

# Scams That Changed India's Capital Market

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## Abstract

**Purpose of the Study:** The present paper covers a brief historical evolution of Capital Market in India and detailed study and factual analysis of the most critical scams which had hit the Capital Market in India. Furthermore, the paper also discusses the reasons and loopholes in the regulatory framework for such scams to take place. The paper finally examines the implication of such scams on Indian Financial Market and various reforms taken up by the Government of India, Securities and Exchange Board of India (after this SEBI) and Reserve Bank of India (RBI).

**Methodology:** Descriptive and analytical methodology is adopted in the present paper. The present paper has relied upon primary sources, like statutes and committee reports, and secondary data primarily gathered from books, journals, magazines, newspapers, websites, and other related reliable sources.

**Principal Findings:** Capital Market in India is under-developed and small when compared to other developing economies of the World. The main reason for such under-development of Capital Market in India is the lack of trust, which investors have on the Capital Market. One of the most prominent reasons for lack of confidence is the scams, which shook the roots of Capital Market in India.

**Application:** The present paper has significant application in the field of securities laws, capital market and the role of financial market regulators, like RBI for banks and SEBI for the capital market, to check malpractices.

**Novelty:** The present paper talks about, two of the most controversial and talked about scams of India's Security Market, i.e. Harshad Mehta scam and Ketan Parekh scam, which happened right under the nose of SEBI and RBI. These scams changed the picture of India's Capital Market. Both these scams shook the soul of Dalal Street and led to unaccountable losses to the small and retail investors. Many of these small and retail investors became bankrupt, which forced many of them to commit suicide. Both the scams were unearthed by the renowned journalist Ms. Sucheta Dalal. The scams exposed the loopholes in India's Banking Sector and Capital Market.

**Limitation:** The present paper limits itself to study Harshad Mehta Scam and Ketan Parekh Scam. The paper factually analyses the impact of these scams on the banking sector and the capital market in India.

**Keywords:** Capital market; Banking sector; Retail investor; Regulator; Scams; Harshad mehta; Ketan parekh

## Introduction

### Historical Evolution of Capital Market in India

The capital market and stock exchange in India historically dates as back as almost 200 years. The Calcutta Stock Exchange was the first stock exchange of India, which was founded in 1830 (which was later incorporated in 1908). The first stock exchange was established in Calcutta. However, the nerve center of the capital market in India has always been Bombay. The Indian capital

market is the oldest in Asia. The earliest records relating to the Indian capital market are obscure, limited and meagre. However, by the end of the 18th century, majorly the trading in the loan securities of East India Company was taking place. Moreover, it was not until 1830; the term "broker" emerged in India. When a group of six people called themselves 'share-broker'. Gradually, the number of brokers grew with time. By 1830s, the trading in the shares of the Banks commenced. By 1850s, the trading in the securities of East India Company and the shares of the banks initiated under a sprawling 'Banyan Tree' which is located in the

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present-day 'Horniman Circle Park', Mumbai. The enactment of the Companies Act, 1850, introduced the limited liability for a corporate entity. It resulted in the growth of the modern-day company. In turn, this further encouraged greater participation of companies in the Indian capital market. The American Civil War, which broke out in 1861, resulted in cutting off the supply of cotton from the United States of America to Europe. Thus, forcing European textile industries to look towards India. It caused an increase in demand and a rise in prices of cotton in India. The sudden increase in demand for cotton led to wealth creation in India. It occasioned the establishment of several new companies in India. Similarly, the opening up of the Suez Canal in 1869, led to an increase in exports to the United States of America and the United Kingdom. It further facilitated the formation of several new companies in India. The shares of many of these companies were traded on various stock exchanges in India. There was a change of wind when the American Civil War ended in 1865. The investors to reinvest in the American capital market rushed to the Indian capital market to sell their scripts, allotments and shares. However, there was no one ready to buy these securities. Thus, the bubble which had formed over 30 years, just busted leading to depression. The depression paved the way for a formal market in the form of Bombay Stock Exchange which was established in 1875 on the Dalal Street in Bombay. In 1887, "Native Share and Stock Brokers' Association" was created, ensuring that only native Indian could be a broker on Bombay Stock Exchange.

### **Pre-Independent Capital Market in India**

The Capital market in India was majorly unregulated in India till the enactment of the Bombay Securities Contracts Control Act, 1925. The Indian Capital Market could not develop in the pre-independent era because there were very few Indian Companies. Besides, the securities which were traded on the Stock Exchange were negligible. Moreover, the British or foreign companies which were running in India preferred the European capital market to raise funds rather than the Indian Capital Market. Thus, the large part of the pre-independent Indian capital market was dominated by the securities backed by the Government.

### **Post-Independent Capital Market in India**

The British Government in India during the Second World War introduced the Controller of Capital Issue under the Defence of India Act, 1939. The primary purpose for the appointment of the Controller was to channelize resources to support Britishers in War. The Controller was retained after the War with certain modifications. The main object was to control the raising of capital by the companies in India and to ensure the use of national resources to serve the goals and priorities of the Britishers in India. At the same time, also protect the interest of the investors. In April

1947, the relevant provisions of the Defence of India Act, 1939, were enacted into the Capital Issues (Continuance of Control) Act, 1947. In 1950, the Constitution of India put the stock markets and forward market under the exclusive domain of the Parliament. As a result, the Securities Contracts (Regulation) Act, 1956, was enacted by the Parliament. The Securities Contract (Regulation) Act, 1956, was based on the recommendations of the A. D. Gorwala Committee of 1951. The Securities Contract (Regulation) Act, 1956, was enacted to empower the Government of India with control over all relevant aspects of securities in India. It included the trading of securities on the stock exchange, preventing undesirable transactions on the stock exchange and effective functioning of stock exchanges in India. Till 1992, the Indian capital market was highly regulated by the Controller of Capital Issues (CCI). The Controller of Capital Issue (CCI) closely supervised and controlled the timing, composition, interest rates, pricing, allotment and flotation costs of new issues. Finally, in May 1992, the Capital Issue (Continuance of Control) Act, 1947, was repealed. All controls on raising of capital from the market were removed. In 1992, after the Capital Issue (Control) Act, 1947 was repealed, the SEBI Act, 1992 gave SEBI, which was established in 1988 statutory status. SEBI was made the regulator of the capital market in India. The primary role of SEBI was to ensure that safe transactions of security take place on the securities market. At the same time, promote and develop the securities market in India. SEBI was also entrusted to protect the interest of the investors and regulate the securities market in India.

### **Present Status of Capital Market in India**

The capital market in India is part of the broader financial market. Various financial instruments like equity, bonds, derivatives and other financial instruments are traded between the financial players. There are majorly two types of securities market:

1. 'Primary Market' where the securities are sold for the first time by the companies or corporations to the public, e.g., Initial Public Offer (IPO) or Follow-up Public Offer (FPO).
2. 'Secondary Market' where the previously issued securities are traded by the seller and buyer, e.g., the trading of shares on the stock exchange.

The capital market and market capitalisation to GDP ratio in India have been growing at a relatively slower speed when compared with other leading nations of the World. It could be seen from the Table-1 given below. As could be seen in Table-1, that market capitalisation of India is less than most of the developed and economically powerful countries like USA, Japan, France (thus, the market capitalisation of India will be less than EU as a whole as well) and Canada. Besides, the market capitalisation of India is even lower to comparable developing countries like China and Hong Kong. India has one of the smallest market capitalizations to GDP ratio when compared among the top ten most capitalist

nations in the World. Thus, it could be inferred that the Indian capital market is small when compared with other major economic powers of the World. The reasons for the comparatively small capital market in India are high costs for companies to go public, regulatory constraints and disclosure requirements, speculative nature of the capital market in India, lack of regulatory reform, unstable Government policy or at times policy paralysis and absence of effective investor protection measures. Investor protection is the most important aspect to facilitate the growth of the capital market in India. It would boost the confidence and trust of investors and also encourage companies to seek public money. The factors which have a bearing on the interest of investors in India are insider trading, price rigging, lack of transparency, market volatility, systematic risks, unethical practices and the most prominent being capital market scams.

### Capital Market Scams in India

The relatively small size and weak regulatory framework of the capital market in India make it prone to scams. In India, we have regulatory over-lap which lead to diffusion of responsibility- thereby leaving exposed regulatory loopholes which are exploited by unscrupulous elements. The Merriam-Webster dictionary meaning of 'fraud' is 'a fraudulent or deceptive act or operation'. 'When an unlawful act is done by a bunch of people which is against the statute and the government is unaware', then it is called 'conspiracy'. However, 'when the unlawful act is done, which is not only within the awareness of the administration but which the administration not only encourages but also nurtures', then it is called 'scam'. Capital Market scam refers to the deceptive practices in the stock market to induce an investor to make such purchase or sale decision which may not be in their best interest and are based on false or manipulated information. The purchase or sale decisions made by the investor usually results in a financial loss to such an investor. These deceptive practices of spreading false or manipulated information tend to violate Securities Laws. The Financial Market Scams or the Capital Market Scams is not uncommon in the World. India is not insulated from such Financial Market Scams or the Capital Market Scams. These Financial Market Scams or the Capital Market Scams have shaken the foundation of Dalal Street. They have caused much financial distress to retail investors and resulted in the loss of hard-earned money by a common man. Some of the most infamous scams which shook the stock market in India are [1].

- Harshad Mehta scam (1992), which was the bank and securities scam in which Mr. Harshad Mehta was engaged in price rigging and other gray market activities.
- M. S. Shoe scam (1995), which was masterminded by an exporter Pavan Sachdeva, who rigged up prices of shares, eventually leading to the crashing of the stock market.

- C. R. Bhansali scam (1997), in which Mr. C. R. Bhansali, a chartered accountant positioned his company 'CRB Capital Markets' as a unique financial organisation with excellent prospects. Thus, lured investors to part with their money and risk their future. Mr. Bhansali used these large deposits to rig prices in the stock market and made profits at the cost of others.
- UTI scam (2001), in which the encashment of Unit Scheme-1964 (US-64) was stopped by the RBI, which was one of the most popular and prominent schemes of UTI. The Ketan Parekh scam and other circumstances led to the crashing of the share market, resulting in inevitable erosion of US-64 value. It caused panic among investors, and they started encashing their units. However, the artificial pricing mechanism and accounting policy of UTI put extreme pressure on the scheme. The UTI board took the unprecedented decision of not paying the US-64 unitholders and suspended the repurchase/redemption for six months.
- Ketan Parekh scam (2001), in which Mr. Ketan Parekh produced an artificial increase in the prices of the K-10 stocks by the circular trading mechanism, and pump and dump theory. Thus, making huge profits at the cost of other investors.

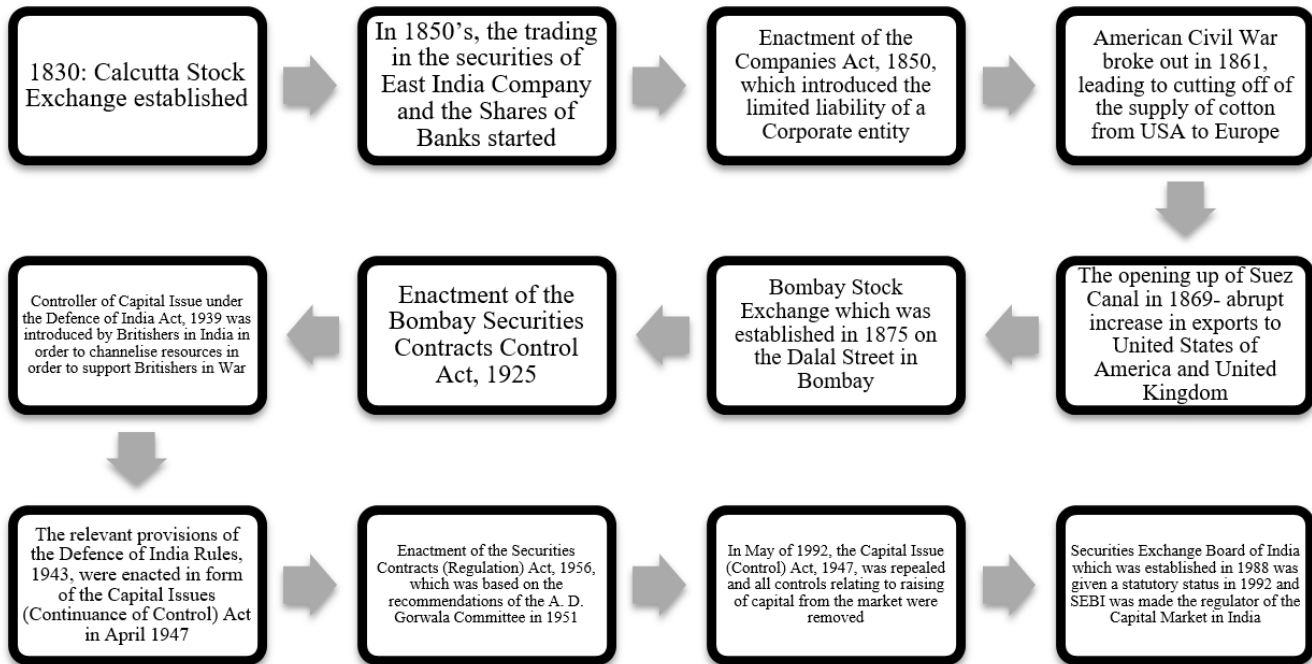
All the scammers use common strategies like insider trading, cartels, collusion, price rigging, price manipulation and nexus with the politicians, brokers, bankers and promoters. These tricks have been successfully engineered and explicitly implemented, especially when there is an expected merger or public issue [2]. The financial regulators have been majorly ineffective. They had taken corrective steps, but only when the investors had been duped of their hard-earned money. The ignorance of investor and greed for quick money makes the work of such scammers even easier. Thus, the role of regulators like SEBI and RBI along with Government shall be to promote investor education and awareness to protect their interest. Now let us consider Harshad Mehta scam and Ketan Parekh scam in detail.

### Harshad Mehta Scam (1992)

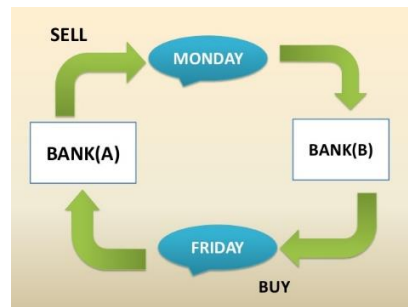
Harshad Shantilal Mehta (1954-2001) was born in a Gujarati Jain family. He was the son of a small businessman. He completed his B. Com. in 1976. He worked in many odd jobs for the next eight years until he started his firm called GrowMore Research and Asset Management in 1984, after becoming a stockbroker at Bombay Stock Exchange (BSE). By 1986, he was actively trading in the Stock Market. In the early 1990s, he rose to prominence in the Indian capital market as he was heavily trading in shares. He was known for his expensive lifestyle and flamboyance. He had a 15,000 square feet penthouse in the poshest area of Mumbai and a fleet of twenty-nine cars. Popular magazines like Business Today

hyped him by tagging him as “The Amitabh Bachchan of the Stock Market”. During the period from 1990 to 1992, the media depicted him as “The Big Bull”. One of the editions of Business Today was titled after him as the “Raging Bull”. However, the economic bubble which was created by him busted in April 1992, when a senior journalist Sucheta Dalal exposed him in ‘The Times of

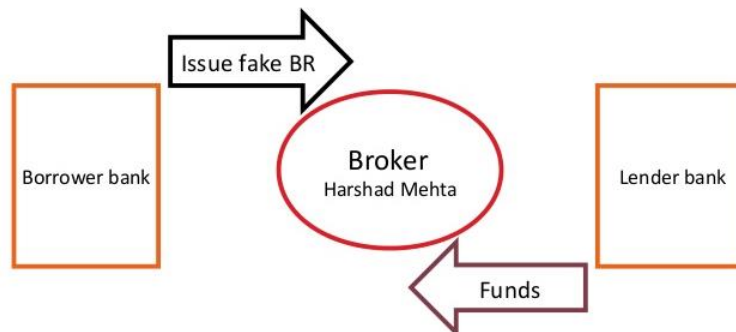
India’. The Harshad Mehta scam started at the beginning of 1990s. Mr. Mehta began to trade heavily in shares. He felt the need for more capital to counter the artificial hammering of the shares. To finance the trading of shares, he exploited the regulatory loophole in the banking system to divert the funds from the banks into the stock market.



**Figure 1:** Historical Evolution of Capital Market in India.

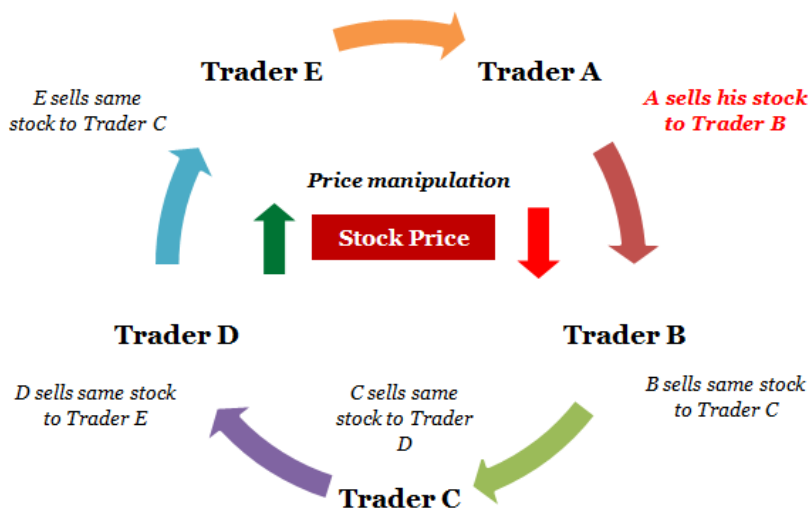


**Figure 2:** Graphical representation of the mechanism of Ready Forward Deals.



**Figure 3:** Mechanism adopted by Harshad Mehta





**Figure 4:** Graphical Representation of Circular Trading

In the early 1990s, the banks were forced to maintain a very high level (38.5%) of Statutory Liquidity Ratio (SLR) in the form of Government Securities. Furthermore, in case of any default on the

part of banks, heavy penalties were imposed on them. Besides, in June 1991, the Government of India also initiated the process of Liberalisation, Privatisation, and Globalisation (LPG), i.e. structural reforms in the Indian economy.

**Table 1:** Market capitalisation of stock exchanges in various countries.

Countries	Market Capitalization					
	USD (million)			Percentage of GDP		
	2010	2017	2019	2010	2017	2019
World	50,941,862	79,214,134	43,270,865	86.5	98.2	-
USA	17,283,452	32,120,703	30,436,313	115.5	146.9	148.1
China	4,027,840	8,711,267	8,515,504	66	65.4	46.5
Japan	3,827,774	6,222,825	6,191,073	67.2	100.1	106.5
Hong Kong	2,711,316	4,350,515	4,899,235	1,185.90	995.1	1053
France	1,911,515	2,749,315	2,365,950	72.2	87.6	85.2
Canada	2,171,195	2,367,060	1,937,903	134.6	129.8	113.1
India	<b>1,631,830</b>	<b>2,331,567</b>	<b>2,179,781</b>	<b>98.5</b>	<b>69.2</b>	<b>76.6</b>
Germany	1,429,719	2,262,223	2,098,174	41.8	49.3	44.5
Korea, Rep.	1,091,911	1,771,768	1,413,717	99.8	88.9	87.3
Singapore	647,226	787,255	697,271	273.8	215.6	188.7

Thus, it put additional pressure on Public Sector Banks (PSU) to perform better due to increased competition. As a result, PSU banks were looking for higher returns on their investment. During this time, the banks were not allowed to invest in the Stock Market. Also, buying Government Securities from Reserve Bank of India (RBI) for a temporary period, due to the temporary increase in the Net Demand and Time Liabilities (NDTL), was an expensive affair. So, banks preferred to purchase such additional Government

securities needed to maintain adequate SLR from other banks rather than RBI, due to the relatively cheaper cost of financing. This mechanism was termed as “Ready Forward Deal”. The Ready Forward (RF) deals were secured short-term loans (usually less than 15 days) from one bank to another against the Government Securities. For example, a borrowing bank would sell the Government Securities to the lending bank with a repurchase clause in the agreement. The borrowing bank would repurchase the

securities after the specified period at a slightly higher price. The price difference between the sale and purchase represents the interest on the loan. Thus, RF deal can be considered equivalent to the Repurchase Agreements. The RF deals were intermediated between the banks by brokers like Mr. Mehta [3]. In the standard settlement process of RF deal mechanism, the transacting banks make payment and take the delivery of securities in the form of Bank Receipt (BR) directly to each other. The role of the broker was limited to bring the participating banks to table to negotiate among themselves. In return, such a broker receives a commission from the participating banks. However, during the scam, some of the banks adopted a different settlement process, which was similar to the settlement process at various stock exchanges. In this settlement process, both the delivery of securities and the payment for such securities were made through the broker. Thus, the seller-bank hand-over the securities in the form of BR to the broker. The broker passes on such securities to the buyer-bank and the buyer-bank hand-over the cheque to the broker, who in turn pays the seller-bank. The buyer-banks issued the cheques were account payee cheques, which meant that such cheque was to be settled only to the payee-bank mentioned on the cheque. However, exceptions were made to this rule in favour of privileged customers like Mr. Mehta. These privileged customers were routinely permitted to credit account payee cheques into their accounts, which were in favour of a seller-banks, to avoid clearance delays, thereby reducing the interest lost on the amount. Thus, brokers effectively transformed the RF Deal into a loan to the broker rather than a seller-bank. Brokers exploited this practice in the money market to their benefit. Hence, allowing themselves to have access to a large amount of money for a short period, which they could invest in stock markets. The cycle of the settlement was carried out with multiple banks. Such a mechanism was abused by brokers like Mr. Mehta to have access to a large amount of fund at their disposal to be invested in stocks by flouting several provisions of the Securities laws.

Besides, the above-explained dubious settlement of RF deal, brokers like Mr. Mehta were able to persuade Banks to issue cheques even without the actual transfer of securities or issue cheques against fake Bank Receipts (BRs), which were worthless pieces of paper or issue cheques against forged securities. Thus, resulting in an out-right violation of RBI guidelines. The gravity of the situation can be understood from the example that the Bank of Karad, which had an equity base of less than Rs.1 Crore, issued BRs worth more than rupees thousand crores. Standard Chartered Bank, a foreign bank, accepted BR's worth rupees two hundred crores from Bank of Karad. On similar lines, the Metropolitan Co-operative Bank also issued BRs of worth hundreds of crores, which was much more than its equity base. Such out-right violations of RBI guidelines and Securities law was possible only because of two probable reasons. Firstly, it may be possible that the bank

officials were either bribed or negligent. Secondly, the bank manager may be aware of such irregularities. Still, they turned a blind eye due to the benefits of higher returns which the broker offered to the bank by diverting the funds towards stock market [4]. Mr. Mehta was able to generate a large amount of capital by exploiting these regulatory loopholes. The availability of resources enabled him to invest heavily in the stock market and rig the prices of stocks. Mr. Mehta was able to spend more than rupees thousand Crores in the stock market and manipulate the prices of shares in the market. A good example is the ACC Cement Company, whose share value was usually hovering around rupees two hundred per share were sky-rocketed to rupees ten thousand per share. Mr. Mehta explained this phenomenon by 'Replacement Cost Theory', by which he meant that the market value of the stock does not reflect the true worth of the share of the company and it needs to be replaced with the real worth of the share. Such artificial spurt in the prices of stocks had a spill-over effect leading to the rise in BSE Sensex which rose from around rupees two thousand in January 1992 to around rupees four thousand five hundred in April 1992. By such rigging of the price of the shares, Mr. Mehta was able to make a large sum of money. In fact, he paid the advance tax of rupees twenty-eight Crores for the financial year 1991-92 [5]. In April 1992, a veteran journalist of The Times of India, Sucheta Dalal exposed the absence of almost rupees six hundred Crores from State Bank of India, which she claimed to have been invested by Mr. Mehta in the stock market [6]. As a result of this exposure, the BSE Sensex crashed from rupees four thousand five hundred to rupees two thousand five hundred causing a loss of around rupees one lakh crores in market capitalisation. As a result, many innocent retail investors became bankrupt overnight, forcing some of them to commit suicide. SEBI, RBI and the Government of India were blamed for the scam. The consequences of the fraud were so severe that the stock market had to be closed down for almost a month [7]. In November 1992, Mr. Mehta was arrested by CBI. Mr. Mehta along with nine others was charged with criminal conspiracy, falsification of accounts, cheating, forgery, bribery, breach of trust and using forged documents under the Prevention of Corruption Act, 1988 and the Indian Penal Code, 1860. In total Mr. Mehta was charged with 72 criminal cases and about 600 civil action suits. Mr. Mehta is also prominently known to have offered a bribe of rupees one crore to the then Prime Minister P. V. Narasimha Rao to hush up all the cases against him. He also advised the Prime Minister to appoint him as the Finance Minister in the interest of the nation. In April 2001, the SEBI debarred Mr. Mehta from dealing in securities for life. In 2003, the Supreme Court of India confirmed the Bombay High Court order of 1999, upholding the 5-year term imprisonment and a fine of rupees twenty-five thousand, against Mr. Mehta and other accused. The whole scam left banks with BRs worth thousands of crores having no value. The banking system lost credibility and a considerable sum of money, to the tune of

rupees four thousand crores. Besides, the loss to the retail investor is unaccounted. The scam had a long term impact in the form of fear among the investor to invest in the stock market [8]. Thus, the scam highlighted the loopholes in the financial system, unfair trade practices in various financial instruments, widespread corruption and ineffective government policies. On 31st December 2001, Mr. Mehta died of a heart attack in the Thane civil hospital at the age of forty-seven. He was in the criminal custody for the cases which were pending against him at Thane prison. About twenty-seven cases were pending against him at the time of his death. The death of Mr. Mehta closed down these cases against him but left some important questions relating to the scam unanswered.

### Ketan Parekh Scam (2001)

Ketan Manharlal Parekh was born in 1963. He belonged to a family of stockbrokers, which helped him in the trading ring. His family-run brokering firm was 'NH Securities'. He was a chartered accountant by training. He was thin, tall, and soft-spoken and was known to maintain a low profile. He was a trainee of Mr. Harshad Mehta. The master manipulator himself trained Mr. Ketan Parekh. He was described as "the Pied Piper of Dalal Street" because whatever he touched, turned into gold [9]. He was known by the sobriquets like "the Pentafor Bull" and "the One-Man Army", which was accorded to him by national business newspapers and the stock market. He was also known by the name of 'KP'. In the late 1990s, a vacuum was created after Harshad Mehta scam. The stock market was not performing well in 1998, and the economy was also passing through a rough patch. As the promoters of listed companies were not able to secure bank loans. Therefore, they were unable to raise money. So, these promoters approached Mr. Ketan Parekh to increase prices of the shares, to facilitate the much-needed liquidity to the companies. In the process, Mr. Ketan Parekh also made pot-loads of money. He was a trained manipulator who made lakhs of rupees for himself and crores of rupees for his clients, who were unscrupulous promoters of the listed companies. The time was also ripe as at the dawn of a new millennium, there was a boom in ICE (Information Technology, Communication, and Entertainment) Sector and much investment was focused in this sector. When Ketan Parekh stuck, almost immediately results could be seen in the form of an increase in the price of the shares of companies. For example, the share price of 'Visual Soft' sky-rocketed from rupees six hundred and twenty-five per share to rupees eight thousand and four hundred and forty-eight per share. Another example is 'Sonata Software', whose share price rose from rupees ninety per share to rupees two thousand one hundred and fifty per share. Ketan Parekh used to manipulate and rig the prices of the shares by way of 'Insider Trading' and 'Circular Trading'. By these tools, Ketan Parekh was able to drive up the costs of the shares by creating a sizable deceptive volume of trading in specific stocks. However, for

effectively executing the mechanism, Mr. Ketan Parekh required large amount of fund, which he received from investment firm controlled by the promoters of listed companies, foreign corporate bodies and co-operative banks. Besides, Mr. Ketan Parekh borrowed rupees two hundred and fifty crores from Global Trust Bank. He also borrowed another rupees thousand crores from Madhavpura Mercantile Co-operative Bank, which was in complete violation of RBI norms and regulations. As the whole World embraced the Information Technology industry. Therefore, considerable investment was seen in the stocks of Information Technology-based companies at the dawn of the millennium in India as well. Mr. Ketan Parekh's favourite shares were from the ten companies, which he targeted for rigging the price of shares by way of circular trading and insider trading. The shares of these targeted companies were called 'K-10' stocks. The K-10 stocks included the shares of 'DSQ Software', 'Ranbaxy', 'Pentamedia Graphics', 'Visual Soft', 'Global Telesystems', 'Zee Telefilms', 'HFCL', 'Silverline', 'Satyam Computers', 'Aftak' and 'Infosys'. Sometimes, even 'Digital Global' and 'SSI' were also dubbed as KP-10 stocks. Mr. Ketan Parekh used to balloon the prices of the K-10 stocks by illegal means like insider trading and circular trading [10]. Finally, dump the inflated shares held by financial institutions like UTI, LIC and other financial institutions (usually mutual funds). Therefore, making huge profits at the cost of these institutional investors. The twenty-first century was pegged to be an Information Technology Century. Yet, the period from 2000 to 2002, experienced a period of excessive speculation in the IT sector due to the collapse of the Dot-Com bubble, which had a significant impact on the stock market. The collapse of the Dot-Com bubble hurt Ketan Parekh as K-10 stocks majorly comprised of shares from IT companies. Besides, other factors that impacted Mr. Ketan Parekh included global economic slowdown and significant erosion of market capitalisation of leading stock exchange. The last nail in the coffin for Mr. Ketan Parekh was the bear hammering of the stock exchanges in 2001, a day after the presentation of the Union Budget. The hammering by the 'bear cartel' comprised of Kolkata based traders, Shankar Sharma, Anand Rathi and Nirmal Bang, triggered a payment crisis for Ketan Parekh. The 'bear cartel' was also called 'KP-Down'. They started hammering the Ketan Parekh's favourite K-10 stocks. As a result, these stocks crumbled like a pack of cards, causing a severe blow to Mr. Ketan Parekh. It resulted in a severe financial crunch for the major bull operators, who were working for Ketan Parekh. It led to disputes in Kolkata Stock Exchange (CSE). Besides, the badla rates shot up to 80% at Kolkata Stock Exchange [11]. So, it resulted in furthering the payment crisis for Mr. Ketan Parekh, as he defaulted on payment to Kolkata brokers. Thus, Kolkata brokers defaulted in payment, and the exchange plunged into crisis. Not only at Kolkata but the 'bear cartel' on the BSE was also hammering the market based on inside information, which increased the troubles for Ketan

Parekh. Ketan Parekh desperately borrowed vast sums of money from Ahmedabad-based Madhavpura Mercantile Co-operative Bank and the Global Trust Bank. These banks issued 'Pay Orders' worth crores of rupees without receiving any securities or collaterals. Ketan Parekh discounted these Pay Orders worth rupees one hundred and thirty-seven crores from Bank of India, which bounced and Ketan Parekh could pay only 7 Crores[12]. Thus, Bank of India initiated a criminal case against him. Therefore, all the borrowings by Mr. Ketan Parekh were not sufficient to check the crashing of K-10 stocks. Both the banks which issued Pay Orders to Mr. Ketan Parekh, i.e. the Global Trust Bank and the Madhavpura Mercantile Co-operative Bank, were also crushed by this event, which eventually led to their bankruptcy as well. The Global Trust Bank was merged with Oriental Bank of Commerce in 2004. The Madhavpura Mercantile Co-operative Bank was liquidated, and its license was cancelled in 2012. The Ketan Parekh Scam again was busted by the veteran journalist Sucheta Dalal, who exposed Ketan Parekh a day after the 2001-02 budget, when the BSE crashed by almost rupees one hundred and forty-seven. The CBI arrested Mr. Ketan Parekh in connection with the Bank of India's criminal complaint. Thus, finally ending the two-year-long market dominance by Mr. Ketan Parekh. It eventually resulted in Mr. Ketan Parekh being punished for two years of rigorous imprisonment for committing fraud in 2008. He was also suspended by the SEBI in 2003 for trading on the stock exchange till 2017. Thus, when the whole scam was busted, it followed with a loss of value of the rigged stocks, which in turn led to massive losses to many investors who had invested in stocks. Still, the major losers were the financial institutions like UTI, LIC and other financial institutes. Even the Bank of India lost a significant amount of money. Both regulators, i.e. SEBI and RBI, were a mute spectator and complacent when the stock bubble was created in the late 1990s and early 2000s. They did not bother to intervene or take any action till such stock bubble was ready to burst. Thus, the regulators were responsible for dereliction of their duties [13-22].

## Reforms and Conclusion

Both the scams, i.e. the Harshad Mehta scam and the Ketan Parekh scam were similar as well as different from each other. Both the scams were identical as both Harshad Mehta and Ketan Parekh adopted the mechanism of price rigging, one using the funds from banks and the other using the funds from investment firms. However, both of them took advantage of inadequacies and loopholes in the regulatory framework of the financial system. The direct impact of both the scams was that there was a sharp decline in the direct participation of the retail investors in the capital market in India. At the same time, both scams were different in the instruments used, securities targeted and reasons for the scam. Harshad Mehta misused tools like 'Ready Forward Deal' and

'Bank Receipts', whereas Ketan Parekh misused instruments like 'Pay Order' and 'Circular Trading'. Harshad Mehta exploited public sector banks, whereas Ketan Parekh used the new private sector and co-operative banks. The Harshad Mehta scam indicated weak regulation of the capital market and prompted immediate reforms in the equity market. In contrast, the Ketan Parekh scam reflected that even in the radically transformed equity market, the checks and controls by the regulators were ineffective. The Harshad Mehta scam was more of a bank scam rather than a securities scam as banking institutions lost thousands of crores. Whereas, the Ketan Parekh scam impacted the institutional investors more than the retail investors. After the Harshad Mehta scam, the SEBI Act, 1992, was passed giving SEBI statutory status. After the Ketan Parekh scam, the SEBI (Amendment) Act, 2002 was passed, giving more teeth to the SEBI as a regulator of capital market in India. Besides, Ready Forward Deals were banned by the RBI after the Harshad Mehta scam and extensive banking sector reform was brought in by the Government of India based on the Narasimhan Committee-I (1991) and Narasimhan Committee-II (1998). After Ketan Parekh scam, the carry-forward system called badla transactions were prohibited. SEBI formally introduced forward trading in the form of exchange-traded derivatives. After the Ketan Parekh scam, the trading cycle for shares was also reduced from one week to one day. To facilitate the trading of securities on the share market and the lessons learned from the scams, the Depositories Act, 1996, was enacted. It ensured free transferability of securities on the stock exchange with speed and accuracy by way of the dematerialisation of the securities in the depository's mode. The SEBI has initiated several reforms since its inception in 1988, either upon happening of a major scam or as preventive reforms. The lesson to take back home for the SEBI is that it has to be proactive rather than reactive to avoid such scams and other capital market crimes. Hence, SEBI must develop a 'Market Intelligence System', which may act as an early warning system. There shall be quick and effective disposal of cases relating to capital market crimes, and the convict shall face deterrent punishment. There shall be strict enforcement of guidelines, regulations, rules, and laws by the regulators. The capital market cannot exist in isolation. So, there must be coordination among all the sectors of the financial market to prevent the scammer from exploiting any possible loophole. Finally, it shall always be remembered that self-discipline is the best way to check any illegal and unethical activities to ensure good health and vibrancy of the capital market. A scam-free capital market is absolutely a pre-requisite for building confidence and earning the trust of the investors in the capital market in India. It requires an effective and efficient 'Investor Protection program'. To protect the interest of investors, SEBI should keep a check on the unscrupulous elements in the capital market. To achieve this, SEBI can create a database of new promoters, entrepreneurs and their companies which enter



the primary market and monitor their functioning. If any company or its promoters have committed illegal activities or have disappeared in the past, then they should not be allowed to enter the capital market again. SEBI has over time, evolved itself and developed a regulatory framework for the capital market in India. So, as to protect the interest of the investors and uphold the integrity of the capital market. SEBI has taken various steps to tackle the issue of capital market crimes by creating a comprehensive and strict regulatory compliance structure and disclosure requirement. At the same time, SEBI has also established the 'Investor Education and Protection Fund' and also undertakes various Investor Awareness Programmes.

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