

# The real reform

Achievement of the Insolvency Code is that debtors now resolve defaults in the early stages



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THE BENEFICIARIES OF the old order usually put every reform to several rounds of *agni pariksha*. They build public opinion against the reform, challenge it before every possible forum, create hurdles in implementation, misrepresent facts and figures and even spread rumours and canards. However, such resistance ultimately takes the reform deeper and makes it stronger. The insolvency reform (IBC) is no exception. It faced tough resistance from day one. The intensity increased with its implementation, as defaulters gradually lost their impunity and companies changed hands. The IBC started emerging stronger as it delivered on its promise, passed the constitutional muster, earned global recognition and became the preferred option for stakeholders in case of default.

There is a need to demystify some myths around the IBC outcomes. I will do so by using round figures here to keep the calculations simple. Most of the myths surround recovery. Let me give an example for quick appreciation. M/s. Synergies Dooray was the first company to be resolved under the IBC. It was with the Board of Industrial and Financial Reconstruction (BIFR) for over a decade. The realisable value of its assets was Rs 9 crore, when it entered the IBC process. It, however, owed Rs 900 crore to the creditors. The resolution plan yielded Rs 54 crore for them. Some condemned IBC because the resolution plan yielded a meagre 6 per cent of the claims of the creditors, disregarding the fact that they recovered 600 per cent of the realisable value of the company, which had been in the sick bed for over a decade. If the company was liquidated, assuming no transaction costs, the creditors would have got at best Rs 9 crore — 1 per cent of their claims.

Let's examine the myth that the recovery through resolution plans is dismal. Two hundred companies had been rescued till December 2019 through resolution plans. They owed Rs 4 lakh crore to creditors. However, the realisable value of the assets available with them, when they entered the IBC process, was only Rs 0.8 lakh crore. The IBC maximises the value of the existing assets, not of the assets which do not exist. Under the IBC, the creditors recovered Rs 1.6

lakh crore, about 200 per cent of the realisable value of these companies. Hypothetically, any other option of recovery or liquidation would have recovered, at best, Rs 100 minus the cost of recovery/liquidation, while the creditors recovered Rs 200 under IBC. The excess recovery of Rs 100 is a bonus from the IBC. Despite the recovery of 200 per cent of the realisable value, the financial creditors had to take a haircut of 57 per cent as compared to their claims. This only reflects the extent of value erosion that had taken place when the companies entered the IBC process. Nevertheless, as compared to other options, banks are recovering much better through IBC, as per RBI data.

Recovery is incidental under the IBC. Its primary objective is rescuing companies in distress. There is a myth that although the IBC process has rescued 200 companies, it has sent 800 companies for liquidation. The number of companies getting into liquidation is thus four times that of the companies being rescued. Numbers, however, to be seen in context. The companies rescued had assets valued at Rs 0.8 lakh crore, while the companies referred for liquidation had assets valued at Rs 0.2 lakh crore when they entered the IBC process. Thus, in value terms, assets that have been rescued are four times those sent for liquidation. It is important to note that of the companies rescued, one-third were either defunct or under BIFR, and of the companies sent for liquidation, three-fourths were either defunct or under BIFR.

The next myth is that the IBC is resulting in huge job losses through liquidation. It is misconstrued that 600 companies — for which data are available and which have proceeded for liquidation — have assets (and consequently employment) at least equal to the aggregate claim of the creditors — Rs 4.6 lakh crore. Unfortunately, they have assets on the ground valued only at Rs 0.2 lakh crore. Take the examples of Minerals Limited and Orchid Healthcare Private Limited, which have been completely liquidated. They owed Rs 8,163 crore, while they had absolutely no assets and employment. What matters in this context is the assets a company has or the employment it provides — not how much it owes to cred-

itors. The IBC process would release the idle or under-utilised assets valued at Rs 0.2 lakh crore, which would have dissipated with time, for business and employment. Fifty one companies having assets valued at Rs 93 crore have been completely liquidated. The Rs 96 crore realised from the sale of these assets has been released. One also needs to consider the jobs saved through rescue of 80 per cent of the distressed assets, and job being created by these companies, post-rescue.

A distressed asset has a life cycle. Its value declines with time, if the distress is not addressed. The credible threat of the IBC process, that a company may change hands, has changed the behaviour of debtors. Thousands of debtors are settling defaults at the early stages of the life cycle of a distressed asset. They are settling when default is imminent, on receipt of a notice for repayment but before filing an application, after filing application but before its admission, and even after admission of the application. These stages are akin to preventive care, primary care, secondary care, and tertiary care with respect to sickness. Only a few companies, who fail to address the distress in any of these stages, reach the liquidation stage. At this stage, the value of the company is substantially eroded, and hence some of them would be rescued, while others are liquidated. The recovery may be low at this stage, but in the early stages of distress it is much higher — primarily because of the IBC. If the entire universe of distressed assets is considered, the percentage of companies or distressed assets getting into liquidation is insignificant. Stakeholders should increasingly address the distress in early stages and the best use of the IBC would be not using it all.

Stakeholders who understand business and have the backing of sophisticated professionals are using IBC with open eyes after evaluating all options. There is no reason to doubt their commercial wisdom. The 25,000 applications filed so far under IBC indicate the value and trust that stakeholders place on the law — the ultimate test of its efficacy.

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