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A performance appraisal of IBC

Despite potential biases introduced by the Dosa approach in analysing its efficacy, the law appears successful in delivering on its key parameters

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The performance appraisal of the Insolvency and Bankruptcy Code (IBC), 2016, has been a favourite pastime for many, with some adopting the Dosa (decision-oriented systematic analysis) approach. This approach predetermines the desired appraisal outcome and then devises a methodology to yield that outcome. For example, they predetermine a poor/negative outcome. They choose recovery as the performance metric, select a purposive sample, underestimate recoveries, overestimate claims, compute a low recovery ratio, and consequently assert the poor performance of the IBC.

However, it is important to note that recovery is not an objective of the IBC. The term "recovery" is not mentioned in the legislation. Further, the law penalises attempts to use the IBC for recovery.

For such appraisers, recovery tends to overlook realisations from equity holdings post-resolution, the reversal of avoidance transactions, and the insolvency resolution of guarantors. Additionally, the claims include written-off non-

performing assets (NPAs) and penal interest on such NPA, encompassing both loans and guarantees against those loans. This results in a distorted recovery rate of 32 per cent against claims, a figure at odds with the World Bank's estimate of recovery of 72 per cent from the IBC process. Even with this flawed estimation, which treats IBC as a recovery law, the recovery rate surpasses that of any recovery law in the country.

It makes sense to link realisation of creditors to the tangible assets on the ground rather than their claims, as the market offers a value for the assets a company has, and not what it owes to creditors. The IBC process is realising a remarkable 169 per cent of the value of the assets of companies . Any alternative option would at best realise 100 per cent minus the cost of such realisation. The excess realisation of 69 per cent is a bonus from the IBC for creditors while rescuing viable companies for the economy.

The IBC liquidates relatively more companies than it rescues. Some appraisers use the high incidence of liquidation to paint a negative picture of IBC's performance. This overlooks a fundamental aspect of the IBC. It offers two modes of resolution — resolution plan and liquidation, allowing the market to make the choice.

Consider the kind of companies getting liquidated. Three-fourths of the companies resolved by liquidation were either sick or defunct. These companies, on average, had assets valued at about 5 per cent of the claims when they entered the IBC process. For such companies, liquidation may indeed be a more appropriate resolution path. Yet, the incidence of liquidation through the IBC is not different from that in advanced jurisdictions.

The metric and methodology for appraising the IBC should align with its objective, which is the resolution of stress. The primary parameter for assessment should be whether the IBC is resolving stress irrespective of the mode of resolution. On this critical parameter, the answer is an unequivocal "yes". Out of the 7,000 stressed companies that entered the IBC process, 5,000 have successfully exited, while the remaining 2,000 are in different stages.

The secondary parameters are the efficiency and efficacy of such resolution. The IBC envisages two efficiency parameters, namely, resolutions to be time-bound and to maximise the value of stressed assets. The performance on these efficiency parameters is less encouraging. During April-September 2023, 127 resolution processes concluded, taking an average of 867 days for completion, compared to the intended 180 days. Similarly, the resolution plans are realising only 86 per cent of the fair value of the companies, suggesting a gap in achieving the desired value maximisation. An efficacy parameter is the quality of resolution. A recent Indian

Institute of Management (Ahmedabad) study finds it to be good. Post-resolution, the companies have witnessed significant improvements: Turnover increased by 76 per cent, profitability ratios converged with benchmarks, and market capitalisation tripled.

IBC aims to serve the broader economy. It was enacted in 2016 as a response to the twin balance sheet syndrome (TBS) crisis. The balance sheets of both firms and banks were under stress, with half the firms reporting an interest coverage ratio of less than one, and banks contending with NPA exceeding 9 per cent. These ratios worsened for some more time till the IBC started bearing fruit. Soon TBS was relegated to a historical footnote as numerous mighty companies changed hands through the IBC process. The efficiency and efficacy resolution of issues like TBS could constitute tertiary parameters.

The NPA of banks, after peaking at 14.8 per cent in September 2018, reduced to a low of 3.2 per cent by September 2023. The banks collectively recorded a historic profit of Rs 2.63 trillion in 2022-23, opposed to a loss of Rs 32,438 crore in 2017-18. Firms improved performance leading to robust balance sheets, with prudent leverage, and interest coverage ratio exceeding 3.5. Corporate governance too witnessed improvement, evident in the decline in related party transactions post-IBC, as found in a study by the Centre for Advanced Financial Research. India's global ranking in terms of resolving insolvency parameters improved from 136th to 52nd in the first three years of IBC implementation.

Will the TBS recur? Unlikely till the IBC in its current form remains in the statute book. The credible threat of losing a company motivates debtors to take proactive measures, steering clear of the IBC process. This is evident from the withdrawal of applications for initiation of the IBC process against 26,518 companies with an aggregate default of Rs 9.33 trillion before admission, reinforcing the idea that the best use of IBC is not using it at all.

The IBC thus appears successful in delivering on the primary, secondary (efficacy), and tertiary parameters. It faces challenges on the secondary (efficiency) parameters related to time-bound resolutions and asset value maximisation. Improvement on these parameters requires the stakeholders, including the government, adjudicating authority, debtors and creditors, and professionals to play their respective roles envisaged for them. Importantly, these do not require any legislative fix. This is, however, a matter for another day.

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