Consumers are suspicious when companies exceed expectations on product recalls

August 4 2020

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Companies that are extremely generous in compensating customers during a product-recall crisis may be creating unintended negative consequences and damaging their corporate reputation, according to

surprising findings by UConn marketing professor Stefan Hock.

His research, titled "The Crisis-Response Match: An Empirical Investigation," has been accepted by the *Strategic Management Journal*. He co-authored it with professor Sascha Raithel of Freie University in Berlin, Germany.

"Recalls are relatively commonplace, and companies want to respond appropriately to these crises when they occur," Hock says. "Product recalls run the gamut from life-threatening, such as electrocution or furniture that can fall on a child, to a minor inconvenience when a product doesn't work as intended."

"Most companies want to 'do right' by their customers," he says. "Our paper offers guidance on the importance of selecting a crisis response that aligns with the degree of severity and responsibility that the company accepts. While attempting to exceed expectations may seem like a favorable decision, it can be counterproductive, both in the eyes of customers and shareholders."

Research Involved Claims of a Dangerous Smartphone

Previous studies by other researchers suggested that exceeding expectations should have either a neutral or positive impact on both firm reputation and financial performance, Hock says.

To test that theory, Hock and his colleague created a fictitious scenario involving a smartphone that was recalled due to a fire hazard. They presented nearly 600 people with articles highlighting the flaws of the smartphone and then asked them to rate two dimensions of a company's reputation, competence, and likeability.

The professors found that ratings took a significant dip when the manufacturer offered overly-generous or stingy compensation. Of particular note was that, if the malfunction was the result of a supplier error, not the fault of the product manufacturer, the company issuing the recall was able to get away with taking less responsibility for the shortcoming.

Why would consumers take this stance? Hock compares it to someone who is walking down the sidewalk and gets bumped by a stranger. The expected response would be for the inattentive walker to apologize to the person he or she brushed against.

"But what if that person said, 'I'm so sorry. Here's $100!' You'd probably be very suspicious of that action. Why would that individual do that?," Hock says. "Well, consumers act the same way when offered overly generous compensation. They wonder if the company is hiding something or if the problem is much more severe than expected."

"We discovered that the best response is well-matched to the situation and involves accepting the appropriate amount of responsibility," Hock says. The more accommodative, such as offering money back or free replacement, the greater the perception that the organization takes responsibility for the crisis. Partial remedies, such as rebates or do-it-yourself repair kits, signal a more defensive response, he says.

Investors' Needs Align with Customers

In the second phase of their investigation, Hock and Raithel tracked the stock prices of 443 U.S. companies that had consumer-safety recalls between 1996 and 2014 to understand the financial impact of customer-recall strategies.

For example, in 2014 Emerson Electric Co. recalled 3.7 million travel

charger kits with a loose wire that posed an electrocution hazard. After receiving 300 reports of injuries, the company offered free replacements. That would be an appropriate response, given the seriousness of the defect, Hock said.

In the same year, Graco recalled 4.7 million strollers with a folding hinge that can pinch a child's finger, posing a laceration or amputation hazard. After 11 reports of finger injuries, some serious, Graco decided to offer free repair kits to affected customers. This was an inappropriate response, given the seriousness of the defect, the researchers concluded.

"Previous researchers did not differentiate between consumers and investors. We were able to make this distinction and analyze the financial consequences of the crisis-response match," Hock says.

"The stock market punishes over- and under- conforming strategies with a .5 to 1 percent reduction in market capitalization, which represents $75 million to $150 million for an S&P 500 stock with median market capitalization," he says. "Investors are not only concerned about the financial costs of highly accommodative behavior, but also about the unclear motivation behind it."

More information: Sascha Raithel et al. The crisis-response match: An empirical investigation, *Strategic Management Journal* (2020). DOI: 10.1002/smj.3213

Provided by University of Connecticut

Citation: Consumers are suspicious when companies exceed expectations on product recalls (2020, August 4) retrieved 27 June 2024 from https://phys.org/news/2020-08-consumers-suspicious-companies-product-recalls.html

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