

## **IBBI ANNUAL DAY LECTURE**

by

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### **EASY EXIT FOR WELL-FUNCTIONING MARKETS: REGULATORY GOVERNANCE AND THE ROAD AHEAD**

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Hon'ble Minister of Finance and Corporate Affairs Smt. Nirmala Sitharaman ji; Hon'ble President, National Company Law Tribunal Chief Justice Shri Ramalingam Sudhakar ji; Chairperson, IBBI, Shri Ravi Mital ji, Whole time Member, IBBI Shri Jayant Prasad; esteemed ladies and gentlemen.

1. A very good afternoon. It is my privilege to be here at the 6<sup>th</sup> Annual Day of IBBI. I would like to thank Shri Ravi Mital, Chairperson, IBBI, for inviting me to be a part of the commemoration of what marks a watershed in the history of economic reforms in India. At the outset, I congratulate the chairpersons and members of IBBI for their exemplary leadership in shaping the insolvency and bankruptcy regime in India.

2. Any reform measure is as strong as the institutional framework that undergirds its implementation. IBBI, within a short span of six years, has achieved extraordinary success in creating and continuously strengthening that framework for enforcing the IBC, a much-needed reformist step, albeit in the face of many uncertainties. The regulator has navigated hitherto uncharted territory with its nimble, focused and resolute efforts. What we have witnessed in the last six years is speed, agility, nuance and constant calibrations to make this historic code meet its purpose. My heartiest congratulations to all those who, through their contributions, have enriched the stupendous journey of IBBI thus far.

3. The economic reforms in India, set in motion in the early nineties, were motivated by the economic needs of the nation, of higher growth, efficiency and competitiveness. Underlying the wide-ranging reforms was the fundamental construct of replacing central planning with markets which, through their invisible hands, were believed to bring about efficiency in resource allocation, providing a decisive push to the overall growth frontier. At the same time, there was a recognition of the possibility that, in certain circumstances, unfettered market forces may fail to deliver desired outcomes. Economic regulators were thus instituted to sit between the State and markets to address market failures and remove obstacles to entry and operation. The focus was largely on unlocking and promoting competition across sectors for achieving productive, allocative and dynamic efficiency. The Competition Act, 2002, was enacted with the overarching aim to prevent practices having adverse effect on competition, to promote and sustain competition in markets and to ensure freedom of trade carried on by other participants in markets. The Competition Commission of India enforces the Act to ensure that entry is not unduly restricted owing to strategic barriers created by large incumbents and that they can compete on merits.

4. Competition, however, is not only about free entry and level playing field; it is also about freedom of exit. Threat of entry is the market's mechanism for disciplining market power. Entry barriers, on the other hand, insulate incumbents from potential competition. When entry is known to be difficult and costly, it curbs the incentive and ability of enterprises to shift resources in response to market signals, thereby curbing the dynamism that competitive markets require. Hurdles to exit, similarly, make resources stay longer in existing firms instead of being relocated for more efficient use. Thus, barriers

to exit, like barriers to entry, weaken the competitive process, which act to relocate resources from one market or firm to another according to changing conditions.<sup>1</sup>

5. As market circumstances change, technologies evolve, new business models outcompete old ways of doing business, some firms thrive, some languish and some fail. Failure is an inevitable outcome of market-driven competitive rivalry. By providing a credible, transparent and time-bound market mechanism for resolution of insolvency wherever possible and easy exit where required, the IBC addresses the fear of failure, which otherwise could act as an entry- deterrent and dampen risk-taking ability. In a way, entry and exit are interlinked. Facilitating entry without easy exit avenues cannot meaningfully help the cause of competition.

6. IBC complements the Competition Act and constitutes that critical building block which completes the legislative architecture India needed, to harness the full potential of markets for growth and efficiency. While we had a patchwork of insolvency laws, IBC provided a modern and comprehensive framework for professionalising the insolvency landscape, maximising the value of stressed assets and easing the closure of unviable businesses. The objectives of past initiatives and legislations were limited and confined to the recovery of bad debts, without much consideration to restoration and rehabilitation of the corporate debtor, or aiming for minimising waste and preserving resources and jobs for economic growth, including scarce entrepreneurship capital. As a result, the macro-economy and larger systemic and behavioural changes were not reckoned to be important long-term objectives, and emphasis was on short-term measures to effect recovery of debts from companies.

7. IBC became an important milestone in the evolution of economic reforms in the country, which made the insolvency resolution a market-based mechanism, balancing the interests of all stakeholders. As the Hon'ble Supreme Court in one of the IBC cases observed, and I quote "*the defaulter's paradise is lost. In its place, the economy's rightful position has been regained.*"<sup>2</sup> unquote

8. Overall, by releasing locked up resources and putting them to more efficient and productive use, IBC led resolution and insolvency process is meant to ensure optimum utilisation of scarce economic resources, while also smoothening the process of 'creative destruction' with greater competitive fervour.

9. However, as we know, translating theory into practice has its own challenges. There are many factors, not all of which can be accounted for *a priori*. As fellow regulators, it is not difficult to imagine the enormity of the task for IBBI, who hit the ground running. Their journey started with some very complex cases of large distressed assets, which had to be handled with dexterity alongside putting in place the processes and building the ecosystem. What I find particularly noteworthy is the way the regulator knitted together all necessary elements to institutionalise a cohesive system in such a short span.

10. For instance, a cadre of resolution professionals had to be created and trained, who are the lynchpins in the process, acting as the conduit between the adjudicating authority, creditors and the debtor. Their role and relevance are of utmost importance in guiding the Committee of Creditors in complying with the provisions of the Code and in ensuring fairness throughout the resolution process. IBBI has rightfully focused on developing this profession as an institution through its regulatory oversight and well-designed capacity-building measures.

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<sup>1</sup> Barriers to Exit – Background Note, OECD Secretariat (2019)

<sup>2</sup>Hon'ble Justice R.F.Nariman in *Swiss Ribbons Pvt Ltd & Anr vs Union of India & Ors*, Writ Petition (Civil) No. 99 of 2018

11. Further, we saw the Government and the regulator effectively use what may be referred to as a 'feedback loop' to learn from experience and improvise accordingly to align the law to emerging needs. Be it for protecting the interest of homebuyers or coming up with the pre-packaged insolvency resolution framework for MSMEs, the Code has been amended in quick response to emerging issues and in line with changing market realities. This applies to regulations as well, which IBBI modifies based on stakeholder consultations. This openness, responsiveness and flexibility is what all regulators must embed in their work to remain fit-for-purpose.

12. As we know, in just about three years since the Code came into force, it made a significant difference, catapulting India's ranking in the World Bank Ease of Doing Business in terms of resolving insolvency from the 136<sup>th</sup> to the 52<sup>nd</sup> position. The average time taken for resolution came down from 4.3 years to 1.6 years. The Code has now been tested in many differing circumstances, in a diverse range of sectors, such as manufacturing, construction, real estate, retail trade, hotels, electricity, transport, etc. A total of 5636 CIRPs were commenced by the end of June 2022. Of these, 3637 have been closed. Of the CIRPs closed, the CD was rescued in 1934 cases.<sup>3</sup> The Code has been interpreted by the judiciary and jurisprudence has evolved, settling many issues faced during its implementation. One can say that it has solidified its position as a transformative legislation.

13. Fuelled by a huge unsatiated appetite for freedom of exit, the insolvency law is changing the way society perceives business failures, as it becomes a reform by, for and of stakeholders. Standing on the two critical pillars of transparency and credibility, the Code and its implementation have continuously strived to build confidence among the creditors and the new management through an efficient bidding process.

14. In the last six years, a lot of distance has been covered as part of the journey of IBC. When a law is enforced or an economic reform measure implemented, it is inevitable that some pitfalls would be identified along the way. It is in the interest of healthy evolution of a regulatory/legislative framework that any review, assessment or criticism of it is based on a set of objective parameters as well as its core tenets as opposed to broad perceptions.

15. Like in the case of IBC, the discussions on 'haircuts' must take place in light of the fact that IBC provides a market-driven mechanism to stakeholders for reorganisation, and the resolution plan is approved by the Committee of Creditors in their commercial wisdom. The extent of the haircut may reflect the degree of discount the market demands. It is a function of the stage of stress at which the company comes to IBC. If significant value deterioration has happened to the assets of the debtor when the resolution process is initiated, the right comparator for the resolution values should be the next logical outcome for the creditors, which is liquidation. It is incumbent upon the stakeholders to avail of the tool that IBC offers at the early days of stress, before the value deteriorates significantly, and not as a last resort, after exhausting all alternative avenues.

16. Time is of the essence in effective resolution. Delays could be value-destructive, and thus, the Code makes the resolution process time-bound. However, meeting timelines with so many participants involved in the proceedings could be challenging. Without getting into the sources of delay and other implementation challenges, what can be said with certainty is that the Government and the regulator are seized of all such issues. They are constantly in touch with stakeholders. The recent notification of IBBI announcing a performance-based pay structure for resolution professionals seeks to align with the objectives of all stakeholders.<sup>4</sup> Be it process related, infrastructural or substantive, we have all the

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<sup>3</sup> IBBI Newsletter Apr-June 2022

<sup>4</sup> IBC Changes to Hasten, Maximise Recovery, Economic Times, September 19, 2022

reasons to believe that any issue that affects the efficacy of the Code would be resolved with the same alacrity that we have seen in these six years.

17. *Ex post* evaluation is an integral part of credible and meaningful implementation of any law or regulation. However, we must not lose sight of the fact that economic regulations often make a difference by inducing behavioural change through incentives and disincentives. These outcomes may not be quantifiable but are most significant. In the case of IBC, the inevitable consequence of a resolution process is, that it has instilled an increased sense of credit discipline, minimising the incidence of default. As the Economic Survey 2021-22 observes, and I quote, *“Distressed assets have a life cycle and their value gradually declines with time. The fact that a CD may change hands has changed the behaviour of debtors. Thousands of debtors are resolving distress in the early stages, either when the default is imminent on receipt of a notice for repayment but before filing an application, or after filing the application but before its admission, and even after admission of the application, and making best effort to avoid consequences of the resolution process.”* Unquote.

18. Thus, IBC is changing debtor-creditor dynamics inasmuch as, it allows for a more positive contribution by both in their respective roles. A transformation in debtors' credit behaviour is being witnessed, and there have been rising instances of debtors coming forward to settle their debts on their own, even before admission of their cases in the National Company Law Tribunal (NCLT), or immediately after filing of such applications. There is growing realisation among debtors that they may lose control and management of their firm permanently as a result of resolution. The resolution provision under the Code thus acts as a major credible deterrent for the debtors and existing promoters of the firm from operating their unit at low efficiency levels, draining the resources of the enterprise, under-utilising and/or mis-utilising them. This is a remarkable achievement. I may mention here that, at the Competition Commission, we gauge the effectiveness of enforcement of the competition law against the touchstone of behavioural changes in market participants pursuant to our decisions. In many cases, enterprises alter their long-standing practices to make them competition-compliant soon after the Commission takes cognizance.

19. Corporates today operate on a global landscape. Their businesses do not necessarily stop at national boundaries. Thus, economic regulations too now take into account the multi-jurisdictional nature of the issues. At CCI, we are increasingly focusing on international cooperation with our counterparts. In the current globalised economic setting, a strategic thrust of the Commission has been on forging strong and sustained partnerships with overseas competition agencies to facilitate knowledge exchange and cooperation in cross-border antitrust and combination cases. Nine MoUs have been signed by CCI with agencies in other jurisdictions. In the case of insolvency resolution, when multiple proceedings are on for the same corporation in different jurisdictions, the restructuring efforts in one jurisdiction will have a bearing on the other jurisdictions, requiring cross-jurisdictional cooperation. It would help to ensure that restructuring efforts are aligned and that the insolvencies are resolved efficaciously. I believe the Government and the Regulator are working towards it, and soon, we will have a robust cross-border insolvency regime in India.

20. The Indian economy has staged a sustained recovery post the pandemic. As we now look at placing the economy at a high and inclusive growth path, it is critical that resources, enterprises and markets work at their full potential. It is imperative to enthuse the entrepreneurial spirit in the country and attract investments and cutting-edge technologies from across the globe. At the Competition Commission, we watch markets and competitive landscapes as they evolve across different sectors, through both our antitrust and combination cases. And, I must say, we see exceptional dynamism, especially driven by the digital revolution. Entrepreneurial energy, aided by the power of digital computing technology and electronic commerce, is set to unlock tremendous growth potential for the

economy. Entry of start-ups, for instance, is playing a particularly significant role in fuelling competition, bringing greater diversity and choice of offerings. We currently have more than 100 unicorns, and many of them could become decacorns in the coming years. This trend is extremely promising for increased vitality of markets and thus, must be encouraged in all possible ways.

21. At the Commission, we are committed to ensuring that young entrepreneurs can enter markets without having to face strategic barriers erected by incumbent large players and that the ground rules of competition are followed by all, so that these new entrants can operate on fair terms. To facilitate inorganic growth, the Green Channel was introduced in 2019 for automatic approval of combinations. This is a first-of-its-kind trust-based system in the world, where notifiable transactions having no overlaps, be it horizontal, vertical or complementary, between the parties, are deemed approved upon filing. It aims to promote speedy, transparent and accountable merger review, striking a balance between facilitation and enforcement.

22. IBC and IBBI, on the other hand, will continue to play a critical role in giving our young risk-takers the comfort of rapid, simple and seamless resolution or exit in case of honest business failures. Fast-tracked insolvency proceedings for a wider pool of start-ups is a welcome move which I believe would contribute significantly in providing an enabling business environment for the start-up industry. A professional and institutionalised mechanism of exit reduces the emotional cost and stigma that has been traditionally attached to business failures and insolvency. Suiting the new economic milieu, the IBC projects exit as a resolvable fall-out of market competition and provides a rather graceful exit for entrepreneurs.

23. We have entered the 'Amrit Kaal' and embarked on the journey of a 'New India' for the next 25 years. As our Hon'ble Prime Minister has said, and I quote, *"During 'Amrit Kaal, the nation will move forward towards attaining resolutions made for Aatmanirbhar Bharat. Today we're working to strengthen 'good governance', 'pro-people pro-active governance'."* Unquote.<sup>5</sup> To fulfil the goals set for the nation and to turn our people's aspirations into reality, we regulators have to think comprehensively, be ahead of time, act as facilitators, break silos and embed our working in the larger socio-economic policy milieu. In their book "Why Nations Fail?", Acemoglu and Robinson show that the decisive role for the development of countries is played by institutions. Our systems must therefore stand on robust and inclusive institutional mechanisms, supported by all relevant stakeholders.

24. IBBI has started its journey remarkably well and has rightfully focused on institutional underpinnings, creating the foundation for a strong and responsive insolvency regime in the country. As they say, "Well begun is half done". The Code is still at its nascent stage. The work related to individual insolvency, cross-border insolvency, group insolvency and valuation profession has begun in right earnest. As the process matures in the days to come, the insolvency regime is expected to impact not only ease of doing business but also overall economic growth.

25. Like everything else, this reform, too, has to keep evolving. That means only one thing - embracing the future. On this 6<sup>th</sup> Annual Day of IBBI, I wish the regulator a fruitful journey ahead and hope as part of stakeholders of this unique Code, we all can realise its true potential.

26. Thank you once again for inviting me.

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<sup>5</sup> PM Modi references 'Amrit Kaal', the era of elixir, in his Independence Day speech, Times Now, August 15, 2022