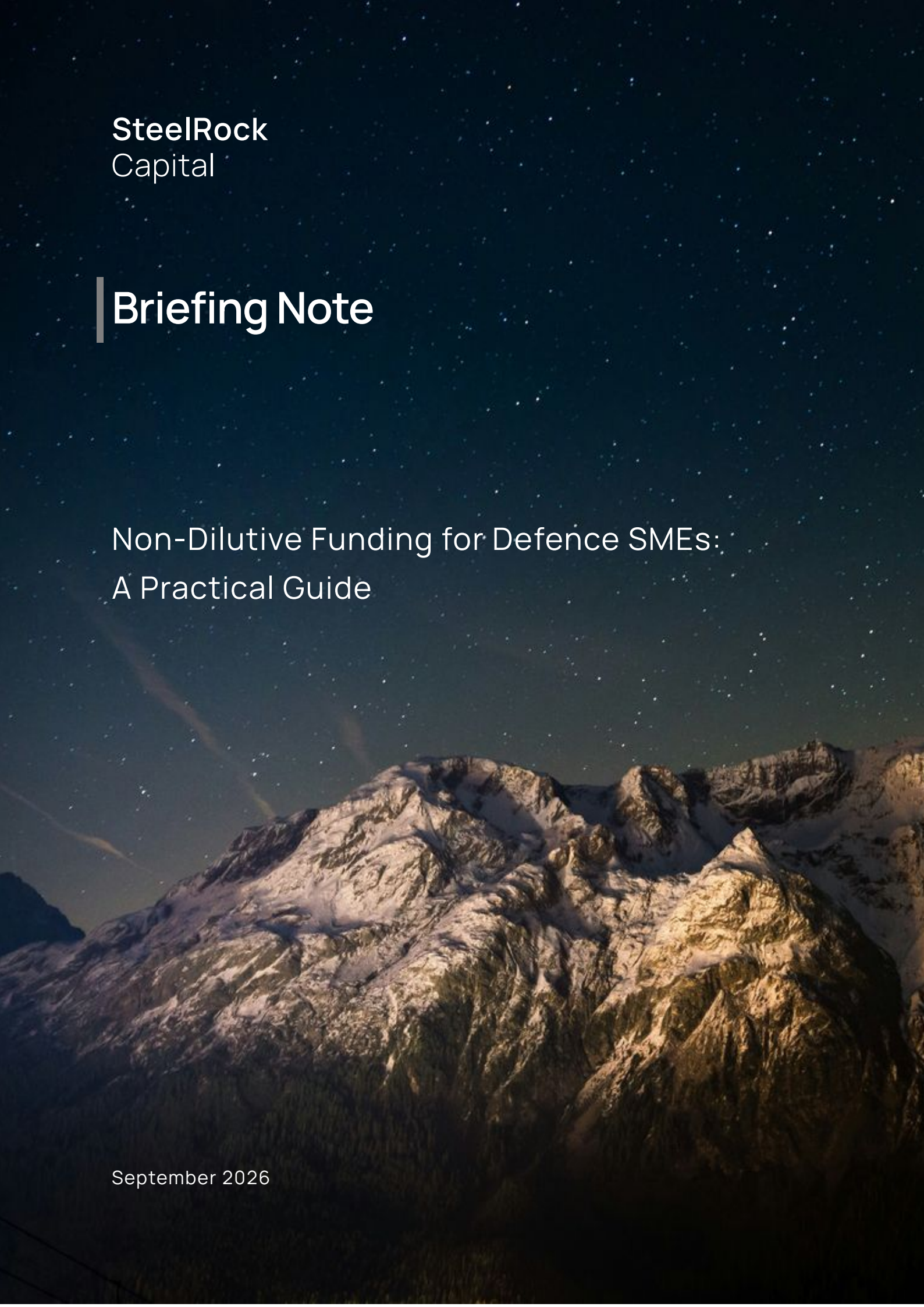
SteelRock
Capital

Briefing Note

Non-Dilutive Funding for Defence SMEs: A Practical Guide



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Purpose of this Briefing

This note sets out, in plain terms, the main forms of non-dilutive funding available to UK defence, security and resilience (DSR) SMEs. This is funding that supports growth and delivery without requiring founders to give up equity.

It covers innovation grants and loans from Innovate UK, R&D tax credits, and the principal commercial debt finance tools used to fund orders and delivery.

Links to the relevant government schemes are included throughout, with a consolidated list at the end.

This briefing note is intended to provide an overview and should not be considered as financial advice.

Why non-dilutive capital matters

The UK defence sector is characterised by high technical ambition, long development cycles and complex procurement pathways. Many of the country's most innovative capabilities originate in SMEs, yet these same firms often struggle to fund growth. Traditional venture capital is not always well suited to defence: development timelines are long, customer concentration is high, and revenues are frequently milestone-based rather than recurring. As a result, founders can find themselves repeatedly diluting ownership simply to survive the journey from concept to contract.

Non-dilutive capital, funding that does not require giving up equity, plays a critical role in bridging this gap. Used correctly, it allows a company to progress from research and development through to production and delivery while preserving ownership, control and long-term value.

The key is sequencing: matching the right instrument to the company's stage of maturity and combining several tools into a coherent capital stack.

Matching funding to your stage

Most defence companies follow a broadly similar path: early technical development, demonstration and validation, initial commercialisation, then contract delivery and scale. Each phase carries different risks and so attracts different forms of capital. The table below gives a simplified view of how the main non-dilutive tools align to Technology Readiness Levels (TRLs).

Stage (typical TRL)	Typical non-dilutive funding
Early R&D (TRL 2–6)	Innovate UK grants; R&D tax credits; other innovation grants
Late R&D / pre-commercial (TRL 6–8)	Innovate UK loans; R&D tax credits and advance funding
Initial commercialisation (TRL 8–9)	receivables finance / contract finance; asset finance; bank and private credit
Delivery and scale	Purchase order / contract finance; asset finance; invoice / receivables finance; export finance; bank and private credit

A common and costly mistake is using innovation capital to solve commercial problems; grants and innovation loans are not designed to finance large purchase orders, long payment terms, or manufacturing ramp-up. That is the role of structured commercial finance, covered later in this note.

Innovate UK grants

Innovate UK is the UK's national innovation agency (part of UK Research and Innovation, UKRI). Its grants are non-repayable awards designed to support research, development and early demonstration, typically most relevant at TRL 2–6.

They are well-suited to feasibility studies, prototype development, system integration, and early trials, and they help reduce technical risk while building credibility with future customers and investors.

How much. Funding is awarded as a proportion of eligible project costs, typically up to 70% for a small company and up

to 60% for a medium-sized company for feasibility studies and industrial research, falling to 45% and 35% respectively for later-stage R&D experimental development.

When. Grants are paid quarterly in arrears, so a company will need to demonstrate that it has funding available to cover the funding gap and any cash-flow implications of incurring project spend ahead of reimbursement.

Eligibility. Applicants must be UK-registered, carry out the project predominantly in the UK and exploit the results from the UK. An SME is defined as having fewer than 250 employees and either turnover up to £50m or a balance sheet up to £43m. Each competition sets its own specific criteria.

How it works now. Innovate UK paused its long-running open "Smart Grants" programme from January 2025 to develop more tailored support (see UKRI guidance). Grant funding is currently delivered through themed and sector competitions published on the Innovation Funding Service, where you can search and apply for all live opportunities. Amounts and deadlines change throughout the year, so check current openings before planning a bid.

Defence-specific note. Defence SMEs should also consider the Defence and Security Accelerator (DASA), an MoD body (separate from Innovate UK) that funds innovation through non-dilutive grants and contracts. It is a natural complement to Innovate UK grants for dual-use and defence-specific technology.

Innovate UK loans

Innovation Loans sit between grants and mainstream commercial finance. They are aimed at later-stage, close-to-market R&D and pre-commercialisation (typically TRL 6–8) where there is a clear route to market, but commercial lenders are not yet willing to lend. They support late-stage R&D and pre-commercialisation activities, including final product development and manufacturing readiness, together with the eligible commercialisation costs introduced under the enhanced scheme. They are not intended to fund general commercial scale-up. Loans must be repaid but remain fully non-dilutive.

How much. Loans range from £100,000 to £5 million and can cover up to 100% of eligible project costs. While no formal match funding is required, companies must still demonstrate

sufficient funding for non-eligible costs and working capital, and adequate overall financial resilience.

Cost and term. Innovation loans are structured in two phases: a project period, during which the loan supports eligible R&D and pre-commercialisation activities, followed by a repayment period. During the project period, loans are drawn down quarterly in advance, with interest charged at half of the 7.4% per annum rate (i.e. 3.7%), the other 3.7% being added to the principal. During the repayment period, the principal is repaid with the full interest of 7.4%. The combined project and repayment periods can extend to a maximum overall loan term of seven years. Exact rates, amounts and timetables vary by funding round and should be confirmed against the live competition on the Innovation Funding Service.

Eligibility. Open to UK-registered micro, small and medium-sized enterprises with a highly innovative, late-stage project that has strong commercial potential and clear economic benefit to the UK.

R&D tax credits: how they work

R&D tax relief is a government incentive that rewards companies for investing in qualifying research and development. It reduces a company's Corporation Tax bill or, for loss-making companies, can be claimed as a cash payment from HMRC. For many defence and dual-use SMEs where R&D spend is high it is one of the most valuable sources of non-dilutive funding available, and it can be claimed every year as part of the company's tax return.

What counts as R&D. Work qualifies where a project seeks an advance in science or technology by resolving scientific or technological uncertainty, not simply applying existing techniques. Qualifying costs typically include staff, externally provided workers and subcontractors, software, consumables, and certain data and cloud computing costs used in the R&D.

The current scheme. For accounting periods beginning on or after 1 April 2024, the previous separate SME and RDEC schemes were replaced by a single merged R&D scheme. Under the merged R&D Expenditure Credit (RDEC), companies of all sizes receive a 20% taxable expenditure credit on qualifying R&D spend, worth roughly 15–16.2% after tax. Loss-making, R&D-intensive SMEs (those spending at least 30% of total expenditure on R&D) can instead claim Enhanced R&D

Intensive Support (ERIS), which provides a more generous cash credit worth up to around 27% of qualifying spend.

How it is paid. The credit is claimed after the financial year-end, through the Corporation Tax return, and can take several months to be received. Profit-making companies see it as a reduction in their tax bill; loss-making companies can surrender losses for a cash payment. Claims must now be supported by an additional information form that must be submitted to HMRC.

Advance funding against the claim. Because the credit arrives in arrears, specialist lenders will advance a large proportion of the expected claim, often around 70–80%, as soon as the R&D is incurred or the claim is being prepared, turning a future HMRC receipt into immediate working capital. The advance is repaid when HMRC pays out. This is genuinely non-dilutive and well suited to defence SMEs funding continuous R&D between contract milestones.

Commercial finance: from orders to scale

Once an SME begins winning contracts, the primary challenge shifts from technical risk to cash-flow timing. Government and prime contractor payment cycles are often long, while manufacturing requires upfront spending on materials, labour and equipment.

The following commercial instruments bridge that gap and, importantly, are usually assessed against the quality of the underlying contract or asset rather than the size of the SME's balance sheet.

Purchase order and contract finance. Funds the cost of fulfilling a confirmed customer order or contract before payment is received, enabling a company to pay suppliers, manufacture and deliver. Particularly relevant in defence, where contracts are often milestone-based with extended delivery cycles.

Invoice and receivables finance. Once invoices are raised, this converts unpaid invoices into immediate cash, typically advancing a large proportion of the invoice value at once, rather than waiting 60–120 days for settlement. It smooths cash flow and supports ongoing operations without dilution.

Asset finance and leasing. Allows a company to acquire equipment, tooling or facilities without large upfront capital

expenditure, converting capital costs into predictable operating expenses. Common for manufacturing machinery, test equipment and vehicles, and can also support capability-as-a-service offerings in export markets.

Asset-based lending (ABL). A blended facility that lends against a combination of receivables, inventory, plant and machinery, and sometimes property. ABL can release more capital than invoice finance alone and scales with the business as it grows, making it useful for SMEs ramping up production.

Stock and inventory finance. Funds the purchase and holding of raw materials, components or finished goods ahead of sale; valuable where long lead-time components must be secured before a contract pays out. Often used alongside purchase order finance.

Export finance and UK Export Finance (UKEF). For companies selling overseas, export finance allows an SME to borrow against the value of an export contract, using the expected payment from the overseas buyer as the basis for the funding.

Private credit insurance (for example from Atradius, Allianz Trade or Coface) and government-backed guarantees and insurance from UK Export Finance (UKEF) reduce the lender's risk, improving pricing and making deals possible that would otherwise be declined. UKEF can step in where the private

Useful links

- **Innovate UK (UKRI):** ukri - innovate uk - overview of the national innovation agency.
- **Innovation Funding Service:** apply-for-innovation-funding.service - search and apply for all live grant and loan competitions.
- **Innovate UK Innovation Loans:** iuk - innovation-loans - programme details and rounds.
- **Smart Grants guidance:** smart-innovation-funding-guidance - status of the paused open grant programme.
- **Defence and Security Accelerator (DASA):** defence-and-security-accelerator - MoD innovation grants and contracts.
- **R&D tax relief (merged scheme and ERIS):** research-and-development-tax-relief - HMRC guidance on rates and eligibility.
- **Growth Guarantee Scheme:** british-business-bank - growth-guarantee-scheme - government-backed lending guarantee.
- **UK Export Finance (UKEF):** uk-export-finance - guarantees and insurance for exporters.

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