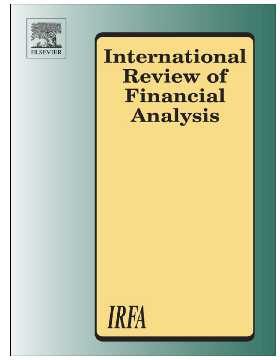

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The Reputational Effects of Analysts' Stock Recommendations and Credit Ratings: Evidence from Operational Risk Announcements in the Financial Industry

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Abstract

This paper investigates whether more favorable stock recommendations and higher credit ratings serve as a reputational asset or reputational liability around reputation-damaging events. Analyzing the reputational effects of operational risk announcements incurred by financial institutions, we find that firms with a "Buy" stock recommendation or "Speculative Grade" credit rating are more likely to incur an equity-based reputational damage. In addition, firms with lower credit ratings incur a much more severe debt-based reputational damage. Moreover, credit ratings are more instrumental in mitigating the debt-based reputational damage caused by fraud incidents or incurred in non-banking activities. Furthermore, the misconduct of senior management could demolish the reputation of firms with less heterogeneous stock recommendations. Finally, credit ratings serve as an equity-based reputational asset in the short term but turn into an equity-based reputational liability in the long term. Overall, our analysis reveals that stock recommendations represent a reputational burden and credit ratings act as a reputational shield; however, the persistence and magnitude of such reputational effects are moderated by time and event characteristics.

Keywords: Reputational risk, operational risk, financial analysts, stock recommendations, credit ratings, financial institutions

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