Market Impact and Herding Behaviour Influence on Investment Decision – Making Behaviour of Individual Investors

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Abstract:

This paper aims to investigate the influence of herding behavior and market impact on the individual investors' investment decision making. The importance of social and psychological factors has been increased due to the growing recognition of behavioural finance. In this empirical study, samples of 250 individual investors were surveyed using a structured questionnaire to find the influence of market sentiment, herding behavior. The data were analyzed through the statistical tools such as descriptive statistical tools such as descriptive statistics, correlation analysis, regression models and ANOVA. The findings reveal both herding behavior and market impact significantly influence investment decisions. The impact of those biases on individual investments decisions can be mitigated through financial literacy programs. Limitations includes sample bias and cross-sectional delight. The findings contribute to the field of behavioral finance it is expected.

Keywords: Market Impact, Herding Behavior, Behavioral Finance, Investment Decision, Psychological Factors

I Introduction:

Market impact and herding behavior profoundly affect the decision-marking process of individual inverters. Under the conditions of risk and uncertainty for taking investment decisions individual rely on both their own information and behaviors of others in the market. The need for understanding social and psychological factor has been particularly increased in view of growing recognition of behavioural finance. It is a common understanding that the decision making process of individual investors mostly based on personal judgements and several other psychological factors. Financial markets are highly dynamic and susceptible to external factors, ranging from external data releases to geopolitical events. These factors significantly impact on investment decisions. The role of media and public sentiment is crucial in influencing investors, as they often rely on emotional cues rather than rational analysis (Shiller, 2000)

Herding behaviour is a phenomenon where individuals take decisions relying on the actions of others, rather than depending on their own independent analysis or information. During periods of market instability i.e market bubbles or crashes herding behaviour is frequently observed, Thus amplification of market trends has been one of the significant consequences of herding behavior. In the digital era herding behaviour has been further magnified by social media, where investor sentiment spreads rapidly across platforms, leading individuals to follow the crowd without independent verification of information.

Since every investor is different, the investment product should be tailored to their needs, personalities, and prompted by marketers. Establishing a practical connection between investor's decision making behavior and psychographic factors, market impact factors and herding factors becomes inevitable to understand true investment behaviors of individuals. As persons behaviors when making investment decisions is influenced by a variety of characteristics viz, personality, emotional intelligence, locus of controls, risk tolerance the financial advisors should take into account all these factors while formulating investors–centric strategies.

II Review of Literature:

Recciardi (2008) published a book chapter titled "The Psychology of Risk: The Behavioural Finance perspective". He presented an outline of the terms "perceived risk" and "decision-making" from the perspectives of conventional finance and behavioural finance. Cognitive biases and emotional components of Investor's decision-making processes are included in behavioural finance.

The study of Syed and Pardhasarathi (2011) on relationship between risk tolerance and socio-economic characteristics of individual investors revealed that individual investors were cautious and the factors like marital status, income, occupation, number of dependents were significant predictors of risk tolerance.

Rant and Das (2015) in their research paper found the nations of full market efficiency and full individual rationality were untrue. Individual investors' decision-making skills are mostly influenced by social factors like herding, contagion, imitation and information cascades.

Sashikala and Chitramani (2018) stated that the primary factor influencing the investment decision with relation to personal and portfolio management is the investor's investment objective prospect features and Harding factors had an impact on short-term investment intention, whereas market and prospect factor had an impact on long-term investment decision. The influence of heuristic considerations on both long-term and short-term investment intention was minimal.

Palak Dewan and Khushdeep Dharni (2019) in their paper stated that hard behaviour could be categorized into market-wide hard behaviour, Institutional hard behaviour and Mutual fund hard behaviour. Kaleem Ullah and Shahid Jan Kakakhel (2020) in their study revealed that investors understand their emotional influence, while growing self-control and investment analysis skills. Fathima Khan Babar (2023) study indicate that herd significantly improves both overconfidence and investing decision. Overconfidence has an adverse influence on investment decision.

III Concepts in Herding Behaviour

Usually herding theory focuses on the tendency of individuals to follow the behaviours of others, particularly in uncertain or ambiguous situations. Herding behaviour may lead to market bubbles in financial markets, as large groups of investors follow each other's action without regard to independent analysis or the underlying fundamentals of an asset. Herding can occur even when individuals have private information (Bickchandani et al., 1992) gains, driven by a fear of missing out.

Herding behaviour can result in market inefficiency, as prices are driven by social influence and sentiment rather than fundamental values. Market impact theory examines how external forces shape investor sentiment, influence asset prices, and contribute to the overall market environment. The impact of individual trades on asset prices is often determined by market liquidity. The rise of social media has changed how information spreads through markets. Platforms like Twitter, Reddit and financial news outlets can rapidly disseminate news, rumours, influencing investor behaviour on a large scale (Tirunillai and Tellis, 2012).

IV Objectives of the Study

An attempt is made in this paper to study the market impact and herding influence on investment decision-making. The specific objectives are as given below.

- To examine the role of herding behaviour on individual investment decision-making.
- To investigate the impact of market movements on individual investors' decision.
- To find the interplay between herding behaviour and market impact

V Hypotheses of the Study

In this study the following hypotheses were examined on the factors relating to market impact and herding influence.

1) HO_1: There is no significant influence of market impact factors of respondents on their investment strategy.
2) HO_2: There is no significant impact of herding factors of respondents on their investment satisfaction.
3) HO_3: There is no significant impact of herding factors of respondents on their investment strategy.

VI Scope and Limitations of the study

This study mainly focuses on the herding influence on investment decision-making. In reality there may be several factors that may influence investment decision-making behaviour. The scope of the study is limited to individual investors. Hence the findings may not be entirely applicable to other factors impacting. Further this study relies on self-reported data which may be subject to biases such as social desirability or recall errors.

VII Methodology of the study

The research is based on a quantitative approach, by using survey-based primary data to understand how market impact and herding behaviour influence the investment decisions of individual investors. The data gathered from individual investors at a specific point of time.

Samples 250 were used to provide a strong base for reliable insights into herding behaviour and market impacts. A larger sample increases the generalizability of findings across various segments of the population viz., age, experience, investment etc. A non-probability convenience sampling technique was used for the study.

As regards data collection, a structured questionnaire was distributed to the participants. The survey consisted of closed-ended questions using a 5 point Likert scale Descriptive statistics consisting of metrics like Mean, Standard Deviation (SD), Correlation, ANOVA were used in the study.

VIII Data Analysis and Interpretation

For this study the entire data collected through primary as well as secondary data have been thoroughly analyzed using statistical tools. The results of the analysis consequently interpretation is depicted in the following sections.

1) **Analysis of descriptive statistics for main variables**

The summary of the descriptive statistics for the key variables to provide an overview of the data in this study is as follows

Table-1: Descriptive Statistics for Variables

Variable	N	Mean	Std Deviation	Minimum	Maximum		kertosis
Herding behaviour	250	3.85	0.2	1	5	0.17	-0.47
Market Impact	250	4.12	0.75	2	5	-0.12	-0.33
Investment Decision- making	250	3.75	0.52	1	5	0.03	-0.049

Risk Tolerance	250	3.5	1	1	5	0.45	-0.58
Investor Experience	250	2.88	1.14	1	5	0.39	-0.033

Source: Primary Data

Interpretation: The data in Table – 1 reveals that the respondents tend to moderately agree with the influence of factors on their investment decisions as per the mean values of herding behaviour and market impact. The value of SD suggest variability in responses, indicating that some individuals rely more on independent decision-taking while others by market trends and herding behaviour.

2) Correlation analysis of relationship between the variables.

The strength and directions of the relationship between the variables as per persons correlation coefficient is presented in the following table.

Table -2: Correlation analysis of relationships between variables

Variable	Herding Behaviour	Market Impact	Investment Decision-Making	Risk Tolerance	Invertor Experience
Herding behaviour	1	0.45	0.55	0.25	0.12
Market Impact	0.45	1	0.6	0.3	0.19
Investment Decision- making	0.55	0.6	1	0.4	0.25
Risk Tolerance	0.25	0.3	0.4	1	0.5
Investor Experience	0.12	0.19	0.25	0.5	1

Source: Primary Data

Interpretation: It is evident from Table -2 data that herding behavior has a moderate correction with investment decision – making and market impact. Thus individuals who are influenced by herding behaviour are more likely to adjust their decisions based on market trends. On investment decision making market impact has a stronger positive correlation indicating markets influence as a significant factor. It seems that risk tolerance does not strongly affect herding tendencies.

3) ANOVA to know the differences between the means of different groups.

With a view to examine statistically the significant differences (herding behavior) and market impact across different investor experience levels ANOVA test conducted and the results are depicted in the following-Table-3.

Table-3 ANOVA of Herding Behaviour by Investor Experience

Source of variation	sum of squares	difference	Mean Square	F- Statistic	P- Value
Between Groups	15.32	2	7.66	6.23	0.002
Within Groups	190.28	247	0.77		
Total	205.6	249			

Source: Primary Data

Interpretation: As per table-3 it can be understood that there exists a significant difference in different investor herding behavior across experience levels. It reveals that more experienced investors are likely to exhibit herding behavior.

4) Regression analysis to examine the relationship between independent Variables and dependent Variables.

Table-4 Regression analysis results (Investment Decision. Making)

Predictor Variable	Unstandardized coefficients (B)	Standardization coefficients (Beta)	T- Statistics	P-Value
Constant	1.12		5.68	<0.001
Herding	0.42	0.45	4.23	<0.001
Market Impact	0.56	0.6	5.02	<0.001
Risk Tolerance	0.19	0.27	2.15	0.032
Investor Experience	-0.1	-0.08	-1.1	0.272

Source: Primary Data

Interpretation: From table-4 it is clear that both herding behavior and market impact have significant positive impact Investment decision-making whereas risk tolerance to a lesser extent. But investor experience has no much effect on investment decision-making

IX Conclusion and Suggestions

In this study the relationship between herding influence and market impact on the investment decision-making behavior of individual investors examined. It has been well-known that financial markets witnessed significant changes in the recent part due to social, psychological auf environmental factors that affect individual investors' decisions. The herding behavior and market impact may not always align economic with traditional theories based on rational decision-making.

Factors such as market volatility, social influence, and personal biases often lead investors to deviate from rational expectations, resulting in herding behavior and susceptibility to market sentiment. The study sought to understand the interplay between individual characteristics and market dynamics, so that provide contribute to both theory and practice. The research also answered various individual characteristics, such as ring tolerance and experience that might influence decision-making. The findings align with existing literature on behavioral finance, which highlights the role of psychological factors in investment decision-making.

Based on the findings of the study the following suggestions can be offered to the prospective investors.

- Investors need to have more awareness on the psychological biases that influence their decision - making. It can be achieved through financial literacy programs. Investors can be trained to make decisions based on fundamentals.
- Investment advises shall integrate basic principles of behavioral finance into their strategies by taking into account herding behaviour and market sentiment.

- The excessive influence of herding behavior particularly during the market bubbles or crashes could be reduced by Regulators through adopting certain measures.

X Research Implications

- By providing empirical evidence relating to herding behavior and market impact influence on Individual investment decisions, this study contributes to behavioral finance. The results of the study denote that investors are more likely to make decisions based on fear of losses rather than on risk assessments. It adds to the literature on social influence and financial markets, stating those investors' decisions often impacted by social cues.
- Financial advisers can leverage the findings to develop strategies for reducing the psychological biases on clients. With a view to identify periods where herding behavior likely to distort prices, the policy makers and regulators should monitor market conditions. Finally, the individual investors can use the findings to reflect on their biases and adjust their strategies resulting in more informed and less emotionally driven decisions.
- In conclusion, this study sheds light on the significant roles of herding behavior and markets impact in shaping investment decision making. It provides valuable insights to come out of the complexity of decision-making in financial markets.

XI Future Research Direction

- In this area of study further research may be conducted to explore the long-term effects of investor behaviors and their implications for market stability and efficiency.

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