

Boom and crisis of the «dot-coms» in the USA (1995–2000)

Financial crises are always predated by periods of prolonged economic recovery and the speculative boom around the stock of certain innovative companies. When the lift reaches its climax, and the market prices of the shares are maximally inflated, a quick decline and crisis begin. «Dot-com» boom (companies that have engaged in sales of goods and services via the Internet) was preceded by a long economic upswing of the 1990s, one of the largest lifts of the twentieth century. Information technology was at the forefront of it, especially the mass proliferation of the Internet since the mid- 1990s. A large number of new Internet companies appears, the majority of which wanted to receive money from the issue of shares, regardless of whether a business of selling goods and services via the Internet would be profitable. As is the case with all joint-stock boom that took place earlier, this approach led to the «dot-com» crisis of March 10, 2000. On the NASDAQ stock market, where most of the «dot-com» shares traded, a rapid drop in their rates began. The huge losses are evidenced by the fact that during 2000, the NASDAQ index fell almost 50 %. If there were over three hundred «dot-coms» in 1999, in 2001, only 76 left. The total capitalization of the «dot-com» shares, part of the Bloomberg US Internet index, fell after the crisis by 1,755 trillion dollars, and the market prices of most stocks declined in 2000 by 80–90 %. Due to the speed of the fall in stock prices, the «dot-com» crisis can be compared with the «Great crash» of 1929. Although the crisis was short-lived and two years later it was replaced by a new rise, the "dot-com" crisis began the sequence of events that led to large-scale global crisis of 2007-2009. Nobody wanted to hinder the heated market of securities, so the «dotcoms» were superseded by the mortgage boom of the mid-2000s.

Keywords: «dot-com»; Internet companies; economic recovery of the 1990s; the «dot-com» crisis of 2000.

Problem statement. The significance of the «dot-com» crisis in the context of the financial history is that it was the result of the economic boom of the 1990s, one of the largest rise of the twentieth century. Although this crisis took a comparatively short time, it starts the sequence of events that led to the global financial crisis of 2007–2009. However, systemic analysis of the causes and characteristics of the «dot-com crisis» in the context of its influence on the background of the global financial crisis of 2007–2009 in the scientific literature is not complete.

Analysis of recent research and publications. General economic causes and sequence of events of the «dot-com» crisis were described by a large number of authors [2, 4, 6, 7, 12-17]. However, in most studies this description is fragmentary. Therefore, the problem of system analysis of preconditions of the "dot-com" crisis in 2000 and its consequences has remained unresolved.

Problem statement. The object of the study is the U.S. financial market of the late 1990s – early 2000s. The subject of the research is the "dot-com" crisis. The purpose of the research is to give a systematic analysis of the preconditions of the crisis, its course and consequences.

Presentation of the basic material. It is commonly known that until the mid-1990s, the Internet had not mass distribution and it was little known outside a narrow circle of specialists. August 9, 1995 is considered to be the beginning of the Internet boom, when Netscape released its browser, Netscape Navigator, and held the initial public offering (IPO). This led to massive excitement around the securities of companies related to information technology (especially Microsoft), and provided further stock market boosting. During the time of the foundation, rapid recovery and disappearance of numerous Internet companies, the move of the capital into the most competitive sector of the economy began. Even such industrial giants as General Motors (the income of many of them began to decline) invested capital in the most profitable financial instruments, in particular in shares of Microsoft and Google.

October 15, 1998. Federal Reserve System of the USA (FRS) announced a reduction of interest rates by 0.25 %, vowing that gradual reduction would continue in the future. Although the actual decline was not so large, it had a psychological significance and this proven way of market increase worked out. Late 1998 showed the highest boom in the American securities market. Investors believed that since the Asian and Russian crises in 1998 have already passed, in the future, the markets will be stable for a long time.

In the center of the boom was the stock of "dot-com" companies that sell their goods and services via the Internet. A typical example of a successful "dot-com" was online store Amazon.com, established in 1994, which has survived to our time and became one of the largest companies. From 1994 to 1999 the shares of the ten largest Internet companies grew by almost 4000 %, four times outpacing total market growth during that time. They provide investors with 100 % profit per year. Major companies in other industries during this time were given an average of 40 % profit per year.

A peculiar feature of the "dot-com" boom was that it began in the late 1990s in the most liquid and diversified market in history. Market participants continued to artificially enhance boom, despite numerous warnings about the inflated rates at which investors bought shares of advertised companies of the so-called «new economy». When investors saw the huge profits obtained by the first buyers of Microsoft and several other major IT-corporations, they believe that any company associated with computers or the Internet will give the same profit. Total boom around information technologies was a maximum at that time, and therefore the revenues that could be obtained from the use of the Internet in business significantly revalued. As in previous booms, everything was focused on making a profit from the placement of shares (the online food store Webvan.com received 375 million dollars from IPO, sportswear store Boo.com – \$ 175 million). Most of these companies remained to live for a short time, maybe a year or a year and a half, but in 1999 nobody knew about it yet.

The boom reached its maximum at the end of 1999 i.e. the NASDAQ stock exchange index, where shares of most Internet companies were quoted, nearly doubled during the year, as the Dow Jones index by 20 %. In mid-1999 The US Federal Reserve has raised its rate from 4.75% to 6.5% in order to slow down the boom. However, the stock price continued to rise and reached its highest level in early March 2000.

The boom ended March 10, 2000, when the NASDAQ stock exchange, where shares of high-tech companies were quoted, began to fall their courses. «Investors with bitterness recollect the myths, illusions and outright deceit, they are blinded by the unprecedented growth of the exchange, took for the truth» [7, p. 211–212]. The new «dot-coms» disappeared daily, those which had recently promised huge profits to investors, such as Boo.com, Dash.com, eToys.com, Flooz.com, FooDoo.com, Pets.com, Xuma.com and many others. The NASDAQ index lost half of its value between March and December 2000, while the S&P 500 index lost 14 %. The losses were huge. 117 new «dot-coms» were particularly affected, their shares increased in price by 200 % the first day after their placement on the market in 1999. Of the 357 «dot-coms» that existed in 1999, only 76 left in 2001. Apparently, in the history there was not yet a case that the whole industry would disappear so quickly. The Bloomberg US Internet index consisted of 270 «dot-com» shares, the total market capitalization of which has declined for seven months in 1,755 trillion dollars. The cost of 77 of those securities has declined by 90 percent, and of 72 – by more than 80 percent.

During the «dot-com» boom, supporters of the «new economy» believed that the Internet offered huge prospects for business, allowing retailers to react very quickly to market changes. Skeptics responded that the sale of goods or services through the Internet was a new sales method and a variety of shops, but the economy remained old. They reminded the boom story around supermarkets, which appeared in 1930s. With the advent of each new method of sales, competitors start to adopt it very quickly and the profits fall. But it was not even what the real economic opportunities of the Internet companies were, but the fact that the so-called «new economy» became a symbol of the grand economic recovery of the 1990s. Therefore, the collapse of the «dot-com» symbolized the end of the era (though the actual economic downturn lasted only two years).

Since March 2000, when stock and other securities prices were maximum, in October 2002, when prices became minimal, market capitalization decreased by two times. This was the largest market fall over one hundred years which can be compared with the collapse of 1929–1933. Since the securities market increased by 100 % and then crashed by 50 %, net growth was essentially zero. The cost remained at the level of 1998, i.e. 20 % below the maximum values. With such a low level in 2002, the restoration of the market began. However, investors who remained owners of the shares and did not sell them from 1998 to 2005, still made a profit. And those who bought stocks in 1982 and did not sell them until 2005, have increased their investment by 16 times. Taking into account the complex percent, the average annual profit was 13% per year [3, p. 47–48].

With the beginning of the fall in share prices of the Internet companies, other market data related to stock began to decline. Until mid-2001, the losses from the decline in prices of shares listed on the NASDAQ stock market reached \$ 4 trillion (not to mention the trillions of losses of other companies). In fact, they absorb all income received during the boom of the 1990s. Institutional investors suffered particularly large losses. The pension funds losses from the decline in stock prices had reached \$ 500 billion, assets of mutual funds declined in value by 25 %, and there was a massive withdrawal by investors of capital, which reached in some months 15-20 billion dollars [11, p. 97, 113].

The ratio of the price of shares to their profitability has decreased. Although in the late 1990s, it was common to hear that the ratio of price and stock revenue has grown by at least 20 %, in 2001 it turned out that it was an exaggeration. The same applies to the growth rate of labor productivity, which allegedly increased from 1% in the early 1990s to 2.5 % at the end of the decade. It turned out that this growth was related to computer manufacturers in most cases, although in that area the rate was overcharged.

In particular, Amazon company (as well as many other «dot-coms») does not produce a profit, carefully concealing it. And investors, knowing nothing about the income of the «dot-com» could imagine any sort of the profitability. In reality, in the first three months of 2000, sales of the Amazon amounted to 574 million dollars, but net losses reached 308 million, operating loss reached 198 million. Compared to the previous period in 1999, sales doubled, but losses increased even more, by four times. The company claimed that it had \$ 1 billion in cash and securities, but did not say anything about 2 billion of debt and more than 1 billion of accumulated deficit,

and that the real equity capital of the Amazon was only 25.6 million dollars. To cover losses the company was constantly releasing new bonds [4, p. 26].

When the boom around the Internet companies ended, the NASDAQ stock market and the Internet companies have not disappeared, but some realities had to be looked at more sober. The largest investment funds, which flourished during the boom of the «new economy», also suffered considerable losses, and in most of them profits fell below zero, i.e. they have become unprofitable. While the average annual return of the S&P 500 index has declined from 1999 to 2001 (+) 24.75% to (–) 10.5 per cent, in the Galileo Fund Agressive Growth it fell from (+) 92.78 % to (–) 26,17 %; in Janus Olympus Fund from (+) 77.24 % to (–) 27.03 %; in Fidelity Agressive Growth from (+) 70.56 % to (–) 38.02 %; in Black Rock Mid-Capitalization Growth from (+) 64.44 % to (–) 22.18 %. The average profitability of investment funds during this time decreased from (+) 76.72 % to (–) 31.52 % [10, p. 239].

After the disappearance of hundreds of «dot-coms» the IT-sector has not been affected by itself and continued to grow. The speculative boom was associated with online stores, and had no direct relationship to such tech companies as Apple, Microsoft, etc. In 2003 the income of the Microsoft, Intel and Sun Microsystems corporations were four times more than in 1995, and Cisco – eight times. In 2003, the IT-sector in the USA had 10 million employees, and investments in information technologies were 11% higher than in 2000 [5, p. 50].

Conclusions and prospects for further research. The analysis of the pre-conditions of the "dot-com" crisis in 2000 and its course showed that this crisis itself was not very long and completed a period of economic recovery of the 1990s, associated with information technology and the so-called «new economy». This rise was probably the most ambitious in the twentieth century. In this sense, the «dot-com» crisis became one of the earliest prerequisites of the global financial crisis of 2007–2009. The study of the origins and patterns of the origin of the global financial crisis of 2007–2009 is a promising direction for further research of the author.

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