

THE ROLE OF PRIVATE AND PUBLIC DEBT IN THE CAPITAL STRUCTURE OF PAKISTANI SMEs: A STUDY OF SMALL AND MEDIUM-SIZED ENTERPRISES (SMES)

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Abstract

This study analyzes the impact of public and private debt on the capital structure of Pakistan's SMEs. Following a quantitative design, 250 SMEs across the manufacturing, services, and retail sectors were analyzed for the year 2024. This study explained the composition of formal public and private credit accessed by SMEs in Pakistan and the formal credit market advantages and disadvantages that smaller businesses face. It contributes to the literature on capital structure in developing economies and provide actionable insights to policymakers, financial institutions, and SMEs on streamlined financing.



1. INTRODUCTION

Pakistan's economy relies heavily on small and medium-sized enterprises (SMEs), which play a vital role in generating employment, contributing to industrial output, and fostering GDP growth. However, SMEs often experience challenges in accessing finance, making the decisions regarding the capital structure they favor critical for the firm's survival and development (Khowaja, Soomro et al. 2021). The financing mix SMEs employ when financing their growth through a combination of equity, private and public debt greatly impacts the growth, economic sustainability, and economic significance of the SMEs. Given the changing economic environment and the increasing attention to formal financial inclusion, it is important to examine the debt financing practices of the SMEs in Pakistan (Begum 2022).

Extensive research exists around the capital structure theories of large corporations. The trade-off theory, the pecking order theory, and agency theory are well known and established frameworks in the literature. However, these theories have yet to be tested in the context of small and medium-sized enterprises, especially in developing markets such as Pakistan. Compared to large corporations, SMEs have higher information asymmetries, a different reliance on capital market access, different owner-manager decision patterns, and different risk profiles. These factors warrant a specific study on the capital structure of these businesses and the determinants of their exposure to private debt, such as bank loans and trade credit, or public debt instruments when they are available (Manzoor, Wei et al. 2021).

The state of Pakistan's financial system provides a compelling case on the financing of SMEs due to the

combination of the formal banking sector and the informal money-lending networks. Specifically, the increasing evolution of the system towards more structured debt markets makes the study of SME financing even more interesting (Zada, Zada et al. 2021). The State Bank of Pakistan has taken the initiative to aid SMEs in accessing formal credit systems, while the Securities and Exchange Commission of Pakistan has developed other mechanisms for financing SMEs. Unfortunately, even with these conditions, SMEs in Pakistan still experience the under-financing problem. This becomes more apparent if we consider the debt and family combination obligations and the limited public debt instruments on offer. The combination of debt instruments and family financing public together with the limited but growing public debt instruments creates a scenario that defies simplistic explanations and requires further study (Nazir, Khan et al. 2024).

This study fills a notable gap in the literature in the case of SMEs in Pakistan by exploring the patterns of the case SMEs in Pakistan focusing on the use and the structure of debt. According to Atif, Altaf et al. (2024), the patterns of debt structure and debt decisions have been studied primarily in the context of large firms and developed markets. In South Asia and particularly in Pakistan, debt decisions in SMEs have been underexplored. Given Pakistan's position as a developing economy with a large informal sector, under-resourced and regulatory burdens SMEs with market imperfections, the gap in understanding the financing decision of such SMEs is multidimensional. This lack of knowledge has implications not only for research and policy, which is built on the understanding of such financing decisions, but also for the development of the financial sector in the country.

Given varying interest rates, unstable currencies, and changing policies, all opens the door to looking at how SMEs evaluate and choose their financing options (Khan, Sulaiman et al. 2021). This research looking at SMEs in Pakistan, examines how these firms evaluate their financing options and the degree to which different characteristics of these firms impact their decisions regarding the variation of debt in their capital structure. This study compiles a dataset of 250 SMEs in Pakistan and examines

financing behavior of these firms in different sectors and geographical areas of Pakistan. The insights gained through the study will assist institutions aimed at SME financing in understanding the credit risk and financing behavior of these firm. The insights will also assist policymakers in their efforts to tailor support initiatives, assist owners and managers of SMEs in formulating best capital structures and give the desired degree of financial flexibility with their growth targets.

Research Objectives

1. To study the structural composition and the proportional importance of public and private debt elements of the capital structure of SMEs in Pakistan across different manufacturing industries.
2. To evaluate and describe the firm specific determinants of capital structure decisions of SMEs, in particular the role of profitability, asset structure, firm size, growth opportunities.
3. To explore and describe the relationship of borrowing behavior and firm performance in order to give insights on the capital structure optimization of Pakistani SMEs.

Research Questions

1. What are the differences in the levels of private and public debt that comprise the capital structures of Pakistani SMEs, and how do these differences change by sector and firm size?
2. What are the firm-specific determinants of capital structure for SMEs, and how do these factors affect the decisions made, including the strength of these influences?
3. What are the effects of capital structure decisions, specifically the proportions of private debt and public debt, on the financial performance and growth of SMEs in Pakistan?

Significance of the Study

This research holds considerable significance for stakeholders in the economic landscape of Pakistan. For policymakers and authorities, the research provides insights into the pattern of debt financing

available to SMEs, thus enabling the design of more appropriate debt-financing policies. Financial institutions may find the research useful in understanding the financing behavior, credit needs, and risk of SMEs to design appropriate financial instruments and credit evaluation techniques. SME owners and managers may find the research useful in providing appropriate recommendations on the optimization of capital structures in alignment with their growth targets and characteristics. In terms of scholarship, this study adds to the still developing literature on the capital structure of emerging market SMEs, especially within the South Asian context, and sets the stage for subsequent comparative work within the region.

LITERATURE REVIEW

The classic theories of capital structure are set out by Modigliani and Miller. They assert that in perfect capital markets, the value of a company is unaffected by how it finances itself. Later theories, however, acknowledged the impact of market imperfections within the framework of taxes, costs of bankruptcy, agency problems, and information gaps on the financing decision. For SMEs, the impact of such imperfections is even greater, making the decision on capital structure even more critical (Brusov and Filatova 2023). The trade-off theory holds that firms seek to optimize their capital structure by leveraging the benefits of tax deductibility of interest payments on debt and counterbalancing the potential losses associated with financial distress. The implication of the theory is that firms with steady cash flows and a significant proportion of fixed assets should use more debt, as they face reduced bankruptcy risks and can better capitalize on the tax benefits of debt financing (Cerkovskis, Gajdosikova et al. 2022).

Pecking order theory, developed by Myers and Majluf, provides an alternate view focused on smaller and medium enterprises (SMEs). This theory states that firms prioritize internal financing, then debt, and finally external equity, largely defeating the purpose of financing garnered by external investors. For SMEs, where the asymmetries of information are disproportionately greater because of minimal information disclosure and the absence of credit ratings, the pecking order theory will likely hold greater explanatory power (Djabang, Shubita et al.

2025). Small enterprises are primarily reliant of on retained earnings and, more importantly, private debt from banks, family sources, and private family members because the absence of the track record and transparency runs the risk of them being denied access to equity markets or unfavorable debt market. This explains the strong preference of private debt over public debt, particularly in relation to SMEs, to the extent that information asymmetries can be mitigated more easily to relationship lending and via personal debt contracts and guarantees (Rodriguez 2024).

Every theory adds another layer to the understanding the SMEs take in the decisions of the capital structuring. In the framework of Jensen and Meckling, the managerial discretion's cost can be mitigated by the free cash flow being reduced by the "debt" being used as a disciplinary tool. Nevertheless, in the small to medium enterprises (SMEs), the ownership and the management being the same entity, the traditional approach of the agency managerial conflict, is much less the case. More so, the stress and conflict of ownership between the managing cringers, especially in SMEs, becomes paramount. When SMEs do deal with cash flow or other related financial issues, the distinctions of the public and private debts become more applicable. In terms of the overall debts, and disallowing the public debts, private debts do have much closer monitoring both in their contracts and at the entity level of the proprietary control of the being entity (Poutziouris, Markou et al. 2022).

Cross country empirical research on capital structure in emerging markets has developed literature on distinguishing features of firms in developing economies compared to developed economies. For instance, emerging market firms tend to employ lower leverage ratios, incur higher costs of capital, rely more on short-term rather than long-term debt, and have a greater concentration of their debt funds in short-term debt instruments. In the case of Pakistani enterprises, formal credit remains inaccessible, and many SMEs rely on trade credit and family loans, as well as rotating savings associations (VAN BEEK 2022). The risk-averse behavior of banks towards SME lending, because of perceived default risks and inadequate collateral, has created a financing gap that limits the growth and

formalization of SMEs. The Asaan Finance scheme introduced to SMEs and various refinancing facilities have been designed to fill such gaps, but their effectiveness in reaching the intended target has been questioned (Delikanlı and Kılıç 2021).

The determinants of capital structure of SMEs have various contexts in which they have been studied, notably firm size, profitability, asset tangibility, and growth opportunities. As firm size increases, so does leverage, due to better access to capital and more favorable lending terms. Information asymmetries decrease, and lenders offer better terms to larger firms. Profitability contains some theoretical ambiguity (Lussuamo and Serrasqueiro 2021). The trade-off theory argues profitability is positively correlated to leverage, and therefore, firms have a greater debt capacity to obtain, in addition to the benefits of the tax shield. The pecking order theory, however, claims profitability is negatively correlated to leverage, as they will use retained earnings. The more tangible fixed assets are, the more collateral a firm has. This positively influences debt financing, especially in SMEs which need asset-backed lending. Growth opportunities may have a negative relationship with leverage. Agency theory suggests a firm may have gamble restrictions on high-risk projects; however empirical research has produced mixed evidence (Czerwonka and Jaworski 2021).

In the capital structure literature, the characteristics that differentiate private from public debt have started to be studied. Particularly, the information asymmetry, monitoring costs, flexibility, and costs related to different debt financing sources. The private debt negotiated with banks, financial institutions, and other private lenders involves relationship building with the borrower (Pham and Hrdý 2023). In the case of small and medium enterprises (SMEs), this relationship banking model may lower information costs and lead to more flexible debt instruments, but to the detriment of the borrower, it may also build dependence and reduction of financing elasticity. In contrast, small enterprises may be excluded from public debt instruments (e.g. bonds) because the requirements of transparency, pre-determined debt ratings, and minimum size requisites are stringent. Nonetheless, debt capital markets in emerging markets are developed to the point of introducing SME

exchanges and public debt in the form of pooled bonds to medium-sized enterprises in the upper SME tier (Amoa-Gyarteng and Dhliwayo 2023).

RESEARCH METHODOLOGY

The researchers adopted quantitative research design to investigate the significance of both private and public debt on the capital structure of Pakistani SMEs. For this research, a cross-sectional approach was conducted, and data collected from the 250 total SMEs in the country's manufacturing, services, and retail sectors. Data collection was conducted between January 2024 and December 2024 for relevance. Primary data were collected through questionnaires while secondary data was gathered from audited financial statements, reports from the State Bank of Pakistan as well as the Securities and Exchange Commission of Pakistan (SECP) database. For sampling, stratified random sampling was used to guarantee appropriate representation pertaining to various firm sizes, sectors, and regions of Pakistan. The study focused on the measurement of debt-equity ratios, leverage ratios, firm size, profitability, asset structure, and growth opportunities as pivotal determinants. The SPSS software was used for statistical computation with multiple regressions to analyze the relationship between the independent and dependent variables. The research instrument was assessed for reliability and validity using the Cronbach's alpha and factor analysis, respectively. Ethical considerations included the protection of respondent confidentiality and the collection of informed consent from participants prior to the collection of data.

RESULTS AND DATA ANALYSIS

Sample Characteristics and Descriptive Statistics

The research sample included 250 SMEs from each of the country's primary economic regions. Approximately 42% of the sample were manufacturing firms, 36% were from the service sector, and 22% were retail enterprises. Geographically, the sample consisted of 35% from Punjab, 28% from Sindh, 18% from Khyber Pakhtunkhwa, 12% from Balochistan and 7% from the border regions. Considering the sample firms by size, 58% of the firms were small, defined as those with annual sales revenue of PKR 10-100 million;

the other 42% were medium-sized enterprises (PKR 100–800 million). Most firms were young, the average being 8.7 years (SD=4.3 years). The study's

fundamental financial descriptive statistics are shown in Table 1.

Table 1: Descriptive Statistics of Financial Variables (N=250)

Variable	Mean	Median	Std. Deviation		Minimum	Maximum
Total Debt-to-Equity Ratio	1.47	1.32	0.68		0.15	3.85
Private Debt Ratio	0.73	0.68	0.24		0.08	0.98
Public Debt Ratio	0.27	0.25	0.19		0.00	0.76
Leverage (Total Debt/Assets)	0.58	0.56	0.21		0.12	0.94
Firm Size (log of total assets)	16.42	16.28	1.85		12.64	20.37
Profitability (ROA %)	6.83	6.20	4.91		-8.40	22.50
Asset Tangibility	0.48	0.46	0.22		0.08	0.89
Growth Opportunities		0.14	0.12	0.09	-0.05	0.48

Analysis of the capital structure of SMEs in Pakistan shows the following. The firms in the sample have significant levels of debt 47% more than equity. The average total debt to equity ratio is 1.47. Most of the debt 73 percent comes from private sources. Most private loans come from banks and other private lenders. The average ratio for public debt is 0.27 which is small but 38 percent of the sample firms have no public debt at all which shows that they have restricted access to the formal debt capital market. The average ratio of 0.58 for leverage shows that 58 percent of total assets are debt which means that they are considerably dependent on borrowings.

Profitability, reflected in the return on assets, has the most diverse performance levels across the sample enterprises, ranging from -8.40 percent to 22.50 percent.

Correlation Analysis

Table 2 presents the Pearson correlation coefficients among the key variables, providing initial insights into relationships before conducting multivariate analysis. The correlation matrix helps identify potential multicollinearity issues and preliminary associations between capital structure components and firm characteristics.

Table 2: Correlation Matrix of Key Variables

Variable	1	2	3	4	5	6	7
1. Leverage	1.00						
2. Private Debt Ratio	0.42**	1.00					
3. Public Debt Ratio	-0.38**	-0.87**	1.00				
4. Firm Size	0.36**	-0.31**	0.34**	1.00			
5. Profitability	-0.28**	-0.19*	0.16*	0.23**	1.00		
6. Asset Tangibility	0.47**	0.33**	-0.29**	0.18*	-0.11	1.00	
7. Growth Opportunities	0.15*	0.08	-0.07	0.26**	0.41**	-0.05	1.00

Note: ** Correlation significant at 0.01 level; * Correlation significant at 0.05 level

Prior work shows the evidence for positive and meaningful relations. Some proof comes from correlation in the opposite sign and the stronger magnitude in debt ratios correlation of private (-) and public (-) debt ($r = (-) 0.87$, $p < 0.01$), and the

explanation comes from their climacteric nature (composing) of the two variables for every rise in one of the variables, there will be a drop in the other (public debt). Larger firms in the sample reached (Positive) correlation with Total ($r=0.36$, $p<0.01$),

with public debt ($r=0.34$, $p<0.01$) and correlate negatively with private debt ($r=-0.31$, $p<0.01$) suggesting larger SMEs are more likely to access public debt. Profitability negatively correlates with all forms of debt and ($r=-0.28$, $p<0.01$) predicts excludes the pecking order theory that profitable firms will internally finance. Asset tangibility predicts the correlation strongly positively with debt ($r = 0.47$, $p < 0.01$) contrary to the prediction that it will be negatively and rather predictably correlating proving the importance of collateralizable assets (in-forms of) in Pak SMEs to obtain debt financing.

Regression Analysis: Determinants of Overall Leverage

Multiple regression analysis was conducted to identify the determinants of overall leverage among sample SMEs. The dependent variable was the leverage ratio (total debt to total assets), and independent variables included firm size, profitability, asset tangibility, and growth opportunities. Table 3 presents the regression results.

Table 3: Regression Analysis of Leverage Determinants

Variable	Coefficient	Std. Error	t-statistic	p-value	VIF
Constant	-0.124	0.186	-0.667	0.506	-
Firm Size	0.038	0.008	4.750	0.000***	1.24
Profitability	-0.009	0.003	-3.000	0.003**	1.31
Asset Tangibility	0.421	0.067	6.284	0.000***	1.18
Growth Opportunities	0.187	0.142	1.317	0.189	1.42

$R^2 = 0.384$; Adjusted $R^2 = 0.374$; F-statistic = 38.23 ($p < 0.001$)

Note: *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$

The regression model provides an F-score of 38.23 ($p < 0.001$) reflection strong overall significance, explaining 37.4% of variance in leverage ratios of Pakistani SMEs. Firm size positively influenced leverage ($\beta = 0.038$, $p < 0.001$), which means larger SMEs have higher debt ratios, probably due to greater relative creditworthiness and access to formal financing. Profitability has a negatively significant pecking order thesis influenced ($\beta = -0.009$, $p < 0.01$), exhibiting that larger debt financing losses by more profitable firms not and external retained earnings. Whereas Asset tangibility is vertically more significant predictor ($\beta = 0.421$, $p < 0.001$), positively

so confirming that more debt financing is available to firms having greater proportions of fixed, collateralizable assets. Growth opportunities, in contrast to leverage the model is positive, but statistically insignificant, indicating that the absence of other factors, growth opportunities alone is unlikely to explain the overall leverage of Pakistani SMEs.

Regression Analysis: Determinants of Private Debt Usage

A second regression model examined the factors influencing the proportion of private debt in total debt composition. The dependent variable was the private debt ratio, calculated as private debt divided by total debt. Table 4 presents these results.

Table 4: Regression Analysis of Private Debt Ratio Determinants

Variable	Coefficient	Std. Error	t-statistic	p-value	VIF
Constant	1.142	0.124	9.210	0.000***	-

Firm Size	-0.028	0.007	-4.000	0.000***	1.24
Profitability	-0.004	0.003	-1.333	0.184	1.31
Asset Tangibility	0.217	0.069	3.145	0.002**	1.18
Growth Opportunities	0.142	0.165	0.861	0.390	1.42
Firm Age	-0.008	0.003	-2.667	0.008**	1.15

$R^2 = 0.241$; Adjusted $R^2 = 0.225$; F-statistic = 15.47 ($p < 0.001$)

Note: *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$

Regression analysis shows large firms depend less on private debt ($\beta = -0.028$, $p < 0.001$). This could be because larger SMEs have more alternative financing options, like access to public debt. Concerning asset depreciation, an increase in the private debt ratio is reinforced ($\beta = 0.217$, $p < 0.01$). This illustrates that banks emphasize secured lending and are more willing to finance firms that carry more private debt. Including the age of the firm in this model shows the declining dependence on private debt captured in a negative significant coefficient ($\beta = -0.008$, $p < 0.01$). This implies older firms have a greater reliance on more complex financing structures with lower private

debt, which indicates a diversification of finance. Hence the results indicate that profitability and growth opportunities, the other variable of interest in this analysis, are unlikely to be significant factors driving the overall ratio of private to public debt that the firm utilizes.

Sectoral Analysis of Capital Structure

Analysis of variance (ANOVA) was conducted to examine differences in capital structure patterns across the three major sectors represented in the sample. Table 5 presents mean leverage and debt composition statistics by sector along with ANOVA results.

Table 5: Capital Structure Patterns by Sector

Sector	N	Mean Leverage	Mean Private Debt Ratio	Mean Public Debt Ratio
Manufacturing	105	0.63	0.68	0.32
Services	90	0.54	0.76	0.24
Retail	55	0.56	0.78	0.22
F-statistic		4.21**	3.86**	3.72**
p-value		0.016	0.023	0.026

Note: ** $p < 0.05$

A sectoral analysis reveals significant discrepancies in the capitalization of operations across industries. Among different industries, the manufacturing sector exhibits the highest average leverage, at 0.63, which is higher than that of services (0.54) and retail (0.56). This is in line with expectations since manufacturing firms, on average, possess more fixed assets that can be used to secure more debt. However, it is interesting to note that manufacturing

firms have the highest relative public debt at 32%, while servicing and retailing have 24% and 22%, respectively. This may be explained by the fact that, on average, manufacturing firms are larger and have more formal organizational structures conducive to public debt issuance. In contrast, the service and retail sectors exhibit greater reliance on private debt, with ratios of 0.76 and 0.78, respectively. This may

be due to their smaller average size, fewer tangible assets, and more restricted access to formal capital markets.

Firm Size Categories and Debt Composition

The sample was stratified into small and medium-sized categories based on revenue thresholds to examine how firm size influences debt composition. Table 6 presents comparative statistics and independent samples t-test results.

Table 6: Debt Composition by Firm Size Category

Category	N	Mean Leverage	Mean Private Debt Ratio	Mean Public Debt Ratio	Mean Asset Tangibility
Small Enterprises	145	0.55	0.79	0.21	0.43
Medium Enterprises	105	0.62	0.64	0.36	0.55
t-statistic		-2.67**	5.34***	-6.12***	-4.38***
p-value		0.008	0.000	0.000	0.000

Note: *** $p < 0.001$; ** $p < 0.01$

In a comparative perspective on small and medium-sized businesses, notable differences arise in capital configuration. Most medium-sized businesses are able to access formal credit markets and are able to use more leverage (0.62 vs. 0.55, $p < 0.01$). Even more important in the differential capital structures, medium-sized businesses incur public debt to a greater extent, devoting 36% of their total debt to public versus smalls' 21% ($p < 0.001$). This indicates that small businesses face problems of information voids, credit histories, and small transaction, rating, or size thresholds. A greater difference in access to

formal debt is explained by small enterprises' reliance on private debt of 79% total debt versus 64% of medium enterprises. This helps explain, in part, the greater access to private and public debt markets.

Profitability and Capital Structure Relationship

To further explore the relationship between profitability and capital structure choices, the sample was divided into tertiles based on return on assets. Table 7 presents leverage and debt composition patterns across profitability levels.

Table 7: Capital Structure by Profitability Tertiles

Profitability Group	N	ROA Range (%)	Mean Leverage	Mean Debt-to-Equity Ratio	Mean Private Debt Ratio
Low Profitability	83	-8.40 to 4.20	0.64	1.78	0.77
Medium Profitability	84	4.21 to 8.80	0.57	1.40	0.72
High Profitability	83	8.81 to 22.50	0.52	1.23	0.69
F-statistic			6.83***	8.42***	2.91*
p-value			0.001	0.000	0.056

Note: *** $p < 0.001$; * $p < 0.10$

Analyzing profitability and debt provides an understanding of the connection profitability has with leverage. There appears to be an inverse pairing profitability has with leverage which aligns with the pecking order theory. Specifically, the average leverage of the less profitable firms, which have the largest average debt to equity ratios of 0.64 and 1.78

respectively, shows that these firms have to depend on a lot of external debt financing because they are not generating cash with internal funds. On the other end of the spectrum, more profitable firms are less leveraged (0.52) and have a lower debt equity ratio (1.23) which shows that they depend more on retained earnings to finance their needs. While

trends of private debt ratios are nearly statistically significant ($p=0.056$), it implies that less profitable firms broadly have restricted access to the public debt markets, and as such, rely more on private debt. Thus, profitability constitutes an important variable in the pecking order of financing and debt profitability in Pakistani SMEs.

DISCUSSION

The findings from this study advance our comprehension of the capital structure of Pakistani SMEs, especially how, why, and to what degrees the capital structure of Pakistani SMEs varies and how these variations correspond to differing capital structure theories. The relative and sustained dominance of debt from private sources, which averages about 73% of total debt, demonstrates the inaccessibility of public debt and formal capital markets to Pakistani SMEs. The dependency on private debt, especially commercial bank loans and debt from private lenders, points to the potential operational and structural constraints faced by smaller SMEs. The positive and significant correlation between the tangible assets of the firm and various debt levels demonstrates that collateral is fundamental in the latter part of the formal debt theories, as well as proving that Pakistani lending institutions operate on the assumption of capital market and debt structures as risk-averse. The limited equity and substantial fixed and formal structural assets prevalent in the SMEs significantly hinder growth and formalization within the SMEs.

The negative link between profitability and leverage demonstrates the pecking order theory within the context of Pakistani SMEs financing behavior. This deviance is dismissing the static trade-off theory. In this case, instead of tax shield optimization, the order of financing and the asymmetrical information grabs the attention. Perhaps the profitable firms finance their activities internally to retain financial flexibility and avoid the external financing costs of ownership dilution. The disparities between the service and retail sectors and the manufacturing sector regarding leverage and access to public debt primarily stem from the differences in asset configuration, business model characteristics, and economies of scale. The size and asset balance sheet of manufacturing firms allow them easier access to

public debt and secured debt, which is why they have higher Average Debt Ratios and Access Indices. The larger asset size and balance sheet of manufacturing firms also allows them easier access to secured and public debt.

The disparity between small and medium-sized enterprises in regard to access to public debt reflects a gap in the financing public debt provides in Pakistan's SME ecosystem. Accessing different sources of financing is more attainable for medium enterprises due to their size, credit history, and organizational complexity held in comparison to smaller enterprises. This leaves a smaller firm in a financing cycle lack the organizational growth to achieve the size required to access public debt. Findings indicate that the financing gap for smaller enterprises focuses on credit guarantee schemes, alternative credit assessments, and debt instruments of appropriate size that will enhance financial inclusion and aid the growth of additional SMEs.

CONCLUSION

The analysis of the 250 SMEs in Pakistan analyzes the dynamics of private with public debt with respect to equity financing of emerging markets and the Pakistan SME landscape. The analysis demonstrates the peculiarities of the SME landscape in Pakistan. They manifest the constraining factors at the market and the firm level in the limited adoption of alternative financing. Further, the analysis elaborates on the roles played by the firm's scale, asset configuration, and profit in the capital structure decision and the outcome of those decisions. The relationship of firm size, constituent of debt, and the overall debt, fixed and variable debt splits, asset structure, and the profitability manage the variation in the leverage and profitability with the order theory is a valuable contribution to the path dependence on traditional mediation theory and collateral.

This research fills a gap in the literature on how SMEs in emerging markets formulate a capital structure, going on to explore the case of Pakistan within its economic and institutional context. Empirical literature describes the various components of capital debt and the determinants within a firm and external to a firm, and how different markets and institutional arrangements impact a firm's capital structure. Differences in the

policy frameworks within a country, as shown in the literature, can explain the variation in the structure of capital across different sectors and sizes of firms. Gaps in information, poorly devised alternate credit risk assessments, discrepancies in debt provision, and weaknesses within the SME-lending market can explain systemic weaknesses in the financial system. These weaknesses can, and, in the case of Pakistan, do, rationalize the expansion of private debt markets. Finally, the research underscores the reliance of smaller, newer SMEs on private debt and the role of relationship banking in servicing their unmet financing needs.

The study thoroughly analyzes cross-sectional data across sectors and regions and outlines some of the limitations. Future studies could build on the work of the current study by conducting longitudinal studies on capital structure evolution as firms mature, cross-country comparative studies on South Asian economies for cross-regional analysis, and qualitative studies on the financing decision-making process. The current evidence will allow the formulation of targeted policies aimed at improving capital structure and financing practices that will sustain an appropriate financial balance as the economy of Pakistan grows, addressing the financial inclusion of SMEs in Pakistan.

RECOMMENDATIONS

For policymakers, the elaboration of more targeted financing approaches considering the characteristics of SMEs and financing tools, credit guarantee schemes which mitigate lender risks, and windows of alternative credit assessments centered on business cash flows and not solely on collateral, and graduated public and private debts to bridge the public and private debts to SMEs. For Financial institutions, continuation of the relationship banking paradigms to reduce information asymmetries, development of sector specific lending and sector lending expertise which will allow to appreciate the diverse business model and risk profile and the integration of financing tools with the cash flow and growth stage of the SMEs. For SME owners and managers, financial management will include the systemic construction of the asset base to support debt, the optimized debt and equity structure to gain access to

credit, and the transparent record keeping and documentation of creditworthiness.

The appropriate regulatory and institutional framework for developing debt capital markets for SMEs will promote growth opportunities and build expectations around smaller SMEs. Future monitoring of changes in the capital structure of SMEs will form the foundation for more precise and focused refinements of these recommendations based on the prevailing economic conditions in Pakistan.

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