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ANALYZING HERDING BEHAVIOR: A STUDY OF INVESTOR TRENDS IN INDIAN STOCK MARKETS

Dr. Mohammadali Gulamhaidar Hajur

Assistant Professor,
Gandhinagar Institute of Commerce, Gandhinagar University, Kalol Khatraj, Gujarat, India
Email: mohammdalihajur@gmail.com
ORCID ID: https://orcid.org/0009-0006-5064-2337

Dr. Shabbirali Sherali Thavara

Assistant Professor,
D.L Patel Commerce College (Affiliated to HNGU, Patan), Vidhyanagari campus, Himmatnagar, Gujarat, India.
Email: thavara58@gmail.com

Abstract

Herding behavior, observed when individuals imitate one another, whether in synchronized actions or adherence to peer standards, reflects the influence of social dynamics. This empirical study, employing a convenient sampling method, measured herding among 489 Indian stock market investors. It sought to identify and understand factors influencing herding behavior within this demographic. The study's outcomes hold significance for both market practitioners and investors equipped with analytical tools. By discerning the underlying causes of investor herding through data collected from 489 individuals, the research makes a valuable contribution to the field of behavioral finance. This understanding of how investors perceive and engage in herding behavior serves as a strategic tool for mitigating potential risks within stock markets. The findings underscore that among Indian investors, herding is shaped by various factors, including Emotion, Risk Aversion, Fear of Missing Out (FOMO), and reliance on Heuristics. Notably, risk aversion and the application of heuristics are positively correlated with herding tendencies. This insight into the intricate interplay of psychological and behavioral factors enhances comprehension and aids in developing strategies to navigate potential market risks.

Keywords: *Herding Behavior, Emotion, Risk Aversion, Fear of Missing Out, Heuristics and Investment Decision*

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INTRODUCTION

Herding behavior pertains to individuals making decisions based on the actions of others, particularly observed in financial markets where investors often mimic peers rather than conducting independent analyses. This tendency can result in market inefficiencies, increased volatility, and the formation of bubbles (Galariotis et al., 2016). People tend to imitate others even without superior information, driven by factors like social influence, information asymmetry, and the desire to conform. Understanding herding behavior is crucial for policymakers and investors aiming to encourage rational decision-making in financial markets (Chang et al., 2000). Various models, such as the information cascade, herding game, and contagion models, have been developed to explain herding behavior. Familiarity with these models allows policymakers and investors to better understand and mitigate the risks associated with herding, promoting more efficient financial markets. This literature review explores the concept of herding behavior, its causes and consequences, and the diverse models employed in its study (Chen & Lin, 2016).

Causes of Herding Behavior: Herding behavior in financial markets stems from various factors. One key cause is informational cascades, where individuals follow others, assuming they possess superior information (Bikhchandani et al., 1992). Social pressure, fear of missing

out (FOMO), and the urge to conform to social norms also contribute (Banerjee, 1992). A study on Korean institutional investors (Chang et al., 2000) highlighted social pressure and conformity as major drivers of herding behavior.

Informational Cascades: Herding behavior often arises from informational cascades, where individuals base their decisions on the actions of others, assuming these actions reflect superior information (Bikhchandani et al., 1992). In financial markets, this manifests as investors observing others buying or selling a stock and assuming these actions are informed. Even without superior information, individuals may emulate these actions. Bikhchandani et al. (1992) developed a model illustrating that, despite having private information about an asset's true value, individuals may disregard it and mimic others' actions. This dynamic can lead to herding tendencies, where many investors imitate a few, even without a basis in superior information.

Social Pressure: Social pressure is another cause of herding behavior, where investors may conform to others' actions in the market, irrespective of perceived superior information (Scharfstein & Stein, 1990). This pressure can stem from colleagues, friends, or media promoting specific investment strategies. A study on Korean institutional investors (Chang et al., 2000) emphasized that social pressure and conformity were the main drivers of herding behavior. Investors often followed their peers, even without a basis in superior information, highlighting the influential role of social pressure in financial markets.

Fear of Missing Out (FOMO): The fear of missing out (FOMO) contributes to herding behavior in financial markets, where investors follow others to avoid potential profit loss. This phenomenon was evident during the 1987 stock market crash, as the fear of being left behind drove investors to emulate market trends, even without superior information.

LITERATURE REVIEW

In stock markets, herding behavior often arises from a key factor: a lack of knowledge. This is particularly notable in emerging markets where information distribution is uneven, leaving some investors more informed. Faced with inadequate analysis and confidence, these investors may resort to mimicking others' decisions, intensifying their fear of higher risk exposure (Adair et al., 1994).

Investors may exhibit herding behavior driven by factors such as peer pressure, the inclination to conform to others' actions. Conforming to the crowd's opinion fosters herd behavior (Sunder et al., 2019) with rating behavior showing a positive correlation to prior crowd ratings. (Dutta, 2013) also underscores how conformance behavior contributes to the herd effect.

Additionally, herding behavior is influenced by risk aversion, as individuals tend to follow the majority to mitigate risks, believing the majority's actions are safer (Hirshleifer & Teoh, 2003) (Lee et al., 1991). (Menkhoff et al., 2006) suggest that higher risk-taking may stem from increased bullishness, reduced herding, or lower risk aversion. Investors tend to follow the majority to avoid risks, thinking it protects them from losses (Menkhoff et al., 2006). Lack of market knowledge can also drive herding, as investors fear risk exposure and copy others without analyzing data (Adair et al., 1994). Risk aversion significantly influences herding behavior, as evidenced by (Hwang & Salmon, 2004) (Cipriani & Guarino, 2005). High-risk aversion among institutional investors leads to herding behavior, with a tendency to follow others to avoid potential losses. Additionally, when investors are highly risk-averse, they closely mimic others, contributing to increased herding and market volatility (Cipriani & Guarino, 2005). This connection between risk aversion, herding, and market dynamics suggests a pivotal role for risk profiles in shaping investor behavior, potentially leading to market inefficiencies and heightened volatility (Nath & Brooks, 2020).

The Fear of Missing Out (FOMO) drives investors to copy others, fearing they might miss out on potential gains. If they see people profiting from certain stocks, they might buy those stocks to avoid missing the opportunity (Barbarino, 2021). Barber and Odean (2001) found that FOMO can lead investors to make irrational decisions, like buying overpriced stocks that recently had high returns, just to avoid missing out on potential profits. According to (Chiang & Zheng, 2010) study on the Chinese stock market revealed that the Fear of Missing Out (FOMO) contributes to herding behavior, where investors imitate others even without rational or fundamental support. In the context of cryptocurrency markets, (Chen et al., 2020) found FOMO to be a key predictor of herding behavior in Bitcoin markets. They explained that the decentralized nature of cryptocurrencies and the potential for high returns can trigger FOMO and lead to herding. Overall, FOMO is identified as a significant factor in understanding herding behavior, especially in emerging markets like cryptocurrencies. Research by (Goyal et al., 2021) found that Fear of Missing Out (FOMO) partially mediates the impact of herd behavior and loss aversion on investment decisions. The study suggests that FOMO enhances the influence of loss aversion and herd behavior on retail investors' investment choices. FOMO involves investors skipping due diligence to invest in high-return schemes out of a rational fear of missing potential gains.

Heuristics, mental shortcuts in decision-making, contribute to herding behavior among investors. Biases, such as following others based on social proof, can result from these shortcuts. Research in Chinese markets shows that heuristics like representativeness and anchoring contribute to herding. Top of Form Investors and experts often use quick problem-solving techniques called heuristics for efficient decision-making. The attitudes of millennials, especially in how they approach copying, regret, loss aversion, and handling gains or losses in their portfolios, are likely to influence the mental shortcuts (heuristics) they employ in product research and prediction.

Emotional factors such as fear, anxiety, and greed have been identified as significant contributors to herding behavior among investors (Devenow & Welch, 1996). Studies suggest that emotions are often triggered by market volatility and uncertainty, leading investors to rely

more on social cues and follow the actions of others to mitigate risk and uncertainty. Additionally, research shows that negative emotions such as fear and anxiety have a stronger impact on herding behavior than positive emotions like greed or optimism (Caglayan et al., 2021). Based on above extensive literature review following model is drafted with below mentioned hypothesis.

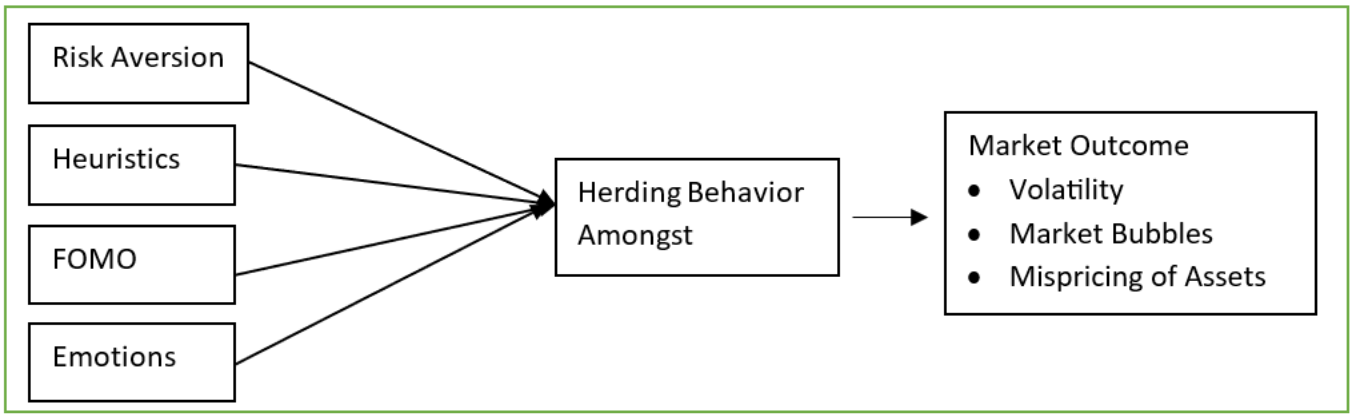

Figure 1 Conceptual model and Hypothesis

H1: Risk Aversion has significant effect on Herding Behavior Amongst Investors
H2: Risk Heuristics has significant effect on Herding Behavior Amongst Investors
H3: Fear of Missing Out has significant effect on Herding Behavior Amongst Investors
H4: Emotions has significant effect on Herding Behavior Amongst Investors

RESEARCH METHODOLOGY

The term research methodology refers to the methodical and reasoned approach that researchers employ in conducting studies or investigations. It provides a structured framework outlining the procedures and techniques utilized for the collection, analysis, and interpretation of data to address research questions or test hypotheses. This research is descriptive in nature where researcher has tried to measure herding behavior in stock market with the help of primary data by using SPSS.

3.1 Objective Behind Study

The primary objective of this study is to discern the factors that exert influence on herding behavior within the stock market. In accordance with the findings from the literature review, the factors identified for measurement purposes include risk aversion, heuristics, fear of missing out, and emotional considerations.

3.2 Population and sample

The population under consideration in this research pertains to the comprehensive grouping of individuals, subjects, or elements meeting specific criteria and garnering the researcher's attention. For the purpose of this study, the focus is on salaried individuals actively participating in stock market transactions, drawn from various regions within the state of Gujarat. The sampling method employed for this research is a convenient sampling approach. In this regard, the researcher meticulously identified specific areas within Gujarat and collected responses from salaried individuals predominantly engaged in urban occupations. This methodological choice aimed to provide a nuanced understanding of the perspectives and behaviors of salaried individuals with respect to stock market participation within the urban context of Gujarat.

3.3 Data Analysis

Data from 489 respondents across various locations in Gujarat state were collected for the study. Different statistical tests, including descriptive analysis, normality testing, factor analysis, and regression, were applied to gain insights into the dataset. These methods were chosen based on the research goals, offering a comprehensive examination of the data and ensuring a thorough and systematic analysis. SPSS version 25 was used to apply above test. We have also applied skewness and kurtosis to check the normality of data and we have found that data was normal and within the range (Velasco & Verma, 1998).

3.3.1 Descriptive Analysis:

Table 3.3.1 Demographic Information

Demographic Profile	Items	N	%
Gender	Male	385	78.73%
	Female	104	21.27%
Age	20-30	109	22.29%
	30-40	175	35.79%
	40-50	115	23.52%
	50-60	90	18.40%
Education	SSC	19	3.89%
	HSC	45	9.20%
	Graduation	220	44.99%
	Post-Graduation	145	29.65%
	Ph.D.	10	2.04%
	Other	50	10.22%
Monthly Income	Up to 20000	121	24.74%
	20000-40000	149	30.47%
	40000-60000	132	26.99%
	60000 And Above	87	17.79%

From the above table it is clear that ut of 489 respondents 78.73% were male and remaining 21.27% were female. 22.29% of respondents were aged between 20-30 age, 35.79% of respondents were aged between 30-40 age, 23.52% of respondents were aged between 20-30 age and remaining 18.40% were belonging to age group of 50-60. From education point of view, 3.89% has studied up to SSC, 9.20% have studied up to HSC, highest 44.99% respondents were Graduated, only 29.65% were post graduated, 2.04% have done their study up to Ph.D. while rest 10.22% have done their education in diploma, IT etc.

3.3.2 Exploratory Factor Analysis:

EFA test was employed to identify the actor that influence herding behavior in stock market. For that researcher have applied validity and reliability test like KMO and factor loading of each construct. KMO test measures the suitability of data for factor analysis which generally range between 0 to 1. To ensure the accuracy for factor analysis, factors having score below 0.5 were removed. It is good if it lies between 0.7 to 1.0. in our test KMO has value of 0.813 which lies between accepted standard. Moreover, a significance level of .000 suggests that the KMO value holds statistical significance, indicating a very low probability of it occurring purely by chance.

Table 3.3.2.1 - KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		**0.813**
Bartlett's Test of Sphericity	Approx. Chi-Square	13359.582
	df	781
	Sig.	0.000

Reliability analysis is a statistical method employed to gauge the stability and consistency of a measurement tool. In Table 4, Cronbach's alpha coefficients have been computed for five distinct variables: Heuristics, Risk Aversion, FOMO, Emotion, and Herding Behavior. The resulting values indicate that the items measuring each construct demonstrate considerable reliability and internal consistency. All values surpass the commonly accepted threshold of 0.70, as outlined by Cronbach in 1951. This implies that the instrument utilized for assessing Heuristics, Risk Aversion, FOMO, Emotion, and Herding Behavior is likely to yield dependable and consistent results across diverse samples and over time.

Table 3.3.3.2 Reliability Test

Sr. No	Construct	N of items	Cronbach α
1	Heuristics	5	0.875
2	Risk Aversion	6	0.809
3	FOMO	6	0.731
4	Emotion	5	0.893
5	Herding Behavior	5	0.871

The following table presents the Rotated Component Matrix for a set of items related to various constructs in a psychometric scale. Principal Component Analysis (PCA) was conducted, and the components were subsequently rotated to enhance interpretability. The matrix displays the loadings of each item on the identified rotated components.

Table 3.3.2.3 – Rotated Component Matrix

Items	1	2	3	4	5
H1	0.916				
H2	0.913				
H3	0.871				
H4	0.832				
H5	0.785				
RA1		0.763			
RA2		0.750			
RA3		0.727			
RA4		0.697			
RA5		0.686			
RA6		0.669			
FOMO1			0.718		
FOMO2			0.627		
FOMO3			0.621		
FOMO4			0.602		
FOMO5			0.589		
FOMO6			0.572		
E1				0.820	
E2				0.803	
E3				0.749	
E4				0.566	
E5				0.530	
HB1					0.830
HB2					0.803
HB3					0.776
HB4					0.748
HB5					0.721

Loadings exceeding a predefined threshold (e.g., 0.500) are generally deemed significant, signifying the strength of the association between an item and its respective component. These components serve as latent constructs that underlie the observed variables. The understanding of these components should be derived from an analysis of the individual items that contribute to each component.

3.3.3 Regression Analysis:

Regression analysis was employed to discern and quantify the correlation between herding behavior and the four independent variables: risk aversion, heuristics, fear of missing out, and emotions. The statistical significance level for all independent variables is observed to be .000, and the corresponding beta values are .385, .359, .261, and .221, respectively. This implies that risk aversion, heuristics, fear of missing out, and emotions exert a noteworthy impact on herding behavior. Consequently, all four hypotheses (H1, H2, H3, and H4) have been validated.

Table 3.3.3.1 Coefficients[a]

Model		Unstandardized Coefficient		Standardized Coefficient	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-9.11086	0.46		0	1.000
	Heuristics	0.385	0.46	0.385	6.125	0.000
	Risk Aversion	0.359	0.46	0.359	7.085	0.000
	FOMO	0.261	0.46	0.261	5.315	0.000
	Emotion	0.221	0.46	0.221	4.852	0.000
a. Dependant Variable: Herding Behavior						

Beta values, standardized coefficients indicating the change in the dependent variable due to a one-standard deviation increase in the independent variable, were examined. A positive beta indicates a positive correlation, while a negative beta suggests a negative association. Notably, Heuristics showed the strongest impact on Herding Behavior (beta = .385), signifying that a one-standard deviation increase in heuristics corresponds to a .385 standard deviation increase in Herding Behavior. Other significant contributors include Risk Aversion (beta = .359), Fear of Missing Out (beta = .261), and Emotions (beta = .221), all influencing Herding Behavior.

In conclusion, the findings underscore the significance of heuristics, risk aversion, fear of missing out, and emotions in comprehending and addressing herding behavior. Addressing these factors could potentially mitigate the occurrence of herding behavior among investors in the stock market.

CONCLUSION AND DISCUSSION

The primary aim of this research was to identify determinants influencing herding behavior among investors. The findings reveal a significant positive influence of emotion, risk tolerance, fear of missing out, and heuristics on herding behavior. The study, encompassing data from 489 individual investors, substantiates the presence of herding behavior. Emphasizing the role of an investor's emotions, risk tolerance, fear of missing out, and reliance on heuristics, the study demonstrates how these factors can contribute to the manifestation of herding behavior. While such behavior may offer advantages at an individual level, its proliferation on a larger scale poses the risk of inducing volatility and bubbles in the stock market.

Education and training play a crucial role in empowering investors and investment managers to make well-informed decisions, mitigating the impact of herding behavior. Investor education should focus on diversification, risk-return understanding, and discouraging emotional decision-making. Investment managers can employ behavioral finance strategies, incorporating decision-making biases like loss aversion and anchoring into models. Techniques such as contrarian investing can be utilized to capitalize on market inefficiencies. The strong association between herding behavior and these variables suggests that managers can guide investors in avoiding such behavior by addressing emotional reactions, promoting thorough analysis, and offering risk management tools. This approach aids investors in making more informed and independent investment decisions.

LIMITATIONS

Given that this study was conducted specifically in the Gujarat region, it's important to acknowledge that the results may not be universally applicable to other regions. Regional variations in income levels, diverse thought patterns among the population, unique investment patterns, the reliability of information sources, and differing levels of knowledge can all contribute to significant variations in decision-making behaviors.

Moreover, the study's reliance on a random sampling method introduces another layer of limitation. While random sampling is a widely-used technique, it does come with inherent constraints. In this context, the findings might not fully capture the intricacies and nuances present within the diverse demographic and socioeconomic landscape of the Gujarat region. The outcomes could potentially be different

if other sampling methods, such as stratified or purposive sampling, were employed to target specific subgroups that might have distinct characteristics influencing decision-making processes.

Therefore, it is essential for researchers and practitioners to exercise caution when extrapolating the study's findings beyond the Gujarat region. The multifaceted nature of decision-making, shaped by regional dynamics and sampling methodologies, necessitates a nuanced interpretation of the study's implications in a broader context.

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