Manipulation of stock price and its consequences

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Abstract

With expansion of financial markets and capital market and also existence of so many buyers and sellers who are looking to gain from their trades, manipulation has taken a new display. Forgers are able to manipulate the trading activity of the stock market and offer a false display and mislead the investors and encourage them to buy their shares. Manipulation in capital market can cause investors to be uncertain to the capital market and it is an obstacle to market depth. Certain controls and special regulations needed to deal with this phenomenon in order to avoid distorting the minds of investors and confronting false prices.

Keywords: Price manipulation, Market depth, Data manipulation

Introduction

The most controversial issues goes back to the first formation of the capital market in its modern form (Amsterdam, Netherlands), is discussion of financial market manipulation. Studies in other countries about the manipulation of prices say that manipulation refers to activities which in any way may interfere the free function of supply and demand, to create artificial prices and false view of market activities, and finally lead to misleading market.

Discussion about manipulation in both developed and emerging markets is important issue to be addressed. Although in developed markets through appropriate legislation and effective oversight mechanisms, many aspects of manipulation is limited.

In contrast, emerging markets do not have efficient and effective regulatory system to prevent market manipulation, so market manipulation and price are impressed by people who have the power to widely order.

Public confidence increase the integrity of market, liquidity strength and its performance increases and this has a significant importance in capital market, especially stock markets.

The most important prerequisite for the development and deepening of capital markets in each financial system as the engine Economic mobile , is the public confidence to the integrity and rightness a basis for determining the fair price of a capital asset and thereby optimize allocation of funds to different areas of the economy .In general, raised issue is that if investors gain the insightthat prices do not reflect true value of stock ,this will destroy their confidence to the capital market . In a manipulated market or a market which is threatened by manipulation ,it is not expected that prices reflect a true view of current which affect demand and supply. In fact, stock market manipulation can take full advantage and of the economicresources to deal with serious threat.

Manipulation definition and its types

Manipulation is any interference in the market mechanism that prevents determination of a fair price, as well as any factor that may affect the stock price artificially. Superficial transactions, Chinese order in a specific volume, increase in company›s stock price by rumors and stock collection at low prices in order to gain profit are the best examples for manipulation. United States Securities Exchange Commission has defined manipulation as follow: intentional and preplanned behavior in order to control or to influence artificially to market of special security byinvestors .

Market manipulation generally refers to activities that may somehow interfere with the functioning of the free market supply and demand and activists mock demonstration and create a false prices for stock market, and finally lead to mislead market participants.

You can find manipulation as an important issue in both developed and emerging markets. Prices

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should be determined by the market without any interference .Prices should reflect the value of the stock by the accounting information and all information which is revealed about company, without any judgment on behalf of investors.

One of the most important distortions in stock prices can be done by manipulation and if investors come to believe that the stock price does not reflect the true value of the stock they will lose their confidence to the market. Consequences of manipulation which can have loss to investors is as follows: the lack of public confidence in the integrity and rightness of market, justice in capital asset pricing, reduction in liquidity of stock, deduction in investment and not optimized resource allocation and finally decrease in economic growth. Iran›s capital market as an emerging market is not exempt from this issue and efforts to attract investors into this market and obtaining long-term public confidence in order toincrease investment growth requires creating mechanisms to prevent behavior that can lead to the manipulation of the stock exchange .So attracting public trust for investing in this market and preventing from intense and sectional volatilities by right determination of prices will lead to resource allocation in areas with high performance and make economical growth .

What can be found on manipulation of securities in all studies, there are three types of manipulation. Each of researchers have examined one aspect of manipulation.

Manipulation based on information

This strategy is the manipulations of stock prices by spreading false rumors and misleading information .People who invest in securities are sensitive to market risk. Investors impression by information and rumors is shown in price volatilities and trades volumes. So,there would be incentive for forgers to publish misleading information and guide public opinion toward their illegitimate interests.

Examples of this kind of transaction is manipulating coalition, that investors creating a coalition buy securities ,then release rumors about company so they can sell their shares with higher prices and gain profit.

Manipulation based on practice

Activities instead of transactions which affect real or realized value of trading assets and change it. In this kind of manipulation managers are known as manipulators and their function impress prices,like shutting down a factory to influence the price. But since managers have limited gaining a position buying or selling their companies in many countries,this type of manipulation has rarely occurs.

Transaction-based on transaction manipulation

In this type of manipulation,doing transactions among themselves (with the purchase and sale of securities) creates a vision of an active market and by artificial increase in prices and trading volume will attract other investors to buy shares. One of the factors that affect investors' decision is the volume of transactions, liquidity which can be considered the most important feature.It is evident that if the liquidity power increases it can add to attractiveness of a share to investors.

In such circumstances, forgers can manipulate the trading activity of the stock market by offering a false display and mislead investors and encourage encourage them to buy their shares and they will sell their shares at higher prices.

Background of manipulating stock prices

Issue of market manipulation is almost as old as the first securities market. Historically artificial influence in stock prices has been an important issue .So that after the Amsterdam Stock Exchange began in early 17th century, traders in the stock found that they can manipulate prices by several ways and thereby achieve profits.So they used the stock in hand in a concentrated period, sold their shares by creating a weak perspective for share. Investors who feared of this situation also began to sell their shares .So traders could buy again after stock prices fell enough .At lower prices, sold shares are redeemed. This Strategy was called“bear raid”. Due to the success of this strategy, brokers found that using this strategy along with publishing false information and misleading rumors about the future of the company can also have better results.

By formation of united security markets in other countries and lack of obstacle laws, this kind of manipulation in stock prices appear with intense and weakness points and got a new display. In some markets,a combination of different strategies is used to accelerate profits of price manipulation at the same time. By the way price manipulation is being continued and a large amount of profit was obtained by some at Wall Street in 19th century .

After the 1929 crisis, there was a general concern thatdecline in stock prices is because of massive influx for short selling and manipulation is derived from the this matter.

SenateBanking and Currency Committee's concerns about the operation of the securities market followed an investigation .Although studies show fewer

samples from manipulating stock prices through the massive influx of for short sale but other examples of manipulating stock prices revealed. When this kind of price manipulation become epidemic, it become illegal in some countries (Allen &Gale, 1992).

Huebner argues that the manipulation of stock prices is one of the most extensive discussions in 1934,and after the Great Depression of 1929, the largest public issue that has caused a drop in stock prices was massive influx of short-sale securities with the objective of price manipulation.

However it is very hard to display cases that lead to unbalanced market, by appropriate legislation, will lead to a reasonable advanced balance of the securities markets. But it should not be assumed that market manipulation is solved in the market and this kind of manipulation is quite complex and very difficult to hide it.But in emerging market manipulation, in all kinds and extensively, is done by those who have enough power.The first investigations about price manipulation, is Hart studies in 1977, that have studied price manipulation using econometric models in asset markets. Huert has discussed conditions under which profitable speculation may occur in a non-probabilistic and when demand function is nonlinear,speculators will be able to make profitable trades (Jarrow,1992).

Impact of stock price manipulation

Manipulation in market refers to kind of a business leading to distorted prices and enable manipulators to gain profits at the expense of other market participants losses (Kaming, 2010). When a group of traders, at the expense of other investors, earn extremely high returns,this difference in performance is enough to cause concern to investors from entering the market.

In a manipulated market or exposure ,we should not expect that prices have a true reflection of current economic realities affected to supply and demand. Indeed, manipulating the stock market can threaten all benefit and exchange economic resources. Studies about impact of price to the quality of stock market in Taiwan show that stock prices are higher during the period of manipulation of prices.

So that the cumulative abnormal stock returns are manipulated by more than 70% which is much higher than in developed markets returns.Thereby stock manipulated shows increase in trading volume, as well as increased volatility, resulting in an increase in liquidity during manipulation period. In addition, market manipulation, will worsen market depth that shows stock manipulation can cause an inefficient market that makes high increase in volume and volatility but reduce market depth and can have an extreme effect on market efficiency (Hoang, 2007).

Wu and Aggrwal (2004) offered theories about some empirical evidence of the manipulation of stock prices in the United States .They have developed Allen and Gale model and they found that people with inside information about the company's securities are likely to be known as the manipulators,Securities that have low liquidity,are more likely to be vulnerable to price manipulation and They will increase the volatility of price manipulation, They also found that the prices will increase during manipulation and after period of manipulation it will reduce. When the trimmer starts selling, price and liquidity of the share is more than when he has bought it. So they offered a model in this case and concluded that manipulation could have an influence on market performance. (Walter & Howie, 2003) studied the Chinese market manipulation and found that the manipulation is one of the obstacles that hinder the development of China's stock market.

Conclusions

Issue of market manipulation is almost as old as the first securities market.Any intervention that prevents market supply and demand to be released refers to a form of manipulation.As regards that market manipulation cause the lack of investor confidence to the stock market and There will be preventing the development and deepening of the capital market as an economic engine.

According to studies conducted in the field of stock market manipulation and stock price based on investors' insufficient information and asymmetry information in the market are the main cause of manipulation. As well as the consequences of manipulating stock prices, include preventing the spread of market, not entering of investors in the market, lack of market confidence , increase the frequency as well tired shareholders, the Exchange requires listed companies to disclose timely information as one of the main areas to prevent manipulation. Disclosure of executive instructions listed companies on the Stock

Exchange in connection with this matter has been approved by the board of exchange. Also, informed people are recognized to be the possibility of manipulation in securities. Securities that have low liquidity. According to this information, in order to prevent market manipulation by inside information. Article 46 of the Securities Market Act Islamic republic of Iran mentioned people with inside information in companies and has established punishments to prevent abuse of this people as individuals' aware of company's inside information.

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