

Abstract

My thesis focuses on the study of the Dot.com bubble, mainly showing the way it occurred as well as analyzing the causes of its burst and its similarities with a typical speculative bubble. I firstly decided to discover the bubble burst and the main implications in the American economy by starting from an analysis of the New Economy: as a matter of fact, the new paradigm which has begun in the '80s played a deep role in the rise and fall of the technological market. It is necessary to assume that the bubble would not even have occurred without the rise of the New Economy. Secondly, my analysis has focused on a detailed investigation between the two different phases of the bubble, concentrating on the motivations of its marvellous rise and the causes of its rapid fall. Finally, I have concluded my dissertation by focusing on the main speculative-bubble-related aspects of the Dot.com bubble, which have certainly represented an indicative example of an economic bubble, such as the 1600's tulip bubble: in fact, it was characterized by an extremely rapid rise of prices, by an exaggerated confidence on the profitability of the products sold, and finally by a clearly visible speculative activity by the market operators.

The New Economy belongs to the transition from a heavy industry-based economy (known as Old Economy) to a technological-based economy; the term New Economy became extremely popular in the '90s with the explosion in the telecommunication and services sector, mainly thanks to the rise of Internet and its consistent use both in the everyday life and in the economy. The transition from the Old to the New Economy in the late '80s brought with it huge shifts both in the economical and structural aspects, which affected the entire way of making a business. In particular, the growth of a technology-based economy has created the opportunity to discover new products as well as the opportunity to guarantee a more sustainable economic process. In such a context, it assumed a relevant importance the telecommunication industry as well as the semiconductor one, which is at the basis of the creation and development of the new technologies, such as the radio, and of course, computers.

However, what is really interesting when trying to understand the New Economy is its practical implication in the real economy: in fact, the New Economy set up a new era of business, characterized by new rules and innovative beliefs at the macro-economic level: in the New Economy there is the claim to correlate a low unemployment rate, high growth, high wages and low inflation.

Additionally, a considerable aspect in the analysis of the New Economy and its consequences in the business law regards globalization. Notably, globalization represents the other side of the New Economy in three ways: firstly because globalization can measure the interdependence between world economies; in this way, since the New Economy started to shape the world, economies have become more and more integrated through the creation of free trade areas as well as the creation of several international organization with the goal of guaranteeing a deep connection between different economies. Secondly, globalization affected the economy in progress and innovations: actually, it has been clearly visible a great high-tech revolution which gave the chance to discover new products and explore new ways of communicating; in fact, the most important aspect in this frame regards the rise of telecommunication and information industries and the birth of the ICT (Information and Communication Technology). The result has been the genesis of an instant communication and connection between individuals, generating what Marshall McLuhan called "Global Village". The third form of globalization is directly connected to the second one: the birth of the ICT, in fact, established a new way of working, known as the "Third Industrial Revolution", namely the "e-business".

The e-business is straightly linked to the concept of Internet, which represents the key for understanding more briefly the role of the New Economy rise in the world. In fact, the e-business derives from the usage of the web as resource for selling goods and making profits. Internet, on the other hand, is the logical consequence of the expansion of the ICT and telecommunications. Thanks to the Internet, millions of users can communicate in a more and more interactive network, generating what John Cassidy defined an "information superhighway", to describe the informative radicalization which occurred in the new era. New ways of making business were created, with the birth of new internet-based companies (B2B and B2C), which operates entirely in the web market.

Progresses in the e-business and Internet in general became evident in the impact on the financial markets. This is one of the main aspects to be described when analyzing the impact of the new technologies among the economies. Reasonably, the stock market was clearly modified in order to let it be more efficient and more avant-garde. Innovations, according to Nicholas Economides, can be traced in the creation of new operators and the allowance for new users to access to the market. Additionally, the figure of the broker was deeply reduced due to the possibility given to every single individual investor to operate from its personal computer and having instantly access to any information regarding the stock market and market trends. Moreover, the innovation can be seen in the need for the creation of a stock market which could allow the new companies to be listed on the stock market. That is the case of the NASDAQ, born in 1971 as a technological stock market, and which will be central in the rise and burst of the Dot.com bubble.

Explaining the New Economy, I retain is necessary to introduce the Dot.com bubble, as it has originated “due to” the new products created by it, namely the Dot.coms, and the new ways of thinking of business developed by the New Economy analysts.

The phenomenon of the Dot.com companies gained evidence at the beginning of the '90s as a result of the transformations I have just analyzed. A Dot.com is a company which essentially operates in the web market, through an online sales channel; they are companies which tend to sell goods and services in an extremely volatile market, following the experiences developed by companies such as Microsoft or Netscape. These companies, also know as start-ups are basically characterized by an idea, which plays an essential role, representing the sole sufficient requisite for being commercialized.

Dot.coms are theoretically marked by a specific theory, the “Dot.com theory”, following the logic of “getting big fast”, and that is, namely, getting more and more users in order to make profits. Anyway, this is one of the most dangerous limits of the Dot.com theory, namely believing that more users would mean more clients and buyers. A second limit can be found in the market analysis made by investors and companies owners: in fact, companies lacked of defined business plans, too weak and slightly accurate.

The rise of the Dot.com bubble started when the stock market, in particular the NASDAQ, became interested in those technological companies, allowing in the end their listing on the stocks.

In the listing and in the expansion of the Dot.com market, three factors occurred: primarily, the economic manoeuvres by the FED, and namely the cut of interest rates to 4,75%, which canalized huge amounts of inflows of foreign capital in the US; secondly, the technological innovations became essential for the financial market, mostly in the NASDAQ: basically, the new softwares as well as the increasing use of personal computers gave individual investors the opportunity to easily access in the stock market. In such a context, a key role has been undertaken by the “venture capital” (risk capital used for financing new companies). Here comes the speculation, and the bubble occurred. The reason was the usage of inappropriate metrics in valuing those companies, forgetting about fundamental rules in the market analysis. However, the decisive step in the process was represented by the IPOs. Managing an IPO means for a Dot.com to “go public”, and that is, being listed on the stock market. Carrying out an IPO represents for investors a real speculative business, which can generate awesome profits. The critical point in managing an IPO is determining the companies’ shares price. Here the speculation has come, in particular, due to avidity and greed by Venture capitalists. When determining a share price, it should be reasonable to fix it in accordance with deep and accurate analysis, mainly focused on the goods profitability and on the companies’ economic history. As a consequence, a contradiction is clearly visible in analyzing how IPOs were conducted in the during the ‘90s Dot.com bubble: in fact, companies which were listed on the stock market not only were of a modest size, but they also lacked of business plans and analysis about profitability.

Ultimately, it all resulted in the phenomenon of “overvaluation”. It was said that overvaluation is the direct consequence of an excessive confidence in the market. Additionally, HSBC Holdings reported an overvaluation of approximately 40% in the companies listed on the NASDAQ: it was noted that it was the ultimate result of having listed companies selling fake products, lacking of any link with the real economy.

The rush for IPOs became an evident reality: in three years (1996-1999) more than 150 Dot.coms went public, plumping a process of emulation and inflating a speculative bubble. On

the other hand, people as individual investors, continued inflating the bubble by emulating each other, giving the birth to a virtual community of risk takers, investing just because others do the same.

Therefore, between 1996 and 2001, more than 2000 companies approached an IPO, making enormous profits in the first days of trading: an example was TheGlobe.com, listed on November 1998 with a price of 9\$ per share, reaching a price of 63\$ in the first-day trading (+605,6%). These trends allowed the stock indexes to rise at incredible levels, with the NASDAQ reaching the peak of 5132,52 points on March 2000; immediately after, the bubble became bursting.

When a bubble rises and then bursts, the same steps occur: John Cassidy have shown in its book "Dot.con" the two cycles representing a speculative bubble, one virtuous, the other vicious. In particular, from 1994 to March 2000, the speculative bubble rose until 5132 points in the NASDAQ index, characterising a cycle where share prices rose, allowing the rising of profits to be used for new investments, guaranteeing an economic and productivity growth, and so on. On the contrary, when the bubble started to deflate, it resulted in the same but reversed cycle: in 2001, when Fed's Chairman Alan Greenspan decided to rise interest rates for the first time, there was a drop in investments, affecting growth and productivity, resulting in the breakdown of corporate earnings due to the fact that investors do not want to buy over-priced shares; as a consequence, the disequilibrium between demand and supply as it stresses the market, allowed the cycle of self-sustaining.

It was the Fed's intervention that started the process of deflation and, as a consequence, laid the foundations for the Dot.com crisis. In detail, before a "do-nothing" political period (keeping the federal funds rates fixed at 5,5%) which gave the bubble the opportunity to inflate and clearly showed the Fed's inclination in favour of what happens in Wall Street, Alan Greenspan took the decision to rise the federal funds rates to 5,75%, and it would be followed by other increases. According to John Cassidy, rising the interest rates while a speculative bubble grows is the worst thing to be done; anyway, that is the sole opportunity to re-establish sanity. Although the consequences were disastrous, the breakdown was not immediate. Anyway, when the Fed scheduled a new interest rates raise to 6% in January

2001, the fall started. In 12 months, the Dot.com market lost the 50% of its value, from 6,7 trillion dollars to 3,2 trillions, while the NASDAQ reached a value of 800 points starting from a peak of of 5132 points.

Accordingly, the crisis was amplified by the role of medias; therefore, they have shaped the rise and fall of the Dot.com market. Notably, on the one hand, medias had a tremendous impact in the inflation of the speculative bubble, as they created a propagation mechanism, influencing people to invest in the market through an excessive confidence in it. Simultaneously, medias guaranteed a great coverage for some companies, allowing them to be successful: that is, for example, the Amazon.com case, for which the medias played a central role in its growth.

On the other hand, when the bubble busted, medias played a key and contrary role, as they augmented the extent of the crisis, and that has clearly represented the extreme volatility of the technological market.

Hence, what happened as a consequence of the Fed's intervention and what we could call a "media bubble" was the collapse of the assets: in a few months, the bubble deflated due to a drop in the investments and a consequent price slump; the market meltdown was represented by the fall of the major stock indexes, describing a huge breakdown and a comeback to levels reached two years prior the crisis.

It was seen as the end of an era and the failure of the New Economy paradigm by several commentators such as James Cramer, who answered to a question about the crisis by saying: "Yeah, it's over, the Gold Rush is over!".

In the end, when there is a speculative bubble, buyers try to escape as soon as they can; anyway, inevitably prices collapse and everybody is affected by it.

What I have tried to do in my thesis was analyzing the economical, institutional and cultural dynamics, which led to the outbreak of the technological bubble; in detail, I have investigated the causes of its rise and fall in such a short period of time.

Although the New Economy played a key part in the formation of the Dot.com bubble as it is at the basis of the new technologies, products and companies created in the late '80s, I strictly refuse the idea of the New Economy as a primary cause of the technological crisis. In fact, it is

preferable to focus on the positive aspects of the paradigm, which have allowed us to upgrade to a more interactive world and have change our habits and ways of economize.

Besides, the causes of the Dot.com bubble should be searched in the individual behaviours as well as in the market "corruption", which permitted an unsustainable distortion in the market: two main causes can be traced both in the use of metrics ignoring cash flows in the business analysis, without focusing on the profitability of the products, and the structure of the market itself as well as the investors behaviours, which led to the propagation of the overvaluation phenomenon in the companies stocks.

In conclusion, many lessons can be learned from a deep study of the Dot.com speculative bubble, not just for avoiding a new one, but also to guarantee an efficient explanation of the crisis. The first lesson regards with no doubts the role of Internet: we should start to consider it as a technology, necessary and phenomenal, and not as business model; we should focus more on its value as a business resource rather than on thinking of it as the only way for making profits. Secondly, it has to be learned that strong business plans are necessary when starting an activity. Ultimately, companies operating in the web should understand that the Dot.com theory as it was considered is a failure, most of all in the belief that popularity means profitability.

Lastly, it is not clear if these lessons would have avoided the bubble burst; though, probably they could have reduced the risks of failure for hundreds of companies. Consequently, it is to be hoped that those errors won't be repeated, so as to avoid a new technology-related speculative bubble.