A New Age of Acquisitions in Hospitality & Tourism: The bidding war to acquire Starwood

Summary

In April 2015, numerous hospitality industry insiders speculated that Starwood Hotels and Resorts was open to being acquired. Since then, a number of companies have expressed interest in bidding for Starwood, including Hyatt, Marriott International, and Chinese companies such as Jin Jiang International Hotels, Hainan Airlines' parent company HNA Group, and sovereign-wealth fund China Investment Corp (Wei and Karmin, 2015). On November 16, 2015, Reuters reported that Marriott International, Inc. agreed to acquire Starwood Hotels and Resorts Worldwide, Inc. for US$12.2 billion, which would create the world's largest hotel company. However, Marriott's acquisition attempt ran into competition from a consortium of investors led by a Chinese firm - Anbang Insurance Group Co. Anbang has aggressively acquired U.S. assets, expanding its hospitality business in response to a high growth trend in the Chinese travel market.

On March 18, 2016, in an unprecedented action, Starwood dropped Marriott's bid and opted for a US$13.2 billion all-cash offer from Anbang with an estimated value of US$78 per Starwood share. Marriott then proposed a counter-offer of approximately US$13.6 billion, equating to US$77.94 per Starwood share. As Anbang sweetened its offer on March 28 to US$14 billion, Marriott refused to increase its offer price but confirmed that it was committed to accomplishing the acquisition. Marriott also publicly expressed its doubt as to whether Anbang was able to come up with the financing to acquire Starwood (Yu, 2016).

Abruptly, on March 31, 2016, Anbang Insurance Group decided to withdraw its all-cash offer of US$14 billion for Starwood Hotels & Resorts Worldwide Inc., and walked away from the three-week bidding war citing "various market considerations" as the reason for its withdrawal. The departure of Anbang from the deal to acquire Starwood cleared the way for the acquisition by Marriott International Inc. Starwood reaffirmed its commitment to a takeover by Marriott, and on April 8, 2016, Starwood and Marriott shareholders met and approved the merger, creating the world's largest hotel chain.

This case study highlights four classic theories of merger and acquisitions (M&A) that can be applied to explain the bidding attempts for Starwood by Marriott and Anbang, in addition to identifying potential causes of success and failure, impacts, and competitive influences of M&As. The competing theoretical and practical perspectives will ensure lively in-depth discussions and contextualize students' understanding of abstract theories.

Target Audience

The target audience for this case is senior-level undergraduate hospitality management, business management, or international business majors who are nearing the completion of their program. Potentially taught in a capstone course, this case would also be applicable in financial or managerial accounting courses, and strategic management courses. At the instructor's discretion, this case could also be modified for graduate level courses; however, for the purposes of organizing this teaching note, all instructions for the lesson plan herein will be directed toward senior-level hospitality undergraduate students.

Learning Objectives

Upon successful completion of reading the case, the assigned supplemental readings, viewing the videos, and preparing the discussion questions and related assignments, students will be able to:

- Connect financial performance information to a series of publicly reported organizational, managerial, and financial activities within firms.
- Interpret and apply four classic theories related to M&As which potentially can explain why these occur in a competitive global marketplace.
- Conduct research and synthesize pertinent and relevant evidence to support logical explanations for M&As.
- Evaluate and project the impacts of M&As from both the acquiring and acquired perspectives.

Theoretical Perspectives

A highly relevant, impactful, and up-to-date real-world case is presented to facilitate student learning and understanding of key motivations and impacts of M&As. The following four classic mergers and acquisitions theories were selected to provide rich theoretical perspectives for students:

- Efficiency theory (Porter, 1985)
- Monopoly theory (Porter, 1985)
- Valuation theory (Ravenscraft & Scherer, 1987)
- Empire-building theory (Black, 1989)

Lesson Plan

Learning Prerequisites

Before assigning the case, students should have prior knowledge of Financial Accounting and Managerial Accounting. In addition, to provide context for theory exploration, it would be helpful if students had prior exposure to hospitality and/or service industries operations and strategic management.

Lesson Structure

Three phases of learning are expected to occur when studying this case. To begin, students are expected to develop a general understanding of the four theories of M&As. Then, by analyzing information presented in the case and collected from additional readings, students are expected to carry out preliminary analyses with both qualitative and quantitative methods to explain M&As using the theories presented. Finally, students are expected to evaluate potential impacts and reasons of success and failure of M&As within a competitive hospitality market environment.

Students will be asked to prepare for the lesson by reading the case, additional materials, and watching the video clips. Because this case is ongoing and of a contemporary nature, students are required to research and provide updated information on the merger to bring the case to a current status. Prior to coming to class, students should have developed a general understanding of the case and relevant theories and should be able to carry out preliminary analysis to support discussions from the following topics (the instructor can provide reference to Trautwein (1990) so students may have an overview of these four theories):

- Efficiency Theory
- Monopoly Theory
- Valuation Theory
- Empire-building Theory
- Potential Causes of M&A Success
- Potential Causes of M&A Failure
- Potential Impacts of M&As
- Competition Impacts of M&As

Lesson Schedule

1. ***Assignment instructions:*** Due to the large amount of information required to prepare and execute the assigned discussion questions in the case, it is recommended to prepare students either online or in a face-to-face meeting ahead of the scheduled class activities. The instructor should assign the readings, videos, and Part I Discussion Questions either as homework, or as notes for small group discussion which will occur during class time.
2. ***In-class activities:*** It is estimated that the in-class small discussion group activities will require 60 to 90 minutes in order for students to attain a comprehensive understanding among their peers, and to adequately contextualize the concepts learned in class to real world events. The small groups could either represent different companies (Starwood, Marriott, or Anbang), or take different theoretical perspectives from Table 1. The instructor may break up the Part I Discussion Questions, depending on the time constraints.
    - *Group forming:* It is recommended for students to form small groups of no more than five per group for optimal results (2 minutes).
    - *Case synopsis:* Instructions will be provided to each group for producing a synopsis of the case with the main points highlighted (10 minutes).
    - *Question addressing:* The instructor will assign questions to the groups from Part I at the end of the case. Groups will share their individually prepared findings and come to a consensus as to the most feasible solution to their assigned question (15 minutes).
    - *Presentation*: A designated leader from each group will present the group's solutions to the class, allowing time for questions and debate (20 minutes). The instructor will pose guided questions based on the additional readings.
    - *Check for understanding:* In the remaining time (13 minutes), the instructor will ask the students to write a brief summary about their own opinions and perspectives on the main topics presented. Additionally, students will be asked whether their own opinions and perspectives changed as a result of the larger group discussion.
3. ***Essay question assignment:*** Prior to the end of class, the instructor should assign the individual essay question in Part II of the Discussion Questions of the case. As the students should be familiar with the theories presented in terms of M&As, they will be instructed to relate these theoretical perspectives to the timeline of events from the Marriott-Starwood-Anbang bidding war. Papers/submissions will be collected and/or graded at the instructor's discretion.
4. ***Assessment***: Depending on the modality of the course and the time allowed for the case, the instructor will assign small group presentations (using the same groups from the previous activity), allowing students in-class time, or time outside class to prepare. The small group presentation should be centered on the group's collective interpretation, application, and justification of potential M&As theories, with reference to details from the essay question. An assessment rubric for the group presentation is provided at the end of this teaching note.

Analysis of Discussion Questions

The following is an in-depth analysis to provide the instructor with a guideline for interpreting and grading students' work:

Part I. Discussion Questions Analysis:

Question 1: *Since the merger of Marriott and Starwood in April of 2016, what new developments or consequences have occurred in the merged company?*

Due to the contemporary nature of this case, there should be regular updates on the facts related to this merged company. Some statistics include, but are not limited to, the number of rooms and hotels, the number of countries this company has gained presence and market share, the number of brands, the current stock price, annual sales and net income, any new loyalty programs, etc. Negative consequences could also follow from this merger and can be updated, such as breakdown of the merged company, significant profit and sales shrinkage, stock price drop and reported cultural misfit.

Question 2: *Where else in recent history have we seen similar mergers and acquisitions in the hospitality and tourism industry (i.e. hotels, restaurants, airlines, etc.)?*

A few examples in the restaurant industry include:

- 2014 merger of Burger King and Tim Horton's.
- Darden sold Red Lobster to Golden Gate Capital for US$2.1 billion in May, 2014.
- Roark Capital Group, the Atlanta-based private equity firm that in recent years bought such giants as Arby's and CKE Restaurant Holdings Inc.
- In short, since 1989, the Chain Restaurant Merger and Acquisition Census has captured over 2,800 transactions since 1989, including quick service, fast casual, full service, food service management and cafeteria/buffet firms (Epstein, 2014).

A few examples in the hotel industry include:

- AccorHotels acquired Onefinestay for €148M (US$168 million) in April of 2016.
- Blackstone paid about US$4 billion for Strategic Hotels & Resorts Inc. in 2015 and later sold it to Anbang for US$6.5 billion in March of 2016.
- Accor Bought Fairmont, Raffles and Swissotel Brands for US$2.9 billion in 2015.
- Interval Leisure Group bought Starwood's time-share business for about US$1.5 billion in 2015.
- Marriott acquired the Gaylord brand and hotel management company for US$210 million in 2012.
- Accor sold Motel 6 to Blackstone Group for US$1.9 billion in 2012.
- Blackstone Group LP took Hilton private for more than US$18 billion and US$7 billion in assumed debt in 2007.

A few examples in the airline industry include:

- US Airways and American Airline in a deal of US$11 billion in 2013.
- Southwest Airlines purchased AirTran for US$1.4 billion in 2011.
- United and Continental Airlines merged in May 2010 for a deal of US$3 billion.
- Delta and Northwest Airlines merged for a deal of US$17.7 billion in 2008.

Question 3: *After reading the letter from then Starwood's CEO Mr. Tom Mangas, what operational and other business-related adverse consequences on Starwood do you anticipate has happened as a result of the merger*?

- Employees of Starwood would expect layoffs after the merger, as the new company strives to improve efficiency in all potential aspects.
- Starwood may lose some of its brands as a result of the merger. For example, Sheraton and Westin hotels compete directly with Marriott Hotels and Resorts-branded hotels, and could be targets for significant changes.
- Cultural fit of Marriott and Starwood can also be an issue as the culture and philosophy behind the two business models may not be well aligned within the short time window of merging. Marriott core values (http://www.marriott.com/culture-and-values/core-values.mi) are stated as "putting people first, pursuing excellence, embracing change, acting with integrity and serving our world". While Starwood (http://www.starwoodhotels.com/corporate/about/values/index.html?language=en_US) believes in "Go the Extra Step", "Play as a Team" and "Do the Right Thing".
- Starwood has a world renowned loyalty program Starwood Preferred Guest (SPG), and as the merger finalizes, participants of this program may find their SPG points not as lucrative as they used to be. One example is that the point redemption value might appear less valuable for elite-tier Starwood members if the Marriott Rewards program policies are used for the SPG program.

Question 4: *Using the financial information figures in the Appendix A, explain why Starwood put itself up for sale.*

- Based on Figure 1, the market value of Starwood reached a stagnant stage since 2014 and even worse, started to decline, which could have been a reflection of market pessimism on the future of this company and inability of the company to improve its financial performance. The income statement summaries in Figure 2 were more alarming from an operational perspective. Starwood revenue had been declining since 2012, along with net income and net operating income. There had been no sign of improvement. Lackluster performance of Sheraton and select service properties could have been two key reasons.
- The capital structure in Figure 3 also indicates leverage increases since 2013 and could lead to more business and financial risks. The statement of cash flow summaries in Figure 4 sends consistent messages as Figure 2. As revenues and incomes continued to decline since 2013 (Figure 2), cash flows from operating activities had shown a similar pattern of decline since 2012 (Figure 4). As a hotel

company, it appears that Starwood was losing ground on its core business. However, some good signs can also be observed from Figure 4, as Starwood started to sell its assets since 2013 to pay down its debt, indicated by the increasing cash inflows from investing activities and increasing cash outflows in financing activities. These activities reflect Starwood's attempts to focus more on managing and franchising business models while trying to be less capital intensive, which can be an effective option to improve operations efficiency, as well as adding value to shareholders.

- In short, Starwood's inability to improve its performance and value resulted in three major top-level executive changes in 2015. It appeared Starwood was facing significant challenges to improve from within and needed to "explore a full range of strategic and financial alternatives to increase shareholder value," (Business Wire, 2015) therefore, selling itself may have been one of the alternatives to achieve the goal of adding shareholder value.

Question 5: *Based on the financial information figures in the Appendices A and B, discuss how stock prices influenced those internal management activities of Marriott and Starwood between 2015 and 2016.*

- Stock prices in Figure 1 exhibited clear stagnancy and decline for Starwood between 2015 and 2016. Combined with income statement summaries in Figure 2 which further supported Starwood's performance decline since 2012, it appears that Starwood was unable to improve its performance. As a result, Starwood lost three top-level executives and openly "explore[d] a full range of strategic and financial alternatives to increase shareholder value," (Business Wire, 2015) including putting itself up for sale.
- Stock prices in Figure 5 reflected successful performance improvement and market optimism of Marriott, which was supported by its consistently increasing sales and net income (Figure 6) and clear strategy to emphasize management and franchise businesses--Marriott started to sell its tangible assets to pay down its debt, embarking further on accelerated growth in intangible assets (Figure 7 and 8). As a result, the leadership at Marriott was well poised to grow via further M&As.

Question 6: *Based on Figures 9 and 10 in Appendix C, and information from this case, explain why stock prices of Marriott and Starwood exhibited the observed behaviors between January of 2011 and April of 2016.*

- Between 2014 and November of 2015, Marriott appeared to significantly and consistently outperform Starwood, as indicated by its stock price change consistently above that of Starwood (Figure 9). It is worth noting that before 2014, both companies' stock price changes were very closely correlated, indicating similar market reaction or belief about their future development.
- Since November of 2015, because Marriott announced its bidding for Starwood, stock price changes of Marriott and Starwood started to become highly correlated, which was expected as the market considered these two companies as one, and therefore, priced them similarly. However, Anbang joined the bidding to acquire Starwood and raised the bidding offer to US$14 billion. Immediately, the stock price of Starwood observed a significant increase to reflect a higher valuation (Figure 10). Later on at the end of March when Anbang dropped out of the bidding, the stock price of Starwood declined accordingly to reflect the Marriott new bidding price of US$13.3 billion, a 15.6% increase from its previous bidding price.

Part II. Essay Question Analysis:

Mergers and acquisitions (M&As) have mesmerized and fascinated both professional experts and academia alike for a long time, resulting in a series of classic but abstract theories trying to understand and explain why M&As take place. Four classic theories of M&As are pertinent to this case (see Table 1) and to the events which occurred during the bidding war. Using those theoretical perspectives listed below (guided by the seminal articles referenced in the last column of the table) and the two assigned readings from the case, allocate one or more theories to explain the bidding activities which occurred within each company (i.e. Starwood, Marriott, and Anbang). Provide a detailed explanation, which should include justification from the financial figures in the appendices and relevant public information found in your own research.

Four classic theories of mergers and acquisitions (M&As) are pertinent to this case and they are not mutually exclusive. First, efficiency theory contends that achieving synergies is the driving force behind M&As (Porter, 1985). Potential efficiency improvement can result from financial, operational and managerial synergies after M&As (Trautwein, 1990). Marriott's interests and bidding for Starwood can be largely explained by this theory, as Marriott could benefit from at least US$200 million in annual cost savings in the second full year after closing. In addition, post-merger asset sales would increase efficiencies and accelerate unit growth, which would result in improved earnings. Starwood's capital recycling program can generate about US$1.5 to US$2.0 billion of after-tax proceeds from the sale of owned hotels over the next two years. Moreover, economies of scale can significantly increase efficiency in areas such as reservations, procurement and shared services. Additional customer loyalty and revenue increases can also result from the combined sales expertise and increased account coverage, which should improve property-level profitability, in addition to owner and franchisee preference for brands of the merged company (Marriott, 2015). Evidence can also be observed in the income statement summaries over the last five years (Figures 2 and 6). Marriott has consistently improved both the top and bottom line, while Starwood has remained relatively stagnant and even started declining since 2012. It is possible that Marriott leveraged its capabilities for improving the business model and performance to unleash hidden potentials in Starwood after the acquisition. One unfortunate consequence of pursuing efficiency by M&As, however, usually is layoffs in the acquired company, which was expected to be a painful experience for Starwood employees. However, a leaner cost structure and improved revenue usually will add value to company shareholders and therefore would be welcomed.

Second, monopoly theory argues that pursuing bigger market power leads to M&As (Porter, 1985). One direct result of this acquisition is the birth of the largest hotel company on this planet, boasting more than 5,500 hotels in over 100 countries, spanning across 30 brands. The merged company will effectively deter potential competitors from entering the firm's market because of this concentric acquisition. In addition, this merger will act as an effective response to online travel agencies and home-sharing companies such as Airbnb and Homeaway. By leveraging Marriott's worldwide development organization and owner and franchisee relationships, the merged company can also accelerate the growth of Starwood's brands, resulting in a broader global footprint and strengthened capability to serve guests wherever they travel. In addition, leveraging Starwood's first-mover advantage in the lifestyle category and Marriott's broad range of brands in this segment, the merged company will be positioned as the leader in the lifestyle space and expect to accelerate growth of its lifestyle brands (Marriott, 2015). The income summaries in Figure 6 also provide evidence that Marriott has been successfully increasing its sales and profits over the recent years. In particular, the capital structure and statement of cash flow Figures 7 and 8 indicate that Marriott had begun to sell its tangible assets to pay down its debt while maintaining its revenue improvement trend, setting the stage for the company's further movement into the managing and franchising space with accelerated growth opportunities.

Third, valuation theory takes the perspective of unleashing potential unrecognized value of the acquired company, because managers of the acquiring company have better information about the value of the acquisition target than does the stock market (Ravenscraft and Scherer, 1987). With 20 years of experience in the hotel industry, Arne Sorenson worked his way up to the top of Marriott. Before his current position as president and chief executive officer of Marriott, he worked as Marriott's executive vice president, chief financial officer and president of continental European lodging. Prior to joining Marriott in 1996, he was a partner with the law firm Latham & Watkins in Washington, D.C, specializing in mergers and acquisitions litigations. His experience gives him an advantage in not only possessing a complete understanding of the hotel business, but also an in-depth command of M&As. It is likely that he recognized the potential values within Starwood unnoticed by the market in general. In addition, Marriott's bid included a small portion of cash with the majority paid by Marriott stocks, specifically, one share of Starwood common stock exchanges for .92 share of Marriott common stock. After the acquisition, Starwood shareholders would own 37% of the new merged company. This arrangement also suggested the leadership at Marriott was confident in the future development of the merged company, because the market would quickly realize the unrecognized value of the merged company and price it accordingly. It is expected that the merged company will be able to return at least US$2.25 billion in dividends and share repurchases to shareholders in the first year following the merger. In addition, attractive shareholder returns will follow because of Marriott's management and franchise strategies that minimize capital investment in the business (Marriott, 2015). Evidence is observed in Figure 9 as Marriott consistently outperformed Starwood from 2014, which could be an indication of unique managerial knowledge about the business model. This unique piece of knowledge can then be utilized to improve Starwood's performance after the merger. Starwood's Sheraton brand and select service properties were widely recognized as underperforming, yet Starwood had not been able to make a turn-around in these two areas. It appears that Marriott, with its management and franchise expertise and strong owner franchise relationships, was poised to make a difference after the acquisition.

Fourth, empire-building theory believes that managers are driven by their own interests and utility maximization. If the managers of the acquiring company believe M&As are beneficial to their own interests, they will plan and execute M&As, regardless of whether such endeavors are in the best of interest of shareholders (Black, 1989). It is not likely that this theory applies to Marriott in this case, given Arne Sorenson's deep history with Marriott and successful acquisitions in the past of many major hotel firms, such as AC Hotels, Gaylord Hotels, Protea Hospitality Group, and Delta Hotels in recent years. Moreover, Marriott has consistently improved its performance over the years, indicating that previous acquisitions were satisfactory to its shareholders. Marriott's success should be a reflection of its command in the business model, corporate culture, and branding. Anbang, on the other hand, is a private company, which was barely known to the general public until its recent active acquisition activities in the hospitality industry. Given its latest acquisitions are, in general, bearing low investment return expectations and carrying high exposure and image potential, empire-building theory could be a reasonable explanation. Anbang's dropping-out of the bidding for Starwood may have very well been attributed to a regulatory related issue in China. There were indications that Anbang exited the bidding because it encountered trouble in financing or approval. In particular, it may have exceeded its overseas investment quota set by the Chinese government.

Lastly, these four theories are not mutually exclusive. For example, a company can bid for a target company because its manager possesses a unique piece of information, such as a client list about the target company, which if used properly after the acquisition, can significantly improve operations efficiencies of the merged company and lead to significant increases in market power.

Assessment

To assess students' comprehension and ability to contextualize the timeline of the Marriott-Starwood merger using financial data and M&As theories, students will be assigned in small groups to create a presentation demonstrating their collective knowledge on the essay assignment from the Part II essay question. It is recommended that students include three to five references other than those provided in the assigned readings and references of the case. The following rubric is based on a 10-point scale, which may be adjusted to align with the existing grading scales within the course. The details for the last two criteria in the rubric (Spelling & Grammar and Formatting & Presentation) will be left to the discretion of the instructor.

Analysis of the Learning Objectives

Upon successful completion of reading the case, the assigned supplemental readings, viewing the videos, preparing the discussion questions and related assignments, students will be able to:

1. *Connect financial performance information to a series of publicly reported organizational, managerial, and financial activities within firms.*

   Specific analysis techniques such as horizontal and vertical analyses are powerful tools to use when trying to identify and explain the driving forces behind financial information. In addition, fundamental analysis and present value model are commonly recognized methods to facilitate understanding and interpreting financial information from a valuation perspective.

2. Interpret and apply four classic theories related to M&As which potentially can explain why these occur in a competitive global marketplace.

   By comparing and contrasting, contextualized analyses can be carried out with mastery of key theoretical arguments and principles. In other words, M&As do not exist in void, information about potential acquirers and the target need to be understood within a specific and competitive industry context.

3. Conduct research and synthesize pertinent and relevant evidence to support logical explanations for M&As.

   Two perspectives can be taken for this objective: grounded theory or hypothesis testing. On the one hand, students can collect information related to a particular M&A, and then by

Criteria	Ratings				Points
Identification and Contextualization of Chosen Theories	Students demonstrate an enhanced understanding of the link between theory and context through incorporation of relevant materials that go beyond those provided in the case (4 pts)	Students demonstrate an understanding of the link between theory and context through incorporation of relevant materials provided in the case (3 pts)	Students' presentation is complete but does not reflect an understanding of the theories or context using the case materials as a basis (2 pts)	Items are missing OR the presentation is incomplete (0 pts)	4
Use of Qualitative and Quantitative Information (Financial Data) for Justification	A minimum of six analyses are conducted and explanations provided in the presentation (4 pts)	A minimum of four analyses are conducted and explanations provided in the presentation (3 pts)	Three or fewer analyses are conducted and explanations provided in the presentation and/or no quantitative analysis (2 pts)	No analyses are conducted OR the presentation is incomplete (0 pts)	4
Spelling & Grammar	No spelling or grammatical errors (1 pt)	One spelling or grammatical error (0.5 pts)	Two spelling or grammatical errors (0.25 pts)	Three or more errors/ incomplete (0 pts)	1
Formatting & Presentation	No formatting errors (1 pt)	One formatting error (0.5 pts)	Two formatting errors (0.25 pts)	Three or more errors/ incomplete (0 pts)	1
Total Points Possible					10

analyzing the information at hand, can identify explanations. Alternately, students can first resort to a particular theory and then collect data to test if the theory is supported.

4. Evaluate and project the impacts of M&As from both the acquiring and acquired perspectives.

   Based on information collected, students are expected to understand the motivations and goals of M&As by proficiently executing 1, 2, and 3 above, which can then be used as guidelines for students to assess and forecast potential impacts of M&As.

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