The study of behavioural finance has revealed the existence of an interesting phenomenon in the individual decision making process of investors that is, herding. Herding is one of the aspects of behavioural finance that helps us to know how the investor’s thought processes drive the stock prices away from its fundamental value and which in turn brings instability in the market. Herding is generally believed to be an important component of behaviour in financial markets. It reflects the emotional and collective feeling of a group of investors and is also termed as ‘crowd behaviour’. Herding occurs when a group of investors behave in a similar fashion and one such group of investors is mutual funds. Mutual funds are the institutional investors that have become the dominant group in the financial markets. These are the entities that invest on the behalf of the small investors. The small investors generally do not have adequate time, knowledge, experience and resources for directly accessing the capital market. They have to rely on an intermediary which undertakes informed investment decisions and provides the consequential benefits of professional expertise. Mutual funds gave the benefits of balanced portfolio and low transaction costs. Reduced risk, expert professional management of the money and safe investments are the investment motives of an investor while investing in mutual funds. Thus, they usually pool their investment into the mutual funds and rely on the mutual fund managers for the safe investment.

Mutual funds have proved to be a safe intermediary in capital and money market. Safety of funds, dispersal of risks and a satisfactory yield are the important characteristic of mutual funds. But in India, mutual funds have taken their investors for granted, as a result of which unprofessional conduct have emerged. The managers and analyst are often prone to herding in their investment; financing and reporting decisions, even within firms. Analysts often manipulate their own forecasts to get closer to their colleagues in order to signal that their information is correlated with the consensus information. In this way, analysts overvalue consensus forecast information in their earnings prediction and make sure that their forecast is closer to the consensus forecast. Thus, analysts often deviate from the optimal forecasts and submit suboptimal forecast by observing herd behaviour. Not only this, the fund managers and financial analysts are generally considered to be an important group of investors in financial markets. Because of the better experience and specialization in the subject, the fund managers and analysts are believed to have an edge over other investors in interpreting the public information. They also have better access to corporate information because of good access to management, sophisticated models, distinctive interpretation, etc. Fund managers are highly specialized in the subject to extract and analyze private information from the decision of others. Their earnings forecasts, stock recommendations and research reports are not only used for the portfolio management of the fund companies but also by many professional parties and individual investors as inputs for investment strategies and stock valuation models.

The bigger challenge for the mutual fund industry is that there exists a huge gap between the delivery and the expectations of investors. It has been observed that the performance of mutual funds has been lower than their reasonable expectations. As a result, mutual fund participants in the market are the losers with diminishing confidence of the investment community. The mutual fund managers often fail to
achieve whatever is promised by them in their schemes. These results are very astonishing because asset managers are hired by the institutions on the basis of their professional expertise at higher salaries. This performance gap might exist due to the clash of interest between the client’s expectations and the career and compensation concern of the fund managers. The asset managers because of their conflicted interest might not put their efforts to the fullest and opted to follow the herd. And this behaviour of the fund managers grinds down the vital and entire purpose of a small investors investment in mutual fund.

Considering the importance of mutual funds as an essential investment vehicle, several academicians have tried to study the behavioural patterns of the mutual fund managers while taking the investment decisions. The researches have shown that the reputation and career concern of the fund managers often inclined them towards herd. Herd iii behaviour replicates the emotional and collective feelings of a group of investors and is also termed as crowd behaviour. It is the behavioural approach of societal conduct that follows the interactive observations of elements such as action and payoffs of the prior investors.

Several researchers have also tried to study the relationship of herding with various investment factors and the demographic profile of the fund managers that might have an impact on herding. Herding literature by different researchers varies with the variation in the herding measure used and the countries where the researches have been done. The theoretical and empirical researches have made a huge discussion in their work, on the effects of herding on the market as a whole. Various studies that focused on herding, its effects and the factors that influence the herd behaviour have come out with contradictory conclusions.

The management of an investment portfolio by the fund managers requires knowledge, experience, constant research, fundamental and technical analysis of the companies, appraisal and reappraisal of securities, markets, different sectors within the market and individual securities. Realizing the importance of mutual funds, it becomes necessary for the management of the mutual funds to adopt the unique investment strategies for gauging the needs of the national economy. It becomes imperative for the fund managers to rely on their own private information, instead of relying on the information of their peers thereby assessing the viability of industries whose securities could be purchased by them with minimum risk and maximum returns. After assessing the industries and securities, it requires a sound portfolio management.

Keeping in view the growing importance of mutual funds and the above stated significance, the present study is undertaken to study the existence of herding in mutual funds in the Indian market and its relationship with demographics of the fund managers and other related variables. Further, an attempt is made to obtain a comprehensive understanding of the level of herding on the basis of different attributes of the stocks. Every possible effort has been put to make the study meaningful so that it proves to be useful for undertaking any improvements in the performance of mutual fund schemes and will help stakeholders of mutual fund as well as financial markets to iv execute strategies to protect against or exploit herding. In this study, an attempt is made to examine the various aspects of herding and also the factors influencing the investment decision of the mutual fund managers.

The complete study is discussed in six chapters. The first chapter is dedicated to the introduction of the subject herding and its determinants and consequences. The second chapter contains an expanded discussion on the literature with a complete and
comprehensive review of the extensive research papers, theses and reports in the related subject. The special focus has been given to the herding measure introduced by Lakonshok et al. (1992) (LSV 1992). The third chapter includes the research design and methodology. It spells out the nature of the problem, objectives, hypotheses, research methodology, statistical techniques, limitations of the study and future scope of research. The fourth chapter is devoted to the detailed profile of the six mutual fund houses taken for the analysis. The fifth chapter is about the analysis of herding in mutual fund market, its relationship with the demographics of the fund managers, fund managers perception towards herding and interpretation of results derived from applying the relevant statistical tools and techniques to the data. The last chapter presents the findings of the study, the conclusion thereof and the recommendations to formulate effective strategies in order that the behavioural aspects can be avoided in the investment decisions taken by the mutual fund managers.