



Product Recalls – the Scale of the Problem

Introduction

Product recalls affect many industry sectors. This article looks at the frequency, size and cost of recalls across various different sectors but, if you want more specific information relevant to your industry, there are many useful information sources out there. We would particularly recommend the quarterly reports from Sedgwick (<https://www.sedgwick.com/>) which look in detail at the following sectors:

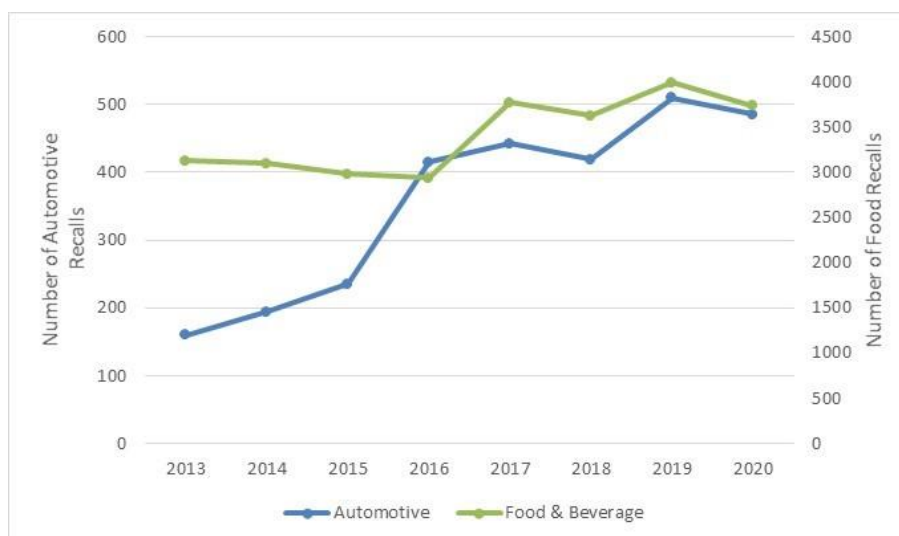
- Automotive;
- Food and beverage;
- Pharmaceutical;
- Medical devices;
- Electronics;
- Toys; and
- Clothing.

We would also highlight the following sector-specific sources for UK recalls:

- Electrical products - <https://www.electricalsafetyfirst.org.uk/product-recalls/>;
- Food - <https://www.food.gov.uk/news-alerts/search/alerts>; and
- Drugs and medical devices – <https://www.gov.uk/drug-device-alerts>.

The Frequency of Product Recalls

Recalls appear to be on the rise in many different sectors. For instance, we have seen significant increases in automotive recalls over the last few years, followed by only a very modest (given the slowdown caused by the pandemic) reduction in 2020.



European Automotive and Food & Beverage Recalls 2013-2020



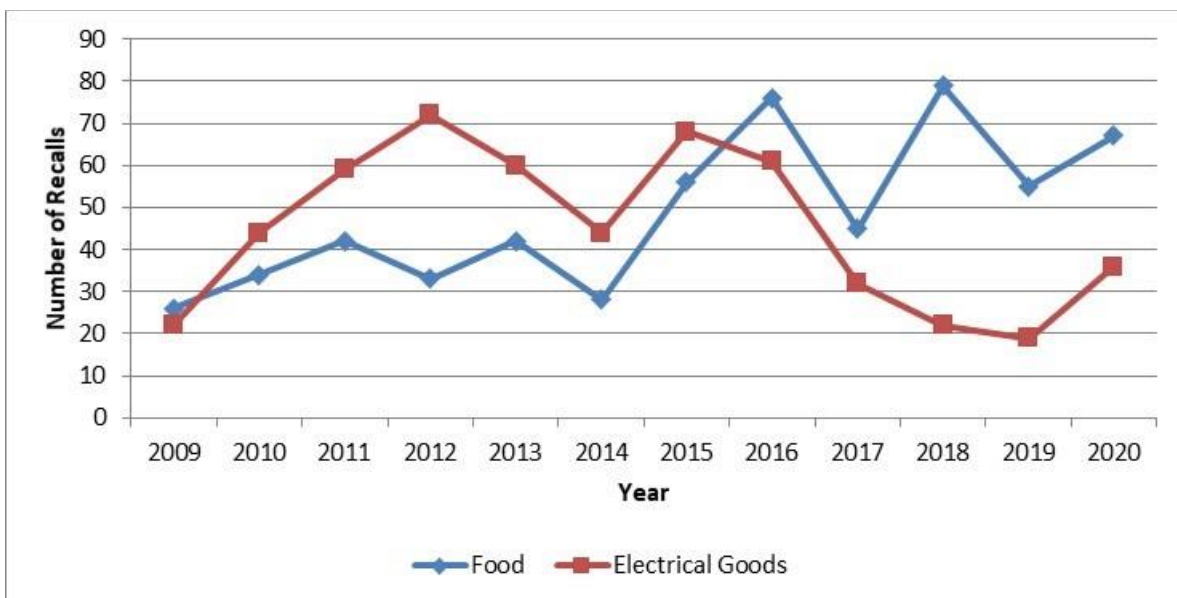
Even including the slight dip in 2020, we have seen a massive threefold increase in the number of automotive recalls across Europe in only seven years! Nobody seems entirely clear on the reason for this, or how long the trend may continue for.

The graph also shows an upward trend in food recalls across Europe, which are now hovering around the 4000/year mark. Meanwhile, in the electronics sector, recalls across Europe have risen from 176 in 2018 to 225 in 2020. Sedgwick suggest a number of possible reasons for the recent rise in this particular sector. As well as the ongoing trend towards increasing complexity of smart devices, they cite three distinct issues related to Covid-19:

- Increasing usage of consumer electronic products during lockdowns;
- Expedited launch of new products to respond to urgent pandemic issues; and
- Supply chain problems caused by the global disruption.

Counterfeiting remains a major problem in the sector too. USB chargers are the most commonly recalled product category across Europe, consistently making up 20-30% of recalls over the last few years.

Within this overall European picture, food recalls have clearly been rising in the UK over the last ten years, as can be seen from the graph below. However, the picture for electrical goods is more complex. Whilst there has been a downward trend in electrical recalls for much of this period, the tide now appears to have turned. In line with the European data, there was a significant rise in 2020 followed by an unprecedented 50 recalls in the first six months of 2021 alone.

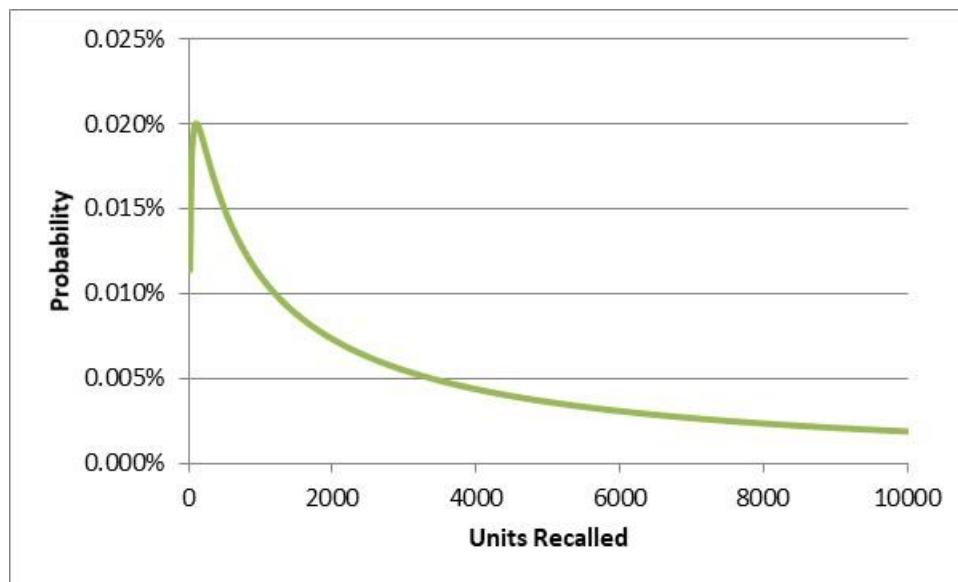


UK Food and Electrical Goods Recalls 2009-2020

The Size of Product Recalls

Obviously, there is considerable variation in the size of recalls from sector to sector. Data from the US for 2020 shows that the average numbers of units recalled were between 65 000 and 80 000 across consumer products, automotive and food and beverage sectors; whereas in pharmaceuticals and medical devices they were nearly an order of magnitude greater, at around 400 000 units per recall.

These averages also mask significant variations within industries. The graph below shows the variation in size of consumer product recalls in the US in 2020.



Distribution of US Consumer Product Recalls in 2020 by Number of Units

From the graph we can see that the most likely event was a recall of just a few thousand units, but:

- Over 10% of recalls involved more than 100 000 units;
- 2% of recalls involved more than 500 000 units; and
- One recall involved 5.7m units.

This huge variation in the scale of recalls makes planning much more difficult: clearly a plan designed to recall a few thousand or tens of thousands of units will likely struggle if there is a requirement to recall hundreds of thousands.



The Cost of Product Recalls

There was widespread global media coverage of Peloton's decision to recall their *Tread* and *Tread+* treadmills in May 2021. Peloton were responding to a request from the US Consumer Product Safety Commission (CPSC) following one death and 72 other injuries attributed to Peloton treadmills. Much of the media commentary focused on the huge fall in Peloton's share price, 14% in the first 24 hours following the announcement; but is this a useful benchmark of the likely costs of a recall?

Firstly, the Peloton recall was far from typical. The reported number of units involved, 125 00, places it roughly in the top 10% of recalls by size by 2020 standards. In addition, it is a high-value product – most large recalls involve cheaper items – so it is a massive recall by value. Another factor that made the case interesting, and unrepresentative, is the strength of Peloton's brand and the fact that the company has enjoyed such spectacular growth during the pandemic; so there was a lot of brand value to lose. Secondly, within a week of the announcement, Peloton's share price had recovered to within 5% of its pre-recall value. It is important to note too that over the week in question, the Nasdaq index had itself fallen by 3.8%! So, even for such a large and high-profile recall, the long-term cost to the company appears to be quite modest.

This finding is echoed by academic studies of recalls. A study by Davidson and Worrell in 1992, looking at 133 product recalls across various sectors, found an average fall in share price of 0.7% around the announcement of a recall. A more recent (2009) study by Chen, Ganesan and Liu, looking specifically at 153 CPSC recalls, found a similar sized fall following proactive recalls (ie where a firm recalls before any safety incidents have been reported). However, interestingly, they found no significant fall in share price for reactive recalls of consumer products (ie recalls in response to reports of harm, like the Peloton recall).

Whilst these finding of such modest **average** impacts on firms involved in product recalls seems surprising at first, it does make sense on reflection. Fundamentally, products recalls are now so commonplace that it is not a massive surprise when one occurs: both investors and customers appreciate that doing business in the modern environment of complex global supply chains means that there will be occasional problems. Neither investors nor customers will automatically penalise a firm for announcing a recall; rather they form a judgement on the company based on how well it manages the recall.

The average impacts from these studies probably mask a wide range of variation from firms that manage the recall exceptionally well and emerge with their reputations enhanced; to those that allow a recall to drag on for years and are permanently weakened by the incident. Indeed, given the increasing take-up of specialist product recall insurance policies and operational support; the impacts of well-managed recalls could be even less in future. However, for firms that fail to prepare adequately, poorly-managed recalls will continue to be defining moments for both executives and the firms that they run.