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Google sets up options market

EMPLOYEES WILL BE ABLE TO SELL IN ONLINE AUCTION

By Elise Ackerman
Mercury News

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Google announced Tuesday the creation of the first-ever

marketplace for employee stock options. Starting next spring, Googlers who have vested options will be able to sell them through an online site to institutional investors.

The search giant said it took the step because it was worried that employees currently are undervaluing their options, which typically have a term of 10 years and could grow in value. But Google's stock, after skyrocketing 370 percent between August 2004 and January 2006, has stalled this year. For brief periods this year, the options held by some Googlers appeared worthless, even though they can gain in value over time.

"We are doing this to make the value of options more tangible to employees," said Dave Rolefson, Google's equity and executive compensation manager. "If you ask a candidate or a new hire who just received an option grant how much those options were worth, you might get answers all over the map."

The online auction, which will be managed by Morgan Stanley, will give workers an answer in cold, hard cash, allowing Googlers to log in and see how much they could get for their options -- even those that are underwater.

Google said it expects employees with in-the-money options will still do better with the auction, because institutional investors will pay a premium for the opportunity to hold the option over time and benefit from a rise in Google stock. For employees who sell, they will be able to profit immediately from their options if they wish, rather than wait years for them to achieve maximum value.

For example, an employee with an option to buy Google at \$500 a share might think the option was worthless on a day, like Tuesday, when the stock closed at \$481.78.

In the real world, however, where options to buy and sell stocks at a fixed future price are traded every day, the option to buy Google at \$500 a share in January 2008 was worth about \$70 on Tuesday, even though the stock closed below the option strike price.

In the future, the Googler who held the option to buy Google at \$500 could sell it for a gain of \$70 through the auction. Of course, Google hopes that understanding the value of

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an option will convince employees to hold on to it -- and work hard at their jobs at Google.

“We think other companies might look at us and maybe copy us,” said Dave Sobota, Google's senior corporate counsel. “We think it's a new and exciting way to motivate employees.”

According to recent research conducted by the University of Illinois and Michigan State University, it's common for options holders to discount their value. Bill Briggs, chief executive of Net Worth Strategies, a compensation consulting firm based in Bend, Ore., that worked with the researchers, said people can underestimate an option's value by as much as 60 percent, making them more likely to consider competing job offers that might seem more lucrative.

Google's executive team will not be eligible for the program, which will only include options issued after Google's initial public offering in August 2004.

Google gives its employees options that are good for 10 years. However, if these options were sold in the online auction, the institutional buyer would have only two years to exercise the options, making them less valuable.

Institutional buyers, who will be invited by Google to participate, will not be able to resell the employee stock options.

Google declined to disclose how many options an average employee holds. However, based on a rough calculation -- the number of eligible outstanding options divided by the number of employees as of Sept. 30 -- Googlers hold an average of 700 options each.

Nell Minow, co-founder and editor of the Corporate Library, a governance advisory firm, said the program was “innovative” and “clever,” but would not necessarily persuade employees to hold onto their options, and thus remain with Google.

“I think it is just as likely that it will encourage them to sell,” Minow said.

Mark Fuchs, Google's chief accountant, said the program would increase the amount of money the company pays in stock-based compensation, according to accounting rules. Fuchs added that the program is intended to make Google's employee retention efforts more efficient and is not driven by accounting considerations.

Ted Buyniski, an executive compensation expert, said the increased stock-compensation expense may dissuade other companies from following Google's example.

But James Glassman, a senior fellow at the American Enterprise Institute, said Google's program could start a trend at companies with large market capitalizations.

“It's a terrific idea,” Glassman said. “By making the value of options transparent, Google enhances the value of those options in the eyes of employees.”

Google's options auction

How it will work:

Employees who have vested stock options will log into an online tool provided by Morgan Stanley.

They will see what the market price is for their options, depending on the strike price and the price of Google stock.

The tool will calculate the total potential gain to the employee.

The employee will decide whether to sell the options, which would be purchased by institutional investors most likely doing so as a hedge on other investments involving Google shares.

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