Testimony of Craig Barrett, CEO of Intel Corporation
House Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
June 3, 2003

Thank you, Mr. Chairman and Members of the Committee, for holding this important hearing. I am pleased to be here today to offer my perspective on the important role that employee stock ownership plays in creating jobs and expanding economic opportunity in the United States. I would like to briefly address three topics:

- The importance of stock options to America's economic health
- Why expensing stock options is not a solution to corporate corruption
- Why expensing stock options will confuse corporate financial reporting

Let me begin by expressing my strong support for H.R. 1372, the Broad-Based Stock Option Transparency Act of 2003. As Representatives Dreier and Eshoo stated in their own testimony today, H.R. 1372 recognizes that stock options help companies attract and retain a highly skilled, dedicated, and productive workforce at every level. The bill's disclosure requirements are a much needed reform. I commend Representatives Dreier and Eshoo for their leadership and look forward to working with them.

America's economic greatness throughout history has been built on two elements of our national character. One is our love for ideas – our relentless drive to "build a better mousetrap." Our ideas lead to spectacular inventions, exciting innovations, and expanding productivity.

Second is our entrepreneurial spirit – our willingness to take economic and personal risks to create jobs, wealth, and opportunity for ourselves and for others.

These characteristics were on display in 1968 when Robert Noyce and Gordon Moore founded Intel, the company I am privileged to serve. Like most other new enterprises, Intel began without much financial capital, but with a huge amount of intellectual capital, and an entrepreneurial willingness to take risks. To succeed, Intel's founders needed to attract men and women to the company who had specialized knowledge and expertise, and keep them in the face of stiff competition for their services. They couldn't begin to match the salaries such workers could get from more established firms; but they offered something better: an opportunity to be equity stakeholders in the company's future success. Intel began by granting stock options to nearly one-third of the workforce; today, all Intel employees participate in the stock option program.

I’m especially proud of Intel’s story, but we aren’t alone. Many companies, especially in the high-tech field, use stock options to attract and retain a highly specialized work force in a competitive economic environment. The technology sector has been at the forefront of a trend toward more knowledge workers. This trend has been developing in the economy for decades and is rapidly accelerating. In the early 1980s, tangible assets in the form of equipment and goods made up 70 percent of all nonfinancial corporate assets. By 2000, tangible assets made up about half of all assets, with the other half coming from intangible assets – patents, copyrights, software – in short, ideas and knowledge.[1]

Research indicates that the number of knowledge jobs increased from 43 percent to 62 percent between 1982 and 2000.[2] Knowledge workers now outnumber factory workers by two to one. Even people who hold traditionally blue-collar jobs in manufacturing usually need specialized training to work with advanced robotics and computerized production lines.

What does all this talk about global competition and knowledge workers have to do with the issue of expensing stock options? In a word: *everything.*

[1] Source: *In the Company of Owners: The Truth About Stock Options* by Joseph Blasi, Douglas Kruse and Aaron Bernstein, 2003, p. 225.
[2] Yankelovich, 1982; Gallup, 2002.

Some people would like you to think that what's at stake in this debate is an esoteric matter, with little impact beyond the green-eyeshade world of accountants and CFOs. In fact, what's at stake is the future strength and vitality of the American economy. Mandatory expensing of stock options means that stock options will only be offered to the most senior managers, if at all. The cost of doing anything else, in accounting terms, will be prohibitive. That means the movement toward broad-based employee ownership will come to a halt. It means start-up firms won't be able to offer employees a stake in the company's future success.

The economic harm of stock option expensing cannot be overstated. Three-quarters of the net new jobs created in the U.S. between 1999 and 2000 were created by small businesses with fewer than 500 employees.

A report by the Bureau of the Census[3] found that start-up companies in the first two years of operation created virtually all of the net new jobs in the economy. The incentive that many small and start-up businesses use to entice talented men and women to work for them, and motivate them to work long hours at low pay (much like the situation for associates in law firms), is the prospect of one day being a co-owner of the business and reaping ownership's rewards. Without the ability to offer stock options, many industry leaders today – including Intel – would never have gotten off the ground.

Without the ideas and entrepreneurial energy of small business start-ups, our Nation's ability to compete in the

[3] Source: US Bureau of the Census; *Endogenous Growth and Entrepreneurial Activity in Cities* by Zoltan J. Acs and Catherine Armington, Center for Economic Studies, Working Paper #CES-WP-03-2, January 2003

global economy will be dealt a serious blow. Right now, American business is at the forefront of innovation and new technology. Without incentives to attract and retain key workers in these fields, we will lose ground to fierce competitors in Asia and elsewhere where there is no intention to expense stock options. Productivity will suffer as well; research shows conclusively that companies with broad-based employee ownership have higher productivity, higher returns on equity, higher returns on assets, and higher levels of employee satisfaction.

Rank-and-file American workers will suffer the most from the mandatory expensing of stock options. Professors Joseph Blasi, Douglas Kruse, and Aaron Bernstein are co-authors of *In the Company of Owners: The Truth About Stock Options and Why Every Employee Should Have*

Them, a book I would highly recommend to anyone interested in the issue of the growth in employee ownership – the phenomenon the authors call “partnership capitalism.” The book details how broad-based employee stock ownership has benefited average workers by increasing their job satisfaction, stability, and economic security. They found that the average rank-and-file workers at the 100 largest Internet-based companies earned an average of $425,000 in stock option profits between 1994 and 2001. These earnings financed a lot of homes, college educations, and secure retirements.

At a recent Senate roundtable on the issue of expensing, Professor Kruse warned that expensing would “hurt the chance of employee ownership for the middle and working classes and the employees of technology companies.”

His associate, Professor Blasi, added that stock option expensing would result in the “protection and enhancement” of stock options for top executives, while “rolling back partnership capitalism” in the United States.

A popular reason given for expensing stock options is that it will help solve the problem of corporate corruption. I disagree. The collapse of Enron, WorldCom and others had nothing to do with the issue of stock option expensing – it had to do with scandalous abuses, greed and criminality by top executives who betrayed the public trust. We need to take action to prevent such abuses in the future. Let me outline a plan for comprehensive stock option reform that I believe will help achieve that goal.

First, all employee stock option plans should be approved by shareholders.

Second, stock option plans should be broad based and permit the participation of a substantial majority of the employees. No more than 5% of options should go to top executives.

Third, and this is a key element of the Dreier-Eshoo bill, companies should provide investors with expanded, more frequent, and more understandable disclosures – in plain English.

Fourth, stock options should vest over long terms – at least four years.

Fifth, the compensation committees should be made up entirely of outside directors.

This plan for comprehensive stock option reform would expand employee ownership, provide shareholders with more transparent and understandable information, and give corporate leaders greater oversight and accountability. These reforms would be good for job creation, innovation, entrepreneurship, and economic growth.

Let me conclude by briefly addressing one of the unintended consequences of the proposal to expense options. With the recent corporate scandals and resultant congressional legislation, CEOs are required to certify their company's financial results as being accurate and transparent to the investor community.

Expensing options using the Black-Scholes technique is inherently inaccurate. In a recent, op ed piece in the Wall Street Journal, I pointed out that using Black-Scholes would have cost Intel over three billion dollars in expenses for options that were underwater, that is, their strike price was below the current market price, and might never be exercised. The proponents of option expensing did not challenge this fact; they merely stated that there were other features of the P/L statement that gave equally inaccurate results. In a sense, they were saying two wrongs make a right. I fail to see how our investors would benefit from reported financial results that would be in error by three billion dollars. With all due respect to those who would support option expensing, I suggest they focus their efforts on fixing the current shortcomings of our accounting principles before they move to take away something that underpins our economic competitiveness.

Thank you very much for this opportunity to testify. I look forward to your questions.