

Catalysing SME Financing in Pakistan

Policy Brief

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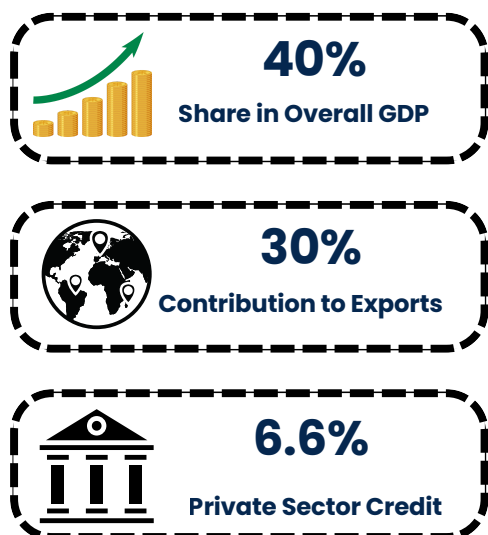
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The Economic Backbone Under Stress

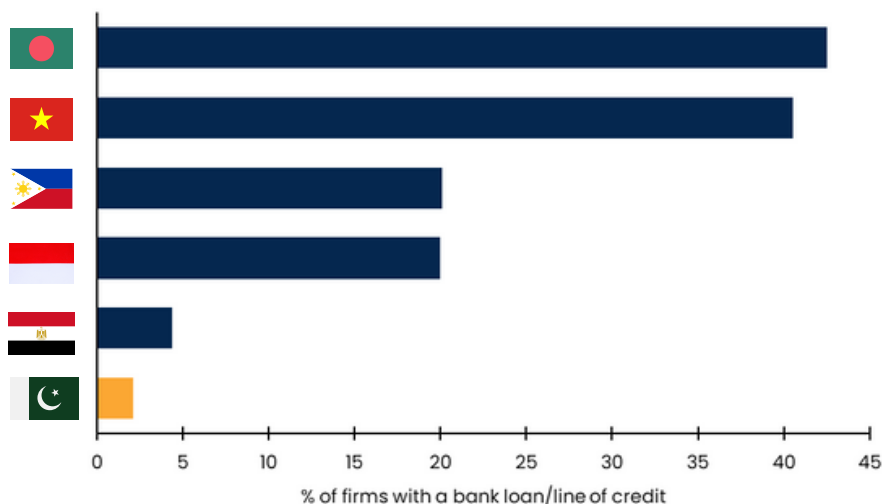
Small and medium enterprises in Pakistan cannot be overlooked, even if pinpointing their exact economic contribution proves challenging due to limited timely data. Conservative estimates place their share of gross domestic product at around 40%, while they account for 80% of non-agricultural employment. The sectoral breakdown reveals the modern structure of Pakistan's economy: Service Sector SMEs contributed a leading 58.4% to GDP in 2024-25, followed by Agriculture SMEs at 23.54%, and Industry SMEs at 18.07%. This distribution mirrors broader national trends toward digital and service-driven economic activity, though agriculture and industrial SMEs remain vital, especially in rural and manufacturing regions.

Despite this substantial economic footprint, SMEs struggle to scale and become enterprises. There are various reasons behind this, including human capital constraints, limited access to modern technology, and low productivity levels that keep many businesses trapped in subsistence-level operations. Most Pakistani SMEs operate with outdated equipment and processes, resulting in productivity gaps that make them less competitive both domestically and internationally. Innovation remains largely absent from their business models, with few investing in research and development or adopting new technologies that could enhance their market position. The skills shortage compounds these challenges, as many SME owners and workers lack the technical expertise and business acumen needed to modernize operations or expand into new markets. Management practices often remain informal and family-based, limiting the professional development necessary for growth. Without adequate human capital development, these enterprises find it difficult to move beyond traditional sectors or low-value-added activities, constraining their ability to contribute meaningfully to economic transformation.

Pakistan's SME Landscape: Key Numbers



Pakistani firms trail emerging markets peers in terms of access to credit



Source: SBP, World Bank Enterprise Surveys | Note: For each country, we have taken the last available data

However, underlying all these challenges is perhaps the most fundamental constraint: the persistent lack of financing for both growth and working capital needs. According to World Bank Enterprise Surveys¹, a mere 2.1% of firms in Pakistan report having access to bank loans or lines of credit, compared to the South Asian average of 31.6%. Pakistan's performance lags well behind regional peers such as Indonesia (20.6%) and Bangladesh (42.5%), though it fares better than the Philippines (20.1%). This financing gap represents one of the most significant constraints on Pakistan's economic growth potential, as even SMEs with innovative ideas and skilled management find themselves unable to access the capital needed to invest in productivity improvements, technology upgrades, or market expansion.

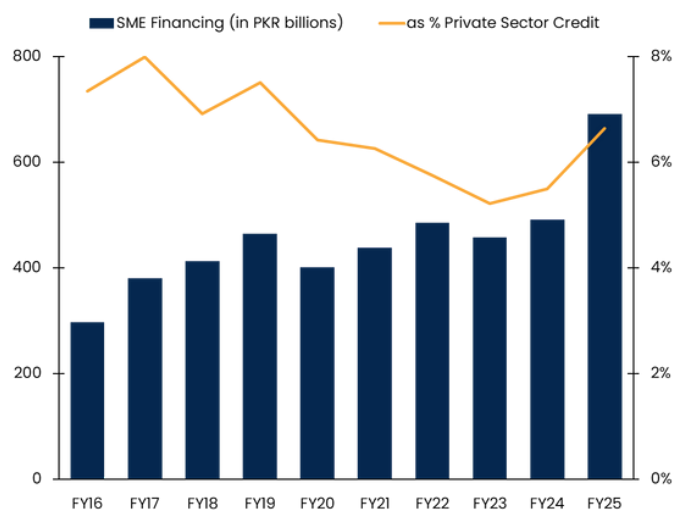
Recent Progress

In absolute terms, the SME financing has seen periods of lull followed by bouts of accelerated activity, mirroring the broader macroeconomic trends. With the ongoing monetary easing and stabilization, things appear to have improved considerably lately, as evidenced by SME loans reaching PKR 691B by FY25. Not only is it the highest level on record, the figure represents a jump of 40.7%, or almost PKR 200B, compared to the end of the preceding year, far outpacing the 11.4% growth seen in non-SME loans.

On the other hand, the share of SMEs in private sector loans reached 6.6%, reverting near its 10-year mean after registering a 17-quarter record. Most importantly, the number of borrowers also scaled to a fresh peak of 276,593 by June², continuing their momentum after first breaking the barrier of 200,000 in March.

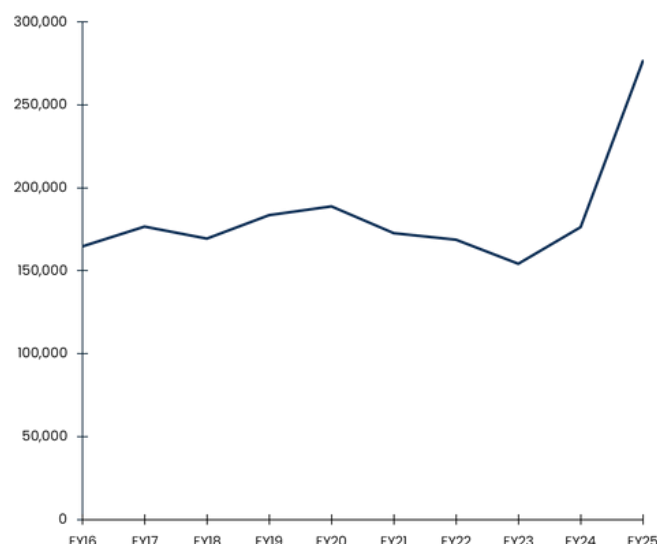
A majority, PKR 354B, went towards working capital, accounting for just half of the SME loans. However, this dominance has waned substantially from its past levels, when it made up three-fourths of the pie almost a decade ago. In its stead, fixed investment credit has garnered popularity, surging by 53.6% to stand at PKR 305.61 billion by June and making up more than two-fifths of the current SME financing. On the other hand, trade finance remains quite modest at PKR 30.48 billion. The underlying recompositing can partly be attributed to the introduction of promotional schemes, including loss sharing and refinancing facilities, to encourage banks to lend to the sector.

Nominal Financing peaks but as share of private credit, SME share has been trending downwards



Source: KSBL Analysis based on Quarterly SME Finance Review, SBP

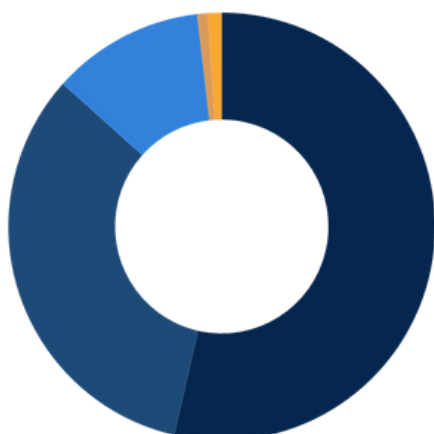
But the recent growth in number of borrowers is truly phenomenal, largely thanks to SME schemes



Source: KSBL Analysis based on Quarterly SME Finance Review, SBP

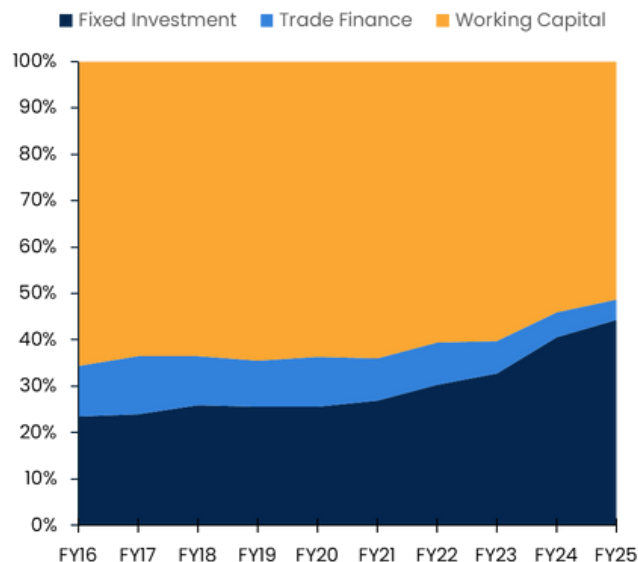
Islamic Banks punch below their weight in SME financing relative to share in industry asset base

■ Domestic Private Banks ■ Public Sector Commercial Banks
■ Islamic Banks ■ Specialized Banks & others
■ DFIs



Source: KSBL Analysis based on Quarterly SME Finance Review, SBP | As of June 2025

Working capital has historically been dominant but fixed investments are now catching up



Source: KSBL Analysis based on Quarterly SME Finance Review, SBP

Where the Credit Flows

There were key sector-specific trends, with services naturally accounting for the majority (53.8%) of the outstanding credit by FY25,³ followed by manufacturing (37%). Meanwhile, SMEs received only a modest 8.8%, or PKR 67.4B, of the Agri financing. Notwithstanding the small proportion, this is actually a massive improvement compared to just 0.4% five years ago, increasing at a compound annual growth rate of 108.6% from PKR 1.7B. To put numbers in context, the overall SME loans rose by 13.1% during the corresponding period while that of non-SMEs were up by 9.8%.

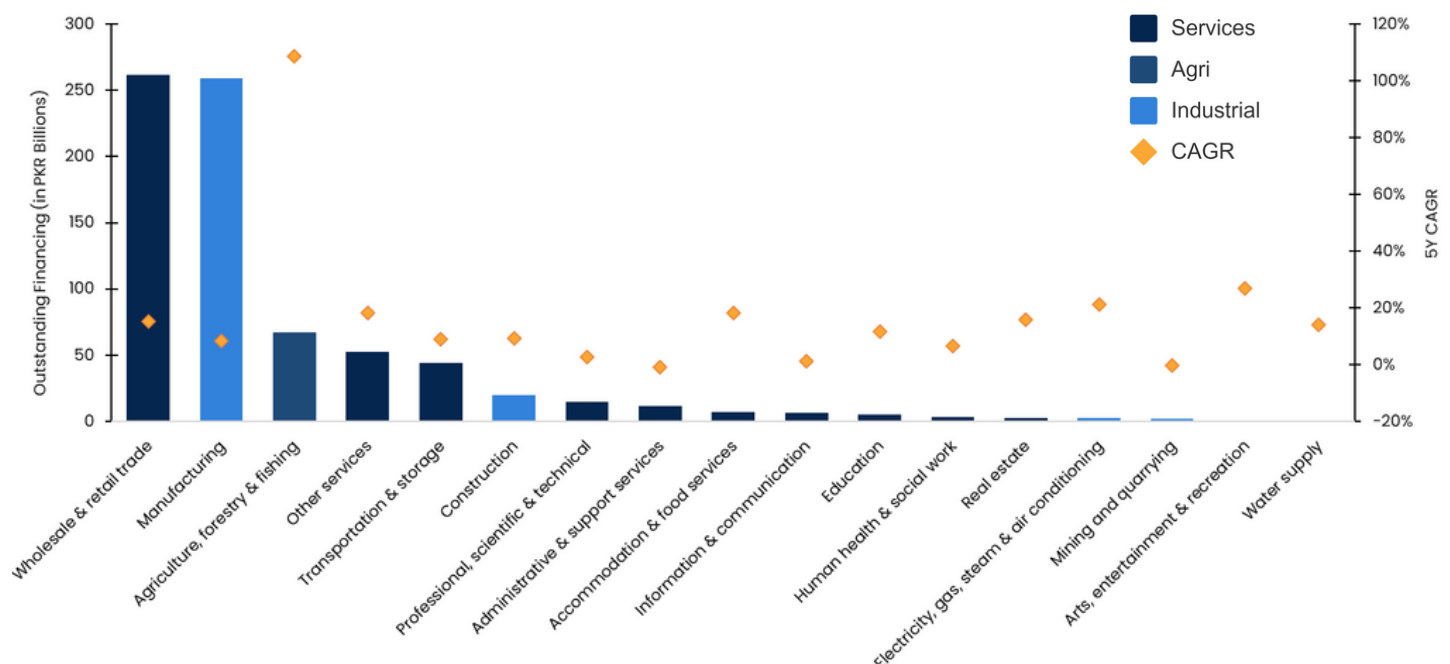
Wholesale & retail trade stands out in SME financing, recording both the highest absolute value and share in subcategory total



Source: KSBL Analysis based on Loans by Type of Financing, State Bank of Pakistan | As of June 2025

At the subcategory level, retail and wholesale trade remained dominant with almost a third (PKR 262B) of all outstanding SME loans. Similarly, within the subsector's aggregate financing regardless of borrower's size, it boasts one of the highest shares of SMEs at 36.7%, followed by transportation & storage 34.9%, more than 2x the average of 16.7% overall. The high concentration of SMEs in retail & wholesale trade is quite understandable, given that around 45% of all business establishments in the country fall under the same subsector, numbering over 3.2 million, according to the latest Economic Census.

Though aggregate volumes remain small, Agri has witnessed a steep surge recently in outstanding credit, outpacing all other categories by a huge margin

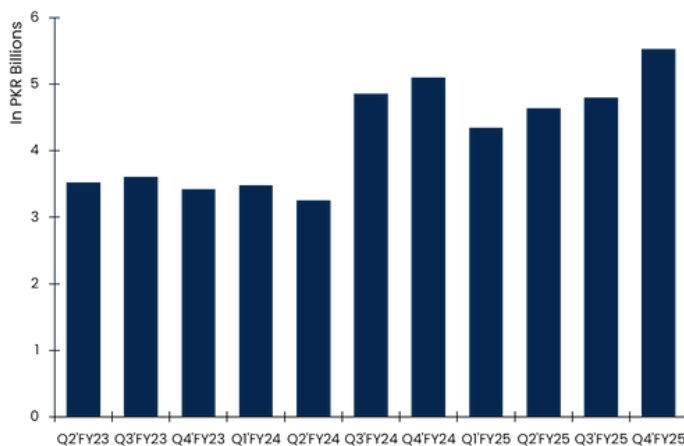


Source: KSBL Analysis based on Loans by Type of Financing, State Bank of Pakistan | As of June 2025

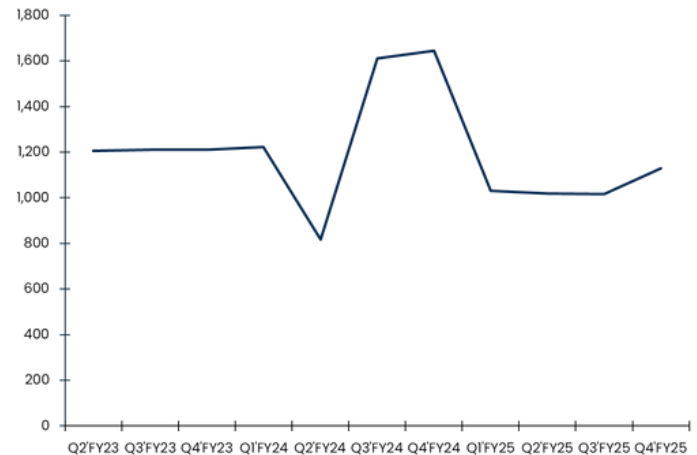
Key SME Financing Schemes and Features

To address the financing gap, the regulator introduced initiatives such as subsidized financing and risk-sharing facilities. However, these measures fell short of achieving the SBP's target of PKR 800B in outstanding SME financing for 700,000 borrowers by FY23. Two years later, the targets remain unmet. A major intervention, the Refinancing Facility for Modernization of SMEs, aimed to support operations, particularly for purchasing local and imported machinery. Available to both new and existing SMEs, the loan offered a 10-year repayment period with equal installments, a 6-month grace period, and a fixed 6% mark-up. Despite these efforts, the program struggled to meet the growing demand for financial support. As of June, combined with the Credit Guarantee Scheme for Women Entrepreneurs, over 1,100 borrowers had PKR 5.5B in outstanding credit, highlighting the gap between available support and the sector's needs.

Years after the introduction of SME Modernization Scheme, credit uptake has remained minimal



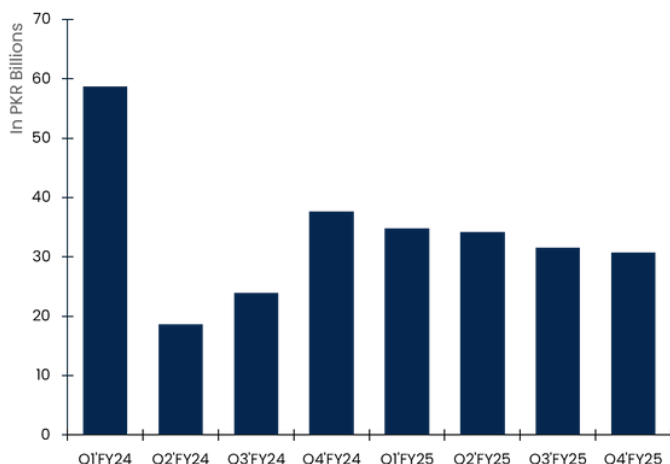
...while that in the number of financing accounts has been even more disappointing



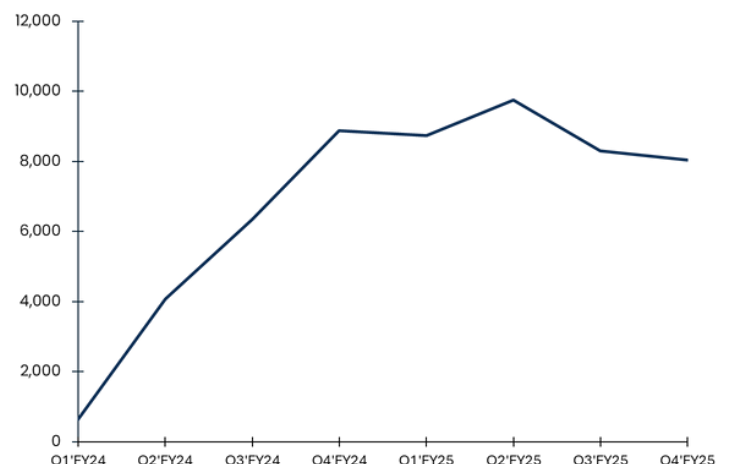
Source: KSBL Analysis based on Quarterly Banking Statistics, SBP | Includes scheme for women entrepreneurs

The SBP's SME Asaan Finance Scheme (SAAF)⁴, introduced in 2021, addressed the previous shortcomings by providing risk coverage to participating banks, alongside 1% refinancing. For new borrowers, the loan cap was set at PKR 10 million, including term and working capital loans, with a 9% mark-up. The Government of Pakistan provided risk coverage ranging from 40% to 60% based on the loan amount, valid for four years. Although the program faced a slow start due to macroeconomic challenges, it stabilized, with outstanding credit of PKR 30.7B across 8,039 accounts. As of March, five banks had availed financing exceeding PKR 5B. Meanwhile, the Prime Minister's Youth Business & Agriculture Loan Scheme⁵, launched or rebranded in January 2023, approved 159,635 SME applications totaling PKR 93.2B, with PKR 86.9B disbursed and PKR 60.9B in outstanding credit. However, despite these efforts, the financing still falls short of addressing the full potential and demand of SMEs.

After initial volatility amid macro uncertainty, financing amount under SAAF seems to have stabilized



Number of accounts availing the facility has seen long-term increase but leaves room for improvement



Source: KSBL Analysis based on Quarterly Banking Statistics, SBP

Source: KSBL Analysis based on Quarterly Banking Statistics, SBP

Why Interventions Fall Short?

Despite the positive momentum created by recent efforts aimed at improving SME financing, significant barriers persist that hinder the sector's growth. While various financial models have been introduced, these efforts often fall short in addressing the unique needs of SMEs, particularly those in emerging sectors or underserved regions. The interventions, though beneficial, frequently lack the flexibility required to meet the diverse demands of the SME landscape. Much of this is due to systemic limitations in financial products, infrastructure, and the use of technology, all of which have yet to fully evolve in alignment with the dynamic needs of SMEs.

As the financing landscape continues to evolve, it's evident that a more targeted and adaptable approach is needed—one that better supports the diverse operational models of SMEs. Existing solutions, while well-intentioned, must be reassessed to ensure they align with the real-world complexities faced by businesses across sectors. The need for more customized, flexible financial products and solutions has never been clearer. Moreover, these solutions should integrate innovative risk-sharing models and collaborative partnerships between the public and private sectors to maximize their reach and impact. Without such targeted interventions, many SMEs will continue to face barriers to accessing the capital they need to grow and thrive.

This provides the necessary context for the Roundtable discussions, where key stakeholders came together to address these persistent barriers. The participants examined the foundational challenges inhibiting effective SME financing and emphasized that, to unlock the true potential of interventions, these obstacles must be tackled head-on with tailored solutions. The roundtable also emphasized the importance of collaboration between financial institutions, government bodies, and the private sector to create an ecosystem that is better equipped to support the growth of SMEs.

In the next section, we will explore the challenges identified by the roundtable participants, alongside their recommendations for creating more inclusive and sustainable financing models that can better serve the diverse needs of SMEs.

Policy Goals vs Reality

	Target	Actual
SME Financing Amount	PKR 800 billion	PKR 691 billion
As % of Private Sector Credit	17%	6.6%
SME Borrowers	700,000	276,593
As % of Total SMEs*	13%	3.9%

Source: KSBL Analysis based on SBP Quarterly SME Finance Review, National SME Policy 2021, National Financial Inclusion Strategy, Realising the promise of responsible digital payments for merchants in Pakistan – BETTER THAN CASH ALLIANCE REPORT

*This proportion has been calculated backwards based on BTCA report and the 2023 Economic Census.

Roundtable: Addressing Key Challenges

Challenge 1: Lack of Reliable and Consistent Data

One of the primary issues highlighted was the lack of reliable data on SMEs, which severely hampers financial interventions. Misclassification of SMEs, particularly in sectors like retail, exacerbates the problem, making it difficult to accurately categorize businesses for targeted support. This issue is compounded by challenges in tracking energy usage, particularly as SMEs transition towards renewable energy sources, which further complicates data accuracy.

Recommendation 1: Standardizing SME Definitions and Improving Data Collection

To address this, the participants emphasized the need for standardized SME definitions across all authorities. Aligning these definitions with the 2021 SME Policy would ensure that all financial institutions and government agencies operate using the same criteria. Furthermore, improving data collection mechanisms is critical. Regular, detailed breakdowns of SME activities by sector, geography, and size would enable more informed policymaking and support the design of targeted interventions. International examples, like the European Union's SME publications, were cited as best practices.

Challenge 2: Lack of Sector-Specific Financing Products

Another significant challenge identified was the lack of financing products tailored to emerging high-growth sectors, especially technology and non-traditional business models. While SMEs in traditional sectors such as retail and manufacturing also face challenges, these newer industries are especially underserved due to financial institutions' limited capacity to understand their unique operational needs and risk profiles. As a result, these sectors struggle to secure the capital necessary to scale and innovate, hindering their potential for growth and contribution to the economy.

Recommendation 2: Inclusive Financing for Startups and Underrepresented Sectors

The roundtable participants called for the creation of customized financial products that cater to the specific challenges of these high-growth sectors. For example, seasonal working capital for agriculture and hardware financing for tech startups were highlighted as key needs. The experience of Bangladesh,⁸ where industry associations have used group guarantees to mitigate risks and expand access to finance, was presented as an example of how to approach financing for emerging sectors. Additionally, participants emphasized the importance of collaborative financing models involving both public and private sectors to ensure these products reach the businesses that need them most. Such approaches could help alleviate risks while providing the necessary capital for these industries to thrive.

Challenge 3: Credit Assessment Difficulties

Creditworthiness remains a fundamental barrier to SME financing, especially as many businesses operate with informal financial systems and lack proper documentation. This makes traditional credit assessment models ineffective, forcing lenders to either reject viable borrowers or demand excessive collateral.

Recommendation 3: Utilizing Alternative Credit Scoring Models

To overcome these challenges, the participants recommended adopting alternative credit scoring models that utilize non-traditional data, such as bank transactions, utility payments, and supply chain relationships. This approach, proven effective in markets like Kenya,⁹ offers the potential for more accurate credit assessments for SMEs. Notably, some banks in Pakistan, including JS Bank, have begun partnering with fintech startups like AdalFi¹⁰ to identify creditworthy SMEs. Leveraging big data analytics and machine learning algorithms could enhance the accuracy of these models, allowing for real-time credit assessments and faster loan approvals.

Challenge 4: Lack of Financial Literacy and Awareness

A recurring issue discussed was the lack of awareness and financial literacy among SMEs, which significantly hinders their ability to access financing. Many SMEs remain unaware of the diverse financing options available to them, limiting their ability to make informed decisions that could drive their growth.

Recommendation 4: Promoting Financial Literacy and Awareness

To address the lack of financial literacy, the roundtable emphasized the importance of nationwide financial education campaigns aimed at SMEs. These initiatives should focus on raising awareness of the various financing options available to businesses, from working capital loans to export financing. By improving financial literacy, SMEs will be better equipped to navigate the financial landscape and make informed decisions that drive growth.

Challenge 6: Ambiguity in Defining Women-Led Businesses

The lack of clear criteria for defining women-led businesses creates confusion in identifying and supporting them. Without standardized gender-disaggregated data, businesses led by women—especially those with minority equity stakes but significant leadership roles—often remain unclassified, hindering targeted financial support and policy interventions. This ambiguity limits the effectiveness of efforts aimed at empowering women entrepreneurs.

Recommendation 5: Defining Women-Led Businesses and Improving Data Collection

Pakistan should define women-led businesses based on both equity ownership and leadership roles like CEO or founder. Enhanced gender-disaggregated data is needed to ensure these businesses are properly recognized. Additionally, specialized financial products and targeted interventions should be developed to support women leaders with lower equity stakes, ensuring they are included in the SME financing ecosystem.

Roundtable Participants Profile

Regulators & Public Sectors	Credit Guarantee & Financial Institutions	Academia & Research	Technology, Innovation & Media
Mukesh Kumar Provincial Chief Sindh, SMEDA Najmus Saqib Additional Director, SBP Raheel Soomro Policy Analyst & Joint Director, SBP	Atif Salim Malik COO, JS Bank Imtiaz Khalid Head of SME, JS Bank Muhammad Adil Mansoor Head of Research, NCGCL Samina Geti Banker & SME Specialist	Dr. Ahmad Junaid Dean & Rector, KSBL Aijaz Haq Head of External Growth & Linkages, KSBL Mutaher Khan Head of Case Research Center, KSBL	Salman Akhter CEO & Co-founder, AdalFi Syed Azfar Hussain Project Director, NIC Karachi Fatima Attarwala Editor Business & Finance, Dawn

The Path Forward

Progress in SME financing is evident with initiatives like the Asaan Karobar Card program¹¹ and State Bank's regulatory relaxations, which have shown that targeted policies can create momentum. However, scaling these efforts requires a coordinated approach with key stakeholders, especially tax authorities. The integration of digital payments and Raast technology can streamline credit assessments and applications. Success depends on transitioning from fragmented pilots to a unified system where regulatory bodies, technology platforms, and financial institutions collaborate effectively.

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