



Evaluating the role of insolvency and bankruptcy frameworks in enhancing startup and MSME sustainability in India

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Abstract

This study evaluates the impact of India's Insolvency and Bankruptcy Code (IBC), 2016 on the sustainability of startups and Micro, Small and Medium Enterprises (MSMEs). Employing a hybrid legal research approach integrating doctrinal analysis, empirical evaluation, and comparative legal methodology, the study finds that while the IBC has significantly strengthened India's insolvency resolution ecosystem, the outcomes for startups and MSMEs remain uneven. Structural and procedural bottlenecks, including high resolution costs, rigid statutory timelines, and limited access to interim financing, disproportionately impact smaller enterprises. For startups, the IBC's valuation mechanisms often fail to capture the value of intangible assets, leading to undervaluation and liquidation. MSMEs face challenges arising from their operational structure and limited financial resilience, with the majority of insolvency cases resulting in liquidation rather than successful resolution. Comparative analysis reveals that India can draw lessons from international insolvency frameworks prioritizing business reorganization and debtor-in-possession financing. The study concludes that while the IBC has marked a transformative shift in India's insolvency landscape, its ability to support startup and MSME sustainability remains limited by procedural, structural, and market-based constraints. Future reforms emphasizing cost-effective restructuring pathways, specialized institutional capacity, and valuation methodologies suitable for intangible-asset-driven business models are necessary to enhance the IBC's effectiveness in promoting entrepreneurial resilience and long-term economic growth.

Keywords: Insolvency and bankruptcy code, startups, micro, small and medium enterprises (MSMEs), entrepreneurial sustainability, insolvency resolution, corporate insolvency resolution process (CIRP), intangible assets

Introduction

Micro, Small and Medium Enterprises (MSMEs) and startups form a foundational pillar of India's entrepreneurial landscape, contributing significantly to innovation, employment generation, and inclusive economic development. According to the Ministry of MSME (2023) [12], this sector accounts for nearly 30% of India's GDP and employs more than 110 million people, yet it remains highly vulnerable to financial shocks due to structural constraints such as limited collateral, dependence on informal credit, and inadequate financial literacy. Prior to 2016, India's insolvency framework was widely regarded as inefficient, fragmented across multiple legislations, and plagued by excessive delays that undermined creditor confidence and discouraged entrepreneurial risk-taking. Comparative research by Djankov *et al.* (2008) [7] positioned India among the slowest jurisdictions in the world in resolving insolvency, highlighting the urgent need for systemic reform.

The Insolvency and Bankruptcy Code (IBC), 2016 represented a major legislative shift aimed at correcting this institutional weakness by creating a unified, time-bound resolution framework. Early empirical studies suggest that the IBC has contributed to improved recovery outcomes, shorter resolution timelines, and enhanced credit discipline (Sengupta *et al.*, 2019). The Reserve Bank of India (2021) similarly reported an improvement in the overall health of the banking sector as non-performing assets (NPAs) began declining partly due to the deterrent and corrective impact of the Code. Scholars have argued that the adoption of a creditor-in-control model, the establishment of the Insolvency and Bankruptcy Board of India (IBBI), and the introduction of licensed insolvency professionals have

fundamentally altered India's insolvency ecosystem, making it more predictable and market-responsive (Sengupta *et al.*, 2019).

Expanding on this, global literature has consistently shown that strong insolvency laws are positively associated with entrepreneurial dynamism. Armour and Cumming (2008) [2] observe that efficient bankruptcy frameworks reduce the cost of business failure and foster innovation by encouraging entrepreneurs to pursue higher-risk ventures with the assurance of an orderly exit if the business becomes unviable. In the Indian context, this insight is particularly relevant because startups often rely on intangible assets, intellectual property, and external funding—assets that are difficult to value in liquidation but could be preserved through effective restructuring. The literature on corporate finance and insolvency further indicates that timely resolution mechanisms enhance firm value, protect creditors and employees, and reduce the likelihood of value-destructive liquidation (Warren & Westbrook, 2009).

In the specific case of MSMEs, the IBC's impact has been mixed. The IBBI (2023) reports that although MSMEs constitute a large proportion of insolvency filings, many of these cases ultimately result in liquidation rather than resolution, suggesting structural limitations in how MSMEs engage with the insolvency process. These enterprises often lack access to qualified insolvency professionals, face difficulties obtaining interim financing, and struggle with the cost and complexity of participating in Corporate Insolvency Resolution Process (CIRP). To address these challenges, the government introduced the Pre-Packaged Insolvency Resolution Process (PPIRP) for MSMEs in 2021, reflecting global trends favoring debtor-in-possession restructuring for smaller entities. However, scholarly

reviews indicate that the uptake of PPIRP has been limited due to procedural uncertainties, creditor skepticism, and varying levels of awareness among MSMEs (Sengupta *et al.*, 2019; IBBI, 2023).

For startups, the literature highlights unique vulnerabilities. Many early-stage firms fail not due to flawed business models but due to cash-flow inconsistencies, market volatility, or funding gaps. Because startups typically hold intangible assets such as patents, software, or proprietary technology, conventional insolvency proceedings often undervalue their assets and prospects for turnaround. Studies on entrepreneurial ecosystems underscore that insolvency frameworks must adapt to these characteristics to avoid premature liquidation and the destruction of intellectual capital (Armour & Cumming, 2008) [2]. Furthermore, the role of insolvency law in shaping investor confidence becomes especially significant for startups, where risk capital depends on regulatory predictability and timely resolution mechanisms.

In the global comparative context, research shows that well-designed insolvency frameworks support business resilience by preserving going-concern value and enabling meaningful restructuring rather than liquidation (Warren & Westbrook, 2009). India's IBC aligns with several of these principles, yet persistent challenges—including uneven tribunal capacity, delays in admission, valuation inconsistencies, and the dominance of liquidation—suggest that its benefits for MSMEs and startups have not been fully realized. As India positions itself as a leading startup hub and MSME-driven economy, evaluating how effectively the insolvency and bankruptcy framework supports enterprise sustainability becomes vital. The existing literature highlights both substantial progress and ongoing gaps, demonstrating a clear need for deeper examination of how the IBC contributes to—or falls short in—enhancing long-term viability for MSMEs and startups.

Methodology

This study adopts a hybrid legal research approach, integrating doctrinal analysis, empirical evaluation, and comparative legal methodology to assess how India's insolvency and bankruptcy framework influences the sustainability of startups and Micro, Small and Medium Enterprises (MSMEs). The methodology is structured to examine both the legal architecture of the Insolvency and Bankruptcy Code (IBC), 2016 and its practical implications using publicly available data, scholarly research, and judicial developments.

Doctrinal Legal Research

Doctrinal research forms the foundational component of this study. It involves a systematic examination of primary legal materials such as the Insolvency and Bankruptcy Code, 2016; subsequent amendments; subordinate legislation; and relevant rules and regulations governing MSME insolvency, including the Pre-Packaged Insolvency Resolution Process (PPIRP). Case law from the National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT), and the Supreme Court of India is critically analyzed to trace interpretative trends and legal principles shaping insolvency outcomes.

The doctrinal method is widely recognized for its systematic and structured analysis of legal rules, facilitating clarity in understanding statutory frameworks and judicial reasoning

(Hutchinson & Duncan, 2012) [9]. Applying this method helps identify the legal barriers and enabling provisions that affect the capacity of startups and MSMEs to engage effectively with insolvency mechanisms.

Empirical Legal Analysis

To complement doctrinal findings, the study incorporates empirical legal research. This approach examines how laws and legal institutions function in practice through the analysis of quantitative data and observable outcomes. Empirical legal research is crucial in insolvency studies, particularly because formal rules often diverge from real-world implementation.

Data Sources and Variables

Data were obtained from the Insolvency and Bankruptcy Board of India (IBBI) Annual and Quarterly Reports, which provide details on insolvency filings, case outcomes, recovery rates, and resolution timelines. Indicators such as the average time taken for corporate insolvency resolution, liquidation rates among MSMEs, and success rates of resolution plans were compiled to evaluate the performance of the IBC in enabling business continuity.

Secondary datasets, including reports from the Reserve Bank of India (RBI), were used to assess the broader financial environment within which startups and MSMEs operate. These datasets help illuminate whether insolvency reforms have influenced credit availability, debtor behavior, or enterprise survival trends.

Literature-Informed Analytical Framework

Academic literature on insolvency and entrepreneurship informs the interpretation of doctrinal and empirical findings. Prior studies highlight how insolvency regimes influence firm behavior, economic efficiency, and creditor-debtor relations. For instance, Claessens and Klapper (2005) [5] examine how bankruptcy frameworks across emerging markets affect firm performance and credit markets, offering insights applicable to India's evolving ecosystem. Similarly, research by Ghosh (2025) [8] analyzes the impact of IBC reforms on bank credit behavior, providing a contextual backdrop for understanding MSME and startup financing challenges.

This literature is used to develop analytical criteria for evaluating the effectiveness of India's insolvency framework in supporting enterprise sustainability—specifically through restructuring effectiveness, timeliness, creditor coordination, and the preservation of going-concern value.

Comparative Legal Methodology

The study employs comparative analysis to contextualize India's insolvency system within global developments. Comparative methodology enables researchers to identify structural strengths and weaknesses by evaluating how different jurisdictions design and implement insolvency regimes (Siems, 2014) [7]. While the focus remains on India, selective references to international trends—such as reorganization frameworks in OECD countries—help assess whether the IBC's current design is equipped to meet the needs of startups and MSMEs, especially those with innovation-driven, asset-light business models.

Policy and Institutional Analysis

In addition to doctrinal and empirical perspectives, policy analysis is incorporated to evaluate institutional intent and

regulatory implementation. Policy analysis helps contextualize insolvency reforms within broader economic and regulatory goals, including credit market stabilization and entrepreneurial ecosystem development (Posner, 2007). Parliamentary Standing Committee Reports, RBI circulars, IBBI discussion papers, and government notifications were reviewed to trace the rationale behind reforms and identify institutional bottlenecks affecting MSMEs and startups.

Limitations of the Methodology

The study acknowledges several methodological limitations. First, firm-level microdata for MSME insolvency cases are limited in public sources, restricting granular empirical evaluation. Second, wide disparities in capacity across NCLT benches may influence case timelines and outcomes, complicating uniform generalization. Third, startups often possess complex financing structures and intangible assets that are difficult to assess through publicly available data. Despite these limitations, combining doctrinal, empirical, comparative, and policy analysis provides a robust and multidimensional methodology suitable for evaluating the insolvency framework's impact on enterprise sustainability.

Results and Discussion

Performance of IBC in Startup and MSME Resolution

Analysis of IBBI data indicates that the Insolvency and Bankruptcy Code has strengthened India's insolvency resolution ecosystem, but the outcomes for startups and MSMEs remain significantly uneven. The average time for completing Corporate Insolvency Resolution Processes (CIRPs) continues to exceed statutory limits, with many cases extending beyond 500 days despite reform efforts (IBBI, 2023). Recovery rates under the IBC have improved compared to the pre-IBC regime, reflecting global evidence that creditor-in-control models enhance the efficiency of insolvency outcomes (Claessens & Klapper, 2005) [5]. However, for MSMEs, a majority of CIRP cases continue to result in liquidation, revealing structural difficulties in sustaining resolution plans for smaller enterprises (IBBI, 2023).

Creditors' roles also shape outcomes. Financial creditors (primarily banks) dominate the Committee of Creditors (CoC), but startups and MSMEs frequently depend more heavily on operational creditors such as suppliers. Since operational creditors lack voting rights in resolution decisions unless they become financial creditors, many smaller enterprises face disadvantages in negotiations, reducing their likelihood of successful restructuring. These challenges align with global findings that creditor composition frequently influences restructuring viability, especially for smaller, cash-constrained firms (La Porta *et al.*, 1998) [13].

Startups, meanwhile, exhibit unique patterns due to their dependence on intangible assets and venture capital structures. With limited tangible collateral and uncertain cash flows, startups struggle to attract resolution applicants and often exit the insolvency process without reorganization. This reflects well-established literature on the difficulties of valuing innovation-driven, intellectual property-heavy firms through standard insolvency mechanisms (Baird, 1993) [4]. These results suggest that while the IBC has improved system-level functioning, it has yet to meaningfully support distressed startups or MSMEs through effective and sustainable reorganization pathways.

Legal and Procedural Barriers

Findings indicate that structural and procedural bottlenecks within the IBC framework remain critical barriers for smaller enterprises. Resolution costs—including insolvency professional fees, valuation expenses, and litigation-related costs—often exceed the financial capacity of MSMEs and early-stage startups. This aligns with empirical studies showing that insolvency costs disproportionately burden small firms, pushing them toward liquidation rather than restructuring (Alderson & Betker, 1996).

Rigid statutory timelines, though intended to ensure efficiency, often conflict with the realities of overburdened NCLT benches, resulting in procedural delays and frequent extensions. Judicial congestion increases uncertainty for both debtors and creditors, ultimately reducing the likelihood of value-preserving resolutions. Similar institutional capacity constraints have been identified globally as key determinants of insolvency effectiveness (Djankov *et al.*, 2008) [7].

Distress financing remains another challenge. MSMEs and startups find it difficult to secure interim finance during insolvency due to limited assets and perceived risk. Additionally, valuation disputes—especially for tech-driven startups—delay bidding processes and reduce the attractiveness of distressed companies for resolution applicants. These findings reinforce established research that illiquid and difficult-to-value firms face disproportionately low recovery prospects in insolvency proceedings (Warren & Westbrook, 2009).

Startup-Specific Issues

Results show that the IBC framework often fails to accommodate the structural and financial realities of startups. The most significant barrier is the valuation of intangible assets such as intellectual property, proprietary technology, and digital platforms—assets that traditional liquidation frameworks undervalue due to uncertain income potential. Research highlights that insolvency systems designed around tangible assets inherently disadvantage IP-heavy firms (Baird, 1993) [4], a finding consistent with the patterns observed in Indian startup insolvencies.

Founder liability concerns also influence outcomes. Many startups rely on personal guarantees for obtaining early financing. Once insolvency proceedings begin, personal insolvency risks deter founders from pursuing restructuring, thereby accelerating shutdowns. Additionally, the scarcity of insolvency professionals with experience in handling high-growth, venture-backed firms contributes to procedural inefficiencies.

Cross-border funding adds another layer of complexity. Startups commonly rely on foreign equity or convertible instruments, but insolvency proceedings often struggle to integrate such capital structures within domestic insolvency priorities. These challenges mirror global concerns regarding the misalignment of modern startup financing models with traditional insolvency regimes (Armour & Deakin, 2001) [3].

MSME-Specific Issues

MSMEs face distinctive challenges arising from their operational structure and limited financial resilience. Section 240A of the IBC provides certain relaxations for MSME promoters—allowing them to submit resolution plans despite prior defaults—but this exemption has not

significantly altered liquidation trends. Many MSMEs lack the financial resources to craft viable plans or secure interim financing during CIRP.

The introduction of the Pre-Packaged Insolvency Resolution Process (PPIRP) in 2021 aimed to provide a faster, less disruptive restructuring mechanism. However, adoption rates remain low due to creditor hesitation, lack of awareness, and insufficient clarity on implementation procedures (IBBI, 2023). These limitations align with international findings showing that pre-pack frameworks succeed primarily in jurisdictions with mature restructuring cultures and stable creditor coordination (Skeel, 2003) ^[19].

Access to credit continues to be constrained during distress periods, and MSMEs often possess weaker bargaining power relative to secured creditors. This imbalance results in reduced likelihood of going-concern preservation, mirroring outcomes observed in other emerging economies (Claessens & Klapper, 2005) ^[5]. The cumulative results indicate that while policy reforms exist, MSME sustainability under insolvency conditions remains fragile.

Comparative Legal Insights

Comparative analysis reveals that India can draw meaningful lessons from international insolvency frameworks. The U.S. Chapter 11 model prioritizes business reorganization and debtor-in-possession financing—tools that help preserve going-concern value and encourage entrepreneurial resilience. Studies show that Chapter 11's flexible restructuring mechanisms enable small enterprises and innovative firms to remain operational during insolvency (Warren & Westbrook, 2009).

Singapore's simplified insolvency program provides another relevant model. Designed for micro and small companies, it reduces procedural complexity and cost barriers, enabling quicker restructuring for distressed businesses. Such frameworks emphasize accessibility and cost proportionality—factors crucial for MSMEs in India.

These comparative insights highlight that India's insolvency regime would benefit from enhancing reorganization pathways, expanding access to interim funding, and building specialized insolvency capacity to support smaller firms.

Impact on Business Sustainability

Results indicate that predictable and efficient insolvency mechanisms positively influence investor confidence, credit market stability, and entrepreneurial activity. By reducing uncertainty associated with business failure, a functional insolvency framework encourages risk-taking—a critical factor in startup-led innovation (Armour & Cumming, 2008) ^[2]. For MSMEs, insolvency certainty helps maintain relationships with suppliers, lenders, and customers even during distress, mitigating business disruption.

However, the persistent liquidation bias, procedural delays, and structural limitations within the IBC framework continue to restrict its ability to preserve jobs, protect assets, and ensure continuity for smaller enterprises. This aligns with global research showing that insolvency reforms must evolve continually to meet the needs of complex and innovation-driven business environments (Jackson, 1986) ^[11].

Overall, while the IBC has significantly strengthened India's insolvency landscape, its effectiveness in enhancing sustainability for startups and MSMEs depends on further calibration toward flexibility, cost accessibility, and reorganization-centric procedures.

Conclusion

The analysis demonstrates that the Insolvency and Bankruptcy Code (IBC), 2016 has significantly strengthened India's institutional framework for resolving financial distress by improving recovery rates, enhancing creditor confidence, and reducing systemic inefficiencies that previously characterized insolvency proceedings. These developments are consistent with global evidence that creditor-oriented and time-bound insolvency regimes promote financial discipline and improve the functioning of credit markets (Claessens & Klapper, 2005; Djankov *et al.*, 2008) ^[7]. However, despite these improvements at the macro level, the study finds that the benefits of the IBC have not been evenly distributed, particularly for startups and Micro, Small and Medium Enterprises (MSMEs) that form the backbone of India's entrepreneurial ecosystem.

For startups, the IBC's emphasis on traditional valuation mechanisms and tangible assets often results in the undervaluation of intellectual property-driven business models. This challenge reflects long-standing observations in insolvency literature that innovation-intensive firms struggle within conventional liquidation-oriented frameworks (Baird, 1993) ^[4]. Additionally, the complexity of capital structures, prevalence of personal guarantees, and cross-border investor relationships make it difficult for startups to participate effectively in the Corporate Insolvency Resolution Process (CIRP). As a result, early-stage ventures frequently exit through liquidation or withdrawal rather than meaningful restructuring.

MSMEs, meanwhile, continue to face operational and financial constraints that hinder their engagement with formal insolvency mechanisms. Despite statutory relaxations such as Section 240A and the introduction of the Pre-Packaged Insolvency Resolution Process (PPIRP), liquidation outcomes remain disproportionately high, indicating that existing procedural flexibilities may be insufficient to overcome structural barriers. These findings align with international evidence that small enterprises often lack the bargaining power, resources, and credit access necessary for successful reorganization (Alderson & Betker, 1996). Limited access to interim financing, judicial delays, and high-resolution costs exacerbate these challenges, reducing the likelihood that MSMEs can preserve going-concern value during distress.

Comparative insights further underscore the need for reform. Jurisdictions such as the United States and Singapore demonstrate that simplified, reorganization-centric models—supported by debtor-in-possession financing, flexible restructuring mechanisms, and specialized legal infrastructure—can significantly improve outcomes for smaller firms (Skeel, 2003; Warren & Westbrook, 2009) ^[19]. Aligning India's insolvency approach with these principles could strengthen business continuity, reduce liquidation bias, and enhance the resilience of innovation-driven enterprises.

Overall, the findings suggest that while the IBC has marked a transformative shift in India's insolvency landscape, its ability to support startup and MSME sustainability remains limited by procedural, structural, and market-based constraints. To realize the full potential of the IBC, future reforms must emphasize cost-effective restructuring pathways, specialized institutional capacity, improved access to distressed financing, and valuation methodologies suitable for intangible-asset-driven business models. Such

reforms would not only align India's insolvency regime with global best practices but would also contribute meaningfully to economic continuity, employment preservation, and long-term entrepreneurial vitality.

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