Helping build more resilient businesses

CIMA bite-sized briefing:
Proposal

The Chartered Institute of Management Accountants® (CIMA®) urges the UK Government to:

► Ensure businesses can better weather economic shocks by creating an Allowance for Corporate Equity.
► Incentivise equity rather than debt-based finance without introducing complicated and detrimental changes to the tax treatment of debt.
► Encourage businesses to have more reserves to better cope with economic shocks.

About CIMA

The Chartered Institute of Management Accountants (CIMA), founded in 1919, is the world’s leading and largest professional body of management accountants, with members and students operating in 179 countries, working at the heart of business. CIMA members and students work in industry, commerce, the public sector and not-for profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure it remains the employers’ choice when recruiting financially trained business leaders. Chartered Global Management Accountant® (CGMA®) is the most widely held management accounting designation in the world. It distinguishes more than 137,000 accounting and finance professionals who have advanced proficiency in finance, operations, strategy and management.

CIMA is a founding member of the Association of International Certified Professional Accountants® (the Association), which combines the strengths of the American Institute of CPAs® (AICPA®) and CIMA to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents more than 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. In the UK alone, CIMA has more than 80,000 members working across all sectors. With broad reach, rigour and resources, the Association advances the reputation, employability and quality of CPAs, CIMA and CGMA designation holders and accounting and finance professionals globally.

One of the core missions of the organisation is to develop research and analytical thinking of the challenges faced by our management accounting professionals and also the wider and global finance sector.

Contact

For further information about CIMA and its submission, please contact Ross Archer, Lead Manager — Public Policy at ross.archer@aicpa-cima.com.
The issue – overview

In CIMA’s Budgeting for Recovery report, CIMA recommended the creation of an Allowance for Corporate Equity as a way of encouraging equity-based growth rather than debt-based development without complicated and detrimental changes to the way the tax system treats debt. Encouraging UK SMEs to be funded through equity rather than debt helps build a stronger economy that is more stable.

Promoting equity-based finance to build stronger SMEs:

Currently, UK businesses are reliant on debt.¹ Research that American Express commissioned in 2019 showed that a third of UK SMEs are finding it difficult to access the finance they need.² Unsustainable UK Corporate debt could reach £100 billion in the 1st quarter of 2021, over half of this is lending to SMEs according to the City UK.³ The British Business Bank SME Finance Survey 2019 found that ‘just over a third thought that it would be a lot or a little more difficult to access debt and equity finance, whilst only 3% thought it would be a lot or a little easier’.⁴

The levelling-up agenda needs to address the need for equity finance. BEIS research on ‘Equity finance and the UK Regions’ on the regional variations in the demand for equity finance found that it was concentrated in London, the South-East and East of England regions. They accounted for 67% of all equity deals and 75% of all invested funds in the UK.⁵ They estimate the equity gap is between £6.5 billion and £12 billion and they rank the regions with the highest potential additional demand for equity finance in order as Yorkshire and Humberside, followed by East Midlands, West Midlands, Northern Ireland, South West, North West, Wales, Scotland, South East, East of England, London and North East.⁶ The Federation of Small Businesses states that ‘equity finance for small businesses is still pretty limited and a lot of the finance available, especially in the north of England, is dependent on EU funds. So, something will need to be done about that position quite quickly’.⁷ Encouraging equity finance should be part of efforts to increase SME business

---

¹ Economic outlook improving, but data shows huge SME debt challenge remains | EY UK
² UK SMEs are turning to new sources of finance as they struggle to access funds | bmmagazine.co.uk
³ TheCityUK Predicts £100B Unsustainable Corporate Debt by Q1 2021 | £72B £28B Under Govt Schemes; Calls for Govt Seed Funding for Newly-Created UK Recovery Corporation - Reorg
⁴ BBB Small Business Finance report 2019 | british-business-bank.co.uk
⁵ Equity Finance and the UK Regions | publishing.service.gov.uk
⁶ Equity Finance and the UK Regions | publishing.service.gov.uk
⁷ Stable financial backing for SMEs is crucial | SMEforGrowth.co.uk
Proposals

In the long-term, ensure businesses have more reserves to weather economic shocks

Most big businesses have around six months of reserves to help weather crises and difficulties. But for SMEs, their reserves could be as little as a week or two of cash. In the long term, following this crisis, we would urge all businesses to start building their reserves again to help protect against future disruptions, whether related to this virus or not. The government should also consider what good corporate behaviour for large and small businesses looks like in relation to reserves. This may be an area they wish to review after this crisis and once the economy is on a better footing and growing again.

A British Chambers of Commerce study showed that most UK firms have no more than three months’ cash in reserves.8 The British Chambers of Commerce research also showed that only 6% of UK businesses have enough cash to cover the next 12 months.9 Incentivising companies to increase business reserves is an important long-term objective. We understand this may be difficult at this time while businesses are already struggling to survive. However, the possibility of future virus outbreaks and any economic decline means increasing company equity, including business reserves, will help strengthen companies to withstand any future shocks. The government should consider the long-term incentives to increase company equity within the tax system.

Create an allowance for corporate equity.

An allowance for new shareholder equity could be considered as a means of achieving this. For example, in Italy, this has worked through multiplying net equity increases since a certain date (the start date of the scheme) by a notional rate of interest.10 The allowance is then deducted from a company’s net taxable income or carried forward. Equity increases that qualify for the allowance include cash contributions, undistributed profits and waivers of amounts the company owes to its shareholders. The equity increases must be net of any decreases and there are anti-avoidance measures in place. This will help encourage the growth of corporate equity without penalising companies that use debt.11 12

For more information about these proposals and CIMA’s other policy suggestions for economic recovery and paying back the costs of the pandemic, please read our report

Budgeting for Recovery and a Long-Term Economic Future for the UK.