Ease of exit for businesses in India

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Introduction

'Ease of doing business' is essentially related to the freedom which a business can have – at the time of taking the first step, during all the time it survives, and also at the time it wants to take an exit. While much stress has been put on how to make things easy for a business to enter[2], it must be noted that ease of exit is also equally crucial. The *Chakravyuh* episode in the Mahabharata is the perfect example of how the ability to enter, but not exit can have severely adverse consequences[3]. While enabling voluntary exit is inevitable, facilitating withdrawal of unviable firms is seen as a part and parcel of industrial restructuring[4]. As such, in the laws and policies introduced by the Government in the recent times, attempt to make exit of companies an easier process has been a common characteristic.

Speaking specifically about corporate forms, though corporate entities are born to be perpetual, yet exit might be a quintessential requirement many a times – in some cases, it would be entirely voluntary, marking the end of the purpose for which the entity was born; in other cases, it might be forced, say in cases where the entity does not remain a viable one. There might be several other reasons as well. In any case, an impeded exit has substantial fiscal, economic and political costs[5], and leads to non-viable businesses consuming resources with no results at all. Hence, it is pertinent to note that exit and entry are closely co-related, because where there exists a framework promoting easy entry but difficult exit, it will only demotivate ventures with a high-risk element from entering into the market.

Exit norms for companies are generally contained in the law(s) governing the companies, as winding up provisions or even as a part of revival and rehabilitation provisions (*as explained later*). The authors analyse how certain factors can scale up or scale down the ease of exit for corporate businesses, and whether the different ways of exit under the Indian framework imbibe such factors.

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[2] By simplifying incorporation of companies- removal of minimum capital requirements; integrated process for incorporation; harmonious steps are being taken by different regulatory bodies to make incorporation a cohesive process; obtaining licenses and registrations easier etc.
[3] *The Chakravyuha Challenge: Ease to enter, barriers to exit-* https://pib.gov.in/newsite/printrelease.aspx?relid=136862
[4] See, for instance observations of Goswami Committee on Industrial Sickness and Corporate Restructuring.
[5] Bloom, N. & John van Reenen, 2010, "Why do Management Practices Differ across Firms and Countries?" Journal of Economic Perspectives., site last visited 16.03.2020

Barriers to exit

Ease of exit is adversely affected by barriers to exit. In several studies conducted globally, barriers to exit have been defined to imply such managerial and strategic factors that keep firms in business even when they earn low or negative returns[6]. Studies around the world also show that factors like burdensome regulations, specialised assets having low resale value, resettlement costs towards employees, etc. may be identified as barriers to exit. Such barriers, like barriers to entry, also weaken the market discipline mechanisms of the competitive market process[7].

In India, several committees formed by the Government, for instance, the Goswami Committee, the Eradi Committee, and the Irani Committee, pointed out loopholes in processes concerning exit of companies, and hence suggested that focus be laid upon factors like time taken due to pendency of court approvals, availability of funds to the liquidator to carry out the liquidation process and infrastructural lags.

The Goswami Committee, in its report of 1993[8], noted several practical issues in winding up of companies (delays in inventorising assets and records, delays in sale process, long procedures for debtor realisation, inflation of claims by certain claimants, contentious and adversarial process of settlement and distribution of proceeds, etc.), and concluded that '*the greatest barrier to industrial restructuring is that it is virtually impossible to liquidate and wind up an unviable firm*'. Interestingly, the most glaring aspect of sale process, as observed by the Goswami Committee, is the insistence on going concern sale. When a firm is operationally unviable and cannot get a consensus to reorganize its debts and labour force, the act of selling it as a "going concern" can hardly make the firm turn-around. The Eradi Committee in 2000[9], recognised that winding up is a 'long-drawn affair'. Similarly, the Irani Committee, in 2005[10], noted "*the liquidation process in India is costly, inordinately lengthy and results almost complete erosion of value.*" Even the Bankruptcy Law Review Committee[11] observed that liquidation is a weak link in the bankruptcy process and must be strengthened as a part of ensuring robust legal framework.

Post such unequivocal opinions, there has been significant overhaul in the winding up regime in India including that in the form of Insolvency and Bankruptcy Code, 2016 ('Code') and amendments to the Companies Act, 2013 ('Companies Act'). While the Code has significantly changed the winding up landscape, we study all possible routes and see if there is something more which can be done.

Routes of exit

In India, there are several ways of exit under the Companies Act as well as the Code – some are voluntary while some may be involuntary. A brief introduction to each of the ways is as follows –

1. Voluntary liquidation

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[6] Porter, 1976; Harrigan, 1981. See https://one.oecd.org/document/DAF/COMP(2019)15/en/pdf, Pg. 8

[7] Barriers to Exit – Background Note- https://one.oecd.org/document/DAF/COMP(2019)15/en/pdf

[8] Report of The Committee on Industrial Sickness and Corporate Restructuring (July, 1993)

[9] Report of the High Level Committee on Law relating to Insolvency and Winding up of Companies, 2000

[10] Report of the Expert Committee on Company Law 2005

[11] The Report of the Bankruptcy Law Review Committee, 2015

A solvent company can opt for voluntary liquidation under section 59 of the Code. In case of voluntary liquidation, the appointment of liquidator is decided upon by the shareholders at the same general meeting of shareholders wherein the resolution approving voluntary liquidation is passed, and as such NCLT does not have a role in the process until the final stage i.e. filing of application for dissolution. Creditors' approval by 2/3rd majority is required if there is a debt.

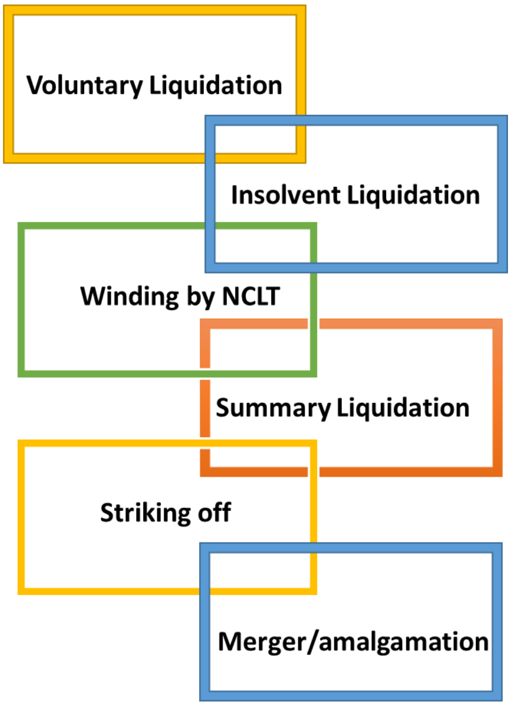
2. Liquidation via Insolvency process

The Code enables creditor driven process as well as self-filing. Insolvency process may be initiated by the creditors, either financial creditor under section 7 or operational creditor under section 9, upon default in payment by the company (referred to as corporate debtor under the Code). With NCLT being the adjudicating authority, all activities, decisions and progress have to reported to NCLT. Liquidation process follows, if resolution fails. Even, at any time during the resolution process, the creditors' body may decide by majority that the company be liquidated. All processes are managed by an insolvency professional, in the capacity of either resolution professional or liquidator, as the case may be.

If the company has committed a default, recourse to section 59 is not possible. The company can opt for self-filing under section 10 of the Code. In that case, except for initiation, all provisions will apply to the process, and therefore, the process does not remain a voluntary process anymore.

3. Winding up by NCLT

Section 271 of the Companies Act provides for winding up in cases like, by way of member's special resolution; on application of Registrar for non-filing of financials for 5 consecutive years, and other reasons set out under the said provision. Governed by the provisions of the Companies Act and newly introduced Companies (Winding Up) Rules, 2020, the winding up process, too, has significant involvement of NCLT as well dependence on the company liquidator and the creditors.



Note that 'inability to pay' is no more a criterion and a creditor is no more an eligible petitioner for the purpose of section 271 of the Companies Act. Hence, if a company defaults, the only option before the creditor is to take the company to insolvency hrough the route under the Code.

4. Summary liquidation

Besides, section 361 of the Companies Act provides for a summary liquidation procedure for certain classes of companies[12], wherein the role of NCLT is replaced by Central Government (Regional Director), and the liquidator is required to sell the assets within 60 days of order.

However, notably, the lengthy winding up rules apply to both the modes – section 270 as well as section 361 of the Companies Act.

5. Striking-off under Companies Act, 2013

Also known as the fast-track exit route, striking off under section 248 of the Companies Act allows companies having no operations/ nil assets and liabilities to dissolve the company in a quick and easy manner, substantially reducing dependence on a professional and on representation before the NCLT, unless an appeal for revival is filed.

Additionally, the Registrar of Companies may *suo-moto* initiate striking off process against a company on grounds such as non-commencement of business/ non-operation for minimum 2 years etc.

6. Mergers/amalgamations under Companies Act, 2013

In case of merger/ acquisition, the transferor company may dissolve pursuant to the scheme itself - without any explicit application as such. Considering that the assets and liabilities of the transferor company are completely transferred to the transferee company, the company may be dissolved irrespective of its existing liabilities, provided that due assent is received from the shareholders and creditors, as well as approval of the scheme by the NCLT. A carve-out from this considerably lengthy process has been provided for in case of fast-track merger by specified categories of companies[13]. As a result of section 233 of the Act, for the purposes of fast-track merger, the concerned authority is the Central Government, i.e. regional director.

Choosing the best way

As seen, there can be various options available to a company to choose from. In the following paragraphs, the authors have attempted to enlist a few factors that companies (may) keep in mind while deciding the appropriate route for exit.

The recourse to each of the mode will broadly vary depending upon eligibility, solvency, asset-liability position of the company and the extent of judicial intervention, etc. Besides procedural regulatory framework, there might be pure commercial considerations, e.g. saving taxes, while choosing a way to depart.

For instance, a company which has not defaulted in payment obligations, can choose voluntary winding up or striking off. However, where it has negligible *assets/liabilities*, striking off will be a better

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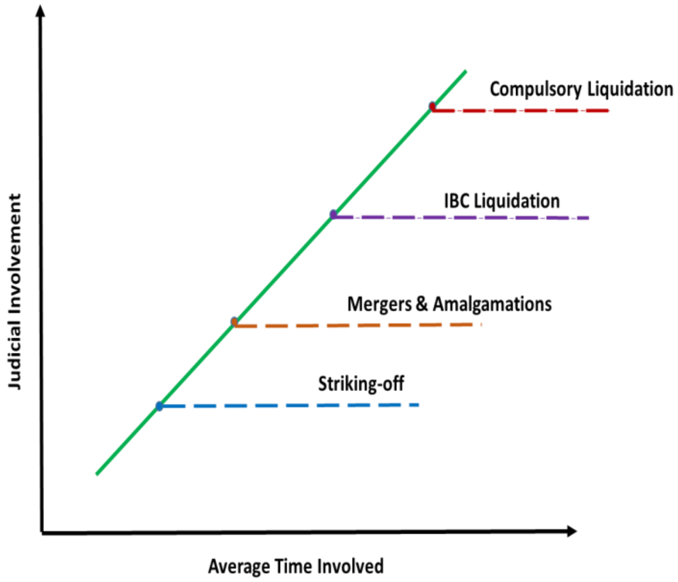
[12] Ref. section 361 (1) read with rule 190 of the Winding Up Rules - (a) companies having deposits not exceeding Rs. 25 lakhs; or outstanding loans not exceeding Rs. 50 lakhs; or turnover not exceeding Rs. 50 crores; or PSC not exceeding Rs. 1 crores.

[13] Section 233 (1) provides that provisions of Fast-track merger shall be applicable in cases of merger between two or more small companies or between a holding company and its wholly owned subsidiary

option, other things remaining the same. In a different scenario, where the company is *cash/asset surplus*, distribution of the same in liquidation might have *tax implications* on the shareholders[14].

Further, *time and cost* are other significant factors. Processes such as insolvency or merger/ acquisitions are comparatively lengthy as well as costly. It is rather pertinent to note that the high average time taken to resolve insolvency process in India is one of the primary reasons for introduction of the Code. In the "Time to Resolve Insolvency" Report, 2015 the World Bank reported that as on 2015, the average time taken to resolve insolvency in India was 4.3 years, as compared to UK's 1 year and USA's 1.5 years. As per latest data, in India, the average time taken to resolve insolvency is 1.6 years[15], time to complete liquidation process (voluntary or otherwise) is between 1-2 years[16], and that for a merger/amalgamation scheme may range from 6 months to 1 year.

Another factor is *flexibility* to conduct the process. Where the process involves high involvement of judiciary, the same might not be a preferred mode, for time and cost considerations. While there is an extensive involvement of NCLT in case of mergers/ insolvency processes/ winding-up under Companies Act, processes such as striking off, fast track merger and voluntary liquidation are relatively much more independent of such involvement. While it goes without arguing that involvement of NCLT instils greater confidence amongst the stakeholders, it also means addition in timelines, and increase in professional costs, etc. Having said so, given the present situation where NCLTs are over-burdened with matters, the timelines are further elongated.



The various options available for exit, with their features, are summarised as below:

[14] Section 46 of the Income Tax Act.
[15] World Bank Data: https://data.worldbank.org/indicator/IC.ISV.DURS?locations=IN
[16] IBBI data shows that maximum number of cases fall in the category. See Quarterly Newsletter [October-December, 2019], Volume 13.

Particulars	**Modes of exit**							
	Processes under IBC				***Processes under Companies Act***			
	Voluntary Liquidation Process	***Voluntary Insolvency Process***	***Involuntary insolvency process***	***Liquidation process under IBC***	***Winding Up***	***Summary Liquidation***	***Striking-off***	***Mergers***
Governing Statute	Sec. 59, IBC	Sec. 10, IBC	Sec. 7/9, IBC	Sec. 33, IBC	Sec. 271, CA, 2013	Sec. 361, CA, 2013	Sec. 248, CA 2013	Sec. 230-232, CA, 2013
Who can be an applicant	Company	Corporate applicant, including the company itself	Creditors	Resolution Professional (through creditors or otherwise by law)	Company; Contributory; RoC; CG, suo-moto by NCLT	Company	Company; RoC	Company; member; creditor; liquidator [Possible under IBC too]
Eligibility criteria	Solvency	Min default of Rs. 1,00,000/-; SR from shareholders	Minimum undisputed default of Rs. 1,00,000	Failure/ non-receipt/ non-approval of resolution plan; decision taken by CoC before expiry of moratorium.	On criteria as mentioned in section 271 – SR by company, default in filing returns, fraudulent conduct of business, etc.	Low level of deposits, outstanding loans, etc.	Nil assets & Liabilities.	Approval of scheme by members and creditors
Application to be made before NCLT	Not needed- SR to be passed	Yes		Yes	Yes	To Regional Director (RD)	To RoC	Yes
Appointment of professional, if needed	By shareholders *via* SR	By NCLT		By NCLT	By NCLT	By RD	N.A.	Only for appearance before NCLT
Involvement of creditors	For approval only.	High, decisions are taken by CoC		Medium – Consultation committee is for advising the liquidator only.	High	Low	Low	Approval of scheme.
Involvement of NCLT	Only at the time of dissolution	Sanction of resolution plan/liquidation order.		Periodical reporting, and then dissolution.	Comparatively higher involvement	Low	Not applicable. However, NCLT can wind up a struck-off company.	Approval of scheme

Concluding remarks

Brought into picture in light of the present needs and reform requirements, it was expected that the Code will improve the business climate by allowing easier exit[17], and India's improved standing in the Ease of Doing Business index[18] suggests that the Code indeed has made its contributions.

While the primary objective of the Code, as enshrined in its preamble, has been revival of the failing companies, the numbers suggest a deviation- since its inception, around 58% of the cases under CIRP have ended up in liquidation *vis-à-vis* a meagre 14% where resolution plans have been approved. Cumulative figures as on 31.12.2019 suggest that of the 1961 present cases of CIRP, 780 have moved to liquidation and resolution plans have been approved in 190 cases only. As regards voluntary liquidation, out of the 579 cases as on 31.12.2019, 101 have been dissolved while in another 171 cases final report has been submitted. The data further suggests that it was only during the nascent stage on the Code that voluntary liquidation process did not happen to deliver. On the contrary, it must be appreciated that in the previous four quarters, that is, Oct-Dec'18 to Oct-Dec'19 the final reports have been filed for majority of the cases initiated during the respective quarters.

As regards timelines, majority of CIRP cases have crossed the 270 day mark, and majority of liquidation cases (including voluntary liquidation cases) are between the time period of one year to two years. Further, 22 liquidation cases and 43 voluntary liquidation cases have crossed 2 years.

However, the above is only a reflection of the matters under the Code – one must not forget that the overburdened NCLT is the also the judicial body for matters under the Companies Act. Data reveals that as on 30.09.2019, of the total number of cases before NCLT, 55% were of the Code alone, and the remaining 45% comprised of all matters under the Companies Act like mergers, oppression and mismanagement, revival of companies etc. Hence, processes like merger, which could otherwise have been concluded within an average time-period of 6 months, now take a year or even more thus leading to unwarranted delay.

While there are various options for exit, yet there is a need to revamp the infrastructural set-up so as to speed up the success rate. The same will also ensure optimal utilisation of the laws to balance the interests of all. For this, some steps may be suggested. The *first* of such steps must be to reduce the burden of NCLT – by setting up more benches, mandatory imposition of costs for frivolous litigation and by equipping the NCLT with ample staff and support. *Secondly*, attempt may be made to provide greater flexibility to professionals in the conduct of the processes. *Thirdly*, necessary mechanisms be introduced to deal with non-marketable/unsaleable assets. *Fourth,* the law is not sufficiently equipped with penal provisions for discouraging unhealthy conduct of those stakeholders who might act with self-serving interests to the detriment of collective process. *Fifth*, the stakeholders at large, including

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[17] Quoted by Hon'ble Finance Minister- Smt. Niramala Sitharaman- https://economictimes.indiatimes.com/news/economy/finance/ibc-improves-business-climate-by-allowing-easier-exit-nirmala-sitharaman/articleshow/71398632.cms

[18] As per the Doing Business Report by World Bank, India jumped 14 steps to 63 in the overall EoDB ranking, and a striking 56 places to stand at the 52nd rank in the Ease of Resolving Insolvency individually. The World Bank recognised that with the reorganisation procedure available, through the Code, companies have effective tools to restore financial viability, while creditors have better tools to successfully negotiate and have greater chances to realise the money.

government authorities, should be educated about the processes involved, and their respective rights and actionables in the processes. *Lastly*, a regime for pre-packaged rescue can be developed. It is a practice evolved in the UK and the US by which the debtor company and its creditors conclude an agreement for the sale of the company's business prior to the initiation of formal insolvency proceedings. The actual sale is then executed on the date of commencement of the proceedings/date of appointment of insolvency practitioner, or shortly thereafter (and the proceeds distributed among the stakeholders in the order of priority)[19].

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[19] See Interim Report of BLRC, Pg. 78