

How does CEO background affect stock market returns around product recall announcements? Evidence from the US automobile industry

Management
Decision

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Received 26 July 2023
Revised 2 November 2023
3 February 2024
27 April 2024
15 July 2024
Accepted 18 July 2024

Abstract

Purpose – This paper aims to highlight the role of the CEO's background in the stock market reaction to a product recall. Based on the upper echelons theory and the crisis management literature, we argue that the CEO's background influences the expected response in a product harm crisis and the updating of investors' expectations following a product recall announcement. We test if the CEO's background influences the abnormal stock market returns around product recalls and how it affects the way investors interpret the recall strategy and severity.

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

Findings – We observe that the stock market's reaction is less negative if the firm's CEO presents a core specialist background and for firms led by insider CEOs. This result is in line with our argument that in the presence of a crisis that requires operational and firm-specific knowledge, such as product recalls, the best alignment in terms of the CEO's background occurs when the CEO was recruited inside and is a core specialist. Finally, we also find that the CEO's background has a moderating effect on the impact of the recall strategy and severity on the stock market reaction to a recall announcement. In particular, a recall with high severity has a more negative stock market reaction when the CEO is a core specialist as such an event is not expected by the market.

Practical implications – These results have important implications for practitioners and scholars working in the areas of product quality and corporate governance. Given the high frequency and high costs for firms to carry out these operations in the automobile industry, we recommend a careful analysis of the CEO's background before their appointment as well as careful planning to prevent and to adequately react appropriately to product quality problems. While there is a common tendency among executives to cut discretionary expenditures such as spending on product safety, our results regarding the stock market

Funding: This paper is financed by Portuguese national funds through FCT – Fundação para a Ciência e a Tecnologia, I.P., projects numbers UIDB/00685/2020 (António Miguel Martins) and UIDB/04007/2020 (Cesaltina Pires).

Data availability statement: The dataset generated during the current study is available in commercial databases that the authors acquired through a license. Information on how to obtain it and reproduce the analysis is available from the corresponding author on request.

Conflict of interest: The authors have no relevant financial or non-financial interests to disclose.

Compliance with ethical standards: The authors have no relationships or interests that could directly or potentially influence or impart bias to the work.

