Micro-Businesses and Barriers to Growth

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Axiom
Economics

Contents

This report was prepared for the Financial Conduct Authority Financial Services Consumer Panel by Axiom Economics Ltd, London, United Kingdom.

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Executive Summary by the Financial Services Consumer Panel (FSCP)

Who are we?

The Financial Services Consumer Panel (FSCP) is a statutory body that represents the interests of individual and small business consumers in the development of financial services regulation in the UK. The Panel advises and challenges the Financial Conduct Authority (FCA), with a focus on ensuring consumer interests are considered from the earliest stages of policy development.

Overview and Objectives

This report was commissioned by the FSCP to test the core hypothesis that there is more that could be done in the UK through regulation to improve the financial services and products available to sole traders and micro-businesses to support their growth. The report is a desk-based literature review, drawing on publicly available data, published research, and expert analysis with a number of key recommendations from the Panel for the FCA to consider as a regulator.

The review describes the UK SME finance landscape, highlights trends in access to finance, and identifies the barriers that are most acute for the smallest firms. A key theme running throughout is the transition challenge: very small firms often begin life as unincorporated businesses reliant on personal finance products, and then face significant frictions when trying to move into business banking and business lending products as they grow.

Key Findings

1) **Personal finance reliance and persistence of personal liability**

Unincorporated businesses (including sole traders) commonly use consumer credit to fund business activity, while micro-entities may access business products but frequently do so with directors providing personal guarantees, preserving personal liability.

The report highlights why consumer credit is used despite often being more expensive than business borrowing, citing evidence on speed, success rates and awareness gaps regarding non-bank finance options.

2) **Access to finance has worsened over time for the smallest SMEs**

Across the literature synthesised in the report, real-terms SME bank lending has declined over the past decade. The smallest SMEs face the sharpest constraints, including lower application success rates and higher decline rates than larger firms.

3) **Access to non-lending services is comparatively strong, but cashflow frictions remain**

Point-of-sale payment tools and cloud accounting/invoicing systems are widely accessible even for very early-stage firms, but cashflow frictions remain, including trade-offs between fees and settlement speed and constraints associated with third-party payment processing platforms.

4) **Barriers cluster into three recurring themes**

The report groups barriers into three broad clusters:

- Technological barriers (digital identity, AML/KYB cost and limited timely data sharing).
- Regulatory and compliance barriers (disproportionate cost of small loans, widespread personal guarantees and related frictions).
- Cultural and behavioural barriers (financial hygiene, planning and capability constraints).

The FCA's SME Access to Finance programme

The Panel is pleased that the FCA's SME Access to Finance programme is examining how FCA regulation affects SME access to finance across debt, equity, hybrid and alternative finance. We believe that our report and a number of early conversations with the team through the report's life has helped to shape this work and we look forward to reading what the FCA publishes in September of this year.

Headline Recommendations

The report makes four main recommendations. In summary, these are:

1) **Clarify how the Consumer Duty applies at the sole trader / micro-business boundary**

The FCA should test, and then clarify, how Consumer Duty expectations apply at the sole trader/micro-business level to regulated firms and then publish a short expectations statement with practical examples of good and poor practice. This should be grounded in real customer journeys and aligned to the FCA's SME Access to Finance work.

2) **Outline a good "financial readiness" baseline and modernise frictions that don't fit a digital economy**

The FCA should set out what a good "readiness" baseline looks like for sole traders and micro-entities, and test whether KYC/KYB and information requirements remain proportionate for digital-first businesses. Where firms decline applicants, expectations should support clearer feedback and signposting to reduce "discouragement" and improve re-application.

3) **Assess the level of friction created by personal liability requirements (especially personal guarantees) by firms within the backdrop of the growth agenda.**

The FCA should describe what good practice looks like on personal guarantees and related personal liability frictions in the regulatory perimeter, and communicate perimeter limits clearly. The FCA should use the SME programme to examine how personal liability requirements interact with discouragement, choice of funding route, and growth outcomes for the smallest firms.

4) **Support work already underway and accelerate consent-driven data sharing and Open Finance for SME lending**

The FCA should accelerate work that improves the information available to lenders through secure, consent based data sharing, aligned with the FCA's Open Finance delivery approach.

1. Introduction by Axiom Economics

This report is commissioned by the Financial Services Consumer Panel (the Panel), a statutory body that represents the interests of individual and small business consumers in the development of financial services regulation in the United Kingdom. The Panel works to advise and challenge the Financial Conduct Authority (FCA) from the earliest stages of policy development, to ensure that the consumer interest is placed at the heart of regulation. The Panel commissioned this research to investigate the experiences of sole traders and micro-businesses when it comes to barriers they face in growing their business. The report is a desk-based literature review.

The central hypothesis examined in this report is: “There is more that could be done in the UK through regulation to improve the financial services and products available to sole traders and micro businesses to grow.” The Panel commissioned a desk-based review of existing research, expert opinion and case studies to evaluate this hypothesis. The Panel initiated the research in November 2025, with a research and drafting period running through to March 2026.

This report is a literature review. The methodology comprises a desk-based review of publicly available data, published research, policy documents and expert analysis. The review draws on a range of authoritative sources, including the British Business Bank (BBB), the BVA/BDRC SME Finance Monitor, the Federation of Small Businesses (FSB), UK Finance, the Department for Business and Trade (DBT), the Centre for Finance, Innovation and Technology (CFIT), and relevant academic literature. Where the review has identified gaps in the existing evidence base, these are noted as opportunities for further research by either the FCA or the Panel.

The Panel recognises that a literature review of this nature has inherent limitations: it relies on published data and analysis, and cannot substitute for primary research with businesses and lenders. The gaps identified in this report — including the role of mutuals, the impact of relationship banking, and the experiences of merchants with payment processing platforms — are areas where the Panel sees scope for further investigation.

The report is structured in three parts. First, an overview of the landscape for sole traders and micro-businesses wishing to expand and grow in the UK economy. Second, an examination of the types of financial barriers these businesses face, with particular attention to barriers that fall within or adjacent to the FCA's regulatory remit. Third, a brief review of relevant international experience.

Data on aggregate SME lending trends is sourced principally from the British Business Bank (BBB) Small Business Finance Markets reports. Survey data on SME financing experiences, application rates and declination rates is sourced from the BVA/BDRC SME Finance Monitor (up to Q2 2025). The Federation of Small Businesses (FSB) IPSOS SME Finance Survey (2023) contributes evidence on the behavioural barriers to finance. UK Finance Business Finance Review (Q3 2025) provides sector-level data on lending trends. The Centre for Finance, Innovation and Technology (CFIT) Smart Data for SME lending taskforce report (August 2024) provides analysis of the potential of digital data sharing. The Department for Business and Trade (DBT) 'Backing Your Business' plan (January 2026) sets out the government's proposals for improving SME access to finance.

The research provides clear evidence in support of the central hypothesis. The UK's SME financing market is characterised by declining real-terms lending, falling application success rates, and a pronounced gap in credit availability for the smallest businesses. The smallest SMEs — those with no employees — face a declined application rate of 46%, more than eight times the rate experienced by the largest SMEs. The evidence supports the view that regulatory action could meaningfully improve outcomes for sole traders and micro-businesses.

Three categories of barrier are identified: technological, regulatory and compliance, and cultural and behavioural. Technological barriers centre on verification and validation challenges and on the absence of timely, comprehensive data sharing between SMEs, lenders, and public bodies. Regulatory and compliance barriers arise from the structure of lending regulation and the economics of small loan provision. Cultural and behavioural barriers reflect the limited financial capability of many business owners and a lack of planning for the financial lifecycle of the business.

2. Landscape of SME Finance

This section provides an overview of the SME financing landscape in the UK, with a focus on the experiences of sole traders and micro-businesses. The term SME encompasses a broad range of sizes and ages of firms, from sole-traders through to medium-sized limited companies with up to 250 employees. In this section we create a typology of SMEs by their size and ownership structure, which helps distinguish between the experiences and challenges of different types of business. The focus of this report is on unincorporated businesses (sole traders and small partnerships) and micro-entities, as these are the firms that face the most significant barriers to accessing finance.

Using the lens of this typology, we describe the experiences of SMEs in gaining access to finance. Across business types there are very different experiences of lending sources, from sole-traders using consumer credit products due to lack of access, through to larger SMEs accessing business lending and equity financing. Over time, the UK has seen a decline in traditional bank-loan lending to SMEs. Non-traditional lenders now account for the majority of lending to SMEs. More broadly, non-lending financial services such as modern point-of-sale technology and accounting technology are available at relatively low cost to all business types and are easy to access for sole traders and small firms. Furthermore, a number of these non-lending services do facilitate and advance credit to SMEs without the level of oversight and protection given by traditional banks.

Financial Typology of SMEs

We create a typology of SMEs which categorises businesses into types by their size and ownership structure, with a focus on business routes to accessing finance.[1] Given our main interest is in the financial experience of SMEs in accessing finance, we develop a typology focused on financial product access and use, financial challenges, financial opportunities and the FCA/FOS definition of SME. The typology

[1] Existing typologies of SMEs tend to focus on business size, sector and market definition. Typologies based on business size tend to focus on revenue, balance sheet and employee numbers (these map to HMRC reporting requirements). Sectoral typologies tend to focus on industrial sectors and technology / capital requirements. Market definition typologies focus on geographic and jurisdictional boundaries.

is shown in Table 1 below. While the typology covers the full range of SME types, this report focuses principally on the first two categories — unincorporated businesses and micro-entities — as these are the businesses where barriers to finance are most acute and where regulatory intervention has the greatest potential to improve outcomes, consistent with the hypothesis under examination.

At the smallest end of the spectrum are **unincorporated businesses**, which include sole traders and small partnerships with unlimited liability. These entities are often indistinguishable from the owner's personal finances. Because they frequently lack a formal business history or rigorous reporting requirements, they rely heavily on personal finance products such as credit cards (often capped at £25,000), overdrafts, and personal loans. Their primary funding comes from personal savings, windfalls, or gifts, though some utilise merchant cash advances. The benefit of this structure is zero formal business reporting and speed of access; however, the lack of a corporate "track record" often forces these owners to rely on their own consumer credit scores for access to credit.

Micro-entities are defined by having fewer than 10 employees, a turnover of less than £1 million, and a balance sheet below £500,000. These businesses begin to bridge the gap between personal and corporate finance. While they can access business bank accounts, credit cards, and startup loans (such as those from the British Business Bank), lenders often require personal guarantees from directors due to a lack of established financial history. They benefit from simplified FRS 105 reporting and audit exemptions, and they may attract initial external funding from angel investors or shareholder funds.

As firms grow into **small companies** and **medium companies**, their financial options expand significantly. These larger SMEs access more sophisticated products including invoice and asset financing, revolving credit facilities, and equity finance. The experiences and challenges of these larger businesses, while important, are distinct from those of sole traders and micro-entities and are not the primary focus of this report.

Table 1: Typology of SMEs

Type	Definition	Funding	Financial Products	Finance Benefits/Challenges
Unincorporated	Sole traders; Small Partnerships; Wholly owned; Unlimited liability	Retained personal funds; Windfalls; Gifts; Merchant cash advance	Personal finance products; Credit cards (£25K); Overdrafts; Personal loans	Zero business reporting; No business history; Transaction history; Access to consumer credit
Micro-entity	Turnover < £1m; Balance Sheet < £500k; Employees 1-10	Angel investing; Shareholder funds; Merchant cash advance	Business bank account; Business credit card; Business loans; BBB Startup Loans	Simplified FRS 105 reporting; Audit exemption; Little/no business financial history; Director personal guarantees
Small company	Turnover < £15m; Balance Sheet < £7.5m; Employees 11-50	VC investing; HNW (High Net Worth) investing	Business Loans; Invoice financing; Asset financing (e.g. leasing)	Established credit history; Less reliance on personal guarantees; FRS 102 Section A reporting
Medium company	Turnover < £54m; Balance sheet < £27m; Employees 51 - 250	Private Equity; Syndicated Loans; Public Markets	Revolving Credit Facilities; Trade Finance; FX/Interest Rate Hedging; Supply Chain Finance	Intangible capital; Thin equity markets

Business Lending vs Consumer Credit Usage

Across firm types there is notable variation in the use of business loans and lending products versus consumer loans and lending products. Many unincorporated business and micro-entity businesses are partly or wholly financed by consumer credit. BVA/BDRC Finance Monitor statistics report that in 2024, 30% of SMEs used personal credit cards or loans to manage business cash flows, rising to 55% among small traders.[2] While for many businesses this use of consumer credit will form part of the overall credit and debt portfolio of the business, Merchant Savvy UK Business Finance Statistics reports that in 2025, 25% of SMEs used consumer credit cards as their “primary source of finance”, other sources being personal savings, inheritances, redundancy payments and loans from family.[3]

Why do sole-traders and early stage businesses use consumer credit when it is, on average, more expensive than a business loan? The BBB SME Intermediary Survey 2024 included a question module on choice of access to finance. Responses reveal three main reasons for use of consumer credit instead of business credit: speed, success rates and awareness. Personal credit cards offer instant liquidity, compared to a 4-6 week wait on business loan applications. Success rates are much higher for personal credit: only 44% of small business bank loan applications were successful in 2024, compared to over 95% of credit card applications by sole traders / directors. Awareness is also a factor, with 69% of micro-businesses reported lack of awareness of non-bank alternative business finance options e.g. asset finance or peer-to-peer lending. This evidence is consistent with the hypothesis that there is more that could be done to improve access to business finance products for sole traders and micro-businesses.

The widespread use of consumer credit products among SMEs, in particular unincorporated SMEs and Micro-entities may deliver benefits to businesses, but also creates risks for individual entrepreneurs and for lenders. Consumer credit products are typically not designed for small business usage, their loan terms, pricing, issuance and product features and terms are intended for the purchase of consumer products and services by individuals.

Access to Non-Lending Financial Services

While there is significant variation in access to financial lending services by firm type, this is not the case for non-lending financial services. A positive feature of the SME market in the UK is widespread access to non-lending financial services, even for embryonic sole traders with no business history or access to business banking. Across the typology of business types, all businesses are able to access non-lending

[2] BVA/BDRC SME Finance Monitor 2024
[3] Merchant Savvy UK Business Finance Statistics 2025

financial services such as point-of-sale technologies, and cloud-based accounting, invoicing and financial management tools.

New forms of POS payments technology are available at low cost and without qualifying criteria. These services are commonly offered with no monthly fees or up-front cost, with fee structures based on merchant transaction fees (typically 1.69-1.75%). These services offer instant setup and low-friction transfer of credit to personal / business bank account, and increasingly offer options for automatic syncing to cloud accounting systems.

SMEs of all types also have access to cloud accounting and financial management tools. These online accounting systems semi-automate business accounting, invoicing, and tax compliance. They are typically low cost (introductory plans costing £10 - £15 per calendar month), and assist with compliance (e.g. HMRC Making Tax Digital requirements, ease of VAT filings, PAYE completion) and are scalable as the firm grows.

There is also evidence that some small and micro SMEs face difficulties accessing suitable business current accounts, as suggested in the House of Commons report in SME Finance and a FSB report into experiences and challenges of SMEs in Northern Ireland.

Many small SMEs therefore start business life with access to non-lending financial services which are crucial for business activities such as receiving payments, inventory management, invoicing, and compliance; yet are reliant on consumer credit or other non-business credit for the financing of their activities.

3. Trends in SME Finance

This section describes recent trends in SME financing in the UK using SME lending statistics. The analysis in this section focuses on SME financing using business lending products (not consumer credit), as consumer credit used by SMEs is not measured in business lending statistics.

Aggregate Lending Trends

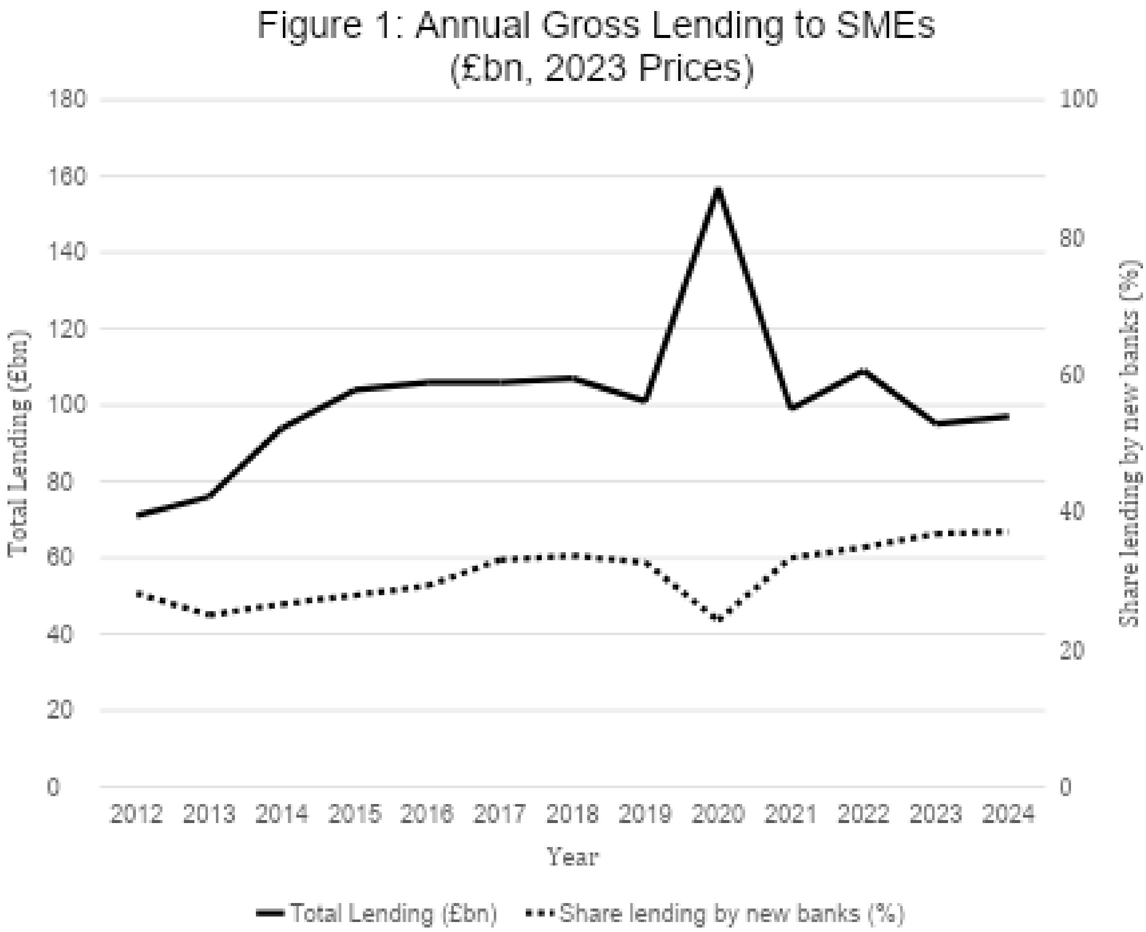
Trends in aggregate lending to SMEs are shown in Figures 1 and 2, which use lending data provided by the British Business Bank (BBB).[4] Figure 1 shows total aggregate lending to SMEs in real terms (using 2023 prices), together with the share of total bank lending attributable to new banks. Total lending over the period has experienced a slight decline in real terms, from more than £100bn per annum in the period 2015-2018, to less than £100bn in 2023 and 2024. This trend downwards is interrupted by the spike in SME lending occurring during the Covid-19 pandemic, during which government-backed lending schemes resulted in an approximate 60% increase in total lending to SMEs.

The gradual decline in overall lending to SMEs has occurred during a period in which the composition of lending by traditional bank lenders (the five largest UK banks and their subsidiaries) and new bank lenders (which together sum to aggregate lending) has changed, with an increase in the share of total lending attributable to new bank lenders. This has increased from 25% in 2013 to 37% by 2024.

Figure 2 illustrates the levels of traditional-bank and new-bank lending over the period. Early in the period, lending to SMEs was concentrated in the traditional banks, with the five largest banks accounting for approximately three-quarters of all lending to SMEs. Over the past decade, changes to authorisation and regulation have increased the number of banks. Since 2014, UK has issued 60 new banking licenses, of which 36 are to serve SMEs. These banks have increased their lending to SMEs with a rapid rise in financing in real terms, with an 80% increase in lending by new banks over the period. However, over the period the levels of lending in real

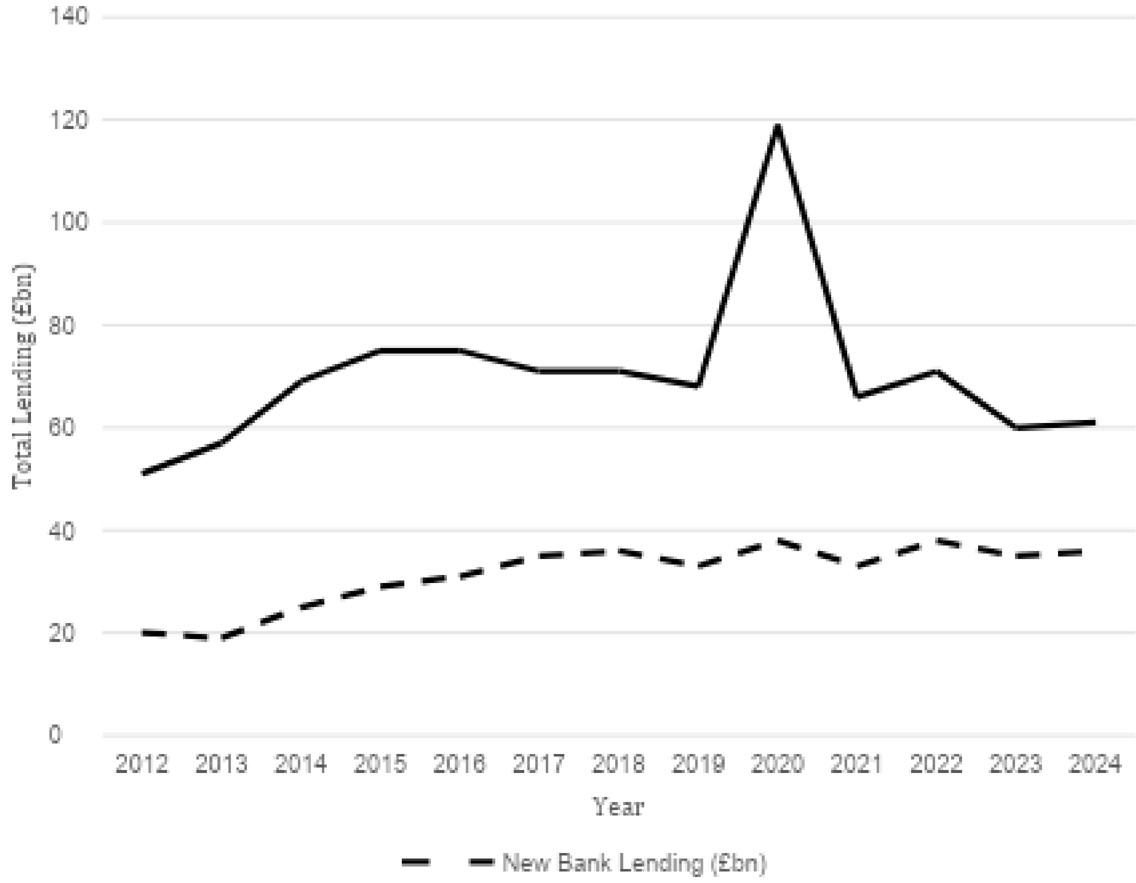
[4] British Business Bank Small Business Finance Markets 2024/5

terms by traditional banks have declined, by approximately £20bn per annum, whilst the levels of lending in real terms by new banks have increased, by approximately £15bn. Note that the large increase in SME lending arising from the government-backed Covid-19 loan schemes was mostly channelled via traditional banks, illustrated by the spike in SME lending by traditional banks seen in Figure 2. The net effect of this pattern is the observed overall decline in aggregate lending. This decline is of particular concern for sole traders and micro-businesses: while many rely primarily on consumer credit, the contraction in business lending reduces the viable options for those seeking to transition to formal business finance.



Source: British Business Bank

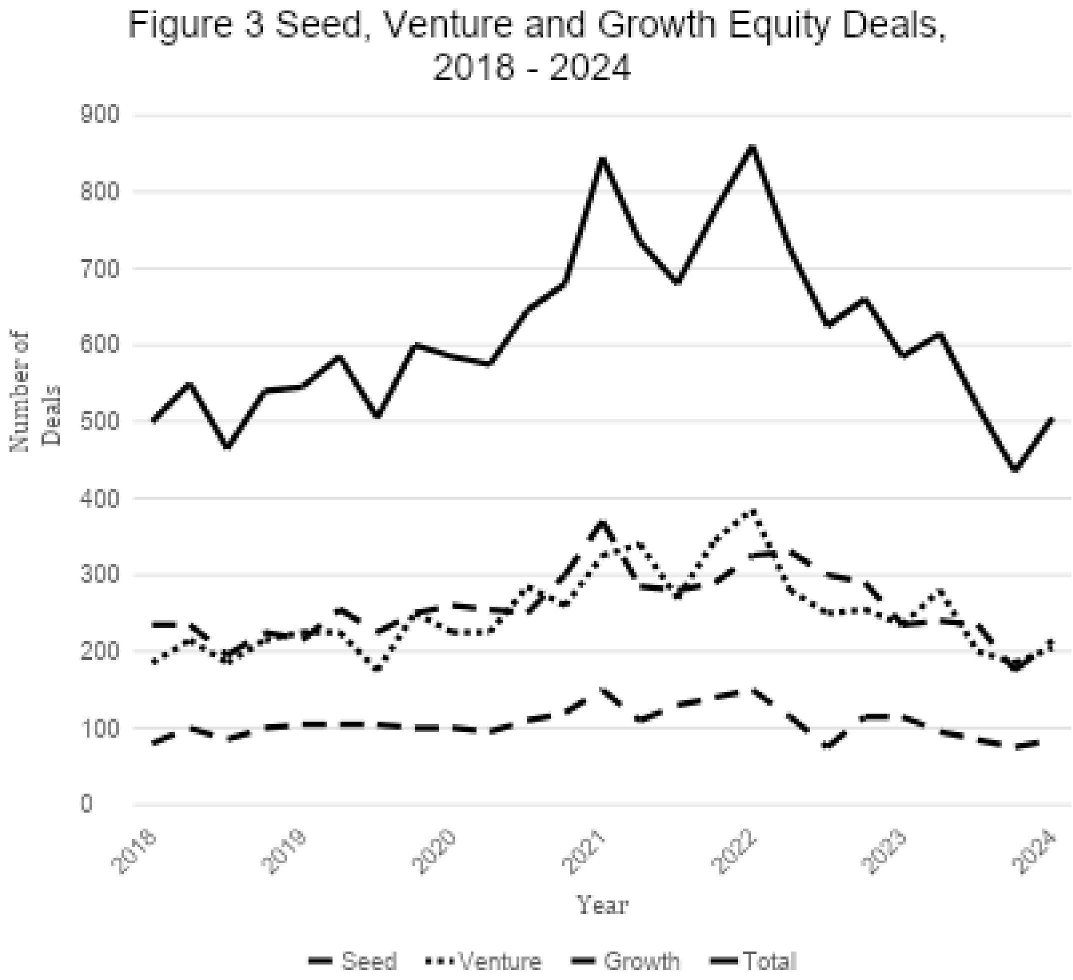
Figure 2: Annual Gross UK Traditional Bank and New Bank Lending to SMEs (£bn, 2023 Prices)



Source: British Business Bank

SME Equity Financing

The decline in SME lending from the banking sector over the past decade has been accompanied by a simultaneous decline in SME equity financing. Equity financing is typically accessed by businesses at more mature stages of growth, such as small and medium companies, and is therefore of less direct relevance to the sole traders and micro-businesses that are the primary focus of this report. However, the decline in equity finance has broader implications for the financing ecosystem as a whole. Data from the British Business Bank and Beauhurst show that the number of equity deals completed by UK SMEs has fallen significantly, From an average of 500-600 per quarter during 2018 and 2019 to fewer than 300 as of Q3 2024. The value of deals completed has fallen correspondingly and the decline in dealmaking has been concentrated in Seed and Venture deals, which are the stages most relevant to smaller and newer businesses.



Source: British Business Bank

Unmet Demand and Financing Needs

The trends of reduced aggregate lending to SMEs and equity investment into SMEs suggest that there may be unmet demand for financing among SMEs (however, it is possible that some of the reduction in lending and equity investment might be attributable to lower demand on the part of SMEs). A wide range of studies suggest significant levels of unmet demand by SMEs. The academic literature documents how businesses face widespread unmet financing needs, and that these needs are particularly acute among businesses in lower income geographies, and businesses founded by entrepreneurs from minority backgrounds.[5] The policy literature in the UK documents the size of unmet financing needs among UK-based SMEs today.

Estimates of the scale of unmet demand vary across sources. The Centre for Finance, Innovation and Technology (CFIT) has estimated up to £22bn of unmet financing demand. The British Business Bank's Small Business Finance Markets reports document a persistent gap between SME financing needs and available credit, particularly for the smallest firms. Survey data from the FSB/IPSOS SME Finance Survey for 2023 estimates that 25-30% of SMEs do not obtain the financing they require.[6] The BVA/BDRC SME Finance Monitor reports that 75% of SMEs declined for finance do not apply elsewhere after the decline of their first application, suggesting that businesses are quickly discouraged from applying for credit in light of rejection. This pattern of discouragement is particularly concerning for sole traders and micro-businesses, who are already the most likely to be declined and the least likely to have access to professional advice on alternative financing options.

Further data on application and rejection rates suggests that the problem of unmet demand for financing among UK SMEs has worsened over time. Time series data from the BVA/BDRC survey reveals that declined application rates on lending applications in the period Q1 2024 to Q2 2025 stood at approximately 43%, significantly higher than 26% declined application rate pre-pandemic (declined application rates fell dramatically during the period of the Covid-19 pandemic due to the availability of government-based loan schemes.)

Evidence from application data also shows that smaller SMEs face significantly higher likelihood of their financing applications being declined. Measuring the size of an SME by the number of employees, BVA/BDRC data shows that the smallest businesses (those with no employees) experience a 46% decline rate, compared with 44% among businesses with 1-9 employees, 15% among businesses with 10-49 employees and 5% among businesses with 50-249 employees. The overall decline rate of 43% therefore masks a wide dispersion by firm size, with the smallest SMEs being more than 8 times more likely to be declined for finance compared with

[5] For a recent review of the literature, see Rao et al. (2024).
[6] FSB/IPSOS SME Finance Survey 2023.

the largest SMEs. This evidence strongly supports the hypothesis that more could be done to improve financial services for the smallest businesses.

4. Barriers to Growth in SME Lending

This section addresses the barriers to growth in SME lending which explain the reduced lending over time in real terms, falling acceptance rates, and particularly severe challenges in access to finance among sole traders and micro-businesses. The discussion focuses on barriers that fall within or adjacent to the FCA's regulatory remit, or where the FCA could use its convening and influencing power to improve outcomes.

Sole traders and firms in the UK face a variety of barriers to growth. These include skills gaps — particularly a lack of suitably qualified potential workers and limited routes into on-the-job skill development such as large-scale apprenticeship schemes. Low consumer confidence is also a significant drag, with UK consumer confidence having been net negative since 2016 and remaining below pre-Covid levels, accompanied by an increased personal saving rate and weak consumption growth.

The focus of this report, however, is on barriers to accessing financial services and finance. The barriers are grouped into three categories: technological, regulatory and compliance, and cultural and behavioural. In addition, this section considers the role of cashflow and payments infrastructure, and the potential contribution of mutuals and regional institutions.

Technological Barriers

Two forms of technological barrier hold back SME lending in the UK. The first is barriers to verification and validation — that is, the ability of businesses to verify and validate their status when accessing financial products and services. Sole traders typically access financial products by relying on their individual status as a consumer credit or mortgage credit applicant and holder. However, at the point of incorporation, firms begin to face a range of specific challenges.

i) Verification and validation loops present a particular problem: business current account applications require evidence of pending invoices, yet supplier setup itself requires business current account credentials before an invoice can even be issued.

Paper-based invoicing compounds this by adding costs to the verification process, creating a circular dependency that is difficult for new businesses to escape.

ii) The cost of Anti-Money Laundering (AML) regulations is another significant technological barrier. AML checks are time-consuming and expensive for both businesses and lenders, and crucially they are applied uniformly to loans of all sizes. This creates a disincentive for small loan applications, as the compliance overhead is disproportionate relative to loan value. As a result, businesses frequently resort to consumer credit — which carries lower compliance burdens for lenders — even though it is generally more expensive.

iii) The time and administrative cost of KYC/KYB checks flows from the same structural problem. The absence of a Company Digital ID system in the UK means that Know Your Customer (KYC) and Know Your Business (KYB) checks must be conducted manually with each new counterparty. This is slow and costly for both the business and the lender, and acts as a further friction in the lending process.

The second is limited data sharing and business histories for newly incorporated companies.

When a sole trader incorporates as a limited company, the business begins its formal existence with no financial history of its own. The owner's personal credit history, transaction records, and consumer credit profile — all of which may provide meaningful signals about the quality and conduct of the underlying business — cannot be transferred to the new corporate entity. Lenders making decisions on business credit applications for newly incorporated firms therefore face a fundamental information asymmetry: the business lacks the filed accounts, trading history, and credit track record on which lending decisions typically depend. This "thin-file" problem is particularly acute for micro-entities in the period immediately following incorporation, and is a significant driver of the elevated decline rates observed among the smallest SMEs.

The challenge is compounded by the lag in the availability of financial data on newly incorporated businesses. Companies House filings — the primary source of auditable financial information on limited companies for lenders and credit reference agencies — can be up to 18 months out of date. A business that incorporated 12 months ago and has since grown substantially may still present to a lender with either no filed accounts or data that understates its current trading position by a wide margin. VAT returns, which are filed quarterly and provide a near real-time measure of business revenue for the majority of trading businesses, are not currently accessible to lenders or credit reference agencies. Cloud accounting data, which tracks financial transactions in close to real time, similarly remains siloed within individual businesses and their accountants. The net effect is that the data available to support lending decisions for smaller, newer businesses is systematically older, thinner, and less accurate than the data available for more established firms.

This data gap creates both a market failure and a policy opportunity. The CFIT Smart Data Taskforce has identified a set of data assets that could be shared digitally to address the thin-file problem. The BBB and UK Finance have also advocated for improved data sharing between lenders, HMRC, and Companies House. Consent-driven Smart Data sharing — analogous to the Open Banking model already in operation for current account data — would allow newly incorporated SMEs to actively share their financial data with potential lenders, demonstrating creditworthiness in close to real time. The FCA's forthcoming roadmap on Open Finance represents an important opportunity to advance this agenda.

Regulatory and Compliance Barriers

Regulatory and compliance barriers centre primarily on access to finance, and arise from a combination of regulatory design, lender incentives, and the structure of business ownership in the UK.

i) Compliance costs and small loan sizing create a structural problem for micro-businesses and sole traders seeking small amounts of capital. Small loans are lower revenue-generating for lenders but face exactly the same compliance and onboarding costs as larger, more profitable loans. As a rational response, lenders tend to restrict the supply of small loans, leaving a gap in the market that is particularly acute for the smallest businesses.

ii) Personal guarantees present a significant regulatory tension. Business owners incorporate specifically to obtain the protection of limited liability, yet in practice they frequently face requirements to provide personal guarantees when seeking business finance. This also creates a coordination challenge in businesses with multiple directors, since guarantees may need to be agreed across several individuals. The practical consequence is that many entrepreneurs fall back on consumer credit to fund business activity — even though using consumer credit for business purposes is typically outside the terms and conditions of those products. The Federation of Small Businesses (FSB) has reported that over 50% of SME owners have personal guarantees in place and has previously raised a super-complaint with the FCA on this issue. Lending data indicates that 36% of loans to SMEs require personal guarantees.

The FCA's follow-up work on the FSB super-complaint examined the use of personal guarantees in the limited part of the SME lending market that the FCA regulates. The FCA's findings indicated that the number of guarantees in place to support regulated lending is low, that there were no material concerns regarding compliance, and that the number of complaints to the Financial Ombudsman Service related to regulated lending was low. However, it is important to note that these findings relate to a very limited segment of the SME lending market — the majority of SME lending is not directly regulated by the FCA. The concerns raised by the FSB relate primarily to the unregulated market, where practices may differ. The recent DBT 'Backing Your Business' plan proposes a mandatory code of conduct for accredited lenders that use the BBB Growth Guarantee Scheme (GGS) to ensure the use of personal guarantees under the scheme is fair and transparent. DBT also proposes to work with industry bodies to build on their existing lender commitments to use personal guarantees responsibly.

Cashflow, Payments and Settlement

Access to finance is not only about borrowing to fund growth. For many sole traders and micro-businesses, short-term cashflow management and business survival are more pressing day-to-day concerns than capital for expansion. The financial infrastructure through which small businesses receive and manage payments is therefore directly relevant to their financial wellbeing, and is an area where the FCA has regulatory powers.

The point-of-sale (POS) interface between digital payment systems and real-world transactions is a critical juncture for small businesses. Merchants face a trade-off between low transaction fees with slow settlement (where funds may take several days to reach the merchant's bank account) and higher fees for faster or instant settlement. For businesses operating with thin cash reserves — as many sole traders and micro-businesses do — this trade-off can create acute cashflow pressure. A delay of even a few days in receiving payment for goods or services already delivered can force a business to rely on overdraft facilities or consumer credit to bridge the gap, adding cost and financial risk.

Third-party payment processing platforms such as Stripe, Square, SumUp and others have become integral to the operations of many small merchants and sole traders. These platforms offer ease of setup, instant access to payment services, and increasingly offer adjacent financial services including working capital advances and business accounts. However, there is a concern that merchants can become locked into the ecosystems of these platforms. Funds received through a payment processor may be available instantly for use within the platform's own suite of services, but transferring those funds to an external bank account can take several working days. For many small businesses operating on tight margins, the practical effect is that merchants are incentivised to keep their funds within the platform's ecosystem in order to access them quickly, rather than moving them to a bank account where they could be managed alongside other business finances. This dynamic warrants further examination, particularly as the volume of transactions processed through third-party platforms continues to grow.

Compounding these issues, much SME transactional activity now sits outside traditional banking channels. Card platforms, payment processors, and other intermediaries handle a significant volume of merchant transactions, but banks often lack visibility of this activity. Card networks and payment processors are under no obligation to share transaction data with banks or lenders. This creates material information gaps for lenders seeking to assess the creditworthiness of small businesses whose revenues flow primarily through non-bank channels.

The FCA has regulatory authority over payment services and electronic money institutions, and therefore has the power to address aspects of the settlement and payments environment that affect small businesses. The Panel considers that the cashflow challenges arising from payment settlement timing and the practices of payment processing platforms are areas that merit further attention from the FCA.

Cultural and Behavioural Barriers

Businesses, especially smaller ones, also face barriers that are rooted in a lack of financial capability and knowledge, manifesting in behaviours that constrain their ability to access and benefit from finance.

i) Financial hygiene is a significant factor. Industry estimates suggest that limited companies collectively lose significant amounts of potential credit access due to poor hygiene of corporate credit profiles. Common issues include filing accounts late with Companies House, allowing accounts to show a net negative position, and making unnecessary use of bank overdrafts when liquid assets are held elsewhere. These behaviours signal financial distress to lenders even when the underlying business is viable, resulting in loan rejections that could have been avoided.

ii) Business life-cycle planning is another cultural barrier, particularly at the transition from sole trader to incorporated company. Sole traders often do not plan in advance for the moment when they will need to incorporate. The move to a limited company structure typically arises reactively — triggered by a specific business need such as seeking investment, adding directors, or wanting access to credit — rather than as part of a deliberate financial strategy. As a result, the finances of the sole trader are not structured in anticipation of incorporation: personal and business banking are frequently conflated, personal credit histories may carry blemishes from the early years of trading, and there is limited ability to demonstrate business creditworthiness on the basis of personal financial history alone.

iii) Financial capability is a broader underlying issue that affects multiple dimensions of business behaviour. Limited financial capability impacts cashflow management, the choice of funding and financing options, management and financial accounting practices, and awareness of the risks associated with conflating personal and business banking. Without a sufficient level of financial literacy, business owners are less able to navigate the financing landscape effectively, less likely to know about alternative sources of finance, and more likely to make decisions that inadvertently damage their creditworthiness. Evidence from BBB and FSB surveys consistently highlights financial capability as a barrier for the smallest businesses.

iv) **The decline in relationship banking** is a further factor that has disproportionately affected sole traders and micro-businesses. The withdrawal of dedicated small business banking branches over the past two decades has reduced the availability of face-to-face mentoring, relationship management and early-stage business support that was traditionally provided by local bank managers. As the number of business accounts per relationship manager has grown, banking relationships have become increasingly transactional, weakening the quality of support available to micro and small firms in particular. The existing evidence on the impact of branch closures on SME lending outcomes is limited, and this is an area where the Panel considers further research would be valuable.

The Role of Mutuals and Regional Institutions

Building societies, credit unions, and other mutual institutions have the potential to play a greater role in supporting SME lending, particularly for sole traders and micro-businesses in regions underserved by the major banks. Mutuals operate under a different ownership and governance model to shareholder-owned banks, with mandates that emphasise member service and local economic development rather than shareholder profit maximisation.

Recent developments in the UK mutual sector are relevant. In 2024, Nationwide Building Society — the UK's largest building society — completed its acquisition of Virgin Money, a full-service bank that provides a range of products to smaller businesses. According to Nationwide, this means that for the first time in the UK, a full-service business bank will be part of a large mutual. Similarly, Coventry Building Society acquired the Co-operative Bank in early 2025. Both building societies have indicated that integration with the acquired banks will be gradual, and the longer-term implications for small business lending are not yet clear. However, the greater scale of these mutuals could potentially help them compete with the incumbent banks in serving smaller businesses (BBB, 2025).

The role of community development finance institutions (CDFIs) and credit unions in serving the financing needs of sole traders and micro-businesses — particularly those in underserved regions or from minority backgrounds — is an area where the existing evidence base is limited. The Panel considers this to be a topic worthy of further investigation, whether through primary research or through engagement with the mutual sector and regional financial institutions.

Learnings from International Experience

The UK's challenges in SME financing are not unique. A number of comparable economies have developed policy interventions that have materially improved SME access to finance. While the focus of this report is on barriers and opportunities within the UK, a brief review of selected international examples provides useful context.

Germany's Sparkassen network of approximately 350 regional public savings banks demonstrates that dedicated institutional structures for regional lending can deliver sustained credit access in areas underserved by larger national banks. The model is analogous in some respects to the UK building society sector, but with a more explicit statutory commitment to supporting local business growth.

The United States Community Reinvestment Act (CRA) of 1977 provides a model of reporting requirements with regulatory consequences. Empirical evaluation (Ding & Re 2022) finds that localities entering CRA scope experience an increase in SME lending of approximately 5-6% per annum, with effects that persist over a ten-year period.

The French 'Droit au compte' principle guarantees every consumer and business the right to a bank account, preventing financial exclusion. The Netherlands has adopted one of the most advanced models of mandatory e-invoicing, which creates a digital audit trail that facilitates bank verification of business activity.

These international examples illustrate that reporting requirements, institutional structures, digital infrastructure, and risk-sharing programmes can each contribute to improved SME access to finance. The relevance of individual models to the UK context will depend on the specific regulatory and institutional landscape, and the Panel notes that further detailed comparative work may be warranted in specific areas.

5. Recommendations

Across the literature reviewed in this report, a consistent pattern shows up: the smallest firms are asked to behave like established corporates, while the risks they face often look far more like those faced by consumers. That mismatch creates avoidable friction (when small businesses are trying to borrow to start, stabilise or grow) and avoidable harm (when personal liability is inauspiciously shifted onto owners). The Panel asks the FCA to treat this concern as a priority—using the tools it already has—rather than waiting for a perfect perimeter solution.

The Panel's recommendations are:

1) Clarify how the Consumer Duty applies at the sole trader / micro-business boundary

The FCA should review how Consumer Duty expectations are applied by firms to sole trader/micro-business.

The Axiom review finds sole traders often rely on consumer products, while micro-entities frequently face personal liability via guarantees, creating consumer-like detriment channels in "business" journeys. Furthermore, the FCA engagement on SME access to finance has already highlighted lack of clarity on how rules (including the Duty) apply as a theme to explore.

The Panel suggests that the FCA perform a wide-ranging review of how the Duty applies to sole traders and micro-businesses and the real customer journeys facing them, and then publish a short explanation note along with good and poor practice examples. The Panel also suggests that this work closely aligns with the SME Access to Finance programme, so that it feeds directly into any later clarifications or consultations.

2) The FCA should outline a good “financial readiness” baseline and modernise frictions that don’t fit a digital economy

The FCA should outline a good “financial readiness” baseline for sole traders and micro-entities, and test whether current lending frictions and information requirements remain proportionate in a modern, and increasingly digital economy.

The review identified recurring barriers linked to readiness and modern business models, including verification/KYC friction, thin-file data gaps, and behavioural factors such as financial hygiene and capability. The FCA’s own SME access to finance also mentions SME readiness and ID/verification barriers as practical issues affecting outcomes.

The Panel recommends that the FCA consider publishing a concise readiness framework for SMEs to utilise and promote consistent feedback/signposting from firms when declining applicants (what was missing; how to improve; where to seek alternatives) to reduce “discouragement” after rejection.

The Panel suggest the FCA also explore whether a simple transparency tool (e.g. a “scoreboard”-style reporting of approval/decline rates by segment/provider type) would help accountability, competition and SME decision-making within firms.

3) Assess the level of friction created by personal liability requirements (especially personal guarantees) by firms within the backdrop of the growth agenda.

Against the backdrop of the Government’s growth agenda and increasing “risk in the system”, the FCA should examine whether personal-liability frictions—particularly personal guarantees—are creating avoidable barriers for sole traders and micro-businesses and set out what proportionate practice looks like within the parts of the market the FCA regulates and supervises.

Axiom identifies personal guarantees as a key compliance barrier and a regulatory tension (limited liability in theory, personal liability in practice), which can push entrepreneurs toward consumer credit and deter productive investment. Furthermore, the FCA’s own follow-up work after the FSB super-complaint reports low levels of guarantees in the regulated segment and explicitly notes most SME lending sits outside FCA remit.

The Panel would like to see a short expectation note by the FCA on proportionate practice for personal guarantees in the regulatory perimeter (e.g., transparency of terms, communications standards, and avoiding unnecessary guarantees on very small borrowing where appropriate). Alongside this, it should build in questions around personal liabilities as part of the SME access to finance programme, including understanding further interactions with firms that discourage or transition people from business to consumer funding.

It would also encourage the FCA to publicly articulate whether it supports expanding the perimeter so that all personal guarantees used in SME lending are subject to FCA conduct standards (and therefore Duty-aligned expectations) and provide a clear recommendation to HM Treasury on the preferred legislative route.

4) Support work already underway and accelerate consent-driven data sharing and Open Finance for SME lending

The FCA should support and encourage schemes that improve the information available to lenders (and portability of SME data), reducing friction in decision-making and improving outcomes for the smallest firms. This includes encouraging consent-driven information sharing through Open Banking and Smart Data initiatives, promoting existing tools that improve SME financial health, and inputting in the Department for Business Trade on a mandatory code of conduct for Growth Guarantee Scheme accredited lenders.

The FCA's own Open Finance roadmap explicitly highlights lending to SMEs as a high-impact early use case for secure, consent-based data sharing, which the Panel also encourages. We would also encourage the FCA, as part of this work, to consider conducting a review of payment processing platforms that have the potential to provide end-to-end SME lending without any outside organisation having sight of this data and consider whether such firms can be encouraged to share this data as part of the Open Finance roadmap to help increase competition in the market.

In conclusion, taken together, these recommendations ask the FCA to do three things: clarify how outcomes-based Consumer Duty expectations apply at the smallest-firm level, strip out unnecessary friction that is discouraging viable firms, and use data and transparency to drive practical change.

6. Conclusion

The evidence presented in this report provides strong support for the Panel's core hypothesis: there is more that could be done in the UK through regulation to improve the financial services and products available to sole traders and micro-businesses. The SME financing market in the UK is characterised by a trend of declining real-terms lending, falling application success rates, and a persistent and widening gap in credit availability between the smallest and largest businesses. At the current rate of declined applications — 43% on average, and 46% for businesses with no employees — the financing market is failing a significant proportion of the UK's entrepreneurs.

The barriers identified in this report are structural, not incidental. Technological barriers — the absence of a universal digital business identity, the high cost of AML and KYC compliance, and the limited availability of timely financial data on smaller firms — have their roots in the architecture of the UK's financial infrastructure and will not be resolved by market forces alone. Regulatory and compliance barriers — including the economics of small loan provision and the widespread requirement for personal guarantees — reflect structural features of lending regulation and market design that require attention. Cashflow and payment settlement challenges — including the trade-offs faced by merchants using point-of-sale platforms and the constraints of third-party payment processing ecosystems — represent a further dimension of the problem, and one where the FCA's regulatory authority over payment services is directly relevant. Cultural and behavioural barriers — including poor financial hygiene, inadequate lifecycle planning, and limited financial capability — are amenable to intervention through education and tooling, but require deliberate policy support to reach the scale needed to make a material difference.

This report is a desk-based literature review and recognises that the evidence base on a number of the topics examined is incomplete. In particular, the role of mutuals and regional institutions in SME lending, the impact of relationship banking and branch closures on the smallest businesses, and the experiences of merchants with third-party payment processing platforms are areas where the Panel has identified gaps in the existing research. These gaps are opportunities for further primary research, whether conducted by the FCA directly or commissioned by the Panel in the coming year.

Sole traders and micro-businesses are the foundation of the UK economy, accounting for the majority of business entities and a significant share of employment and economic activity. Their ability to access finance on fair terms is not simply a matter of commercial convenience: it is a prerequisite for economic growth, for the equitable distribution of economic opportunity, and for the realisation of the UK government’s ambitions for a dynamic, innovative, and inclusive economy.

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