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Impact Of IBC on Credit Networks and Firm Performance

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Abstract

The Insolvency and Bankruptcy Code, 2016 serving as an inclusive legal system for resolving insolvency issues including corporate entities, partnership firm, and persons. It represents an important departure from the previous insolvency system in India, both in its structure and approach. The Code is designed to optimize the value of the corporate debtor's assets through ensuring an equitable consideration of the interests of all stakeholders throughout the resolution process. One of its major goals is to promote a strong market for stressed assets and to offer a dignified exit route for genuine business failures. The initial years following its implementation have delivered impressive and commendable results.

The effective insolvency and bankruptcy system can considerably hinder the growth and efficiency of credit markets. Recognizing this, India executed the IBC in 2016 as a comprehensive reform aimed at addressing rising non-performing assets (NPAs) and strengthening credit flow, ultimately contributing to GDP growth. The IBC marked a pivotal shift from a debtor-in-possession to a creditor-in-control model, with the objective of lowering borrowing costs, enhancing the availability of credit, and encouraging firms to opt for long term financing solutions. The findings indicate that the introduction of the IBC led to a notable decline in the cost of borrowing and positively altered the structure of corporate debt. These financial improvements, in turn, contributed to better performance outcomes for financially distressed firms compared to their non-distressed counterparts.

This research paper will shed light on whether the introduction of the IBC has led to more effective credit flows and better risk management practices by creditors, which is crucial for the overall health of the financial system.

Keywords: IBC, Credit Networks, Firm performance

INTRODUCTION

The Insolvency and Bankruptcy Code (IBC), 2016, serves as India's unified bankruptcy legislation, aiming to streamline and consolidate the country's insolvency and bankruptcy processes. Its primary goal is to facilitate the revival of financially distressed corporate debtors. The Code mandates that the entire resolution process, including any related litigation, must be completed within a strict timeline of 330 days. The effectiveness of the IBC can be seen in the successful resolution of several cases. Though the number of companies undergoing liquidation is nearly four times higher than those that have been resolved, the asset value of the 250 resolved companies is four times greater than that of the 955 companies in liquidation.

The code not only sought to resolve defaults faster but also to preserve value, maximize recovery, and incentivize creditors to act in the best interest of the distressed firm. In essence, it created a new framework for managing distressed assets and significantly impacted the credit networks - the relationship between lenders, borrowers, and regulators - as well as the performance of firms affected by insolvency.¹

*SreeMetaliks Limited v. Union of India*² This case serves as a landmark decision made during the early stages of the code's implementation, focusing on the validity of the order and examining whether the initiation of the CIRP was in line with established legal standards. The court's ruling emphasized the jurisdictional responsibilities of the tribunals, asserting that they are bound by clear regulations. Tribunals cannot deny an individual's rights due to negligence and must always follow the principles of natural justice.

In the case of *Swiss Ribbons Private Ltd. v. Union of India*³, the Court ruled that denying an Operational Creditor the right to vote in the CoC is not discriminatory. The judgments in the *Swiss Ribbons* case played a crucial role in facilitating settlements and resolutions in both pre-insolvency and insolvency situations. As the IBC is implemented, it faces challenges, but the government has been proactive in identifying these problems. Each

¹ BatraSumant, Corporate Insolvency: Law and Practice, (First edition, EBC, 2018)

² *SreeMetaliks Limited vs. Union of India* W.P. 7144 (W) OF 2017

³ *Swiss Ribbons Private Ltd. v. Union of India* (2019) 4 SCC 17

amendment to the IBC aims to remain relevant and address the current concerns of the business world. As the IBC continues to evolve to meet the dynamic challenges of the real world, further amendments may be expected. The Court has advanced the Code's goal of "restoring the economy to its proper place" by prioritizing financial creditors, which will help ease debt repayment and allow capital to flow into the business sector. The Code maintains the objectives of economic legislation by distinguishing between operational and financial creditors and aims to accelerate the economy's debt recovery process.

This study aims to analyze the impact of the IBC on credit networks and firm performance by comparing the scenarios before and after its execution. It will assess whether the IBC has facilitated quicker decision-making in resolving corporate defaults, improved the accessibility of credit, and positively impacted the financial health and performance of firms post-recovery. The analysis will also consider the effectiveness of IBC in fostering a competitive, transparent credit market, ultimately contributing to enhanced economic growth and development in India.

STATEMENT OF THE PROBLEM

The introduction of the IBC has considerably changed Indian credit landscape and corporate performance environment. Though, there is an urgent requirement to systematically assess its wider effect on credit networks - like lending behavior, credit availability, and risk perception amongst financial enterprises - as well as on firm level performance indicators comprising productivity, effectiveness, and capital structure. The problem lies in recognizing whether the IBC has merely improved recovery mechanism or has also led to long standing behavioral and structural change in how credits are allocated and how firms work in response to the new insolvency system. This research paper also aims to assess the extent to which IBC has influenced firm performance by enabling distressed firms to either restructure effectively or experience sensible liquidation, and how this has affected their ability to attract credit in the long run.

LITERATURE REVIEW

Dipti Mehta (2017)⁴ in her article describes the evolution of the corporate insolvency resolution framework in India has led to the introduction of IBC, which represents the most recent and significant policy initiative in this area. The IBC is a streamlined, modern law that provides a clear and cohesive solution to the insolvency resolution challenges faced under the current Indian conditions. When fully implemented, the law has the potential to transform not only the way insolvency cases are addressed in India but also the entire credit environment of the country.

Jaswant Saini and Satish Kumar (2020)⁵ the paper examines the functioning of the NCLT as a debt recovery mechanism and provides an overview of the impact of the IBC NPAs. The study relies entirely on secondary data sourced from official web portals of the NCLT, RBI, and IBBI, as well as research articles by leading scholars. The findings suggest a slight improvement in the overall NPAs of banks.

Mukhijia (2018)⁶, has states A brief overview of the evolution of insolvency laws in India highlights the unification of various legislations over time. The objective of the IBC has been clearly defined, with appropriate emphasis placed on the exit options available to both debtors and creditors within the Indian legal framework. The author has also considered the scope and interpretation of the Code, as shaped by judicial rulings. Ram Singh and Hitesh (2021)⁷ in their study, develop a model to analyze the dynamics of the IBC processes in the aftermath of the Covid-19 pandemic. This model will be used to examine the effects of the pandemic on various aspects of financial disputes and their consequences, including: the number of disputes between debtors and creditors following Covid-19; the frequency with which these disputes are brought before the NCLT; the impact of the pandemic on the occurrence of 'out-of-court' settlements; the nature of disputes resolved amicably versus those addressed under the corporate insolvency resolution process at the NCLT; and the recovery rates in disputes that are settled compared to those that are litigated.

Handa (2018) find out that, the IB Code is silent on the situation of international creditors and their privilege to approach NCLT to prompt corporate insolvency processes. However, the Supreme Court in *Macquarie Bank Limited vs. Shilpi Cable Technologies Ltd*⁸ set a precedent that foreign creditors shall have the same right as accessible to domestic creditors to begin and participates in Corporate Insolvency Resolution proceedings in IBC 2016.⁹

RESEARCH OBJECTIVES

- To analyze the impact of IBC on the credit behavior of financial companies, comprising changes in lending patterns, credit risk assessment, and recovery rates post implementation.

⁴ Dipti Mehta, *Insolvency and Bankruptcy laws – A look into the position of foreign countries*, Mehta & Mehta, (2017)

⁵ Jaswant Saini, S. K. *The Emergence of Insolvency and Bankruptcy Reforms in India Our Heritage*, 68(30), 2020

⁶ Mukhijia Ashish (2018), *Insolvency And Bankruptcy Code Of India*, Lexis Nexis Publications

⁷ Ram Singh and Hitesh Kumar Thakkar, *Settlements and Resolutions Under the Insolvency and Bankruptcy Code*, Indian Economic Journal, 2021

⁸ Civil Appeal No.15135 OF 2017

⁹ Himanshu Handa, *Orchestrating the UNCITRAL Model Law on Cross-Border Insolvency in India*, IJLM&H (2018)

- To examine the effect of IBC on the availability and cost of credit for firms across various sectors, especially for stressed and non-performing companies
- To assess the influence of IBC on firm performance indicators, like profitability, operational effectiveness and productivity before and after resolution.

INSOLVENCY AND BANKRUPTCY CODE, 2016

The IBC provides a structured and time-bound framework for resolving insolvency cases involving individuals, companies, and partnership entities. The legislation ensures adequate time for the completion of resolution proceedings, aiming for effective debt restructuring or resolution for both corporate bodies and individuals.

The IBC designates the Insolvency and Bankruptcy Board of India (IBBI) as the principal regulatory body overseeing insolvency and bankruptcy procedures across the country. Only certified IRPs are authorized to administer the insolvency process. These professionals are entrusted with managing the debtor's assets and operations during the resolution period, ensuring neutrality and transparency in the process.

The Code establishes two specialized tribunals to handle insolvency cases, depending on the nature of the entity. The Debt Recovery Tribunal (DRT) is responsible for cases involving individuals and partnership firms, though the NCLT adjudicates insolvency matters related to companies and LLPs. Certain amendments to the IBC disqualify specific categories of individuals from participating in the resolution process. Promoters, members of management, willful defaulters, and disqualified directors of companies with outstanding non-performing debts are prohibited from submitting resolution plans or purchasing assets during liquidation proceedings, thereby ensuring greater accountability and fairness.

The insolvency process begins when a petition is filed by a financial creditor, operational creditor, or the corporate debtor itself before the relevant adjudicating authority. The tribunal must decide within 14 days whether to accept or reject the application. Upon acceptance, a Resolution Professional is appointed to devise and implement a comprehensive resolution plan within a stipulated period of 180 days.¹⁰

The IBC has fundamentally reshaped the credit ecosystem in India by introducing a time-bound, creditor-driven resolution process. Before its implementation, India's insolvency framework was plagued by delays, poor recoveries, and a lack of clarity for lenders and borrowers alike. By setting a structured mechanism and enforcing strict deadlines, the IBC has improved the credit discipline among borrowers and enhanced the confidence of lenders. Banks and financial institutions have become more proactive in monitoring loan accounts, leading to early identification and resolution of financial stress.

THE EFFECT OF IBC ON CREDIT NETWORKS AND FIRM PERFORMANCE

From the viewpoint of firm performance, the IBC has introduced a deterrent against willful default and mismanagement. The threat of losing control over the company during insolvency has compelled promoters to act more responsibly, thereby improving corporate governance standards. For enterprises undergoing resolution, the IBC provides a second chance by enabling restructuring and strategic acquisition by stronger players. This has not only assisted revive several distressed firms but also preserved jobs, maintained asset value, and restored production capacities, contributing to overall economic stability.

In spite of its positive results, challenges remain. Many cases continue to result in liquidation, and resolution timelines are often extended due to litigation and operational bottlenecks. In addition, the impact of IBC on credit networks varies across sectors and firm sizes. Though large firms have benefited from strategic takeovers and better credit terms post-resolution, smaller firms often face higher borrowing costs due to perceived risks. Consequently, though the IBC has brought about a systemic shift in India's insolvency regime, its long-term effectiveness depends on continuous improvements in infrastructure, judicial capacity, and creditor-debtor coordination.¹¹

In *Nikhil Mehta v. AMR Infrastructure Ltd*¹², both the NCLT and NCLAT concluded that an advance payment made by an allottee to a real estate developer does not automatically qualify as a financial debt. This case is important as it marked the first judgment allowing allottees to initiate proceedings under Section 7 of IBC. Both tribunals ruled that "consideration for the time value of money" is essential for a debt to be classified as a financial debt. The case involved a 'committed returns scheme', where homebuyers paid for their property, and the developer made periodic payments to them until possession was handed over. In this case, the NCLT ruled that the allottees were not financial creditors because there was no consideration for the time value of money. However, this decision was overturned by the NCLAT.

¹⁰ Ahlawat & Associates, Insight Into The Bankruptcy, Insolvency & Rehabilitation Proceedings In India, International Lawyers Network, June 15, 2020

¹¹ Dayitha TK, The Impact of the Insolvency and Bankruptcy Code on the Indian Banking Sector's Financial Stability and Credit Accessibility, JLRJS (2024)

¹² CA (IB) No 543/KB/2017

In the case of *P Mohanraj v. Shah Bros. Ispat (P) Ltd.*¹³ it was ruled that when a resolution professional assumes control of the management of a corporate debtor during the CIRP and represents the debtor in judicial proceedings, this also extends to criminal proceedings.

*Swiss Ribbons Pvt. Ltd and another v. UOI and Ors.*¹⁴ case of *Swiss Ribbons* is a landmark judgment regarding the constitutional validity of certain provisions of the IBC. The primary issue addressed in this case was the constitutional validity of the IBC. The judgment recognized the economic significance of the IBC in addressing India's growing problem of NPAs and stressed the importance of timely resolution of insolvency cases for the efficient functioning of the economy. It emphasized the need for a robust insolvency resolution mechanism to ensure the maximization of asset value and the protections of stakeholder interest. This case played a crucial role in validating the constitutional legitimacy of the IBC, and providing legal clarity on its provisions, thereby facilitating the effective resolution of insolvency cases in India.

CONCLUSION

One of the most notable impacts of the IBC has been its effect on credit networks. The code has provided creditors with a clearer, more predictable pathway for recovering dues, thereby strengthening the overall trust in the financial system. Lenders, particularly banks, have become more vigilant in assessing risk, as they now have a legally defined process for dealing with NPAs. The possibility of a quicker resolution process under the IBC has increased the willingness of banks and financial institutions to extend credit, knowing that they have a mechanism in place to safeguard their interests in case of default.

The IBC has incentivized companies to adopt more responsible financial practices, as the risk of insolvency no longer carries the same level of ambiguity it once did. The clear resolution processes under the IBC have provided firms with a renewed sense of confidence in their ability to recover from financial difficulties.

Furthermore, the IBC has been instrumental in improving investor confidence in the Indian market. Investors now have greater assurance that in case of corporate distress, there is a transparent and structured process for resolution. This has led to a boost in FDIs and has attracted worldwide capital, as international investors prefer operating in markets where legal system is predictable and efficient.

To improve the effect of IBC on credit network it is necessary to build up institutional capacities, reduce delay in resolution through faster judicial process, and improve the efficiency of IRPs. Also, better coordination amongst creditor, timely admission of cases, and promoting pre packaged insolvency scheme for MSMEs can further streamline resolutions. Strengthening data analytics for early detection of financial distress and incentivizing timely settlement can also contribute to the healthy credit culture and improved firm level outcome.

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¹³ *P. Mohanraj v. Shah Bros. Ispat (P) Ltd* (2021) 6 SCC 258

¹⁴ *Swiss Ribbons Pvt. Ltd and another v. UOI and Ors* (2019) 4 SCC 17