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A STUDY ON THE IMPACT OF POLITICAL FACTORS ON THE HERD BEHAVIOR IN THE FINANCIAL MARKETS

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Abstract—*Investor behavior in emerging financial markets such as India and other emerging economies are increasingly influenced by the political and policy-related developments. Theories of behavioral finance has exhibited that heightened political uncertainty intensifies collective investor actions, particularly in bouts of stock market volatility. A review of existing literature reveals substantial evidence of herding tendencies in Indian markets (Agrawal, Singhal, & Swarup, 2016; Gupta & Kohli, 2021), as well as growing acknowledgment of political and policy shocks as critical determinants of market dynamics (Kalra & Gupta, 2023; Verma et al., 2025). However, direct empirical investigations linking political factors to herding remain limited. This study addresses this gap by integrating behavioural and political-economic perspectives to conceptualize how political events and uncertainty influence investors in India. This research study examines the impact of event like union budget announcements and geopolitical developments between 2025 on herd behavior in the Indian equity market. The findings are expected to enhance understanding of behavioural responses to political risk and provide insights for regulators, policymakers, and investors seeking to mitigate instability arising from collective market movements.*

Keywords: *Herd Behaviour, Political Events, Political Risks, Behavioural Finance, Stock Market Volatility.*

Introduction:

Investor behaviour in equity markets in shaped not only by firm-level fundamentals and global macro conditions, but also by political and policy-related factors. In emerging economies like Brazil, India, where the participation of investors in the market is rapidly increasing and regulatory regimes becoming very fluid and unstable creating potential behavioural anomalies, one such being herd behaviour. The tendencies of the investors to mimic the actions of other investors, ignoring or neglecting their private cues and information, which amplify market volatility, distort price discovery and contribute to market fragility (Bikhchandani & Sharma, 2000). In the Indian context, markets have witnessed episodes of higher volatility in combination with political events—it could be in the form of elections, major policy shifts and regulatory reforms. These uncertain events affect the investor psychology and behaviour both personally as well as collectively.

These are has been numerous studies linking herd behaviour with the Indian Markets (Gupta & Kohli, 2021; Agrawal, Singhal & Swarup, 2016). It is further, found that there has been relatively fewer studies that link political events like election outcomes, geopolitical risk and policy uncertainties with herd behaviour. A comprehensive understanding of the interplay between political factors and herd behaviour of investors. This of great significance for the regulators who are interested monitoring systemic risk for Institutional investors and exposure of emerging market dynamics for Retail investors.

This study aims to explore the impact of political events on investor sentiment and decision-making and understand the extent of herd behaviour associated with politically significant periods or events like union budget announcements, national elections and geopolitical events in the Indian equity market. This study aims to integrate behavioural finance with political risk assessment and contributes to the theory which offers insights into when Indian investors might tend to follow the crowd behaviour under certain political conditions, thereby increasing their susceptibility to herding behaviours.

Review of Literature

The concept of herd behaviour in Financial markets traces its roots in the reputational-concern frameworks and in informational-cascade. Banerjee (1992) argues that investors may ignore private information and simply follow the actions of predecessors, leading to herd behaviour. The individuals lack of confidence in their knowledge and the desire to conform to group behaviour and avoid social ostracism is the leading cause of her behaviour. The investors stuck in the mob mentality adopt attitudes and behaviours which are significantly different from their personal beliefs and morals. Bikhchandani, Hirshleifer & Welch (1992) extend this by formalising how fads and fashions emerge when individuals base decisions on the observation of others.

Sharma & Bikhchandani (2000) noted that herding behaviour of investors may lead to destabilisation of markets and increase fragility. The above theoretical foundation have been supported by adequate empirical evidence across both the developed and emerging markets alike (Chang & Lin, 2015).

Evidence from India: Herding Behaviour

In the Indian financial market, numerous studies have documented evidence of herd behaviour among investors. Agrawal, Singhal & Swarup (2016) investigated individual investor decision making in India context and found that her behaviour is characterised by uncertainty and regret avoidance and low financial literacy. The system-dynamics modelling approach of the study showed that Indian investors follow the decisions of the market leaders rather than rely on their own analysis. Further, Gupta & Kohli (2021) in their empirical study from 2003-2017 across three periods of pre-crisis, crisis and post-crisis found that there has been impact of herding during the crisis and post-crisis period but not in the pre-crisis period in the Indian stock market.

Batchu & Padmasree (2021) in their empirical investigations used Cross-Sectional Absolute Deviation techniques and confirmed herding dynamics in certain market conditions in India. While Bharti & Kumar (2019) also identified that investor mimic and behavioural biases in the market stress amplify herding.

Political/Policy Uncertainty and Financial Markets in India

There is more optimism in this context, as there is steady increase in the research in Indian Financial Markets into herd behavior. The impact of political factors impacting herd behavior in the Financial Markets in the context is scarce, especially the link between policy uncertainty and geopolitical risk with market behavior in India. Kalra & Gupta (2023) examines the impact of economic policy uncertainties in the Indian stock markets and thereby, higher uncertainties would further lead to dampening the returns of the investors and spike in volatility.

Verma, Verma, Yadav & Ahmed (2025) in their investigation identified impact of Geopolitical Risk Index on volatility of Nifty-50 stock and concluded that Indian Markets are sensitive to both global and domestic political shocks. Wadhwa & Goodell, 2024 found that state-election induced political uncertainity significantly impacts the increase in the stock-price crash risk, especially for smaller and leveraged firms. This study was significant in identifying the relevance of political events on investor behavior in Indian context.

Linking Political Factors and Herd Behaviour:

The studies on the interplay of political factors and herding behavior in the Indian context has not adequately explored. Khan & Gopal (2022) identified that external shocks prompt herding and bubble formation in the Indian stock markets. Further, they identified that geopolitical/political shocks can trigger herd behavior among investors. Tabassum, Natchimuthu & Krishna (2023) in their research indicated that Russia-Ukraine war period promoted her behavior among Indian Investors, especially in the down-market trends and low-liquidity segments, suggesting that political stress may nurture group-thinking among investors.

The above review of literature clearly indicate evidence of herd behavior in Indian Financial Markets and but the studies indicating the impact of political uncertainty in triggering herding behavior is scarce and underdeveloped. This research gap is the motivation for the current research to examine the role of political factor such as the announcement of Union budget of 2025 as a catalyst in triggering herd behavior.

Research Methodology:

This research uses quantitative research methodology. The population to be studied was the most vibrant and with greater demographic variations and diverse characteristic feature of the city of Bengaluru. The sample for the study was drawn through convenience sampling method and 235 respondents from various walks of life. The primary data for study was collected through a structured questionnaire, drafted and curated to evaluate the variables considered for this study. The study had concentrated on collecting responses especially after the announcement of Union Budget of 2025 and its impact on the investment decisions of the investors with respect to herd behaviour. This is an unique study looking into the impact of a political factor impacting investment behaviour. Bengaluru, being a dynamic landscape and the population both interested in investment as well as politically aware was therefore selected as the right choice for this study.

Data Analysis and Interpretation:

The survey from the sample of 235 respondents drawn from the city of Bengaluru. The demographic profile of the respondents of the survey is described below: The age profile of the respondents were 53% of respondents were in the age group of 20-30 years, while 35% were in the age of 30-40 years, while 10% of the respondents were in the age group of 40-50 years and only 2% were above 50+ years. While male respondents were 58% and the remaining 42% were female respondents. The survey indicated that 27% of the respondents were students, 25% were Self-employed, 25% were Salaried and the remaining 23% of the respondents were Working Professional. The income distribution of the respondents were 46% respondents were earning an income below ₹ 50,000, 26% were earning between ₹ 50,000 -₹ 1,00,000, while 19% reported income between ₹ 1,00,000 -₹ 2,00,000 and the remaining 9% reported an annual income of above ₹ 2,00,000.

The research study identified that 35% of the respondents reported an investment experience of less than one year, while 29% of respondents indicated an investment experience of 1-3 years, 25% of respondents had 4-7 years and 11% reported over 7 years of investment experience. This is clear that the respondents are mature investors. Majority of the respondents, i.e., 49% of respondents indicated that Wealth accumulation was the major investment objective of the respondents. While 40% indicated Income generation as their investment objective and only 11% identified that there are investing to take care of Retirement Planning.

While analysing the impact of political factors on herd behaviour. The first step is to analyse the source of Political new exposure of the Investors. The Survey indicated that Social Media is the most preferred for Political News, indicated by 37% of respondents, while 33% respondents indicated Online News portal, 17% identified Television, while a small majority indicated Friends or Family/Newspaper for the source of Political News.

Further the Analysis of the impact of Political News (Budget Announcement) on Herd behaviour is discussed in below:

Table No.1: The impact of Political News on Herd behaviour

Particulars		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
I closely follow political news	N	73	117	38	6	1
	%	31%	50%	16%	3%	1%
Influence of Political Events on Investment Decisions	N	89	121	19	5	1
	%	38%	52%	8%	2%	1%
I bring about an immediate Investment change after major Budget Announcements	N	91	116	22	5	2
	%	39%	49%	9%	2%	1%
I have tendency to avoid Investment Decisions during politically unstable period	N	90	100	35	10	0
	%	385	43%	15%	4%	0%
I often follow what other investors are doing	N	46	116	47	18	8
	%	20%	49%	20%	8%	3%
I follow crowd behaviour in Investment decisions	N	75	100	41	13	6
	%	32%	43%	17%	13%	6%
I am influenced by others on Stock Market Investments	N	74	93	37	25	6
	%	32%	39%	16%	11%	2%

My Confidence increases by observing crowd behaviour Stock Trading	N	84	94	38	16	3
	%	36%	40%	16%	7%	1%
I usually invest without doing research, but based on Others' Investment choices	N	83	96	33	17	6
	%	35	41	14	7	2
I do change my portfolio and Investment Decisions when the majority are doing the change in theirs	N	93	99	29	10	4
	%	40%	42%	12%	4%	2%
During Market crisis, it is safer to act as the Majority does	N	92	98	33	9	3
	%	39%	41%	14%	4%	1%

Table No. 1, indicates that there is a strong connection between political awareness and investment behaviour among respondents. It is noted that a majority of the respondents follow political news, which is indicated by 81% respondents either agreeing or strongly agreeing to that that political developments acts as a background against which financial decisions are made. Political events do clearly impact investment decisions of the Individuals. About 90% of respondents agree or strongly agree that political events affect their investment choices. Further it is noted that 88% of respondents they have been a sensitive investor especially immediately after the budget announcement. This is a clear indication that government decisions/announcements and fiscal policies have a direct impact on the investment behaviour, reflecting high sensitivity of investment behaviour towards macroeconomic and policy-related signals.

The research also suggests a risk-averse attitude, whereby the uncertainty caused by political conditions leads the investors to withdraw or delay the participation in the market. This is identified by 81% of the respondents have clearly indicated that politically unstable periods are avoided by the respondents to make major investment decisions.

The study identifies that nearly 69% of respondents are clear that they are following what other investors are doing, while 75% acknowledge that they follow crowd behaviour in investment decisions. Further, 71% feel that they gain confidence for investing, by observing crowd behaviour in stock markets. It is also noted that 82% respondents have reported changing their portfolio when majority investors make similar changes. These trends indicate that investors are psychologically comfortable while following the herd behaviour in stock trading, especially in uncertain market conditions.

It is also identified that the tendency to follow herd behaviour is even stronger in times of market crisis. This tendency indicates that uncertainty and fear amplify her behaviour, as investors perceive their individual decisions of investment more risky than collective decisions.

Overall, the analysis indicates that investors are highly influenced by political events and strongly guided by crowd behaviour. While political awareness helps investors stay informed, excessive dependence on majority actions and reduced individual research may increase the risk of irrational decision-making, especially during volatile or crisis periods.

Conclusion:

This is study identifies that political events, government announcement and fiscal policies will surely affect the investment behaviour of individuals and it further leads them to follow herd behaviour to reduce their exposure to investment risks by following herd behaviour. Further studies could explore herding behaviour in crypto currency markets during political announcements. Research could be undertaken to compare the implications of herd behaviour impacting investment behaviour in relation to political events.

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