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Effects of the Size of Acquisition on a Hotel Group's Financial Performance

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ABSTRACT
This study investigates the relationships among the amount of money, the number of target hotels acquired in acquisitions, and financial performance of the acquirer hotel groups during the post-acquisition period. Results of a regression analysis revealed that the extent of increase in both EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) and Operating Efficiency Ratio of acquirer hotel groups were more dependent on the number of target hotels acquired by the acquirer hotel groups than on the amount of money invested in the acquisitions. The findings of this study indicate that more target hotels acquired by acquirer hotel groups resulted in both lower increased percentage of annual EBITDA and a higher increased percentage of annual Operating Efficiency Ratio. The size of acquisitions has significant influence on acquirer hotel groups' financial performance, the directions of which vary between different indicators of corporate financial performance.

Key words: hotel, merger and acquisition, financial performance, acquisition size

Introduction

Statistics supplied by Securities Data Corporation (SDC) indicate that since the '80s, public and private hotel-industry acquisitions have been increasing dramatically. In Kwansa's (1994) study, it was summarized that from 1980 to 1990, the total value of merger and acquisition activity by the hospitality (hotels and restaurants) industry ranked in the top 18th—$25.93 billion. To be specific, 83 deals of acquisition transactions were completed in the lodging sector, involving both U.S. and non-U.S. companies (1981–1988), with a total value of $10.02 billion.

Canina (2001) concluded that especially since 1993, the aggregate value related to public and private lodging-industry acquisitions increased dramatically. The value of acquisitions in 1998 was almost 1,000 times greater than in 1993. Compared with the data of the public lodging-industry acquisitions during the same periods, the aggregate value of public lodging-industry acquisitions experienced a tremendously high proportion of the total value of lodging-industry acquisitions from 1995 to 1998. The growing trend of the size of acquisitions in hotel industry has drawn the attention of many researchers. More researchers focused on the financial impact of M&A, especially on those which are stock-performance related. (Yang, Kim, & Qu, 2010)

Based on a multi-case study using a comparative historical analysis of four UK hotel companies during 1979–2004, Quek (2011) found out that acquisition motives—value maximizing by increasing market share and acquiring brand of hotel groups—show a high success rate in financial performance as well as in purchasers' geographical share. Additionally, this horizontal study also implied that organizational inefficiencies are reduced over the years of combinations resulting from M&A activities in the hotel industry; if financial inefficiency is decreased, it is apparent that a hotel's financial performance might be better as a result.

From the perspective of determinants causing systematic risk, Kim, Kim, & Gu (2012) concluded that larger sized hospitality firms with lower debt burden and relatively slow growth rate can help lower systematic risk and strengthen firm value. Rather than via development of new hotel properties, growing hospitality firms should adopt the conservative

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financing policy via consolidation-oriented (mergers and acquisitions) growth strategies.

Four of the largest worldwide hotel acquisitions to date occurred in sequence in 2016: Minor International Pcl (Tivoli Hotels & Resorts, February 2016), AccorHotels (Fairmont Raffles Hotels International, April 2016), Marriott International (Starwood Hotels & Resorts, September 2016), Red Lion Hotels Corporation (Vantage Hospitality Group, Inc., October 2016). During the post-acquisition period, it is valuable to test the impact of the acquisition activities on hotel financial performance. Most previous studies research the stock performance or risk of M&A activities, but few studies focus on the corporate financial impact of the acquisition activities or to what extent the size of acquisition activities impacts corporate financial performance. This study tries to fill this research gap and offer both academic and practical implications for financial management in hospitality companies. The purpose of this study is to examine the effects of the size of acquisition on financial performance in the context of the public hotel (lodging) industry. The results of this study are useful for hotel managers who consider acquisition as an option of growth against other managerial options to boost business.

Literature Review

Effect of Mergers and Acquisitions on Hotel Groups' Financial Performance

In Canina's research (2001), several theoretically positive effects of mergers and acquisitions are concluded: 1) If the acquiring entity is of the higher level of management than its target firm, better performance might be gained through improved management; 2) More systematic management in the post-M&A entity leads to more efficient employment structures and facilities, or a new beneficial combination of products and services; 3) Performance of the acquirer firm might be raised as the market power of the company has been increased.

Empirical studies suggest that mergers and acquisitions are value-adding in the hospitality industry since excess returns are earned by both the target and acquiring entities at the time of merger announcement (Canina, 2001). Compared with the S&P 500 index, statistical results indicated that the acquiring hospitality firms experienced positive gains from post-M&A activities (Yang, Kim, & Qu, 2010).

In practice, however, gains from mergers and acquisitions might not be easy to achieve because of the following: 1) the processes of mergers and acquisitions are costly and difficult; 2) the decisions of mergers and acquisitions might be imprudent merely for avoiding being acquired by other companies, because a large number of mergers and acquisitions take place within the industry (Canina, 2001). Furthermore, the crises that occur in the broader marketplace might have a massive impact on the industry. During the massive crisis in the U.S. financial market in 2008, much less M&A activities were undertaken by hotels because of the skepticism of investors or acquiring firms about the slow economy and high leverage, not to mention the considerations of gains from M&A activities (Yang, Kim, & Qu, 2010). What's worse, a phenomenon of discrepancy between hotel managers' statements of success in M&A activities and corporate virtual financial performance was suggested in Canina, Kim, and Ma's study (2010). For example, mergers are value-adding exclusively for the target companies, whereas the shareholders in acquirer companies merely break even (Jensen & Ruback, 1983). Managers in acquirer companies, however, might have a bias when evaluating their own management decisions.

To verify whether M&A activities in the hospitality industry are successful or not (in this study, only acquisition activities are focused), the differences of acquirer hotel groups' financial performance between the pre- and the post-acquisition period must be ascertained. Furthermore, establishing which acquisition activities have what impact on acquirer hotel groups' financial performance will allow for more efficiency in business and management, as the knowledge is used to evaluate what size of acquisition is the best financial option for the acquirer hotel groups.

Hotel Groups' Financial Performance

Canina, Kim, and Ma's study (2010) concluded there are three major diverse approaches to measure acquirer hotel groups' financial performance to define the success of the acquisitions. Based on the changes of stock prices around the date of public

announcement of the acquisitions, the changes of stock prices after acquisition completion, and operational performance after acquisition completion, three approaches represent three different perspectives: a financial market perspective in the short-run, a financial market perspective in long-run, and an operational perspective. Among those perspectives, the first two approaches mainly focus on abnormal stock returns either around the date of public announcement of the acquisition or three to five years after deal completion.

Compared with those two approaches, the operational performance approach is more appropriate for the purposes of the current study. Since the main purpose of this study is to improve the managerial efficiency to make wiser decisions on acquisition activities, accounting-based data such as EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) and Operating Efficiency Ratio are proper metrics to evaluate the acquirer hotel groups' financial performance. The differences of the indexes between the pre- and the post-acquisition activity can indicate whether the performances are improved. The hypotheses of this study are as follows (see Figure 1):

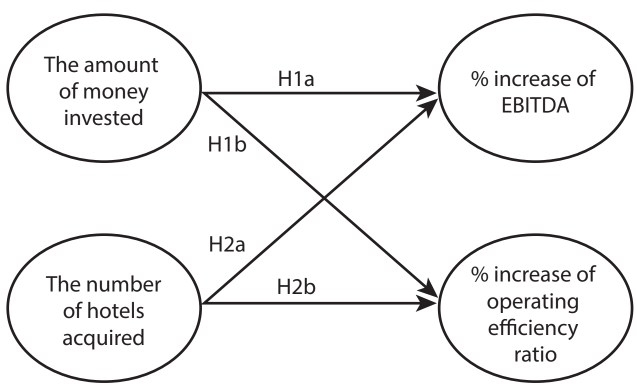

Figure 1. Conceptual Model.

H1a. The amount of money invested in acquisition activities influences the acquirer hotel group's increased percentage of EBITDA.

H2a. The number of hotels acquired in acquisition activities influences the acquirer hotel group's increased percentage of EBITDA.

H1b. The amount of money invested in acquisition activities influences the acquirer hotel group's increased percentage of Operating Efficiency Ratio.

H2b. The number of hotels acquired in acquisition activities influences the acquirer hotel group's increased percentage of Operating Efficiency Ratio.

Methodology

Data Collection

This study mainly examines secondhand data collected through Internet-based research. The data depicting amount of money invested and number of hotels acquired in acquisitions are extracted from final acquisition news published on the hotel groups' official websites or professional websites that focus on the hospitality industry. After first being gathered online, all data were cross-referenced on other related websites to confirm the reliability of the data (see Table 1).

In terms of the financial performance data of the hotel groups, all original data were extracted from the income statements in the Form 10-K[1], which is required for public companies to report to the public by the federal securities laws. The annual report on Form 10-K provides a comprehensive overview of the company's business and financial condition

Table 1. Acquisition Overview

	Amount of Money Invested (Transaction Monetary Value in U.S. Dollars)	Number of Properties Acquired
Marriott	13,000,000,000	1,300
Red Lion Hotels	27,000,000	1,000
AccorHotels	2,700,000,000	155
Minor International	318,771,584	14

[1] Resource retrieved from: U.S. Securities and Exchange Commission (https://www.sec.gov/fast-answers/answers-form10khtm.html).

Table 2. Financial Performance Overview

	Income after Undistributed Operating Expenses		Total Revenue	
	2015	2016	2015	2016
Marriott (in U.S. Dollars)	1,255,000,000	2,486,000,000	14,486,000,000	17,072,000,000
Red Lion Hotels (in U.S. Dollars)	−695,000	5,034,000	32,856,000	40,809,000
AccorHotels (in Euro)	564,000,000	604,000,000	1,368,000,000	1,603,000,000
Minor International (in Baht)	7,731,967,234	8,090,898,119	46,760,276,322	56,380,922,947

and includes audited financial statements (U.S. Securities and Exchange Commission, modified in 2009).

Measures

In the hospitality industry, there is no consensus on the exact measurement of corporate financial performance. Different methods have been used in various previous studies (Kim, Cha, & Cichy, 2011). Generally, the EBITDA is a significant indicator for hospitality companies to analyze their profitability. Without considering financing and accounting decisions, EBITDA is widely used by hospitality companies to compare the values and revenues among companies. And it is an appropriate measurement of a hotel's financial performance during a given period (usually a year). EBITDA is calculated by adding interest, taxes, depreciation, and amortization to the pretax (net income).

In Kim et al.'s study, an accounting-based metric—Operating Efficiency Ratio—was adopted as the measurement of financial performance, and the Operating Efficiency Ratio is calculated by dividing income before fixed expenses by total income (Schmidgall & Damitio, 2001). This study uses the same measurement of financial performance because Operating Efficiency Ratio reflects the efficiency of the management activities, and hotel mergers and acquisitions are management decisions mainly made by the management and owners of the hotels, whether the acquirer or the target hotels.

Specifically, this study focuses on the changes of financial performance of the acquirer hotels between the pre- and the post- acquisition period (year 2015 and 2016). The percentage increases of the Operating Efficiency Ratio and EBITDA are calculated to indicate how they are influenced by acquisition activities. The percentage increases of Operating Efficiency Ratio is calculated by subtracting the indexes in 2016 from those in 2015, and the percentage increases of EBITDA is calculated by dividing the differences between 2016 and 2015 by the counterparts of the data in 2015 (See Table 3).

Findings

The regression results were all significant. (See Table 4.)

H2a is supported while H1a is not. $F(2, 1) = 95.556$, $R^2 = 0.995$. The analysis showed that the number of hotels acquired in acquisitions ($\beta = -1.285$, $t = 13.600$, $p < 0.05$) was a significant predictor of increased percentage of EBITDA, while amount of money invested in acquisitions ($\beta = 1.008$, $t = 10.674$, $p = 0.059$) was not. Thus, it is concluded that more (target) hotels acquired in the acquisitions will result in reduction of the percentage increase of EBITDA.

Table 3. OER and EBITDA Increase

	Operating Efficiency Ratio		Δ Operating Efficiency Ratio	EBITDA		Δ EBITDA
	2015	2016		2015	2016	
Marriott	8.66%	14.56%	0.0590	1,279,000,000	1,223,000,000	−0.0458
Red Lion Hotels	−2.12%	12.34%	0.1445	24,395,000	18,517,000	−0.3174
AccorHotels	41.23%	37.68%	−0.0355	450,000,000	494,000,000	0.0891
Minor International	16.54%	14.35%	−0.0218	7,545,167,078	7,841,256,871	0.0378

Table 4. Correlations, Means, and Standard Deviations

	1	2	3	4	M	SD
1. AMT. Money	1				4,005,300,000.0000	6,115,760,249.27945
2. NUM. Hotels	-	1			617.2500	629.87585
3. INC. EBITDA	1.008	−1.285*	1		−0.06	0.181
4. INC. OER	−0.788	1.305*	-	1	0.0366	0.08317

Note: *p < 0.05; **p < 0.01; n = 4

Despite its exclusion of financing and accounting activities, EBITDA provides an accurate indication of hotel companies' profitability. The more target hotels are acquired in the acquisitions, the greater the burden of operating expenses (including the variable and fixed expenses) on the acquirer hotel groups. Due to the high acquisition costs and operating expenses, the extent of growth of the profitability of the acquirer hotel groups is limited or impeded during the early period of post-acquisition activities.

H2b is supported while H1b is not. F (2, 1) = 134.992, R^2 = 0.996. The analysis showed that the number of hotels acquired in acquisitions ($\beta = 1.305$, $t = 16.407$, $p < 0.05$) was a significant predictor of increased percentage of Operating Efficiency Ratio, while the amount of money invested in acquisitions ($\beta = -0.788$, $t = -9.907$, $p = 0.064$) was not. Thus, it is concluded that more (target) hotels acquired in the acquisitions will result in greater percentage increase of Operating Efficiency Ratio.

Without considering the fixed expenses, the Operating Efficiency Ratio indicates the level of hotel groups' management efficiency. As more target hotels are acquired in the acquisitions, the size of the acquirer hotel groups becomes larger. This leads to decrease in direct expenses of acquirers. For example, procurement costs go down as the size of the procurement increases because suppliers are more willing to offer discounts or credits on the goods and service for the larger acquirer hotel groups.

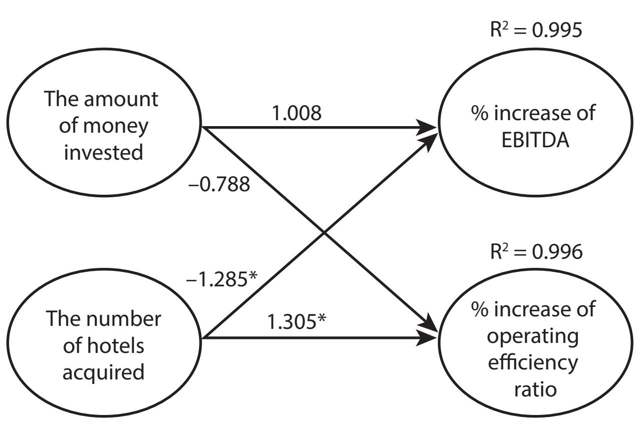

Figure 2. Regression Results.

Discussion and Conclusions

Based on the analysis outcome, two hypotheses are supported. One finding of this study shows that the number of target hotels acquired is a better predictor of acquirer hotel groups' financial performance, while the amount of money invested is not. Another finding of this study reinforces that hotel acquisition of a larger number of target hotels is associated with lower percentage increase of EBITDA but higher percentage increase of Operating Efficiency Ratio. This study provides general support for a theoretical resource in terms of evaluating and predicting corporate financial performance in the post-acquisition period in the context of the hospitality (lodging) industry.

The findings of this study are expected to improve the understanding of effective hotel acquisitions and provide suggestions for (acquirer) hotel managers to make decisions about acquisition activities. This study contributes to research and practice concerned with hotel financial performance and discusses the effects of the size of acquisition on an acquirer hotel group's financial performance by utilizing different indicators. In particular, the results of this study reinforce that the number of (target) hotels acquired in the acquisitions is a significant predictor of the (acquirer) hotel groups' financial performance. It is indicated that managers should pay more attention to the number of target hotels they decide to acquire than the acquisition investments.

The findings on two financial indicators in this study appear contradictory but in fact are not. It is important to identify the difference between those

two financial indicators to decide which financial improvement is the first managerial concern in hospitality business for the specific business period. It is recommended that managers should further compare the proposed increased percentages of EBITDA and Operating Efficiency Ratio, and evaluate the maximum decrease in percentage increase of EBITDA that is acceptable and the minimum increase in percentage increase of Operating Efficiency Ratio expected, if managers consider expanding the size of the acquisition by acquiring more hotels.

Limitations and Future Research

There are several limitations in this study that can be addressed in future research. The primary limitation of this study is that the financial performance of hotel groups vis-à-vis particular managerial activity should be studied in a time-series analysis. Most of the research samples in this study completed the acquisitions in late 2016. Consequently, the financial data for post-acquisition period are not representative enough and ungeneralizable. Further research on the future cash flows for forward-looking financial performance is called for.

From the perspective of shareholders, the data of operational performance adopted are only part of the acquisition gains (Canina, Kim, & Ma, 2010). To supplement the extent of this study, stock appreciations should be considered in the future studies to constitute a complete and direct measure of shareholder value creation in acquisitions as well. The contrast and comparison between the future study and this study can provide further suggestions for managers to make more rational decisions on corporate acquisitions. In addition, this study focuses on acquisition activities alone. In theory, however, merger and acquisition activities are generally combined as one research subject. Future studies on related topics can expand the research scope to include hotel merger activities to gain supplementary findings.

Other limitations include sample size and the accuracy of the measurement. The sample size of this study is extremely small. Only four major acquisitions that occurred in 2016 were selected. Expanding the sample size and conducting difference analysis for large-, medium-, and small-size acquisitions that have occurred within three to five years might yield valuable insights. As for the accuracy of measurement, this study extracted financial data from public income statements and cash flows provided online. Each public hotel group, however, implements different formats of the statements and provides different itemized information. All necessary financial indicators would have benefited from further inspection. For future studies, the measurement should go through the peer-review process to ensure the reliability and validity of the metrics.

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