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Herding Bias and Investment Decision Making – a Systematic Literature Review

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ABSTRACT

The issue of herding bias and investment decision-making has been extremely important in recent times to understand the irrationality of investors. This study comprehensively analyzes the literature on herding bias and investment decision-making to understand the various dimensions of herding biases and their impact on the decision-making of investors. A systematic literature review of relevant research papers from leading databases was conducted to determine the current research trends, develop a nomological network by identifying the variables used as antecedents, mediators, moderators, and outcomes, and highlight the most popular theories referred in studies. The findings of this study reveal behavioural biases, herding bias, investment decision-making as the main thematic domains. Further, the study also found a dearth of literature, especially relating to collectivist and individualistic societies, and concluded that future studies should also contemplate different psychological and social aspects, such as trading behaviour and investor patterns while studying the impact of herding bias on decision-making of investors.

Keywords: behavioural biases; herding; herding bias; investment; investment decision making; systematic literature review

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ОРИГИНАЛЬНАЯ СТАТЬЯ

Стадное чувство и принятие инвестиционных решений – систематический обзор литературы

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АННОТАЦИЯ

В последнее время вопрос стадного поведения и принятия инвестиционных решений приобрел особую актуальность в связи с иррациональным поведением инвесторов. В этом исследовании всесторонне анализируется литература, посвященная стадному поведению и принятию инвестиционных решений. **Цель** исследования – определить влияние стадного поведения на принятие решений инвесторами. Систематический обзор научных статей из ведущих баз данных позволил выявить текущие тенденции в исследованиях и разработать номологическую сеть. Выделены переменные, которые используются как предшествующие факторы, медиаторы, модераторы и результаты. Также определены самые популярные теории, на которые ссылаются авторы исследований. Результаты исследования показывают, что основными тематическими областями являются: поведенческие предубеждения, стадное чувство и принятие инвестиционных решений. Кроме того, выявлен недостаток литературы, особенно по коллективистским и индивидуалистическим обществам. Сделан **вывод**, что в будущих исследованиях при изучении влияния стадного поведения на принятие решений инвесторами следует учитывать такие психологические и социальные аспекты, как торговое поведение и модели поведения инвесторов.

Ключевые слова: поведенческие искажения; стадное чувство; стадное поведение; инвестиции; принятие инвестиционных решений; систематический обзор литературы

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INTRODUCTION

The term ‘herding’ describes people’s propensity to mimic the rational and irrational judgments of others. In general, it has been seen in the existing strand of literature that the terms “herding” or “herd behavior” in economics and finance, refer to the process by which economic agents imitate other’s actions and/or base their judgments on those of others [1, 2]. The article [3] postulated a relationship in which the availability of information and herd behaviour are interconnected. They discovered that investors are more likely to follow the choices made by individuals or groups when information is ambiguous. Thus, investor herding behaviour is the main reason for financial bubbles. Investment decisions refer to the decisions made by individuals or firms to invest capital to gain a better return on investment. The study [4] argues that investors choose to forgo short-term gains to receive larger returns.

A precise set of goals must be achieved for each investment. Practically speaking, there are various goals for investing, including choosing risk and return as well as protection from inflation, growth, and liquidity risks [5, 6]. Decisions about investments are not always logical. Studies have connected behavioural biases to how people make investing decisions [7–10]. Hence, it is extremely important to understand investors’ herding behaviour as it could hamper their decisions on the choices of investments made. When examining investor behaviour, it is important to minimize herding biases in order to enhance investor rationality, leading to improved investment returns [11, 12]. And thus, it is imperative to comprehend the fundamental elements of herding bias and their influence on investors’ decision-making through a systematic literature review which is the first of its kind. The need for this study is essential as it has been observed that Investors are often blamed when they operate their business in herds [13, 14]. This brings instability during the time of crisis [15]. Therefore, it is crucial to decipher their herding behaviour on the investment decision making.

LITERATURE REVIEW

Behavioural bias refers to irrational thoughts and actions that might unintentionally affect the way decisions are made [16, 17]. The term “behavioural biases” in investment decision-making refers to the irrationality that results from the interaction of heuristic biases, cognitive illusions, framing effects and the herd mentality of investors [18–20]. Three behavioural biases exist: overconfidence, the disposition effect, and herding. The research defined overconfidence bias as a tendency where people have an unjustified faith in their instinctive abilities and

judgments [21, 22]. It has been claimed by researchers that overconfident people, due to their innate tendency, become extremely confident about their cognitive ability while undermining the prevailing risks in investments [23]. The study examined the disposition effect and created a framework based on several components (such as mental accounting, self-control, regret aversion, and tax consideration) [24, 25]. The prospect theory has been cited in the majority of empirical investigations as an explanation for the disposition effect [26].

The term ‘herding’ describes people’s tendency to copy the rational and not so rational judgments from others [27]. Therefore, investor herd behaviour is the main reason for the financial hurdles. Previous research find that managers of US pension funds are not affected by the herd behaviour and have little influence on stock prices when trading major equities by [28]. Institutional investors’ trading behaviour is influenced by their prior trading position [29]. They also discovered that herding behaviour in big stocks became less aggressive over time. Previous researchers argued that investors decide to forgo short-term gains to receive larger returns [30, 31].

According to traditional finance, individual investors are logical actors who choose investments to maximize profits while minimizing investment risk by determining the inherent share prices value [32]. However, behavioural finance contends that various psychological biases heavily impact a person’s financial choices. In behavioural finance, psychological biases are used in identifying and assessing of investment options available to the investors [33, 34]. This frequently explains both the market and the individual’s divergence from conventional financial theory. Investor behavioural biases would persist even when their investing judgments follow a rational decision-making procedure [35].

There are a number of factors which influence day-to-day investment decisions of individuals, which includes social interaction, motivation, inclination, and enthusiasm [36]. Investors do so through financial goals, periodicals, and accessible funding [37]. Investors’ lack of confidence and technical expertise in their ability to make wise decisions cause them to act in a biased manner [38, 39]. The rational decision-making of individuals is impacted by behavioural biases, such as heuristics, herd mentality, cognitive illusions and the framing effect. Due to time constraints, high costs, and a lack of knowledge and interest, individual investors have fewer opportunities to examine stocks [40].

Previous researchers defined herding as the process of thoughts or actions of members of a group (the herd) through a variety of interactions rather than through centralized coordination [41]. Past researchers argued that herding happens when individuals intentionally

replicate other investors' actions [42]. The authors mention two types of herding: "spurious" herding, in which investors make decisions based on comparable sets of fundamental data, and "intentional" herding, in which investors actively seek to imitate other investors' actions [43, 44]. The former could result in a successful outcome, whilst the latter could not. Intentional herding can also lead to excessive volatility, fragile markets and systemic risk. It is highlighted that although the "lemming-like" behaviour of investors is frequently blamed in the popular media of financial markets, it is still very difficult to conclude that herding occurs in actual financial markets for a variety of reasons using field data. Previous researchers developed a methodology that helps to estimate herd behaviour in financial markets and claimed that herding arises due to the uncertainty of information events in the market [45]. Additionally, investors with a herd mindset tend to follow the herd, believing that the decisions made by the majority of investors are always correct [46, 47]. When it comes to buying and selling stocks, a herding investor makes judgments based on what the crowd does, rather than following rationality.

Studies by [48, 49] have pioneered theoretical work on herd behaviour, where agents with access to private information make decisions in turn. The authors found that once a number of agents have reached the similar conclusion, all subsequent agents abandon their own data and replicate the actions of their predecessors. Investors can respond to the introduction of fundamental information. Market participants can deduce information from the actions of previous participants. Analysts can conform to safeguard their reputations. Institutional investors can conform for reasons linked to compensation. Investors can exhibit irrational behaviour. And herd behaviours can arise from psychological and/or social norms [50, 51].

METHODS

This study includes a thorough evaluation of research papers published between 1995 and 2024 on herding bias and investing in decision-making. The review included only research papers published in reputed international peer-reviewed journals between 1995 and 2024. Other sources such as books, conference papers, working papers, and doctoral dissertations were excluded from the review because the year 1990s attracted significant attention in terms of investment behaviour. Further screening of the articles was done using the abstract analysis, which merely helped us in meeting our criteria. It is therefore imperative to understand previous research in peer-reviewed journals. However, some prestigious journals, such as the Journal of Economic Psychology, the Journal of Behavioral and

Experimental Economics, and the Journal of Behavioral and Experimental Finance were also excluded because, after the abstract screening, they did not meet the scope of our study. The objective of this study is to focus on herding bias and investors' decision-making. Therefore all the studies that typically emphasize these two concepts have been taken into consideration. The eligibility of research papers was examined through their titles and abstracts. Although there is already extensive literature published on herd bias and the decision-making of investors, very few studies have investigated the relationship between herding bias and the decision-making of investors. Therefore, 52 papers that focused on herding bias and investors' decision-making were selected for this study.

The articles were searched using leading databases, such as Web of Science, Scopus, EBSCO, and Google Scholar. Keywords, such as "behavioural biases," "herding," "herding bias," "investment," "investment decision making," "herding bias and investment decision making," and "herding and herding bias" are used to find relevant research papers. Some top-rated journals in this field, such as The Journal of Finance, Review of Behavioural Finance, Financial Analyst Journal, European Financial Management, and International Review of Financial Analysis, are also searched. Furthermore, the references of some of the most prominent research papers were also utilized to find other sources, which were then evaluated to determine their applicability to the study. *Figure 1* depicts a flowchart of the selection of articles considered for review.

RESULTS AND DISCUSSION

Trends of Publications

The main focus of the study is to identify current research trends that examine the relationship between herd bias and investor decision-making. In this section, the study attempts to categorize articles by year, region, theme, journal, discipline, and category.

Year-wise Research Publications

Figure 2 shows the number of studies carried out every five years between 1995 and 2024. The highest number of studies was conducted in the period from 2016 to 2020. However, during the period of 2021–2022, there was a decline in the number of studies. The reason for this could be the COVID-19 pandemic, in which many organizations did not have an effective decision-making mechanism to forecast any strategy for a longer tenure in terms of investment. The period 2023–2024 has gained momentum again because of the upsurge in the number of investors during these years. Investors tend to be affected by many behavioural biases, particularly herding bias. An increasing number of studies on

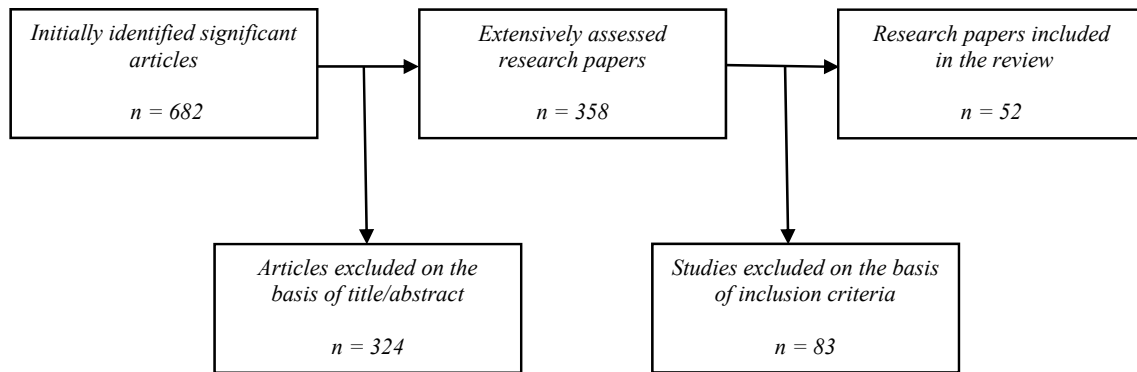


Fig. 1. Flowchart Showing the Selection of Articles

Source: Compiled by the authors.

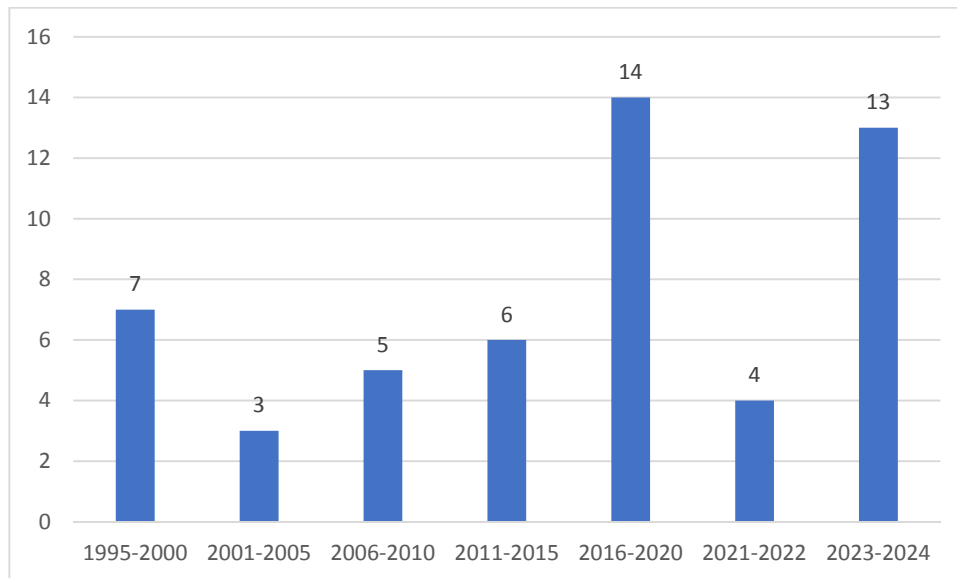


Fig. 2. Year-wise Studies

Source: Compiled by the authors.

this topic is useful for understanding individuals' investment decisions.

Region-wise Studies

Figure 3 shows the number of studies conducted in various regions of the world from 1995 to 2024. It is thought-provoking to find out that the studies on herd bias and investors' decision-making are being conducted on continents like Asia, North America, and Europe. The majority of studies (42.31%) were conducted in Asia, followed by North America (26.92%), and only (11.54%) of the research was carried out in Europe. The probable reason for having the maximum number of studies on the Asian continent is that, going forward, Asian countries will become a hub for financial investment opportunities. Increased economic growth and urbanization in these regions offer significant potential for growth and profits for investors willing to take risks associated with investment decisions. Additionally, Asia has the highest middle-class

population that is actively interested in financial investments [52].

Figure 4 shows the different themes employed by researchers between 1995 and 2024. The fields of herding and herding bias have been the primary focus of research. It is interesting to note that from 2017 to 2020 a layer of complexity was added to the herding bias problem by incorporating investment decision-making. As a result, from 2021 to 2024 a combination of factors was highlighted, including behavioural biases and focusing on herd bias and investors' decision-making. To gain the necessary understanding of the constructs across several domains, themes were developed to evaluate the constructs in various time frames systematically. Identifying themes in the data enables us to ascertain the areas that may arise from the lack of the existing literature.

Journal-wise Publications

As presented in Table 1, research papers on the issues in this study were published by a wide range of journals.

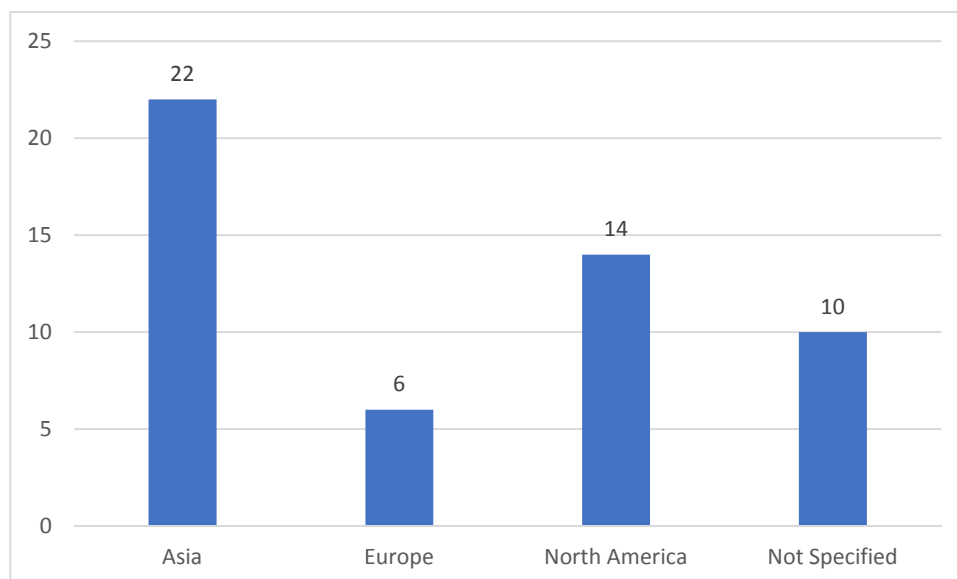


Fig. 3. Region-wise Studies

Source: Compiled by the authors.

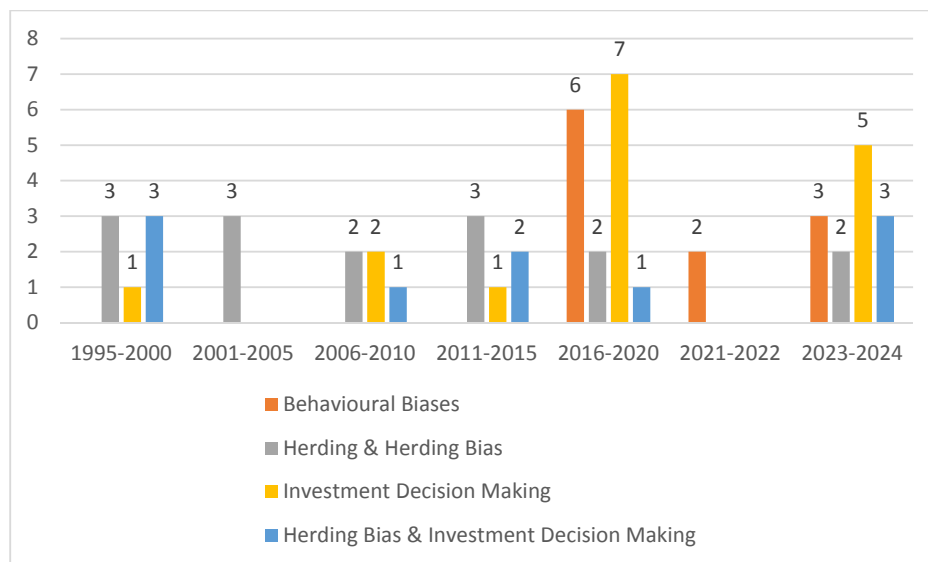


Fig. 4. Theme-wise studies

Source: Compiled by the authors.

For example, the American Business Review published 7.69% of articles. The Review of Behavioural Finance published 5.77% of articles, and Qualitative Research in Financial Markets published 5.77% of the research papers.

Discipline and Category-wise Distribution

An analysis of these 52 research papers reveals that 27% of the research studies were from the finance discipline, 19% were from the economics discipline, 12% were from the accounting, and 6% were from the business management subject area. Regarding the category of journals, it was found that 8% of research papers were published in A* category journals, 25%

were in A category, 17.31% were in B category, 10% were in C category, and 17.31% were Scopus-indexed. The publication of these papers in very high-category research journals indicates the relevance of the research topic. Table 2 provides a breakdown of the subject-wise publications in this field.

Most Cited Publications

Table 3 shows the most cited publications on herding bias and investment decision-making. The highest number of citations, with 2323 times cited, has been achieved by the article “Herding and Feedback Trading by Institutional and Individual Investors.” Meanwhile, the research paper “Herding in Financial

Table 1

Publications by Source Title

Journal	Number of Research Studies	Percentage
The American Economic Review	4	7.69
The Review of Behavioral Finance	3	5.77
The Qualitative Research in Financial Markets	3	5.77
The Journal of Finance	2	3.85
The International Journal of Housing Markets and Analysis	2	3.85

Source: Compiled by the authors.

Markets: A Systematic Literature Review” followed quite a distance with 322 citations overall. Lastly, the research paper titled “Estimating a Structural Model of Herd Behaviour in Financial Markets” has slightly lower citations of 192. Many other research papers are also followed with similar number of citations.

Country-wise Studies

Figure 5 shows the majority of the countries where research papers on herding bias and investment decision making have been published. India dominates the sample with more than 5 publications, namely 8 research papers, with a percentage of 15.38%. The UK and Pakistan also published 5 research papers in this field, with 9.61% each.

Nomological Network of Herding Bias and Decision-Making of Investors

This SLR highlights numerous variables used as antecedents, determinants, mediators, and moderators. These variables were grouped into three categories: behavioural biases, decision-making of investors, and herd bias. The theme of herding behaviour witnessed several changes in the herd and herding bias in different contexts, such as financial markets, laboratory markets, online experiments, investment newsletters, and institutional and individual investors. The literature on investors’ irrational behaviour shows that investment differs among individuals and occurs in different contexts. Many studies show investment satisfaction, attitude, and corporate reputation as mediating variables to measure the indirect effects of antecedents and the outcomes and risk aversion as moderating variables to find the strengths or weaknesses of the constructs for the same. Various behavioural biases, such as anchoring, representativeness, herding, and

Table 2

Publications by Subject Area

Subject Area	TP	Percentage
Finance	14	26.92
Economics	10	19.23
Accounts	6	11.53
Business Management	3	5.76

Source: Compiled by the authors.

Table 3

Top 5 Most Cited Publications

Title	Citation
Herding and Feedback Trading by Institutional and Individual Investors	2323
Herding in financial markets: A Systematic literature Review	322
Estimating a Structural Model of Herd Behaviour in Financial Markets	192
Elucidating investors rationality and behavioural biases in Indian stock market	72
Can herding improve investment decisions?	43

Source: Compiled by the authors.

availability biases, have been used as antecedents to reinvestment decisions in different domains and contexts. Antecedents for investment decisions include market sentiment, past behaviour, and overconfidence, which cause changes in office investments, mutual funds and stocks, as well as the intention to invest in the holistic analysis of the relationships between the constructs.

Figure 6 depicts the mediator-moderator framework for herd bias and the decision-making of investors. It has been revealed that there are very few mediators and moderators are used in quantitative empirical research papers to establish the impact of herd bias on the decision-making of investors. Researchers have identified different dimensions of herding bias and the decision-making of investors. It is imperative to comprehend that various factors that mediate this relationship have been used in researchers’ interpretation. Factors such as investment satisfaction, judgment/valuation, attitude, corporate reputation, risk perception, risk tolerance, investor behaviour, market anomalies, and market sentiment have all been used as mediators in studies at different time phases. Concerning the dimensions mentioned above, researchers also argued about different moderators, including risk aversion, financial

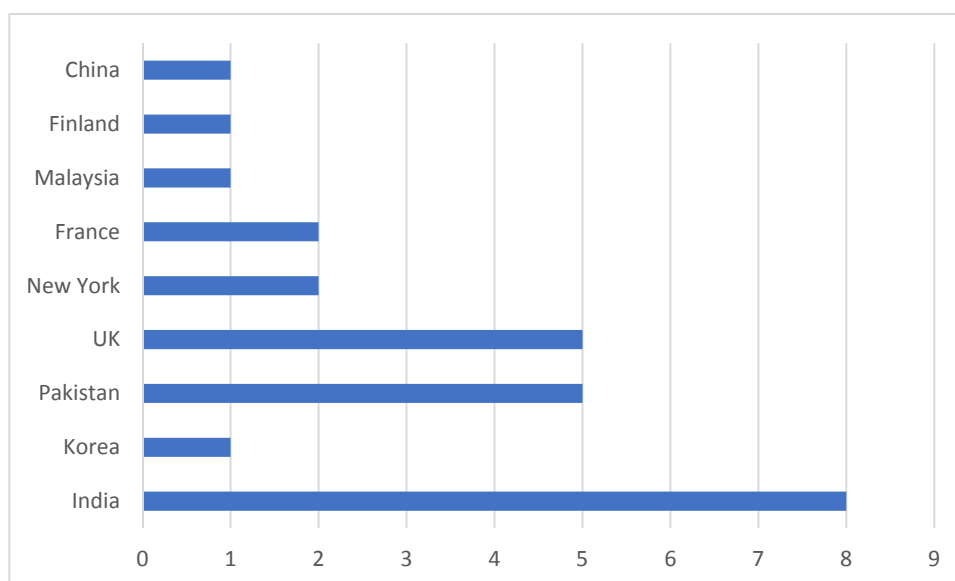


Fig. 5. Country-wise Publications

Source: Compiled by the authors.

literacy, investment decision-making, social media, and national culture. Studies like those by [53] have used market efficiency as a moderator, which in turn added a valuable perspective to the literature by highlighting the role of different behavioural aspects, with the effect on the decision-making of investors in particular. Similarly, the study by [54] emphasizes that herd behaviour has a negative impact on the efficiency of the market and the performance of investment. Researchers such as [55] use risk aversion in their studies to determine its effect on herding behaviour and investment decision-making. All the above-mentioned dimensions add valuable insights to the discourse by highlighting the relationships in the existing literature.

Theories Used in Herd Bias and Investment Decision-Making Studies

The most significant models and theories used in the research of herding bias and investment decision-making. In the field of traditional finance, theory development had been based on rationality [56]. Traditional financial pioneers promote reason in decision-making by justifying choices based on the information at hand [29]. Traditional financial theories, such as the Arbitrage Pricing Process, the Capital Asset Pricing Model, and the Options Pricing theory Merton have dominated the minds of financial analysts to provide answers to investment-related questions. These ideas support and advance the traditional idea that investors are rational when making decisions about investment, assuming that they make rational decisions.

The most prominent theories in the area of behavioural finance are the *prospect theory*, which

works in accordance with expectancy utility theory to explain decision-making in uncertain situations. By fusing the psychological and behavioural components of economic and financial decision-making, prospect theory has brought about a fundamental shift in traditional finance by introducing it to the newly growing field of behavioural finance. Due to a lack of acceptable justification for a variety of investors' irrational behaviours, the traditional ideas of the efficient market hypothesis and anticipated utility theory have been replaced by behavioural finance.

The foundations of behavioural finance were laid by Kahneman and Tversky's introduction of *prospect theory* in 1979. The three main heuristics on which this theory is based are accessible, representative, and anchored. The study by included the gambler's fallacy bias and overconfidence bias in their list of heuristic biases. In addition, numerous behavioural economists have introduced the concept of loss aversion disposition effect and mental accounting, which helped to advance the field of behavioural finance. And hence, behavioural biases have become a significant area of research in behavioural finance.

Another prominent theory used in the area of behavioural finance is the theory of *bounded rationality*, which extends the assumption of prospect theory to the extent that it is carried out in defence of bounded rationalism. As a result, investors frequently oversimplify their decision-making processes and are vulnerable to behavioural heuristics that may result in systemic errors and good investment choices, but do not maximize options. Due to intrinsic risk perception asymmetries in the value function of investors, judgements regarding investments may be made more intuitively and based

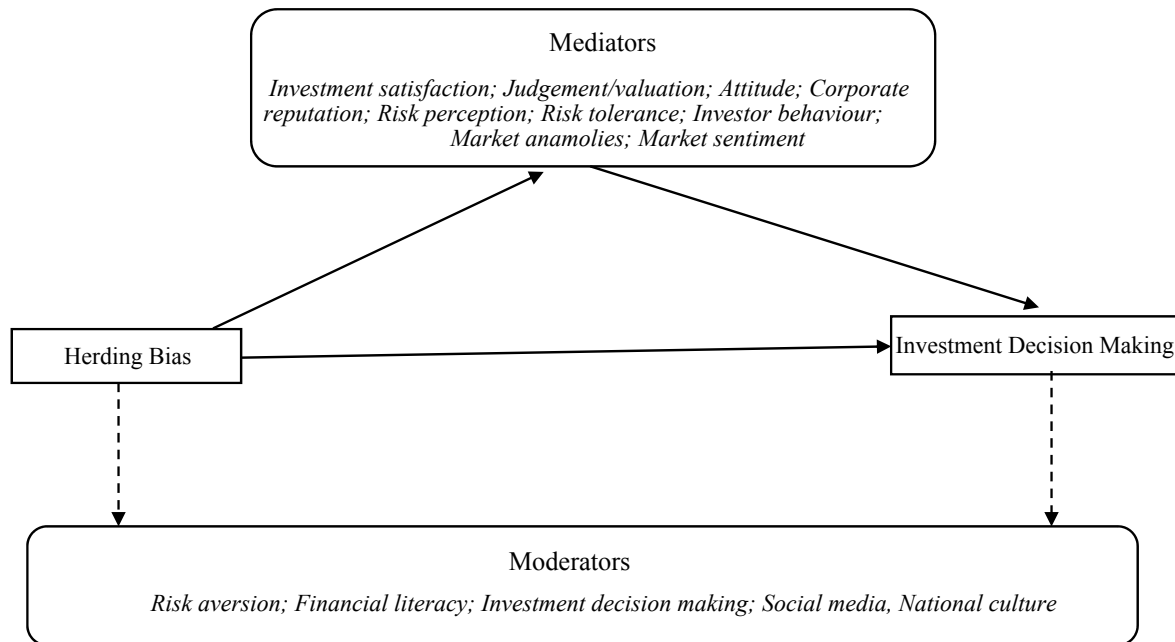


Fig. 6. Mediator-Moderator Framework

Source: Compiled by the authors.

on past performance rather than on logical analysis and objective factors.

Previous research has also focused on the utilization of resources to gain a competitive advantage. A type of strategic management, known as resource-based theory, focuses on the internal strengths and limitations of the company. From this perspective, a firm's immovable and diverse resources play a significant role in developing a competitive advantage [58]. Resource-based theory states that a corporation is equivalent to the diverse array of resources it holds. Resources are assets that are attached semi-permanently to a company, both tangible and intangible. Networks acquire the resources owned by other businesses to gain a competitive edge. This implies that investment in resources and competencies may not always be evaluated from the perspective of an individual firm without adapting to complementary inter-firm resources.

According to the *efficient-market hypothesis*, a classical version of finance theory states that investors make logical decisions regarding the financial items they want to invest in. However, "the theory of behavioural finance" contends that an investor's decision to purchase a financial instrument is influenced by their psychological, sociological, and emotional preparedness.

Expected utility is based on the hypothesis that the most advantageous option will be selected. This is established based on the theory of perspectives. Compared to other less likely outcomes, even if the value of the first is lower, there is still a preference for secure rewards. It should be remembered that because

the experience of loss is a component of human subjectivity, it cannot be measured. Even though several factors contribute to this, including family influences, investment objectives, risk factors, guilt, justifications, fear, and agony. Therefore, loss aversion incorporates the feelings and aspirations of people with which investment decisions are made using logical justifications.

CONCLUSION

This work contributes to several theoretical insights into herd bias and decision-making of investors in the literature. After synthesizing the chosen research papers, the study found that most of the work was conducted between 2016 and 2020. Most studies have been conducted in Asia. Further, Prospect theory is commonly used in studies of herd biases and investor decision-making. This research also analyses herd bias and investment decision-making theories in understanding theoretical foundations of the construct. The study also reveals that these theories originate from economics, statistics, and finance. Furthermore, financial theories dominate this field. This research paper also highlights several research gaps in the literature review. The study found that most empirical research on herding bias and investment decision-making domain is cross-sectional in design, providing a very limited view in comparison to other attitudinal and behavioural outcomes. Second, the absence of cross-cultural studies on this topic was another notable gap. As most investigations have been conducted using secondary data from different stock exchanges, they may have

problems with generalizability. It would be fascinating to observe whether investors from various parts of the world respond to different biased behaviours while investing. Therefore, cross-cultural research should be conducted to determine whether results obtained from various samples are similar.

Third, this review of the literature has revealed that there has been a lack of qualitative research. The concepts of herd bias and decision-making of investors are highly individualized. An accurate picture of the bias towards certain investments by many respondents cannot be obtained using a predefined scale. Only open-ended inquiries allow responders to express their concept of transcendence. Therefore, future research should employ qualitative methods, such as ethnography, thematic analysis, and grounded theory. Fourth, the review identified very few studies that used mixed-methods research; with respondents limited by predetermined options in closed-ended inquiries. Future researchers could combine quantitative and qualitative methods to triangulate data and determine if they produce similar results.

This study's gap analysis can be very helpful in the advancement of herd bias and decision-making of investors. In addition to the gaps listed above, this study also recommends additional research on herding biases and decision-making of investors in context of cultural aspects of investment and herding behaviour, which can be observed in the form of the transformation of society from collective to individualistic, and the search for changes in the patterns of investment due to enhanced diversification in technological media. A promising research direction needs to examine perceived collectivism vs. individualism values using Hofstede's cultural model. Notably, the study further asserts, that since collectivist societies predominate in the Eastern world, behavioural biases will be inextricably linked to principles of empathy, compassion, and respect when making investments. However, investment decisions in Western countries are more independent. The study also aims to propose additional cross-cultural comparison studies to provide empirical support for this gap.

This study concludes that even though the area of research has grown vividly over the past twenty-five years, gaps are still persistent in the field of herding bias

and decision-making of investors. Dimensions, such as behavioural biases, herding behaviour, and investment decisions are becoming more relevant in the current environmental landscape. It is essential to understand these biases when making investment decisions to ensure efficiency and effectiveness. By synthesizing the extensive literature on herding bias and decision-making on investors, this research significantly adds to the field. It will aid future researchers in understanding the current state of the field and identifying areas that need further investigation.

This literature review provides various scopes for future research. First, future studies focus on emerging stock markets because of the increased expansion of emerging economies. Potential, institutional, and individual investors prefer to invest in the share market, offering a wealth of opportunities for further research. Second, empirical research, which is based on primary data, needs to be prioritized to examine investor behaviour when making investment decisions. Third, in addition to stocks, multi-asset, and bonds can also be considered when examining herding bias. Finally, studies focusing on home bias and herding behaviour should be conducted to make sound investment decisions. It is also possible to conduct research by combining many investment classes, including institutional (mutual funds, hedge funds), individuals, financial advisors, pension funds, etc.), in order to determine the variation in their behaviours and how behavioural biases affect their ability to make good financial decisions.

The study would be highly beneficial for financial firms where investors regularly monitor the stock markets. It would help them to advance their understanding before making a decision, as herding bias can lead to irrational investments where traders follow the crowd.

This study has several limitations. First, the review was limited to papers written and published in English. Second, even though every attempt was made to include as many publications as possible in the literature review, some studies might have been left out because databases such as ScienceDirect and ProQuest were not used. Third, there could be scope for the involvement of qualitative studies on herding bias and investment. Finally, future researchers could expand on this work by conducting mixed-methods studies.

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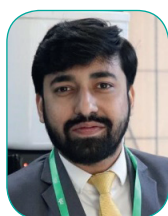
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