

Long-term incentive plan design among mid-cap industrials - wtwco.com

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Executive Summary

This analysis examines long-term incentive plan design among 58 mid-cap industrial companies in the S&P Industrials 400 with calendar fiscal years. The study investigates how LTI design contributes to CEO pay-performance alignment, using a framework where compensation actually paid (CAP) and total shareholder return (TSR) percentiles within 25 percentage points are considered aligned. Key findings show that 71% of mid-cap industrials demonstrate aligned pay, with performance awards comprising the largest portion of LTI (59% weighting), followed by restricted stock (37%) and stock options (4%). TSR and financial returns on capital are the most common performance measures. The analysis reveals that companies using custom peer groups for TSR measurement show higher rates of pay-performance misalignment compared to those using industry or broad indices, suggesting potential issues with peer group definition or sample size.

Key Insights

1. 71% of mid-cap industrials show CEO pay aligned with TSR performance, while 13% show pay materially higher and 16% show pay materially lower than performance
2. Performance awards dominate LTI composition at 59% average weighting, reflecting the shift toward performance-based compensation
3. Companies using custom peer groups for TSR measurement show higher rates of pay-performance misalignment (80%+ when misaligned) compared to those using industry or broad indices

Practical Takeaways

- Companies should evaluate whether their custom peer groups are too narrowly defined or have insufficient sample sizes for meaningful relative performance comparison
- The typical allocation of 73% absolute goals and 27% relative goals among mid-cap industrials provides a benchmark for balancing different performance measurement approaches

Frameworks Mentioned

Pay-Performance Alignment Zone — Framework where CEO compensation actually paid (CAP) and TSR percentiles within 25 percentage points are considered aligned

CEO Sharing Ratios — Calculation comparing five-year cumulative CEO CAP to change in market capitalization over the same period, adjusted for M&A activity

Critical Analysis

Strengths include clear methodology for defining pay-performance alignment, comprehensive data set of 58 companies, and specific quantitative findings. The peer group analysis provides actionable insights about potential design flaws. Limitations include focus on a single sector and time period, potential selection bias in the calendar fiscal year requirement, and lack of discussion about other factors that might influence pay-performance relationships beyond LTI design. The analysis appears vendor-neutral and data-driven.

Organizational Practice

Mid-cap industrial companies typically structure LTI with 59% performance awards, 37% restricted stock/units, and 4% stock options. Most use two or three performance measures, with TSR (relative basis) and financial returns on capital being most common. Companies allocate an average of 73% to absolute goals and 27% to relative goals.

Strategic Implications

The data suggests a trend toward performance-based LTI structures in industrial companies, with the choice of peer group composition potentially impacting pay-performance alignment outcomes. The prevalence of custom peer groups among misaligned companies indicates this may be an area requiring closer examination in compensation program design.

Validation Status: passed
