

ClearBridge 100: Incentive Plan Goal Setting

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Introduction

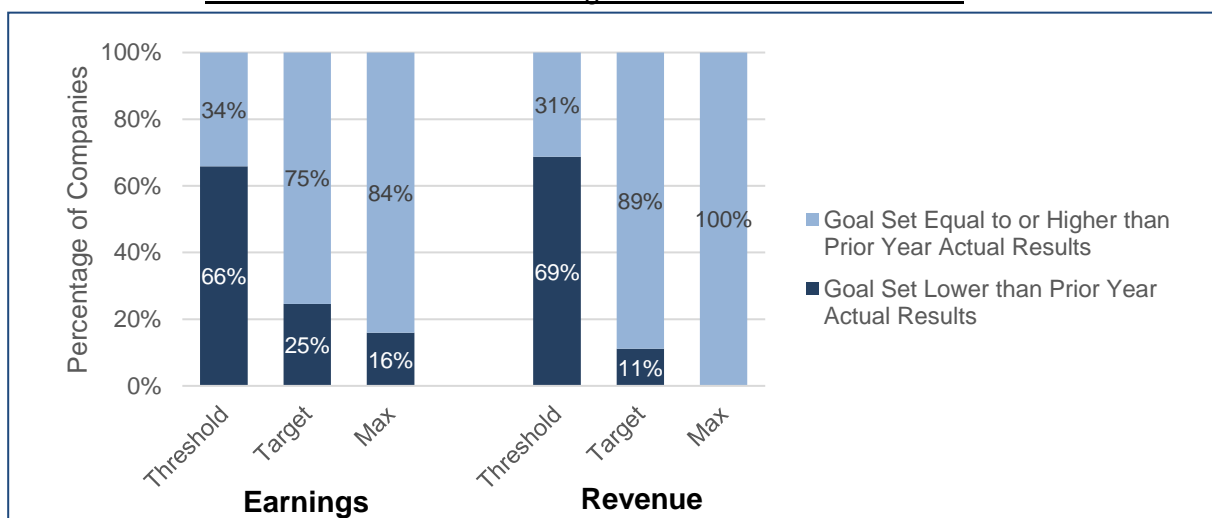
Setting goals for executive incentive plans that align with the company’s strategic objectives and are realistic and motivating for executives, yet rigorous enough to satisfy shareholders and other external pressures, is one of the biggest issues facing boards today. When setting incentive plan goals, boards are balancing multiple competing forces and ultimately, are trying to predict the future without a crystal ball. So where are most companies finding the sweet spot? In order to answer this question, ClearBridge Compensation Group (“ClearBridge”) analyzed the goals set by 100 S&P 500® companies (the *ClearBridge 100*¹) for their annual incentive plans (“AIP”) and long-term incentive (“LTI”) plans.

Annual Incentive Plan (“AIP”) Goals

Annual incentive plan goals are set considering multiple factors, such as the company/industry outlook for the year, historical and projected growth rates for the company and its peers, and shareholder expectations of company performance.

Among *ClearBridge 100* companies, earnings and revenue were the two most commonly used AIP metrics. For both of these metrics, we analyzed companies’ AIP goals (threshold, target, and maximum) compared to their prior year actual performance. As shown below, companies more commonly set their target and maximum goals equal to or higher than prior year actual results, whereas threshold goals were more commonly set lower than the previous year’s performance.

Exhibit 1: AIP Threshold/Target/Max vs. Prior Year Actual



¹ The *ClearBridge 100* is comprised of 100 S&P 500® companies to provide a database representative of executive compensation practices and trends of the broad U.S. market



When the target AIP goal is analyzed as a percent of the previous year's actual performance, growth rates at the 50th percentile were 4% for earnings and 3% for revenue.

Exhibit 2: AIP Target Goal vs. Prior Year Actual

Percentile	Earnings	Revenue
90th	+15%	+18%
75th	+8%	+6%
50th	+4%	+3%
25th	0%	1%
10th	-13%	-1%

To provide additional perspective, we also analyzed how companies set the range around target (from threshold to maximum). Companies typically look to set these ranges such that the threshold represents a minimally acceptable level of performance to warrant some payout, and the maximum represents outstanding performance. Among *ClearBridge 100* companies, threshold and maximum earnings and revenue goals as a percent of the target goal are shown below.

Exhibit 3: AIP Threshold/Max as % of Target

Percentile	Threshold		Percentile	Maximum	
	Earnings	Revenue		Earnings	Revenue
90th	97%	98%	90th	118%	111%
75th	95%	98%	75th	112%	110%
50th	91%	95%	50th	110%	104%
25th	85%	90%	25th	105%	102%
10th	80%	80%	10th	104%	101%

In 35% of cases, companies set the range from threshold to maximum symmetrically around target (e.g., 90%-110% or 85%-115%).

Long-Term Incentive (“LTI”) Goals

Setting goals for long-term incentive plans can be even more challenging than for annual incentive plans due to the length of the performance periods involved (typically 3 years). In setting LTI plan goals, companies are looking to balance multiple factors – shareholder expectations of performance, alignment of pay with performance outcomes, and retention/motivation of executives. The two most commonly-used LTI metrics by *ClearBridge 100* companies are earnings and TSR, and the rest of this section focuses on these metrics.





Earnings Goals

Among *ClearBridge 100* companies, there is a wider range of earnings goals for LTI goals compared to AIP goals, likely due to the challenge in setting goals over a multi-year period. Threshold and maximum earnings goals as a percent of the target goal are shown below.

Exhibit 4: LTI Earnings Threshold/Max as % of Target

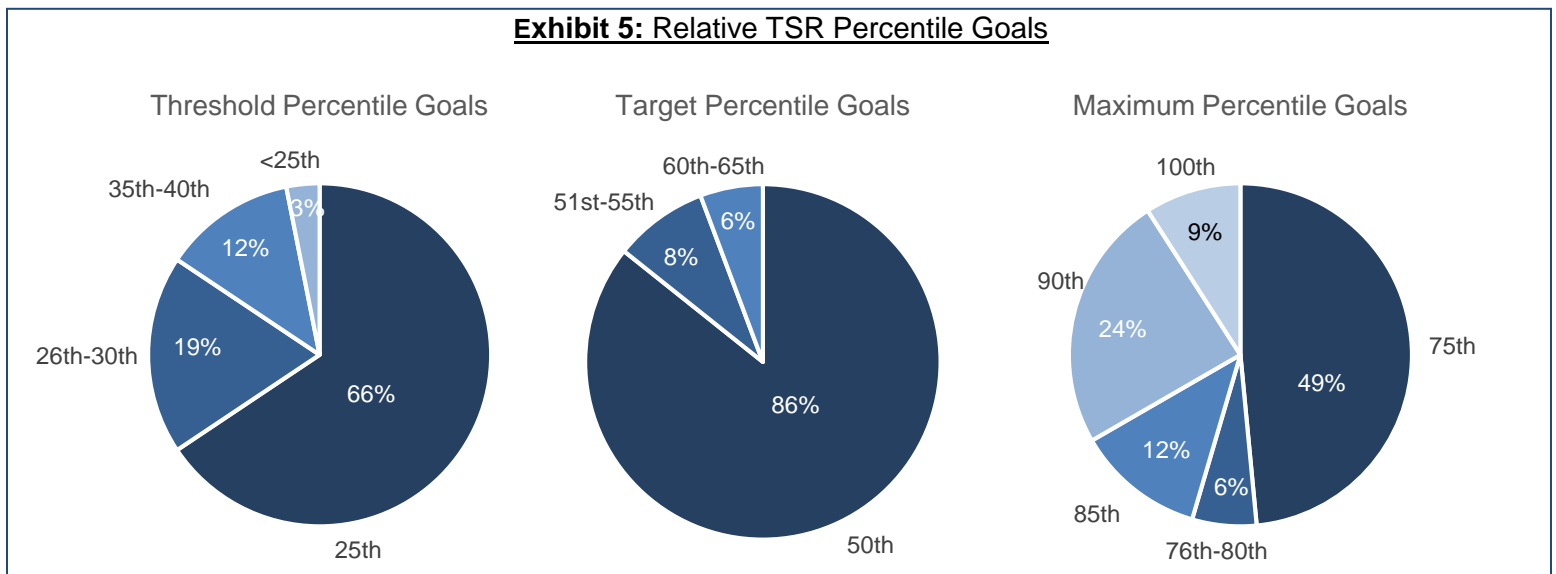
Percentile	Threshold	Percentile	Maximum
90th	96%	90th	123%
75th	93%	75th	120%
50th	90%	50th	109%
25th	82%	25th	106%
10th	77%	10th	105%

Relative TSR Goals

About 50% of *ClearBridge 100* companies used a stock price or TSR metric in their LTI plan. The vast majority of companies who used a stock price/TSR metric used relative TSR, with threshold, target, and maximum goals set at specific percentiles of the comparator group.

The most common approach among *ClearBridge 100* companies is to set relative TSR goals at the 25th and 50th percentiles for threshold and target, respectively. 86% of companies set target at 50th percentile of their respective comparator groups and 66% set threshold of 25th percentile. The most common maximum goal was the 75th percentile (49% of companies), although more than half of companies set maximum goals above the 75th percentile for increased challenge to earn the maximum payout.

Exhibit 5: Relative TSR Percentile Goals





Conclusion

There are many factors that influence setting goals for a company's incentive plan, and each company will have its own unique set of circumstances to consider. Still, there are a number of general observations in the market that companies can consider when setting their goals. Ultimately, boards need to take all of the factors into account and determine what they believe to be the best approach to drive long-term shareholder value.

To discuss this topic and any additional issues, please contact us at (212) 886-1022.

ClearBridge Compensation Group is an independent consulting firm providing advice to boards of directors and senior management on the design of effective executive compensation programs. Our aim is to establish transparent connections between management and shareholders and understandable links between performance and compensation. To learn more about ClearBridge, please visit our website www.clearbridgecomp.com.