

Offering Stock Options

Have stock options lost their sparkle? Maybe--but this compensation tool can still be useful if you know how to do it

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Taking Stock

It's not the first beating stock options have taken in the press, and it likely won't be the last. But the fury over new options expiring which has more than 100 companies under internal or federal investigation for illegal or unethical options backdating, has many wondering if this compensation tool has lost its luster.

If small-cap CEOs are any measure, the answer may be yes. The top dogs have been taking fewer options, according to research prepared for Entrepreneur by compensation research firm Equilar Inc. Among companies with fewer than 100 employees and than \$1 million in revenue, the prevalence of stock option grants for the chief executive fell from 52.2 percent in 2003 to 45.5 percent in 2005, though the median value of the options rose over that three-year period. By contrast, the use of restricted stock doubled for these companies, from 12 percent to 24.6 percent.

But experts say that doesn't mean options will be going away anytime soon. For small-cap or pre-public companies with limited options have become an indispensable way to recruit, retain and motivate employees. And the backdating scandal isn't going to stop their use, either, says Joseph Rich, president of compensation consulting firm Pearl Meyer & Partners in New York City. "Some companies will restructure [their policies] so they're above reproach on this issue, but options are still a very good tool, particularly for pre-public and venture-backed companies," he says.

At Aptimus, a \$20 million online advertising network based in San Francisco, CEO Rob Wrubel sees options as a critical weapon for talent and believes most employees should have some ownership of the company. The new accounting rules, however, have put management on some pause. "We spent a lot of time reviewing alternatives and asking, '[Should] we do away with the program?' But we decided no," Wrubel, 45. "We came to the conclusion that it's still a valuable tool and a reasonable thing if we can manage the expense." Because of the expense, Aptimus is more careful with the size of grants and what percentage of outstanding equity it allocates for options.

With so many companies under investigation for backdating options, the perception issue could be a nagging problem, even for companies that are doing things right. Wrubel's approach is simple: "If you have a consistent pattern of board meetings and grants that is documented and regularly adhered to, and you are granting options within that pattern and it has been declared part of your compensation approach, then a lot of these issues go away."

Rich recommends granting options at the same time every month, preferably the day after earnings come out. "That's when they have as much knowledge as they're ever going to have," he says. That narrows the gap between what management knows and what investors know, so the watchdogs are less likely to cry foul. Companies will lose some flexibility in the process, says Rich, "but granting every month, that's probably not a problem."

Whether employees will continue wanting to receive options, given the controversy, is another matter. "There is certainly a portion of the population that would rather have cash," says Fred Whittlesey, founder of Bainbridge Island, Washington-based Compensation Venture Group. But if a company is experiencing a backlash from employees and prospective hires, Whittlesey blames it on the company's failure to communicate well and promote its options strategy.

"Companies assume far too much about what employees understand and remember," he says. "And when you're small, you have a very good opportunity to communicate face to face with people--an opportunity you don't have when you have 100,000 employees." Whittlesey suggests using the buzz about backdating to get a positive message out there. "It's an opportunity for a CEO to go out and say, 'We're never going to be like those companies, and here's why.'"

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