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Family firms and product recalls: an event study for the US automobile industry

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Abstract

Purpose – This study explores whether the unique organizational form of family firms helps to mitigate the negative effects caused by the announcement of product recalls.

Design/methodology/approach – The authors use an event study, for a sample of 2,576 product recalls in the United States (US) automobile industry, between January 2010 and June 2021.

Findings – The authors found that stock market's reaction to a product recall announcement is less negative for family firms. This superior performance is partially driven by the family firms' long-term investment horizons and higher strategic emphasis on product quality. However, the relationship between family ownership and cumulative abnormal returns around product recall announcements is nonlinear as the impact of family ownership starts by being positive but becomes negative for higher levels of family ownership. The authors also find that family firm's chief executive officer (CEO) and managerial ownership influence positively the stock market reaction to product recall announcements.

Practical implications – This work has several implications for family firms' management as well as for investors and financial analysts. First, as higher managerial ownership is associated with a greater emphasis on product quality, decreasing stock market losses when a product recall occurs, family firms should consider increasing equity-based compensation. Second, as there seems to exist an optimal proportion of family ownership, family firms should consider the risks of increasing too much their ownership share. Third, investors and financial analysts can use the results in the study to help them in their investment and trading decisions in the stock market.

Originality/value – The authors extend the knowledge of product recalls by studying the under-researched role of the flexible, internally focused culture of family businesses on the stock market reaction to product recalls.

Keywords Product recall, Family firms, Stock market reaction, Event study, Automobile industry

Paper type Research paper

1. Introduction

According to Dawar and Pillutla (2000) a product recall event takes place when a firm's product does not conform to mandatory safety standards or contains a defect that may lead to unreasonable substantial damage, serious injury or death to customers. A product recall can be "*among firm's worst nightmares*" (Van Heerde *et al.*, 2007, p. 230), because it tends to cause consumer panic, substantial costs, financial supply chain disruptions and damage of reputation (e.g. Zhao *et al.*, 2013; Ni *et al.*, 2016). Due to globalization, increased demand and product complexity, as well as stricter product safety legislation, product recall events have dramatically increased in frequency in recent times (Dawar and Pillutla, 2000).

An issue that seems essential in the product recall process, but which has been almost ignored, is the role played by the firm's organizational culture. Wowak and Boone (2015) refer to a set of research opportunities on the subject of product recalls, highlighting the little knowledge that exists about the impact of family firms on the firm's probability of experiencing

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