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ECONOMIC TRENDS
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Why Options Are Repriced

The usual rationale doesn't hold up

During the stock market boom, hefty stock options for top executives were all the rage as a way of encouraging management to build shareholder wealth. Then, when many stocks took a dive, leaving options strike prices way under water, many companies began repricing such options. They needed to do this, they said, to retain valuable managers and keep them focused on their shareholders' interests.

If you think all this sounds a bit self-serving, you'll find support in two studies slated to be presented this month at the Academy of Management's annual meeting in Washington. In the first study, Timothy G. Pollock and colleagues at the University of Wisconsin at Madison looked at options repricing among a group of 136 software companies in 1998. They found that decisions to reprice a CEO's stock options were strongly affected by both the CEO's power within his company and by the concentration of stock ownership.

Specifically, companies that suffered sharp stock declines were far more likely to reprice the CEO's options if he or she were also the board chairman, a sign of entrenched executive power. But they were far less likely to do so if institutional owners or the CEO himself held big blocs of company shares.

In the second study, researchers led by Catherine M. Daily of Indiana University compared companies that repriced executive stock options in 1997 and 1998 with a matched group of companies that didn't reprice. They found little difference in the two groups' earnings in the year prior to repricing. But in the following year, companies that repriced saw much higher executive turnover (and sharper stock declines).

In sum, although powerful CEOs tend to favor repricing their options, institutions that hold big blocks of shares seem to take a dim view of the practice--as do CEOs themselves if they're already big stockholders. And using repricing to hold on to top execs doesn't seem like a very effective strategy.