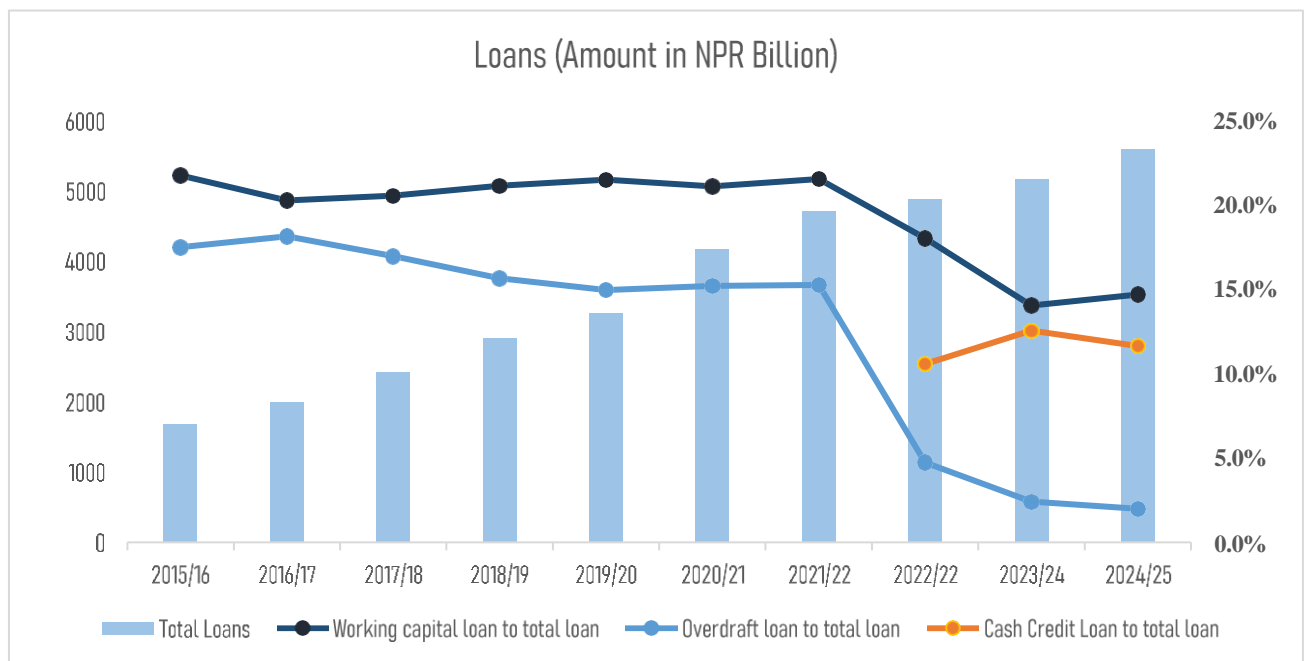


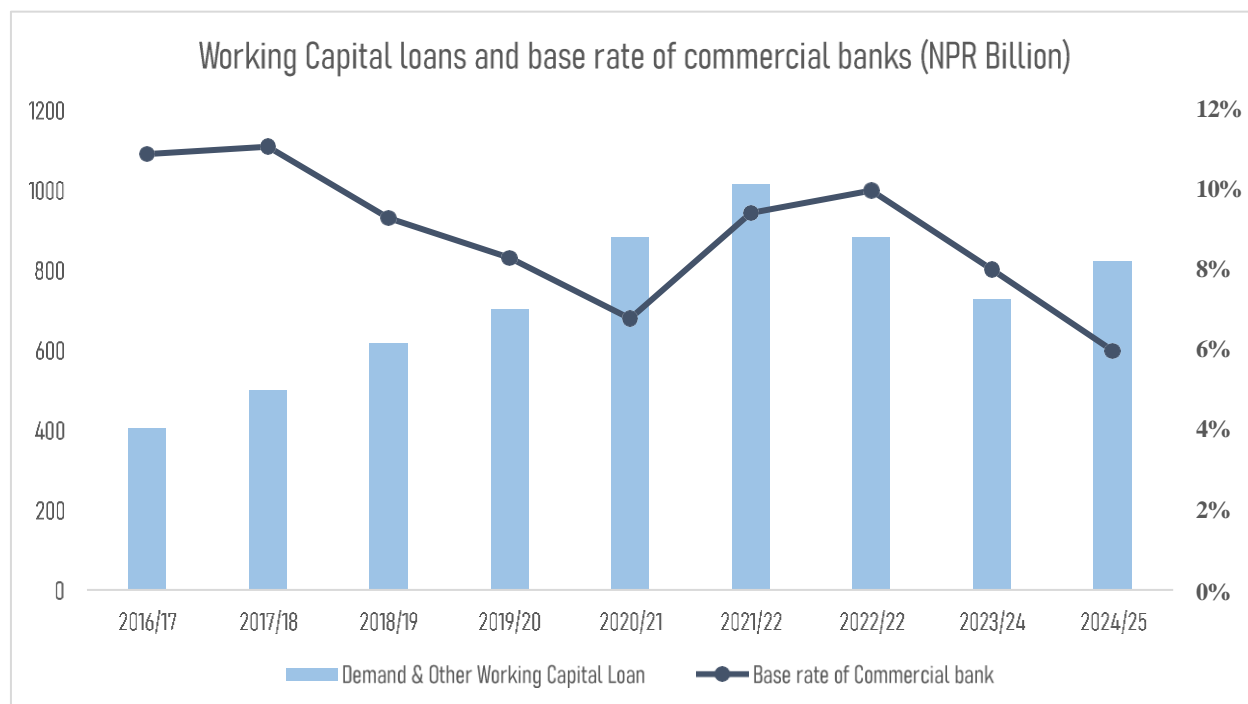
Working Capital Lending in Nepal

A business can be profitable on paper and still face cash flow challenges. While sales may appear strong, the actual cash is not always immediately available, as it may be tied up in inventory or locked in unpaid receivables. At the same time, expenses such as salaries, supplier payments, rent, and logistics must be paid without delay. This mismatch between cash inflows and outflows creates liquidity pressure, especially during peak seasons or when customers delay payments. In such situations, a working capital loan becomes essential. It is a short-term financing solution designed to support the day-to-day operations of a business by bridging the gap between cash going out and cash coming in. Unlike long-term loans used for capital investment, it functions as a financial cushion, helping businesses maintain smooth operations even during temporary cash shortages.

To bring discipline and consistency to such financing, Nepal Rastra Bank introduced the Working Capital Loan Guidelines, 2022, effective from mid-October 2022. The guidelines were aimed at standardizing how banks determine working capital limits, strengthening monitoring practices, and reducing misuse or over-financing under the working capital category. Over time, the framework has been refined through amendments, including updates in January 2023 and August 2023, along with additional flexibility measures introduced in March 2026, particularly for procurement-related financing and businesses affected by infrastructure projects such as highway expansion.

From Overdraft Dominance to Cash Credit Discipline





The chart clearly illustrates two distinct phases in Nepal’s banking sector credit dynamics: a prolonged expansionary phase up to FY 2021/22 and a sharp structural correction thereafter. While total loans increased continuously throughout the period, the composition and quality of credit particularly working capital financing changed dramatically after 2022, reflecting both macroeconomic stress and decisive regulatory intervention by Nepal Rastra Bank (NRB).

Between FY 2015/16 and FY 2021/22, Nepal experienced rapid credit growth under relatively accommodative macroeconomic and monetary conditions. As shown in the chart, total loans rose steadily from NPR 1,682 billion to NPR 4,709 billion, reflecting strong liquidity, low interest rates, and policy support for economic expansion. During this period, working capital loans consistently accounted for around 20–22% of total loans, indicating a stable and significant reliance on short-term business financing.

However, a closer look at the composition of working capital lending reveals an increasing structural weakness. Overdraft loans dominated, accounting for 17.5% of total loans in FY 2015/16, peaking at 18.1% in FY 2016/17, and remaining elevated at 15–16% through FY 2021/22, as depicted by the light blue line in the chart. The persistence of overdraft lending at these levels suggests that such facilities were no longer used as temporary liquidity bridges but had evolved into quasi-permanent financing instruments.

This trend coincided with an extended period of excess liquidity and low borrowing costs, particularly following the COVID 19 shock. NRB’s supportive monetary stance aimed at sustaining economic activity



created conditions in which overdraft limits were repeatedly rolled over, often without meaningful principal repayment or strong linkages to inventory cycles, receivables, or turnover. Instead of financing working capital tied to productive activity, overdraft credit increasingly flowed into speculative and non-productive uses, including real estate and asset price trading.

By FY 2021/22, the macroeconomic consequences of this lending pattern became evident. Nepal faced a widening trade deficit, sharp import growth, declining foreign exchange reserves, and mounting balance-of-payments pressure. The chart reinforces this diagnosis: while total loans continued to rise sharply, the structure of credit increasingly favored flexible but weakly monitored overdrafts, amplifying overheating rather than productive investment. These conditions forced NRB to reconsider not just the pace of credit growth, but its quality and allocation.

The second phase, beginning in FY 2022/23, marks a decisive structural shift in Nepal's working capital financing framework. Although total loans continued to grow from NPR 4,880 billion in FY 2022/23 to NPR 5,592 billion in FY 2024/25, as shown by the rising bars, the share of working capital loans fell sharply, declining from 18% in FY 2022/23 to 14% in FY 2023/24, before stabilizing at 14.7% in FY 2024/25.

This adjustment coincided with monetary tightening, as NRB raised policy rates and absorbed excess liquidity to control inflation and stabilize the external sector. Higher interest rates significantly increased borrowing costs, dampening discretionary credit demand. Yet the most striking change visible in the chart is the collapse of overdraft lending, which fell from 15.3% of total loans in FY 2021/22 to 4.7% in FY 2022/23, and then further to around 2% by FY 2024/25.

This decline cannot be explained by market forces alone. Instead, it reflects explicit regulatory intervention through NRB's Working Capital Loan Guidelines, 2079. These guidelines-imposed limits on overdraft usage, restricted automatic rollovers, and required stronger linkage between credit limits and actual business activity. As a result, overdrafts previously used as permanent funding were systematically phased out.

Simultaneously, the chart illustrates a structural shift in working capital composition with the emergence of cash credit loans, represented by the orange line. Cash credit financing appears only from FY 2022/23 onward, rising to about 11% of total loans in FY 2022/23, increasing further to nearly 13% in FY 2023/24, before moderating slightly to around 12% in FY 2024/25. This pattern coincides with a sharp decline in the share of overdraft loans during the same period, indicating a deliberate rebalancing of short-term financing instruments. Unlike overdrafts, cash credit loans are drawing power based, asset linked, and self-liquidating, ensuring that credit utilization adjusts automatically with inventory levels, receivables, and actual business turnover. The growing share of cash credit therefore reflects a maturing approach to working capital management, emphasizing discipline, transparency, and closer alignment between credit expansion and real



economic activity.

Taken together, the chart and supporting data confirm that the post 2022 shift was not a cyclical contraction but a structural correction. NRB deliberately combined higher interest rates with stricter loan classification and supervision to discourage speculative borrowing, improve asset quality, and realign bank lending with the real sector. The replacement of overdrafts with cash credit represents a move away from credit-driven asset inflation toward discipline, transparency, and productivity-oriented financing.

In this sense, the decline in overdraft loans and the stabilization of working capital financing after FY 2022/23 mark a turning point in Nepal's banking sector signaling the transition from an easy credit regime to a more sustainable and prudentially sound financial system.

First Move from Collateral to Cash Flow: NRB's Working Capital Reform 2022

Nepal Rastra Bank (NRB) introduced the Working Capital Loan Guidelines, in August 2022, and they became effective from October 2022, marking a clear shift from collateral driven lending to cash flow and turnover based working capital finance. The primary purpose was to curb over financing, roll-over financing, and the diversion of working capital funds into non-productive uses, by ensuring that working capital limits reflect the borrower's actual operating cycle and sales turnover rather than collateral value alone. Under the original framework, NRB required banks to determine working capital limits mainly from projected annual turnover/sales and operating cycle indicators. For borrowers whose total working capital exposure from the entire banking system was up to NPR 2 crore, the cumulative working capital limit was capped at 20% of projected annual turnover, with tenure restricted to one year or less and renewal allowed only after fresh assessment. However, NRB allowed an expanded ceiling of up to 50% of projected turnover in justified cases, provided banks conduct and document detailed operating cycle analysis such as Cash Conversion Cycle (CCC), Inventory Conversion Period, Days Sales Outstanding (DSO), Lead Time, and Accounts Payable Period, and record the justification in the credit file; otherwise, the exposure would be treated as non-compliant.

Beyond the turnover caps, NRB introduced structural and technical controls to ensure working capital lending remains self-liquidating and operationally linked. For borrowers with working capital needs exceeding NPR 2 crore, banks were mandated to segregate requirements into Fluctuating Working Capital Need (FWCN) and Permanent Working Capital Need (PWCN) and structure lending instruments separately instead of providing a single revolving limit. A major technical reform was the strict enforcement of Drawing Power (DP): even when a limit is sanctioned, actual disbursement is restricted to the value of eligible and verified current assets (inventory, receivables, etc.) after applying margins, requiring physical verification, valuation, DP computation, and ensuring utilization never exceeds DP thereby eliminating "sanction based utilization" and tightening liquidity discipline against speculative withdrawals. NRB also formalized the distinction between short term operational liquidity and structural WC needs: FWCN (seasonal/cyclical) is financed through short



term facilities (generally up to 1 year) with renewal based on updated turnover and asset verification, while PWCN (baseline locked funds) is financed through periodic/term based structures (typically 3–10 years) to improve banks' asset–liability maturity matching and prevent long term finance being disguised as short term WC. To strengthen utilization control, banks must conduct regular inspections of current assets/liabilities, update reports in loan files, reassess DP, and require borrowers to route sales proceeds through accounts with the lending bank to validate real cash inflows and reported turnover targeting diversion, circular transactions, and inflated sales projections. Operationally, NRB restricted working capital limit increases during the last month of each quarter (Asoj, Poush, Chaitra, Asar), limited overdrafts only to natural persons (excluding firms/companies/institutions), and prohibited using cash credit limits to pay loan principal, interest, or bank charges (preventing self-servicing/evergreening). Finally, NRB also provided borrower side relief by restricting banks from charging prepayment penalties on periodic working capital loans repaid early, except in cases of loan takeover/transfer, as clarified through subsequent FAQs and amendments.

Transition and Tuning: The Revision of Working Capital Guidelines 2079

However, soon after the Working Capital Loan Guidelines were implemented in mid-October 2022, it became clear that the sudden change created serious practical problems for businesses and banks. Many firms already had working capital facilities far above the new ceilings, such as cash credit and revolving limits exceeding 20% of annual turnover (up to NPR 2 crore) or even higher limits that had been rolled over for years. Immediate compliance with the new rules would have meant sudden reduction of facilities, disruption of daily business operations, inability to purchase inventory, delayed supplier payments, and increased financial stress, particularly during a weak economic period. To address this, Nepal Rastra Bank introduced its first major revision in January 2023. Under this revision, borrowers who had working capital loans above the prescribed limits were allowed to adjust gradually instead of reducing limits at once. Excess working capital exposure could be paid down through a phased, installment based mechanism, with borrowers required to repay the excess amount over time starting with 10%, followed by 20% installments, and a final 30% repayment by mid July 2025. Banks were also instructed not to charge prepayment penalties on periodic working capital loans paid earlier than schedule (except in takeover or transfer cases). In addition, certain documentation and monitoring requirements were applied more practically, reducing compliance burden without abandoning asset verification or turnover based assessment. These changes were made due to strong pressure from the private sector, feedback from banks facing implementation difficulties, and NRB's own assessment that abrupt enforcement could negatively impact economic activity. While keeping the core policy intact turnover linked limits, Drawing Power based on verified current assets, and restrictions on overdrafts and cash credit misuse NRB softened execution to allow a smoother transition.

Further refinements were introduced in August 2023 through the amendment dated August 2023, focusing on making the policy more realistic and sector sensitive, especially for manufacturing and production based industries. NRB recognized that manufacturing firms naturally require higher and longer cycle working capital facilities due to larger inventory holdings, longer processing periods, and delayed receivables compared to trading or service businesses. As a result, the amendment adjusted key thresholds and applicability. For



example, the guideline was not applied strictly to borrowers with total working capital loans up to NPR 1 crore, and this exemption was extended up to NPR 3 crore for manufacturing industries. Similarly, for turnover linked assessment slabs, manufacturing firms were allowed higher practical ceilings (such as up to NPR 4 crore under the standard assessment category) compared to other sectors. Banks were explicitly guided to consider actual operating cycles including inventory conversion period, work in progress time, and receivable days when determining limits, rather than applying the same rigid turnover percentage across all sectors. Permanent working capital needs of such businesses were encouraged to be financed through periodic or structured credit facilities, instead of forcing them entirely into short term revolving limits like cash credit. The main reason for this amendment was the growing recognition that uniform ceilings did not suit all sectors equally, and that overly tight rules could unintentionally restrict productive industries, slow manufacturing activity, and affect employment. Through these changes, NRB aimed to balance financial discipline with economic reality, support real sector growth, and maintain stronger risk control without harming production and business continuity.

NRB Working Capital Flexibility Measures 2026

In March 2026, Nepal Rastra Bank introduced the latest round of easing measures under the Working Capital Loan Guidelines to address ongoing business stress and sector specific disruptions, while still maintaining regulatory discipline. One major change related to procurement working capital loans, where NRB shifted these facilities away from rigid long-term structures and directed banks to move them toward a periodic working capital structure. Under this approach, repayment terms are now to be determined based on each bank's own working capital policy and the borrower's actual cash flow capacity, rather than fixed tenures that may not match business cycles. In addition, NRB allowed a onetime rescheduling facility for certain existing procurement working capital loans, provided the bank conducts a proper cash flow assessment and documents clear justification. This rescheduling option must be exercised only once and completed by mid-July 2026, without automatically degrading the loan's classification if conditions are met. Furthermore, NRB introduced special restructuring and rescheduling relief for enterprises displaced by the expansion of the Mahendra Highway and the Mid Hill Highway, recognizing that such infrastructure projects disrupted regular business operations through relocation, loss of access, or temporary shutdowns. For such cases, banks are permitted to restructure or reschedule affected loans, subject to recovering at least 10% of the interest due and completing the process by July 2026.

The main reason behind these March 2026 amendments was to provide targeted flexibility during continued economic and operational stress, particularly where disruption was caused by public infrastructure development rather than poor borrower behavior. NRB aimed to support affected enterprises, maintain credit flow, and prevent unnecessary loan deterioration, while ensuring that loan classification and provisioning discipline remained stable through conditions such as cash flow analysis, justification requirements, and minimum interest recovery. These changes reflect NRB's evolving approach of balancing prudential regulation with practical economic realities, ensuring that working capital regulation supports business continuity without encouraging misuse or weakening financial stability.



Conclusion: Working Capital as a Stability Oriented Credit Tool

Working capital loans are critical because they keep businesses functioning in real time financing inventory, raw materials, supplier payments, and bridging cash flow gaps between sales and collections. At the macro level, working capital credit acts as a key liquidity transmission channel, supporting continuous production, trade, employment, and tax generating economic activity.

Yet because revolving facilities can be repeatedly drawn and renewed, they require close monitoring to prevent short term liquidity support from morphing into persistent leverage or speculative financing. In this context, Nepal's working capital framework functions as a stability oriented, counter cyclical guardrail, linking credit more closely to verifiable turnover and operating cycles while discouraging misuse.

The evolution of the guidelines from their introduction in 2022 to subsequent refinements demonstrates policy learning and adaptability. Looking ahead, as macro financial conditions evolve, further recalibration may be warranted to ensure that working capital regulation continues to balance healthy credit flow for productive businesses with financial system stability over the economic cycle.

