Social media amplifies damage of product recalls to firms—rivals, too

August 2 2015, by Ed Kromer

A product recall is never good news for a firm. And though it might seem like a great occasion for schadenfreude, a recall is not necessarily good news for competitors, either.

So states new research on the social media multiplier of product recalls by Abhishek Borah, an assistant professor of marketing at the University of Washington's Foster School of Business.

His paper with co-author Gerard Tellis of the University of Southern California is titled "Halo (Spillover) Effects in Social Media: Do Product Recalls of One Brand Hurt or Help Rival Brands?" It has been accepted for publication in the *Journal of Marketing Research*.

Borah's study of the automotive industry reveals that product recalls provoke a sharp increase in negative chatter on social media sites. This online trash talk amplifies the damage, slashing sales and the market cap—or total market value of unpurchased shares—of the recalling company.

But the damage doesn't end there. Innocent firms often face a similar fate when they get caught in a "perverse halo" of negativity created by a domestic competitor's recall.

"Bad news travels fast on social media," Borah said. "Our study demonstrates that a recall event increases negative chatter that can have damaging effects on the sales and stock market performance of rivals."

The auto industry is rampant with recalls. In 2014 alone, 64 million vehicles in the United States were ordered back to the dealership to repair defects. This, plus a proliferation of dedicated online discussion, blog and review sites—such as automotiveforums.com and edmunds.com—makes cars the perfect context for studying the relationship between social media and recall events.

For the study, Borah and Tellis considered four automobile manufacturers: Japanese firms Toyota, Honda and Nissan, and American firm Chrysler. They tracked multiple models within each automotive brand.

The authors analyzed the daily traffic, topic and tone on more than 1,000 automotive social media sites following recall announcements during an 18-month period. Using sentiment analysis or opinion mining techniques—computer programs that evaluate public feelings about a product by reading social media—they found a sharp increase in negative chatter following a recall.

As might be expected, the negative chatter extended to other models of the same car brand—that is, a Toyota Corolla recall incited worries about Tacoma, Prius and RAV4, which are distinctly different classes of Toyota vehicles.

But they also found that a Toyota recall sparked negative chatter about competing manufacturers Honda and Nissan—brands whose cars had a clean bill of health. Such negative talk, the authors found, can increase damage to the bottom line even of domestic rivals.

Borah and Tellis call this phenomenon a "perverse halo," or a perception that others share the problem of the product being recalled.

To assess the impact on company stock price, they aggregated car models—also called "nameplates"—across each brand and found that the online chatter sparked by a rival's recall erased $7.3 million, on average, from an innocent firm's market cap over six days.

To assess the impact on sales, they compared monthly figures of each brand's most similar models—Toyota Corolla versus Honda Civic versus Nissan Sentra, for instance. What they found was that the negative online buzz about both the brand issuing the recall and its nearest rival multiplied the negative effect on sales of the "innocent" rival brand.

"If a Honda nameplate has an issue, the resulting chatter will cause Toyota's closest car sales to go down, too," Borah said.

He added that the perverse halo effect appears to act differently depending on how much the product dominates the market. That is, a recall a recall for a top seller like Toyota Corolla will have a greater negative impact on the smaller-market Nissan Sentra. Conversely, a Sentra recall will leave less of a dent on top-dog Corolla.

Curiously, Borah and Tellis found that the perverse halo has an inverse effect on car companies identified with different nations of origin. A recall of a Toyota car—recognized as a Japanese brand—resulted in a decrease in negative chatter about Chrysler cars, understood to be an American brand.

The result? A Toyota recall increases Chrysler sales and market cap, at least temporarily.

"A brand like Chrysler should be cashing in when a competitor from another country has a recall event," Borah said.

Recalls are a growing phenomenon in a modern marketplace that's seeing more defective food, drugs, toys and electronics than ever before.

Borah said that firms should be as concerned about their rivals' recalls as they are about their own—especially rival firms of similar size and from the same nation or origin.

Borah advised that the recalling firm can mitigate the damage of a recall by quickly providing pertinent information to social media.

"During crisis situations, it is imperative for firms to communicate with consumers in the right way," he said. "They can relay information about the recall, post a comprehensive set of FAQs to allay concerns, ensure that searches for information are directed to a dedicated recall microsite, and know the hashtags and keywords being used to discuss recalls so they can engage in two-sided dialogue to address specific concerns."

What firms should not do, the authors say, is broadcast a public apology.

"We find that apology advertising has harmful effects on both the recalled brand and its rivals," Borah said. "In general, such ads backfire because they increase attention to and elaboration about the crisis."

His advice for firms caught up in a domestic rival's perverse halo? Sit tight. Keep quiet. Wait it out. And try to differentiate your company from competitors so that the next time, you don't get associated with another brand's recall.

More information: Borah, A., & Tellis, G. J. (2015). Halo (Spillover) Effects in Social Media: Do Product Recalls of One Brand Hurt or Help Rival Brands? *Journal of Marketing Research*, 150723133545004. DOI: 10.1509/jmr.13.0009

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