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Innovation and Incentives: What High-Performing Sectors Reveal About Pay Design



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Boards regularly ask whether an innovation-driven strategy requires an unconventional approach to incentive design. As companies increase investment in artificial intelligence, digital transformation, and new business models, compensation committees are assessing whether their traditional pay structures should change as well. Innovation introduces longer development cycles, greater uncertainty, and shifting priorities. Traditional financial metrics may appear misaligned with that complexity.

However, an exclusive Pearl Meyer review of incentive structures in several leading S&P 500 sectors suggests a more restrained conclusion: Innovation strategy can coexist with well-planned, traditional incentive design.

High-Performing Sectors: Different Businesses, Similar Pay Designs

We examined incentive designs in several S&P 500 sectors with the highest median three-year total shareholder return (TSR), excluding Financial Services. Three sectors led the index, compared to the overall median of 39%:

- Information Technology: 75%
- Consumer Discretionary: 57%
- Communication Services: 50%

We then compared their incentive architecture to the broader index to assess whether structural differences were evident.

These sectors differ meaningfully in their business models and drivers of growth. Information Technology is characterized by rapid innovation cycles and high R&D investment, while Consumer Discretionary includes a broader mix of retail and consumer-facing businesses, and Communication Services is shaped by platform scale and media dynamics. Despite these differences, incentive structures across the three sectors are broadly similar.

The comparison indicates that high-performing, innovation-oriented sectors largely maintain conventional incentive structures.

Long-Term Incentives (LTIs): Consistency Over Experimentation

Across the S&P 500, LTI plans most commonly use two performance metrics. The typical structure combines relative TSR with a financial measure such as revenue, earnings, margin, or free cash flow.

In the three sectors reviewed, that structure largely remains intact.

- The median number of LTI metrics is two.
- Relative TSR is included in approximately 70% of plans, either as a standalone metric or alongside financial measures as a modifier.
- Financial metrics continue to anchor performance share units.
- Innovation-specific milestones appear less frequently in long-term equity awards.

There is no broad evidence that these sectors rely on materially more complex or experimental LTI designs.

Why Innovation Metrics Appear Less Often in LTIs

This does not mean innovation metrics are ineffective. In certain situations—such as new commercialization milestones, extended product development cycles, or large-scale transformation initiatives—non-financial measures may reinforce strategic priorities. Their effectiveness depends on clear definition, measurable criteria, and alignment with tangible outcomes.

Within the sectors reviewed, LTIs remain primarily anchored in financial and market-based outcomes. Boards continue to use relative TSR and financial performance to reflect economic results rather than embedding innovation effort directly into multi-year equity awards.

Practical considerations also influence this pattern. Equity awards require clearly defined performance conditions at grant to ensure accounting certainty and predictable expense recognition. Incorporating multi-year innovation targets is possible, but establishing durable, objective criteria can be difficult. Many companies therefore rely on relative TSR and clearly measurable financial metrics to maintain clarity for participants and transparency for investors.

Annual Incentives: Strategic Reinforcement or Innovative Strategies

Innovation-related objectives appear more frequently in annual incentive plans. In the sectors reviewed, annual plans often incorporate innovation-related goals such as:

- Product or platform launch milestones
- Market expansion or customer adoption targets
- Operational transformation initiatives
- Technology deployment benchmarks

These measures focus on execution within a defined time limit. They allow boards to emphasize progress on strategic initiatives that management can directly influence in the near term.

By contrast, long-term equity plans continue to measure broader financial and shareholder outcomes.

A Deliberate Difference: Execution vs. Outcomes

A consistent pattern emerges across these three sectors: a clear separation of roles between annual and long-term incentive design.

- Annual incentives reinforce strategic execution priorities (which may include innovation initiatives).
- LTIs measure economic outcomes over time.

Another pattern in these annual plans is metric concentration. They tend to include slightly fewer metrics than the broader index, reflecting prioritization rather than expansion. Boards emphasize a limited number of objectives instead of broad scorecards.

When Innovation Metrics Are Appropriate

Innovation-specific metrics are neither inherently superior nor inherently flawed. Their value depends on context and construction.

In certain environments, incorporating innovation-oriented measures into your LTI design may be appropriate. Examples include:

- Development of new business models
- Commercialization of emerging technologies
- Multi-year digital transformation programs
- Significant integration efforts

When performance conditions are clearly defined at grant and linked to measurable business outcomes, such metrics can support accountability and long-term alignment.

Discipline remains essential. Non-financial measures should be specific, measurable, and tied to economic objectives. They should complement financial performance rather than

replace it.

Design Simplicity Over Complexity

A consistent feature across the high-performing sectors reviewed is structural simplicity.

LTI plans generally use two clearly defined metrics. Boards avoid embedding multi-year innovation milestones that are difficult to forecast or measure over extended periods. Financial and market-based measures provide predictability and comparability.

Annual incentive plans offer more flexibility, but even there, metric counts remain concentrated. Boards emphasize a small number of defined priorities rather than expanding the scorecard.

The overall pattern is clear:

- Annual incentives reinforce near-term strategic execution.
- LTIs anchor economic outcomes.

While business-level innovation strategies may change rapidly, incentive architecture in these sectors remains disciplined and focused.

Overall, the analysis shows that supporting innovation does not necessarily require redesigning LTI architecture. This top-performing sector comparison indicates that disciplined, conventional structures can accommodate innovative strategy without structural reinvention. For boards, the focus may be less on adding complexity and more on ensuring that incentive design remains clear, economically grounded, and aligned with long-term value creation.

About the Author

Pat has 25+ years advising boards and senior management on incentive design, performance measurement, and corporate governance, with deep experience supporting both private and public companies.

About Pearl Meyer

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