OXFORD INNOVATION ADVICE

Oxford Innovation Advice Insight Report

Breaking Barriers:

Unlocking Financial Access for SMEs

Written by Andrew Finley

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This report explores fresh insights and practical strategies to help SMEs secure external finance- empowering growth, innovation, and long-term success.

Foreword

Access to finance has long been recognised as one of the most significant barriers facing the UK's small and medium-sized enterprises (SMEs)—a sector that makes up 99.9% of all UK businesses, supports the majority of jobs, and generates over half of the nation's annual business turnover.

In recent years, the financial landscape has undergone rapid change. The rise of alternative lenders has disrupted the dominance of traditional banks, reshaping how and where SMEs seek funding. At the same time, global economic shocks—from international conflicts to soaring energy and raw material costs—have added new layers of complexity to the financing challenge.

This report explores fresh perspectives on how SMEs can be better supported in navigating this evolving landscape. By understanding the barriers and identifying innovative solutions, we aim to help unlock the full potential of the UK's vital SME sector.

Why Oxford Innovation Advice

Oxford Innovation was established nearly 40 years ago with a mission to enable entrepreneurs and innovators build successful businesses. Our passion lies in revitalising communities, fostering innovation and empowering businesses and entrepreneurs to build a better future.

During the last 15 years, Oxford Innovation Advice has supported more than 34,000 SMEs to innovate, raise finance, adopt digital technologies and grow. Proving specialist support to SMEs in all aspects of financial management and finance raises, from debt to specialist mortgages and equity, has been a cornerstone of our activity. Since 2017, we have supported 800 SMEs to raise £227m of finance to invest in accelerating their business growth.

Contents

Executive Summary

The ability of an SME to secure finance is essential to their ability to start and grow. The Government's "Backing Your Business" strategy[1] dedicates a chapter to unlocking access to finance which includes some useful initiatives, mainly based upon improving supply of funding and removing the requirements for personal guarantees. Whilst these efforts are welcome, they do not address the issue of lack of financial management skills amongst SMEs or offer any support to make it easier for them to navigate increasing complexity of finance options.

In this report we discuss options for improving demand for finance to ensure that SMEs can benefit from the increased supply of finance. These are based on our experience of supporting >800 SMEs across England in the last 8 years to seek and secure external finance.

Key conclusions taken from this insight report:

- Supply of traditional finance is not the primary problem- the lack of fundamental financial management skills is a significant issue for SMEs.
- The market for finance is expanding, and SMEs are not equipped to navigate the complexity of the choices on offer.
- An SME's primary bank is often the first, and only source they explore – rejection usually causes them to abandon plans.
- There is a consistent failure point for equity seeking Start-ups when founder capital is exhausted, but traction is not sufficiently progressed to attract angels

Our recommendations:

1. A2F projects should include practical support to SMEs to strengthen their financial management skills rather than focusing just on securing funds
2. Engagements should include a comprehensive appraisal of needs and objectives to ensure that chosen sources of finance are appropriate to each business
3. Create pre-seed investment funds to address gaps in market provision

[1] Backing your business: our plan for small and medium-sized businesses - GOV.UK

An increasingly challenging landscape for SME finance

Small and medium-sized enterprises (SMEs) continue to face tough conditions when it comes to securing finance. A range of factors are contributing to this:

- **Reduced appetite from traditional banks:** Major banks are increasingly cautious about lending to SMEs, largely due to concerns about risk. The approval rate has fallen from 80% in 2018 to around 50% last year. Research confirms that rejection usually leads to businesses abandoning their investment plans.
- **Rise of alternative finance:** Challenger and specialist banks now hold 60% market share and are reshaping the market, offering more options but also adding complexity to the choices available.
- **Knowledge and confidence gaps:** Many SMEs lack awareness or understanding of the financing options available. 69% of intermediaries report that low confidence and limited knowledge are major barriers to accessing finance.
- **Over-reliance on primary banks:** 50% of SMEs only approach their main bank when seeking finance and just 5% would consider shopping around. Consequently, SMEs are missing out on more suitable and/or competitive alternatives.
- **Hidden sources of funding:** Over the past five years, there has been a growing, though under reported, reliance on personal savings and informal support from friends and family for SME finance.

Together, these trends highlight both the shifting nature of the SME finance market and the need for better support and guidance to enable access to this wider range of funding solutions

Ensuring SMEs secure appropriate finance

There are four key areas that are critical to addressing the challenges associated with improving access to finance for SMEs:

- Improved financial literacy
- More robust financial records and forecasts
- Reduced transaction costs
- Increased access to equity funding

The next section discusses each issue and potential solutions.

Financial Literacy and Management Skills

A study by the Federation of Small Businesses (FSB) estimated that over 50% of SME's do not produce monthly management accounts. In general, estimates from various sources suggest that around 40% to 60% of UK businesses, particularly smaller ones, do not regularly produce monthly management accounts. It is clear from our experience that most clients do not possess the skills or resources to do so. This significantly hampers their ability to raise finance as lenders do not consider them to be a viable risk, leaving them with possibly highly costly "payday loans" type providers as their only option.

Hand in hand with this is the lack of any form of cashflow management beyond an occasional look at their current bank balance. Research by the Association of Chartered Accountants (ACCA) revealed that 50% of small businesses were found to have poor cash flow management skills. The weakness that is inherent in this scenario leads not only to poor credit risk profiles but also heightened vulnerability and lack of resilience.

It is clear from our client engagements that a majority of clients do not possess the skills or resources to do so.

The provision of interactive, intensive skills development in basic financial management practices delivers benefits in terms of enhanced options for funding but also a greater understanding of margins, pricing and cashflow, with commensurate improvements in competitiveness and profitability.

Inadequate financial records or forecasts

The provision of credible financial forecasts, with predictions based upon historical performance is a critical element in securing competitively priced funding.

In the arena of equity financial forecasts are a fundamental requirement, without which investors are highly unlikely to progress any interest, regardless of the perceived attractiveness of the proposition. Again, independent research from Intuit QuickBooks found that c60% of SME management were lacking in this area. With increasing states of market volatility, these skills are essential for businesses as part of the day-to-day running of their business as well as for funding applications.

This is in part due to a lack of financial technical staff employed by SMEs. According to the British Business Bank (BBB) Small Business Finance Markets report, it is estimated that only 20 to 30% of SMEs have a dedicated finance manager or accountant on their staff. This is heavily weighted to the larger enterprises under the SME umbrella, so it is safe to assume that most SMEs do not employ a finance professional.

To address this gap, most SMEs engage external accountants; however, their role is often limited to preparing historical financial statements, typically at year-end. In our experience, this is frequently the only point at which many businesses gain clarity on their profit or loss. This limited financial visibility often extends to a poor understanding of product margins, contributing to suboptimal profitability.

A UK government study on SME finance indicated that businesses that received financial management training were more resilient during economic downturns, had a 40% lower likelihood of facing severe financial distress and were more likely to expand their operations and hire additional staff.

As part of Oxford Innovation Advice's Access to Finance programmes, we deliver a two-day financial forecasting workshop which incorporates a simple to use template that gives business owners, with no financial planning skills, the opportunity to create a 2-year forecast with associated cashflows. With modules covering each line of a profit and loss account including margins, pricing and stock levels, the experience leaves them more confident around financial terminology and accounting processes, with the skills and tools to produce their own financial forecasts unaided.

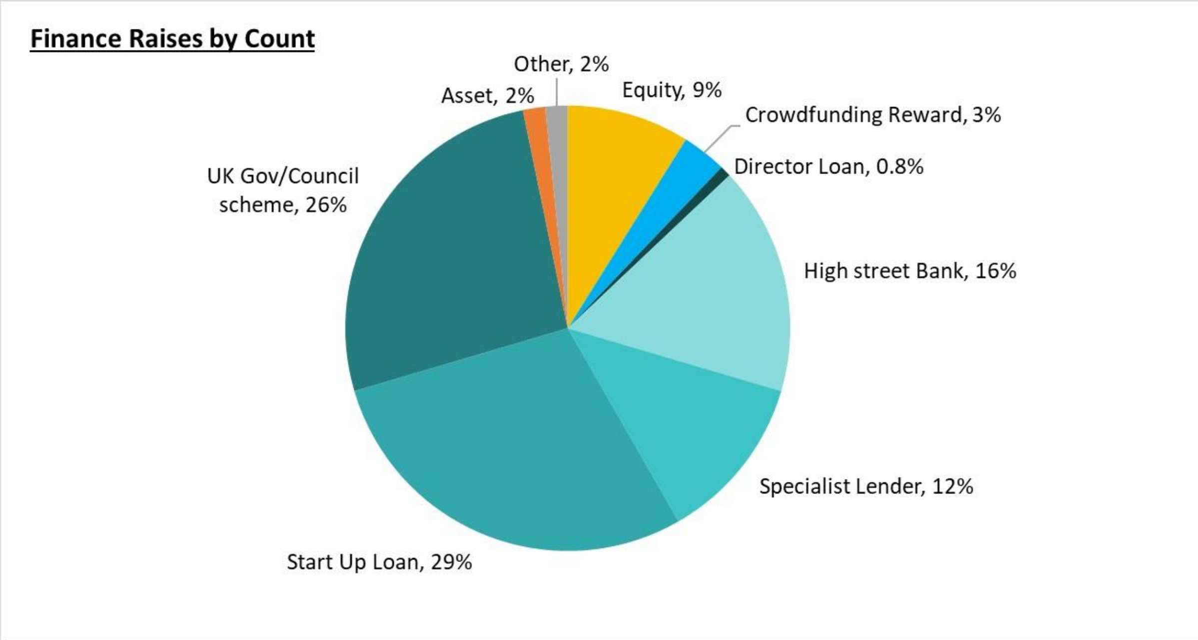
High transaction costs

A consequence of low levels of expertise in financial management is that SMEs find it harder to secure funding, often due to the poorly presented business case that accompanies funding applications

The recent Business Finance Market report by the British Business Bank shows that 51% of smaller businesses only approach their main bank when seeking finance. The appetite of the major banks for what is perceived as high risk debt fluctuates and, currently, is showing a trend towards reducing value and volumes, with 'Challenger Banks now holding a record 59% market share in lending.

The graph below shows how the impact of high-quality support brings about more diverse sourcing of finance with only 16% of finance raises provided by high street banks. Startup loans, specialist lenders and government/local authority backed schemes, when considered in context of need, proved more popular with SMEs.

Figure 1: source of finance raises – OI Advice Access to Finance programmes, 2017-2023.



As an example of the extent of the growing number of alternative providers, during the last 8 years, Oxford Innovation Advice supported 1360 successful applications, securing over £227m from a portfolio of >120 different funders.

As the market for alternative lenders continues to expand, informed understanding of the services provided by this growing number of providers is essential.

Failure to do so, can result in inappropriate finance arrangements with penal interest charges and associated conditions, as businesses turn to the apparently "easy" option. Often, those lenders will assess applications lacking robust projections as high risk, and so, levy higher interest charges.

There is a market failure here in that, according to UK Finance, only approximately 20% of SMEs utilise brokers when accessing finance. For commercial reasons, the broker networks do not adequately address the high volume, but comparatively low value (<£50k) end of the market represented by the micro (<10 employees) and start-ups so, FCA authorised, independent advice is required if businesses are to secure the right finance from the right lender on the right terms.

Access to early-stage risk capital

Innovative start-ups need early-stage risk capital that finances the often-precarious period when they mature to the point of unlocking inherent potential. Their lack of assets, trading history or robust revenue streams means that, once initial startup loans or founder investment is consumed, the primary source of finance (seed finance) is from the early-stage equity markets- typically angels or specialist venture capital funds. These businesses often fail when founders exhaust start-up funds before they reach the point of being a credible seed investment opportunity for those equity investors. With no other source of finance, potentially scalable businesses are left with no option other than closure.

There is a role for public sector intervention here through the provision of pre-seed funding that helps founders reach the point of being investable. Average investment values are comparatively low (<£50k) with the objective being to facilitate the achievement of key development milestones that will result in more robust investment propositions and, consequently, a better likelihood of success.

Follow on funds, provided as match to angel or other early-stage equity investment, ensures that these vital sources of potential significant economic impact are not lost. They also deliver long term sustainable impact in the form of evergreen funds through the recycling of exit dividends.

Hand in hand with the provision of pre-seed funds is the requirement for high quality equity accelerators, thus ensuring the best possible chance of success for those startups seeking to transition from the potential for growth, supported at initiation by founders' funds, to the successful application for seed capital equity investment. These accelerators are intensive programmes combining mentorship with the application of structured modules covering all the components an equity investor will seek assurance on if an investment is to be agreed.

Implications for policy makers

Recent policy has tended to concentrate on improving the supply of finance available to small businesses. Despite Government interventions, the knowledge and take-up of funding by SMEs has not changed significantly in recent years. In our opinion, supply is no longer the critical issue, it is SMEs' lack of understanding and capability in finance that makes it difficult for them to secure finance.

Just 23% of businesses nationwide saw their capability to access finance as 'strong' or 'above average' while only 14% of businesses had attempted to access finance in the last 12 months. 42% of those were unable to access finance or had done so with difficulty.

Evidence suggests that, rather than initiatives to increase supply, the focus should now be on improving demand for finance, i.e. supporting SMEs to select the most appropriate source of finance and present themselves as an attractive proposition to finance providers.

The supply of finance from both private funders and also Government-backed schemes such as those run by the British Business Bank, is good in most areas (early stage equity is the exception) but, without quality propositions many businesses will fail to raise funds. There is a need for SMEs to be provided with high quality skills development in finance when trying to attract investment in order to ensure medium- and longer-term funding needs are considered early in the business growth stage. Applying a strategic approach requires high quality, FCA certified, advisors and coaches, a focused business support policy, and enhanced provision and take-up of investor readiness support.

Summary

The challenge of SME's struggling to raise capital is often presented as a failure in the available market liquidity and lender appetite.

We consider this to be misconstrued.

Often the answer lies in building robust financial planning, forecast and management skills. We have examples where clients came to us believing they needed external finance to fund operational growth when, after thorough analysis, their needs were met just through better cashflow management, margin control and supplier agreements.

Clearly, this is not always the case and support is needed to help prepare businesses for funding applications, but it serves as a useful example of the theme of this paper which is specialist, high quality business support is the key to building sustainable financial management skills, with the associated benefits of developing more profitable and resilient businesses to support local economies.

Recommendations

Oxford Innovation Advice recommends the following for policy makers looking to support SME businesses with finance:

- Access to Finance is an integral requirement for growth and should be seen as an integral element within a holistic package of business support rather than exclusively, a standalone solution.
- Educating SMEs in the skills associated with financial management is essential. Simply injecting money risks deepening the liabilities for those businesses not able to satisfactorily control their cash.
- Address the lack of supply in high risk, early-stage growth capital, particularly in equity markets. This is a significant barrier to innovation and the development of a new generation of scalable businesses that will have beneficial impacts on both the local, and national, economy.

Oxford Innovation Advice

Oxford Innovation Advice empowers ambitious businesses to build a brighter future as the UKs leading provider of SME business support programmes and has been delivering coaching and advisory services for over 35 years. We facilitate economic prosperity for ambitious businesses by providing trusted and timely advice that enables them to thrive. We create and deliver business support programmes that nurture a culture of innovation to generate sustainable growth.

Delivering exemplary business support solutions in four key competencies; innovation, growth, finance and manufacturing.

Contact us today

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Oxford Centre for Innovation, Blue Boar Court, 9 Alfred Street, Oxford, OX1 1BY.

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