

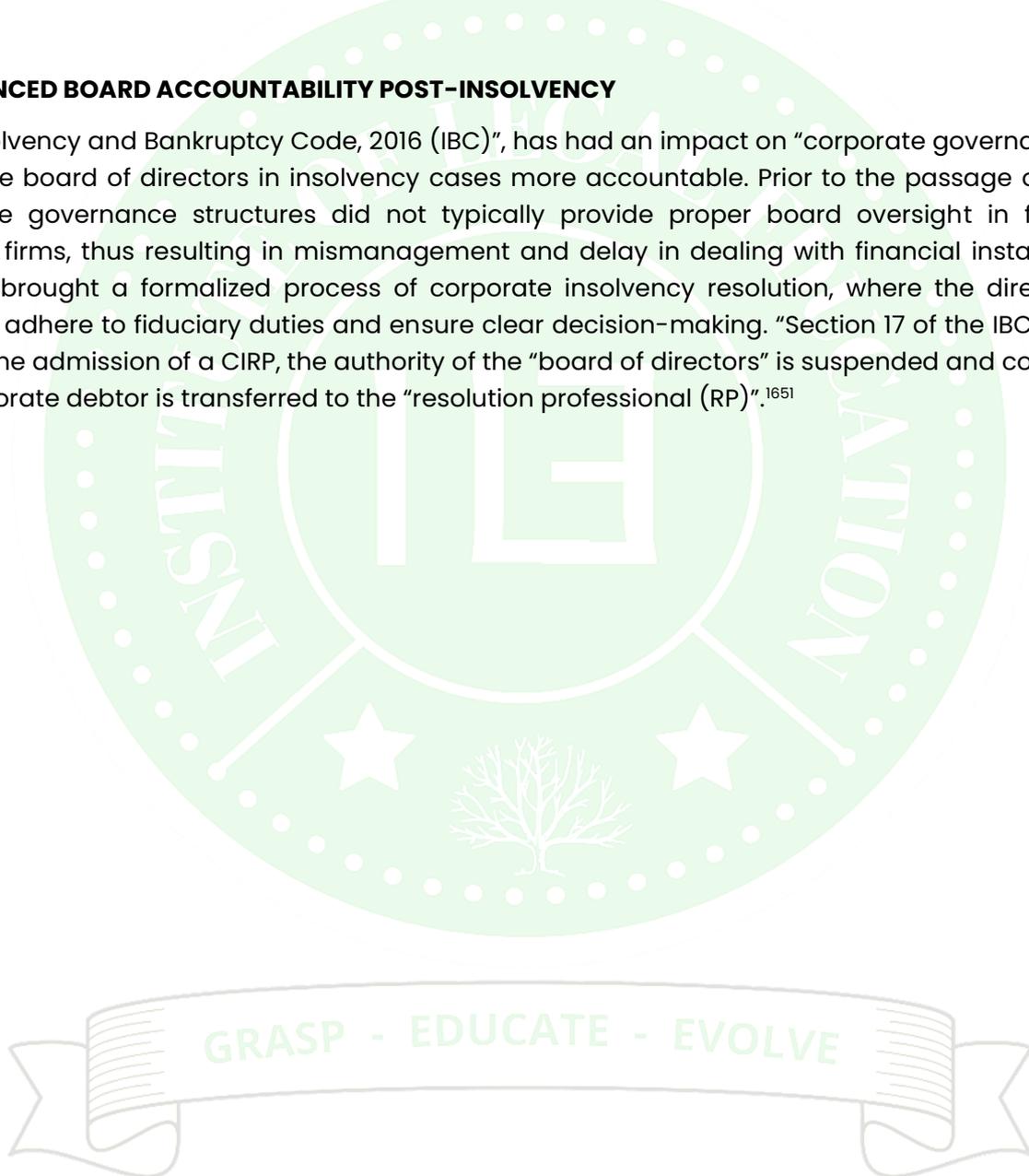
IMPACT OF THE “INSOLVENCY AND BANKRUPTCY CODE” ON CORPORATE GOVERNANCE PRACTICES

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1.1 ENHANCED BOARD ACCOUNTABILITY POST-INSOLVENCY

The “Insolvency and Bankruptcy Code, 2016 (IBC)”, has had an impact on “corporate governance” as it made the board of directors in insolvency cases more accountable. Prior to the passage of the IBC, corporate governance structures did not typically provide proper board oversight in financially stressed firms, thus resulting in mismanagement and delay in dealing with financial instability. The IBC has brought a formalized process of corporate insolvency resolution, where the directors are made to adhere to fiduciary duties and ensure clear decision-making. “Section 17 of the IBC” requires that on the admission of a CIRP, the authority of the “board of directors” is suspended and control over the corporate debtor is transferred to the “resolution professional (RP)”.¹⁶⁵¹



¹⁶⁵¹ Rajeshwar Rao, “Rajeshwar Rao: Strengthening the Insolvency and Bankruptcy Code (IBC) framework for effective resolution,” 2024 available at: <https://www.bis.org/review/r241218g.htm> (last visited March 31, 2025).

“Section 17 of the IBC” requires that when a “corporate insolvency resolution process (CIRP)” is admitted, the “board of directors” powers are suspended and the management of the corporate debtor is entrusted with the resolution professional (RP). This is a deterrent against board-level negligence and ensures that directors are acting in the best interests of stakeholders prior to financial distress rising to the level of insolvency. By capping the powers of the board after insolvency, the Code dissuades bad governance practices and enhances control.¹⁶⁵²

The function of directors in the IBC is also specified by Section 19, which mandates the staff of the corporate debtor, including directors, to assist the RP. Non-compliance with this can lead to legal action, forcing board members to keep proper books of accounts and assist in the resolution process. This adds accountability, as directors are required to make full disclosure of financial affairs and business activities to facilitate a smooth insolvency resolution.

Also, the IBC has strengthened the “fiduciary duties of directors” in avoiding fraudulent and preferential transactions. The provisions of “sections 43 to 51 of the IBC” give the power to the RP to examine and question transactions that might have been made to the prejudice of the creditors. This includes preferential transactions, undervalued transactions, and fraudulent transfers made prior to the initiation of insolvency proceedings. By making directors personally responsible for such transactions, the Code ensures boards take prudent financial decisions and put the interests of creditors first.¹⁶⁵³

The addition of Section 66, addressing wrongful trading and fraudulent behavior, has further

enhanced board responsibility. It provides for the adjudicating authority to hold directors personally responsible for any fraudulent trading or mismanagement that led to the insolvency of the company. This provision acts as a powerful deterrent against reckless financial actions, forcing boards to be more cautious in their governance practices.¹⁶⁵⁴

Another key influence of the IBC on board responsibility is its focus on transparency and disclosure. The mandate of directors to present timely and true financial statements under the “Companies Act, 2013”, has been supported by insolvency law. Any act of concealment of financial trouble or misrepresentation of financial reports can result in disqualification of directors under “Section 29A of the IBC”, thereby excluding them from taking part in resolution processes. This provision ensures that boards of directors have high corporate governance and financial integrity standards.

Additionally, the IBC has strengthened the position of independent directors in governance. Independent directors are now under the expectation of being more actively involved in the monitoring of financial decision-making and ensuring that there is early attention to signs of distress before reaching the stage of insolvency proceedings. Through strict imposition of good risk management and financial prudence, the Code fosters best “corporate governance practices” that safeguard the interests of stakeholders. In general, the IBC has provided a strong framework of board accountability through suspending powers of directors after insolvency, applying transparency conditions, and attaching liabilities for mismanagement. Such provisions instill corporate boards with the responsibility to adopt sound governance practices, hence decreasing cases of financial

¹⁶⁵² “Section 17-Management of affairs of corporate debtor by interim resolution professional,” Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR available at: <https://ca2013.com/section-17-management-affairs-corporate-debtor-interim-resolution-professional/> (last visited March 31, 2025).

¹⁶⁵³ “Section 43-Preferential transactions and relevant time,” Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR available at: <https://ca2013.com/section-43-preferential-transactions-relevant-time/> (last visited March 31, 2025).

¹⁶⁵⁴ Pooja Tidke, Krushi N Barfiwala and Rima Desai, “Section 66 of the Insolvency and Bankruptcy Code- A brief overview” *Parinam Law Associates*, 3 August 2022.

mismanagement and enhancing business sustainability.¹⁶⁵⁵

1.2 INFLUENCE OF THE CODE ON CORPORATE FINANCIAL DISCIPLINE

The introduction of the “Insolvency and Bankruptcy Code, 2016”, has significantly influenced corporate financial discipline in India. Prior to the coming into force of the IBC, companies used to indulge in wanton borrowing, bad financial management, and financial misreporting owing to poor insolvency laws. The IBC has brought in a formalized system that rewards corporations for being financially prudent and transparent to escape insolvency proceedings.

Another crucial element of financial discipline imposed by the IBC is the pre-emptive detection and cure of financial stress. Section 10 of the IBC makes it possible for corporate debtors to voluntarily initiate insolvency procedures, giving way for early action before the company's financial woes intensify. This provision necessitates companies to have proactive finance planning and keep liquidity buffers so that they don't fall into insolvency.

The Code also prescribes strict timelines for resolution of insolvency, as laid down under Section 12. The time limit for the CIRP is 330 days, including delays caused by litigation, to ensure that companies facing financial stress do not linger in extended uncertainty. This has prompted businesses to implement sound financial planning and debt management to steer clear of entering into insolvency proceedings.

Borrowing practices by corporations have also been greatly affected by the IBC. Financial creditors, being in a strong position to determine insolvency resolution under Section 21, now lend with tougher terms, expecting firms to show financial health and good governance procedures prior to extension of credit. This has improved financial prudence, as firms are now

less inclined to indulge in excessive leverage and are obligated to be more financially transparent.

The effect of the IBC on corporate financial prudence is also reflected in the preference for debt repayment. Section 53 of the IBC lays down a formal hierarchy for distribution of proceeds in liquidation, with secured financial creditors taking precedence over other parties. This has resulted in greater responsibility in corporate debt management, with companies being more concerned with timely repayment of dues to prevent insolvency risk.¹⁶⁵⁶

Another important element of financial prudence brought in by the IBC is preventing fraudulent transactions. Sections 43 to 51 lay down tools to reverse preferential and undervalued transactions, so that corporate debtors cannot play tricks with financial records or siphon off assets prior to insolvency proceedings. This has made companies keep clean and transparent books of accounts, and instances of financial mismanagement have decreased.

The enactment of Section 29A has also gone a long way in bolstering financial discipline in corporate organizations. By disqualifying defaulting promoters and related parties from being involved in the resolution process, the section deters negligent financial practices and encourages prudent corporate management. Businesses now have more of an incentive to stay in financial health and avoid defaults because promoters stand to lose control over their businesses in case they fail to meet their financial commitments.

In addition, the IBC has impacted financial discipline by strengthening investor confidence in the corporate world. The disciplined insolvency resolution process ensures that companies follow strict financial standards, and

¹⁶⁵⁵ Mayashree Acharya, “Independent Directors- Applicability, Roles And Duties” ClearTax, 4 January 2022.

¹⁶⁵⁶ “NCLT: Dissenting secured creditor cannot be treated higher than other creditors under Section 53 of the IBC just because they enjoy security interest – Vaish Associates Advocates,” available at: <https://www.vaishlaw.com/dissenting-secured-creditor-cannot-be-treated-higher-than-other-creditors-under-section-53-of-the-ibc-just-because-they-enjoy-security-interest/> (last visited March 31, 2025).

Indian businesses are more attractive to local and foreign investors. With better financial discipline, firms can now access funding at lower interest rates and use a wider range of financial instruments for business growth.

Also, the activity of the “Insolvency and Bankruptcy Board of India (IBBI)” in overseeing insolvency professionals has developed financial discipline. By making sure that resolution professionals adhere to stringent rules when dealing with troubled companies, the IBC has declined cases of financial mismanagement and provoked corporate entities to make strong financial practices.¹⁶⁵⁷

1.3 STRENGTHENING OF INTERNAL CONTROLS AND RISK MANAGEMENT

The “Insolvency and Bankruptcy Code, 2016 (IBC)”, has been instrumental in enhancing “internal controls and risk management” in corporate bodies in India. Before its implementation, most companies did not have formal internal mechanisms to track financial distress, and hence there was uncontrolled mismanagement and subsequent insolvency. The IBC has brought in a system that requires financial discipline, transparency, and accountability, thus forcing corporations to implement strong internal control systems to avoid risks.

Perhaps the most important manner in which the IBC has strengthened internal controls is by the function of the “resolution professional (RP)” under Section 17. When a company enters the “corporate insolvency resolution process (CIRP)”, the board of directors of the company is put on hold, and the management is taken over by the RP. This clause imposes financial prudence by ensuring that all transactions in the course of insolvency proceedings are under scrutiny, preventing fraudulent or wanton financial actions. This also serves as a deterrent, forcing companies to have proper internal

controls in place to prevent insolvency proceedings.

Moreover, the IBC imposes risk management through the mandate of maintaining clear financial books. Section 19 of the IBC requires co-operation between company staff and the RP for the purpose of providing proper financial information to make decisions. Failure to provide necessary records or not supplying records, as well as a lack of co-operation with the RP, can attract penalties, further highlighting the necessity of having well-organized financial controls. This has prompted companies to enhance their internal risk assessment procedures to identify early signs of financial stress.

The IBC also affects risk management in terms of provisions regarding fraudulent and preferential transactions. Sections 43 to 51 authorize the RP and adjudicating authorities to examine transactions that might have been carried out with the intention of defrauding creditors. In ensuring that all financial transactions are carried out openly and honestly, the IBC encourages the establishment of more robust internal audit mechanisms in corporations. Firms are now obliged to have more effective financial monitoring systems in place to avoid entering into transactions that might be challenged during insolvency proceedings.¹⁶⁵⁸

Additionally, the introduction of Section 29A has tightened corporate governance by avoiding fraudulent promoters and related parties from taking part in the resolution process. This has compelled businesses to strengthen their in-house compliance systems and refrain from financial malpractices, as non-compliance will lead to stringent legal penalties. Consequently, companies are now investing in improved risk management systems, such as independent audits, strengthened internal reporting systems,

¹⁶⁵⁷ “What Is the Role of the Insolvency and Bankruptcy Board of India (IBBI)?” Law4u available at: <https://www.law4u.in/top-answer/9567/what-is-the-role-of-the-insolvency-and-bankruptcy-board-of-india-ibbi> (last visited March 31, 2025).

¹⁶⁵⁸ “Section 43-Preferential transactions and relevant time,” Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR available at: <https://ca2013.com/section-43-preferential-transactions-relevant-time/> (last visited March 31, 2025).

and stronger compliance systems to prevent disqualification from future business activities.

Another central risk management feature supported by the IBC is financial creditor priority in insolvency resolution. According to Section 21, financial creditors, who comprise the “committee of creditors (CoC)”, have considerable decision-making power in approving resolution plans. This provision has encouraged companies to keep their books of accounts clear and make timely repayment of debt obligations. Firms are now compelled to adopt stringent risk analysis and liquidity management procedures to avoid financial distress that may result in insolvency proceedings.

In addition, the IBC has strengthened the position of independent directors in managing financial risks. As a part of reforms in corporate governance, independent directors are now required to take a proactive approach towards detecting and managing financial risks before they develop into insolvency. Through the installation of better internal controls, firms can showcase financial stability, thus minimizing their vulnerability to insolvency risk and their ability to build investor confidence.

1.4 THE ROLE OF CORPORATE GOVERNANCE IN PREVENTING INSOLVENCY

“Corporate governance” is important to avoid insolvency by maintaining financial prudence, transparency, and accountability in the conduct of business. The “Insolvency and Bankruptcy Code, 2016”, has emphasized the need for good corporate governance practices in ensuring financial well-being and averting financial distress. By setting strict governance standards, the Code has compelled companies to take proactive measures for financial management to avert insolvency.¹⁶⁵⁹

One of the core means through which corporate governance assists in avoiding insolvency is by the function of the board of directors in financial

management. According to the “Companies Act, 2013”, the “board of directors” is charged with ensuring financial integrity and that business decisions are in line with the financial health of the company. “Section 166 of the Companies Act” specifies the fiduciary responsibilities of directors, which require them to act in the best interest of the company and its stakeholders. By ensuring strict compliance with these provisions, corporate governance mechanisms assist in identifying financial distress at an early stage, thus avoiding insolvency.

The IBC has also strengthened corporate governance obligations by laying greater stress on timely disclosure of financials. Section 92 of the Companies Act of India mandates companies to file annual returns with correct financial information, while Section 129 obliges the preparation of financial statements that are in accordance with accounting standards. These sections ensure that companies are kept transparent about their financial reporting, minimizing the prospect of insolvency on the grounds of improper management or financial misdeeds.

“Corporate governance” also plays a crucial role in avoiding insolvency by making sure that companies practice responsible borrowing and debt management. With the advent of the IBC, financial creditors have been accorded precedence in decision-making under Section 21, resulting in more stringent lending norms. Companies must now prove strong financial governance practices in order to access credit, thus it is necessary for boards to have good debt management practices in place.

Another major feature of company governance in the prevention of insolvency is enforcing risk management structures. “Section 134 of the Companies Act” requires that the report of the board contains a statement regarding risk management policies and internal controls. This allows companies to regularly identify, evaluate, and control financial risks, which in turn minimizes the chances of insolvency. The IBC

¹⁶⁵⁹ ET CONTRIBUTORS, “Building a Better Boardroom: The role of IBC in advancing corporate governance in India” Economic Times, 30 December 2023.

has also enhanced this requirement by imposing penalties for mismanagement and fraudulent transactions, forcing companies to implement stringent risk assessment processes.¹⁶⁶⁰

Independent monitoring has also played a key role in avoiding insolvency. The position of independent directors, as defined in “Section 149 of the Companies Act”, has been given prominence under the IBC, so that companies are subject to external monitoring of financial decision-making. Independent directors are supposed to oversee financial performance, avoid excessive risk-taking, and ensure that companies adhere to financial regulations. This has considerably enhanced corporate governance standards, lowering cases of financial distress due to mismanagement.

Additionally, corporate governance frameworks encourage “ethical business practices”, which play a vital role in insolvency prevention. The IBC has introduced stringent penalties under Section 66 for fraudulent trading, discouraging directors from engaging in financial misconduct. This has led to the adoption of better governance practices, ensuring that companies operate with financial integrity and avoid insolvency risks.

Adoption of corporate governance best practices has also improved investor and creditor confidence, which is essential for business viability. Businesses that follow good governance standards are likely to get investment and obtain credit at better terms. Such financial stability lessens the likelihood of insolvency, as firms have access to adequate resources to weather economic slumps and financial crises.

6.5 CORPORATE SOCIAL RESPONSIBILITY AND INSOLVENCY RESOLUTION

The “Insolvency and Bankruptcy Code, 2016 (IBC)”, has made a substantial contribution to

“corporate social responsibility (CSR)” in the context of insolvency resolution. CSR, as defined under “Section 135 of the Companies Act, 2013”, requires companies with specified financial criteria to set aside a part of their profits for social causes. Yet, when a business is involved in insolvency proceedings, its financial commitments are largely focused on clearing outstanding debts, which leaves pertinent questions regarding the continuity of CSR activities during these times.¹⁶⁶¹

Under the IBC, priority of claims under insolvency resolution is specified under Section 53, which states the waterfall method of distribution of assets. Expenditures relating to CSR are not specifically mentioned to be prioritized, so when a company goes into insolvency, the major concern would be repayment of debts. Good corporate governance norms, however, urge companies to continue their CSR commitments since ethical business practices and stakeholder involvement are important in ensuring the long-term viability of the business.

Additionally, under the Companies Act, failure to adhere to CSR commitments can invite punishment under Section 135(7). Even in the case of insolvency, the board or resolution professional of the company needs to ensure that historical CSR commitments are reflected in financial disclosures. This has brought about debate as to whether CSR costs should be treated as operational liabilities under the IBC. Others contend that CSR obligations must be incorporated in the claims made under Section 5(21), which establishes operational debt. The law is still unclear on this point, and more regulatory guidance is needed.

Further, the responsibility of the “resolution professional” in upholding corporate values during insolvency is paramount. In accordance with “Section 25 of the IBC”, the resolution professional has the duty to ensure the

¹⁶⁶⁰ “Section 134. Financial statement, Board’s report, etc,” Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR available at: <https://ca2013.com/134-financial-statement-boards-report-etc/> (last visited March 31, 2025).

¹⁶⁶¹ “Corporate Social Responsibility (CSR) Under Section 135 of Companies Act 2013,” Dewan P.N. Chopra & Co., 2023 available at: <https://www.dpnindia.com/corporate-social-responsibility-under-section-135-of-companies-act-2013-2> (last visited March 31, 2025).

preservation of the assets' value of the company, indirectly encompassing its brand image and social responsibilities. Firms that proactively incorporate CSR into their governance systems prior to insolvency are more likely to be able to continue operations after resolution since a robust focus on social responsibility fosters public confidence and investor trust.

Additionally, the role of creditors, as stipulated under "Section 21 of the IBC", also plays a critical role in making CSR-related decisions while resolving insolvency. The "Committee of Creditors (CoC)" concentrates mainly on financial restructuring, but companies with effective CSR policies tend to be in good books of creditors and investors who appreciate responsible business practices. This has resulted in increasing awareness that CSR obligations cannot be abandoned entirely during insolvency, but incorporated into long-term resolution plans.¹⁶⁶²

Therefore, the IBC, though not specifically dealing with CSR responsibilities during insolvency, has placed great stress on governance systems that involve ethical and social considerations. Organizations that actively ensure that their CSR policies are aligned with governance principles are in a stronger position to manage insolvency without compromising their corporate image and stakeholder relations.

1.6 THE CODE'S IMPACT ON MINORITY SHAREHOLDER RIGHTS

The "Insolvency and Bankruptcy Code, 2016", has made a substantial impact on minority shareholder rights, reforming corporate governance frameworks to promote greater transparency and accountability. Minority shareholders, as "Section 2(68) of the Companies Act, 2013", defines them, typically have limited say in corporate decision-making,

rendering them most vulnerable in the process of insolvency. The IBC has made various provisions affecting their rights, both negatively and positively.

One of the most pronounced effects of the IBC on minority shareholders is suspending the board of directors under Section 17 when a company becomes insolvent. Shareholders, including minority stakeholders, lose direct control over corporate governance since decision-making authority shifts to the resolution professional and the "Committee of Creditors (CoC)". Although this is a way to ensure a organized insolvency resolution process, this also restricts the power of minority shareholders in safeguarding their interests.

Moreover, according to Section 30(4), the CoC is empowered to sanction resolution plans, generally giving precedence to financial creditors over the equity shareholders. As minority shareholders are generally not represented in the CoC, their rights in insolvency resolution are compromised. This has been a matter of concern regarding the erosion of shareholder value, given that the equity holders receive minimal to no recovery after the company is liquidated under Section 53.¹⁶⁶³

In spite of these difficulties, the IBC has also brought about provisions which are aimed at greater transparency and accountability, which incidentally favor minority shareholders. Section 29A, for example, bars defaulting promoters and associated parties from bidding for the company during the resolution process. This guards against undesirable promoters taking back control of the company at the cost of minority shareholders, thus improving the standards of governance.

Additionally, the IBC calls for resolution professionals to ensure observance of norms of corporate governance under Section 208, and hence fair disclosure of financial details. Minority shareholders gain from such a

¹⁶⁶² "Constitution of Committee of Creditors (CoC) under Section 21 of Insolvency and Bankruptcy Code 2016 (IBC)," IBC Laws available at: <https://ibclaw.in/constitution-of-committee-of-creditors-under-section-21-of-ibc/?print=print> (last visited March 31, 2025).

¹⁶⁶³ KPKTOTO, "Togel Online" KPKTOTO available at: <https://indiacorplaw.in/2023/05/shareholder-protection-under-ibc-a-myth-or-a-possibility.html> (last visited March 31, 2025).

provision as it ensures greater transparency in conducting insolvency proceedings. Where the resolution plan causes a change in management, minority shareholders also stand a chance to determine if the new management configuration is in line with their interests.

Additionally, the launch of “pre-packaged insolvency resolution” under Section 54A specifically for “micro, small, and medium enterprises (MSMEs)” has given another mechanism that could be availed by larger businesses in the future as well. The system is designed to keep the current management in control while the restructuring is being done, and it could have better solutions for minority shareholders than the conventional insolvency processes.

1.7 CORPORATE CULTURE AND ETHICAL CONSIDERATIONS POST-INSOLVENCY

The “Insolvency and Bankruptcy Code, 2016”, has created a paradigm shift in corporate culture, with a focus on ethical governance, fiscal prudence, and stakeholder confidence. After insolvency, those companies that are successfully resolved are likely to implement better governance practices to avoid future financial stress. This has resulted in a cultural shift in corporate organizations, with a focus on long-term viability over short-term profitability.

One of the principal ethical issues in the aftermath of insolvency is ensuring the responsibility of the new management towards retaining transparency. After approval of the resolution plan, according to “Section 31 of the IBC”, the company shall follow the governance structure identified in the approved resolution plan, which will comprise ensuring financial discipline, complying with the statutory requirements, and implementing ethical business operations. Companies that fail to uphold these standards risk facing insolvency proceedings again, as seen in cases where

businesses re-enter financial distress due to governance failures.¹⁶⁶⁴

Also defining corporate culture after insolvency is the role of independent directors under “Section 149 of the Companies Act”. Insolvent companies tend to bring on new independent directors to monitor governance activities to ensure ethical considerations come first. Independent directors are also crucial in reviving investor confidence by stimulating accountability and avoiding financial mismanagement.

An additional key element of corporate culture after insolvency is how employees and stakeholders are treated. Section 53 of the IBC gives preference to secured creditors for the distribution of assets, but little is usually left for claims by employees. Yet, corporations that desire to restore their image and be viable in the long term need to implement equitable labor practices, such as keeping previous promises and maintaining job security among retained employees. Ethical reasons mandate that corporations should balance profit recovery with social responsibility and institute a culture based on respect for all stakeholders.

Additionally, the IBC has asserted the significance of ethical behavior by providing for penalization of fraudulent trading under Section 66. This section acts as a deterrent against directors making fraudulent financial deals after insolvency, as fraudulent conduct against creditors or falsification of financial reports may result in legal action. Consequently, businesses that come out of insolvency are more circumspect regarding making unethical business decisions, which translates into an overall cultural shift towards responsible management.¹⁶⁶⁵

Lastly, the position of creditors in determining corporate culture after insolvency cannot be overlooked. Section 29A, which prohibits

¹⁶⁶⁴ Shakti Deb and Indrajit Dube, “Corporate ownership and insolvency law: An evidence from India,” 53 Common Law World Review 60–78 (2023).

¹⁶⁶⁵ Pooja Tidke, Krushi N Barfiwala and Rima Desai, “Section 66 of the Insolvency and Bankruptcy Code- A brief overview” Parinam Law Associates, 3 August 2022.

defaulting promoters from taking control, has ensured that companies in new hands give utmost importance to ethical decision-making. Creditors and investors expect greater governance standards from settled entities, forcing businesses to implement stronger internal controls and risk management policies.

In summary, the IBC has been a game-changer in shaping corporate culture after insolvency, injecting a higher focus on ethical governance, fiscal discipline, and stakeholder involvement. Firms coming out of insolvency with an ethical approach to business are more likely to ensure long-term prosperity and stay clear of financial adversity in the future.

