

# Literature Review on the Impact of Internal and External Compensation Gap of Senior Executives on Enterprises

Yang Yang, Chuling Wu

School of Southwest Petroleum University, Chengdu 610000, China.

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**Abstract:** With the exposure of the sky-high salary of senior executives and the promulgation of the government's salary limit policy, the academic community has set off a wave of research on the salary gap. At present, scholars have mainly studied the executive compensation gap from both internal and external aspects, and discussed the impact of the compensation gap on corporate performance, corporate innovation, risk bearing, audit costs, earnings management, corporate financialization, and executive voluntary resignation. This paper summarizes the existing literature, summarizes the existing research results, with a view to providing theoretical reference for the improvement of enterprise compensation incentive mechanism and future research on corporate governance theory.

**Keywords:** Senior Executives; Pay Gap; Journals Reviewed

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## 1. Introduction

In recent years, the issue of top executives' sky-high salary has been widely concerned by the society. At present, the research of salary gap is mainly influenced by championship theory and social behavior theory. According to the championship theory, the salary gap of employees is an important factor to stimulate employee competition, and the salary gap has a positive incentive effect on employees; The theory of social behavior emphasizes the fairness of salary distribution, and believes that widening the salary gap will cause dissatisfaction among employees, which will lead to the decline of communication efficiency and damage organizational performance. There are certain differences in the research direction and results of the research on executive compensation gap. Based on the existing literature, this paper summarizes the impact on the enterprise from the external compensation gap and the internal compensation gap of senior executives.

## 2. The impact of internal compensation gap of senior executives on enterprises

### 2.1 Impact on enterprise performance

At present, scholars have studied more about the impact of internal compensation gap on corporate performance, but the conclusions are not consistent. Sun Kai (2019), Wang Yuxia (2021) and other scholars confirmed the view that there is a positive correlation between the internal compensation gap of senior executives and corporate performance through empirical methods. On the other hand, scholars such as He Qixue (2017), Wei Fang (2018) and Zhang Wei (2018) believe that the executive compensation gap will ultimately damage corporate performance. With the deepening of the research, some scholars have innovatively integrated the two views, and there is an inverted "U" type nonlinear relationship between the two. Dong Shulan (2017), Chen Ding (2019), Li Qian (2021) and other scholars demonstrated this inverted "U" model through empirical methods.

### 2.2 Impact on innovation

The question of whether managers' compensation can effectively motivate senior managers to make effective decisions to promote innovation has aroused the discussion of the relationship between the two. Ye Tao (2022) and other scholars believe that the

internal compensation gap between executives can help promote enterprise innovation. Fan Songwei (2022), Wang Xinhong (2023) found in his research that the larger the executive pay gap, the higher the performance of enterprise technology innovation. Wang Jia (2022) believes that there is an inverted U-shaped nonlinear relationship between the compensation gap between executives and employees and the innovation investment of enterprises.

## **2.3 Impact on risk taking**

The promotion mechanism will affect the risk selection behavior of senior executives. Senior executives hope to get higher wages through promotion, and are willing to choose projects with relatively high risk and income to improve their management performance. The internal salary gap of senior executives is positively correlated with the level of risk bearing. Zhu Xiaolin (2018), Wang Xiufen (2019) and other scholars have verified this view in their research. While Dong Weiwei (2020), Liu Nian (2020) and other scholars believe that when the pay gap is large, the management will be more willing to choose a conservative strategy to maintain this advantage, so as to select low-risk projects and reduce the risk bearing level. Wang Ran (2022) and other scholars believe that the relationship between the two is not a simple linear relationship, and the relationship between the internal compensation gap of senior executives and risk taking is an inverted U-shaped relationship.

## **2.4 Impact on other factors**

Earnings management. On the one hand, the impact of the internal compensation gap on earnings management is affected by the social comparison theory. However, Yang Wei (2019) and other scholars have come to a diametrically opposite conclusion, believing that the high salary of the management will reduce their motivation to manipulate earnings, that is, the compensation gap between executives and employees reduces the level of earnings management.

Audit fee. Present scholars have little research on the impact of salary gap on audit costs, and have focused on the internal salary gap, but the research conclusions are quite consistent. They believe that when the remuneration of the management has a large difference, the executives are more inclined to invest in projects with high risk and high return under the incentive of higher salary, which increases the difficulty and risk of audit and leads to higher audit costs.

# **3. The impact of external compensation gap of senior executives on enterprises**

## **3.1 Impact on enterprise performance**

Compared with the research on the vertical pay gap, the research on the horizontal pay gap by domestic scholars is relatively small, and the impact of the external pay gap on corporate performance is also controversial. Li Wenjing (2014), Sun Jie (2022) found that the larger the peer executive compensation gap, the stronger the positive incentive effect. On the contrary, Zhang Xingliang (2016) and Zhang Qian (2017) believed that the increase of the pay gap would affect the trust between senior executives, improve the turnover rate, and reduce enterprise performance. Tao Jianhong (2021) found that the horizontal pay gap will negatively affect employee engagement, which will further affect enterprise performance. At the same time, some scholars also support the conclusion that the external compensation gap of senior executives has a nonlinear correlation with corporate performance. Zhao Jianmei (2017), Sun Lixue (2018), Wu Yijuan (2022) and other scholars have verified this nonlinear relationship.

## **3.2 Impact on innovation**

Gao Juan (2020) believed that the pay gap between senior executives can promote enterprise innovation. Yuan Zeming (2021) found that the external compensation gap of senior executives has a diametrically opposite effect on the level of innovation and innovation efficiency, which has a promoting effect on the level of innovation, but has an inhibiting effect on innovation efficiency. Zhang Jing (2022) proposed that the increase in the external compensation gap of senior executives will first promote and then inhibit enterprise innovation, that is, the relationship between the two meets the inverted U-shaped hypothesis.

## **3.3 Impact on risk taking**

Different from the research on internal compensation of senior executives, although there are relatively few scholars studying the impact of external compensation of senior executives on risk taking, their conclusions are basically consistent, that is, the expansion of external compensation of senior executives can improve the level of enterprise risk taking, and this conclusion is applicable to whether

the compensation level of senior executives is higher or lower than the industry average.

### 3.4 Impact on other factors

Enterprise financialization. An Lei (2018), Liu Bin (2022) and other scholars proposed that managers should be committed to the promotion of enterprise value and long-term development. However, due to the existence of agency problems, managers will make financial investments in pursuit of short-term benefits. When the salary of senior executives is higher than the average salary of peers, managers will be committed to the development of the company's main business based on the satisfaction of acquisition, thus inhibiting the financialization of physical enterprises.

The senior management leaves voluntarily. In the case of open pay in China, executives will pay more attention to the fairness of external pay gap than internal pay gap. Li Xiaojun (2021), Zhou Xichun (2022) and other scholars found in their research that when the executive pay is higher than the average salary, it is easier to stimulate their sense of identity and satisfaction with the company, thus reducing the probability of active resignation, and on the contrary, it will increase the rate of active resignation.

## 4. Conclusion

### 4.1 Literature review

After sorting out the literature, it is not difficult to find that the research on the impact of executive compensation on enterprises is not mature, and it is mainly concentrated in the research on the impact of corporate performance and enterprise innovation, while the research on the impact of other aspects is relatively small. At the same time, compared with the research on the internal compensation gap of senior executives, the research on the external compensation gap of senior executives is not sufficient. After summary, the impact of the internal and the external compensation gap of senior executives on the enterprise is not completely consistent.

### 4.2 Research prospects

First of all, there are certain differences between industries. At present, scholars' research mostly stays at the stage of the whole industry. The conclusions of the research are not targeted. Industries should be properly distinguished. Secondly, because there is a large gap in the salary level in different regions, so the regional differences will have an impact on the research of the salary gap to a certain extent, but few scholars will take it into consideration, and future research should consider the differences in the consumption level between regions. Finally, executive compensation should not only be limited to cash compensation. Wu Zhongxin and other scholars have improved the measurement of executive compensation, including implicit compensation such as on-the-job consumption, but this method has not been popularized, Future research can further explore an improved method acceptable to the public.

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