Operational Risks and Financial Performance and the Context of Jordanian Banking Environment

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Banking sector environment stability plays a crucial role in countries` economic development and its stability. The recent subprime financial crisis has unleashed and exposed the importance and the vital role performed by the banking sector overall national economy health. Despite of such, the fundamental role of the banking sector, which cannot be neglected, confront several types of risk that may arise as a result of several internal and external factors. Thus, it may be significantly affected by many operational risks, and if the banking institutions been able to manage it successfully, either directly or indirectly, it will lead to value creation for banks. Peccia (2003) proclaim that banking environment has changed and keep on changing continuously, this eventually has changed the shape of operational risks as it became more difficult to certain extent. Issues related to operational risk is still no sufficiently explored area in finance field. Where, the Operational risk is just differing in comparison to other types of risks that banks do encounter because, it is unsystematic, which leads to reduction of banks returns, may be due to inadequate internal processes, people, processes, and systems of the bank. Basel committee on banking supervision (2003), Basel accord II indicates that trends such as globalization, business environment expansion and financial services sophistication, reinforce the necessity for suitable management system of operational risk. While Operational risks were for the first time treated as a self-contained regulatory issue in the â€œOperational Risk Management document published by the Basel Committee on Banking Supervision in 1998. The New Basel Capital Accord was first subedited in a proposal during 1999, which was released during 2001 and became effective by 2007; within the framework, the operational risk was aligned in the so-called Pillar 1, which indicates its inclusion in the calculation of banks' overall capital charge. Basel Committee (2003) define operational risk as that amount of loss which result from inadequate or improper internal processes, or people mistakes or systems failure or from external events. This definition excludes reputational and strategic risk, but includes legal risk. We should note that, operational risk usually deals only with losses, unlike market risk which takes into consideration profit volatility. Operational risk relates to internal controls, corporate governance and personnel that may lead to fraud, error, and performance failure, that may accommodate and adverse impact on financial performance. The proposed methodology of the study will investigate the effect of operational risks on listed Jordanian commercial banks financial performance and banks` stock market value, also it will examine the role of loans to deposit ratio and equity to total assets ratio on the nature and magnitude of the relationship between the independent and dependent variables. The study sample will consist of all 13 listed commercial banks at ASE. The study models will examine the effect of operational risks on two dependent variables financial performance (EPS) and stock market value (MV), with the existence of two control variable Loans to deposit (LD) and Equity to total Assets (EA).

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