# TRANSFORMING BUSINESS AND THE INSOLVENCY SYSTEM

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The Prime Minister mentioned the Insolvency and Bankruptcy Code (IBC 2016) as one of the key legislative reforms that would help aid India's path to self-reliance on a high growth trajectory. The IBC, along with the Goods and Services Tax regime, among other key reforms, were helping in significantly improving the ease of doing business in India and enabling it to emerge as a 'Make for World' platform. He also credited these reforms for a surge in Foreign Direct Investment into India in 2019-2020, to the tune of nearly $74.5 billion, or a significant increase of 20 per cent from the previous year.

The IBC has been a far-ranging and structurally significant reform that has transformed insolvency resolution in India. Replacing a rather inefficient bankruptcy law regime, the IBC has focused on time-bound resolution, rather than liquidation, as an empowering tool to support companies falling within its ambit. It has successfully instilled confidence in the corporate resolution methodology, and perhaps, more importantly, on creating a possibility for the creditors recouping some of their investments in firms being liquidated or going in for resolution. Its core implication has been to allow credit to flow more freely to and within India while promoting investor and investee confidence. Despite the suspension of the IBC for a limited duration due to the COVID 19 pandemic, in the short, medium and long term, it will prove to have been a timely reform. It will greatly streamline insolvency processes in a sustainable, efficient, and value retaining manner.

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India, unfortunately, suffers from a serious backlog in court cases, to the tune of nearly four crore matters pending final judgment. The novel coronavirus pandemic is likely to exacerbate this. The enforceability of contracts has been a challenge. On an average, it takes as many as 1,445 days for a contract to be enforced, and that too at a cost of nearly 31% of the claim value. This is simply unacceptable.

Along with further streamlining and reinforcing the IBC, the Government of India is also working toward decriminalisation of minor offences. NITI Aayog is playing an active role in this exercise, which will significantly reduce the risk of imprisonment for actions or omissions that are not necessarily fraudulent or an outcome of *mala fide* intent. Criminal penalties including imprisonment for minor offences act as major deterrents for investors. The government's intent is to help differentiate between good faith mistakes and intentional bad faith actions, so as to penalise the former, and criminalise the latter.

Other legislative measures that will further improve the investment climate, include the rolling out of the commercial courts, commercial divisions and the Commercial Appellate Divisions Act, 2015, to allow district court-level commercial courts, and the removing of over 1,500 obsolete and archaic laws. Together with the IBC, these highlight a major and multi-dimensional effort by the government to provide comfort, relief and reliability to the potential investors.

The IBC is both flexible and dynamic, which makes it impactful, given how forward thinking the concept of an omnibus legislation of its nature actually is. The IBC goes beyond other similar pieces of legislation across the world, and through the Insolvency and Bankruptcy Board of India (IBBI), it has established an unprecedented organisation that both regulates and develops insolvency policy, and assesses market realities.

The Ministry of Corporate Affairs (MCA), in its year end summary press release, provided the context of India' s rapid rise in the Ease of Doing Business rankings, and IBC's important role of the IBC in it. According to the Resolving Insolvency Index, India's ranking improved to 52 in 2019 from 108 in 2018, a leap of 56 places. Further, the recovery rate improved nearly threefold from 26.5% in 2018 to 71.6% in 2019. And, the overall time taken in recovery also improved nearly three times, coming down from 4.3 years in 2018 to 1.6 years in 2019.

Two key drivers for the IBC are relatively short time-bound processes, and the focus on prioritising resolution rather than liquidation. The report of the Bankruptcy Law Reforms Committee speaks of the critical need for speed in the working of the bankruptcy code. It is clear that the inability to make significant decisions without full clarity of ownership and control delays resolution. And, the longer the delay, the more likely that the entity in question would move towards liquidation rather than resolution. The delays result in low value liquidation due to a high economic rate of depreciation. Higher value stems from the firm being acquired as a going concern.

Going forward, there could perhaps be a look at institutionalising the introduction of a pre-packed insolvency resolution process, the need for which is highlighted by the necessary suspension of the IBC proceedings. This will also help resolve matters expeditiously, outside of the formal court system, and allow resolution even during the COVID-19 altered reality.

The MCA along with IBBI are working diligently on putting in place a Micro, Small and Medium Enterprises (MSME) and non-MSME framework to help expedite this process.

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At the same time, given the need for social distancing and the suspension or limitation of physical hearings, a concerted effort should be made to enhance the role of digitally conducting all processes and hearings to achieve greater efficiency in the new normal. Bringing in technology would help ease of access to justice and greatly help ease of doing business from a process and efficiency standpoint as well. The IBC has provided a major stimulus to ease of doing business, enhanced investor confidence, and helped encourage entrepreneurship while also providing support to MSMEs. Its further streamlining and strengthening will surely instil greater confidence in both foreign and domestic investors as they look at India as an attractive investment destination.

*Rajiv Kumar and Desh Gaurav Sekhri are, respectively, Vice Chairman and Officer on Special Duty, NITI Aayog. The views expressed are personal*

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