The Truth About Stock Options

They're a step in the right direction, but they're not real employee ownership

BY MARJORIE KELLY

Am I the only one who's grown weary of the endless trumpeting about the glory of stock options? Everyone's getting rich, the headlines blare. The stock market is "democratizing," pundits announce with fanfare. Yes, corporations may be intent on serving shareholders, we're told, but because employees are shareholders too, they're sharing in the gains—thanks to stock options. Pardon me if I stuff a sock in the trumpet.

I would offer for the reader's consideration a simple scenario: Let's say your colleagues are laid off, your benefits have been cut, your pension has been reduced, your hours have steadily increased, and you've been handed a couple hundred dollars worth of stock options: Are you "sharing in the gains"?

Now, granted, a handful of employees are indeed becoming millionaires. But the reason they make the headlines is because they're news. Which is to say, they're a rare event—something along the lines of "First Woman in Congress." Remember when those stories were everywhere in the 1970s? It was because—in 99 out of 100 cases—congressional seats were *not* going to women, but men. The same can be said today of stock market wealth. The lion's share is going not to employees, but to the wealthy, and to the hand-picked few being invited into the aristocracy: CEOs.

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A 1999 Federal Reserve survey found stock options were extended to non-management employees (i.e. small fry) by *only 7 percent* of companies. This hardly constitutes a world-shattering redistribution of wealth. Top managers, by contrast, got *279 times* the number of options awarded to other employees—according to a 1998 Financial Markets Center (FMC) survey. And these lavish management options actually *reduced* the money available to pay non-managers, by an estimated $500 per employee, according to the FMC.

Despite the impression the media might give, stock options are not "making everyone rich," but are in fact concentrated in the technology sector—to an overwhelming extent. A 2000 study by UBS Warburg economist Joseph Carson found that, in adding up the entire net-gain value of all outstanding S&P company options at June 30, 2000, nearly 60 percent was in technology firms. And nearly a third of the total net-gain value was at just six firms: Microsoft, Cisco, Yahoo!, America Online, Sun Microsystems, and Broadcom.

The notion that employees are getting rich from stock options is a figment of the media's imagination.

Even the few employees who do get stock or options aren't all that lucky—compared to the really lucky folks: the wealthy. As an illustration, imagine an exceptional employee, Tom, who at XYZ Corp. makes $70,000 a year, and owns $35,000 of his company's stock. If his stock returns, say, 10 percent a year, he gets $3,500 as a shareholder. But he makes twenty times that as an employee—so less than 5 percent of his income is as a stockholder, while 95 percent is an employee. He is twenty times more an employee than he is a stockholder. If the company holds down wages or cuts benefits and pensions to drive up its share price, he can lose far more than he gains.

The real winners in this scenario are the 1 percent wealthiest families—most of whom do not work—who reap a major windfall from our friend's labors. If XYZ Corp. has a $1 billion market cap, Tom's $35,000 in stock represents an infinitesimal fraction of the company's value. The 1 percent wealthiest families own about half of all stock, so they own hypothetically half of XYZ stock. When its $1 billion value goes up 10 percent, they gain $50 million, while our friend gains $3,500. On whose behalf is he really working?

Still, I must admit employee stock options are a step in the right direction. In granting to employees a right to pocket the increase in stock's value, option companies implicitly recognize that employees have a right to wealth they help create. Options are a foot in the door of an emerging free-market truth: that wealth belongs to those who create it. Or perhaps I should say they're a big toe in the door, and that door should open much wider.

Options are a good move, but a small one. Employees still must *buy* the stock, when many lack the wherewithal to do so, since the corporation's overall aim is to hold wages down. As a result, 90 percent of all employees "flip" stock options (exercising the options but selling the stock immediately), according to a study by Westward Pay Strategies. Stock options thus discourage long-term employee ownership.

There are more direct, long-term ways for employees to share in the wealth they create, like profit sharing, Employee Stock Ownership Plans, or other forms of real employee ownership—to which this special issue is devoted. Robert Beyster, founder and CEO of SAIC—and a major proponent of employee ownership—said it best: "Those who contribute to the company should own it." Employees are making enormous contributions to companies today, and they should have an ownership stake equally as enormous. Stock options may be a step in that direction. But what we need is a leap.

Sources: "Employee Stock Options Background Report," by the Financial Markets Center, April 2000, P.O. Box 334, Philmont, VA 20131; www.fmcenter.org. "Employee Ownership in the New Economy," paper by David Binns, Foundation for Enterprise Development, 7911 Herschel Ave., Suite 402, La Jolla, CA 92037; www.fed.org.

CORRECTION

Last issue, our story "Is IBM Still Socially Responsible?" reported the company had created "a lifetime post-retirement cap of $25,000 per family for health insurance premiums." This was incorrect. The $25,000 represents company contributions to an account, which will also accrue interest from IBM. Within ten years, the account balance could grow to $53,000, or possibly up to $96,000 by age 65, assuming 7 percent interest, according to IBM spokesperson Janna Weatherbee. Business Ethics *regrets the error.*