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FINANCIAL SYSTEM SECURITY: HARSHAD MEHTA AND THE BILLION-DOLLAR SCAM

Harshad Mehta, the iconic "Big Bull" of the Indian stock markets, unceremoniously departed from this world on 31 December 2001. Mehta, the notorious architect of a billion-dollar Indian stock market scam that was exposed in early 1992, left behind a legacy of criminal cases, legal battles, debts and soured dreams. He had single-handedly both ignited and shattered the dreams of millions of Indians of earning the glamourous returns that stock markets potentially offered.

As if right out of a fairy tale, Mehta's was a classic rags-to-riches story. Spending his early childhood in a small Indian town, he became one of the foremost stockbrokers in India. Mehta died in custody 10 years after the scandal that made him a household name in India.

What were the deficiencies in the microstructure of the Indian financial system that Mehta was able to exploit to pull off his billion-dollar scam?

Pre-1991 Indian Financial System

Long before the formal financial systems came about, Indian traders exchanged promissory notes called "hundis". Trading in these promissory notes usually took place under a large banyan or neem tree. The hundis were used for both local trade and trade between port towns and inland centres of production. They were used as instruments to provide liquidity to the markets and also to move money across time and space. Formal banking systems evolved with the setting up of the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. A formal stock market came into being with the setup of the Bombay Stock Exchange ("BSE") in 1875. By the 1980s, the financial system of the country consisted of a formal banking system, the BSE, 22 regional exchanges and a government debt market.

The Indian financial system was dominated by state-owned banks and other financial institutions with the government controlling the banking, insurance and mutual funds sectors. Competition and efficiency considerations were secondary to the government's spending

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Professor Preeti Goyal and Professor Sanjay Dhamija prepared this case for class discussion. This case is not intended to show effective or ineffective handling of decision or business processes.

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needs. Thus, little competition existed within the banking sector and the financial markets had virtually no integration with the international financial markets.

Banking System

The Indian economy was protected and thus closed to the world. The banking system was regulated by the Reserve Bank of India ("RBI"), India's central bank. It was plagued with administered interest rates operated under a regime of controls and over-regulation. The system of administered interest rates was accompanied by explicit direction in the areas of lending and deposits.

> *Financial markets in India in the period before the early 1990s were marked by administered interest rates, quantitative ceilings, statutory pre-emptions, captive market for government securities, excessive reliance on central bank financing, pegged exchange rate, and current and capital account restrictions. As a result of various reforms, the financial markets have now evolved to a regime characterised by market-determined interest and exchange rates, price-based instruments of monetary policy, current account convertibility, phased capital account liberalisation and auction-based system in the government securities market.*[1]
>
> \- Dr. V.Y. Reddy, ex-governor of the RBI

Isolated from market conditions, interest rates on government securities were artificially fixed at low levels. The financial environment at the time was characterised by segmented and underdeveloped financial markets and intermediaries with very basic and limited financial instruments. Consequently, by the end of the 1980s the restricted availability of bank credit to only certain sectors of the economy had had an unfavourable effect on the viability and profitability of banks.

Banks were required to keep aside 25% of bank deposits with the RBI as cash reserve ratio ("CRR"). Another 38.5% of a bank's deposits went into statutory liquidity ratio ("SLR"). SLR reserves were required to be invested in government and certain other approved securities collectively known as SLR securities. Banks were free to deploy only the remaining 36.5% of their deposits, and that too went into priority sector lending.

Introduced by the RBI, the portfolio management scheme ("PMS") was another innovative scheme produced by a regime dominated by controls and regulation. The deposits accepted by banks under this scheme were to be invested in the securities markets on behalf of the depositors. Theoretically, under the PMS the money had a lock-in period of one year, transactions were supposed to be at market rates and nobody could guarantee a fixed return. At the time that the PMS was introduced, many public sector units ("PSUs")[2] were sitting on large amounts of idle cash. While the PSUs were keen on earning a respectable return on this cash, the banks vied for these funds under the PMS to increase their profitability. Even though the PMS was to be provided at clients' risk and invested in the securities market, in practice PMS deposits became like regular deposits, with banks informally guaranteeing returns. Because PMS money was supposed to be held merely in fiduciary capacity by banks, it did not form part of the banks' deposits. It was therefore free from the draconian reserve requirements of CRR and SLR that were imposed on banks.

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[1] Reddy, V.Y. (22 July 2007) "Glimpses of Indian Economy and Its Financial Sector", Speech, http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/78461.pdf (accessed 22 August 2007).

[2] PSUs were state-owned firms.

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Equity Market

The Bombay Stock Exchange

Established in 1875, the BSE was Asia's oldest stock exchange. After the BSE, the Ahmedabad[3] Stock Exchange was set up in 1894. In the 20th century, 20 more regional exchanges were set up throughout India.

Beginning as a voluntary non-profit-making association, the BSE metamorphosed into the country's leading stock exchange, boasting the largest market share. Next in line were the Delhi and Calcutta[4] stock exchanges. Accounting for the majority of trading in the equity markets, the BSE became synonymous with the Indian capital markets. With a daily turnover of INR 4 million[5] per day in 1981, the BSE had 517 brokers. While the number of brokers had only increased to 550 by 1991, the daily turnover had increased to INR 23 million per day.[6]

In order to trade at the stock exchanges, brokers had to purchase trading cards. Although stock exchanges sometimes auctioned the trading cards of defaulting members, they rarely issued new trading cards. Trading cards were like family heirlooms, handed down from one generation to next. The strong demand for these trading cards made them very expensive. Much like mom-and-pop stores, most brokers of the stock exchange were organised as partnership firms with limited capital. BSE brokers resisted any change to their organisational structure. The mutualised character of the stock exchanges was similar to that of an elite club—one that was run by the brokers for the brokers, and where the investors seemed to be of little consequence.

Trading at the stock exchanges was done using an open outcry system. Prices quoted in the newspapers provided only the range of the price at which securities traded for the day. Due to the lack of automation and transparency, the actual cost of trade could easily be hidden from the investors.

The overwhelming market share of the BSE provided it with a dominant market position, so much so that it bred both arrogance and resistance to change. The BSE faced little competition and came to be associated with various negative characteristics such as vested interests, opaque dealings, a callous attitude towards investors and a frigid attitude toward change.

Settlement and Badla Transactions

The market followed the system of account period settlement. Under this system, the trading cycle was a fortnight long and the clearing and settlement of trades took place a fortnight after the trade cycle ended. This meant that, if someone bought or sold shares on a given day, he would first have to wait for the end of the trading period. After this the settlement period started, and another fortnight would pass before the person would receive the funds or be required to make delivery of the required shares. The long trading and settlement cycle made settlement risky because any of the parties to the transaction might default on the trade due to such reasons as a change in prices or availability of resources. Thus both the buyer and the seller were at risk until settlement took place. Subsequent to the settlement, it took a few months before ownership of the stock was transferred to the buyer with the registrar. Many of the problems faced in settlements were due to the physical delivery of share certificates.

[3] Ahmedabad was a city in the western Indian state of Gujarat.
[4] Calcutta was renamed to Kolkata in January 2001.
[5] US$1 = INR 31.23 on 31 March 1992; US$1 = INR 48.80 on 31 March 2002.
[6] Singhal, R. (2004) "Financial Sector Reform in India: Is There a Grand Design?", Occasional Paper, Center for the Advanced Study of India, University of Pennsylvania.

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Forged or damaged share certificates and fake signatures on physical certificates frequently led to bad deliveries. The lack of automation of the market infrastructure made trade execution slow, inefficient and opaque.

Due the existence of a settlement deferral product called "badla",[7] transactions could be carried forward from one settlement period to the next. Badla combined all of the following into a single product:

- Transfer of market position
- Stock lending/borrowing
- Borrowing/lending in the money market
- Margin trading.

In a badla transaction, the badla financier would settle the position on behalf of the trader. Stock exchanges regularly organised sessions for badla transactions. The cost for executing a badla transaction was called the "badla rate". By paying the badla rate to the badla financier, the trader was able to defer the trade settlement to the following settlement period. At the beginning of the next trading period, the positions of the trader and the badla financier were reversed. The badla rate would be fixed by the stock exchange in the customary opaque manner and usually ranged between 15% and 35% per year.[8] At times when money was tight, this rate could work out to be as high as 70–80%[9] of the borrowed amount.

Badla was like a futures contract without an expiration date. It enabled a trader to transfer outstanding buy or sell positions and not take or give delivery, thereby playing with price expectations. It also facilitated a trader to hold overleveraged positions, which potentially could—and occasionally did—create payment crises for the markets. The system provided a natural opportunity for traders to increase their already overleveraged positions.

The government made various attempts to rid the market of the ill effects of badla. Badla was banned in 1969, which merely motivated badla users to let it exist as a surreptitious system. Unable to comprehensively crack down on badla, the government officially revived it, allowing an open position to be carried forward for a maximum period of three months. Badla regulations were frequently flouted, and once again due to the lack of effective monitoring, the market remained exposed to the adverse effects of the badla system.

The Government's Role in the Equity Market

The stock exchanges were crippled by highly manual processes that, coupled with the lack of transparency and surveillance, made the common investor very suspicious of the stock markets. Yet the high expected returns from stock markets kept luring investors in.

The government played a dominant role, even in the primary equity markets. Through the office of the Controller of Capital Issues[10], the government prescribed all facets of raising capital in the equity markets, including the amount of capital that could be raised, the price at which it could be raised and the instruments that firms could use for the issue. This usually increased the cost of capital for most firms.

[7] The concept of badla was borrowed from the London Stock Exchange. The Milan Stock Exchange also used a similar deferral product, known as "riporti".
[8] Pathak, B.V. (2008) *The Indian Financial System: Markets, Institutions and Services*, 2nd Edition, Pearson Education: India.
[9] Basu, D. and Dalal, S. (2005) "The Scam", Kensource Information Service P Ltd, India.
[10] Controller of Capital Issues was an officer in the Government of India's Ministry of Finance who was responsible for ensuring that the capital issues were in accordance with the Capital Issues (Control) Act, 1947.

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Inefficiencies and irregularities in the primary market were rampant. The prospectuses provided by issuing firms were very sketchy. Firms were able to make exaggerated claims about their operations and charged application fees from applicants of new issues. It was four to six months, as opposed to the mandated 20 days, before money was returned to unsuccessful applicants. The information released by firms in the market was very selective; firms tended to release only the information that was expected to have a positive effect on their share prices.

Debt Market

As the largest issuer of debt, the government of India was the primary player in the debt markets. Mainly due to statutory requirements, public sector banks participated in the debt markets as the largest investors. The investments of private and foreign banks in the debt markets were largely dependent on the CRR and SLR requirements set forth by the regulator.

The central bank, the RBI, was the government's debt manager and was responsible for launching and selling government securities. The subsidiary general ledger ("SGL"), which listed the details—including the current owner—of all the issued government securities, was maintained by the RBI's public debt office ("PDO"). The RBI was thus also responsible for the government securities' after-sale process, which included keeping the SGL updated with the most current owners of the securities and ensuring that the process was executed in a smooth and risk-free manner.

As a banker to the government, the RBI bought all of the government's debt, which was subsequently sold to debt market investors. Any government deficit was then monetised.[11] Investors in government securities included financial institutions, finance companies, insurance companies, mutual funds, and pension and provident funds. The government bond market was closed to the public and was conspicuously secretive. Bond prices were not quoted publicly. Though the RBI announced the issue of some securities, most issues were on an off-market basis; it was essentially an inter-institutional market. Finally, brokers played the important role of bringing together buyers and sellers, thereby providing liquidity to the market.

Deals were driven by a handful of brokers and treasury officials of banks. In addition to Mehta, the main brokers included V.B. Desai, Bhupen Champaklal Devidas, Hiten Dalal, C. Mackertich, Naresh Aggarwala, D.S. Purbhoodas and Jayantilal Khandwala. The major players from the banking side included Citibank, Bank of America, Canara Bank, Grindlay's Bank, State Bank of India, Standard Chartered Bank and Syndicate Bank.

On the infrastructure side, inefficient systems led to delays in settlement and transfer of government securities. To illustrate, if Desai bought a government-issued 12% 2002 bond from Mehta, Mehta would fill out a sale form and take it to Desai for confirmation of the trade. Once Desai counter-signed the form, Mehta would submit it to the RBI's PDO. The PDO would then check the bond's details in the SGL. Once the details of the trade were confirmed the funds from Desai's current account with the RBI were transferred to Mehta's current account, again with the RBI. The highly manual nature of the process, coupled with surging trading volumes, made the process slow and cumbersome.

The corporate debt market made up a minuscule share of the total debt markets. The government discouraged firms from using debt markets for raising funds. One of the tools used to discourage corporations from issuing debt was the regime of regulated interest rates. The interest rates were administered in such a way that the rates offered by banks on

[11] Monetisation was the printing of currency notes by the county's central bank.

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corporate loans made them more attractive than borrowing from the debt markets. Another method used by the government was to permit firms to use a relaxed debt–equity ratio when using banks and financial institutions for funds, as opposed to a tighter debt–equity ratio when borrowing from the market.

Market Regulation

The regulatory framework of the Indian financial system broadly consisted of the Ministry of Finance of the government of India, the RBI and the Securities and Exchange Board of India ("SEBI"). The RBI was the centre of the country's financial and monetary system and was fully responsible for its banking system. The RBI regulated the government securities market and money market. The governing board of the BSE regulated the stock market. Prior to 1991, the brokers of the exchange had elected other brokers to the board, thus making it impossible to implement regulations that went against the brokers' interests. The government nominated the executive director of the stock exchanges, but because he reported to the board, even his powers were crippled. Therefore, regulation was the biggest casualty and implementing any stringent regulation was almost impossible, leaving investors with nowhere to go to have their grievances redressed.

SEBI, an autonomous body, was established through an administrative order in 1988 to regulate the equity markets. One of its mandates was to provide reassurance to investors that it was safe to undertake transactions in the securities market. In addition, it was responsible for regulating and promoting the development of the securities market. The early years of SEBI were not easy, as the reform programme initiated by SEBI was under attack from the market intermediaries, which had clear self-interest in opposing it.

Post-1991 Narasimha Rao Government

The Narasimha Rao government was elected to power in 1991, and Manmohan Singh was appointed finance minister. This was a turning point for the Indian economy, as the government mandate now was to move towards a system driven by markets as opposed to government diktats. With liberalisation of the economy came the privatisation of PSUs, and shares of large PSUs were now up for grabs. December 1991 saw the first divestment with privatisation of Unit Trust of India, India's first unit trust, set up in 1964. Leading Indian development banks Industrial Development Bank of India and Industrial Credit and Investment Corporation of India, which had previously been provided with easy government money, now had to go out into the market to raise capital.

With liberalisation, the government wanted PSU banks to compete and earn profits. The government wanted them to deliver results immediately with the same infrastructure and skills. For the debt securities that the banks were holding, a problem arose each time a new debt security with a slightly higher coupon was issued: the price of the old security fell. With the declining value of bank portfolios, which eroded their profitability, banks were told to show their investments at cost in their books.

Due to the ever-increasing budget deficit, PSUs floated their own bonds and borrowed directly from institutions that could afford to buy the bonds. Leading PSUs were also required to raise funds through the issue of their own bonds. National Thermal Power Corporation and Indian Railways Finance Corporations emerged as major bond issuers, often sitting on hundreds of millions of rupees in short-term cash. PSUs needed to put this money somewhere. Virtually no debt rating methods were in place. These firms did not possess the necessary skills to sell or service debt instruments. On one occasion it almost took a year to make allotments because printing the bonds was not allowed until a mortgage was created. Thus

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allotment letters themselves became instruments that were traded. Banks needed deposits and PSUs needed money. Alliances between banks and PSUs appeared to be mutually beneficial; banks agreed to pick up the bonds of PSUs on the condition that the PSUs would also make additional deposits with them.

In July 1991, the finance ministry decided to liberalise the interest rate on corporate debentures and bonds. Companies could now issue debentures at rates higher than existing PSU bonds. Effective October 1991, the interest rate on government securities was increased from 11.5% to 12%. In March 1992, the government once again increased the interest rate on government bonds to 12.5%.[12]

With liberalisation, the protected economy was suddenly exposed to the harsh consequences of competition from foreign firms. The freeing-up of the interest rates on debt, PSUs being left high and dry to raise their own money, and increased coupon rates on government securities threw the debt markets into turmoil.

The Scam

Since 1987, debt market brokers had been undergoing transformation. The second-generation brokers were more educated and ambitious than their predecessors. Some were equipped with foreign degrees and also had done stints with investment banks or other corporations. Brokers, who had been acting as agents for banks, now had a vision of becoming full-fledged bond traders, buying and selling on their own account.

Banks with a temporary increase in liabilities did not want to buy the statutorily required SLR securities. They instead entered into ready forward (“RF”) deals. An RF deal was like a repurchase agreement—in essence a short-term loan secured against government securities, given from one bank to another bank. Banks also entered into RFs on behalf of their customers under the PMS. Legally, RFs were not loans and therefore were not treated as liabilities for counterparty banks, thus freeing them from CRR and SLR requirements.

In executing the RFs, the two banks would typically be brought together by a broker. Brokers merely brought together buyers and sellers and were not required to handle the physical exchange of securities or money; yet in the lead-up to the scam, brokers had effectively started acting as dealers, thereby taking positions in the market.

Given the new self-defined role of the brokers, some banks deviated from the normal settlement of RFs and adopted a settlement process similar to the process followed in settlement of stock market transactions: the seller and the buyer made the delivery of securities and money, respectively, to the broker, who in turn handed over the cheque to the seller bank and the securities to the buyer. In the process, the brokers were able to get hold of the crossed account payee cheques, which were drawn in favour of the bank receiving the loan. To avoid a loss in interest on the cheque amount due to clearing delays, it was possible for privileged (usually corporate) customers to credit account payee cheques in favour of a bank into their own accounts. For the securities settlement, instead of actually moving the securities back and forth, brokers used a bank receipt (“BR”) in lieu of making delivery of actual securities. A BR was like a promissory note assuring that the seller had the securities that would be delivered to the buyer if and when the need arose. Thus, rather than being a loan to a bank, the RF was effectively transformed into a loan to a broker. Nevertheless, because an RF was like a secured loan it would be secured even if it was to a broker.

[12] Basu, D. and Dalal, S. (2005) “The Scam”, Kensource Information Service P Ltd, India.

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Three techniques were used to circumvent the need for government securities for BRs: convincing the bank officials to bypass the requirement for a BR; using photocopies of the allotment letters of securities; and colluding with banks to issue fake BRs. Mehta colluded with two small and lesser-known banks—Bank of Karad and the Metorpolitan Co-Operative Bank—which would issue fake BRs (ie, BRs that were not backed by any government securities) as required. These banks also deposited cheques issued in their own names into Mehta's accounts with them.

Once the fake BRs were issued, they were given to other banks, which wrongly assumed that they were lending against government securities. In some cases, copies of PSU bond allotment letters were also used as security. The lending banks in turn gave money to Mehta. Because Mehta operated in both the money market and the capital market, he invested the money from banks in the equity markets. Using the badla system, he built large, overleveraged positions in the equity markets. When RFs matured, the shares would be sold for a profit and the money due to the bank would be returned.

Meanwhile, excessive trading led to a phenomenal increase in stock prices. The Sensex[13] rose from 1,000 in February 1991 to 4,500 in March 1992. As long as the stock prices were going up, this scam worked beautifully because the banks kept getting their money back when due. Interestingly, Mehta was able to pull this off without anyone catching on to his game until 22 April 1992, when a column in the *Times of India*, a leading Indian daily, accused him of illegally using the banking system to finance his stock market investments.

> *The State Bank of India (SBI) is making frantic efforts to reconcile the books of its securities and investment department in the wake of the discovery that several hundred crore[14] rupees had been advanced without following due procedure and possibly without collateral.*
>
> *According to top-level sources in the bank, the key figure is allegedly a big bull [Harshad Mehta] who has been in the news recently because of his huge transactions in the stock markets. A couple of other big and reputable broking houses are also said to be involved. …*
>
> *However top-level sources in SBI pointed out that after the scandal was unearthed 11 days ago, the bull operator was called to the bank and has reportedly agreed to reconcile the books by paying cash and depositing securities.*
>
> *He has agreed to give cheques worth only Rs. eight crore [US$2.56 million] and square the balance in the form of securities.*
>
> *SBI sources say the scam was unearthed when an officer in the securities and investment department who is allegedly the key figure in this operation went on leave recently.*
>
> *According to these sources some discrepancies like cheque and delivery dates not coinciding were discovered when a reconciliation of the department's books was done a few days ago. This triggered a major investigation by SBI authorities.*[15]
>
> - Sucheta Dalal and R. Srinivasan, Times of India

[13] The Sensex was the BSE's prime index, which included 30 stocks and was calculated using the market capitalisation weighted method.
[14] One *crore* = 10 million.
[15] Dalal, S. and Srinivasan, R. (22 April 1992) "SBI Goof-Up in Broker Deals", *Times of India*.

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The scam screeched to a halt when the article hit the newsstands, leaving many banks with worthless BRs—it was estimated that INR 40 billion had been swiped from the banking system. At the same time, with equity prices crashing by 40%, the Sensex dipped to 2,500 within a couple of months, wiping out investors' net worth by US$32 billion.

> *By the time news of a stock market scam involving Mehta hit the headlines, and the subsequent collapse of the market in 1992, thousands of ordinary investors had lost their life savings.*[16]
>
> - Anonymous, Asia Money

The scam adversely impacted several of India's major commercial banks, including a number of foreign banks operating in India. The scam also claimed a number of casualties: K.M. Margabandhu, the chairman and managing director of UCO Bank, was arrested and sacked; V. Mahadevan, one of the managing directors of the State Bank of India, was unceremoniously removed from office.

Harshad Shantilal Mehta

> *Harshad Mehta, stockbroker: born Raipur, India 1954; married; died Bombay, India 31 December 2001.*
>
> *Known as the "Big Bull" of the Indian stock market, Harshad Mehta was charged in 1992 on 27 counts for engineering the biggest stock-market scam to rock the country since independence, but the flamboyant Mehta had once been the investors darling.*[17]
>
> - Singh K., The Independent

Harshad Shantilal Mehta was born in a Gujarati family.[18] He spent his early childhood in Mumbai, where his father ran a small business. Due to his father's ill health, the family had to move to Raipur in the central Indian state of Madhya Pradesh, but Raipur could not interest Mehta for long. Even though his father was against it, after completing his schooling, Mehta was back in Mumbai.

Completing his undergraduate degree in 1977, Mehta began his career as a dispatch clerk with New India Assurance Company.[19] As time went by, he became interested in the stock markets. Towards the end of the 1970s, Mehta married Jyoti, whom he had known for five years. Mehta used to play cricket in the apartment complex where Jyoti lived and had met her during the Daandiya[20] holiday. Mehta and his brother Ashwin spent their evenings analyzing tips and financial statements. To understand the stock market and its operations, the two brothers also invested heavily in the stock market. While learning the tricks of the trade, Mehta went through a couple of cycles of boom and bust.

In the early 1980s, Mehta quit his job with New India Assurance to work for BSE stockbroker P. Ambalal. Mehta realised during his stint with Ambalal that, to stay ahead of the market,

[16] Asia Money (1 February 2001) "Harshad Mehta: A Legacy of Fraud", http://www.asiamoney.com/Article/2057192/Channel/18853/Harshad-Mehta-a-legacy-of-fraud.html (accessed 23 October 2008).
[17] Singh, K. (12 January 2002) "Harshad Mehta", http://www.independent.co.uk/news/obituaries/harshad-mehta-729662.html (accessed 23 October 2008).
[18] A family originating from Gujrat, a state in the western part of India.
[19] New India Assurance Company was one of the largest non-life insurers in India.
[20] Daandiya was a singing and dancing festival originating from Gujrat that went on throughout the night for nine consecutive nights.

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insider information was of significant value. (Insider trading was not a crime in India until November 1992.) Later, while working as a sub-broker for stockbrokers J.L. Shah and Nandalal Sheth, Mehta entered into overleveraged positions, leading to huge losses. Unable to sustain these, the Mehtas sought to settle their dues by selling their house. Subsequently, Mehta offered his house as a guarantee to his bosses. Although Shah and Sheth worked out a repayment plan for Mehta, they banished him from the trading floor with their firm.

Mehta emerged from this struggle even stronger. In 1981, the Mehta brothers teamed up to start their own firm, Grow More Research and Asset Management Company Limited, a sub-broking partnership firm in a rented office with a mere two-person capacity at the time. Around the middle of 1984, when a trading card was being auctioned at the BSE, with assistance from Mehta's previous broker mentors, Shah and Sheth, Mehta made a bid for the BSE card. With powerful friends in control at the BSE and close connections with the regulators, Mehta achieved dizzying success in a short period of time. His achievement was such that his actions, perceived or actual, drove the movement of not only the Sensex but also individual stock-specific activities. Due to Mehta’s interest in the Associated Cement Company, the company’s stock was bid up to US$320.20. Mehta used replacement cost theory as an explanation for such valuations, the premise of the theory being that the basis of valuing old companies ought to be the amount of money that would be needed to create another such company.

Mehta was said to have started a bull run, earning himself the nickname Big Bull. A video newsmagazine featured Mehta feeding peanuts to bears at a Mumbai zoo! At the peak of his career, he lived a glamourous life often compared to that of a movie star. He owned Madhuli, a 1400 square meter mansion that included a billiards room, mini theatre, swimming pool and golf course. He enjoyed fuelling his own publicity and showing off his success to journalists. His taste for expensive cars also attracted media attention. Later, S. Dalal, one of the journalists who broke the scam in the *Times of India*, wrote in one of her columns:

> *Harshad's problem has always been his flashiness. In 1992, when I broke the story about the Rs 6 billion [US$19.21 million] that he had swiped from the State Bank of India, it was his visits to the bank's headquarters in a flashy Toyota Lexus that was the tip off. Those days, the Lexus had just been launched in the international market and importing it cost a neat package.*[21]
>
> - Sucheta Dalal, Times of India

Charismatic, cheerful and at the same time recklessly ambitious, Mehta told a newspaper in 1992:

> *I thought I'd be like to be Pied Piper. I thought I can sell dreams ... that asset-creation is not a crime, that if you wanted to be Harshad Mehta come to the stock market.*[22]
>
> - Harshad Mehta

By the early 1990s, Mehta was a sensation loved by both investors and the business media. He was portrayed as the ultimate rags-to-riches stock market success story. The dreams of an extraordinarily ambitious man in the faceless crowd had been realised. But where did Mehta get his endless supply of money from? Nobody seemed to have any clue.

[21] Dalal, S. (31 December 2001) “Harshad Mehta: From Pied Piper of the Markets to India's Best-Known Scamster”, http://www.indiaabroad.com/money/2001/dec/31dalal.htm (accessed 23 October 2008).
[22] Ibid.

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Then, on 22 April 1992, the stock market scam was exposed, bringing down with it several financial entities. Mehta, the hero of millions of investors, was now the cause of their despair. Mehta, who had singularly taken the capital market to unprecedented heights, was now also squarely blamed for its crash. His fall from the pinnacle of glory was as fast and sensational as had been his spectacular rise.

Investigations exposed the ingenious ways by which Mehta siphoned funds from the banking system to fund his stock market investments. Investigators revealed how Mehta cleverly used BRs to create the stock market frenzy. Holding Mehta responsible for the loss of more than US$1.28 billion, the investigators arrested him on 5 June 1992.

In 1995, when Mehta publicly announced that he had paid US$320,000 in party donations to the then prime minister of India and president of the Congress party,[23] P.V. Narasimha Rao, for getting him off the hook, Mehta once again created an uproar in the country. He had not given up. In 1998, he made a short-lived comeback as a stock market guru. He began dispensing stock tips in a weekly newspaper column as well as on his own website. Just as before, the strategy was simple: Mehta collaborated with the owners of a few companies, and through his column and website, he recommended the shares of these companies to unwary investors. His game, however, did not last long. Subsequently, after investigations, SEBI permanently banned him from stock market-related activities.

According to the investigating agency, the Central Bureau of Investigation,[24] Mehta continuously funded himself by selling the undeclared parts of his 1992 stock portfolio. It is the sale of these shares that landed him back in police custody, where he eventually died. With 28 cases registered against him, the decade-long legal tug of war that had started in 1992 was still on when Mehta died. Just before his death, Mehta seemed defeated. With his passing away, Mehta's dreams of coming back to the capital markets were truly over.

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[23] Congress was a leading Indian political party.
[24] The Central Bureau of Investigation was the investigation agency of the government of India.

[redacted]

EXHIBIT 1: INVESTMENTS FOR WHICH NO BANK RECEIPTS WERE HELD

Name of Bank	Rs. in billion	US$ in million
National Housing Bank(NHB)	11.99	38.39
State Bank Of Saurashtra	1.75	5.60
SBI Capital Markets Ltd(SBI Caps)	1.21	3.87
Standard Chartered Bank	3.00	9.61
Total	17.96	57.51

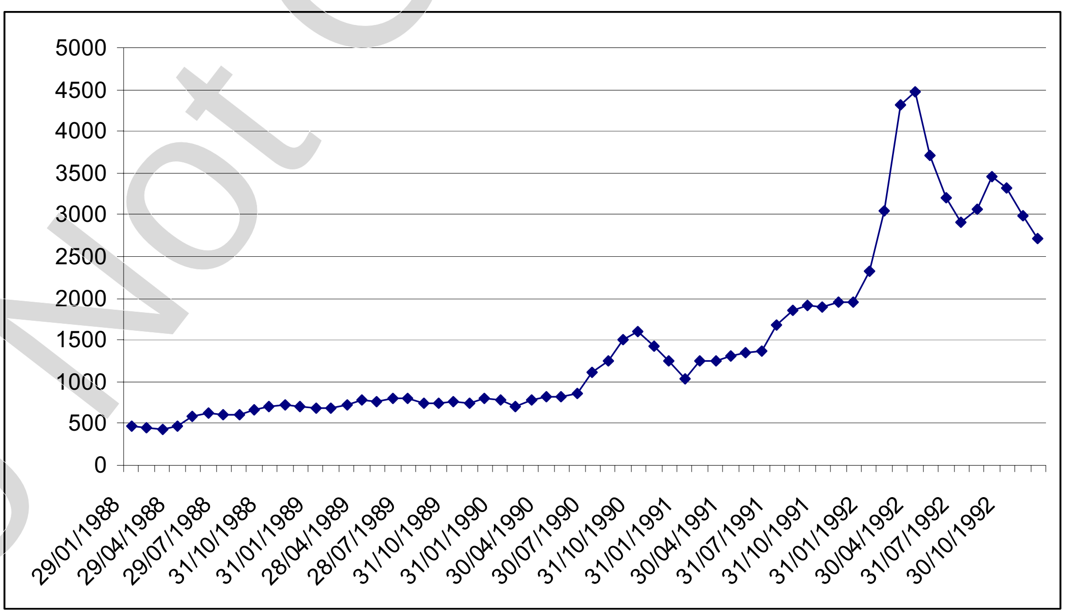
Source: Reserve Bank of India (1992) "The Janakiraman Committee Report".

EXHIBIT 2: BANK RECEIPTS WITHOUT SECURITY BACKING

Name Of Bank	Rs. in billion	US$ in million
Standard Chartered Bank	7.55	24.17
Canbank Financial Services Ltd(Canfina)	4.25	13.61
Canbank Mutual Fund	1.03	3.30
Total	12.83	41.08

Source: Reserve Bank of India (1992) "The Janakiraman Committee Report".

EXHIBIT 3: SENSEX MONTHLY HIGH VALUES
1988 TO 1992



Source: Centre for Monitoring Indian Economy (various issues) "Monthly Review of the Indian Economy".

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