Restricted Stock Units – A Microsoft Creation

By: Brent Longnecker

The "Why"

Microsoft – Arguably one of the most significant companies ever worldwide – with a market cap today of over $2 Trillion – was founded by Bill Gates and Paul Allen in 1975. It eventually came to dominate the personal computer operating system market. With its 1986 initial public offering and the significant rise in its stock, it collectively created three billionaires and over 12,000 millionaires among Microsoft employees.

Life was excellent, with many more millionaires to mint. That is until May 1998, when the Department of Justice and Attorney Generals of 20 other states filed Antitrust charges against Microsoft, claiming that bundling additional programs into its operating system made them a monopoly. The suit was primarily a result of Microsoft's top competitor – NetScape – going bankrupt because Microsoft started giving its browser software away for free.

What most do not know is that this attack on Microsoft had an impact on its stock price. That, coupled with the fact that Microsoft made most of those millionaires through the stock options, began to cause employee disenchantment. When the value of the options dropped, Microsoft started to experience more turnover than it had ever experienced. With Microsoft known to invest heavily in its employees, losing talent was not – no pun intended – an option!

The result – Restricted Stock Units.

Bill Gates had this to say about options versus Microsoft's creation of Restricted Stock Units (RSUs):

"When you win with options, you win the lottery. And when you don't win, you still want it. The fact is that the variation in the value of an option is just too great. I can imagine an employee going home at night and considering two wildly different possibilities with his compensation program. Either he can buy six summer homes or no summer homes. Either he can send his kids to college 50 times or not. The variation is huge, much greater than most employees have an appetite for. And so, as soon as they saw that options could go both ways, we proposed an economic equivalent. So what we do now is give units."

What is a Restricted Stock Unit (RSU)?

An RSU is a form of long-term incentive compensation issued by an employer to an employee in the form of company shares. After remaining with the employer for a certain period, RSUs are usually given through a vesting and distribution schedule.

The critical difference between a stock option and an RSU is that the option gives the employee the right to purchase the company's stock at a predetermined price and date. It is an award entirely based on appreciation! An RSU is a whole-based plan, meaning it cannot go "underwater" like an option.

However, the timing of taxation is an additional discussion. There is NO financial planning for an executive unless they have a well-thought-out pay package.

Microsoft understood this and "pivoted" accordingly. That is what GREAT COMPANIES do! Plus, they can think outside of the box. Today, because of Microsoft, other companies such as Amazon, Uber, Apple, Verizon, IBM, Facebook, and Intel – are 8 of the top 10 companies using RSUs to attract, retain, and motivate the talent they desperately need to succeed.

Conclusion

It is beneficial when one knows the "why" behind something. Too many today assume and accept. However, Microsoft did something special here that would not just help them out competitively during a rough patch but would also add to the "compensation arsenal" companies can now draw from to be the best they can be for their most important asset – their people!

Thank you, Microsoft!