The Persistence of Customer Incompatibility: Evidence From a Retail Bank Acquisition

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Incompatible customers, whose needs and behaviors are misaligned with the operation, pose a significant challenge for service businesses. They undermine focus (Fitzsimmons & Fitzsimmons, 2006; Skinner, 1974; Tsikriktsis, 2007), introduce operational complexity, and are served with less efficiency and effectiveness than their more compatible counterparts (Roth & Jackson, 1995). However, the persistence of customer incompatibility is not well understood. On the one hand, theory suggests that customers make rational and optimal choices, such that an incompatible customer may be a short-lived problem – switching rapidly to a firm that is better equipped to serve his or her needs (Cohen & Whang, 1997; Sutton, 1986). On the other hand, frictions such as information asymmetries (Israel, 2005), switching costs (Farrell & Klemperer, 2007), and the limited availability of local options may prolong incompatible customer relationships, and in such cases, it is unclear whether their preferences will conform or the incompatibility will persist over time.

To explore these dynamics, we leverage a natural experiment that arose in the aftermath of a nationwide retail bank acquisition. Prior to the acquisition, the acquirer and target banks, which each had thousands of branches across the United States, operated differentiated service models that targeted customers with dissimilar needs. The branch networks of these two firms overlapped in some markets, giving customers in those markets the opportunity to choose which of the two banks suited them best. In non-overlapping markets, the customers had no such choice. We use this natural variation to identify ex-ante differences in customer compatibility with the acquirer bank, reasoning that customers who actively chose not to transact with the acquirer would be less compatible with it on average than customers who were not given an opportunity to reveal their preferences.

Following the acquisition, the branch integration process, wherein routines were changed over, employees were retrained, branches were re-branded, and customer accounts were converted, took place in a staggered fashion (one state at a time) over a three year period. We use a difference-in-differences empirical strategy to analyze how the satisfaction and intended loyalty of 979,209 legacy and acquired customers changed in response to the service model conversion.

Controlling for market and transaction-level differences, we confirm that the transaction satisfaction, overall satisfaction, and intended loyalty of acquired customers declined precipitously following the conversion, and persisted at diminished levels even 24-36 months following the integration. Interestingly, these declines were driven primarily by the "less compatible" acquired customers, who had actively chosen not to engage with the acquirer prior to the acquisition. "More compatible" customers, by contrast, reported an initial decline in satisfaction following branch integration, but after a year, exhibited patterns that converged with those of non-acquired customers. These patterns highlight the capacity of customers to make prudent choices among competing firms. Customers report significant declines in satisfaction and loyalty following their conversion to an operating model they did not select themselves, and the effect is most pronounced among customers who had actively declined that model.

Furthermore, our results suggest that customer incompatibility may be a persistent phenomenon. In particular, among the 483,868 acquired customers, those who were flagged as "less compatible" prior to the acquisition exhibited a significantly bigger and longer-lasting decline in transaction and overall satisfaction following the conversion. Even 24-36 months after, the “less compatible” customers who remained with the bank reported larger declines in transaction and overall satisfaction than their “more compatible” counterparts.

These results suggest that the customer acquisition practices of service firms may have important long run implications for their operating performance. In particular, they highlight a persistent operational challenge associated with growth by acquisition strategies and blanket marketing campaigns that fail to account for the needs and behaviors of customers they bring to the firm. Customers who are poorly aligned with the firm may remain so, neither defecting nor adjusting to its operating capabilities. To the extent these customers are persistently less satisfied, they may cost more to serve, undermine employee morale, and inhibit the firm’s reputation for quality.

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