
Influence of Herd Behavior on the Investment Choices of Mutual Fund Investors in India.

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Abstract

Behavioral finance elucidates the mindset and perceptions of investors regarding their financial choices. Each investor varies from others in numerous ways owing to various factors such as demographic and socio-economic backgrounds. A judicious investment choice is crucial and constitutes a significant consideration.

This study examines the influence of herding behavior on investors in Indian mutual funds. By examining psychology and highlighting the flaws of the human psyche, it uncovers errors made by both personal and institutional investors. This research examines the influence of herding tendencies and overconfidence biases on investment decisions in India. The study intends to gather essential data using questionnaires administered to 113 individuals engaged in mutual fund investments. The findings indicate that overconfidence and herding bias exert a substantial favourable influence on investment choices. The overall findings indicate that individual investors possess restricted knowledge and are more susceptible to psychological mistakes. The research results also reveal the presence of these four behavioral biases influencing personal investment choices. This research will assist financial intermediaries in providing counsel to their clients.

Keywords: Behavioral Finance, Collective Behavior, Investment Choices, Mutual Funds.

Introduction

Behavioral finance examines the emotions and psychology of investors that affect their investing choices, as well as the typical mistakes made by individuals when making financial decisions based on emotions. Decision-making is the most complex and challenging endeavor for investors. Each investor is unique in various dimensions owing to factors such as demographics, socioeconomic status, education, gender, and age. A sound investment decision is crucial and requires careful consideration, yet the perfect request can lead a successful investor to triumph. Numerous psychological and behavioral elements affect investors' decision-making, as examined by researchers such as Merikas et al. (2007), who conducted an empirical investigation of the primary influences on individual investor behavior in the Greek Stock Exchange. Anderson et al. (2007) examined the impact of financial incentives on herding behavior inside a simulated financial market through two distinct experiments.

Herding is a concept in investor behavior that refers to the tendency of investors to mimic the investment choices of others in the stock market, potentially leading to significant, uncharacteristic movements or cash flows based on seemingly minimal fundamental information. Herding constitutes the fundamental basis of deception in finance. The herding effect in financial markets is identified as the tendency of investors to replicate the behaviors of their peers (Al-Tamimi, 2006). Investor herding behavior leads to decision-making influenced by peers, culminating in unhappiness with investment outcomes. If investors refrain from exhibiting herding behavior, they can make autonomous investment choices, and the returns they receive from their investments enhance their confidence as well (Torrecillas, Yalamova, & McKelvey, 2016). Professionals typically deliberate on the existence of herding, as investors rely on collective information rather than their own data, leading to price discrepancies of securities from their intrinsic value; thus, numerous favorable investment prospects at present may be influenced (Chen & Volpe, 1998). Herd behavior refers to an individual's tendency to emulate the actions (whether logical or illogical) of a large group. The collective mentality arises from

two factors; primarily, there may exist a societal compulsion for uniformity. Generally, individuals prefer not to depart from their affiliated organization. Secondly, there exists a prevalent notion that a substantial collective is incapable of erring. Acquiring stocks driven by price momentum while disregarding fundamental economic tenets of supply and demand is referred to in behavioral finance as herd behavior, resulting in erroneous decisions (Byrne, 2007).

It is a rebuttal to the lack of sufficient knowledge and the presumption that those in our vicinity can provide a different perspective on decision-making. Research indicates that individuals struggle significantly when opposing a substantial majority, often suppressing their own viewpoints.

Literature Review

Scharfstein and Stein (1990) elucidated the elements affecting the disposition of retail investors. The psychological elements affecting investor conduct were determined through principal component analysis. The findings from main component analysis identified six behavioral dimensions influencing investor behavior in the Indian stock market: conservatism, vigilance and discretion, remorse aversion, cognition, prudence, and precaution under confidence.

Bikhchandani (2000) provided a summary of empirical studies regarding herd behavior in financial markets, the definition of herding, the factors contributing to herd behavior, the effectiveness of prior research in recognizing the phenomena, and the impact of herding on financial markets. Kutan and Riza (2006) employed a novel methodology inspired by Hwang and Salmon's (2004) approach, utilizing a cross-sectional dispersion of trade volume to examine herding behavior on the Toronto Stock Exchange. The herd phenomenon comprises three fundamental elements: stationary herding, which indicates the presence of the phenomenon regardless of market conditions; intentional herding, which pertains to investors' expectations regarding the entirety of assets; and the third element, feedback herding, which emphasizes that current herding is influenced by prior herding. Maditinos (2007) employed a power-law distribution of stock price fluctuations within a sector indicative of herding behavior and the emergence of the dot.com bubble. The findings demonstrated that DFA is capable of identifying the source of stock-market bubbles, although it cannot ascertain the onset of crashes.

Chiang and Zheng (2010) demonstrated that knowledgeable investors tend to display herding behavior, particularly in the consumer and technology sectors during bullish and bearish markets, respectively, as the negative coefficient is not confined to declining markets and to volatile and uncertain stocks.

Jansirani and Shanmugasundaram (2012) investigated investor behavior to determine if it is reasonable or irrational in response to capital market information through a descriptive study. The surveys were disseminated to 500 investors, and the information was examined utilizing SPSS. The findings revealed that investors act logically in response to information pertaining to the specific capital market.

Prosad, Kapoor, and Sengupta (2012) examined the phenomenon of herding behavior within the Indian equity market. The herding linear regression model was examined, and a quadratic functional form of linear regression was utilized. The findings indicated that the Indian market exhibited such efficiency that no herding behavior was observed.

Cakan and Balagyozyan (2013) examined the phenomenon of investor herding within the Turkish banking industry. The approach utilized by Chang et al. (2000) for daily stock returns from 2007 to 2012 was implemented.

Herding was discovered to be present. An examination was conducted on asymmetry in relation to market returns, revealing that herding behavior occurred solely during market upswings.

Jayaraj (2013) presented an innovative technique known as de-trended fluctuation analysis (DFA), an econo-physics approach utilized in finance and herding studies to detect the transition from efficient-market dynamics to herding tendencies. The study investigated if DFA identifies the shift from efficient market trading to herding behavior and the expansion of the NASDAQ dot-com stock market bubble.

Dehghani and Sopian (2014) investigated the herding tendencies of uninformed (non-private placement) and informed (private placement) investors in the IPO aftermarket during 2011, employing the methodology of Christie and Huang. Research indicated that inadequately educated investors demonstrate sensible conduct during market downturns throughout the consumer, industrial, trading, and services sectors.

Paulo Lao and Harminder Singh (2011) investigate herding tendencies within the stock markets of China and India in their research. The research utilizes the Cross Sectional Absolute Deviation (CSAD) methodology introduced by Tan, Chiang, Mason, and Nelling (2008) to assess herding behavior. The results indicate that herding behavior is present in both the Chinese and Indian stock markets, contingent upon certain market conditions. In the Chinese market, collective behavior intensifies during market downturns accompanied by elevated trade volumes.

Conversely, the research indicates herding tendencies in India under bullish market conditions. Herding behavior is more prevalent during significant market fluctuations in both markets. The Indian stock market has a comparatively less occurrence of herding behavior. Nonetheless, the stock markets in China and India are perceived as more perilous and less sophisticated compared to their industrialized counterparts.

Nonetheless, an examination of prior research suggests that numerous behavioral biases are either interconnected or an extension of other behavioral biases. This research examines solely four biases that are commonly seen in financial decision-making. Although herding behavior has been analyzed in various research, we have sought to enhance the field by providing evidence of herding in Indian mutual funds. This work examines a recent timeframe that, to our knowledge, has not been previously explored in the Indian context.

Research Methodology

The current research employs a cross-sectional design and utilizes quantitative methods for data analysis. A survey instrument has been developed, and a survey methodology is employed to gather responses. The true sample size for the research was 125, although several questionnaires were insufficiently completed. Consequently, merely 113 surveys were deemed valuable and chosen as the sample size. The convenience sampling method is employed to gather data from Mutual Fund investors. The objective of this research analysis is to elucidate and derive conclusions from the gathered data. Inferential statistics and descriptive statistics are utilized for the analysis of data. SPSS software utilized for statistical analysis. Initially, Cronbach's Alpha is utilized to assess the dependability of the data. The interval of 0.70 to 0.90 is deemed acceptable. Secondly, the correlation coefficient is employed to examine the association between investing decision-making and behavioral biases. Subsequently, regression analysis is performed to ascertain the influence among variables.

Data Examination and Interpretation

This segment consisted of findings and analysis of the data. Initially, the Cronbach's alpha assessment for evaluating reliability was conducted. Secondly, the relationship coefficient between behavioral biases and investment decision-making is examined. The findings from the reliability assessment (Table 1) revealed that the Cronbach Alpha coefficient is 0.762. Consequently, the instrument is dependable since the Cronbach alpha value exceeds 0.6.

Table 1. Reliability statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
0.762	0.740	5

Table 2. Investor's demographic profile

Demographic Components	Frequency	Percentage
Age		
18 -25	34	30.0
25 – 30	30	26.5
30 – 35	07	6.1
Above 35	42	32.5
Gender		
Male	84	74.3
Female	29	25.6
Level of Education		
Undergraduate	28	24.7
Graduate	34	30.0
Postgraduate	38	33.6
Other	13	11.5
Profession		
Business	59	52.8
Salaried	54	49.2
Experience		
Under 5 years	44	38.9
6 -7 years	16	14.1
8 - 10 years	19	16.8
11 - 15 years	18	15.9
Above 15 years	16	14.1

Table 3. Results of correlation

		Investment Decision Making	Overconfi- dence	Anchoring	Disposition	Herding
Investment Decision Making	Pearson Correlation	1	0.409**	0.378**	0.325**	0.402*
	Sig. (2-tailed)		0.000	0.000	0.000	0.000
	N	113	113	113	124	138
Over- confidence	Pearson Correlation	0.409**	1	0.498**	0.541**	0.463*
	Sig. (2-tailed)	0.000		0.000	0.000	0.000
	N	113	113	113	124	138
Disposition	Pearson Correlation	0.378**	0.498**	1	0.614**	0.604*
	Sig. (2-tailed)	0.000	0.000	0.000		0.000
	N	113	113	113	124	138
	Pearson Correlation	0.402**	0.463**	0.604**	0.523**	
Herding	Sig. (2-tailed)	0.000	0.000	0.000	0.000	1
	N	113	113	113	124	

The correlation is noteworthy at the 0.01 significance level (two-tailed). The examination of the interconnections among variables (table 3) revealed that all variables exhibit a robust correlation with one another. A positive correlation of 0.409 exists between investment decision-making and overconfidence characteristics, significant at the 1% confidence level. This indicates that a rise in investor overconfidence correlates with an enhancement in investing decision-making. The correlation coefficient between Anchoring bias and investment decision-making is 0.378, which is significant at a 1% confidence level. This indicates a substantial positive correlation between anchoring bias and the variable of investment decision-making; as anchoring intensifies, investment decision-making likewise escalates. The correlation between disposition bias and investment decision-making is significantly positive, quantified at 0.325, and is noticeable at a 1% confidence level. This indicates that the process of making investment decisions likewise escalates alongside an increase in disposition bias. The correlation between herding bias and investment decision-making is 0.402 at a 1% significance level, indicating a positive association; when herding bias rises, investors adjust their investment choices accordingly.

Table IV. Statistical regression examination.

Model	R	R Square	Adjusted R Square	Standard error of the estimate
1	0.477 ^a	0.235	0.218	0.6582

Predictors: herding, overconfidence, disposition, anchoring

Determinants: Herd behaviour excessive confidence, disposition effect, anchoring bias. The aforementioned study (table 4) presents the outcomes of linear regression. Investment decision-making is regarded as the dependent variable, whereas four independent variables are examined in the study: overconfidence, anchoring, disposition, and herding bias. The model's adequacy was tested by analyzing the findings of the model summary. The model summary reveals that R Square accounts for 0.235 of the variance in investment decision-making, but the adjusted R squared is 0.218, closely aligning with R squared. A dependable model suggested due to the elevated value of R. The findings indicate a predictability level of 23.5%, which is considered low. Nonetheless, this could be attributed to the other variables not accounted for in this model.

When considering various investment alternatives, individuals encounter a crucial inquiry regarding the optimal strategy for investing in financial instruments and the extent to which past stock market price fluctuations can predict future price trends. According to the premise of rationality, mutual fund investors seemed inclined to select financial instruments that optimize profits and mitigate losses (Ahmad Zamri, Ibrahim, Haslindar, Tuyon, 2017). Individuals are regarded as both rational and irrational in their investment practices. Behavioral finance examines the illogical elements of human behavior as investors in their decision-making processes. This field of study suggests that cognitive biases hinder investors from achieving full rationality during investment decision-making. A logical action connected to a degree of uncertainty and risk inherent in every investment choice (Paul Slovic, 1972). Diverse cognitive biases affect these risks and uncertainties. These cognitive biases pertain to the conduct of investors and their decision-making in investments. Behavioral biases are regarded as fundamental components of behavioral finance that integrate personal conduct and market dynamics. In the realm of behavioral finance, numerous biases are present. This research examines four biases: overconfidence, anchoring, disposition effect, and herding bias.

Following an examination of research articles concerning diverse behavioral biases, it was recorded that the majority of financial and economic theories indicate that individuals act rationally in investment decision-making solely when they possess all pertinent facts. In instances where information is incomplete, empirical research has shown recurring patterns of irrationality resembling the decision-making processes of individual investors facing risk and uncertainty. The four prevalent behavioral biases have also been recorded as influencing the stock market or portfolio selection in the decision-making process. Their involvement generates inflated trade activity and culminates in increased transaction expenses. The current research elucidates market psychology, revealing the reasons behind investors' decisions to buy or sell stocks, as well as instances when individuals refrain from trading altogether; thus, the paramount difficulty confronting investor's lies in making investment judgments. The current study indicates that the profits and losses experienced by investors primarily hinge on their investment decision-making abilities. It noted that the current investing decision-making process requires a deeper comprehension of individual investors' behavioral biases, which have been identified both before to and during the global financial crisis. The emphasis of the current research was on individual investors, who were discovered to possess insufficient understanding of the implementation of traditional finance theories in their decision-making processes, hence rendering them more susceptible to psychological misjudgements. The findings of our research indicate that out of four independent variables, only two—Overconfidence and herding bias—exert a significant influence on

investment decision-making, with t-values of 3.759 and 2.561, respectively, while the other variables, disposition and anchoring, do not significantly affect investment decisions. The current research concentrated primarily on the design and examination of four behavioral biases: anchoring, overconfidence, disposition effect, and herding behavior. Future research may be enhanced by examining additional behavioral biases that significantly influence individual investment decisions in their distinct manner. Furthermore, the research might be expanded to explore the influence on collective or corporate investment decision-making as well.

Conclusion

The field of behavioral finance has arisen to address the challenges encountered by conventional finance. Behavioral finance fundamentally posits that investment decisions are not solely driven by rational thought. Behavioral finance seeks to comprehend the irregularities in the investment market by deconstructing the two premises of traditional finance: (i) investors inadequately revise their beliefs and (ii) there exists a consistent deviation from the ideal decision-making process in investment selections (Kishore, 2004).

In the 1960s, Kahneman and Tversky focused on many areas of study. Following the oil crisis of the 1970s, they collaborated on research that yielded incongruous findings on the Efficient Market Hypothesis and Expected Utility theory (Daniel Kahneman and Amos Tversky, 1979). In the 1980s, behavioral finance surfaced as a distinct viewpoint that integrated behavioral and psychological elements. Economic and financial decision-making can be seen as the domain of behavioral finance, which offers behavioral and psychological insights (Abay, Blalock, & Berhane, 2017). Research on Tversky's normative theory in the scientific domain.

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