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Employee Directors and Internal Compensation Fairness: Evidence from China

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Abstract: *The new Company Law effective July 2024 stipulates that limited liability companies and joint stock limited companies with more than 300 employees should have employee representatives on their boards of directors. Whether and how do employee directors in Chinese listed companies play their governance role? Based on data from listed companies spanning 2010 to 2022 and from the perspective of internal pay equity, this study empirically examines the governance effectiveness of employee directors. The findings reveal that the establishment of employee directors in listed companies, and a higher proportion of employee directors on the board, are associated with a smaller internal pay gap within enterprises. Mechanism analysis indicates that employee directors fulfill a decision-making function by increasing the likelihood of the board reviewing proposals related to employee protection, thereby raising employee compensation levels and narrowing the internal pay gap. However, the supervisory function of employee directors is not effectively exerted, as their impact on excessive executive compensation is insignificant.*

Keywords: *Employee Director, Common Prosperity, Internal Pay Gap, Pay Equity, Income Distribution*

1. Introduction

Employees are key stakeholders of a corporation, and the protection of their rights and interests is crucial for sound corporate governance, as well as social harmony and stability. The effectiveness of this protection fundamentally hinges on whether democratic management channels—enabling employee oversight and participation in corporate management—are unobstructed. Objectively speaking, China's system of democratic employee management within enterprises has been continuously improved. Institutions such as labor unions, employee supervisors, and workers' congresses have, to a considerable extent, addressed employees' demands for the protection of their interests. However, infringements upon employee rights, including arbitrary layoffs and wage arrears, still occur frequently in Chinese enterprises. Therefore, exploring an effective channel for democratic employee management represents a viable path to strengthening the protection of employee rights.The inclusion of employee representatives on the board of directors to participate in corporate decision-making is regarded as the highest level of employee participation. The new *Company Law*, effective July 2024, has expanded the scope of enterprises required to establish employee directors to "limited liability companies or joint stock limited companies with 300 or more employees." Furthermore, the *Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening the Reform of the Industrial Workforce Development* (October 12, 2024) emphasizes "upholding and improving the system of employee directors and employee supervisors." Consequently, the employee director system has become a significant means for employee participation in democratic management. Thus, investigating the mechanisms and pathways through which employee directors participate in board governance holds substantial practical significance for refining corporate democratic management systems.

International research on employee directors is extensive, yet a consensus on their governance effectiveness remains elusive. On one hand, the right of employees to participate in corporate governance can effectively mitigate the neglect of employees resulting from the sole pursuit of shareholder value maximization[1], help curb aggressive tax avoidance and real earnings management[2], improve corporate financing conditions by improving relationships with creditors[3], and effectively reduce internal agency costs while enhancing governance efficiency[4-5]. On the other hand, employee directors may impede corporate performance[6] and adversely affect the stock price and return on assets of family businesses[7].In recent years, some listed companies in China have explored introducing employees onto their boards. A limited number of domestic scholars, based on China's institutional context, have empirically studied the governance effects of establishing employee directors in listed companies. Their findings suggest that introducing employee participation on the board can improve corporate investment efficiency and increase cost stickiness. The existing literature provides valuable references for this study. However, direct empirical evidence on the impact of employee director participation in governance on the protection of employee rights and interests is still lacking. To address this gap, this paper examines the protective mechanism and realization pathways of employee director participation in board governance for employee rights, using the internal pay gap within listed companies as the analytical lens.

The potential marginal contributions of this paper are as follows: First, while existing studies have explored the influence of various director types—such as directors appointed by non-state shareholders, independent directors with experiences of poverty or overseas background, and female directors—on income distribution fairness, our findings demonstrate that employee directors can narrow the internal pay gap. This extends the research on director-type factors influencing internal pay disparities. Second, existing research on the governance effects of employee directors often focuses on perspectives such as corporate value or governance efficiency, with scant literature examining their direct governance role from the angle of employee rights protection. Our conclusions enrich the study of the economic consequences associated with employee directors, providing theoretical grounding and direct empirical evidence for the feasibility of the employee director system within the context of Chinese modernization, thereby addressing a gap in domestic research on the economic outcomes of employee directors.

2. Institutional Background, Theoretical Analysis, and Research Hypotheses

2.1. Institutional Background

Globally, Germany's system of employee co-determination represents a relatively well-developed model of employee director systems. By "internalizing externalities," this system effectively mitigates labor-capital conflicts and class contradictions. Its fundamental framework is established through numerous laws and regulations: The 1951 *Co-Determination Act for the Coal and Steel Industry* first mandated the system for stock corporations and limited liability companies with over 2,000 employees in the coal and steel sectors. Subsequently, the 1952 *Works Constitution Act* extended its application to general enterprises with more than 500 employees, requiring employee representatives to occupy one-third of the supervisory board seats. The 1976 *Co-Determination Act* stipulated its application to large enterprises with over 2,000 employees, granting employee and shareholder representatives equal voting power on the supervisory board[8-9]. From its inception to development, Germany's employee director system has progressively expanded both the scope of covered entities and the proportion of employee representation rights, evolving from initial trials in specific industries.

China's employee director system has also expanded its application scope, originating from pilot programs in enterprises with specific ownership structures, though without explicit stipulations regarding the precise proportion of such directors. The 1993 *Company Law of the People's Republic of China* first proposed that "there shall be employee representatives on the board of directors," limiting its application to "limited liability companies established by two or more state-owned enterprises or by other two or more state-owned investment entities," without specifying a required ratio. The revised *Company Law* in 2005 stipulated that, in addition to the aforementioned entities, wholly state-owned companies' boards should include employee representatives, while other limited liability companies and joint stock limited companies could choose to do so voluntarily. The 2006 *Measures for the Administration of Employee Directors in Pilot Enterprises with Boards of Directors of Wholly State-Owned Companies (Trial)* introduced the formal concept of the "employee director," explicitly requiring that boards of directors in central state-owned enterprises include at least one employee director. The official promulgation of the 2009 *Measures for the Administration of the Performance of Duties by Employee Directors in Pilot Central State-Owned Enterprises with Boards of Directors* further clarified the specific duties of employee directors, including responsibilities related to matters affecting vital employee interests such as compensation systems. The newly revised *Company Law* in 2023 mandates that, besides wholly state-owned enterprises, limited liability companies and joint stock limited companies with more than 300 employees should also include employee representatives on their boards of directors. The evolution of the employee director systems in Germany and China is detailed in *Figure 1*.

During the process of introducing, exploring, and refining the employee director system in China, despite existing defects such as holding multiple concurrent positions, marginalization pressures, "amphibious" roles, and high entry barriers[10-11], its value remains worthy of recognition. On one hand, within state-owned enterprises, given the dominant position of public ownership of the means of production, employees are not only the masters of the country but also of the enterprise, making it

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imperative to safeguard their democratic rights and oversight. On the other hand, democratic management has a strong historical foundation in China, and "path dependency" aligns with national conditions. Furthermore, while the non-public sector contributes to the establishment of a unified national market, mitigating labor-capital conflicts constitutes a crucial aspect of this development.

The Evolution of the German Employee Director System		**The Evolution of the Employee Director System in China**	
Coverage Scope of the Employee Director System	**Policy Basis**	**Coverage Scope of the Employee Director System**	**Policy Basis**
Joint Stock Limited Companies and Limited Liability Companies in the Coal and Steel Industries with More Than 2,000 Employees	The Co-Determination Act for the Coal and Steel Industry (1951)	Limited Liability Companies Established by Two or More State-Owned Enterprises or Other State-Owned Investment Entities	Company Law (1993)
General Enterprises with More Than 500 Employees	Enterprise Constitution Act（1952）	Wholly State-Owned Companies	Company Law (2005)
Large Enterprises with More Than 2,000 Employees	Co-Determination Act (1976)	1. Wholly State-Owned Companies; 2. Limited Liability Companies and Joint Stock Limited Companies with More Than Three Hundred Employees.	Company Law (2023)

Figure 1: The Emergence and Development of the Employee Director System

2.2. Theoretical Analysis and Research Hypotheses

Shareholder primacy theory posits that employee participation in corporate governance diminishes shareholder interests and hampers operational efficiency[12]. As human capital becomes increasingly central to long-term corporate value creation, the traditional composition of board members often fails to adequately balance the interests of various stakeholders, including investors and employees. This inadequacy can trigger conflicts such as labor disputes[11] and employee shirking[4]. The employee director system serves to align the interest orientation of board decisions. Leveraging their unique position as employees and informational advantages, employee directors can fulfill the distinct institutional roles of safeguarding employee interests and managing human capital[13]. Their functions are primarily exercised through two channels: advisory and supervisory[14]. On one hand, employee representative directors can act in an advisory capacity, proposing motions related to employee rights protection during board meetings to improve the compensation of ordinary employees. On the other hand, they can perform a supervisory role, enhancing oversight over excessive executive compensation, thereby promoting greater internal pay equity.

First, the employee director system can promote a greater board focus on employee rights protection through relevant proposals, leading to increased compensation for ordinary employees and a consequent reduction in pay disparity. According to team effectiveness theory, board decisions result from interactions among heterogeneous members, where individual directors' backgrounds and role orientations significantly influence issue attention and information quality[15]. Employee directors are primarily oriented towards two roles: protecting employee interests and managing human capital[13]. Their inclusion in board decision-making allows them to advocate for employee rights, better harnessing human capital in value creation. From a resource dependence perspective, as technological progress and business models evolve, human capital has become a key determinant of dynamic competitive capability. Employee directors are better positioned to recognize the value of employee compensation incentives for sustainable development and long-term corporate interests. The specificity of human capital creates exit barriers for its owners, making employees genuine bearers of corporate risk. By representing employees in making reasonable decisions to protect their interests, employee directors encourage shareholders and employees to share risks jointly, partake in corporate gains, and elevate ordinary employees' pay levels, thus narrowing internal pay gaps[5]. Regarding motivation and capability, employee directors enjoy equal rights and bear corresponding duties as other board members. Furthermore, the new *Company Law* permits employee directors to serve on audit committees, enhancing managerial transparency and democratic participation. Therefore, as employee representatives on the board, they possess ample

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motivation and capability to engage in corporate decision-making, mitigate information asymmetry between employees and the board, ensure employee interests are considered in compensation system design by the board and management, and utilize their directorial authority to raise ordinary employees' compensation levels.

Second, the employee director system provides a crucial channel for employee supervision. Employee directors can fulfill a supervisory role, curbing excessive executive compensation and thereby reducing pay disparity. Executives in listed companies often possess significant bargaining power during compensation contract negotiations[16], enabling them to seek excessive pay. Such excess compensation is detrimental to both employee and shareholder interests. Employee directors can mitigate this by strengthening the synergy between employee and shareholder oversight. Firstly, excessive executive compensation often harms overall employee welfare. During corporate downturns, managers aiming to meet performance targets and maintain high pay-performance sensitivity may resort to short-sighted actions, such as reducing overall employee compensation and benefits. During upturns, managers may focus solely on securing excessive pay and increasing their own pay-performance sensitivity, neglecting the sensitivity of employee compensation to performance—a manifestation of the "inchworm effect"[17]. Compromising employee interests thus frequently becomes the first recourse and primary consequence of managerial compensation manipulation. Secondly, establishing employee directors in listed companies can enhance the synergy between employee and shareholder supervision. Managers' opportunistic pursuit of excessive compensation not only diverts resources otherwise allocable to employees, eroding their interests, but also deviates from shareholder interests. Shareholder representative directors in Chinese listed companies typically advocate for shareholder interests. Introducing employee directors to the board creates a focal point for coordinated employee and shareholder supervision, harnessing their combined oversight power to alleviate the Type I agency problem of executives using excessive compensation for self-enrichment.

Based on the foregoing analysis, this paper proposes the following hypotheses:

H1: The establishment of employee directors or an increase in their proportion on the board can reduce internal pay disparity within enterprises.

H2: Employee directors, by fulfilling their advisory function, increase the likelihood of proposals for employee rights protection, thereby raising employee compensation levels and subsequently reducing internal pay disparity.

H3a: Employee directors, by exercising their supervisory function, can constrain excessive executive compensation, thereby reducing internal pay disparity.

The specific mechanism through which the employee director system influences internal pay disparity is illustrated in *Figure 2*.

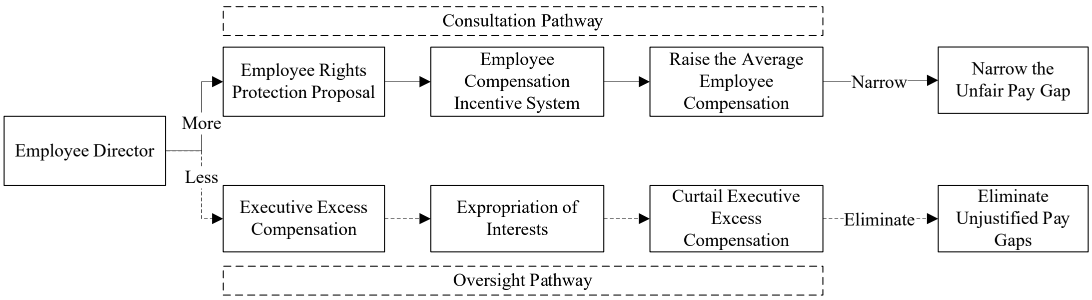

Figure 2: Transmission Mechanism

However, the supervisory function of employee directors has been widely questioned, with doubts raised about their effectiveness in curbing executive compensation. First, regarding the selection and appointment of employee directors, in practice, when the number of such positions is limited, many employee representative roles are assumed by trade union chairs or other individuals who also hold mid-to-senior management positions[13, 18]. Enterprise trade unions are often highly dependent on senior management in terms of funding and labor relations, and this lack of independence makes effective supervision difficult. In this context, the term "employee" is broadly defined and includes members of the management itself. The trend toward the bureaucratization of employee representatives[19] means these representatives may join the ranks of senior management, making the expectation of "self-supervision" unattainable.

Second, concerning the authority of employee directors, the new *Company Law* still does not stipulate a specific proportion for employee representatives. Moreover, the power to formulate the company's articles of association rests with the shareholders' meeting and senior management[20]. Consequently, the weight of employee representatives' authority remains potentially constrained by executives, who may choose to limit it to protect their own excessive compensation.

Furthermore, employee directors themselves face a "dual-role" dilemma and conflicts of fiduciary duty[19-20]. Research indicates that excessive executive compensation can have a significant positive impact on firm value[21]. When the principal-agent relationship inherent in their employee status conflicts with their fiduciary duties as directors appointed by the company, it is uncertain whether employee representatives will prioritize corporate interests or employee welfare. This is because the potential benefits to employees from increased firm value might far outweigh the costs of managerial encroachment on their interests.

In summary, the supervisory efficacy of employee directors remains debatable.

H3b: The supervisory role of employee directors is limited; they struggle to effectively constrain excessive executive compensation and thus have no significant impact on internal pay disparity within enterprises.

3. Research Design

3.1 Sample and Data Sources

To mitigate the influence of exogenous shocks—such as the impact of the financial crisis on the economy and the suppressive effect of the 2009 "*salary restriction order*" on executive compensation, both of which could affect corporate pay disparity—this study selects China's Shanghai and Shenzhen A-share listed companies from 2010 to 2022 as the initial research sample. The sample is processed as follows: (1) Excluding ST and *ST companies; (2) Excluding companies in the financial industry; (3) Excluding samples with missing values for any variable. To minimize the influence of outliers, all continuous variables are winsorized at the 1% and 99% levels. After these procedures, a final sample of 31,100 firm-year observations is obtained. The primary firm-level data and macroeconomic data used in this study are sourced from the China Stock Market & Accounting Research (CSMAR) database. Missing data related to employee directors are supplemented and cross-verified using the Chinese Research Data Services (CNRDS) platform.

3.2. Model Specification and Variable Definitions

Following prior research, this paper constructs the following econometric model for empirical testing:

$$Diff_{it} = \alpha_1 ED_{it} + \alpha CV_{it} + \sum Company_i + \sum Year_t + \varepsilon_{it} \tag{1}$$

$$Diff_{it} = \beta_1 EDrat_{it} + \beta CV_{it} + \sum Company_i + \sum Year_t + \varepsilon_{it} \tag{2}$$

Following the methodologies of Kong Dongmin[22] and Zhang Zhengtang[23], this paper defines the dependent variable, internal pay disparity (Diff), as the ratio of average managerial pay (AMP) to average employee pay (AEP). Considering that independent directors typically receive remuneration in the form of allowances, and that some senior managers may not receive monetary compensation—both of which could distort the calculation—AMP is specifically defined as: (Total managerial compensation - Allowances) / (Total number of directors, supervisors, and senior managers - Number of independent directors - Number of directors/supervisors/senior managers receiving no compensation). AEP is defined as: (Cash paid to and on behalf of employees + Change in payable employee compensation - Total managerial compensation) / Total number of ordinary employees.

Simultaneously, the model incorporates a set of control variables CV_{it}. The detailed definitions and calculations of all variables are presented in *Table 1*.

Table 1: Definition of Key Variables

Variable Nature	Variable Name	Variable Symbol	Definition / Measurement
Dependent Variable	Internal Pay Disparity	Diff	As detailed in the preceding section (Ratio of Average Managerial Pay to Average Employee Pay).
Explanatory Variables	Employee Director	ED	Equals 1 if the firm has at least one employee director on its board in the given year, and 0 otherwise.
	Employee Director Ratio	EDrat	Number of employee directors / Total number of board directors.
Control Variables	Board Size	Board	Natural logarithm of the total number of directors on the board.
	State-Owned Enterprise	SOE	Dummy variable: 1 for state-owned enterprises, 0 otherwise.
	Profitability	ROA	Net profit divided by total assets.
	Growth	Growth	Year-on-year growth rate of operating revenue.
	Firm Size	Size	Natural logarithm of total assets.
	Ownership Concentration	Top10	Combined shareholding percentage of the top ten largest shareholders.
	Leverage Ratio	Lev	Total liabilities divided by total assets.
	Tobin's Q	TobinQ	Market value divided by the replacement cost of total assets (approximated by total assets).
	Excess Employment Rate	Exce	Calculated as the deviation from the industry norm based on employee count and sales revenue.
	Proportion of Independent Directors	Inddir	Number of independent directors / Total number of board directors.
	Management Shareholding	Mshare	Combined shareholding percentage of directors, supervisors, and senior managers.
	Local GDP Growth	TGDP	Provincial GDP growth rate: (Current year GDP - Prior year GDP) / Prior year GDP.
	Herfindahl-Hirschman Index	HHI	Sum of squared firm-specific main business revenue shares within its industry (measure of industry competition).
	Number of Employees	Employee	Natural logarithm of the total number of employees.
	Firm Age	Age	Natural logarithm of the number of years since the firm's IPO.
	Firm Fixed Effects	Company	Dummy variables for each firm.
	Year Fixed Effects	Year	Dummy variables for each year.

4. Empirical Results

4.1. Descriptive Statistics

Table 2 presents the descriptive statistics of the main variables. The mean value of internal pay disparity (Diff) is 4.944, with a standard deviation of 3.750 and a median of 3.895. These figures are largely consistent with prior literature. The maximum and minimum values are 23.35 and 0.643, respectively, indicating substantial variation in pay disparity across firms. The mean of ED is 0.041, suggesting that firms with employee directors constitute approximately 4.1% of the total sample. For EDrat, the maximum value is 0.143, with a standard deviation of 0.022. This indicates that even in firms with the highest representation, employee directors occupy only 14.3% of board seats—a level notably lower than that observed in countries like Germany but consistent with the current state of the system in China.

Table 2: Descriptive Statistics

Variable	Observations	Mean	Std. Dev.	Min	Median	Max
Diff	31100	4.944	3.750	0.643	3.895	23.35
ED	31100	0.041	0.199	0	0	1
EDrat	31100	0.004	0.022	0	0	0.143
Board	31100	2.295	0.256	1.609	2.303	2.944
SOE	31100	0.392	0.488	0	0	1
ROA	31100	0.048	0.068	-0.259	0.048	0.233
Growth	31100	0.169	0.419	-0.589	0.103	2.639
Size	31100	22.30	1.325	19.88	22.11	26.37
Top10	31100	0.578	0.153	0.227	0.585	0.903
Lev	31100	0.436	0.205	0.056	0.431	0.904
Tobinq	31100	2.050	1.350	0.837	1.613	8.786
Exce	31100	-0.029	1.099	-6.030	0.310	0.890
Inddir	31100	0.376	0.054	0.333	0.364	0.571
Mshare	31100	0.115	0.181	0	0.002	0.662
TGDP	31100	0.093	0.052	-0.071	0.090	0.237
HHI	31100	0.137	0.144	0.022	0.090	0.873
Emplyee	31100	7.716	1.278	4.605	7.644	11.230
Age	31100	2.116	0.898	0	2.303	3.332

4.2. Benchmark Regression Results

This study employs Models (1) and (2) to examine the impact of establishing employee directors and their proportion on internal pay disparity within firms. *Table 3* reports the test results for Hypothesis H1, with both individual and time effects controlled for in all specifications. Columns (1) and (2) present the

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results using the presence of employee directors (ED) as the explanatory variable, while Columns (3) and (4) report results using the proportion of employee directors (EDrat). The results indicate that the regression coefficients for ED and EDrat are significantly negative at the 1% level, regardless of whether all control variables are included or only a subset is controlled for. This suggests that the establishment of employee directors exerts a significant negative effect on pay disparity. Furthermore, a higher proportion of employee directors is associated with a stronger curbing effect on pay disparity. These findings imply that the employee director system contributes, to some extent, to optimizing corporate governance. Therefore, Hypothesis H1 is supported.

Table 3: Benchmark Regression Results

Variable	(1}	(2}	(3}	(4}
	Diff	Diff	Diff	Diff
ED	-0.361***		-0.338***	
	(-3.35)		(-3.40)	
EDrat		-3.481***		-3.258***
		(-3.67)		(-3.72)
Controls	Yes	Yes	Yes	Yes
Constant	4.964***	4.964***	-6.681***	-6.666***
	(381.12)	(383.61)	(-8.33)	(-8.31)
Company FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Adjusted R-squared	0.673	0.673	0.723	0.723
Observations	31100	31100	31100	31100

Note: The t-statistics are shown in parentheses; *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

4.3. Robustness Checks

4.3.1. Propensity Score Matching (PSM)

To mitigate potential endogeneity concerns arising from sample selection bias and reverse causality, this study further employs the Propensity Score Matching (PSM) method. All control variables from the baseline regression model are used as matching covariates. A Logit regression is first estimated to calculate the propensity score, followed by radius matching to pair firms with employee directors (treatment group) and those without (control group). The two-way fixed effects regression is then re-estimated using the matched sample. The results indicate that the coefficients for ED and EDrat remain significantly negative at the 1% level, consistent with the baseline regression findings. Detailed results are presented in *Table 4*.

4.3.2. Instrumental Variable (IV) Approach

To further address other potential endogeneity issues, this study employs an instrumental variable approach for re-examination. The instrumental variable is constructed based on the adoption of employee directors among other firms within the same industry. Specifically, on the one hand, the prevalence of employee directors or the general emphasis on employee rights within a firm's industry may influence its own governance structure, as failure to follow suit could lead to the loss of human capital. This satisfies the relevance condition of the instrument. On the other hand, whether other firms in the same industry have established employee directors does not directly affect the focal firm's income distribution decisions, thus meeting the exogeneity condition. Following prior research, this paper uses the industry-year average of the employee director adoption dummy (IV1) and the industry-year average of the employee director ratio (IV2) from the previous period as the instrumental variables. The IV-2SLS (Two-Stage Least Squares) method is then applied for estimation. The regression results presented in *Table 4* show that the baseline findings remain robust even after, to a certain extent, mitigating endogeneity concerns such as reverse causality.

Table 4: Test Results Based on PSM and the IV Approach

Variable	(1}	(2}	(3}	(4}
	PSM		IV Approach	
	Diff	Diff	Diff	Diff
ED	-0.335***		-3.8970***	
	(-3.37)		(-7.0666)	
EDrat		-3.230***		-34.7854***
		(-3.68)		(-6.8502)
Controls	YES	YES	YES	YES
Constant	-6.721***	-6.706***	-6.5716***	-6.4167***
	(-8.35)	(-8.33)	(-8.2040)	(-8.0165)
Company FE	YES	YES	Yes	Yes
Year FE	YES	YES	Yes	Yes
Adjusted R-squared	0.722	0.722	31100	31100
Observations	30,968	30,968	YES	YES

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5. Mechanism Analysis

5.1. Impact of Employee Directors on Employee Compensation Levels vs. Executive Compensation Levels

The internal pay disparity (Diff) is defined as the level of average employee pay (AEP) relative to average managerial pay (AMP). Therefore, the dampening effect of employee directors on pay disparity could stem from their role in raising ordinary employees' compensation, suppressing unfair or unreasonable executive compensation levels, or a combination of both. To identify the specific pathway, this study separately examines the impact of employee directors on AEP and AMP. Given the large magnitude difference between the compensation variables and other variables, both AEP and AMP are divided by 10,000 before regression to mitigate its influence on the coefficients. The results are presented in *Table 5*. The findings indicate that when the dependent variable is AEP, the coefficients for the employee director variables are significantly positive at the 1% level. In contrast, when the dependent variable is AMP, the coefficients for the employee director variables, while negative, are not statistically significant. This suggests that the establishment of employee directors and a higher proportion thereof have a positive effect on employee compensation levels, but their impact on executive compensation is limited. This implies that, regarding the compensation system, employee directors primarily play an advisory role in decision-making, while their supervisory function over executive compensation appears weaker. These mechanism analysis results are consistent with the theoretical framework.

Table 5: The Effect of Employee Directors on Employee and Executive Compensation

Variable	(1}	(2}	(3}	(4}
	AMP	AMP	AEP	AEP
ED	-0.7373		0.9329***	
	(-0.6351)		(5.0270)	
EDrat		-5.1712		8.7993***
		(-0.5058)		(5.3845)
Controls	Yes	Yes	Yes	Yes
Constant	-3.3e+02***	-3.3e+02***	-38.3001***	-38.3354***
	(-35.9297)	(-35.9271)	(-26.2683)	(-26.2952)
Company FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Adjusted R-squared	0.3034	0.3034	0.4838	0.4839
Observations	31111	31111	31111	31111

5.2. Advisory Function: Employee Directors and Employee Rights Protection Proposals

The rights and responsibilities of employee directors include attending to and conveying reasonable employee demands, representing employee interests, and safeguarding their legitimate rights. As such, employee representatives have the right to participate in board decision-making and submit proposals related to employee rights. Therefore, employee directors can influence board attention towards safeguarding employee compensation levels by putting forward relevant employee rights protection proposals for board deliberation. This study utilizes Python to crawl the detailed records of board meeting proposals and manually organizes proposal titles and contents to identify whether each firm's annual board meetings included proposals related to employee rights protection. Using the dummy variable Resolution (indicating whether the listed company's board deliberated on employee rights protection proposals in a given year) as a mediating variable, a Probit model is employed to further verify the impact of employee directors on board decisions. Columns (1) and (2) of *Table 6* show that the establishment of employee directors significantly increases the likelihood of listed company boards proposing employee rights protection-related motions. This empirical finding validates the influence mechanism posited in the theoretical analysis.

5.3. Supervisory Function: Employee Directors and Constraining Excessive Executive Compensation

This study follows the methodologies of Cheng Xinsheng[24] and Cai Guilong et al.[25] to measure Overpay, defined as the difference between actual executive compensation and expected compensation. Specifically, expected compensation is first calculated using Model (3), and then the difference between actual and expected compensation is derived using Model (4). This difference serves as the proxy variable for excessive executive compensation (Overpay). The impact of employee directors on the excessive

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executive compensation of listed companies is then further tested. The empirical results are shown in Columns (3) and (4) of *Table 6*. The results indicate that the effect of the employee director variables is not statistically significant. This suggests that establishing employee directors or increasing their proportion does not significantly constrain excessive executive compensation, providing further evidence for the limitations in their supervisory role over executive pay. Consequently.

$$\begin{aligned} Lnpay_{it} &= \alpha + \alpha_1 Lnpay_{i,t-1} + \alpha_2 Size_{it} + \alpha_3 ROA_{it} + \alpha_4 ROA_{i,t-1} + \alpha_5 Lev_{it} + \alpha_6 TobinQ_{it} \\ &+ \alpha_7 Region_{it} + \sum Industry + \sum Year + \varepsilon_{it} \end{aligned} \tag{3}$$

$$Overpay = Lnpay_{it} - LnExpectpay_{it} \tag{4}$$

Table 6: The Results of Mechanism Analysis

Variable	(1}	(2}	(3}	(4}
	Resolution	Resolution	Overpay	Overpay
ED	0.2134**		0.0063	
	(2.4861)		(0.4586)	
EDrat		1.5203**		0.1050
		(1.9806)		(0.8653)
Controls	Yes	Yes	Yes	Yes
Constant	-3.3276***	-3.3519***	0.2843**	0.2842**
	(-5.8225)	(-5.8673)	(2.5754)	(2.5741)
Company FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Adjusted R-squared	-	-	0.1203	0.1203
Observations	17900	17900	29381	29381

6. Research Conclusions

This study, from the perspective of internal pay disparity within listed companies, explores the direct governance effects of employee director participation in board governance on the protection of employee rights. The findings indicate that establishing employee directors or increasing their proportion on boards contributes to narrowing internal pay disparity and enhancing pay fairness within firms. Mechanism analysis reveals that employee directors primarily fulfill a decision-making advisory function: they elevate employee compensation levels by increasing the likelihood of proposals related to employee protection, thereby reducing the pay gap. However, employee directors do not effectively perform their supervisory function, as their impact on restraining excessive executive compensation in listed companies is statistically insignificant.

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