

December 2001

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Recommended Citation

Campbell, John, "Internet Finance Forums: Investor Empowerment through CMC or Market Manipulation on a Global Scale?" (2001). *AMCIS 2001 Proceedings*. 413.
<http://aisel.aisnet.org/amcis2001/413>

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INTERNET FINANCE FORUMS: INVESTOR EMPOWERMENT THROUGH CMC OR MARKET MANIPULATION ON A GLOBAL SCALE?

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Abstract

The Internet plays an increasingly important role in the dissemination of information about exchange traded stocks including the “rumors” and “tips” frequently posted on Internet-based finance forums. The pervasiveness of the Internet presents many difficulties for regulators who must balance the potential benefits offered by the technology against the capability for some individuals to systematically cultivate and exploit the uncertainty or enthusiasm of others. This research-in-progress seeks important insights into how Internet forums might encourage or discourage moral dialogue. Initial results based on quantitative and qualitative analysis of postings to an Internet-based finance forum are reported. The preliminary analysis provides some insight into community views on the substance and ethics of stock price manipulation, and the role of Internet-based communication environments.

Keywords: Finance forums, stock price manipulation

Introduction

The importance of online communities has evolved beyond the realm of social phenomenon to become important knowledge-sharing media with real and significant economic consequences (Armstrong and Hagel 1996; Hagel and Armstrong 1997; Investor Relations Business 1999; Kollock 1999). As the Internet has become more accessible, there has been a substantial increase in the amount of investment advice and information that can be accessed online. The Internet now plays an important role in keeping financial markets better informed by allowing private share investors access to information about exchange traded securities anywhere in the world. Recognized sources of Internet-based information include the web sites of official securities exchanges, listed companies and third party operators providing access to a variety of investment information including real-time market data, research and trading recommendations. However, in their search for legitimate information sources, many investors also seek out the investment rumors and tips frequently posted to Internet-based finance forums.

Finance forums can be an important source of collective insights (stories, myths, behavior norms, etc.) on a broad range of topics relating to securities and securities trading. These forums empower private investors by supporting synchronous and asynchronous digital conversations on key securities related topics including trading strategies, tax implications, comparative assessments of stockbrokers and services, private research and community focused investor white papers. For many, these forums instill a strong sense of community and camaraderie both at the group and subgroup levels. From an international perspective, forums also allow individuals located in different parts of the world to exchange information about projects partnered by companies listed in other countries.

However, not all forum participants have trading objectives that are collectively beneficial. The organization and structure of many financial forums enable some individuals to systematically cultivate and exploit the uncertainty or enthusiasm of others (Campbell 2000, 2001; Goldwasser 1999). The manipulation can be intentional or unintentional and is usually motivated by a desire to effect an increase or decrease in the price of some security over a comparatively short period of time. Although there are a number of ways by which investors can be manipulated on Internet finance forums, the most common technique is known as “ramping”. Stock ramping usually involves an organized campaign aimed at increasing the price of a particular stock by the

rapid dissemination of false or excessively optimistic information through a variety of media including finance forums and email. The ramping of a stock can initially have a very seductive effect. Both the company and its investors can be lulled into a false sense of security by a rising stock price. However, this type of promotion inevitably leads to a lower price as the promoters rapidly offload their holdings to trusting newcomers who, in turn, force the price lower as earlier expectations are not met.

Method

This study investigates a “ramping” style promotion that occurred on an Internet-based finance forum and that centered on a small and thinly traded company listed on the Australian stock exchange. An interpretative approach is used to reconstruct a condensed narrative of communication during the original conversation. Content analysis is also used to generate quantitative data to identify systemic patterns or trends that emerged during the course of the conversation. An examination of the digital conversation indicated some degree of attempted manipulation in the communication strategies used by some of the conversation participants. The analysis has led to the preliminary specification of a model that identifies the major stakeholders and important variables that describe how Internet finance forums influence stock market behavior. This model is illustrated in Figure 1.

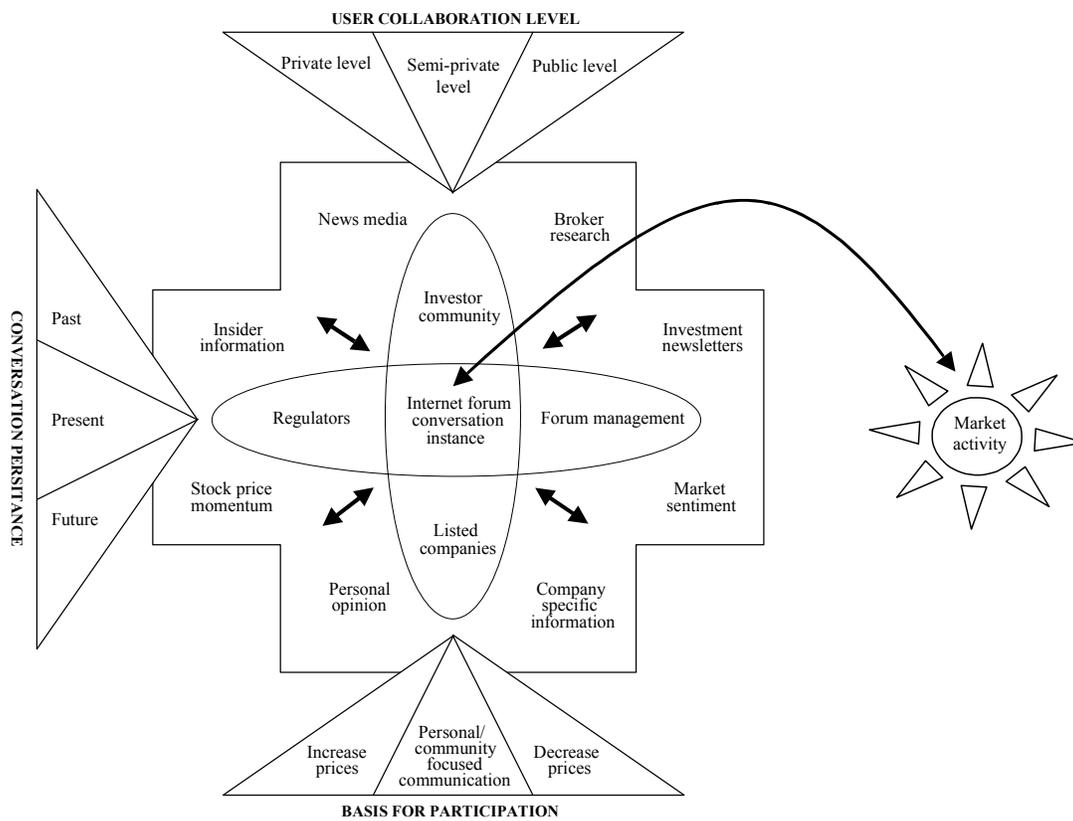


Figure 1. A Model of the Interaction Between Finance Forums and Securities Markets

Initial Findings

The initial findings indicate that online financial forums have the potential to be a source of false investment information and that regulators, companies, and investors are still trying to come to terms with the impact of the Internet.

Implications for Investors

Confounding all expectations that novice investors are the most likely victims of stock ramping and therefore should be the most aggrieved by the turn of events, many inexperienced forum members were uncritical of the manipulative strategies that were used. The fact that some posts may have misled them might have been secondary to the role that the contained information may have

had in their personal development as traders. The frequent posts and high enthusiasm of the promoters could have assisted these new users in their attempts to seek out investment tips, make decisions and gain confidence.

Implications for Forum Management

While most investment forums attempt to satisfy regulatory requirements, very few sites offer behavior exemplars, information threads, or even basic information to help prevent contributors from posting misleading information. The forum studied here was moderated and also had a formal documented policy of removing inappropriate posts. However, it would appear that very few posts, if any, were removed from this conversation despite the apparent contravention of at least five of the eleven posting rules specified by the forum administration.

Implications for Regulators

One striking feature in the final days of the conversation was the diversity of definitions that emerged for the meaning of stock ramping. The forum participants displayed a strong unwillingness to come to terms with the legal status of stock ramping and other manipulative behavior. For example, one protagonist even cited a thesaurus as an authoritative source on the meaning of ramping.

The monitoring systems and remedies of the regulatory body seemed to be lacking. Although an increased price and volume activity was quickly detected by the ASX no visible follow-up action occurred, allowing the forum conversation to continue building momentum. In fact not only did the action of the regulatory body fail in its primary objective of keeping the market better informed, but the company's response was used by some forum members to create further rumor.

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