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Do Executive Stock Options Encourage Risk-Taking?

by [Randolph B. Cohen](#), [Brian J. Hall](#) and [Luis M. Viceira](#)

Abstract

Executive stock options create incentives for executives to manage firms in ways that maximize firm market value. Since options increase in value with the volatility of the underlying stock, executive stock options provide managers with incentives to take actions that increase firm risk. We find that executives respond to these incentives. There is a statistically significant relationship between increases in option holdings by executives and subsequent increases in firm risk. This relationship is robust to the inclusion of fixed effects, year effects, and a variety of other controls and does not seem to be driven by reverse causality. However, the estimated effect on risk-taking is small and we do not find a negative (or positive) market response to option-induced risk-taking. In sum, although options appear to increase firm risk, there is no evidence that this effect is either large or damaging to shareholders.

Keywords: [Risk and Uncertainty](#); [Motivation and Incentives](#); [Stock Options](#); [Executive Compensation](#);Language: English Format: Print [Read Now](#)

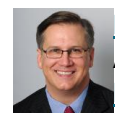
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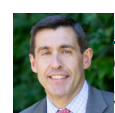
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