Digital Deception: A Role of Social Media in Insider Trading and Market Manipulation

Rishit kumar[1], Dr. Rajiv kumar Bhartiya[2]

[1,2]The ICFAI University, Dehradun (LLM)

ABSTRACT

The rise of social media platforms has significantly altered the dynamics of financial markets, presenting new challenges for market oversight. In India, the intersection of social media and stock trading has brought to light concerns regarding the use of insider trading tactics. This paper investigates how social media—through the spread of unverified rumors, speculative commentary, and targeted influence—can be leveraged to manipulate markets. It reviews India's legal framework addressing insider trading, assesses the current regulatory responses, and identifies the difficulties posed by the rapid dissemination of information online. By analyzing case studies and recent events where social media influenced market behavior, the study highlights the critical need for flexible regulatory approaches. The results indicate that while social media fosters greater access to information, it also demands stronger tools to detect and prevent market manipulation, ensuring the integrity and transparency of financial markets in the digital era.

Keywords: Social media, Insider trading, Stock market, Digital influences, Financial markets, Investor behaviour, Market volatility, Ethical investing

INTRODUCTION

A well managed financial market that includes stocks, bonds, debentures, derivatives etc plays a crucial role in the development of countries economy. It gives assurance to the investors to invest the money in the market for smooth flow of the economy. But there are some traders who for the sake of their own profit try to manipulate the market. They try to run the market the way that suits their portfolio. They give least concern about the country's wealth or economy. These types of activities to manipulate the market are restricted in almost every country. It is the duty of the regulators to detect such manipulation cases. These activities of manipulating the market must be quashed by the regulators of the market and must ensure the fairness and efficiency of the market.

But these days the manipulation cases have become more complex, coupled with high trading volumes which makes the manual observations of such cases not feasible. Due to the growing complexity of cases, the researchers around the world have developed several intelligent systems that automatically detect different complex manipulation cases. Therefore to detect and recognize the review paper stock market manipulation, it comprehensively discusses the state of the art method.

This paper offers a clear definition of manipulation taxonomy, outlining various manipulation types and categories, along with findings from early experimental studies. In conclusion, it presents a comprehensive review of automated techniques for identifying cases of stock market manipulation.

Social media impacts the stock market by quickly disseminating information, influencing investor

emotions, and driving market trends. Viral content or speculative rumors can trigger abrupt price changes, leading to volatility. Although it provides quicker access to information, it also heightens the risk of false information and impulsive trading decisions. More investors are turning to social media for investment information. While it offers many advantages, it also presents opportunities for fraudsters. Social media enables them to reach large audiences quickly, cheaply, and with minimal effort, making it easy to share information that appears authentic and trustworthy.

Fraudsters may spread false information either anonymously or by pretending to be someone else. They might fabricate credentials, create fake profiles, or impersonate legitimate sources. Identifying the individuals behind these accounts can be challenging, and the anonymity of social media often makes it difficult to hold fraudsters accountable. Investment information on social media can often be inaccurate, incomplete, or misleading. It can create false perceptions of widespread agreement or credibility, making it seem as though many people are investing in a particular asset when that's not true. Fraudsters exploit social media to attract investors into various scams, including impersonation fraud, cryptocurrency investment scams, romance scams, market manipulation schemes, and community-based investment fraud. Following are the few of the fraudulent schemes the investors should be aware of:

IMPERSONATION SCHEME

Fraudsters often impersonate legitimate brokers, investment advisers, or other trusted sources of market information on social media. They may create account names, profiles, or handles designed to resemble those of real individuals or firms. In some cases, they even develop fake websites that use the legitimate firm's logo, link to the actual website, or mention real employees from the company.

They may also post comments on social media accounts of brokers or advisers, directing investors to fraudulent websites. Additionally, fraudsters have been known to hack into social media accounts, using them to send fake investment offers to the hacked individual's contacts. If you receive an investment recommendation via social media, even from someone you trust, be cautious. Always verify the message through direct, offline communication to confirm its authenticity.

CRYPTO INVESTMENT SCAMS

Fraudsters often take advantage of investors' fear of missing out to attract them to cryptocurrency investment scams on social media. Cryptocurrencies are marketed under various names, such as digital assets, coins, tokens, and more.

How can you tell if a crypto investment is a scam? Promises of high returns with little to no risk are strong indicators of fraud. Scammers may display fake historical returns on websites to suggest impressive profits or show investment accounts with rapidly increasing values and large gains, but these are often fabricated.

ROMANCE SCAMS

Romance scams on apps and websites have become more common as fraudsters exploit anonymity to hide their deceptive motives. These scammers might be based in different countries, and communication could be limited to messaging due to language differences.

Never invest money based on advice from someone you've only met online or through an app. Avoid sharing any personal financial or identity information, such as your bank or brokerage account details, tax documents, credit card information, Social Security number, passport, driver's license, date of birth,

or utility bills.

In what ways does social media influence stock market trends?

Social media plays a major role in shaping stock market trends by amplifying news, spreading rumors, and influencing investor sentiment. Platforms like Twitter and Reddit speed up the dissemination of information, boosting retail investor involvement and driving price fluctuations. However, this also heightens market volatility due to the spread of unverified information and emotion-driven decisions.

By allowing small investors to share insights, social media levels the playing field with larger institutional traders. While this promotes greater transparency, it can also fuel herd behavior, leading to irrational market enthusiasm or panic.

Moreover, discussions on social media can trigger meme stock movements or sudden market rallies, demonstrating its ability to rally collective action. Investors should carefully evaluate such trends before making decisions to avoid speculative losses.

Examples of how social media has influenced the stock market?

Instances like the GameStop incident highlight how social media can affect the stock market, with Reddit users from r/WallStreetBets orchestrating a short squeeze that led to a sharp price increase. Similarly, tweets from prominent figures like Elon Musk have demonstrated how social media can influence stock prices, reflecting its strong impact on market behavior. Platforms such as Twitter and Reddit have consistently driven trading activity by sparking enthusiasm among retail investors. For instance, tweets about cryptocurrencies have resulted in notable price fluctuations, illustrating the volatility that social media can introduce.

These examples emphasize the dual nature of social media in the markets. While it provides a platform for retail investors to influence prices, it also increases the risks associated with misinformation and speculative trading, highlighting the need for careful analysis and informed decision-making.

In what ways can social media sentiment affect stock prices?

Social media sentiment influences stock prices by shaping how investors view the market. Positive sentiment can drive up demand and prices, whereas negative sentiment may trigger sell-offs. Automated trading algorithms that analyze sentiment further intensify these effects by executing trades based on trending topics.[1]

Tools that monitor keywords and hashtags like "bullish" or "bearish" can directly impact real-time price changes. Trading driven by sentiment often increases market volatility, as investors react to dominant social narratives. While sentiment analysis can offer valuable insights, relying solely on it without comprehensive research can be risky. Investors should complement sentiment data with fundamental and technical analysis to make well-rounded decisions. The sentiment can be both positive and negative.

Effect of positive sentiments

Stock prices can be significantly influenced by positive sentiment trending on social media. When users share favorable comments about a particular company or market trend, it can attract the attention of more investors. This increased interest can drive up the stock's price due to higher demand. The impact is often more pronounced with emerging technologies, innovative businesses, or growing industries, as enthusiastic social media posts can boost market enthusiasm.

Effect of negative sentiments

Conversely, negative sentiment on social media can cause stock prices to decline. Rapidly spreading

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[1]Franklin A. Gerutz, (2002), "The Globalisation of Insider Trading Prohibitions", Transnat'l Law Vol-15, p- 63

critical discussions, concerns about a company's performance, or negative news can prompt investors to reconsider their investments. Since social media content can go viral, the impact of negative sentiment can be amplified, leading to sell-offs and heightened market volatility. The rise of communities like WallStreetBets on Reddit has demonstrated how collective negative sentiment can challenge traditional market behaviors.

CASE STUDIES

GameStop (GME) Short Squeeze (2021):
The GameStop incident is one of the most notable recent examples. Institutional investors were caught off guard when retail investors, organized through the WallStreetBets community on Reddit, initiated a short squeeze on GME stock. This coordinated buying effort, heavily influenced by social media, led to a significant surge in GameStop's stock price. This case underscores how online communities can challenge traditional market dynamics and trigger scrutiny of existing market regulations.[2]

Elon Musk's Tweets and Tesla's Stock Price:
Elon Musk, Tesla's CEO, is known for his active presence on Twitter. His tweets, whether about personal matters or Tesla's business updates, have been shown to impact the company's stock price. For instance, tweets about Tesla's valuation or upcoming products have led to substantial price fluctuations, highlighting how influential social media figures can directly affect market trends.

COVID-19 Vaccine Announcements and Biotech Stocks:
The announcement of successful vaccine developments during the global COVID-19 pandemic had an immediate impact on the biotech sector. This news was largely spread through social media, with investor sentiment shaped by discussions on platforms like Twitter and stock forums. Biotech stocks experienced sharp price fluctuations in line with the prevailing mood, illustrating how real-time information sharing on social media can drive market trends.[3]

SPAC (Special Purpose Acquisition Company) Boom:
Social media has contributed to the recent surge in popularity of SPACs. Discussions on platforms like Twitter and investment forums fueled excitement around these investment vehicles. This buzz led to a spike in new SPAC offerings and rising stock prices. However, concerns about regulatory oversight and the quality of certain SPAC deals eventually triggered market corrections, highlighting the volatility that can result from social media-driven trends.

How scammers can manipulate the stock price to profit at your expense?
Fraudsters can manipulate a company's stock price—either upward or downward—by spreading false information on social media, profiting at the expense of unsuspecting investors. For instance, they may use social media to artificially inflate a company's stock price through methods such as:

Pump and Dump Schemes: Creating a buying frenzy by making false or misleading claims to drive up the stock price, then selling their shares at the inflated value.[4]

Scalping: Recommending a stock to boost its price and subsequently selling shares at the higher price to make a profit.

Touting: Promoting a stock without disclosing any compensation received for the endorsement,

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[2] Kavaljit Singh (2001) "Financial Frauds and Market Crashes: Casino Capitalism Indian -style", The Management Accountant, May 2001, Vol36

[3] Bhattacharyya Utpal and Daouk Hazem, (2002), "The World Price of Insider Trading", 54 Journal ofFinance, pp -75-108

[4] Agrawal Sanjiv, (1996) "Insider Trading Worldwide Practice" SEB1 and Corporate Laws August, 1996, pp-55-62

misleading investors about the stock's true value.

In other cases, fraudsters spread negative rumors to drive down a stock's price, encouraging investors to sell. They then buy shares at the artificially low price to benefit from the recovery. These fraudulent activities can occur anonymously or under false identities on social media, often disguised through tactics like memes to appear more credible.

Are social media trends influencing the future of investing?

Yes, social media trends are transforming investing by making financial insights more accessible and allowing retail investors to impact the markets. These platforms encourage collective action and amplify trends, changing traditional market dynamics while also presenting challenges such as misinformation and increased volatility.

Social media facilitates quick information exchange, helping retail investors become more informed and confident. However, depending on unverified trends can be risky, emphasizing the need for critical analysis and balanced decision-making.[5]

With technology increasingly incorporating sentiment analysis into trading platforms, social media's influence on market behavior is expected to expand. Investors will need to adapt by integrating social media insights with well-structured investment strategies.

Precautions that needs to be taken while using social media insights

Investors should confirm the credibility of social media insights before making decisions. It's important to avoid emotional reactions to trends, prioritize fundamental analysis, and verify information through trustworthy sources to reduce the risks of misinformation and speculative losses. Diversifying investments and maintaining disciplined strategies can safeguard portfolios from impulsive choices influenced by hype. A solid understanding of market fundamentals and the ability to filter out unverified information are key when relying on social media data.

Social media insights should be viewed as complementary, not primary, sources of information. Combining these insights with thorough research helps ensure well-informed decisions, reducing the risks linked to herd mentality and market volatility. You've probably encountered online or social media ads claiming to offer stock tips, some even claiming to be connected to well-known figures in finance and investing. These ads often promise extraordinary returns, such as 100% or more. Clicking on them may lead you to be added automatically to a group chat on social media, where you'll start communicating with someone posing as an "investment adviser" or their "assistant," who recommends buying shares of well-known companies.

If you follow their advice and see positive returns, it can create a false sense of trust. Once this trust is established, the so-called adviser might suggest investing in smaller companies (even those listed on major U.S. stock exchanges) and ask you to share screenshots of your purchases. Eventually, the stock price drops significantly, causing you to lose most of your investment.

The promise of high returns with little to no risk is a classic sign of investment fraud. All investments carry risks, and high potential returns usually come with high risk. If an offer sounds too good to be true, it likely is.

CONCLUSION AND SUGGESTIONS

The advent of social media has significantly reshaped financial markets, offering both new opportunities

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[5] Prakash N and Reddy Vinay (2000), "Insider trading in the global context", SEBI and Corporate Laws-Magazine, May, pp-15-19

and notable risks. In India, platforms such as Twitter, WhatsApp, and Telegram have become influential in spreading information quickly, affecting investor decisions and, in some instances, enabling market manipulation. This trend raises serious concerns about the evolving nature of insider trading, as the distinction between public and non-public information becomes increasingly ambiguous.

Traditional insider trading regulations focus on material, non-public information obtained through corporate channels. However, the digital era has broadened this scope. Social media allows for the swift dissemination of unverified, speculative, and sometimes misleading content, which can artificially drive stock prices up or down. This environment enables coordinated efforts, often concealed behind anonymity, to manipulate markets, thus eroding investor trust and market integrity.

India's regulatory body, the Securities and Exchange Board of India (SEBI), has made progress in tackling these issues. Nevertheless, the rapid pace of digital communication often outstrips regulatory responses, making it challenging to detect and prove insider trading cases linked to social media manipulation. Additionally, the absence of clear regulations regarding social media use for financial purposes complicates enforcement efforts.

To address this emerging threat, a comprehensive strategy is required. Regulators should strengthen their surveillance systems, employing advanced technologies such as artificial intelligence and data analytic to track social media activities and identify potential market abuse. Legal frameworks need to evolve to tackle the specific challenges posed by digital platforms, including clearer definitions of insider information in the context of social media. Furthermore, financial institutions and investors must be educated about the risks associated with relying on unverified social media information.

In summary, while social media has democratized access to financial data, it has also introduced new risks to the stock market. Effective regulatory measures, technological advancements, and investor awareness are crucial to maintaining the integrity of India's financial markets against the rising threat of social media-facilitated insider trading.

Strategies to Address the Growing Threat of Insider Trading Through Social Media
Enhance Regulatory Frameworks:
- **Revise Legal Definitions**: Modify existing laws to explicitly include social media-distributed information under the scope of insider trading.
- **Establish Clear Guidelines:** Develop detailed regulations on the appropriate use of social media for financial communications, clearly differentiating between lawful information sharing and illegal market manipulation.

Improve Surveillance and Monitoring:
- **Leverage Advanced Technologies:** Deploy artificial intelligence, big data analytics, and machine learning tools to monitor social media for suspicious activities, such as coordinated false information campaigns or unusual trading behaviors.
- **Implement Real-Time Monitoring:** Create systems capable of detecting and swiftly responding to rumors or manipulated content that could impact the market.

Promote Investor Education and Awareness:
- **Financial Literacy Initiatives:** Raise awareness among investors, particularly retail investors, about the dangers of acting on unverified social media information.
- **Encourage Critical Thinking:** Advise investors to critically evaluate the reliability of information sources before making investment decisions.

Strengthen Enforcement Measures:
- **Global Collaboration:** Work with international regulatory agencies to identify and penalize cross-border insider trading activities facilitated by social media.
- **Impose Stricter Penalties:** Enforce harsher consequences for individuals and entities involved in market manipulation through social media, including hefty fines and potential imprisonment.

Promote Corporate Responsibility:
- **Establish Robust Internal Controls:** Urge companies to implement strong internal protocols to prevent the unauthorized sharing of material non-public information, even through informal digital channels.
- **Mandate Timely Disclosures:** Require companies to promptly and transparently disclose significant information, reducing the likelihood of selective or misleading information spreading on social media.

Encourage Ethical Social Media Practices in Finance:
- **Develop a Code of Ethics:** Create a set of ethical guidelines for financial professionals, including analysts and influencers, to promote responsible and accurate information sharing.
- **Hold Platforms Accountable:** Make social media platforms responsible for hosting and amplifying misleading financial content, with clear obligations to take action against harmful practices.

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