Market Manipulation:
an artificial picture which masks the true value

Market manipulation is a practice in which people engage in activities which interfere with the normal operations of financial markets. It is a deliberate attempt to interfere with the free and fair operation of the market and create artificial, false or misleading appearances with respect to the price of, or market for, a security, commodity or currency. In a manipulated market certain transactions create a false price for traded securities.

The Rules of the Securities and Exchange Commission of Sri Lanka Act no 36 of 1987 (as amended) state that, no person shall create, cause to be created or do anything that is calculated to create a false or misleading appearance or impression of active trading, or a false or misleading appearance or impression with respect to the market for or the price of any securities listed in a licensed stock exchange (Rule 12). Rule 13 indicates that no person shall by means of purchase or sale of any securities that do not involve a change in the beneficial ownership of those securities, or by any fictitious transactions or by any other means, create a false market in any securities listed in a licensed stock exchange.

These practices (Market manipulation) are illegal in many regions of the world, although sometimes it can be difficult to distinguish between normal activity and market manipulation. In modern financial markets, manipulations are often taken in hidden ways that cannot be easily detected and outlawed. The possibility that the markets can be manipulated is an important issue for both the regulation of trading and the efficiency of the market. Security regulators generally prohibit market manipulations on the basis that they distort prices, hamper price discovery, and create deadweight losses. In particular, many Asian stock markets have securities that are thinly traded and therefore more susceptible to manipulation.

Market manipulation distorts free market values. It creates an artificial picture which masks the true value of the security or securities being manipulated. The manipulators can use this to their advantage to earn a profit, while investors who are unaware of the manipulation and who make decisions based on the available information stand to lose, sometimes substantially, as a result of manipulation. In fact, manipulators count on this, often making a profit on the losses of others. If you do not allow for pure free market supply and demand fundamentals to dictate

equilibrium prices, a price variance will occur. Transparency is a must if investors are to understand the true nature of the marketplace. When interested parties manipulate the markets, the activity impacts investors involved with the securities they manipulate, and it also harms the market as a whole. This makes it a matter of concern not just for individuals, but for the financial industry in general. When manipulation drives a stock value down in a bear raid, for example, other investors who hold the stock lose because of the market manipulation. When market manipulation does something like creating an inflated market value, the market as a whole suffers and can even drag down the rest of the economy.

Manipulation can occur in a variety of ways, from insiders taking actions that influence stock prices to the release of false information or rumors in Internet chat rooms. Manipulation may involve a number of techniques to affect the supply of, or demand for, a security. They include: spreading false or misleading information about a company, improperly limiting the number of publicly-available shares, rigging quotes, or pricing trades to create a false or deceptive picture of the demand for a security. It is well known that large block trades can influence prices. For example, by purchasing a large amount of stocks, a trader can drive the price up. Often, these practices require the cooperation of several individuals working together because few people have the clout to manipulate the market on their own. Some examples of manipulative practices including rapid buying and selling to make it look like there's lots of activity on a particular security, withholding or adding supplies of securities to control prices, and “ramping the market,” in which people try to push prices up.

We can further explain Market Manipulation by using some examples,

- **Price manipulation.**

  Placing buy or sell orders (or both) into the trading system in order to change or maintain the price of a stock. The motives for attempting to do this vary: to increase the value of a position in the market for finance or accounting purposes, to be able to issue new shares at a higher price or to cause such a price rise that other investors are attracted to the stock, creating demand that the manipulator can sell into (called "pump and dump").

- **Marking the close or ramping.**

  Making a purchase or sale of a security near the close of the day's trading, with the objective of affecting published prices, particularly the reported closing price. This might be done to avoid margin calls (when the trader's position is not self-financed) to support a flagging price or to affect the valuation of a portfolio (called "window dressing"). A common indicator is trading in small parcels of the security just before the market closes.

- **Wash trades and pre-arranged trading.**

  A wash trade is a trade in which there is no change in the beneficial ownership of the securities - the buyer is, in reality, also the seller. A pre-arranged trade involves two parties trading on the basis that the transaction will be reversed later, or with an arrangement that removes the risk of ownership from the buyer. "Pooling or churning" can involve wash sales or pre-arranged trades executed in order to give an impression of active trading, and therefore investor interest in the stock.

- **False or misleading information.**

  Companies can be tempted to re-release information or present information in an over-optimistic manner, in order to generate interest in the company's securities or help a flagging market. In some cases this includes unrealistic, unsubstantiated or incorrect data, projections or evaluations. When the perpetrators use the demand generated by the false information they have spread to sell their own shares, the operation is known as "hype and dump".

Allen and Gale (1992) classify three types of manipulation: The first kind can be described as action-based manipulation, that is, manipulation based on actions that change the actual or perceived value of the assets. The second kind can be described as information-based manipulation, that is, manipulation based on releasing false information or spreading false rumors. A group of investors would combine to form a pool: first to buy a stock, then to spread

favorable rumors about the firm, and finally to sell out at a profit. There is a third kind of manipulation that is much more difficult to detect and rule out and is referred to as trade-based manipulation. It occurs when a trader tempts to manipulate a stock simply by buying and then selling, without taking any publicly observable actions to alter the value of the firm or releasing false information to change the price.

Punishment for Market Manipulation

Section 51 (2) of the Securities and Exchange Commission of Sri Lanka Act no 36 of 1987 (as amended) states that any person who is found guilty of an offense under the Act for which no penalty is expressly provided for under the Act, shall be liable on conviction after summary trial by a Magistrate to of imprisonment of either description for a period not exceeding five years or to a fine not less than Rs 50,000 and not exceeding Rs 10 Million or to both such imprisonment and fine.

Source

Allen, F., D. Gale, 1992. Stock-price manipulation. The Review of Financial Studies

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