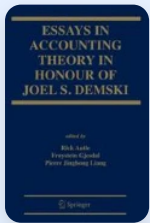


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The Structure of Performance-Vested Stock Option Grants

| Chapter

| pp 227–249 | [Cite this chapter](#)



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Abstract

U.S. executive compensation traditionally relies on stock options that vest over time. Recently, however, a growing number of institutional investors have called for the use of performance-vested options that link vesting to the achievement of performance targets. We examine the factors influencing the structure of performance-vested stock option grants to U.S. CEOs. We find that performance-vested options comprise a greater proportion of equity compensation in firms with lower stock return volatility and market-to-book ratios, and in those with new external CEO appointments, providing some support for theories on the options’ incentive and sorting benefits. However, firms with larger holdings by pension funds are less likely to completely replace traditional options with performance-vested options, and make traditional options a greater percentage of option

grants, suggesting that token performance-vested option grants may also be used to placate pension funds that are calling for their use. In addition, our exploratory examination of performance-vesting criteria finds similarities and differences to prior studies on the choice of performance measures in compensation contracts.

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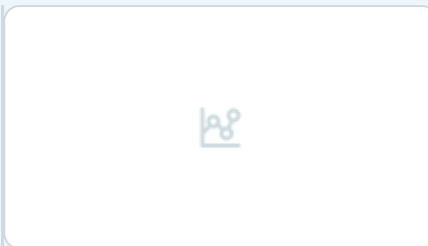
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