Equity Incentives, Pay Gap and the Cost of Equity Capital:

Evidence from Chinese Listed Companies

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Abstract: This study explores the effects of equity incentives on the cost of equity capital from the perspective of pay gap, which has not received much attention in research on Chinese listed companies. We find that the implementation of the equity incentive plan has a significantly positive effect on the pay gap in enterprise. By dividing enterprise pay gap into the internal executive pay gap and the executive-employee pay gap, we find that under the influence of equity incentives, firms with large internal executive pay gap have a significantly lower cost of equity capital according to tournament theory; however, the executive-employee pay gap has a significantly positive effect with the cost of equity capital, which is consistent with behavioral theory’s prediction. Furthermore, we find that the enterprises’ ownership and regions’ development level are playing an important role in the effect that equity incentives act upon the cost of equity capital. The findings make incremental contributions on studying the economic consequences of China’s equity incentive plan, and we quest the implications of these findings for reforming Chinese