

Nudging in IBC: Behavioral Perspective

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Abstract— The enactment of Insolvency and Bankruptcy Code (IBC) was an economic reform in India. The code came into force from 2016. The enactment of IBC was a major reform in the corporate world. The IBC structured and focused on the exit mechanism for corporates and ease of doing business in India. The code welcomed a cultural shift in many aspects of businesses. We can consider that the code is emerging as a behavioral law with the intention to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote Entrepreneurship, availability of credit and safeguard the interests of all the stakeholders. The code is leveraging default rules, which is a behavioral principle given the anchoring bias of individuals by providing default choices to the economic agents such as maximizing their welfare and the society as well. The word nudge has captured in the corporate world and nourishing to accelerate the advance of behavioral science into the corporate mainstream. As nudge units growing up in the private sector, they are helping companies to promote change and increase productivity.

Index Terms: IBC, Exit mechanism, ease of doing business, default, behavioral principle, Nudge

INTRODUCTION

The Insolvency and Bankruptcy code is a one stop solution for resolving insolvencies, which previously was a long process that did not offer an economically viable arrangement. The code aims to protect the interests of small investors and make the process of doing business less cumbersome. The Insolvency and Bankruptcy Code, 2016 is one of the path-breaking economic reforms introduced by India

- IBC promises a better and painless procedure for restructuring or reorganization of firm's debt and also speed up the liquidation of a failing business and efficient recovery of creditor's investment.

- IBC introduced the much awaited and much-needed creditor driven procedure for resolving insolvency and bankruptcy

Key features of IBC

- The Code brings a paradigm shift from “Debtors in possession” to “Creditors in Control”
- Insolvency test moved from “erosion of net worth” to “payment default”
- Single insolvency and bankruptcy framework. It replaces/modifies/amends certain existing laws & Time bound resolution process at each stage
- Establishment of Insolvency and Bankruptcy Board-a regulator as an independent body
- A clearly defined distribution of recovery proceeds
- Insolvency Professional to take over management and control of the Corporate Debtor
- Government dues would rank below the claims of other creditors
- Have provisions to deal with concealment, fraud and /or manipulation leading to fine and/or imprisonment
- Provide confidence to Lenders and Investors in the debt market

What is Nudge Theory?

The principles of ‘nudge theory’, first enunciated by James Wilk around 1995, it is rediscovered by legal scholar Cass Sunstein and the Nobel Prize-winner & behavioral economist Richard Thaler in their renowned book ‘Nudge: Improving Decisions About Health, Wealth, and Happiness’ in 2008. Nudges can be used by both businesses and government to shape the behavior of employees, customers, and citizens. Nudge theory is an indirect approach and helps to modify situations for people & their behavior in a particular direction, more effectively encourages positive choices rather than trying to restrict undesirable behavior with some kind of sanctions.

A nudge is a precise intervention that doesn't eliminate free choice. It's about creating 'choice architecture', which is simply a better environment for decision-making. It's based on the assertion that people tend to make decisions quickly and under pressure, and that many of are guided by biases and psychological fallacies.

Nudging is the systematic and evidence-based development and implementation of nudges in creating behavior change. Today the field of 'nudging' as a discipline and is increasing in its influence on public policy and behavior change strategies across the world.

The Nudge theory is a way of offering small clues that support decision-making. It's not about penalizing people financially or limiting their freedom if they don't act in a certain way. Instead, it is about making it easier for them to make a certain decision.

Building Choice Architecture -Nudging works on the principle that small actions can have a substantial impact on the way people behave – and it creates 'choice architectures' for these actions that encourage (but don't force) people to make better decisions.

The World Bank, UN, OECD and EU have also established nudge units, as have high-profile companies such as Swiss Re and AIG. Their focus is on influencing people's behavior using insights drawn from economics and psychology, rather than trying to push people into doing things using threats or regulations.

According to Thaler three principles should guide the use of nudges:

- 1 All nudges should be transparent and never misleading
- 2 It should be as easy as possible to opt out of the nudge
- 3 There should be good reason to believe that the behavior being encouraged will improve the welfare of those being nudged.

Nudge theory is a flexible and modern concept for:

- Understanding of how people think, make decisions, and behave,
- Helping people improve their thinking and decisions,

- Managing change of all sorts, and
- Identifying and modifying existing unhelpful influences on people.

The Behavioral Insights Team use the EAST acronym when it comes to effectively stimulating behavioral change: Easy, Attractive, Social and Timely.

Nudging in IBC : Behavioral Perspective

- Law Vs Behavior of humans - According to Pound's theory of 'social engineering', law is an attempt to mold the behavior of humans. Its effectiveness can be judged by the behavioral changes it is able to bring about.
- Ease of doing business- The enactment of IBC itself is a nudge. It is simplification of legal procedure. Indian Government transformed norms and changes in the policy structure of IBC (Insolvency or Bankruptcy Code) leads to ease of doing business.
- Value Maximization- in IBC liquidation or recovery is an outcome of the market forces; the law is only an enabler giving choices and nudging a company towards value maximizing outcomes. The stakeholders decide whether to seek resolution and, if so, the mode of resolution. They weigh various options and choose the one that best suits their needs. They will not use the code if they find that the outcome under it is not consistent with market realities. When they use the code, they have a choice between rescue and liquidation. The "invisible hands" of the market works towards the best outcome.
- Going Concern - The Primary focus of the legislation is to ensure Revival and continuation of the corporate entity by protecting it from its own management and from death by liquidation
- Time bound resolution -IBC is providing a framework for early recognition reporting and time bound resolution of stressed assets. The code is absolutely voluntary and safeguards the interests of all stakeholders
- Providing convenient choices to stakeholders - The code affords convenient choices in the form of providing two way solution to the stakeholders. Firstly – it provides automatic choice of resolution and secondly it serves them

a choice to exit by providing withdrawal mechanism

- Code jurisprudence – code is problem solver to debtors and creditors. The code provides creditors a chance to assess the viability of the corporate debtor –IBC has nudged the behaviors of debtors and creditors and this has resulting substantial recoveries for creditors .
- Freedom to Exit mechanism-By providing a market mechanism for the rescue of a failing yet viable firm or by freeing up resources through liquidation of unviable firms, the IBC provided the “ultimate freedom” to exit.
- Leveraging default rules- With IBC non-repayment of loan is no more an option and ownership of the firm is no more a divine right and equity is no more the only route to own a firm. Now the process is time bound, fair & Equitable, ensuring highest recovery.
- Emphasizing social norm -Taking a signal from ‘failure bias’ of individuals, the code talks about ‘Emphasizing social norm’ to enhance good behavior by focusing on influencers that people can relate to.

Our ancient scriptures have guidance to offer in respect of the borrowing behavior, saying:

अग्निशेषम् ऋणशेषम् शत्रुशेषम् तथैव च ।

पुनः पुनः प्रवर्धत तस्मात् शेषम् न कारयेत् ॥

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Meaning - ‘If a fire, a loan, or an enemy continues to exist even to a small extent, it will grow again and again; so do not let any one of it continue to exist even to a small extent.’

- Promoting Entrepreneurship - IBC has introduced competition for entrepreneurship and capital. It encourages entrepreneurs to compete with one another to utilize the resources locked up in inefficient or defunct firms.
- IBC and Credit culture -IBC has created a credit culture that discourages defaults. The practice of dragging lenders to court to delay the repayments of outstanding loans is slowly coming to an end. India’s Insolvency and Bankruptcy Code is ensuring that lenders get repaid on time and this is making India a more attractive investment destination.

- Establishing and amending the laws associated with reorganizing and resolving the insolvency of entities

Applying Nudging in Business Management

The relatively new concept of nudging can help businesses do everything from boost staff engagement to increase market share by subtly indicating which choice to make. For many businesses, overcoming indifference and getting clients, customers or employees to behave a certain way is an ongoing challenge. The solution is to give them a nudge.

The word nudge has captured in the corporate world and nourishing to accelerate the advance of behavioral science into the corporate mainstream. As nudge units growing up in the private sector, they are helping companies to promote change and increase productivity on the factory floor, design better products, drive higher sales, and enhance decision-making processes . Nudge units create win-win outcomes for companies, employees, and customers. There is a huge potential when applying the Nudge theory in sales and marketing.

Nudging to pay taxes- Reminders and a simplified language help tax authorities to collect outstanding tax payments more efficiently. Early reminders are especially attractive from a tax collector’s perspective.

CONCLUSION

Nudging is still its inception stage. It gives positive outcome if properly implanted in identified areas. Nudging is necessary during existing situations to Governments, Businesses, and educational institutes and also for human beings. Nudge units create win-win outcomes for companies, employees, and customers. There is a huge potential when applying the Nudge theory in sales and marketing. The objective is to encourage regulation that is designed to be efficient, accessible to all and simple to implement. Law or rather regulation making has gone one step further to imbibe the behavioral principles into achieving the desired economic outcomes, leading to maximization of social welfare. The Code tests positive on all these fronts and is slowly and progressively ‘nudging’ its way towards achieving its statutory objectives

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