The Economic Times – Two Merger Cast a light on Governance, and its chinks – 11.04.2022

SOME SEE A NEED TO TIGHTEN LAX REGULATIONS AND ZERO TOLERANCE FOR PRICE-SENSITIVE INFO LEAKS

Two Mergers Cast a Light on Governance, and its Chinks

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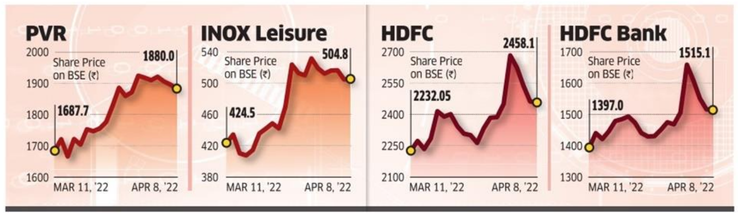

ET Intelligence Group: Corporate India witnessed two large merger announcements in the past two weeks: of PVR-Inox and HDFC-HDFC Bank. In the first instance, two listed entertainment companies, PVR and Inox, announced their merger to form India's largest multiplex chain. In the second, HDFC and HDFC Bank said they would merge in a deal that would create the world's sixth most valuable lender.

While the latter announcement took the Street by surprise, the market seems to have had a prior inkling of the PVR-Inox deal. The stocks of both PVR and Inox intraday surged 5% and 12%, respectively, hitting their 52-week highs on Friday, March 25, ahead of the merger announcement on Sunday, March 27. In contrast, the HDFC twins — both members of the Nifty50 index — did not post any extraordinary price movements before the merger announcement this Monday.

These contrasting incidents point to two aspects of corporate governance. One is the need for better protection of price-sensitive information, especially during large corporate actions like mergers and acquisitions. Secondly, it is possible for large companies working with a battery of lawyers and senior advisers to keep price-sensitive information confidential, as demonstrated by the latest case of the HDFC merger.

"The HDFC merger announcement was a real surprise for everyone in the stock market," said G Chokkalingam, founder of Equinomics Research. "It shows that the management has been brilliant in keeping the price-sensitive information confidential — a tough job given the large number of people involved. While setting an example for others, such conduct also helps companies in the long run," he said.

Volatility and price action in stocks ahead of a corporate action are fairly common, given the challenge of having all the parties involved to maintain high governance and confidentiality standards.

"The leakage of information is an issue of the character of the individuals and result of a slow, ineffective and inefficient judicial ecosystem," said JN Gupta, managing director of proxy advisory firm SES and a former executive director of Sebi. "The process of penalising is so cumbersome and long and riddled with failure that nothing happens. Penalties are nominal and there is no zero-tolerance for price-sensitive information getting leaked," he said.

Research has shown the business environment in developing markets like India is typically characterised by inadequate disclosure and weaker enforcement of securities regulations. Information leakage is common when it comes to corporate actions like mergers and acquisitions, and it is for the market regulator to tighten the lax regulations.