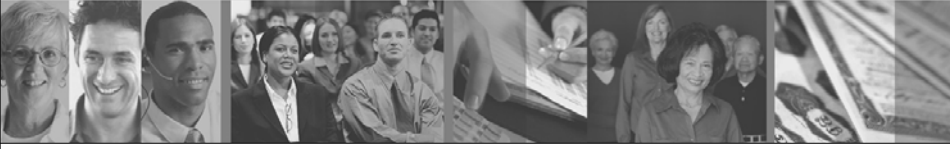




# 2nd Annual CEP Symposium







Understanding Ownership: Unraveling the Myths of Ownership and Equity Compensation

Corey Rosen  
National Center for Employee Ownership  
[www.nceo.org](http://www.nceo.org)


<b>NCEO</b>	Overview	
	<ul style="list-style-type: none"><li>• Brief review of data on what's happening to broad-based ownership.</li><li>• Discussion of what creates ownership cultures—and why you probably don't have one.</li><li>• Company stories</li><li>• Discussion</li></ul>	

# 2nd Annual CEP Symposium


	<h2>Equity Compensation is Everywhere</h2>	
	<p><b>2002 General Social Survey of NORC shows:</b></p> <ul style="list-style-type: none"> <li>• 23.3% of employees in for-profit sector own stock; 14% have options</li> <li>• 40% of employees in companies with stock have stock in their employer.</li> <li>• Median ownership \$10,000; mean \$83,000</li> </ul>	
3		

	<h2>Employee Ownership by Industry</h2>																			
	<table border="0"> <thead> <tr> <th></th> <th style="text-align: center;">Company Stock</th> <th style="text-align: center;">Stock Options</th> </tr> </thead> <tbody> <tr> <td><b>Industry</b></td> <td></td> <td></td> </tr> <tr> <td>Computer services</td> <td style="text-align: center;">58.3%</td> <td style="text-align: center;">56.5%</td> </tr> <tr> <td>Comms/utilts</td> <td style="text-align: center;">55.3%</td> <td style="text-align: center;">42.6%</td> </tr> <tr> <td>Finance/insur</td> <td style="text-align: center;">39.8%</td> <td style="text-align: center;">27.1%</td> </tr> <tr> <td>Manufacturing</td> <td style="text-align: center;">31.5%</td> <td style="text-align: center;">20.0%</td> </tr> </tbody> </table>		Company Stock	Stock Options	<b>Industry</b>			Computer services	58.3%	56.5%	Comms/utilts	55.3%	42.6%	Finance/insur	39.8%	27.1%	Manufacturing	31.5%	20.0%	
	Company Stock	Stock Options																		
<b>Industry</b>																				
Computer services	58.3%	56.5%																		
Comms/utilts	55.3%	42.6%																		
Finance/insur	39.8%	27.1%																		
Manufacturing	31.5%	20.0%																		
4																				

# 2nd Annual CEP Symposium


<b>NCEO</b>	Broad-Based Equity and Corporate Performance	
	<ul style="list-style-type: none"><li>• Data from Joseph Blasi, Douglas Kruse, and Aaron Bernstein, <i>In the Company of Owners</i> (Basic Books, 2003).</li><li>• In plans that provide options to most or all employees, productivity grows 17% in a three-year post plan period compared to what would have otherwise have been expected.</li><li>• Net return on assets grows 2.3 percent per year faster.</li></ul>	

5


<b>NCEO</b>	More Blasi/Kruse Data	
	<p><i>Looking at all the studies on all forms of broad equity sharing, companies following this model showed:</i></p> <ul style="list-style-type: none"><li>• Productivity gains of four percent, compared to firms that do not adopt such practices</li><li>• Total shareholder returns 2 percent greater</li><li>• Profit levels – as measured by return on assets, return on equity, and profit margins—about 14% higher</li></ul>	

6

# 2nd Annual CEP Symposium

<b>NCEO</b>	The Wharton Study	
	<ul style="list-style-type: none"><li>• 159 “new economy” companies studied in 2001 by David Larcker, Christopher Ittner, and Richard Lambert.</li><li>• Larger than usual grants to CEOs and other top executives do not affect stock prices up or down.</li><li>• Larger than usual grants to managers, individual contributors (high performing non-management employees), and technical employees results in better performance.</li></ul>	


7

<b>NCEO</b>	Sesil/Krumova Study	
	<ul style="list-style-type: none"><li>• Rutgers and NYU professors looked at companies with broad options in 1995-1997 and 2002-2002, capturing up and down markets.</li><li>• Options increase productivity 20% to 33% in the first period (varies with company size), and companies kept this advantage in the second period, except for a slight decline (to a still elevated level) in smaller companies.</li><li>• Broad options clearly work, they conclude, in up and down markets; moreover, size is not clearly related to how well they work.</li></ul>	


8

# 2nd Annual CEP Symposium

---


<b>NCEO</b>	A Necessity for High-Tech	
	<p>There's not been a single successful company in the history of high-tech in the last two decades that has done that without broad-based stock option plans. When I originally heard about that in school, I would have called it socialism, when in fact it is the ultimate form of capitalism. It is a very effective way to align interests.</p> <p>John Chambers, CEO, Cisco Systems, <i>San Francisco Chronicle</i>, 2/29/04</p>	

9


<b>NCEO</b>	But Not Just for High-Tech	
	<p>Most of the companies that have stock that are included in the <i>Fortune</i> 100 Best Companies to Work For list offer either broad-based stock options, ESOPs, or other broad based ownership plans other than ESPPs to their employees.</p>	

10

# 2nd Annual CEP Symposium


<b>NCEO</b>	Even Your Latte Needs Options	
	<p>We believed very early on that people's interaction with the Starbucks experience was going to determine the success of the brand. The culture and values of how we related to our customers, which is reflected in how the company relates to our employees, would determine our success. And we thought the best way to have those kinds of universal values was to build around company-owned stores and then to provide stock options to every employee, to give them a financial and psychological stake in the company...As a result, Starbucks has the lowest employee turnover of any food and beverage company.</p> <p><i>Howard Schultz, CEO of Starbucks, quoted in Entrepreneur, Nov. 2003.</i></p>	

11


<b>NCEO</b>	Just Executive Plans	
	<ul style="list-style-type: none"><li>• Blasi, Kruse and Bernstein reviewed all the data and concluded that concentrated ownership in the top five executives actually leads to a decline in shareholder returns.</li><li>• Review of 84 studies through 2000 by Encyclopedia of Corporate Governance indicated 56 found increasing executive equity compensation was unrelated or negatively related with subsequent performance gains, 22 found a positive one, and 16 found a mixed relationship.</li></ul>	

12

# 2nd Annual CEP Symposium


<b>NCEO</b>	More on Just Executive Plans	
	<ul style="list-style-type: none"><li>• 2003 review of 229 studies by Robert Grams for <i>WorldatWork</i></li><li>• Company stock price performance associated with (but not necessarily caused by) higher actual ownership by executives</li><li>• Performance is unrelated or negatively related to options and other awards that represent compensation through ownership.</li></ul>	

13


<b>NCEO</b>	Do Employees Value Options?	
	<ul style="list-style-type: none"><li>• Survey of 1,105 stock optionees by Sibson Consulting in 2000 and 2003 found they do, with no significant change in attitudes from 2000 to 2003 despite the drop in stock prices.</li><li>• 75% say options send a message that everyone is an owner, 38% say they work harder because of options, and 53% say they are more loyal to the company.</li><li>• Options are the most cost-effective way to lure an employee to a new job.</li></ul>	

14

## 2nd Annual CEP Symposium


<b>NCEO</b>	2005 NCEO data	
	<ul style="list-style-type: none"><li>• 1,176 employees in 8 public companies gathered in 2002</li><li>• Most employees have a very clear understanding of how these plans work.</li><li>• Having options has a significant impact on motivation independent of all other motivational factors.</li><li>• These results are especially impressive given the dismal state of option value in 2002.</li></ul>	

15


<b>NCEO</b>	What Employees Think	
	<ul style="list-style-type: none"><li>• It is exciting to receive stock options in this company: Yes: 67% No: 13%</li><li>• Stock options are over-rated as an employee benefit: Yes: 34% No: 37%</li><li>• My options will provide me with substantial financial gains: Yes: 30% No: 35%</li><li>• The better my performance, the more stock options I will receive: Yes: 32% No: 38%</li><li>• I would feel comfortable explaining how stock options work: Yes: 56% No: 29%</li></ul>	

16

# 2nd Annual CEP Symposium


<b>NCEO</b>	40% is a Big Number	
	<ul style="list-style-type: none"><li>• About 40% of employees say ownership makes them work harder. Is that good or bad?</li><li>• Many employees already work as hard as they can; they are just that way; others are just impossible to motivate.</li><li>• Getting 4 out of 10 people in a company to work harder is actually an impressive achievement, especially since no one reports working less hard because of ownership.</li></ul>	

17


<b>NCEO</b>	Do Broad Option Grants Affect Share Prices?	
	<ul style="list-style-type: none"><li>• 2003 study by Eric Hager at the Univ. of British Columbia finds that announcement of actual grants of options to most employees results in a positive market reaction in the Canada and in the U.S. (when grants are for more than 1% of equity).</li><li>• Price increased from about 1% to 4% on announcement date.</li><li>• 2003 study by Watson Wyatt finds that a 1% increase in the percentage of options granted broadly leads to nearly a 1% increase in total market capitalization.</li></ul>	

18

# 2nd Annual CEP Symposium


<b>NCEO</b>	So What Are Companies Going to Do?	
	<ul style="list-style-type: none"><li>• Several studies indicate about 40% to 50% will eliminate broad-based options or drastically reduce them.</li><li>• Few companies will eliminate ESPPs. At least half will “stand pat.” Those making changes will mostly reduce the look-back period and/or discount. Ten to fifteen percent of companies will just offer a 5% discount.</li><li>• Just 3% will reduce total equity in executive plans.</li></ul>	

19


<b>NCEO</b>	Can They Sustain That?	
	<ul style="list-style-type: none"><li>• Demographers predict significant shortages of skilled labor and, in some sectors, any workers as the population ages, has more immigrants, and the need for educated employees grows.</li><li>• So if your competitor still has broad equity (half will, after all), can you really keep equity limited?</li></ul>	

20

## 2nd Annual CEP Symposium


<b>NCEO</b>	What Will Employees Think?	
	<ul style="list-style-type: none"><li>• Are you kidding? For years you told us you wanted us to think like, act like, and actually be owners. We were, you said, your most important asset.</li><li>• But now you say, “sorry, actually executives are our most important asset, and we want the already often scandalous gap between their pay and yours to grow. Now go out there and do a great job!</li></ul>	

21


<b>NCEO</b>	What Will Shareholders Think?	
	<ul style="list-style-type: none"><li>• The accounting and shareholder reform efforts that are driving these changes were not about equity for non-management employees; they were about excessive grants to executives.</li><li>• Companies with broad options perform better, and the market apparently knows it.</li></ul>	

22

## 2nd Annual CEP Symposium


<b>NCEO</b>	So What Are these Changes About?	
	<ul style="list-style-type: none"><li>• It's hard not to conclude they are about one thing: greed.</li><li>• The perception of the heroic CEO who virtually alone makes a company great or mediocre has seriously distorted compensation systems. It's not fair, it's not responsible, and it's not good for shareholders. It's just greedy.</li></ul>	

23


<b>NCEO</b>	But What If You Do Want an Ownership Culture?	
	<ul style="list-style-type: none"><li>• Just sharing equity is not enough.</li><li>• An ownership culture is NOT simply one where people want to hold on to shares forever.</li><li>• Ownership cultures are where employees think and act like businesspeople. They have the information, the motivation, and the opportunity to make effective decisions about the work they do.</li></ul>	

24

## 2nd Annual CEP Symposium

<b>NCEO</b>	Ownership Itself Doesn't Lead to Improved Performance	
	<ul style="list-style-type: none"><li>• Research shows that just sharing ownership widely, without creating an ownership culture, has little or no impact on performance.</li><li>• Ownership is a reward for ownership behaviors, not an incentive. In fact, research shows that incentive pay in general is only weakly linked (if linked at all) to measurable changes in corporate performance.</li></ul>	


25

<b>NCEO</b>	Key Elements of Ownership Culture	
	<ul style="list-style-type: none"><li>• Open-book management and critical numbers: break key drivers of performance into measurable, trackable numbers for individual work units.</li><li>• Structured opportunities for participation: teams, ad hoc committees, job enlargement, self managing work units, etc.</li><li>• Make specific links between profits, ideas, and performance.</li></ul>	


26

## 2nd Annual CEP Symposium

---


<b>NCEO</b>	Ownership Cultures and Innovation	
	<ul style="list-style-type: none"><li>• Innovation is what will distinguish winners from losers.</li><li>• More people need to make more decisions about more things more quickly.</li><li>• Lots of small ideas matter; lots of good small ideas matter even more.</li><li>• Opportunity to contribute ideas is enormously motivating.</li></ul>	


27

<b>NCEO</b>	Creativity and Ownership Culture	
	<ul style="list-style-type: none"><li>• Research by Theresa Amabile at Harvard shows that creativity is not fostered by financial incentives, time pressure, competition, organizational streamlining, or fear. And it doesn't just come from creative types either.</li><li>• Creativity is a nurtured process. Cooperation, teams, opportunity, security, and time make it happen.</li></ul>	

28


# 2nd Annual CEP Symposium

<b>NCEO</b>	Equity in the Other Sense	
	<ul style="list-style-type: none"><li>• Pay equity matters—and we are running away from it fast.</li><li>• Perceptions of pay inequity are one of the most efficient causes of high turnover.</li><li>• Research repeatedly shows that people are happier making less money in an environment where they think their pay is fair relative to others than more money when they don't. Sorry—telling employees the huge pay at the top ultimately benefits them won't cut it.</li><li>• And, above all, remember that telling employees to win one for the shareholder is not a motivational speech.</li></ul> <p>29</p>	

<b>NCEO</b>	Examples	
	<ul style="list-style-type: none"><li>• Whole Foods</li><li>• W.L. Gore</li><li>• Southwest Airlines</li></ul> <p>30</p>	

# 2nd Annual CEP Symposium

---

<b>NCEO</b>		
	<p>Questions</p>	