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THE LINK BETWEEN STRATEGY EXECUTION AND CAPITAL ALLOCATION

AN EXPLORATORY CASE STUDY OF LISTED FINNISH SMALL CAPS

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ABSTRACT:

Allocating financial resources is a quintessential part of strategy execution. Firms have different capital needs based on factors such as competitive position, ownership structure, and the firm's current stage in the business lifecycle. Regardless of their present circumstances, all firms have a strategy, whether intended or emergent. In most cases, the strategy process yields tangible objectives that management and other stakeholders use as a measure of strategy execution.

This qualitative thesis explores how the allocation of financial resources is relevant to the firm's quest to achieve its goals. The research design is an exploratory multiple case study, which includes four cases. Each firm is publicly traded and part of the Nasdaq Helsinki Small Cap subset. Document analysis is the primary data collection method, while descriptive, prescriptive, and diagnostic analysis are used for data analysis. The research period begins in 2018 and continues to the present day.

The study produces two key findings. Firstly, it shows that capital allocation policy tends to be optimized for the specific metrics that management follows. Therefore, financial targets can be viewed as a proxy for management focus. This finding highlights the importance of choosing optimal metrics. Another key finding of the study is that goal setting is often approached negligently. Several instances show that firms include inconsistent targets, presumably to increase the likelihood of achieving some of them. This finding has clear managerial implications. It is better to have fewer consistent objectives than a collection of wishes that cannot realistically co-occur.

Keywords: Capital allocation, strategy execution, financial resources, opportunity cost, managerialism, goal setting, competitive position.

1 INTRODUCTION

Firms exist to sell products and services. Over the corporate lifecycle, firms aim to deliver a return on shareholders' equity above the cost of capital without taking unreasonable risks. Most firms fall short of this goal, while others pass with flying colors. Many variables affect the realized outcome. Significant factors include the size of the total addressable market for the firm's products and services and the degree to which they solve the intended problem (Pelham, 2000). However, in the long term, the firm's capital allocation process can become another significant driver of financial performance (Guedj et al., 2009). Poor capital allocation can ruin a great company, while exceptional capital allocation can turn an average company into a great one.

This thesis aims to contribute in two distinct ways. Firstly, it seeks to add to the growing literature on strategy execution and capital allocation policy. More specifically, the thesis explores the connection between stated financial targets and management's capital allocation decisions. Secondly, the thesis provides relevant takeaways to various stakeholders on the covered topics. Managers can learn to develop and execute attainable targets and strategies to build trust between the executive team, board of directors, and shareholders. Employees can better understand how corporate targets relate to their responsibilities and expectations and the future actions of management. Finally, investors can learn to evaluate a firm's financial targets' feasibility and the effectiveness of its capital allocation process.

1.1 BACKGROUND

Regardless of size or industry, goal setting and capital allocation policy are essential for all enterprises. However, for most firms, these internal activities only concern a select group of individuals (Graham et al., 2015). This is not the case for publicly traded companies. There are significant benefits to developing and maintaining a reputable image in the eyes of investors, lenders, analysts, and potential employees. Although corporate transparency is undoubtedly on the rise, there needs to be more visibility into the inner workings of a listed company. Announcements on strategic direction and

related financial objectives can offer a unique perspective on management's sentiment, vision, and level of ambition. However, analyzing a firm's capital allocation policy removes the curtain entirely. In the present study, capital allocation refers to the financial resources available to the firm as a result of its operational performance and capital market activities. Although part of the broader concept of resource allocation, the present study does not address physical, technological, or other non-financial resources.

1.2 Research Gap

Although certain aspects of the capital allocation process are a conversation staple in the Finnish business landscape, the discussion revolves mainly around dividend policy. The same phenomenon is apparent in academia. According to Brunzell et al. (2014), dividends as a form of capital allocation have been covered extensively in literature. Studies have focused predominantly on dividend payment practices, the relationship between stock price and dividends, and the impact of taxation dividend policy (Ed-Dafali et al., 2023). Furthermore, Brunzell et al. (2014) note that companies often use dividends as a baseline for other forms of capital allocation, such as share repurchases. For instance, Jagannathan et al. (2000) argue that share repurchases are more cyclical, while dividends tend to be more predictable over time. Although comparison can be helpful, capital allocation decisions do not exist in isolation. While researchers have studied capital allocation as a broad concept, they mainly do so from the firm's internal perspective. It is typical for studies to focus on capital allocation at the divisional level (e.g., Bardolet et al., 2011). Literature on capital allocation at smaller, less diversified firms is scarce. Furthermore, studies seldom consider the external perspective of capital allocation by including material from investor relations. If great capital allocators are to think like investors, research needs to explore what that looks like from the outside. The present study aims to do just that.

1.3 Research Questions

Competition for human and financial capital is fiercer than ever. Managers must cultivate trust and confidence in their ability to steward the firm to attract both forms of capital.

A proven way to succeed in this endeavor is to consistently set and execute feasible financial targets while simultaneously practicing sensible capital allocation accretive to shareholder value. The present study explores how managers utilize the aforementioned tools and the inherent link between them.

Given the above, the present study aims to answer the following research questions:

RQ 1: *How are strategy execution and the pursuit of financial targets reflected in the firm's capital allocation?*

RQ 2: *What factors shape the firm's strategic and financial objectives in the medium term?*

1.4 Key Concepts

Capital allocation and strategy execution are the main concepts of the present study. Related concepts include risk management, corporate governance, free cash flow, and agency theory. Capital allocation refers to the "*distribution, re-distribution, and investment of financial resources to maximize profits*" (Saalmuller, 2022, p.1). In essence, capital allocation examines the managers' ability to act as investors with firm resources (Bardolet et al., 2011). There are four main outlets for capital allocation.

First and foremost, managers can allocate capital within the business. This process is known as establishing an 'internal capital market' (Gainer et al., 1994), especially within diversified firms. This process means that management will attempt to allocate internal capital to business segments and subsidiaries as efficiently as possible. Other ways of allocating capital internally include organic growth investments (Saalmuller, 2022) and necessary capital expenditures to maintain current or develop new capabilities.

If management concludes that the investment opportunities available to the firm are not sufficiently attractive, it can choose to return capital to shareholders. Firms must meet specific prerequisites for this to be a viable option. Most importantly, the decision cannot

endanger the firm's solvency. The two most common ways to return capital to shareholders are dividends and share buybacks. Of the two, paying a dividend is a more concrete option because shareholders receive cash directly to their bank account. However, implementing a share repurchase program is a more tax-efficient option because it increases the remaining shareholders' ownership stake in the business without creating a taxable event. On the other hand, stock buybacks disproportionately favor informed shareholders, as uninformed shareholders are more prone to sell their shares when undervalued (Oded, 2020 and Stephens & Weisbach, 1998). Although dividends are more common in practice, both are viable methods for returning capital to shareholders.

Most firms use debt as part of their capital strategy to improve return on equity and lower their weighted average cost of capital (WACC). However, debt can become a burden if employed excessively or for the wrong reasons. In most extreme cases, debtors will assume control of the firm if it fails to repay its loans. Maintaining a healthy balance sheet by opportunistically paying off debt is an essential capital allocation tool for management. Public companies' debt often consists of both bank loans and bonds. Although bank loans can also be paid off in advance, purchasing bonds in the open market is usually a more opportunistic option for astute managers. When investors see the firm's bonds as distressed, they trade below their nominal value, increasing the yield to maturity. As a result, the firm can capture an attractive return if it believes the market is overly pessimistic about its earnings prospects. According to Mao and Tserlukevich (2015), bond repurchases are carried out via an open-market purchase, tender offer, or a privately negotiated purchase.

Mergers and acquisitions (M&A) form the fourth pillar of capital allocation. Firms engage in M&A for a variety of reasons. The most common cause is to drive inorganic growth that would otherwise be inaccessible or require an unrealistically long timeframe. Another common justification for acquisitions is improved profitability through cost and scale synergies. The remaining entity can minimize overlapping costs, thus expanding

the existing profit pool. Other motivations may include entering a new market or eliminating competition.

In the process of capital allocation, managers assume the role of investors. Hence, managers face challenges similar to those faced by individual investors. Bardolet et al. (2011) argue that managers tend to “overinvest in underperforming divisions” (p. 1466) and vice versa. It is common for investors to “cut the flowers while watering the seeds,” which refers to the same phenomenon.

Strategy execution is the process of implementing a strategy. The implemented strategy can be intended or emergent (Mintzberg & Waters, 1985). Whether the firm deliberately formulated the strategy or emerged due to external factors, it must deliver on its intent. This intent takes the form of choices and actions collectively referred to as strategy execution. According to Neilson et al. (2008), this process is difficult to control because employees must make independent decisions based on available information and their self-interest. For this reason, agency theory is closely linked to strategy execution.

Evaluating management's effectiveness in executing a particular strategy can be complicated. The reason is that variance can significantly impact the outcome even when strategies are intended. However, in the long term, variance tends to even itself out. In public companies, a three-year strategy period is often as long-term as it gets. Management is expected to elaborate on their chosen strategy and provide feasible financial targets based on that strategy. Therefore, achieving self-set targets can be a helpful proxy for successful strategy execution in public companies.

According to Eisenhardt (1989), agency theory is concerned with the agency relationship that is formed when one party (agent) conducts work on behalf of the other party (principal). She argues that the issue of risk sharing and the different goals between the parties are the main issues that the theory tackles. The agent focuses on preserving their job while the principal seeks to maximize their return on equity. Although the employee-

employer relationship is the most common one, there are many other agency relationships, such as the one between majority and minority shareholders or the one between buyers and suppliers (Eisenhardt, 1989).

According to Davis (2005, p. 143), corporate governance “describes the structures, processes, and institutions” around and within an organization. Essentially, it is a system of checks and balances that protect the different interests in play. There are notable differences between governance practices based on culture and jurisdiction. For instance, in Finland, it is generally frowned upon that the chief executive officer is also the board's chairman. In any case, corporate governance is closely related to capital allocation and strategic management because it impacts the organization's decision-making and risk-taking behavior.

Risk management is the final important related concept. There are many forms of risk management, such as financial, operational, and reputational risk management. As a general concept, risk management seeks to protect the firm’s continuity. It can also stabilize earnings variance and differences in managers’ risk preferences (Bartram, 2000). Therefore, the benefits of risk management improve the conditions for successful capital allocation.

1.5 Thesis Structure

The present study includes six chapters. The first chapter introduces the topic to the reader. A concise background is provided before identifying a research gap that the study aims to address. Subsequently, research questions are formed for this purpose. Finally, the chapter discusses key concepts and addresses potential delimitations.

The second chapter is a literature review. The aim is to gain an understanding of extant literature on topics relevant to the present study. This process helps the researcher connect novel findings to previous research and establish a research context for the remainder of the thesis.

The third chapter concerns research design. It outlines the study's methodology, discusses the case selection process, names the case companies, and highlights the data collection process employed in the present study.

The fourth chapter introduces the case companies in detail and presents the data. The reader is familiarized with each case through a concise background of the firm, its ownership and organizational structure, as well as its market position. Furthermore, strategy and financial targets are discussed before moving on to financial performance and capital allocation policy.

The fifth chapter discusses the implications of the previous chapter's findings and data. The chapter includes a separate discussion for each case company and a cross-case discussion. This chapter also addresses the research questions generated in chapter two.

The final chapter summarizes the key findings. Subsequently, theoretical and managerial implications are presented. The study concludes by discussing limitations and offering suggestions for future research.

1.6 Delimitations of the Study

The present study is based on a narrow set of business subjects. Each case company is headquartered in Finland, and their shares are listed on a Finnish stock exchange. Additionally, case companies are classified as small caps. Furthermore, the data considered in the study is limited to the period starting in 2018. These are the primary location, time, and population-related delimitations of the study that affect the generalizability and relevance of the findings. Resource constraints and the chosen research design led to a more focused approach to the scope of the study.

2 LITERATURE REVIEW

2.1 STRATEGY EXECUTION

Ghemawat (2002) argues that the potential of mass markets due to the railroad network in the United States in the late 1800s ultimately led to the emergence of strategy as a crucial business concept. Bigger opportunities meant that organizations were more complex than ever before. Competition became fierce and sophisticated. Navigating a large organization to successful outcomes in an unprecedented environment required a more formal approach (Ghemawat, 2002, p. 38). Since the early days of strategy research, there have been several distinct paradigms. A significant development occurred when literature moved from the positioning approach toward a resource-based view (Rabetino et al., 2021). In the former paradigm, strategic management was concerned with the relative positioning of the firm's current products and business units within the industry and the industry itself. The latter focused on competencies and capabilities, which the firm could leverage to remain competitive beyond current products and business units (Ghemawat, 2002, p. 68).

Translating ideas into action is often more cumbersome than coming up with the idea in the first place. Successful strategy execution requires harmonious actions throughout the entire organization. Neilson et al. (2008, p. 83) find that 60 % of organizations struggle with strategy execution according to their employees. Their research identifies decision rights and information flow as key determinants of effective execution. The authors find that decision-making and information exchange aspects are less noticeable than organizational structure changes, which are more concrete (Neilson et al., 2008, p. 84). As a result, firms make superficial changes that do not address the underlying issues. The authors list 17 traits exhibited by organizations that implement strategies effectively. Understanding one's role in the organization is the most important trait. Consistent and prompt information relay between headquarters and functional divisions is another shared trait among effective organizations. Additionally, Neilson et al. (2008, p. 86) find that strategy execution is more effective in organizations that refrain from reversing decisions.

Higgins (2005) provides a model for successful strategy execution based on the original McKinsey 7S framework. Originally, the seven S’s were strategy, skills, style, staff, structure, systems, and shared values. Reflective of the research paradigm at the time, the main modification made by the author was the replacement of ‘Skills’ by ‘reSources' as one of the S's. Additionally, Higgins adds 'Strategic Performance' as the eight S. He notes that it is crucial to monitor and acknowledge the results that successful execution yields (Higgins, 2005, p. 7). The study discusses two business cases, one where execution was successful and another where it failed. The main difference between the two is how employees react to a change. In the successful case, the new CEO convinced most employees of his vision (Higgins, 2005, p. 8). The author argues that the CEO of the unsuccessful case "did a poor job of selling his initiative" (Higgins, 2005, p. 9). The initiative required significant restructuring, which staff found challenging to embrace. Reporting and decision rights became unclear under the new system, and many employees had to move to a new location (Higgins, 2005, p. 10). The main finding of the article is that becoming effective at execution often requires substantial change. The issue is that people rarely embrace change on their own. Hence, selling the vision to underlings is a prerequisite for strategy execution. This is an under-discussed aspect of strategic management as it is routinely taken for granted by researchers and practitioners.

Financial Planning & Forecasting

Financial planning is an essential part of strategy execution. Uniting the entire organization behind a vision for the future requires ambitious yet achievable financial targets. Firms utilize various financial plans that address liquidity, investment opportunities, operational efficiency, tax impacts, or strategic objectives. Financial plans and forecasts can be prepared for either short-term or long-term purposes.

In the long run, stock returns and realized earnings are highly correlated. However, in the short term, valuation relies heavily on sentiment and market expectations on

earnings development. Management can take an active role in this dynamic in two ways. Firstly, it can set medium to long-term financial targets supported by a detailed strategy. Additionally, management can issue annual or quarterly earnings guidance, which can be revised during the period if necessary. According to Hirst et al. (2008), these voluntary disclosures help establish market expectations and build trust between market participants. The authors view financial forecasting as having three main components: antecedents, characteristics, and consequences (Hirst et al., 2008, p. 2). The authors argue that previous research has disregarded choices related to characteristics. Instead, studies have focused on explaining the motives for forecasting and what consequences have surfaced (Hirst et al., 2008, p. 3).

Antecedents are "factors that exist at the time the manager makes the decision to issue a forecast" (Hirst et al., 2008, p. 10). Antecedents are derived from environmental conditions and firm-specific characteristics. For instance, if regulation does not shield firms from litigation when forecasts are not achieved, firms will refrain from issuing them altogether (Hirst et al., 2008, p. 11). As for firm-specific antecedents, they are influenced by historical forecast accuracy and managerial behavior. Hirst et al. (2008, p. 18) find that firms that can beat market expectations are more likely to provide financial forecasts.

Hirst et al. (2008, p. 23) state that a significant portion of forecasts are qualitative. The authors suggest that forecast form (i.e., numerical or non-numerical) depends on managerial certainty. Research shows that forecasts, in all forms, are linked to several consequences. Ultimately, the consequences arise because market participants see forecasting as an example of managerial ability and competence. Hence, market reaction to forecasts is affected by the firm's reputation for providing credible forecasts (Hutton & Stocken, 2007 as cited in Hirst, 2008, p. 28). Furthermore, firms issue forecasts to reduce information asymmetry between market participants, which is linked to a lower cost of capital (Leuz & Verrechia, 2000 as cited in Hirst et al., 2008, p. 13). Investing is ultimately about trust. Managerial competence is a scarce asset that the market rewards. Therefore, forecast accuracy can impact the cost of capital either positively or negatively.

The availability of such benefits would suggest that high-ability management teams are more likely to utilize forecasts as a signaling tool. Baik et al. (2011) confirm this notion. Their study finds that firms with high-ability CEOs are more likely to issue forecasts and that the frequency and accuracy of forecasts increase in line with ability (Baik et al., 2011, p. 1646).

STRATEGIC PLANNING

Financial planning is only one, albeit important, part of the strategic planning process. Strategic planning typically precedes financial planning. Hewlett (1999 as cited in O'Regan & Ghobadian, 2002) defines strategic planning as "the process by which firms derive a strategy to enable them to anticipate and respond to the changing dynamic environment in which they operate." All firms have a strategic planning process to an extent. The process is formal and explicit in some firms while informal and implicit in others. O'Regan and Ghobadian (2002) study the impact of a formal planning process. Their study includes responses from 195 small to medium-sized manufacturing companies in the UK. The authors find that both internal and external factors can disrupt the strategic planning process. Low-performing firms reported greater impact from all factors, especially those classified as external (p. 424). The findings suggest that a formal planning process does not eliminate implementation challenges but makes dealing with them faster and easier. However, it should be noted that the study uses an opinion research approach in its data collection process. Firms that have spent considerable time and effort establishing a formal planning process may be inclined to emphasize its usefulness. Hence, the study has an element of self-selection bias.

Dye and Sibony (2007) offer practical advice for improving the strategic planning process. The authors find managers often reach for the stars instead of picking the low-hanging fruit. They suggest beginning the process by "thoughtfully identifying and discussing the strategic issues that will have the greatest impact on future business performance" (p. 42). For the next step, the authors recommend considering who should be involved. The process should include those responsible for bringing the strategy to life. The authors

also emphasize the need for cross-participation between business units to improve organization-wide strategic alignment (Dye & Sibony, 2007). The cadence of planning cycles is an essential consideration for firms. If the planning process is too frequent, there will not be sufficient time to achieve the intended outcomes. On the other hand, infrequent or rigid planning cycles lack flexibility if there are significant changes in the operating environment such as new regulation or M&A activity. The authors describe a performance-based alternative to traditional time-based planning cycles. Firms may opt to use KPI triggers at a divisional level to determine when a new strategic direction is needed. This system's advantage is that divisions performing well do not undergo an unnecessary planning process that may cause more harm than good. However, the system may promote an organizational culture predicated on short-term results. Dye and Sibony (2007, p. 47) offer guidance for firms that have developed an overreliance on financial metrics in their strategic performance management. They recommend implementing and tracking non-financial metrics that predict future financial performance.

2.2 CAPITAL ALLOCATION METHODS

Investors, and humans in general, value predictability (Zhang et al., 2021). As a result, specific categories have emerged to make the universe of securities more approachable. Capital allocation style is one of the most prominent factors used for categorization. For instance, firms are defined as dividend or growth stocks. Categorization shapes investor profiles. Hence, market reaction to announcements can often be explained by the firm's perceived capital allocation tendencies. If a growth company suddenly announces a dividend, the market reaction is likely negative because the firm's valuation counts on growth prospects. And growth requires capital. Therefore, if the firm returns capital, the foundation of its valuation crumbles. Although categorization is helpful to a certain extent, it can become a roadblock for management. There are many instances where firms take on debt to continue paying dividends. Some listed Finnish companies have recently even issued new shares while simultaneously distributing capital to shareholders (Nixon & Bacon, 2012). Similarly, growth companies often have customer

acquisition costs far above the potential lifetime value of said customers. Capital allocation should always consider the expected return of internal investment opportunities in relation to the firm's cost of capital (Morone & Paulson, 1991).

Graham et al. (2015) study factors that influence and shape this process within firms. Their data is based on survey responses from over 2.000 executives in the U.S., Europe, and Asia. The findings suggest that decision-making authority over high-level corporate policies is relatively concentrated. For instance, nearly half of the surveyed CEOs make M&A decisions independently (Graham et al., 2015, p. 456). Interestingly, CFOs are less involved in M&A decisions despite playing a pivotal role in capital structure and payout-related matters. Firm and CEO characteristics influence the degree of delegation. The authors find that CEOs retain more control the longer they remain in the position. Moreover, Graham et al. (2015, p. 463) conclude that CEOs of larger firms and public firms are more likely to delegate. The study also finds that net present value estimate is the most important criterion in internal capital allocation, closely followed by manager reputation (Graham et al., 2015, p. 465).

INTERNAL CAPITAL MARKET

The internal capital market is the most important concept within the realm of capital allocation. This is because of its role as a predictor of firm value and performance. Peyer (2002) explores this proposition in his study. The author posits that a firm uses its internal capital market efficiently if capital is distributed to divisions based on their marginal return on invested capital (Peyer, 2002, p. 1). The study aims to empirically test the theoretical arguments put forth by Stein (1997) in his paper titled *Internal Capital Markets and the Competition for Corporate Resources*. The work by Peyer provides several necessary confirmations based on previous literature and new findings. Peyer (2002) shows that firms with efficient internal capital markets utilize external capital more liberally. Providers of external capital are confident in the firm's capital allocation process. Hence, they choose to make capital more available to the firm. Furthermore, the author argues that excessive use of debt often harms firm value except in cases

where internal capital markets operate efficiently (Peyer, 2002, p. 29). In essence, firms with attractive investment opportunities and the ability to capture them are more likely to utilize debt in their capital structure, improving various metrics such as return on equity. Consequently, such firms are valued higher in the public markets.

Benz et al. (2018) study capital allocation practices based on survey answers from chief financial officers. The study aims to uncover the pain points associated with distributing capital internally. The study contains survey data from 115 firms. The study's primary focus is the interaction between lower-level management and headquarters. The authors attempt to show how and why different stakeholders make decisions in the corporate investment process. The study fills a gap in the research by examining "aspects of the capital reallocation across divisions" and "the agency relationship between top management and division managers" (Benz et al., 2018, p. 3-4). The study provides several significant findings. It confirms that the psychological pitfall of "watering the weeds" also exists within internal capital markets. Survey respondents revealed that poorly performing divisions often receive new capital. CFOs suggest that firms do this to maximize capital productivity. However, at the same time, the respondents note that divisional managers frequently inflate financial projections to attract capital from headquarters (Benz et al., 2018, p. 2). Despite potential agency issues, one of the key findings from the study is the necessity for decision-making flexibility at a divisional level. Not only does private local information exist that aids division managers, but micromanaging each project would remove top management from more important tasks. Overall, the study provides valuable insights into the inner workings of capital allocation within profit-seeking corporations. Its strengths and weaknesses stem from using surveys as the data collection method. The survey method often yields a broad data set. However, only CFOs competent enough to answer the questions in the survey may choose to participate. Hence, the data is not necessarily representative of the population. Furthermore, the data relies on the perspective and opinion of a single actor within each firm (the CFO).

DIVIDEND POLICY

Dividends are the primary vehicle for returning capital to shareholders. It is widely regarded as a valuable gauge to judge the quality of a firm and its attractiveness as an investment. A firm's strategy concerning the use of its earnings is referred to as dividend policy (Ed-Dafali et al., 2023). According to Barros et al. (2020, p. 365), the literature on dividend policy focuses on the dividend payout ratio, its impact on firm value, and taxation as a driver behind dividend policy decisions. In addition to taxation, ownership and firm-specific factors influence dividend policy. The study includes dividend data from 83 firms listed on a Euronext stock exchange and part of the Euronext 100 index (Barros et al., 2020). The findings indicate that there is a correlation between taxes and dividends. The authors assign this to the fact that profitability precedes taxes. Therefore, the firms that pay more in taxes also have higher earnings that need to be reinvested or distributed to shareholders (Barros et al., 2020, p. 371). The study also finds a correlation between firm size and dividend policy. However, it should be noted that the study's sample consists of companies included in the Euronext 100 index. This index contains only large and solvent firms. Therefore, findings related to firm size are less relevant. Regarding the stability of a firm's dividend policy, the study finds that higher profit margins introduce an element of stability (Barros et al., 2020, p. 372). Authors argue that this occurs because a higher profit margin brightens the firm's future outlook and encourages the distribution of current profits. However, higher-margin firms may have a better-than-average competitive position in their respective industries and value chains. They enjoy economies of scale, high barriers to entry, technological superiority, or another competitive advantage that commands robust financial results. If such a firm has implemented a dividend policy, there are likely limited investment opportunities despite a strong market position. Hence, dividend policy remains stable because management is confident in the firm's earning power over time.

In addition to firm determinants affecting dividend policy, Ed-Dafali et al. (2023, p. 2) identify six important dividend research streams, including capital market valuation, payment practices, risk governance, and price–dividend relationship in their bibliometric

review of the literature. Key theories within dividend research include agency costs and asymmetric information. Moreover, researchers often study dividend policy together with share repurchases. Oded (2020) finds that there is a meaningful tradeoff with dividends. While minimizing potential agency costs of free cash, predetermined payouts limit financial flexibility. The author finds that dividends commit management to distribute unnecessary cash while share repurchasing programs do not, as they are subject to management’s judgment (Oded, 2020).

Within the price–dividend relationship research stream, Liu and Chen (2015, p. 194) examine whether management uses dividends as a "signaling device." The study attempts to isolate such behavior by controlling for other motives for dividend payments, such as excess cash and limited investment opportunities. Findings show that firms that increase their dividend are generally larger and more profitable than those that decrease their dividend (Liu & Chen, 2015, p. 196). However, the study concludes that dividend changes are not a reliable predictor of future earnings development. The authors also find that managers use dividends as a signal for earnings prospects. However, according to the study, “it is difficult to distinguish it from other motives” (Liu & Chen, 2015, p. 207).

SHARE REPURCHASES

Share repurchases, also known as stock buybacks, rose dramatically in popularity between 1980 and 2000 (Oded, 2020). Although the initial excitement has waned, share repurchases remain an essential capital allocation measure. Stephens and Weisbach (1998) study the extent to which share repurchase programs are implemented during the 1980s. The findings suggest that these programs often take one of two routes. Most (57 %) firms acquire at least the number of announced shares (Stephens & Weisbach, 1998, p. 314). However, many firms acquire less than 5 % or even none of the announced shares. These findings indicate that share repurchases are used primarily for two distinct purposes. Firms that hold excess cash and view their stock as severely undervalued will announce and fully execute a share repurchase program. On the other hand, share

repurchase programs are used as a signaling device by managers to express to market participants that the firm's valuation does not reflect the firm's earnings prospects. By doing this, management attempts to achieve the signaling benefits of a share repurchase program without committing any capital. The difference between the two groups of companies is stark. Stephens and Weisbach (1980, p. 314) note that over 30 % of firms buy back twice as many shares as they first intended to. The study's key finding is that, in aggregate, firms acquire approximately 80 % of the announced shares (Stephens & Weisbach, 1998, p. 332). This finding contrasts Oded's (2020) claim that share repurchase programs do not commit managers to actually distributing capital.

A crucial task for today's managers is controlling investor sentiment. In the stock market, price drives narrative. Hence, a detached attitude regarding the firm's share price is not a viable option for executives. There are tools for controlling narrative and price at management's disposal, mainly investor relations. However, sometimes it is mandatory to "put your money where your mouth is" to deliver a message. Management uses share repurchases to do that. However, it may be hesitant to announce a share repurchase program due to the associated stigma. This stigma is not entirely unfounded, as literature has shown that management may use share repurchases for their own benefit. Busch and Obernberger (2017) study the extent of potential price manipulation. Their study includes data on over six thousand share repurchase programs by nearly three thousand U.S.-based firms. The findings show that share repurchases increase price efficiency by closing the gap between share price and fundamental value. A gap is created when positive public information is not incorporated into the share price or negative public information temporarily drives the share price below fundamental value (Busch & Obernberger, 2017, p. 347). Furthermore, the authors conclude that share repurchases are not used as a form of insider trading. On the contrary, findings show that the variance in returns between the firm and the broader market narrows because the idiosyncratic risk is lower due to the share repurchase program.

DELEVERAGING

Firms can deleverage their balance sheet by repurchasing publicly traded bonds from the open market or paying bank loans prematurely. Companies often find this an attractive use of corporate capital because they know the return on investment explicitly, unlike with other forms of capital allocation. The optimal debt level for a firm depends on various factors such as industry characteristics, market position, growth prospects, ownership structure, and macroeconomic conditions. Julio (2015) studies the motive for debt repurchases by listed U.S. companies. The study finds that firms repurchase a significant amount of their outstanding debt once they choose to deleverage. On average, debt-to-equity decreases by over 10% following the transaction (Julio, 2015, p. 17). The study's main findings are related to the timing of debt repurchases. Debt repurchases are preceded by increasing debt levels and adverse development in free cash flow generation (Julio, 2015). Hence, the findings imply that premature debt retirement is a reactionary measure.

A significant portion of debt service literature deals with de facto bankrupt firms where creditors have assumed control. Mao and Tserlukevich (2015) discuss the topic from the perspective of a solvent firm. The authors provide many astute observations about deleveraging. The study's main point is that premature debt retirement is inherently zero-sum in a frictionless setting because paying off debt does not impact firm value per se (Mao & Tserlukevich, 2015, p. 1653). It is simply a transfer of assets from the firm to the creditor. However, in the real world, creditors are dispersed and possibly uninformed. Therefore, the authors state that deleveraging through open-market debt repurchase can "result in a value transfer from bondholders to shareholders" (Mao & Tserlukevich, 2015, p. 1658). Such value transfer can occur only when the debt repurchase transaction occurs below face value. Therefore, an expectation gap leads to a value transfer from one stakeholder group to another. Creditors have doubts regarding the firm’s earning power. They do not expect to receive full payment at maturity. If management has an alternate outlook on future cash generation, it may opportunistically repurchase bonds. Not only will this generate a one-off profit (i.e., value transfer), but it will also decrease

future interest expenses. Mao and Tserlukevich (2015) make an important distinction regarding the extent to which this measure is available. If creditors are willing to sell debt below par, the firm must have considerable debt compared to its cash and cash equivalents. In other words, if the firm had enough capital to pay back its debt fully, its bonds would not trade at distressed levels (Mao & Tserlukevich, 2015, p. 1648). Therefore, if management uses limited cash reserves for opportunistic deleveraging, it expects increased earnings or new equity financing to fill the financial deficit in the future.

MERGERS & ACQUISITIONS

Despite its significance in the modern business landscape as an essential strategic capital allocation measure, researchers describe existing literature on mergers and acquisitions (M&A) as scarce (Ferreira et al., 2014). However, there has been a growing trend in the number of articles on M&A per year since the 1980s despite its relative scarcity within management literature. The field has gone through paradigms similar to those of other management research fields. In the 1980s, researchers focused on describing what was happening in practice. From there, researchers shifted their focus to explaining the underlying theory of M&A and its impact on firm performance. More recently, M&A has been studied through the lens of the resource-based view (Ferreira et al., 2014).

Although case-specific motives exist for each M&A transaction, the desired result is always the same. Firms attempt to enhance their competitive position to increase profits and firm value. However, most acquisitions end up failing (Chatterjee, 2009). Common causes include overpayment (Antoniou et al., 2008) and post-acquisition integration problems (Hitt et al., 2001 as cited in Ferreira et al., 2014). To increase the probability of success, firms will “execute streams of mutually interrelated acquisitions” (Laamanen & Keil, 2008, p. 663), improving their acquisition capabilities. Laamanen and Keil (2008) study the performance of serial acquirers. They find that firms that engage in M&A activity systematically perform better over more extended periods than opportunistic

acquirers. Furthermore, the study finds that serial acquirers exhibit a distinct capability of managing acquisition programs (Laamanen & Keil, 2008, p. 670).

An important theory in M&A literature is the 'hubris hypothesis' developed by Richard Roll. Roll (Roll, 1986) argues that managers have limited takeover opportunities over the course of their careers. As a result, they exhibit overconfidence in their judgment of valuation and available synergies when launching an acquisition bid. Kristoffersen and Sælmann (2019) build on this theory by studying the impact of disclosing an estimate of achievable synergies. The findings show that disclosing acquirers generally acquire larger targets and pay a lesser premium (Kristoffersen & Saellmann, 2019, p. 45). Although the authors conclude that disclosure does not solve overpayment issues, it is essential in mitigating overconfidence and hubris.

Capital Allocation in the Finnish Context

Finnish investors are known for their appetite for dividends. Most recently, investors bid up the shares of Reka Industrial after it announced a special dividend. The dividend represented approximately one-third of the firm's market capitalization at the time of announcement. The firm sold its primary business in late 2022. Shortly after, it initiated a strategic review process to identify a use for the proceeds, which is still ongoing. Pre-announcement, the firm's shares traded in the 6.0 – 6.50 range. In the weeks following the announcement, the share price rose rapidly, reaching its peak at approximately 8 euros per share. A misguided attitude toward dividends is the only explanation for the price action and market reaction, as the announcement did not impact future earnings or enterprise value. The firm simply transfers cash to shareholders, who are subsequently taxed on it.

Finnish literature on capital allocation reflects the broader sentiment displayed by the local investment community. According to the bibliometric review of dividend policy literature by Ed-Dafali et al. (2023, p. 6), Finland is among the most per-paper-cited countries on the topic. Interestingly, Sweden is among the least cited countries.

Researchers have studied ex-dividend day trading returns in the Finnish stock market (Rantapuska, 2008) and dividend taxation as a driver of earnings management in Finnish SMEs (Karjalainen et al., 2023).

Literature on other forms of capital allocation in Finland is scarce. Högholm and Högholm (2017) study share repurchase programs by public Finnish companies between 1998 and 2013. The study finds that most (70 %) programs fail to repurchase shares (Högholm & Högholm, 2017, p. 17). The results starkly contrast the findings presented by Stephens and Weisbach (1998). In their study, Stephens and Weisbach show that over half of U.S. firms complete the repurchase program. Another critical difference is that Finnish companies are more conservative regarding the scope of the repurchase program. U.S. companies aim to retire 7 % of the firm's outstanding shares (Stephens & Weisbach, 1998, p. 318), while Finnish peers seek approximately 4 % (Högholm & Högholm, 2017, p. 17). Both studies report statistically significant abnormal returns during the announcement period. However, the cumulative average abnormal return (CAAR) is higher for U.S. companies at 2.7 % over a three-day event window (Stephens & Weisbach, 1998, p. 325). CAAR for Finnish firms is 1.5 % over a five-day event window (Högholm & Högholm, 2017, p. 18). Overall, the difference is clear. Share repurchases are not as widely appreciated and utilized in Finland as in other countries such as the U.S. A combination of two factors can explain the difference. Less capital is available for share repurchases because dividends are the preferred capital distribution vehicle. Additionally, ill-timed share repurchases by well-known companies such as Nokia in the past have certainly left a mark on investors and managers.

3 DATA AND METHODOLOGY

3.1 Research Method

The present study aims to explore the interplay between capital allocation and strategy execution in Finnish publicly traded companies. More specifically, it explores how firms with smaller market capitalizations successfully execute their intended strategy. In the context of the present study, strategy execution refers to the managerial ability to effectively set, revise, communicate, and achieve financial targets.

The researcher attempts to introduce theoretical and managerial contributions based on the intricacies of a small subset of companies. For this purpose, an exploratory case study research design is proposed for the present study. Due to the lack of extensive prior research, the chosen design allows for the generation of questions and theories for future research. There are many reasons for why case study research has become popular. According to Eisenhardt and Gaebner (2007), theory derived from studying cases will likely be accurate and compelling. Traditional research often focuses on changing the reader's perception of past literature. On the other hand, case studies attempt to present novel information that allows the reader to see the world differently (Siggelkow, 2007). Furthermore, case studies are often appropriate when studying a "contemporary phenomenon within its real-life context" (De Massis & Kotlar, 2014:16).

3.2 Case Selection

This study uses a form of stratified sampling to select cases. This sampling method divides the subject population into subgroups based on selected characteristics. The aim is to improve informational value and reliability by decreasing the heterogeneity of the sample (Etikan & Bala, 2017). Due to the nature of the research topic, other forms of sampling, such as simple random or cluster sampling, were not an option. The choice was between stratified sampling and purposive sampling. In the end, stratified sampling was selected because purposive sampling may misrepresent the population due to recency and selection bias.

The study includes four case companies. The number of subjects was determined based on research objectives and resource constraints. The study aims to provide high-level takeaways based on real-life occurrences. Therefore, studying fewer cases in greater detail is deemed more valuable than vice versa.

Four characteristics were used to form the strata. These include location, classification, size, and time. Firstly, all companies in the strata are Finnish companies. This means that each firm was founded in Finland and is currently headquartered there. Limiting the study to one country has its benefits and drawbacks. Management culture differs from country to country. Therefore, focusing on one country's corporate world at a time can be more fruitful. On the other hand, choosing companies from one country means that each firm is exposed to the same economy. Hence, there is a greater chance that short- to medium-term financial results result from economic conditions instead of firm-specific factors.

All case companies share the attribute of having their shares publicly listed on the Nasdaq Helsinki stock exchange. The reason for limiting the study to publicly listed companies is two-fold. Firstly, public companies must publish extensive financial reports by law. With this data, the present study is possible. Secondly, public companies can access various capital allocation measures that private companies generally cannot. This means that management possesses more optionality, significantly increasing outcome variance. Hence, it was concluded that the subjects of the study would be solely public companies.

The present study's research period starts in 2018 and continues to the present day. Hence, all firms that entered the stock market through an initial public offering or reverse merger after 2018 are excluded from the strata. Furthermore, the study focuses on smaller public companies. Hence, only firms included in the Nasdaq Helsinki Small Cap index are considered
for selection.

After the sampling process, 44 companies were in the strata. Four were selected randomly from this group. As a result, the following firms were selected as the case companies of the present study: Wulff Group, Solteq, Nurminen Logistics, and Honkarakenne. The case firms, along with data and findings, will be introduced and discussed in the next chapter. Below is a graphical illustration of the sampling process.

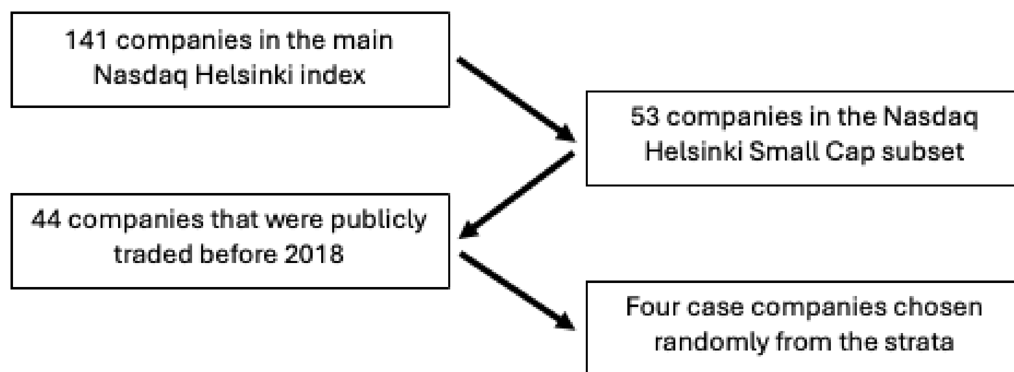

Figure 1: The sampling process used to determine the case companies for the study

3.3 Data Collection

The present study is a qualitative multiple case study. The primary data collection method for the study is document analysis. Public reports and filings by the case companies are the primary data sources. Reports from industry experts and analysts are also used. According to Bowen (2009, p. 27), document analysis is a "systematic procedure for reviewing and evaluating documents." This data collection method is most suitable for qualitative case studies (Stake, 1995 as cited in Bowen, 2009) that require specific information about the subject's operating environment (Mills et al., 2006 as cited in Bowen, 2009). Furthermore, Bowen (2009, p. 29) argues that in interpretive research, document analysis is often "the only viable source." One of the disadvantages of relying on document analysis is the lack of elaboration. Bowen (2009, p. 31) frames this limitation succinctly by stating that documents are "created independent of a

research agenda." The present study attempts to minimize the impact of this limitation by including data from alternative sources such as industry and analyst reports.

3.4 DATA ANALYSIS

In qualitative research, the strategy used for the timing of analysis plays a key role (Harding & Whitehead, 2016). In the present study, analysis occurs simultaneously with data collection. The process begins with the researcher identifying and recording the case company's strategy and financial target history. Each set of economic targets in effect during the research period is recorded. Two data analysis methods are applied at this stage before moving on to the next stage: inductive reasoning and coding. The researcher utilizes inductive reasoning to interpret developments in the firm's strategic direction during the research period (Eisenhardt & Gaebner, 2007). Furthermore, coding is used to systematically identify passages of interest and categorize them by topic for later use. The reason for this order of operations is to develop an understanding of the firm and its management's objectives before inspecting the manner in which it attempts to reach them.

The second data analysis stage involves gathering relevant case-specific data from financial statements. This includes information about the firm's shares such as stock price, outstanding shares, market capitalization, and dividend policy. Moreover, capital flow data for each fiscal year within the research period is recorded. This data includes free cash flow from operations, net change in debt, outgoing dividends, capital expenditure, divestments, acquisitions, change in cash balance, and possible adjustments due to currency effects. Subsequently, each fiscal year within the research period is analyzed by comparing realized performance to predetermined targets. The primary techniques utilized include descriptive, prescriptive, and diagnostic analysis.

The structure for presenting data is based on the framework from Eisenhardt (1989). According to the author, case study research should begin with a within-case analysis before attempting to identify cross-case patterns. Furthermore, Eisenhardt (1989, p. 540)

states, "*the idea is to become intimately familiar with each case a stand-alone entity."* For this reason, the present thesis includes a section on the background, management & ownership, organizational structure, and market position of each case company. Eisenhardt (1989, p. 540) describes these write-ups as *"central to the generation of insight."* A

3.5 VALIDITY AND RELIABILITY

Validity and reliability are crucial concepts in the field of research. Studies do not exist in isolation but build on previous literature. For this process to take place, findings must be accurate and consistent.

Validity is "concerned with the meaningfulness of research components" (Drost, 2011, p. 114). There are four types of validity: internal, external, construct, and statistical conclusion validity (Drost, 2011). Establishing construct validity requires evidence in several other validity types that fall into translation and criterion-related validity categories (Drost, 2011, p. 116). The primary motivation for a case study is to highlight a particular phenomenon rather than producing causal and generalizable findings (Gomm et al., 2009). Therefore, the present study is primarily concerned with internal validity. The main challenge in establishing internal validity is accounting for confounding factors. Capital allocation is an umbrella term for the different sources and destinations of cash in a business. It is the same for all companies. Capital is raised, deployed, and distributed. The present study examines how a firm's capital allocation measures reflect its strategic and financial targets. However, leadership changes or market conditions impact the firm's strategy and performance. Specific circumstances of each case company are reviewed carefully and discussed thoroughly in the within-case analyses to improve the validity of findings.

According to Bollen (1989, as cited in (Drost, 2011), reliability refers to the consistency and stability of measurement. Errors that affect reliability can be random or systematic (Drost, 2011, p. 106). It is also important to note that validity and reliability are not

mutually exclusive. A measure can be reliable while not being an appropriate choice for the intended outcome (Drost, 2011). The researcher's subjectivism and the research process's rigor are the main reliability concerns in a case study design (Quintão et al., 2020). In the present study, these concerns are tackled through methods of self-reflection and data source triangulation. For instance, case selection is done with an element of randomness, which removes any bias from the process.

4 FINDINGS AND ANALYSIS

4.1 WITHIN-CASE ANALYSIS AND CASE DESCRIPTIONS

In this chapter, the case companies are analyzed individually following the guidelines provided by the chosen research design. Case descriptions begin with a concise background of the firm's history and meaningful events. Next, management and ownership are highlighted before evaluating changes in organizational structure during the research period. Strategy and associated financial targets are discussed subsequently. Case analyses conclude with an analysis of financial performance and capital allocation policy during the research period.

4.2 WULFF GROUP

BACKGROUND

Wulff Group is a Finnish reseller of office supplies. Its primary markets are Finland, Sweden, and Norway. 97 % of revenue comes from this region. Finland is the largest market, with a 69 % share of turnover and 75 % of the group's employees located there. During the 2023 fiscal year, Wulff Group employed an average of 262 people. Notably, it is the Nordic region's only publicly traded office supplies business (Wulff Group, 2024).

Wulff Group has an extensive history. It was founded by Thomas Wulff in 1890 as a paper company. The firm remained in the founding family for three generations until 1987, when it was sold to a private equity firm (Wulff Group, 2013). The firm was sold once again in 1992 to Mercantile Group. It operated as a subsidiary under the Mercantile Group for a decade before being purchased by one of its main competitors, Beltton Group, in 2002. Beltton Group was a publicly listed company before the transaction. The name of the remaining entity was subsequently changed to Wulff Group. Compared to the eventful fifteen-year period culminating in the Beltton–Wulff merger, the firm has since enjoyed relative stability.

MANAGEMENT & OWNERSHIP

Wulff Group's executive team has experienced changes in both structure and personnel during the research period. At the start of the period, the group had a six-person executive team. In addition to the group CEO, CFO, and CMO, the team also included the CEOs of the three main subsidiaries: Wulff Entre, Wulff Supplies, and Wulff Beltton. By the end of 2023, the executive team was downsized to four roles. The CEO of Wulff Beltton was removed from the executive team because the subsidiary was divested during the 2023 fiscal year (Wulff Group, 2024). Only one executive team member stayed at the firm throughout the research period. However, the most significant change occurred in 2019 when longtime CEO and majority owner Heikki Vienola stepped down as group CEO. He was replaced by Elina Rahkonen, who had previously occupied the role of group CFO from 2014 to 2017 (Wulff Group, 2020).

The appointment of a group CEO with a background in accounting is worth noting. Although case-by-case analysis is necessary, such an appointment may imply that the firm has entered a corporate lifecycle stage requiring rigorous cost control. All companies and industries go through a lifecycle in one way or another. Of course, actions can be taken by management and other stakeholders to extend or even return to an earlier stage in the lifecycle. However, pulling this off is challenging because organizational structures and activities are designed to address specific customer needs and value propositions. Suddenly, changing course is demanding and costly. Another way to maximize shareholder value in a declining industry is to consolidate. Due to lower market activity, there is downward pressure on profit margins. Larger firms with economies of scale can fund acquisitions with current free cash flow to extend their profit runways. Wulff Group is currently using this strategy. Figure 2 shows the business lifecycle. The "lifecycle extension" trajectory most accurately demonstrates what Wulff Group is trying to achieve. The success of this effort depends on the firm's ability to control costs by eliminating redundancies post-acquisition. Therefore, appointing a former CFO as group CEO is a logical and warranted choice.

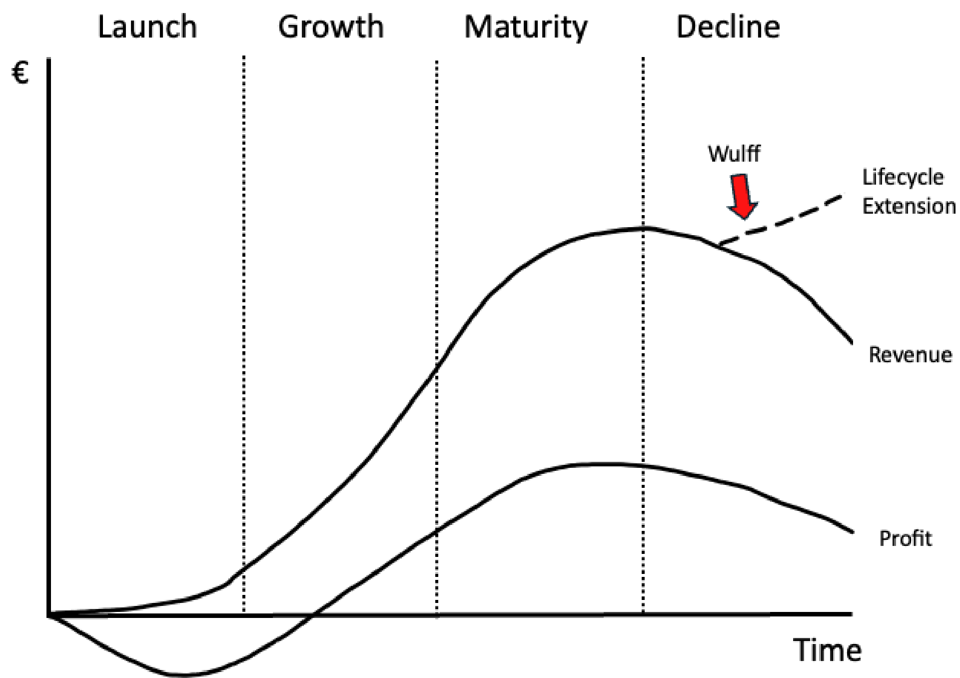

Figure 2: Stages in the business lifecycle

The ownership and control of Wulff Group have remained stable since becoming a publicly listed company in 2002. The majority owners of Beltton before the acquisition of Wulff Group were Heikki Vienola (46 % ownership) and Ari Pikkarainen (25 % ownership). The former has remained the largest shareholder throughout the firm's journey as a listed company. However, the latter sold most of his shares during 2020 and 2021. As a result, the firm's current ownership structure is relatively concentrated. Vienola owns approximately 36.50 % of the firm. Excluding institutional owners, the next largest individual owner controls 2.50 % of the firm (Wulff Group, 2024). This level of concentration is typical for smaller public companies. However, if the stock's free float is restricted due to a stagnant controlling owner, it may discourage investors from accumulating a meaningful stake in the firm. Not only is it challenging to fill the purchase order without causing a significant increase in share price, but it can also be challenging to sell the shares later on.

The board composition of Wulff Group remained nearly unchanged during the research period. The firm has a four-person board. Half of the board consists of family members of the largest shareholder. Moreover, each board oversees a specific business function, which includes corporate finance, business development, marketing and communication, and sales development.

Organizational Structure

The organization has grown in size due to inorganic growth achieved through acquisitions. In 2018, Wulff Group employed 191 people on average. That number rose to 262 by 2023. According to its admission, the firm has a sales-oriented organizational culture. Nonetheless, the share of employees working in sales went from 54 % in 2018 to 40 % in 2023. Due to the growth in total headcount, the number of salespeople still grew during the period. However, with turnover nearly doubling in the same timeframe, it would suggest that management sees less potential for growth in the foreseeable future.

Wulff Group segments its business into 'Contract Customers' and 'Expert Sales.' The former segment accounts for over 90 % of turnover. This segment includes the office supplies business as well as trade show consulting. Office supplies are sold both online and in physical stores. While it is possible to make one-off purchases, larger customers are often under a recurring contract. The Expert Sales segment includes consulting services and related products. The aim is to improve wellbeing at the workplace by improving things such as ergonomics and indoor air quality. At the end of 2023, the group comprised twenty-two companies, including the listed entity. There were seventeen subsidiaries in Finland, two in Sweden, and one in Norway and Denmark (Wulff Group, 2024).

Market Position

Wulff Group has significantly altered its market position during the research period. In 2018, it estimated the total size of its primary markets to be around two billion euros

annually. It listed the local subsidiaries of Lyreco and Staples as its main competitors in these markets. Wulff estimated the size of the Finnish office supply market to be around 400 million euros in 2018. With its 56 million euros of revenue, Wulff accounted for 14 % of the market. Lyreco Finland had a 15 % market share, while Staples Finland had a little less, at 12 %. RCK Finland was another significant player with its 5 % market share. According to Koponen (2023), the Scandinavian office supply market is highly fragmented. Not only are there various small niche players, but customers can also purchase many office supplies directly from hypermarkets and other generalist stores.

According to Wulff's estimate, the size of the local office supplies stayed the same from 2018 to 2023. However, Wulff’s share of the total market increased by ten percentage points to 24 %. The main reason for this development was the firm’s acquisition strategy. Wulff’s main competitors have employed a similar approach, which has resulted in significant consolidation in the Finnish office supplies market. Lyreco Finland accounted for 20 % of the market, up five percentage points from 2018. RCK Finland doubled its market share to 10 % (Asiakastieto, 2024). The three largest players accounted for over half of the local market. Nonetheless, the industry's large players still have room for inorganic growth.

Strategy & Financial Targets

During the research period, Wulff Group had three different sets of financial targets. It had initially laid out its long-term financial targets in the second half of 2015. These targets were in place for the 2018 and 2019 fiscal years. Upon the arrival of a new CEO in 2019, the firm set new medium-term financial objectives. They also emphasized that the strategy would consider potential acquisitions (Wulff, 2019). Finally, the firm made minor adjustments to the economic targets in December 2021.

The financial targets the board of directors approved in October 2015 reflect the preceding years. After initially recovering from the 2007-2009 financial crisis, Wulff Group’s turnover began declining rapidly in 2012. The firm had nearly reached the 100

million euro revenue milestone in 2011. However, by 2015, revenue had decreased by over 30 % due to divestitures and slowing demand. Given this backdrop, the targets laid out in 2015 appear rational. Table 1 shows the complete set of financial targets. The overall sentiment is defensive. Although Wulff Group can be considered a relatively asset-light business, a dividend payout ratio (DPR) above 50 % leaves management with minimal flexibility for capital allocation. Despite the high DPR, the firm also aimed to keep its equity ratio above 40 %. The firm had not reported EBIT margins above 2 % between 2011 and 2015. Nevertheless, it set out to achieve above 4 % EBIT margins in the upcoming years (Wulff Group, 2015).

Metric	**Target**
Revenue Growth	Exceeding industry average
EBIT Margin	4 % or above
Equity Ratio	40 % or above
Dividend Payout Ratio	50 % or above of earnings per share

Table 1: Wulff Group’s financial targets for the 2016-2019 period

Shortly after appointing a new CEO in late 2019, Wulff Group published its revised financial targets and a new strategic direction. The firm saw an opportunity to take a more active role in the market's consolidation. In light of the downward trend in the firm’s business activity during the decade, it set an ambitious target for 5-10 % long-term average annual revenue growth. It could be expected that profitability would take a backseat, at least for a while. However, the financial targets also stipulated that the firm would aim to improve its EBIT margins over the following years. Despite clearly pivoting to an acquisition-based strategy, the firm also decided to include a dividend target (Wulff Group, 2019).

Metric	Target
Revenue Growth	5 – 10 % annually
EBIT Margin	Growing
Dividend	Growing

Table 2: Wulff Group’s financial targets for the 2020-2021 period

In late 2021, Wulff slightly revised its financial targets for the 2022-2026 strategy period. It increased its revenue growth target from 5-10 % to 15-20 %, essentially doubling down on its acquisition strategy. Despite management seeing opportunity for even higher growth going forward, profitability and dividend targets were kept intact (Wulff Group, 2021). Achieving all the targets in unison would require not only exceptional execution but also luck.

Metric	Target
Revenue Growth	15 – 20 % annually
EBIT Margin	Growing
Dividend	Growing

Table 3: Wulff Group’s financial targets for the 2022-2026 period

After the latest revision of financial targets, Wulff Group embarked on a new strategic direction. Previously, the group had routinely divested unrelated subsidiaries to concentrate on its core businesses. However, recently, it expanded into two new verticals: accounting services and staffing. In 2022, it entered the accounting industry through an acquisition. In early 2024, it introduced Wulff Works, the group's staff leasing business. The motive for these moves is unclear. Accounting revenue is estimated to reach three million euros in 2024 (Wulff Group, 2024). It is a minuscule part of the group. Not to mention that the industry is highly competitive in Finland. There are many serial

acquirers in the space. It is unlikely that Wulff Group can build a lasting competitive advantage at a meaningful scale. The entry into the staffing industry is equally difficult to comprehend. The CEO of Wulff Works was previously in charge of Eezy, one of the largest staffing firms in Finland. Since going public, Eezy has seen its share price fall over 75 %. The firm has continuously struggled with profitability. One explanation for the sudden shift in strategy may be that management has concluded that it can no longer profitably grow in its core business and has decided to look elsewhere to reach the firm's financial goals.

FINANCIAL PERFORMANCE & CAPITAL ALLOCATION

During the research period, Wulff Group's financial performance was mediocre. At the surface level, the firm was able to rise to a new level of turnover. Before acquiring one of its primary competitors, the firm's revenue had stagnated at around 55 million euros. Post-acquisition, the average annual turnover has risen to 95 million euros. However, the incremental revenue has yet to be translated into profits. In 2020, the cost of goods sold (COGS) was approximately 65 % of turnover. Since 2021, COGS has been nearly 70 % on average. Personnel costs have remained at approximately 20 % of revenue. Management has been unable to eliminate redundancies as effectively as they initially thought.

The firm's focus on profitability was a recurring theme throughout the research period. Each set of financial targets included a target for EBIT margin. Compared to the years preceding the research period, Wulff Group was able to improve profitability. On average comparable EBIT margin for the period was approximately 4 %. Between the years 2014 and 2017, EBIT margin did not exceed 2 %. However, profit cannot be examined as a standalone figure. At the start of the research period, Wulff Group had 2.4 million euros of interest-bearing debt and approximately 0.2 million euros in cash and cash equivalents. It operated with an asset base of 25 million euros. By the end of the research period, the firm's interest-bearing debt had risen to approximately 11 million euros. It had 0.4 million euros of cash and cash equivalents. Total assets on the balance sheet doubled to 50 million euros. The firm has had to take significant risks to increase earnings.

Furthermore, financing costs were 300 % higher in 2023 compared to 2018, substantially reducing the impact of increased turnover and EBIT on after-tax earnings and free cash flow.

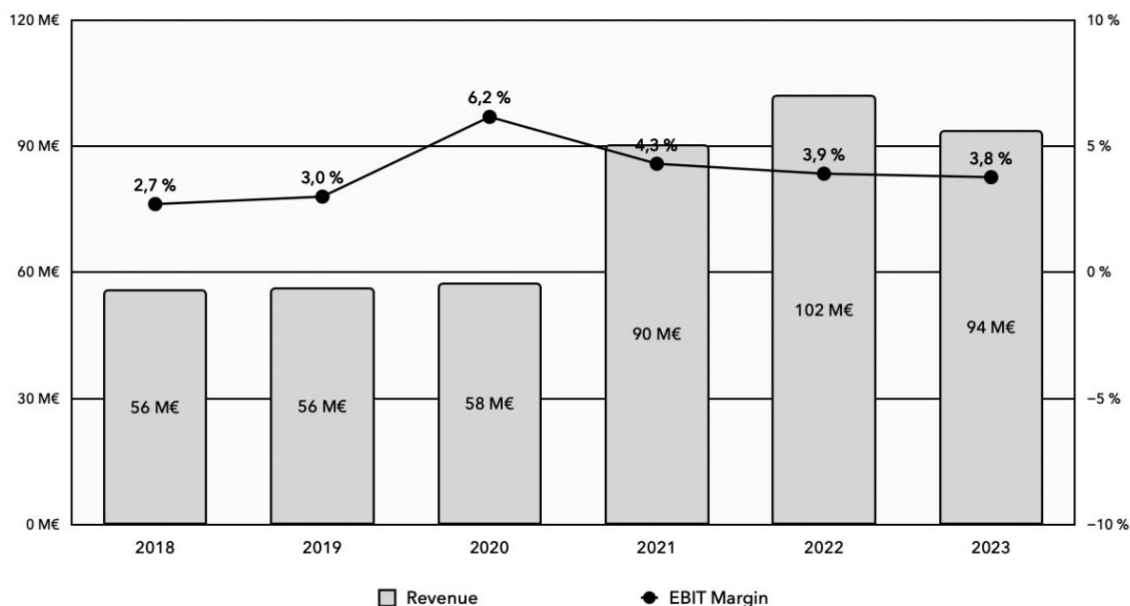

Figure 3: Revenue and EBIT margin figures for Wulff Group

In the 2023 annual report, the CEO states that management is ecstatic to propose another dividend increase (Wulff Group, 2024). Unsurprisingly, dividends have been an area of focus throughout the research period. For the 2018 fiscal year, Wulff Group's dividend was 0.10 euros per share. The dividend was raised by one cent in each of the following years, culminating in a 0.15 euro dividend for the 2023 fiscal year. Including 0.3 million euros in share repurchases, the firm returned over 5 million euros to shareholders during the research period. This is a considerable sum because the firm generated only 3 million euros in free cash flow during the same timeframe. Moreover, it started the period with a market capitalization of less than 11 million euros.

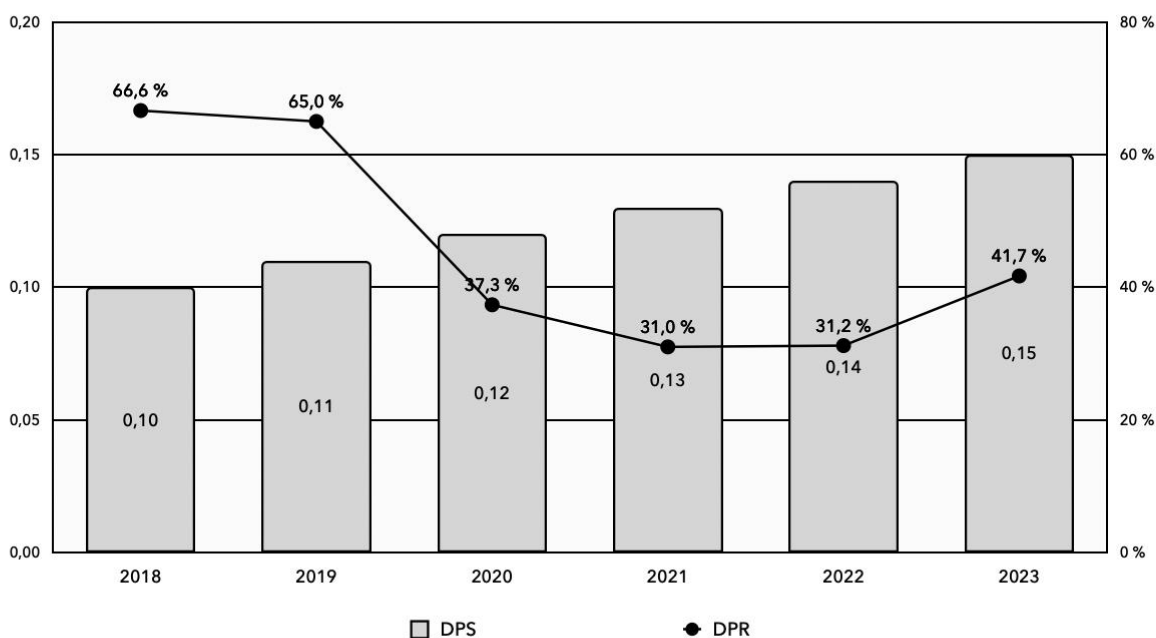

Figure 4: Dividend payout ratio and dividend per share figures for Wulff Group

DISCUSSION

Wulff Group took significant steps in their capital allocation policy to achieve their financial targets during the research period. Improving profitability was one of the main objectives for the firm. The main initiative in this pursuit was the overhaul of the firm's real estate strategy. In 2019, Wulff purchased a logistics center in Sweden that they had been leasing since 2010. The purchase price was 3.1 million euros. The rationale for the purchase was to make room for expansion and improve operational efficiency for better cost control (Wulff Group, 2020). In the same year, the firm purchased an office building in Espoo, Finland, which became its new headquarters. Real estate purchases during the 2019 fiscal year totaled 6.5 million euros. The firm's headquarters underwent remodeling to expand the premises in 2022. The impact of these transactions is twofold. The firm can decrease fixed costs by owning the properties it needs, thereby improving operating leverage and profitability. However, the strategy ties up a significant amount of capital. In the case of Wulff, the firm used adjustable-rate debt to fund the purchases. As a result, it has suffered from rising interest expenses in the past few years. It should be noted that the firm uses EBIT margin as its profitability target as opposed to other

metrics such as net profit or return on invested capital. As per its definition, EBIT omits interest expenses. Hence, costs are moved downward in the profit statement but not eliminated. Property ownership is often necessary for companies with specific needs that would otherwise significantly hinder the owner's ability to find a new tenant for the space. It is unlikely that this is the case for Wulff Group as the firm does not manufacture products. Therefore, property ownership may become a restrictive factor in the future when it comes to operational flexibility.

Revenue growth is another recurring proponent of Wulff Group's strategy and financial targets during the research period. The firm has communicated clearly that it does not expect the Nordic office supplies markets to grow. The pandemic has accelerated many trends, such as work-from-anywhere. As a result, the demand for office space and related services has weakened. Furthermore, the industry is highly competitive due to low entry barriers. There are also minimal differentiation opportunities. Competitive advantages are based on transitory qualities such as assortment breadth and customer service. Firms have limited pricing power due to nonexistent switching costs and routine tendering procedures by large customers. Consequently, Wulff Group has adopted a growth strategy based on acquisitions and market consolidation. The firm has stated that being a public company provides a unique advantage in this pursuit relative to its competitors (Wulff Group, 2019). The firm completed a marquee acquisition in 2021 when it acquired its main competitor, Staples Finland. The purchase price was 6.0 million euros, and the transaction was done at a significant discount to book value due to the target company's loss-making in the years preceding the acquisition. The firm initially intended to use acquisitions to fuel growth in 2019. Having not completed an acquisition in 2020, the question arises whether the firm was under pressure to show topline growth. The target company could not break even during a period when Wulff Group saw significant margin improvement. Between 2017 and 2020, the firm saw its EBIT margin go from 0.1 % to 6.2 % while ROIC went from -1.1 % to 15.2 % (Wulff Group, 2021). Management may have been overconfident in achieving a similar turnaround for a competitor. Retrospectively, it is puzzling why Wulff decided to double its share of the

Finnish office supplies market before expanding into new verticals in 2022 and 2023. Research indicates that market share does not automatically predict profitability (Rasmussen, 2024). Firms of all sizes can achieve a market position, allowing them to generate above average profits. Therefore, purchasing competitors in a structurally low-margin industry is not necessarily accretive.

An alternative theory is that acquiring Staples was a precursor to the foray into new verticals. The acquisition increased Wulff's customer base and presence in the local business landscape. Although this presence does not currently translate to profits, management may sense an opportunity to monetize these customer relationships by upselling novel higher-margin services. If this is the case, the plan is yet to prove successful. At the end of 2022, Wulff's accounting services had an annual revenue run rate of 2 million euros (Wulff Group, 2023). After completing two acquisitions in early 2024, management estimated revenue run rate to be at 3 million euros. However, the combined revenue of the acquired firms for the previous fiscal year was approximately 1.3 million euros (Suomen Asiakastieto, 2024). These figures imply that Wulff has been unable to increase or even maintain the accounting firm's revenue base that it acquired in early 2022.

The firm has insisted on growing its dividend payment annually during the research period. Management has expressed delight in being able to achieve this. From an outside perspective, it appears that the end has justified the means. In relation to net profit, Wulff's cumulative dividend payout of approximately 40 % is reasonable on its own. Under normal circumstances, the firm's capital expenditure requirements are relatively moderate at around 1.5 % of revenue. However, during the research period, Wulff had multiple ongoing initiatives with significant capital requirements. In this context, the dividend policy appears misguided. At its best, it is unsustainable, while reckless at its worst. Figure 5 shows Wulff Group's interest-bearing debt and earnings per share (EPS) development during the research period. Although EPS has increased, debt has substantially outpaced it. Management has backed itself into a corner by promising

shareholders an ever-growing dividend. The disconnect between earning power and debt level has not gone unnoticed in the stock market. After increasing by over 200 % between 2018 and 2021, Wulff Group's share price fell 33 % and 41 % in 2022 and 2023 respectively. All in all, the case of Wulff Group shows the power of goal setting for both good and bad. Organizations need targets as well as a plan to reach them. It is of utmost importance which targets are selected and for what reason. Reaching a misguided goal can be detrimental.

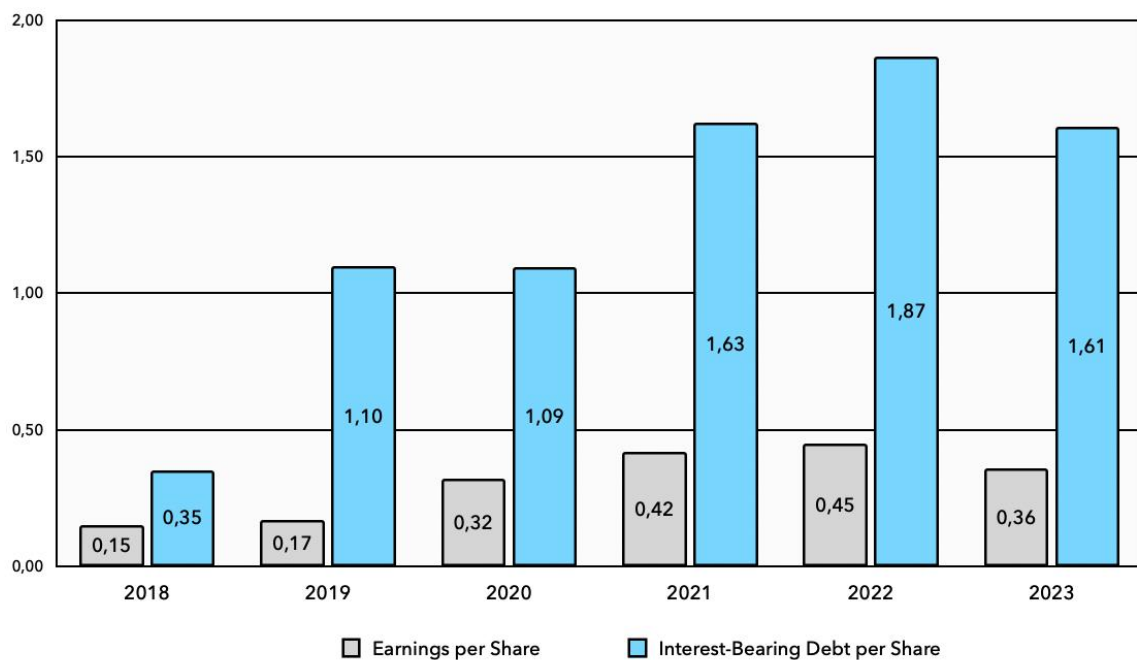

Figure 5: EPS and interest-bearing debt per share figures for Wulff Group

4.3 SOLTEQ

BACKGROUND

Solteq is a Finnish IT and software company that focuses on the energy and commerce sector. Its operations are based in the Nordics, Poland, and the United Kingdom. At the end of the research period, the firm employed 498 people and had a revenue base of 57.7 million euros (Solteq, 2024).

Two Finnish entrepreneurs, Ali Saadetdin and Seppo Aalto, founded the firm in 1982. It operated as a private company as Tiedonhallinta until 1999 before going public via an initial public offering. Subsequently, its name was changed to Solteq in 2000. The firm’s story as a public company had a tumultuous start as its IPO coincided with the IT bubble. Its market capitalization reached 60 million euros in early 2000 before plummeting to 12 million by the end of the year (Solteq, 2001).

Management & Ownership

Solteq’s board of directors saw frequent turnover during the research period. Only one of the five members that made up the board of directors in 2018 remained by 2022. On the other hand, the executive team has remained intact for much of the research period. The firm had the same CEO from 2018 to early 2022 until he resigned, and a board member took over. Solteq's human resources, marketing, and digital services leaders remained at the firm throughout the period. The CEO assumed the responsibilities of the 'Software' business segment in late 2020 (Solteq, 2021). Overall, the firm’s leadership remained surprisingly stable during a period that was characterized by extreme volatility for both the business and the share price.

Ownership of Solteq has been institutionalized significantly throughout its listed history. At the end of 2000, approximately 90 % of outstanding shares were owned by individual investors (Solteq, 2000). The two founders together owned over 45 % of the firm. By 2022, the founders’ ownership had shrunk to 6 %. On the other hand, insurance companies and pension funds owned approximately 35 % of the firm (Solteq, 2022). This is not an unusual development for a small-cap company. Institutional investors feel more comfortable investing in the firm after it has an established track record. Founders often take a backseat as the firm matures and its growth rate stabilizes. Solteq's ownership structure was diverse and balanced at the end of the research period. The largest shareholder controlled approximately 10 % of the firm. Founders remained part of the firm's story, while meaningful institutional ownership provided stability.

ORGANIZATIONAL STRUCTURE

There were several changes in Solteq's organizational structure during the research period. At the end of the 2018 fiscal year, Solteq employed 586 people. The firm had only one reporting segment, Software Services, which included the Digital Services and Core Business Solutions business units (Solteq, 2019a). By the end of the year 2023, Solteq had 498 full-time employees. The firm also made changes to its reporting segments starting from January 2023. The business was divided into two segments: Utilities and Retail & Commerce (Solteq, 2023a). For the 2019 to 2022 strategy period, the firm's reporting business segments were Solteq Software and Solteq Digital. In effect, the business was structured based on the type of product being sold. However, with the latest strategy revision, the firm is structuring its operations based on its primary customer markets, energy and retail.

MARKET POSITION

Competitive analysis is challenging in the information technology (IT) industry. Competition is distinctly different compared to traditional, mature industries. This is because there are endless applications for digitalization. Hence, firms operating in the sector will identify a specific niche to focus on. For instance, certain firms cater their services to the public sector. Long-term success ultimately depends on the firm's standing within the niche and the demand environment dictating pricing conditions. Furthermore, the industry is exceptionally employee-driven, so attracting and retaining talented professionals is a vital competitive factor. Another point of differentiation for IT firms is the range of technology providers they partner with. Although most use several partners, some firms focus on only one technology partner. Innofactor is an example of this in the Finnish market with their exclusive Microsoft partnership (Grönqvist, 2023). On the other hand, Solteq has a host of technology partners. In addition to Microsoft, they partner with firms such as IBM, Magento, Informatica, and Amazon (Grönqvist & Rostedt, 2023).

Another critical choice for IT firms is the level of in-house research and development investment. Solteq is an outlier in this category. It has heavily invested in product development for its main customer markets: retail and energy. To date, this decision has not born fruit. In its 2023 annual report, the firm wrote down most of its capitalized product development costs. The write-down amounted to 7.5 million euros (Solteq, 2024). On a risk management basis, in-house product development is inherently riskier than a pure consulting business. Solteq has recently underperformed its peer group by a wide margin. In 2023, its organic revenue decreased by 7 %. The peer group's average organic growth was 3.4 %, while the median was 0.3 % (Grönqvist & Rostedt, 2024). One explanation for Solteq's underperformance and weak market position is its decision to focus on the retail industry. This market is difficult because the largest buyers (Kesko and S-Group) have extraordinary bargaining power.

STRATEGY & FINANCIAL TARGETS

During the research period, Solteq had three sets of financial targets. Targets for the 2018 and 2019 fiscal years were initially set in May 2016 by the firm's management. Before setting these targets, the firm had seen strong performance during 2015 and early 2016. The firm had a positive momentum after a few relatively slow years. The announced targets were optimistic and aggressive. The firm acknowledged that the growth rate was considerably higher than what it had previously been able to achieve. The target for annual revenue growth was 20 %. The firm also strived for EBIT margins above 8 %, a net debt-to-EBITDA ratio of less than 3.5, and a dividend payout ratio of 30 % or higher (Solteq, 2016). The firm cited internationalization as the main lever in achieving these medium-term targets. Management predicted that international growth would be inorganic, while growth in the Nordics, on the other hand, would be organic (Solteq, 2016). According to management, Solteq's unique advantage comes from its ability to offer products and services for the entire e-commerce value chain. The firm aims to be a one-stop shop for customers with an omnichannel sales strategy.

Metric	Target
Revenue	Above 20 % annual growth
EBIT Margin	8 % or above
Net Debt-to-EBITDA	less than 3.5
Dividend Payout Ratio	30 %

Table 4: Solteq’s financial targets for the 2016-2019 period

In late 2019, Solteq announced a change to its organizational structure. The change divided the firm into two business segments: Solteq Software and Solteq Digital. From 2020 onward, the segments will report their results separately. Additionally, both segments were given their own financial targets. These values are shown in Table 5 below. Management explained that this change would "drive growth, especially in international markets" (Solteq, 2019b). Solteq Software includes revenue from selling proprietary products such as retail POS systems and related services. On the other hand, Solteq Digital includes revenue primarily from IT consulting. Management stated previously that the firm’s competitive advantage comes from the ability to offer relevant products and the IT expertise required to implement them. This announcement doubles down on that assertion. In other words, management sees more growth potential in the Software segment going forward. If it can tap into this potential, the firm's sales mix will improve drastically. Consequently, this would lead to improved profitability and competitive position. On the other hand, the primary function of the Digital segment is to provide stability by improving IT consultants’ billing rates.

In 2019, approximately 30 % of revenue came from the Software segment, while the rest came from Digital. Given this revenue split, the implied growth rate is considerably lower than previously, at around 10 %. It seems that the strategic priority shifted from growth to profitability, as the implied EBIT margin is 13 %. Additionally, this may reflect the firm's

recent financial performance. Its EBIT margin expanded from 4.3 to 9.8% from 2018 to 2019, while revenue was flat.

Metric	Target
Solteq Software – Revenue	Above 20 % annual growth
Solteq Software – EBIT Margin	Above 25 %
Solteq Digital – Revenue	Above 5 % annual growth
Solteq Digital – EBIT Margin	Above 8 %

Table 5: Solteq’s financial targets for the 2020-2022 period

The third and final revision came in early 2023. Once again, the firm's segment reporting changed. Going forward, business segments were based on Solteq's primary customer markets: Retail & Commerce, and Utilities. Management felt that this segment structure would improve Solteq's ability to provide tailored solutions to clients in their respective markets (Solteq, 2023b).

Metric	Target
Retail & Commerce – Revenue	Above 8 % annual growth
Retail & Commerce – EBIT Margin	8 % or above
Utilities – Revenue	Above 15 % yearly growth
Utilities – EBIT Margin	18 % or above

Table 6: Solteq’s financial targets for 2023 and going forward

Financial Performance & Capital Allocation

Solteq’s financial performance during the research period was twofold. From 2018 to 2021, the firm grew steadily (8 % CAGR) while maintaining strong profitability with an

average EBIT margin of 8.3 %. However, the operating environment during this period was ideal as firms rapidly accelerated their IT investment due to the ensuing global pandemic. The problems started in the second quarter of 2022 when the firm announced that it was facing challenges in its 'Utilities segment (Solteq, 2022). These firm-specific challenges and a more difficult operating environment reversed Solteq's revenue growth, and profit turned into a loss. The problems continued in 2023 when the firm saw its revenue shrink by over 15 %. Due to the problematic two-year period, the firm generated only 0.9 million euros in cumulative profit before taxes during the research period despite accumulating 371 million euros in cumulative turnover.

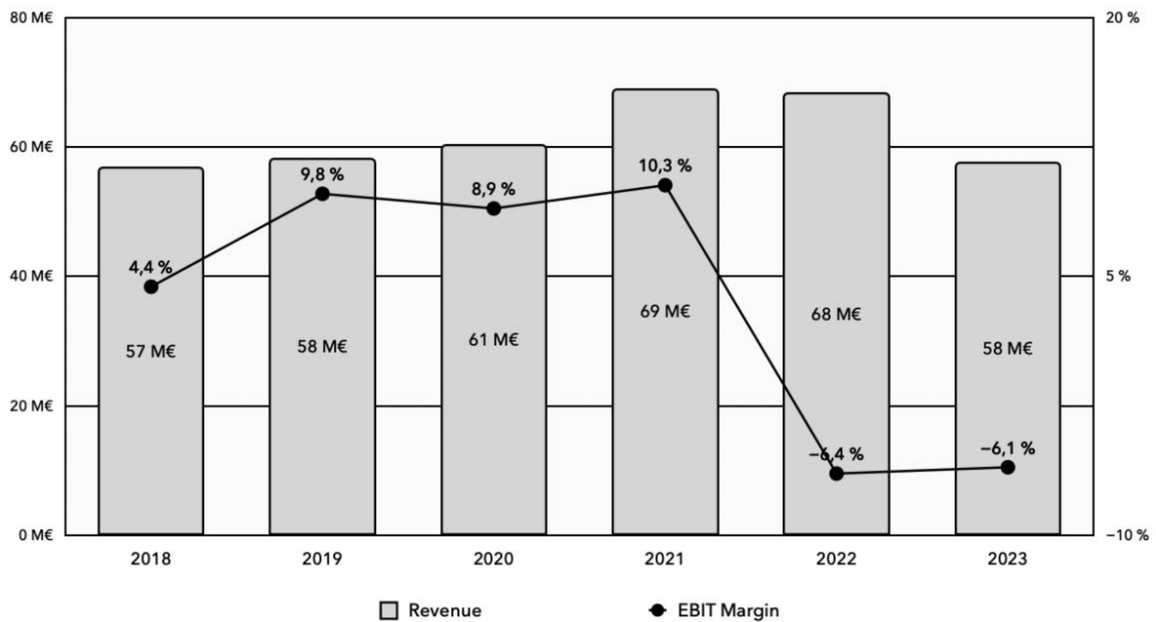

Figure 6: Revenue and EBIT margin figures for Solteq

Solteq's cash flow was negative during the research period. Although the firm faced significant headwinds during 2022 and 2023, it produced nearly 15 million euros in cash flow from operations. However, due to the firm’s capital-intensive strategy, its aggregate free cash flow for the period was -5.5 million euros. On average, annual capital expenditure was approximately 3.4 million euros. Research and development costs accounted for most of the capital expenditure. In 2023, management concluded that R&D costs would no longer be capitalized on the firm's balance sheet (Solteq, 2024). As

a part of this evaluation, it also wrote down previously capitalized R&D expenses by 7.5 million euros. To fill the capital void created by negative free cash flow, Solteq had four options: exhaust existing cash reserves, raise new capital through share issuance, increase debt, or divest parts of the business. The tricky part of the equation was that the firm had a low cash balance and a high net debt to EBIT ratio at the start of the research period. At the end of 2017, Solteq had only 1.5 million euros in cash and cash equivalents. Meanwhile, it had over 24 million euros of interest-bearing debt. On average, the firm had generated around 2.5 million euros in the preceding years. Maneuvering this mountain of debt leaves no room for mistakes or surprises. Hence, Solteq has had to rely on divestments to supplement its capital requirements when operational performance has been insufficient. The firm received over 18 million euros from the two divestments during the period. However, it also spent approximately 10 million euros on acquisitions. Figure 5 shows the relationship between Solteq's available capital and the change in interest-bearing debt. Available capital is calculated by adjusting free cash flow for capital spent on acquisitions and capital received from divestments. For instance, in 2023, free cash flow was -9.5 million euros, while divestments generated 14.1 million euros. Therefore, the available capital for the fiscal year was 4.6 million euros. It is noticeable how debt influences decision-making. Excluding 2018, management reduced debt whenever it had available capital. In 2022, the firm's free cash flow was negative, but management decided to proceed with acquisitions worth over 5 million euros. Management funded the acquisitions with debt despite the firm already being highly leveraged. This can be seen as a last-minute attempt to right the ship. When the challenges persisted in 2023, management was obliged to complete a significant divestment.

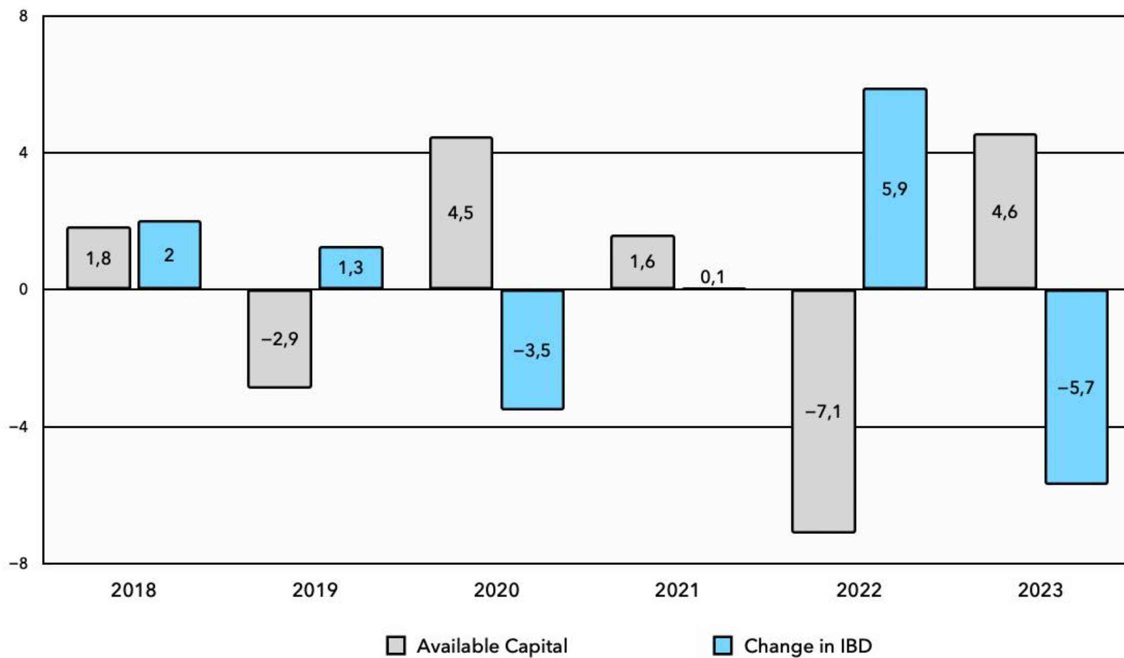

Figure 7: Available capital and change in interest-bearing debt for Solteq

DISCUSSION

Solteq had one clear objective during the research period. Management wanted to achieve revenue growth through international expansion. The motive for this strategy was clear. It had exhausted most of the growth available locally. Additionally, its pricing power in core customer markets in Finland was inadequate. To achieve this objective, the firm underwent multiple changes in its organizational structure. It also completed several acquisitions during the period. The overarching theme in the firm's acquisition strategy has been the continued focus on the product business in favor of the IT consulting business. During the research period, Solteq carried out two divestments. In 2019, it sold its SAP ERP integration business. In 2023, it continued the same trend by selling its Microsoft ERP business. On the acquisition front, Solteq purchased three firms in Denmark and four in Finland. Three of the four local acquisitions were firms from the energy industry, while one was a minority shareholder buyout (Solteq Oyj, 2024). Two of the earlier Danish acquisitions were IT firms that focused on e-commerce and retail, while the latest acquisition was in the energy industry. Solteq spent 4.7 million euros on international acquisitions during the research period. This figure accounts for cash

balances held by the acquired entities. Before the 2018 acquisition of the Danish company TM United A/S, Solteq did not report revenue by geographical region. After the acquisition, management stated that approximately 20 % of revenue comes from outside Finland. Despite several add-on investments abroad and significant local divestiture, Solteq has failed to increase its international revenue in relative and absolute terms. In 2023, the firm generated 9.18 million euros in international revenue, which was 0.5 million euros less than in 2018.

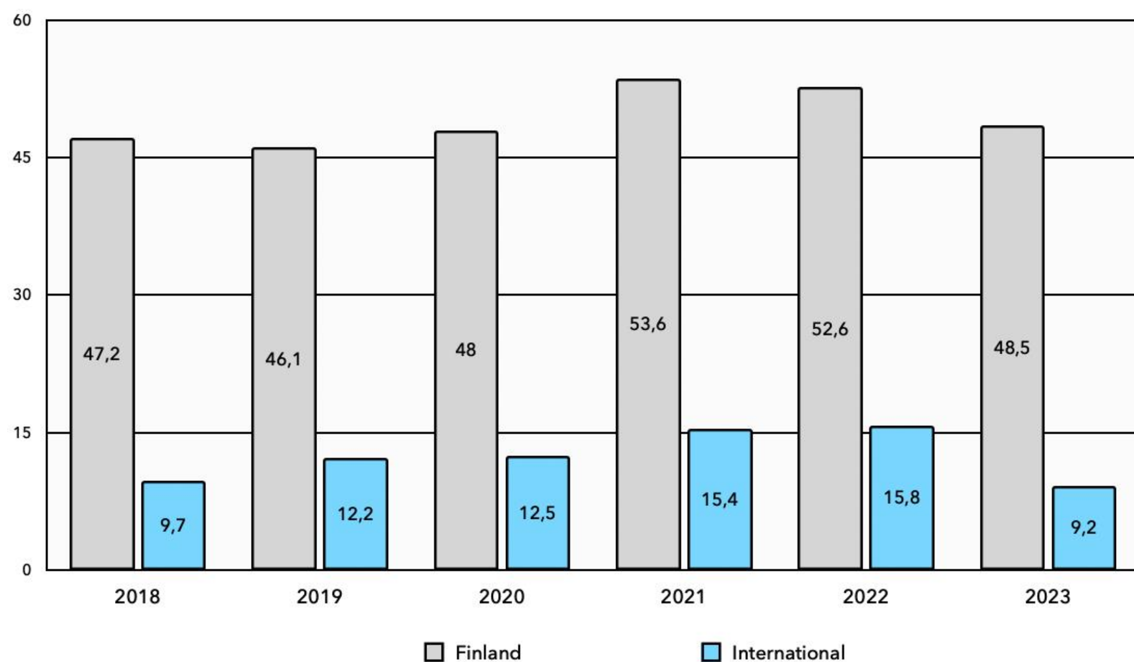

Figure 8: Revenue figures by geographic region for Solteq

The link between financial targets and capital allocation policy is abundantly clear in the case of Solteq. After failing to reach its debt coverage target in 2018 and 2019, management removed the target altogether from the following strategy revision. Instead, management continued to seek strong growth. Interest-bearing debt peaked at over 30 million euros at the end of 2022 due to large acquisitions. The firm distributed 3 million euros in dividends during the 2021 fiscal year. This payout kept the firm's cash balance relatively low, meaning management would likely use debt to fund future acquisitions. In retrospect, this decision is difficult to justify. The firm had nearly six times

as much interest-bearing debt than it had generated in cash flow from operations on average during the preceding three fiscal years. Despite the high debt load, management felt it was a time to reward shareholders. This decision can be explained by the general investor sentiment in Finland. The firm had solid results for a few years, and owners were anxious to share in on the profits. Another explanation is that management extrapolated previous years' financial development into the future and justified a dividend based on that exercise. Nonetheless, actions taken by management and the headwinds faced by the company led to a massive divestment in 2023. The firm received 14.1 million euros for its Microsoft ERP business. This sum represents nearly 100 % of the firm's equity market capitalization at the end of the research period. However, only 5.7 million euros was allocated to debt payoff. The rest was used to cover operating losses and maintenance capital expenditure. Although many things did not go according to plan for Solteq during the research period, capital allocation stands out from the rest. Instead of using its highly valued stock to fund acquisitions during 2020 and 2021, management opted to distribute a dividend. Alternatively, the firm could have issued shares and reduced its debt load. Instead of seeing its rising share price as an opportunity to increase the firm’s resilience, management did the opposite by distributing capital. Furthermore, internal capital allocation has also been suboptimal. The firm accrued over 20 million euros of capital expenditures during the research period. The majority of this sum was capitalized on the balance sheet as R&D expenses. Management wrote down nearly all of these expenses in 2023. Over 70 % of the firm's balance sheet was comprised of goodwill at the end of the research period. The true value of this goodwill is up for debate, as acquisitions have not been effective in improving the firm's performance. From a financial standpoint, Solteq wasted the opportunity of a lifetime that was created by the global pandemic as firms looked to invest heavily in their digital systems. The firm is now back at square one. However, it will likely not enjoy the same confidence from its stakeholders this time.

4.4 NURMINEN LOGISTICS

BACKGROUND

Nurminen Logistics is a Finnish logistics firm that specializes in international rail transport. It also offers services related to cargo forwarding and customs processing (Nurminen Logistics, 2024a). It is a business-to-business operator that does not deal with private customers. The primary markets where Nurminen operates are the inter-Nordic rail routes and the routes from Europe to Asia. Outside of Finland, the firm has offices in China, Latvia, Lithuania, and Austria to help support its global operations. At the end of the research period, the firm employed 186 people with a revenue base of 128 million euros (Nurminen Logistics, 2024a).

The firm was founded in 1886 as a general store by John Nurminen, a farmer at the time. The business underwent significant changes during the 20th century. The firm explored new industries such as travel and shipping. It was also Finland's first air cargo forwarder. By 1990, the firm had shifted from air freight to ground freight forwarding. It also expanded globally during this phase. The start of the 21st century saw another significant development as the firm invested heavily in railway equipment and opened a major logistics center in Helsinki. The firm entered the Finnish stock market in 2008 amidst the global financial crisis. Since 2010, it has continued to leverage its rail transport capacity and unique geographical position to become a major logistics operator between Europe and Asia (Nurminen Logistics, 2024a).

MANAGEMENT & OWNERSHIP

The leadership of Nurminen Logistics has seen continuous turnover throughout the research period. At the beginning of 2018, the executive team consisted of four members: the group CEO, the VP of the Terminal Services division, the VP of the Rail Transport division, and the CFO. By the end of 2023, the executive team had grown to seven members. In addition to previous roles, it now had a chief operating officer, a chief people officer, and a chief development officer. The number of board members also increased during the research period. The board had four members at the beginning,

while it had six at the end. Two underlying factors can explain the changes. Firstly, the business has seen strong revenue growth during the period. In 2017, its turnover was 75.8 million euros. By 2023, this number had risen to 128 million euros. Secondly, the research period was defined by significant share dilution. New investors who provide substantial capital seek a certain degree of control. In practice, this means there will be changes in leadership and board composition.

Ownership of Nurminen Logistics has become less concentrated throughout its time as a public company. After going public through a reverse merger, the founding family owned over half of the outstanding shares (Nurminen Logistics, 2010). At the end of 2023, they owned approximately 14 %. However, this change has occurred through dilution rather than the sale of shares. The firm has used dilution several times to raise new capital and convert existing debt into shares. As a result, share count increased by over 500 % between 2009 and 2023. Ownership can be described as balanced at the end of the research period. The ownership structure contains institutional owners, investment companies, and members of the founding family (Nurminen Logistics, 2023).

ORGANIZATIONAL STRUCTURE

There have been minimal changes in the firm’s organizational structure during the research period. The central development has been the firm's expansion into the Europe-Asia rail route market. At the beginning of the research period, Nurminen highlighted Russia as a critical source of competitive advantage. By the end of 2022, management had halted all logistics operations in connection with Russia due to the Russian invasion of Ukraine. Additionally, the firm decided to seize the direct route to China. It has since opened new routes between Europe and Asia that bypass Russia. However, changes in organizational structure have been mainly caused by geopolitical events rather than internal decisions. Additionally, the firm changed its business segment reporting policy in 2020. The business was separated into four profit centers: Asian rail transport, multimodal services, cargo services, and Baltic operations.

Previously, results were reported under one consolidated business segment. This change had a decentralizing effect on the firm's leadership dynamics.

Market Position

Nurminen Logistics operates in an industry that is expected to grow over time. Increased economic activity inherently means that there is growing demand for logistics operators. However, there are many ways that freight can be transported. As per statistics by the Organization for Economic Co-Operation and Development (OECD), sea freight accounts for over 90 % of global shipping volume (DHL, 2023). Therefore, Nurminen competes against direct competitors and other means of freight shipping. Although rail transport is more expensive than ocean shipping, it offers speed and reliability (Pursimo, 2023).

The firm's market position differs based on the business segment and geographical market. Rail transport between Europe and Asia is a blue ocean strategy because there is currently little to no competition (Pursimo, 2023). On the other hand, the firm has a strong market position in the more mature Baltic and Nordic rail transport markets. It is currently seeking growth from central Europe, where it is yet to achieve scale. Finally, the firm also provides terminal and forwarding services. These markets have relatively low barriers to entry. Hence, they are more competitive and less profitable (Pursimo, 2023). Management sees them as supporting services that enable profitability in other parts of the value chain.

Strategy & Financial Targets

Nurminen Logistics had three different sets of financial targets during the research period. The focal point of its strategy also shifted from Russia to Asia and Europe. In 2017, the board of directors outlined the firm’s long-term financial targets. They reported a plan to grow revenue faster than the overall market. Management also included two targets for profitability ratios. The intended strategy to reach these targets focused on vertical integration and international expansion (Nurminen Logistics, 2018). Before the research period, the firm had reported mixed results. Its revenue had fluctuated

between 40 to 80 million euros since going public in 2008. Seemingly never-ending cost-cutting measures have upheld profitability. As a result, the firm employed half as many employees at the end of 2017 than in 2010, even though nominal revenue was virtually unchanged (Nurminen Logistics, 2018).

Metric	**Target**
Revenue Growth	Above market
EBIT Margin	7 %
Return on Equity	12 %

Table 7: Nurminen Logistics’ financial targets for the 2018-2020 period

Nurminen updated its strategy and financial targets in the fall of 2021. Despite failing to show a profit during the 2018-2020 strategy period, the firm published a highly ambitious set of financial targets. The firm stated that it aims to reach revenue of 200 million euros by the end of the strategy period in 2023. Furthermore, this growth was to be achieved organically without any acquisitions. Management set the new EBIT margin target at 9 % while the equity ratio was to remain above 33 %. The firm also wanted to manage its debt by keeping the gearing ratio below 100 % and net debt-to-EBITDA below 2.5. Finally, it also announced an intention to distribute capital. Management was aware of the firm's unique position as the link between Europe and Asia. The strategy relied on aggressive growth from this segment. Management also believed that new business from Asia would improve its position in the Baltic Markets (Nurminen Logistics, 2022). The strategy was ambitious because ocean shipping historically accounted for nearly all freight transport between China and Finland (Pursimo, 2023). The firm foresaw a change in the horizon.

Metric	**Target**

Revenue	200 million euros during the strategy period
EBIT Margin	At least 9 %
Equity Ratio	At least 33 %
Gearing	Below 100 %
Net Debt-to-EBITDA	Less than 2.5x
Dividend	Growing (33-50 % of EPS)

Table 8: Nurminen Logistics' financial targets for the 2021-2023 period

In anticipation of strong financial performance, the board of directors confirmed a new strategy and revised financial targets in late 2023. The previous set of targets was supposed to be in place for the 2023 fiscal year. At this point, it was clear that the firm would not reach its revenue target of 200 million euros. Management likely did not want to be tied to the dividend payout ratio range of 33 – 50 % following an acquisition that significantly increased the debt on the firm's consolidated balance sheet. The most notable change in the revised objectives is the lack of a revenue target. Management is shifting its focus from growth to profitability and solvency. However, acquisitions are also mentioned as a growth lever, suggesting that revenue development is difficult to predict during the 2023 – 2025 strategy period. Other than that, the main change is that the firm anticipates some improvement in each target metric. Notably, management sees EBIT margin reaching 13 %.

Metric	**Target**
EBIT Margin	Above 13 %
Equity Ratio	Above 40 %
Gearing	Below 100 % and below 2.5
Net Debt-to-EBITDA	Less than 2x

Dividend	Growing in absolute terms

Table 9: Nurminen Logistics' financial targets for the 2023-2025 period

FINANCIAL PERFORMANCE & CAPITAL ALLOCATION

The research period was eventful for Nurminen Logistics. In 2018, the firm expanded its business by opening a railway connection between Finland and China (Nurminen Logistics, 2019). This business turned out to be of utmost importance in the coming years. The global pandemic set in motion a series of events that caused a global supply chain crisis, drastically increasing ocean shipping costs. As a result, Nurminen could operate its China railways at maximum capacity. However, after the Russian invasion of Ukraine in 2022, the firm had to adapt. It quickly opened a new route from China to Europe, combining ocean and rail shipping (Nurminen Logistics, 2023). Finally, in 2023, the firm completed an acquisition where it became the largest private railway operator in Finland.

Despite a turbulent operating environment, Nurminen reported strong aggregate financial results during the research period. There was a clear polarization between the first and second half of the research period. Between 2018 and 2020, annual turnover was approximately 76 million euros, while the corresponding EBIT figure was -6.7 %. As for the 2021 to 2023 period, revenue was nearly twice as high at an average of 131 million euros. More notably, average EBIT margin improved from -6.7 % to 11.8 %. However, the 2023 fiscal year results include a non-recurring item related to an acquisition, which boosted EBIT by 12.5 million euros. The adjusted average EBIT margin for 2021 to 2023 was 8.6 %, which is impressive for a logistics operator.

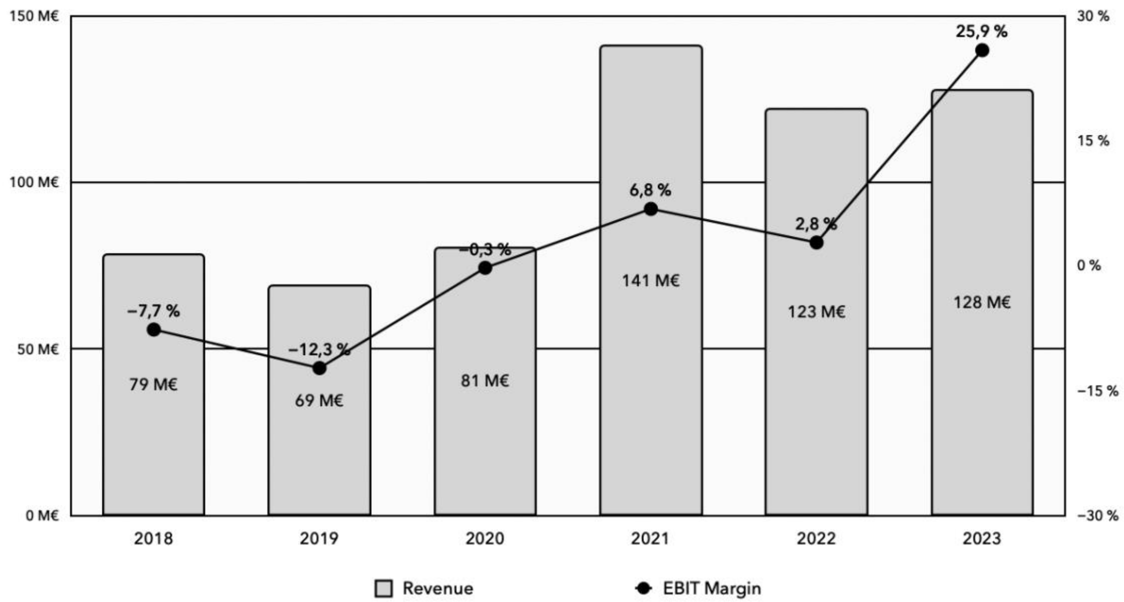

Figure 9: Revenue and EBIT margin figures for Nurminen Logistics

The firm's capital allocation activity was arguably even more eventful than its operational environment and performance. During the research period, Nurminen completed a sizeable real estate transaction, increased its outstanding shares by nearly 80 %, and bought a railway operator at a steep discount. It also used 24 million euros to pay off debt. Altogether, management allocated almost 50 million euros of capital during the research period. Approximately 60 % of this was generated through operations, while the rest came from share issuance and asset sales. Notably, the firm sold its Russian subsidiary in 2018 for 7 million euros. The firm continued operating in Russia by using rental equipment and partners as part of its transition to a more asset-light strategy.

Due to its light capital expenditure requirements, Nurminen Logistics has strong free cash flow conversion. During the research period, the firm generated 31 million euros of cash flow from operations. Its capital expenditures totaled 13.1 million euros. However, this figure includes a significant property purchase in the port of Helsinki in 2020. The purchase price was 8.7 million euros. The firm's adjusted annual capital expenditure was less than 1 million euros. The total free cash flow for the period was more than the net profit, even if the real estate transaction was included in capital expenditures.

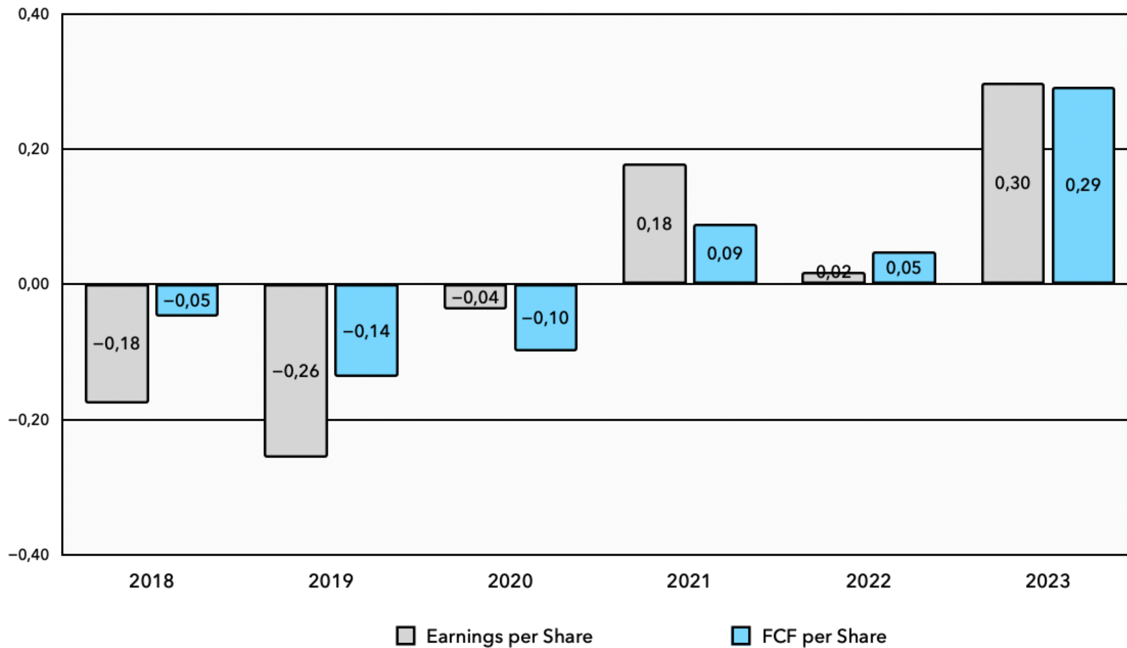

Figure 10: Free cash flow and earnings per share figures for Nurminen Logistics

As mentioned, the firm used 24 million euros for debt repayment between 2018 and 2023. Nonetheless, its interest-bearing debt increased from 15.9 million euros to 38.6 million euros during the same period. This is because the firm assumed more debt through acquisitions than it managed to pay off. However, assets have grown faster, which has had a stabilizing effect on the firm's solvency. The latest acquisition in 2023 had the most notable impact on the equity ratio as the firm bought 21 million euros worth of net assets for 9.2 million euros. The steep discount was attributed to the risky nature of the acquired business.

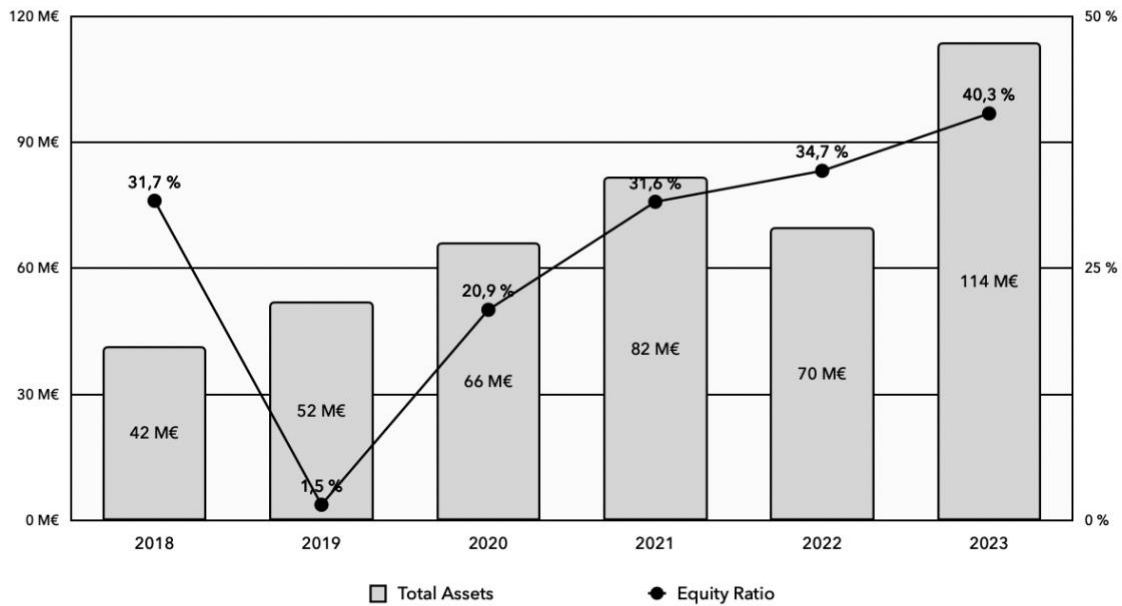

Figure 11: Total assets and equity ratio for Nurminen Logistics

DISCUSSION

During the research period, Nurminen had two overarching objectives. The firm wanted to enhance profitability while simultaneously controlling its debt ratios to build a strong base for future growth. The main initiative taken by the firm in its capital allocation policy to achieve these goals was a large share issuance in 2020. The effect of this transaction was twofold. Firstly, the firm desperately needed a capital injection to stabilize its equity ratio, which stood at 1.5 % at the end of 2019. Secondly, fixed costs would decrease by approximately 1 million euros annually through ownership instead of leasing (Nurminen Logistics, 2021). The main criticisms related to this transaction are its timing and structure. The issuance was done just before an inflection point for the business. The firm was valued at 14.1 million euros based on the subscription price. In the three following fiscal years, the firm would generate 36 million euros of free cash flow. If the firm had not structured the transaction as an off-market-directed issue, this would not have been a problem. However, by deviating from equal treatment of shareholders, it raises questions regarding the timing.

One of the main challenges for Nurminen historically has been the share of profits between equityholders in the parent company and minority interests. The firm generated approximately 18 million euros of free cash flow during the research period. Dividends paid to minority interests during the same period exceeded 8 million euros. Moreover, returns on equity have been significantly more robust for minority interests. On average, they have seen a 46 % return on equity with no losing years. On the other hand, equity in the parent company has returned less than 10 % per annum on average. Minority interest's share of total profits during the period was over 70 %. Remedying this situation must have played a part in the firm’s decision to complete an acquisition in 2023 that entails significant political risk. The purchase price is telling of this inherent risk. The firm paid 9.2 million euros for a company with 21.5 million euros in net assets. Cash reserves alone made up 8.7 million euros. In 2023, the acquired firm generated 16.5 million euros in after-tax profits. At the moment, it seems that taking on the political risk was worth it. However, the firm brought along two investors into the deal who owned approximately 20 % of the target company post-transaction. One of them was the firm's CEO, who was already a significant shareholder in the parent company with a 6.6 % ownership stake. It is puzzling why the firm would go against its interests and financial objectives in this manner. In 2023, it was required to pay 4.5 million euros of the total purchase price. According to management, the inclusion of minority interests in the acquisition was necessary due to the lack of available capital at the parent company. The deal was announced in January 2023. At the end of the 2022 fiscal year, the firm had over 6 million euros of cash on its balance sheet. It also had over 2.5 million euros available in an overdraft facility provided by the firm's primary banking partner. In the original announcement, management also guided for growing revenue and earnings if the transaction went through as expected (Nurminen Logistics, 2024b). The firm could have undoubtedly completed the acquisition without the help of partners.

4.5 Honkarakenne

Background

Honkarakenne is a Finnish log house builder. The firm sells various house packages and related services, such as planning and construction, under its "Honka" brand (Honkarakenne, 2024). The firm's backbone is its innovation of the "non-sag log." This innovation transformed log building by enabling tighter seams between logs, improving the energy efficiency of log houses (Honkarakenne, 2023b). Logs became a relevant construction material option due to this innovation.

The firm's story began in the late 1950s as a sawmill factory. The second generation of entrepreneurs saw an opportunity in commercial log house manufacturing, and the firm has been on that path ever since. Exporting has been an important part of the firm's growth and continuance. Approximately 30 % of its sales have come from abroad in recent years. At the end of 2023, Honkarakenne employed 169 people with a revenue base of 46.3 million euros (Honkarakenne, 2024).

Management & Ownership

Honkarakenne is a family-owned business, which is reflected in the firm's management and ownership. The firm was managed by the CEO, Marko Saarelainen, throughout the research period. However, the rest of the executive team experienced turnover during the same period. At the start of the research period, the executive team consisted of the CEO, CFO, CPO, and Finland's country manager (Honkarakenne, 2019). By 2023, the executive team included two new roles: chief product officer and export director (Honkarakenne, 2024). Excluding the CEO, a different person occupied each role at the end of the period compared to the start.

Ownership of the firm was stable throughout the research period. The majority shareholders are members of the founding family, local private investors, and a few institutional investors. It should be noted that the firm has a dual-class share structure, which is used to retain control in the founding family. Literature suggests that dual-class

share structures could lead to lower stock returns and other issues, such as management entrenchment (Govindarajan et al., 2018).

Organizational Structure

Similarly to other case companies, there have been minimal changes in the firm's organizational structure during the research period. The main development was the firm's decision to halt sales to Russia in 2022. In 2023, there was no revenue from Russia for the first time in 25 years. As a whole, the organization grew from approximately 140 employees to 170 employees from 2018 to 2023. The share of employees working in manufacturing compared to sales and administrative roles remained at approximately four-to-one throughout the period (Honkarakenne, 2023a).

Market Position

Honkarakenne operates within the log construction industry. In 2022, the market size was approximately 350 million euros (Arola, 2023). Exports accounted for 50 million euros of the total market. With its 18.9 million euros of export revenue, Honkarakenne had a nearly 40 % share of export volume. However, it had less than 20 % of the local log construction market, the firm's main revenue source (Arola, 2023). Furthermore, Honkarakenne also competes against other types of prefabricated house manufacturers, not just those that utilize logs as the main building material. Significant players include firms such as Kastelli and Finnlamelli (Suomi rakentaa, 2023). On a larger scale, manufacturers of prefabricated houses also compete against traditional construction companies. Overall, it is a highly competitive market with structurally low profitability. The average EBIT margin in 2022 for manufacturers of prefabricated houses was 1.8 %. Honkarakenne is one of the more profitable firms in the industry. It has achieved this position by building a reputable brand and continuously improving its operational processes. Nonetheless, material and personnel costs typically account for over 80 % of Honkarakenne's revenue.

STRATEGY & FINANCIAL TARGETS

Honkarakenne had two sets of financial targets during the research period. During the 2018 fiscal year, management outlined a new strategy and financial targets for 2018 to 2021. Unlike all other case companies, Honkarakenne does not provide numerical financial targets. Instead, management offers descriptive targets that they strive for. The primary objective for the firm was profitable growth in key markets (Honkarakenne, 2019). Secondary objectives included maintaining a healthy balance sheet and increasing the absolute value of export volume. Overall, the strategy emphasized taking the firm to a new level. Management highlighted brand image and the firm's broad set of products and capabilities as the primary strategy levers (Honkarakenne, 2018). At this point, Russia was still an important market for the firm. This is evident because management reported it as a standalone business segment. In 2018, 16 % of revenue came from Russia, down six percentage points from the previous year (Honkarakenne, 2019).

Metric	**Target**
Revenue	Profitable growth
Service Revenue	Growing
Exports	Growing in absolute value
Equity Ratio	Stable and strong

Table 10: Honkarakenne’s financial targets for the 2018-2021 period

Honkarakenne did not make changes to these targets during the predetermined strategy period from 2018 to 2021. In late 2021, management published new targets and a revised strategy for the 2022 to 2024 period. The new strategy introduced only minor changes. Growth is still mentioned as a key objective. However, in the future, management saw growth coming primarily from increased export volume. Additionally, it emphasized that profitability would not be sacrificed for growth (Honkarakenne, 2021).

Metric	Target
Exports	Growing
Profitability	Higher than previously

Table 11: Honkarakenne's financial targets for the 2022-2024 strategy period

Financial Performance & Capital Allocation

As a whole, Honkarakenne had stable financial results throughout the period. Its annual revenue was 56.5 million euros, over 30 % higher than in the preceding five-year period. The firm also completed an impressive profitability turnaround during the research period. Between 2013 and 2017, the firm was profitable during only one fiscal year. During the 2018 to 2023 period, the opposite was true, as the firm lost money only in the final year. The average EBIT margin stood at 4.5 % while the return on equity was around 15 %. Honkarakenne's cash conversion metrics are also impressive. It generated 11.3 million euros in free cash flow during the research period. This figure represents over 70 % of cumulative EBIT. It should also be noted that the firm experienced elevated capital expenditure during the period due to the renewal of its production line. This investment accounted for over 60 % of its 11 million euros of capital expenditure. Normalized capital expenditure is less than 2 % of annual revenue.

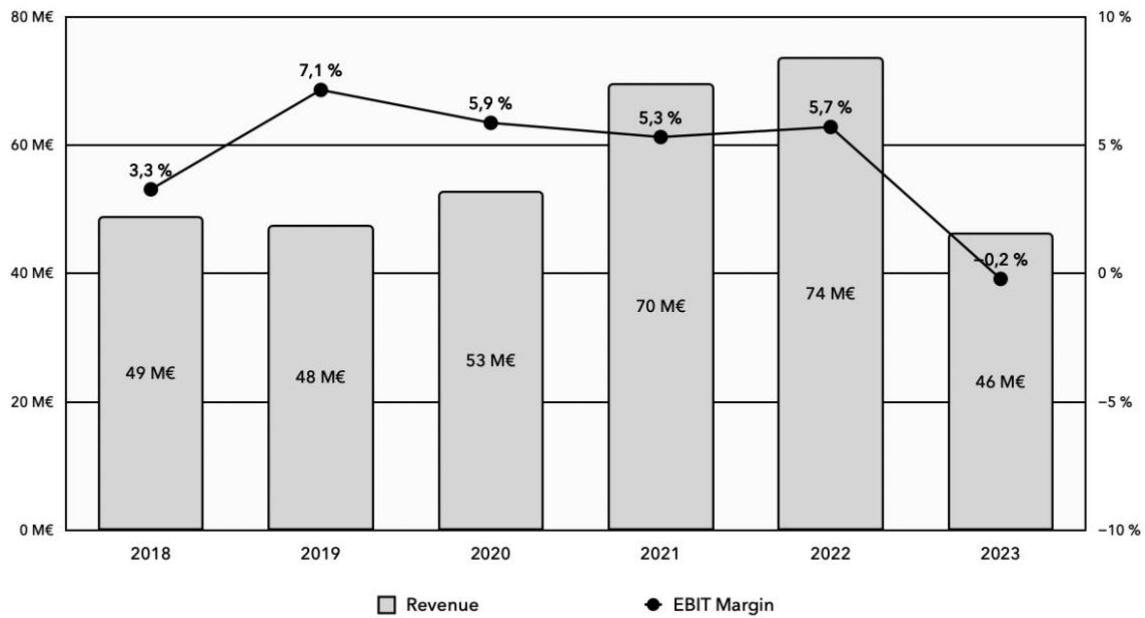

Figure 12: Revenue and EBIT margin figures for Honkarakenne

One of the main objectives for Honkarakenne during the research period was to grow its export volume. The firm failed to reach this goal. Export volumes stayed mostly flat from 2018 to 2020. In 2021, exports increased by 60 % year-over-year (Honkarakenne, 2021). However, this change reversed in 2022 as the Russian invasion of Ukraine began. In 2023, export volumes were nearly 20 % lower than in 2018. Adjusting for the missing revenue from Russia, the firm has been able to increase export volume to other markets. The question is whether demand can be sourced elsewhere. Product quality, brand reputation, and trends such as sustainable living support the firm’s international growth ambitions.

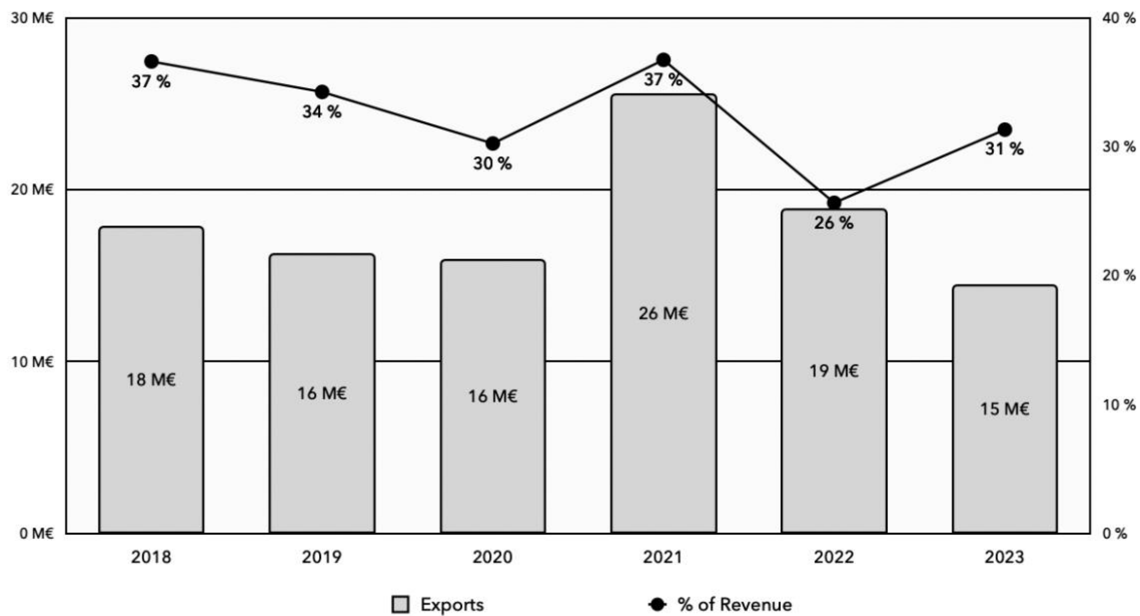

Figure 13: Export volumes and their share of revenue for Honkarakenne

A significant development in the firm's capital allocation policy occurred in 2020 when it restarted shareholder distributions. The firm continued to return capital for the rest of the research period. While some payouts were structured as capital distributions instead of dividends, in practice, they are indistinguishable apart from their treatment in accounting. Cumulatively, shareholder distributions equaled 4.7 million euros during the period. The firm also reduced its interest-bearing debt by approximately 2.8 million euros. At the end of the period, it held less than 1 million euros of interest-bearing debt on its balance sheet. On average, Honkarakenne finished each fiscal year with four times as much cash reserves as interest-bearing debt. Overall, the firm’s capital allocation reflects the cyclicality of its business. Management chooses to remain cautious during periods characterized by favorable market conditions and strong financial performance to survive through difficult periods. This is relatively uncommon in the modern business zeitgeist because firms typically maintain lean balance sheets to boost profitability ratios such as ROE and ROA.

DISCUSSION

Honkarakenne's management was consistent on their objectives for the firm and the strategy to achieve them during the research period. The firm aimed for profitable growth through increased export volumes. The market for prefabricated log houses in Finland is six times as large as the export markets combined (Arola, 2023). However, the local market conditions are significantly worse than in export markets. Honkarakenne is the most profitable firm in the sector with its 4.5 % EBIT margin in the 2018 to 2023 period. Although the local demand environment is stable, there is severe pressure on margins even for the most efficient manufacturers. Local buyers are more knowledgeable and price-sensitive because they have been desensitized to the novelty of log houses. Hence, manufacturers with strong brands and production capabilities aim to maximize export volumes to improve profitability.

In the case of Honkarakenne, an apparent mismatch exists between the intended strategy and capital allocation policy. After completing its long-awaited turnaround, the firm immediately reinitiated its dividend and deleveraged its balance sheet. This occurred concurrently with the firm's significant investment for the production line renewal project. The firm also did not have net debt during the period. However, in the process, Honkarakenne's sales and marketing expenditure has stalled. Annual spending was down 20 % on average in 2022 and 2023 compared to 2020 and 2021. The firm has also repatriated a significant portion of its non-current assets in recent fiscal years. Between 2020 and 2021, approximately 5 % of its non-current assets were held in foreign subsidiaries. This figure was down to 2 % on average in 2022 and 2023. In its strategy, management outlines that it will increase exports by "allocating resources to chosen markets" (Honkarakenne, 2024, p. 6). This intention is not visible in the firm's capital allocation policy, however.

4.6 CROSS-CASE ANALYSIS

Although the case companies are vastly unique, there are similarities in their target setting and capital allocation practices. The most striking similarity is the general attitude

toward dividend policy exhibited by management teams. As a consolidated group, the case companies distributed over 50 % of free cash flow to shareholders during the research period. This is despite each firm citing growth as a priority in their financial objectives. Notably, all case companies distributed at least one dividend. This includes Solteq that has clearly positioned itself as a growth company. Notably, Honkarakenne was the only company that did not include an explicit goal to distribute dividends despite choosing to do so in a number of years. This is interesting because from a financial standpoint, it is the most suitable candidate for regular dividend payments. Throughout the research period, the firm maintained a strong balance sheet with minimal debt. Furthermore, its capital expenditure requirements are moderate and predictable meanwhile free cash flow conversion is extremely strong. When it comes to the capacity to pay dividends, Solteq is on a completely different end of the spectrum compared to Honkarakenne. Nonetheless, the firm had a dividend target from 2016 to 2019. Although this target did not directly impact capital allocation during those fiscal years, it is likely that it had a retroactive influence on the decision to distribute a dividend in 2021.

Wulff Group was the only case company that engaged in share repurchases during the during period. And even in their case, the repurchase program was insignificant, representing less than 10 % of dividends paid out during the same period. It also failed to offset dilution resulting from stock-based compensation. All in all, buybacks were disregarded as a form of capital allocation despite there being ample opportunities for them. It is difficult to pinpoint the origin of the hesitance toward share repurchases. More than likely, it is a combination of investment and management culture that is unique to Finland. This cultural idiosyncrasy is also reflected in the way firms set financial targets. None of the case companies mentioned EPS growth in their financial targets. Instead, nearly every set of objectives included a target for revenue and EBIT margin. Solvency metrics such as equity ratio or net debt-to-EBITDA were also commonly used. Using cash reserves to retire shares does not positively impact the metrics above. Hence, it follows that management teams may be incentivized to optimize for chosen metrics instead of making the best decision under the circumstances.

Each company has a different opportunity set available to them. Therefore, it is not a surprise that the targets they set range widely. However, there are certain overarching themes that are evident in the way firms approach goal setting and strategy execution. First and foremost, firms rarely adopt a long-term perspective when setting financial objectives. Instead, they will typically operate in three-year strategy cycles. If nothing groundbreaking has occurred within the strategy period, management will publish new targets based on the latest market outlook and firm-specific factors. However, if there are major personnel changes or other significant events such as a large acquisition, objectives are often revised right away. As for the content of financial objectives, firms are often highly specific. Instead of providing a possible range, firms will instead give a specific number that they want to reach. It can be useful for firms to provide quantifiable objectives for financial performance indicators as this gives their stakeholders something to measure execution against. However, it may also have an anchoring effect on both management and shareholders that consecutively leads to short-term thinking and actions. Among the group of case companies, Wulff and Solteq fell victim to this pitfall especially.

Another common theme is the lack of continuity when it comes to setting financial objectives. Not only do firms regularly revise target values but also the benchmarks that management use to measure performance against. There is nothing inherently wrong with switching benchmarks when the situation warrants it. For instance, if a firm is entering a growth phase, it may not be helpful to preserve a profitability benchmark in the set of financial targets. However, more often than not, benchmarks are switched or removed altogether due to unfavorable development. This was most evident in the case of Wulff. At the start of the research period, the firm was aiming for EBIT margins above 4 % while distributing at least half of its earnings to shareholders. When these targets remained out of reach, management intervened abruptly. The dividend target was omitted while the target for EBIT was changed to ‘growing’.

5 CONCLUSION

5.1 Key Findings

The study sought out to explore how conducive capital allocation policy is in relation to the firm's intended strategy and explicit financial objectives. The core finding of the study is that chosen target metrics can be a helpful proxy for management focus. Financial objectives are the culmination of corporate intent and culture. Management teams will go to great lengths to deliver on this intent. This was unmistakably evident in the case of Wulff Group. The firm had reached a strong market position while boasting industry-leading profitability. However, management had set out to grow revenue at a faster rate than the overall market. Winning market share organically without margin degradation when primary competitors are loss-making is difficult. Therefore, the firm switched to an acquisitive strategy. The marquee acquisition of its large competitor in 2021 was financed primarily by bank loans. Despite catapulting the firm to an elevated revenue base, the acquisition has not been accretive as the firm has not captured the expected synergy benefits. Management has subsequently turned their focus to chasing growth from non-core verticals.

There is a tendency for management to approach strategic and financial objectives as a collection of wishes rather than as a coherent and consistent set of targets. It is clear that targets should be reviewed and revised when an organization goes through significant changes. However, there should be a clear intention whenever setting and changing objectives. Solteq provided the most glaring example of a contradictory target setting. In 2016, the firm introduced its new long-term objectives. The firm wanted to grow its revenue by over 20 % annually, with EBIT margins remaining above 8 %. Additionally, management aimed to reach a net debt-to-EBITDA ratio of less than 3.5 while distributing approximately 30 % of annual net profits to shareholders as dividends. Taken together, these targets are completely unattainable even in a dream scenario. This would be the case even if the growth target could be reached organically. However, this is not the case, as management declared that most of the growth would be driven by acquisitions. Moreover, these targets were given at a time when the firm was ramping

up its research and development expenditure. In summary, management wanted to complete growth acquisitions, pay down debt aggressively, and increase R&D spending all while distributing nearly a third of after-tax profits to shareholders. It should be noted that the firm's net debt-to-EBITDA ratio was 8 at the start of 2016. It is not surprising that none of these targets were reached by the end of 2019, when the firm introduced a new strategy, financial targets, and a revised organizational structure. During the 2016 to 2019 period, net debt nearly doubled while no dividends were distributed. Management omitted targets related to solvency and capital distribution from the subsequent revision. The takeaway is that doing something on all fronts simultaneously is unrealistic. If management sees the firm growing revenue at over 20 % annually through acquisitions while maintaining strong EBIT margins, what is the point of returning capital to shareholders, especially when the firm is already highly leveraged? Goals drive actions, and actions drive results. Selecting ill-advised objectives can have a profound impact on the firm's capital allocation policy and financial performance.

5.2 Theoretical Implications

The present study is concerned with two theories: the principal-agent theory and the hubris hypothesis. These theories are closely related to each other. However, the hubris hypothesis can be true also when there are no apparent agency conflicts present. This scenario could occur, for instance, when the CEO of a firm is also the majority owner. Nonetheless, the present study finds support for both theories. Roll (1986) posits that significant opportunities for M&A transactions are difficult to come by. Executives may find it difficult to pass on an opportunity even if contains several red flags. This was the case at Solteq where management kept on making acquisitions despite the firm's deteriorating financial health. Executive compensation is derivative of firm size and financial performance. Therefore, it is rational that management would be in favor of an aspirational capital allocation policy. The potential upside significantly outweighs the downside. Similarly to other domains, such as professional sports, there is a limited number of experienced managers. Hence, an executive is likely to find a replacement job

if an aggressive approach to capital allocation results in inadequate performance, culminating in the termination of employment.

According to research by Liu and Chen (2015), initiating or increasing dividends does not serve as a useful predictor of upcoming financial results. The present study finds support for this claim. For instance, Nurminen Logistics' profit margin for the 2021 fiscal year was nearly 10 %. The firm decided to initiate a dividend only to see their profit margin collapse to 1,2 %. In the case of Solteq, the firm reported strong results in 2020 and 2021. After distributing a dividend in 2021, the firm's cumulative losses in the following years were bigger than the profits of those record-breaking years.

Laamanen and Keil (2008) finds that firms rarely make unrelated acquisitions. This is true for the case companies as well. A systematic approach to acquisitions was exhibited especially by Solteq and Wulff. Each acquisition made by the firms were done according to their respective growth strategies. For instance, Solteq made acquisitions abroad to increase its international presence. It also acquired companies in sectors such as energy that management had identified as attractive. Wulff on the other hand made several systematic acquisitions to enter the accounting services vertical. Laamanen and Keil (2008) also argue that systematic acquirers perform better than their opportunistic peers. The present study finds no evidence for this claim. Although the verdict is still out, Nurminen Logistics, an opportunistic acquirer, seems to have gotten the better of the systematic acquirers in this cohort. Developing a capability to acquire and integrate firms is not useful on its own. The underlying strategy also has to be sound and suitable for the firm's financial reality. For instance, Solteq's acquisition playbook may have been well honed, but the financials did not support it.

Discussions of the agency theory typically focus on the difficulties principals face when trying to align their interests with their agents. However, the present study suggests that the reverse can be equally valid. A controlling shareholder can impede management's ability to achieve the intended objectives. For instance, in the case of Wulff Group,

management is simultaneously expected to reach ambitious growth targets while increasing the dividend each year and upholding profitability. This is incredibly challenging to do when the core business operates on very slim margins, as is the case with Wulff. Therefore, if shareholders insist on a growing dividend, management will find it challenging to satisfy other financial objectives when the operating environment deteriorates. The implication is that agency conflicts on both sides must be addressed to create an environment where all parties can succeed.

5.3 Managerial Implications

The findings of the present study offer valuable implications for managers. The primary lesson for practitioners is to consider the long-term impact of the contents of investor communication material, such as strategy and financial target announcements. This material plays a vital role in shaping the perspectives of various stakeholders. Consider the case of Solteq. In 2016, the firm intended to distribute dividends relative to financial performance during a given fiscal year. This intention did not materialize during the strategy period. However, in 2020, the firm reported strong results due to significant tailwinds from the operating environment. It also received a large one-time payment related to a divestment during the year. Management used these factors as justification to retrospectively fulfill the capital distribution intention. This dividend payment was highly untimely as the firm faced significant challenges in the following years and would have had a dire need for the previously distributed capital. It follows that managers must exercise caution and diligence when choosing which metrics to track and objectives to pursue. There must be a clear path to achieving the objectives based on market research and strategy initiatives. Creating a list of wishful goals to make everyone happy is insufficient.

Another important implication for managers is how one should approach hitting or missing a target. There is a tendency to get ahead of oneself once targets are reached. Wulff Group had set a goal of growing revenue by 5 to 10 % annually in late 2019. After reporting a nearly 60 % increase in revenue in 2021 due to a large acquisition,

management revised its growth target to 15-20 % per annum. In the following two years, the firm saw its nominal revenue grow by less than 2 % per annum on a cumulative basis. The combined revenues of Wulff and Staples exceeded 100 million euros in both 2019 and 2020 before the firms merged. In 2023, the group reported a total turnover of 93.8 million euros. With its core market shrinking and the expansion into accounting services proving slower than expected, management effectively backed itself into a corner. To reach the goal of 200 million euros in revenue by 2026, the annual growth rate would have to be nearly 30 %. The firm is now expanding to yet another vertical to promote revenue growth. This time it is doing it organically, presumably due to the lack of available capital for M&A. It is important to remain realistic even when everything goes according to plan.

5.4 LIMITATIONS OF THE STUDY

The present study's limitations arise primarily from two constraints. First and foremost, the thesis is based on a narrow set of business subjects. When dealing with only a handful of cases, there will always be a lot of variance in characteristics such as business quality and management competence. The sampling process reinforced this constraint. The study focuses on Finnish public companies that fall under the category of small caps. By definition, these firms will often aim for rapid growth. Therefore, there is more likely to be similarities between the case firms’ financial objectives and capital allocation.

The data collection process in the present study did not include first-hand accounts from case company representatives. Therefore, conclusions drawn from corporate behavior may need more nuance and context. However, this is partly mitigated by all case companies being public. There is an expectation that all necessary disclosures are included in public filings. Nonetheless, this is a limitation that can be addressed in future research.

5.5 SUGGESTIONS FOR FUTURE RESEARCH

The present study uses market capitalization as a differentiating characteristic to explore the phenomenon. In the future, it would be interesting if researchers examined financial goal setting in firms with a particular profile. For instance, a study could focus on how companies in the middle of a turnaround utilize investor communications and capital allocation. Similar research could be done on growth and dividend firms or cyclical and non-cyclical firms. Additionally, longitudinal studies need to be conducted as the present study is focused on a relatively short time period that also included a rare event in the form of a global pandemic. Another possible direction for future research could be to compare and contrast long-term shareholder returns based on chosen financial target metrics. The present study showed that there are risks associated with picking misguided metrics. For instance, optimizing for revenue growth may lead to unfavorable acquisitions. Similarly, optimizing for specific financial performance indicators such as EBIT or EBITDA can also have unwanted consequences.

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