

Capital allocation\_\_\_\_\_

5

(often overlooked)  
principles for  
communications



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A company's capital allocation policy is often the most crucial component of both its equity story and of management's credibility. As some investors say, it is not the company's capital but investors' that is being deployed and this can only continue as long as companies demonstrate an ability to generate attractive risk-adjusted returns. It also forms a key identifier for various investment strategies, such as growth versus income.

While capital allocation is under intense scrutiny from stakeholders, FGS Global receives consistent feedback that detailed and strategic communication on these is overlooked. Policies are seen as high-level and without clear prioritisation, with management appearing unwilling to commit to defining the trajectory of the company.

Management must navigate the fine balance between having a capital allocation policy that is clear and precise enough to inspire investor confidence, while providing the flexibility to endure unpredicted disruptions without shocking the market. And IR professionals are often left to balance internal pressures with investor expectations for clarity and transparency. [The FGS Global Equity Advisory & IR team leverages its deep sector expertise to advise companies on all matters related to their capital markets communications, providing an objective framework to make sure this debate is the right one.](#) Supported by insights from over 260 perception study interviews conducted with investors and sell-side analysts, we set out 5 practical recommendations to align with best practice and inspire investor confidence.

# 1. Defining your capital allocation policy - the importance of being earnest

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“It’s very important for companies to have a very clear methodology in terms of how they allocate capital - organic growth, investing capex in the business, doing M&A, the hurdles for share buybacks.”\*

*\*Direct quotes from perception study interviews*

Very often, companies have a detailed internal framework for decision-making on capital allocation, but shy away from communicating this to avoid being held accountable or to preserve flexibility. However, vague or generic language can be interpreted as a signal of low conviction or an attempt to avoid detailed discussion on the topic; both unhelpful.

At a minimum, the policy priorities as well as sources and uses of capital must be clearly communicated to all stakeholders, and the rationale fully explained. It is not enough to just show the order of preference; companies must justify this by showing alignment with the strategy, and any targets (for example, spend on R&D or M&A, maximum leverage, minimum returns) should align with these priorities. Investors also want to know how the capital allocation policy is driving superior shareholder returns.



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“If you’re going to spend large amounts of money [on M&A] then you have to have a defined return on investment.”

M&A must be fully integrated into the policy so investors are not surprised by any announcements; they may not like the price but will always understand the strategic rationale. For serial acquirers, this means communicating a clear framework around M&A that outlines objectives, criteria, and approach to integration. In our experience, investors also appreciate being provided with a clear guideline of what the company won’t do, say for example, deals outside of their core competency, or those dilutive to EPS by >5%. Evidence of openness to the possibility of divesting businesses that are not value-accretive is also well-received.

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“What makes them stand out from their peers is their capital allocation. In the last financial year they just stuck to their dividend policy... whereas their nearest peer didn’t pay the dividend. So, the credibility that they have as a company, and as a management team when it comes to shareholder remuneration, is very, very good.”

Similarly, it is helpful to have a dividend policy that is robust enough to cope with economic cycles, while providing flexibility in times of financial stress. Where this approach leaves the company with excess cash, share-buyback programs can be assessed as an opportunistic, flexible short-term instrument.

## Illustrative proof-points or KPIs for investors

### Organic growth >

- Evidence of accelerating organic growth
- Growing return on investment

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### Inorganic growth >

- Indication of size (bolt-on/strategic, xx% of revenues)
- Threshold returns and other criteria (EPS accretion)

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### Shareholder returns >

- Payout ratio, whether linked to EPS/FOCF
- Leverage target and credit rating
- Criteria for additional shareholder returns, potentially linked to leverage

# 2. Announcements on corporate actions and the power of repetition

We often underestimate the power of repetition, and when announcing any corporate action, such as M&A, it can be extremely helpful to link this back to the existing strategy. For example, positioning a transaction as a means of fulfilling a strategic ambition of increasing exposure to a focus market allows you to reiterate key selling points of the company and the investment case.

Of course, delivery on the strategy is not sufficient justification in isolation and overplaying this can come across as being defensive or hint towards overpaying. It is therefore important to accompany this with sufficient evidence that the investment is value accretive. Indicators of a positive returns profile will be scrutinised by investors and are therefore crucial in communications.

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“Part of the problem is the communication on returns... it will benefit them to listen to the questions and frame their answers in terms of returns rather than just growth.”

## Focus questions for announcements

- What rationale and proof points make you confident in achieving positive returns from this transaction? What is your track record from previous investment plans?
- How are you funding the transaction? How do you justify changes to the shareholder returns policy, if any?
- How quickly can you reduce your leverage (so shareholder remuneration may improve)? How much scope is there for upside in the short, medium and long-term?
- Does it increase TAM and if so from what to what? What are the market drivers?
- Does it improve competitive positioning, access to customers, enable incremental revenues or improve quality of revenues? Can this be defined by synergies and / or incremental growth / margin?
- From a defensive standpoint, does it protect market position?
- For bolt-on transactions, are there benefits to the wider Group?
- What is the impact on key financials and targets?

# 3. Getting ESG right – making the connection to return on capital

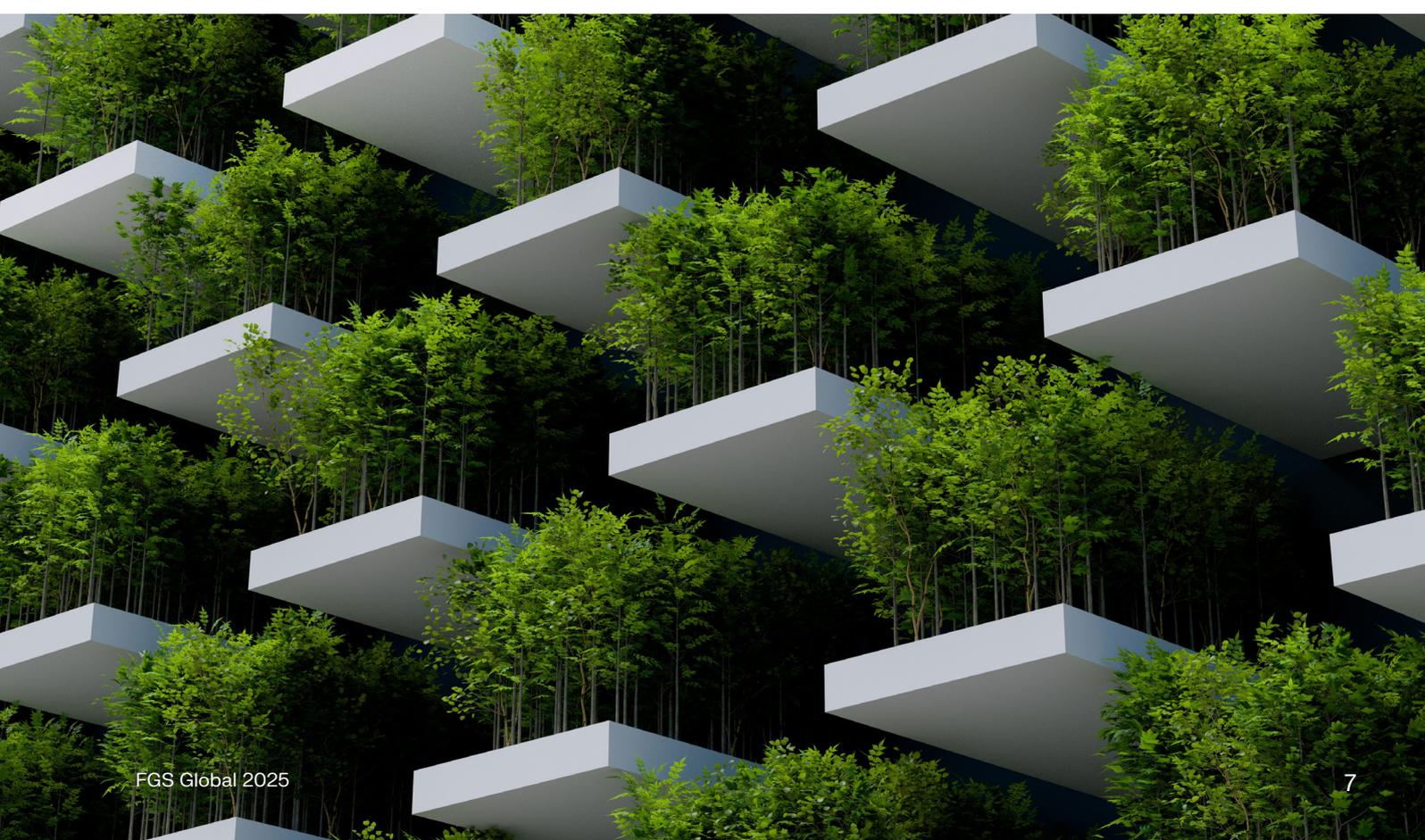
While detailed discussions around a company’s sustainability policy might appear to be ebbing in interest in recent times, risk assessment of investments is not - after all, most investment decisions are long-term. As some investors pointed out to us, looking at track record of past investments is part of their good governance due diligence.

It is therefore beneficial for any major investment decision to be accompanied by transparency on how ESG was factored into the process, such as evidence of a meaningful investment of CEO time, regular reviews, and alignment of management incentives to the long-term success of a project.

Companies can also highlight how capital allocation into ESG related projects creates value for shareholders, for example by explaining how they can create or deepen a competitive advantage, be at the forefront of innovation, position the company for regulatory change and shifting market demands, or reduce the likelihood of stranded assets.

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“There is less capital allocation tie-back to how management and senior executives are remunerated [than we would like].”



# 4. Building credibility by tracking evidence of success

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“We know that they are pouring a lot of money into this project and we don’t necessarily see how successful they are... they need to disclose more data... What’s the level of sales, how is it growing, and how are the cost-savings being achieved? Give us some KPIs every quarter and update us on these KPIs to show that it’s successful.”

Building investor confidence starts with establishing a track-record of success, and for key elements of your policy, showcasing this track record will support credibility.

This is particularly true for companies with multiple segments. Delegation of decision making can increase as companies become more complex and CEOs become overloaded. Given the market has limited visibility on the next layer of management, it is helpful to demonstrate the effectiveness of this process and emphasise that ultimate ownership lies with the CEO.

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“We need to make sure that if R&D is [completely] at the business level it doesn’t move into a situation where people can go off-piste and do their pet projects... we need to see it executed properly.”

There are many means to achieving this, for example through transparency around return on investment at the divisional level (frequently demanded for conglomerates) or by hosting dedicated events for investors to showcase products and innovations, which in turn demonstrate the effectiveness of R&D spend.

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“I would like to know more about the capex requirements, cash flows and ROCE of the individual divisions, not only the Group.”



## Indicators of a successful track record

### Selected disclosure

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- Trajectory of ROCE or shareholders returns vs benchmarks, over time
- Indicators of progress against previous commitments, including synergies
- Specific examples of successful M&A transactions

### New KPIs

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- Proportion of sales from new products / cross-selling initiatives
- NPS for improved customer experience

### Investor events

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- Innovation Showcases

# 5. What to do when things don't go as per plan: say it as you see it

Even after following all due diligence and protocols, things can turn out differently versus expectations. Acquisitions may take longer than expected to integrate and realize synergies, and significant investments may fail to deliver the intended results. Market downturns above expectations can also cause greater cash flow pressures than anticipated.

Delaying communication of negative news to the market and doubling-down on the old positive narrative until the issues become unavoidable only adds to investor frustration and reduces credibility. Instead, the objective should be to minimize the degree of negative surprise by being transparent about the issue at hand. In doing so, companies demonstrate a clear understanding of what went wrong and that they have a clear action plan to address this.

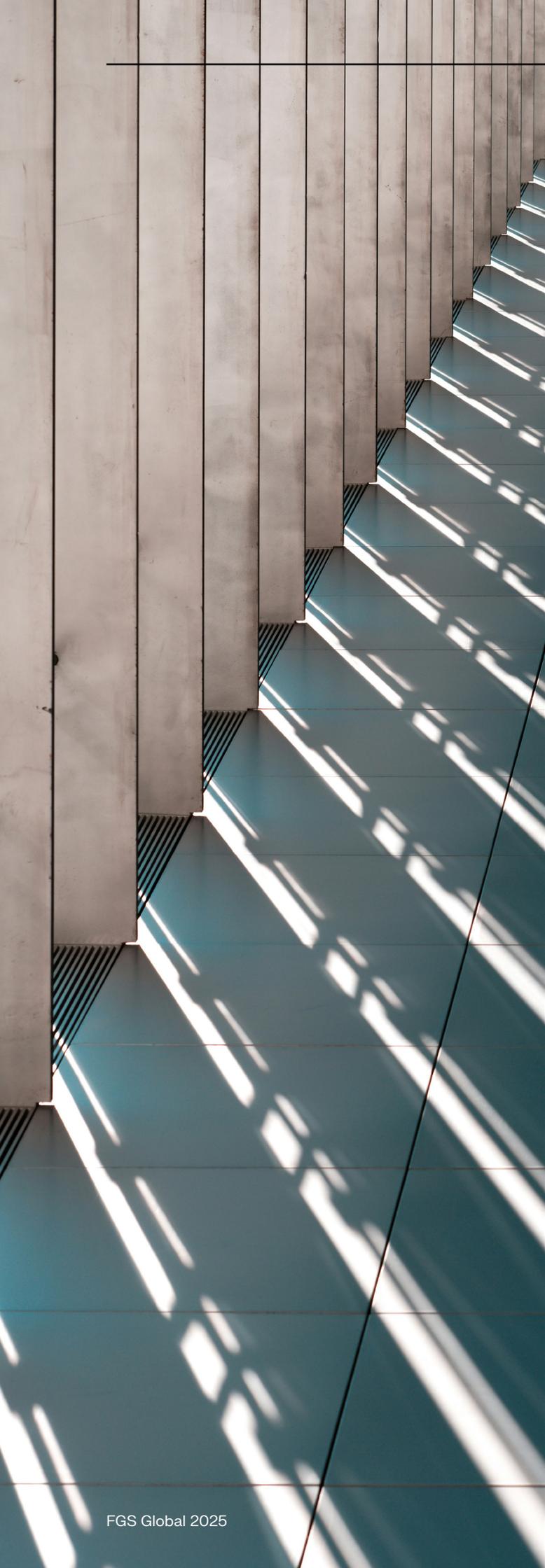
This may sometimes necessitate shareholder returns decisions to deviate from the policy, for example dividend cuts driven by cash flow pressures or excessive reliance on buybacks where growth opportunities are more limited than anticipated. These scenarios do not need to be overly punitive to the share price. Communications could emphasise that the change represents a pragmatic approach and allows the company to address other investor concerns, for example by strengthening the balance sheet and enabling delivery on the strategy.

The key is to be transparent in the face of unforeseen circumstances. In such situations, it is helpful for companies to have a very good understanding of key shareholders, their concerns and priorities through proactive and consistent engagement.

## Investor Perception Studies

Perception Studies are in-depth, impartial studies to gauge external sentiment through rigorous interviews and analysis. A comprehensive Perception Study (as conducted by FGS Global Equity Advisory & IR) can provide:

- Analysis of clarity and transparency of your strategy and key messages
- Market's perception of Management and Supervisory Board
- Overview about strengths and weaknesses of the company (or its divisions)
- Profound insights into valuation and assessment of financial performance
- Investors' opinions on capital allocation policy
- Feedback on the quality of your messaging with knowledge about potential gaps between messages and the market's understanding



In conclusion, a good capital allocation policy explicitly defines what the company stands for and helps set expectations for the future. This is supported by clear and consistent communications and announcements that tie back to core principles and the corporate strategy.

While the decision making on capital allocation lies with management, the role of an investor relations team is crucial in communicating it effectively, given their frequent touchpoints with the market. IR professionals play a critical role in bridging what a company is willing to disclose with what investors want to know.

The FGS Global Equity Advisory & IR team leverages its deep sector expertise to advise companies on these matters, and all others related to their capital markets communications.

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# About Equity Advisory and Investor Relations

A multidisciplinary team with extensive public capital market experience including Equity Research, IR, Equity Sales and Banking Advisory, working with companies across the US, Europe and Asia.

Providing confidential and practical advice to the Board of Directors, Management and IR on all matters related to capital market strategy and engagement, optimising valuation and market impact through communications excellence.

Aligning seamlessly with the broader strategic communications services within FGS Global.

## Supporting companies to deliver clear and compelling messaging

### Capital market events

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- Equity story impact from M&A
- Activist / short attack support
- Crisis support

### Pre- & Post-IPO advisory

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- Counsel in sustainable equity story including KPI benchmarking
- IR set up and best practice development
- Post-IPO support across reporting cycle

### Core equity advisory services

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- Market driven positioning advice
- Equity story substantiation / refresh
- Investor / Capital Market Days

### Investor intelligence

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- Perception studies
- Disclosure benchmarking
- Investor analysis

### ESG

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- ESG positioning, integration into equity story and investment case
- ESG disclosure benchmarking & advisory
- Governance advice, remuneration proposal and Board advisory

# About FGS Global

## A leading global communications powerhouse

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### Influential

Over 1,400 professionals worldwide

### Global

31 offices across the globe  
3 continents  
30+ languages

### Integrated

We support over 100 of our clients in more than one region



We help leaders lead in their markets, influence their stakeholders and win in decisive moments.

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