CAP analyzed payouts under long-term incentive plan performance cycles that ended in 2015 through 2020. This analysis includes 120 companies from ten industries with median revenue of $36B. We selected these companies to provide a broad representation of market practice across large US public companies.

Long-term performance plans are important performance-based tools that companies use to reward executives for achieving medium to long-term financial objectives and creating shareholder value; they often represent the most significant portion of executive compensation programs. Setting appropriate performance goals is critical to establishing a strong link between pay, performance, and shareholder outcomes. The challenge is to achieve a balance between rigor and attainability, amidst expected industry and economic factors, to motivate executives to drive long-term company performance and shareholder returns.
Key Takeaways

Based on our analysis of long-term incentive payouts from 2015-2020, the degree of difficulty, or “stretch”, embedded in long-term performance goals translates to:

- A 95 percent chance of achieving at least Threshold performance
- A 70 percent chance of achieving at least Target performance
- A 20 percent chance of achieving Maximum performance

Summary of Findings

Prevalence of Long-term Performance Plans

Nearly all of the large cap companies in our study use long-term performance plans (97%). Long-term performance plans are awarded to executives at “target” and provide the opportunity to earn above or below target based on the achievement of pre-determined performance goals. They can be denominated in cash or stock. Stock is far more common for public companies (97%).

Performance Measurement Period

Three-year performance periods are most common. 97 percent of the companies in CAP’s study with long-term performance plans have at least one plan with a three-year performance period. Only three percent of companies have a plan with a performance period of longer than three years (i.e., four or five years).

Performance Metrics

Long-term performance plans predominantly use objective financial or stock price metrics. The most common long-term performance plan metrics are relative Total Shareholder Return (TSR), Return measures, and Earnings per Share (EPS). Many companies use a combination of financial and stock price metrics to balance line-of-sight for executives and direct alignment with shareholder outcomes.

A handful of companies use strategic or non-financial metrics in long-term incentive plans, though it is far less common in long-term vs. annual incentive plans. For example, companies have increasingly incorporated Environmental, Social, and Governance (ESG) metrics into the annual incentive plan but few have added such metrics to the long-term incentive plan. Companies that use long-term strategic or non-financial metrics often do so because they have key non-financial objectives and priorities that are important to the business and measurable, like safety or emissions. One reason companies avoid using more subjective metrics in long-term equity-based incentive plans is that metrics must be objective to preserve the favorable accounting treatment allowed for equity awards.

In some cases, companies with cash-based long-term incentive plans have introduced ESG metrics into their long-term plans because cash plans are already subject to variable accounting. One example is Nike, which uses long-term Diversity, Equity, and Inclusion (DE&I) and sustainability metrics. As companies continue to define objective goals around their long-term ESG strategies, we may see more companies use these metrics in long-term equity plans as many companies view ESG and strategic goals as longer-term in nature.
Pay and Performance Scales

Compensation committees annually approve threshold, target, and maximum performance goals, and corresponding payout opportunities, for each metric in the long-term performance plan. Target performance goals are most often set in line with the company’s business plan for absolute metrics or at median of the comparator group for relative metrics. Proxy advisory firm, Institutional Shareholder Services (ISS), has pushed for companies to set target goals for relative TSR above median of the comparator group. We have seen some companies follow this guidance in paying at target for performance at the 55th or 60th percentile; however, most companies continue to pay at target if TSR results are at median vs. the comparator group.

Executives most often earn between 25 and 50 percent of target for achieving threshold performance and 200 percent of target for achieving maximum performance. Only five percent of companies provide for payouts of greater than 200 percent of target for achieving maximum performance goals (i.e., 250 to 300 percent of target).

Long-term Incentive Plan Payouts Relative to Goals

All Companies

Based on CAP’s analysis of long-term incentive payouts for performance cycles that ended in 2015-2020 (e.g., for companies with 3-year performance plans, the analysis includes the following performance cycles: 2013-2015, 2014-2016, 2015-2017, 2016-2018, 2017-2019, and 2018-2020), the degree of “stretch” embedded in long-term performance goals translated to:

- A 95 percent chance of achieving at least Threshold performance
- A 70 percent chance of achieving at least Target performance
- A 20 percent chance of achieving Maximum performance

This shows that participants are receiving a payout, at least at the minimum payout level, 95 percent of the time when achieving at least threshold performance goals, and receiving maximum payouts 20 percent of the time, or once in every 5 years.

As demonstrated in the chart below, the percentage of companies achieving target and above generally trended upward for payouts made for performance periods that ended in 2016 to 2019 before dropping off in 2020, likely due to the impact of COVID-19 on some industries.
By Industry

Our study found that select industries have payout distributions that fall outside the norms of the broader group. Companies in the health care, pharmaceutical and insurance industries paid at target or above 80-85 percent of the time versus 70 percent for the full sample. Conversely, companies in the consumer goods and retail industries, where Revenue growth has lagged that of other industries in recent years, achieved target performance slightly more than 50 percent of the time. Several factors may contribute to such differences in payout distributions, including metric selection, goal-setting, and economic influences.

This same pattern between industries is also true for annual incentive plan payouts, indicating that payouts across annual and long-term plans are generally aligned and reflective of performance.

Average payouts for each industry are distributed as indicated in the following chart:
Looking Ahead

Our research indicates that over the last six years companies set long-term performance goals that translated to:

- A 95 percent chance of achieving at least Threshold performance
- A 70 percent chance of achieving at least Target performance
- A 20 percent chance of achieving Maximum performance

The impact of COVID-19 on certain industries and the resulting disruption to pay programs may cause payout patterns to be outside the normal range for the 2019-2021 and 2020-2022 performance cycles. For future performance periods, we expect payout patterns to return to the norms identified in our research.

Over time, however, we may see these patterns change as companies continue to consider how longer term non-financial priorities, such as ESG objectives, digital transformation, and market share, best fit in their compensation program.
Methodology

The 120 companies in our study had a revenue size ranging from $18 billion at the 25th percentile to $72 billion at the 75th percentile. Median revenue was $36 billion.

CAP reviewed payouts under long-term incentive plan performance cycles that ended in 2015-2020 to determine the distribution of payouts and the frequency with which executives achieve target payouts. In this analysis, CAP categorized long-term incentive payouts (as a percentage of target) into one of six categories based on the following payout ranges:

<table>
<thead>
<tr>
<th>Payout Category</th>
<th>Payout Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max</td>
<td>10% below Max to Max</td>
</tr>
<tr>
<td>Target – Max</td>
<td>10% above Target to 10% below Max</td>
</tr>
<tr>
<td>Target</td>
<td>+/- 10% of Target</td>
</tr>
<tr>
<td>Threshold – Target</td>
<td>10% above Threshold to 10% below Target</td>
</tr>
<tr>
<td>Threshold</td>
<td>Up to 10% above Threshold</td>
</tr>
<tr>
<td>No Payout</td>
<td>0%</td>
</tr>
</tbody>
</table>