National Compensation Survey Collects Test Data on Stock Option Plans

How important are stock options in the United States economy? The National Compensation Survey (NCS) program is currently testing the feasibility of collecting publishable data on the incidence of this well publicized employee benefit. This article discusses the test procedures used to identify the incidence of stock option plans.

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Over the past few years, the Bureau of Labor Statistics (BLS) made substantial progress towards integrating three Office of Compensation and Working Conditions (OCWC) surveys—the Employment Cost Index, the Employee Benefits Survey, and the Occupational Compensation Survey—into one comprehensive program, the National Compensation Survey (NCS). Goals for the NCS include establishing a common sample, database, and set of procedures, and reducing the time and resources required of both survey respondents and BLS field economists.

The NCS must have the flexibility to reflect new and significant compensation practices in both the private and government sectors. One of the most talked- and written-about aspects of employee compensation in recent times is the granting of stock options. Historically, stock options usually were awarded only to high-level executives in a firm. Today, they are increasingly granted to employees outside the executive ranks, including lower-level managers, computer programmers, production workers, and others throughout the organization.

While there have been some surveys and much anecdotal evidence reported in the media, there has been no statistically sound, national survey to measure the actual extent to which stock options are offered.

Because BLS is committed to keeping up with changes in compensation practices, NCS designed a test to collect data on the incidence of stock option plans throughout the economy. Stock option plan incidence measures the percent of private industry employees covered by such plans. Although the main objective of the test is to publish data on incidence, information relating to plan costs may also be reported.

What are stock option plans?

Stock option plans are only available to employees of for-profit, private sector companies. They can be very complex, but the basic concept is simple: The *Wall Street Journal* defines a stock option as "the right to buy a stock at a fixed price by a fixed time."[1] For example, ABC Corp. is offering all employees the option to buy up to 100 shares of its stock at a cost of $10 a share within the next 10 years. The grant price of $10 a share is the current market price of the company's stock. If the stock's price increases to $15 a share, employees with an option to purchase 100 shares at $10 can pay $1,000 and end up owning $1,500 worth of stock. They can hold their shares and hope the value continues to increase, or they can sell them for a $500 profit.

By tying a portion of employees' compensation to the company's stock, stock option plans, in the view of many compensation analysts, are intended to motivate employees to increase their productivity.[2] Employees may only profit with a rise in the price of their company stock.

There are often a variety of complex restrictions on the actual exercise of options. Just like pension plans, most stock option plans have vesting schedules that require employees to wait a certain length of time before they are eligible to purchase shares. Some plans allow employees to purchase, over time, an increasing portion of a predetermined number of shares. Employees have a maximum time frame during which they must exercise their options. Options expire on predetermined dates. An employee may choose not to exercise an option by not purchasing shares during the allowable time frame.

Some companies offer "cashless exercises" so employees can buy their shares at the option grant price and sell them at the current market price in one transaction. A brokerage firm purchases the shares for the employee at the option price, then immediately sells them at the market price. This allows employees to receive the difference between the option price and the market price, without a cash layout.

The tax and accounting rules for stock options can also be very complex. Different types of options have different tax liability consequences for the company and the employee. Publicly-held companies must disclose the potential effect of stock options in their financial statements or as footnotes to those statements.

Two-phase implementation

There are two phases involved in the inclusion of stock option plans in the NCS.

Phase 1

This phase evaluated the effectiveness of a questionnaire designed to collect stock options data. The test sample was developed in an unusual way. Because the goal was to gauge the validity of the questionnaire, only companies already identified as having stock option plans were surveyed. Information from the National Center for Employee Ownership (NCEO) was used to compile the sample. Due to the nature of the source data, tabulated phase 1 data should not be used as an estimate of the incidence or characteristics of stock option plans.

The initial questionnaire contained 10 questions about stock option plans for two separate employee groups, (1) executives and senior managers and (2) other employees. It also contained questions about company data, such as industry, employment size, and recordkeeping practices.

Timing. Phase 1 consisted of several steps. Testing began in April, 1999 with the initial selection of 100 companies from the NCEO member list. For test purposes, selected companies met three conditions: They employed 100 or more employees at the time of selection; they had no current involvement in other Bureau OCWC compensation surveys; and they were companies for which appropriate corporate contacts in financial operations or human resources could be located.

Company selection and data collection extended from April 5 to July 30, 1999 (see box). Phase 1 testing included three separate mailings as well as follow-up phone contacts, if necessary. On May 20, an initial pre-notice letter was sent to the 100 companies selected for the survey. The mailing was intended to pique respondent interest and inform them that they had been selected for the survey. The ini-

Collection Summary, 1999

	Process steps	*Number of questionnaires*
April 5 – May 14	Company selection and refinement	
May 15	Refinement completed	
May 20	Pre-notice letter mailing	
May 28	Initial test survey mailing	
May 28 – June 18	Period of collection for initial request	
June 18	Second test survey mailing	
June 28 – July 30	Telephone follow-up and questionnaire recontact	
	Total collection period	
	Questionnaires mailed	100
	Questionnaires completed	73
	Mail	57
	Fax	9
	Telephone	7
	Questionnaires lost	
	Nonresponses	22
	Refusals	3
	Other unit losses (acquisitions)	2
	Initial mailing responses	
	Mail responses	21
	Second mailing and follow-up responses	
	Total	52
	Mail	36
	Fax	9
	Telephone	7

tial questionnaire mailing was completed on May 28, with a requested return date of June 18. As expected, some companies returned their surveys promptly, others needed a reminder. Follow-up letters and a second copy of the questionnaire were mailed on June 18, with a deadline date of July 2. Starting on June 28, non-responding companies were contacted by phone to verify that the questionnaire had arrived. These units were then given the alternative of providing stock option plan data over the telephone or via fax. Completed questionnaires were accepted through July 30.

Collection. During the collection period, 73 completed questionnaires were received—57 via mail. During the initial collection period (May 28-June 18), 21 mail responses were received; and during the second collection period (June 18-July 30), an additional 36 were received. Nine companies opted to return their questionnaires via fax and seven others chose to provide the information over the telephone.

Information was not available for 27 companies. Twenty-two companies did not respond to the questionnaire (no data were provided), 3 refused to provide information, and 2 were acquired by other companies during the collection period. None of these companies were replaced in the sample.

There were 37 completed questionnaires from construction or manufacturing companies and 36 from service, trade, or transportation companies.

The sample selection was biased toward high tech establishments (communications, computer software companies, hardware manufacturers and suppliers, and biotechnology firms) because they composed the majority of the NCEO member list.

Results and analysis. When reviewing the results of the phase 1 questionnaire, it is important to remember that the sample of companies used was not designed to be a statistically representative sample of the economy. The questionnaire's goals were to determine the effectiveness of the test questions and the survey process, not to measure the incidence of stock option plans (each company was identified as already having a stock option plan).

TABLE 1. **Responses to selected questions from a stock option plans test survey, 1999**

Survey question[1]	Executives and senior managers	Other employees
Have the owners / stockholders approved a stock option plan?		
Total responses	73	73
Yes	68	64
No	5	9
Was the most recent grant a one-time event or part of a regular on-going plan?		
Total responses from companies with approved stock option plans	67	64
On-going	59	50
One-time	8	14
In the most recent grant, what types of options were granted?[2]		
Total responses from companies with approved stock option plans	67	62
Non-qualified stock options (NSO)	56	44
Incentive stock options (ISO)	44	33
Other	3	0
For the most recent grant, which criteria determined the number of shares granted?[2]		
Total responses from companies with approved stock option plans	64	63
Individual performance	51	57
Salary / pay	38	41
Company performance	32	17
Equal size[3]	4	5
Other	5	7

[1] Questionnaires were designed to determine the effectiveness of the survey questions and the process. Tabulations do not reflect average incidence or plan levels.

[2] Multiple answers were allowed for this question.

[3] Equal size grants for all plan participants.

Each questionnaire sought data for the entire company, not an individual establishment or physical location (as is done for the rest of the NCS). Unless otherwise noted, all questions were asked about two separate employee groups, (1) executives and senior managers and (2) other employees. Results are based on the 73 questionnaires received during the collection period. The following selected questions discuss the responses of the 68 companies with approved stock option plans. Some questions allowed multiple answers. (See table 1.)

- Have the owners/stockholders approved a stock option plan?

As expected, most companies stated that the owners/stockholders had approved a stock option plan. The results also showed that the majority of companies in the sample provided stock option plans to both executives and senior managers and other employees. Of the 68 companies with an approved plan, 82 percent distributed stock options to at least some employees in both groups.

- What year was the stock option plan (initially) approved?

Based on the average number of years prior to 1999 that the stock option plan was approved, the average length of time since approval of a stock option plan was 5.2 years for plans for executives and senior managers and 4.5 years for other employees.

- Was the most recent grant a one-time event or part of a regular, on-going plan?

The vast majority of companies with approved stock option plans used on-going plans as opposed to one-time-only grants. The percentage of companies with on-going plans for executives and senior managers was higher (88 percent) than those for other employees (78 percent).

- In the most recent grant, what types of options were granted? (This question allowed multiple answers.)

Non-qualified stock options[3] were the most common options granted. However, many companies also granted some degree of incentive stock options[4] to both employee groups.

- For the most recent grant, which criteria determined the number of shares granted? (This question allowed multiple answers.)

For both employee groups, individual performance was the criteria used most often for determining the number of shares granted (80 percent of the time for executives and senior managers and 91 percent of the time for other employees). Salary and pay level were also important criteria for determining the size of stock option grants. Company performance played a more important part in shares granted to executives and senior managers than it did for other employees.

- Which department is responsible for record-keeping for the stock option plan? (This question allowed multiple answers.)

The finance or accounting department was selected by 58 percent of the 68 companies with approved stock option plans as a department responsible for record-keeping. Human resource departments were responsible in 39 percent of the companies. (See table 2.)

TABLE 2. **Department responsible for stock option plan record-keeping, 1999**

Department	Number of times selected[1]
Finance / accounting	40
Human resources	27
Legal	12
Other	7

[1] Multiple answers were allowed for this question.

Phase 2

In winter 1999-2000, BLS will launch phase 2 of the NCS inclusion of stock option plan incidence data. The sample for phase 2 will be a statistically valid, national sample of about 2,000 companies.

In addition to the tested and improved mail survey, plans now call for respondents to have the option of supplying company information using a secure Internet site developed for the NCS program. This will be the first time that such a collection vehicle is used by NCS.

Phase 2 results will be available in the summer of 2000. A future article in this publication will discuss phase 2 findings. ■

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[1] *Wall Street Journal,* April 8, 1999.

[2] The National Center for Employee Ownership (NCEO) Internet site at http://www.nceo.org.

[3] Non-qualified stock options (NSO)—Under the Internal Revenue Code, a non-qualified (or non-statutory) stock option is taxable as wages (and deductible by the employer) when exercised by the employee. The employee does not generally recognize taxable income at the time the stock option is granted. NSOs can be issued with an exercise price below the fair market value of the stock. When the NSO is exercised, the spread (difference between fair market value and exercise price) is taxed. After the NSO is exercised, any future appreciation will be taxed as a capital gain when the stock is sold.

[4] Incentive stock options (ISO)—Under Internal Revenue Code, an incentive (or statutory) stock option is not taxable to the employee or deductible by the employer either when granted or exercised. The employee is taxed when the stock acquired under the option is sold, exchanged, or transferred by bequest or inheritance. An ISO cannot be issued with an exercise price below the fair market value of the stock, but after the stock appreciates, the option can be exercised without being subject to tax on the spread (difference between fair market value and exercise price). If the sale price is higher than the exercise price, this profit is taxed as a capital gain.