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THE IMPACT OF INTERNATIONAL ACQUISITION ANNOUNCEMENTS ON THE RETURNS OF U.S. LODGING FIRMS

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Abstract

The existing hospitality literature describes how global diversification in the hotel industry looks for a broader presence regardless of existing global representation. However, the finance literature reports a negative impact from global diversification because of the potentially higher cost of coordinating corporate policies. Moreover, agency problems can increase along with the size of the firm. This study measures the wealth impact of hotel global diversification on bidders at the time of international acquisition announcements. We find significant abnormal positive returns on the day of the announcement. We also find that international acquisitions have lower abnormal returns than domestic acquisitions at the time of the announcement.

Introduction

The hotel industry is considered to be one of the global leaders in the service sector economy. Global diversification in the hotel industry has been in response to increasing international travel. As reported by Litteljohn (1997), international arrivals increased by a factor of more than 25 times between 1950 and 1990. U.S. hotel chains have expanded largely through acquisitions of other chains with an existing global network (Cruz & Wolchuk, 1998). Research indicates that the ability to be located in strategically placed countries and/or "gateway cities" is believed to be an important way to help develop a hotel brand (Whitla, Walters, & Davies, 2007).

However, there are no previous studies to demonstrate the financial impact of global diversification on the hotel industry. There has been some work done in the restaurant industry, but the evidence is contradictory. Hua and Upneja (2007) show a significant and negative relationship between a restaurant firm being "international" and market capitalization (used by the authors as a proxy for size). On the other hand, Hua and Upneja (2008) find a significantly positive relationship between foreign earnings and firm value (as measured by market capitalization).

Further conflicts between international expansion and firm value enhancement exist in the finance literature. Research by Denis, Denis, and Yost (2002) indicates there is a valuation discount attributable to global diversification. Thus, the purpose of this study

is to attempt to determine if hotel global diversification creates a positive wealth impact or not for shareholders during the period surrounding acquisition announcements.

Literature Review

One way for a hotel firm to become global is through acquisition of existing firms (Cruz & Wolchuk, 1998). Hotel acquisitions in the United States have different outcomes as compared to acquisitions in other industries. When a hotel bidder acquires another hotel target firm through merger or tender offer in the U.S., the bidder's returns are significantly positive on the announcement day (Canina, 2001; Kwansa, 1994). These positive bidder returns are generated for a number of reasons. Better managers in the acquiring firm create efficiencies and provide better performance after the firms merge. Therefore, the newly merged firm reduces redundant facilities and offers better product and service. In addition, increased market power raises performance (Canina).

While hotel acquirers have positive returns around the time of the domestic acquisition announcement, shareholders of acquiring firms in other industries have mixed returns. Jensen and Ruback (1983) summarize event studies regarding corporate takeovers and find that shareholders of bidding firms do not make gains (but they don't lose either). They also dispute that any gains increase market power. Overall, the evidence for a positive impact on bidder firms in non-hospitality industries remains unclear.

One measure of a firm's worth is excess value. Excess value is defined as the difference between the actual market value and the weighted sum of the divisional value. When firms expand through acquisition and increase their business segments, excess value has shown to decline during the two years following the acquisition (Graham, Lemmon, & Wolf, 2002). The main reason that excess value is reduced is that the discounted target unit is added to the acquiring firm. In the hotel industry, undiversified hotel firms have better profit growth and better market return performance than diversified hotel firms (Lee & Jang, 2007). Thus, diversification may not be a good strategy for hotel firms based on recent research.

Nevertheless, hotel firms have pursued global expansion strategies. For example, both Holiday Inn and Hilton have properties in 70 countries (Whitla et al., 2007). According to Whitla et al., many hotel chains that are geographically diverse continue to seek non-domestic locations. This appears to be a smart decision given tourism projections. The worldwide average annual growth rate of international tourist arrivals from 1995 to 2020 is 4.1 percent. This outpaces the projected growth rate of 3.8 percent for the Americas and 3.1 percent for Europe. Moreover, these rates are below that of other regions, with Africa at 5.5 percent, East Asia and the Pacific at 6.5 percent, the Middle East at 6.7 percent, and South Asia at 6.2 percent (World Tourism Organization, 2008).

As tourism in the U.S. market has slowed, U.S. lodging firms have expanded internationally. Lee (2008) examines the relationship between lodging firm performance and internationalization (either through acquisition or development) for the period 1997–2006. His study focuses primarily on properties in Europe and Asia. He finds a U-shaped relationship between Tobin's Q (roughly the ratio of market value of equity to book value of equity) and internationalization for all foreign properties, but a linear relationship between Tobin's Q and internationalization to Asian countries.

There are a number of motivations for conducting international acquisitions (Hopkins, 1999). Strategic motives are those where the acquiring firm intends to create synergy and provide complementary resources. The market motive is based upon entering new markets in new countries. Similar to the strategic motive, the economic motive involves establishing economies of scale, reducing the duplication of resources and, subsequently, reducing the undervaluation of the target firm. However, globalization has a dark side in that a high degree of market integration may increase competition and could result in cultural clashes (Moeller & Schlingemann, 2005).

Previous studies highlight both the positive and negative impact of global diversification on firm value. One positive impact is based on the internationalization theory of synergy. This occurs as firms process valuable information-based assets by bringing buyers and sellers within the same firm and internalizing (Denis et al., 2002). Without this process, information-based assets would be hard to sell. Global diversification increases intangible assets and increases the value of the firm (Morck & Yeong, 1992).

Although globalization could produce cultural clashes as discussed by Moeller and Schlingemann (2005), multinational firms can take advantage of price changes and tax codes. Moreover, global diversification satisfies investors' desire for risk reduction through diversification (Denis et al., 2002). If a firm's global diversification costs less than individual global diversification, investors are willing to invest in a globally diversified firm.

Nevertheless, there are potential negative impacts of globalization as well. One of these is the high cost of coordinating corporate policies (Denis et al., 2002). One such cost could be the information asymmetry between headquarters and international divisions. In addition, an agency problem could develop because of managers engaging in "empire-building" by raising more assets under their control (Jensen, 1986). Moeller and Schlingemann (2005) find that U.S. firms acquiring non-domestic firms have significantly lower stock returns during the announcement period than those firms that acquire domestic firms. Denis et al. find that international diversification results in greater valuation discounts than those associated with the acquisition of domestic firms.

The effect of international diversification on firm performance can vary by industry. Capar and Kotabe (2003) examine the German service industry and find a curvilinear relationship between international diversification and performance. International

diversification tends to decrease performance up to a certain level because of the reduced economies of scale associated with large expansions. Thus, larger service firms do not perform as well as their smaller counterparts.

This study focuses on hotel industry globalization, which involves real estate decisions (either securitized or non-securitized properties). The literature on the benefits of international diversification of real estate assets shows mixed results. Diversification of securitized properties is beneficial because real estate returns have lower cross correlations than common stock or bond investments due to local factors (Eichholtz, 1996). Therefore, international portfolios of real assets have higher expected returns at lower risk. Gordon, Canter, and Webb (1998) construct a global mixed-asset portfolio with U.S. financial assets along with U.S. and international real estate securities. Their findings show benefits from international diversification in holding securitized real estate in a portfolio.

Some literature does not support international diversification of securitized properties. Mull and Soenen (1997) and Wilson and Zurbruegg (2003) find that the inclusion of U.S. REITs in mixed-asset foreign portfolios does not significantly increase risk-adjusted returns for the years between 1985 and 1994. When Stevenson (2000) uses securitized real estate data across ten countries, he finds no evidence for the international diversification benefits in the mixed-asset portfolio. Thus, it is an empirical question whether international hotel acquisitions will have a positive impact on the firm surrounding the time of the acquisition announcement.

Data and Methodology

Sample and Data Description

This study uses a sample of U.S. hotel-acquiring firms from the Securities Data Corporation (SDC) International Merger and Acquisition Database (SDC-IMAD) for the period 1986–2004. U.S. hotel-acquiring firms should have foreign hotels as their target with complete acquisitions. Both acquiring firms and targets are classified with the 7011 SIC code (hotel industry). A total of 21 global acquisition deals were retrieved and are shown in Table 1.

Table 1
List of international hotel acquisitions

<u>Acquirer</u>	<u>Target</u>	<u>Target nation</u>
Loews Corp.	Lowes Le Concorde hotel	Canada
ITT Corp.	Marriott Corp—Prince de Galles	France
ITT Corp.	Sahben group—Tweed Heads Resort	Australia
Hilton Hotels Corp.	National Bank of Greece—Astir Resort Complex	Greece
Marriott International, Inc.	Royal Garden Riverside Hotel	Thailand
ITT Corp.	CIGA SpA (Fimpar SpA)	Italy
ITT Corp.	Kajima Corp Park—Grand Hotel	Japan
Loews Corp.	Hotel Vogue	Canada
ITT Corp.	Hotel Diplomat Sp Zoo	Poland
ITT Corp.	Sheraton Skyline Hotel	United Kingdom
ITT Corp.	Beijang International Club	China
Wyndham Hotel Corp.	Bristol Place Hotel	Canada
Marriott International, Inc.	Renaissance Hotel Group NV	Netherlands
Capstar Hotel Co.	Guildford Sheraton Hotel	Canada
Capstar Hotel Co.	Holiday Inn—Metrotown	Canada
ITT Corp.	Hotel Internacional de Iguazu	Argentina
ITT Corp.	Hotel Libertador	Argentina
ITT Corp.	CIGA SpA (Fimpar SpA)	Italy
Choice Hotels Holdings, Inc.	Quality Inns India	India
Choice Hotels International, Inc.	Flag Choice Hotels	Australia
Choice Hotels International, Inc.	Flag Choice Hotels	Australia

Estimation of Abnormal Stock Returns

To measure the acquisition performance of the acquiring firms, this study uses the market model. Previous hospitality literature (Kwansa, 1994; Sheel & Nagpal, 2000; Oak & Andrew, 2005) also uses the market model. This study uses the ordinary least squares regression market model to calculate excess returns. Brown and Warner (1985) show how to calculate excess return measures. R_{jt} is defined as the observed arithmetic return for security j at day t . A_{jt} is defined as excess return for security j at day t . R_{mt} is the return on both the CRSP equally-weighted market indexes over day t . The equation is shown below.

$$A_{jt} = R_{jt} - \hat{\alpha}_j - \hat{\beta}_j \times R_{mt}$$

$\hat{\alpha}_j$ and $\hat{\beta}_j$ are estimates of α_j and β_j by regressing R_{jt} on R_{mt} over the estimation period preceding the event window. The estimation period ranges from $t = -255$ to $t = -46$, which

is relative to the initial date of acquisition announcement day $t = 0$. For every day in the event period, the excess return (A_{jt}) is averaged to make the sample mean:

$$AR_{jt} = \frac{\sum_{j=1}^N A_{jt}}{N}$$

where N is the securities number in the sample and t is the trading day relative to the event day. From 30 days before to 30 days after the international acquisition announcement, the cumulative abnormal return (CAR_{jt}) is:

$$CAR_{jt} = \sum_{t=-30}^{30} AR_{jt}$$

The significance of cumulative abnormal returns is tested by a nonparametric rank test used in the literature (Corrado, 1989; Nicolau, 2002; Oak & Andrew, 2005). The rank test is useful under highly nonnormal distributions and avoids the misspecification problem of parametric tests whereby the event-date excess return variance increases (Corrado). The rank test is calculated by:

$$Z = \frac{\frac{1}{N} \sum_{i=1}^N \left[K_{i0} - \frac{1}{2}(T+1) \right]}{\sqrt{\frac{1}{T} \sum_{t=1}^T \left[\frac{1}{N} \sum_{i=1}^N \left[K_{it} - \frac{1}{2}(T+1) \right] \right]^2}}$$

where K_{it} = rank of the abnormal returns in the time series estimated for the security i , N = the number of securities, and T = the total number of days being observed. Eventus software (Cowan, 2005) is used to estimate cumulative abnormal returns and the significance test. This test will be used to test the following research hypothesis.

Research hypothesis: Hotel international acquisition announcements positively affect the returns of the acquirer.

Discussion of Results

While we retrieved 95 global acquisition deals from the SDC, only 21 deals were used due to the lack of stock return data. As can be seen from Table 1, seven companies with 21 deals are distributed over 16 years. ITT Corporation has the largest number of deals (ten) and other hotel corporations have between one and three deals. ITT Corporation and Choice Hotels International acquired partial shares from CIGA and Flag Choice Hotels. We used this sample of deals to calculate the mean abnormal stock returns of the acquirers for the event period (30 days before the announcement to 30 days after the announcement). The results are shown in Table 2.

Table 2
Mean abnormal returns for international acquisitions

Day	N	Mean Abnormal Return	Rank Test Z
-30	21	-0.16%	-1.12
-29	21	0.27%	0.83
-28	21	-0.34%	-1.31*
-27	21	-0.10%	-0.08
-26	21	-0.27%	-1.28
-25	21	0.15%	-0.3
-24	21	-0.81%	-1.16
-23	21	-0.30%	0.32
-22	21	0.40%	1
-21	21	-0.05%	-0.47
-20	21	-0.46%	-0.7
-19	21	0.53%	0.99
-18	21	0.12%	-0.04
-17	21	-0.85%	-0.38
-16	21	0.60%	0.56
-15	21	-0.48%	-1.15
-14	21	0.06%	-0.19
-13	21	-0.10%	-0.86
-12	21	-0.16%	-0.12
-11	21	-0.08%	-0.47
-10	21	-0.34%	-0.79
-9	21	0.41%	0.83
-8	21	0.67%	1.52*
-7	21	-0.61%	-1.46*
-6	21	0.55%	1.71**
-5	21	0.88%	2.37***
-4	21	-0.66%	-1.72**
-3	21	-0.24%	-1.11
-2	21	0.29%	1.28
-1	21	-0.08%	0.67
0	21	0.62%	1.91**
1	21	-0.36%	-0.15

2	21	-0.26%	-0.55
3	21	-0.03%	0.14
4	21	0.36%	-0.29
5	21	-0.25%	-0.43
6	21	0.23%	0.43
7	21	0.45%	0.82
8	21	1.02%	1.99**
9	21	0.09%	0.5
10	21	-0.48%	-1.74**
11	21	0.03%	0.18
12	21	-0.19%	-0.39
13	21	0.12%	0.49
14	21	0.13%	0.78
15	21	-0.70%	-1.86**
16	21	0.65%	1.29*
17	21	0.11%	0.45
18	21	0.00%	0.67
19	21	-0.01%	0.4
20	21	-0.07%	0.41
21	21	-0.10%	-0.44
22	21	0.30%	-0.14
23	21	0.02%	-0.04
24	21	-0.22%	-0.78
25	21	-0.68%	-2.00**
26	21	0.44%	0.5
27	21	-0.04%	-0.44
28	21	-0.08%	-0.13
29	21	-0.43%	-0.65
30	21	-0.21%	-0.85

*, **, ***: significant at the 0.10, 0.05 and 0.01 levels using a 1-tail test.

There were significant positive returns for global hotel acquirers on the day of acquisition announcement (day 0). This result for international hotel acquisitions is similar to the result for firms making domestic lodging acquisitions¹ (see Table 3). In

¹ Since a previous study on domestic acquisitions (Canina, 2001) did not use the market model, we cannot compare our results with it. Our international acquisition uses the market model to calculate cumulative abnormal returns. To compare international acquisitions with domestic ones, this study uses the market model for domestic acquisitions. The sample includes deals in which both acquirers and targets are from the U.S. hotel industry and stock returns are available for acquiring firms.

terms of international acquisitions, the acquiring firms' abnormal return percentage is positive and significantly different from zero on the acquisition announcement day. The mean abnormal returns on day 0 are 0.62 percent. It supports our hypothesis that on announcement day, international hotel acquisitions positively affect the returns of acquirers. Similarly, domestic lodging acquisitions show mean abnormal return percentages on the announcement day of approximately 0.69 percent. Both domestic and international lodging acquisitions have positive and significant mean abnormal returns on the acquisition announcement day.

Table 3
Mean abnormal returns for domestic acquisitions

Day	N	Mean Abnormal Return	Rank Test Z
-30	190	-0.18%	-1.42*
-29	190	0.28%	1.44*
-28	190	0.54%	1.95**
-27	190	0.01%	-0.23
-26	190	0.10%	-0.34
-25	190	-0.26%	-1.46*
-24	190	0.06%	0.7
-23	190	0.17%	-0.59
-22	190	-0.01%	-0.42
-21	190	-0.02%	0
-20	190	0.00%	0.35
-19	190	-0.20%	-1.48*
-18	190	0.18%	1.01
-17	190	0.07%	-0.53
-16	190	0.25%	-0.2
-15	190	-0.36%	-1.59*
-14	190	-0.06%	-0.42
-13	190	0.08%	-0.32
-12	190	-0.10%	-0.95
-11	190	-0.01%	-0.21
-10	190	-0.05%	-0.26
-9	190	-0.23%	-1.28
-8	190	0.14%	0.31
-7	190	0.34%	1.38*
-6	190	-0.49%	-1.21

-5	190	0.18%	-0.18
-4	190	-0.42%	-2.11**
-3	190	0.12%	0.13
-2	190	0.26%	0.75
-1	190	0.78%	2.56***
0	189	0.69%	2.81***
1	190	0.15%	0.11
2	190	0.60%	1.56*
3	190	0.05%	0.37
4	190	-0.10%	-1.51*
5	190	0.16%	0.77
6	190	0.01%	0.07
7	190	-0.04%	0.32
8	190	0.32%	0.68
9	190	-0.21%	-0.19
10	190	0.05%	-0.57
11	190	0.22%	0.42
12	190	-0.02%	-1.01
13	190	0.14%	0.43
14	190	-0.02%	0.15
15	190	0.05%	0.26
16	190	0.19%	0.17
17	190	0.32%	1.02
18	190	-0.42%	-1.39*
19	190	-0.20%	-0.41
20	190	0.06%	-0.27
21	190	-0.19%	-0.56
22	190	0.21%	0.29
23	190	-0.12%	-0.04
24	190	-0.06%	-1.64*
25	190	0.10%	1.06
26	190	-0.06%	-1.1
27	190	-0.16%	-1.60*
28	190	-0.28%	-0.61
29	190	0.08%	0.19
30	190	0.35%	0.86

*, **, ***: significant at the 0.10, 0.05 and 0.01 levels using a 1-tail test.

We run a similar test delineating the prior sample into three different periods: 30 days prior to the announcement day, one day prior to the announcement and 30 days after the announcement. This is shown in Table 4.

Table 4
Mean cumulative abnormal returns for international acquisitions

<u>Days surrounding the announcement</u>	<u>N</u>	<u>Mean cumulative abnormal returns</u>	<u>Rank test Z</u>
(-30, -2)	21	-1.09%	-0.616
(-1, 0)	21	0.53%	1.819**
(+1, +30)	21	-0.17%	-0.337

**Significant at the 0.05 level using a 1-tail test.

For international acquisitions, the abnormal return from one day prior to the announcement to the announcement day is 0.53 percent, which is significant and positive, as expected. The research hypothesis is accepted for the (-1 to 0) period. In Table 4, the cumulative abnormal return is insignificantly negative 30 days before and 30 days after the acquisition announcement. It means that acquiring firms neither lose nor gain in the (-30 to -2) and (+1 to +30) periods.

We also examined the CAR for domestic acquisitions. As shown in Table 5, the abnormal return in the same period is significantly positive at 1.46 percent. In terms of domestic acquisitions, the cumulative abnormal return in the (-30, -2) period is 0.39 percent and modestly significant. Those in the (+1 to +30) period are insignificantly negative. Unlike domestic acquisitions, it appears international acquisitions do not have significant information diffusion prior to the acquisition announcement. This is also consistent with previous results by Moeller & Schlingemann (2005) indicating that U.S. acquirers with international targets have lower announcement returns than those with domestic targets.

Table 5
Mean cumulative abnormal returns of domestic acquisitions

<u>Days surrounding the announcement</u>	<u>N</u>	<u>Mean cumulative abnormal returns</u>	<u>Rank test Z</u>
(-30, -2)	190	0.39%	-1.332*
(-1, 0)	190	1.46%	3.796***
(+1, +30)	190	1.17%	-0.399

*, *** : Significant at the 0.10 and 0.01 level using a 1-tail test

Conclusions and Recommendations for Further Research

This study examines whether or not shareholders of U.S. hotel firms gain wealth when international acquisitions are announced. No previous studies have focused solely on hotel international acquisitions using an event study methodology. This study supports the notion that hotel international acquisitions produce positive abnormal returns. The results show that the mean abnormal return is significantly positive at the day of announcement. In the period just before (–30 days to –2 days) and just afterward (+1 days to +30 days), the cumulative abnormal return is insignificantly negative. The most important finding in this study is that international hotel acquisitions produce significant positive returns on the day of announcement, much like domestic hotel acquisitions. Thus, the result tends to support our research hypothesis.

One limitation of this study is the small sample size. Although there were a total of 95 deals, the database we accessed had return data on only 21. Future studies could examine the abnormal returns (if any) for hotel REITs mergers and acquisitions. Given the limited amount of research on international hospitality acquisitions, it would be interesting to investigate global acquisition in the restaurant and casino industries as well.

Finally, we noticed that the cumulative mean abnormal return of 0.53 percent for international acquisitions from one day prior to the announcement day was significantly less than 1.46 percent for domestic takeovers. The cumulative mean abnormal return difference between domestic and international acquisitions may be an indication of the valuation discount for global diversification as argued by Denis et al. (2002). Further investigation into the existence of such a discount in the field of hospitality acquisitions could be warranted.

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