Capital Allocation: The Decision is the Easy Part

30th April 2026

Capital discipline without communication is only half the job

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After more than two decades working across public and private markets, advising institutional investors, founders and Executive teams on strategy and Investor Relations you develop a feel for where value gets lost. It is rarely in the strategy. It is rarely even in the execution. More often, it is in the gap between what a management team decides and how clearly, they explain why.

The Board spends months debating whether to initiate a share buyback, increase the dividend or deploy capital into an acquisition. The communication of that decision to investors receives a fraction of that attention. Not because management does not care what the market thinks but because the decision and communication are treated as separate exercises: the first 'strategic', the second 'administrative'. It is a distinction that costs more than most management teams realise. That gap between decision and communication is where valuation gets lost.

> *"Once they become CEOs, they face new responsibilities. They now must make capital allocation decisions, a critical job that they may have never tackled and that is not easily mastered.'"*
>
> **Warren Buffett**

According to the FCA's own review of buyback activity across the FTSE 350, 42% of all capital returned to shareholders now comes via buybacks. The mechanism has become mainstream. The framework for communicating such significant decisions has not.

What has changed — and why it matters now
In the era of low rates and compressed discount factors, a credible growth story, expanding addressable market and revenue momentum was enough to sustain a premium valuation or multiple. That era has passed.

The key questions investors ask of UK management teams have shifted materially over the past five years. I spent most of my career on the buy-side, drilling management teams on what they would do with surplus cash, whether there was a framework behind those decisions, and how disciplined the deployment process really was. At h2Radnor, we help management teams answer those key questions. Our expert team has sat on both sides of that conversation, and we know from direct experience what a credible answer requires, and what the absence of one costs.

Investors are no longer simply focused on what drives growth and the market opportunity. They want to know what the company will generate along the way and what management will do with it. In City parlance: cash conversion, returns on capital deployed, and the discipline applied to free cashflow allocation have become as central to investment decisions as the growth story itself. Capital discipline is no longer a supporting slide. It is often the key to the investment case.

When the metrics in the Results statement do not match the language at the Capital Markets Day, which does not match the framing in the one-on-ones, or how the sell-side talks about the story, investors cannot form a view and are left wondering. Pricing/valuation therefore reflects the uncertainty instead. The question every investor is ultimately asking is why this business deserves a different multiple to its closest comparable peer. Inconsistency across announcements and touchpoints makes that question unanswerable and the market responds accordingly.

Nasdaq's 2025 Global Issuer Pulse survey found that 61% of buy-side investors want clearer links between corporate strategy, KPIs and quarterly results, and 71% focus more on forward-looking indicators. The message could not be clearer. Most management teams hear it but not as many act on it with sufficient precision.

The consistency problem
Capital allocation decisions *per se* are rarely the issue. The issue is that a sequence of decisions, however sound, without a stated framework connecting them, will not read as anything other than circumstantial. Management sees considered adaptation (with the benefit of many, many hours of internal discussions and Board meetings). The market sees inconsistency.

The pattern has become familiar. A capital return programme is announced for the full year with apparent conviction. A committed framework clearly stated. By the half year, the language has quietly softened, without explanation or acknowledgement. Then comes the change catalyst: a macro headwind, a deal in the pipeline, a guidance revision. The programme is modified, suspended, and eventually reinstated once conditions stabilise. Typically, in time for the next full-year announcement, where the cycle begins again…

Companies that cannot demonstrate continuity of thinking on capital allocation are routinely assigned a higher cost of equity than their underlying business warrants. That discount is not a market misjudgment. It is the precise and predictable consequence of communication failures, and it is entirely avoidable.

The credibility cost: **Vodafone** illustrates the cost at scale. Between 2019 and 2024: dividend cuts, portfolio disposals, leverage resets, a full framework rebasing. Each defensible in isolation. Collectively, the market stopped believing there was a framework at all. The valuation discount that followed persisted long after the operational picture had cleared. The numbers bear this out. The share price fell more than 50% and would not re-rate even as the business improved. Peers traded at multiples two to three times higher. The market had stopped discounting the operations and was discounting management. Operational recovery shows up in the next results but credibility recovery does not.

There is a further consequence that Boards rarely anticipate. Companies, without even a stated framework, are materially more vulnerable to activist approaches. An activist does not need an operational grievance, only an absence of a framework. Where management cannot articulate a consistent position on capital deployment, the activist articulates one for them.

The framework argument

The distinction between communicating individual capital allocation decisions and communicating an allocation framework is, in our view, the most important and most under-appreciated idea in Investor Relations. The two are not the same thing and treating them as such is where most management teams leave value on the table. A stated framework gives investors a basis for accountability and accountability builds trust. In h2Radnor's experience, the companies that attract the lowest 'uncertainty discount' are the most consistent and the most precise.

The credibility reset: For years, **M&S** made individual capital decisions with store investment, dividend suspension, partnership commitments and without a clearly stated hierarchy governing them. Again, each defensible in isolation. The market could not form a stable view. Under a new CEO, Stuart Machin, that changed. A clear framework was established and consistently communicated: invest in high-returning store renewals with explicit payback hurdles, drive structural cost reduction to fund it, restore the dividend when the balance sheet allowed.

The re-rating that followed was not simply a function of better results. or an improved retail environment. It reflected a market that had finally been given the tools to price the business with confidence and the shares more than tripled from their 2022 lows.

Sophisticated institutional investors now <u>expect</u> quantified commitments such as Return on Investment Capital thresholds, leverage ranges, cash conversion targets and not just simple preferences. Management teams are increasingly expected to operate at that level in their external investor communications. That is the gap. And it is entirely closeable.

Closing the gap

This is core to our work at h2Radnor. We work with management teams to build out and articulate the framework that sits behind the numbers:- the stated priorities, the return thresholds, the triggers for change and then prepare CEOs, CFOs and IR on how to carefully deliver those messages, as well as advising them on the questions that follow.

Remember investors are not looking backwards. They are testing forward intent:- what will management do when cash exceeds what the business needs? And is the answer governed by a framework, or by circumstance or randomness? The companies that can answer that question consistently at their results, at roadshows and in one-on-one meetings with investors, are the ones the market prices with confidence. The ones that cannot are priced for uncertainty and the market hates uncertainty.

The problem is rarely the business. It is the gap between what management knows and what the market can see. History tells us that gap has a direct cost in valuation, in vulnerability, in the terms on which capital is raised. It is always worth closing.

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