THE ROLE OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016 IN MODELLING AN INTEGRATED BANKRUPTCY RISK ASSESSMENT FRAMEWORK FOR BUSINESSES

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ABSTRACT

In this paper I have begun by discussing about the broader definition of bankruptcy . I have also explored as to what are the reasons that lead to a company's position being insolvent and bankrupt. To make this discourse more fruitful I have also looked onto some contemporary issues which are highly pertaining to the topic at hand. A detailed look into these issues could possibly give us a warning bell as to where lies the source of the fundamental problems. I have discussed in detail as to why it is necessary would for the business enterprises or upcoming start-ups to have a fair idea of the market and the risks that are inherent and then move ahead with it . Assessing the market prior to new corporate ventures is the key to framing a constructive risk assessment framework which would provide to be extremely helpful not only in the exigencies of the company but also to avoid any such problems arising in the future. I have discussed in length the nuances of applying the Insolvency and Bankruptcy Code in the domestic market and how companies can benefit from it. The effectiveness of the Code has proved to be viable for holding up to be swift dispute resolution mechanism. I have also argued as to how there has to be more efforts from the Government to make this process more accessible. It could be in terms of having more corporate outreach programmes and thereby filling some of the loopholes, and addressing them with more clarity and transparency in policies. I have summarised all these issues categorically and then provided some substantive solutions as to how a business can frame a model where they can assess the risk of bankruptcy and avoid future exigencies which would ensure a smooth functioning of the venture.

INTRODUCTION

Though the term ‘bankruptcy’ has not been defined in any statute, it is important to have a fair understanding of what it is. It is the state where a business or a company is not in a condition to pay their outstanding debts. This is a condition where the company’s liabilities are more than the company’s assets. The situation of bankruptcy is not a new scenario in the world. It exists right from where the formalised concept of business were there in the market. In India, there had been a notion where bankruptcy had been associated with negativity. The owners of bankrupt business firms were deemed to be morally and legally weak. However the recovery laws could be traced back right to the ages of Manu. These ideas were conceptualised back then and it gave effect in what we call as the authoritative documents. Much of these social stigmas still linger in the society, the magnitude of which has reduced in the contemporary times. Much credit goes to the corporate and banking structure, especially after the country got independent. There were several ramifications which led to the present structure. If we are to discuss them, we need to understand how the bankruptcy laws evolved in our country to what it is at present. It is a common fact that there are a lot of industries which wither due to certain flaws and become redundant. When India was under the Colonial Rule, there were Provincial Insolvency Act, 1920 which mainly revolved around tackling crisis in the Presidency towns. In the post colonial times there were several legislations like the Sick Industrial Companies Act, 1985, which was passed, followed by the Recovery of Debt due to banks and financial institutions act, 1983. More recently the Companies Act, 2013 has been framed and it is a landmark act for the running and controlling of corporate firms and companies. It includes most of the concerns and auxiliary parts that are related to bankruptcy. These chain of legislations led to the formulation of what we have as the Insolvency and Bankruptcy Code of 2016 which gives a speedy process of insolvency resolution mechanism in the country.

EVOLUTION AND DEVELOPMENT

There are several reasons that could lead a business to be bankrupt.I would begin by discussing about the prevailing condition of the market. In this context we consider the economy in which the business is functioning. To elucidate further, I would refer to the prevailing condition of the global economy. Those companies which are global chains have suffered massively due to the Covid Pandemic. Many of them could not pay salaries to their employees and a substantial number of them have become insolvent. This is an extraordinary situation, however there are also general shifts in the trends in the markets that lead to bankruptcy. There was a very famous store selling music DVDs in Kolkata and it was pushed to this point of liquidating the business because the trend is to download songs or games and there are hardly consumers who purchase the CDs at the original price. Moving ahead, one of the primary issues for which companies become bankrupt is the source of financing. Some companies take huge loans with a vision of successfully making an impact in the market. However as time evolves, the company is unable to make good returns and ends up in large amount of debts. They are not even in a condition to pay the existing debts, notwithstanding the interest that will be levied on them. In this modern world, the fate of the companies lie in the hands of the managers and the board of directors. There has to be proper planning as to how the business wants to venture ahead. They should frame a constructive plan of including the interests of the company along with a damage resistant mechanism. The managers should have that know how by which they can channelize their efforts to becoming fruitful actions. With faulty decisions, a company is to land up as a bankrupt one. There are other unanticipated reasons that lead to business getting bankrupt. They might be due to lawsuits that involve one of the partners or they can go onto natural disasters that lead to the business getting reduced to ashes.

I would elaborate the abovementioned causes through the lens of economics. One of the primary factors that lead to the cornering of a company is low demand. If the company produces products that doesn't generate sufficient demand in the market, the company would not be able to get profits. Suppose, a company is producing something which has no relevance in the present situation. On this line, what also is noteworthy is the level of competition in the market. It is important to notice whether the product that the company is producing can sustain itself with other competitors in the market. There are various parameters starting from quality, cost and longevity that can determine this. What is also important is the amount of costs that the company is incurring to manufacture the product. It will be of no use even if the company is earning revenue if it does not earn sufficient profit.

APPLICABILITY OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The Coronavirus pandemic has affected all the sectors to a huge extent. We can take up the example of the pharmaceutical industry. It is an exception to the other industries. They have influenced a major hold in the market . With this pandemic raging, the needs for medicines, drugs and vaccines increased tremendously. This led to the Pharmaceutical giants making a huge profit out of it. There are a lot of career options that have increased in the pharmaceutical industry and undoubtedly the stock market prices of these companies are at an unparalleled high. According to reports, there were around 2.7 million jobs that were created in India by the medicine industry. That speaks for itself. We have this debate of vaccine monopolies in India and the world. This is something that is inevitable after the pandemic. However contrasting this, I would look onto the restaurant industry. This is one of the most badly hit sectors in the economy. There are reports of tons of restaurants that have become bankrupt and shut down. We have the giants such as Zomato which has terminated 13% of its employees and curbed the salaries of the remaining to a half.[1] The number of restaurants in the country is expected to be reduced by 40%. This implies that lakhs of jobs will be lost.

The Insolvency and Bankruptcy Code of 2016 has played an instrumental role in tackling issues of bankruptcy to a large extent. As laid down in the Binani Industries vs Bank of Baroda case, resolution is the foremost objective of the code.[2] It is a fact that the IBC has been framed so that companies find a way of rescue mechanism by a large number of ways. Critics have mentioned that there was no difference in the post IBC period due to the large number of liquidations and bankruptcies, however there are a lot of factors that need to be kept in mind before we go that far. If we look into this, we find that the most of the companies that have been liquidated through IBC were already defunct. However, this tells us that the IBC gave a way of resolution for these companies. There had been companies whose resolution plans got higher value than that what was claimed.[3] There are several other companies that have benefitted through the resolution mechanism and the advantage of it being dealt by a resolution expert.

However there are some positives that should also be taken into account. After the pandemic, Indian companies lost out on many things. The Indian companies use more of equity financing than that of debt financing.[4] Thus they take a lot of loans from banks. This is one of the primary reasons that Indian Corporate sector has bounced back better than other countries. Thus the

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[1] Nishant Sharma, *Zomato To Lay Off Staff, Cut Salaries As It Sees Up To 40% Indian Restaurants Shutting Down*(Feb 02, 2022, 10:00PM), https://www.bloombergquint.com/technology/zomato-sees-at-least-a-fourth-of-all-restaurants-shutting-down-over-6-12-months.html

[2] Binani Industries v. Bank Of Baroda and Anr., 2018, S.C.C. Online N.C.L.A.T. 521(India)

[3]Anuradha Guru, Neeti Sikha, *Our Bankruptcy Code deserves credit for what it has achieved*(Feb 04,2022,7:00PM), https://www.livemint.com/opinion/online-views/our-bankruptcy-code-deserves-credit-for-what-it-has-achieved-11627838610230.html

[4] Sushanta Das, Medha Shekhar, *Analysing Health of Corporate Sector before and after the Pandemic*(Feb 05,2022,5:30PM), https://thedailyguardian.com/analysing-health-of-corporate-sector-before-and-after-covid-pandemic.html

corporate stress is not very high. However, taking certains risks into consideration, this issue should be dealt more specifically so that these don't convert to bankruptcies.

There are certain mechanisms through which a company can have a bankruptcy risk assessment framework to sustain their businesses. Imminent risks are to be taken into consideration. If the company understands that they are losing out on money and assets, they should immediately take steps so that no further damage is done to them. If the company loses on basic financing, they will not be able to sustain themselves. Thus cutting out on expenses, salaries and unimportant commodities could be an effective way to avoid bankruptcy. There are a few assets that become non performing, it is better the company sells them off. The Supreme Court also stated that the court should try to refrain from matters arising out of it because they are essentially regulated by the govt.[5] If this does not work out and there are concerns that it is a stressful situation, the company has to negotiate with it's creditors and chalk out a plan by coming into consensus. This will be beneficial for the company because most companies lose out on this aspect and thus are not able to lend in the future. One of the efficient ways as to how companies could save them from bankruptcy is by hiring professionals like attorneys who have the knowledge and can act as consultants to keep the company working in good condition. The ultimate solution would be to keep a track of potential buyers who could at least buy a sufficient number of activities of the company. This would need the managerial staff to be in connection with them so that when the situation demands, they can do so without hassles. However, this should be kept as the last option for tacking any exigency.

CONCLUSION

Thus I can say that when a company is set up, it should take into account the various paths by which they can save themselves from a potential risk of getting bankrupt. The Insolvency and Bankruptcy Code, 2016 is a benchmark by which the process of resolution has been laid down in simple terms. The code has just been active for around six years and it has gained sufficient ground for dealing with insolvency and bankruptcy. Though there are several issues and challenges that have come up before us which foretells the need of improvising the code by updating them to the current needs of the society and corporate world. We are living in challenging situations and our economy depends on how the corporate world ranging from

[5] K. Sashidhar v. Indian Overseas Bank, A.I.R. 2018 S.C. 257(India)

small scale businesses to large companies function. The govt. also needs to spread this idea of effective running of businesses through workshops and awareness programs. In this way, the companies will be well equipped with what is expected of them to run a successful business. With regard to small scale businesses, they amount to a large section of our country and they are crucial to the self sustainability of the country. The govt. should also work on providing them with facilities that will help them to do business with ease. The business owners also have the responsibility of having a fair knowledge of the market before they jump in with their actions. Thus if there is a balance between the administration and the owners or managers, the companies would benefit a lot from them.