

# Chapter 9


## Herd Behavior and Social Influence on Financial Markets: A Review of Literature

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### **ABSTRACT**

*This chapter aims to provide a comprehensive review of the existing literature on herd behavior and social influence in financial markets. Drawing from the evidence collected and theoretical perspectives, the primary objectives of this research are to critically understand how these phenomena influence the decisions of investors, dynamics of markets, and achievement of the Sustainable Development Goals (SDGs). The role of psychological factors, social networks and information, and potential consequences for financial stability and sustainable investments will be examined in the context of the chapter. In the end, this review will be useful in creating the strategies and recommendation for avoiding the negative impact of herd behavior while managing to use the social influence for positive social and environmental change.*

DOI: 10.4018/979-8-3373-1494-5.ch009

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## 1. INTRODUCTION

Market conditions involve both rational and psychological or social factors, which impact financial market dynamics. Among these behaviors are herd behavior and social influence that exert large impacts on the efficiency, volatility, and stability of the market. Herd behavior, defined as investors' tendency to mimic others' decisions rather than relying on independent analysis (Banerjee, 1992), often results in synchronized, irrational market movements. Social influence goes beyond the self and is also defined by the way the decisions made by investors are influenced by the behavior and decision-making of others within any social context, including social contexts present in social media platforms (Bikhchandani et al., 1992).

Recognition of the impact of herd behavior and social factors is important because those factors can intensify market fluctuations containing such consequences as fluctuation of assets' prices, formation of bubbles and crashes (Shiller, 2000). For instance, potentially these bubbles like dotcom in the 1990s and housing before the 2008 financial crisis were qualitatively created by significant separation of actual price of assets and their fair values in the market due to collaborative behavior of numerous investors, not necessarily by the intrinsic value of these assets (Shiller, 2000). Such events raise so much doubt over various conventional theories such as efficient market hypothesis and market efficiency (EMH) which argues that the value of securities already embodies all accessible information and that the investors always respond rationally given this information system (Fama, 1970).

The transposition of herd behavior and social influence from theory to practice is not an abstract academic discourse but raises practical questions about financial soundness as well as policymaking. The antagonistic impact, which is prevalent during bear markets, like during the global financial crisis of 2008 amongst institutional and retail investors, amplified the negative effect and the systemic risk (Lux, 1995). Knowing these behaviors, the regulators and policymakers can develop actions that would influence the markets to avoid crises in the future (De Long et al., 1990).

The recent trends in the global financial market include digital platforms and social media, thereby amplifying the impact that social pressure has on investors (Feyen et al., 2021). Social media and other online forums such as Twitter, Reddit, and trading communities make sharing of information and opinions very easy thus coaxing coordinated trading and herding (Li et al., 2023). In early 2021, the GameStop short squeeze powerfully illustrated how social influence can disrupt traditional market mechanisms, as a collective of retail investors rallied on social media platforms like Reddit's "r/WallStreetBets" to coordinate a massive buying frenzy (Desiderio et al., 2025).

The use of social media has remained high and is set to increase from about 2.86 billion in 2017 to about 6 billion in 2027 (Dixon, 2023). This explosive growth just

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