HARVARD BUSINESS PUBLISHING

Google's Bad Options

3:40 PM Tuesday March 10, 2009
by Ben W. Heineman, Jr.

About two months into 2009, and 45 firms have options exchanges or other repricing programs, according to Equilar, a compensation research firm. Twenty-one of the 45 will complete them in the first quarter; the other 24 are subject to shareholder approval.

At this rate, there could be well over 200 such programs this year, compared to 17 options exchanges for all of 2007 and 58 in 2008. Big names include Google, Starbucks and Advanced Micro Systems. Google is allowing 17,000 employees to exchange 8 million options for the $310 closing price on Friday, March 6, 2009, down from a 2007 high of $747.

Is there any justification for such programs when experts estimate that 499 of the Fortune 500 CEOs have underwater options; that 85 percent of all granted options are below the strike price; and when investors generally are, of course, in a world of hurt?

In my view, the answer is a resounding "No."

One argument for options is alignment of shareholder and employee interests. But Google's announcement--like those of other repricing/exchanging companies--puts a stick in the eye of those investors who have painfully ridden the stock down. They don't get a "do-over" for their huge losses--plus they have the added hit of new "expensed" option costs to dilute earnings (more than $400 million).

Google's option exchange is a also bad idea because it doesn't align with today's world. Google's pitch: the company has been buffeted by larger economic forces, and it must massively reset all options to retain employees. But millions of people have suffered devastating losses through no fault of their own. Taking a risk on the economy and the market, not just the company, is the nature of business. By exempting employees from the economic forces that are devastating the nation, Google is sending a terrible message--and setting a terrible precedent. If large numbers of companies follow the Google lead, the anger about business compensation, already at sans culotte proportions, will become even more uncontrollable.

The motivation and retention arguments for exchanging or resetting options are equally weak. What kind of motivator is it to remove moral hazard: if things go badly, no problem, we'll just reset the options. And with unemployment heading toward double digit rates, what facts support the idea that the broad employee population is going to jump ship? People are desperate to keep their jobs.

If Google and the other resetting companies want to retain and motivate, they should give new, right-sized, forward-looking stock options or restricted stock grants now--hopefully with "pay for performance with integrity" conditions. They can use private, targeted grants to retain special "at risk" employees. But they should not exemplify the besetting sin of the the recent past--business hubris--by ignoring the plight of so many others who did nothing wrong but don't get a "do over."

Ben W. Heineman, Jr., GE's former Senior Vice president for Law and Public Affairs, is distinguished senior fellow at Harvard Law School's Program on the Legal Profession and senior fellow at the Kennedy School of Government's Belfer Center. He is the author of "High Performance with High Integrity" (Harvard Business Press 2008).

###