



# The Debate on Performance Shares— Who Has It Right?

By Charles Tharp and Ani Huang

After a decade of complete primacy, performance-based share units (PSUs) are undergoing a moment of intense scrutiny.

Investors like CII and Norges Bank are questioning whether:

- PSUs should be the prevailing form of long-term incentives for CEOs, and
- whether they are in fact tied to better performance

In response to investor input, proxy advisors like ISS and Glass Lewis are softening their requirements around performance-based equity. It can be tough to sort through all the differing perspectives. Here is a resource we hope will help clarify how the varying findings compare to each other, which questions are being asked (and answered) and key considerations for you in your work with the Compensation Committee.

## Bottom Line

**Although research is limited, it seems likely there could be negative consequences of the trend toward greater homogenization of pay among large public companies.**

- ISS recently made headlines by breaking with its historic preference for performance-based pay, and investors seem increasingly willing to support long-vesting RSUs.
- While studies suggest that companies with innovative LTI design perform better than peers, companies should view these results with caution and undertake their own analysis to determine if their approach to long-term incentives is optimal in view of their business strategy, competitive landscape, company culture, and talent objectives.
- The Center believes that “best fit” should guide the design of executive compensation and encourages companies to resist being overly swayed by either prevailing practice or the headlines generated by limited research on LTI design and company performance.



In most publicly held companies, the compensation of top executives is virtually independent of performance. On average, corporate America pays its most important leaders like bureaucrats. Is it any wonder then that so many CEOs act like bureaucrats rather than the value-maximizing entrepreneurs companies need to enhance their standing in world markets?<sup>3</sup>

# Long-Term Incentives: A Brief History

Long-term incentives are intended to motivate sustained performance and to align the interests of management with those of shareholders. While historically representing a relatively small portion of the executive pay package, LTI awards now comprise approximately 70% of the total pay of S&P 500 CEOs.<sup>1</sup> The mix, too, has evolved over time; initially, stock options predominated while now, performance-based equity and time-vesting restricted shares are most prevalent.<sup>2</sup> While stock options continue to be an important form of LTI for many companies, their prevalence and weighting has declined among the S&P 500.

## FROM OPTIONS TO PSUs: A QUICK EVOLUTION

- **1950s–1990s:** Stock options reigned, boosted by tax perks and the notion that if the stock goes up, everyone wins.
- **1990s–2000s:** [Academic critiques](#) and [tax changes](#) elevated performance-based pay, making time-vested stock options and performance shares more popular.
- **2000s–2010s:** The dot-com bust, accounting changes, and implementation of Say on Pay eroded the dominance of stock options. Proxy advisors, especially ISS, pushed for performance-based equity.
- **2012–2024:** The PSU takeover. Semler Brossy reports PSU prevalence among S&P 500 companies surged from 75.7% to a near-universal 95.4%.
- **Today:** LTI plans feature “cookie-cutter” designs, such as widespread use of TSR and a 3-year performance period.

1. Meridian Compensation Partners, S&P 500 CEO's Reported Compensation 2021-2024, <https://www.meridiancp.com/app/uploads/2024/12/SP-500-CEOs-2020-2023-1.pdf>

2. Pay Governance, S&P 500 Compensation Trends, <https://www.paygovernance.com/viewpoints/s-p-500-ceo-compensation-trends-2>

3. Michael C. Jensen and Kevin J. Murphy, CEO Incentives—It's Not How Much You Pay, But How, Harvard Business Review (May-June 1990)



## What Happened to Options?

Beginning in the 1950s, stock options were the most prevalent form of compensation, driven in part by favorable tax treatment, with gains taxed at capital gains rate (25%) versus the top marginal ordinary income rates of 70% to 90%.<sup>4</sup> At this time, LTI was a much smaller portion of total pay than now. After the burst of the dot com bubble (2000) and the change in accounting rules (2005) that required companies to record an expense for the granting of stock options,<sup>5</sup> their prevalence declined dramatically.

Meanwhile, performance-based equity did not gain popularity until the 1970s, in response to a stagnant stock market and the pressure of global competition that increased the focus on productivity and company performance.<sup>6</sup> In the 1990s, long-term incentives in general gained positive momentum based on the work of Jensen and Murphy (1990), who noted the modest alignment of CEO pay and the creation of shareholder value.

## Enter Performance Shares

The prevalence of performance-based equity increased dramatically (from 76% in 2012 to 95% in 2024, [according](#) to Semler Brossy) following Dodd Frank Say on Pay rules in 2011.<sup>7</sup> **Why? As a result of the say-on-pay requirement, proxy advisory firm influence skyrocketed.**

Institutional Investor Services (ISS), the dominant proxy advisor, has traditionally held the view that time-vesting incentives, including stock options, are not performance-based compensation and has taken a negative view if less than 50% of equity awards are in the form of performance-based equity. In a major shift for 2026, ISS changed its stance and will **no longer require that half the long-term award be performance-based**. Time-based equity awards will be viewed more favorably if they have extended vesting horizons.

Meanwhile, the prevailing major metric (TSR) and performance period (three years) directly mirror the major quantitative test used by ISS in their pay-vs-performance assessment.

4. Carola Frydman and Raven E. Saks, Executive Compensation: A New View from a Long-Term Perspective, 1936-2005, <https://www.federalreserve.gov/pubs/feds/2007/200735/200735pap.pdf>

5. Financial Accounting Standards Board, Summary of Statement No. 123 (revised 2004), <https://www.fasb.org/page/PageContent?pagelId=/reference-library/superseded-standards/summary-of-statement-no-123-revised-2004.html&bcpath=tf>.

6. Joseph Bachelder, What Has Happened to Stock Options, Harvard Law School Forum on Corporate Governance, Oct. 2, 2014.

7. SEC, Investor Bulletin: Say-on-Pay and Golden Parachute Votes, <https://www.sec.gov/files/sayonpay.pdf>

# The Promise: Pay and Performance in Sync

In theory, PSUs earned based on TSR performance *should* provide a strong link between CEO pay and return to shareholders, given that stock price is the primary driver of pay and returns. For CHROs and compensation committees, PSUs are appealing; they align with majority investor and proxy advisor views while simplifying pay-vs-performance messages.

**However, recent research** raises provocative questions as to whether the dominance of PSUs in long-term incentives best serves shareholders.

**Our analysis found the (often conflicting) research can be grouped into three areas of focus:**

- 1** Do performance shares produce a strong pay-for-performance relationship *when comparing realizable pay and TSR* (for example, the Dodd-Frank “compensation actually paid” table)? Note that this may not align with how most companies define pay and performance.
- 2** Do companies that adopt the prevailing mix of long-term incentives (dominated by PSUs) create more shareholder value than companies that don’t?
- 3** How does the level of share ownership by senior leadership impact the return to shareholders and is there an optimal level in creating shareholder value?

## WHY IS THE RESEARCH CONFLICTING?

One difficulty with executive compensation research is that often, the researchers are not asking the same *questions*. This means the results are not directly comparable—in this case, one study is asking whether unvested holdings are aligned with stock price, whereas the others are asking whether the use of PSUs is correlated to long-term shareholder value.

## KEY RESEARCH FINDINGS

- **Pay Governance** found companies with PSUs show robust alignment of realizable pay (Compensation Actually Paid) with TSR, but *not* Summary Compensation Table pay. This was the only study to find an advantage with PSUs.
- **Farient Advisors’ Marc Hodak** showed that PSU-heavy companies paid their CEOs more but delivered weaker shareholder returns.
- **Norges Bank** found that among their US holdings, firms using PSUs underperformed sector peers without PSUs.
- **Virginia Tech Professor Felipe Cabezon** found companies that change their pay structure to become more similar to other firms (often, by adopting PSUs) underperform in shareholder returns and firm valuation compared to those with tailored designs.
- **Willis Towers Watson (WTW)** reported that “enduring high-performance firms” relied more on stock options, had longer vesting, and fewer metrics—tailoring incentives instead of adopting the most common practice.



# Question 1

## Do performance shares produce a strong pay-for-performance relationship when comparing realizable pay and TSR?

Pay Governance analyzed the alignment of both Summary Compensation Table (SCT) pay and Compensation Actually Paid (CAP) with relative TSR versus industry peers for 159 of the S&P 500 companies over the 4-year period from 2000 to 2023. **The analysis found a poor alignment of SCT pay and relative TSR but a robust alignment of CAP with relative TSR.**<sup>8</sup>

The poor alignment of SCT pay and relative TSR is due to the fact that the SCT is a mix of pay earned in the reporting year (salary, bonus and nonequity incentive compensation), changes in pension benefits that may be realized upon retirement, other compensation (perquisites and executive benefits), and the estimated value of long-term incentives that may be earned in future years if performance targets and vesting requirements are achieved. It is easy to see why the measures

### CAP AND TSR:

The Dodd-Frank Pay Versus Performance mandate requires companies to disclose the “relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions.” However, the SEC’s definition of “compensation actually paid” is a realizable number, valuing outstanding and recently vested long-term incentives based on annual changes in stock price.

of pay disclosed in the SCT, the majority of which are yet to be earned over future years, would not correlate with prior years’ relative TSR.

The robust alignment of CAP with relative TSR is *also* not surprising, given that long-term incentives are the largest portion of CEO pay, performance-based equity is the most common form of long-term incentive award, and TSR is the prevailing metric for performance-based equity. It would be almost impossible for CAP and TSR to fail to be aligned over the performance period—but what about returns over time?

<sup>8</sup> Ira Kay, Ed Sim, and Mike Kesner, Pay Governance LLC, Does Compensation Actually Paid Align with Total Shareholder Return, Harvard Law School Forum on Corporate Governance, Aug. 8, 2024.

# Question 2

## Do companies that adopt the prevailing mix of long-term incentives (dominated by PSUs) create more shareholder value than companies that don't?

A question raised by academics and other researchers is whether the increase in homogeneity of incentive design has been beneficial to shareholders as compared to the performance of companies that have taken a differentiated approach.

Recent studies appear to indicate that companies that deviate from the prevailing practice of dominant PSUs provide greater returns to shareholders than companies using the standard approach.

STUDY	KEY FINDINGS
<b>Farient Advisors (Marc Hodak)</b> —Analysis of S&P 500 companies, 2008–2017 updated through 2022	<p>Reported CEO pay for companies granting PSUs was 35%–40% higher than CEO pay at companies that did not grant PSUs.</p> <p>Companies granting PSUs also had lower total shareholder return than non-PSU-granting companies.<sup>9</sup></p> <p>An updated analysis covering results through 2022 found similar results.<sup>10</sup></p>
<b>Norges Bank</b> —Analysis of U.S. holdings, 2017–2023 (1,803 companies, including most of the S&P 500)	<p>Found that the minority of firms without PSUs outperformed peers, even when “controlling for company size, beta and other factors.”<sup>11</sup></p> <p>Norges Bank remains an outspoken critic of PSUs.</p> <p>In 2019, the Council of Institutional Investors joined in this position, calling PSUs “a mirage” and advocating instead for RSUs with long vesting periods.<sup>12</sup></p>
<b>Professor Felipe Cabezon</b> —Analysis of firm valuation and shareholder returns, 2006–2019	<p>Found that companies that change their pay structure to be more similar to others <i>underperform</i> by exhibiting lower pay-for-performance sensitivity, lower firm valuation, and lower stock returns compared to companies with more differentiated mixes of incentives.<sup>13</sup></p>
<b>Willis Towers Watson (WTW)</b> —Study of high-performing firms (S&P 500 companies whose TSR outperformed 90% of the time over the last decade)	<p>Found that companies taking a more tailored approach to incentives outperformed those adopting the prevailing mix.</p> <p>These high-performing firms granted more stock options, had longer vesting periods, and used fewer incentive metrics.<sup>14</sup></p>

9. Marc Hodak, Farient Advisors, “Are Performance Shares Shareholder Friendly?” *Journal of Applied Corporate Finance*, Summer 2019.

10. Marc Hodak, Andrew W. Lo and Chaoyi Zhao, “Study of PSUs See Higher Pay, Lower Performance,” Farient Advisors, <https://farient.com/2025/05/15/psus-study-sees-higher-pay-lower-performance/>, March 15, 2025.

11. Ola Peter Gjessing, Norges Bank, <https://corpgov.law.harvard.edu/2024/08/28/time-to-rethink-performance-shares/>, August 28, 2024.

12. Council of Institutional Investors, <https://www.cii.org/files/ciicorporategovernancepolicies/20190918NewExecCompPolicies.pdf>, September 19, 2019.

13. Felipe Cabezon, “Executive Compensation: The Trend Towards One-Size-Fits-All,” *Journal of Accounting and Economics*, 2025, vol. 79.

14. Michael Oclaray, Melissa Severance and Erik Nelson, WTW, “Enduring High-Performing Companies Take a Best Fit Approach to Executive Pay,” <https://www.wtwco.com/en-nz/insights/2025/03/enduring-high-performing-companies-take-a-best-fit-executive-pay-approach>.



# Question 3

## **How does the level of share ownership by senior leadership impact the return to shareholders and is there an optimal level in creating shareholder value?**

Norges Bank believes that a “substantial proportion of total annual remuneration should be provided as shares that are locked in for at least five and preferably ten years, regardless of resignation or retirement” and that the board should develop pay practices that are simple, without “performance conditions and complex criteria.”<sup>15</sup>

In support of their pay philosophy, Norges references research showing that if management has significant share ownership (10% or greater of outstanding shares), the company delivers superior returns to shareholders.<sup>16</sup>

Indeed, research by Equilar finds that for Russell 3,000 companies, the highest median three-year TSR is associated with CEO ownership between 6% to 15% of outstanding shares.<sup>17</sup> On the other hand, while there are academic studies that also support a positive relationship between executive share ownership and company performance,<sup>18</sup> a meta-analysis of the literature shows mixed findings.<sup>19</sup>

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15. Norges Bank Investment Management, CEO Remuneration: CEO Remuneration Should be Value-Creating for the Company, <https://www.nbim.no/en/responsible-investment/position-papers/ceo-remuneration/>, 2017.

16. Lilienfeld-Toal, et al, “CEO Ownership, Stock Market Performance, and Managerial Discretion,” *The Journal of Finance*, Vol. LXIX No. 3, June 2014, 1013-1050.

17. Jessica Phan, Equilar, The Effects of CEO Ownership on Total Shareholder Return, Harvard Law School Forum on Corporate Governance, <https://corpgov.law.harvard.edu/2018/11/23/the-effects-of-ceo-ownership-on-total-shareholder-return/>, November 23, 2018.

18. Randall Morck, Andrei Shleifer and Robert Vishny, Management Ownership and Market Valuation, *Journal of Financial Economics* 20 (1988) 293-315.

19. Chamu Sundaramurthy, Dawna L. Rhoades and Paula L. Rechner, A Meta-analysis of the Effects of Executive and Institutional Ownership on Firm Performance, *Journal of Managerial Issues*, Winter 2005, Vol. 17, No. 4 (Winter 2005), pp. 494-510.

# What Do Investors Think?

While Norges Bank and CII advocate for longer term share awards that are not contingent upon performance, overall, institutional investors hold varying views on the appropriate mix of long-term incentives.

STUDY	KEY FINDINGS
<p><b>ISS Survey—</b> (325 institutional investors, corporations, board members, and corporate advisors, 27% U.S.)</p>	<p>Less than half (43%) of investors wanted ISS to continue penalizing companies with less than 50% of CEO equity in the form of PSUs.<sup>20</sup></p> <p>70% of non-investors indicated a strong preference for a revised approach which allows time-vesting equity with extended vesting (often five years).</p>
<p><b>Glass Lewis Survey—</b> (487 investors and non-investors, 45% U.S.)</p>	<p>Survey found that globally, a majority of investors would consider supporting time-based awards in specific circumstances but generally prefer performance-based awards.<sup>21</sup></p> <p>“North American investors were more willing to consider supporting time-based awards if the award size is reduced (61.5% vs. 41.9% for other investors).”<sup>22</sup></p> <p>Overall, 92% of investors prefer that a large portion of equity compensation be performance-based.</p>
<p><b>Pay Governance in partnership with IR Impact Survey—</b> (more than 100 large investors globally, 53% North American)</p>	<p><b>Satisfaction:</b> 43% were satisfied or very satisfied with current state, 30% were neutral, 27% were dissatisfied with current pay-for-performance alignment.<sup>23</sup></p> <p><b>Preferred form of long-term incentive:</b> 37% of respondents expressed a preference for PSUs, 34% both PSUs and long-vesting time-based RSUs, 24% long-vesting time-based RSUs.</p> <p><b>Preferred long-term incentive mix:</b> 51% would prefer LTIs to be mostly PSUs, 35% preferred a mix of 50/50 PSUs and RSUs, 14% preferred mostly time-based RSUs.</p> <p><b>While the survey did not include stock options as a choice for investor preference:</b> 52% of investors said stock options are performance-based and 48% said time-based.</p>

20. Institutional Shareholder Services, 2024 ISS Global Benchmark Policy Survey, October 10, 2024, <https://www.issgovernance.com/file/policy/active/Policy-Survey-Summary-2024.pdf>, p.5

21. Glass Lewis, Policy Survey 2024, <https://resources.glasslewis.com/hubfs/2024%20Policy%20Survey/2024%20Glass%20Lewis%20Policy%20Survey%20Results.pdf>, p 27.

22. *Id.*

23. Ira Kay, Linda Pappas and Lane Ringlee, Pay Governance, Are Institutional Investor Preferences for Performance-Based Equity Really Diminishing in Favor of Time-Based Shares? <https://www.paygovernance.com/viewpoints/are-institutional-investor-preferences-for-performance-based-equity-really-diminishing-in-favor-of-time-based-shares>

# What This Means for CHROs and Heads of Total Rewards:

- **Best Fit Over Best Practice:** Market practice provides a benchmark, but not a blueprint. Incentive design should align first with company strategy, talent objectives, and competitive context.
- **Balance Simplicity with Accountability:** Excessive reliance on performance conditions can add complexity without improving alignment. Ownership-based models or hybrid mixes may provide more powerful alignment.
- **Reassess the Role of Options and Vesting:** Stock options and longer vesting horizons, while currently less favored by proxy advisors, may better reinforce entrepreneurial risk-taking and long-term value creation.
- **Engage Stakeholders Proactively:** As ISS and other advisors revisit their stance on time-based awards, companies have greater latitude to design LTIs that fit their unique needs without automatically triggering negative votes.

## The data so far suggests a paradox.

While PSUs have created tighter pay-for-performance optics, they may also create mediocrity by pushing everyone into the same mold. For CHROs, the takeaway isn't to abandon PSUs overnight but to ensure they are a part of a thoughtful, strategy-driven mix rather than a reflexive adoption of prevailing practice.

**Ask:** Does our LTI mix reinforce our strategy, or just proxy advisor references?

**Test:** Would a more tailored blend—longer vesting, some options, greater ownership—better align with our performance and talent goals?

**Remember:** Homogeneity reduces criticism of incentive design, but it may also reduce shareholder value.