

# Insolvency and Bankruptcy Code-2016: It's Impact on the Corporate Sector of India

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DOI: <https://doi.org/10.51244/IJRSI.2026.1305000185>

Received: 20 May 2026; Accepted: 25 May 2026; Published: 08 June 2026

## ABSTRACT

The Indian Insolvency regime has undergone a historic change with the introduction of the Insolvency and Bankruptcy Code 2016. This is an umbrella laws to deal with insolvency and bankruptcy situation. Previously many laws were passed and implemented but they failed to make an impact due to frail bureaucratic and judicial procedures, and these laws were not exactly favouring the creditors. But every laws have their own importance on the basis of time and situation and depending on the implementing authorities. But this laws is paradigm shift from debtor supporting laws to creditor supporting laws, it would not only strengthen the creditor rights but also expedite the process of limitation of time period. The new law is expected to increase the confidence of the investors. but the code should be subjected to necessary improvements to evolve and become a foolproof mechanism. This law is creditor friendly and limitation of time to complete the process. So investor's confidence can develop to invest in these economical activities.

**Keywords:** Insolvency, Bankruptcy, Code, creditor, debtor, stakeholders, Regulation.

## INTRODUCTION

The Insolvency and Bankruptcy Code (IBC) 2016 is a unified, time-bound Indian law designed to resolve corporate distress, tackle non-performing assets (NPAs), and protect creditor interests. It replaced a slow, fragmented legal framework with a centralized system that prioritizes business revival over immediate liquidation. The Insolvency and Bankruptcy Code 2016, has been a game changer in the realm of economic legislations with a remarkable journey to its credit. Nearly one decade since its enactment in 2026, the code is a well-oiled apparatus today, buttressed by a thriving eco system and institutions. The implementation of the code has been facilitated by a vibrant ecosystem. The process under the code are driven by regulated professional and professional entities, comprising of about 4000 insolvency professionals, three Insolvency professional agencies, about 90 Insolvency professional Entities, 16 Registered valuers. In addition, the NeSL serves as an Information Utility to address the issues around information asymmetry in the insolvency ecosystem (IBBI, Annual Report: 2021-22). the code has rescued corporate debtors in distress through resolution and at the same time it has aided filtering out of unviable firms though timely liquidations. the code is viewed as an economic law which has brought perceptible behavioural change among debtors and has brought about a cultural shift in the dynamics and balance between lenders, borrowers, promoters and creditors.

## Bankruptcy Regimes:

In India different bankruptcy laws have been implementing from time to time on the basis of situations. India was depending on the Presidency Town Insolvency Act-1909, for implemented in the earlier presidential town Calcutta, Bombay and Madras. Provincial Insolvency Act-1920, implemented rest of India, before independence. In 1964, the Law Commission of India published its 26<sup>th</sup> Report on Insolvency Laws, which included amendments to the Provincial Insolvency Act of 1920 (Khan et. al.). The report was a result of the Government of India referring the subject of Insolvency laws to the Law Commission for consideration. The Sick Industrial Companies Act (SICA) of 1985 was a law in India that helped identify and revive companies that were struggling financially; it was introduced on the recommendation of the Tiwari Committee, the law attempted to guarantee recovery in 90 days from the date of request and a ban on exchanges (Gunturu; et. al: 2023). The law helped in

reviving the potent industries and closing the unviable industries, and liquidating the companies to invest elsewhere. Despite that, the time is taken to determine issues turned out to be considerably higher and long lasting and far reaching effects, such as loss of employment in those industries, loans of revenue to the government and a decrease in production as well. (Gunturu et. al: 2023). Subsequently, it was not that much effective, so the government introduced 'Board for Industrial and Financial Reconstruction Regulation-1987' to control the sickness of the companies. The BIFR was governed by the Sick Industrial Companies (special provisions) Act, 1985 and the Board of Industrial and Financial Reconstruction Regulations, 1987. After this law, in 1991, the Narasimhan committee recommended 'The Recovery of Debt Due to Banks and Financial Institutions Act (RDDBFI). This act was mainly focused on the Banks and other financial institutions and their increasing NPAs. This was to improve the speed at which recuperation suits were acknowledged by Banks. Debt Recovery Tribunals (DRT) were established under this Act, and the Bank would approach the DRTs for a resolutions. The DRTs had the right to pass orders that power the civil court procedures. But had constraints on the domains that they can act on, this confined the orders of DRTs. But this law barely had any impact on the Banks and their NPA's. as the NPA's of the financial institutions were still untouchables and financial institutions and their balance sheets were still facing the weight of the NPA's cycle was becoming dreary (Gunturu et al: 2023). In the year 1998 on the recommendation of the Narasimhan Committee 'securitization and Reconstruction of Financial Assets and Enforcement security Interest Act (SARFAESI) was introduced, it was enacted in the year 2002. In this Act, DRTs were used but instead of Banks approaching the DRTs, any other third parties like the borrowers, guarantors or any individuals can approach the DRTs. It bought an important change from the past .i.e., now the bank can take over the possession of assets from the defaulters, once the assets is declared as NPA, without tedious court procedures (Gunturu et al: 2023). This helps the process to smoothen a bit. NCLT was formed based on the recommendations of the Eradi Committee in 2002. This formed an umbrella structure for the companies, and NCLT act as a regulator for companies and make sure they follow rules and regulations from the government. In the year 2013, a major change in the companies Act was taken place by replacing from 'inability to pay' to 'failure to pay'. This followed the banks to clear tedious legal procedure smoothly (Gunturu et al: 2023). Before the introduction of IBC 2016, there existed a wide spectrum of insolvency regulations summarised as the Government regulations and the Reserve Bank of India (RBI) Regulations, most of which were suspended after the introduction of IBC-2016 (Abhirami, et al. p-21, 2022). The introduction of insolvency and Bankruptcy Code-2016 was a landmark changes in the corporate sector of India. This is the only bankruptcy law has taken considerations of both the parties and importance of time also. It is consolidated the archaic insolvency laws and provided unified single legislation that extensively deals with the insolvency regime in India. The legislation pertaining to insolvency are considered to be the most important as insolvency legislations involves the economical strengthening of a nation by assisting those entities which shows potential to stay in business and by paving the way for a clean exist for those which cannot be revived (Abhirami, et al. p-21, 2022). The IBC-2016 is a comprehensive compilation of laws, rules and regulations about the subject of bankruptcy law in India. It is one of the biggest economic reforms, which provides uniform and comprehensive insolvency legislation. The code is termed 'the umbrella legislation' under which all the insolvency legal frame works of the nation compile. It was formed after an elaborate understanding and reconsiderations of previous laws that governed the insolvency proceedings of the land. The objective of the code is to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals in a time bound manner. The Bankruptcy law deals with the reorganisation and liquidation of firms in case of default on contractual agreements by the concerned parties (Khan, Tanveer Ahmad). A core objective of IBC-2016 is to balance the interest of the stakeholders involved in the transactions. Its framework engages six categories of stakeholders, such as creditors, debtors, banks, Assets Reconstruction Companies (ARCs), the bond market, and the economy. With respect to the corporate insolvency system, it induces the need for the choice of the procedures of insolvency, keeping the primary stakeholders interests as the prime motive. Since a corporation has funding from equity and debt shareholders and creditors are the primary stake holders. Corporate insolvency is initiated when the corporate defaults or when the equity owners become inefficient (Abhirami. et al.. p23:2022). It may be done through either corporate insolvency resolution process (CIRP) or liquidation, and the code aims to maximise the value by striking a balance between the two. As the resolution process involves the maximisation of the values of assets and simultaneously benefits both stakeholders (Abhirami. et al.. p23:2022). The study mostly cover the demand side impacts of the bankruptcy reforms in various contexts.

## Changes made in IBC:

The newly enacted code has undergone many legislative changes. The code created its ecosystem with insolvency and bankruptcy resolution professionals and administrators in the process. The new code will work in hand with National Company Law Tribunal as it (Appellate Authority), with many benches across the country to look over the cases. The code take in to consideration of different security forms like immovable and movable properties and mortgage like simple mortgage, mortgage by conditional sale, Anomalous mortgage, etc. in the recently enacted code, any of the creditors irrespective of his claim against the debtor can file (Gunturu et al: 2023). This brings an advantage to the small scale creditors. Considering all the above aspects, the newly enacted IBC is creditor friendly in nature.i.e, it strengthen the rights of the creditors. In this paper the scholar look into the impact of strengthening creditor's rights on the stock market investor and the relationship between them. Strengthening creditor's right will affect the creditor cycles of the companies as well as the credit market breadth.

## LITERATURE REVIEW

The topic Insolvency and Bankruptcy Code-2016, brought a lot of changes in corporate sector in India. After its implementation, there is lot of reaction among the intellectual and corporate experts. So the research scholar explain some reaction here and as evidance of that statement, the scholar have to prove the intention of the subject. Here the authors, Galindo, and Micco (2004) state that 'improving the creditors right will reduce the volatility in the credit market'. It will reduce the borrowing cost of the firm thereby increasing the firm's value. La porta et al.(2000) and Bae and Goyal (2003) has mentioned that it will improve the operating leverage, operating income variability, and cash flow risk of the firms. The author Serrra Coelho, L.M.(2021) has paper talks about the US context and talks about the long term and short term impacts of pre-chapter 11 stock price abnormalities filed under the Bankruptcy Abuse Prevention and consumer protection Act (BAPCPA) code of the USA and the 1978 Bankruptcy code and performance is similar in both cases. The paper also concludes by saying that "Bankruptcies filed under the new code led to more negative post filings, and announcement period stock abnormal returns than similar event occurring under the old Act." Rimbey, Anderson, and Born (1995) reported that "compared to pre 1978 Reform Act filing the counterpart led to more negative pre-filing. Rose-Green and Dawkins (2000) stated that "liquidated firms have large abnormal returns in the year on Bankruptcy announcement date as well as on the recognition under chapter 11 date.

We look at the impact of IBC as an external shock impacting the stock market and how the investors are reacting to it. This from another can be understood as "How the investors in the stock market are reacting to the strengthening of creditor rights in the market. Creditor rights strengthening will increase the anticipated price level of the stock market. In the paper (1980), in the case of solvent firms, ex-post returns are expected to be lower than the ex-ante returns. Strengthening creditor rights in the market will have an impact on the market through two different channels: (1) Credit crunch (2) Moral Hazard:

(1) Cedit Crunch: in the paper by Hae, Razin, and Tong (2008) strengthening creditors right enhance the stock market performance in two different ways: (i) well protected creditors will lead to an increase in the stock price in a credit constrained situation. (ii) With strong protection of creditors, the probability of credit crunch leading to binding credit constraints falls. As the strengthening of creditor rights happens, the credit crunch in the market decreases. This will lead to an increase in stock prices and a decrease in volatility. The increase in stock prices will happen through two channels, 1. By diminishing the effect of credit crunch, 2. By increasing the market value of the firms in a credit crunch regime.

The volatility of the stock will also decrease through two different channels: namely, 1. The difference in the stock prices between the firms that have credit constraints and that don't will come down with strong credit rights. 2. The probability of the firms facing credit constraints will decrease with stronger credit rights kicking in.

(2) Moral Hazard: in the paper Hale, Razin, and Tong (2006) it is reported that weak creditor protection will induce risk taking ability in the managers of the firm. Pushing them to take riskier investments considering only the upper end of the returns, completely ignoring the lower end of the returns. This leads to the moral hazard.

Strengthening creditor rights will help them in influencing the firm's decision. In the paper by Nini, Smith, and Sufi (2009) it is reported that "creditors will impose restrictions on capital expenditure as the quality of credit on borrower's side decreases. This will invoke other contractual terms like collateral securities, hike in interest rates, or using the financial covenants of the firm etc. with the new restrictions in place, the operating performance of the firms are likely to improve and will increase the firm's market value". Visiria (2012) talks about the reforms in credit enforcement in the Indian context, and tells that stronger enforcement of credit will decrease the credit accessibility to the smaller firms that are borrowing and improve for the wealthy borrowers. Gopalan (2015) talk about the fast track debt recoveries and how it affects the debt contracts of the firm and its financing and assets structure. It reports that with the improvement of debt recovery firms will now look at the long term debts and reduce short term debts, firms were also decreasing the total number of banking relations, and decreasing borrowing from multiple lenders. Tanya Jain (2022) look in to the casual effect between DRTs and product innovations. The paper reports on the tangible assets of the firms and their investments, it concludes by saying that the firms with high tangible assets saw an improvement in the firm's performance in terms of profitability, sales and exports while firms with low tangible assets lost their market shares and saw a decline in their performance. With DRTs the Total factor productivity increased by 6% for the firms with high tangible assets. This explains that with enhanced creditor rights and fast-tracking of DRTs the firm with high tangible assets are performing well.

The Insolvency and Bankruptcy Code of 2016 aims to simplify the process of handling insolvency and bankruptcy process effectively. It provides a more efficient and sustainable way to recover money from debtors who default on their payments. It is a comprehensive legislation of reorganization and insolvency resolution of corporate body, partnership firms and individuals in a time bound manner. Earlier also this type of laws but that was not effectively dealing the issues in a time bound manner, so the parties were suffering a lot of problems. By doing study of the overall problems, government introduced the new law 'The Insolvency and Bankruptcy Code-2016'. The main objectives of the laws is to maximize the value of assets of insolvent entities, promote entrepreneurship, availability of credit and balance the interest of all stake holders. The code establishes a time bound mechanism for resolving insolvency cases and provides with the resolution plan. A resolution plan is a comprehensive proposal designed to address the financial crisis of a struggling company, known as the corporate debtor. This plan offers a structured approach to tackle the company's insolvency, which is its inability to repay its debts. It outlines a strategic roadmap encompassing measures such as debt restructuring, capital infusion, and operational improvements. The ultimate goal is to revive the company's financial health and enable it to meet its financial obligations. The resolution plan is subject to evaluation and approval by the Committee of Creditors, a group representing the company's lenders, before being implemented under the insolvency framework.

### **Impact of IBC on Corporate Governance:**

A total of 1797 Corporate Debtors(CDs) completed the process resulting in continuation of business, of which 480 CDs were rescued through resolution plans and 1317 CDs were saved midway into the process, through withdrawal or closure. One third of the CDs for which resolution plan was approved, were in deep distress at admission stage. In addition, 1609 CDs which were economically unviable were referred for liquidation. Three fourths of these CDs were either sick or defunct (IBBI Annual Report 2021-22). thousands of debtors are resolving distress in early stages of distress when default is imminent, on receipt of a notice for repayment but before filing an application, after filing application but before its admission, and even after admission of the application, and making best efforts to avoid adverse consequences of resolution process (IBBI Annual Report 2021-22:1). Till march 2025 more than 30,745 application, for initiations of CIRPs of CDs having underlying default of more than Rs 13.94 lakh crore were resolved before their admission. (IBBI Annual Report 2024-25:1). the code has been navigating uncharted waters for the past one decade. In this journey many mile stone have been achieved and learnt many lessons, responding to market realities the code have been amended many times since its enactment, making it one of the most dynamic legislations of recent times (IBBI Annual Report 2021-22:1).

It has significantly transformed the corporate governance landscape by emphasising the role of creditors as that of a stakeholder. And put in place strong measures to prevent directors and promoters from taking loans or alienating assets as the first signs of stress. It is also imposes civil and criminal liabilities for the erring directors of the company and has barred the promoters from being resolution applicants. The relevance of the IBC to

business practices start from the shift of power from borrowers to the creditors, it has brought a discipline in borrowing practices. The guidelines of RBI stated that the purpose of Bank loans has to be strictly met and monitored by the lenders. If a promoters divert the funds granted to him, this is seen as wilful default, which may result in the promoters not getting loans in the future. Thus, promoters are willing to pay off debts before going into the mechanism. The IBC-2016, played a significant role in bringing about behavioural changes in the creditors too. The circular by RBI on the Prudential Framework for resolution of Stressed Assets makes it mandatory for lenders to recognise incipient signs of stress in loan accounts immediately on default by classifying such assets as Special Mention Accounts (SMAs) (RBI 2019). Owing to the implementation of such stringent measures of the IBC, the borrowers are now more careful in maintaining their accounts, and the creditors are now more cooperative, thanks to the framework of the committee of creditors (COC) (Abhirami. et al.. p24:2022). The increase in the recovery rates has increased investor confidence in capital markets. A recent study using the world Bank's Doing Business data showed that lack of insolvency resolutions is one of the main drivers behind 'missing' corporate bond markets. There is a positive correlation between the recovery rate, recovery timeline, and corporate bonds- to-GDP ratio.

The insolvency regimes are a set of rules that apply to the borrowers, which help him in restructuring transactions. These regimes had been helped in initiate negotiations, as a proposed measure to recovery against insolvency proceedings. There are two different types of insolvency regimes when resolving a distressed situation, one that will support the creditors, while the other support the debtors and depending on the country's laws these regimes are crafted (Gunturu et al: 2023).

## CONCLUSION

The paper addressed the theoretical gap of strengthening creditor rights and its impact on Indian stock markets, the paper looks at the event from a theoretical point of view which has been explored very little, in the past, we have seen papers where the relationship between creditor rights and firm investment or creditor rights and managers decision making and other things were explored. But so far very few papers across the world explored the relation between creditor rights and stock markets, there is one paper there was looking at in the context by Coelho (2021) but it was looking at the stock prices of the firms before and after changes in BAPCPA. Though out the paper, we have discussed the positive aspects of strengthening creditor rights, but when we look at the negative aspects, strengthening creditor rights will increase the influence of creditors in decision making and it will be hard for the company to raise debt as debtors will have least of the control. Hence even in the company wants to, it cannot raise debt and this might take away the investment opportunities of the firm as they are completely dependent on capital. This brings us to the question of the capital structure of the firm. Hence there is a lot more to explore from this context. We can look at the capital structure of the firms that are into bankruptcy to understand the impact of creditor rights on bankruptcy etc.

## Suggestions:

In order to drive the process in a more effective and efficient way, the IBC ecosystem must also harness the use of Information Technology (IT). Presently the stake holders of IBC work in silos and have their separate fragmented technological platforms, there is need for a comprehensive IT platform that can ensure end to end integration and digitisation of the processes and serve as a single source of truth, an integrated platform can improve the outcomes of the insolvency process including minimising delays, increased transparency, increase participation of resolutions applicants, facilitation in effective decision making, maximisation of value etc. It is expected that the ecosystem comprising of professionals and Institutions will also grow in capacity and competence to meet the expectation of the market and stakeholders. Supported by the commitment of the government, the Judiciary, the IBBI and all the players of the ecosystem, it is hoped that the gains made so far will be dealt with the same commitment and alacrity as has been done since the inception of the code.

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