

THE POSITIVE IMPACT OF INSOLVENCY AND BANKRUPTCY CODE ON THE ECONOMY

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Abstract

The Insolvency and Bankruptcy Code (IBC) was introduced by the Indian Government in 2016 to address corporate insolvency and improve the Ease of Doing Business. The IBC aims to simplify insolvency proceedings, focus on timely resolutions, fair asset utilization, and enhance financial system credibility. Its significance in India's economic landscape is evident in the lives of billionaires like Anil Ambani and Vijay Mallya, who faced financial difficulties due to various circumstances. The piece digs into the lives of Ambani and Mallya, extracting lessons from their downfall. It goes on to explain the IBC's ramifications, objectives, and highlights, emphasising its importance in India's economic environment, increasing 'Ease of Doing Business' rankings, and the broader goal of reducing crony capitalism. The commentary goes on to discuss how the IBC has streamlined insolvency resolution processes, strengthened creditor rights, and developed a culture of fiscal discipline, eventually increasing investor confidence and economic stability.

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Introduction

The stories of billionaires starting from rags to becoming rich are often an inspiration to a vast population. However, India also has seen a lot of riches-to-rags stories. There have been many billionaires in the country who have now become bankrupt. Several high-flying billionaires have vanished entirely, their debt appetites having destroyed them.

Anil Ambani, the chairman of Reliance Communications, was once India's richest man. His net worth was once far greater than that of his brother, Mukesh Ambani. He was also once named the world's sixth richest person by Forbes in 2008, with a net worth of approximately \$42 billion. Anil Ambani came perilously close to facing prison time until RIL Chairman, Mukesh Ambani bailed him out. Since Anil Ambani had offered a personal guarantee, Supreme Court ordered him to pay Ericsson AB's India unit about \$77 million of past dues or face prison. Anil Ambani had been fending off creditors and fighting cases while his Reliance Communications Ltd. slid into bankruptcy. As his telecom carrier went bankrupt, his unprofitable Reliance Naval & Engineering also ran into financial difficulties. To reduce debt, Reliance Capital was selling assets. In a

London court, Ambani was defending himself against Chinese lenders.¹

There's another infamous businessman suffering from bankruptcy, Vijay Mallya. The absconding liquor baron also known as the "King of Good Times," was once a wealthy businessman. Mallya, a former Rajya Sabha MP and former owner of an Indian Premier League franchise, had dabbled in a variety of fields, including sports, politics, and the now-defunct Kingfisher Airlines.

There's a certain amusement to the Mallya case. The extravagant businessman begins with a beverage empire, grows, runs into financial difficulties, and is then pursued by the banks. Mallya faced a bankruptcy order in the UK, which was being pursued by a consortium of 17 Indian banks led by the State Bank of India (read SBI). The consortium was attempting to collect around Rs 9,000 crore (\$1.3 billion) that Mallya was believed to have diverted in order to buy a stake in approximately 40 companies all over the world.²

¹ P R Sanjai and Bhuma Shrivastava, *The year Indian tycoons faced bankruptcies, jail and death*, FINANCIAL REVIEW, (Mar 1, 2021, 3:35 PM),

<https://www.afr.com/wealth/investing/the-year-indian-tycoons-faced-bankruptcies-jail-and-death-20200101-p53o3d>.

² ET Now Digital, *Throwback: Anil Ambani to Vijay Mallya, these 7 Indian billionaires went bankrupt*, ET NOW NEWS,

Mallya once mocked Donald Trump, the former President of the United States, as he was being compared to him and said, "I am not yet anywhere near bankruptcy." Well, the tables have turned and how, for the "King of Good Times". According to Business Today, he was referring to the 1998 incident when Trump's companies declared bankruptcy. According to a report in the Economic Times, the London High Court granted him a bankruptcy reprieve, stating that he should be given time to resolve his petitions in Indian courts first.³

Kingfisher Airlines, was established in 2005, but it was forced to shut down in 2012 due to debt that made it difficult for the airline to continue. The airline was also under investigation for money laundering and financial irregularities. Mallya left the country on March 2, 2016, the day a clutch of banks moved the Debt Recovery Tribunal against him.⁴ Seeing what he threw the

(Mar 3, 2021, 12:46 AM), <https://www.timesnownews.com/business-economy/companies/article/throwback-anil-ambani-to-vijay-mallya-these-7-indian-billionaires-went-bankrupt/678305#:~:text=The%20woes%20of%20the%20ex,amid%20his%20Reliance%20Communications%20Ltd.>

³Rimi Chakraborty, *Pramod Mittal to Nirav Modi, 5 Indian billionaires who went into bankruptcy*, GQ (Mar. 1, 2021, 2:30), <https://www.gqindia.com/get-smart/content/pramod-mittal-to-nirav-modi-5-indian-billionaires-who-went-into-bankruptcy>.

⁴ BUSINESS STANDARD, <https://www.business-standard.com/about/who-is-vijay-mallya> (last visited Mar 1, 2021).

money on, an airline, racing, cricket teams, and so on, there was a relevant economic and public policy argument to be made. India had to push forward with its bankruptcy reform.⁵

Insolvency and Bankruptcy Code, 2016

In a study titled "House of Debt,"⁶ Credit Suisse analysed 10 Indian companies, including those owned by billionaires, and found that rapidly rising debt levels were impacting their finances. A year later, a report entitled "The House of Debt: Revisited"⁷ revealed that ten corporate groups' debt had increased by 15% compared to the previous year and profits remained under pressure. In a capitalist free market there will always be mistakes. That is exactly the goal of the system: to encourage people to explore new technological spaces in order to benefit from technological advances. This makes it work as a single system that increases living standards. But we need a quick way to eliminate the flood of errors.

Many companies are suffocating under the

⁵Tim Worstall, *The Vijay Mallya Case Shows Why India Really Must Change Its Bankruptcy Laws*, FORBES, (Mar. 1, 2021, 12:35 PM)

<https://www.forbes.com/sites/timworstall/2016/03/10/the-vijay-mallya-case-shows-why-india-really-must-change-its-bankruptcy-laws/?sh=67a80ca163a0>.

⁶ Ashish Gupta et al., *House of Debt*, CRED. S. 1, 5 (2015), <https://plus.credit-suisse.com/r/V4pSWN2AF-WEIY95>

⁷ Megha Bahree, *Top Indian Companies Burdened With Debt*, FORBES, (Mar. 3, 2021, 4:25 PM)

<https://www.forbes.com/sites/meghabahree/2013/08/19/top-indian-companies-burdened-with-debt/?sh=31b69dd9725d>

weight of debt. The Indian government and the central bank, the Reserve Bank of India, have made several attempts to revive these companies in the past. In an attempt to recover money from defaulting debtors under existing insolvency and bankruptcy laws, banks were embroiled in years of protracted litigation that proved to be a disaster. Additionally, under current bankruptcy law, it would take years to decide whether to rescue or liquidate a troubled company, which would allow management to sell the company's assets. Recognizing the importance of legal reform to improve the business climate and credit markets in India, the Government of India introduced the Indian Insolvency and Bankruptcy Code in 2016, a comprehensive law to combat insolvency of individuals and companies. The 2016 Insolvency Code aims to unify the current system by introducing a uniform insolvency code. In December 2015, the Lok Sabha passed the Insolvency and Bankruptcy Bill, Code 2015 No. It was numbered , was tabled by Arun Jaitley and signed by the President on May 28, 2016. The IBC was introduced in the backdrop of a rise in non-performing loans to provide a consolidated framework for speedy resolution of corporate insolvencies and related partnerships. In the

case of *Swiss Ribbons*⁸, the Supreme Court has held that the main objective of an IBC is to facilitate the rehabilitation and survival of the debtor company. So, a broader vision of the common good comes into play: three class goals. The IBC identifies three categories of persons who can initiate or initiate corporate insolvency proceedings (read 'CIRPs'): financial creditors, operational creditors and corporate debtors.

The three class targets

Three class goals of the IBC defines three categories of companies that can activate or initiate the CIRP: financial creditors, operational creditors and corporate debtors. In the case of a business debtor, the Supreme Court ruled in the case of *Mobilox Innovations v. Kirusa Software*⁹ noted that operational debts should be free of pre-existing disputes that cannot be immediately resolved in bankruptcy proceedings. The Code proposes the following measures to resolve insolvency:

- **Initiation:** In the event of a default, the debtor or creditor can initiate the resolution process. The process is monitored by an insolvency specialist. The professional manages the debtor's assets and provides the

⁸ *Swiss Ribbons Pvt Ltd v. Union of India*, AIR (2019) 4 SCC 17

⁹ *Ibid.*

creditor with financial information about the debtor. This procedure lasts 180 days, during which any civil action against the debtor is prohibited.

- **Insolvency Resolution:** The insolvency administrator would appoint a committee of creditors who have lent money to the debtor. The Commission will decide on the future of the debt. They can choose to pay off the debt through debt restructuring or to sell (liquidate) the debtor's assets to repay the debt. If no decision is made within 180 days, the debtor's assets will be liquidated.

- **Liquidation:** The insolvency specialist oversees the liquidation process when the debtor declares bankruptcy. The proceeds from the disposal of the debtor's property will be distributed in the order specified below. :

- i) The costs of the insolvency proceedings, including the remuneration of the insolvency administrator,
- ii) Secured creditors whose loans are backed by collateral, dues to workers, other employees,
- iii) unsecured creditors,
- iv) dues to government,

- v) priority shareholders and
- vi) equity shareholders.

The code also authorizes the creation of a fund called the Indian Insolvency and Bankruptcy Fund.

Highlights of the IBC

1. Time-bound procedure

In India, insolvency resolution initially took an average of 4.3 years. This value is significantly higher than in other countries such as the United Kingdom (1 year) and the United States of America (1.5 years).¹⁰ These delays arise from the time it takes for courts to decide cases and the uncertainty resulting from a lack of information about ongoing insolvency proceedings. India's average recovery is just a quarter of a dollar, making it one of the worst-performing economies of a similar size. Legal experts point out that parallel proceedings in different jurisdictions (courts, debt collection courts) have often led to disagreements and delays in resolving debt problems for creditors. The code establishes a procedure for the rapid

¹⁰ KR Srivats, *Bankruptcy code: Jaitley introduces Bill in Lok Sabha*, THE HINDU BUSINESS LINE (Mar 4, 2021, 4:25 PM) <https://www.thehindubusinessline.com/economy/policy/bankruptcy-code-jaitley-introduces-bill-in-lok-sabha/article8013813.ece>.

resolution of bankruptcies. This is important because it ensures the error is resolved quickly. If the debtor does not repay the debt, the creditors take the debtor's assets into custody and have 180 days to resolve the bankruptcy issue. In order to ensure that the resolution process runs smoothly, the code offers the debtor protection against restructuring requests from creditors during this period. The Code also consolidates provisions of existing legislation to provide debtors and creditors with a single platform to resolve insolvency matters. All companies and individuals are subject to the 2016 Code.

2. Utilisation of Assets

The IBC was adopted by the government in 2016 in response to the need for changes in insolvency laws to improve India's business climate and credit markets. In society, we have a finite number of usable assets. We want them to be put to good use. If a discrepancy happens, we want the assets to be moved to new uses as early as possible. When we consider the whole economy, the question of who gets paid what for their loans is a trivial issue. The previous Companies' bankruptcy provisions were scattered through many laws. As a result, this

reform is extremely welcome, because it puts the emphasis where it should be in economic terms. The ease with which a new business venture can be formed is important, but cleaning up the mess left by those who fail is more important. As with the majority of business projects, there is a probability that they would crash. What we want is for the productive assets, left over from a company loss to be reallocated to another part of the economy. They aren't meant to be squandered: that is something that makes everyone poorer. We want to make use of the productive assets in the economy. We want them to be used by anyone who can bring value to them. We'd like to see them used in value-added systems. What we don't want is for assets to be locked up and unable to be used. When the production arrangement fails, we want the potentially valuable assets to be released to be checked in other arrangements, to see how they can be combined to perform a different role that adds value.

The IBC is also expected to settle the issue of Non-Performing Assets (read 'NPAs') by creating a robust mechanism for resolution of credit-related disputes between creditors and corporate debtors. NPAs have long plagued India's financial sector, and many of

the country's businesses are struggling under huge debts. The aim is to address the problem of NPAs in two parts. First, it encourages changes in debtor behaviour to ensure informed business decisions and avoid corporate insolvencies. Secondly, it provides a methodology for the recovery and restructuring of companies in financial difficulty.

The main objective of the law is to facilitate insolvency resolution and liquidation in a timely manner and to improve India's ranking in the 'ease of doing business' index.¹¹

3. Efficiency in Resolution Process

The new Code would create deadlines and a network of insolvency professionals to reduce court workload. An efficient insolvency mechanism is important to economic policymakers because it serves two functions: first, it supports the credit system, and second, it improves the economy's business sector. It offers a mechanism for financial institutions to maximise the value of their claims on a

troubled debtor and secure their financial stability by supporting the credit system. An insolvency system allows a creditor to file for liquidation or reorganisation against a debtor who is in financial distress, bringing discipline to the debtor-creditor relationship, which is essential for long-term relationships.¹²

Insolvency professionals will aid in the execution of the code's insolvency settlement, liquidation, and bankruptcy proceedings. To make such proceedings easier, information utilities can compile, collate, authenticate, and disseminate financial data.

4. Legislative Implication

The Companies Act 2013, the Income Tax Act, and the Payment and Settlement Systems Act 2007 are among the 12 laws that the Code intends to amend. The legislation aims to harmonise and update laws governing the reorganisation and resolution of corporations, partnership companies, and individuals in a timely manner in order to maximise asset value.

5. International Implications

¹¹ Shinu Vig, *Insolvency Reforms in India: Policy and Economic Implications*, 25 THE JOURNAL OF CONTEMPORARY ISSUES IN BUSINESS AND GOVERNMENT, 1 2019
https://cibg.org.au/article_1204_48e311c8c20093b4fdc20e499a6816c1.pdf.

¹² Ibid.

India's 'Ease of Doing Business' rankings are expected to increase if the country's bankruptcy regime is revamped. These reforms have had a significant impact on India's "World Bank Ease of Doing Business (EODB)," which has risen 14 places in the last three years to rank 63rd out of 190 countries. For the third year in a row, the World Bank has ranked India among the "top 10 improvers."

Cross-border issues were associated with Indian companies that have claims against defaulting global companies. The IBC has attempted to incorporate efforts for cross-border insolvency, but these are insufficient to deal with default cases. However it is best to take things one step at a time.

6. Social Implication: Preventing Frauds

Diamonds may be man's best friend, but no one can say the same about diamond merchant Nirav Modi. Modi and his uncle Mehul Choksi were accused of defrauding PNB of nearly Rs. In 2018, PNB notified the Department of Corporate Affairs that three of Modi's companies, Firestar Diamond, A Jaffee and Fantasy, had filed for Chapter 11 bankruptcy in the Southern District of New York in the United States. One of the hallmarks of the fraud was the apparent

façade of independent companies, which were in fact companies regulated by Nirav Modi, undefined To quote Amitabh Kant, CEO, NITI Aayog, "IBC will ensure the end of the world of crony capitalism."¹³ Previously, one could take loans and not repay them. If you don't pay now, you will lose your business. "Crony" is a term used when characterizing capitalism as an economy in which companies profit by returning money from political and business alliances rather than taking risks. With the introduction of IBC, it has become difficult for promoters to regain ownership of their companies after bankruptcy and also to exert excessive leverage on their balance sheets. Now it's do or die. After the implementation of the IBC, India's ranking in resolving insolvency issues fell from 136th in 2017 to 52nd in 2020, according to a World Bank report¹⁴. Recovery rates under the IBC are weak. The ongoing insolvency proceedings are also a problem. Approximately 71% of cases are pending for more than 180 days, a significant deviation from the goal of rapid

¹³ Srijan Anant, and Aayushi Mishra, *A Study Of Insolvency And Bankruptcy Code And Its Impact On Macro Environment Of India*, 7 IJEDR 1, 5 2019 <https://www.ijedr.org/papers/IJEDR1903007.pdf>.

¹⁴ World Bank. 2020. *Doing Business 2020*. Washington, DC: World Bank. DOI:10.1596/978-1-4648-1440-2.

bankruptcy resolution.¹⁵ Another important topic is the digitalization of the IBC ecosystem. The lack of digitalization has led to difficulties in insolvency proceedings and very long delays that go far beyond legal limits. Acceptance of cases at the NCLT often proves to be a challenge. In its report, a parliamentary select committee has suggested digitization of the National Company Law Appellate Bodies (read 'NCLATs'). Virtual hearings should be held for speedy resolution of pending cases.

The way forward

Key stakeholders must do their utmost to ensure that the strength of the IBC is not diminished. The goal should be to close any gaps discovered. Statistics show that a significant percentage of liquidations occur when the debtor's assets decrease over time due to a long and delayed bankruptcy process. Therefore, the timing aspect of insolvency resolution is important. The government must allocate adequate budgetary resources for the training and development of insolvency specialists, improving judicial infrastructure and

digitizing insolvency procedures. The IBC has undoubtedly revived the culture of failure in India. This has not only proven effective in curbing the growing menace of NPAs but has also boosted the economy by bringing several benefits including strengthening credit discipline. According to reports, a total of Rs 25,000 crore has been pumped into the banking system since 2016, following the IBC default. However, like any other law, there are areas in the IBC where significant improvements can be observed. Much work remains to be done to make Indian insolvency processes comparable to those in other experienced and mature countries around the world.

Conclusion

The IBC has been described as a "game changer," having a positive effect on the economy's future contours. Given there was nothing prior to the code, the performance assessment of the code would have to be a "relative evaluation." Because of its position in the appointment, and examination of professionals, critics have argued that the IBC has too much government involvement. There is still a shortage of infrastructure to deal with high-volume insolvency cases. The success of the "Make in India" campaign would be contingent on the creation of an

¹⁵ Prasad, Gireesh Chandra.

"<https://www.livemint.com/Industry/Banking/Bankruptcy-Code-Deviated-from-Goals-Needs-Revision-Parliamentary-Panel-11627987510087.html>." *Mint*, 2 Aug. 2021,

www.livemint.com/industry/banking/bankruptcy-code-deviated-from-goals-needs-revision-parliamentary-panel-11627987510087.html.

atmosphere in India where entrepreneur and financier failures are managed promptly. The smooth operation of a credit market ensures that all stakeholders are working together to help entrepreneurial growth succeed. One phase in this direction is the IBC Code. It's entirely possible that the current Bankruptcy Code for India contains some rules that aren't quite perfect. However, the legislation's concept and thrust are fantastic, since it refers to the most crucial aspect of consumer economy. There will be errors in market economy; and that is the beauty of the economy. What matters is how effectively they are corrected.