PhD Projects 2018/19

Project 1 - Credit rating agencies and political economy.

The US sub-prime crisis followed by the European debt crisis brought mounting criticism of the credit rating agencies (CRAs) for their role amid deteriorating economic conditions. Several regulatory reforms to monitor CRAs have been approved in Europe and the US, yet little is known about their effectiveness in improving the quality of ratings in the corporate rating sector. Rating quality is of utmost importance as ratings are strongly embedded into regulations and affect the welfare of both borrowers and investors. Credit ratings are a major concern for corporate managers; they affect a firm's access to the bond market, and impact employee and customer relationships as well as business operations. Negative rating actions can trigger events such as bond covenant violations, increases in bond coupons or loan interest rates, and forced bond repurchases.

Many countries in Europe and the USA have experienced degrees of political turmoil following the recent financial crises and therefore the voting preferences in these countries have moved toward more extremist and populist parties, and caused shifts in the ideology and policies of several countries. These have enormous negative influence on the level and cost of public and private debt, credit risk, swings in capital flows, currency valuation and economic growth.
This PhD research project aims to investigate various aspects of the link between credit risk and political economy in light of the current developments during the recent financial crisis and post-crisis periods. The project aims to investigate the effects of political impairments upon financial markets and real economic activity. It will explore the consequences of increased political and sovereign risk for firms' ratings, cost of capital, investment, and financing decisions. The project also aims to investigate whether the recent regulatory reforms of the credit rating industry have been successful in improving the quality of corporate credit ratings taking into account the major issue of political uncertainty in many countries.

This PhD research project aims to apply empirical and theoretical frameworks to analyse the performance of corporate ratings, focusing on the effects of the recent regulatory reforms and political uncertainty. The econometric analysis in this project will benefit from a quasi-experimental research design such as the difference-in-differences (DD) estimation, and the bias-corrected matching estimator of the Average Effect of the Treatment on the Treated (ATT). A variety of fixed effects and limited dependent variables models will be tested. Moreover, the project aims to develop innovative theoretical models of political economy and credit risk, that will be tested through the use of econometric analysis and simulations as well as calibration.

The project has the potential to deliver findings of relevance to a range of market participants, as well as credit rating agencies, regulators and policy makers.

Project 2 - Polarization of tastes in a networked society

Increasing evidence shows a substantial rise of political polarization in all OECD countries. The mainstream media and social networks industry have both been considered to be among the main factors responsible for such a striking polarization. However, the mechanism behind this dynamic is still not clear. On one hand, the media are often accused of producing not always rigorous and biased news, and social networks of creating echo-chambers and enhancing the diffusion of unfiltered material. On the other hand, both these industries simply respond to the demand and thus to the taste of the users. The first part of this project would focus on proposing and testing an alternative theory capable of explaining why and how polarization of tastes might arise in a competitive market for news. This part will make substantial use of tools from Behavioural Economics and Game Theory.

A second question will investigate the consequences of such polarization with respect to different metrics. Relatively few studies discussed the impact of echo-chambers on the outcome of coordination-problems such as voting or consumption of network-goods (goods whose benefit increases with the number of users). In particular, the second part of this project will investigate under which circumstances polarized networks (networks where individual with similar tastes are more likely to be connected to each other) are beneficial to some market suppliers and how this might incentivise them to induce such polarization. This part will make use of tools from Industrial Organization and Game Theory.

Project 3 - Ownership structure, Financial Reporting Quality and Tax Havens: An Analysis of Private versus Public European Firms

The use of tax havens has come under increasing scrutiny from regulatory authorities and policymakers, especially in the context of the fiscal crisis that has afflicted many countries in recent years. The Panama Papers lift the lid on how shell companies and tax havens are used to conceal the ownership of assets worth billions. In essence, tax havens are jurisdictions that impose no or very low corporate taxes and hence offer firms the ability to reduce their overall tax burdens in their home country. Further characteristics of tax havens include lack of information sharing with foreign authorities and non-disclosure of regulatory and administrative requirements. Extant literature examining tax-haven operations almost exclusively focuses on public firms, however the behaviour of private firms should also be considered due to the latter's dominant role in many European countries.

The broad aims of the study are; (i) to analyse the ownership structure of private and public firms operating in tax havens; and (ii) to examine the effects of offshoring in tax havens on financial reporting quality for both types of firms. Furthermore, we consider relevant institutional factors as well as firm-specific characteristics. In order to achieve these aims, the study would employ a large sample of public and private firms domiciled in Europe. The research methodology involves a number of econometric techniques including the use of GMM and PSM to control for self-selection by firms to operate in tax havens.

Project 4 - CEO power and compensation peer group choice

Despite considerable media attention and political scrutiny regarding executive pay, as well as the introduction of the say-on-pay shareholder vote, median total compensation for S&P 500 CEOs increased to a record $11.5 million during 2016. For the typical CEO, a large portion of total pay comprises of a performance-based cash bonus. In principle, executive bonuses should reward managers for good performance. Performance evaluation often involves comparing the firm's performance (e.g., Total Shareholder Return) with that of a specially selected group of peer firms (the peer group). The rationale is that managers who outperform their peers, even in a market downturn, should be rewarded for their contribution. Which firms the compensation committee select as peers, however, necessarily has a large impact on performance evaluation, and the size of bonuses paid to management. Francis et al. (2016) suggest that selecting high quality peers incentivises managers to maximise firm performance. Selection of low quality (or poorly performing) peers, however, may make it easy for managers to attain a high bonus pay-out, and may even lead to 'rewards for failure'.

The project aims to examine whether high powered CEOs exercise influence over the peer selection process so as to be evaluated against low quality peers (thus maximising their expected bonus). While appropriate peers would be selected under efficient contracting, the managerial power view of CEO compensation suggests that executives with high bargaining power (e.g., due to entrenchment, high succession risk, or an ineffective board of directors) are able to capture the pay process (Chen et al., 2013). Managers with a high degree of power over the pay process may therefore influence the peer group selection in order to achieve a lower quality peer-benchmark, and have a greater chance of being awarded a high bonus. The project would focus on executive pay practices in the U.S., exploiting the fact that, since 2006, U.S. listed firms have been required to publicly disclose the peer groups used in determining executive pay, as well as the methodology used to select peers. Despite this, there is little extant literature on the topic. Variation in peer quality would be modelled with respect to firm-level corporate governance and ownership variables, as well as CEO-level characteristics.