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The flawed creditor divide in the IBC

RESTORE BALANCE. When law departs from commercial reality, it distorts market mechanisms. Therefore, the divide between financial and operational creditors lacks basis

The Insolvency and Bankruptcy Code, 2016 draws a sharp distinction between financial creditors (FCs) and operational creditors (OCs), based on the premise that financial debt embodies the time value of money (TVM). Building on this, the Code presumes that FCs possess commercial wisdom and the willingness and ability to defer repayment. Accordingly, it accords FCs primacy in the insolvency process: they control it, determine its outcome, and enjoy priority in the distribution waterfall. OCs, by contrast, stand at the periphery, procedurally and substantively.

This distinction, however, rests on a misconception. TVM is a basic economic principle: a rupee today is worth more than a rupee tomorrow. Conversely, a rupee receivable in the future is worth less today. If one parts with ₹100 today and receives ₹110 a year later, the additional ₹10 is the compensation for waiting in the face of uncertainty.

Money carries time value because the future is uncertain. A creditor who defers repayment takes on a range of risks: inflation may erode purchasing power; the borrower may default; new investment opportunities may arise and be missed; and the broader economic, policy, technological, or environmental landscape may shift in ways that diminish the worth of the money when it finally returns. For individuals, there is also an existential uncertainty: one may simply not live long enough to enjoy the benefits of delayed repayment.

A rational economic actor prefers to use money today rather than defer its use. Deferral is acceptable only when accompanied by compensation for the uncertainty associated with time. The longer the deferral, the greater the uncertainty, and therefore the higher the compensation required. Interest, in essence, captures the price of waiting and serves as the premium for uncertainty.

Crucially, every deferred payment embeds TVM. This principle does not discriminate between a bank lending to a steel plant and a vendor supplying coal on credit to the same plant. In both cases, someone parts with money today with the expectation of a return tomorrow. The economic substance is identical: transfer of present value in exchange for future payment, carrying a premium for time.

The real economy makes no distinction between operational and financial debt in terms of TVM. Roughly two-thirds of corporate bank lending is in the form of working capital loans, which primarily fund payments to suppliers, inventory procurement, and other operating expenses. Suppliers effectively finance the operating cycle, sometimes directly by giving credit, and sometimes indirectly, by enabling the borrower to use bank finance to pay them. In economic terms, supplier credit and working capital loans perform the same function: they finance the operating cycle of the business.

A familiar commercial practice illustrates the point. The cash price of goods is lower than the credit price. If a buyer pays immediately, it receives a cash discount. If it pays later, it foregoes the discount. This foregone discount is, in substance, interest. The buyer could alternatively borrow at interest from a bank to pay the supplier upfront and avail the discount. Or, the supplier may borrow funds at interest cost to supply on credit to the buyer without a discount. Economically, the two choices are equivalent. A supplier supplying on credit is mathematically no different from a bank offering working capital finance. The Supreme Court in *Pioneer Urban* (2019) held that real estate allottees qualify as FCs as their payments have a commercial effect of borrowing. This reasoning applies equally to OCs. A manufacturer using steel supplied on credit is effectively deploying the supplier's capital to produce cars. The economic substance is identical: a transfer of present value in return for a deferred value that inherently embeds TVM.

A robust insolvency regime rests on economic logic. The time value of money does not distinguish between a banker and a supplier; neither should the law

UNCONVINCING RATIONALE

The rationale for privileging FCs is unconvincing. It is difficult to accept that FCs inherently possess superior commercial wisdom merely because they specialise in lending, while OCs, who run businesses, manage production cycles, and assess counterparty risk daily, do not. The resolution plans approved so far offer little insight into the underlying businesses, with little indication that post-resolution earnings would meaningfully service debt. Moreover, 13 per cent of the companies that proceeded to liquidation were ultimately rescued, through going-concern sales and restructuring, pointing to lapses in commercial judgment. Nor is it accurate to assume that FCs would readily reschedule repayment to avoid liquidation. The high proportion of cases culminating in liquidation, despite FCs steering the process, suggests otherwise. In several approved resolution plans, FCs have opted for immediate exit rather than remaining invested to share in potential future value creation. Rather, secured FCs may have an incentive to pursue liquidation, as the realisation of security in liquidation may equal or exceed what they would receive under a resolution plan.

The assumption that OCs would push for liquidation to secure immediate recovery is equally misplaced. A supplier's economic fate is closely tied to the debtor's survival. Liquidation eliminates a customer; a resolution plan preserves the order book. In many cases, OCs have a strong incentive to keep the enterprise alive.

FCs, typically banks or large lending institutions, are secured creditors, while OCs are almost always unsecured. FCs use sophisticated data-driven risk models, while OCs face significant information asymmetry as they rarely have access to the financial health of the borrower. FCs generally hold a diversified credit portfolio capable of absorbing the failure of a borrower. OCs, by contrast, are specialised vendors whose business survival is tied to the solvency of the debtor. Recognising their inherent vulnerability, several jurisdictions ensure that unsecured creditors, who are predominantly OCs, have a seat at the decision-making table.

A robust insolvency regime rests on economic logic. The TVM does not distinguish between a banker and a supplier; neither should the law. No major insolvency regime uses TVM to classify creditors or exclude an entire class of creditors from decision-making on this basis. All creditors extend capital, all bear uncertainty, and all deserve a meaningful role in resolution. The current framework risks disincentivising supplier credit, distorting credit markets, and raising the cost of doing business. A course correction, anchored in the universality of the TVM and supported by global practice, is essential to restore balance, fairness, and economic coherence to the Code.

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