HERDING BEHAVIOUR AMONG INDIVIDUAL AND INSTITUTIONAL INVESTORS:

A Review of Behavioral Finance

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Abstract

Behaviour finance challenge the asset pricing theory and market efficiency. Herding is one of the sentiments of behaviour finance. Herding is a short term phenomena which explain that the investor follow the crowd instead of their own belief. The aim of the paper is to understand that herding which may take away the fundamental value of stock and sometimes create price bubble. The study also include various types of herding such as intentional and unintentional and also study the effect of herding among individual as well as institutional investor in stock market.

Keywords: Institutional Investor, Individual Investor, Herding Behaviour

1. Introduction

Imitating the behaviour of each other is called herding.(Banerjee ,1992) coined the meaning of herding as everyone imitate what other are doing even if their information suggest to do something else. Herding arises when investor decide to follow the other decision or movement in the market rather than follow his own beliefs and piece of Financial information. This behaviour may be seen on a number of grounds and not necessary leads to efficient market outcomes. The psychological definition of herding has evolved as a scenario in which individual abide by the group decision and follow them even when they perceive that the group to be wrong. Individual investor influenced by market sentiment and rely more on public information for their trade and attention grabbing events (Hwang, 2004).Herding may take away the stock price from fundamental price and sometimes may create the price bubble (Choi et.al, 2015).

Herding may be intentional or unintentional (Bickhchandani and Sharma, 2001) Intentional herding arise when trader follow the crowd instead of follow their own private information. They believe that other have superior information. (Bickchandani et.al, 1992), (Banerjee, 1992), and (Park and Sabourian, 2011) studied that rational traders are sentiment driven they imitate the other market participant buying and selling activity , resulting similar stock buy and sell by the investors rather than informational signals. Whereas, unintentional herding arises when professionals have similar qualification and education and convert this information similarly which lead to similar conclusion. Example financial institution reacts common to similar risk (Hirshleifer et.al, 1994). In unintentional herding, traders rely on public information and interpret similarly and end up same side. Both intentional and unintentional herding is related with uncertainty and information availability. (Scharfstein and Stein, 1990) developed reputation based model to state institutional or professional investors have reputational risk when they act differently from the crowd. (kremer and Nautz, 2013) found that herding is more of unintentional.

The causes of herding divided in two ways one is information driven and other is behaviour driven (Bickchandani and Sharma, 2001).Information driven herding may arise due to similar educational background. Investor may herd because they follow similar trading strategy, momentum investment. Contrary to behaviour driven herding occur when investor follow others due to reputation and disregard their private information and trade with crowd.

2. LITERATURE REVIEW:

2.1 Herding among Individual investors:

Dorn, Huberman and Sengmueller, (2003) Studied with the sample of 30000 retail clients from German brokers and found strong tendency to herd at daily and quarterly. It was also identified that retail investors are more prone to systematic biases in comparison to professional investors. (Goodfellow, Bhol and Gebka, 2009) found the individual herding arise only bearish market.(Barber and Odean, 2002) also found that retail client tends to buystock that experience abnormally large price movement, trading volume.(Choi , 2016) examined both online and offline individual investors trading activity which was gather from Korean brokerage firm. It was found that online investors weak herding behaviour whereas, offline investors shows stronger herding. It was also investigated that investor age 40-60 dominate the offline trading and 30-50 are most active in online trading.

2.2 Herding among Institutional investor:

Chhattopadhyayet.al (2017) examined the presence, persistence and predictability of herding by foreign Institutional Investor in Indian Market. It was studied in the three strands. First strand examined the herding by FIIs trading of individual stock with the help of excess buy over sell of stock related to total trade (with the help of volume based and count based ratio). Second strand analyzed the trends in trading patterns and with the application of run test if the pattern persist continuously, it proves herding confirmed. The third strand predicts the possibility of herding in individual stock applied by six data mining models. Data was collected from 2003 to 2014 from Nifty 50 in which out of 37 stock Indexed consistently, 9 stocks(24%) herding predict with more than 70% accuracy. contrary Lao and Singh (2011) compared two emerging market china and India. It was found that the herding is more prevailed in china market in comparison to Indian market. The intensity of herding is more during the large market movement. To applied the test and detected herding in the sampled stock from 1999 to 2009. It was found that the major reason of lower herding in India is large institutional investor, better information and skilled trader. It was also found that herding occur during the extreme condition in both the market. (Lakshmanet.al, 2013) studied on the analysis of various types of institutional investors that mutual fund increases the tendency of herding in comparison to other institutional investors. However, the regulator closely watches the mutual fund activity and the reason for herding further. It was interesting watched that herding started declining before the peaked in early 2008.This phenomenon describes that market stress arrival the market to equilibrium. Conversely to common belief that herding more prevail in the market stress .The evidence found that the herding appear more before crisis. Once the crisis come in to light herding becomes much weaker.(Huang et.al, 2016) study also inspects the impact of institutional herding explain the risk and return relationship and its magnitude for this the institutional investor categorized in three segments such as foreign investor, dealer investor and mutual fund investor. The result found that foreign investors have better relationship than other two institutional investors.

2.3 Herding among Individual and Institutional investor

Hsieh (2013) It was found that the tendency of herding stronger in institutional investor in comparison to individual investor at Taiwan stock market. Individual investors were less informed while institutional investor relatively more skill full and sophisticated.

Conclusion:

The study describe herding behaviour of institutional investor determined by correlated private information whereas, individual herding likely to be driven by behaviour and emotion. Institutional investors herd more and earn more profits on small firms on the other hand individual investors herd more but lose more on small firm. It was also identified that offline investors tend to herd towards the same direction more than online investor. The finding also suggest that the herding of institutional investor speed up the price adjustment process. Communication among broker who works in the same local brokerage firm branch might also drive the difference in herding between offline and online investors.

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