

# The Impact of Insolvency and Bankruptcy Code 2016: A Comprehensive Study

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## Abstract

Insolvency and bankruptcy have emerged as significant concerns in the global economy, impacting firms, economies, and individuals alike. Economic volatility, high corporate debt levels, industry disruptions, and inadequate financial management contribute to the escalation of insolvency risks. The COVID-19 epidemic has made these difficulties worse, leading to a surge in bankruptcy filings worldwide. In response to the need for efficient resolution mechanisms, India introduced Insolvency and Bankruptcy Code, 2016 (IBC), introduced for streamlining insolvency proceedings and protecting stakeholders' interests. While the IBC has achieved notable successes in resolving cases, challenges still must be addressed, including declining recovery rates and prolonged resolution times.

**Keywords:** Insolvency, Bankruptcy, Global Economy, Insolvency Risks, Economic Volatility, Insolvency and Bankruptcy Code (IBC), Stakeholders, COVID-19 Pandemic, Resolution Mechanisms.

## Introduction

In this digital economy and globalisation era, companies, industries, and countries have grown dependent on each other using modern economic principles for business. Companies and countries are becoming interdependent and interlinked to such an extent that if any factors negatively affect any particular economy, its ripples are felt across nations, affecting thousands of corporations and people. The best example of this is the Russia-Ukraine war; an article in the European Central Bank blog mentions that “The war triggered a massive shock to the global economy, especially to energy and food markets, squeezing supply and pushing up prices to unprecedented levels.” (Arce et al., 2023) This also caused many businesses to shut down and even exit from the war-torn countries, which affected many companies and economies across the globe. According to the World Bank’s projections as of March 2023, the conflict could burden developing economies by 70 billion USD. In developed economies like the US, the conflict will cost an estimated 1.5 Trillion USD over the next decade. (*News in Numbers: The Human & Economic Cost of the Ukraine War*, 2023) An article in National Geographic Education titled “Effects of Economic Globalization” mainly mentions the less spoken downsides of globalization on the micro industries and smaller people of the nation (Effects of Economic Globalization, n.d.).

This causes companies and businesses in the smaller industries to insolvency and bankruptcy as the jobs are outsourced to other countries to leverage economies of scale or the services are imported from foreign nations due to the availability of cheaper talent overseas. These insolvency and bankruptcy cases are affected by multiple factors and have several causes, from microeconomic and environmental conditions in the country to global factors such as recession or economic slowdown. Though the adverse effect is on

the company, the significant suffering is on the creditors, investors and the people. The solution for this is either corrective actions or developing a strategy in the early phases of bankruptcy. Still, later, in the state of bankruptcy, the ultimate resolution is liquidating the company by selling the assets and paying off the liabilities. Still, yet again, the creditors and investors are determining whether they will get the invested amount or a percentage payoff to the actual amount invested or lent to the company.

In the contemporary global economy, bankruptcy and insolvency are inevitable events that affect individuals, companies, and economies globally. To encourage entrepreneurship, preserve financial stability, and boost investor confidence, insolvency cases must be resolved quickly. Many nations have passed laws to expedite the resolution process and safeguard stakeholders' interests because they understand the need for a robust legal framework to handle insolvency and bankruptcy concerns. Chapter 11 of the US bankruptcy code in the United States of America (*Chapter 11 - Bankruptcy Basics*, n.d.), the UK Insolvency Act 1986 in the United Kingdom (Participation, n.d.-b), and the Australian Insolvency Law in Australia (Contact, 2017) are just a few examples of the many nations that have put in place appropriate legislative frameworks to handle insolvency. The Insolvency and Bankruptcy Code, 2016 governs these insolvency and bankruptcy matters in India (*Insolvency and Bankruptcy Code, 2016.*, 2016). Though the exact amount is unknown, based on the World Bank report, businesses that become insolvent and close their doors lose or sideline billions of dollars in company value, employment, and capital. Investors and financial institutions perceive risk at a higher cost of capital due to inefficient debt collection and inadequate business exit procedures. Corporate restructuring is hindered by legal and regulatory frameworks, which makes it impossible for many financially distressed but still viable enterprises to file for bankruptcy and continue operating as going concerns. Governments everywhere have been concentrating more on bolstering their credit ecosystems since the last global financial crisis, among other things, by enhancing their commercial insolvency procedures. Functional legal, regulatory, and institutional frameworks are essential for commercial banks and firms to handle non-performing loans, ease business departure and restructuring, resolve commercial disputes, and recover debts. Thus, a systematic approach to insolvency and debt settlement promotes economic growth and enhances the investment environment. (World Bank Group, 2023).

To ease the resolution and liquidation process and solve India's bankruptcy and insolvency cases. The government of India Introduced The Insolvency and Bankruptcy Code, 2016 (IBC), It is an important piece of Indian law that modifies and unifies rules pertaining to the reorganization and insolvency resolution of different organizations, including as corporations, partnership businesses, and private people. The objective was to offer a simplified and effective framework for handling situations of corporate and individual insolvency and for addressing insolvency-related concerns. The Insolvency and Bankruptcy Board of India (IBBI) (*Insolvency and Bankruptcy Board of India*, n.d.), the regulatory body in charge of implementing the IBC, provides a strong institutional foundation for it.

IBC 2016 defines insolvency as “*Insolvency is defined as a financial condition or state experienced when a legal entity or a person’s liabilities (debts) exceeds their assets, commonly referred to as ‘balance-sheet’ insolvency or when a legal entity or person can no longer meet their debt obligations on time as they become due, commonly referred to as ‘cash-flow’ insolvency.*” and Bankruptcy as “*a successful legal procedure that resulted from an application to the relevant court by legal entity or a person to have themselves declared bankrupt; or an application to the relevant court by a creditor of a legal entity or a person to have the legal entity or person declared bankrupt; or a special resolution which a legal entity files with the Registrar of Companies to be declared bankrupt*” (Taxmann, 2023).

The significance of the 2016 Insolvency and Bankruptcy Code will become clear as we go more into this topic. In addition to comprehending the shortcomings in the resolution and liquidation procedure prior to the Insolvency and Bankruptcy Code of 2016, we will also comprehend the elements causing or leading to insolvency and bankruptcy of people and organizations around the world, including India.

### Research Objective

- What effect does the bankruptcy and Bankruptcy Code of 2016 have on the adjudication of cases involving bankruptcy in India?
- What are the factors causing insolvency and bankruptcy?

### Methodology

To comprehensively understand the landscape of global insolvency and bankruptcy through a review of previously published material in blogs and news articles. We will obtain quantitative information on insolvency, creditor losses, and economic influence from trustworthy sources, such as the International Monetary Fund (IMF) and the World Bank.. The effect of the insolvency legislation and the underlying causes of insolvency and bankruptcy will be examined through this data. This research will aid in our comprehension of the pre-implementation and insolvency resolution system in India. A comparative analysis will be conducted to analyse insolvency frameworks. Insolvencies of companies across the globe will be used as examples to understand the Insolvency and Bankruptcy issues. Through this methodology and evidence-based analysis, the research endeavour seeks to contribute to a deeper understanding of the global insolvency dynamics of the insolvency frameworks. This methodology enhances the reliability and validity of the study through an in-depth analysis of all the comprehensive factors influencing International bankruptcy insolvency and the impact of the Insolvency and Bankruptcy Code.

### Insolvency and Bankruptcy a global issue

Every year, billions of dollars are lost in the form of money, people and company value due to insolvency. These insolvencies in companies always exist in every country across the globe. Before the era of globalisation, the effects of a company would be felt within that nation, but in the globalisation era, the interconnected world creates a ripple effect. It affects a series of countries and people. With globalisation, multinational companies are spread across seven continents, having multiple offices and significantly contributing to the host country's economy at the same time while having investors and creditors across the globe; if such a company is to become insolvent and head into bankruptcy, this has a negative impact across every host country and not just home country.

An understanding can be drawn from a case titled "*The Collapse of Lehman Brothers: A Case Study*" by Nick Lioudis, In this case, he speaks about the collapse of Lehman Brothers, the US investment bank ranked fourth in terms of size, during the 2007-2008 recession period and how the collapse of such a huge investment bank had a massive impact on the share market, its employees and the global economy as well (Lioudis, 2024).

Globally, the number of bankruptcy cases and insolvency filings has increased, indicative of growing market turbulence and economic volatility. The International Monetary Fund (IMF) reports that Over the past 10 years, the number of corporate bankruptcy cases worldwide has increased at an average yearly growth rate of almost 5%. Different institutional, legal, and economic factors contribute to the variations in the number of bankruptcies throughout nations. With about 60,000 business insolvencies in 2023,

France was predicted to have the highest number globally. The number of bankruptcies in China has increased significantly in the last several years, nearly quadrupling from 2015 to 12,000 in 2022. This increase reflects both modifications to bankruptcy procedures and the rise in corporate debt in China during this time. The Chinese bankruptcy code was revised in 2007, and between 2007 and 2017, courts specifically for bankruptcy cases were formed. The COVID-19 pandemic's economic effects also increased insolvencies (*Topic: Corporate Insolvencies Worldwide, 2023*).

Several businesses suffered significantly as a consequence of the COVID-19 epidemic.. For example, bankruptcies in the retail sector in the United States hit a record in 2020, and bankruptcies in Sweden peaked right after the outbreak. However, several governments provided firms with previously unseen levels of financial support, which lessened the crisis's harshest consequences. The high rates of inflation that the globe experienced in 2022 and 2023 have made matters worse for many businesses, as manufacturing costs are rising and customers are making savings. In the first quarter of 2023, over half of the Norwegian enterprises faced difficulties due to increased purchasing prices. In the UK, insolvencies among businesses rose by 50% in 2022, highlighting the effect of inflation in that year (*Topic: Corporate Insolvencies Worldwide, 2023b*). In Sweden, 700 bankruptcies were reported in November 2023. This was even more than the 578 bankruptcies recorded in the first few days following the COVID-19 pandemic in April 2020. The rising inflation rates must be considered with the rising number of bankruptcies in 2022 and 2023. The most bankruptcies were reported in the construction sector. (*Bankruptcies After COVID-19/Inflation 2023 | Statista, 2023*)

### **Factors contributing to Insolvency and Bankruptcy**

One prominent contributor is economic volatility, including recessions, business cycle swings, and market turmoil. Businesses have higher operating expenses, lower consumer spending, and dwindling income sources during unstable economic times, all of which have the potential to cause them financial hardship and insolvency. High corporate debt levels also contribute significantly to the escalation of insolvency risks. Businesses that are too leveraged or have unsustainable debt arrangements may need help refinancing, paying interest on existing debt, or fulfilling other financial responsibilities, especially during hard times. Another essential element that leads to insolvency is the disruption of the industry. Technological improvements, shifting customer tastes, and governmental changes can disrupt traditional company models, which might make incumbent players obsolete. Businesses that don't innovate or adapt to changes in the sector risk losing market share, seeing their revenues decline, and eventually going bankrupt.

The interconnectedness of the global economy, fueled by globalisation and multinational corporations, amplifies the ripple effects of insolvency and bankruptcy. The collapse of an international company can reverberate across multiple countries, affecting suppliers, customers, creditors, and economies worldwide. Risks of insolvency are also exacerbated by poor financial management. Financial mismanagement also contributes to insolvency risks; economic collapse is more likely when inferior financial management methods are used, such as insufficient risk assessment, excessive dependence on debt financing, and improper resource allocation. Insolvency risks are further increased by ineffective capital allocation, ambitious expansion initiatives, and a lack of backup plans. The global economy has been significantly impacted by the COVID-19 pandemic, exacerbating pre-existing weaknesses and causing a sharp increase in bankruptcy cases worldwide. A wave of bankruptcies and insolvencies has resulted from lockdown measures, supply chain disruptions, demand shrinkage, and liquidity issues that have adversely impacted

enterprises across industries. Taub (2023), in his article in *The New Yorker* titled “How the Biggest Fraud in German History Unravelling”, speaks about Wirecard AG, a German payment processing company, filed for insolvency amidst allegations of accounting fraud and mismanagement. The discovery that its balance sheet was missing €1.9 billion shook the financial world and eroded investor confidence. Concerns were raised over the integrity of the fintech industry as a whole, as well as regulatory supervision and corporate governance shortcomings in Germany, following the bankruptcy of Wirecard AG. This tragedy made clear how crucial solid regulatory frameworks, accountability, and openness are to preserving confidence and stability in the financial markets.

Many factors shape the global landscape of insolvency and bankruptcy, each contributing to the complex web of economic challenges businesses worldwide face. Among the leading causes of bankruptcy risks are industry upheaval, high corporate debt levels, economic instability, and inadequate financial management, all of which exacerbate financial vulnerabilities and hasten business failures. Moreover, the worldwide economy's interdependence, propelled by globalisation and multinational enterprises, intensifies the knock-on consequences of insolvency and bankruptcy, extending beyond national boundaries and impacting stakeholders throughout continents. The COVID-19 pandemic, which has raised the frequency of bankruptcy filings and shown how susceptible businesses are to unforeseen disruptions, has made these issues worse. The collapse of companies like Wirecard AG is a stark reminder of the importance of robust regulatory frameworks, accountability, and transparency in preserving confidence and stability in financial markets. Addressing these underlying issues and implementing proactive measures will be essential to mitigating the risks of insolvency and bankruptcy, safeguarding economic resilience, and fostering sustainable growth in an increasingly interconnected world.

### **India and its Insolvency and Bankruptcy Code, 2016**

As a developing country, India often provides opportunities for people to embark on entrepreneurial and business ventures to boost the nation's economy. As a result, the country is often subject to many insolvency and bankruptcy cases, which need timely resolution to safeguard the Creditors, investors and the people at large. These are the best examples from which we can understand the insolvencies and bankruptcies in India.

Once a major force in the Indian aviation sector, Kingfisher Airlines Ltd. was forced into bankruptcy in 2012 due to growing debt, difficulties running the business, and legal troubles. Several factors contributed to the airline's bankruptcy, including excessive operational expenses, fierce rivalry, and poor management. (Bhasin, 2011) Kingfisher Airlines eventually stopped and was liquidated because it could not develop a workable resolution plan despite efforts to raise money and get the airline back up and running.

The year 2019 saw the filing for bankruptcy of DHFL (Dewan Home Financing Corporation Limited), one of India's most prominent home financing organisations, due to claims of financial irregularities, loan repayment defaults, and a liquidity crisis. The bankruptcy process of the firm exposed concerns over the stability of the Indian financial system and the need for more regulatory oversight of non-banking financial companies (NBFCs). The Reserve Bank of India appointed a resolution specialist, conducted forensic audits, sold assets and held talks with creditors to help DHFL restructure its debt and continue operating. (Venkatesh, 2021)

In the past, India's handling of bankruptcy and insolvency cases has been marked by inefficiencies, hold-ups, and complicated legal procedures. Value degradation resulted from the disjointed legal system and the absence of a single insolvency rule, making it challenging to resolve cases promptly. The Indian



government recognised the need for change and enacted the Insolvency and Bankruptcy Code 2016 to address these issues and advance an open and effective resolution procedure.

### **Era Before Insolvency and Bankruptcy code**

Before enacting the Insolvency and Bankruptcy Code (IBC) in 2016, India grappled with fragmented laws and mechanisms governing insolvency and bankruptcy proceedings. These inconsistent laws exacerbated the inefficiencies and uncertainties in the settlement of insolvency cases, which frequently led to drawn-out and onerous resolution procedures. The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) (*Sick Industrial Companies (Special Provisions) Act, 1985 and BIFR*, n.d.), which attempted to treat industrial illness through the Board for Industrial and Financial Reconstruction (BIFR) (Testbook, 2024), was one of the significant pieces of legislation that preceded the IBC. Nonetheless, SICA's procedure was criticised for being cumbersome and inefficient. Although it gave banks the ability to pursue security interests in non-performing assets without the need for judicial action, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 lacked a complete framework for handling insolvency. Although the Companies Act of 1956 established winding-up processes, they were laborious and needed a framework for resolving insolvencies. Furthermore, the Recovery of Debts Due to Banks and Financial Institutions Act 1993 (RDDBFI Act) created Debt Recovery Tribunals (DRTs) to adjudicate debts. However, a comprehensive solution for insolvency is still needed. To streamline procedures and boost efficiency in India's bankruptcy system, the IBC's implementation in 2016 was a turning point in the country's insolvency resolution framework by introducing a unified and time-bound framework for insolvency resolution across several entities and sectors. (Roy, 2019)

### **Post Insolvency and Bankruptcy code**

The Government of India passed the comprehensive Insolvency and Bankruptcy Code (IBC) in 2016 to deal with the problem of insolvency and bankruptcy in a timely way. By merging and changing the rules of corporate reorganization, partnership firm, and individual insolvency resolution, it establishes a standard legal framework. Under the terms of the Insolvency and Bankruptcy Code (IBC), the Insolvency and Bankruptcy Board of India (IBBI) was created to supervise insolvency professionals, insolvency professional agencies, and information utilities involved in the bankruptcy resolution process. Establishing the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) to hear issues about corporate entities in bankruptcy and insolvency is one of the critical components of the IBC.

The time-bound character of the 2016-implemented Bankruptcy and Bankruptcy Code (IBC) necessitates stringent timelines for settling bankruptcy cases. According to the code, the adjudicating body may grant extensions, However, the process of resolving insolvency must be completed in 330 days. This clause guarantees prompt settlement, reduces value erosion, and maintains the ability of successful enterprises to continue as going concerns. The creditor-in-control system, which gives financial creditors the authority to file for bankruptcy against non-compliant businesses and take an active role in the resolution process, is the cornerstone of the IBC. Protecting their interests, maximising recoveries, and accepting or rejecting resolution plans are all crucial tasks for financial creditors, who usually own most of the debt. In addition, the IBC established specialised adjudicatory authorities to hear appeals and adjudicate insolvency issues, such as the National Company Law Appellate Tribunal (NCLAT) and the National Company Law

Tribunal (NCLT). These forums increase investor trust and confidence in the insolvency resolution procedure by offering a clear and effective means of settling bankruptcy issues. (*MERITS OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016*, n.d.-b)

### **Impact of Insolvency and Bankruptcy Code, 2016**

The settlement of several well-known bankruptcy cases, including those involving Essar Steel, Videocon Industries and Jet Airways (Ramroop, 2023), has been made more accessible by the IBC since its founding. The bankruptcy procedure in India has been reestablished, employment has been protected, troubled enterprises have been regenerated, and maximum creditor recovery has been achieved. In the World Bank's 2016 evaluation of the ease of resolving insolvencies, India ranked 136th out of 189 countries. However, by 2019, India has risen to 63rd in the index. Before establishing IBC, India had a debt collection rate of about 26% and a case closing duration of more than four years. The average recovery rate for financial creditors is 43%, and for operational creditors, it is 49%, after the suggestion to introduce IBC. (Verma, 2020)

A CRISIL Rating study claims that declining recovery rates and longer resolution times have hampered the efficiency of India's Insolvency and Bankruptcy Code (IBC). Between March 2019 and September 2023, recovery rates fell from 43% to 32%, and the average resolution time surpassed the prescribed 330 days by rising from 324 to 653 days. The principal causes of these difficulties were limited judicial bench strength and delay in recognising and addressing defaults. Significant post-IBC admittance delays have also lowered recovery rates, which has resulted in a decline in asset values and less-than-ideal recoveries. To solve these problems, the IBC changed last year, approving the segregated sale of assets and resolution plans and increasing the National Company Law Tribunal's bench count. Changes unique to a particular industry and a clause requiring corporate debtor audits. The efficacy of the IBC may be increased by expanding pre-pack resolutions to significant corporations, digitising the process, and increasing capacity, as stressed by Sushant Sarode, Director at CRISIL Ratings Ltd. In spite of these obstacles, the IBC has resolved numerous stressed assets with higher recovery rates than earlier systems, thereby enhancing India's credit culture. Since its inception in 2016, the IBC has helped resolve ₹3.16 lakh crore of debt stuck in 808 cases, with creditors realising 32% of admitted claims and 169% of the liquidation value on average (The Hindu Bureau, 2023). Nonetheless, issues with the IBC's implementation still exist, such as capacity issues among insolvency specialists, court delays, and operational bottlenecks. These issues must be resolved to fully use the IBC and improve the efficacy and efficiency of India's bankruptcy resolution system.

### **Conclusion**

In conclusion, due to the complex web of interactions and relationships that characterise the global economy, insolvency and bankruptcy have become major worries for firms, economies, and individuals globally. Insolvency risks escalate due to factors such as industry shocks, high corporate debt levels, economic instability, and inadequate financial management. These factors ultimately result in financial difficulties and business bankruptcies. These issues have been worsened by the COVID-19 Pandemic, which has increased the number of bankruptcy filings and exposed firms' susceptibilities to unanticipated shocks.

The Insolvency and Bankruptcy Code, 2016 (IBC) has been implemented in India, which has been a major step in simplifying and accelerating the resolution of bankruptcy cases. For both corporate and individual

cases, the IBC has offered a uniform and time-bound structure for resolving insolvency challenges. In order to supervise the code's execution, it has also developed a strong institutional framework, which includes the Insolvency and Bankruptcy Board of India (IBBI). Notwithstanding its successes, the IBC has had to contend with problems like declining recovery rates and drawn-out settlement times. The code is being changed to address these problems and new methods are being implemented to boost efficacy and efficiency. In order to address these problems and ensure that the insolvency resolution process runs well, the parties must work together. To manage these complex issues and lower risks while preserving global economic stability, governments, businesses, and other stakeholders must collaborate. The Bankruptcy and Bankruptcy Code (IBC) in India and similar legislative frameworks in other countries are crucial in providing an organized and transparent procedure for resolving bankruptcy cases, safeguarding the interests of creditors, investors, and the public at large.

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