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The Crystal Report on Executive Compensation



OPTION CERTIFICATES MORPH TO WALLPAPER

by Graef Crystal

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As this is written, the Dow Jones Industrial Average just closed at 8,579, down 679 points from the close on Oct. 8. The Dow is down 35.3 percent for the year.

The Standard & Poor's 500 Index has fared even worse. As of today, it has dropped 38.3 percent for the year.

Several months ago, I looked at 4,120 stock option grants that were made to CEOs running companies with then market caps of \$3 billion or more and that were outstanding as of the end of the company's 2007 fiscal year.

I know I am wrong, but I am going to assume for the sake of simplicity that all those option shares are still outstanding and have been during the last 12 months. I am also going to assume that all those options have been fully exerciseable during the last 12 months.

Now fasten your seatbelts:

- Looking back one year to Oct. 9, 2007, those 4,120 option grants could have been exercised to provide their holders with pre-tax gains of \$13.6 billion.
- Six months ago, on April 9, 2008, the gains would have dropped to \$11.3 billion.
- Three months ago, on July 9, 2007, the gains would have dropped to \$10.2 billion.
- One month ago, on Sept. 9, 2008, the gains would have dropped to \$9.4 billion.
- As of yesterday, i.e., Oct. 8, 2007, the gains would have dropped to \$5.5 billion
- And as of the close today, on Oct. 9, 2008, the gains would have dropped to \$4.5 billion.

Just 39 percent of the 4,120 grants contained any paper profits as of the close today. Yet assuming that those options all had ten-year terms (another heroic assumption), those options have been outstanding an average of five years.

As for you CEOs with all-underwater grants, you can pray for a market resurgence. But perhaps a more practical solution would be to use your option certificates to re-do the walls on your half-bath, or, if you've been in the job a while, your full bath.

Obviously, CEOs who have free shares have fared relatively much better than option holders. That's good news for them, but, for my part, it's bad news.

If we are truly going to have pay-for-performance in this country, what has happened to stock options is what should have happened to all CEOs. If you're going to be paid the big bucks for crossing Niagara Falls on a high wire, you should not have a safety net six inches underneath the wire.

The compensation data for this article were obtained from Equilar, Inc., a leading provider of executive pay data (www.equilar.com).

2009 marks Graef Crystal's 50th anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay. In the Spring of 2009, he will be teaching a course in executive compensation at the University of California at Berkeley's Boalt School of Law.