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How to preserve firm value during mergers and acquisitions

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Researchers from San Diego State University, University of North Carolina at Greensboro, and University of Georgia published a new paper in the *Journal of Marketing* that shows that customer

dissatisfaction with M&As can negate any gains in synergy and efficiency.

The study, forthcoming in the *Journal of Marketing,* is titled "Despite Efficiencies, M&As Reduce Firm Value by Hurting Customer Satisfaction" and is authored by Nita Umashankar, S. Cem Bahadir, and Sundar Bharadwaj.

The sheer enormity of mergers and acquisition (M&A) activity suggests that they must be rewarding, otherwise firms would not engage in them. M&As allow firms to reduce prices and innovate, both of which should satisfy customers. Further, M&As generate synergies, which enable firms to become more efficient through improvements in scale and scope, which leads to cost savings.

However, M&As typically lead to poor financial results. This has been explained by overpayments as a result of optimism regarding synergies and cost efficiencies. However, this new study shows that a key reason for the failure of many M&As is due to customers' dissatisfaction with the M&A process.

Why do M&As harm customers? M&As are incredibly expensive, complex, and heavily scrutinized by investors. Further, M&As are often paid for by corporate debt. As a result, executive attention is diverted to the price of the deals, capital requirements, paying back debt providers, and appeasing investors. In the process, customer experience is underinvested in, or even overlooked. The researchers demonstrate that during M&As, executives turn their attention away from customers and toward financial and debt-related issues, which then harms the customer experience and satisfaction.

How specifically does this turn of attention by the firm affect customers? First, M&As often result in layoffs to reduce redundancies,

which, while beneficial from an efficiency perspective, harms the customer experience. The remaining employees that are not laid off are likely to be stressed and their dissatisfaction with a major corporate shake-up negatively affects customers and the service they experience. Second, firms may either change or consolidate procedures such as credit policies, payment terms, and loyalty programs during an M&A to minimize the complexity of managing two separate systems. While these actions may be efficient, customers are likely to see their hard-earned privileges curtailed or taken away. Third, firms may consolidate products and brands or eliminate them altogether, resulting in customers' loss of preferred products and brands. In fact, customers defect even before they know exactly how an M&A will affect them. As Umashankar summarizes, "Customers who face poorer service, a loss of privileges, and a loss of favorite brands and products will feel negatively about their relationship with a post-M&A firm."

To demonstrate the financial impact of M&As due to customer dissatisfaction, the researchers compared the firm value of M&A and non-M&A firms due to differences in customer satisfaction and firm efficiency. Compared to that of non-M&A firms, the customer satisfaction of M&A firms was 1.14% lower a year after the M&A. In contrast, compared to that of non-M&A firms, the efficiency of M&A firms was .29% higher in the same period. The value of M&A firms was 2.43% lower than the non-M&A firms a year after the M&A, which translates into a loss of $481 million for the average firm in our sample. "Although firms may be motivated to pursue an M&A to exploit scale-related synergies that provide cost-benefits, we show that efficiency gains fail to compensate for customer dissatisfaction-related financial losses," says Bahadir.

Thus, it is essential for firms to allocate some of their attention to customer-related issues. The financial payoff of such attention is meaningful. M&A firms that pay greater attention to customers relative

to financial issues experience a 45% reduction in loss of firm value from the M&A. Executive attention to customers can help firms significantly reduce M&As' damaging effects on customer satisfaction and firm value.

A potential remedy is to have a marketer on the board of directors, which can reduce customer dissatisfaction from an M&A and thus increase firm value. Given that a marketing leader is a custodian of customer interests, he or she provides marketing-related advice to the board and the executive team, which ensures that firm strategies are customer-centric. During an M&A, marketers on the board help minimize a depletion of executive attention on customers and marketing-related issues, which then lowers customer dissatisfaction. Bharadwaj explains that "We find that the value of a firm with just one person with a marketing title on the board in the post-M&A year was 4.28% higher compared to firms that did not have any marketing representation. Adding these board positions is not trivial, especially during an M&A process. However, the financial consequence of not having marketers on the board during M&As is severe."

Overall, executives and M&A consultants must make customers (in addition to investors, banks, and regulators) part of their conversation when considering engaging in an M&A.

More information: Nita Umashankar et al, EXPRESS: Despite Efficiencies, M&As Reduce Firm Value by Hurting Customer Satisfaction, *Journal of Marketing* (2021). DOI: 10.1177/00222429211024255

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