

Improving IBC

What is the issue?

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- Insolvency and bankruptcy code (IBC) was introduced to address the bad debt issues.

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- But there are some areas of concern which allows existing promoters to game the system.

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What is the significance of IBC?

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- As the Indian financial sector faces a serious problem with bad debt, a ray of hope on the horizon is the modern insolvency process.

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- The mechanism is closely supervised and time-bound, and the first test cases are winding their way through it at the moment.

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- It is generally hoped that the new law will permit speedy and efficient resolution of many such cases.

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- In appropriate ones, assets will be revived under new management.

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- This will help clean up the private sector in a sense with weak promoters, owners and managers being replaced by new ones who will turn some of these distressed assets into profitable ventures.

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What are the areas of concern?

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- If even after this new process, it appears that existing promoters of troubled companies somehow manage to retain control or have some sort of advantage in the retention of such control.
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- There are increasing number of voices raised that the system could be gamed by existing promoters.
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- Naturally, if the existing promoter is the best or the only possible alternative, and all that is needed is a reasonable renegotiation of terms, then banks are perfectly justified in considering that option.
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- Certainly, this is not illegal under the insolvency and bankruptcy procedure.
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- However, it is imperative to have a mechanism to ensure there is, in fact, no undue preference being accorded to existing owners.
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- That will only kick the problem of bad loans down the road, precisely what the new insolvency law is designed to avoid.
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What needs to be done?

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- Banks, must ensure the widest possible set of management and ownership structures is considered.
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- The priority must be not just the preservation of capital in each case but also its efficient management in the future.
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- If the former owner makes the best bid for a stressed asset then the second best bidder should be asked if he is willing to match it and, if so, he should be allowed to take over.
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- Such a setup will ensure that the system is not being gamed by the existing owners while also not foreclosing any opportunity for reviving an asset that has a possibility of recovery.
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- The recovery from the slowdown requires banks to take reasonable haircuts while preserving capital.
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Source: Business Standard

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