More than 130 companies are under scrutiny in the US for alleged backdating of stock options and dozens of executives have lost their jobs, but the significance for the corporate governance system is in dispute. To what extent has backdating been the product of systemic problems? Is it relevant for the future or only for the past? Our empirical work on backdating (co-authored with Yaniv Grinstein) suggests this practice deserves all the attention it has been getting and more.

First, opportunistic timing of option grants has been alarmingly widespread. Studying all the unscheduled option grants to chief executives during 1996-2005, we find a highly abnormal concentration at monthly share price lows. Twelve per cent of option grants to CEOs (15 per cent before Sarbanes-Oxley) have been "lucky grants" - awarded at the month's lowest price. We estimate about 1,150 lucky grants owe their status to "manipulation" - opportunistic timing via backdating, use of inside information suggesting the stock price is likely to appreciate, or otherwise. We further estimate that about 850 CEOs (10 per cent of all CEOs) and about 720 companies (12 per cent of all companies) received or provided lucky grants that were manipulated. There is evidence they have been to a significant extent produced by backdating and not merely spring-loading based on inside information.

Second, grant manipulation has not been primarily a new-economy phenomenon but rather has been widespread in old-economy companies. Third, manipulation reflected rational economic decisions. Lucky grants were more likely when the potential pay-offs from manipulation were relatively high. For a given CEO with more than one grant, the odds of each grant being lucky increased when the gap between the lowest and the median price in the grant month was higher.

Fourth, grant manipulation was correlated with factors that are associated with increased influence of the CEO on the company's internal pay-setting and decision-making processes. Lucky grants were more likely to occur when the company did not have a majority of independent directors on the board. They also were more common when the CEO had longer tenure.

Fifth, the evidence contradicts the claims made by Wall Street Journal columnist Holman Jenkins and others that backdating was rationally used by companies as a tax-advantaged substitute for other forms of compensation. This view suggests that, other things equal, companies awarding lucky grants should tend to provide lower CEO compensation from other sources. It turns out, however, that CEOs benefiting from lucky grants received a significantly higher total compensation from other sources, not a lower one.

Sixth, the amounts transferred to CEOs via backdating have hardly been small change. The average gain to CEOs from grants that were backdated to the lowest price of the month exceeded 20 per cent of the reported value of the grant and increased the CEO's total reported compensation for the year by more than 10 per cent.
Seventh, in a study of directors' luck issued today, we find there is a significant incidence of manipulation among the option grants awarded to outside directors. Nine per cent of occasions on which directors received grants fell on days with a stock price at a monthly low. We estimate that about 460 companies and 1,400 outside directors have been involved in "lucky" grants that did not owe their status to mere luck.

Backdating, some might respond, is largely a past problem. Reporting requirements imposed by Sox and heightened attention by investors and regulators in the future will curtail this practice. But this is hardly reassuring.

The patterns we have studied reflect persistent, widespread and systematic governance problems: the existence of incentives to provide executives with increased compensation below the radar screen; the prevalence of pay-setting processes not geared to maximise shareholder value; and the failures of internal monitoring systems. These problems do not go away just because regulators and increased outside scrutiny shut off one (especially troublesome) practice produced by them.

While significant backdating might belong to the past, its underlying causes are problems with which the corporate governance system must continue to wrestle. This is why past cases deserve investors' full attention.

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