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## Snapchat, the South Sea Bubble and nature of speculation

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### Summary

Financial bubbles are cyclical in nature, appearing and disappearing across the economic landscape and are to some extent unavoidable. No two bursts are the same but red flags could push us to reflect on the current situation and of the future of speculation. What would the South Sea Bubble, one of the earliest bubbles of modern capitalism have in common with Snapchat? This paper will discuss the commonalities of these two phenomenon's.

### Financial Bubbles

Financial bubbles have risen across world economic across different industries and under the span of several century and are mostly known for the terrible social consequences led by them when they burst.

Surprisingly some economists deny the phenomenon of bubbles but most agree that they are only visible after they "pop". Companies net assets are devaluated when the assets through more critical inspection no longer reflect from their initial intrinsic value.

### Here comes the South Sea Company (1711)

In a period where the British government was seriously in debt different schemes were offered (such as lotteries) to reduce that liability but none were as ingenious as the South Sea Company.

Incepted by Harley, Earl of Oxford but mostly managed by John Blunt (a director of an unofficial bank "Hollow Sword Blades Company")<sup>[1]</sup> the company agreed to accept government debt<sup>[2]</sup> by offering the public to swap them against their joint-stock of the South Sea Company.

Closing the deal included the government granting a monopoly of the trading ports of South and Central America<sup>[3]</sup> to the SSC. John Blunt's ambition was to use this monopoly to replicate the spectacular success of East Indian company (1600).

In part due to the initial demand for the SSC many joint-stock companies appeared across the country which lead to the Bubble Act of 1720. This Act forbid ventures not granted by a Royal charter and thus led to a decrease in competition which in hand further accelerated the demand for the SSC.

The specular success of the SSC from an initial 300£/100£ equity (April 1720) to 890/100 (June 1720) was mostly associated with John Blunt as he was a master crowd psychologist and could contrive fanciful stories. Add bribery of parliament officials and important political figures (including at one point the King himself George II) to key positions within the SSC. John Blunt was masterful to create trust in this speculative art.

But sadly, after reaching 890£ the SSC stock started to fall and even John Blunt with all his trickery couldn't stop the burst. To avoid further loss a deal was made with the Bank of England to prevent panic (unsuccessful) which led to the final buyout of the SSC[4] by a reluctant Bank of England and the East India Company on the 9<sup>th</sup> of December 1720. A witch hunt ensued and retroactive laws were enacted, several members of the SSC board were accused and convicted to restore the strict value of their estate.

### **Current IPO tech atmosphere**

As of late 2016 there are currently 170 unicorns[5] globally with a combined value of more than \$600 billion from 39 with a combined worth \$100 billion in 2013 (1).

### **Snap Inc.**

Praised as one of the most famous Unicorns pre-IPO, Snap Inc. is a start-up company created by 3 students from Stanford University. Snapchat is an app known for its ephemeral messaging and appeal towards the younger generation (mostly the "millennials"). Praised for its innovative outlook on communication and product design they are currently valued at \$28 billion[6] while "only" generating 300m/year in sales.

Facebook launched a bid to buy them for \$3 billion back in 2013.

### **Commonalities, differences**

There are some commonalities that could be inferred by observing these two cases. For instance Snapchat appears after the spectacular success of Facebook. This is to some extent similar to SSC which came after East India Company.

The South Sea Company managed to thrive due to the marketing of John Blunt thus hiding the elusiveness of their business model. It is similar to Snap Inc. where as today we are still eluded on how they justify an \$28 billion valuation.

Interestingly enough the SSC eventually failed because they never held any extensive rights over the trading ports of south/central America. Similarly, Snapchat yields a promise of some sort of monopoly thus justifying to investors its valuation.

But to be fair Facebook also struggled with their valuation but were later saved by introducing their mobile business model. Often it is read that experts who value tech companies such as WhatsApp, Facebook, Instagram base their value on user base which depending on how you view it can be seen as "monopolies". But as with the SSC the promise of monopoly cannot by itself justify the high valuation. Monetization of that position is key.

### **Psychological phenomenon and future**

So what else could justify such a high price? *Social Psychology*

*Herd behavior* from behavioral finance explains us that the market trend affects the behavior of investors, leading to an increase/decrease of risk-taking. Seen in the SSC some early signs at Snap Inc., shows that they do not escape this behavior as they increased by \$9 billion of market capitalization within their first day of trade (!) (2).

*Greater fool theory*: Investors understand that their stock might be over-valued but they believe that there is another fool down the line whom can buy it from them. The SSC was a victim of it: at a high 500£/100£ equity investors still bought the equity until the collapse of SSC.

*Extrapolation*: a classical bias where people believe past performance will lead to future performance in order to justify their investment. Equally observable from the SSC.

But what can this tell us about the future?

New mobile technologies and the possibility to trade with ease from our phones have made "trading barriers" much less problematic enabling even the pauper to invest.

Decades ago one would need a broker and call him to access a trade then digital advances enabled the internet to a more democratic brokerage (1994[7] online brokers became available).

Today thanks to the technology found in our smartphones it is conspicuous that trading apps have furthermore democratized financial transactions.

This leads to this anecdote from Snap's IPO: "*Here's How Snap's IPO Just Proved We're In a Tech Bubble*" (3) when a Uber driver in L.A. can buy a Snap. stock while at the same time drive his car, an surprisingly simple but impossible feat only some decades ago.

The argument I wish to state forward is that the social psychological phenomenon's I described above can only be amplified by the removal of barriers and therefore increase the crowd effects seen from the 18<sup>th</sup> century.

#### Works Cited

1. [Tech Unicorn Valuations Are In Trouble. Fortune.com](#)
2. [Snapchat's Roaring IPO: Everything You Need to Know](#)
3. [Wieczner, Jen. Here's How Snap's IPO Just Proved We're In a Tech Bubble](#)
4. [Riley, Charles. Nintendo shares are up 120% \(!!!\) thanks to Pokemon Go](#)
5. [MACKAY, Charles. Extraordinary popular delusions. 1852.](#)

[1] The Bank of England was the only bank authorised at that time, therefore unofficial banks emerged

[2] The debt amounted to 30'981'712 pounds + 5%/annum

[3] England was at war with Spain at that time. Spain were owners of territories in South/Central America

[4] Nearly taking England into ruin.

[5] A Unicorn is a company valued more than \$1 Billion.

[6] As of 05.03.2017