New web for the gullible investor…

The spider is the same, so is the intention. Only he is now using a hi-tech tool – the Internet – to swindle the lay investor

Don’t get taken in by ‘hot’ investments on the Internet. Check out the company’s record on the stock exchange websites

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Lately, I’ve been getting junk email advising investment in one stock or another. One says: “Good news about Indian auto manufacturer, Jay Bharat Maruti. An Italian auto major last week visited India to hold talks about investing in this company.” Another reads: “Big news about ITI – the government agrees to divestment”.

Securities frauds using technology aren’t new. The 19th and 20th centuries saw railroad scams, ponzi schemes, oil and gas limited partnership scams, penny stock fraud, and insider trading, to name a few. In those days, telegraph, previously used to send stock market news, began to be used to send buy and sell orders from cruise ships crossing the Atlantic. When radio took off in the 1920s, it gave information on stocks quicker than ever before. As the telephone became popular, brokers used it to hawk investment opportunities.

New bait…

In the 21st century, with 50.6 million users in India alone, the Internet is having a huge impact. Significantly, the population of online investors is also rising. Today, 142 NSE brokers offer online trading against less than 10 five years ago. In 2005-06, 11.7 per cent of the total trading on the NSE was online.

Today, earnings announcements, press releases, and other financial information are available to anyone with a computer and a modem. One can also communicate directly with analysts, short sellers, other investors and companies.

And it’s this popularity of the Internet that has caught the fancy of cleats, who are using it to trap others in scams that, save for the technology, are similar to those prevalent even in the 13th century.

Why has the Internet become so effective in facilitating fraud? One, it is cheap. The average cost of a personal computer is very low today, and unlimited Internet access is also available for a song. Two, it is efficient. Data mining and extractor programs let fraudsters target investors with specific investing objectives with seemingly personalised pitches. Three, using the Net is easy. With negligible overheads, a little imagination and a few mouse clicks, a fraudster can run a scam from home.

Of the scores of online investment newsletters, only some offers valuable information. Many others falsely claiming to independently research the stocks they profile, or spread false information or promote worthless stocks. Fraudsters also "scalp" the stock they hype, driving up its price with baseless recommendations and then selling off their own holdings at high prices. At that point, the hype stops, the stock price tumbles and investors lose.

Online bulletin boards, popular forums for investors to share information, typically feature "threads" of messages on investment opportunities. While some messages may be genuine, many are bogus. A single person can easily create widespread interest in thinly traded stocks in which public knowledge is sparse, by posting a series of messages under various aliases.

… don’t bite

We are in the longest bull market, and no one wants to be left out. Given this mindset, one's ability to analyse an investment could be compromised by a desire to get rich quick. Add with people tending to lend credibility to what they see on the Net, you have the makings of an easy mark.

Unlike cold calls or postal solicitations, the Internet is non-intrusive. You make an affirmative decision to start looking for investment opportunities. Since you’ve decided to log on, you tend to let your guard down a bit, and may become less apt to do the necessary research – and get sucked into a scam. Technology has also made it possible to enter and exit a stock quickly. When gains are made, greed overtakes. That is when one becomes easy prey.

Think twice before investing in any opportunity on the Internet. Anyone can reach thousands by building a web site, posting seemingly credible messages on a bulletin board, entering a discussion in a live ‘chat’ room, or sending mass e-mails.

Check out the websites of the stock exchanges (www.nseindia.com and www.bseindia.com). Indian regulations require each listed company to file its financials, shareholding pattern and other price-sensitive information with the exchanges. For negative information on companies and individuals, visit www.watchoutinvestors.com, a free public service website that aggregates information on all regulatory actions for economic offences. When investing in IPOs, FPOs and NFOs, go carefully through the offer documents. Find them on Sebi’s website www.sebi.gov.in.

The US has been quite active in this area. In 1998, following a nationwide sweep, SEC filed 23 enforcement actions against 44 individuals and companies for deceiving investors. In one case, Francis A. Tribble and Sloane Fitzgerald Inc sent more than 6 million unsolicited e-mails, built bogus web sites, and started an online newsletter promote two small, thinly traded "micro-cap" companies. SEC nailed them and imposed huge penalties.

The SEC has now issued ‘Internet Fraud’, an alert to help investors evaluate investments promoted on the Net, spot fraud and avoid costly mistakes.
Surely, the sheer volume of information on the Internet hampers the government's ability to regulate all postings; so it must encourage self-regulation and create market-watch groups. Exemplary punishments shall also help reduce fraud.