Impact of Product Recall on Share Price
We often talk about the impact of a crisis on a business. Specifically, how a business responds to a crisis will be a major factor in determining when, and whether, that business recovers. This is surely true, but we wanted to look beyond good crisis management and focus on what other factors are involved that may impact the company’s value during and after a crisis. Could the type of crisis be important, the size of the company, or the public awareness of the brand involved?

We wanted to understand what specific factors may increase the likelihood that the share price of companies experiencing recalls are negatively impacted. If you work for a company that has an elevated risk of share price impact from a product recall crisis you better be prepared. Read on to find out if your business fits that profile.

“Could one type of company be more at risk than another; even before a crisis has hit?”
In this paper we focused on the change in share price of 15 food companies that had experienced a product recall. We recorded the share price leading up to and following each product recall. Product recall is the correct, responsible and legal course of action to take in order for companies to protect the safety of their consumers. We recognise that any company can have a product recall and it is likely that all companies will experience recall at some point.

Food and beverage recalls

The intention here is not to evaluate the effectiveness of recall action or explore the reasons for the recalls; but rather to attempt to identify the reasons for the impact of the product recall on share price. It is also important to note that share price reflects many aspects of a company’s performance concerning internal and external market factors which are not considered here.
Background to study

There are vast numbers of food product recalls with all types of food products being involved. The graph below shows the RASFF notifications and US FDA Recall events from 2014-2018. The 2018 number is estimated based on the numbers for Jan-Aug 2018.

We looked at the share price of food companies who were involved in product recalls. The selection criteria were as follows:

- The product recall must have taken place between 2012 and 2017 with the majority between 2015 and 2017
- The company must be publicly traded

In total, 15 companies were included. This is a limited data set but it enables important observations to be made. We looked at 6 companies whose share price was negatively impacted by a product recall and a further 9 companies where the share price in the days after the product recall announcement did not reduce at all or in worst case, reduced very slightly before a rapid bounce back.
The share price data was recorded 5 days before “day zero”, the date of the official recall announcement either by the food company or by the authorities. It was then recorded for a further 120 days after day zero.

The share prices of the food companies were divided into two groups; those whose share price reduced substantially following a product recall and those whose share price appeared unaffected by the recall. The percentage change in share price from day zero was calculated and the average of data from the two groups of food companies was plotted in the graph below.

The average share price change of the two groups follows a substantially different profile. The companies where the product recall has an impact on share price shows an immediate and rapid decline in value, down by an average of 15% across the companies in this set. The line shows that the average share price does not recover within the 120 days. This is of course an average, but in fact the share prices of 4 of the 6 companies do not recover back to the day zero price within 120 days.

In contrast, the average share price change from the other set of companies shows a gradual increase in share price after day zero. Looking beyond the average to the individual share price data, four companies had a very small decrease immediately after day zero, but this was between 1 to 2% reduction for up to 6 days. The share price of the remaining 5 companies did not show any decrease.

Why does share price change dramatically in one group but remains almost unaffected in the other?
Factors that impact share price following recall

We identified a number of factors to attempt to identify which contribute most to the share price impact:

- Scale of recall (tens/thousands/millions of products affected)
- How widespread (local, national, international)
- Safety impact (Class III, Class II, Class I)
- Scale of company involved (global, regional, national)
- Brand awareness (supplier unknown to general public, limited awareness of company with general public, major brand)
- Consumer affected by recall (adults only, all ages, targeted at children)

We used a basic risk rating model with low (risk = 1), medium (risk = 2) and high (risk = 3) for each factor.

By multiplying the risk rating for each of the 6 factors together, we calculated a risk score for each company’s recall. The range of possible risk rating was from 1 – 729.

It was found that for companies whose share prices were impacted by the recall, the recall risk rating ranged from 96 – 216. For those companies whose share price appear to be unaffected by the recalls, the recall risk rating ranged from 4 – 72.

For example: A company that had a recall with the following factors:

- Involving millions of units = 3
- Nationwide recall = 2
- Class III = 1
- National company = 3
- Major brand = 3
- Product for adults only = 1

Recall Risk Rating = 3 x 2 x 1 x 3 x 3 x 1 = 54

Therefore, in the example provided above (recall risk rating of 54), it could be concluded that it would be unlikely for that company’s share price to be impacted by a recall as defined by the risk ratings given.
Looking further into the risk ratings, the factor that has the greatest impact on determining whether a product recall will impact share price is “Scale of the company involved”. The largest companies will generally have share price protection from a product recall due to the sheer scale of the company and the wide range of other products it supplies. Smaller companies that are primarily selling in one country are more exposed.

The next two most important factors are the “Safety impact” and then the “Scale of recall (units)”. These two factors are likely to generate media interest, drive public awareness and social media activity. However, media interest is usually very short lived for all but the most extreme recall cases. Even the largest food recalls are typically only in the mainstream media for a matter of days. Essentially after the initial news report, there is not a lot of new information available on products that have relatively short shelf lives and so there is less opportunity for news editors to develop the story. Of course, if the scale of the recall increases to cover wider geographic areas and product ranges, the story gets new life and that can increase the damage to the company’s reputation and have a negative impact on share price.

Finally, there is insufficient data here to confirm that recalls related to food and drink products targeted at children would have an increased negative impact on share price, but this is also likely to be an important factor.
Conclusions

These findings suggest that a global food company with multiple product lines and markets will have some protection against share price impact caused by a product recall. However, a smaller, national food company that has a serious health related recall involving a large number of products could see its share price severely reduced. In general terms, the knock-on effects from decay of share price can lead to longer term loss in confidence, lower investment and becoming a target for takeover. All of these can impact the long-term stability and lead to a terminal decline in company fortunes.

Raised media attention, albeit usually short lived can lead to nervousness with investors if they perceive concern in the company management or a track record of crises.

If, as generally believed, a product recall is an inevitable occurrence of modern food production, ensuring the company is prepared by having effective plans, trained teams that carry out annual scenario-based recall exercises is essential to minimise the overall impact on the business; even if some factors discussed here are out of the company’s control.