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TWO SCAMS, ONE LESSON: REGULATORY AND GOVERNANCE FAILURES IN THE HARSHAD MEHTA (1992) AND KETAN PAREKH (2001) SECURITIES FRAUDS AND THE REFORMS THAT FOLLOWED

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CERTIFICATE

This is to certify that the project report titled "Two Scams, One Lesson: Regulatory and Governance Failures in the Harshad Mehta (1992) and Ketan Parekh (2001) Securities Frauds and the Reforms That Followed" has been prepared by Prachi Ranjan, Roll No. 34, a student of the LL.M. programme at New Law College, Pune, Bharati Vidyapeeth (Deemed to be University), under my guidance and supervision.

To the best of my knowledge, the work is original and has not been submitted to any other university or institution for the award of any degree or diploma.

Rashmi Dubey
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Date: 13/11/26

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LIST OF ABBREVIATIONS

Abbreviations	Definitions
ACC	Associated Cement Companies
BR	Bank Receipt
BSE	Bombay Stock Exchange
CBI	Central Bureau of Investigation
CSE	Calcutta Stock Exchange
GTB	Global Trust Bank
JPC	Joint Parliamentary Committee
LODR	Listing Obligations and Disclosure Requirements
MMCB	Madhavpura Mercantile Co-operative Bank
NSE	National Stock Exchange
PFUTP	Prohibition of Fraudulent and Unfair Trade Practices
PIT	Prohibition of Insider Trading
RBI	Reserve Bank of India
RF	Ready Forward
SAT	Securities Appellate Tribunal
SBI	State Bank of India
SCC	Supreme Court Cases
SEBI	Securities and Exchange Board of India

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CHAPTER 1: INTRODUCTION AND LITERATURE REVIEW

1.1 Introduction

A securities market runs on a simple bargain. Investors part with their savings because they believe that prices broadly reflect real demand and supply, that intermediaries stay within the limits set for them, and that someone with authority is watching. When the bargain breaks, the damage is not confined to the wrongdoers. Banks lose depositors' money, honest brokers face payment crises, and ordinary households withdraw from equity for years.

India's market history contains two episodes that tested this bargain within roughly nine years of each other: the securities scam of 1992, associated with the broker Harshad Mehta,[1] and the market manipulation of 1999–2001, associated with the broker Ketan Parekh.[2] Popular accounts present both as tales of individual audacity. This study reads them differently. Each is treated as a failure of institutions: of the regulator, of the banks and exchanges that handled the money and the trades, and of the governance of the companies whose shares were traded.

In 1992 the money came largely from the banking system. Mehta used ready forward transactions in government securities and bank receipts that were not always backed by the securities they described, and he channelled the resulting funds into a narrow set of shares.[3] In 2001 the money came from promoters of listed companies, from financiers and, importantly, from co-operative banks, and it was directed at a hand-picked group of technology, media and telecom shares that came to be known as the K-10 stocks.[4] The mechanics differed, but the underlying weaknesses were strikingly similar: thin supervision, opaque funding, and boards and managements that did not ask difficult questions.

The study first reconstructs each episode, then compares what went wrong in each, and finally assesses the legislative and regulatory reforms that followed, with particular attention to the corporate governance framework that now applies to Indian listed companies and to market intermediaries.

1.2 Significance of the Study

The subject deserves attention for four reasons. First, the two episodes are turning points in Indian securities law. The first pushed the Securities and Exchange Board of India (SEBI)

[1] Joint Parliamentary Committee on Irregularities in Securities and Banking Transactions, *Report* (Lok Sabha Secretariat 1993).
[2] Joint Parliamentary Committee on Stock Market Scam and Matters Relating Thereto, *Report* (Lok Sabha Secretariat 2002).
[3] Debashis Basu and Sucheta Dalal, *The Scam: Who Won, Who Lost, Who Got Away* (Kensource Information Services 2007).
[4] A Gupta, 'Scams That Changed India's Capital Market' *SunText Review of Arts & Social Sciences* (ISSN 2766-4600).

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towards statutory status and led to a new, electronic exchange, while the second accelerated the end of the badla system, the move to rolling settlement and a sharper enforcement toolkit.[5] Second, the techniques involved, such as price rigging, circular trading and the misuse of non-public information, have not disappeared. Contemporary commentary on retail-investor fraud still lists inflating prices through misleading information and then selling, trading on privileged information and manufacturing the appearance of volume as standard patterns of abuse.[6] Understanding how earlier episodes unfolded helps in recognising their modern variants.

Third, the topic sits at the junction of banking regulation, securities regulation and company law, which are often studied separately. The scams show that gaps at the boundaries between these areas can be as dangerous as gaps within any one of them. Fourth, the lessons bear directly on present debates about board independence, whistle-blower protection and the speed of enforcement.

1.3 Research Problem

After 1992 India made significant changes: SEBI received statutory powers, a screen-based exchange was established and the depository system was legislated. Even so, a second large-scale manipulation emerged in 2001, and it exploited several weaknesses that were strikingly familiar, including bank lending to a broker without adequate security, weak surveillance of concentrated trading, and little visibility into how trades were funded. The research problem is therefore to determine why the lessons of the first episode were only partly absorbed, what each episode reveals about regulatory and governance failure, and how far the later framework, including Clause 49 of the Listing Agreement, the Companies Act 2013 and the SEBI regulations, addresses those failures.

The study addresses the following questions:

(1) How did each scheme operate, and how was it funded?

(2) Which regulatory, supervisory and governance failures allowed each scheme to grow before it was detected?

(3) What do the two episodes have in common, and where do they differ?

(4) What reforms followed each episode, and how effective have they been in closing the identified gaps?

1.4 Hypothesis

The central hypothesis is that both episodes owed less to a complete absence of rules than to

[5] Securities and Exchange Board of India Act 1992.

[6] Shivam Shukla, 'Stock Market Fraud: How to Identify Investment Scams, Avoid High-Risk Trading, and Protect Your Wealth' *Mint* (4 April 2025).

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fragmented oversight, weak internal controls in financial institutions, and unaccountable concentrations of power in brokers and promoters. It follows that reforms aimed at these weaknesses, namely a statutory regulator with real enforcement powers, transparent and rapidly settled trading, and independent oversight within boards, have reduced the risk of such episodes without eliminating it.

1.5 Objectives of the Study

(1) To describe the structure and modus operandi of the 1992 and 2001 securities frauds.
(2) To identify the regulatory failures and corporate governance failures that enabled them.
(3) To compare the two episodes systematically.
(4) To trace the legal and institutional reforms that followed each episode.
(5) To evaluate those reforms and suggest improvements.

1.6 Scope of the Study

The core period is 1992 to 2003, with later developments considered up to the present framework of the Companies Act 2013 and the SEBI Listing Obligations and Disclosure Requirements Regulations 2015. The study is confined to the Indian legal system. It does not conduct an empirical event study of price movements, nor does it examine criminal procedure in detail. Monetary estimates of the frauds vary between sources, so figures are reported as approximations and attributed to their sources.

1.7 Research Methodology

The study is doctrinal, descriptive and analytical, with a comparative element. It relies on primary materials, namely statutes, regulations, parliamentary committee reports and judicial decisions, and on secondary materials, namely books, scholarly articles and press reports. No field work was undertaken. Citations follow a single footnoting convention, modelled on the OSCOLA style, with a full citation at first mention and a short form with a cross-reference thereafter. Where sources disagree on facts or figures, the divergence is noted rather than resolved by assertion.

1.8 Literature Review

The principal narrative account of the first episode is the work of Debashis Basu and Sucheta Dalal, which reconstructs the money trail between banks, brokers and shares in detail and remains the standard reference for readers.[7] Its strength is the reporting; its limitation, for a legal study, is that it is not organised around doctrinal questions. The official diagnosis is found in the report of the Joint Parliamentary Committee on the 1992 scam and in the report of the

[7] Basu and Dalal (n 3).

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committee set up by the Reserve Bank of India under R Janakiraman, which examined the securities transactions of banks.[89]

For the second episode, the main official source is the report of the Joint Parliamentary Committee that investigated the 2001 market crash, which considered the role of brokers, banks, exchanges and regulators.[10] Press and journal accounts add detail about the K-10 stocks, the bear raid after the 2001 Budget and the failure of co-operative bank lending.[111213] Short comparative treatments, including those by Gupta and by Vyshnavi, are useful for chronology and reform summaries but are largely descriptive.[1415]

On corporate governance, the international starting point is the Cadbury Report, which framed governance in terms of board structure, audit and accountability.[16] In India, the Kumar Mangalam Birla Committee translated these ideas into Clause 49 of the Listing Agreement, and later committees chaired by Naresh Chandra, N R Narayana Murthy and Uday Kotak refined them.[17181920] Empirical work by Black and Khanna found that the announcement of Clause 49 was associated with positive market reactions for firms more likely to be affected by it, supporting the view that governance reform carries real value for investors.[21]

The gap in the literature is the absence of a study that places the two scams side by side through the specific lens of regulatory and governance failure and then maps each failure to the reform that responded to it. This study attempts to fill that gap.

[8] JPC Report (1993) (n 1).
[9] Reserve Bank of India, *Report of the Committee to Enquire into Securities Transactions of Banks and Financial Institutions* (RBI 1993).
[10] JPC Report (2002) (n 2).
[11] L Mishra, 'Who's Ketan Parekh and Why's He Bad for the Market?' *India Today* (2012).
[12] '2001 – Ketan Parekh Scam: Stock and Bull Story' *India Today* (2009).
[13] C Chakraborty, 'Remember Ketan Parekh? Some KP10 Stocks Still Doubled Investor's Wealth' *The Economic Times* (2016).
[14] Gupta (n 4).
[15] A Sai Sree Vyshnavi, 'The Rise and Fall of Harshad Mehta: Case Study on Financial Fraud and Post-Scam Reforms in India' (SRM Institute of Science and Technology, Trichy Campus).
[16] Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee 1992).
[17] Securities and Exchange Board of India, *Report of the Kumar Mangalam Birla Committee on Corporate Governance* (SEBI 1999).
[18] Ministry of Corporate Affairs, *Report of the Committee on Corporate Audit and Governance* (Naresh Chandra Committee) (2002).
[19] Securities and Exchange Board of India, *Report of the SEBI Committee on Corporate Governance* (Narayana Murthy Committee) (2003).
[20] Securities and Exchange Board of India, *Report of the Committee on Corporate Governance* (Kotak Committee) (2017).
[21] Bernard Black and Vikramaditya Khanna, 'Can Corporate Governance Reforms Increase Firms' Market Values? Evidence from India' (2007) 4 Journal of Empirical Legal Studies 749.

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CHAPTER 2: THE HARSHAD MEHTA SECURITIES SCAM (1992)

2.1 The Market and Regulatory Setting before 1992

In the late 1980s and early 1990s, India's securities market was small by today's standards and heavily manual. Trading on the Bombay Stock Exchange (BSE) took place on the floor through brokers; shares were held as paper certificates; and settlement could take weeks. SEBI had been set up in 1988 as an administrative body, but it did not yet have statutory backing or meaningful enforcement powers.[22] Public sector banks were the dominant players in the money market, and they invested in government securities partly to meet statutory liquidity requirements.

Two features of the setting are especially relevant. First, banks traded securities among themselves through brokers rather than directly. The broker introduced the buyer and the seller, and in practice often handled the cash and the paper as well, which placed enormous trust in intermediaries. Second, a bank's record of the securities it owned and those it had lent against was maintained by manual systems that were easy to bypass. The combination of intermediated trading and weak records created the conditions for fraud.[23]

2.2 Harshad Mehta: Background and Rise

Harshad Shantilal Mehta, born in 1954, completed a Bachelor of Commerce degree in Bombay and worked in a variety of sales jobs before entering the stock market. After a stint with an insurance company he moved into broking, rose through a series of firms during the 1980s, and became a member of the BSE in the mid-1980s through his own firm.[24] By around 1990 he had become a prominent figure, and the press gave him the nickname 'Big Bull'.

His public reputation was built on a heavy concentration of buying in particular shares, most famously Associated Cement Companies (ACC). The price of ACC rose from around ₹200 to several thousand rupees within a short period, and Mehta defended the rise through what he called a 'replacement cost' theory, arguing that the company's shares had been undervalued relative to the cost of building a comparable plant.[25] The theory sounded plausible to many investors. It also served as a convenient justification for a rise that, as later investigations showed, was powered substantially by borrowed money.

2.3 Modus Operandi

The scheme depended on two connected mechanisms: the misuse of ready forward (RF) transactions, and the use of bank receipts (BRs) to create credit that was not backed by

[22] Securities and Exchange Board of India Act 1992.
[23] Janakiraman Committee Report (n 9).
[24] Daksesh Parikh and Arun Katiyar, 'Security's Scandal: Harshad Mehta Being Put Behind Bars, Millions Lose Their Fortune' *India Today* (1992).
[25] Sucheta Dalal, 'The Pied Piper of Dalal Street' *The Times of India* (24 April 1992).

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securities.

A ready forward deal is, in essence, a short-term secured loan between banks. One bank sells government securities to another with an agreement to buy them back shortly afterwards at a slightly higher price, so that the difference works as interest. In practice the deal was routed through a broker, who arranged the transaction and, at the time, often handled the payments as well.[26] That arrangement meant that the money from the lending bank frequently passed through the broker's account rather than moving directly to the borrowing bank.

A bank receipt was a document issued by the selling bank confirming that it held securities and would deliver them, or hold them on behalf of the buyer. Properly used, a BR was a stopgap while physical securities were in transit. Mehta and his associates are reported to have obtained BRs from a small number of banks, among them the Bank of Karad and the Metropolitan Co-operative Bank, that were not backed by actual securities.[27] A BR of this kind looked like proof of a security but represented nothing. Larger banks accepted such receipts as security for the cash they lent, and the cash flowed to the broker.

The funds so obtained were not used for the purpose for which they had been advanced. They were channelled into the stock market to buy shares in a chosen set of companies, and the resulting demand pushed prices upwards. Rising prices made the shares appear more valuable as collateral and attracted other buyers, which lifted prices further. In effect, the broker was converting short-term interbank money into long-term equity positions, and his ability to keep the cycle going depended on the market continuing to rise.[28]

Two clarifications are needed on terminology. The manipulation of prices through concentrated buying with borrowed funds is better described as price rigging or a bull operation than as circular trading in the strict sense, and some popular accounts use the label 'pump and dump' loosely for it.[29] The legally significant feature is that bank funds were diverted to speculative use through false or unsupported documents.

2.3.1 The Role of Banks

Public sector banks were not merely victims. The reports that followed identified lapses in how banks dealt with brokers: accepting BRs without verifying the underlying securities, allowing brokers to handle cash that should have moved between institutions, and failing to reconcile

[26] Basu and Dalal (n 3).
[27] Basu and Dalal (n 3).
[28] Central Bureau of Investigation, 'The Securities Scam of 1992' (CBI Archives) <https://cbi.gov.in> accessed 22 May 2018.
[29] Kishore Kumar, '1992 Indian Stock Market Scam – The Complete Case Study of Harshad Mehta' (*Intellipaat*, 29 May 2025).

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their holdings.[30] The State Bank of India (SBI) and the National Housing Bank were among the institutions with large exposures. The episode therefore revealed an internal control failure inside the banking system that was independent of the stock market's own weaknesses.

2.4 Exposure and Collapse

The scheme came to public attention in April 1992, when the journalist Sucheta Dalal reported in *The Times of India* on irregularities involving a broker and the State Bank of India.[31] Once questions about the missing securities began to be asked in public, the process that had fuelled the boom reversed. Banks demanded repayment, positions had to be sold, and the Sensex fell from roughly 4,500 points to around 2,500 points in the following months. Estimates of the wealth erased in the market run into the order of ₹1,000 billion, and the downturn lasted about two years.[32]

The Reserve Bank of India set up a committee under R Janakiraman to examine banks' securities transactions, and Parliament constituted a Joint Parliamentary Committee to inquire into irregularities in securities and banking transactions.[3334] Criminal investigations were led by the Central Bureau of Investigation (CBI), which registered numerous cases against the broker and bank officials.[35]

Table 1: Chronology of the 1992 Securities Scam

Period	Event
1990–1991	Heavy buying in ACC and other shares by Mehta and associates; the 'replacement cost' explanation is publicised.
April 1992	The Sensex reaches a record high, close to 4,500 points.
April 1992	Press reports raise questions about State Bank of India's securities and the use of bank receipts; the market begins to fall.
1992	RBI's Janakiraman Committee and a Joint Parliamentary Committee are constituted; the Special Court Act is enacted.
Late 1992	Mehta is arrested by the CBI; criminal cases and civil recovery proceedings follow.

[30] JPC Report (1993) (n 1).
[31] Dalal, 'The Pied Piper of Dalal Street' (n 25).
[32] Parikh and Katiyar (n 24).
[33] Janakiraman Committee Report (n 9).
[34] JPC Report (1993) (n 1).
[35] CBI, 'The Securities Scam of 1992' (n 28).

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Period	Event
1993	The JPC reports; Mehta makes a public allegation concerning a payment to the Prime Minister, which was disputed.
1999–2001	A first conviction is recorded by the Special Court; Mehta dies in custody in December 2001 with several cases still pending.

2.5 Legal Aftermath

The scale and complexity of the transactions made ordinary proceedings unsuitable, so Parliament enacted the Special Court (Trial of Offences Relating to Transactions in Securities) Act 1992. The Act created a Special Court to try offences connected with the scam and a Custodian with power to attach the property of persons notified under it, so that assets could be preserved for the benefit of the banks and institutions that had been defrauded.[36] The Supreme Court considered the working of this mechanism in several decisions, including those dealing with the Custodian's powers and with proceedings arising from the notified transactions.[37][38]

The criminal process was slow. A first conviction came several years after the events, and Mehta died in custody in 2001 while other cases were still unresolved.[39] The delay is itself a point of analysis: deterrence depends not just on the severity of the penalty but on the speed with which it is imposed.

2.6 Impact on the Securities Market

The episode had several consequences. The immediate effect was the market crash and a long period of investor caution. Beyond that, it exposed gaps in banking supervision, in the handling of securities and in the powers of the market regulator. It led directly to the statutory strengthening of SEBI, to restrictions on how banks dealt with brokers and, over the next few years, to the creation of an electronic exchange and a depository system.[40] The episode also left a lasting political and legal debate about accountability for failures in public sector banks.

[36] Special Court (Trial of Offences Relating to Transactions in Securities) Act 1992.
[37] *Harshad Shantilal Mehta v Custodian* (1998) 5 SCC 1.
[38] *Hiten P Dalal v Bratindranath Banerjee* (2001) 6 SCC 16.
[39] Basu and Dalal (n 3).
[40] Vyshnavi (n 15).

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CHAPTER 3: THE KETAN PAREKH SECURITIES SCAM (1999–2001)

3.1 The Market Setting

The second episode took place in a very different environment. By the late 1990s SEBI had statutory powers and the National Stock Exchange (NSE) had introduced screen-based trading in 1994, yet important structural features of the earlier era persisted. Settlement on the BSE and regional exchanges still relied on account periods, and a financing system known as badla allowed traders to carry positions forward from one settlement to the next by paying interest to financiers, which made leveraged speculation easy and relatively opaque.[41]

The period was also one of global enthusiasm for technology, media and telecommunications stocks. Indian markets followed the global trend, and shares of software, media and entertainment companies rose sharply in 1999 and early 2000. When the dot-com bubble burst in 2000, prices of such shares fell around the world, and Indian technology stocks were no exception.[42]

3.2 Ketan Parekh

Ketan Parekh was a chartered accountant from a family with a background in stock broking, and was said to have been trained in the ways of the market by Harshad Mehta.[43] He kept a low profile in contrast to his predecessor, but his influence grew in the late 1990s as promoters of companies looked for someone who could generate interest in their shares at a time when bank credit was hard to obtain. According to press accounts, he built relationships with promoters and financiers who would supply funds and, in return, benefit from a rising share price.[44]

3.3 Modus Operandi

The scheme centred on a group of stocks that were popularly labelled the K-10 stocks. Accounts vary on the exact membership of the list, but it is generally said to have included companies such as DSQ Software, Pentamedia Graphics, Visualsoft, Zee Telefilms, HFCL, Silverline Technologies, Aftek and Global Telesystems, along with larger names such as Satyam Computer Services, Infosys and Ranbaxy that lent credibility to the group.[45] Some of the price increases in the smaller names were dramatic; Visualsoft, for instance, is reported to have risen from the range of ₹600 to several thousand rupees per share.[46]

Several techniques were used in combination.

[41] JPC Report (2002) (n 2).
[42] Chakraborty (n 13).
[43] Mishra (n 11).
[44] 'Ketan Parekh Scam: Stock and Bull Story' (n 12).
[45] Chakraborty (n 13).
[46] Gupta (n 4).

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Circular trading and price rigging. Orders to buy and sell the same shares were matched between connected parties, creating the appearance of active demand without any change in genuine beneficial ownership. In the standard description, identical buy and sell orders are entered at about the same time, in the same quantity and at the same price, so that the shares change hands on paper but not in substance, while the reported volume rises.[47] Such activity can be used to push a price upward and to attract genuine investors who interpret the volume as interest.

Use of non-public information. Parekh and his associates were alleged to have traded with the benefit of information that was not available to the public, including information about corporate developments shared by promoters. Insider trading, in simple terms, is dealing in securities on the strength of material, non-public information, and it undermines the principle that all investors should have access to the same information at the same time.[48]

Preferential allotments and promoter funding. Shares of favoured companies were allotted on a preferential basis to entities associated with the operator, and funds were drawn from promoter-controlled investment companies, from overseas corporate bodies and from financiers. The committee that examined the episode paid particular attention to how these flows allowed a small group to hold substantial positions with limited capital of their own.[49]

Bank finance. To sustain the positions, large sums were borrowed from co-operative banks, in particular the Madhavpura Mercantile Co-operative Bank (MMCB) in Ahmedabad and, to a lesser extent, Global Trust Bank (GTB). Contemporary accounts record exposures of approximately ₹1,000 crore for the former and ₹250 crore for the latter, with the MMCB lending alleged to have violated Reserve Bank norms on exposure to the capital market.[50] The banks issued pay orders without receiving adequate security, a practice that echoed the unsecured use of bank paper in 1992.

3.4 Unravelling

The positions were vulnerable to any sustained fall in prices. The bursting of the global technology bubble in 2000 weakened the K-10 stocks, and in early 2001 the Union Budget was followed by sharp falls in the market. A group of bear operators was reported to have sold the K-10 shares aggressively, on the basis, some accounts say, of knowledge of the operator's stretched positions.[51]

[47] G Ramesh Babu, *Portfolio Management (including Security Analysis)* (Concept Publishing Company 2007).
[48] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992.
[49] JPC Report (2002) (n 2).
[50] Gupta (n 4).
[51] Chakraborty (n 13).

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The decline triggered a payment crisis. Brokers in Kolkata, who had carried positions financed by badla, could not meet their obligations; badla rates are reported to have risen sharply, and the Calcutta Stock Exchange (CSE) was thrown into a crisis of defaults.[52] At the same time the banks that had financed the operator faced losses. Pay orders issued by MMCB and GTB were discounted with other banks; a pay order batch of about ₹137 crore discounted with the Bank of India was dishonoured, with only a small fraction recovered, and the Bank of India took legal action.[53]

Table 2: Chronology of the 2001 Market Manipulation

Period	Event
1999–early 2000	Technology, media and telecom shares rise sharply; the K-10 stocks lead the rally.
2000	The global dot-com bubble bursts; Indian technology stocks fall and pressure builds on leveraged positions.
February 2001	The Union Budget is followed by a steep fall; bear operators target the K-10 stocks.
March 2001	A payment crisis at the Calcutta Stock Exchange; MMCB and GTB pay orders come under scrutiny; Parekh is arrested by the CBI.
April 2001	A Joint Parliamentary Committee is constituted to inquire into the stock market scam.
2001–2003	Badla is discontinued and rolling settlement is introduced in stages; SEBI's PFUTP Regulations follow in 2003.
December 2002	The JPC submits its report.
2004 and 2012	GTB is merged with Oriental Bank of Commerce (2004); the licence of MMCB is cancelled (2012).

3.5 Legal and Regulatory Response

The CBI registered cases against Parekh, SEBI conducted its own investigation, and the Joint Parliamentary Committee examined the roles of the exchanges, the banks and the regulators.[54]

[52] Basu and Dalal (n 3).
[53] Gupta (n 4).
[54] JPC Report (2002) (n 2).

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SEBI subsequently took action against Parekh and entities associated with him, including orders restricting their access to the securities market, and further proceedings in different forums continued over the following years.[55]

The episode also tested the limits of SEBI's powers at the time. Investigations of manipulation depend on access to trading data, bank records and communications, and the power to search, seize and attach assets had been limited. These limits were addressed in later amendments to the SEBI Act.[56]

3.6 Impact on the Securities Market

The consequences were broader than the fate of a single operator. The market fell sharply, retail investors suffered substantial losses, and the Kolkata exchange suffered a loss of credibility. Secondary accounts estimate the amount involved at around ₹4,000 crore, though such figures should be treated with caution given the varied ways in which exposure and loss can be measured.[57] MMCB failed and was eventually liquidated, while GTB was merged into another bank. More lastingly, the episode strengthened the case for discontinuing badla, moving to rolling settlement, extending derivatives trading and giving SEBI wider enforcement powers.

[55] Gupta (n 4).
[56] Securities and Exchange Board of India Act 1992.
[57] Gupta (n 4).

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CHAPTER 4: A COMPARATIVE ANALYSIS OF REGULATORY AND GOVERNANCE FAILURES

4.1 Framework of Comparison

Comparing the two episodes requires some disciplined categories. This chapter distinguishes between three layers of failure: regulatory failure, meaning gaps in the powers, coordination and vigilance of public authorities; institutional governance failure, meaning lapses in internal control and oversight within banks and exchanges; and corporate governance failure at the level of listed companies whose shares were manipulated.

4.2 Side-by-Side Comparison

Table 3: Comparison of the 1992 and 2001 Episodes

Dimension	Harshad Mehta (1992)	Ketan Parekh (2001)
Principal source of funds	Interbank money obtained through ready forward deals and bank receipts	Funds from promoter-linked entities, financiers and co-operative banks; badla finance
Core technique	Bull operation funded by diverted bank money; use of unsupported bank receipts	Circular trading and price rigging in the K-10 stocks; preferential allotments; alleged use of non-public information
Target shares	Select large-cap stocks, notably ACC	A group of technology, media and telecom stocks
Institutions weakened	Public sector banks and the banking supervisory system	Co-operative banks, regional exchanges and the badla system
Trigger of collapse	Press exposure and demands for repayment	Global tech bust and the post-Budget fall; bear raid and payment crisis
Regulatory position	SEBI newly statutory; limited powers	SEBI statutory but without full search and attachment powers
Principal official inquiries	RBI Janakiraman Committee; JPC (1993)	JPC (2002)

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Dimension	Harshad Mehta (1992)	Ketan Parekh (2001)
Immediate legal response	Special Court Act 1992	Investigations by SEBI and CBI; later amendments and regulations

4.3 Regulatory Failures

Fragmented supervision. In 1992 the RBI supervised banks, SEBI had a nascent role over the market, and stock exchanges policed their own members. No single body had a view of how bank money was moving into shares. In 2001, the same fragmentation reappeared in a different form: co-operative banks fell under a system of dual control involving the RBI and state authorities, which made supervision of risky lending harder, while the exchanges and SEBI were not in a position to see the funding of positions across banks and brokers.[58]

Limited surveillance. In both episodes unusual patterns were visible in prices and volumes, but market surveillance systems were not designed to detect connected trading across multiple accounts or to link trading patterns with bank flows. Surveillance that observes only prices is poorly equipped to detect manipulation financed from outside the market.

Insufficient enforcement powers. In 1992 SEBI had only recently obtained statutory footing. By 2001 it had more authority, but investigations still ran into limits on obtaining records and attaching assets, and the Securities Laws amendments of 2002 were needed to strengthen them.[59] The pattern shows that creating a regulator is not the same as equipping it to act.

Exchange governance and structure. Exchanges were owned and run by their broker members, which created inherent conflicts of interest in disciplining the most active members. The badla system, which allowed financiers to carry positions with little transparency, made risk difficult to see and amplified the payment crisis when prices fell.[60]

4.4 Governance Failures within Financial Institutions

The banks involved lacked effective internal controls. In 1992 large banks accepted bank receipts without verifying that the corresponding securities existed and allowed brokers to handle sums that should have been transferred directly between institutions.[61] In 2001 co-operative banks issued pay orders and extended large loans to a broker without adequate security, in breach of prudential norms.[62]

[58] JPC Report (2002) (n 2).
[59] Securities and Exchange Board of India Act 1992.
[60] JPC Report (2002) (n 2).
[61] Janakiraman Committee Report (n 9).
[62] Gupta (n 4).

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Underlying such lapses is a governance problem. Boards and senior managements are meant to set risk limits, monitor concentration of exposure and ensure that internal audit functions independently. The evidence in the committee reports suggests that, in the institutions concerned, either these functions were absent or they were overridden by individuals who valued short-term business or personal gain over prudence. The point is not unique to India; the Cadbury Report's emphasis on the board's accountability for internal control and on an independent audit function reflects the same insight.[63]

4.5 Governance Failures within Listed Companies

In 2001, the companies whose shares were being driven up were themselves part of the problem. Promoter-dominated boards approved preferential allotments, related-party dealings and arrangements with the operator without effective scrutiny from independent directors, since the concept of independent directors and audit committees was not firmly entrenched in the listing regime at the time.[64] Disclosure was patchy, and shareholders had little visibility into the relationships between promoters, financiers and the operator.

The corporate governance dimension is less obvious in the 1992 episode, since the central failures were within the banking system and the stock market rather than within issuer companies. The comparison is nonetheless instructive: in 1992 the governance failure was concentrated in financial institutions, while in 2001 it also reached issuers. The expansion of the problem from banks to listed companies helps explain why the later reform agenda, notably Clause 49, focused on boards of listed companies.

4.6 Common Threads

Four common threads emerge. The first is information asymmetry: the people who understood the flows of money, namely the operator and a small group of financiers, knew far more than the regulators, the exchanges or the investors. The second is conflicts of interest: brokers acted as intermediaries, financiers and principals at the same time, and exchanges were governed by the very persons they had to discipline. The third is slow enforcement: criminal and regulatory proceedings took years, which weakened deterrence. The fourth is the vulnerability of retail investors, who were drawn in by rising prices and bore a disproportionate share of the eventual losses.

4.7 Why the Lesson Was Only Partly Learnt

A natural question is why the second scam happened at all after the first led to reform. Three explanations stand out. First, the reforms after 1992 concentrated on the immediate

[63] Cadbury Report (n 16).
[64] JPC Report (2002) (n 2).

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vulnerabilities, namely bank dealings with brokers and the creation of a statutory regulator, and left structural weaknesses such as badla, broker-run exchanges and co-operative bank supervision relatively untouched. Second, the new rules were only as effective as their enforcement, and enforcement powers were incomplete. Third, the market evolved: the operator adapted to the new environment by shifting the source of funds from public sector banks to promoters and co-operative banks, and the target from established blue chips to a fashionable sector. The lesson is that regulation must anticipate how actors will adapt, rather than only respond to the last episode.

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CHAPTER 5: REFORMS THAT FOLLOWED AND AN ASSESSMENT OF THE CORPORATE GOVERNANCE FRAMEWORK

5.1 Reforms after 1992

The statutory foundation of SEBI was the most significant reform. The Securities and Exchange Board of India Act 1992 gave SEBI the mandate to protect investors, promote the development of the securities market and regulate it, and empowered it to issue directions and regulations.[65] The Act also prohibited manipulative and deceptive devices and insider trading in connection with securities transactions.[66] The Securities Appellate Tribunal was established under the Act to hear appeals from SEBI's orders.[67]

Market infrastructure was reformed in parallel. The NSE introduced screen-based trading in 1994, which reduced reliance on floor-based broker intermediation, and the Depositories Act 1996 enabled the dematerialisation of securities, removing the risks of physical certificates and making ownership records more reliable.[68] In the banking sector, the RBI tightened the rules on how banks dealt in securities and used brokers, drawing on the recommendations of its own committee.[69]

5.2 Reforms after 2001

After the second episode the reform agenda was directed at the structural weaknesses identified by the parliamentary committee. Badla was discontinued in 2001 and replaced by rolling settlement, introduced in stages and shortened over the following two years, which reduced the scope for carrying leveraged positions and made settlement far more rapid. Derivatives trading, which had begun in 2000, expanded and offered a transparent and regulated way of taking leveraged positions.[70]

On enforcement, the Securities Laws (Amendment) Act 2002 strengthened SEBI's powers of investigation, search and seizure and penalty, and the SEBI Act now prescribes substantial monetary penalties for fraudulent and unfair trade practices and for insider trading, along with criminal sanctions for serious offences.[71] SEBI's PFUTP Regulations 2003 define and prohibit manipulative and deceptive practices in detail, covering conduct such as creating a false appearance of trading and manipulating prices.[72] The Supreme Court has confirmed that civil

[65] Securities and Exchange Board of India Act 1992, s 11.
[66] Securities and Exchange Board of India Act 1992, s 12A.
[67] Securities and Exchange Board of India Act 1992, s 15K.
[68] Depositories Act 1996.
[69] Janakiraman Committee Report (n 9).
[70] JPC Report (2002) (n 2).
[71] Securities and Exchange Board of India Act 1992, ss 15G, 15HA and 24.
[72] Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to

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penalties under the SEBI Act can be imposed on the basis of breach of a statutory obligation without proof of intention, which makes enforcement more practicable.[73]

The insider trading regime, initially contained in the 1992 Regulations, was replaced by the 2015 Regulations, which define unpublished price sensitive information, require organisations to maintain codes of conduct and controls, and, following later amendments, include an informant mechanism that rewards whistle-blowers for information about violations.[74][75] Exchanges were also restructured: the transition from broker-owned associations to corporatised and demutualised entities during the following decade reduced the conflict of interest that had been identified.

5.3 The Evolution of Corporate Governance Norms

The corporate governance reforms followed a distinct path. The Kumar Mangalam Birla Committee recommended minimum standards for the composition of boards, the role of audit committees and disclosure, and these were incorporated in Clause 49 of the Listing Agreement from 2000.[76] The Companies Act 1956 was amended in 2000 to require audit committees for public companies of a certain size. Subsequent committees, namely the Naresh Chandra Committee on audit and governance and the Narayana Murthy Committee, refined requirements on auditor independence, financial disclosures and the role of independent directors, and Clause 49 was revised accordingly.[77][78]

The Companies Act 2013 placed several of these ideas on a statutory footing. It requires listed companies to have a minimum proportion of independent directors, prescribes criteria for independence, requires an audit committee and a nomination and remuneration committee, mandates a vigil mechanism for directors and employees to report concerns, and regulates related-party transactions.[79] The SEBI Listing Obligations and Disclosure Requirements Regulations 2015 consolidated and extended the listing-related requirements on board composition, committees, related-party transactions and disclosure of material events.[80] The Kotak Committee on corporate governance further recommended measures on board effectiveness and the role of independent directors.[81]

Securities Market) Regulations 2003.
[73] *SEBI v Shriram Mutual Fund* (2006) 5 SCC 361.
[74] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992.
[75] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 2015.
[76] Birla Committee Report (n 17).
[77] Naresh Chandra Committee Report (n 18).
[78] Narayana Murthy Committee Report (n 19).
[79] Companies Act 2013, ss 149, 177, 178 and 188.
[80] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015.
[81] Kotak Committee Report (n 20).

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5.4 Mapping Failures to Reforms

Table 4: Identified Failures and Corresponding Reforms

Failure identified	Principal reform
Regulator without statutory powers	SEBI Act 1992 (statutory status); Securities Laws (Amendment) Act 2002 (enhanced investigation and penalty powers)
Paper-based holding and settlement; broker-handled cash	Screen-based trading (NSE); Depositories Act 1996; rolling settlement
Opaque leveraged carry-forward positions	Discontinuation of badla; regulated derivatives
Unsecured bank lending to brokers; weak internal controls	RBI tightening of securities dealings by banks; strengthened prudential norms
Insider trading and market manipulation	SEBI PIT Regulations (1992, replaced 2015); PFUTP Regulations 2003; informant mechanism
Broker-controlled exchanges	Corporatisation and demutualisation of exchanges
Promoter-dominated boards; weak audit oversight	Clause 49; Companies Act 2013 provisions on independent directors and committees; SEBI LODR 2015
No channel for insiders to raise concerns	Vigil mechanism under the Companies Act 2013; informant mechanism under the PIT Regulations

5.5 Critical Assessment

The reforms have closed many of the most obvious gaps. Dematerialisation and rolling settlement have virtually eliminated the paper-based vulnerabilities of 1992. Derivatives trading and the end of badla have made leveraged positions more visible. SEBI today has far wider powers than it did in 1992 or 2001, and the Securities Appellate Tribunal provides a specialised appellate forum.

Nevertheless, several concerns remain. First, promoter dominance continues to be a feature of many Indian listed companies, so formal compliance with independence requirements does not always translate into genuine independent oversight; the empirical evidence of Black and Khanna shows that the market valued Clause 49, but it cannot show that compliance is

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substantive in every case.[82] Second, enforcement remains slow, as it did in the 1990s, with proceedings often taking years to conclude, which weakens deterrence. Third, manipulation has adapted to new technology and new instruments, and surveillance must keep pace. Fourth, governance failures have continued to appear in later episodes involving listed companies, such as the Satyam accounting fraud of 2009, which shows that board and audit reforms are necessary but not sufficient on their own.

Fifth, the supervision of co-operative banks, which played a central role in 2001, has remained a persistent difficulty, as later failures of such institutions have shown. The structural problem of divided supervision identified after 2001 has been addressed only gradually.

5.6 Testing the Hypothesis

The hypothesis stated in Chapter 1 is largely supported. Both episodes exploited fragmented oversight, weak internal controls and unaccountable concentrations of power rather than a vacuum of formal rules. The reforms that targeted these features, particularly the statutory strengthening of SEBI, the modernisation of trading and settlement, and the move towards independent board oversight, have reduced the scope for repeating the earlier techniques in their original form. The hypothesis is only partly supported with respect to the claim that corporate governance reform is the central safeguard: the more important protections have been the structural and enforcement reforms, with corporate governance serving as a complement that addresses promoter-level and issuer-level risks.

[82] Black and Khanna (n 21).

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CONCLUSION AND SUGGESTIONS

The Harshad Mehta and Ketan Parekh episodes are usually remembered for their central characters, but their lasting significance lies in what they revealed about institutions. In 1992, bank money was diverted into shares through intermediated deals and unsupported bank receipts. In 2001, promoters, financiers and co-operative banks funded a concentrated operation in a favoured group of shares. The details differed, yet the same weaknesses were present: fragmented supervision, limited surveillance, broker-controlled infrastructure, weak internal controls and slow enforcement.

The legislative response has been substantial. SEBI is now a statutory regulator with significant enforcement powers; trading and settlement are electronic and rapid; badla has gone; and listed companies are subject to detailed rules on board composition, audit oversight and disclosure. These changes are a direct, traceable response to the failures documented by the parliamentary committees. They have not, however, made the market immune to fraud.

The following suggestions follow from the analysis.

(1) *Integrated surveillance.* Strengthen cross-market and cross-institution surveillance so that trading patterns, bank exposures and fund flows can be viewed together, with systematic data sharing between SEBI, the RBI and other regulators.

(2) *Faster enforcement.* Expand specialised capacity for securities cases and set realistic timelines for investigation and adjudication, since delayed sanctions weaken deterrence.

(3) *Substantive board independence.* Move beyond numerical compliance by strengthening the process for appointing and removing independent directors and by requiring clearer explanations of how related-party transactions are evaluated.

(4) *Co-operative bank supervision.* Complete the move to a single, effective supervisory framework for co-operative banks, particularly with regard to capital market exposure.

(5) *Whistle-blower protection.* Reinforce the protection and incentives for insiders who report wrongdoing, both within companies and to the regulator.

(6) *Investor awareness.* Continue to improve retail investor education so that investors can recognise warning signs such as unexplained price surges and unusual trading volumes.

(7) *Anticipatory regulation.* Regularly review the framework against emerging forms of manipulation, including those involving new technologies and trading platforms, rather than responding only after a crisis.

The title of this study speaks of one lesson. It can be stated simply: rules matter only when the institutions charged with applying them have the powers, the information and the independence

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to do so. The reforms since 1992 have moved the Indian market a long way in that direction, but the work of keeping institutions vigilant is continuous.

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