Six years of Indian bankruptcy laws: Some stylized facts

Abstract

We present some stylized facts from data on insolvency and bankruptcy proceedings in India, post the latest bankruptcy law, passed in 2016.. Specifically, for the period between December 2016 and December 2022. we report that 30.68% of the 6195 insolvency proceedings ended up in liquidation; recoveries for creditors (overall) did not exceed 34 per cent of the admitted claims. Recovery for financial creditors was 37.60 per cent. Our findings are in line with Djankov et al. (2008), Succurro (2012) and Camacho-Miñano (2013)*.* We further examine data on ease of access to the insolvency platform. We report that financial creditors’ have reduced their dependence on the statutory bankruptcy platform whereas operational creditors have increased their reliance. As a consequence, the amounts of admitted claims in litigation show a strong positive skew. We posit the measure of ease of access to bankruptcy resolution platforms is a robust measure of of *ex post*  efficiency of bankruptcy laws, even though the small amounts in litigation may overwhelm the judicial infrastructure, and lead to delays in closure of insolvency proceedings.

Some stylized facts

Access to bankruptcy platforms:

* + 1. by initiator FC/OC/CD<by year>
    2. by default amount <resolution/liquidation>

begin

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Protection of equity and creditor rights has emerged as an important determinant in the development of the equity and debt markets in an economy, with implications for availability of capital at reasonable rates, and thereby for economic growth. Countries with poorer investor protections, measured by both the character of legal rules and the quality of law enforcement, have smaller and narrower capital markets. These findings apply to both equity and debt markets \cite{Porta1997}.

The defining feature of various securities is the rights that they bring to their owners (\cite{Hart1995, Porta1998}). National legal frameworks tend to be influenced largely by historical antecedents and inherited legal systems where countries have been liberated from foreign rule. In a study of legal rules covering protection of corporate shareholders and creditors, the origin of these rules, and the quality of their enforcement in 49 countries, La Porta et all document (i) the quality of law enforcement is the highest in Scandinavian and German civil law countries (ii) next highest in common law countries (iii) the lowest in French civil law countries. Th study underscores these results are not just a consequence of different income levels in countries with different laws. Yet it is widely recognized that law and the quality of its enforcement are potentially important determinants of what rights security holders have and how well these rights are protected. Since the protection investors receive determines their readiness to finance firms, corporate finance may critically turn on these legal rules and their enforcement.\cite{Porta1998}.

In the case of equity finance, shareholder rights include voting powers, periodic and continuous disclosures on corporate developments and templated financial statements to protect against surreptitious expropriation by management. For creditors, some of this protective legal cover includes recognition of security of the loan, and the ability to grab assets in case of a loan default.

Important aspects of the strength of creditor rights are the specific features of a country’s insolvency regime and its enforcement. Recent financial crises have further highlighted the importance of well- functioning insolvency systems to prevent and resolve corporate sector financial distress\cite{Claessens2002}. Literature has already highlighted the complex role of creditor rights in affecting not only the ex-post resolution of distressed corporations, but also in influencing ex-ante incentives and an economy’s dethegree of entrepreneurship more generally.

*Au contraire*, weak protection of creditor rights in insolvency is a key source of financial barriers (\cite{Porta1997, Shleifer1997, Demirgüc-Kunt 1998, Ponticelli2016}).

In what follows, we examine these issues in greater detail, the context being that a modern insolvency and bankruptcy law has been in operation for almost seven years. In Section 2, this paper reviews the literature around the co-evolution of law and finance, and specifically, the intent and content of modern bankruptcy laws in the context of protection of creditor rights. In Section 3, we review some conceptual issues regarding the efficiency of bankruptcy laws. Section 4 presents some stylised facts emerging out of data on resolution/liquidation proceedings over the last seven years. The following section concludes.

## 2. Economic foundations of modern bankruptcy laws

Although the Babylonian Talmund had a detailed discussion on division of the estate of a bankrupt person, it was not until the 1500's England that it was recognised that creditors’ rights had to be protected through special laws outside the common civil law. The first bankruptcy law passed in England in 1542, was titled "An Act against such persons who make bankrupts," explicitly recognising that since credit is the life blood of trade and commerce, a default in one link in the chain can have a cascading effect throughout the system.

That was not always the case. In fact, the evolution of Bankruptcy laws from Roman times to the first formal bankruptcy law in 1542, illustrates the changing perception of debtors from criminals to failed entrepreneurs. \cite{Radin1922} narrates the fate of “a duly adjudicated debtor in fifth century BCE, if he failed to pay the judgment or get it paid, might have been killed by his creditor or sold into foreign slavery, or, if there were several creditors, might have been cut into pieces by them in proportion to their (creditors’) shares.”

Early English law inherited this “criminality” view of defaulting debtors. Baird and Jackson(1990)\cite{Baird1990} describe early English laws as "viciously punitive from the perspective of the debtor.” Imprisonment for debt was the order of the day, and common law authorized "body execution," i.e., seizure of the body of the debtor to be held until payment of the debt. In other common law territories, punishments upon debtors included forfeiture of all property, “relinquishment of the consortium of a spouse,” imprisonment, and death.

As commerce expanded, terminal measures were sought to be replaced with remedial actions. Individual collection remedies, such as the common law execution, imprisonment and denial of consortium of spouse did not address the distinct problems presented by a debtor's multiple defaults. Carving out the body of a debtor doesn’t replenish the creditor’s pool of capital.

Also, trade and commerce necessitated multiple creditors or varying seniority and vintage. There were the secured creditors, who held valuable security in their possession for the credit granted; operational creditors included the trade creditors who would despatch raw material on credit, most often on verbal promises to pay on due date.

When multiple creditors are in the play for the estate of a debtor in default, a court-supervised procedure and a templated protocol of distribution of assets in the only way to maintain order in the distribution and to avoid a Titanic-like situation. There has to be an incontrovertible finding of seniority/vintage of the secured credit and a detailed public hearing inviting all operational creditors to file their claims. In essence, bankruptcy laws are designed to protect creditors’ rights not only against the corporate debtor but also between themselves.

Formally stated, bankruptcy is court-supervised process which provides a platform for financially distressed firms to resolve their debts due to its creditors, and occasionally governments. The main economic function of corporate bankruptcy is to reduce the cost of default by having a government-sponsored procedure that resolves all debts simultaneously \cite{White2007}.

In the context of the financial crises in the last 30 years, authors have noted an increased interest globally in the design of insolvency systems from a point of resource allocation, efficiency, and stability as well as equality and fairness; see \cite{Stiglitz2001, Hart2000} for reviews.

A game theoretic view of bankruptcy laws in the context of creditor protection is developed in Baird and Picker (1991)\cite{Baird1991}. Beginning with the traditional view of bankruptcy law that diverse general creditors of a firm face a collective action problem in case the debtor becomes insolvent, the general creditors now are the firm's residual owners. In this framework inherits from the criminality view of bankruptcy which admitted of seizure of the debtor’s assets. In this case, bankruptcy law is designed in the first instance to allow the co-owners (creditors) to act collectively, in the interest of realizing the maximum value of the asset for the common good of all.

Therefore, it is argued that bankruptcy serves principally to frame the negotiations between this senior creditor and the firm's erstwhile owner shareholder-managers. A bankruptcy proceeding is needed largely because these negotiations cannot be entirely the province of private contract.

Bankruptcy is best appreciated as a forum in which the pool of creditors on the one hand and shareholder-managers of the defaulting debtor negotiate with each other.

Bankruptcy's rules have a dual function: to enforce the agreement between these parties and to ensure that this agreement does not compromise the rights of any third parties. This has been justified on theoretical grounds \cite{Jackson1986) that collective action problems between the creditors may lead to inefficient loss of complementarities between the firm’s assets, as creditors seek their individual remedies against the specific assets charged to them. If secured creditors’ enforcement rights were not stayed in bankruptcy, then enforcement by multiple secured creditors would lead to inefficient liquidation \cite{Webb, 1991}.

Bankruptcy laws are the central pillar of creditor protection in that they require a coordinated resolution involving all creditors \cite{Langhofer2004}. This mandatory participation prevents individual debt collection remedies that tend to destroy asset value. Bankruptcy laws exist to resolve the conflict that arises among creditors when a debtor becomes insolvent. In the absence of a bankruptcy system, creditors generally find individual debt collection remedies privately optimal, even though a coordinated liquidation would maximize the value of the assets to be distributed to the creditors as a group. A bankruptcy law that mandates a collective process avoids this inefficient liquidation.

India has inherited the common law provisions in English The first bankruptcy legislation can be traced to the Government of India Act, 1800, wherein insolvency jurisdiction was conferred upon the Supreme Court at Fort William, Calcutta (now known as Kolkata) and Madras (now rechristened Chennai) and the Recorder's Court at Bombay (now: Mumbai). These courts were empowered to make rules and orders for granting relief to insolvent debtors on the lines intended by the Act of the British Parliament called the Lord's Act passed in 1759.

The first designated insolvency courts for relief of insolvent debtors were established by the Act of 1828 in the three Presidency towns of Calcutta, Bombay and Chennai.

The Indian Insolvency Act, 1848 retained the framework for relief of insolvent debtors established by the Act of 1828. The Provincial Insolvency Act, 1907 instituted a special insolvency jurisdiction, specifying the conditions under which a debtor could be adjudicated on his own petition or on a petition by a creditor.

Broadly, while Indian laws were written after English law, there is a distinct pro-debtor bias, in so far as it stressed surrender by the debtor of all his goods for the benefit of his creditors in return for immunity from court process and harassment. However, the Presidency town of Bombay had already adopted a provision--based on section 1(1)(g) of the English Act—with an unambiguous pro-creditor intention. The Law Commission Report (1908) recommended the Bombay legislation be adopted in all jurisdictions:

"the most effective way of instilling a healthy fear in the minds of dishonest judgment-debtors would be to enable the Court to adjudicate him an insolvent if he does not pay the decretal amount after notice by the decree-holder, by specifying a period within which it should be paid, on the lines of the Bombay amendment to the Presidency Towns Insolvency Act."

The move towards a modern bankruptcy law was initiated in 2014, when the Union Ministry of Finance established a [Bankruptcy Law Reforms Committee](https://ibbi.gov.in/uploads/resources/BLRCReportVol1_04112015.pdf) (BLRC) under the Chairmanship of T. K Viswanathan. The committee marked a significant departure from earlier efforts at legislation—pro-debtor or pro-creditor—when it centered its enquiry on the "Key economic question in the bankruptcy process." The Viswanathan Committee report's clear and unamiguous narrative highlights the primacy of preserving value in a stressed asset in the context of creditor protection. It is a very illuminating read on the intent behind the draft code, which subsequently was refined by the [Joint Parliamentary Committee on the Insolvency and Bankruptcy Code](https://eparlib.nic.in/bitstream/123456789/762113/1/jcb_2016_insolvency_bankruptcy_bill.pdf), 2015 (Chairperson: Mr. Bhupender Yadav).

The intention of Indian Parliament is clearly enunciated in the preamble of the Insolvency and Bankruptcy Code 2016:

"An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders."

## 3. Objectives of Bankruptcy laws

The economic foundation of bankruptcy laws has been established. But to what objective? How is the economy, pool of creditors or debtor unable to pay her debts better off with bankruptcy laws? And how to evaluate the efficiency gains arising out of bankruptcy laws? These are questions that determine the co-evolution of law and finance in different economies.

It has been well documented that bankruptcy laws have impact on the development of the financial markets \cite{Levine1998, Porta1997, Porta1998}. Succurro (2012) provides empirical evidence that the investment share of GDP is higher in countries characterized by highly efficient bankruptcy system; the more efficient the insolvency procedures in terms of time, cost and recovery rate, the more readily available debt is and the higher the Investment/GDP ratio is. The investment share of gross domestic product is positively associated with the degree of sophistication of bankruptcy laws \cite{Succurro2012}.

Stiglitz (2001) approached this problem statement from a point of resource allocation, efficiency, and stability as well as equality and fairness \cite{Claessens2002}. Insolvency regimes include a number of features designed to balance conflicting viewpoints: protecting the rights of creditors and other stakeholders – essential to the mobilization of capital for investment and working capital and other resources – against protecting of rights of debtors, including protection against the premature liquidation of viable firms.

To recap, in the context of efficiency measures, the first overall objective of bankruptcy laws is the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner. The allocation of risk plays a critical role in providing confidence in the credit system and fostering economic growth for the benefit of all participants \cite{IMF1999}. For example, the protection afforded to a creditor to commence insolvency proceedings against a debtor as a means of enforcing its claim reduces the risk of lending and, thereby, increases the availability of credit and investment capital. Equally, an insolvency law also serves to allocate risk *inter se* among different creditors. For example, the special treatment afforded by statute to secured creditors vis-a-vis unsecured creditors protects the value of security, which may be particularly important for those debtors that, because of their credit risk, cannot obtain (or cannot afford) unsecured credit.

The second objective of an insolvency law is to protect and maximize value for the benefit of all interested parties and the economy in general. This objective is most obviously pursued during rehabilitation, where value is maximized by continuing a viable enterprise. But it is also a primary objective of liquidation procedures where rehabilitation has been judicially determined to be unviable.

It has been argued that the second objective is dominant during rehabilitation, where value is maximized by continuing a viable enterprise. But it is also a determining objective of procedures that liquidate enterprises that cannot be rehabilitated \cite{IMF1999}. This paper argues a two-way causality between the two objectives, in that the achievement of the second (value maximization) objective is often furthered by the fulfilment of the first (equitable risk allocation) objective.

This paper holds that the two objectives of value maximization and of equitable risk allocation are not sequentially causal, but two facets of a single objective of resolving distress in insolvent firms. They differ only in the time dimension. The objective of equitable risk allocation dominates the economics of a running firm, ensuring availability of credit at reasonable rates, whereas the objective of value maximization kicks in when the firm in unable to pay its debts. Bankruptcy laws, therefore, serve a critical purpose prior to and after the initiation of insolvency.

Elsewhere, the problem statement has been reformulated to identify the efficiency gains from bankruptcy laws at different points in the resolution/liquidation process. The literature identifies five distinct roles of bankruptcy law\cite{Smith2004}. These are: (1) to verify assets and liabilities, (2) to improve coordination among claimholders, (3) to protect third-party claimants, (4) to maintain asset value during bargaining, and (5) to alleviate the impact of liquidity constraints among claimants and potential acquirers.

Given the importance given to equity shareholder and creditor protection in all economies, as key pillars of economic development, the research interest has turned to evaluating the efficiency of bankruptcy processes in various economic regimes, across varying time periods.

There is no ultimate approach to the efficiency assessment \cite{Staszkiewicz2019}. A good bankruptcy law should achieve many, not always compatible, goals. A bankruptcy law has to decide what to do with the insolvent firms and how to compensate the creditors.

Thorburn proposes the reference point for efficiency can take the form of market value or market oriented procedures \cite{Thorburn2000}, time, cost, and recovery rate of the procedure \cite{Succurro 2012}, ability to strike a balance between debtors and creditors protection \cite{Franks1996, Porta2008}, or the behavioral changes of process actors.

The literature has made a useful distinction in various definitions of bankruptcy efficiency. Cornelli suggests a framework to analyze the efficiency properties of bankruptcy procedures, distinguishing between ex-ante and ex-post efficiency \cite{Cornelli1997}. Ex-post efficiency consists in maximizing the ex-post value of the insolvent firm, whereas ex-ante efficiency consists in maximizing the proceeds to creditors from the reorganization of the firm and providing incentives for the creditors to monitor the firm. If the choice of what to do with the firm can be regarded as ex-post efficiency, the effect on the incentives can be regarded as ex-ante efficiency. Camacho-Miñano et al. (2013) add another measure of ‘interim efficiency,’ as a measure of realization of the assets in the shortest time at the lowest achievable cost.

Couwenberg (2008) defines three distinct stages of the bankruptcy process (\cite{Couwenberg 2008}. The first stage, also termed ex ante efficiency, aims to provide incentives for entrepreneurs to limit the usage of the legal procedures for bankruptcy. The second stage, aka interim efficiency, kicks in during the financial distress, when the bankruptcy procedure is tainted by conflicts of interest of participants. The third stage of ex post efficiency is achieved if all creditors and other parties receive the highest payouts in accordance with contractual rights.

Broadly, there is consensus in the literature that efficiency of the laws and bankruptcy processes can be evaluated in terms of costs of the bankruptcy process, recovery rates for creditors and strict adherence to priority rules. Since several difficulties arise in the study of the first and the second stages of the bankruptcy process, Succuro (2012) study focuses attention on the third phase of the bankruptcy process that can be analysed by considering specific efficiency proxies \cite{Succuro2012}.

In this paper, we follow the Cornelli (1997) framework and the metrics in Succuro (2012) to get an initial assessment of the ex-post efficiency of Indian bankruptcy laws in the seven years of operation.

## 4. Some stylized facts

In respect of the bankruptcy law procedures, there is no one-size-fits-all approach to the efficiency measures. The reference point for efficiency can take the form of market value or market oriented procedures \cite{Thorburn2000}, time, cost, and recovery rate of the procedure \cite{Succurro2012}.

The World Bank *Doing Business* *Report* (2020)—since discontinued--reports the time, cost and outcome of insolvency proceedings involving domestic legal entities. It notes reforms relating to introduction or shortening time limits on bankruptcy procedures as positive reform. To the Succurro (2012) metrics, we add two innovative measures: (i) access efficiency as a measure of ease of access to the initiator of insolvency proceedings and (ii) market participation efficiency as a measure of market participation in the bankruptcy liquidation proceedings. The theoretical rationale here is that greater market participation in the bankruptcy liquidation process would lead to higher competitive rigour and lead to better price discovery for the bankrupt firm’s assets.

In what follows, we investigate five metrics on data over six years, from December 01, 2016 to December 31, 2022:

1. Time taken from initiation of insolvency and bankruptcy proceedings to final decree;
2. Percentage of proceedings that end up in bankruptcy liquidation;
3. Percentage of recovery for creditors;
4. Success rates by initiator of insolvency proceedings;
5. Competitive market participation in assets of insolvent firms.

The dataset is provided by a government institution, set up under the Insolvency and Bankruptcy Code (IBC), 2016, updated quarterly. At the end of December 2022, the dataset contains 6195 entries, as reported in Table 1. Of our interest are 2512 entries, spanning 610 cases of Corporate Insolvency Resolution Process (CIRP) yielding resolution plans (resolution cases, Row C), and 1901 cases of CIRPs yielding liquidation plans (liquidation cases, Row D).

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Outcome | Description | CIRPs initiated by | | | |
| FCs | OCs | CDs | Total |
| Status of CIRPs | 1. Closure by Appeal/Review/Settled | 243 | 644 | 7 | 894 |
| 1. Closure by Withdrawal u/s 12A | 216 | 570 | 7 | 793 |
| 1. Closure by Approval of Resolution Plan | 340 | 216 | 54 | 610 |
| 1. Closure by Commencement of Liquidation | 851 | 849 | 201 | 1901 |
| 1. Ongoing | 1042 | 854 | 101 | 1997 |
| Total | 2692 | 3133 | 370 | 6195 |
|  | FC: Financial creditors; OCs: Operational Creditors; CD: Corporate Debtors Providers | | | | |

Table 1: Status of insolvency cases brought to adjudication under the Insolvency and Bankruptcy Code (2016).

The table admits of two observations. One, the number of insolvency cases that ended up in liquidation (1901) is about three times the number of cases that were resolved and rehabilitated (610). The second observation is that insolvency cases initiated by operational creditors (3133) exceeds the number of cases initiated by financial creditors (2692).

### 4.1 Time from initiation to closure

In what follows, we advance the findings of Djankov et al. (2008) who report the actual long term average of the duration of proceedings in Poland at 854 days and of Camacho-Miñano  *et al* (2013) who report mean duration in Spain is 427 days.. The World Bank Doing Business Report \cite{WorldBank2021} provides a global database.

Table 2 summarises the distribution of time taken by the judicial system in India, from initiation of insolvency proceedings to closure.

|  |  |  |
| --- | --- | --- |
| Sr. No. | Descriptive statistics (No. of days) | |
| 1 | Minimum | 42 |
| 2 | Median | 402 |
| 3 | Maximum | 1819 |
| 4 | Skewness | 1.20 |
| 5 | Kurtosis | 4.32 |
| 6 | 1st Quartile | 279 |
| 7 | 3rd Quartile | 624 |

Table 2: Distribution of time taken in the insolvency resolution process

The median time taken is 402 days, as against the statute’s mandate of 180 days. The distribution of insolvency resolution time is documented in Fig 1.

|  |
| --- |
|  |
| Fig. 1: Time taken from initiation of insolvency proceedings to closure; dashed line at median |

India’s median of 402 days (1.10 years) compares favourably with the resolution times reported in the World Bank, Doing Business Report 2021 (since discontinued). The reporting periods are different: based on data collected in 2018-19, the World Bank report puts India at 48th place, with a reported resolution time of 1.6 years..

### 4.2 Of cases that end in liquidation

Table 1 presents summary statistics of the full caseload of 6195 insolvency proceedings initiated after the new law came into effect from December 01, 2016. Closure of insolvency proceedings out of appeals/reviews and out of court settlement accounted for 894 cases (approx. 14 per cent). Closures by withdrawal of proceedings accounted for another 793 cases (12.80 per cent). The number of “CIRPs yielding liquidations” (liquidation cases) at 1901 (30.68 per cent) is almost three times the number of “CIRPs yielding Resolution Plans” (resolution cases), at 610 (9.85 per cent). The Indian percentage of ~31 per cent compares with 40% in the United States (\cite{Altman1987}, 30% in the UK (\cite{Buxton2003}), 20% in Germany (\cite{Lexa2010}) and 10% in Japan (\cite{Imanaka2010}).

Thus Miller (1977) has compared the reorganization option to a "call option": the shareholders will call on the option (to share in whatever benefits the reorganiza tion creates) if their plans succeed but will not call on the option if their plans fail. Costs of reorganization, of course, are borne not by the shareholders but by the creditors.

Armour2012: It was also suggested that

oversecured banks had little incentive to monitor receivers, leading to inflated

professional fees for the conduct of the receivership (Mokal, 2004). However, in

cases where the value of the firm’s assets was less than the amount owed to the

secured creditor (that is, they were undersecured), the bank was the residual

claimant and the receiver would have appropriate incentives to maximize value

(Armour and Frisby, 2001; Ayotte and Morrison, 2008).5

IBBI2019: The Code does not enable a stakeholder to file an application for liquidation. It enables filing an application for initiating corporate insolvency resolution process. Only after a resolution fails to yield resolution plan, the CD is ordered into liquidation. As evident from section 33 of the Code:

4.1 Recovery metrics

In terms of the 610 cases that were settled through the resolution platform, total recoveries amounted to 33.84 per cent of the total admitted claims, of which the recovery percentage for financial creditors was 37.60 per cent. Our analysis compares well with the findings in an Indian Institute of Management, Ahmedabad study \cite{IIMA2023}. For a sample of 542 insolvency cases that closed with resolution, the study reports the average recovery rate is about 33.2 per cent, of which the financial creditors have an average recovery of about 38.5 per cent and the operational creditors at 23.8 per cent.

For a panel of 91 countries, Succurro (2012) report a mean recovery rate of 40.55 per cent, with a standard deviation of 25.90. The World Bank, Doing Business Report (2021) documents a global perspective.