



Can agents sensitive to cultural, organizational and environmental issues avoid herding?



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ARTICLE INFO

Article history:

Received 27 October 2016

Accepted 20 January 2017

Available online 24 January 2017

Keywords:

Herding

Culture

Governance

Education and training

Financial development

Business style

Technology

ABSTRACT

Our findings indicate that herding behavior is affected not only by the cultural variables already discussed in the literature but also by other variables associated with organizational and environmental issues such as governance, technology, education and training, business style and conditions, and the development of equity and non-equity markets. Some of these act as catalysts, for example governance and technology. Others may have a corrective effect, such as the development of financial markets, business style, and education and training. If corrective factors are sufficiently developed, intentional herding practices could be reduced in the future.

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1. Introduction

Since ancient times, imitation has been a resource used to learn and to make decisions. Herding appears in a market when investors opt to imitate the trading practices of those they consider to be better informed, rather than acting upon their own beliefs and private information (see [Lo \(1999\)](#) or [Loewenstein \(2000\)](#), among others).

But financial decisions are not necessarily structured decisions. There are no complete models involving all the variables affecting the decision and the relationships among them ([Barberis and Thaler, 2003](#); [Kuran and Sunstein, 1999](#); [Shiller, 1999](#); [Shiller and Pound, 1989](#); [Stasser and Titus, 1985](#); [Stasser et al., 1989](#)).

According to [Fremount et al. \(1970\)](#) and [Hogarth \(2001\)](#), decision making is a conscious and human process involving both individual and social phenomena. Whenever agents are involved in making decisions, a number of factors can affect the process they follow and ultimately the decision they make. The factors can be organized into three major groups: perception issues (influenced by the background and experience of the perceiver), organizational issues (policies and procedures, hierarchy, legislation, politics) and environmental issues (economic, financial or technological development).

Previous studies in the literature discuss the relevance of the six dimensions of cultural paradigms proposed by Professor Geert Hofstede in order to explain both social and individual behavioral patterns. But culture changes very slowly and cultural dimensions are only calculated over long periods of time. In order to detect the influence on herding of other more dynamic factors, we take into account, in addition to the cultural factors suggested in [Chang and Lin \(2015\)](#), other issues

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that have to do with the degree of governance of a country, with its educational and professional training system, with the environment in which its companies do business, with its technology development and with some specific financial factors reflecting the state of its financial development.

This paper attempts to shed light on general issues (both organizational and environmental) influencing the trend towards herding practices in 35 different countries. As personal issues are much more difficult to model, comprise very different aspects and are less generalizable (they can, at most, be generalized through what we call cultural issues), the main contribution of this paper is based on the incorporation of a wide range of organizational and environmental variables that may affect herding behavior. We try to analyze whether specific country characteristics determine herding intensity.

The usefulness of this article is twofold. On the one hand, it is interesting to know which organizational or environmental issues are able to mitigate or correct herding behavior and which factors can enhance or catalyze herding practices. On the other hand, our results may shed light on the extent to which herding behavior may be avoidable if it is not considered appropriate.

2. Database

The empirical study focuses on a sample of listed stocks of 35 international markets for a 15-year period from January 2000 to June 2015. Market selection is based on trying to cover those markets previously analyzed in the literature, together with some other stock markets that seem to have been underestimated despite their importance in financial terms. The final sample consists of 141,365 market-day observations and arises from the stock returns of 39,096 companies from all the countries under study.

This study has been carried out using daily returns on all common stocks and the daily returns on the market indexes obtained from Datastream (Thomson Financial). The database has been checked and corrected according to the recommendations of [Ince and Porter \(2006\)](#). In addition to the stock returns and the cultural variables associated to perception issues, we use a broad set of variables representing the organizational and environmental issues under study. The data are obtained from multiple sources. These variables can be grouped as follows, according to their communality:

2.1. Cultural dimension

The Hofstede index ([Hofstede, 2001](#); [Hofstede et al., 2010](#)) is a six-dimensional model of national cultures. The six dimensions comprise the following: power distance index (pdi), individualism versus collectivism (idv), masculinity versus femininity (mas), uncertainty avoidance index (uai), long-term orientation versus short-term normative orientation (lto) and indulgence versus restraint (ivr).¹ The effect of these variables on the herding level in the markets is not expected to be homogeneous. Since Hofstede introduces six representative variables of the cultural dimension, the same number of variables has also been used in the other dimensions (see below) for the sake of homogeneity.

2.2. Governance dimension

This group comprises information on how countries exercise authority at an institutional level. Greater governance will produce greater confidence in market investors, which promotes a greater attraction of all types of investors. This may result in investors having more information and confidence in their actions, so herding may decline. However, attracting more investors can result in the appearance of uninformed investors, who might induce greater herding. Therefore, the observed result on herding is an empirical question. The variables included in this group are taken from the Worldwide Governance Indicators ([WGI, 2015](#)) gathered by the World Bank, and are as follows: Voice and accountability (va), political stability and absence of violence (ps), government effectiveness (ge), regulatory quality (rq), rule of law (rl) and control of corruption (cc). In all cases, the higher the value of the variable, the more governance is enhanced.

2.3. Technology dimension

The technological development of a country certainly affects the behavior and habits of its inhabitants. A higher technological capacity is associated with more training and greater intellectual development. Improved technology produces an increase in the dissemination of information and of negotiation, which will induce less herding. However, further technological development can democratize access to investing, which may cause less informed investors to start trading. The result of the effect of these variables on herding is thus an empirical question. The variables considered are: Innovation (inn), company spending on R&D (srd), individuals using internet % (iui), firm-level technology absorption (tab), technological readiness (trd), FDI and technology transfer (fdi).²

¹ Source web page of Hofstede.

² The reference source for information on technology, education and training, and business style and conditions is the World Economic Forum.

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