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Impact of Herd Behavior on Investment Decision of Investors And Stock Market Price Volatility – An Empirical Study

Dr. B. Shekhar[1]
Professor. Dept.of P.G. Studies in MBA
Visvesvaraya Technical University, Jnanasangam, Belgaum, Karnataka State, India.
Email - drbstut@gmail.com, Mob:09620230696

Mr. Prasad R.A[2]
Research Scholar, Department of Studies and Research in Commerce.
Tumkur University, Tumkur, Karnataka State, India.
Email - prasaadharya@gmail.com, Mob:9741632305

ABSTRACT

This paper analyses the influence of herding behaviour on Indian retail and professional investors and its impact on stock market price volatility in financial capital Market. By referring to psychology and pointing out the imperfections of a human mind, it reveals mistakes committed by both individual and professional investors. In the 2008 financial crisis, behavioral inclinations affected not only the investors but also market-supporting entities and regulatory institutions. This study mainly study on how irrational behavior influence on retail and professional investors and how they will take investment decisions based on different available sources.

Key words: Behavioural finance, Herd Behaviour, stock price volatility, retail investors.

INTRODUCTION

Herding is described as imitation behavior resulting from individual factors and often leading to inefficient outcomes for the market as a whole or Individuals are known to be influenced by others in their decision making. When deciding which restaurant to make reservations at or which colleges to attend people frequently imitate the actions of their predecessors. Restaurants with a greater number of guests or colleges with more students tend to appear more appealing to the observer. This is generally referred to as herd behavior. The same thing can be applicable to the financial markets. Investors substantially follow the direction of the market or the suggestion of financial experts. Understanding the behavior of investors in financial markets is essential. Investment behavior has been an area of interest fortportfolio managers, brokers, investors as well as academic researchers. History reveals that irrationalities in investment behavior have been the reason behind major booms and busts in the market. Investors do not make decisions based on their own judgment which leads to mispricing of securities. It leads to an inefficient market situation characterised by speculative bubbles.

Since India is an open economy, it is sensitive to foreign market movements and actions of Foreign Institutional Investors. Corporate governance provides greater transparency of information disclosure by firms and institutions. Thus the investors are better informed and are expected to make rational decisions. Still many circumstances we observed irrational behavior. The most recently example being the stock market crash of year 2008; one of the biggest in Indian stock market history. These irrationalities can be attributed to various heuristic driven and frame dependent biases. Different behavioral biases like loss aversion, overconfidence, optimism, anchoring, mental accounting are some irrational behaviors and herding as important reasons behind market anomalies.

REVIEW OF LITERATURE

Cristian Ionescu in his study entittled by ***the herd behavior and the financial instability*** he opined that, Herd behavior can be both irrational and rational. An irrational herd behavior is based on psychological factors that determine the course of the action of the financial actors (therefore, there are no objective factors of action). A rational herd behavior (profit-seeker) may result in an economic and financial boom, but in time leads to (endogenous) financial instability.

Decamps and Lovo (2002) state that the pre-requisite for qualifying an investment decision as herd behavior is that an investor changes its investment decision in line with the decisions of other investors. **Banerjee (1992)** has stated that investors imitate other investors rather than making use of their information and this situation can be characterized as herd behavior.

Barbara Alemanni and Jose Renato Haas Ornelas (2006) in their study entittled by ***Herding Behavior by equity foreign investors on emerging markets*** explained that, The degree of herding behavior may also impact the volatility of returns. Investors are often blamed to enter and exit emerging markets in herds, bringing instability to these markets especially during crisis.herding behavior not only impact on emerging markets but also to the developed countries,

Robert R. Prechter, Jr. study entittled by ***Unconscious Herding Behavior as the Psychological Basisof Financial Market Trends and Patterns.*** state that, Human herding behavior results from impulsive mental activity in individuals responding to signals from the behavior of others. Impulsive thought originates in the basal ganglia and limbic system. Herding behavior while appropriate in some primitive life-threatening situations, is inappropriate and counterproductive to success in financial situations.

STATEMENT OF THE PROBLEM

Herding is a behavior that consists in imitating other agents' actions. Although it is refered to in many fields of economics, herding is particularly often invoked to explain financial market anomalies such as the excessive volatility of asset prices or the emergence of financial bubbles. We can see extreme volatility in stock exchange. Some time this volatility created by irrational behavior of investors and it leads to stock market imperfection. In this time investors not possible to predict stock market performance. So this study mainly emphasise on that irrational behaviour of investors impact on investors and stock market.

NEED OF THE STUDY

Indian capital market can be volatile due to the herd behavior of the investors. It is therefore imperative for indian to take the necessary pre-cautionary measures to ensure that an aggregate reversal in portfolio investment flows would not result in a de-stabilising impact on the economy. This study emphasizes the need to improve market supervision and strengthen the financial structure in efforts to reduce the impact of capital reversal on the indian financial market. this study examines the impact of herd behaviour on stock price volatility in India and examines the existence of herd behavior among investors in the Indian capital market.

OBJECTIVES OF THE STUDY

✓Tocritically evaluate the concept of Herd Behaviour in Investment

✓ToStudy On Impact of Herd Behaviour impact on stock market price volatility

✓Toknow the impact of herd behaviour on indian investors

✓Tofind out solution for enhancing good decision making capacity of investors

HYPOTHESIS

Null (Ho) = Herd Behaviour adversely impact on retail investor's investment

Alternative (H1) = Herd Behaviour favorably impact on retail investor's investment

RESEARCH METHODOLOGY

In order to achieve the above stated objectives, the relevent data has collected from the primary and secondary sources. A primary data has collected by coducting a sample survey of totally randomly selected investors through a well designed and exhaustive questionnaire. This present study recieved information from 100 investors and information gathered through convinient sampling method. Seconadry information has been collected from books, journals , magazines, news paper and websites.

SCOPE OF THE STUDY

The study has wide scope in analysing the retail investos behavior, Present study A convinient random sample was followed of 100 investors and study restricted to Bangaloor (capital city of karnataka).

✍Statisical tools used for data analysis

✍Simple chi-square test is used for analysis of data testing of the hypothesis

DATA ANALYSIS AND DISCUSSION

Table No.1- Showing the Classification of Respondents on the Basis of Their Profession

Sl No	Profession	No. of Respondents	Average year of Investment Expirience	Percetage (%)
01	Business man	76	11	76%
02	Private employees	14	06	14%
03	Govt employees	07	03	07%
04	Agriculturist	03	04	03%
	Total	**100**		**100%**

Primary Source

Above Table shows that, this study based on respondent's opinion, now here collected information from different professional investors such as, businessman, private employees, government employees, agriculturist. Businessman had longer expirience in the field of investment and basically they are crucial role player in capital market.

Table No 2- Shows The Respondents Opinion About, Expirience Of Irrational Behavior Or Is Herd Behaviour Impact On Investors In Their Investment ?

Sl No	Opinion	Frequency	Percentage
01	Yes	56	56%
02	May be some time	18	18%
03	No	23	23%
04	Don’t know	03	03%
	Total	**100**	**100%**

Primary Source

In this of study collected opinion of investors about herd behavior impact on their investment. Here more than 56% respondents said that, their investment decision making depends upon Herd behavior, it means they opined that they always follow their investment guru, experts and trusted stock brocker's information and some time they influenced by some investment professional person who are provide information through television. 18% investors out of 100%, state that, herd behavior impact on their investment, according to them, only sometime they feel to get others information for their investment decision making but they are not completely follow others information blindly which is given by someone, they think rationally about all available oppertunities then they will make investment.

23% respondents were opines that, they never follow others information in their investment decision because they think what they had information that is rational and prudent so they desire to make investment on the basis their own ideology, they don't like to imitate the action of others.

Out of 100% only 3% of the respondents were don't know the concept of herd behavior .

Table No.3- Showing Different Sources Of Information Available To Investors Make Investment Decision

Sl. No	Sources	No. of respondents	%
01	Top Investment Guru or Experts	**10**	**13.51 %**
02	Stock Brocker's advice	**19**	**25.67 %**
03	Online publicity through websites	**03**	**4.05 %**
04	Investment professional's suggestion through television	**04**	**5.40 %**
05	Business channels exibhiting information	**11**	**14.86 %**
07	All the sources stated Above	**27**	**36.49 %**
	Total	**74**	**100 %**

Primary source

The above table representing what are all the sources available to investor to take decision making. Out of 100% respondents only 13.5% repondents said that, they always follow investment legend or expert's piece of opinion as a tool of investment decision making and they try to imitate experts information. Say for example, warren buffet, Richard branson and etc.

25.67% respondents are receive informatoion from their trusted stock brocker's consultancy. On the basis of stock broker's advice they will put investment. Ultimately gain or losses of investors decided by stock bockers.

Only 4.05% of the respondents are expert in searching information in online. Their investment always based on information, data, available via internet.

Some time some retail investors desire to put investment on the basis of available piece of information given by some news channel. say for example TV 9 kannada channel "Hana Bhavishya" programs. Here 5.40% of investors are like to make investment on the basis of information or cunsultancy given by some investment professional through those type of programmes.

14.86 % respondents watch business channels and collect more information on different portfolio securities later they will take investment decision.

Majority 36.49 % respondents like to receive securities and investment information from all the sources

TESTING OF WORKING HYPOTHESIS WITH CHI-SQUARE

Null (Ho) = Herd Behaviour adversely impact on investor's investment

Alternative (H1) = Herd Behaviour favorably impact on investor's investment

Table No.4 Shows The Impact Of Herd Behaviour On Investment, According To Respondents Point Of View

Sl. No	Particulars	O	E	(O-E)	$(O-E)^2$	$(O-E)^2/E$
01	Good investment decision possible from herd behaviour	12	18.5	-6.5	42.25	2.28
02	Only Sometime good but not every time brings good decision	28	18.5	9.5	90.25	4.87
03	Only Sometime causes adversly but imitation of expert's action yield good results	26	18.5	7.5	56.25	3.04
04	Bad Decision come out from herd behavior	08	18.5	-10.5	110.25	5.96
	Total	74				X^2=16.15

Expected Frequency=74/4=18.5
Calculated value=$(O-E)^2/E$= 16.5
Degree of freedom=(4-2)= 3
Table value (degree of freedom 3)=7.815

In this study only 74 (54+18) respondents were stated herd behavior impact on investor's investment decision, this investors take investment decision on available information which is provided by investment experts, stock brockers, mass group opinion. In this study 12 respondents were given positive opinion about impact of herd behaviour on investment decision. According to them imitation of investment action of investment experts and considering the others mass opinion will facilitate to make proper investment decision and this investors are still like to follow herd behavior.

28 respondents were given partly favourable opinion towards herd behaviour. according to them herd behavior only some time favourably impact on investment but imitations are not good always. Majority of respondents not agree with irrational behavior in investment

26 investors opined that, herd behavior is only Some time causes adversly but imitation of expert's action yield good results. They ageed with irratonal behavior investment and they follow expert advice for the purpus of get more yield.

Only 8 respondents out of 74 Said that, behavioral finance is not good finance. irrational behavior, over confidence, over trust and others suggestions are not yield more income because some time experts are deliberately provide informational bias. So prudent decision making is leads more returns. Prudent investment decision making is come from fundamental and technical analysis of securities in scientific and systematic manner.

Table value (degree of freedom 3)=7.815, and calculated value is X^2=16.15, which is greater than table value. Therefore the null hypothesis rejected and alternative hypothesis is accepet. Totally interpretation is herd behaviour impact on investors while making investment decision.

FINDINGS

1) Investors are completely ignore their own private information and try to follow others piece of information for the purpus of making decision.

2) Normally businessman involved more trading and investment in the stock market. even though they had own idealogy and more rational than other professional investors they also follow other expert's foot steps, they shows reluctance to take their own information for the purpose of take a rational investment decision making

3) Only 23% of the investors are not imitating others while making investment decision. They are thoroughly analyse available information. With the help of own information they desire to construct their own portfolio. This is indicating rationality and prudent behaviour of investors in stock market but in this study find existence of rational investors are only few.

4) 74% of the respondents agreed that, their investment decision making influenced by expert advice. So this study find out existence of irrational behavior or herding behavioer quit common in indian stock market. Here investor's investment decision depends upon others suggestion. In this way this study find out poor rationality in majority investors. This is not good indication for stock market stability or performance

5) 3% of the investors are investing blindly without knowing rationality or standard investment theories.

6) Majority investors are opined that through imitating the actions and advice of experts, they can expect only Sometime good return on their investment but every time it will not generate good gains. In other hand 26% of the respondents are explained that, herd behavior is good technique, because following expert's information instead of implementing their own information they believed to get more yied. according to them experts or professional are more expirienced and trained people who can analyse the investment oppertunities and threats easily when compared retail investors. Hence some time herding behaviour impact adversly but not all the time. This irrational but acceptable from the point of retail investors because they had limited source.

7) 25.67% of majority respondents are follow stock broker's consultancy and their advice become investor's decision

8) Investors are received information from different source such as, Top Investment Guru or Experts, Stock Brocker's advice, Online publicity through websites, Investment professional's suggestion through television, Business channels exibhiting information. This are all piece information become investment decision making for majority investors.

SUGGESTION

✓Overcome of herd behavior is necessary for gain stable return by investors and it can easily boost up stock market performance. with reducing irrational behavior facilitate to decrease stock market price volatility, because of herd behavior if some persons buys same group of securities frequently causes every one will eager to purchase those similar securities, this action leads to automatically increase those securities demand, the ultimate result is increase the stock prices incredibly, in other hand if some investors desire to sell some similar stock simentaneously means it will impact on all other investors also arrive to sell those securities without taking any consideration and they don't use their own ideas, strategy, information. Due to some gossips every one sell those securities, ultimate result is decrease the security's demand and price of the securities in the stock market. This is type of movement indicates extreme stock market price fluctuation hence investors are need to avoid imitation of others decision blindly without considering any prudent reason. blind following is not good.

✓Here every investors want to keep onething in their mind, buys stock that are undervalued and sell them when they are overvalued, here the threshold is fundamental value they are called "Smart money" this principle helps to every investors instead expect everything from others,

CONCLUSION

Very interesting phenomenon in the field of economics and investment is “herding” in human, when they flock each other under some condition rather than taking their own decisions on the basis of their own beliefs. This decision is perfectly rational when the belief is that the others have better information. However the belief can be propagated by herding if all belief that a specific stock is going to increase in future and everybody tries to buy that stock which increases its demand and resulting high price in the stock market. Now a days stock market and investors are mainly affected by herd behaviour, irrationanal behavior is not favourable steps for building good stable stock market and even investors also suffer much due to imitatation of others, so investors want to stop the blind following on others. They just want get proper information which available from different sources and make investment decisiosn according to their own convinient.

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