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Premium

The Insolvency and Bankruptcy Code allows the market to make the most efficient choice

Liquidation or rescue is an outcome of the market forces; the law is only an enabler giving choices and nudging a company towards value maximising outcomes. The stakeholders decide whether to seek resolution and, if so, the mode of resolution.

Written by MS Sahoo Updated: February 8, 2021 09:22 IST



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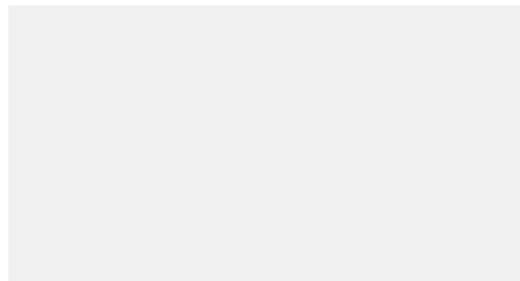


The "invisible hands" of the market works towards the best outcome, which we should respect and accept.

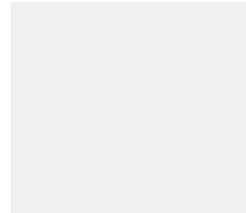
The Insolvency and Bankruptcy Code, 2016 was enacted to resolve the stress of companies. Some, however, argue that because the corporate insolvency resolution process (CIRP) rescues only about 25 per cent of companies and leads to liquidation for the rest, the code is not delivering on its mandate. These numbers do tell a story, but not the entire story. Let me tell the story as I comprehend.

First, the CIRP enables the market to attempt to resolve stress through a resolution plan whereby the company survives. When it concludes that there is no feasible resolution plan to rescue the company, the company proceeds for liquidation. The market usually rescues a viable company and liquidates an unviable one. Take the examples of Ghotaringa Minerals Limited and Orchid Healthcare Private Limited which caught media attention. They together owed over Rs 8,000 crore to creditors, while they had absolutely no assets and workers when they entered CIRP. There are quite a few companies which have negligible assets and/or are defunct when they enter CIRP. Many of these are beyond rescue for a variety of reasons, including creative destruction, and their continuation is a cost to the economy. In such cases, the code enables liquidation to release available resources to alternate uses. One should not fret over liquidation in such cases. It is welcome, as it releases the assets as well as the entrepreneur stuck up in an unviable company, which is a key objective of the code.

Second, on the face of it, 25 per cent of companies were rescued and 75 per cent proceeded for liquidation. In value terms, however, 75 per cent of the assets were rescued and 25 per cent of assets proceeded for liquidation. Importantly, of the companies sent for liquidation, 75 per cent were either sick or defunct, and of the companies rescued, 25 per cent were either sick or defunct. The companies rescued had assets, on average, valued at 25 per cent of the amount of claims against them, while the companies ordered for liquidation had assets valued at 5 per cent of the amount of claims against them. In terms of these facts, the extent of liquidation under the code does not appear worrisome.



Third, the stress that a company suffers is like an illness which can be treated by a variety of options. Allopathy is one of the options for a patient, just as the code is one of the options for resolving stress of a company, others being, the scheme of arrangement under the Companies Act, 2013, the RBI prudential framework, etc. Some patients treat their illness with over-the-counter (OTC) medicines, some visit a doctor. Most patients get relief at the outpatient department (OPD) of a primary health centre. Patients with complicated illness move to a secondary care hospital, the more complicated ones to tertiary care and the most complicated ones to quaternary care. Normally, recovery is better if diagnosis and treatment start early. When the illness is at an advanced stage, some patients recover, while some don't, despite the best efforts of doctors. The percentage of



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In a major relief for the makers and fans, director Venkat Prabhu's *The Greatest of All Time (GOAT)*, starring "Thalapathy" Vijay, has received government nod to hold a special show on its release day on Thursday (September 5). On August 24, production company AGS...

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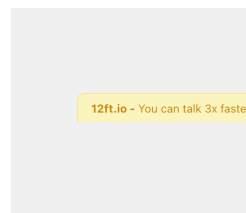
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Some patients survive, while some don't, despite the best efforts of doctors. The percentage of survival at this stage may not be significant. However, the number of patients who recover in OPDs, and at primary, secondary care, and tertiary care hospitals as a percentage of those who visit a doctor gives a fair idea about the efficacy of allopathy as an option for treatment of illness.

The credible threat of CIRP that a company may change hands has redefined the debtor-creditor relationship. In the words of the Supreme Court, "defaulters' paradise is lost" under the code. Faced with the possibility of the CIRP, a debtor makes all-out efforts to prevent the stress, or resolve it much before it translates into a default, or settles the default to prevent filing of application for initiation of CIRP. Even after an application is filed, a debtor continues efforts to resolve the financial stress midway through settlement, review, mediation, or withdrawal to avoid the consequences of CIRP. There are also examples of settlement with the approval of the apex court.



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About 30,000 applications have been filed for initiation of CIRP. Of them, 10,000 are yet to be disposed of. Of the balance 20,000, the stress underlying 16,000 applications were resolved before admission, and the stress underlying 4,000 applications entered CIRP for resolution. Of these, 1,900 are ongoing, while 800 got resolved, through settlement, review, mediation, or withdrawal. The remaining 1,300 have completed the process. At this stage, the value of the company is substantially eroded, and hence some of them (300) were rescued, and others (1,000) liquidated. That works out to a rescue rate of 25 per cent of CIRP. Another way to work out the number of companies where the stress was resolved (before admission plus midway closure and resolution plans) as a percentage of the number of applications concluded, that is, 17,000/18,000, which gives a rescue rate of 95 per cent. Thus, only 5 per cent of companies seeking resolution through the code end up in liquidation. Of these, 75 per cent are defunct to start with.


Liquidation or rescue is an outcome of the market forces; the law is only an enabler giving choices and nudging a company towards value maximising outcomes. The stakeholders decide whether to seek resolution and, if so, the mode of resolution. They weigh various options and choose the one that best suits their needs. They will not use the code if they find that the outcome under it is not consistent with market realities. When they use the code, they have a choice between rescue and liquidation. The "invisible hands" of the market works towards the best outcome, which we should respect and accept.

This article first appeared in the print edition on February 8, 2021, under the title "Reading the bad debt numbers". The writer is chairperson, Insolvency and Bankruptcy Board of India.

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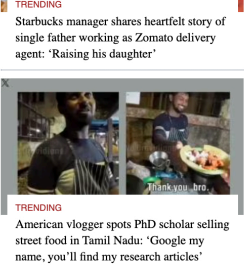
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