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Restricting internet searches causes stock market instability

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Limiting internet searches for investors increases stock market crash risk by 19%, a new study has found.

The research by RMIT University looked at the ramifications on the stock market following Google's withdrawal from mainland China in 2010.

It found access to unbiased information about companies' performance—aided by unrestricted internet search results—led to investors making more informed decisions.

On the flip side, search results manipulated to show overly positive information led to stocks for those companies being overvalued temporarily, increasing the stock market crash risk by 19%.

The study has been published in the *Journal of Financial Economics*.

Lead researcher Dr. Gaoping Zheng, a lecturer in finance at RMIT, said the study showed search results influenced decisions, a challenge to previous thinking that they merely justified people's existing ideas.

"Until now it's been widely thought that unrestrictive internet searches result in bias and an overvaluation of stocks but that would mean restricting search would decrease stock market crash risk. Instead, we saw a significant jump," Zheng said.

"This suggests internet searching does not exacerbate investors' biases—instead, it facilitates their ability to access and analyze information."

The research has implications for Australia following Google's recent attempt to withdraw from the country.

"While China has alternative search engines, their results are concentrated and an identical search on Google would show vastly different results." Zheng said.

"Our research emphasizes the importance of access to diverse results and if Google did decide to withdraw, it could have a destabilizing impact on the economy."

Comparing China during and after Google

In 2010, Google unexpectedly withdrew its searching business from China, reducing investors' ability to find information online.

To measure the impact, researchers divided a list of Chinese firms into two groups: firms that had a high search volume on Google prior to 2010 and firms that were not regularly searched for on Google prior to 2010.

By averaging the stock price cash risk of both groups after Google withdrew and comparing their standard deviation, the researchers found firms that were regularly searched for on Google were 19% more unstable.

Zheng said while Chinese investors could still look for information about stocks using other search engines, they were more likely to be shown positively-biased information from websites hosted in China.

"Google was more likely to show content from international websites such as Bloomberg, Reuters or The New York Times, which are free from political constraints to talk about what is happening," she said.

"Investors were more likely to overvalue stocks due to biased information found through Chinese-owned search engines."

Zheng said restricted searches gave firms opportunities to hide adverse news from the public, preventing potential investors from discovering accurate information online.

"If managers withhold negative news, investors are less likely to mitigate their misconceptions and biases surrounding a certain stock," she said.

"Let's say I believed that eating carrots could cure cancer and searched the internet to confirm this. An unrestricted search would correct my bias because I would find that carrots are not actually a cure for cancer."

More information: Yongxin Xu et al. Internet searching and stock price crash risk: Evidence from a quasi-natural experiment, *Journal of Financial Economics* (2021). DOI: 10.1016/j.jfineco.2021.03.003

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