IB Code - The Euthanasia to kill viable companies?

IB CODE AS THE ICU FOR SICK INDUSTRY HAS **KILLED MORE COMPANIES THAN IT COULD REVIVE** – EVEN VIABLE COMPANIES WITH OPERATIONAL PLANTS AND LARGE SCALE EMPLOYMENT GET ISSUED DEATH CERTIFICATES- LAWYERS AND **CONSULTANTS MINTING MONEY** WHILE LENDERS AGONISINGLY WAIT FOR CASH

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The IB Code 2016 is a landmark piece of legislation amongst a horde of path breaking reforms brought in by the current government. This single piece of legislation has allowed us to jump several places in the world ranking on ease of resolving insolvencies. We at ASSOCHAM applaud this strong and revolutionary reform.

The IB Code addresses most of the important failings of the past, while **offering a uniform and comprehensive legislation that allows creditors to assess the viability of a debtor as a business decision, and agree upon a plan for revival.**

Then why after 15 months of the IB Code in practice, is the country still failing to tackle NPAs?

THE LINE BETWEEN A REGULAR BUSINESS CAUGHT IN THE FLUCTUATING GLOBAL AND DOMESTIC ECONOMIC CYCLES, AND A FRAUD, AND/OR A WILLFUL DEFAULTER NEEDS TO BE REDRAWN

Genuine promoter vs willful defaulter and/or fraud

WE ALREADY HAVE THE MECHANISM TO IDENTIFY FRAUDS, AND WILLFUL DEFAULTERS, SO A BLANKET BAN ON ALL PROMOTERS INCLUDING GENUINE CASES OF DEFAULT DUE TO FACTORS BEYOND HUMAN CONTROL IS PENALISING THE INDIAN ECONOMY AND NEEDS TO BE TWEAKED TO ALLOW GENUINE PROMOTERS TO PARTICIPATE

Early on, just as the IB Code became the go-to tool for banks and industry as hope for revival and recovery, the IB Code Ordinance was introduced in November 2017, quickly becoming an Act preventing promoters from participating in the resolution plan for the revival of their own companies.

This Act had the unintended and unfortunate consequence of painting the genuine promoter and entrepreneur with the same brush as a fraud, and/or a willful defaulter. **Equating and further penalising a genuine entrepreneur whose industry has been hit by external factors for reasons beyond their control, and putting them on the stand along with frauds and willful defaulters is akin to punishing an already harassed farmer for drought.**

December 2017 saw 40 cases disposed off by the NCLT—30 into liquidation. In other words 75% of businesses hoping, and working for revival were liquidated—**banks will never recover the debt of 75% of the companies in question, the employees of 75% cases joined the ranks of unemployment, 75% of productive assets have been left to gather rust.** In our country a large number of businesses are family-promoted enterprises. The promoter is the life blood of the company and vice-versa. It is rare for a third party to have any interest in that company. By debarring promoters of such companies from trying to revive their own companies, the Act takes away the only chance that these companies have for revival. This means that the company is compulsorily sent for liquidation resulting in loss to the government exchequer, and massive unemployment. In turn this adversely affects the socio-economic fabric of our society.

IT IS LIKE PENALISING A CANDIDATE FOR LOSING ONE ELECTION BY DEBARRING THEM FOR LIFE FROM CONTESTING ANOTHER ELECTION

Personal guarantees—when should they be invoked

TO INVOKE THE PROMOTERS' PERSONAL GUARANTEE NOW WITHOUT GIVING THEM A CHANCE TO REVIVE THE COMPANY UNDER IB CODE IS THROWING THE BABY WITH THE BATH WATER. IT TREATS THE PROMOTER LIKE A CRIMINAL AND THE INDIAN ENTREPRENEURIAL SPIRIT A CRIME

Every business carries a risk of failure due to various reasons such as recession, competition, etc. Thus historically, entrepreneurs were reluctant to set up new industrial ventures because failure meant recovery. This recovery was done for the loans taken by the business through auction or sale of the businessperson's household and personal effects. To encourage industrialisation and entrepreneurship, the legal principle was created, that if a company is incorporated under the Companies Act, the liability of the shareholders becomes limited. A company was held to be a distinct legal entity separate from its shareholders and directors. This legal principle gave protection to businessmen, and ushered in the era of an industrial revolution.

The new section 29A takes away from the promoter who himself is a victim of the recent severe industrial downturn the chance to revive his embattled company. This is severely detrimental. We would be going back in time when only foreign businesses and big corporates owned the country's resources, while the common Indian citizen remained workers and employees with no say. It is my humble request not to kill entrepreneurship as it would have deep implications on the economy and the society.

Revamping the health of Indian banks

IN MOST CASES, TANGIBLE VALUE OR LIQUIDATION VALUE OF THE ASSETS MAY NOT BE MUCH, BUT THE EARNING POTENTIAL OF SUCH ASSETS MAY BE MUCH HIGHER WHICH CAN BE CAPTURED ONLY THROUGH THE UPSIDE OF EQUITY VALUE

The current level of NPA includes accrued interest, and interest upon interest while the company was not making profits. Such overdue interest amount whether paid or unpaid, or replaced by corporate loans is seldom backed by security of tangible assets. The asset value itself deteriorates sharply due to bad news.

For the success of any resolution plan, the viable and sustainable debt of the company needs to be worked out, instead of mandating maximum haircut to be allowed.

So for stronger balance sheets, banks need to copy the LIC model which runs on a mix of debt-equity and instead of ignoring equity, banks should focus on how to maximise their recovery out of equity in cases where banks lost their debt in the past. Holding 80-90% equity as some banks may like to do to maximise their returns will also not help because then the equity value will not be there. For that they need to understand the way equity upside works. Ideally banks should hold around 20-30% in a company, but on a maximum basis they may opt for 40% equity in a company. But in any case, owning above 40% equity in a company will keep the public away from that company and banks will not get any upside. While the public holding should ideally be again a similar of 30-40%, preferably around 40%, while the rest could be with the promoter to incentivise him to run the company in a professional manner.

ANY AMOUNT OF RECAPITALISATION WILL NOT HELP UNLESS THE BANKS STRENGTHEN THEIR SYSTEMS AND TRY TO RECOVER AS MUCH AS POSSIBLE FROM THE NPAS INSTEAD OF CONSIGNING THE COMPANIES TO THE FLAMES IN TOTO. RECENTLY, THE BANKS ARE RELUCTANT TO ACCEPT ANY PROPOSAL WHERE THEY NEED TO TAKE LARGE HAIRCUTS. INSTEAD STRANGELY, THEY CHOOSE LIQUIDATION IGNORING RECOVERY HOWEVER SMALL. THE ADDITIONAL POTENTIAL OF EQUITY UPSIDE IS TOTALLY IGNORED. THE EFFECT OF THIS LIQUIDATION ON OTHER STAKEHOLDERS LIKE EMPLOYEES, SUPPLIERS, CUSTOMERS AND PUBLIC SHAREHOLDERS IS TOTALLY IGNORED. THIS APPROACH NEEDS TO BE QUESTIONED, AND COMMERCIALLY OPTIMISED DECISIONS NEED TO BE TAKEN BY THE BANKS IN THE INTEREST OF ALL STAKE HOLDERS