# HOW THE INSOLVENCY AND BANKRUPTCY CODE RESHAPED FINANCING OF DISTRESSED FIRMS: *EVIDENCE FROM INDIA*

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**Abstract**

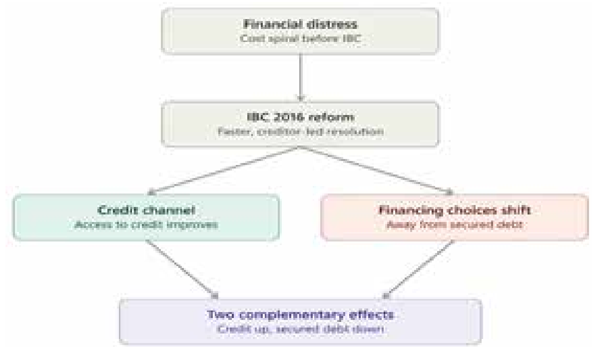
The Insolvency and Bankruptcy Code (IBC), 2016, transformed India's insolvency framework by introducing a time-bound, creditor-controlled resolution process. This article reviews recent empirical evidence on how the reform has influenced the financing and recovery of financially distressed firms. The evidence shows that the IBC strengthened lender confidence, improving distressed firms' access to credit at lower borrowing costs and supporting their financial recovery and operational performance. At the same time, the creditor-oriented regime altered corporate financing behaviour. To reduce the risk of losing control in the event of default, firms, particularly those with substantial tangible assets, became less dependent on secured debt and increasingly substituted it with equity, unsecured borrowing, trade credit, retained earnings, and cash reserves. The findings suggest that the IBC, 2016, has not only expanded access to finance for distressed firms but also reshaped capital structure decisions, leading to more resilient financing strategies among financially distressed firms.

## Introduction

In India, the Insolvency and Bankruptcy Code (IBC) came into existence in May 2016. It replaced a variety of laws, such as the Sick Industrial Companies Act, 1985, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, with a single, time-bound resolution process. In the previous regime, defaulting promoters could sometimes remain in control of a firm for years while the resolution process dragged through various tribunals. On average, the resolution process took over four years, and recovery rates were estimated at 26% (Kumar, Chaturvedula & Rastogi, 2025). The resolution process was changed drastically by the IBC. It shifted India from a debtor-controlled to a creditor-controlled insolvency regime, limited the resolution process to 180 days, extendable to 270 days, transferred control of the firm to a committee of creditor-appointed Resolution Professionals as soon as insolvency proceedings began, and barred defaulting promoters from bidding to regain control of their own firm.

The author argues in their previous article (Seal & Mukherjee, The Management Accountant, Volume 61, June 2026) that financial distress is not just a balance sheet problem; it is an operational cost amplifier. Distressed firms pay wage premiums to retain their key employees, have tighter, costlier supplier credit, pay a 'Distress premium' on borrowed capital, and incur heavy legal, advisory, and restructuring overheads. All these expenses together create a self-reinforcing spiral in which rising costs deepen distress and, in turn, raise costs further. The IBC was partly created to break this cycle. It sought to restore the lender's trust and, through that channel, restore the troubled firm's access to affordable financing before the spiral could deepen further by making the resolution faster, more predictable, and more creditor-friendly.

Almost a decade after the implementation of IBC, a growing body of empirical work has examined whether the Insolvency and Bankruptcy Code (IBC), 2016, has achieved its intended goal of improving outcomes for distressed firms. Taken together, the evidence strongly supports the conclusion that the IBC has had a positive impact. The IBC has improved distressed firms' access to external finance, enhancing their financial flexibility and promoting better operational and financial performance. Although the extent of these benefits varies across firms and contexts, the reform has generally increased financially distressed firms' capacity to recover and obtain finance.




## IBC and Credit Channel

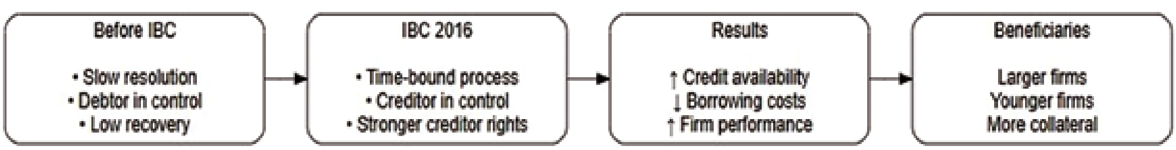
One of the earliest and most direct examinations of this question is provided by Bose, Filomeni, and Mallick (2021), published in the Journal of Corporate Finance. The authors use a panel of 33,845 Indian nonfinancial firms between 2008 and 2019 and a difference-in-differences framework, comparing distressed and non-distressed firms before and after the introduction of the IBC, to investigate whether the reform improved distressed firms' access to credit and whether any improvement in financing translated into superior firm performance. Their results support, to a considerable level, what they call the credit channel. Post-implementation of IBC, distressed firms experienced increases in access to long-term and short-term debt of 6.3% and 1.4%, respectively, compared to non-distressed firms. The average cost of borrowing also declined by around 0.8%. Such improvements in financing had a substantial economic impact. An increase in long-term debt by one standard deviation was associated with an improvement of about 16.7% in return on assets, and a decline in borrowing costs by one standard deviation was associated with an improvement in firm performance of about 2.3%.

The evidence therefore suggests that the IBC not only enhanced firms' access to finance, but also the ability of distressed firms to convert improved financing conditions into better operating performance. But these benefits did not accrue evenly across firms. Larger, younger distressed firms with more collateral captured most of the gains, whereas smaller, older, less collateralized firms showed little or no statistically significant improvement. The authors explain this heterogeneity by different lending methodologies. Institutional lenders rely primarily on hard, verifiable data such as audited financial statements and pledged collateral, rather than on relationship-based or 'soft' information. The

IBC made the insolvency resolution process faster, more predictable, and more creditor-friendly. IBC also reduced the risks associated with asset-based lending and encouraged greater credit supply to firms that could provide credible collateral. Firms that did not possess these characteristics remained relatively constrained in their ability to obtain finance. Importantly, the IBC appears to have increased the firm's credit supply, unlike previous legislation, such as the SARFAESI Act, 2002, which often prohibited firms from borrowing against secured assets due to the higher risk of collateral loss. The result is largely an impact of IBC's focus on keeping firms in business through resolution rather than quick liquidation.

The study by Kumar, Chaturvedula & Rastogi (2025) demonstrates that the Insolvency and Bankruptcy Code (IBC), 2016, has significantly improved the financial condition of distressed firms in India. The overall financial strength of distressed firms improved from 0.052% to 0.071%. There is an improvement of about 36.54% after the introduction of IBC, whereas the financial strength of non-distressed firms declined from 0.071% to 0.062%, a decrease of about 12.7%. The distressed firms gained access to credit by 5.34–5.90 % more than the non-distressed firms after the IBC was implemented. The reform improved access to financing for distressed firms, reducing their borrowing costs by 1.15% and increasing their borrowing by 4.03%. However, not all firms benefited equally. The authors find no significant improvement for firms with high promoter ownership, but a 4.48 increase for firms with low promoter ownership. These findings suggest that firms that are more dependent on non-promoter financing benefit the most from the reform. Other tests (placebo test) confirmed the results, which also showed a 4.79-percentage-point improvement in the financial position of distressed firms after the IBC. These results suggest that the IBC restored lenders' confidence by enabling a faster, more efficient insolvency resolution process, thereby making them more willing to extend credit to financially distressed firms. This greater access to finance has enabled distressed firms to better manage their financial obligations, continue operating, and improve their prospects for recovery. Thus, we can say that IBC 2016 has helped distressed firms by enhancing their access to funds, lowering their borrowing costs and increasing their recovery from financial distress.

Taken together, these two studies provide strong evidence demonstrating that the Insolvency and Bankruptcy Code (IBC) has largely achieved its main objective of replacing India's slow insolvency regime with a more efficient system. The results indicate that the reform increased lenders' confidence, which in turn increased lending to financially distressed firms. Financially distressed firms thus had easier access to financing, could borrow at lower costs, and could continue their operations and recover from financial distress. Overall, the evidence suggests that the IBC was effective in rebuilding confidence in the credit market by making debt more accessible and more affordable to distressed firms.




## Change in Financing Choices

With the implementation of the IBC 2016, firms with a large proportion of tangible assets were less likely to revert back to secured debt, even when creditors were more willing to lend. This was because the IBC gave creditors greater control in insolvency proceedings, making management more fearful of losing control over their companies and assets if financial distress worsened over time. These firms replaced secured debt with other sources of finance to access the necessary financing without increasing secured borrowing. This is well supported by Agarwal & Singhvi, (2023) in their paper 'Creditor-controlled insolvency and firm financing– Evidence from India'.

Specifically, the authors found,

- Firms raised additional funds from shareholders rather than borrowing against their assets. Because equity does not require collateral or interest payments, it reduces the financial burden and the risk of financial distress.

- Firms prefer to raise additional capital through collateral-free borrowing, thereby reducing the risk of asset seizure by creditors in the event of insolvency.
- Companies prefer to finance purchases more through trade credit, effectively delaying payment, rather than taking out secured bank loans. As trade credit generally doesn't require collateral, it provides short-term liquidity while reducing dependence on asset-backed financing.
- Firms prefer to finance more through internally generated profits than by external borrowings. This method of financing helps the firm to reduce debt and creditor intervention.
- Companies built up larger cash reserves as a safeguard to ensure they had funds during tough times and to reduce their reliance on secured borrowing.

The substitution occurred because the IBC increased the risk of secured borrowing from the managers' perspective. In the new insolvency regime, a default on secured loans could result in creditors taking control of the firm and its assets. This led firms to reduce their dependence on secured debt, especially among those with major tangible assets, and to diversify their funding sources by increasing their use of equity, supplier credit (i.e., accounts payable), retained earnings, and cash reserves. In other words, the IBC did not reduce firm's need for finance. With this, we can say that IBC 2016 changed firms' financing decisions, with firms reducing their dependence on collateral-backed borrowing and shifting towards alternative financing sources that were less likely to trigger creditor intervention under the IBC.

## Conclusion

The combined results of the two sections suggest a mixed, and seemingly counterintuitive, impact of the Insolvency and Bankruptcy Code (IBC), 2016, on financially stressed firms. On one hand, the IBC 2016 has made the insolvency resolution process faster, more predictable and more creditor-friendly, thereby strengthening the credit channel. With this, lenders' confidence increased, lowering the perceived risk of lending to distressed firms and leading banks and other financial institutions to lend more and at lower rates. Therefore, distressed firms were able to access external finance more easily, enabling them to continue operations, meet financial obligations and improve overall performance.

At the same time, the same institutional reforms that induced lenders to increase the supply of credit, also changed the preferences of the borrowing firms. In the creditor-controlled insolvency setting, default on secured borrowing can trigger the resolution process, in which creditors take over the firm, exposing promoters to a high risk of losing both managerial control and ownership. As a result, many firms, particularly those with substantial tangible assets that could serve as collateral, became more cautious in their use of secured debt despite the increased availability of credit. Instead, they increasingly replaced secured borrowing with alternative sources of finance such as equity, retained earnings, trade credit and cash reserves. These financing choices allowed firms to obtain the required funds while limiting the risk of creditor intervention in the event of future financial distress.

The two sets of results are thus not contradictory but rather two complementary behavioural responses to the same institutional reform. The IBC, at the same time, increased the supply of credit by strengthening creditor rights and changed the demand for different forms of financing by raising the costs of relying on collateral-backed debt from the managers' perspective. In other words, as lenders became more willing to provide finance, firms became more selective about the type of finance they sought. The reform, therefore, affected not only the availability of capital but also firms' capital structure decisions. This suggests that IBC has not only improved access to finance but also reformed corporate financing behaviour by balancing the benefits of greater access to credit with the higher risk of loss of control under the creditor-oriented insolvency regime. MA

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