

Commentary: Success and Failure of Mergers and Acquisitions

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Success and Failure of Mergers and Acquisitions

Mergers and acquisitions (M&As) are strategic actions that are on the minds of many managers because they claim that M&As are value enhancing through a variety of sources, such as economies of scale and/or scope from the combined organization and the elimination of poor managerial practice. Regardless of the justification, managers argue that the result of M&As is greater efficiency and, ultimately, an increase in value for the acquiring company. The empirical evidence does not uniformly support managers' claims. In fact, an abundance of empirical research has examined the performance of acquirers across all industries and in general has failed to find consistent evidence of improvements in value after the acquisition. However, some M&As are value enhancing. For example, the limited empirical evidence in the lodging industry shows that M&As are successful on average (Yang, Qu, & Kim, 2009; also see Chapter 43).

Despite decades of study across many academic disciplines, we are still unable to fully answer the central question: Why do the acquisitions of some firms perform better than those of others? This is not due to a lack of interest or the lack of significant contributions by academics but rather the complexity involved in each step of the entire M&As process from the premerger valuation stage through the final postmerger integration stage. Researchers have made progress toward answering this question, but additional insights remain to be discovered.

The other two chapters related to M&As in Part VII do provide some additional insights regarding the success or failure of M&As in the hospitality industry, but others still remain for further research. The main purpose of this chapter is to provide a commentary on these two chapters. In Chapter 40, Jeffrey S. Harrison and Zhaoping Liu shed light in answering the question of why the acquisitions of some firms perform better than others by discussing some of

the possible factors associated with success or failure of M&As and some of the major reasons claimed to motivate M&As. It then relates these factors to specific M&A deals in the hospitality industry. In this way, it highlights the main characteristics of certain deals associated with success or failure. The other chapter, “Good News for Buyers and Sellers: Acquisitions in the Lodging Industry” (Chapter 43), by Linda Canina, is an empirical analysis that provides evidence that the stock market reacts favorably to merger announcements in the lodging industry for both acquiring and target firms. The results found in this study differ from those for the overall market in which the stock market only reacts favorably for the target firm. On average, for the overall market, the unexpected returns to the acquiring firm are negative.

Since both of these chapters are related to the success or failure of M&As, this commentary will expand upon the discussion of the factors related to success, present further empirical analyses on some of the factors related to successful M&As discussed in the Harrison and Liu chapter (Chapter 40), and update the analysis in the Canina chapter (Chapter 43). We begin with a discussion of the definition and measurement of success followed by a brief presentation of the main empirical findings for the overall market and the hospitality industry. The final section presents conclusions and some ideas for future research.

Successful Mergers and Acquisitions

In order to identify the factors associated with the success or failure of an M&A, it is important to first clarify the definition of success. According to the finance textbook definition, a merger is successful when the postmerger value of the integrated firm is higher than the sum of the paid acquisition price for the target firm and the value of the acquiring firm prior to the

merger (e.g., Brealey, Myers, & Allen, 2005, p. 826). For example, assuming that Firm A would like to merge with Firm T, success is defined as follows: $V_0^C > P_0^T + V_0^A$, where: V_0^C equals the value of combined firm in period 0, P_0^T equals the acquisition price of firm T in period 0, and, V_0^A equals the value of firm A in period 0. Consequently, a successful M&A is one in which the value of the combined firm exceeds the cost of the investment. If the net present value of the investment is positive then the M&A is expected to be successful.

However, the financial market typically defines a successful merger in such a way that the value of the combined Firm C exceeds the sum of the values of the separate entities, $V_0^C > V_0^T + V_0^A$, where V_0^T equals the value of firm T in period 0. The total synergy value, as viewed by the financial market, resulting from a merger, equals the difference between the combined firm value and the sum of each individual firm value, $V_0^C - (V_0^T + V_0^A)$. Even though the two definitions appear to be different, theoretically they are the same. The difference between the two definitions of success lies in the difference between the market's valuation of the target firm and the price paid for the target.

In theory, the price and the value of the target firm should be equal, but in reality they may not. The acquisition price (P_0^T) frequently exceeds the market's valuation of Firm T (V_0^T), due to the additional premium paid to shareholders of Firm T. The acquisition price per share in many cases is 40% to 60% higher than the actual share price (Moeller, Schlingemann, & Stulz, 2005).

This is due to the fact that shareholders of Firm T will not sell or exchange their shares if they are unable to realize a higher price relative to the price that they would receive in the stock market. Therefore, the premium given to the shareholders of Firm T can be viewed as an incentive to part with their existing stock. The acquiring company is willing to pay this requested

premium to shareholders since managers expect a much greater return on synergy to result from the merger. Redefine the price paid for Firm T in period zero as the value of Firm T plus a price premium, $P_0^T = V_0^T + PP_0^T$, where PP_0^T is the price premium, then a successful M&A is one in which the net present value of the total synergy less the price premium is greater than zero, $V_0^C - (V_0^T + V_0^A) - PP_0^T > 0$. This represents the expected net gain to the acquirer, or the expected net synergy.

Synergy occurs when two or more units can be run more efficiently and/or effectively when they are combined as opposed to separately. The identification and realization of synergies is not straightforward. Synergies differ in terms of measurability and the required efforts to generate benefits. Operational synergies result from economies of scale in, for example, production, administration, and marketing. They come from eliminating excess capacity and related costs or from economies of scale in purchasing, production, administration, and marketing. Collusive synergies are benefits that are derived from increased market and purchasing power. An example is revenue enhancement, which refers to the possibility to achieve a higher level of sales together than either company on their own. Collusive synergies may be attained when a superior product from the target is combined with the more extensive distribution channel of the acquirer. Managerial synergies result from applying complementary competencies, replacing incompetent managers, or from using the skills of general management across different areas of business. Financial synergies come from risk diversification and coinsurance.

The main difficulties in estimating and realizing the synergies associated with the merger are accurate valuation of the combined firm and determining the best processes and procedures to utilize throughout each stage of the merger to ensure an effective integration of the systems of

the two firms. The Harrison and Liu chapter (Chapter 40) discusses several factors related to success or failure of M&As. Their view, which is verified by the representation shown earlier of the net gain to the acquirer, is that it is vital to have accurate valuation and effective M&A practices implemented throughout the entire M&A process for the realization of the expected synergies into fruition in any successful merger. More specifically, the factors that they discussed are high premiums paid for the target; higher financing costs due to increased leverage; other costs, such as unaccounted implementation expenses; the degree of relatedness; high levels of executive turnover; cultural clashes; management distraction; and in the case of conglomerate mergers, manager's inability to manage a noncore enterprise.

We agree that the value and realization of potential synergies are directly influenced by the price paid for the target firm as well as the plans for synergy capture and the postmerger integration. If the degree of relatedness, financing methods, and cultural differences are not considered thoroughly during the due diligence and negotiation stages, then the valuation of net synergy may be too high due to unaccounted costs associated with integration. Hence, the estimated value creation due to synergies will not be realized. In order to accurately estimate and realize potential value creation, thorough analysis and planning for each stage of the merger process is essential.

M&As are usually divided into three stages: the premerger process, the actual deal, and the postmerger integration process. Each process has its own crucial role in the acquisition deal. The most accurate estimation of the potential value creation and the firm's ability to capture the value involves a thorough analysis during each stage of the M&A process and a plan for managing each of the stages. The final outcome of the M&A is the result of the success of premerger decision making plus the success of postmerger implementation (Pablo, 1994). Given

that the first two stages of the M&A process are successful, it is more likely that the final implementation stage will also be successful if managers plan to proactively manage the integration process of the relevant areas. However, it is very complex both to estimate the value of the combined company and to identify the integration methods that maximize the realized net benefits of the merger.

In practice, premerger and postmerger processes are often viewed as separate issues by managers (Chanmugam, Shill, Mann, Ficery, & Pursche, 2005; Tetenbaum, 1999). Many companies do not plan the integration process until after the deal is announced or even closed (Carr, Elton, Rovit, & Vestring, 2005), which is too late. Often different groups and even managers are involved in the predeal and postdeal stages. This may result in a disconnection between the expected benefits of the M&A with the achievement of those benefits during the integration process. Thus, in order to achieve the desired synergy, managers need to incorporate the plan of action early on based on the identification of the areas where integration is important and the degree of integration.

A related point addressed by Harrison and Liu is that one of the key components missing from current M&A methodologies and practices is the failure to analyze corporations as a complex system of interconnected elements and relations. The representation of the value of the combined firm with respect to the value of each of the separate firms, $V_0^C > V_0^T + V_0^A$, shows this is true since the value of the combined firm is greater than the sum of the value of each in a successful merger. The valuation of the combined firm involves the estimation of each of the M&A benefits that are expected within the combined firm with its own linked system of human resources (HR), technology, and organization that is different from the premerged firms. In the process of creating this new corporate entity, mergers disrupt the balance through the removal

and addition of certain elements and corporate functions. The modification alters revenue, turnover, and profits, which are directly related to the interaction of the groups of activities within the corporate system. Any valuation of the integrated system, which involves the analysis of the expected sales, turnover, and profits of the new combined firm cannot be accurately performed by simply aggregating key financial numbers but rather by analyzing the expected performance of the integrated combined firm, VOC.

In order to identify potential synergies and realize these synergies, a good understanding of the strengths and weaknesses of the business processes of both firms is required. Synergy is not realized by mere possession of resources nor is it inherent in the tangible or intangible assets of the firms. Rather, it is the result of combining the existing resources of the two firms in a unique way. The unification of these resources in a way to maximize value and synergy requires viewing the combined corporation as a system of new processes. It is these processes that deliver the product or service efficiently, and it is the value of these processes that drive the resulting valuation of the combined firm.

Since the analyses, processes, and procedures during each stage of the M&A is important, Harrison and Liu (in Chapter 40) suggest that the lack of insight about the factors that lead to merger success is related to the most frequently utilized research methodology of analyzing the stock price reaction of the acquirer and target. This type of methodology measures the financial market's perception of whether or not they believe that the resulting merger will be successful, but it does not analyze the processes used throughout the stages of the M&A that result in the successful realization of the expected synergies. They propose that a case- based empirical method may lead to further insights. In order to understand the differences in the methodologies and the insights revealed by each, the next section briefly reviews a bit of the empirical evidence.

In addition, we provide empirical evidence that reveals the importance of the factors related to success or failure that were discussed by Harrison and Liu (in Chapter 40) and expand upon the empirical evidence provided in the Canina chapter (Chapter 43) for a more recent period.

The Empirical Evidence

M&A is an area of study in several academic fields. The initial research was concentrated mostly in the finance literature where the focus was whether acquisitions added value to the firm. This issue was analyzed by assessing the relationship between acquisition activity and firm performance through changes in shareholder value (Carper, 1990). For a detailed review of the literature and discussions of the methodology, see King, Dalton, Daily, and Covin (2004).

This methodology involves an analysis of the stock price reaction of the bidding and target firms at the time of the M&A announcement. Furthermore, it assumes that the financial market is efficient. The efficient market view is that market prices aggregate the information of many traders, so that the stock price reaction reflects the financial market's expectation about the deal. A positive price change is consistent with the view that the market perceives the announcement of the deal as good news about the firm while a negative price change is consistent with the view that the market perceives the announcement as bad news. That is, any change in the value of the acquirer or target firm's common equity at the time of the M&A announcement is driven by a change in the market's estimates of the firm's future financial performance. Under this view, if the excess return of the stock is positive on the announcement date of the merger, this is consistent with the idea that the market believes that the future performance of the company will improve.

The researchers who have addressed the question of wealth gains from M&As in this way typically find two patterns: (1) target shareholders earn significantly positive returns and (2) acquiring shareholders earn little or negative returns (Asquith, 1983; Bradley, Desai, & Kim, 1983; Dodd, 1980; Dodd & Ruback, 1977; Jensen & Ruback, 1983; Kummer & Hoffmeister, 1978; Malatesta, 1983). The first result supports the view that a premium is paid to the target shareholders. It is well known that the acquirers pay too much for the targets (Bower, 2001). The existing evidence regarding the gains to acquiring shareholders is mixed. At best, the results show slightly positive excess returns. The acquiring shareholders will benefit from the M&A only if the financial market expects that the current market value of the benefits exceed the costs associated with the M&A transaction, which means that the market expects a positive net synergy, $V_0^C - (V_0^T + V_0^A) - PP_0^T > 0$. On the other hand, if the excess return is negative, then the stock market views the announcement as bad news because they expect that the merger will result in a reduction of the combined firm's overall value.

Using this methodology, it is possible to account for the details of the deal such as the degree of relatedness, financing method, hostile or friendly merger, etc., that may impact the market's perception of the news. In addition, as mentioned earlier, it reveals whether or not the market expects the net synergy of the M&A, $V_0^C - (V_0^T + V_0^A) - PP_0^T$, to be positive. A positive unexpected return for the acquirer is consistent with the market's expectation of a positive net synergy.

The literature that examines the relations between the acquiring and target firm's abnormal returns to the characteristics of the acquirer and the target as well as the deal characteristics has made significant headway. This literature finds that abnormal returns are lower for acquisitions by firms with low leverage (Maloney, McCormick, & Mitchell, 1993),

large holdings of cash (Harford, 1999), low managerial share ownership (Lewellen, Loderer, & Rosenfeld, 1985), overconfident management (Malmendier & Tate, 2005), large capitalization (Moeller, Schlingemann, & Stulz, 2004), acquisitions of public firms (Chang, 1998; Fuller, Netter, & Stegemoller, 2002), acquisitions opposed by target management (Schwert, 2000), conglomerate acquisitions (Morck, Shleifer, & Vishny, 1990), and acquisitions with competition (Bradley, Desai, & Kim, 1988).

As Harrison and Liu discuss in Chapter 40, this type of methodology is not ideal since it has mainly focused on the general characteristics of the deals and has failed to address the specifics of the procedures and processes implemented during each of the stages of the M&A process. However, a line of research exists in the disciplines of both finance and management that has focused on the processes that acquirers use to realize value from acquisitions. It addresses issues about how firms integrate, transfer, and manage the resources of the combined firm. In addition, this research explores the processes that lead to effective integration and how the dynamics among acquiring firms' top managers and between the acquiring and target top management teams influence acquisition implementation success.

In this stream of literature, the resource-based and organizational learning perspectives have been used as the theoretical framework in order to inform our understanding of the specific internal capabilities, cultures, and decision processes that allow acquirers to realize value from acquisitions and how this process may vary as a function of intended strategy (Haleblian, Devers, McNamara, Carpenter, & Davison, 2009; King, Slotegraaf, & Kesner, 2008; Uhlenbruck, Hitt, & Semadeni, 2006). Cording, Christmann, and King (2008) examined long run stock returns in conjunction with survey responses on each M&A. They identified four dimensions related to integration decisions: integration depth, integration speed, top management turnover, and market

focus. They also identified two intermediate goals: internal reorganization and market expansion. They found that integration decisions lead to the achievement of different intermediate goals, which suggests the relationship between a given integration decision and acquisition performance should be considered through the acquisition's intermediate goals. In addition, their research suggests that acquirers pursue multiple intermediate goals and that these intermediate goals are related.

The empirical research on M&As specific to the hospitality industry is limited and it focuses primarily on the analysis of the abnormal returns to the acquirer and to the target around the time of the announcement. In Chapter 43, Canina found positive excess returns to both the acquirer and the target on the merger announcement data. Yang, Qu, and Kim (2009) examined the long-term abnormal returns to hospitality acquirers as well as the association between excess returns with financing methods and size. Their study showed that hospitality acquirers receive positive abnormal returns 12 months postmerger and that there is negative association between the use of cash to finance the acquisition and the acquirers' excess returns.

The empirical evidence for the lodging industry supports the notion that M&As are value enhancing for acquirers in the lodging industry. As a result, a more detailed analysis of these M&As on a case by case basis may provide additional insights on the underlying factors associated with success or failure for M&As across other industries. Chapter 40 is a start in that direction. The methodology used by Harrison and Liu (in Chapter 40) of analyzing the details of the deal in light of the outcome is appropriate in order to get information regarding the specific procedures and managerial practices associated with successful or unsuccessful M&As. As verified by the study of Cording et al. (2008), this type of methodology reveals insights different

from the results found by using the most frequently utilized methodology of analyzing the stock price reaction of the acquirer and target.

The Canina chapter (Chapter 43) provided empirical evidence on M&A activity and the financial market's perception of the expected success for the lodging industry over the period from 1982 to 2000. The Harrison and Liu chapter (Chapter 40) addressed the importance of the degree of relatedness of the acquiring and target firms as one of the relevant factors to achieving a successful acquisition. The next section begins with an update of the Canina chapter, which covers the period from 2000 to 2006. It shows the importance of M&As in the lodging industry over this period. In addition, we provide empirical evidence on the financial market's perception of the expected financial benefits to the acquiring and target firms as a result of the M&A. This analysis is performed for the overall lodging sample and then for subsamples formed on the basis of various measures of the degree of relatedness, one of the factors related to success as discussed by Harrison and Liu in Chapter 40.

Lodging Mergers and Acquisitions for the Period From 2000 to 2006

M&As in the lodging industry are prevalent worldwide. From January 1, 2000, to September 20, 2006, these deals involved target companies based in 76 different nations and acquiring companies based in 85 different nations. Exhibit 45.1 shows the annual number and annual market value of target stocks for worldwide lodging acquisitions completed or pending. The data sample, supplied by Securities Data Corporation (SDC), includes M&As of both public and private companies in which at least one of the companies involved operates in the lodging industry. In 2000, a total of 301 M&As occurred around the world in which the acquirer or the

target was involved in the hotel industry. The aggregate value of the targets was about \$26 billion. Even though M&A activity dropped in 2001, it began to pick up again in 2002. By 2004, the value of the targets was \$46 billion. In 2005, there were 424 hotel-related worldwide M&As in which the total value of the targets was \$66.5 billion. As of September 20, 2006, 297 M&As were announced, and the targets have been valued at \$41.8 billion.

Acquirer and Target Wealth Gains

Using the data sample, previously mentioned, which covers the January 1, 2000, through September 20, 2006 period, we performed an analysis of the stock price reaction on the announcement day of the M&A for both the publicly traded target and the publicly traded acquiring firms in the lodging industry. The methodology used is the same as in Chapter 43 by Canina. This will shed some preliminary evidence regarding the possible wealth gains as a result of the deal to the bidders and the targets over this more recent period.

As shown in Exhibit 45.2, the excess return of both the acquirer and the target is positive. On average, there was a 0.07% daily excess return on the M&A announcement day on the acquirers' stock, and there was a 4.25% daily excess return on the targets' stock for the entire sample. The financial market's reaction to the M&A announcement is favorable for both the acquiring and target firms. The results show that the shareholders of both the acquiring and target firms gain at the time of the merger announcement. The announcement of an acquisition reflects positive information about the firms involved, which in turn fosters a favorable stock price response. These effects predict that the combined firm will generate cash flows with a present value in excess of the sum of premerger market values of the acquiring and target firms.

The extremely large excess returns of the target firm make it quite clear that the target shareholders benefit upon the announcement of the merger, which is consistent with the empirical evidence found in other industries. For the acquiring firms, the excess return is much lower than for the targets. However, the excess return is positive, implying that the financial market expects the M&A gains to exceed the costs. This positive price response may be due to stockholders' expectations regarding the firm's ability to realize the potential benefits of monopolistic market power, increased productive efficiency due to synergies, or increased efficiency due to the removal of inefficiencies that are expected to be realized during the integration stage. In other words, the positive price reaction implies that the financial market perceives that the M&A transaction is a positive net-present value investment for the bidder, indicating that they expect benefits claimed by management while promoting the deal to be realized during the integration process. As a result, one can conclude that, on average, lodging industry mergers continue to be value-maximizing tactics.

In sum, lodging firms' mergers have increased the value to the shareholders of the target firms, while at the same time most likely increasing the value of shareholders' stake in the acquiring firms. In order to gain insight regarding the importance of the integration stage during the M&A process, the next section presents an analysis of the stock price reaction of both the bidding and target firms as a function of various measures of the degree of relatedness— one of the success factors discussed by Harrison and Liu (in Chapter 40).

Degree of Relatedness

The degree of the relatedness of the two firms, both operationally and culturally, as well as the type of M&A, affects the level and areas of integration. Relatedness refers to aspects outside the two organizations (external relatedness) as well as to aspects inside the two organizations (internal relatedness). The role of relatedness has attracted attention in M&A research (Chatterjee, 1986; Lubatkin, 1987; Seth, 1990). Research related to the external relatedness has focused on relatedness of the firms concerning target markets and the firms' market positioning in terms of product quality and price. Capron and Hlland (1999) and Capron, Mitchell, and Swaminathan (2001) provide evidence that a high level of external relatedness is associated with a higher potential for a successful merger. Research with respect to internal relatedness has focused on the merging firms' organizational culture (Chatterjee, Lubatkin, Schweiger, & Weber, 1992; Datta, 1991; Datta, Grant, & Rajagopalan, 1991). Chatterjee et al. (1992) found that the financial market's perceptions about the earnings impact of a merger are correlated with the target managers' perceptions of cultural differences between their top management team and that of the acquiring firm. According to Jemison and Sitkin (1986), cultural issues are often overlooked by the managers of the acquiring firm during the merger planning process and hence during the integration process. However, investors appear to view cultural issues as important. On an overall basis, this work provides strong evidence that low internal relatedness is detrimental for M&A success.

In the next section, we present empirical evidence regarding the relationship between the degree of relatedness and the markets' reaction to M&A announcements in the lodging industry.

Two different measures of the degree of relatedness are examined; horizontal and nonhorizontal and international and domestic M&As.

Horizontal and Nonhorizontal Mergers and Acquisitions

M&As can be divided into the following categories; horizontal, vertical, and conglomerate. In horizontal M&As, both companies operate in the same industry and on the same industry level. Both companies are competitors. Vertical M&As involve firms that operate in different stages of the same industry. Firms in conglomerate M&As, on the other hand, do not operate in the same business sector at all. The characteristics of the acquirer and the target are the most similar in horizontal M&As and most different in conglomerate M&As. The likelihood that the degree of both internal and external relatedness is higher in horizontal M&As is greater than in vertical or conglomerate M&As (Chatterjee et al., 1992). This implies a greater chance of success for horizontal versus vertical and conglomerate (nonhorizontal) mergers.

The pressure on the target firm to conform to the culture of the bidder may depend upon the degree of dissimilarity of the cultures of the two organizations (Berry & Annis, 1974; Weber, 1988). Poor cultural fit has been the downfall of many mergers that appeared to make good strategic sense (Weber & Schweiger, 1989). Culture is defined as “the set of important understandings that members of a community share in common” (Sathe, 1983, p. 6). The communities’ shared history and experiences define their unique culture and impacts the way in which they interact with one another. Culture influences organizational practices, such as conduct, leadership styles, and administrative procedures (Lorsch, 1986).

In order to examine the wealth gains associated with horizontal versus nonhorizontal mergers, we categorized the sample according to whether the industry name of the acquiring and target firms are the same (horizontal) or different (nonhorizontal). Since the data sample consists of deals in which either the acquirer or the target is in the lodging industry, the deals categorized as horizontal involve firms that are both in the lodging industry.

Exhibit 45.3 shows that the excess returns to both the acquirers and the targets are higher for horizontal versus nonhorizontal mergers. For horizontal M&As, the average announcement day excess returns are 0.20% for the acquirers and 5.64% for the targets. For nonhorizontal M&As, the average announcement day excess returns are 0.04% for the acquirers and 4.03% for the targets. The larger excess returns for the stockholders of the acquiring firms involved in horizontal M&As relative to those of nonhorizontal M&As imply that the market expects higher future benefits relative to the costs associated with horizontal versus nonhorizontal M&As.

There are a variety of reasons for this result: potential benefits due to operational, collusive, and managerial synergies; a more efficient integration process; and lower integration costs. As stated previously, a significant body of research has addressed the concept of relatedness in M&As. Low internal relatedness is frequently reported to have detrimental effects on M&A performance. On the other hand, there are more conflicting findings with respect to the impact of external relatedness on M&A performance. On an overall basis, horizontal M&A transactions have higher degrees of relatedness than nonhorizontal deals and as a result, higher performance, at least in the lodging industry.

International and Domestic Mergers and Acquisitions

International deals introduce extra layers of difficulty relative to domestic M&As. Firms involved in international transactions face many more difficulties than domestic M&As due to unfamiliarity, cultural integration, legal and regulatory differences, and different business cultures (Larsson & Risberg, 1998; Vaara, Tienari, Piekkari, & Sääntti, 2005). For example, the “cultural clash” may be amplified by national differences on top of corporate differences (Vaara et al., 2005). These researchers argue that since individuals from different nations are socialized into different skills, rules, and habits, interaction between them is likely to cause misunderstandings. As a result, the postmerger integration stage may be hampered. Thus, the likelihood of a successful international M&A is less than that of a domestic one if differences in organizational cultures negatively impact the financial success of mergers in the lodging industry.

Nevertheless, cross-border M&As have been persistent. Regional economic integration has shown to stimulate cross-border M&As (Chapman, 2003; Dermine, 2000). A key goal associated with the creation of the European Union (EU) was the deregulation and promotion of the integration of national markets toward a single European market as a prerequisite for achieving world leadership. The industrial structure across Europe is characterized by its having relatively small firms with their activity heavily concentrated within their national borders. This is especially true when compared to the industrial structure of the United States. The integration of the national economies, the increase in deregulation of a large number of economic sectors, and the listing of a number of large European corporations previously controlled by their national governments has decreased the cost of making corporate acquisitions and transactions across

European borders. In fact, the volume of M&A activity in Europe did rise significantly in the latter part of the 1990s (Campa & Hernando, 2004). This increase in M&A activity has been part of a wider worldwide increase in corporate restructuring and is not unique to the EU.

In order to analyze the differences in wealth gains for international and domestic M&As, we categorized the data sample according to whether the names of the target and acquiring nations were the same (domestic) or different (international). Exhibit 45.4 shows that international M&As are important in the lodging industry. More specifically, 23.85% of the total number of M&As in the data sample is international deals. These international deals represent 22.76% of the total market value of all target companies over this period. The average size of the target is slightly higher at \$115.37 million for the domestic group as compared to the international group where the average size of the target is \$108.51 million.

The results presented in Table 45.4 show that the financial market views domestic mergers favorably and international M&As unfavorably for the bidding firms. The average daily stock excess return for the acquirers is -0.53% and 0.17% for international and domestic M&As, respectively. The shareholders of the bidding firms lose at the time of an international transaction but gain at the time of a domestic merger. These results imply that the financial market views international M&A announcements as bad news for the bidding firms.

As stated previously, the integration stage is likely more difficult for international deals. The empirical evidence presented here is consistent with this view. The stock market views the announcement of international M&As as bad investments for the acquirers (i.e., negative net present value investments—the expected costs associated with the deal exceed the expected benefits). For the targets, the excess return is 2.06% for international M&As while it is 4.68% for domestic M&As. This result is consistent with most M&A research. The shareholders of the

target firm benefit upon the announcement of the merger for both the domestic and international transactions.

Two possible reasons for the differences in the gains associated with international and domestic M&As are mispricing of the target and the risk of unexpected costs due to institutional constraints. Even though the EU promotes integration, there still may be a large number of legal, economic, and cultural barriers that may result in higher costs—different corporate governance regimes, ownership concentration, takeover regulation, protection of shareholder rights, and informational transparency—that are realized during the integration stage. It has been argued that market access is a key motive for foreign direct investment (Pringle, 1991). It may be the result that bidders without operations in an international market prior to the acquisition may be prepared to pay higher premiums than domestic and other cross-border bidders. Higher premiums result in lower benefits. As a result, a market access motive behind the deal may reduce the likelihood of a successful M&A.

Conclusion

The success of M&As for the bidding firms in the lodging industry differs from the overall market. In addition, for the acquiring firm, domestic and horizontal M&As fare better than international and nonhorizontal mergers. This evidence implies that the structure of the industry as well as the degree of relatedness may impact the success. Without a thorough analysis of M&As across different industries and without knowledge of the motives behind each merger, it is difficult to identify the factors underlying the differences in the success of M&As in the lodging industry versus other industries with certainty.

However, it is possible that the motives underlying M&As in the lodging industry are related to overcapacity, product or market extension, and geographic roll up. Overcapacity M&As are common when there are potential gains associated with restructuring. This kind of industry consolidation can increase the acquirer's market power and form entry barriers for competitors. Product or market extension M&As are used to extend into new markets or products. Geographic roll-up M&As seek growth and efficiency gains by buying out competitors in geographically fragmented markets. This M&A type has many similarities with both overcapacity and extension mergers, but unlike extension M&As they only occur domestically. These mergers allow the acquirer to benefit from economies of scale and scope. This is because mergers of companies in the same types of markets, though in different geographic regions, may contribute to market power and to earnings via market power.

Even though success in M&As is uncertain, research and practice suggest guidelines that improve the likelihood of success. Success depends on the M&A opportunity one faces, as well as the process by which one manages it. How the deal ends up depends on the opportunities, the constraints that you start with, and what you do along the way. Synergies are a key driver of the economic impact of the deal. However, benefits occur only if the synergies are realized. The recognition of a strategic threat or opportunity in the firm's competitive environment motivates most deals. The industry positions of the buyer and target are important determinants of the attractiveness of a deal. The firm may want to engage in M&A activity to acquire special capabilities and to improve its strategic position. Strategy impacts deal success. Successful acquirers must engage in an analysis of the strategic positions of the buyer and target. The buyer and target are unique in terms of their structure, leadership, and culture. The ability to achieve a successful union of the two organizations has an influence on the ability of the new firm to

realize merger synergies and strategic benefits. Failure to integrate well can kill a deal that, in theory, looked like a winner. As a result, successful acquirers plan for the postmerger integration stage. This appears to be more difficult for international and for nonhorizontal mergers, and as a result, more planning is required.

In this commentary we expanded upon the discussion on the factors associated with successful M&As as presented in Harrison and Liu's Chapter 40. Our discussion focused on the importance of those factors as they impact the valuation of the combined firm, the valuation of the acquirer and the target as separate entities, the price paid for the target, the expected benefits of the M&A, and the procedures implemented in order to realize the expected benefits during each stage of the M&A process. In sum, there is still much to learn about each, especially about how firms integrate, transfer, and manage the resources of the combined firm. This reinforces the need for research with a greater focus on acquisition implementation.

In addition, we updated the empirical evidence for the lodging industry, which was presented by Canina in Chapter 43, on the excess returns for the acquirer and the target for the more recent period of 2000 to 2006. The results remained unchanged from the period of 1982 to 1999. The excess return for both the acquirer and the target were positive. This result differs from that of the overall market where it has been found consistently that the excess return for the acquirer is at most zero and positive for only the targets.

We agree with Harrison and Liu (in Chapter 40) that the lack of an understanding of all of the factors underlying successful deals is partially due to this research methodology of analyzing the market stock price reaction of the acquirer and the target around M&A news announcement events. This type of methodology is capable of identifying the characteristics of the deals and the general characteristics of the firm that are associated with successful M&As.

However, this type of methodology is unable to identify the best practices associated with realizing the expected gains. Furthermore, this type of research does not aid valuation.

Since the financial market views M&As in the lodging industry as successful for both the acquirer and target on average, we believe that the lodging industry is a fruitful industry to further pursue M&A research. The Harrison and Liu chapter (Chapter 40) investigated on a case by case basis the specifics of several M&A deals for lodging and restaurant companies. Further research that expands upon the cases analyzed by Harrison and Liu is a worthwhile pursuit.

Exhibit 1. Number and Value of Mergers and Acquisitions by Year (January 1, 2000-September 20, 2006).

Announcement Year	Number of Mergers and Acquisitions	Total Value of All targets (\$ millions)	Mean Value of All Targets (\$ millions)
2000	301	\$26,067.70	\$86.60
2001	221	\$16,596.00	\$75.10
2002	247	\$18,392.48	\$74.46
2003	291	\$19,636.00	\$67.48
2004	286	\$46,036.84	\$160.97
2005	424	\$66,512.69	\$156.87
2006	297	\$41,843.88	\$140.89
Total	2067	\$235,085.59	\$113.73

Exhibit 2. Summary Statistics of Mergers and Acquisitions (January 1, 2000-September 20, 2006).

Number of M&As	2,067
Total value of targets (\$ millions)	\$235,085.59
Mean value of targets (\$ millions)	\$113.73
Announcement day average excess return	
Acquirer	0.07%
Target	4.25%

Exhibit 3. Summary Statistics of Mergers and Acquisitions: Acquirer and Target in the Same Industry Versus Different Industries

(January 1, 2000-September 20, 2006).

	Number of Mergers or Acquisitions	Percentage of Total Number	Total Value of All Targets (\$ Millions)	Percentage of Total Target Value	Mean Value of All Targets (\$ millions)	Announcement Day Excess Return	
						Acquirers	Targets
Different (nonhorizontal)	1578	76.34%	\$190,608.35	81.08%	\$120.79	0.04%	4.03%
Same (horizontal)	489	23.66%	\$44,477.24	18.92%	\$90.96	0.20%	5.64%
Total	2067		\$235,085.59		\$113.73 '	0.07%	4.25%

Exhibit 4. Summary Statistics of Mergers and Acquisitions International Versus Domestic (January 1, 2000-September 20, 2006).

	Number of Mergers or Acquisitions	Percentage of Total Number	Total Value of All Targets (\$ Millions)	Percentage of Total Target Value	Mean Value of All Targets (\$ millions)	Announcement Day Excess Return	
						Acquirers	Targets
International	493	23.85%	\$53,494.73	22.76%	\$108.51	-0.53%	2.06%
Domestic	1574	76.15%	\$181,590.87	77.24%	\$115.37	0.17%	4.68%
Total	2067		\$235,085.59		\$113.73	0.07%	4.25%

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