Report on Master Thesis

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

Student:	Michal Nedeľka
Advisor:	doc. PhDr. Adam Geršl, Ph.D.
Title of the thesis:	ESG Scores and Credit Risk

Short Summary

This thesis investigates the impact of Environmental, Social, and Governance (ESG) scores on the default risk and profitability of non-financial firms. Using a unique dataset provided by a Czech banking institution, the author constructs models to assess the relationship between ESG performance and credit risk, employing Ordinary Least Squares (OLS), binary choice methods, and the Generalized Method of Moments (GMM). The findings indicate that firms with lower ESG scores are more sensitive to changes in profitability and solvency regarding default risk, while liquidity is a more significant factor for firms with higher ESG scores. Additionally, firms with superior ESG performance show greater persistence in returns, highlighting the role of ESG in enhancing financial stability and profitability.

Contribution

This thesis makes a valuable contribution by exploring the relatively under-researched area of the relationship between ESG performance and credit risk within the context of non-financial firms. The study is particularly significant given the growing importance of ESG considerations in financial decision-making and the regulatory environment. By utilizing a robust dataset from a Czech bank and applying advanced econometric techniques, the thesis provides new insights into how different aspects of ESG influence credit risk and profitability. The research also differentiates between firms with varying ESG scores, offering a nuanced understanding of how ESG factors impact financial outcomes differently based on a firm's ESG performance.

Methods

The methodology employed in this thesis is appropriate and well-executed. The author uses a comprehensive dataset of firm-level ESG scores and financial indicators, applying OLS and binary choice models for credit risk analysis and GMM for profitability analysis. The thesis also incorporates robustness checks and considers various lags in the data, enhancing the reliability of the findings.

Literature

The 21-page literature review is thorough and well-organized, covering the history and development of ESG, credit risk, and the intersection of these areas. The author effectively situates the study within the broader context of existing research, identifying gaps that the thesis aims to address. The review is well-referenced, drawing on a range of sources to provide a solid theoretical foundation for the empirical analysis. However, the discussion on controversies surrounding ESG scores, such as greenwashing and the lack of standardized ESG metrics, could be expanded to provide a more critical perspective. Some authors such as Fraser (2016) are not listed in References, however.

Manuscript Form

The manuscript is well-structured, with a clear flow of information and a logical progression from literature review to methodology, results, and conclusion. The tables and figures are well-presented and enhance the readability of the thesis. The thesis meets all formal requirements, including a complete bibliography and adherence to the standard format. However, minor language errors and formatting inconsistencies should have been addressed before final submission.

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Overall evaluation and suggested questions for the discussion during the defense

Michal has developed a well-rounded and rigorous thesis that contributes to the understanding of ESG scores and their impact on credit risk. The study is timely and relevant, given the increasing focus on sustainability in finance. The thesis fulfills the requirements for a master's thesis at the Institute of Economic Studies, Faculty of Social Sciences, Charles University. I recommend it for defense and suggest **a grade of A.**

The results of the Turnitin analysis do not indicate significant text similarity with other available sources.

Questions for Defense**:**

1) How do you address potential endogeneity issues in your analysis, particularly concerning the use of ESG scores as a predictive variable?
2) Could you discuss the implications of your findings for financial institutions considering ESG factors in their credit risk assessment processes?

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

CATEGORY		POINTS
Contribution	(max. 30 points)	30
Methods	(max. 30 points)	29
Literature	(max. 20 points)	18
Manuscript Form	(max. 20 points)	18
TOTAL POINTS	**(max. 100 points)**	**95**
GRADE	**(A – B – C – D – E – F)**	**A**

NAME OF THE REFEREE: prof. PhDr. Petr Teplý, Ph.D.   *Digitálně podepsáno (16. 8. 2024)*
                                                                                          Petr Teplý

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DATE OF EVALUATION: August 16, 2024   **Referee Signature**

EXPLANATION OF CATEGORIES AND SCALE:

CONTRIBUTION: The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.

Strong	Average	Weak
30	15	0

METHODS: The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.

Strong	Average	Weak
30	15	0

LITERATURE REVIEW: The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.

Strong	Average	Weak
20	10	0

MANUSCRIPT FORM: The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.

Strong	Average	Weak
20	10	0

Overall grading:

TOTAL	GRADE
91 – 100	A
81 - 90	B
71 - 80	C
61 – 70	D
51 – 60	E
0 – 50	F