

Abstract

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Influences by others when making investments and predictions in stock markets, referred to as herding, is a widely discussed phenomenon in financial economics. This thesis aims to understand herding by applying theories of social influence. In a series of studies employing a multi-trial experimental approach, undergraduates made predictions of stock prices. On each trial they received information about the current price and the predictions made by other fictitious participants, forming a majority or a minority herd. Study I investigated how different rewards altered the level of influence from a herd making random predictions. Experiment 1 ($n = 80$) demonstrated that the tendency to follow others overrides the effect of a financial reward for individual performance. In Experiment 2 ($n = 80$) a reward for following a majority herd increased the influence, but a reward for following a minority herd did not. Addressing the importance of consistency for herding, in Study II ($n = 96$) consistency was varied both as agreement between the others' predictions (correlation) and within the others' predictions (variance). Correlation increased the herd influence, but no effect of variance was observed. Studies I and II suggested that the influence from a consistent random majority herd was associated with the use of a consensus heuristic. Study III further explored the processes mediating majority and minority influences, with the focus on accuracy motives. The results of Experiment 1 ($n = 64$) showed that the participants followed a majority herd independently of whether its predictions were accurate or random. In Experiment 2 ($n = 80$) the majority influence was reduced by requesting participants to focus their attention on the accuracy of the others' predictions. It was found in Experiment 3 ($n = 60$) that a minority herd was influential only when its predictions were accurate and when the participants were requested to focus their attention on the accuracy of the others' predictions. The focus instruction thus seemed to break the tendency to use a consensus heuristic. Study IV ($n = 80$) examined whether induced expertise and augmenting the validity of price information would have the same effect, showing that the others only influenced participants' predictions when participants were non-experts and the price was invalid. The results of Studies I-IV demonstrate that in prediction tasks based on uncertain information people use heuristic processing more extensively than has been assumed in previous social influence research. A majority herd seems to be influential due to the use of a consensus heuristic. However, no support was found for the proposition that minority influence is associated with systematic processing. Instead, the tendency to follow the price instead of a minority suggests the use of a "minority heuristic". Factors such as focus instructions, high price validity and expertise suppressed heuristic processing.

Keywords: Social influence, Herding, Majority vs. minority influence, Stock markets, Financial incentives, Heuristic vs. systematic processing, Predictions, Behavioural finance.

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Social Influence in Stock Markets

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Avhandling för avläggande av filosofie doktorsexamen i psykologi, som med vederbörligt tillstånd av samhällsvetenskapliga fakultetsnämnden vid Göteborgs universitet kommer att offentligens försvaras fredagen den 11 september 2009, kl. 10.00 i sal F1, Psykologiska institutionen, Haraldsgatan 1, Göteborg.

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