Dot Com Bubble Burst

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Introduction

The **dot-com bubble** was a stock market bubble fueled by highly speculative investments in internet-based businesses from 1995 to 2001. It saw the value of equity markets grow dramatically, with the technology-dominated Nasdaq index rising five-fold during that period.

Around 1994-95 internet-related tech companies attracted a massive amount of attention from venture capitalists and traditional investors alike. This influx of money combined with the exploding popularity of the internet in general caused the web sector to expand rapidly in terms of valuation over the course of a few years despite many companies lacking concrete paths to profitability.

Background of the Event

- In 1990 the WorldWide Web was introduced which gave new commercial opportunities. This gave Stanford Federal Credit Union the chance to offer fully online internet banking services, which also made them the first financial institution to do so. As technology became better it allowed the commercial volume to grow reciprocally.
- Netscape developed SSL, which is a method to transfer secure data launched in 1994. This opened for an online shopping market as the customers now could transfer money safely. The following years many companies launched their online shopping sites.
- Until 1995 it was free to register an internet domain, but it was added a fee as the interest grew.

Reason for Rise

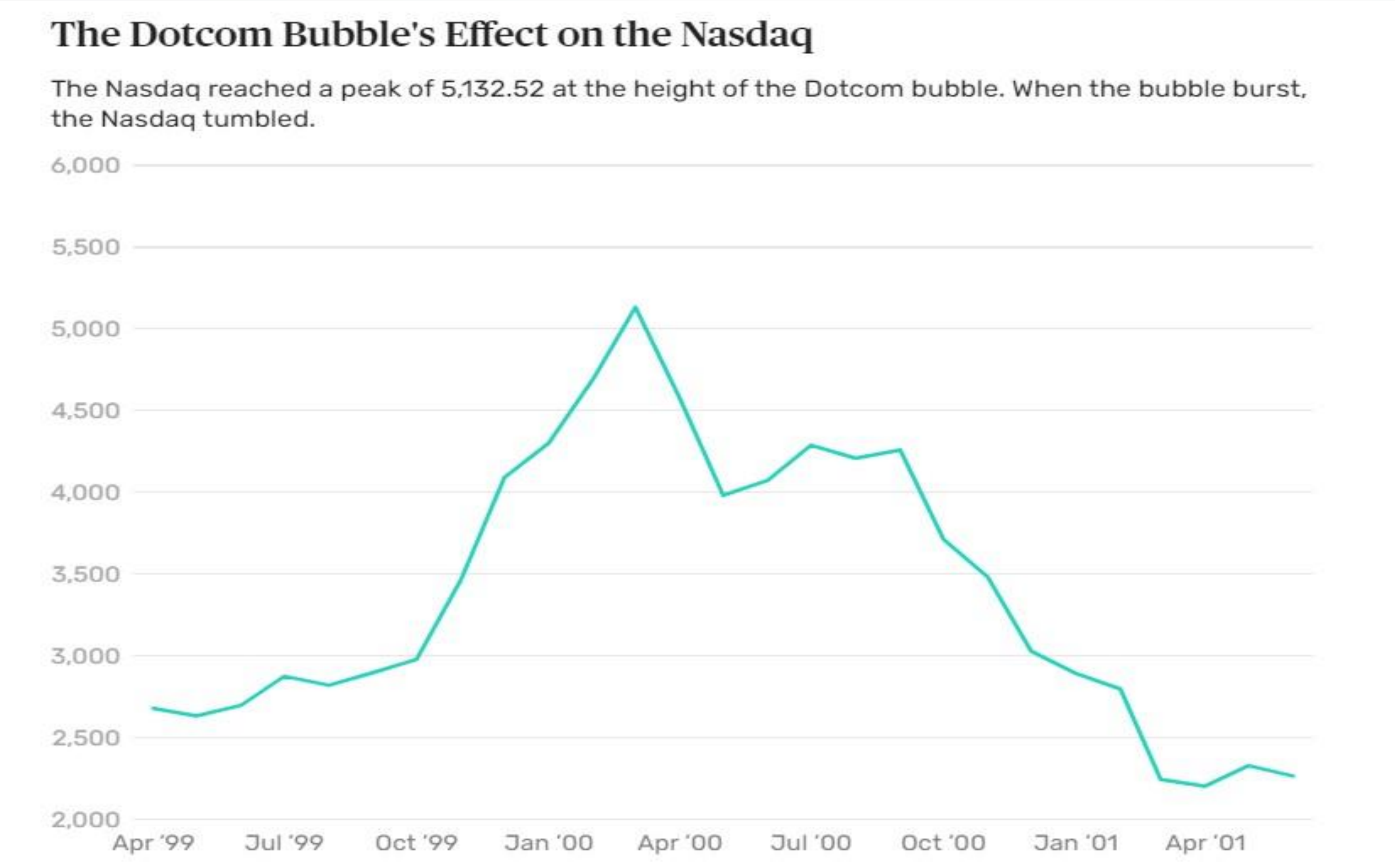
- In the early 90s, the advent of web browsers made the internet much more accessible for the average consumer. Once rare, computers began to appear in more and more households in the U.S., eventually becoming somewhat of a necessity. As the popularity of computers and the internet grew, many new web companies emerged to carve out their slice of the rapidly expanding information technology and online commerce industries.

- In the late 90s, low interest rates made speculative equity investments more attractive than bonds.

Reason for Fall

- The most apparent cause of the dot-com bubble bursting was excessive hype. Investors saw an opportunity to make quick profits and jumped at the idea. They encouraged others to join them while hyping up dot-com companies and overvaluing them
- The hype surrounding a new invention – the internet – triggered the dot-com bubble. Although the internet had already emerged before the 1990s, it was only later that several tech startups began using the ".com" domain to participate in the new market. However, in the absence of sufficient business planning and cash flow generation, many companies couldn't keep up and survive.
- The media had also done its part to encourage investors and companies in this industry to take on risky stocks by spreading overly optimistic expectations of future profits, especially with the mantra of 'getting big fast'. Business publications such as Forbes, Wall Street Journal, and others contributed to their 'campaigns' to drive demand and inflate the bubble.

Nasdaq Value Fluctuation



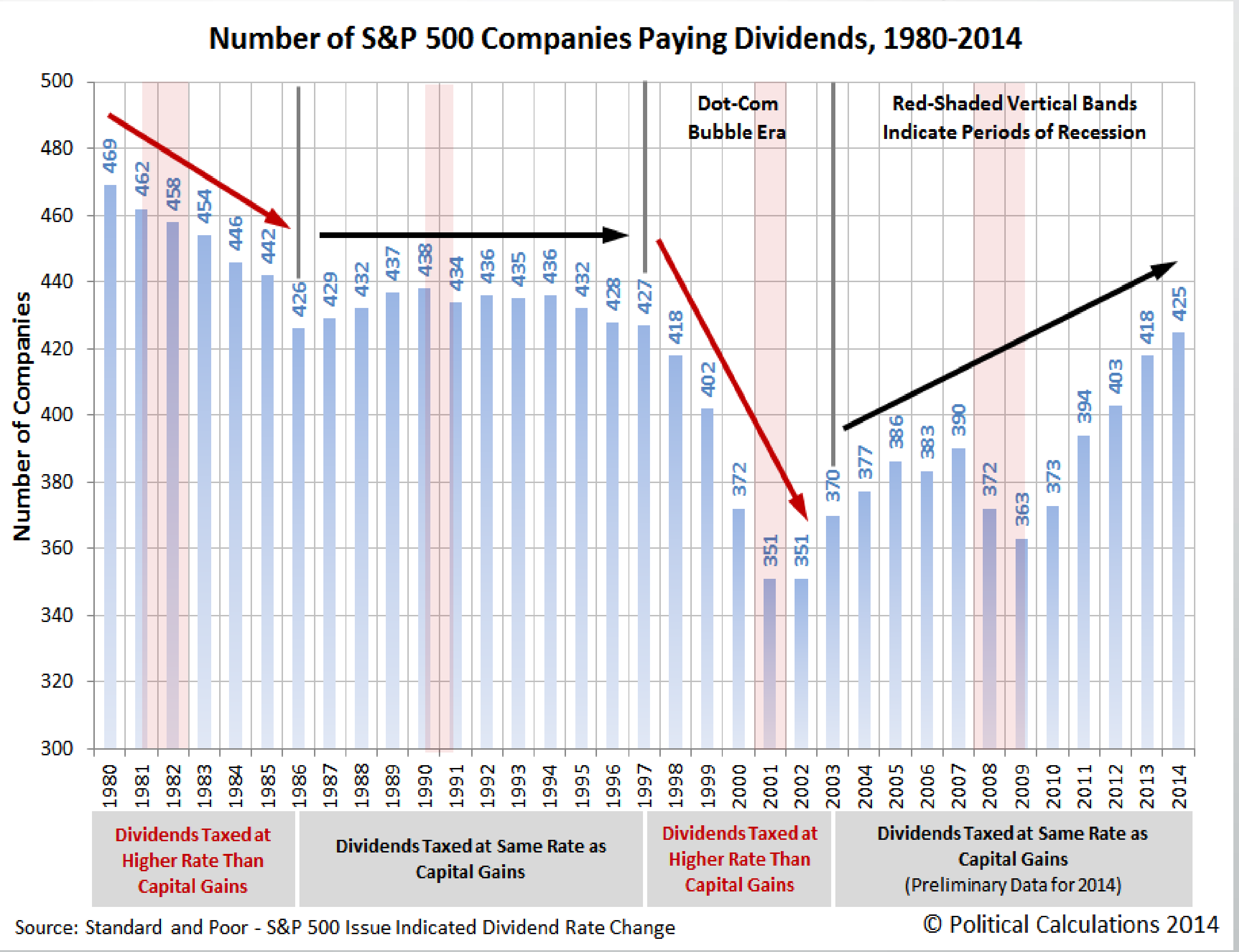
Dot Com Bubble started in April 1997 and ended in June 2003.

Dot Com Bubble began because of the Taxpayer Relief Act of 1997 (TRA97)

- It left dividend tax rates unchanged.
- It made investors favor the low-to-no dividend paying stocks over those that paid out more significant dividends.
- High volatility.

Dot Com Bubble ended thanks to the Jobs and Growth Tax Relief Reconciliation Act of 2003

- Tax rates for capital gains and for dividends once again be equal to one another.
- Volatility was reduced.



Impact on Corporation

The investment bond market was badly hit, has been in perpetual decline.

Many dot-com liquidated or other companies acquired.

The domain names were snapped up by domain investors or businesses with more traditional business models.

Also, due to the crisis, the interest rates of banks dropped very low to about 1%, which would further go on to play a major role in 2008 crisis.

Not only did this bubble burst lead to a mild recession, but it also shook confidence in the new internet industry. It went so far that even larger and more successful companies were affected.

For Example:- Intel had stock on the financial market since the 1980s, but it plummeted from $73 to about $20 to $30. Although the company was not directly involved in the dot-com bubble, it was still hit hard. And as a result, it took a long time for the stock prices to rise again.

Several companies went bankrupt

Impact on US Economy

- Many telecommunication companies and other companies also filed bankruptcy.
- A huge loss for companies which provide internet.
- The top investment firms such as Citicorp, Merrill Lynch, etc. were fined or accused as fraud for misleading the investors.
- Thousands of employees were laid off in the name of cost cutting and business restructuring.
- Overall, the effect was much worse for investors than
for the companies. According to New-York Times, about 48 percent of all dot-com firms survived the crash, although most of them lost a significant portion of their value.

Google, Amazon, eBay, Microsoft,...emerged successful from the crisis and proved that they are fit for the long-run.

Conclusion

First, one has to accept that even the best statistical and mathematical model, be it as good as possible, will never be able to explain all of the stages a market is going through.

Second, since a bubble can only be identified as such after it burst, caution is needed at the stock markets.

As bubbles are not predictable with certainty, we are going to see a lot more bubbles in the future.

Also a company should always look up to its basics and should accept that if they dream of making a lot of money, it requires a sufficient amount of time.

Conclusion

However, there is a way to prepare for a similar event. And that is knowing that every bubble follows a pretty simple rule – they are all about the hype. By researching each company individually and carefully, one may avoid getting on the hype train and losing their money.

For example, the sudden spike in the issuance of IPOs by new technology companies, including GameStop and many technology stocks reaching all-time high in 2021 have concerned many investors of a potential economic bubble.

Also, rather than investing in a company's future, one should focus on how they are doing in present.