Project on Harshad Mehta Scam 1992

The story of Harshad Mehta Scam

The Harshad Mehta scam was about exploiting loopholes in India's banking system to funnel money into the stock market. Mehta and his associates found creative ways to tap into bank funds and use them to artificially inflate stock prices.

Harshad Mehta's story is often described as a rags-to-riches tale gone wrong. Born in a lower-middle-class Gujarati family, Mehta moved to Mumbai (then Bombay) in the 1970s to make his fortune.

He started his career doing odd jobs, including selling hosiery and cement. But Mehta had bigger ambitions. He was fascinated by the stock market and soon started working as a jobber (a kind of broker) at the Bombay Stock Exchange.
Mehta was a quick learner and had a knack for understanding market dynamics. By the 1980s, he had set up his own firm, GrowMore Research and Asset Management. His rise in the stock market was meteoric. Known for his aggressive trading strategies, Mehta soon earned the nickname "Big Bull" of Dalal Street.

What set Mehta apart was his ability to spot undervalued stocks and his persuasive skills in convincing others to invest. He became famous for his "replacement cost theory" - the idea that companies' stocks should be valued based on the cost of setting up a similar business from scratch.

Mehta's lifestyle reflected his success. He owned a fleet of luxury cars, lived in a plush 15,000 sq ft apartment in Mumbai's posh Worli area, and was often seen in designer suits. His lavish parties became the talk of the town.
But behind this glitzy facade, Mehta was playing a dangerous game. He used his connections in banks and financial institutions to access funds illegally and manipulate stock prices. This risky strategy would ultimately lead to his downfall.

1. The Ready Forward Deal Loophole: Banks in India needed to maintain a certain percentage of their deposits in government securities. They often traded these securities among themselves through 'ready forward' deals - essentially, short-term lending arrangements. Mehta exploited this system by posing as a broker between banks.

2. Bank Receipts (BRs): Instead of moving securities, banks would issue BRs as proof of transaction. Mehta managed to get banks to issue BRs without actually holding the securities.

3. Diverting Funds: Mehta obtained funds from banks using these fake BRs. But instead of using the money for security transactions, he diverted it to buy stocks.

4. Pumping Stocks: Mehta used these funds to buy large quantities of select stocks, artificially inflating their prices. He would then use these overvalued stocks as collateral to borrow more money, creating a cycle.

5. The Bear Cartel: Mehta was also in a brawl with a group of bearish traders. He used the bank funds to keep buying stocks, forcing these traders to buy at higher prices to cover their positions, further driving up prices.

One famous example of Mehta's stock manipulation was ACC (Associated Cement Company). In just a few months, he drove ACC's stock price from around ₹200 to nearly ₹9000.

The scam started unravelling when the State Bank of India reported a shortfall in government securities. Investigations revealed that the bank had issued Mehta BRs but had not delivered the securities.

As news of the fraud spread, the stock market crashed. The Sensex fell from 4500 points to 2500 points in months, wiping out huge amounts of investor wealth.

Drawbacks of Stock Market

1. **Significant Risk**: Stock market investments are high-risk investments. During unfavourable market scenarios, an investor could lose their entire investment. Stocks are highly volatile investments. Therefore, it is advisable to invest with caution.
2. **Timing:** It is almost next to impossible to time the market. The volatile nature of the stocks makes it difficult to hit the bull’s eye. Buying low, selling high is a good strategy. However, buying them at the lowest and selling at the highest is not very easy.
3. **Knowledge:** Stock investing requires in-depth research about the company and the market as well. Studying the financial statements, annual reports, comparing the historical performance, sector analysis, etc. is a tedious job. Therefore, unless one can do all the research before investing, stock investing is a gamble.
4. **Emotions:** Seeing the stock movements, investors often buy at high prices with an anticipation that the prices would go up (out of greed). Also, they end up selling at low and making losses with an expectation that the price may fall further (out of fear). Price fluctuations are frequent. However, it is essential not to get carried away by them.
5. **Stockholders are paid last:** In a scenario where the company goes out of business, first, the preference stockholder and bondholders or creditors are paid. And in the last, the common stockholders are paid.

Technical Terms

1 **Stock**

A stock represents ownership in a company. When you purchase a share, you own a small piece of that company.

2. **Stock Market**

The stock market is a marketplace where stocks are bought and sold. Major stock exchanges like the NSE (National Stock Exchange) and BSE (Bombay Stock Exchange) in India facilitate this trade. It connects buyers and sellers, providing liquidity and a platform for price discovery based on supply and demand.

3 **Dividend**

Dividends are a portion of a company's profits distributed to shareholders. For instance, if a company announces a ₹10 dividend per share, and you own 100 shares, you'll receive ₹1,000. Dividends are usually paid quarterly and are a reward for investing in the company.

4 **Initial Public Offering (IPO)**

An IPO is when a company offers its shares to the public for the first time to raise capital. For example, Hyundai India's IPO in 2024 marked its entry into the stock market, giving investors the chance to own a stake in the company.

5 **Index**

An index, like the Sensex or Nifty 50, measures the performance of a group of stocks, offering insights into the broader market's performance. It serves as a benchmark for individual investments.

6 **Portfolio**

A portfolio is the collection of investments owned by an individual or institution. Diversification investing across stocks, bonds, and mutual funds is key to building a balanced portfolio to manage risk.

7 **Liquidity**

Liquidity refers to how easily an asset can be bought or sold in the market without affecting its price. Stocks of well established companies are easier to trade compared to smaller and unestablished companies that have low-volume resulting in a longer time to find a buyer.

8 **Bull Market**

A bull market is characterized by rising stock prices and optimistic investor sentiment. For instance, if the Nifty 50 index climbs steadily for months, it’s considered a bull market, often reflecting economic growth or positive business conditions.

<u>Point of view on Scam 1992</u>

According to my POV, Harshad Mehta was a **GENIUS** and he exploited the loop holes in the Indian Banking System to make money. The transaction between banks i.e. purchase & sell of government bonds through brokers used to be settled in **14 days**, and in that period, money used to be kept in the account of broker. Harshad Mehta started using that money and started investing in a selected stocks & rigging the market. The massive buying of selected stocks using banking funds by Harshad Mehta resulted in astronomical rise in the price of few stocks. Rotating the money between various banks and the stock market, he made huge return in a small time period. The transaction between banks could also take place through issuance of bank receipts rather than physical transfer of government securities.

There were others who were also involved in this but they weren't punished as much as Mehta because they were laying low.

Harshad's image as **Bachchan of Dalal Street** put him on the radar of many big names and he had a lot of enemies because of the same. He became a poster boy and many people grew envious of him which made his enemies gang up on him and corner him.

Harshad Mehta was a hero for many but they also started hating him after his shares dropped due to Biggies ganging up on him.

Plus his association with big names like Plus his association with big names like **Chandra swami** who was self-styled godman who became famous of his close connection with Narsimha Rao. In 1991, as **Narsimha Rao** became the PM, Chandra swami built an ashram in Delhi on the land allocated by **Indira Gandhi**.

Chandra Swami was directly associated with PV Narsimha Rao who was the PM at that time, he used his power to make sure that Mehta spends as much time in jail as possible and for that a number of criminal charges were imposed on him.

Then there was the famous briefcase Case in which Harshad Mehta’s lawyer Ram Jethmalani claimed that his Harshad Mehta had paid Rs 1 crore to the then Prime Minister PV Narasimha Rao.

With all his enemies ganging up on him, Chandra swami using his political connections and power to keep him behind bars and his close aide Ketan Parekh betraying him, Mehta fell in a trap of criminal charges and CBI injury and finally lost his life in custody.

Disclose

The Harshad Mehta scam, also known as the 1992 securities scam, was one of the biggest financial scandals in India, and Harshad Mehta was at the center of it. Here are some of the key mistakes and fraudulent activities that led to the scam:

1. **Manipulation of Stock Prices:** Harshad Mehta artificially inflated stock prices, particularly in the shares of companies like ACC, Zee, and others. He used his influence to create a false impression of high demand for these stocks, making them appear more valuable than they actually were.

2. **Fraudulent Use of Bank Receipts:** One of the primary ways Mehta manipulated the system was by using fake bank receipts (BRs) to secure funds. He forged BRs to obtain large amounts of money from banks, which he then used to buy stocks. This fraudulent practice allowed him to control huge amounts of money that he didn't actually have.

3. **Misuse of the Banking System:** Mehta exploited the loopholes in the banking system to get money from banks without any real collateral. He used the funds to manipulate the stock market, effectively creating an artificial demand for stocks. This caused a massive surge in stock prices, which he sold to make huge profits.

4. **Lack of Transparency:** Mehta took advantage of the lack of regulatory oversight in the Indian financial markets at the time. The stock exchanges, banks, and other financial institutions were not as closely regulated, allowing him to carry out his manipulative practices without much scrutiny.

Navya Naveli Dubey
Janvi Bansal