Operational Risk and Reputation in Financial Institutions: Does Media Tone Make a Difference?

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Abstract

Operational risk announcements are unexpected adverse media news that potentially harm the reputation of financial institutions. This paper examines the equity-based and debt-based reputational effects of financial sentiment tones in operational risk announcements and shows how such reputational effects are moderated by alternative sources of public information. Our analysis reveals that the net negative tone and litigious tone have adverse reputational effects, and the uncertainty tone mitigates the adverse reputational impact. Additionally, alternative, simultaneous sources of information neutralize the reputational effects of textual tones. First, third-party information about the event (i.e. regulatory announcements and final settlements) dissolves the favorable (adverse) reputational impact of the uncertainty tone (litigious tone). Second, loss amount disclosure and firm recognition substitute the reputational effects of the net negative tone and uncertainty tone only in Anglo-Saxon countries and market-based economies. Overall, our findings indicate that the reputational effects of the media materialize most when there is lack of certain, quantifiable and regulated public information about the operational risk event.

Keywords: Content Analysis, Financial Sentiment, Media News, Operational Risk, Reputational Risk, Textual Tone

JEL Classifications: D8 Information, Knowledge, and Uncertainty, G1 General Financial Markets, G2 Financial Institutions and Services

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