Influence of Herding Behaviour on Perceived Market Efficiency: A Study of Individual Investors in Stock Market of Sri Lanka

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Abstract

This study examines the influence of herding behavior on perceived market efficiency among individual investors on the Colombo Stock Exchange. Behavioural finance has long argued that investors do not always act rationally, and that collective behavioural patterns such as herding can undermine how efficiently markets process information. In an emerging market context like Sri Lanka, where retail investors dominate trading activity and the market continues to experience episodes of volatility and reform. The interaction between these behavioural tendencies and perceptions of efficiency becomes particularly relevant. Drawing on a quantitative approach, primary data was collected from 300 active investors through a structured questionnaire. The reliability and validity of the measures were assessed, and the Multiple Linear Regression analysis was then employed to examine how herding behaviour influences investors' perceptions of market efficiency while accounting for demographic characteristics such as age, education, and investment experience. The findings reveal a significant negative association between herding behaviour and perceived market efficiency. Investors who frequently follow market trends or mimic the actions of others are more likely to view the market as inefficient. In contrast, more experienced and better-educated investors demonstrated higher perceptions of market efficiency, reflecting a greater ability to interpret market signals independently and resist herd influence. The study offers meaningful implications for regulators and market practitioners. Strengthening financial literacy, promoting independent decision-making, and enhancing transparency in market information can help reduce herd-driven inefficiencies. Furthermore, establishing Early Warning Mechanisms to monitor and respond to herd-induced volatility could strengthen market resilience. Overall, this research contributes to the growing body of evidence in behavioral finance by demonstrating how psychological and social dynamics affect investors' understanding of market functionality in an emerging market setting.

Keywords: Behavioural finance, emerging markets, herding behaviour, perceived market efficiency

ISSN 2792-1220, eISSN 2806-514X