

INDIA MAY NOW BE READY FOR DIRECT LIQUIDATION PATHWAYS AS THE SYSTEM MATURES

Why exit matters?

AS THE INSOLVENCY and Bankruptcy Code (IBC) completes 10 years, one criticism continues to dominate the public discourse. Too many companies, the argument goes, are going into liquidation. The criticism is emotionally appealing. A system that liquidates more firms than it rescues appears, at first glance, to have failed in preserving businesses and jobs. But the criticism misunderstands the insolvency law.

In many cases, liquidation is evidence of the framework functioning exactly as intended. A modern insolvency regime has two equally legitimate outcomes. It must rescue viable firms through restructuring. But it must also close unviable ones swiftly so that capital, labour, land, and entrepreneurial energy move to more productive uses. Economies grow not merely by preserving firms, but by continuously reallocating resources away from inefficient enterprises towards more competitive ones.

Economists have long recognised that productivity growth in dynamic economies arises from “creative destruction”, where inefficient firms exit and resources migrate towards more productive enterprises. An insolvency framework that systematically discourages exit risks weakening productivity growth itself. A market economy requires not only the freedom to succeed, but also an orderly mechanism to fail.

The IBC was enacted precisely to enable this transition. Before 2016, India’s insolvency regime was excessively preservation-oriented. Laws such as the Sick Industrial Companies Act trapped firms in prolonged rehabilitation attempts, even where there was little prospect of revival. Capital remained locked in unproductive enterprises, bad loans accumulated, and both corporate and banking balance sheets weakened.

The IBC introduced a fundamentally different philosophy: a time-bound, market-driven process where creditors and investors determine whether a business deserves revival or exit. It recognised that failure is inherent in a competitive market economy. Competition displaces ineffi-

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cient firms, innovation displaces the old order, and resources must continuously move towards more productive uses.

Yet India appears to have over-internalised the case for rescue, but under-internalised the legitimacy of exit. Institutional practice increasingly displays a preference for revival over liquidation. Successive amendments have progressively widened the rescue window, while judicial approaches often treat liquidation as something to be avoided except as a last resort. This risks weakening the economic logic of insolvency law.

The purpose of insolvency law is not to preserve companies at all costs, but to resolve financial distress efficiently. Where a business remains viable, rescue creates value because the firm possesses “going concern surplus”, the additional value from keeping assets, employees, customer relationships, and organisational systems together. But where this surplus no longer exists, liquidation

becomes economically desirable. Repeated attempts to revive unviable firms destroy value, delay resource reallocation, weaken credit discipline, and create enterprises that survive without competitiveness. There is also a moral hazard concern. If markets begin to believe that insolvency law will systematically prioritise preservation over exit, the disciplining effect of insolvency weakens. Credit allocation becomes less efficient, lenders grow more cautious, and viable firms ultimately bear the cost through tighter credit conditions and higher capital constraints. Rescue should emerge from genuine economic

viability, not from institutional discomfort with liquidation. If creditors and markets believe that a company retains going concern value, they will produce a credible resolution plan. If they do not, liquidation should follow swiftly and efficiently.

The perception that India liquidates excessively is unsupported by comparative evidence. As of March 2025, 4,422 companies had completed the corporate insolvency resolution process. Of these, 1,419 ended in approved resolution plans while 3,003 proceeded to liquidation. These numbers are not unusual. Mature insolvency jurisdictions such as the US,

the UK, and Australia report similar, and in some cases even higher, proportions of liquidations within formal insolvency systems.

This is because formal insolvency everywhere deals primarily with the most distressed subset of firms. Most financially troubled companies resolve distress outside court through refinancing, restructuring, asset sales, or negotiated settlements. Firms that eventually enter formal insolvency are usually those where private rescue efforts have already failed, and economic viability is seriously doubtful. Consequently, liquidation rates are naturally high across jurisdictions.

The condition of firms entering the IBC is therefore critical. A large proportion of firms proceeding to liquidation were already defunct before entering insolvency. On average, the value of their assets was barely 5% of the claims against them. Four-fifths had ceased operations years earlier, possessed negligible going concern

value, and had little prospect of revival. Expecting such firms to be revived through insolvency resolution is a misunderstanding of both economics and commercial reality. In such cases, continued attempts at revival only delay value realisation, increase costs, and trap scarce resources in unproductive enterprises.

The effects of the rescue orientation are now becoming visible. Liquidation rates have moderated in recent years. However, this appears to have come at the cost of both timely resolution and value preservation. The average time to arrive at a resolution plan in 2025-26 was 886 days. Similarly, the value realised under resolution plans during January-March 2026 was only 23% of admitted claims. The trend underscores an important reality: not every distressed company is capable of rescue.

As the system matures, India may now be ready for differentiated insolvency pathways. At present, every corporate debtor must first undergo the resolution process, and liquidation follows only if it ends up with no approved resolution plan. But many firms are manifestly beyond rescue from the moment they enter insolvency. Requiring such firms to undergo a full resolution process merely delays the inevitable, erodes value, increases costs, and burdens institutional capacity.

Several mature jurisdictions, including the US, permit direct liquidation proceedings where rescue is commercially unrealistic. India should seriously consider a similar framework. Allowing creditors or adjudicating authorities to place evidently unviable firms directly into liquidation would preserve value, accelerate resource reallocation, reduce process costs, and allow the insolvency system to focus its energies on genuinely viable businesses.

The success of the IBC should not be measured by how many firms are kept alive. It should be measured by whether the system efficiently preserves viable businesses and closes unviable ones. Rescue should emerge from genuine economic viability, not from policy anxiety about closure. Liquidation is not a pathology of insolvency law, but an integral part of market efficiency.

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