Global Advanced Research Journal of Management and Business Studies (ISSN: 2315-5086) Vol. 5(7) pp. 162-171, July, 2016
Available online http://garj.org/garjmbs/index.htm
Copyright © 2016 Global Advanced Research Journals

Full Length Research Paper

Post-Merger Profitability Analysis: A Case of Lloyds TSB

Ahmed H. Al-dmour[1]* and Khaldoun M. Al-Qaisi, Ph.D[2].

[1]M.Sc. / Business Administration / 2015, *The University of Anglia Ruskin
E-Mail Address: ahmad.d_91@live.com
[2]Associate Professor of finance, Faculty of Business, Vice Dean of Scientific Research and Graduate Studies, Amman Arab University, Jordan
Address: Amman P.O.BOX: 2234, code 11953, Phone: Mobile 00962-777715577 or 00962-795513444
E-Mail Address: khaldoun_21@yahoo.com

Accepted 22 May 2016

This paper conducts a study of the influence of bank mergers on the financial performance of the merged banks, using the takeover of Halifax Bank of Scotland (HBOS) by Lloyds TSB in September 2008 as an example. In spite of certain limitations, accounting ratios are still convenient and reliable analytical tool in all financial decision-making processes. The results show that the financial performance of Lloyds TSB in the areas of profitability after merger is not improved significantly. This result is inconsistent with previous studies that bank M&A results in improved profitability. However, it would be incorrect to say that M&A activities are completely negative (or positive) to banks.

Keywords: Lloyds TSB, profitability, merger, financial performance, accounting ratios, decision-making

INTRODUCTION

Mergers and acquisitions (M&A) are among the most important pillars in corporate finance. They are being adopted, almost on a daily basis, by corporations as a way to achieve instantaneous growth in their business, gain a huge market share, achieve greater efficiency and to maintain a strong competitive position in the market. Among various industrial sectors the financial industry, especially the banking industry, is the most active player in the game of M&A (Focarelli et al. (2002). M&A activities affect the behaviour of stock price and the profitability of firms. Therefore, the impact of M&A on the shareholder's wealth is one of the most research area in corporate finance. This assay also aims at assessing the effect of M&A on the shareholder's wealth by focusing on the case of takeover of Halifax Bank of Scotland (HBOS) by Lloyds TSB in September 2008. Specifically, by using data obtained from Financial Analysis Made Easy (FAME) database, this assay examines the behaviour of stock prices using event study methodology and analyzing the profitability pre and post the TSP acquisition of TSB. This paper also represents the reasons for the choice of banking sector and the acquisition deal between TSB and HBOS, and discusses the rationale and theories of M&A.

Literature Review

Rational and theory of the merger

The large number of M&A transactions in different industrial sectors, especially the banking sector, is driven by several motives. This broad list of rationales (i.e. motives) can be explained by two important groups of theories of M&A; neoclassical theories and behavioral theories. Neoclassical hypothesis is based upon the proposition that rational decisions are made by rational managers that aim at maximizing the shareholder wealth. This group includes the motives that intent to increase the value of the merging firms where the owners of the firms are the effectual claimant. Under this theory, any shock to the economy, technology or regulatory environment of an industry, will results in a reaction of firms both inside and outside the industry to reallocate assets though M&A (see Harford 2005). Inc contrast, the behavioral hypothesis is based on the assumption that firm's managers do not act to the best interest of the shareholders and thus they are not rational. This group includes the motives that focus on the interests of the managers without aiming at increasing the value of the firm. (see Motis, 2007; Dilshad, 2013). Consequently, motives of M&A tend to reflect either shareholders interests or managerial interests (e.g., Saari, 2007).

Although there are several motives or reasons that banks involve in M&A transactions, we will focus on the most important ones and highlight those that are relevant to the case of the acquisition of HBOS by Lloyds TSB.

Synergy

Creating business synergy is the main theoretical argument behind banks M&A transactions. According to Dilshad (2013), it belongs to the group of neoclassical theories, which assumes that M&A will be done if the return is positive to the shareholders of both acquiring and targets firms. More specifically, synergy exists if the value or the return of the two combined firms is greater than the value or the return of individual firms before the merger. In other words, synergy refers to the phenomenon of 2 + 2 = 5 (see e.g. Ross et al., 2012; Dilshad, 2013). There are two types of synergy; operating synergy and financial synergy. Operating synergy consists of economies of scale and economics of scope (Tamosiuniene and Duksaite 2009). Sharma (2009) argue that both economies are the main drivers for M&A in bank sector. Through economies of scale, the banks slash the operating costs by lowering overheads and by combining both information technology and risk management systems. While, through economies of scope, bank merges its business with another type of financial institution to achieve benefits from selling financial services using already existed distribution network. Consequently, Ross et al. (2012) argue that both economies of scale and scope should result in a significant cost reduction to create synergy and thus a combined firm may operate more efficiently than two individual firms. Increasing operating efficiency was one of the main drivers for the acquisition of HBOS by Lloyds TSB.

Financial synergy refers to the reduction of the cost of capital of newly firm after the merger or acquisition, which results of uncorrelated cash flows of merged firms or the better match of growth opportunities with funds generated internally (Tamosiuniene and Duksaite 2009). More specifically, if one firm has extra capital but without any growth opportunities and another firm has larger growth opportunities but no excess capital, then the combined firm can achieve higher profit and thus results in financial synergy (Dilshad 2013).

Technology

It is one of neoclassical explanations of M&A waves. Harford (2005) stated that Coase (1973) is the first one to argue that industry's technological changes lead to merger. If there is a change in an industry's environment (e.g. technological changes), then managers has to response to this change to improve the performance of the firm. For example, if a firm has no access to a new technology that has been introduced to the industry, then merger or acquisition between this firm and the other that has access to this technology and has expertise may result in a positive synergy by decreasing total costs (Dilshad 2013). The acquisition of HBOS by Lloyds TSB, for example, aims at reducing cost by combining the technology of both banks, clearing unnecessary duplication of systems and combining back offices of both banks .

Access to intangible assets

Gaining access to intangible assets is also one of the driving forces behind M&A transactions. These intangible assets are considered as the most valuable assets in firms and when they come together, they result in a development in the capabilities of the firms. If merging firms have different human capital, customer capital, structural capital, organizational cultures, patents or know-how then merger or acquisition between these firms may achieve huge progress in the form of product or process innovation (Motis, 2007; Tamosiuniene and

Duksaite, 2009).

Tax benefits (Financial cost savings)

Tax reduction may be considered as a strong incentive for some M&A transactions. It could result in a financial cost saving, which does not imply an increase in the value of the combined firms. Instead, financial cost saving reflects a reallocation of wealth from shareholders to debt holders. Tax benefits come from the use of tax losses, unused debt capacity or the surplus of funds. Such tax benefits played an important role in M&A decisions, but they are not sufficient to decide whether merger will or will not occur (Motis, 2007; Ross et al., 2012).

The followings are rationales (i.e. motives) that are belong to the behavioural hypothesis and do not expect to have any effect on the product market or create value to shareholders.

Agency

The separation between owners and managers results in a difference between the behaviour of the firm in practice and what is predicted by the economic theory. This is because the managers do not represent the shareholders' interest, and thus the decisions, which expect to affect the efficiency of the firm, are taken by management has other objectives but not firm's value maximization. In other words, this motive states that the managers are looking at gains and benefits at the expense of stockholders benefits (Motis, 2007; Dilshad, 2013).

Hubris

This motive is also known as Managerial Pride. It assumes that managers are non-rational and overconfident about their abilities to manage firms and about their valuation of target firm, which, as they think, is more accurate than market valuation. This may lead them to overpay the target firm as they overestimate the expected synergies that will result from M&A. And thus cause a huge loss to acquiring firm and its shareholders. This overpayment results from an intense competition between bidders because of hubris. This motive is known also as winner's curse because winning bidder feel regret for overpay for the target firm (Motis, 2007; DePamphilis, 2011; Dilshad, 2013).

Empire building

This motive states that managers aim at expanding the size of the firm very quickly through involving in M&A transactions. Their motivation to do so is to increase their compensation, because they think it is directly attached to the size of the firm (see e.g. Motis, 2007; Dilshad, 2013).

Previous Studies

According to Focarelli et al (2002), there are two approaches to measure the success of bank M&A in terms of financial performance. By comparing pre and post M&A performance, the first approach seeks to analyses the influence of M&As based on accounting variables (e.g., Badreldin and Kalhoefer 2010) and studies investigating the cost and profit extra-efficiency (e.g., Ekkaykkaya et al., 2009), although some studies use the two approaches together (e.g., Lozano-Vivas and Weill, 2009)]. Meanwhile, the second approach analyses the performance of bank M&As using an event study methodology, which includes examination of the effects of any type of event on the direction and magnitude of stock price changes, such as the market reaction to M&A announcements through the analysis of changes in stock prices, (e.g., DeLong and DeYoung, 2007). Nonetheless, using the two approaches in analysing bank M&As provides inconsistent results, as some studies traced improved performance, while others reported no improvement, or deterioration in performance. However, Rhoades, (1993) studied the influence of M&A in banking industry on the efficiency and profitability for the domestic and cross border mergers. He came to the conclusion that domestic M&A improve the cost efficiency and create little improvement of profit efficiency and little or no improvement in the profit or cost efficiency in the cross-border mergers. Resti (1998) has explored the effects of merger on performance, target markets and the merged banks. His study also examine the extra efficiency derived from the comparison with a benchmark. He concluded that merged banks tends to have increased their efficiency in the years after the merger and it is true when the deal of merger of two banks operating on the same local markets and when the size of the new bank is not so big.

In their study on Italian banks, Focarelli, et al., (2002) found that banks were able to improve ROE after M&A as it decreased the capital and developed lending policies by restructuring the loan portfolio of the acquired bank, which increased profits. In their investigation on the impact of strategic similarities between bidders and targets on post M&A financial performance in EU, Altunbas and M. D. Ibanez, (2004) concluded that bank mergers improved equity, particularly in the case of cross border mergers. Another analysis of the post M&A performance by Campa and Hernando (2004) concluded that M&A resulted in significant improvement in the performance of banks under study in addition to an

increase in equity by an average of 7%, two years after transaction.

Studying a case in Malaysia, (Uchendu 2005) claimed that bank consolidation facilitated bank expansion, a matter that led to growth in the country's banking sector. While Cornett, (2006) dedicated his study to examining the operating performance around commercial bank mergers. The two researchers found out that bank merger significantly increases the operating performance of merged banks, as large bank mergers produce greater performance gains than small bank mergers, activity focusing mergers produce greater performance gains than activity diversifying mergers, geographically focusing mergers produce greater performance gains than geographically diversifying mergers, and performance gains are larger after the implementation of nationwide banking in 1997.

Fritsch (2007) investigated M&As long term effects on the target banks and found significant improvement in performance and loan growth. While Vennet (2002) provides evidence on operating performance changes, pre and post M&A, for U.S. banks acquired by non-U.S banking organizations, giving the example of 83 commercial banks. The researchers find that cross-border acquisitions result in improved target performance and increased profitability in cash flow as well as improvement in labor utilization, with loan losses remaining stable.

Despite the positive findings of the researches mentioned earlier, a number of studies found no evidence on performance improvement post M&A. For example, Vennet, (2002) found partial increase in profit efficiency, but with no tangible gains in terms of cost efficiency and return on assets for European merged banks on the first year after an acquisition. Meanwhile, Correa's study (2008) found no positive performance effect in the first two years after cross-border acquisitions, because profitability was affected by a decrease in the banks' net interest margin and by the lack of cost-efficiency gains. Furthermore, there is no evidence of obvious positive effects of M&A on profitability ratios such as ROE and ROA for US banks, according to DeLong and R. DeYoung (2007). Also, some studies traced deterioration in the performance of banks that underwent M&As. In a study on the performance of US bank mergers, (Knapp, et a. 2006) alluded to the finding that banks achieved profitability below the industry average. Meanwhile, Beccalli and Frantz (2008) proved a slight deterioration in ROE after M&A of European banks. A different study that aims to measure the performance of Egyptian banks after M&A by calculating return on equity to determine the degree of success of banking reforms in strengthening and consolidating the Egyptian banking sector. Badreldin and. Kalhoefer (2009) found that not all banks that have undergone deals of mergers or acquisitions have shown significant improvements in performance and ROE when compared to their performance before the deals.

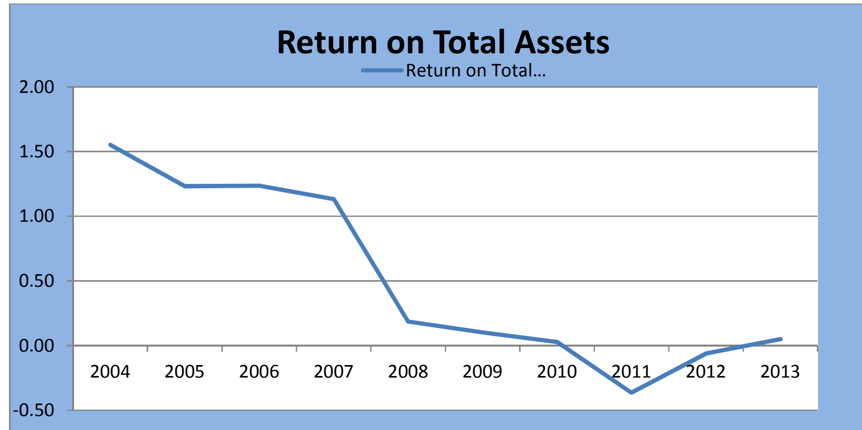
METHODOLOGY

The aim of the paper is to answer, "What is the influence of M & A on the bank's profitability?" It also explores the effects of merger on profitability of the bank by using different accounting such as ratios return on total assets, return on capital employed, and return on shareholders' funds. For this purpose, Lloyds TSB is chosen as Sample Company for this paper. The paper is mainly based on secondary data which have been collected through annual reports of the Lloyds TSB banks as well as journal and websites. The data of just preceding years of the year of merger took place has been considered for pre-merger study and the data. Financial ratios can be an important tool for business owners and managers to measure their progress toward reaching company goals, as well as toward competing with larger companies within an industry. Management makes extensive use of these accounting ratios to access the performance of the organization. These accounting ratios also help in making rational decisions and future planning for the betterment of the organization.

Justification for the choice of company and sector

As a result of global financial crisis of 2008 the financial industry has reshaped due to many corporate restructuring that took place during the crisis. One of these major restructuring is the acquisition of HBOS by Lloyds TSB, which is pushed by the UK government under a public interest ground to maintain the stability of the UK financial system. More specifically, the large withdrawals of deposits from HBOS after the sharp decline in its share prices, following the rumours about HBOS request of emergency fund from bank of England, has forced the government to facilitate the acquisition process (Peston 2008). This step aims at stop the expected downturn in the financial system and maintains the stability of the British banking sector. Both banks are the largest banks in the British banking sector. However, the choice of Lloyds TSB by British government was because of its strength at the beginning of the banking crisis. It has a market share of 9%. A HOB was the largest Mortgage lender in UK with 20% market share, but it faced serious financial difficulties because of its exposure to the funding requirements on short-term basis and bad loan portfolios (see Stephan, 2011; Ross et al. 2012).

Banking industry is considered as a back bone of any country's economy, where the failure of this important



Graph 1: Return on Total Assets
Source: FAME Database 2014

sector results in the collapse of the entire economy. Because banking sector is a vital and dynamic one, it went through huge structural changes as a result of many forces. Morris (2004) argues that, over the last 30 years, the banking industry went through significant fundamental transformations, which results in social structure and behavioural changes in the banks. The plenty economic transformations, the intense competition, technological innovation and deregulation have aroused a big wave of M&A in the banking industry around the world to improve the effectiveness of providing financial services (see (Focarelli et al., 2002; Dilshad, 2013). This should make the M&A in banking industry more important from a business perspective and hence, the market for such M&As more competitive (Ekkayokkaya et al. 2009).

Hypothesis: In order to fulfill the main objective of the study, following hypothesis has been formulated:
HOa :: Profitability of merged bank (Lloyds TSB) does not improve after merger**.**
nHOb: profitability of the merged bank (Lloyds TSB) improves after merger.(Post-merger profitability)

Financial Profitability Analysis

Financial performance pre and post-merger

A large number of empirical studies have been exclusively focus on examining different issues related to M&A. Part of these studies concentrates on evaluating the performance and profitability of firms before and after M&A. The other part, which will be discussed in the next section, focuses on stock price reaction and shareholders' wealth maximization through M&A. This section evaluates the financial performance of Lloyds TSB before and after its acquisition to HBOS, which took place on January 2009, using some financial ratios. Despite some limitation, financial ratios are considered as a proper and reliable tool for financial analysis, and most frequently used in the process of financial decision making. Furthermore, owners and managers use financial ratios to measure the progress they achieved in term of attainment of company's goals and competition with other rivals, as well as to access the company's performance (Kemal 2011). Data on financial ratios of Lloyds TSB for ten years, starting from 2004 to 2013, have been obtained from Financial Analysis Made Easy (FAME) database to answer this question does the acquisition of Lloyds TSB to HBOS improves its financial performance especially its profitability? To answer this question, operating performance methodology will be used, which focuses on comparing the financial performance pre- and post-acquisition (see Liargovas and Repousis 2011). To do this comparison, t-test is applied to examine whether the difference in the financial performance before and after the acquisition is statistically significant or not. Also, in this section a trend analysis is applied (i.e. intra-company analysis) to evaluate and analyze the financial over the time to find whether there is an improvement in financial performance or not. A set of financial ratios namely profitability ratios have been used in the analysis, which are, according to Kemal (2011), more reliable and efficient ratios to examine the profitability of a company (Because of data availability, other sets of financial ratios such as activity ratios, solvency ratios, ..Etc could not be used in the analysis).

Profitability analysis

The profitability ratios used in this analysis are: return on total assets, return on capital employed, and return on shareholders' funds. These ratios show the ability of the bank to attain profit from its assets and shareholders' equity. Table 1 shows the values of these ratios, their percentage changes, their averages, and the t-test

Table 1. Profitability analysis pre- and post-acquisition

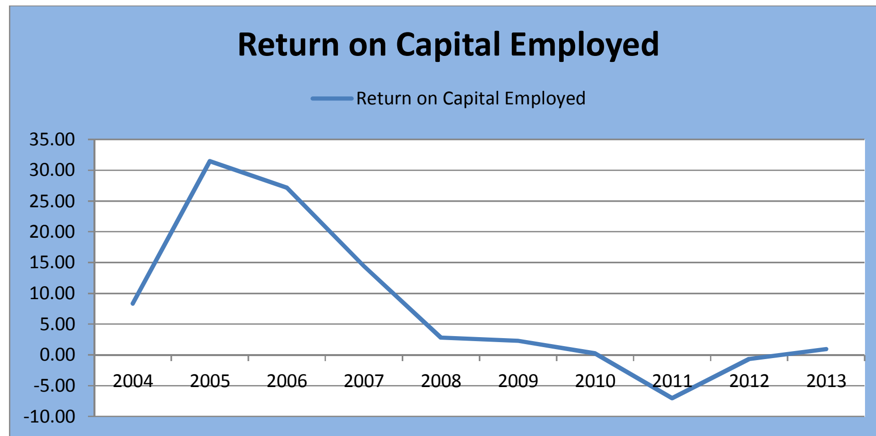
	Post-acquisition					Pre-acquisition				
	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Profitability ratios										
Panel A: **Return on Total Assets (%)**	0.05	-0.06	-0.36	0.03	0.10	0.19	1.13	1.24	1.23	1.55
%change	-1.79	-0.83	-13.88	-0.72	-0.45	-0.84	-0.08	0.00	-0.21	
Avg. Return on Total Assets	-0.05					1.07				
Avg. Difference	-1.12									
T-test statistics	-4.54***									
Panel B: **Return on Capital Employed (%)**	0.93	-0.68	-7.02	0.22	2.30	2.79	14.45	27.15	31.46	8.33
%change	-2.36	-0.90	-33.05	-0.90	-0.17	-0.81	-0.47	-0.14	2.78	
Avg. Return on Capital Employed	-0.85					16.83				
Avg. Difference	-17.69									
T-test statistics	-3.11**									
Panel C: **Return on Shareholders' Funds (%)**	1.06	-1.30	-7.71	0.61	2.41	7.17	32.95	38.08	37.47	35.01
%change	-1.82	-0.83	-13.64	-0.75	-0.66	-0.78	-0.13	0.02	0.07	
Avg. Return on Shareholders' Funds	-0.99					30.13				
Avg. Difference	-31.12									
T-test statistics	-5.12***									

*,**, and *** indicates the significance at 10%, 5% and 1%, respectively.

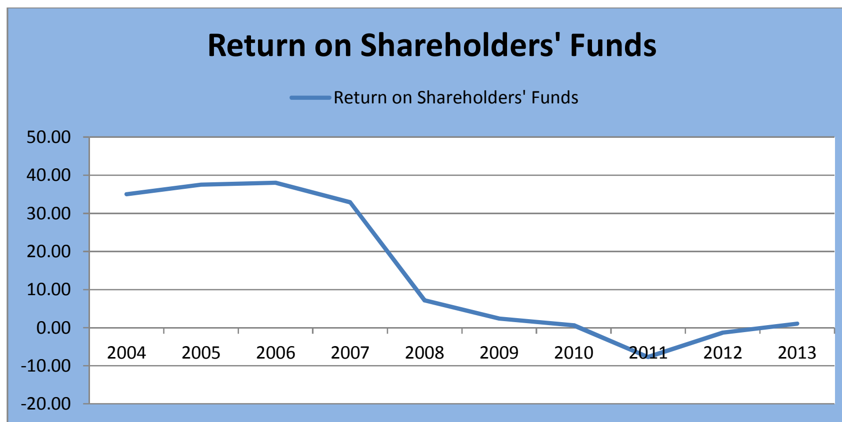
statistics that tests the difference between the averages pre- and post the acquisition. As shown in table 1, all the profitability indictors show that Lloyds TSB's profitability is declining all over the time. Regardless of the volatile behaviour of profitability ratios during the first three years of the sample, 2004 to 2006, all of the profitability indicators show a decline in their value after 2006. For example, as shown in panel A in table 1 and graph 1, the return on total assets (thereafter ROA), declines by 8% from 1.24% in 2006 to 1.13% in 2007. The drop in this ratio continues even in 2008, where the ROA drops by 84% compared with its value in 2007. One reason that can explain the drop in the profitability of Lloyds TSB in pre-acquisition period is the global financial crisis that starts in USA and hits the UK's banking sector in 2007. Even after the acquisition transaction, the profitability of Lloyds TSB still suffers as indicated by the continuous drop in the values of ROA ratio from 2009 until 2012. The year 2011 was the worst compared with other years in post-acquisition period. The value of ROA in this year is -0.36%. By looking at profit and loss statement, the bank achieved loss of £2,787 million.

Furthermore, the deterioration in the profitability of Lloyds TSB as shown by ROA is confirmed by the value and the behaviour of return on capital employed during the same period. Panel B and graph 2 show that, during pre-acquisition period, the ability of the bank to generate profit on each dollar of capital employed (i.e. long-term financing) declining steadily all over the period from 2006 to 2008. The maximum drop in return on shareholder's fund is by 81% in 2008 compared with 2007. The ability of Lloyds TSB in generating profits on each dollar of long-term financing continues to decline even after the acquisition of HBOS. The value of the ratio of return on capital employed drops from 2.3% in 2009 to -0.68% in 2012. Similar to ROA, the value of return on capital employed ratio in 2011 is the lowest, it is -7.02% compared with its other values in both periods. This drop in the value after the acquisition indicates that Lloyds TSB is inefficiently using its capital employed to attain higher return than the cost of long-term financing and its long-term financing strategies are not effective.

Return on shareholders' funds ratio also shows a bad profitability situation for Lloyds TSB during both pre- and post-acquisition. As shown in Panel C and graph 3, the bank's ability to generate profit from its shareholders' funds invested in the company starts to decline after 2006 to become 32.95% and 7.17% in 2007 and 2008



Graph 2. Return on Capital Employed
Source: FAME Database 2014



Graph 3. Return on Shareholders' Funds
Source: FAME Database 2014

respectively. That is, before the acquisition, the bank achieved approximately £0.33 on each £1.00 invested by the shareholders in 2007 compared with £0.07 in 2008. Even after the acquisition, the amount of profit achieved on each £1 of equity declines until the bank attains loss on its equity in 2011 and 2012. The bank achieved a loss of approximately £0.08 on each £1 of equity in 2011 compared with a loss of £0.01 in 2012.

In summary, the trend analysis shows that there is a clear weakness in the financial performance of Lloyds TSB in term of profitability during both periods; pre- and post-acquisition. In other words, the bank suffers low level of profitability before the acquisition, which even declines further after the acquisition to the extent that the bank attain loss in 2011 and 2012. This implies that the acquisition does not result in a financial synergy, and thus it proves to be a failure acquisition in UK's banking industry.

Furthermore, the results of t-test, in table 1 in all panels, also show that the profitability of Lloyds TSB after the acquisition is lower than that before the acquisition. That is, the difference in the averages of all profitability ratios (post-acquisition profitability minus pre-acquisition profitability) is negative and statistically significant at 5% and 1% level of significance. For example, the average of ROA ratio is -0.05% in post-acquisition period compared with 1.07% in pre-acquisition period. Thus, the results of t-test consistent with the results of trend analysis, where both confirm that the acquisition of Lloyds TSB to HSBO does not improve the financial performance of the merged bank as it should be. According to Ross et al. (2011) this is planned to achieve cost saving, however, the estimation of these costs was incorrect. This also confirms that this acquisition was not successful one.

Impact of financing announcement

This section aims at examining the impact of the acquisition of Lloyds TSB to HBOS on share price and

Table 2. Daily, abnormal and cumulative returns over the -10,+10.

Date	R_i	R_m	$E(R)_i$	AR_i	CAR	t-stat.
04-09-2008	-0.058	-0.025	-0.039	-0.019	-0.019	-0.972
05-09-2008	-0.026	-0.023	-0.036	0.010	-0.009	0.513
08-09-2008	0.105	0.038	0.058	0.047	0.038	2.422
09-09-2008	-0.007	-0.006	-0.009	0.002	0.041	0.107
10-09-2008	-0.042	-0.009	-0.015	-0.028	0.013	-1.404
11-09-2008	-0.041	-0.009	-0.014	-0.027	-0.014	-1.380
12-09-2008	0.023	0.018	0.027	-0.004	-0.018	-0.227
15-09-2008	-0.056	-0.040	-0.062	0.006	-0.013	0.301
16-09-2008	0.022	-0.035	-0.054	0.076	0.063	3.861
17-09-2008	0.000	-0.023	-0.036	0.036	0.099	1.813
18-09-2008	-0.164	-0.007	-0.011	-0.153	-0.054	-7.796
19-09-2008	0.185	0.085	0.128	0.057	0.002	2.886
22-09-2008	-0.038	-0.014	-0.022	-0.016	-0.013	-0.808
23-09-2008	-0.049	-0.019	-0.030	-0.019	-0.033	-0.976
24-09-2008	0.020	-0.008	-0.013	0.033	0.000	1.670
25-09-2008	0.023	0.020	0.029	-0.006	-0.006	-0.312
26-09-2008	-0.085	-0.021	-0.033	-0.052	-0.058	-2.650
29-09-2008	-0.144	-0.054	-0.084	-0.061	-0.118	-3.091
30-09-2008	0.042	0.017	0.025	0.016	-0.102	0.828
01-10-2008	0.099	0.012	0.017	0.082	-0.020	4.177
02-10-2008	0.047	-0.018	-0.029	0.075	0.055	3.844

thus on shareholders' wealth. In other words, the objective of this report is to find whether positive or negative cumulative returns are achieved to the shareholders of Lloyds TSB. Therefore, an event study methodology is used. The basis of this methodology is to examine the existence of abnormal returns for the shareholders around the date of announcement about the acquisition. It is widely used in the literature of merger and acquisition to assess the change in the value of shareholders' wealth.

To perform this analysis, a specific identification of the announcement date is required. In this case, the acquisition of Lloyds TSB to HBOS is announced on 18th of September 2008,, data on daily stock prices and FTSE 100 index is obtained from published data From these data, daily returns of stock, abnormal returns (i.e. excess return), cumulative abnormal return of the relevant firms, and daily market returns index are calculated. The event analysis is performed over event window of 21 days; from 10 days before and 10 days after the announcement of the acquisition in addition to day 0 which is assigned as the announcement date (i.e. event window -10 to +10).

Daily stock returns (i.e. the actual returns) are calculated from daily stock prices as follows:

$$R_{i,t} = LnP_{i,t} - LnP_{i,t-1}$$

Where $R_{i,t}$ is the return on stock *i* on day *t*, $P_{i,t}$ and $P_{i,t-1}$ are the prices of stock *i* on day *t* and *t-1* respectively. Market returns are calculated in similar way; the difference in the natural log of daily prices.

The abnormal return is measured as the difference between the actual return and the expected return of the stock as follows:

$$AR_{i,t} = R_{i,t} - E(R)_{i,t}$$

Where, $AR_{i,t}$ is the abnormal return. $E(R)_{i,t}$ is the expected return. According to Liargovas and Repousis (2011), the abnormal return is the part of the return that is not expected and, thus, it is an estimate results from the change in the value of the firm as a result of merger and acquisition. The expected return on the stock is estimated using the market mode (i.e. CAPM) as follows:

$$E(R)_{i,t} = \alpha_i + \beta_i R_{m,t} + \varepsilon_{i,t}$$

Where, $R_{m,t}$ is the market return, $\varepsilon_{i,t}$ is the residual term. Finally, cumulative abnormal return is the summation of abnormal return from day -20 to +20.

Whether the stock is affected by the event of the acquisition or not is addressed by whether the stock experiences a positive or negative abnormal return (AR) or cumulative abnormal return (CAR). Also, whether the acquisition of Lloyds TSB to HBOS creates value to the shareholders of Lloyds is addressed by whether the AR and CAR are positive or negative after the acquisition.

The results of event analysis are reported in table 2. The results show that on the date of the announcement the AR is of Lloyds is negative -15.3% and statistically significant (t-stat. = -7.796). This means that the shareholders did not expect any benefit from the acquisition. However, the AR is positive during the -3 days before the announcement but statistically significant on day -2 and day -1 before the announcement (t-stat. = 3.861 and 1.813 respectively). This may imply that the shareholders were able to get some information about the transaction before the announcement. The results also show that half of AR and more than half of CAR values after the announcement are negative, where the AR is significant at t= +1, +4, +6, +7, +9, and +10. However, the average AR (CAR) over the period [+1:+10] is 1.09% (-2.9%). More specifically, on the first day after the announcement, the shareholders seem to receive a positive AR and CAR (5.7% and 0.20%) which creates a wealth for them. But in the following days after the announcement, the CAR is negative as the gain in share prices slips downwards in most of days. This means that the market react negative to the announcement of the acquisition with respect to Lloyds TSB. This indicates that the acquisition does not create any wealth for the shareholders.

CONCLUSION AND RECOMMENDATIONS

A review of literature show that there are many motives and benefits of M & A for companies to consider after merge as an alternative strategy for enhancing their business performance and growth. This paper is conducted to examine the profitability of the Lloyds TSB bank after merger deal.

The financial crisis of 2007 - 2008, which started in USA, hits UK and significantly affected the banking sector. As a result, the UK government found that for the public interest and, thus, saving the banking sector from inevitable failure to force the acquisition of Lloyds TSB to HOBS. This reports analysis the profitability of this acquisition as well as its impact on the shareholders' wealth using operating performance and event study methodologies. The results show that the profitability of the Lloyds TSB is declined after the acquisition as indicated by profitability ratios. Also, the results of event study show that the acquisition does not achieve its objective, which is the creation of wealth for the shareholders

The findings **are found to be in conflict with** previous findings that bank M&A results in improved profitability. However, it would be incorrect to say that M&A activities are completely negative (or positive) to banks. Therefore, the Lloyds TSB bank should come up with more impressive and aggressive business strategies that would enhance its financial performance and efficiency, in order to maximize the benefit from post M&A. It is important that the Lloyds TSB should follow the same business policies and incentive plans and try to minimize the cost of capital in order to maximize the returns.

REFERENCES

Altunbas Y and Ibanez MD (2004). “Mergers and acquisitions and bank performance in Europe: The role of strategic similarities,” European Central Bank, no. 35, pp. 1-35.

Beccalli E and Frantz P (2008). “Do M & As in the EU banking industry lead to an increase in performance,” DIEF Working Paper, no. 50, Macerata.

Badreldin A and Kalhoefer C (2009). “The effect of mergers and acquisitions on bank performance in Egypt,” Journal of Management Technology, no. 18, pp. 1-15.

Campa JM and Hernando I (2005). “M&As performance in the European financial industry,” Journal of Banking and Finance, vol. 30, pp. 3367–3392.

Correa R (2008). “Cross-border bank acquisitions: Is there a performance effect,” Board of Governors of the Federal Reserve System, International Finance Discussion Papers, no. 922.

Cornett MM McNutt JJ and Tehranian H (2006). “Performance changes around aank mergers: Revenue enhancements versus cost reductions,” Journal of Money, Credit, and Banking, vol. 38, no. 4, pp. 1013-1050.

DePamphilis DM (20101). Mergers and acquisitions basics: negotiations and deal structuring, San Diego, , Academic Press

DeLong M and R. DeYoung (2007). “Learning by observing: Information spillovers in the execution and valuation of commercial bank M & As,” The Journal of Finance, vol. 62, no. 1, pp. 181–216.

Dilshad M (2013). "Profitability Analysis of Mergers and Acquisitions: An Event Study Approach" Business and Economic Research ISSN 2162-4860 2013, Vol. 3, No. 1

Duksaitė1 E and Tamošiūnienė R (2009). " Why Companies Decide to Participate in Mergers and Acquisition Transactions", Mokals-Liruvos Ateits 1 tomas, No3 Science –Future of Lithunia Vol.1

Ekkayokkaya M, Holmes P, and Paudyal K (2009). “The Euro and the changing face of European banking: Evidence from mergers and acquisitions,” European Financial Management, vol. 15, no. 2, pp. 451–476.

European Central Bank, “Beyond ROE-how to measure bank performance,” Appendix to the Report on EU Banking Structures, September 2010.

Fritsch M (2007). Long Term Effects of Bank Acquisitions in Central and Eastern Europe. [Online]. Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1008838

Focarelli D, Panetta F, and Salleo C (2002). “Why do banks merge?” Journal of Money, Credit, and Banking, vol. 34, no. 4, pp. 1047-1066.

Harford J (2005). ‘What drives merger waves?’, Journal of Financial Economics, vol. 77, no. 3, pp. 529–560..

Kemal M (2011). Post-Merger Profitability: A Case of Royal Bank of Scotland (RBS) , International Journal of Business and Social Science Vol. 2 No. 5; [Special Issue -March

Knapp M, Gart A and Chaudhry M (2006). “The impact of mean reversion of bank profitability on post-merger performance in the banking industry,” Journal of Banking and Finance, vol. 30, no. 12, pp. 3503-3517.

Liargovas P and Repousis S (2011). The Impact of Mergers and Acquisitions on the Performance of the Greek Banking Sector: An

Event Study Approach , International Journal of Economics and Finance Vol. 3, No. 2; May 2011

Lozano-Vivas A and Weill L (2009). “How does cross-border activity affect the EU banking markets?” European Financial Management, vol. 18, no. 2, pp. 303-320.

Motisi J (2007). "Mergers and Acquisitions Motives", Toulouse School of Economics - EHESS (GREMAQ) and University of Crete jrissy.motis@univ-tlse1.fr

Morris T (2004, September). Bank Mergers Under a Changing Regulatory Environment. Retrieved June 2011. http://www.jstor.org/stable/pdfplus/4148819

Peston R (2008). " The creation of Lloyds HBOS" http://www.bbc.co.uk/blogs/ thereporters /robertpeston/2008/09.

Resti A (1998). "Regulation can foster mergers, can mergers foster efficiency?" The Italian case, Journal of Economics and Business, Vol.50, No. 2, 157-169.

Rhoades AS (1993). “The efficiency effects of horizontal bank mergers,” Journal of Banking and Finance, vol. 17, no. 3, pp. 411-422.

Rossi S and Volpin PF (2005). ‘Cross-country determinants of mergers and acquisitions’, Journal of Financial Economics, vol. 74, no. 2, pp. 277–304

Sharma V (2009, December 17). Do Bank Mergers create Shareholder Value?
www.minneapolisfed.org/mea/contest/2010papers/sharma.pdf

.

Saari R (2007). "Management Motives for Companies, Mergers and Acquisitions" ,A research proposal to be presented at accounting tutorial, Turku School of Economics.

Stephan A (2011). "Did Lloyds/HBOS mark the failure of an enduring economics-based system of merger regulation?" , Northern Ireland Legal Quarterly 62(4), : 62 N. Ir. Legal Q. 539 2011

Uchendu O (2005). “Banking sector reforms and consolidation: The Malaysian experience,” Central Bank of Nigeria Bullion, vol. 29, no. 2, pp. 453-460.

Vennet RV (2002). “Cross-border mergers in European banking and bank efficiency,” University of Gent Working Paper 152.