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INSOLVENCY AND BANKRUPTCY LAWS & ENTREPRENEURSHIP IN INDIA

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ABSTRACT

In India, young entrepreneurs are coming up with various innovative and entrepreneurial ideas every day. The government of India has fueled these ideas by launching the budding policy of Startup India. It supported new venture ideas and funded various start-ups. The sole objective of the Startup India initiative is to promote the creation of Intellectual Property in India and to generate employment. Many small businesses or ventures fail in India due to poor implementation of business ideas, lack of funding, lack of awareness, etc., due to which these small businesses become insolvent or bankrupt. The enactment of the Insolvency and Bankruptcy Code, 2016 has put forth some major difficulties and some conditions which are proved to be the cherry on the cake of entrepreneurial ideas. In this paper, we have discussed how entrepreneurship has evolved or drowned with the enactment of the Insolvency and Bankruptcy Code, 2016. Moreover, a conceptual relationship between entrepreneurship and insolvency laws in India has been discussed thoroughly.

Keywords: Insolvency, Entrepreneurship, Small Business, Insolvency and Bankruptcy Code, 2016

How IBC helped improve India's Ease of Doing Business

Due to a significant improvement in its position in resolving insolvency, one of the seven variables used to construct the index, India's ranking in the World Bank Ease of Doing Business Index rose by 14 spots to 63 in 2019.[4] India's position in resolving insolvency improved by 56 spots to 52 in 2019 from 108 the previous year. The Insolvency and Bankruptcy Code (IBC), which went into effect in 2016, deserves credit for this. The IBC's adjudicating body, the

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[4] *India Rank 63rd in World Bank's doing business report,* https://pib.gov.in/newsite/PrintRelease.aspx?relid=193994 (last visited Jan 20, 2023).

National Company Law Tribunal (NCLT), received 21,000 cases during a three-year period. Out of 21,000 instances, 10,000 have been resolved, with 1,500 cases resolved through resolution or liquidation and 8,500 cases resolved before admission. The remaining cases are in various states of bankruptcy.[5] Nearly 150 cases have been settled thus far, and 600 businesses have been told to liquidate. The NCLT has withdrawn or rejected nearly 300 cases. Prior to IBC, the rate of debt collection was about 26%, and it took more than four years to resolve a case. IBC altered this. Financial creditors now collect an average of 43% of their debt, while payment is made recover an average of 49% of their debt. The typical length of time under IBC has decreased to 1.6 years from 4.3 years in the past. Just after IBC, the cost of resolution dropped from 9% during the prior resolution system to 1%.

The Impact of Insolvency Law on How People view Business Failures

According to IBBI Chairperson M S Sahoo, the insolvency legislation is transforming how society views company failures as it becomes a reform by, for, and of the stakeholders, driven by a growing unquenchable demand for freedom of exit.[6] The Insolvency and Bankruptcy Code (IBC), which offers a time-bound and market-linked framework for the resolution of stressed assets, has passed the constitutional exam less than five years after it was enacted.

The Code perhaps has the largest body of case laws and has become stronger and deeper with each Supreme Court decision. Value-wise, the Code has released 30% of these assets through liquidations and recovered 70% of distressed assets through insolvency resolution programmes.

Firms that would not be able to withstand market pressure would need to apply the Code for either a clean and dignified withdrawal from the business or a rearrangement of operations. The new maxim for aspiring businesspeople in the nation will soon be "Failing in Succeeding." There will soon be a day when failure will be celebrated.

Doing business in India became much simpler as a result of significant improvements in the process for resolving insolvency and the introduction of new markets for resolution plans, interim financing, and liquidation assets, among other things. It was noted that, most importantly, *"the rule of law got institutionalized in an anarchic stressful situation when the claims of all*

[5] Diksha Munjal, *Explained: The insolvency and bankruptcy code (IBC)- where does it stand today?* THE HINDU (2022), https://www.thehindu.com/news/national/explained-what-is-the-insolvency-and-bankruptcy-code-ibc-and-where-does-it-stand-after-more-than-five-years-of-being-in-place/article65969421.ece (last visited Jan 20, 2023).

[6] *Insolvency law changing the way society perceives biz failures*: IBBI CHAIRMAN MINT (2021), https://www.livemint.com/news/india/insolvency-law-changing-the-way-society-perceives-biz-failures-ibbi-chairman-11624185969762.html (last visited Jan 20, 2023).

creditors together are inconsistent with the available assets of the company" despite the fact that six amendments and dozens of subordinate laws have kept the Code relevant to changing needs and addressed implementation issues."

The apex court aggressively resolved the jurisprudence, clarified various conceptual issues, resolved controversial matters, and cleared grey areas at an unprecedented rate, bringing in clarity as to what is permitted and what is not, while allowing the power to experiment to the legislature.

A cadre of 3,500 insolvency professionals, three insolvency professional agencies, 80 insolvency professional companies, 4,000 registered valuers, 16 registered valuers' organizations, and one information utility has also been developed thanks to the Code.

Transforming Business and The Insolvency System

The IBC has fundamentally changed insolvency resolution in India by its extensive scope and structural significance. The IBC has prioritized time-bound settlement over liquidation as an enabling tool to support businesses coming under its purview, replacing a relatively ineffective bankruptcy law regime. It has been successful in fostering confidence in the corporate resolution technique and, perhaps more crucially, in providing creditors with a chance to partially recover their investments in companies that are being liquidated or are undergoing resolution. Its main impact has been to increase investor and investee trust while allowing finance to flow more freely to and within India. Despite the IBC being temporarily suspended because of the COVID 19 epidemic, it will turn out to have been a timely reform in the short, medium, and long terms. Processes related to insolvency will be considerably streamlined in a sustainable, effective, and value-preserving way.

Unfortunately, there is a significant backlog of court proceedings in India, with close to four crore cases still awaiting a decision. This is anticipated to get worse as a result of the next corona virus epidemic. Contract enforceability has proven to be difficult. A contract can be enforced in as long as 1,445 days on average, and it costs close to 31% of the claim's value. Simply said, this is unacceptable.

The Indian government is attempting to decriminalize minor offences in addition to streamlining and strengthening the IBC. This initiative, in which NITI Aayog is actively participating, will greatly lower the possibility of incarceration for deeds or omissions that are not necessarily fraudulent or the result of mala fide intent.

For small infractions, criminal sanctions, including incarceration, serve as strong deterrents to investors. The goal of the government is to make it easier to distinguish between honest errors and deliberate bad-faith behavior so that the former can be punished and the latter can be criminalized.

New Guidelines for Bankruptcy: Recognizing the crucial contribution of Small Firms to the COVID-19 Recovery

Over 95% of all firms are small businesses, and they provide more than 60% of all jobs worldwide. In emerging economies, where they provide a significant contribution to job creation, the delivery of public goods and services, and the promotion of economic growth and poverty alleviation, these corporations' disproportionate role is even more obvious.

These companies are among the ones affected by the epidemic the worst. Many micro and small businesses (MSEs), which are frequently run by entrepreneurs and supported by personal funds, struggle to secure appropriate funding and are susceptible even in the best of circumstances. Social alienation, brief closures, and health and safety requirements have disrupted operations, lowered employee productivity, and decreased revenues, leaving many businesses unable to pay debts when they become due. Many nations will experience a challenging period of escalating bankruptcies that might impede business and economy for years if there aren't stronger legal and regulatory structures for insolvency.

Despite all the difficulties faced by smaller businesses, a lot of domestic insolvency processes were created with huge enterprises in mind. MSEs encounter special challenges while negotiating difficult and drawn-out bankruptcy systems. They may lack the funds to hire attorneys, and they may have difficulty obtaining funding a crucial component of an effective reorganization. Banks and other creditors frequently adopt a passive attitude rather than actively investing resources in restructuring these businesses because the amounts at stake in troubled MSEs are minimal. This usually results in the business being liquidated in pieces. Even after the insolvency procedure is over in certain nations, debtors are still weighed down by liabilities.

Given this, there is a growing understanding that efficient insolvency and creditor rights (ICR) systems must be aware of the particular requirements of MSEs and designed to meet those needs. *"The World Bank and the United Nations Commission on International Trade Law (UNCITRAL) have updated the Principles for Effective Insolvency and Creditor/Debtor Regimes as a standard-setter (ICR Principles)."* In addition to serving as a significant resource for

governments considering domestic ICR legislation to deal with the growing number of troubled MSEs, they reflect new principles to manage the bankruptcy of MSEs.

The major goals of these modifications are to streamline insolvency procedures for MSEs and guarantee that debts for natural person entrepreneurs are discharged at the conclusion of the procedure. The promotion and support of informal, out-of-court workouts, or a hybrid combination of court and out-of-court processes, as well as the simplification of restructuring procedures, a broad discharge-of-debts regime, and the subsequent liquidation for entrepreneurs are key benchmarks in the new MSE ICR Principles. These elements are adaptable and can be made to match any domestic insolvency and creditor/debtor system, either by changing already-existing laws or by having governments create a distinct MSE framework.

Discrete legislative and regulatory design components including eligibility, commencement criteria, conversion of procedures, procedural formalities, the handling of management after filing, reorganization plans, and discharge are all addressed in the new MSE ICR Principles. In a broader sense, the MSE ICR Principles focus on lowering obstacles to MSE debtors using insolvency systems by introducing straightforward, inexpensive, and rapid processes while preserving creditors' rights.

The effectiveness of the post-pandemic recovery efforts will depend on MSEs' financial stability because to their crucial role in the global economy. The correct regulations and governmental actions are essential in guaranteeing that viable MSEs endure in the future and that business owners who must shut down can start afresh in more favorable economic circumstances. Policymakers should incorporate an evaluation of domestic insolvency laws into their pandemic response efforts given the difficult financial positions MSEs are in as a result of COVID-19, with an emphasis on how well these regimes currently support MSEs and small business owners. This might boost financial sector stability, encourage economic growth, and safeguard local economies' healthy businesses. Additionally, it might contribute to a better, more durable, and sustainable future for all small enterprises worldwide.

Insolvency Laws and Entrepreneurship

The fact that bankruptcy law's significance is ever growing is evidence that the field has developed beyond simply assisting in the orderly collection and distribution of a debtor's assets. The corporate ethos of society is actively shaped by this area of law, which also projects society's priorities and judgements of the risks that enterprises may lawfully take. When seen in this light,

corporate insolvency legislation may have an impact on company culture. Although the primary purpose of insolvency law is to offer exit routes for struggling businesses, its rules also caution entrepreneurs about the risks associated with starting a business. Thus, the distribution of entrepreneurial risk affects people's willingness to start enterprises. The Preamble of the IBC identifies the expansion of entrepreneurship as one of its goals in recognition of this.

It is not while a corporation is in its infancy that insolvency law is most pertinent to an entrepreneur. Once irrevocable expenditures are made at later stages of a company's growth, insolvency typically becomes a genuine risk. This shows that the role of insolvency law after a firm has been around for a while is just as crucial as the role it would play in the beginning.

Low-cost insolvency proceedings also incentivize inefficient firms to file for insolvency more quickly, thus allowing for their liquidation in case reorganization is not feasible and pushing them out of the market. Ease of entry and an even playing field in the market thus need to be coupled with feasible exit and reorganization strategies in order to foster entrepreneurship and innovation. Accordingly, ease of insolvency proceedings can be crucial in determining the success of government policies geared towards promoting innovation, competitiveness, and entrepreneurship.

There are two effects of an insolvency regime on the emergence of new businesses. The first may be understood as the way an area's insolvency laws communicate its business culture, particularly its attitude about taking chances and failing as an entrepreneur. The second batch of effects refers to much more focused worries that company owners have as a consequence of the characteristics of departure and rescuing options offered in the occasion that their business manages into problems.

The IBC has the majority of the aforementioned qualities. The amount of time a CD spends in the formal insolvency resolution process is projected to decrease further once the pre-packaged insolvency resolution process (PPIRP) is fully implemented. India's insolvency law limits the amount of time that insolvency proceedings must conclude. Along with a discharge and a moratorium to prevent any interference with the creditors' ability to decide collectively, the IBC also includes procedures for individual bankruptcy. Insolvency regimes in other countries, including the United States (US) and the United Kingdom, share these characteristics with the IBC (UK).

Innovation and Insolvency Laws

Though many factors go into determining whether an insolvency law is more accommodating of debtors' or creditors' interests, increased involvement of a company's management after insolvency proceedings begin contributes to a more debtor-friendly regime. In the Indian context, Section 29A can be seen as moving further away from the debtor-friendliness of the IBC. In a debtor-friendly insolvency regime, the management may choose to postpone insolvency proceedings for fear of liquidation. On the flip side, in a creditor-friendly insolvency regime, the creditors may be quick to liquidate rather than seriously pursuing reorganization through insolvency. Notwithstanding whether the insolvency law is more conducive to the interests of creditors or debtors, incentives for each of these stakeholders to act according to their interests will continue to exist. Despite this equivalence, there are some distinct effects on innovation that arise from the level of flexibility given to a CD by insolvency law.

Debtor-friendly policies are less likely to hinder ex-ante risk-taking and innovation, according to research. In their empirical analysis, Acharya and Subramanian showed that a more debtor-friendly system boosts creativity by using data from patent filings following the enactment of the US Bankruptcy Code in 1978. The involvement of management once bankruptcy proceedings begin was one of the criteria used to determine whether an insolvency system was debtor-friendly. According to their research, industries' innovativeness decreased in nations where creditor rights in the context of insolvency increased. On the other hand, creativity rose in places where creditor rights were restricted. When compared to more traditional industries, creative businesses are less likely to incur debt, according to the study's analysis of data from the G-7 nations. This is how a business counteracts the consequences of a creditor-friendly system. When considering insolvency law as a way to reallocate credit to the market's more productive uses, the study's conclusions are highly important. According to Acharya and Subramanian's study, firms using this finance are less likely to be those pursuing risky innovation as creditor protections in insolvency laws improve.

"The creditor-in-possession regime of the IBC was envisioned to avoid some of the problems caused by the debtor-in-possession rescue framework that preceded it. Prior to the IBC, the reorganization of distressed corporations under the Sick Industrial Companies (Special Provisions) Act, 1985 was plagued with delays and its pro-rehabilitation bias resulted in inefficient companies being able to remain in the market."

It makes sense that India would be skeptical given its past experiences with a debtor-in-possession system. Nevertheless, attention must be taken to avoid overcorrecting. The IBC imposes further restrictions that hinder promoters and the current management from regaining control of their organization through the bankruptcy resolution process, even when contrasted to another creditor-in-possession regime (the UK).[7]

Due to corporate innovation, insolvency law now extends beyond just being used during a company's withdrawal from the market. Corporations have exploited insolvency and bankruptcy rules deliberately to gain an advantage over rivals or even to increase their negotiating leverage with employees. Instead of forcing the settlement process toward what might seem to be the best result, the best course of action in circumstances where there are concerns that the IBC will be exploited may be to allow stakeholders to utilize their existing rights more effectively. For instance, legislating more or better marketing, disclosure of the promoters' antecedents to creditors, etc. can lessen the knowledge asymmetry that encourages such exploitation if the issue is with some promoters abusing the insolvency resolution process. *"If these steps are unsuccessful, stronger forms of intervention might be taken into consideration. Strong intervention often warrants equally strong justification and rhetoric. In the context of Section 29A, the language that accompanied the amendment referred to 'unscrupulous promoters' whose 'misconduct' had led to the CD's distress. This language has found its way into literature and judgments that justify Section 29A. While there is no explicit generalization, this rhetoric has probably strengthened the stigma and skepticism associated with entrepreneurs who have undergone the insolvency resolution process. Irrespective of its intention, the scope of the ineligibilities under Section 29A has left little room for a narrative in which there are promoters that deserve a second chance."*

Conclusion

The IBC has demonstrated over the last five years that it is able to change in response to market demands and market peculiarities. This has made it possible to test various regulatory regimes through experimentation. For instance, the PPIRP environment is once again considering the debtor-in-possession paradigm that was repealed by the IBC. According to this article, there is a connection between bankruptcy legislation, innovation, and entrepreneurship. Therefore, it is

[7] *Insolvency and Bankruptcy Board of India*, , https://ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf (last visited Jan 20, 2023).

important to consider this link in the Indian context while assessing the IBC's success toward the goals it set out to accomplish five years ago.