t is property, plant, and equipment. All continuous variables are scaled by the beginning total assets which is required to be at least $1 million. We require the number of observations with non-missing data per industry-year to be at least 10. We estimate equation (1) by industry-year where industry

is defined using Fama-French 48 industry classification. Financial reporting quality, FRQ_t. is defined as the absolute value of the residual from equation (1) multiplied by –1 such that the reporting quality increases with its value. Continuous variables are winsorized at the 1st and 99th percentiles.

3.4. Hypothesis Testing

To examine the effect of SPAC combination on the financial reporting quality of peers, we estimate the following OLS regression.

$$FRQ_t = \beta_0 + \beta_1 Peer_t + \beta_2 Post_t + \beta_3 Peer_t \times Post_t + \beta_n Controls + \gamma_k + \delta_t + \varepsilon_t \quad (2)$$

FRQ_t is financial reporting quality defined previously. $Peer_t$ is an indicator variable that equals one if a firm is a peer to the SPAC combination and zero otherwise. $Post_t$ is an indicator variable that equals one in the year at least one SPAC combination exists and zero in the preceding year. Our variable of interest is the coefficient on the interaction between $Peer_t$ and $Post_t$, β_3. A positive (negative) β_3 is consistent with scrutiny (contagion) hypothesis, indicating that SPAC combinations have positive (negative) impact on peer firms' financial reporting quality.

We control for various firm characteristics that may be correlated with the variables of interest. Specifically, *Controls* include $Size_{t-1}$ which is the natural log of total assets at the beginning of year t. MTB_{t-1} is market-to-book ratio at the beginning of the year to control for variation in growth opportunities. To account for the potential effect of capital structure on financial reporting quality, we include Lev_{t-1} which is leverage defined as long-term debt to total assets at the beginning of the year. ROA_{t-1}, return on asset in year t-1, controls for firm performance. $Loss_t$ is an indicator variable that equals one if income before extraordinary items is less than zero and zero otherwise. $Zscore_{t-1}$ is Z-score at the beginning of the year which controls for default risk. $Opcycle_{t-1}$ is operating cycle at the beginning of the year. $Bign_t$ is an indicator

variable that equals one if the firm is audited by Big 4 audit companies. $Firmage_t$ controls for firm age. $Vsale_t$ ($Vocf_t$) controls for volatility of sales (cash flow from operations) for the past five years and we require at least three years of sales (operating cash flow) to compute volatility. All continuous variables are winsorized at the 1st and 99th percentiles. Finally, γ_k (δ_t) are industry (year) fixed effects. Standard errors are clustered by firm. Appendix A details variable definition.

4. Empirical Results

4.1. SPAC Combinations

Details on the industry and location of SPAC combinations are shown in Appendix B. Panel A of Appendix B shows the number of SPAC combinations in different industries across the sample period. Two distinct properties of the distribution are 1) concentration in manufacturing and service industries, and 2) surge in SPAC combinations over time across industries. Out of 304 SPAC combinations, 122 SPACs are merged with firms in manufacturing industry with chemical, transportation equipment, and electronic equipment as the most merged sub-industries. Closely following, 112 SPACs are merged with firms in service industry with business service totaling 41 mergers in 2021. Over the sample period, almost all sectors experience increasing number of SPAC combinations, consistent with the growing trend among private firms using SPAC to go public.

Panel B of Appendix B shows the distribution of SPAC combinations according to the merged firm's headquarter location. Among 253 U.S. companies successfully merged by SPACs, the greatest number of SPAC combinations are headquartered in a single state, California (67). The city with the greatest number of SPAC combinations is New York City (29). SPACs often merge internationally. Outside U.S., SPACs are merged with firms in Israel and U.K. the most

totaling 16 out of 51 mergers. We exclude SPAC combinations outside U.S. when peers are defined based on MSA for empirical analyses.

4.2. Descriptive Statistics and Correlation

Table 2 presents descriptive statistics for both samples selected using industry and location and compares peers and non-peers in pre- and post-SPAC combination periods. When industry is defined using SIC code, there are 3,852 peer firms, those in the same 3-digit SIC code, and 1,618 non-peer firms, those in the different 3-digit SIC code, but same 2-digit SIC code as shown in Panel A. Peers exhibit lower value of FRQ_t compared to non-peers, indicating lower financial reporting quality in both pre and post SPAC combinations.

Panel B compares 252 peer firms in the same MSA as SPAC combinations with 1,714 non-peer firms in the different MSA from SPACs. Similarly, peers report lower financial reporting quality compared to non-peers in the pre-SPAC combination period. However, the difference in FRQ_t becomes insignificant in the post period. While the reduction in the difference may indicate improvement of financial reporting quality by peer firms, firm characteristics between peers and non-peers differ in a few aspects. Thus, it is important to take into consideration these potential factors in regression analyses.

Table 3 shows Pearson correlation matrix for the sample including both pre- and post-SPAC combination periods. Bottom left Pearson correlation for the sample based on industry definition and top right shows for the sample based on the location. $Peer_t$ is negatively correlated to FRQ_t, indicating lower financial reporting quality for peer firms.

4.3. Spillover Tests

Table 4 shows regression results for spillover test by SPAC combinations on peers' financial reporting quality. Columns 1 through 3 show results for the sample identified based on

industry and Columns 4 through 6 are for the sample using MSA. Columns 2 and 5 include control variables. Columns 3 and 6 include independent variables in equation (1) as additional control variables. Chen, Hribar, and Melessa (2018) identify measurement errors when the residual from the first model is used as the dependent variable in the second model. One of the suggested solutions to generate unbiased estimates is to include the first model regressors in the second model.

Across different models and definitions of peers, the coefficient on the interaction between $Peer_t$ and $Post_t$ is significant and positive. For example, the coefficient on $Peer_t \times Post_t$ is 0.0062 ($p < 0.05$) in Column 3 and the coefficient is 0.0104 ($p < 0.05$) in Column 6. Further analysis reveals that FRQ_t of the industry peers of SPAC combinations increases by 0.025 standard deviations from its average levels in the years SPAC combinations occur. This effect size compares with the increase in FRQ_t by 0.14 standard deviations associated with one standard deviation increase in firm size ($Size_{t-1}$). Overall, these results indicate that peers of SPAC combinations increase financial reporting quality more compared to non-peers in the post-SPAC combinations. This is consistent with scrutiny hypothesis where SPAC peers revisit and monitor internal controls and financial reporting quality.

5. Additional Analyses

5.1. Cross-sectional Tests

We investigate whether the increase in peers' financial reporting quality after SPAC combinations varies with visibility within industry. The results of analyses suggest that SPAC combinations' peers are restraining earnings management due to potential increase in SEC's scrutiny (Brown et al. 2018) and investors' penalty (Gleason et al. 2008). If this is the case, SPAC peers subject to increased attention are more likely to restrict earnings management. We measure

firms' visibility using profitability and market share at the beginning of the year. Profitability is measured as gross profit, sales minus cost of goods sold and selling, general, and administrative expenses, scaled by sales and market share is measured as sales scaled by total sales within 2-digit SIC code industry. We divide sample into high and low profitability and market share using industry-year median in the post year. After including pre-year observations, we repeat our analyses using equation (2) separately for high and low groups of visibility.

In Table 5, columns 1 and 2 contrast high and low group based on profitability and columns 3 and 4 based on market share. The improvement in financial reporting quality of peers around SPAC combinations are evident in both high groups in columns 1 and 3. For example, the coefficient on $Peer_t \times Post_t$ for high profitability group is 0.009 ($p < 0.01$), but for low profitability group, the coefficient is not significantly different from zero. Similarly, the coefficient on $Peer_t \times Post_t$ for high market share group is 0.007 ($p < 0.01$), but for low market share group, the coefficient is not significantly different from zero.[1] These results indicate that restriction in earnings management by SPAC peers are concentrated among firms that are more visible and hence subject to potentially increased scrutiny, strengthening our conclusion that peer firms of SPAC combinations are more likely to attend to and reassess the quality of financial reporting.

5.2.Robustness Tests

5.2.1. Sample Restriction

One possible limitation of our research design stems from SPACs concentrated in certain industries in recent years. For example, business service industry shows an increasing number of SPAC combinations ranging from one in 2016 to 41 in 2021 as shown in Appendix B. Thus, it is

[1] We perform same analyses with samples selected based on MSA but did not find significant variation in the coefficient of the interaction in cross-section. We acknowledge that the sample size of MSA is small before the split and thus the low power may be the reason for the lack of significance.

possible our results are driven by SPAC combinations in certain industries. To address this issue, we use alternative definition of peers and non-peers using only the first SPAC combinations in the industry and repeat analyses. Specifically, we look at two years prior and subsequent SPAC combinations and define peers as firms that experience no SPAC combinations within the same 3-digit SIC code in two years prior to SPAC combinations and then experience SPAC combinations in year t and/or in the two following years. Non-peers are firms that are in the same 2-digit SIC code (but different 3-digit SIC code) with peers but do not experience SPAC combinations in both two proceeding and two following years of SPAC combinations. This process provides cleaner tests by preventing 1) one industry from driving the result and 2) the sample from frequently switching between peer and non-peer. The main downsides are that 1) by requiring two years of data before and after SPAC combinations, the most recent SPAC combinations are not accounted and 2) the power of tests is reduced with sample size.

Table 6 presents the results of analyzing two years before and after SPAC combinations (i.e., excluding SPAC combination years). We continue to observe increase in FRQ_t for peers of SPAC combinations in the post period across different models. Column 3 of Panel B shows the coefficient on $Peer_t \times Post_t$ is 0.0110 ($p < 0.10$) after including firm and year fixed effect. The results support that SPAC peers increase earnings quality, consistent with the main results.

5.2.2. Pseudo Analysis using Traditional IPO

While SPACs have unique characteristics compared to traditional IPOs, the primary purpose is the same: to go public. It is possible that the effect of SPACs on peers we report may be due to changing landscape of private firms going public rather than distinctive characteristics of SPACs. To address this potential alternative explanation that the observed effect is due to overall IPOs, we perform Pseudo analysis using traditional IPOs over the same sample period.

First, we obtain information on traditional IPO from Dr. Jay Ritter's website.[2] Then, we follow the same research design using SIC industry classification to identify peers and non-peers of traditional IPOs instead of SPACs for the years between 2013 and 2021. This process provides 13,496 peers and 6,875 non-peers. Then, we perform regression analyses using equation (2).

Table 7 shows the results. The coefficient on the interaction between $Peer_t$ and $Post_t$ is significantly negative after including all control variables (−0.0036; $p < 0.01$). In addition, we exclude overlapping sample of SPACs and IPOs to rule out possible confounding effect from a particular set of peers and non-peers of both SPACs and IPOs. The results stay similar. Overall, these results using traditional IPOs are opposite to our results using SPAC combinations. While the negative coefficient may indicate that peers of traditional IPOs exhibit decrease in financial reporting quality, we limit our interpretation to that SPAC combinations have a varying effect on peers' financial reporting quality compared to traditional IPOs and open further investigation on IPOs to future research.

6. Conclusion

We investigate whether and how firms going public through SPACs affect their peers' earnings quality. We find that SPAC peers are more likely to decrease the use of discretionary accruals compared to non-peers in the years of SPAC combinations. This result is consistent with continuous and elevated monitoring by regulators restraining peers of SPAC combinations from engaging in earnings management (i.e., scrutiny hypothesis). This effect is opposite to an alternative possibility of SPAC combinations' optimistic forecasts pressuring peers to engage more in earnings management (i.e., contagion hypothesis). We further show that the increase in financial reporting quality is driven by SPAC peers who are more visible, as measured by high profitability

[2] https://site.warrington.ufl.edu/ritter/ipo-data/

and high market share, in line with more visible firms being affected more by the regulatory scrutiny. Our results are robust to different definition of peers and time frame as well as a falsification test using IPO firms instead of SPAC combinations.

Our study makes several contributions. First, the results of this study reinforce the importance and effectiveness of the SEC's monitoring by reporting that peers of SPACs that are heavily spotlighted in recent years by the regulators are more likely to decrease earnings management than non-peers. Second, we contribute to the literature on SPACs which has largely concentrated on the performance and disclosure of SPACs themselves. By analyzing the effect of SPAC combinations on peer firms' earnings quality, we shed light on a potential mechanism through which SPACs may affect financial reporting environment.

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Appendix A – Variable Definition

Variables	Definition
$Bign_t$	An indicator variable equals one if the firm is audited by a Big 4 audit firm and zero otherwise.
Controls	A set of control variables including $Size_{t-1}$, MTB_{t-1}, Lev_{t-1}, ROA_{t-1}, $Loss_t$, $Zscore_{t-1}$, $Opcycle_{t-1}$, $Bign_t$, $Firmage_t$, $Vsale_t$, and $Vocf_t$,
$Firmage_t$	Age of firm.
FRQ_t	Financial reporting quality, calculated as the absolute value of the residual from equation (1) multiplied by −1.
$Loss_t$	An indicator variable for loss which equals one if income before extraordinary items for the year t is less than zero and zero otherwise.
Lev_{t-1}	Leverage, defined as the ratio of long-term liabilities to total assets at the beginning of year t.
MTB_{t-1}	Growth potential, measured as the ratio of the beginning market value to the beginning book value of equity.
$NegOCF_t$	An indicator variable for negative operating cash flows which equals one if cash flow from operations is less than zero and zero otherwise.
OCF_t	Cash flow from operations.
$Opcycle_{t-1}$	Operating cycle, calculated as the sum of the days in receivable and the days in inventory in year t-1.
$Peer_t$	An indicator variable that equals one if a firm is a peer to SPAC combinations and zero otherwise. Peers are defined as firms in the same 3-digit SIC code or MSA as SPAC combinations. Non-peers are firms in the different 3-digit SIC code or MSA as SPAC combinations.
$Post_t$	An indicator variable that equals one for the year that SPAC combinations occur for SPAC peers and non-peers and zero in the preceding year.
PPE_t	Property, plant, and equipment in year t.
ROA_{t-1}	Return on assets, measured as income before extraordinary items for the year t-1 divided by total assets at the end of year t-1.
$\Delta Sales_t$	Change in sales from year t-1 to t.
$Size_{t-1}$	Firm size, measured as the natural logarithm of the beginning total assets.

TA_t	Total accruals, defined as income before extraordinary items less cash flow from operations.
$Vocf_t$	Volatility of operating cash flow, calculated as the standard deviation of cash flow from operation scaled by beginning asset for the year t-4 through year t.
$Vsale_t$	Volatility of sales, calculated as the standard deviation of sales scaled by beginning asset for the year t-4 through year t.
$Zscore_{t-1}$	Altman Z-Score, calculated as 0.3 × (Net income/Asset) + 1.0 × (Sales /Asset) + 1.4 × (Retained earnings/Asset) + 1.2 × (Working capital /Asset) + 0.6 × (Market value/Liabilities) at the beginning of year t-1.

Appendix B – SPAC Combinations Industry and MSA Distribution

Panel A. SPAC Combinations Industry											
Industry	Sub-industry	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Manufacturing (122)	Chemical & Allied Products							3	8	25	36
	Transportation Equipment								8	23	31
	Electronic & Other Electric Equipment								4	17	21
	Instruments & Related Products									10	10
	Industrial Machinery & Equipment								2	6	8
	Food & Kindred Products								3	3	6
	Other						2	1		7	10
Services (112)	Business Services	1			1	2	3	7	19	41	74
	Health Services							3	1	13	17
	Amusement & Recreation Services							3	3	5	11
	Engineering & Management Services								2	3	5
	Other							1	2	2	5
Financial Institutions (21)	Non-depository Institutions								1	7	8
	Insurance Carriers								1	4	5
	Other							1	3	4	8
Transportation & Utilities (20)	Electric, Gas, & Sanitary Services						2			5	7
	Transportation Services					1	1	2		1	5
	Communications							1		4	5
	Other									3	3
Wholesale and Retail (17)	Miscellaneous Retail								1	6	7
	Other						1	1	5	3	10
Mining & Construction (10)	Oil & Gas Extraction				1		3		1		5
	Other						1		2	2	5
Agriculture (2)	Agricultural Production – Crops									2	2

Panel B. SPAC Combinations Headquarter Location			
Region	State / Country	City	No. SPAC Combination
U.S (253)	CA (67)	San Francisco	14
		Los Angeles	4
		Palo Alto	4
		Other	45
	NY (33)	New York	29
		Other	4
	TX (24)	Houston	7
		Austin	5
		Irving	3
		Other	9
	MA (15)	Boston	7
		other	8
	FL (13)	Miami	3
		Other	10
	IL (12)	Chicago	7
		Other	5
	VA (11)	McLean	3
		Other	8
	GA (10)	Atlanta	5
		Other	5
	Other (68)		68
Outside U.S. (51)	Israel		8
	United Kingdom		8
	China		7
	Luxembourg		6
	Canada		3
	Other		19

Table 1. SPAC Combination Sample Selection

SPAC combinations completed firms from spactrack.net and stockmarketmba.com between 2005 and 2021	318
Less: Missing completion date	(9)
Less: Missing CIK on SEC EDGAR	(3)
Less: SIC code 6770 or missing	(2)
Number of SPAC Combinations	304

Table 2. Descriptive Statistics

Panel A. Industry Sample

	Pre-SPAC Combinations			Post-SPAC Combinations		
	Peer	Non-peer	Difference	Peer	Non-peer	Difference
FRQ_t	−0.0841	−0.0628	0.0214***	−0.0824	−0.0682	0.0142***
$Size_{t-1}$	6.3141	6.8385	0.5244***	6.3929	6.8751	0.4823***
MTB_{t-1}	3.9545	2.9874	−0.9671***	4.0398	3.4055	−0.6344*
Lev_{t-1}	0.1994	0.2401	0.0407***	0.219	0.2548	0.0359***
ROA_{t-1}	−0.0987	−0.0095	0.0893***	−0.1052	−0.0286	0.0766***
$Loss_t$	0.4535	0.3517	−0.1019***	0.4408	0.3671	−0.0737***
$Zscore_{t-1}$	1.7291	2.3972	0.6680**	1.7142	2.2438	0.5296*
$Opcycle_{t-1}$	143.2953	135.496	−7.7993	148.6681	138.7235	−9.9446*
$Bign_t$	0.5589	0.5358	−0.0231	0.5556	0.534	−0.0216
$Firmage_t$	18.9873	23.3906	4.4033***	19.9873	24.3906	4.4033***
$Vsale_t$	0.1956	0.2079	0.0123	0.2005	0.2182	0.0177*
$Vocf_t$	0.0943	0.0607	−0.0336***	0.0967	0.0639	−0.0328***
No. obs	3,852	1,618		3,852	1,618	

Panel B. MSA Sample

	Pre-SPAC Combinations			Post-SPAC Combinations		
	Peer	Non-peer	Difference	Peer	Non-peer	Difference
FRQ_t	−0.0752	−0.0555	0.0197***	−0.0636	−0.056	0.0076
$Size_{t-1}$	7.0277	6.5863	−0.4414**	7.1479	6.656	−0.4919**
MTB_{t-1}	5.1696	3.9637	−1.2059	5.8251	3.8509	−1.9742*
Lev_{t-1}	0.2315	0.2054	−0.0261	0.2387	0.2174	−0.0214
ROA_{t-1}	−0.1062	−0.0578	0.0484	−0.0824	−0.0633	0.019
$Loss_t$	0.4286	0.3687	−0.0598	0.381	0.3623	−0.0186
$Zscore_{t-1}$	3.1059	3.1161	0.0102	4.1197	2.851	−1.2687
$Opcycle_{t-1}$	177.679	163.5874	−14.0916	194.3384	167.6115	−26.7269*
$Bign_t$	0.7302	0.6931	−0.037	0.7143	0.6896	−0.0247
$Firmage_t$	22.8254	24.6984	1.8730*	23.8254	25.6984	1.8730*
$Vsale_t$	0.1769	0.1918	0.0149	0.1786	0.1933	0.0147
$Vocf_t$	0.1089	0.0814	−0.0275**	0.1097	0.0812	−0.0285**
No. obs	252	1,714		252	1,714	

This table compares means of the main variables in the pre and post SPAC combination periods for the sample selected using industry classification in Panel A and the sample selected using MSA in Panel B. All continuous variables are winsorized at the 1st and 99th percentile. Appendix A provides variable definitions.
***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively.

Table 3. Pearson Correlation Matrix

	$Peer_t$	FRQ_t	$Size_{t-1}$	MTB_{t-1}	Lev_{t-1}	ROA_{t-1}	$Loss_t$	$Zscore_{t-1}$	$Opcycle_{t-1}$	$Bign_t$	$Firmage_t$	$Vsale_t$	$Vocf_t$
$Peer_t$		−0.062	0.068	0.053	0.039	−0.033	0.027	0.025	0.050	0.022	−0.055	−0.026	0.082
		(0.00)	(0.00)	(0.00)	(0.01)	(0.04)	(0.09)	(0.12)	(0.00)	(0.16)	(0.00)	(0.10)	(0.00)
FRQ_t	−0.079		0.330	−0.051	0.055	0.363	−0.292	0.209	−0.103	0.189	0.251	−0.153	−0.393
	(0.00)		(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
$Size_{t-1}$	−0.093	0.368		0.013	0.353	0.478	−0.411	0.216	−0.110	0.671	0.327	−0.277	−0.503
	(0.00)	(0.00)		(0.40)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
MTB_{t-1}	0.039	0.017	0.034		0.003	−0.015	−0.006	0.121	−0.057	0.036	−0.066	−0.028	0.082
	(0.00)	(0.07)	(0.00)		(0.84)	(0.34)	(0.73)	(0.00)	(0.00)	(0.03)	(0.00)	(0.08)	(0.00)
Lev_{t-1}	−0.073	−0.052	0.243	−0.052		0.046	−0.045	−0.211	−0.031	0.273	0.030	0.004	−0.134
	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)	(0.01)	(0.00)	(0.05)	(0.00)	(0.06)	(0.82)	(0.00)
ROA_{t-1}	−0.107	0.460	0.441	0.026	−0.104		−0.474	0.499	−0.183	0.288	0.331	−0.084	−0.602
	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)		(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
$Loss_t$	0.081	−0.263	−0.377	−0.050	0.029	−0.405		−0.235	0.182	−0.248	−0.371	0.123	0.353
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
$Zscore_{t-1}$	−0.031	0.313	0.279	0.160	−0.243	0.570	−0.264		−0.060	0.132	0.100	−0.074	−0.218
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
$Opcycle_{t-1}$	0.023	−0.052	−0.050	−0.020	−0.051	−0.134	0.085	−0.028		−0.092	−0.130	−0.119	0.090
	(0.02)	(0.00)	(0.00)	(0.04)	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)	(0.00)	(0.00)	(0.00)
$Bign_t$	0.021	0.198	0.496	0.089	0.164	0.223	−0.229	0.173	−0.041		0.133	−0.240	−0.309
	(0.03)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)	(0.00)	(0.00)
$Firmage_t$	−0.187	0.168	0.292	−0.002	0.024	0.208	−0.248	0.084	−0.002	0.135		−0.152	−0.346
	(0.00)	(0.00)	(0.00)	(0.86)	(0.01)	(0.00)	(0.00)	(0.00)	(0.81)	(0.00)		(0.00)	(0.00)
$Vsale_t$	−0.030	−0.177	−0.365	−0.007	0.003	−0.165	0.150	−0.143	−0.102	−0.198	−0.089		0.374
	(0.00)	(0.00)	(0.00)	(0.47)	(0.76)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)		(0.00)
$Vocf_t$	0.126	−0.389	−0.482	0.043	−0.025	−0.548	0.281	−0.345	0.093	−0.231	−0.182	0.438	
	(0.00)	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	

This table shows Pearson correlation matrix for the two samples. Bottom left is for the sample based on industry definition and top right is for the sample based on MSA. Below correlation shows p-value. Appendix A provides variable definitions.

Table 4. Effect of SPAC Combinations on Peers' Financial Reporting Quality

	Industry Classification			MSA Classification		
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.0377***	0.0859***	0.0608***	0.0247***	0.0466***	0.0424***
	(4.88)	(9.88)	(6.69)	(8.10)	(4.70)	(3.82)
Peer$_t$ × Post$_t$	**0.0072*** **	**0.0058** **	**0.0062** **	**0.0121** **	**0.0102** **	**0.0104** **
	(2.62)	**(2.07)**	**(2.23)**	**(2.39)**	**(2.04)**	**(2.04)**
Peer$_t$	0.0100***	0.0009	0.0001	0.0117**	0.0115**	0.0107**
	(3.12)	(0.33)	(0.05)	(2.12)	(2.28)	(2.14)
Post$_t$	0.0055**	0.0034	0.0037	0.0005	0.0006	0.0002
	(2.55)	(1.53)	(1.64)	(0.28)	(0.35)	(0.14)
Size$_{t-1}$		−0.0069***	−0.0058***		−0.0033***	−0.0032***
		(−9.82)	(−8.79)		(−3.03)	(−2.85)
MTB$_{t-1}$		0.0001	0.0000		0.0002	0.0002
		(0.50)	(0.07)		(1.17)	(0.91)
Lev$_{t-1}$		0.0270***	0.0255***		0.0024	−0.0003
		(2.62)	(2.62)		(0.24)	(−0.03)
ROA$_{t-1}$		−0.0743***	−0.0708***		−0.0119	−0.0241
		(−8.44)	(−5.97)		(−1.09)	(−1.49)
Loss$_t$		0.0022	0.0028		0.0059	0.0096**
		(0.78)	(0.80)		(1.61)	(2.10)
Zscore$_{t-1}$		−0.0005*	−0.0005**		−0.0010***	−0.0011***
		(−1.74)	(−2.01)		(−3.29)	(−3.73)
Opcycle$_{t-1}$		0.0000	0.0000		−0.0000	−0.0000
		(0.55)	(0.60)		(−0.23)	(−0.36)
Bign$_t$		−0.0030	−0.0033		0.0043	0.0035
		(−1.14)	(−1.25)		(0.86)	(0.71)
Firmage$_t$		−0.0001	−0.0001		−0.0002	−0.0001
		(−0.89)	(−0.66)		(−1.34)	(−1.01)
Vsale$_t$		0.0054	0.0058		0.0172	0.0080
		(0.67)	(0.73)		(1.42)	(0.74)
Vocf$_t$		0.1122***	0.0874***		0.0873***	0.0882***
		(5.04)	(3.68)		(3.17)	(3.11)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Chen et al.	No	No	Yes	No	No	Yes
N	10,940	10,940	10,940	3,932	3,932	3,932
Adj.R^2	0.0583	0.2848	0.2932	0.1761	0.2690	0.2768

This table presents regression results for equation (2) to examine the effect of SPAC combinations on peers' financial reporting quality. The dependent variable is financial reporting quality (*FRQ$_t$*). The main independent variables are *Peer$_t$* that equals one for SPAC peers and *Post$_t$* that equals one for SPAC combination years. All continuous variables are winsorized at the 1st and 99th percentile. Appendix A provides variable definitions.
***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively.

Table 5. Cross-sectional Test

	Profitability		Market Share	
	(1)	(2)	(3)	(4)
	High	Low	High	Low
Intercept	0.0383***	0.0866***	0.0420***	0.0962***
	(4.88)	(4.98)	(4.07)	(5.48)
Peer$_t$* × *Post$_t$	**0.0090*** **	**0.0001**	**0.0069*** **	**0.0054**
	(3.41)	**(0.03)**	**(2.75)**	**(0.93)**
Peer$_t$	−0.0014	−0.0011	−0.0046*	0.0022
	(−0.59)	(−0.23)	(−1.89)	(0.43)
Post$_t$	0.0048**	−0.0002	0.0025	0.0065
	(2.16)	(−0.05)	(1.26)	(1.31)
Size$_{t-1}$	−0.0039***	−0.0076***	−0.0031***	−0.0119***
	(−6.46)	(−5.49)	(−3.86)	(−6.46)
MTB$_{t-1}$	0.0002	−0.0001	0.0003*	−0.0003
	(1.59)	(−0.51)	(1.81)	(−1.14)
Lev$_{t-1}$	0.0186**	0.0395**	0.0146*	0.0415**
	(2.26)	(2.46)	(1.82)	(2.40)
ROA$_{t-1}$	−0.0239	−0.0696***	−0.0663***	−0.0641***
	(−0.89)	(−5.31)	(−4.00)	(−4.69)
Loss$_t$	0.0190***	−0.0128**	0.0088**	−0.0027
	(4.67)	(−2.33)	(2.27)	(−0.45)
Zscore$_{t-1}$	0.0000	−0.0006*	−0.0001	−0.0004
	(0.05)	(−1.71)	(−0.19)	(−1.11)
Opcycle$_{t-1}$	0.0000	−0.0000	0.0000	0.0000
	(1.58)	(−0.00)	(0.75)	(0.53)
Bign$_t$	−0.0018	−0.0028	−0.0029	−0.0005
	(−0.65)	(−0.57)	(−1.04)	(−0.10)
Firmage$_t$	0.0000	−0.0004**	−0.0002*	−0.0002
	(0.02)	(−2.23)	(−1.82)	(−0.88)
Vsale$_t$	0.0049	−0.0048	−0.0018	0.0033
	(0.42)	(−0.44)	(−0.19)	(0.32)
Vocf$_t$	0.1292***	0.0793***	0.1714***	0.0688**
	(3.54)	(2.71)	(4.13)	(2.42)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes
Chen et al.	Yes	Yes	Yes	Yes
N	6,002	4,938	6,125	4,815
Adj.R^2	0.1724	0.2861	0.1790	0.2821

This table presents regression results to examine the effect of SPAC combinations on peers' financial reporting quality in cross-sections. The dependent variable is financial reporting quality (*FRQ$_t$*). The main independent variables are *Peer$_t$* that equals one for SPAC peers and *Post$_t$* that equals one for SPAC combination years. Profitability is gross profit scaled by sales. Market share is sales scaled by industry sales. All continuous variables are winsorized at the 1st and 99th percentile. Appendix A provides variable definitions.

***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively.

Table 6. Robustness Test

Panel A. Number of Observations

	Pre	Post	Total
Peer	1,368	1,368	2,736
Non-peer	640	640	1,280
Total	2,008	2,008	4,016

Panel B. Regression

	(1)	(2)	(3)
Intercept	0.0517***	0.1047***	−0.0030
	(28.41)	(9.10)	(−0.04)
Peer$_t$* × *Post$_t$	**0.0142****	**0.0105***	**0.0110***
	(2.30)	**(1.94)**	**(1.77)**
Peer$_t$	−0.0052	0.0040	−0.0128
	(−0.72)	(0.69)	(−1.36)
Post$_t$	0.0025	−0.0001	−0.0011
	(0.70)	(−0.03)	(−0.28)
Industry FE	No	Yes	No
Year FE	Yes	Yes	Yes
Firm FE	Yes	No	Yes
Controls	No	Yes	Yes
Chen et al.	No	Yes	Yes
N	4,016	3,560	3,560
Adj.R^2	0.3369	0.2638	0.3804

This table shows sample composition in Panel A and regression results in Panel B for the sample selected using four years around SPAC combinations (i.e., two years before and after SPAC combinations). The dependent variable in Panel B is financial reporting quality (*FRQ$_t$*). The main independent variables in Panel B are *Peer$_t$* that equals one for SPAC peers and *Post$_t$* that equals one for SPAC combination years. All continuous variables are winsorized at the 1st and 99th percentile. Appendix A provides variable definitions.
***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively.

Table 7. Effect of traditional IPO on Peers' Financial Reporting Quality

	(1)	(2)	(3)
Intercept	0.0004	0.0226***	0.0054
	(0.09)	(2.75)	(0.62)
Peer$_t$* × *Post$_t$	**−0.0028****	**−0.0031*****	**−0.0036*****
	(−2.53)	**(−2.80)**	**(−3.27)**
Peer$_t$	0.0077***	0.0019	0.0012
	(4.29)	(1.41)	(0.88)
Post$_t$	−0.0016**	−0.0015*	−0.0019**
	(−2.03)	(−1.87)	(−2.41)
Size$_{t-1}$		−0.0055***	−0.0047***
		(−14.24)	(−12.43)
MTB$_{t-1}$		0.0003*	0.0001
		(1.92)	(0.76)
Lev$_{t-1}$		0.0048	0.0064
		(0.92)	(1.26)
ROA$_{t-1}$		−0.0701***	−0.0576***
		(−12.05)	(−7.56)
Loss$_t$		0.0078***	0.0079***
		(4.64)	(3.74)
Zscore$_{t-1}$		−0.0009***	−0.0010***
		(−5.40)	(−5.40)
Opcycle$_{t-1}$		0.0000	0.0000
		(1.33)	(1.21)
Bign$_t$		−0.0030**	−0.0035**
		(−1.97)	(−2.37)
Firmage$_t$		−0.0001	−0.0001
		(−1.55)	(−0.98)
Vsale$_t$		0.0098**	0.0114***
		(2.35)	(2.69)
Vocf$_t$		0.1390***	0.1005***
		(9.70)	(6.30)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Chen et al.	No	No	Yes
N	40,742	40,742	40,742
Adj.R^2	0.0576	0.2939	0.3026

This table presents regression results to examine the effect of traditional IPO on peers' financial reporting quality. The dependent variable is financial reporting quality (*FRQ$_t$*). The main independent variables are *Peer$_t$* that equals one for traditional IPO peers and *Post$_t$* that equals one for traditional IPO year. All continuous variables are winsorized at the 1st and 99th percentile. Appendix A provides variable definitions.
***, **, * denote statistical significance at the 1%, 5%, and 10% level, respectively.