



ILLUSTRATION: SHYAM

MS SAHOO

Chairperson, Insolvency and Bankruptcy Board of India



One code, multiple benefits

The Insolvency and Bankruptcy Code, 2016 provides for the ultimate economic freedom, addresses honest business failures and promotes inclusive growth

A FIRM NEEDS FREEDOM broadly at three stages of a business—to start a business (free entry), to continue the business (free competition) and to discontinue the business (free exit). This enables new firms to emerge continuously, and they do business when they are efficient, and vacate the space when they are no longer efficient. This ensures seamless flow of resources from less efficient uses to more efficient uses and the highest possible growth.

The reforms in the 1990s focused on freedom of entry. It dismantled the licence-permit-quota raj, for the licence to give way to registration. Anybody who met the pre-specified eligibility requirements became entitled to registration. If registration is to be denied, it has to be determined by a reasoned order and that order became appealable. Further, entry requires facilitators. For instance, a firm may not own resources to enter into a business; it can do so only if it can acquire resources from others. Accordingly, the securities laws allowed a firm, subject to meeting the pre-specified eligibility requirements, to access the securities markets, without requiring any approval from any authority.

The reforms in the 2000s focused on creating a free and fair marketplace. Ideally, a firm must have freedom to do business, but not to restrain the freedom of others to do so. It restrains freedom of others if it has market power—control over either price and or quantity—and abuses such market power to the detriment of others. For instance, if a firm adopts predatory pricing and has the financial muscle to sustain it, it effectively thwarts the competitors' freedom to do business. So, predatory pricing was proscribed. Further, a market requires facilitators. For instance, the policies and institutions should be neutral to all firms. Accordingly, the competition law provided the same level playing field to both state-owned and private firms.

A firm has the freedom to commence and continue a business. It may, however, fail to deliver as planned for a variety of reasons. Most often, it is due to competition and innovation where efficient firms drive out inefficient ones or new order drives out old one. While competition and innovation contribute to grow significantly,

they also increase the incidence of firm failure. In a sense, failure is inherent to growth. The failure may also arise from faulty design of the business model, inefficient execution, economic downturn, or in rare cases, mala fide design. Regardless of the reason, failure generally reflects inefficient utilisation or underutilisation of resources and impacts the macro economy in multiple ways and, therefore, needs to be addressed expeditiously.

A failure usually manifests as default in repayment obligations, though there can be occasions when a firm may default without failure and vice versa. Default is a state of insolvency. The failure and consequent insolvency need to be prevented. Where prevention is not possible, it needs to be resolved:

- preferably within the firm as a going concern, as the closure of the firm, destroys organisational capital;
- at the earliest, preferably at the very first default, to prevent it ballooning to un-resolvable proportions;
- in a time-bound manner as undue delay reduces the organisational capital of the firm making resolution difficult;
- by stakeholders who have a claim against the firm;
- in a calm environment when nobody disturbs the firm.

Where resolution is neither possible nor desirable, the firm needs to exit with the least disruptions and cost and release the resources for fresh allocation. The Insolvency and Bankruptcy Code, 2016, (Code) addresses all these endeavours to prevent insolvency, provides a market determined and time-bound mechanism for resolution of insolvency, wherever possible, along with facilitators for quick and effective resolution, and promotes ease of exit, wherever required.

The Code enables the optimum utilisation of resources, all the time, either by ensuring efficient resource use within the firm through a resolution of insolvency or by releasing unutilised or underutilised resources for efficient uses through the closure of the firm. It is believed that if the productive resources that are currently unutilised or underutilised for some reason or other can be put to more efficient uses, the growth rate may well go up by a few percentage points, other things remaining unchanged. Thus, the Code addresses a key economic problem—optimum use of limited resources to satisfy unlimited wants.

The economy witnessed freedom of entry in the 1990s and freedom to compete in the 2000s. The Code now provides the ultimate economic freedom, freedom to exit, and also a mechanism to address honest business failures. It enables an honest firm, undeterred by fear of failure, to get in and get out of business with ease, and thereby unleashes and realises the full potential of every firm and promotes inclusive growth. Thus, the Code addresses a key legal problem—optimum economic freedom for firms to bring out the best in them subject to regulations to address market failure.

It is well established that economic freedom and economic performance have a very high positive correlation. Countries having a high level of economic freedom generally out-perform the countries with the not-so-high level of economic freedom. The index of economic freedom, which measures the degree to which the policies and institutions of an economy are supportive of economic freedom, has substantially improved for India since the 1990s. The outcome has been astounding; the growth rate in the 1990s onwards has almost doubled as compared to the Hindu rate of growth in the preceding period.

The Code also improves ease of doing business, promotes entrepreneurship, develops corporate debt market, increases options for corporate financing, reduces the cost of funds, balances interests of stakeholders and does much more. For the potential to improve growth, and promote inclusive growth, and for addressing key economic and legal problems, the Code constitutes the biggest economic reform in the recent years.