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Risk Allocation and Flexibility in Acquisitions: The Economic Impact of Material-Adverse-Change (MACs) Clauses

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Abstract

I analyze the economic consequences of Material-Adverse-Change clauses (MACs) in merger agreements. MACs, used in more than 90% of acquisitions in my sample, show a high level of customization through the Material-Adverse-Event (MAE) exclusions, which limit the acquirers abandonment option defined through MACs. In this paper, I show the economic consequences of MACs are significant in at least four ways. First, the number of Material-Adverse-Event (MAE) exclusions is negatively related to the premium offered to the target. Second, acquisitions with more MAE exclusions have narrower arbitrage spreads. Third, limiting the abandonment option through MAE exclusions significantly reduces the probability and hazard rates of renegotiation and termination. Finally, acquirers that renegotiate after the target experienced a firm-specific MAE obtain, on average, a 15% reduction in the premium paid. Results imply acquirers are willing to pay more to be able to terminate or renegotiate if necessary. These findings indicate that MACs have an economically meaningful impact on the takeover process.

Keywords: Mergers and Acquisitions (M&A), Deal-protection mechanisms, Material-Adverse-Change clause (MACs), Material-Adverse Event (MAE) exclusions, merger agreement, risk allocation, flexibility

JEL Classification: G34, G32, G14, K12, L14, D86

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