Pay Inequality and Reductions in Corporate Scope

This paper analyzes the relationship between pay inequality and reductions in corporate scope. Drawing on a unique panel dataset comprised of detailed information on division manager compensation and divestiture activity, this study documents that firms are more likely to divest divisions when pay inequality among division managers is high, and that the divisions most likely to be divested are those that contribute the most to pay inequality. Among the managers of remaining divisions within divesting firms, pay inequality declines post-divestiture, and pay levels rise more slowly than they did pre-divestiture. Together, these findings support the notion that pay inequality is a first-order determinant of firm boundaries, thereby contributing to research on social comparison costs within firms, divestitures, and corporate strategy.