

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Jan Šarapatka
Advisor:	Jiří Novák M.Sc., Ph.D.
Title of the thesis:	Catholic Religion, Corporate Governance, and Executive Compensation

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

The thesis links catholic religion with the quality of corporate governance and the compensation of executives on a sample of US firms. In particular, the author investigates if executives in firms headquartered in catholic counties are able to extract higher compensations, checks if the quality of corporate governance of firms in catholic counties differs from that of firms operating in non-catholic counties, verifies if the corporate governance quality affects the level of executive compensations, and tests if CEOs of firms operating in catholic regions are better socially connected. The thesis opens with an appropriate literature review where the author presents existing empirical evidence on the economic effects of religion and the past research on remuneration of executives. The author then formulates his research questions based on the literature, presents the data set, justifies the chosen methodology, and lastly provides a number of robustness checks of the results. For the analysis, several empirical methods are applied; fixed effects, logit/probit, difference-in-difference estimator, and potential related data issues are discussed and well addressed. In general, the thesis is concise, well-written and deals with a relatively novel issue of impact of religion on corporate governance and rent extraction by executives. There are, however, a few points that caught my attention while reading and which should be addressed:

- The author cites Volonté (2015) in regards to the differences in firm board structure between catholics and protestants in Switzerland. That study finds that firms in catholic cantons tend to have one-tier boards while firms in protestant cantons are likely to have two-tier boards, which can be attributed to the cooperation and individualism typical for the two religions. The author adopts this result and assumes it holds also for the US. However, it is also mentioned that the first dominant religion in the US is protestantism. How come then that the Anglo-Saxon countries have virtually universally adopted one-tier corporate board structure? Is this not contrary to the characteristics typical for catholics and protestants in terms of their individualism/cooperation?
- Another cited study by Landes (1998) found that catholics are more likely to create bonds/groups, maintain power within them and thus distance themselves from outsiders, which might foster better conditions for rent extraction in terms of executive compensation. The thesis thus accounts for the rate of catholicism per county and divides counties between catholic and protestants but a control for the religion of executives/CEO is not included. I suppose this data might not be available even for the US but this might be indicative of a CEO's ability to form such bonds. A non-catholic CEO in a catholic county could create an extensive support system that might allow for higher compensation only with difficulties.
- In some of the regressions for executive compensation a proxy for CEO's overall abilities is used. The measure is taken from Demerjian (2012) and it is already a product from regressing firm efficiency on a set of financial and firm-specific variables, i.e. the measure is a residual of this regression. As a result, I believe it might not be a fully independent indicator and could potentially introduce also some other information into the regressions apart from the intended purpose.
- The author includes several performance firm indicators among explanatory variables in individual regressions. However, no information on debt in a firm's capital structure is introduced. Might this not be a relevant factor in terms of compensation a CEO can extract? Furthermore, the debt/GNP ratio is higher in protestant regions than catholic ones as discussed in the literature review section (Stulz and Williamson, 2003).
- Next, endogeneity is a frequent issue that resurfaces in the corporate governance literature and needs to be dealt with. The author introduces lags of relevant variables into the main

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regressions to account for this problem as well as to address the time shift between firm performance indicators and corporate governance variables. However, in regressing board size on a bunch of independent variables, mostly firm financial indicators, lags of firm performance variables (sales, ROA, etc.) should have been introduced instead. Not only can firms with certain financial characteristics be indicative of the size of the board but the board size might affect economic results of a firm. This points to potential endogeneity in the regression. Similarly, regressing sales growth or ROA on the CEO's number of seats or linkages could suffer from the same problem. Not only can firms whose CEO is better connected/holds more seats have differences in profitability but also CEOs of more successful firms in terms of performance can be better connected/asked to sit on more boards of directors in order to, for instance, share their expertise. Thus including lags of seats/linkages would be preferred.

- Last, based on the results of the author's research in this thesis that more extensive social connections in catholic US regions harm a firm's economic performance and facilitate extraction of higher compensations of executives on their boards, could these findings signify on a macro level that countries with prevalent catholic religion suffer from slower economic growth as opposed to countries with other dominant religion?

Overall, the thesis focuses on an interesting and insufficiently researched topic of economic and corporate governance impact of religion. The work is well-written using good English with only few typos reoccurring in the thesis, i.e. "former and letter" instead of former and latter. My reading of the thesis has brought up a few concerns/observations, though. The highlighted issues above should be addressed by the author at the defense. Nevertheless, I recommend this thesis for defense with the suggested grade "excellent".

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY		POINTS
<i>Literature</i>	<i>(max. 20 points)</i>	20
<i>Methods</i>	<i>(max. 30 points)</i>	23
<i>Contribution</i>	<i>(max. 30 points)</i>	28
<i>Manuscript Form</i>	<i>(max. 20 points)</i>	18
TOTAL POINTS	<i>(max. 100 points)</i>	89
GRADE	(1 – 2 – 3 – 4)	1

NAME OF THE REFEREE: *Mgr. Diana Žigraiová*

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Referee Signature