

Five Years of IBC: A Touchstone for Promoting Entrepreneurship



*In the past five years, the IBC has made several landmarks in the field of insolvency and resolution of corporates at national and international level. The recent data of IBBI reveals that till June 30, 2021, 396 companies were rescued through Resolution Plans which yielded ₹2.54 lakh crore. This reveals the relevance of the IBC in rescuing the businesses that were sinking due to genuine business failures besides providing safe exit route for promoters and reasonable recovery of bankers' investments. The Global Insolvency Rank has improved from 136 in 2017 to 52 in 2020 and ease of doing business (EODB) rank improved from 155 to 63. Although this improvement reflects well on the implementation of the Code and the behavioural changes in the ecosystem, there are challenges that need to be resolved as we move forward. **Read on to know more...***



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1. Introduction

Before the Insolvency and Bankruptcy Code 2016 (IBC or Code) came into existence, the insolvency processes in India were governed through a highly fragmented framework with powers of the creditor and debtor under bankruptcy processes being provided for under different legislations and requiring multiple judicial fora to adjudicate. Since the implementation required different judicial settings, the process of resolution was often long drawn. In a situation where one forum decides on matters relating to the rights of the creditor, while another would decide on those relating to the rights of the debtor, the decisions were readily appealed against and either stayed or overturned in a higher court. Furthermore, the insolvency process was marred by delays and extensions in arriving at an outcome thus impacting the time taken and recovery from such cases. This naturally impacted the investment environment in India to the extent it required a predictable and transparent framework for dealing with bankruptcy cases.

2. IBC in Rescuing Businesses

The data released by the Insolvency and Bankruptcy Board of India (IBBI) reveal that by the end of June 2021,

396 companies were rescued through Resolution Plans which yielded ₹2.44 lakh crore. The recovery amount in these cases over and above the liquidation value (i.e value of the Corporate Debtor (CD) at the time of Corporate Insolvency Resolution Process (CIRP) commencement date) is mainly due to the provisions of value maximisation enshrined in the IBC. Besides rescued CDs, 461 CIRP applications were withdrawn which shows the relevance of settlement through various instruments of arbitration. Furthermore, 653 were closed on appeal or review or settled. About 254 companies which were liquidated have yielded ₹1,207 crore against their asset value of ₹1,195 crores¹. From this perspective, this indeed is a big achievement which would have been otherwise not possible prior to the IBC regime. These achievements have transformed the economic scenario in India thereby reposed confidence of entrepreneurs and investors in the Indian economy. Besides this, the resolutions through IBC has helped saving current jobs not just for the Corporate Debtor but also for its suppliers, customers and other related stakeholders and in fact has helped in creating new ones. Imagine the scenario if the financially strained companies were collapsed. What would have been consequence due to job losses and overall impact on economic activity? This reveals the relevance of the IBC in rescuing the businesses that were sinking due to genuine business failures besides providing safe exit route for promoters and reasonable recovery of bankers' investments.

The increase in recovery over and above the value of the CD at the time of CIRP commencement date i.e., liquidation value is on account of the objectives of value maximisation for stakeholders as enshrined in the IBC.

The IBC has established a structured way of initiating CIRP, and at the same time ensured effective management of affairs of CD during CIRP. As regards commencement of proceedings, the World Bank considers it positive if an insolvency framework enables direct liquidation of a corporate debtor (CD). The IBC enabled the committee of



creditors (CoC) to decide to liquidate a CD at any time, even before the preparation of information memorandum i.e the first step towards finding an investor. Furthermore, the IBC provides several relaxations under moratorium to ensure that the CD continues as a going concern (GC) during CIRP. The moratorium on legal cases i.e., protection against offences committed by previous management, the licenses, permits, concessions etc. cannot be terminated or suspended during the moratorium period, continuous supply of goods and services which are critical to protect and preserve the value of CD and moratorium from all the taxes and liabilities during CIRP have enabled rescue of financially strained corporates. Furthermore, the creditor in control regime, enables creditors to take decisions on the CD during insolvency proceedings.

3. Global Economic Achievements under IBC Regime

In the past five years, the IBC regime in India has made several remarkable achievements² which include improvement in Global Insolvency Rank from 136 in 2017 to 52 in 2020; average time taken for resolution reduced from 4.3 years to 1.6 years, rank in ease of doing business (EODB) improved from 155 to 63, getting credit rank improved from 62 to 25 and starting a business rank improved from 151 to 136 among others.

4. Behavioural Changes Across Stakeholders

The Code, with its structure and accompanying intent has earned recognition across corporate circles and has become the preferred route for corporate distress

¹ Insolvency and Bankruptcy News, April- June 2021, p. 14 and p. 19-20 (<https://www.ibbi.gov.in/uploads/publication/f4656f120a5161c281cff40189353824.pdf>)

² Thirty Second Report, Standing Committee on Finance (2020-21): Implementation of Insolvency and Bankruptcy Code- Pitfalls and Solutions, p.20 (<https://ibbi.gov.in/uploads/resources/fc8fd95f0816acc5b6ab9e64c0a892ac.pdf>)

investments including for foreign investors. While the full impact of the new insolvency regime is not expected to be visible in the short term, some successes have already been recorded.

The ability and willingness of the stakeholders- Financial Creditor (FC), business owners, IPs, and trade creditors, to work towards a common goal has led to some initial gains under the Code and their sustained coherent support will determine the success of this regime for the time to come.

The Code has been able to achieve a significant behavioural change among stakeholders which has resulted in substantial recoveries for creditors outside the regime of the Code. It is further motivating them to make the best efforts to avoid default/make good their default. As per the Report of Standing Committee of Finance (on IBC), ~50% of the applications have been withdrawn prior

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to admission of application by NCLTs. With the Code in place, non-repayment of loan is no more an option and ownership of the firm is no more a divine right. The change in behaviour of promoters of the corporate debtors has also been emphasised by Swaminathan J., Managing Director, State Bank of India (SBI) in an interview. “Borrowers have understood that owing business is not a birthright. In case they do not run their business efficiently, they stand to lose control of it,” said Swaminathan³.

The Code has had an impact on the credit market as well. Through provision for resolution and liquidation, the Code reduces incidence of default, and enables creditors to recover their dues through revival of the firm or sale of liquidation assets. It incentivises creditors to extend credit at a lower cost for projects and thereby enhances availability of credit. While the debate concerning the development of India is still ongoing, strong, and efficient laws like the IBC is helping to develop a conducive atmosphere for a strong business environment to flourish.

³ The Resolution Professional (2021): Settlement Will always remain the first resort but we also need Prepack and CIRP on the table, April 2021, p. 10.

5. Ease of Doing Business Ranking

The World Bank started publishing the Doing Business (DB) Report or EODB Rankings in 2003 and continuously published it till 2019. Though the World Bank decided to discontinue⁴ publishing the DB Report due to allegations of data manipulations in 2018 and 2020 DB Reports, the EODB Rankings are considered benchmark for comparing world economies in facilitating businesses and promoting entrepreneurship. The internal audit of the World Bank did not find any irregularities in the data provided by India, but China was found using its clout for data manipulation⁵.

The DB Report used to measure⁶ the processes for business incorporation, getting a building permit, obtaining an electricity connection, transferring property, getting access to credit, protecting minority investors, paying taxes, engaging in international trade, enforcing contracts, and resolving insolvency. On the basis of this analysis, each country is provided EODB Rank, which helps investors make informed decisions about investments. Within the 'resolving insolvency' parameter of the EODB, the World Bank measures indices viz. recovery rate, time taken, costs involved, creditor participation, reforms etc. The purpose behind this is to measure the insolvency regime in a country in the context of the overall economic and investment climate that it seeks to improve – making business decisions easier for investors, government, and other stakeholders. Thus, ease of resolving insolvency is a major component of EODB report. The increasing ranks of India in EODB Rankings is evidence of global recognition of reorganisation procedure available in India under IBC regime. Today, under the IBC Ecosystem, companies have effective tools to restore financial viability. Besides, creditors have better tools to successfully negotiate and have greater chances to realise their investments.

⁴ The World Bank (2021): World Bank Group to Discontinue Doing Business Report, September 16 (<https://www.worldbank.org/en/news/statement/2021/09/16/world-bank-group-to-discontinue-doing-business-report>)

⁵ The Hindu Business Line (2021): World Bank clears India, blames China for pressuring, September 18 (<https://www.thehindubusinessline.com/economy/world-bank-group-to-discontinue-doing-business-report/article36510519.ece>)

⁶ World Bank Ease of Doing Business Report and Methodology <https://www.doingbusiness.org/en/doingbusiness>

The recovery rate, as per the World Bank methodology, is a function of time, cost, and outcome of insolvency proceedings. While reviving ailing firms, certain resolution plans have returned about 200 per cent of liquidation value for creditors. This means that the creditors got ₹200 while they could have got at best ₹100 minus costs of liquidation if these CDs were liquidated. The outcome should improve with the amendment in December 2019 that released the CD from the liability arising from an offence committed under the erstwhile management prior to the commencement of the CIRP.

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As per the latest DB Report, India is the best performer in South Asia on resolving insolvency and does better than average for OECD high-income economies in terms of the recovery rate, time taken and cost of proceedings. This is even though the World Bank index does not consider bigger gains from the IBC i.e., revival of 396 companies, some of which were in deep distress; changed the debtor-creditor relationship, where the defaulter's paradise⁷ is lost, as noted by the Supreme Court; and most importantly changed the credit discipline in our country.

6. Areas of Improvement

Though the IBC has made significantly achieved its objectives⁸ – Resolution, Maximisation of Value of Assets of the CD and Promoting Entrepreneurship, availability of credit and balancing interests of stakeholders – there are some areas which still need improvement. The market recognises that areas of improvement need to be addressed before the regime becomes an embedded, robust, and consistent framework which can support resolutions and supply necessary credit into India's economy. Following broad themes emerge^{9,10,11} that represent the current scenario and opportunities for further development to support the insolvency regime:

⁷ Business Standard (2019): SC upholds Insolvency code, says defaulters' paradise is lost, January 25 (https://www.business-standard.com/article/pti-stories/sc-upholds-insolvency-code-says-defaulters-paradise-is-lost-119012501273_1.html)

⁸ Company Appeal (AT) (Insolvency) No. 82 of 2018, NCLAT (<https://nclat.nic.in/Useradmin/upload/744324065bebc1bd0ef4a.pdf>).

6.1. Legislative hurdles

- a) Various judgements and judicial interpretations of the IBC by the Supreme Court and decisions by NCLTs and NCLATs have brought clarity on several conceptual issues. However, the evolving nature of law has resulted, in various litigations and delays in process affecting recovery for creditors and investor confidence. However, some contradictory judgements across NCLTs and time delays in resolving matters at the judiciary have led to some negative market sentiments towards the effectiveness of the Code.
- b) Investigative issues create hurdles in resolution process and for creditors. Deferring / delaying implementation of approved resolution plan for such issues has significant adverse impact on valuations. Clarity on this front will be something to see in near future.
- c) The insolvency process is often interrupted by last-mile effort/intervention by promotor in trying to get back the control over the assets. Earlier it has

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been seen that if the defaulting promoter of the ailing company is allowed to put up a resolution plan, he would submit resolution plan at substantially discounted rates. Now the law has been changed by way of certain amendments and hence a defaulting promoter, along with various others mentioned in section 29A, have been made ineligible to be a resolution applicant. However, efforts are still made by promoters with help of

⁹ The Report on Bankruptcy Law Reform Committee, Volume I, Rationale and Design, 2015, IBBI (https://ibbi.gov.in/BLRCReportVol1_04112015.pdf)

¹⁰ Transcript of Dr. M.S. Sahoo's speech at webinar on "Digitalisation of India's Mortgage Lending and Valuation Process", organised by Valocity on August 19, 2021.

¹¹ Where Next for IBC – A Keynote address by Dr. M. S. Sahoo, Chairperson, IBBI, at the Seminar on 'Bankruptcy and distressed investment market in India: Opportunities, perspectives and the road ahead' organised by the High Commission of India at London on 10th February 2020. <https://ibbi.gov.in/uploads/resources/cdd1a571ad503a8166c9220df1ade7eb.pdf>

various legal avenues, trying to disrupt the insolvency process and get back the control of assets.

- d) The Indian Judiciary has been facing capacity constraints. The lack of members in judiciary has impacted timely closure of cases. The option may

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be evaluated to set up Circuit benches at the earliest, to clear off long pending cases. Also, technology to use cross-reference precedents may be implemented to enable swift disposal of routine cases.

- e) Lack of well-defined bidding criteria and evaluation matrix for evaluation of resolution plan by CoC.
- f) Currently, there is lack of clarity in the roles and responsibilities of CoC, RP and the Resolution Applicant after the Resolution Plan. Suitable additions in CIRP regulation may be made to identify the roles and responsibilities of CoC, RP and the Resolution Applicant after approval of Resolution Plan by NCLT. The period between NCLT approval and before transfer of control to the Resolution Applicant is a grey area currently, which needs to be addressed.
- g) The liquidation provisions currently lack transparency and clarity on sale of assets in liquidation.
- h) The requirement now is to also focus on the law for individual insolvency, pre-pack for large corporates, cross border insolvency, and group insolvency which are yet to come into force or be available. These provisions will be the next big thing dominating the insolvency space and helping in effective resolution.

6.2. Capacity constraints for Stakeholders

- a) New law and jurisprudence require constant updating of skills to meet market need. While the

focus is required in strengthening insolvency institutions, training of IPs also remains a key area for developing a robust insolvency system. The first step in the direction already seems to have been taken by IBBI, by launching Graduate Insolvency Programme which aims to groom tailor made IPs and inculcate all that an IP needs.

- b) The need of the hour is also development and regulations for tailor-made insolvency valuation professionals, for transparent and credible determination of asset value.
- c) Creditors are playing a key role in the insolvency regime. The FCs usually constitute a CoC which has responsibility to decide the fate of the firm in distress. FCs are expected, to take a step back and reflect on IBC journey so far and incorporate the learnings into the decision. Effective training measures to creditors will also be critical to support effective decision making, as all the stakeholders are bound by decisions of the CoC and the resolution plan, which is a commercial wisdom of CoC.
- d) Capacity building for regulators and judiciary – through trainings and knowledge sharing is also a key area of development.

6.3. Asymmetric information

- a) Information being the most key requirement for a successful resolution. Therefore, there is a need to solve the information asymmetry that exists currently.
- b) Use of technology to manage information leading to more transparent and evidence based decision making by stakeholders especially investors.
- c) Lack of depth in the stressed asset market is affecting the resolution potential. There is a need for developed stressed market which will enable price discovery for distressed assets.

6.4. Constraints for Successful Resolution Applicant

- a) Post-closure litigation by operational creditors including tax authorities and other litigants.
- b) Litigation by unsuccessful bidders often results in the successful bidders getting frustrated and this

has created negative sentiments in the mind of potential bidders.

- c) Inability to comply with resolution plan, due to delay caused due to litigations.

6.5. Timeliness of CIRP

Although the average time involved in IBC is 1.6 years, the NCLT takes considerable time to admit cases. During this time the company remains under the control of the defaulting owner enabling value shifting, funds diversion, and assets transfer. Post admission, although the overall timeline prescribed as per Code is 180 days, (additional 90 days extension), more than 71% of the cases have already crossed the timeline of 180 days. The process usually gets elongated due to appeals and counter appeals, thereby eroding the value of the Company under insolvency. The long duration also impacts the interest of investor in bidding for the asset. In order to iron out this issue and further expedite the insolvency process, the minimum threshold of default has been increased to one crore. This will ensure that only large cases go to NCLT, and the adjudication is faster. However, some issues still need to be addressed to efficaciously expedite the resolution process under the Code. While Pre-Pack (so far release for MSMEs) is a step in the right direction, the efficacy of this can only be seen with the predictability of outcomes over the next 1-2 years.

7. Conclusion and Way Forward

The IBC is one of the most impactful economic law reforms to have been implemented in India with an intent to change the way distressed asset resolution and insolvency works here. It has shown remarkable progress in terms of handling large cases and recovery of dues. Notwithstanding this, creditor actions and appetite towards insolvency, readiness of infrastructure to support the speed of implementation, bandwidth of the legal system and the ability of the IPs to manage large and complex cases have been subjects of scrutiny. The provisions relating to CIRP including fast track resolution, corporate liquidation and voluntary liquidation have been executed with considerable success thus far and those related to Personal Insolvency, Cross-Border, Group, Pre-

Pack etc. are in pipeline for consideration. The IBC provides a safe exit route for companies that have failed despite making all the efforts to revive it.

If the World Bank had continued publishing EODB rankings, there is a high chance that India's rank would have gone up further as the Code matures and the ecosystem develops.

Though EODB rankings has not been published after 2019, various landmark judgements have been passed, and certain landmark cases like Videocon, Jet Airways, DHFL etc., have been resolved in last one year, impact of which on the ease of doing business ranking remains to be seen. While a recent statement by World Bank indicates a discontinuation of the Doing Business Report, the framework developed by it will be helpful in the long run for the developing countries to assess their insolvency regimes and making regulatory decisions, which will reflect the expectations of investors seeking for a transparent and predictable regime and which will treat business failures as a cyclical event. If the World Bank had continued publishing EODB rankings, India's rank would have gone up further.

Several amendments and judicial discourse since the inception of the IBBI have helped plugged the loopholes in the framework and ring-fence both lenders and borrowers. However, in the near future, structural changes which would strengthen the banking system are necessary. Besides, Cross border insolvency, which is currently in pipeline, will also be instrumental in providing legal comprehensive framework, considering the fact that corporates transact business in more than one jurisdiction and have assets across many jurisdictions.

Certain other changes in the IBC regime have also been the long-standing demand of the industry, as the move will help safeguard CDs, protect last mile funding, boost investments in financially distressed sectors, speed-up CIRP, strengthen the overall IBC framework thereby facilitating and promoting entrepreneurship.