The takeover of hbos

Introduction

Mergers and acquisitions have become the most frequently used methods of growth for companies in the twenty first century. Nowadays the information about mergers and acquisitions (M&A) can be seen every day in newspapers, internet, television… M&A can suddenly become a hot topic at anyone's workplace because their company is going to merge with another. There are many sides to an M&A transaction – strategic, legal, financial, and technological… to getting a deal done. One very important element to every deal is the human element, this should always be kept in mind. We are going to evaluate the challenges faced by the management of the new organisation in terms of Human Resource Management (HRM) with reference to the recent takeover of Halifax Bank of Scotland (HBOS) by Lloyds TSB in September 2008. The evaluation will include the role of HRM in analyzing the Lloyds TSB's decision to make a takeover bid for HBOS, how this analysis related to Culture, Conflict and Change within the organisation and possible dilemmas facing Lloyds TSB's stakeholders.

Background and purpose of the takeover of HBOS by Lloyds TSB

Background

On 17 September 2008, very shortly after the demise of Lehman Brothers, HBOS's share price suffered wild fluctuations between 88p and 220p per share, which lost almost half its market value in the week, despite the Financial Services Authority's assurances as to its liquidity and exposure to the wider credit crunch.

However, on 18 September 2008 the terms of the recommended offer for HBOS by Lloyds TSB were announced. The two lenders also revealed plans to raise a combined £17 billion under a government-funded recapitalisation programme aimed at strengthening the UK banking sector's capital reserves. The government backed the deal using a special national interest clause on the grounds that a collapse of HBOS would have had a disastrous impact on the UK.

On 16 January 2009 the Lloyds TSB acquisition of HBOS was completed following final court approval and Lloyds TSB was renamed Lloyds Banking Group plc.

Purpose of the takeover:

The proposed acquisition of HBOS would combine two powerful financial institutions, and would be another significant and positive step on our journey to provide substantial benefits and value for customers and shareholders alike.

Challenges faced by HRM in M&A

Organisational Behaviour Model

Due to the resulting pressure for the M&A to succeed, the management of the new organisation is forced to find new strategies as well as evaluate the additional challenges faced. To answer the question of how well the management performed during the integrating activity, it is useful to look at internal factors using the McKinsey 7-S framework. This framework was developed in the early 1980s by Tom Peters and Robert Waterman. The basic premise of the model is that there is a framework which maps a constellation of interrelated factors that influence an organisation's ability to change.

The McKinsey 7-S model involves seven interdependent factors which are categorized as either “ hard” or “ soft” elements:

“ Hard” elements are easier to define or identify and management can directly influence them: these are strategy statements; organisation charts and reporting lines; and formal processes and IT systems.

“ Soft” elements, on the other hand, can be more difficult to describe, they are less tangible and more specifically related to HRM. These soft elements are as important as the hard elements. A conservative estimate is that roughly 10% of people at work at any one time are directly affected by transformations of this sort. Moreover, another 30% are closely related to those experiencing combination-related tensions and trauma (Buono and Bowditch, 2003). These figures show how the critical challenges faced by management in every M&A relate specifically to HRM. The company that effectively addresses people-related issues up front and throughout integration will have a better chance of succeeding and gaining the competitive advantage it seeks.

The challenges faced by management in term of HRM in M&A.

The HRM issues in the M&A can be classified in two phases; the pre-M&A phase and the post M&A phase. HRM should be involved from the beginning and throughout all stages of the M&A process. Due diligence is important in the first phase while integration issues take the front seat in the later phase, including:

1. Cultural clashes:

2. Each organisation has a different set of beliefs and value systems. The exposure to a new culture during the M&A leads to a psychological state called culture shock. Dissimilar cultures can produce feelings of hostility and significant discomfort which can lower the commitment and cooperation on the part of the employees, therefore post-merger ' cultural clashes' are often blamed for disappointing M&A outcomes.

According to Anders Spilling and Jarle Høien, managers in BearingPoint's Business Strategy and Transformation pratice, there are five areas of cultural conflict:

- Leadership: every company's leadership style can seem unique. When post-M&A senior leaders sitting at the same table motivate their staffs and resolve conflicts in diverse ways the resulting friction often creates additional risks. Examples of these risks could be a lack of commitment to new company goals or a high level of turnover among key employee groups.
- Governance: effective corporate governance requires much more than a system to protect stakeholder interests. It must encompass the way decisions are made in each part of the company and across organisations. One problem that usually arises is the debate over whether the new organisation should adopt one merger partner's governance model or define a different model.
- Communication: Attitudes about confidentiality, preferences for formal versus informal channels and the frequency of communications may all come into play. By anticipating these

risks well in advance, the acquiring company's leadership can develop communication tactics that best support the merger objectives.

- Business process: most companies have distinct ways of developing, updating and enforcing core business processes which must be understood and respected during the integration phase. If changes in core business processes are not deliberately and systemically thought through during the integration phase, organisations face the risk of internal breakdowns and failures in delivery of products and services to customers.
- Performance management and reward systems: new organisation should include efforts to harmonize performance standards and compensation systems where possible, while explaining important differences when necessary. Newly merged companies must help employees understand that their different recognition and reward systems are fair, even if not always uniform across the organisation.

Because cultural change involves both hard and soft issues, HRM considerations will include visible manifestations such as key performance indicators, communication styles, employee interaction…, as well as less tangible corporate values and assumptions about how a company does business, such as how leaders drive and assess results and new organisation governance model… These findings have important implications for how organisations can anticipate post-merger cultural clashes and tailor leadership programs to address their underlying roots, ultimately enhancing merger success rates.

3. Uncertainty job security:
4. The M&A leads to duplication of certain departments, bring about the excess manpower and downsizing is, unfortunately, an inherent result. Hence talking about M&A, the first set of thoughts that occur in the minds of employees are related to security of their jobs, changes in designation, career path, working in new departments and fear of working with new teams. The M&A also changes future opportunities for the employees in the organisation. Some employees also have to be

relocated or assigned new jobs. This may have an impact on the performance of the employees and cause the organisation to lose some talent. The enormous challenges posed by an M&A to the HRM are keeping all employees informed of all crucial decisions as well as enhancing effective two-way communication by involving line managers; ensuring an equitable and fair treatment of employees and in case of lay-offs, HRM should offer outplacement services and fair severance packages.

All these efforts from HRM can help build trust, quell the rumour mill, relieve anxiety, focus people on the business and its possibilities and lessen productivity loss.

5. Inability to manage changes:
6. Often there are rapid changes in the business environment after M&A. Internally HRM will manage a bigger work force, externally HRM's industrial relations will be extended… The role of HRM is to quickly

develop a HR plan to lead the process for helping the company to achieve the synergies it needs. The HRM must fully be prepared for the significant role they will play throughout the M&A process. The issues faced by HR professionals when supporting the M&A are extremely demanding they require the creation of a single unified organisation with a clear purpose and set of values from two groups of people with different cultures. HRM should continuously update their knowledge and skills in managing, controlling and monitoring the enlarged workforce, HRM need the ability to adapt to changing circumstances, acknowledge the problems when they arise, improving communications skills, create training programme, explain new roles to employees, implement stress reduction programmes and orientation programmes, help post merger team building and feedback helpline for employees.

The issues faced by HR during M&A deals are enormous, yet it is clear that the key to the success of an M&A is the management of people. By identifying the common challenges and finding solutions which work for the new organisation. The value of HRM in the M&A should be realised early enough to enhance the chances of a successful deal.

Analysing Lloyds TSB's decision in making a takeover bid for HBOS.

Issues related to Culture, Conflict and Change:

The theory mentioned above regarding issues related to organisation development in term of culture, conflict and change applied very closely to the general challenges faced by the new Lloyds TSB organisation in the post-takeover period.

1. Culture
2. The basis of corporate culture is shared values. These values must be stated as both corporate objectives and individual values, explicit or implicit fundamental beliefs, concepts, and principles that underlie the culture of an organisation.

Lloyds TSB and HBOS were two of the UK’s leading financial services companies, they have some similarities in organisational structure. According to Charles Handy (1985), who popularized the work of Roger Harrison (1972), has linked organisational structure to organisational culture, both Lloyds TSB and HBOS have “ Role culture” in where people have clearly delegated authorities within a highly defined structure. Power derives from a person’s position and little scope exists for expert power. Lloyds TSB and HBOS rest on the strength of strong organisational ‘ pillars’-the functions of specialists, for example, customer advisors, banking advisors, personal financial advisors…

On closer inspection, each of them will have its own unique culture, and like most large businesses are likely to be something of a mix of culture and even, each branch, or division has its own culture.

From table 1- Soft elements by McKinsey 7-S framework in Lloyds TSB and HBOS, while Lloyds TSB creates an exciting place to work with a lively and fun atmosphere, they affirmed on their website that they have a work hard, play hard culture. HBOS seems to have a more formal working environment with very professional attitude in their approach to work, results-driven, always looking for more ways to move forward and over-achieve.

About leadership style, Lloyds TSB built a feedback and coaching culture with regular appraisals twice annually based on Key Performance Indicator system with hierarchy structure. HBOS employed a non-hierarchical culture where everyone was treated equally, fairly. The communication system in Lloyds and HBOS followed these styles as well, hierarchy and non-hierarchy respectively. I don't think these differences in leadership style and communication system were sufficiently considered in the takeover decision.

Governance model of Lloyds and HBOS were almost the same, the core purpose was to ' make it better' for their staff, customers and to maximise shareholders value over time. Both groups were led by a board comprising executive and non-executive directorswith wide experience. The roles of the chairman, the group chief executiveandthe boardand its governance arrangements, including the schedule of matters specifically reserved to the board for decision, were reviewed annually.

Lloyds and HBOS had very different ways of doing business. Lloyds was very conservative, largely a consumer bank. HBOS was aggressively following the high risk business model, HBOS transformed their traditional banking activities into global trading and speculative operations with little oversight and policing. Although the way of doing business is very important in choosing a strategy for the organisation, the unexpected result of HBOS's strategy and the dominance of Lloyds in the takeover meant that the new merger organisation did not take time to affirm which business model should be followed, therefore this aspect was not critical in the decision making of the takeover.

The performance management and reward systems: The Lloyds performance approach includes objective setting using a balanced scorecard, Lloyds has regular performance reviews with competitive remuneration package. HBOS has results-driven rewards, always looking for more ways to move forward and increase achievements. The salary they received is only the beginning because for every role there was a tailor-made total rewards package which was based around three key areas: Performance, Flexibility and Choice. Furthermore, remuneration package for each role, contributory pension scheme, share-save and share-plan schemes, numbers of holidays…. are hard to match between the two organisations. These differences of culture will involve much due diligence to identify implicit as well as explicit issues and will require time to build up a proper plan for HRM. The outcome of this plan has an integral role in the decision of the takeover.

As the result of the takeover, the above differences in culture mean that the exposure to a new culture is unavoidable. The employees of both Lloyds and HBOS not only need to abandon their own culture, values and belief but also have to accept an entirely different culture. The takeover also leads to changes in organisational climate, the main source of organisation conflicts, which are summarized below

3. Conflict
4. Post-takeover integration demands significant involvement in all level of organizations, both Lloyds and HBOS, causing conflict at work from individual level to organisation level.
    - Organisation cultural: there is no doubt that Lloyds's culture is dominant and may lead to feelings of superiority among some of

the employees. The employees of non-dominating culture, HBOS, may also get feelings of loss of identity associated with Lloyds. The dissimilarity in the cultures can produce the feelings of hostility and significant discomfort, for example HBOS may feel uncomfortable with the hierarchy of organisation structure and the communication system of Lloyds. In case of hostility in certain environment, some teams may develop “ us” versus “ them” attitude which may be detrimental to the organisational growth.

- Conflict in maintaining stability: The need for reform in organisation structures, redefinitions of assigned duties and responsibilities, adjusting the procedures and methods of work after the takeover, can result in conflict in maintaining stability. There should be a commitment to maintain employment in those parts of the UK in which either HBOS or Lloyds TSB currently have significant operations. This should be backed by a commitment to take all possible steps to avoid involuntary redundancies in order to avoid the potentially devastating impact on local communities and economies of large site closures.
- Conflict in investment in resources: both Lloyds and HBOS have their own large resources that may already be committed to investments in other areas or strategies before the takeover. As this takeover had a short notice period, assets such as branch offices, CRM software, equipment and people which have just been invested cannot easily be altered, thence conflicts arise. Which invested categories should be dropped? In fact, HBOS had

in-house call centre operations, while Lloyds had a policy to outsource or off-shore its call centre. Each call centre model has its own advantages and disadvantages, what operation model should be maintained? In the short term, HBOS calls for Lloyds TSB to review all existing and planned outsourcing or off-shoring of operations to maximise employment opportunities in the UK for current employees.

- Conflict with past contracts or agreements: Both Lloyds and HBOS entered into contracts or agreements with other parties, such as government, trade unions, suppliers, customers and their own employees. These contracts and agreements can conflict with the changes cause by the takeover. For example, there should be a statement from Lloyds TSB committing that HBOS employees pay, pension provisions, employment benefits will be protected. Also, there should be a commitment that if there are new terms and conditions of employment for HBOS and Lloyds TSB staff, those should be no less favourable than the terms and conditions applying before the acquisition.
- Conflict in power or influence: Another practical problem is differences in the grading or organisational structures. The organisational structures used have different designations for the employees. During the integration Lloyds need to develop a mechanism to remove the differences in the grading systems, bring them to equal levels between Lloyds and HBOS, introducing standard levels of control over decisions, resources or information. Lloyds TSB should make a commitment to dignity at

work for all employees and commit to the highest standards in relation to equality, diversity, equal pay and future career development opportunities post-takeover.

The reaction of the employees in conflicts can vary from anger to dejection and depression. There can also be a fall in the morale, commitment and loyalty which can lead to impaired performance. Identifying the conflicts in advance will help Lloyds TSB management decide on the takeover. I think Lloyds TSB management was confident enough in their ability to control the above defined conflicts and believed that they would get more chances of success in the changes below:

5. Change:
6. In the decision of the takeover bid for HBOS, Lloyds TSB management board had targeted the opportunity to change for a stronger Lloyds Banking Group. As a common reaction, every change in the enlarged Lloyds TSB is resisted at both the individual and the organisational level. According to Alvin Toffler (1970), people are naturally wary of change and suspicion is out of control. Besides the changes in strategic, legal, financial and technology, the changes in HRM should be carefully designed and proceed with gradual pace. As part of the decision regarding the takeover, Lloyds TSB had considered the strategy to overcome the individual resistance and organizational resistance. Monday 19 January is Day one, the two brands still remain separate. A spokesperson for Lloyds TSB said: ‘ It is business as usual.’ This statement helps to maintain the secure feelings in customers, shareholders and employees.

From the early stage of the takeover, Lloyds TSB had set up a guiding team to provide change leadership and handle every steps of the change process. They have created a website to update on a regular basis to shareholders, employees and customers on the proposed acquisition of HBOS by Lloyds TSB and to give them information about the Lloyds Banking Group in this rapidly changing environment. Divisional changes will be communicated via line management and divisional intranet sites. HBOS partner unions, Accord and Unite, will continue to play an important role as before in the new business.

There will be no major changes for the vast majority of HBOS employees. The existing HR policies and procedures remain in place. The 2009 pay review will be in May as usual. There will be little immediate change to Total Reward. The current pension arrangements will continue for all employees. Initially, there will be no change to the HBOS performance management approach. Employees will be introduced to the Lloyds Banking Group performance approach during 2009.

Lloyds TSB was aware of the default response of resistance during the change of the takeover decision. Therefore they had suitable response to manage the sustaining of a healthy climate in order to gain a commitment to change in the whole organisation.

Dilemmas facing Lloyds TSB’s stakeholders

Lloyds TSB and HBOS had, on a number of occasions over the years since 2000, discussed the possibility of a merger. It was only the unique circumstances of September 2008 that enabled this transaction to happen with the nature of the Government’s involvement in the banking sector. In particular, the purpose of Government's interventions that is to stabilise the banking system, provide liquidity and to encourage more lending. Following the collapse of Lehman's, closely followed by the nationalisation of the world's biggest insurance company AIG and the spreading of the world recession meant that the Government needed to take swift and decisive action by taking the extraordinary step of waiving competitions concerns to get the deal done.

Lloyds TSB management board was very aware of the compelling logic of this transaction, including the substantial market positions they would secure and the significant and substantial synergies, the opportunities for growth which a stand-alone Lloyds TSB might not have been in a position to deliver to the same degree. Furthermore, the opportunity to acquire HBOS only came about in the middle of economic adversity and in conditions which are unlikely to be repeated.

Besides the support from Government and the opportunity for growth, Lloyds TSB management board was very mindful of the difficult economic backdrop to this transaction with the prospect of further declines to come. However, Lloyds TSB purchased £17. 9 billion of HBOS net asset value for £7. 7 billion so, they were very much convinced that this was the right transaction for Lloyds TSB. The short-term outlook was indeed difficult and problems with the finances of HBOS will not disappear overnight. However, the earnings potential of Lloyds Banking Group will be significantly improved in the longer term.

Lloyds TSB directors also understood that after the takeover, to reduce the systemic risk in the UK banking system, the recapitalization scheme has already cost Lloyds its 240-year-old independence. The UK Government, as part of the capital raising process, has now become a 43. 4 per cent shareholder in the group.

As part of Her Majesty's Treasury (HMT) recapitalisation scheme, the Group was required to suspend the payment of cash dividends to ordinary shareholders until the HMT preference shares issued as part of the scheme are repaid. This is considered as a noticeable contribution from Lloyds TSB shareholders in their favourable voting for the takeover.

One big concern to the Lloyds TSB employees and unions is the redundancy issue during the global financial recession. Although Lloyds TSB and the government dismissed reports of redundancies involving one third of the workforce and pledged to continue using HBOS headquarters in Scotland, the union leaders believe the job cuts will be about 15, 000 in one year out of a 140, 000 workforce. This brings concern to the employees about the serious plan which is designed to protect the members' jobs and terms & conditions of employment.

The government's dilemma is how to stabilise the banking system and maintain an equitable business environment. The management board's dilemma is how to continue growing and manage the burden of the ailing HBOS, between short term and long term outlook. The shareholders' dilemma is the potential of future substantial share value versus waiving current dividends or the workforce redundancies. In the context of the economic downturn in autumn 2008, Lloyds TSB had to consider the weighting between the benefits and adversities of the takeover, it was really the hard dilemma facing Lloyds TSB's stakeholder in making the decision of the takeover.

Conclusion:

2008 was a very difficult and challenging year for the banking industry, the deteriorated market conditions have continued into 2009, both in the UK and overseas, a prolonged period of economic difficulty for many households and companies. The UK Government had to intervene in the banking system by providing capital and liquidity where the markets had failed.

At times of great economic and financial uncertainty, many apparently settled ideas come under great scrutiny. When Lloyds TSB announced it was acquiring HBOS plc; and now about a year since the transaction was completed (16 January 2009), the deal is still receiving ceaseless criticism. Critics should consider what would have happened to the UK banking industry and the UK economic situation if the takeover had not taken place? If HBOS had failed, how many HBOS branches would have closed? How many employees would have lost their job? How many bank accounts of customers would have been affected?

As a bank with a strong focus on customer relationships, Lloyds TSB is committed to helping its customers wherever possible to manage their way through these challenging times. Without doubt, the Lloyds Banking Group have spent great deal of time to overcome the challenges faced and fulfilled all necessary obligations to society. Here, never forget to mention about the crucial role of Human Resource Management during the pre-takeover and post-takeover. With only a short period of time for preparation, Lloyds TSB Human Resource Management have tried their utmost to create new HR practices and strategies that meet the requirements of the takeover. Employment law challenges, culture clashes, talent retention, employee engagement, recognition and conciliation conflicts, the HRM of Lloyds TSB has harmonised all activities in all phases leading to the creation of a unified organisation with a mission, vision, a clear purpose and values from two culturally different groups. Although there are some shortcomings due to subjective and objective factors, the job that Lloyds TSB Human Resource Management is doing for employees and company is very valuable and highly valued, and it managed not to cause a big disturbance in the UK labour market.

Finally, the decision by Lloyds TSB to takeover HBOS appears to have been the right transaction for the company. The support from government was definitely necessary and the favourable vote from both Lloyds TSB and HBOS shareholders showed that they believed this to be the best solution to the problems of both banks.

The short-term outlook for the enlarged Group is challenging. Whenever economic conditions do begin to normalise, however, we believe Lloyds TSB will be in a very strong position to reap the benefits. Their strong franchise across the whole range of product lines will enable them to do just that. One of the most important ways in which leading businesses differentiate themselves from their peers is through the quality of their people and their strong commitment and Lloyds Banking Group believes that they have the qualities and the right people to ensure the bright future.

APPENDIX 1: Background of Lloyds TSB and HBOS

Lloyds TSB Bank Plc is a UK-based financial services group, which employed about 70, 000 people. It was established in 1995 by the merger of Lloyds Bank, established in 1765 and traditionally considered one of the Big Four clearing banks, with the TSB Group which traces its origins to 1810, creating Britain’s largest retail bank, over all, Lloyds-TSB would be the fourth-largest bank on the stock exchange in terms of assets. Lloyds provides a wide range of banking and financial services to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general and life insurance, pensions and investment provision. Its services are offered through a number of brands, including Lloyds TSB, Cheltenham & Gloucester and Scottish Widows. Its UK turnover in 2007 was £18 billion.

HBOS is a financial services group, which employed about 72, 000 people in the U. K., was created in 2001 in the 9. 7 billion-pound merger of Yorkshire-based mortgage lender Halifax Plc and Edinburgh-based the Governor and Company of the Bank of Scotland. It is the UK’s largest mortgage lender. HBOS provides a range of banking, insurance, financial services and finance-related activities in the UK and abroad. Its UK turnover in 2007 was £4. 25 billion.

The deal of takeover of HBOS by Lloyds TSB was concluded on 16 January 2009. The three main conditions for the acquisition were:

- Three Quarters of HBOS shareholders voted in agreement with the board's actions;
- Half Of Lloyds TSB shareholder voted to approve the takeover;
- UK government dispensation with respect to competition law.

On 19 November 2008, Lloyds TSB shareholders voted 95. 98% in favour of the takeover. They also approved plans to raise £5. 5bn by issuing new shares and special preference shares.

On 12 December 2008, the takeover was approved by HBOS shareholders.

A group of Scottish businessmen challenged the right of the UK government to approve the deal by overruling UK competition law, but this was rejected. The government has allowed the takeover of HBOS by Lloyds TSB to bypass normal competition rules. The exchange of HBOS shares for Lloyds Banking Group shares took place at an exchange ratio of 0. 605 of a new Lloyds Banking Group share for every one HBOS share held. As a result, the UK Government through Her Majesty's Treasury owned approximately 43. 4% of the enlarged ordinary share capital of Lloyds Banking Group.

Lloyds Banking Group is now the largest financial services franchise in the UK with a range of leading market positions in important product lines, such as savings, current accounts, mortgages, insurance and long-term savings. They are also a leading player in the Small and Medium Enterprise (SME) and wholesale banking sectors. The Group clearly has a very significant retail banking footprint and, with approximately 3, 000 branches, is present in more UK locations than any other financial institution.

Lloyds TSB Chief Executive Officer Eric Daniels will be Chief Executive of the enlarged company, and the bank's Victor Blank will be Chairman.

References

- Mullins, L. J. (2007) Management and organisational behaviour. 8th edn. London: Prentice Hall
- Buono, A. F. and Bowditch,