An optimal allocation of capital creates real shareholder value – is your company using its capital wisely?

The capital allocation process is a critical component of strategic execution. Long-term competitive advantage requires companies to develop optimal combinations of resources through a strategic capital allocation process.

Thus, effective capital allocation is one of the most essential responsibilities of the board and management in order to create and sustain long-term shareholder value.

KPMG recommends a structured approach to optimize your capital allocation strategy and to maximize shareholder value.
What questions should the Board ask itself?

- How do we measure shareholder value creation?
- How does Management deal with excess cash?
- Do we have the right controls and metrics in place to enable us to oversee management’s capital allocation decisions and monitor its performance?
- Are we considering all possible options to allocate capital in an optimized way?
- Do we need to think beyond our traditional approach to allocate our capital?
- Which capital is available for allocation? Which sources of capital do we have? Are there any alternative sources that we have not explored yet?
- Does the cash position significantly exceed the required buffer and what can we do with this capital?
- Could a share buy-back program or an extraordinary dividend increase shareholders’ value?

What should the Board consider doing? Which actions should it take?

Develop a capital allocation strategy which supports company’s long-term strategy while considering performance optimization, working capital improvements, R&D and CAPEX investments, organic and inorganic growth, debt financing, capital increase, dividend policy and share buy-back programs.

Questions the Board should ask his management team?

- Does our company create real shareholder value?
- Do we understand our current share price valuation and how it relates to our internal view on the company’s value?
- What is the perception of the company in capital markets?
- Do we have a sound benchmark of relevant historic and forecasted KPI’s with our peers and competitors?
- Can we quantify different financial scenarios and investment opportunities?
- Do we have a view on potential value creation through external growth? What are the hurdles we should consider for a potential acquisition in terms of growth and price?
- Can we create transparency for decisions by making our strategy and capital allocation measurable?
- Is management sensitive to potential biases in the capital allocation process?

How can board members be on top of this issue?

- Analysis of today’s situation in relation to company’s business plan and strategy.
- Develop a sophisticated and stringent capital allocation framework and communicate it internally and externally.
- Gain transparency regarding sources of funds and allocation of capital.
- Reduce cost of capital through optimized capital structure.
- Understand the cost of capital in organic and acquisitive growth.
- Assess share buy-back programs as a flexible short-term instrument along a stable long-term dividend policy.