

## Which Type of M&A Makes an Acquiring Restaurant Firm a Star? Profit-Driven versus Growth-Driven M&A

### Abstract

This study identifies whether profit-driven or growth-driven mergers and acquisitions (M&As) are more beneficial to a restaurant firm aiming to achieve profitable growth after an M&A. The results indicate that, despite the challenges that must be overcome to achieve profitable growth through M&As, profit-driven acquiring firms are more likely to have better post-M&A operational performance than growth-driven acquiring firms. Therefore, this study suggests that when restaurant firms seek to grow their business through M&As, they should pursue this goal after achieving higher operational profitability, along with better cost controls, supply management, and marketing strategies, rather than optimistically adhering to growth strategies before accumulating any internal, market-based competitive strengths.

**Keywords:** *profit-driven M&A, growth-driven M&A, pre- and post-M&A, operational profitability.*

## **1. Introduction**

Fast firm growth is often considered to be a forerunner to significant business success. For example, the media features stories of successful entrepreneurs who have achieved substantial firm growth within short time periods, including Steve Jobs (former CEO of Apple), Jeff Bezos (CEO of Amazon), Mark Zuckerberg (CEO of Facebook), and Zack Ma (CEO of Alibaba). For these remarkably large global companies, mergers and acquisitions (hereafter, M&As) are one of the most frequently used business strategies to rapidly expand capacities and enhance competitive advantages in the market.

In the last two decades, the U.S. restaurant industry has also experienced an unprecedented level of consolidations. U.S. restaurants completed approximately 2,957 M&As between 1981 and 2016: on average there were 66 M&As per year between 1981 and 2003 and 112 M&As per year between 2004 and 2016 (about 70% increase every year) (Kim, 2006; Peakstone, 2015, 2019). Recent data further indicates that the number of restaurant M&As increased by 86% and the median deal size has also increased by about 183% between 2004 and 2016 (Aaronallen & Associates, 2018). The fervor for M&As is based on the belief that gains accrue to the merged entity by achieving superior firm growth and operational profitability compared with firms relying on organic growth. An acquiring firm may enjoy operational benefits from increased market share and market power after an M&A because it can better control the prices, quantities, and quality of products in the marketplace (e.g., Gaughan, 2007; Kumar & Sharma, 2019; Sharma & Ho, 2002; Singh & Montgomery, 1987). In addition, the acquiring firm's superior resources can replace the acquired firm's inefficient resources during an M&A (Garzella & Fiorentino, 2017; Kumar & Sharma, 2019; Trautwein, 1990).

Despite the seemingly rosy perspective, numerous studies have argued that more than half of M&As actually destroy the value of acquiring firms (Kumar & Sharma, 2019; Lewis & McKone, 2016; Renneboog & Vansteenkiste, 2019). There is little direct evidence that M&As have a positive effect on either the financial or operational performance of acquiring firms. Paradoxically, although shareholders of acquired firms are more likely to enjoy positive short-term returns (Agrawal & Jaffe, 2000), scholars have more commonly found negative abnormal returns for acquiring firms' shareholders following acquisitions (Akbulut, 2013; Goranova et al., 2017; Goukasian et al., 2019; Harford, Humphery-Jenner, & Powell, 2012; Lavie & Miller, 2008; Malmendier, Moretti, & Peters, 2018; Moeller, Schlingemann, & Stulz, 2005). Moreover, the negative operational performance of acquiring firms after M&As calls into question the effectiveness of M&As as a popular strategy for business growth (e.g., Dickerson et al., 1997; Fu, Lin, & Officer, 2013; Malmendier et al., 2018; Renneboog & Vansteenkiste, 2019; Rozen-Bakher, 2018).

In addition, the empirical evidence shows that high levels of growth are not always associated with high levels of profitability, but instead could actually constrain a firm's profitability (Aaker & Day, 1986; Delmar, McKelvie, & Wennberg, 2013; Federico & Capelleras, 2015; Fuertes-Callen & Cuellar-Fernandez, 2019; Soininen et al., 2012; Zhou & Park, 2020). These findings clearly indicate that fast firm growth is not necessarily a predecessor of high levels of operating profit but instead can act as an interrupter. The question then is: Why do some M&As positively impact acquiring firms' shareholders and business performance? In other words, why do some firms perform better than others after M&As and under what circumstances? These questions are particularly relevant to the restaurant industry, considering more than half (53.06%) of new restaurants fail within 5 years: if 1,000 restaurants enter the

market every year, more than 531 restaurants (i.e., 150 in year 1, 127 in year 2, 100 in year 3, 84 in year 4, and 70 in year 5) would fail every year after five years and be potential M&A targets (Healy & Mac Con Iomaire, 2019). Particularly, the prospects of M&As are poised to accelerate because nearly two-thirds of public restaurants face the risk of bankruptcy as the COVID-19 pandemic batters the industry in 2020 (Patton & Shanker, 2020). The answers could be strategically applied to minimize financial and operational losses after consolidations.

Under non-M&A circumstances, Davidsson et al. (2009) and Jang (2011) suggested that, even though most companies aim to achieve both growth and profitability at the same time, in practice, growth-focused companies are less likely to achieve higher levels of long-term profitability than their counterparts. These findings demonstrate the way in which a firm's business performance can be differentiated by its strategic choices or emphasis between growth and profitability. Furthermore, the evidence indicates that a firm's growth and profitability are different dimensions of business performance and, thus, should be considered idiosyncratically. Hence, although the findings may not be directly applicable in an M&A environment, comparing the business performance of growth-driven and profit-driven acquiring firms would shed more light on the effectiveness of M&A strategies.

The approach, which considers a firm's growth and profits separately, is also meaningful for understanding why certain restaurant firms perform better than others after an M&A. Both sustainable business growth and high levels of operational profitability are important strategic goals and neither one should be overlooked for acquiring firms, similar to internally grown firms (Garzella & Fiorentino, 2017; Giudici & Bonaventura, 2018; Kumar & Sharma, 2019; Rozen-Bakher, 2018; Sharma, & Ho, 2002). Even so, acquiring firms must prioritize either business growth or high levels of operational profitability since available resources are limited, and one

may not spontaneously follow the other (e.g., Chakravarthy & Lorange, 2008; Delmar et al., 2013; Fuertes-Callen & Cuellar-Fernandez, 2019; Jang & Park, 2011; Lee, 2014; Zhou & Park, 2020). Accordingly, the different business practices and strategic focuses of growth-driven firms cause different post-M&A performances to those of profit-driven firms (Malmendier et al., 2018; Zhou & Park, 2020). For example, growth-focused firms are more likely to pursue faster growth and make risky investments with costly external financing than profit-focused firms planning to reduce redundant resources, which would influence their operating performance and financial position differently (Davidsson, Steffens, & Fitzsimmons, 2009; Fuertes-Callen & Cuellar-Fernandez, 2019; Zhou & Park, 2020). The difference in business performance is more substantial under M&A circumstances, because M&A procedures cause drastic changes in an acquiring firm's operational (i.e., consolidating management structures) and financial conditions (i.e., issuing lump sum debts or stocks and acquiring assets) within relatively short periods of time.

Although these different strategic paths weave the relationships among growth, profitability, and survival in different ways (Delmar et al., 2013; Zhou & Park, 2020), no previous studies have considered these two complementary dimensions simultaneously in restaurant M&A settings. Furthermore, Rozen-Bakher (2018) suggests that acquiring firms' pre-M&A revenue and profitability are more important indicators for post-M&A success than those of acquired firms. Therefore, the main purpose of this study was to investigate the direct relationship between business growth and operational profitability in restaurant firms that acquire other firms. In addition, this study aimed to identify whether or not restaurant firms are more likely to achieve profitable growth when M&As are profit-driven versus growth-driven. This study extends Davidsson et al.'s (2009) model, and the results are compared with Jang's

(2011) findings in restaurant M&A settings, since both studies exclusively focus on internal growth. This study contributes to improving both restaurant managers' and shareholders' understanding of the strategic effectiveness of M&As as a path to profitable growth.

## **2. Literature review**

### *2.1 Positive versus negative effects of M&As on post-M&A performance*

A survey of CFOs shows that the most important motive for M&As is operational synergy (37.3%) in four areas: financial economies, differential efficiency, increased market shares, and, most importantly, operational economies (Garzella & Fiorentino, 2017; Kumar & Sharma, 2019; Mukherjee et al., 2004; Renneboog & Vansteenkiste, 2019). Operational efficiencies are achieved through greater economies of scale, which improves productivity by minimizing fixed unit costs or reducing costs through purchasing and production. Houston et al. (2001) focused on 41 M&A cases in the banking industry and found that most of the benefits from M&As arise from opportunities to eliminate overlapping operations, such as redundant managerial positions, back offices, and branches. Cost savings represent the primary motivation and gains. For banking M&As, revenue enhancements are far less important than cost savings. However, returns from securities in the market also show a strong positive relationship for both the bidder and target banks due to expected cost savings, although the market returns were significantly less than the expected benefits from the management's cost savings projections (Houston et al., 2001). Cummins et al. (1999) also found strong evidence that M&As can significantly improve acquired firms' profitability through cost reductions, technological improvements, and revenue enhancement, in comparison to non-M&A firms.

There is empirical evidence suggesting that acquiring firms leads to insignificant gains in performance after M&As. Malmendier et al. (2018) suggested that an acquiring firm's operating profitability significantly drops after an M&A since the inferior operating efficiency of an acquired firm drags down the operating performance of the consolidated entity. Ravenscraft and Scherer (1987) examined the profitability of acquired U.S. companies after their acquisitions and found that profitability either deteriorated or only improved insignificantly. Roll (1986), Doukas and Petmezas (2007), and Malmendier and Tate (2008) explained this adversarial phenomenon in terms of the hubris hypothesis. Even if a firm experiences gains from an M&A, at least part of the gains are rooted in valuation errors, hubris, overconfidence, or over-optimism playing a role in the merging firms' valuation of synergistic gains (Baker et al., 2005). These errors negatively impact M&A transactions and post-M&A performance (Aktas, De Bodt, & Roll, 2009).

Meanwhile, Delong (2001) argued that growth-focused M&As motivated by geography (i.e., concentrating on certain locations) or activities (i.e., focusing on similar business activities including products and marketing) could enrich the merging firm's shareholders. In Delong's (2001) study, M&As lead to expanded market shares within the same geographical market or similar products increased shareholders' value more than M&As that resulted in diversified geographical areas or activities. More recently, Maksimovic, Phillips, and Prabhala (2011) and Li (2013) also supported the positive effect of acquiring firms' market share on their operating performance. Nevertheless, many other studies did not find any prominent benefits related to an acquiring firm's profitability due to growth-focused M&As. Mueller (1985) and Eckbo (1992) revealed that enhanced market share or market position are not necessarily related to a merging firm's profitability in a positive way and sometimes have negative effects. Mueller (1985) also argued that the effect of an M&A on market share does not directly imply anything about a

merging firm's profitability or shareholders' values because certain types of horizontal mergers could cause merging firms' market shares to decline, even as profits increase (Salant et al., 1983).

Similarly, Gartner (1997) argued that companies that grow rapidly cannot operate profitably due to serious organizational challenges and, on average, the performance of frequently acquiring firms constantly deteriorates across the deals (e.g., Ahern, 2010; Aktas et al., 2009; Laamanen & Keil, 2008; Rozen-Bakher, 2018; Sharma, 2013). For example, the need to expand capacity requires additional space and new employees and equipment, which in turn calls for shifts in organizational structure, training systems, and HR policies. Rozen-Bakher (2018) specified that a company's over-increased workforce size intensifies the risk of the trade-off between revenue growth and operating profitability due to higher management costs and potential organizational conflicts during integration processes, which damage the efficiency gains (e.g., Giudici & Bonaventura, 2018; Weber, Tarba, & Bachar, 2011). Periods of rapid growth are unusually short and often produce performance problems, meaning that firms with more moderate growth have higher profits and generate more value for shareholders (Nicholls-Nixon, 2005).

Under non-M&A circumstances, both Davidsson et al. (2009) and Jang (2011) posited that firms with high profits but low levels of growth are better at establishing profitable growth than firms with low profits but high levels of growth. In other words, both studies revealed that sales growth does not consistently lead to increased profitability, whereas profitability does have a positive effect on sales growth. In the highly competitive restaurant industry, growth strategies are often implemented at the expense of profit and cannot guarantee profitable long-term growth (Chathoth & Olsen, 2007). Jang and Park (2011) also suggested that a growth-focused strategy



may not be desirable for a restaurant firm's long-term operational performance. Their analysis shows that a restaurant firm's sales growth in the previous year negatively impacts the firm's profitability in the current year.

In contrast, profit-focused strategies that create considerable value above costs and allow a firm to charge higher prices than other companies are not easy to achieve. That is, maintaining high profits for popular menu items, such as burgers, fried chicken, or pizza, is extremely challenging because other restaurants can easily duplicate these products. Nevertheless, there are some firms that have maintained high levels of profitability, such as McDonalds. If a restaurant firm focuses on attaining high profits rather than other goals, then it is more likely to have special strengths in areas such as operational efficiency, employees, services, tastiness of food, recipes, relationships with suppliers, location, and/or ownership. In other words, intangible values that cannot be easily duplicated by competitors and require a long time to develop are critical to maintaining higher profits. Furthermore, profitable restaurant firms are in an enviable position in terms of achieving further growth because they can use surplus resources from high profits, such as retained earnings and low levels of financial leverage. In contrast, growth-focused restaurant firms may deplete their internal and external financial resources by pursuing high levels of growth. Consequently, profitable restaurant firms are more likely to have growth potential, while rapidly growing restaurant firms with low profits (e.g., growth-focused firms) are more likely to experience reductions in future growth.

By taking both M&A and non-M&A circumstances into account, this study emphasized a few key points. First, the advantages of economies of scale in M&A settings are more likely to be achieved through a unique combination of resources and capabilities, which may require the elimination of inefficient organizational systems in either the acquiring or target firm (e.g.,

operational synergies), rather than simply combining the two organizations (Karmin & Mitchell, 2000). However, as Rabier (2017) argued, realizing operational synergies can be a double-edged sword because the process of combining resources and capabilities can generate both significant gains for the acquiring firm but also significant challenges. Even just a few poor decisions may substantially destroy the value of the acquiring firm. Therefore, if a restaurant firm is not able to develop high levels of operational and managerial strength before acquiring other firms, then the firm is more likely to be exposed to these downsides. Second, growth-focused firms have to deal with a new business environment after rapid growth without acquiring enough local knowledge about new markets, customers, and employees. Accordingly, growth-focused firms potentially have little room left to manage unexpected challenges during the consolidation process compared with profit-focused firms, which negatively influences the performance of growth-focused firms. Therefore, the following hypotheses were proposed:

*Hypothesis 1. An acquiring restaurant firm's profitability has a significantly positive effect on its sales growth after an M&A.*

*Hypothesis 2. An acquiring restaurant firm's sales growth has a significantly negative effect on its profitability after an M&A.*

*Hypothesis 3. An acquiring restaurant firm's pre-merger profitability has a significantly stronger positive effect on its post-merger profitable growth than its pre-merger sales growth.*

## *2.2 M&A studies in the hospitality industry*

Since 1990, several studies have examined M&As in the lodging industry, but scholars have only recently begun to investigate the M&A activities of restaurant firms. Table 1 summarizes M&A research conducted in the context of the hospitality industry. As shown in Table 1, the two main M&A performance measurements used in the literature are the stock market's reaction to M&A announcements (Kwansa, 1994; Canina, 2001; Yang et al., 2009; Canina et al., 2010; Ma et al., 2011; Chatfield & Dalbor, 2011; Dogru, 2017) and post-M&A operational performance measured by sales growth, ROA, and ROE (Hsu & Jang, 2007; Park & Jang, 2011). However, stock market valuation has received more attention than accounting information.

Although most studies found negative stock returns for acquiring firms after M&A announcements (Bhagat et al., 2005; Dong et al., 2006; Moeller et al., 2007; Hackbarth & Morellec, 2008; Bouman et al., 2009), both acquiring and target lodging companies displayed significant positive stock returns following M&A announcements (Canina, 2001; Yang et al., 2009; Ma et al., 2011). Canina (2001) also found that a favorable reaction from the stock market accrues to both acquiring and target lodging firms, although the gains are much greater for target firms. Yang et al. (2009) reports significant positive stock returns for acquiring lodging firms and REITs in the long term. Ma et al. (2011) revealed that M&As increase the value of acquiring lodging firms and that the increases were more significant when large, unlisted companies merged with small, listed companies. In addition, Dogru (2017) found that the value of acquiring firms can be influenced by corporate governance, financial constraints, and organizational structure.

In terms of operational performance, Kim and Canina (2013) found that creating value is an important motivation for M&As, and the acquiring firm's M&A premium has a positive effect

on post-acquisition performance (revenue per available room and operating income per available room) in the lodging industry. On the other hand, Hsu and Jang (2007) suggested that M&As in the hotel industry have a significant negative effect on the acquiring firm's profitability, as measured by ROA and ROE. However, Park and Jang (2011) only reported positive sales growth for acquiring restaurant firms in the first and second years after an M&A, which calls into question the effectiveness of M&As as a way of achieving sustainable growth. This is the only study to date that has examined the operational performance of acquiring restaurant firms.

Despite the paucity of academic research, the restaurant industry has very distinctive features in terms of M&A activities. First, private equity firms (Sun Capital Partners, Roark Capital Group, Argonne Capital Group, etc.) are actively acquiring franchise/multi-unit/mid-sized restaurant brands that are in trouble, and more than 40% of the largest restaurant franchisees are owned by private-equity companies (Aaronallen & Associates, 2020). Second, acquiring firms can buy restaurants from many franchisees and re-sell them to other franchisees or companies (i.e., Applebee's, Panera Bread, and Buffalo Wild Wings), which increases M&A activities in the restaurant industry (Maze, 2018). Furthermore, lethargic same-store-sales growth due to intense competition and high restaurant failure (15% after one year, 37.62% after three years, and 53.06% after five years in business) is also increasing M&A endeavors (Healy & Mac Con Iomaire, 2019). However, the benefits have mostly been accrued by firms owned by private-equity companies. As a result, many of the biggest restaurant brands, such as Burger King (3G Capital), Panera Bread (JAB Holding Company), and Buffalo Wild Wings and Arby's (Roark Capital Group), are owned by private-equity companies that most customers don't know exist. It is surprising that limited attention that has been paid to M&A performance in the restaurant industry given the magnitude and frequency of M&A activity. Moreover, restaurant companies

continuously drop out of the fastest growth races due to M&As. Therefore, this study intends to fill this research gap by focusing on the effects of M&As on acquiring firms' operational performance and provides insight into the validity of M&A strategies as a vehicle for sustainable growth in the restaurant industry.

(Insert Table 1 Here)

### **3. Methodology**

#### *3.1 Data*

This study used restaurant firms' financial information from the COMPUSTAT database and M&A data from CRSP. The financial information of publicly traded restaurant firms (defined as those with a Standard Industry Code (SIC) of 5812) in the U.S. from 1980 to 2016 form an unbalanced panel dataset. Restaurant firms that did not have financial information from the year before an M&A to two years after were excluded from the sample. The resulting dataset consisted of 4,007 observations with 150 acquiring restaurant firms (see Figure 1). In the current study, acquiring restaurant firms only include public restaurant firms that acquired restaurant firms.

(Insert Figure 1 Here)

#### *3.2. Data Analysis*

All restaurant firms that acquired other restaurants were divided into four sub-groups:

“Star,” “Profit,” “Growth,” and “Poor,” based on their sales growth ( $(\text{sales growth}_n - \text{sales growth}_{n-1}) / \text{sales growth}_{n-1}$ ) and operating profitability (ROA: operating profit / total assets) relative to the industry average. If a restaurant firm had greater than average sales growth and higher levels of operating profitability in the pre-M&A year (one year before the M&A), then the firm was classified as a “Star” firm. If a restaurant firm had greater sales growth but lower levels of operating profitability than average in the pre-M&A year, then the firm was classified as a “Growth” firm. If a restaurant firm had lower levels of sales growth but higher levels of operating profitability than average in the pre-M&A year, then the firm was classified as a “Profit” firm. Finally, if a restaurant firm had lower levels of sales growth and lower levels of operating profitability than average in the pre-M&A year, then the firm was classified as a “Poor” firm. Using the same process, the state of each restaurant firm was also evaluated one, two, and three years after an M&A. This study then examined changes in the operational state of acquiring firms following an M&A. The sales growth rate and ROA of acquiring firms in the pre-M&A year and three years after the M&A were also included in the analysis. The model was adopted from Davidsson et al. (2009) but modified for the context of restaurant firms.

### *3.2.1. OLS (ordinary least square) and fixed/random-effects regression models*

To understand the relationship between acquiring restaurant firms’ operating profitability and sales growth (Hypotheses 1 and 2), this study used ordinary least square regression models and fixed/random-effect regression models. In Model 1, the dependent variable was the sales growth rate of the acquiring restaurant firm divided by the sales growth rate of the restaurant industry. The independent variable was the operating profit over total assets (ROA) of the acquiring restaurant firm compared to the ROA of all restaurant firms. In Model 2, the dependent

variable was the ROA of the acquiring restaurant firm compared to the ROA of all restaurant firms. The independent variable was the sales growth rate of the acquiring restaurant firm compared to the sales growth rate of all restaurant firms. All variables represent the relative operating performance of acquiring firms compared to the industry average. In the fixed/random-effects regression models, the Hausman test was conducted to decide whether the fixed-effects model or the random-effects model was the better choice. Based on the test results, the fixed-effect model was used as the model for all firms, but random-effect models were used for the subgroups of firms categorized as “Profit” or “Growth” in the pre-M&A year, as well as “Star” and “Poor” in the pre-M&A year. To address potential heteroscedasticity, all models used robust standard errors.

**Model 1:** (Sales growth rate of acquiring firms / Sales growth rate of industry)<sub>it</sub> =  $\beta_0 + \beta_1 * (\text{ROA of acquiring firms} / \text{ROA of industry})_{it} + \varepsilon$ : 1, 2, and 3 years after M&A.

**Model 2:** (ROA of acquiring firms / ROA of industry)<sub>it</sub> =  $\beta_0 + \beta_1 * (\text{Sales growth rate of acquiring firms} / \text{Sales growth rate of industry})_{it} + \varepsilon$ : 1, 2, and 3 years after M&A.

### 3.2.2. Logistic regression models

For further analysis, a logistic regression model was used to compare the different effects of profit-driven M&As and growth-driven M&As on the operating performance of acquiring firms (Hypothesis 3). One, two, and three years after an M&A were modelled separately, and in all cases the dependent variable was a dummy variable that was 1 if the acquiring firm was categorized as “Star” and 0 if the firm was categorized as “Poor” in each post-M&A year.

Accordingly, the dependent variable represents the acquiring firm's operational profitability and sales growth rate relative to the industry average. The independent variables were the ROA of the acquiring firm's pre-M&A year over the ROA of the industry's pre-M&A year and the sales growth rate of the acquiring firm's pre-M&A year over the sales growth rate of the industry's pre-M&A year. Thus, the model represents the effects of ROA and sales growth on the probability of being a "Star" relative to the probability of being categorized as "Poor" after an M&A. To eliminate the heteroscedasticity issue, all models used robust standard errors.

**Model 3:**  $\text{Log}(\text{Probability of being "Star"} / \text{Probability of being "Poor"}) = \beta_0 + \beta_1 * (\text{ROA of acquiring firms} / \text{ROA of industry})_{\text{pre-M\&A year}} + \beta_2 * (\text{Sales growth rate of acquiring firms} / \text{Sales growth rate of industry})_{\text{pre-M\&A year}} + \varepsilon$ ; 1, 2, or 3 years after a M&A.

## 4. Results

### 4.1 Descriptive information

As presented in Table 2, 51.33% of the sampled firms were categorized as a "Star," which signifies restaurant firms that are able to engage in M&A activities when they have favorable operational performance. Only 14% of the sampled firms were categorized as "Poor" when they engaged in M&A activities. Furthermore, the proportion of "Poor" firms continuously increased (from 14.00% to 28.70%) for up to three years after an M&A, while "Star" restaurant firms decreased (from 51.33% to 28.70%).

On average, sales growth rate, operating profitability, total assets, and financial leverage for the restaurant industry during pre- and post-M&A periods were 7.62%, 7.45%, \$70 million,



and 55.04%, respectively. In the pre-M&A year, sales growth rate, operating profitability, total assets, and financial leverage were 12.53%, 10.47%, \$134 million, and 46.94%, respectively. These results showed that before taking M&A actions, acquiring firms tend to have higher levels of sales growth, better operating profitability, more assets, and lower levels of financial leverage in comparison with industry averages across all periods.

Despite favorable operational and financial conditions in the pre-M&A year, among the 150 acquiring firms, eight firms (5.33%) were delisted for various reasons one year after an acquisition, 15 additional firms (10%, total 23 firms (15.33%)) were delisted two years after an acquisition, and 12 additional firms (8%, total 35 firms (23.33%)) were delisted three years after an acquisition. The number of acquiring firms categorized as “Growth” increased the most one year after an M&A, from 26 to 38 (+12), while the number of acquiring firms categorized as “Poor” increased the most between one and two years after an M&A, from 21 to 34 (+13). Furthermore, the number of acquiring firms categorized as “Star” decreased the most in the first year after an M&A, from 77 to 57 (-20). Consistent with the outcomes presented in Table 2, Figure 2 clearly shows that the performance of acquiring restaurant firms deteriorated the most between the first and second year after an M&A and deteriorated still further in the third year.

(Insert Table 2 Here)

(Insert Figure 2 Here)

#### *4.2. OLS (ordinary least square) and fixed/random-effects regression analysis*

As seen in Table 3, Models 1 and 2 included all acquiring restaurant firms from the first to the third year after an M&A to allow for an examination of the relationship between operating

profitability and sales growth. The effect of operating profitability on sales growth was not significant in either the OLS regression or the fixed-effects regression models, which does not support Hypothesis 1. Next, the effect of sales growth on acquiring firms' post-M&A operating profitability was examined. In the OLS regression in Model 2, the acquiring firms' ROA was negatively influenced by sales growth at the 1% significance level in post-M&A years. However, using a fixed-effects regression model, the relationship was neither significant nor negative. Thus, the results do not provide evidence to support Hypothesis 2.

(Insert Table 3 Here)

For the next analysis, Models 1 and 2 were the same, but only restaurant firms categorized as "Profit" or "Growth" in the pre-M&A year were included in the sample. By excluding restaurant firms categorized as "Star" and "Poor," the models show the difference in the impact of either operating profitability on sales growth or sales growth on operating profitability between growth-driven acquiring firms and profit-driven acquiring firms. Table 4 shows that operating profitability did not have a significant impact on sales growth in either model. However, sales growth had a significant and negative influence on operating profitability in both the OLS and random-effects regression models at the 1% significance level. This implies that the growth-driven M&A strategy has a significant and negative effect on acquiring firms' operational performance. However, emphasizing a firm's operating profitability does not have a significantly negative impact on sales growth for either profit-driven or growth-driven restaurant firms.

(Insert Table 4 Here)

To investigate the negative effect of sales growth on the operating profitability of acquiring firms, “Star” and “Poor” restaurant firms were also examined with Models 1 and 2. In contrast to the results in Table 4, operating profitability had a significant impact on sales growth in both the OLS and random-effects regression models at the 1% significance level. In addition, sales growth had a significantly positive influence on operating profitability in both the OLS and random-effects regression models at the 5% and 10% significance levels, respectively. These findings explain why the previous models using all acquiring restaurant firms did not show a significantly negative relationship between operating profitability and sales growth. The sample of all acquiring restaurant firms included restaurant firms that were both above and below average in terms of operating profitability and sales growth, which balanced out the negative relationship between operating profitability and sales growth in the rest of the sample.

Figure 3 graphs the states of acquiring restaurant firms after an M&A. The figure shows that 9% of “Star,” 4% of “Profit,” 23% of “Growth,” and 33% of “Poor” restaurant firms in the pre-M&A year became “Poor” firms the year after an M&A. Looking at improvements in ratings, 58% of “Star,” 27% of “Profit,” 8% of “Growth,” and 14% of “Poor” acquiring restaurant firms in the pre-M&A year were categorized as “Star” in the year after an M&A. More importantly, 27%, 27%, and 19% of “Profit” acquiring restaurant firms became “Star” firms in the first, second, or third years, respectively, after an M&A. Furthermore, 8%, 12%, and 8% of “Growth” acquiring restaurant firms were categorized as “Star” in the same periods. The pattern was the reverse for declining firms, with 4%, 15%, and 19% of “Profit” acquiring restaurant firms moving to the “Poor” category in the first, second, or third years, respectively, after an

M&A. Further, 23% of “Growth” acquiring restaurant firms were categorized as “Poor” all three years after an M&A. Although most firms categorized as “Star” (or “Poor”) in the pre-M&A year were also categorized as “Star” (or “Poor”) after an M&A, “Profit” acquiring restaurant firms in the pre-M&A year were more (less) likely to move to the “Star” (“Poor”) category than the “Growth” category after an M&A.

As shown in Table 5, operating profitability had a significantly positive effect on the likelihood of being categorized as “Star” in the first, second, or third years after an M&A, while sales growth did not have such an effect. Furthermore, the coefficients of ROA were much higher than those of sales growth for all years. Therefore, these findings support Hypothesis 3, suggesting that profit-driven M&As are more likely than growth-driven M&As to help acquiring restaurant firms to grow in terms of profitably. In other words, restaurant firms that focus on their operating profitability before acquiring other firms tend to perform better after an acquisition than those that focus more on sales growth. This is consistent with previous empirical studies of non-M&A cases (Davidsson et al., 2009; Jang, 2011, Jang & Park, 2011).

(Insert Figure 3 Here)

(Insert Table 5 Here)

## **5. Discussion and Implications**

In recent decades, many restaurant firms have acquired other firms to grow their businesses quickly and improve operational performance (Aaronallen & Associates, 2018). Enhanced post-M&A performance is one of the main motivations for acquiring firms to engage in M&As. Some acquiring firms perform well after an M&A, while others do not; indeed, more

empirical evidence presents negative abnormal returns after M&As than positive (Akbulut, 2013; Goranova et al., 2017; Goukasian et al., 2019; Harford et al., 2012; Lavie & Miller, 2008; Malmendier et al., 2018). To determine what causes better post-M&A performance, this study focused on the operating performance of profit-driven and growth-driven acquiring restaurant firms. The reason for this approach is that, although profitable growth is the goal of most firms, enigmatically, profit and growth do not seem to follow each other (Davidsson et al., 2009; Jang, 2011; Jang & Park, 2011). Instead, the empirical evidence shows that fast growth tends to harm profit in many cases (Delmar et al., 2013; Fuertes-Callen & Cuellar-Fernandez, 2019; Soininen et al., 2012; Zhou & Park, 2020). To untangle this paradox, comparing post-M&A operational performance between profit-focused restaurant firms and growth-focused restaurant firms is required. Because accounting-based performance can be a more direct measurement of post-M&A gains or losses, the results can shed light on which direction a restaurant firm should follow to avoid potential negative impacts (Fu et al., 2013; Healy, Palepu, & Ruback, 1992; Sharma & Ho, 2002).

This study used regression models to directly examine the relationship between operating profitability and sales growth for acquiring restaurant firms in the first, second, and third years after an M&A. The overall results showed that there is neither a significantly positive impact from operating profitability on sales growth nor a significantly negative influence from sales growth on operating profitability after an M&A. Nevertheless, when restaurant firms are differentiated according to only profit-driven versus growth-driven motives, the effect of operating profitability on sales growth became insignificant and negative. The influence of sales growth on operating profitability, however, was significant and negative after an M&A. Therefore, this study confirmed that sales growth has a significantly negative effect on post-

M&A operating profitability for growth-focused acquiring firms alone. This explains why the impact of M&As on acquiring firms' post-M&A performance has been inconclusive in empirical research thus far (Neely & Rocjester, 1987; King et al., 2004). When only the best ("Star") and worst ("Poor") restaurant firms were included, the relationship presented the opposite results.

The performances of all acquiring firms relative to the industry average were traced from the pre-M&A year until three years after an M&A. As expected, "Profit" acquiring restaurant firms were more likely to be categorized as "Star" and less likely to be categorized as "Poor" in the first, second, and third years after an M&A. "Growth" firms in the pre-M&A year were more likely to be categorized as "Poor" and less likely to be categorized as "Star" after an M&A. Nonetheless, the overall results indicate the difficulty of achieving profitable growth through M&As. The number of "Poor" acquiring restaurant firms increased from one year after an M&A until three years after, while the number of firms categorized as "Star" continuously decreased during the same period (Ravenscraft & Scherer, 1987; Datta et al., 1992; Lavie & Miller, 2008). In addition, 23% of acquiring restaurant firms had delisted by the third year after an M&A, although this study did not examine this in detail. The results were comparable to the initial public offerings (IPO) cases: 32.2% of restaurant firms were delisted within 5 years after going public (Mun & Jang, 2019).

To confirm these findings, a logistic regression model was used with the dependent variable, coded as 1 for firms categorized as "Star" in the pre-M&A year and 0 for firms categorized as "Poor." The results from this logistic regression verified that profit-driven acquiring firms were more likely to achieve "Star" status and less likely to be categorized as "Poor" than growth-driven acquiring firms in the years following an M&A. Therefore, this study concluded that profit-focused acquiring firms were more likely to perform better than growth-

focused acquiring restaurant firms. Accordingly, this study suggests that when restaurant firms seek growth through M&As, they should pursue growth strategies only after achieving competitive advantages through profit-focused strategies rather than unconditionally adhering to growth strategies before building any internal, market-based competitive strengths. By separating the two important business dimensions of profitability and growth, a clearer perspective emerges in regards to restaurant firms confronting critical decisions such as engaging in an M&A. In this sense, this study differs from previous research that directly observed acquiring firms' operating performances after M&As (Scherer, 1988; Dickerson et al., 1997). This study also differs from the work of Davidsson et al. (2009) and Jang (2011), in that their focus was internal growth, while this study focused on external growth.

In summary, the findings specify that the pre-M&A operating performance of acquiring restaurant firms is an important indicator of post-M&A performance (e.g., Rozen-Bakher, 2018). Moreover, the high delisting rate of acquiring restaurant firms after M&As (or fast growth) confirms that maintaining sustainable levels of growth or profitability is a challenging task for all restaurant firms in a competitive environment (e.g., Mun & Jang, 2019). In this context, it is reasonable to expect that growth-focused restaurant firms would be more likely to experience growing pains (i.e., management costs or culture clashes) than benefits during the incorporation process (Malmendier & Tate, 2008; Yao, Yu, Zhang, & Chen, 2011). However, highly profitable restaurant firms are more likely to endure growing pains relatively better than their counterparts due to the benefits of their pre-substantiated resources, including management expertise (e.g., Liu, Sono, & Zhang, 2019). Therefore, this study suggests that restaurant firms should cautiously prepare for the tremendous wave of upcoming M&As that are likely to follow the COVID-19 pandemic by focusing on their internal competitive resources (Patton & Shanker, 2020).

Despite the straightforward nature of these findings, this study is not free from limitations. This study separated the growth and profit dimensions of acquiring firms but did not consider other factors that can affect an acquiring firm's motivations for and the outcomes of M&As. Thus, although the results may not reflect a complete profile of acquiring firms, the findings do provide a clear distinction between two incompatible paths: growth-focused M&A versus profit-focused M&A. The characteristics of acquired firms, such as their financial conditions, market positions, product quality, or operational efficiencies, were also not considered. These factors may represent important features of the targeted firms but are beyond the scope of this study and offer directions for future research.

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Table 1. The M&A research for the hospitality firms: 1994-2017

Title	Author	Sample	Period	Method	Findings
Restaurant					
Mergers and acquisitions and firm growth : Investigating restaurant firms	Park & Jang (2011)	347 restaurant firms, 3,248 firm-year, 714 M & A cases	1980-2007	Sales growth model	Sales growth has no long-term effect after two years
Returns of Merger and Acquisition Activities in the Restaurant Industry	Chatfield & Dalbor (2011)	171 restaurant bidders, 26 targets	1985-2004	Event study	Target had significant positive returns, but bidder returns were close to zero
Lodging					
Acquisitions, Shareholder Wealth and the Lodging Sector :	Kwansa (1994)	83 lodgings	1980-1990	Event study	Shareholders of target hotel companies benefited from acquisitions, and the bulk of the additional wealth occurred two days before and after announcing the acquisition
Determinants of successful acquisition processes in the US lodging industry	Kim & Olsen (1999)	14 hoteliers, 5 investment bankers, 2 hospitality consultants	1980-1990	Delphi technique	Critical success factors - In the pre-acquisition phase Target's cash flow, potential operating synergy, location, due diligence, etc. - In the post-acquisition phase Post-acquisition strategy, employees, degree of integration and plans, etc.
Good News for Buyers and Sellers : Acquisitions in the Lodging Industry	Canina (2001)	57 lodgings	1982-2000	Event study	The stock market reacts favorably to merger announcements for both acquiring and target firms, but much greater gains for the shareholders of target firms
The Post-merger Financial Performance of Hotel Companies	Hsu & Jang (2007)	15 acquiring companies, 23 companies	1985-2000	Event study Jensen measure Financial performance	Shareholders of acquiring companies did not benefit from merger Mergers did not generate profitable effect on acquiring company
Examining Mergers and Acquisitions	Canina (2009)	714 international, 2,266 domestic M&A	2000-2008	Descriptive analyses	Merger performance is the result of the success of pre-merger decision- making plus the success of post-merger implementation
Mergers and Acquisitions: Degree of Relatedness	Canina (2009)	N/A	N/A	Descriptive analyses	The degree of the relatedness of the two firms, both operationally and culturally, affects the level and areas of integration
Hotel M&A: An International Perspective to Creating Value	Canina (2009)	493 international, 1,574 domestic M&A	2000-2006	Descriptive analyses	Financial markets view domestic mergers favorably and international M&A unfavorably for the bidding firms but both target firms' shareholders obtain benefits



Title	Author	Sample	Period	Method	Findings
Merger abnormal returns and payment methods of hospitality firms	Yang, Qu, & Kim (2009)	19 hospitality acquirers	1996-2007	Jensen measure (3,6,9,and 12 months)	Significant positive gains for the acquiring hospitality firms in the long term Absolute size has a significant impact on excess returns of acquirers Negative impact of cash offers is more obvious Stock offers were more favorable to acquirers' equity value
What We Know about M&A Success : A Research Agenda for the Lodging Industry	Canina, Kim, & Ma (2010)	4,966 lodgings	1981-2009	Descriptions	Target firms experience large significant abnormal return, while shareholders of acquiring firms do not gain A merger creates value, even if the gains accrue entirely to targeted company's shareholders
Comparative historical analysis of four UK hotel companies 1979-2004	Quek (2011)	4 UK hotels	1979-2004	Multiple case study, Comparative historical analysis	Industry shocks, such as financial sector deregulation, technological change, hotel industry's growth, property value fluctuations, and competition were drivers of M&A activities The acquisition of brand names and rights is a major motive for UK hotels
Stock Performance of Firms Acquiring Listed and Unlisted Lodging Assets	Ma, Zhang, & Chowdhury (2011)	34 listed, 418 unlisted lodgings	1980-2006	Event study (+-2day returns)	Acquisition of lodging assets on average increases value Acquiring unlisted, larger sized firm increases value Paying by stocks rather by cash for M&A transactions increases value
Acquisition premium and performance improvements for acquirers and targets in the lodging industry	Kim & Canina (2013)	1,218 acquirer 789 target lodgings	1991-2009	Multivariate regression analysis	Acquiring firms pay M&A premium not for future performance improvement but for gaining control of target firm's resources, which are crucial incentives for post-M&A performance
Under- vs over-investment: hotel firms' value around acquisitions	Dogru (2017)	178 observations of hotel-REITs and C-corporation hotels	1995-2013	Panel ordinary least square regression	Financially constrained firms perform better than financially unconstrained firms Both under- and over-investment decrease firm performance Franchising hotels and hotel-REITs perform worse than c-corporation hotels
Hospitality Company					
Predicting merger targets of hospitality firms(a Logit model)	Kim & Arbel (1998)	38 merger targets, 78 non-merger targets, 45 holdout samples	1980-1992	Binomial Logistic Regression Analysis	High likelihood of being a merger target: - Large firm - Mismatch between growth opportunities and liquid financial resources - High ratio of capital expenditure to total assets - Low price-to-book ratio
Detecting informed trading prior to hospitality acquisitions	Oak & Andrew (2006)	35 stock-payment, 20 cash-payment, 26 stock and cash-payment	1983-1999	Quoted spread, Depth	When markets notice informed trading for hospitality firms making subsequent mixed-financed acquisitions, they widen the bid-ask spread and narrow the ask depth Informed traders use information asymmetry of a hospitality acquiring firm's valuation to maximize private benefits
Explanations for the predominant use of cash financing in hospitality acquisitions	Oak, Andrew, & Bryant (2008)	305 cash-payment, 58 stock-payment	1980-2004	Mean value, Binary logistic regression, Ordinal logistic regression	Cash payment positively relates to the acquiring firm's debt ratio Firm size positively relates to the use of cash payments in restaurant industry Free cash flow and internal growth are not significant determinants of the use of cash payments

Table 2. Descriptive statistics of acquiring restaurant firms

		Pre-M&A	1 year after M&A	2 years after M&A	3 years after M&A
“Poor” (Low Growth & Low Profit)	Sales growth	-0.0173	0.0000	0.0019	-0.0711
	ROA	0.0324	0.0255	0.0194	0.0120
	Asset	40	42	175	148
	Financial leverage	0.5539	0.5578	0.5199	0.5624
	Observations	21	21	34	33
	Proportion	14.00%	14.79%	26.77%	28.70%
“Growth” (High Growth & Low Profit)	Sales growth	0.3233	0.3430	0.1964	0.1545
	ROA	0.0165	0.0262	0.0067	0.0193
	Asset	36	84	47	133
	Financial leverage	0.4854	0.4851	0.5056	0.5340
	Observations	26	38	22	17
	Proportion	17.33%	26.76%	17.32%	14.78%
“Profit” (Low Growth & High Profit)	Sales growth	0.0401	0.0423	0.0333	-0.0005
	ROA	0.1159	0.1210	0.1049	0.1004
	Asset	277	429	382	482
	Financial leverage	0.5143	0.4853	0.5963	0.5325
	Observations	26	26	28	32
	Proportion	17.33%	18.31%	22.05%	27.83%
“Star” (High Growth & High Profit)	Sales growth	0.1913	0.1869	0.1159	0.1410
	ROA	0.1368	0.1127	0.1206	0.1209
	Asset	192	309	429	445
	Financial leverage	0.4296	0.4518	0.4637	0.4782
	Observations	77	57	43	33
	Proportion	51.33%	40.14%	33.86%	28.70%
Total Acquiring Firms	Sales growth	0.1253	0.1481	0.0755	0.0492
	ROA	0.1047	0.0824	0.0792	0.0754
	Asset	134	222	243	250
	Financial leverage	0.4694	0.4827	0.5173	0.5225
	Observations	150	142	127	115
	Proportion	100%	100%	100%	100%
Industry Median	Sales growth			0.0762	
	ROA			0.0745	
	Asset			70	
	Financial leverage			0.5504	
	Observations			4,007	

Note:  $ROA = EBIT_t / Asset_t$ ; Asset is total assets in million dollars; Financial leverage =  $Total\ liabilities_t / Asset_t$ ; Observations are the number of firms; Proportion is the percentage of each observations over total observations.

Table 3. OLS and fixed-effects regression analysis of acquiring firms: All M&A firms

Dependent variable	Sales Growth (Company/Industry)		ROA (Company/Industry)	
	OLS	Fixed-effects	OLS	Fixed-effects
[Independent variables]				
ROA (Company/Industry)	-1.8235 (1.8683)	0.6358 (0.3906)	- -	- -
Sales Growth (Company/Industry)	- -	- -	-0.0034*** (0.0004)	0.0293 (0.0235)
Constant	5.3497 (3.7332)	2.8868*** (0.3912)	1.0134*** (0.0812)	0.8982*** (0.0830)

Note: Bracket is standard error; \*significant at 10%; \*\*significant at 5%; \*\*\*significant at 1%.

Table 4. OLS and random-effects regression analysis of acquiring firms: “Growth” and “Profit” firms in pre-M&A year

Dependent variable	Sales Growth (Company/Industry)		ROA (Company/Industry)	
	OLS	Random-effects	OLS	Random-effects
[Independent variables]				
ROA (Company/Industry)	-4.4015 (4.1728)	-0.7416 (0.8690)	- -	- -
Sales Growth (Company/Industry)	- -	- -	-0.0032*** (0.0005)	-0.0030*** (0.0007)
Constant	11.9108 (9.1546)	19.9785 (17.0193)	0.6797*** (0.1780)	0.5352* (0.3061)

Note: Bracket is standard error; \*significant at 10%; \*\*significant at 5%; \*\*\*significant at 1%.

Table 5. Logit regression analysis (“Star” (High sales growth & High operating profit) vs. “Poor” (Low sales growth & Low operating profit))

Dependent variable	“Star” (High sales growth & High operating profit = 1) vs. “Poor” (Low sales growth & Low operating profit = 0)		
	1 year after M&A	2 years after M&A	3 years after M&A
Independent variables			
ROA (Company <sub>preM&amp;A</sub> /Industry <sub>preM&amp;A</sub> )	4.6819*** (1.2653)	5.4286*** (1.6705)	5.1254*** (1.7628)
Sales Growth (Company <sub>preM&amp;A</sub> /Industry <sub>preM&amp;A</sub> )	0.0809 (0.1217)	0.5632* (0.2972)	0.3513 (0.2454)
Constant	-3.5409*** (1.1711)	-5.4550*** (1.7679)	-5.3231*** (1.8043)
Observations	78	77	66
LR chi <sup>2</sup>	59.31***	79.51***	67.25***
Pseudo R <sup>2</sup>	0.6527	0.7523	0.7350

Note: Bracket is standard error; \*significant at 10%; \*\*significant at 5%; \*\*\*significant at 1%.

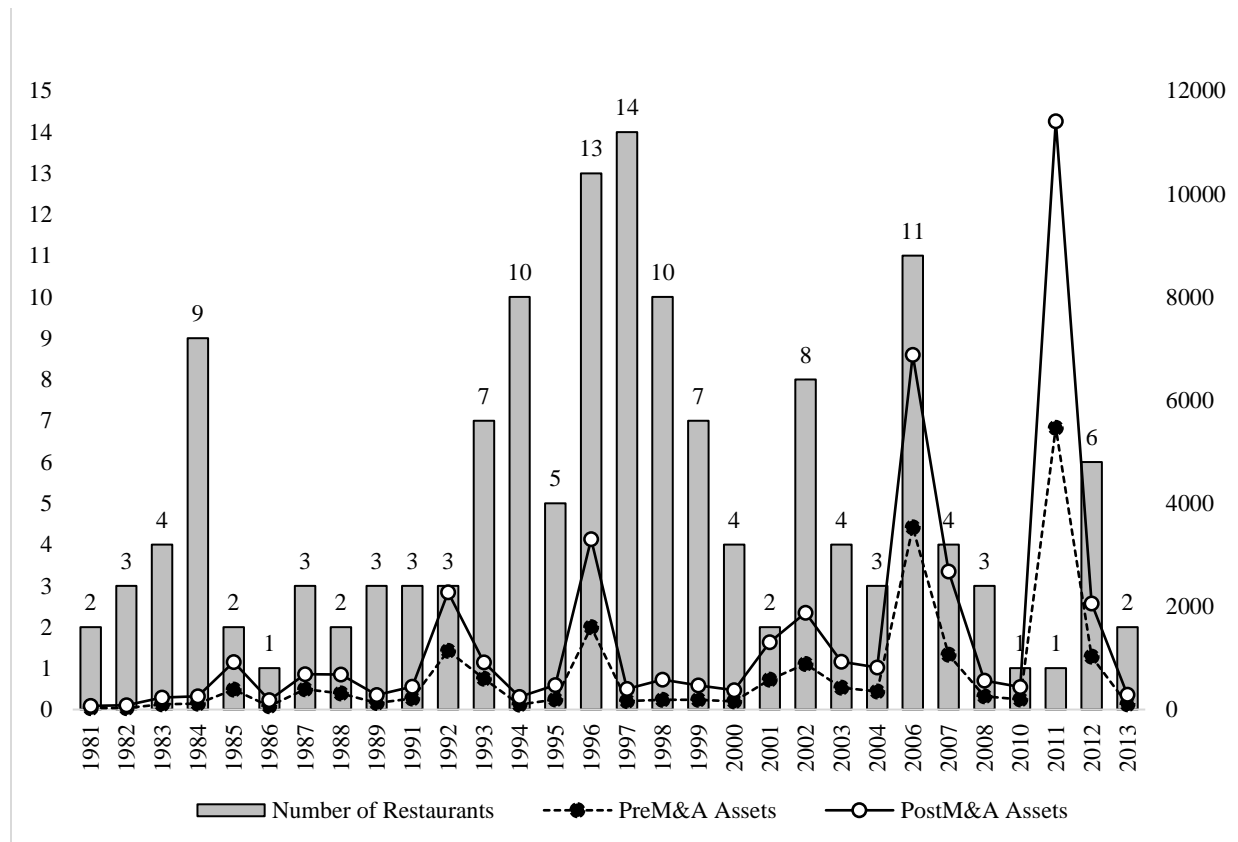


Figure 1. The number of acquiring firms and their asset size between 1981 and 2013

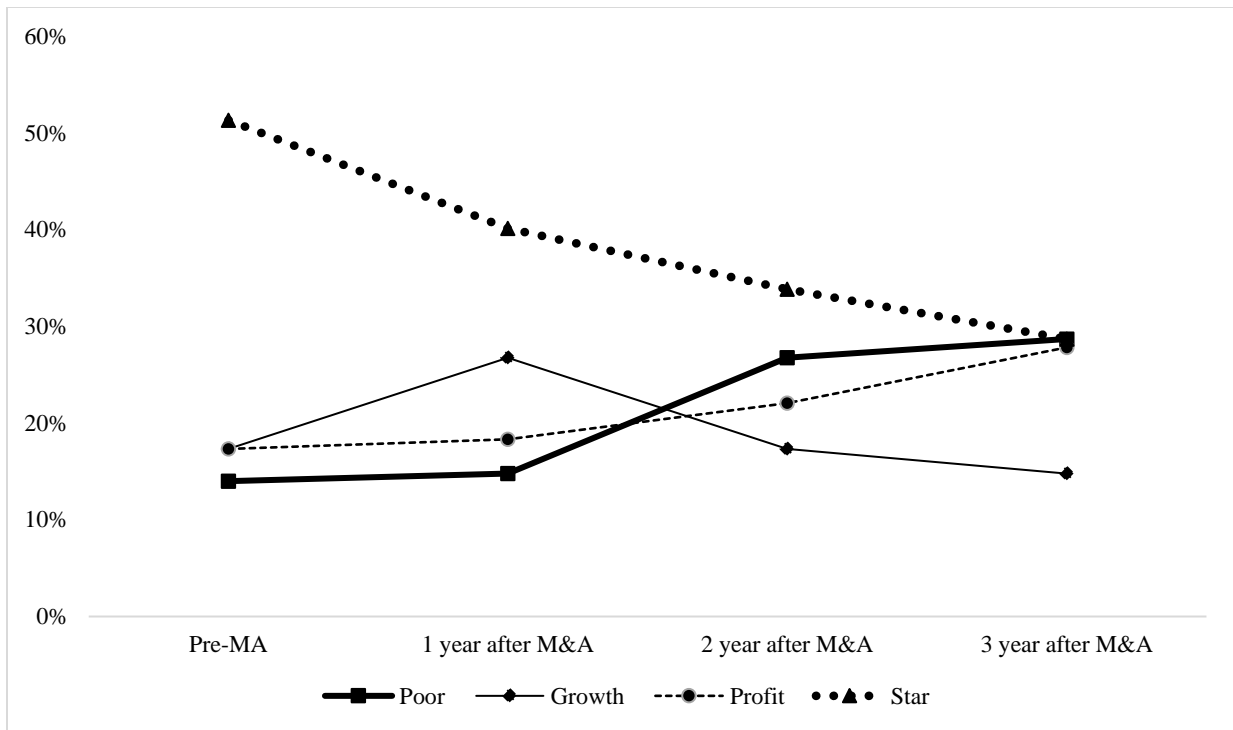


Figure 2. The states of acquiring firms from pre-M&A year to 3 years after M&A

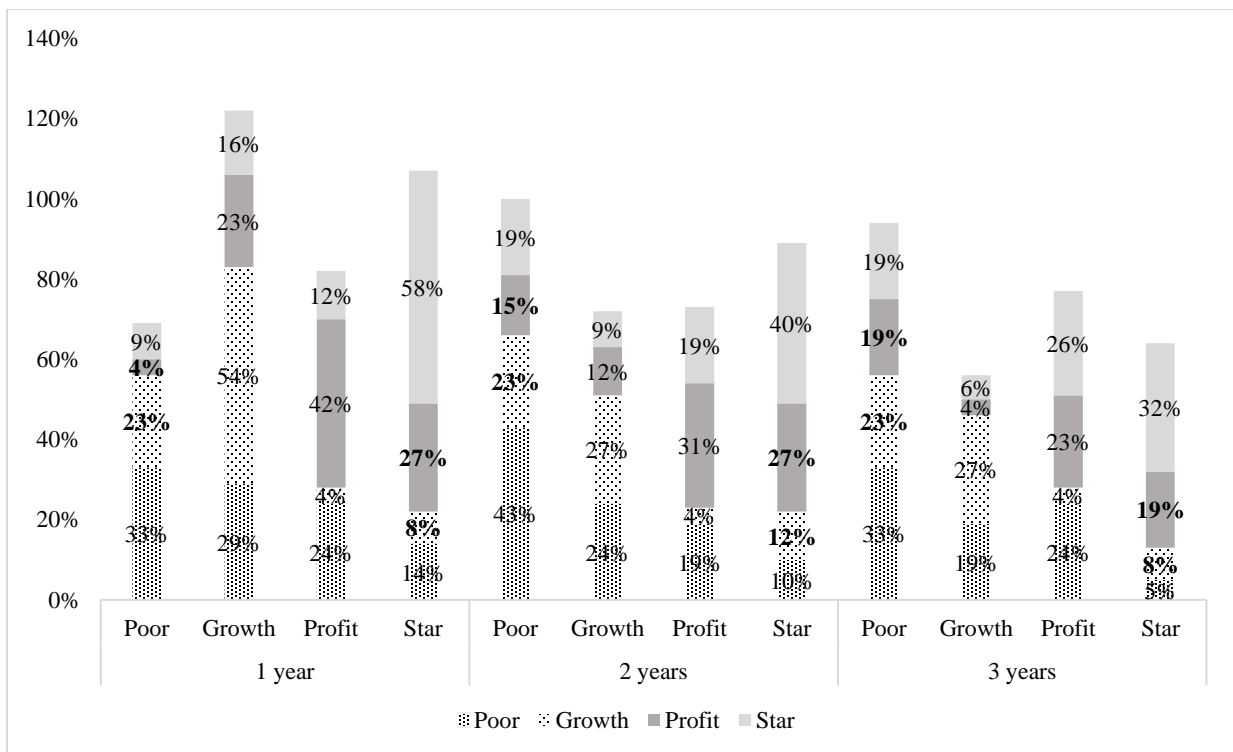


Figure 3. Transitions of acquiring restaurant firms from pre-M&A year to 3 years after M&A