

20th Annual Conference (2024) of the Italian Society of Law and Economics

Sapienza University of Rome

Department of Economics, Rome

December 18-20, 2024

Research Paper Proposal / Extended Abstract

“Unraveling the veil of Information Asymmetry in IBC: Law and Economics Approach to Mitigating Liquidation Risk”

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Unraveling the veil of Information Asymmetry in IBC: Law and Economics Approach to Mitigating Liquidation Risk

Dr. Hiteshkumar Thakkar, Khyati Maurya, Saransh Sood

PROBLEMS

The IBBI data 10 shows that only around 10% (677 of 6567) of the business insolvency cases till March 2023 resulted in a resolution plan, while 30% ended in liquidation. Only 677 of the 6567 corporate insolvency cases started under the legislation up until March 2023 have been successfully resolved¹¹. As many as 2030 matters involved liquidation orders, which account for up to 30% of the total matters while 848 concluded with settlement plans being approved. It must be noted that about 31% of the total matters (i.e. 6567) are still ongoing and have not been concluded, which points out that if all the closed matters are considered, the number of liquidations shall be much higher, at 45% of the total closed matters (i.e. 4514). Thus, it must be noted that around half of the total matters are going for liquidation. Despite the fact that the value of the remaining assets after liquidation was less than 8% of the total debt, the number of liquidations is considerably higher than the resolutions. It is known that recovery from liquidation is less than resolution still more matters are getting into liquidation this was the contradiction that authors seek to address.

OBJECTIVES

The major research objectives of this paper are to analyze the impact of perfect information on expediting the CIRP process, increasing creditor confidence, and consequently, achieving a higher number of resolutions. This, in turn, empowers operational creditors who can benefit from a more efficient and successful CIRP system. By addressing the problem of information asymmetry and implementing the proposed changes, the authors aim to improve the overall efficiency and effectiveness of the CIRP process in resolving insolvency cases and reducing the number of cases that end up in liquidation.

METHODOLOGY

The authors study the existing literature on the information asymmetry and ensuing market failure, thereafter the Microeconomic tools are applied to build a conceptual framework involving a micro-economic analysis using dynamic game-theory models of decision-making by risk-averse creditors which is formalized into a game theory model. The main proposition of the model has been corroborated using data analysis conducted based on the secondary data collected by using information from IBBI that is provided in quarterly newsletters for the fiscal year 2022–2023 . In order to do this, we use the data from the IBBI's (Insolvency and Bankruptcy Board of India) website . This data was then used for descriptive statistics and creating a regression model. The empirical evidence was formulated based on the data collected as a part of the ongoing research project titled, 'Impact assessment of Corporate Insolvency Resolution Process (CIRP) in the State of Gujarat', GNLU Faculty Seed Grant Project (2022-2023). Finally based on conceptual framework and data analysis, the recommendations are provided and findings are concluded.

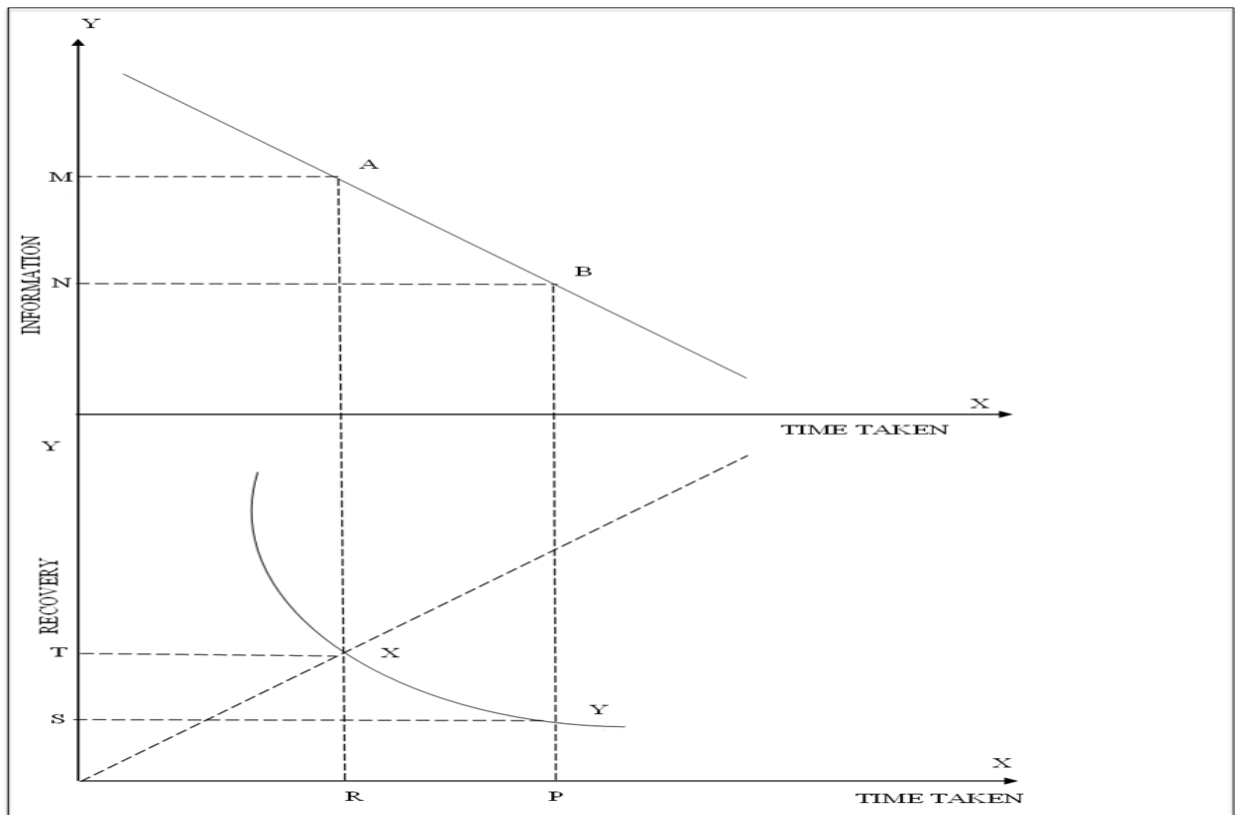
EXTENDED ABSTRACT

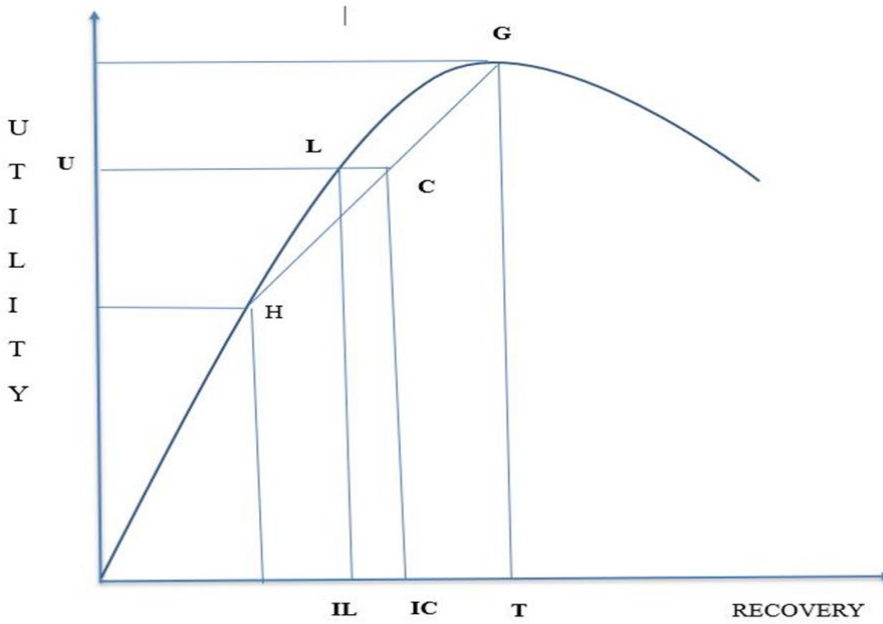
This paper focuses on examining the issue of imperfect information in the Corporate Insolvency and Resolution Process (CIRP) and its impact on the decision-making of the Committee of Creditors (COC). The authors observe that this imperfect information leads to a higher number of liquidations and lower recovery rates. As a consequence, the CIRP process, which is intended to resolve insolvency cases, only succeeds in resolving a small fraction of the total admitted cases, while most of them end up in liquidation. To address this problem, the authors propose a Law and Economics model whereby they identify the Information Utilities system and structural issues surrounding it as a key contributor to information asymmetry in the insolvency market of India. Within this context, two important factors influencing the low recovery rates are highlighted: Firstly the greater control of Financial creditors in the CIRP process, and Secondly, the lack of perfect information in the market. These factors are analyzed using the Law and Economics approach, and a conceptual framework is developed using dynamic game-theory models of decision-making by risk-averse creditors. The idea is that by enhancing the information available to creditors, confidence can be injected into the market, which in turn will reduce litigation and lead to increased certainty of recovery under the CIRP. This, in turn, should motivate stakeholders to opt for the CIRP instead of liquidation, resulting in a greater number of successful resolutions and empowering operational creditors. The dynamic game-theory models are further translated

into mathematical equations to provide a formal analysis of the proposed conceptual framework. To validate the framework in real-world scenarios, the authors perform statistical operations on secondary data. The paper's three main contributions are to provide a coherent microeconomic model on the working of Information Utilities systems and its contribution to increasing the efficiency of the CIRP process. Second, the authors have mathematically modelled the rationale behind the decisions of COC by using the utility function of a risk-averse person using the Law and Economics approach in terms of predictive equations. And third, the paper places the variables into numerical indicators for an evidence-based analysis.

Conceptual Framework :

There is a direct relation between information and amount as recovered because with increase in information levels time taken will reduce this in turn will increase the amount recovered.





Creditors are the risk-averse entities who avoid harm, by increasing the certainty of gains even when they have to compromise with the total amount of recovery. This can be understood through a total utility curve of a risk-averse creditor. Let the total amount due be OT. The amount recovered by way of liquidation, IL, but the probability for the same is very high say X. The amount recovered by way of CIRP, IC, but the probability for the same is very low say Y. Now the decision of the COC depends upon the product of the total amount recovered and the certainty or the probability of that recovery. Although the amount in case of CIRP is higher than in liquidation, the probability of liquidation surpasses that in CIRP. Therefore, the committee of creditors will decide to go for liquidation because the net product of amount recovered in term of probability will be higher in case of liquidation than CIRP, despite CIRP having other benefits of value maximization and keeping the firm as a going concern. To ensure the company goes for CIRP and is not liquidated, the certainty for such recovery needs to be increased in this scenario where the amount of search recovery by CIRP cannot be increased. So in order to increase such certainty, the confidence of creditors should be increased in the entire CIRP process, by making the company coming for resolution liable. The above analysis gives us a new dimension to analyze the behavior of stakeholders involved in the processes of IBC.

Keywords: Information Asymmetry, Game Theory, Liquidation, Information Utilities