Chapter 3
Effect of Informal and Out-of-Court Resolutions on the Post-Bankruptcy Performance of Companies:
Empirical Evidence From India

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ABSTRACT

The need for seeking a timely & cheaper resolution of distressed companies has always been the top priority for creditors & corporate debtors alike. In this regard the current study analyses the role of informal & out of court settlement on the Post-Bankruptcy financial performance of Companies. This is a sample study of insolvent companies approved for out of court settlement under section 12 A of IBC in India. In this study the effect of financial, operational & portfolio restructuring actions under out of court settlement are analysed during pre & post bankruptcy period.The outcome of this research provides strong evidence of changes due to restructuring actions.

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INTRODUCTION

Out-of-court settlement involves debt restructuring which essentially means changing the composition and/or structure of assets and liabilities of debtors in financial difficulty, with limited judicial intervention along with the objective of promoting efficiency, restoring growth, and minimizing the costs associated with the debtor's financial difficulties. An out-of-court restructuring of debt is free from judicial obligation, control or monitoring and, hence does not permanently alter, change, impair, or prejudice the legal rights of (and continuing obligations owed to) holders of debt. Restructuring activities can include measures that restructure the debtor's day to day business (operational restructuring), or efficient asset utilization (Portfolio restructuring) and measures that restructure the debtor's finances (financial restructuring). In situations of financial difficulty, the debtor and the creditors can protect their respective interests more effectively if an informal solution is implemented. An out-of-court restructuring of company avoids bankruptcy consequences for all creditors and other stakeholders, under section 362 of US Bankruptcy Code (section 14 of IBC) which provides automatic stay of payments to creditors, and possible material damage to a company's business operations and going concern value that might be caused by the stigma of Insolvency Process. An out-of-court restructuring avoids the high costs of traditional court monitored resolution including professional fees incurred by the company and creditor representatives, costs of bankruptcy-related litigation, distractions to management, the attendant costs of complying with bankruptcy reporting requirements, and judicial oversight. Insolvency Resolution Process costs can be enormous, especially if the process is contentious and litigated. Another fundamental benefit of an out-of-court restructuring is that its consensual nature reduces restructuring uncertainties and closing risks. On the other hand, a traditional (i.e., non-prepackaged, non-prearranged) bankruptcy resolution poses outcome uncertainties because these court driven cases are inherently litigious. An announced out-of-court financial restructuring that improves the company's balance sheet and liquidity leads to reduced stress or uncertainties among employees, suppliers, other trade creditors, and customers. In an out-of-court process, incumbent management continues to manage and control the company as well as the restructuring process, unless creditors demand new or replacement management as a condition of out-of-court debtholder concessions. There are various methods of informal restructuring ranging from purely contractual agreements that are enhanced by the existence of norms or other types of contractual or statutory arrangements to "hybrid procedures" where the involvement of the judiciary or other authorities is an integral part of the procedure, but is less intensive than in formal insolvency proceedings.

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