

Rationale for IBC

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Outline

- Why reforms?
- What is wrong with the present framework?
- What are the features of a sound approach?

Why reforms?

State of credit markets

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 - India has a domestic credit to GDP ratio of only 77% as opposed to 112% in Singapore and 195% in the UK (Sengupta and Sharma, 2015).
 - There is no well developed corporate bond market.
 - Banks and FIs are the dominant sources of debt financing for enterprises.
 - There is an inherent bias towards secured credit.

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 - An enterprise facing a financial failure is considered viable.
 - Financial rearrangement may earn the creditors a higher economic value than shutting down the enterprise.
 - An enterprise facing a business failure is considered unviable.
 - Cost of financial rearrangement is higher than the NPV of future expected cash flows.
 - The enterprise should be shut down as soon as possible.

Role of bankruptcy reforms

- A sound bankruptcy process helps creditors and debtors assess viability of the enterprise.
- Take quick decisions on whether the entity is facing financial failure or business failure and resolve accordingly.
- This is important to allow both parties to realise the maximum value of the business in the insolvency.
 - This is non-existent in India.

What is wrong with the present framework?

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- Promoters enjoy divine rights to stay on.
- Capital and labour get interminably stuck.
- Estimated recovery rate is as low as 20%.

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- Differential empowerment of different classes of creditors under various laws and regulations.
 - Some debtors were empowered under SICA, 1985.
 - Some secured creditors were empowered under RDDBFI and SARFAESI Acts.
 - Unsecured creditors get left behind.

What are the features of a sound approach?

1. Systemic reform

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- Multiplicity of laws and jurisdiction forums has led to chaos in the current framework.
- All existing laws need to be repealed to give way to a single, coherent approach.
- Insolvency and Bankruptcy Code (IBC) seeks to replace all existing laws on the subject.

2. Debt and equity contract

- The limited liability company is a contract between equity and debt.
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- When a firm defaults, control should transfer to the debt holders.
- The notion of 'divine right of promoters' in a limited liability context needs to end.

3. Organisational capital

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- Rushing too quickly into liquidation can destroy value.
 - It is not the job of the State to decide whether a firm should be preserved as a going concern or liquidated.
 - This is a commercial decision to be taken by concerned parties.

4. Liquidation

- Creditors collectively decide whether the firm is commercially viable and can be saved as a going concern.
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- Liquidation process entails a clear list of payment priorities.

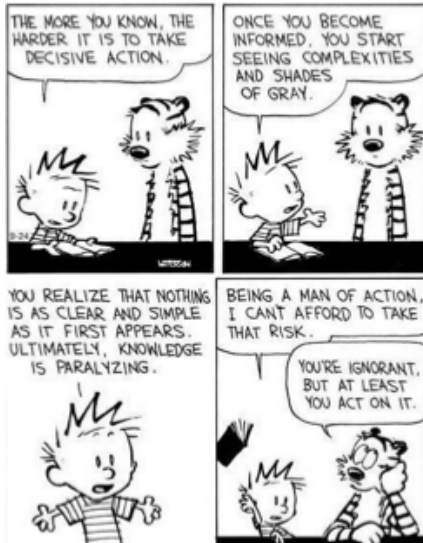
5. Judiciary

- Primary role is to ensure that the law is followed during the conduct of the proceedings.
- Judiciary should not get involved in commercial decisions.

6. Timeliness

- The entire resolution process must work within well-defined timelines to ensure swift decision making.
- Delays are extremely costly for the society.
- Regulated professionals (IPs) and information utilities (IUs) should be used to minimize delays.

Conclusion



Thank you.