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'THE REAL VALUE OF ACQUISITIONS' A CASE STUDY OF LIYOD AND HBOS

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Abstract

The assessment of shareholders' wealth effects (value creation or destruction) of Mergers and Acquisition (M&A) is one of the most researched area in the field of finance. This study is an attempt to understand the wealth effects of M&A through the case of Lloyds TSB acquisition of HBOS. The primary objective of this dissertation is to study and analyze the acquisition of HBOS by Llyods TBS and to investigate whether this acquisition has created wealth for its shareholders. The wealth creation or destruction for shareholders was investigated by examining the daily excess returns that accrue to the shareholders around the date of announcement of the merger deal. The study shows huge positive excess returns for the shareholders of both firms around the announcement date. The results were unlike the earlier results obtained by the other researchers and one of the possible reasons of this kind of result can be found in the external economic conditions prevailing in the market.

Keywords: Shareholder value, acquisition, hi-tech companies, growth strategies

INTRODUCTION

The assessment of shareholders' wealth effects (value creation or destruction) of Mergers and Acquisition (M&A) is one of the most researched area in the field of finance. Neo-classical economic theory assumes that corporate management acts to maximize the wealth of shareholders. Takeovers are seen as devices by which inefficient management teams may be

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replaced (Manne, 1965) and which facilitate the redeployment of capital to more efficient users (Weston, 66-80). Therefore, if companies follow the policies of shareholders' wealth maximization then shareholders should not suffer wealth destruction in the process of acquiring a target firm. At the same time current competitive environment forces the bidder companies to raise the premiums paid to the target companies and let the shareholders of the target companies earn positive and significant abnormal returns in the few days. In such conditions the merger and acquisition process may be viewed as zero net present value investment decision (Limmack, 1991).

However, it has also been argued that shareholders' wealth creation or destruction in an acquisition is contingent on the economic conditions of the period in which acquisition takes place. That is, wealth effects to the shareholders are sensitive to economic cycle (Tse & Soufani, 2001).

In recent years, the changed economic conditions due to the unprecedented turbulence in the global financial markets have given opportunity to stronger firms to increase their horizons by acquiring the firms which could not endure the brunt of the crisis.

One such a case is the acquisition of HBOS by Lloyds TSB. Lloyds TSB believes that the acquisition of HBOS will create a compelling business combination offering substantial benefits. The enlarged group will have excellent breadth and balance with strong positions in retail, corporate banking, SME business banking and long term savings.

Research Objectives

The primary objective of this dissertation is to study and analyze the acquisition of HBOS by Llyods TBS and to investigate whether this acquisition has created wealth for its shareholders. Another purpose of this analysis is to investigate whether merger and acquisition process are efficient strategies in volatile market situations.

Hypotheses

To attain the aforementioned objective the following two hypotheses will be tested:

H_1: Whether positive or negative cumulative returns accrued to Llyods TBS (bidder) or HBOS (target) shareholders and the reasons thereof.

H_2: Whether there is zero or negative combined excess return in the merged firm (Llyods TBS and HBOS combined) and the reasons thereof.

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LITERATURE REVIEW

M&A in General

The issue of shareholders' wealth maximization through mergers and acquisition process is one of the most controversial issues in financial research world and plethora of research papers have been exclusively devoted to this issue. Several studies have reported that there shareholders of acquiring firm get benefitted by the acquisition process while at the same time others report losses to them. Empirically, both camps have found some support for their arguments.

Researches such as Franks et al. (1977), (1989), Firth (1979), Asquith (1983), Jensen et al. (1983), Jarrel et al. (1988) etc. revealed that target firm gain from the takeover process. The reason for the gain is explained in the high premiums paid by bidding firms to the target firms. Other researches such as Frank et al. (1977), Datta et al. (1992) etc. indicate gains for the bidding firms too however others such as Firth (1979), Asquith (1983), Limmack (1991), Sudarsanam et al. (1996) etc. report zero or negative gain for the bidding firms.

Weidenbaum et al. (1987) analyzed ten takeovers studies which report cumulative average abnormal returns to acquiring firm shareholders over three separate event periods. They found that only two of the studies show significantly positive returns around the date of the announcement; four report insignificant gains or losses during that limited time period, and three report significant decreases in the returns to bidding companies. Of even greater interest is the fact that nine of the ten studies go on to report losses in shareholder returns during the period following the announcement of the merger. Using the same methodologies they concluded that the significant negative cumulative abnormal returns due to acquisition indicate that the acquisitions are, on average, a poor investment for acquiring firms (Weidenbaum & Vogt, 1987).

Mishra et al. (2005) say that on an average, a merger is not a wealth creating exercise but transfers wealth from bidders to target shareholders (Mishra & Goel, 2005). Many other studies conclude that the target company's stock price on an average tends to go up from 10 days before the announcement to 10 days after.

Mandelkar relates these positive excess returns of the target shareholders to the 'unique resources' held by the target firm in a given perfectly competitive acquisition market. He argues that if the takeover takes place in a perfectly competitive market, acquisition will result in zero net present value projects. That is, the expected return from an acquisition will be the same as from any other investment production activity with similar risk. The bidding firm will experience no excess stock returns. However, if the target firm has some unique resources, it will earn positive excess return while the bidder firm will earn normal return i.e. no excess return (Mandelker).

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Various other studies segregate the examination of the abnormal returns into friendly and hostile bids. In both of these cases, the target shareholders gain due to acquisition premiums. Hostile transactions usually elicit higher offer prices as a result of `aggressive negotiation' between the management of the two firms (Tse & Soufani, 2001). Huang et al. (1987) postulate that the returns surrounding the announcement of hostile takeovers differ from those surrounding friendly ones. Their findings exhibited an average return of 28.3 and 22.6%, respectively (Huang & Walkling, 1987).

M&As in Banking Industry

Early event studies revealed some variation in the abnormal returns to the merging parties. However, as in the case of any other merging activity, there is a general consensus over the point that acquiring banks suffer losses and destroy the shareholders' wealth in an acquisition activity.

Chavaltanpipat et al. (1999) used ordinary least square technique to investigate the abnormal gains to both target and bidding firms. They analyzed 30 mergers happened from 1980-1993 and found that in 18 acquisitions bidder experienced negative abnormal returns and the target gained positive abnormal returns, in six acquisitions both bidding and target banks experienced abnormal returns, in four acquisitions both bidding and target banks experienced negative abnormal returns and finally in only two acquisitions bidding banks experienced gained positive returns while target experienced negative abnormal returns (Chavaltanpipat, Kholdy, & Sohrabian, 1999).

The similar conclusions were reported by Nail et al. (2005) in their report analyzing various cross border and domestic (U.S.) banks' mergers activities.

More recent empirical studies indicate that the changing regulatory landscape has altered the degree and distribution of stockholder wealth changes in bank mergers. Researches by Becher et al. (2000) and James et al. (2001) show that the capital markets have become more approving of bank mergers as they relate to the acquiring firm's stock. Both studies find that acquirers' returns were not only higher in the 1990s than in prior years, but they also became positive.

LLOYDS TSB'S ACQUISITION OF HBOS

Acquisition Background

The financial meltdown which started from the U.S. mortgage sector spread across the industries and across the geographical area. The primary reason of the meltdown was credit crunch which directly affected the banking and insurance industry. The U.K. banking and

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insurance industry was not exception too, the global crisis hit the U.K.'s banking and insurance industry in 2007.

HBOS was a diversified financial services group, fourth biggest in U.K., engaged in a range of banking, insurance broking, financial services, and finance-related activities throughout the UK, the State and elsewhere in the world. While, Lloyds TSB, fifth biggest in U.K., provided banking and financial services in the UK, the State and elsewhere in the world. Lloyds TSB activities are organized into three divisions: UK Retail Banking; Insurance and Investments; and, Wholesale and International Banking (Wong, 2008). Even these two behemoths could not bear the brunt of the crisis.

However, the stepping stones for this deal were set at the start of the crisis but the acquisition became the only option of survival for the HBOS in the beginning of March 2008 when rumors spread that it had asked the bank of England for emergency funding. This resulted in 17 percent share price fall of HBOS in just one trading day. Aside from Northern Rock, HBOS was one of the U.K. banks most reliant on lending markets, rather than customer deposits, to fund its mortgage-lending business. In the summer 2008, in an effort to shore up its finances, HBOS raised £4 billion from investment banks and existing shareholders. It had tried to raise the funds from shareholders alone, but demand wasn't sufficient. HBOS lost almost half its market value last week, after being badly hit by a shortage of funds to back its mortgages. The company was left in a similar situation to that of Northern Rock. On 17th September 2008, very shortly after the Lehman Brothers collapse, HBOS's share price suffered huge fluctuation ranging from 88p to 220p per share. The Financial Service Authority (FSA) tried to minimize the uncertainty spread in the market by assuring about HBOS's liquidity and financial conditions. There were growing concerns in the HBOS boardroom that a climate of fear was being created about its future that could have led to a funding crisis, or a Northern Rock-style run - on steroids. Later on that day BBC reported that HBOS had finalized a deal with Lloyds TSB (Lloyds TSB seals £12bn HBOS deal , 2008). Finally, the deal was concluded on January 19, 2009.

Terms and Conditions

The deal was negotiated at the very highest level, it is said that Prime Minister Gordon Brown himself finalized the deal between the two. He also assured that since the acquisition is done at unprecedented conditions therefore, this deal can get green signal from the competition authority to overrule the antitrust law.

The final terms were negotiated as; HBOS shareholders to receive 0.83 Lloyds TSB share for each share they own. The offer valued HBOS at £12.2 billion ($22.2 billion), based on Lloyds' closing share price on Sept. 17(232p). The price of each share valued at 232p was 58

percent more than midweek's closing price of 147.1 in London trading. There were three main conditions for the acquisitions as following: Three Quarters of HBOS shareholders voted in agreement with the board's actions, half Of Lloyds TSB shareholder voted to approve the takeover and, UK government dispensation with respect to competition law.

Rationale Behind the Acquisition

Although, this deal was driven by the global crisis and there was no option left with the HBOS except to be merged with Lloyds TSB, but as it is said that the objective of any firm is to maximize the shareholders' wealth and hence Lloyds TSB had to go with the deal only if it could have helped it in making the shareholders' money grow. Followings are some of the motives for the Lloyds that could have attracted it to acquire HBOS.

Business Sustainability

Table 1 displays some of the facts about the two giants at the time of announcement. Together, the banks had 142,000 employees, 2,800 branches and 38million customers. The merged super-bank would dominate the markets for retail banking and mortgages, with close to 30% of both. The combined bank is to be by far the U.K.'s biggest mortgage lender, with more than £1 trillion ($1.783 trillion) in assets and nearly a third of the mortgage and retail deposit markets. It would also be the biggest player in life insurance with around 18% of the market (Lloyds TSB and HBOS: Monster mash, 2008).

Table 1: Lloyds TSB vs HBOS

	Lloyds TSB	HBOS
Branches	1900	1100
Customers	16 million	22 million
Employees	70000	72000
Savings	UK's fourth largest savings provider	The market leader
Retail Saving Balances	£65bn	£139bn

In normal times, creating such a monster would have been impossible; indeed, Lloyds TSB was turned down in 2001 when it sought to take over Abbey National, a bank.

IT Savings

In the acquisition agreement the banks said to derive cost savings by integrating the technology of both the banks, removing duplication of systems. They emphasized on significant cost savings by combining back offices of both the banks. The takeover would result in "cost

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synergies" of over £1 billion by 2011, it stated, or about 10 per cent of the combined cost base. Single dealing and trading platform through wholesale division can result in more savings.

The merged bank will also shave costs from its operations by use 'straight-through-processing' technology, centralizing its back-office operations and offshoring jobs. Lloyds TSB already offshores most of its IT functions, with 30 per cent of its IT jobs based in the UK (Staff, 2008).

METHODOLOGY

The Study

Typically, the shareholder gains from acquisition are estimated by comparing the "abnormal" returns to the shareholder arising from the acquisition and the normal returns from ownership of the stock. A fairly standard and sophisticated methodology has been developed for this purpose (based on the well-known capital asset pricing model). In order to test the hypotheses the returns to Llyods TBS and HBOS are calculated before and after the announcement dates. By investigating these returns the announcement effects on both the companies' share prices are analyzed. The study deduced the market performance by taking the FTSE 100 Index as the market benchmark. The study involved the use of 200 days share prices of both the companies and the market. The detailed description of data and methodology has been given in the Analysis part.

The Data

In order to test the hypotheses the study we require announcement date, excess shareholder returns, cumulative excess returns and excess returns of combined firm. These terms are explained in the methodology part.

To calculate the above values the time period from November 1, 2007 to October 16, 2008 is used. The values of daily share prices of HBOS and Lloyd TSB are taken from the website www.lloydsbankinggroup.com.

The FTSE 100 Index is used as the market benchmark and its daily values are taken from the website http://uk.finance.yahoo.com.

Analytical Approach

As mentioned above to carry out the analysis announcement date, excess shareholder returns, cumulative excess returns and excess returns of combined firm are required. These terms and method to calculate them are explained below:

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Announcement Date (t=0)

It is the date on which the information about a merger bid first appeared in the financial dailies. Keeping t=0 as the date of announcement of merger, date t = (-1) represents a day before the merger and the day t = (+1) represents the day after the merger. In this case, Lloyd TSB announced its plan to merge with HBOS on September 18, 2008. However, a day before on September 17, 2008 BBC reported the takeover deal. But the deal was formally announced on the September 18, 2008. Hence September 18, 2008 is taken as t=0 in this study.

Excess Shareholder Return

It measures the stock market's initial reaction to a merger bid and division of any gains from any new information which becomes available to the market. Daily share price changes were tracked to compute daily excess returns (XR_{it}) for the security i as on a particular day (t) by employing market model (1):

$$XR_{it} = R_{it} - E(R_{it}) \quad (1)$$

Where,

t = day measured relative to an event, XR_{it} = excess return on security i for day t,

R_{it} = return on security i during t, E (R_{it}) = expected rate of return on security i that it would ordinarily earn for a given level of market performance for day t. This is measured using the market model denoted by the equation (2):

$$E(R_{it}) = \alpha_i + \beta_i R_{mt} \quad (2)$$

The study deduced the market performance by taking the FTSE 100 Index as the market benchmark. Values of α and β were estimated by regressing R_{it} (dependent variable) on R_{mt} (independent variable) for the 206 day period ranging from the period November 1, 2007 to August 19, 2008. The period of 20 days prior to the announcement was excluded from the estimation period to ensure that the parameter estimates were not contaminated with the announcement of the merger process. Market model parameters were calculated based on these 206 data points.

Cumulative Excess Returns (CER)

CER in the days surrounding the merger (equation 3) were needed to examine whether shareholders of merging firms gained from the merger.

$$CER = \sum_{t=-K}^{T} XR_{it} \quad (3)$$

Where, CER is the cumulated excess return from day –K through day T.

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Excess Returns of the Combined Firm

Excess returns of the combined firm (equation 4) were calculated for assessing the market expectations from the merger of the two companies. It is a weighted sum of bidder and target firms' excess return.

$XR_{(bt,\ t)} = [XR_{(b,t)} * MV_b + XR_{(t,t)} * MV_t] / [MV_b + MV_t]$ (4)

Where, MV_b and MV_t are market values (i.e. market capitalization) of the bidder and target respectively as at the day before the announcement date (t=-1).

$XR_{(b,t)}$ is the excess returns of bidder firm as on day t and $XR_{(t,t)}$ is the excess return of the target firm as on day t.

ANALYSIS AND EMPIRICAL RESULTS

Returns to the Bidder Firm Lloyds TSB and Target Firm HBOS

The following Exhibit 1 presents the Cumulative Excess Returns (CER) of Lloyds TSB and HBOS accumulated according to equation number (3) for the period (-20 to +20), i.e. from 20 days before the merger and 20 days after the merger. From the exhibit it is clear that the entire time window is displaying higher positive CERs for Lloyds TSB with the mean of 256.15%. In relative terms CER has continuously rose for the whole time line. Till the date of announcement it grew to 252.34% and from the date of merger (t = 0) to next 20 days it grew by 238.86%. This result is ironic to business as usual situation. Normally, the bidding firm's cumulative excess returns decline from 20 days prior to the merger announcement (t = -20) to the date of announcement (t =0). Unusually on the date of announcement Lloyds's excess return is -1.89%, signifying that shareholders did not expect benefits from the mergers, however, just days before the announcement date the excess returns are as much as 19.66% (t = -2), 15.66% (t = -1). This kind of return behavior might be due to shareholders got information about the deal much prior to the announcement. There are few proofs of this information leak as, just before the announcement date BBC reported about the deal finalization. Another possible reason for this unexpected price behavior is the after effects of the global slowdown which was at peak at that time. At the time of the deal U.K. banking sector was collapsed and the merger was one of the rescue measures arranged by the government of U.K. with the help of other players. At that time the prices of almost all the shares were touching the rock bottom and just few days after the merger announcement, the government of U.K. announced the £37 billion of treasury investment for the banking sector. Shareholders might have anticipated this long awaited rescue package for the banking sector and this could have resulted in upside price movement of the share prices.

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For HBOS the CERs were at much higher levels. From 20 days prior to the date of announcement it gained cumulative excess return of 603.22% and over the next 20 days the CER grew by another 603.75% making the total CERs for the timeline at 1206.97% level. These unprecedented levels of can be justified by the same reasons as mentioned above in the case of Lloyds TSB.

Another additional factor that added to these high levels of excess returns is the condition of this banking giant at the time of merger. The company was much bigger than the Lloyds TSB but it could not bear the brunt of the recession and continuously it was going deeper into the problem, finally Gordon Brown's government took the lead in rescuing the bank from failing and advised Lloyds TSB to acquire the firm. These rescue measure infused a positive signal among the shareholders and that resulted in the growing share price of HBOS which was touching the rock bottom before the deal.

Table 2: Daily and Cumulative Excess Returns of Merging Firms During Period (-20 to +20)

		Lloyds TSB					HBOS				
Day (t)	Date	R_{it}	R_{mt}	$E(R_{it})$	XR_{it}	CER	R_{it}	R_{mt}	$E(R_{it})$	XR_{it}	CER
-20	8/20/2008	0.69%	0.97%	-10.72%	11.41%	11.41%	0.99%	0.97%	-27.99%	28.98%	28.98%
-19	8/21/2008	-3.53%	-0.03%	-12.25%	8.71%	20.12%	-2.94%	-0.03%	-29.86%	26.91%	55.89%
-18	8/22/2008	6.96%	2.52%	-8.33%	15.29%	35.42%	6.25%	2.52%	-25.08%	31.33%	87.22%
-17	8/26/2008	-2.50%	-0.63%	-13.17%	10.67%	46.09%	-1.30%	-0.63%	-30.99%	29.69%	116.91%
-16	8/27/2008	1.20%	1.05%	-10.59%	11.79%	57.87%	2.80%	1.05%	-27.84%	30.64%	147.55%
-15	8/28/2008	3.38%	1.32%	-10.17%	13.55%	71.43%	4.18%	1.32%	-27.32%	31.50%	179.06%
-14	8/29/2008	-0.57%	0.63%	-11.23%	10.66%	82.08%	3.36%	0.63%	-28.62%	31.97%	211.03%
-13	9/1/2008	1.23%	-0.60%	-13.12%	14.36%	96.44%	0.40%	-0.60%	-30.92%	31.32%	242.35%
-12	9/2/2008	1.14%	0.32%	-11.71%	12.85%	109.28%	-2.21%	0.32%	-29.20%	26.99%	269.34%
-11	9/3/2008	-2.41%	-2.15%	-15.51%	13.10%	122.38%	-2.18%	-2.15%	-33.83%	31.65%	300.99%
-10	9/4/2008	-5.68%	-2.50%	-16.04%	10.36%	132.74%	-6.84%	-2.50%	-34.48%	27.64%	328.63%
-9	9/5/2008	-2.53%	-2.26%	-15.68%	13.14%	145.88%	-2.48%	-2.26%	-34.04%	31.56%	360.19%
-8	9/8/2008	11.11%	3.92%	-6.17%	17.29%	163.17%	11.43%	3.92%	-22.46%	33.89%	394.08%
-7	9/9/2008	-0.73%	-0.56%	-13.07%	12.34%	175.51%	0.49%	-0.56%	-30.86%	31.34%	425.43%
-6	9/10/2008	-4.14%	-0.91%	-13.60%	9.46%	184.97%	-2.84%	-0.91%	-31.51%	28.67%	454.10%
-5	9/11/2008	-4.07%	-0.89%	-13.57%	9.50%	194.47%	-4.34%	-0.89%	-31.47%	27.13%	481.23%
-4	9/12/2008	2.30%	1.85%	-9.36%	11.66%	206.13%	-1.66%	1.85%	-26.34%	24.68%	505.91%
-3	9/15/2008	-5.44%	-3.92%	-18.23%	12.79%	218.91%	-17.55%	-3.92%	-37.14%	19.59%	525.50%
-2	9/16/2008	2.19%	-3.43%	-17.47%	19.66%	238.57%	-21.72%	-3.43%	-36.22%	14.50%	540.01%
-1	9/17/2008	0.00%	-2.25%	-15.66%	15.66%	254.23%	-19.18%	-2.25%	-34.02%	14.84%	554.85%
0	9/18/2008	-15.10%	-0.66%	-13.21%	-1.89%	252.34%	17.34%	-0.66%	-31.03%	48.37%	603.22%
1	9/19/2008	20.32%	8.84%	1.38%	18.94%	271.28%	28.91%	8.84%	-13.26%	42.17%	645.38%
2	9/22/2008	-3.76%	-1.41%	-14.37%	10.61%	281.89%	-6.07%	-1.41%	-32.44%	26.38%	671.76%
3	9/23/2008	-4.82%	-1.91%	-15.14%	10.32%	292.21%	-13.78%	-1.91%	-33.38%	19.60%	691.36%
4	9/24/2008	2.01%	-0.79%	-13.41%	15.42%	307.63%	0.17%	-0.79%	-31.28%	31.44%	722.81%

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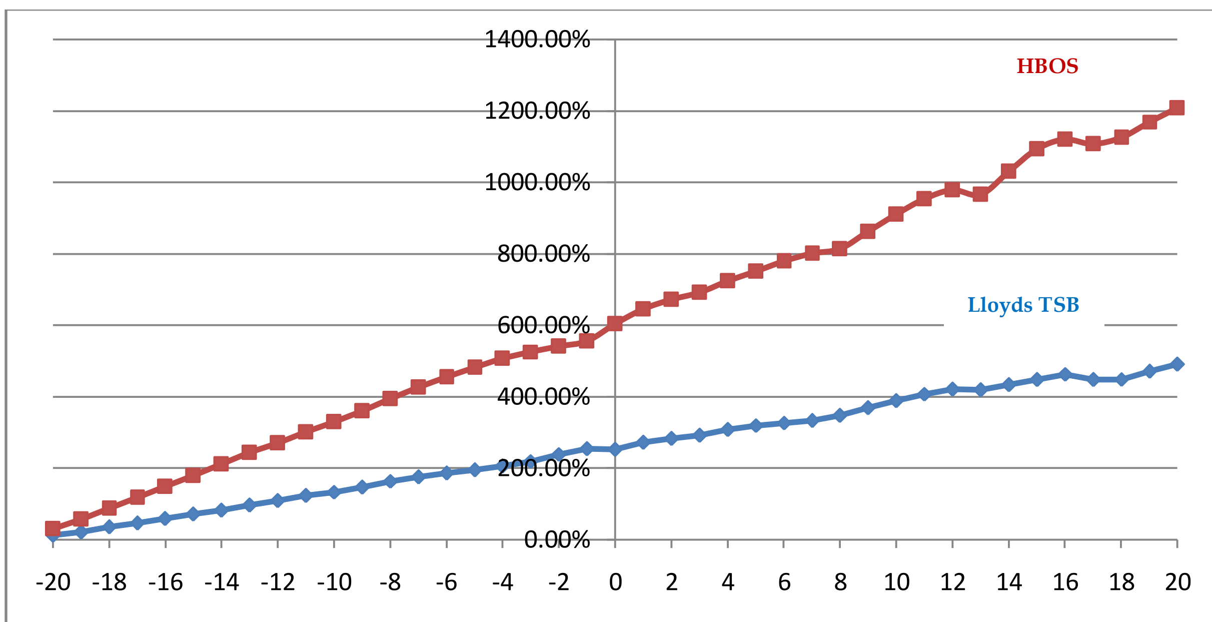
Table 2….

5	9/25/2008	2.34%	1.99%	-9.14%	11.48%	319.11%	1.94%	1.99%	-26.07%	28.01%	750.82%
6	9/26/2008	-8.14%	-2.09%	-15.41%	7.26%	326.38%	-5.82%	-2.09%	-33.71%	27.89%	778.71%
7	9/29/2008	-13.45%	-5.30%	-20.34%	6.89%	333.27%	-18.06%	-5.30%	-39.72%	21.66%	800.37%
8	9/30/2008	4.26%	1.74%	-9.53%	13.79%	347.06%	-13.80%	1.74%	-26.55%	12.75%	813.12%
9	10/1/2008	10.38%	1.16%	-10.41%	20.79%	367.85%	21.00%	1.16%	-27.62%	48.62%	861.73%
10	10/2/2008	4.80%	-1.80%	-14.97%	19.77%	387.61%	14.85%	-1.80%	-33.17%	48.03%	909.76%
11	10/3/2008	10.78%	2.26%	-8.73%	19.51%	407.13%	17.87%	2.26%	-25.57%	43.44%	953.20%
12	10/6/2008	-10.77%	-7.85%	-24.26%	13.50%	420.62%	-19.80%	-7.85%	-44.50%	24.70%	977.90%
13	10/7/2008	-12.93%	0.35%	-11.66%	-1.27%	419.35%	-41.54%	0.35%	-29.15%	-12.39%	965.51%
14	10/8/2008	-6.87%	-5.18%	-20.15%	13.28%	432.63%	24.47%	-5.18%	-39.49%	63.96%	1029.47%
15	10/9/2008	0.83%	-1.21%	-14.06%	14.89%	447.53%	31.20%	-1.21%	-32.07%	63.26%	1092.74%
16	10/10/2008	-10.55%	-8.85%	-25.79%	15.24%	462.76%	-19.09%	-8.85%	-46.36%	27.28%	1120.01%
17	10/13/2008	-14.47%	8.26%	0.49%	-14.95%	447.81%	-27.54%	8.26%	-14.34%	-13.20%	1106.81%
18	10/14/2008	-6.60%	3.23%	-7.25%	0.64%	448.45%	-5.22%	3.23%	-23.76%	18.54%	1125.35%
19	10/15/2008	-0.73%	-7.16%	-23.20%	22.47%	470.92%	0.47%	-7.16%	-43.20%	43.67%	1169.02%
20	10/16/2008	-0.13%	-5.35%	-20.42%	20.28%	491.20%	-1.87%	-5.35%	-39.81%	37.95%	1206.97%

Overall, it can be concluded that the merger and period under review support the theory which puts forward that in an acquisition and merger the target and the bidding both firms' shareholders gain excess returns, that is it creates wealth for the shareholders (See Figure 1). However, the case under review can be taken as a token for the proof of these theories as the results obtained are not free from the external environment. The deal was hugely affected by the outside economic conditions and the gain in the shareholders' wealth cannot be directly attributed to the merger only.

Figure 1: Cumulative Excess Returns



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Announcement Effect

In order to further analyze the announcement effect, the forty days period from day -20 to +20 was partitioned into various sub-periods. Then the proportion of the total build-up in CER during this period as accounted by the various sub-periods was computed.

Announcement Effect and Lloyds TSB

Table 3 shows the announcement effect in CERs of forty days for Lloyds TSB. The exhibit depicts a homogeneous distribution of announcement over the forty days (-20 to 20). Except for the announcement date all other sub-periods are contributing around similar weights for the overall CER. This shows that shareholders were indifferent about the acquisition. However, this behavior of shareholders seems inconsistent with the facts. The deal was carried out to bring out the HBOS from the crisis at time when Lloyds TSB was itself suffering from credit crunch and before the deal announcement the beta value of HBOS (1.87) was higher than Lloyds TSB (1.56), signifying that Lloyds TSB was endangering its business and shareholders' money by investing in a more risky business. These all facts should have instigated worries among Lloyds TSB's shareholders. But against this phenomenon they were completely indifferent over the time line except at the date of announcement. The reason of this indifference may be the invisible hand of government behind this deal, which made shareholders feel safe about their money.

Table 3: CER - Announcement Effect for Lloyds TSB

Sub-Period	-20 to -10	-10 to -1	0	+1 to +10	+11 to +20
CER	122.38%	131.85%	-1.89%	135.27%	103.59%
Announcement Effect (-20 to 0)	48.50%	52.26%	-0.76%		
Announcement Effect (0 to +20)			-0.79%	57.08%	43.71%
Announcement Effect (-20 to +20)	24.91%	26.84%	-0.38%	27.54%	21.09%

Announcement Effect and HBOS

Table 4 shows the announcement effect in CERs for the HBOS's shareholders. The results are quite similar to that of Lloyds TSB and the CERs are distributed homogenously over the time line. The only difference is at the announcement time. Unlike the negative weight in the case of Lloyds TSB, HBOS experienced positive weight at the announcement date, which seems logical as the deal was like a rescue plan for the HBOS to bring it from the crisis and hence shareholders were positive about the deal.

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Table 4: CER - Announcement Effect for HBOS

Sub-Period	-20 to -10	-10 to -1	0	+1 to +10	+11 to +20
CER	328.63%	226.21%	48.37%	306.54%	297.21%
Announcement Effect (-20 to 0)	54.48%	37.50%	8.02%		
Announcement Effect (0 to +20)			7.42%	47.01%	45.58%
Announcement Effect (-20 to +20)	27.23%	18.74%	4.01%	25.40%	24.62%

Excess Returns to Lloyds TSB-HBOS Combined

Using the equation (4) the combined excess returns for 20 days after the announcement date is calculated (Table 5), which is at the higher levels like the separate entities. The cumulative combined excess return reached to 360.95% at 20 days after the announcement.

Exhibit 6: Excess Return to Lloyds TSB-HBOS Combined

Day	Daily Excess Return		Combined Excess Return (XR_{bt})	
t	Lloyds TSB	HBOS	Based on Market value	
			As on (t)	Cumulative Gain/Loss
1	18.94%	42.17%	26.71%	26.71%
2	10.61%	26.38%	15.88%	42.59%
3	10.32%	19.60%	13.43%	56.02%
4	15.42%	31.44%	20.78%	76.80%
5	11.48%	28.01%	17.01%	93.81%
6	7.26%	27.89%	14.17%	107.98%
7	6.89%	21.66%	11.84%	119.82%
8	13.79%	12.75%	13.44%	133.26%
9	20.79%	48.62%	30.10%	163.35%
10	19.77%	48.03%	29.22%	192.58%
11	19.51%	43.44%	27.52%	220.10%
12	13.50%	24.70%	17.24%	237.34%
13	-1.27%	-12.39%	-4.99%	232.35%
14	13.28%	63.96%	30.24%	262.59%
15	14.89%	63.26%	31.08%	293.66%
16	15.24%	27.28%	19.26%	312.93%
17	-14.95%	-13.20%	-14.37%	298.56%
18	0.64%	18.54%	6.63%	305.19%
19	22.47%	43.67%	29.56%	334.76%
20	20.28%	37.95%	26.19%	360.95%

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The above result is unlike the results exhibited by other researches where researchers found that the combined entity after the merger doesn’t provide excess returns to the shareholders. This also negates the common hypothesis formed among the researchers that a merger is either a zero sum game or a loss game for the combined entity.

SUMMARY AND CONCLUSIONS

The purpose of this study was to examine the financial implications of the Lloyds TSB-HBOS merger on shareholders’ wealth. The profitability for shareholders was investigated by examining the daily excess returns that accrue to the shareholders around the date of announcement of the merger deal. Three levels of analysis were carried out in the study namely: excess return for the shareholders of firms, announcement effect and finally excess return for the combined entity.

The study shows huge positive excess returns for the shareholders of both firms around the announcement date. The results were unlike the results obtained by the other researchers and one of the possible reasons of this kind of result can be found in the external economic conditions prevailing in the market. Since, the deal was like a rescue package for a HBOS which had lost its more than half of the market value in just few trading days, so the investors and shareholders might have taken the acquisition as a positive sign.

LIMITATIONS OF THE RESEARCH

There were few limitation in the study carried out in this dissertation. The first and the foremost limitation of this study is that we didn’t take in to account the external economic conditions to analyze the shareholders’ wealth. The excess returns may be due to some external factors affecting the stock price of target or bidding firm and in these conditions it could be erroneous to conclude that shareholders wealth is maximized by acquisition or merger.

Another limitation of the study lies in market orientated nature of the analysis. The model we used relies heavily on market values, and there may be a possibility of shareholders overvaluing the shares (Dong, Hirshleifer, Richardson, & Teoh, 2003).

SUGGESTIONS FOR FURTHER RESEARCH

Similar studies can be carried out on the larger set of merger deals. The general motives behind the merger and acquisition process among loss making or crisis suffered companies may be explored. Future research might investigate whether the shareholders' returns vary with the nature of mode of payment. The profitability of the bidder firms and target firms can be investigated for different kinds of strategies like tender offers, related mergers, unrelated

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mergers or conglomerates. These returns can be studied both for the short term as well as the long term and the performances compared.

Stock price movements (market variables) are one of the tools to study the performance of mergers. Other tools (book value) also can be used to calculate the synergy generated by such deals. A study may be conducted to examine the performance of the companies before and after the introduction of the takeover code.

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