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# Scaling-Up Local Investing for Place-Based Impact

**Sector Profile: SME Finance**

FEBRUARY 2026

## Purpose of this Document

This document sets out a sector profile on small and medium-sized enterprise (SME) finance as an investment opportunity for the Local Government Pension Scheme (LGPS) as part of a local investing strategy. It provides an overview as to how SME finance can be treated as a strategic asset allocation within a local investing strategy that can deliver both commercial returns and positive local impacts. It provides supplementary sector-specific guidance following on from our 2025 White Paper [Scaling Up Local Investing for Place-Based Impact: A Strategic Framework and Guidance for LGPS](#).

This sector profile has been produced as part of a series, with further sector profiles due to be released in 2026, including on **housing** and **infrastructure**.

### Intended Audience

The primary intended audience for this sector profile is the LGPS sector, including:

- LGPS Pools who are responsible for designing and executing local investment strategies on behalf of their partner LGPS Administering Authorities and managing the pooled assets.
- LGPS Administering Authorities who are responsible for articulating their local investment preferences and monitoring performance.
- The fund managers, who can be appointed by LGPS Pools to manage investments on their behalf.

This sector profile is expected to be of interest to other institutional investors, including DC pension funds and insurance companies, as well as strategic and local authorities looking to increase their knowledge and understanding of SME finance as an investment opportunity from the dual lens of achieving financial returns and positive impact.

## Sponsors

We are grateful to the following organisations for sponsoring this report and contributing to its content:

- **NEL Fund Managers**
- **Palatine Private Equity**
- **Fasanara Capital**
- **UK Private Capital**  
(formerly the British Private Equity & Venture Capital Association).

We would also like to acknowledge the support and valuable contributions of **Foresight Group** and **Mercia Asset Management** on this topic as sponsors of the main White Paper.

## TGE co-Authors and Project Team

Sarah Forster, CEO and Co-Founder  
Sam Monger, Head of PBII and Strategic Advisory  
Sam Waples, Head of Data Analytics  
Ben Rosoman, Strategic Advisory Consultant  
Anita Bhatia, Senior Associate

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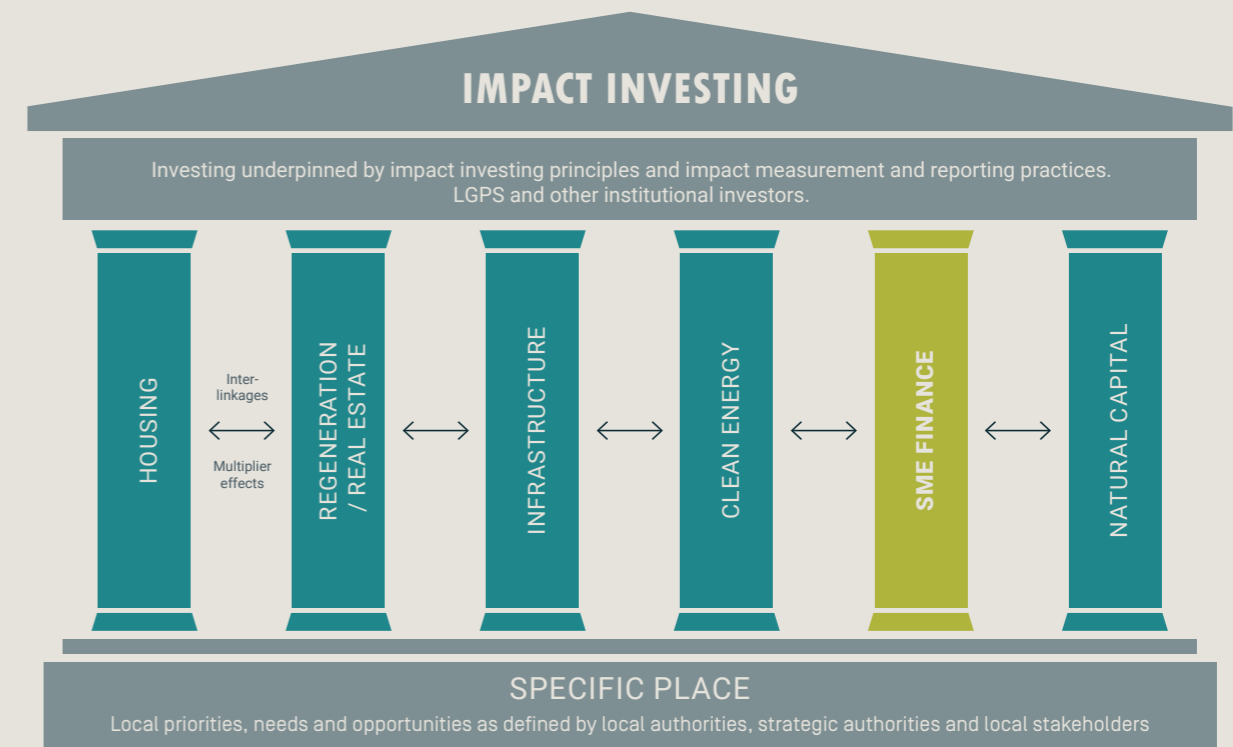
## The PBII Pillar Model

TGE first highlighted the financial and social case for scaling up institutional investment in the UK for the benefit of local people and places in our 2021 White Paper, [Scaling Up Institutional Investment for Place-Based Impact](#), produced in partnership with the Impact Investing Institute and Pensions for Purpose. Here, we introduced a Place-Based Impact Investing (PBII) Pillar Model (see Figure 1) which has proven a useful conceptual framework for the LGPS, private capital firms, fund managers, local government and other place-based organisations and stakeholders.

The pillars serve dual purposes:

- First, they represent policy and priority areas in local and regional development plans. The thinking behind the model is that investment needs and opportunities originate in places – they arise from local government and stakeholders who have the knowledge to understand the local context and relative priority of sustainable development needs, drivers and objectives in that area. PBII starts bottom-up.
- Secondly, they align with well-recognised sectors within economic development policy which also link to the private markets asset classes set out in the government's proposed template for Strategic Asset Allocation. Investors can invest in a range of asset classes to support their local and regional economies and contribute to place-based impact.

Figure 1: The PBII Pillar Model – The focus of this report is SME Finance



The arrows signify the inter-dependency of place-based projects and inter-linkages and multiplier effects of investments.  
©The Good Economy, 2021.

The PBII Pillar model provides a framework for understanding the different channels through which place-based investment can support local economic outcomes. Building on this framework, this Sector Profile focuses specifically on the SME Finance pillar, examining how investment in SMEs can support business growth, job creation, and regional development, and how institutional capital can engage with this pillar in practice.





## 2 / Sector Overview

SME finance comprises a range of financial products and services designed to support the operations, growth, and resilience of SMEs. These financial solutions include a range of debt options, such as overdrafts, invoice finance, loans, asset finance, and private credit, as well as equity funding including seed and growth equity, all designed to provide SMEs with access to the funding they need to develop and grow.

In the UK, SME finance is delivered through a diverse and evolving ecosystem that includes high-street banks, challenger and specialist banks, fintech lenders, community development finance institutions (CDFIs), government-backed schemes, venture capital, angel investors, and private credit and equity funds invested by specialist firms. While traditional banks continue to dominate in secured lending, non-bank and fintech lenders now account for a growing share of SME credit, offering faster, more flexible financing options to businesses that are often overlooked by traditional lenders. Private credit has historically been concentrated more towards larger corporates. This is now changing, with more venture debt and growth credit funds being launched to serve early-stage and lower mid-market SMEs. On the equity side of the market, financing for high-potential and growth-oriented businesses is primarily provided by private capital firms, including venture capital funds, and growth and lower mid-market equity funds, often alongside a variety of debt providers.

For LGPS investors, SME finance offers an opportunity to achieve attractive, risk-adjusted returns while contributing directly to local economic growth, job creation, and regional resilience. Some funds are also backed by the British Business Bank or devolved governments, ensuring alignment with both financial and place-based policy objectives. Given the structural gap in access to private credit and equity for lower mid-market SMEs, institutional capital, including the LGPS, could play an important role in addressing this funding gap in a way that aligns with emerging expectations to increase investment in productive UK companies, with meaningful local benefits.

**SMEs are a vital component of the UK economy, accounting for 99.9% of all businesses and more than 60% of private sector employment.<sup>1</sup> They contribute significantly to innovation, regional development, and economic inclusion. But despite their economic significance, they face persistent financing gaps.**

In 2024, the proportion of smaller businesses in the UK using external finance declined from 50% to 43%.<sup>2</sup> This decline was disproportionately felt in certain regions – while London

remained steady in the proportion of small businesses using external finance, the sharpest year-on-year declines were seen in Wales, the North East and the East Midlands.<sup>3</sup> This widening regional divergence underscores the importance of LGPS and institutional investors as patient capital providers to underserved geographies.

Investing in UK-based SMEs also represents a compelling place-based investment opportunity that can align directly with the UK Government's **Modern Industrial Strategy**. This strategy identifies eight priority sectors – including advanced manufacturing, clean energy, creative industries and life sciences – that are expected to drive the next wave of UK productivity and global competitiveness. Within each of these sectors, SMEs play a critical role as innovators, specialised suppliers, and high-growth potential firms that can deliver outsized economic value when supported with appropriate long-term capital.

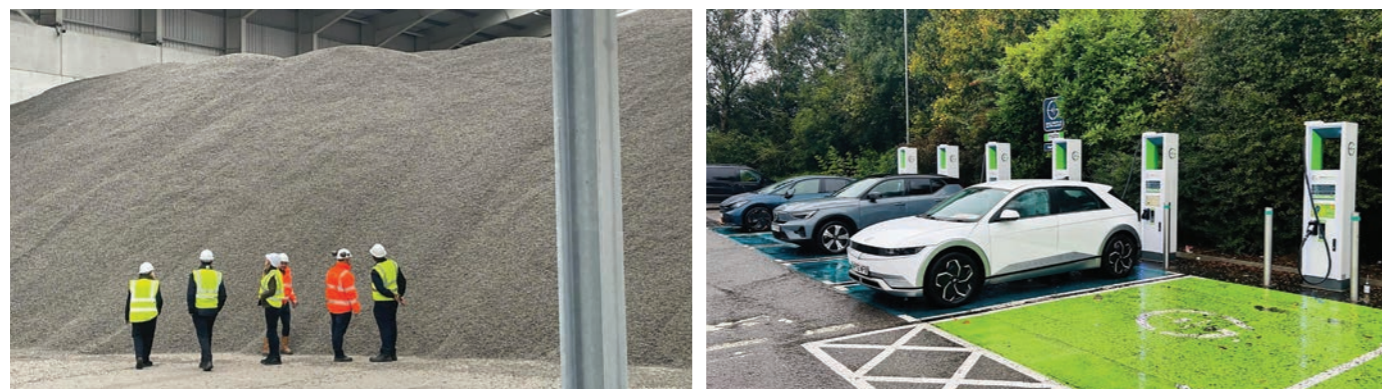
At the same time, SMEs remain vital in the context of the foundational economy – that is sectors such as health and social care, food and farming, retail services, hospitality, construction and transport – that provide essential daily goods and services. These foundational economy sectors remain crucial to the functioning of local and regional economies and to achieving the UK's broader inclusive development objectives (you can find out more information on how foundational economy sectors form a key component of The Good Economy's 3E Model [here](#)). The reality, particularly for many regional economies, is that most jobs are not created in the eight priority growth sectors but rather in these foundational economy sectors. For example, in the East Midlands, around 85% of the people living and working in the region are currently employed outside of the government's eight priority sectors.<sup>4</sup>

Growth in the priority sectors cannot be realised or sustained without the stable infrastructure, workforce, and supply chain capacity provided by these foundational businesses. By allocating capital across both high-growth priority sectors and the foundational SMEs that underpin them and sustain local economies, pension funds can help catalyse balanced long-wave economic development and regional growth.

1. House of Commons Library, Business statistics, Dec 2025.  
 2. British Business Bank, Small Business Finance Markets 2024/25.  
 3. British Business Bank, Nations and Regions Trackers: Small Business Finance Markets 2025.  
 4. RSA, East Midlands Inclusive Growth Commission Final Report, 2025.

### 3 / Market Opportunity and Maturity

SME finance represents a significant investment opportunity within the UK, combining the potential for attractive risk-adjusted returns with meaningful economic, social and environmental outcomes. SMEs underpin the UK economy, yet many continue to face persistent gaps in access to finance, particularly for growth, working capital, and scale-up activity. For long-term investors such as the LGPS, this has led to the development of a growing ecosystem of fund managers and platforms that provide intermediated access to SME finance.



The SME finance sector encompasses a range of distinct sub-sectors, reflecting differences in investment structures, risk profiles, and stages of business support. The market's asymmetries, particularly in underserved geographies and sectors, represent both a need and an opportunity for

institutional participation. The table below provides an overview of the principal sub-sectors within SME finance, highlighting their typical use cases and relevance within the broader investment landscape.

| Sub-Sector                                     | Opportunity  | UK Market Maturity  |
|--|--|---|
| <b>Angel and Crowdfunding</b>                  | Equity finance from individual investors and platforms. Often first cheque investors.  | Angel networks increasingly professionalised. But unlikely to be a focus for LGPS.  |
| <b>Venture Capital (Start-ups)</b>             | Early-stage businesses (pre-seed to Series A+); particularly in green tech, AI, fintech, and health, with high growth potential.   | Active and well-capitalised VC market, centred in London, though still lagging behind the US. Regional hubs (Cambridge, Manchester, Leeds, Edinburgh) growing momentum.               |
| <b>Growth Equity</b>                           | Scale-ups with strong revenue growth, positive cashflow or near-profitability. Lower risk than venture.  | Mature but remains smaller and less liquid than the US or larger buyout segments.   |
| <b>Lower Mid-Market Private Equity</b>         | Control or influential minority investments in established SMEs, often focused on succession, operational improvement, or buy-and-build growth.  | Established but fragmented market, with many regionally based and UK focused managers. Institutional participation is growing, though the segment remains smaller than in the US.     |
| <b>Blended / Government Funds</b>              | Public-private capital targeting underserved regions or sectors (e.g. net zero, innovation). Structured with risk-sharing and guarantees.  | Strong institutional infrastructure. British Business Bank coordinates national and regional initiatives (e.g. Northern Powerhouse Investment Fund, Midlands Engine Investment Fund). |
| <b>Working Capital and Receivables Finance</b> | Provision of liquidity through purchase of invoices, trade receivables, and other short-term obligations. Exposure is to diversified pools of counterparties, typically investment-grade buyers. Offers low duration and strong collateralisation. | Rapidly maturing. Fintech-enabled specialist managers expanding institutional access over the past decade.  |
| <b>Direct SME Lending and Mezzanine Debt</b>   | Term or cashflow lending directly to SMEs for growth or acquisition purposes, typically secured by assets or personal guarantees. Includes receivables finance and asset-backed debt.  | Evolving regional market. Challenger banks and regional funds active; <sup>5</sup> institutional funds emerging via British Business Bank initiatives.                                |

5. Note that challenger banks are less relevant to the LGPS as an investment opportunity because they operate a fundamentally different business model to private credit funds. Though they provide a useful (and expanding) supply of finance to SMEs, their model is generally not a typical vehicle for pension funds to access returns from private credit investing.

SME finance is now recognised as core to the UK's productive finance agenda. According to UK Private Capital,<sup>6</sup> private capital backed nearly 13,000 UK businesses in 2025, supporting 2.5m jobs and contributing 7% of GDP.<sup>7</sup> Nine in ten of these companies are SMEs, and six in ten are outside London, highlighting both the scale and regional reach of the opportunity. This represents a scalable opportunity for LGPS to commit long-term capital through institutional-grade funds and structured vehicles targeting regional economic development.

While the venture ecosystem is well-established in London and expanding in regional hubs, access to scale-up funding remains limited. The fastest growing UK companies are often reliant on overseas investors to scale up, especially for investment rounds of £50m+, and also with smaller deals in the £20m-£50m range.<sup>8</sup> Overall investment activity remains well below the levels seen in leading economies such as the United States. Factors such as smaller fund sizes, fragmented sourcing of investment opportunities, and limited clarity around exit routes have historically made it harder for large institutional investors to participate, particularly in regional markets.

Debt markets are evolving through fintech innovation, although access remains uneven particularly for businesses with limited physical assets or weaker credit profiles. Public-private initiatives such as the British Business Bank's Northern Powerhouse Investment Fund (NPIF) and Midlands Engine Investment Fund (MEIF) play an important role in addressing

these structural gaps and can be further amplified through the mobilisation of complementary private capital.

Alongside mainstream SME finance, social enterprise investment funds play a specialist but important role within the wider SME ecosystem, particularly in supporting enterprises that deliver social and community outcomes alongside commercial activity. Funds such as Big Issue Invest's Growth Impact Fund and Resonance Enterprise Investment Fund, supported by Better Society Capital as a market wholesaler, provide tailored capital to socially driven SMEs that are often underserved by conventional finance. While these vehicles are not typically institutional-grade for pension funds at present, they remain a relevant component of the UK's place-based investment landscape. Moreover, through these funds, investors can achieve more direct, targeted social impact due to the targeted nature of their purpose.

For the LGPS, targeted exposure to SME finance, via the range of opportunities listed, offers a route to back productive, job-creating capital while aligning with fiduciary duties. Yet the ongoing LGPS pooling initiative, designed to achieve greater scale and efficiency, risks unintentionally constraining investment in SME finance by favouring larger allocation sizes and fund structures. Pooling arrangements, combined with internal concentration limits, can make it more difficult for LGPS investors to commit relatively small allocations to regionally focused SME funds. To fully realise the potential of SME finance as a driver of regional economic growth, it is therefore important that pooled structures retain sufficient flexibility to support smaller, place-based investments capable of delivering high local impact.



6. UK Private Capital is the new name for the British Venture Capital Association (BVCA), effective as of 27th January 2026.

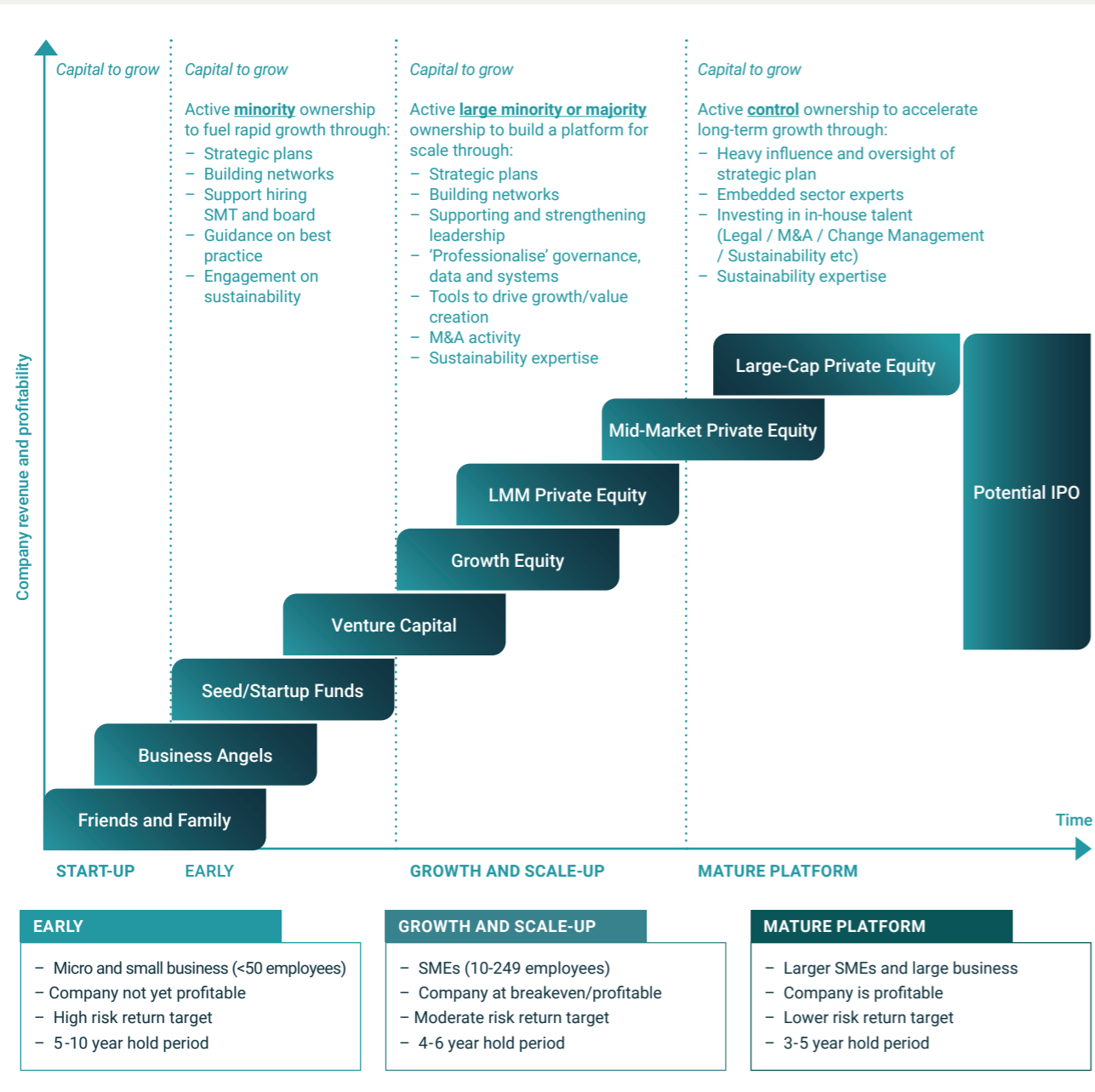
7. BVCA, Economic contribution of UK private equity and venture capital in 2025, May 2025.

8. Based on BVCA, Venture Capital in the UK (Nov 2024). In 2023, 94% of total deal value across deals over £50m of equity included foreign investors. A similar trend is observed in smaller deal sizes, £20m-£50m, where 87% of total deal value included a foreign investor.

Private capital investments support businesses' development at different points in their lifecycle from the point that they are founded through growth and into maturity. While no two companies' circumstances are the same, and not all companies seek to pass through each investment stage in sequence, this simplified chart outlines the different investment stages and how private capital firms support businesses they back.

From an SME perspective, when deciding on a finance provider, key considerations are cost (affordability), terms and value add from the finance provider, particularly in the case of equity investment.

Figure 2: Types of Private Capital Investment by Business Stage



Source: UK Private Capital.

## Spotlight On: University Spin-Out Funds

University spin-out funds provide targeted finance to early-stage SMEs emerging from the UK's research base, particularly in high-growth sectors such as life sciences, advanced materials, clean technologies, and AI. These funds leverage the research capabilities and intellectual property pipelines of leading universities, channelling patient capital and specialist commercialisation support to transform breakthrough research into viable, growth-oriented companies.

Funding for companies coming out of the Golden Triangle (those formed between Cambridge, London and Oxford) is 6.5x that of other regions. Substantial increases in funding are needed in the regions at pre-seed, seed and series A stages to attract talent and resources to support commercialisation. As outlined below, recent years have seen an increase in regionally focused funds launched supporting university spin-outs:

### Northern Gritstone

Founded by the Universities of Manchester, Leeds and Sheffield in 2021, with the University of Liverpool joining in 2025. Focused on addressing the historic funding gap for science and technology ventures in the North of England. By backing research-led SMEs, Northern Gritstone supports regional innovation, high-value job creation, and growth in key priority sectors, particularly in the areas of deep technology and life sciences. As of April 2025, Northern Gritstone has raised over £362m, having secured investment from various pension funds and leading institutional investors including Aviva, M&G and Columbia Threadneedle.

### QantX and the SETsquared Partnership

A £300m investment vehicle established as a partnership between the six SETsquared Partnership universities – including Bath, Bristol, Cardiff, Exeter, Southampton and Surrey – and QantX, a specialist investor in high impact innovative companies in the South and South West. This

partnership, launched in 2024, aims to bring modern economic success to the South and South West regions by increasing the number of spinouts, protecting intellectual property, and creating long-term impact through catalysing the creation and growth of science and technology companies.

### Midlands Mindforge

An investment company established in 2023 to accelerate and capture value from the commercialisation of cutting-edge research generated by eight partner universities across the Midlands. Midlands Mindforge was created by the eight universities of Midlands Innovation, which is a long-standing research and innovation partnership, as a vehicle to accelerate commercialisation and investment activity, drawing on the partnership's existing collaboration infrastructure. By providing patient capital to high-growth, early-stage university spin-outs, it addresses a critical regional funding gap and supports the development of scalable SMEs in priority innovation sectors, especially in life sciences, green tech and deep tech.

In 2025, a new initiative 'Forging Ahead' was also launched by a coalition of 15 Midlands universities, including the eight Midlands Innovation universities. This five-year programme will aim to build on the work of initiatives such as Midlands Mindforge to unlock the region's research and innovation strengths and support the commercial development of university spin-out businesses.

Together, these models demonstrate how university spin-out funds act as effective SME finance vehicles, bridging the gap between research and commercialisation, strengthening regional economies, and offering institutional investors diversified access to the UK's future growth sectors.



## Spotlight On: Digitally Enabled SME Finance

For large institutional investors such as LGPS Pools, direct investment in SME finance has historically been limited by the fragmented and operationally intensive nature of the market. SME transactions are typically small and heterogeneous, requiring specialist origination, underwriting, and servicing capabilities that are not generally held in-house by asset owners. As a result, institutional participation has largely depended on intermediated access models that aggregate SME exposures and manage them at scale.

Specialist asset managers have increasingly developed institutional access platforms that provide diversified exposure to SME finance through regulated fund structures, supported by technology-enabled origination and servicing. In particular, transactional and asset-backed SME finance, such as invoice and trade receivables, has proven well suited to institutionalisation due to its short-dated, self-liquidating nature and strong transparency when aggregated at portfolio level (see Fasanara Capital case study on page 25).

For LGPS Pools, these models offer a practical route to achieving exposure to SME finance at scale, supporting economic activity across regions while remaining compatible with pooled governance, risk management, and fiduciary requirements.



## 4 / Expected Returns and Investment Structures

The UK SME finance market offers a spectrum of investment strategies across the capital structure, ranging from secured and unsecured lending to early-stage and growth equity. Return profiles vary by instrument type, company maturity, and regional and sectoral focus.

Core debt strategies offer predictable income, while value-add and opportunistic strategies target higher risk/return debt strategies or equity exposure in start-up and scaling businesses. For the LGPS, access routes to investing in SME finance are most likely through established private capital funds, where proven models already exist across instruments including SME debt, asset-backed finance, private equity, growth equity, and venture capital, as well as public-private blended structures which are often supported by British Business Bank programmes targeting underserved markets.

Pension funds typically target net returns of approximately 6-8% for debt strategies, with higher return thresholds for equity investments. In preparing this Sector Profile, we gathered feedback from investors active in the SME finance market, who indicate that it is possible to achieve attractive risk-adjusted returns consistent with these requirements through SME investment, often at a premium to comparable mid-market strategies.

The table below sets out expected gross internal rates of return (IRRs) commonly associated with different forms of SME investing.

IRR is one of a number of metrics used to assess private capital fund performance. The expected IRR ranges presented should be interpreted with appropriate caution. Due to the private and varied nature of the SME investment market, publicly verifiable performance data is limited, and these ranges are therefore indicative rather than definitive. The gross IRRs shown reflect target return expectations at the instrument or portfolio level, rather than realised net fund-level returns after fees, leverage, or losses. They represent typical return thresholds or objectives, not measures of dispersion or volatility. In addition, return outcomes in SME investment often differ from those seen in public markets or larger private market strategies, as results are shaped by diversification, deal structure, and manager selection, and may be uneven or skewed rather than following a smooth or predictable distribution.

### SME Finance Sub-Sectors and Typical Return Profile

| Instrument  | Use Case   | Typical Providers  | Expected Target Gross IRR Ranges |
|---|--|--|----------------------------------|
| <b>Senior Secured SME Loans (all-asset security)</b>                | Day-to-day business funding, buying equipment, refinancing existing debt                 | Private credit funds, British Business Bank-backed vehicles                    | 4-7%                             |
| <b>Asset-Backed Lending – Trade Receivables and Working Capital</b> | Short-term funding based on invoices, leasing, or receivables to support ongoing trading | Specialist lenders, fintech platforms, private credit managers                 | 6-10%                            |
| <b>Asset-Backed Lending – Equipment / Property</b>                  | Growth funding secured against physical assets   | Private debt funds, regional lenders   | 8-12%                            |
| <b>Cashflow-Based Secured Loans</b>                                 | Growth or acquisition funding backed by recurring revenues                               | Lower mid-market private credit funds  | 10-15%                           |
| <b>Mezzanine / Subordinated Debt</b>                                | Growth funding where senior debt is limited  | Regional debt funds, mezzanine funds   | 12-20%                           |
| <b>Growth Equity (including lower mid-market private equity)</b>    | Capital to support the expansion of established SMEs                                     | Private equity funds, regional funds and platforms (e.g. NPIF, MEIF, Palatine) | 15-20%                           |
| <b>Early-Stage Venture Capital</b>                                  | Seed to Series A+ for innovation-led firms   | Venture Capital funds, angel networks, university spinouts                     | 20-30%                           |

While this paper focuses on investor returns, it is important to note that for SMEs themselves, the affordability of finance is generally the primary factor determining whether funding is accessible.



## 5 / Challenges, Risk Factors and Mitigations

The table below outlines a selection of risks relevant to SME lending. These are not necessarily specific to only the SME sector; several of the risks highlighted also apply to other forms of lending, including to mid- and large-cap organisations. Also, some of the risks are specific to certain types of SME funding (e.g. direct SME lending vs working capital / receivables financing). As the table demonstrates, there are established mitigation strategies to each of the identified risks.

| Risk   | Mitigation   |
|--|--|
| <b>Financial Risk</b>  |  |
| <p><b>Credit and Default Risk:</b> Direct SME lending carries a higher probability of default given the nature of early-stage, sub-scale, or asset-light firms. Unsecured lending and subordinated structures (e.g. mezzanine debt) can amplify losses. Recovery rates can be especially weak in thinly capitalised businesses or sectors.</p>   | <p>Risk mitigations include strengthened credit assessment, appropriately sized lending, the use of covenants or guarantees, active monitoring, and portfolio diversification. While these measures are primarily relevant to investors undertaking direct SME lending, this approach is unlikely to be viable for the LGPS given the specialist expertise, operational resources, and governance oversight required, reinforcing the case for accessing SME finance through intermediated fund structures.</p>            |
| <p><b>Default and Fraud Risk:</b> Trade receivables and working-capital portfolios primarily expose investors to short-dated buyer payment risk rather than SME balance-sheet credit. Risk is typically mitigated through diversification and credit enhancement, though residual exposures remain around buyer concentration, invoice disputes, and operational or fraud-related risks.</p>   | <p>Risk is mitigated through counterparty due diligence, automated monitoring, and structural protections such as non-recourse arrangements, credit insurance, and diversification limits. Operational controls, including invoice validation and reconciliation, are supported by short-duration exposures that allow portfolios to be adjusted quickly as risks emerge.</p>  |
| <p><b>Liquidity and Exit Risk:</b> SME equity exposures are inherently illiquid, with value realisation dependent on exits such as trade sales, sale to a larger private capital fund, or listings. This creates holding-period uncertainty and vintage risk, particularly where funds rely on early exits to achieve IRR targets in stressed markets or regions with limited buyer demand.</p>  | <p>Experienced private capital firms with a strong track record of successful exits help reduce liquidity risk by planning multiple, realistic exit routes and creating long-term value, and avoiding reliance on early exits to meet return targets. Active portfolio management and realistic time horizons also mean that funds are less exposed if markets slow.</p>   |
| <p><b>Private Markets Risk:</b> The migration of credit from regulated banks to private credit markets introduces potential portfolio-level risks, including fund-level leverage and increased correlation with other higher-risk funding markets, as highlighted by the IMF and Financial Stability Board.</p>  | <p>This risk relates to broader private markets rather than being specific to SME lending, and we note that private credit is less active in this smaller-scale end of the market. Nonetheless, to mitigate risks in this area, lenders can apply conservative leverage limits, senior secured structures, and high underwriting standards supported by robust credit governance and regular stress testing. In addition, transparent and consistent reporting can help to build investor confidence and market trust.</p> |
| <b>Operational and Structural Risk</b>   |  |
| <p><b>Lack of Transparency:</b> Smaller SMEs lack audited financial statements and reliable forecasting. This limits visibility of business fundamentals and raises underwriting and monitoring costs.</p>   | <p>Strengthened financial due diligence and clear reporting covenants improve visibility over SME performance. Targeted support to enhance financial controls and forecasting, combined with ongoing monitoring, reduces uncertainty and builds reliable data over time.</p>   |
| <b>Policy and Market Risk</b>  |  |
| <p><b>Policy Dependency:</b> Government supported programmes (e.g. British Business Bank) play a material role in enabling risk-adjusted returns at the smaller, venture capital end of the market. Policy shifts or funding withdrawals could undermine viability in certain segments.</p>  | <p>Ensure investment strategies are not overly reliant on any single government programme by diversifying across sectors, instruments, and beneficiary types. Experienced managers track policy changes and adjust deployment to maintain commercial viability if public funding changes.</p>  |
| <p><b>Macroeconomic Sensitivity:</b> SMEs are disproportionately affected by cost inflation, rising interest rates, and market shocks. Stress scenarios (e.g. Covid, 2008) have shown sharp declines in SME cashflow and elevated insolvency rates. However, it should be noted that certain macroeconomic factors are less relevant to SME lending. For example, global exchange rate risk is likely to be of limited relevance for SMEs that do not engage in international trade, compared with larger organisations.</p>   | <p>Stress-test assumptions on revenues, margins, and refinancing needs to ensure SMEs can withstand adverse macro conditions. Regular monitoring and early support for struggling SMEs, combined with investing across a mix of sectors and business types, help reduce the impact of wider economic shocks.</p>   |
| <b>Impact Risk</b>   |  |
| <p><b>Responsible Value Creation:</b> A key consideration for SMEs seeking private equity investment is often the effectiveness of a prospective PE-backer's 'active ownership' capabilities in driving the growth of the business. From a fund investor perspective, a private equity firm's ability to rigorously and impactfully deploy non-financial support that helps investee SMEs to grow is likewise often a key driver of value creation and ultimately returns. Assessing a firm's expertise in delivering this operational business growth is a different exercise to the diligence required in a public market context.</p> | <p>Ensure due diligence identifies private capital firms with a strong track record in responsible value creation, supported by high-quality service providers and robust governance, reporting, and impact management (where relevant). For further guidance, see <a href="#">UK Private Capital's Responsible Investor Toolkit</a>.</p>  |

## 6 / Regional Investment Landscape

Across the UK, SME finance presents opportunities for LGPS to support regional productivity, innovation, and inclusive growth. However, effective deployment depends on the availability of investable deal flow, the presence of capable fund managers, and scalable, institutionally structured vehicles. Public funding is a key enabler to help address the fragmentation and sub-scale challenges typical of local SME markets.



The UK has a relatively well-established heritage of regionally embedded investment fund managers, developed in part through the legacy of European Commission and European Investment Fund programmes that supported SME finance and regional economic development. These initiatives helped catalyse fund managers with strong local presence, deep regional networks, and specialist expertise in investing in early-stage and growth-oriented businesses outside London and the South East. This includes organisations headquartered in London with satellite offices in the regions (e.g. Foresight – see case study included in our [2025 White Paper](#)) as well as fund managers which are headquartered in the regions (e.g. NEL Fund Managers – see case study on page 24).

London and the South East continue to play a leading role in venture equity, particularly in fintech, AI, and life sciences; however, additional place-based impact from further capital deployment in these markets may be more limited relative to other regions. In contrast, regions such as the North of England, South West, Midlands, and Yorkshire exhibit high demand for growth capital and credit, especially in manufacturing, digital tech, and clean growth sectors, yet face scale-up funding constraints. Blended finance structures now proven like the Northern Powerhouse Investment Fund

(NPIF) and Midlands Engine Investment Fund (MEIF) play a key role in de-risking investment and anchoring regional fund ecosystems.

Regions such as the South West and North East are seeing increased early-stage activity, especially in aerospace, health-tech, and energy-linked innovation. However, they remain capacity-constrained in terms of institutional capital and by a lack of fund managers providing different types of early-stage finance. In the South West specifically, innovation and investment rates are below the national average despite the presence of a strong base of research and development assets.<sup>9</sup> This indicates that greater emphasis on scale-up activity, alongside improved access to a more coordinated business support ecosystem, could help unlock the growth potential and performance of high-growth businesses in the region.

In the devolved nations, a strong ecosystem of mission-driven institutions, such as the Scottish National Investment Bank, the Development Bank of Wales, and Invest Northern Ireland, plays an important role in supporting long-term investment and partnering with private capital to address regional financing gaps.

9. Great South West, *The State of Growth in the Great South West*, November 2025.

## SME Finance and Inclusive Job Growth

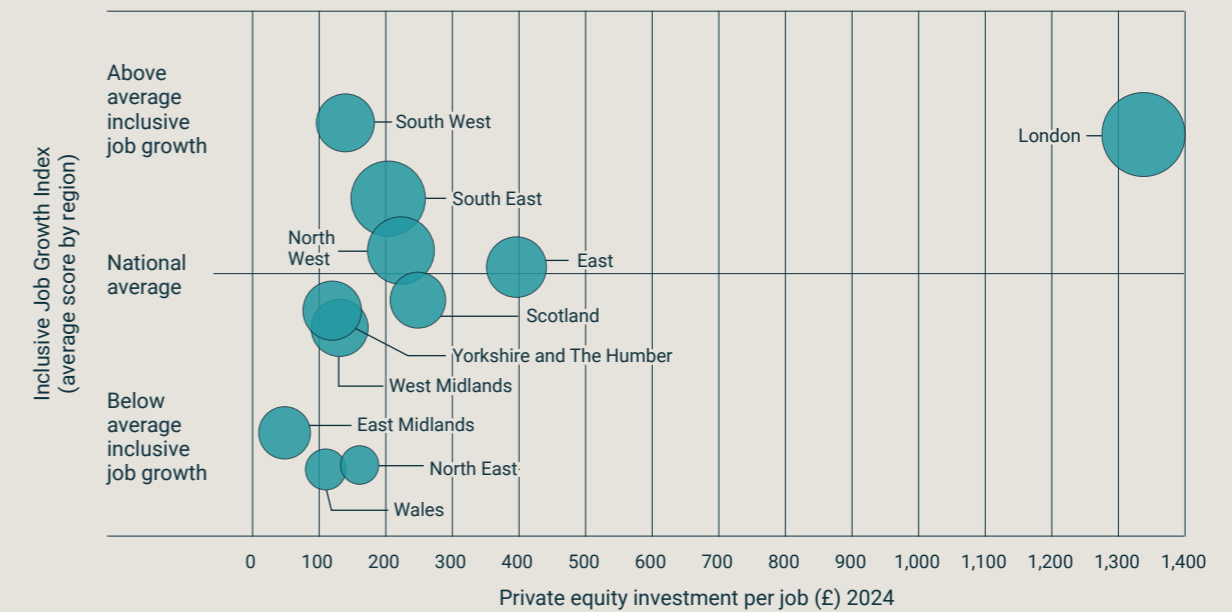
The graph below demonstrates how the Geography of Inclusive Job Growth in the UK correlates with the level of private investment across the UK's regions. This is included to provide a picture of how the regional distribution of investment relates to the 'need' for high-quality employment across the country. Though neither are perfect indicators (see explainer below), this provides a useful insight into the relationship between demand and supply of private investment into UK businesses across the UK's regions.

Several headlines stand out:

- London experiences far greater value of private equity investment than elsewhere in the country, and has above average inclusive job growth characteristics.

- Wales, the North East and East Midlands have the lowest levels of private equity investment, as well as the lowest inclusive job growth characteristics.
- A simple comparison of private equity investment relative to employment shows the regional imbalance. London attracts approximately £1,339 of private equity investment per job, well above the regional average of £284, compared with £49 in the East Midlands, £110 in Wales, and £162 in the North East.
- This shows that London receives a disproportionate amount of private equity investment – private equity often follows economic strength.
- Places more in need of decent jobs receive proportionately less – demonstrating a mismatch between need and investment flow.

Figure 3: Inclusive job growth index vs the value of announced equity deals by UK nation/region, 2023-2024. Dot size represents the number of jobs by region



Source: Inclusive Job Growth Index, The Good Economy. Value of deals, British Business Bank, Nations and Regions Tracker 2025.

### INDICATOR EXPLAINER

#### The Inclusive Job Growth Index

The data presented is based on TGE's proprietary mapping methodology which combines measures of job growth and job inclusion, with:

- Growth measured by private sector job growth, GVA growth, SME dynamism and working age population growth.
- Inclusion measured by earnings quality, job security and accessibility for certain demographic groups.

This analysis highlights areas with strong labour market performance as well as those where job prospects are weakest, providing a useful proxy for the distribution of demand for high-quality employment ("good jobs") across the country, rather than a direct measure of demand for SME investment.

#### The Regional Spread of Private Equity Deals

The data presented is drawn from the British Business Bank's analysis of the regional distribution of private equity investment across the UK. While this information is not specific to SME investment and reflects private equity activity more broadly, it provides a useful indication of how private capital is distributed across regions.

Given that private equity represents only one component of overall investment and labour market dynamics, the figures should be interpreted as an illustrative proxy for general patterns of private investment flows rather than a direct measure of SME finance activity.

## 7 / Principal Participants

The UK SME investment landscape comprises a diverse mix of private and public sector participants, each playing a distinct role in the provision of capital across different stages of business growth. Private sector investors provide the majority of commercial finance, while public sector institutions help to address market gaps, support innovation, and crowd in private investment. Understanding the roles and interactions of these participants is important in assessing how SME finance is delivered in practice and how institutional capital can engage effectively with this ecosystem.

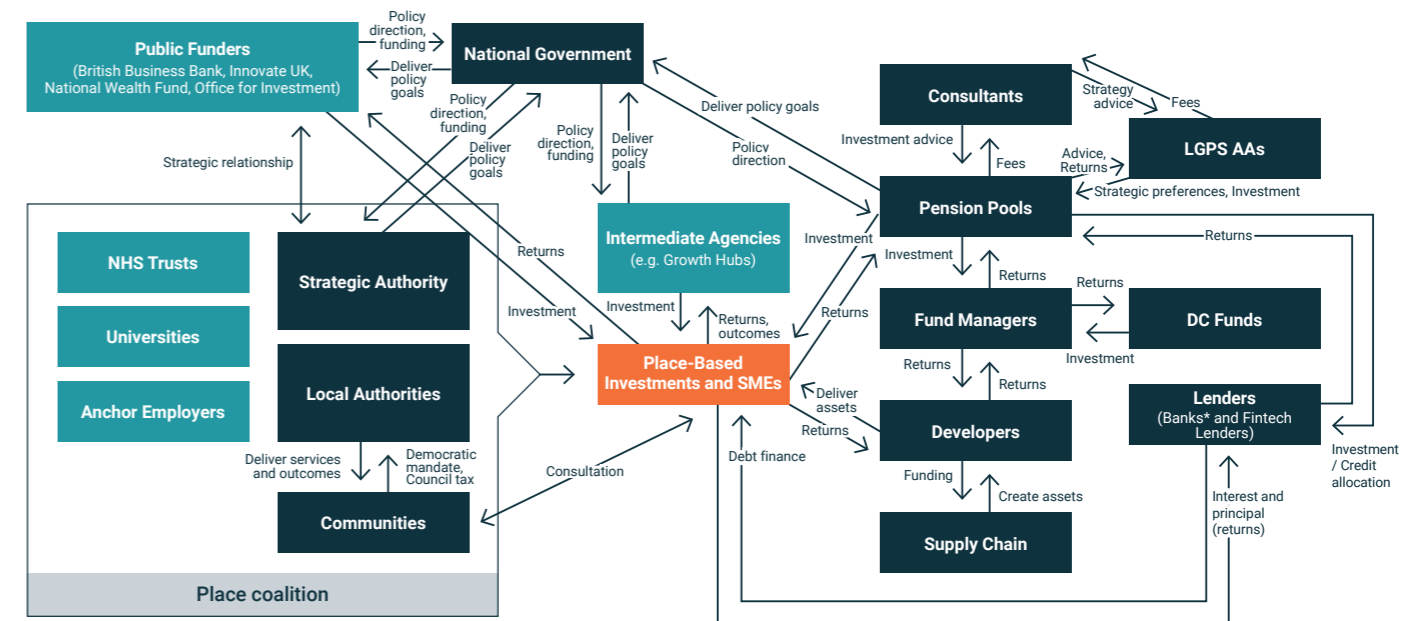
### Public Sector

- HM Treasury:** Sets the policy and regulatory framework influencing SME finance and investment.
- Department for Business and Trade:** Responsible for business growth, trade, and export support policy.
- Office for Investment (OfI):** A joint HM Treasury and Department for Business and Trade unit that facilitates major investments into the UK. Its work supports SMEs indirectly through sector development, supply chains, and regional growth.
- British Business Bank (BBB):** Central coordinating institution for SME finance, delivering national and regional debt, equity, and guarantee programmes.
- National Wealth Fund (NWF):** A government-backed vehicle that mobilises long-term capital into priority areas of the UK economy. While not SME-specific, it supports SME investment indirectly through supply chains and scale-up finance.
- UK Infrastructure Bank (UKIB):** Supports infrastructure and net-zero investment with indirect benefits for SME participation.
- UK Export Finance (UKEF):** Offers guarantees and insurance to support SME exporters.
- Innovate UK (UKRI):** Provides grants and innovation finance to R&D-intensive SMEs.
- Devolved nation investment institutions:** Including the Scottish National Investment Bank, Development Bank of Wales, and Invest Northern Ireland, providing mission-led capital alongside private investment.
- Regional and local investment vehicles:** BBB-backed regional funds and mayoral or combined-authority investment vehicles supporting local SMEs.
- Local authorities and combined authorities:** Provide co-investment and local growth finance initiatives for SMEs.
- Growth Hubs:** A network of 41 Growth Hubs across England, which exists to support and improve business performance, enabling businesses to build their capacity and capability. Growth Hubs are supported and managed by local accountable bodies usually Combined Authorities, or Local Authorities, with core funding from Government.

### Private Sector

- Banks and Fintech Lenders:** High Street banks; challenger banks (OakNorth, Aldermore) and fintech platforms (Funding Circle, Zopa).
- Asset managers,** including the following categories:
  - Venture Capital Firms:** e.g. Balderton, Index, Octopus Ventures, and sector-specific funds (clean tech, biotech, clean energy).
  - Private Equity Firms:** e.g. Foresight, Palatine.
  - Regional Investment Funds:** e.g. NEL Fund Managers, Mercia.
  - Alternative Asset Managers:** e.g. Fasanara Capital.
  - Private Credit Funds:** Offered by a diverse range of investors, including large diversified asset managers (e.g. M&G), specialists in private credit (e.g. Beechbrook Capital), and specific credit funds from regional managers (e.g. Foresight, Mercia).
- Angel Networks.**
- Community Development Finance Institutions:** Non-profit lenders that provide debt finance to SMEs that struggle to access finance from mainstream lenders. E.g. BCRS Business Loans, Business Enterprise Fund (BEF).
- Crowdfunding Platforms:** Facilitate equity raises for startups (indirectly including retail/institutional co-investors). E.g. Seedrs, Crowdcube.
- Industry Bodies:** UK Private Capital, CBI, FSB (Federation of Small Businesses) lobby for SME finance reforms.

Figure 4: Local Investing Ecosystem relating to SME Finance



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\*Note that banks typically provide lending from their own balance sheets, with returns accruing to the bank rather than directly to institutional investors. While banks may act as delivery partners within the SME finance ecosystem, they do not generally intermediate institutional capital in the same way as private credit funds or lending platforms.

## 8 / Illustrative Case Studies

### UK PRIVATE CAPITAL

UK Private Capital is the association representing UK venture capital, private equity and private credit firms, alongside the wider private capital ecosystem of professional advisers and investors. The case studies offer selected highlights of how smaller private capital funds within this industry help to drive SME growth across the UK.

The UK private capital industry backs 13,000 UK companies, 90% of which are SMEs, employing around 2.5 million people. There is a particularly strong relationship between local SME investment and smaller private capital firms that manage venture and lower mid-market private equity funds, where investor commitments range from around £500k to £40m. These firms are often based around the UK and focus on investing across the nations and regions - around 60% of lower mid-market PE investments are outside London and the South East, for example. This investment activity is an important driver of UK innovation, and presents a key opportunity for UK pension schemes that want to support SME finance and local economic growth, particularly the LGPS.

#### Jobs and growth

For example, since 2011 [BGF](#) has invested more than £4.7bn in over 650 businesses across the UK and Ireland, with 74% of capital deployed outside London and the South East. This regional-first approach has supported £7.1bn in revenue growth, £1bn in export growth and the creation of more than 27,000 jobs nationwide.

The theme of job creation is strong across this type of UK private capital. 24 of the last 27 buyout investments made by YFM Equity Partners, a private capital firm with five offices across the UK, were in companies based outside London. The last seven buyout portfolio companies that YFM successfully exited, on average, tripled their number of employees.

[NorthEdge](#), a regionally focused private equity firm that typically invests in founder-led businesses with no previous private capital backing, recently commissioned [research](#) to understand the real-world impact of its investments. This revealed NorthEdge's portfolio had supported around 10,000 jobs, around 70% of which are outside London, and 31% of direct jobs were in the most deprived areas of the UK. Wages at those companies were also 15% more than the UK average, with productivity also 15-20% higher than the UK average.

Maven, a private equity firm with 13 offices across the UK emphasises investing with low or limited leverage, and supporting management teams through hands-on value creation, including bolt-on acquisitions, operational improvement, and strategic expansion.

#### Case study: ConnexAI – creating highly skilled jobs in the North, backed by Bullhound Capital

Originating in Manchester, ConnexAI's journey began when it won the Northern Tech Awards, an initiative founded by the GP Bullhound Group intended to recognise and accelerate high-growth tech companies in the North of England. This helped secure investment from [Bullhound Capital](#), which allowed the company to scale from a bootstrapped AI startup into a global platform. Since Bullhound Capital's investment, ConnexAI's total workforce has grown by 131% and its local team by 90%, driving the creation of high-skilled jobs within the regional ecosystem.

#### Strong returns

Alongside driving growth, national and regional UK private capital firms also have a strong track record of generating attractive returns. Mercia for example, a firm with 11 offices exclusively focused on the UK, invests around £200m per annum (around 85% of this is outside of London), and notes numerous examples of strong performance across its venture and growth investments. For example, one investment in Blue Prism delivered 95x return on investment cost. Another, OXGENE, delivered 20x return on its early investment for its EIS investors and 5x for its later stage investors. An investment into Faradion delivered 4.2x on investments, and another into C7 Health returned 14x costs for its earliest EIS investors.

#### Innovation

[DSW Ventures](#) is an example of how smaller private capital investments fuel the transformation of UK innovation into strong businesses across the country. Based in Manchester, Birmingham and Cheshire, the firm funnels investments of up to £1 million from institutions into pre-seed and seed-stage tech companies based outside the 'Golden Triangle' of Oxford, Cambridge and London. The firm works with founders to maximise the success of businesses - both of entrepreneur-led companies and those spinning ground-breaking technology out of universities in the UK's nations and regions, where equity funding is harder to come by. As well as driving UK-wide innovation, this regional strategy also offers strong investor returns whilst supporting the country's abundance of world-class scientific and technical talent.

#### Opportunity

Looking ahead, private capital firms see lots of opportunity to increase UK national and regional investment. BGF recently announced plans to invest £3bn in UK business over the next 5 years, with specific regional commitments. Likewise, [PXN Group](#), formed from a merger of Praetura Ventures and Par Equity, plans to increase its annual investment rate to reach £300m over five years. Leveraging the firm's deep co-investment network, there are plans to inject £1bn to support the North of the UK's best and brightest founders.

## PALATINE PRIVATE EQUITY

Palatine Private Equity is a UK lower mid-market private equity firm with a regional focus and three main strategies (Buyout, Impact and Growth Credit), recently closing its largest vehicle, Buyout Fund V, at £250m. Palatine is headquartered in Manchester, has a strong sustainability and impact focus (including B-Corp status) and typically backs established, profitable regional businesses across business services, technology and financial services.

### Portfolio Overview

**Fund name:** Palatine Impact Fund I and II

- **Fund size:** Impact Fund II £150m.
- **Asset class and sector:** Private equity – lower mid-market buyout. Sector focus: Education, Healthcare, Sustainability, Tech for Good investing in established, profitable, predominantly regional UK companies.
- **Geography:** Strategy is UK-focused, with a strong emphasis on regional businesses outside London and the South East.
- **Ticket size:** Impact Fund £10m-£20m per deal.
- **Target and actual IRR (net):** Impact Fund targets market rate returns.
- **Investors:** Investor base is primarily institutional investors from the UK and European LPs.

### Investment Objectives

Palatine's impact funds aim to deliver capital appreciation while making "sustainable investments" that address major social and environmental challenges, explicitly targeting a market-rate private equity return rather than concessionary impact capital.

All portfolio companies must contribute positively to society or the environment and avoid significant harm to other sustainability objectives, assessed through Palatine's ESG and impact frameworks. The funds target companies whose growth is directly linked to scaling positive impact in areas such as inclusive employment, education, health, resource efficiency and climate solutions.



### Investee Case Study – Leep

Leep is a Manchester-based training provider that helps long-term unemployed and low-skilled adults return to work, retrain, or progress their careers via pre-employment courses and apprenticeships.

Through its Back to Work division, the group supports more than 11,000 learners per year through pre-employment and upskilling programmes in sectors such as warehousing, logistics, IT, digital, health and social care, and construction.

Before and after Palatine's investment, the business has been rooted in Greater Manchester but delivers programmes for devolved Combined Authorities across multiple UK regions, directly linking training to local labour market needs.

### Outcomes and Impact – Supporting Regional Economies

Leep demonstrates several channels through which its operations and services support regional economies:

- **Employment creation and quality jobs:** Since investment, Leep has expanded to more than **390 employees** and created more than **240 jobs** as the group has grown.
- **Local labour market matching:** Leep works closely with employers in sectors experiencing staff shortages, helping fill regional vacancies in logistics, IT, digital, health and social care and construction, which supports business growth and regional productivity.
- **Tackling unemployment:** The group delivers intensive employability and sector-specific courses that have helped thousands of long-term unemployed people move back into work, including supporting almost **5,000 jobseekers** into employment in the North West during and after the pandemic.

## NEL FUND MANAGERS

Founded in 1989, NEL Fund Managers is an FCA regulated investment management firm based in the North East of England, with offices in Gateshead and Stockton. As the region's first investment management business, NEL has supported over 1,000 businesses, delivering sustainable growth, innovation and impact. The business continues to go from strength to strength with recent board additions and Paul Scott taking on the role of CEO in January 2025.



### More than Capital: Enabling Growth

With its "More than Capital" value proposition, NEL is focused on providing access to finance to SMEs that are key drivers of growth, innovation and job creation. NEL offers flexible financing solutions with speed of execution and deliverability, alongside a relationship-led approach. This includes ongoing strategic support from NEL and an expansive network of advisers to help portfolio companies navigate the challenges of scaling. This commitment to partnership is reflected in the results delivered, with Net Promoter Scores (NPS) in excess of 90% and strong portfolio performance generating unlevered gross returns of 14% on a debt led strategy. Winners of Insiders Alternative Finance Provider of the Year Award 2024 and 2025 is testament to the strength of its value proposition.

### Investee Case Study: Advantex

In January 2026, NEL Fund Managers, delivered a seven-figure investment to fund a successful management buyout at award-winning IT, security and communications firm Advantex, enabling the planned exit of a founder and empowering the leadership team to drive the next phase of growth. Advantex operates in a sector where organisations increasingly rely on innovative, secure and connected technology solutions and the business is well positioned to meet that demand. The investment has been used to accelerate recruitment across engineering, sales, business support and operations. Recent contract wins include SeAH Wind, Hitachi and Newcastle International Airport.

As Advantex now sits within NEL's portfolio of over 130 businesses, they will benefit from the guidance of a dedicated Portfolio Team and wider support model which includes panel events and expert-led roundtables on topics including effective board governance, strategies to achieve net zero, digital transformation and AI.

### Building On Success – A New SME Fund and Opportunity for LGPS Funds

NEL's research and engagement with SMEs confirms a market gap exists for flexible SME financing that sits above public sector interventions, below existing direct lending mandates (typically £10m+ EBITDA) and where bank appetite is limited and formulaic; this is most acute in Northern England.

NEL is currently engaged with British Business Bank and expanding its relationships with LGPS pools to raise a fund that will target this market gap. The scalable investment strategy offers premium risk adjusted returns relative to adjacent mid cap / large cap investment strategies and is more resilient to yield compression. The strategy is helpful to investors seeking additional portfolio diversification, stable contracted yield generation, inflation protection and low correlation to other classes, while delivering regional innovation, job creation and impact.

*"We would be delighted to connect with institutional investors, explain the benefits of our investment strategy and the value in partnering with NEL as we build a more resilient financing ecosystem that is less London centric. – Paul Scott, CEO"*

### Portfolio Overview

**Fund name:** SME Private Credit Fund – currently fund raising.

- **Fund size:** £75m+.
- **Asset class and sector:** SME Private Credit Fund, sector agnostic.
- **Geography:** North of England.
- **Ticket size:** Flexible capital £2m-£7.5m.
- **Target and actual IRR [net]:** Unlevered Net IRR of 8%.

### Investment Objectives

To support UK regional growth and place-based impact without compromising investor returns.

## FASANARA CAPITAL

Fasanara Capital is a London-headquartered, FCA-authorized alternative investment manager founded in 2011, specialising in fintech-enabled, asset-based credit strategies designed for large institutional investors. The firm manages approximately USD 5.5 billion on behalf of pension schemes, insurers and public institutions, including a long-standing mandate from the European Investment Fund, with SME-focused private credit forming the core of AUM. Fasanara has extensive experience structuring and managing bespoke mandates and single-investor vehicles aligned to public-sector objectives.

Fasanara's core capability is its technology-driven origination, underwriting and management of short-dated trade receivables and working-capital assets, enabling institutional capital to be deployed efficiently into the real economy. Through a proprietary platform and a network of over 140 fintech originators, the firm provides highly granular exposure to SME trade receivables, with strong controls around diversification, credit quality and operational risk. This capability can be deployed globally or tailored specifically to domestic markets such as the UK.

### UK LGPS-Focused Implementation – Trade Receivables Strategy

- **Strategy focus:** SME trade and receivables finance – short-dated, self-liquidating working-capital credit.
- **Relevance to LGPS Pools:** Exposure to UK SME financing aligned with productive finance, local economic impact and income generation objectives.
- **Implementation options:** Dedicated UK SME "fund-of-one" vehicle for an LGPS Pool (minimum c. £150m), or customised allocation within an existing structure via a side letter.
- **Regional exposure:** With flexibility on regional deployment across the UK.
- **Structure:** Luxembourg SICAV-SIF or equivalent bespoke structure, Article 8 SFDR aligned.
- **Return profile:** Target net returns of c. 5-7% p.a., with low volatility and no correlation to public markets.

### Investment Objectives

A UK-focused trade receivables mandate would seek to deliver stable, contractual income with low duration and no sensitivity to interest rates or market cycles, while directly supporting UK SMEs' access to working capital. Portfolios are constructed using a highly diversified, multi-originator approach, with strong transparency and reporting suitable for LGPS governance requirements. The strategy is designed to sit alongside LGPS income and CDI-style allocations, providing short-duration, cashflow-generative exposure, offering demonstrable real-economy impact consistent with LGPS fiduciary and stewardship priorities.

### Fund Outcomes and Impact – Specific to SMEs in the UK

Fasanara has:

- Supported **29,572 UK SMEs**.
- Deployed **£16.3 billion** of short-term working capital finance.
- Via a network of **12 active UK-based fintech originators**.
- Directed capital predominantly toward **real-economy sectors**, including retail, consumer services and construction – segments that are critical to local employment, supply chains and regional economic resilience.
- Notably, the strategy has supported over **2,000 women-led SMEs in the UK**.



*"For LGPS Pools, financing short-dated SME receivables provides a clear, measurable transmission mechanism from institutional capital to the domestic economy. The nationwide reach of Fasanara's UK fintech network enables capital to support thousands of businesses across regions, while the short duration, self-liquidating nature of receivables ensures capital discipline, liquidity management and fiduciary alignment. This combination allows LGPS investors to evidence tangible local economic impact without compromising on governance, risk control or return objectives. – Francesco Filia, CEO"*

## 9 / Strategic Fit for LGPS

The table below illustrates how SME finance aligns with LGPS local investing objectives, highlighting its relevance to supporting productive investment, regional economic growth, and place-based outcomes alongside financial return considerations. It sets out how SME investment can contribute to local investing mandates while remaining consistent with fiduciary duties.

| Strategic Priority               | Alignment   |
|----------------------------------|---|
| Regional Growth and Productivity | SME investment directly fosters local entrepreneurship and employment, consistent with local economic development goals. Growing SMEs broaden the local tax base and create supply-chain jobs.  |
| Innovation and Net Zero          | Many SMEs are developing clean-tech, health-tech and other innovations that align with net-zero and public service priorities. Supporting them leverages private finance for broader policy aims.   |
| Resilience and Adaptation        | A diversified SME base enhances local economic resilience, reducing dependence on large employers or volatile sectors. Long-term finance helps SMEs withstand shocks and sustain community stability.<br>Digitally enabled SME finance can also improve payment discipline and liquidity in local supply chains, supporting job retention, fair payment practices, and business continuity across regional economies. |
| Skills and Employment            | SMEs are key drivers of local employment and apprenticeship pathways. Investment can catalyse job creation and upskilling, particularly in underserved regions or emerging sectors.   |

## 10 / Conclusion

SMEs have long been central to the UK economy, playing a critical role in driving productivity, innovation, and job creation, particularly within local and regional economies. And yet SME finance has remained comparatively under-developed within the UK's investment landscape, often due to perceptions that it is a high-risk segment better suited to specialist investors. However, the UK's long-standing record of successful SME formation, innovation, and resilience indicates that this segment is more stable and productive than is frequently assumed, with examples in the market of funds providing private debt and equity for SME businesses and generating competitive and attractive commercial returns for institutional investors.

In 2026, there is also increasing policy emphasis on mobilising institutional capital to support productive investment in the UK economy, reflected in LGPS local investment objectives and initiatives such as the Sterling 20 commitment to UK private markets. Together, these developments create a timely opportunity for institutional investors to take a more active and structured role in supporting SME finance.

Ultimately, strengthening the flow of long-term capital to SMEs, across both priority growth sectors and the foundational economy, represents a significant opportunity to support regional economic development, enhance local productive capacity, and advance the UK's wider place-based policy objectives including driving skills development and job creation.

Addressing this structural investment gap is therefore integral to promoting more geographically balanced and inclusive economic growth while achieving targeted risk-adjusted financial returns. Given that the LGPS is unlikely to invest directly in SMEs due to the specialist expertise and resource intensity required, emphasis should instead be placed on strengthening the UK's fund management ecosystem to enable effective, intermediated access to SME investment.

Taken together, these developments point to a range of SME investment opportunities that offer a credible and attractive entry route for institutional investors. In particular, trade receivables and working-capital finance have become increasingly accessible through technology-enabled origination, servicing, and monitoring platforms, allowing exposures to be aggregated and managed at scale in a way that aligns with LGPS risk, return, and governance requirements. In addition, the lower mid-market presents a compelling opportunity for the LGPS to help address a longstanding funding gap, supporting greater domestic investment in UK businesses and reducing reliance on overseas capital.

**For the LGPS, the continued evolution of pooling arrangements will be central to shaping future investment approaches. Ensuring that pooled structures retain sufficient flexibility to support allocations to smaller, specialist SME funds will be critical if LGPS capital is to effectively support local enterprise, drive regional economic growth, and deliver meaningful place-based outcomes alongside long-term financial returns.**

# Glossary

**Private credit / private debt** – Loans made to businesses outside public markets, usually by specialist funds or lenders (including challenger banks) rather than traditional banks. It includes direct lending and other forms of privately negotiated finance, often accessed by institutional investors through managed funds.

**Working capital and receivables finance / cashflow-based lending** – Short-term financing that provides businesses with liquidity to manage day-to-day operations, often by advancing funds against invoices, trade receivables, or other short-term assets.

**Direct SME lending** – The provision of loans directly to SMEs by lenders or investors, rather than through banks or pooled fund structures. This typically involves bespoke credit assessment, monitoring, and servicing of individual borrowers.

**Mezzanine debt** – A form of subordinated debt that sits between senior debt and equity in the capital structure. It is often used to support growth or acquisitions where senior lending capacity is limited and typically carries higher returns to reflect higher risk.

**Venture capital** – Equity investment in early-stage, high-growth businesses, often in innovation-led sectors. Venture capital investors typically take minority stakes and expect returns to be driven by successful exits.

**Growth equity** – Equity investment in more established SMEs that are scaling operations and have proven business models, often with positive or near-positive cashflows. Risk is generally lower than early-stage venture capital.

**Lower mid-market private equity** – Private equity investment in established, profitable SMEs, typically focused on growth, operational improvement, buy-and-build strategies, or succession planning. Investments are often made through control or significant minority stakes.

**Angel and crowdfunding** – Early-stage equity finance provided by individual investors (angels) or through online platforms that pool capital from multiple investors, often supporting start-ups and young businesses.

**Blended / government funds** – Investment funds that combine public and private capital to support SMEs in underserved regions or sectors. These funds often include risk-sharing features, guarantees, or concessional capital to attract private investment.

**Asset-backed lending** – Lending secured against specific assets such as receivables, inventory, equipment, or property, where repayment and recovery are primarily linked to the value of the underlying assets.

**Institutional grade** – A term describing investment structures that meet the scale, governance, risk management, and reporting standards required by large institutional investors such as pension funds.

**Investment grade** – A classification indicating relatively low credit risk, typically associated with strong ability to meet financial obligations. While formal investment-grade ratings are uncommon for SMEs, the term is sometimes used to describe lower-risk lending structures.

**Pre-seed** – The earliest stage of business financing, often used to develop an initial idea, product concept, or prototype, typically before significant revenue generation.

**Seed** – Early-stage funding that supports product development, market testing, and initial commercial activity, often following pre-seed investment.

**Series A** – A later stage of venture funding aimed at scaling a business with an established product and early revenue, typically used to expand teams, operations, and market reach.

**Internal Rate of Return (IRR)** – A measure of investment performance that reflects the annualised rate of return over time, taking account of the timing of cashflows.

**Gross vs net returns** – Gross returns are returns before fees, costs, and carried interest; net returns reflect what investors receive after all expenses.

**Origination** – The process of sourcing, structuring, and underwriting new investment opportunities.

**Intermediated investment** – An investment approach where capital is deployed through specialist fund managers or platforms rather than directly into individual assets or businesses.

**Lower mid-market** – A segment of established SMEs, typically larger than early-stage companies but smaller than large corporates, often defined by enterprise value or revenue thresholds.

**Exit** – The process by which an equity investment is realised, such as through a sale, refinancing, or public listing.

## Report sponsors



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## About Us

The Good Economy is a leading, independent impact advisory firm. We exist to accelerate the transition to a good economy, where financial systems deliver not just returns but better outcomes for society. We support fund managers, asset owners, allocators and public authorities to align investment decisions with purpose, embedding impact into how economic investment is allocated and governed. By working through established systems, we shape how value is defined, how markets behave, and what good investment looks like – helping our clients lead with integrity and drive meaningful change.

4 Miles's Buildings, Bath BA1 2QS

Scott House, Suite 1, The Concourse,  
Waterloo Station, London SE1 7LY

+44 (0) 1225 331 382  
[info@thegoodeconomy.co.uk](mailto:info@thegoodeconomy.co.uk)

[www.thegoodeconomy.co.uk](http://www.thegoodeconomy.co.uk)