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Influence of Herding Behavior on Investment Decision of SMEs in Bomet County, Kenya

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Abstract: Small and Medium Enterprises (SMEs) play an essential role in economic development as part of entrepreneurship. They provide goods and services, enhance competition, foster innovation and generate employment. The objective of the study was to determine the influence of herding behavior on investment decision in SMEs in Bomet County. The study targeted 4196 SMEs registered in Bomet County of which 108 were selected using stratified random sampling. Reliability of the research instrument was calculated using Cronbach’s coefficient alpha. Primary data was used to obtain the required information by the use of questionnaires. Data obtained was analyzed using descriptive statistics and inferential statistics with aid of Statistical Package for Social Science (SPSS) software version 21 and presentation through tables and summary made in percentages and proportions. The correlation coefficient analysis revealed herding behavior had a positive correlation relationship on the dependent variable. The findings from the multiple linear regression analysis showed that herding behavior had a negative beta of 0.146 this showed it has a negative impact on investment decision hence not significant. The study hence concluded that herding behavior is not an important factor in influencing investment decisions of SMEs in Bomet County. The study recommended that investors not to imitate others but to trust themselves in making their own personal decisions and also the government to implement more policies which boosts the growth of SMEs and further research to be done other factors influencing investment decisions.

Keywords: Herding behavior, investment decision, SMEs

INTRODUCTION

Accumulations of unproductive counters by market participant against expert analysis, skewed market return are some of the indications of herded counters (Ombai, 2010). Explanations as to why investors herd may include: the fact that market participants may gather information from the actions of previous participants, investors may react to the arrival of fundamental information in a similar manner, investors may simply be irrational and herd behavior can arise because of psychological and social conventions (Spyrou, 2013). Herd behavior occurs mostly during periods of extreme market movements as investors would be more triggered to follow the market consensus (Chen et al, 2010).

According to Abdulahi (2014), investment decisions and returns often depend a lot on the investors’ perceptions routines and cognitive or emotional biases unique to individual. A few of the investment, however, will be gainful and the investors will not always make the right investment decisions over period of years (Muthama, Mbaluka & Kalunda, 2013). The investment decision-maker goes through a decision making process consisting of problem recognition, information search, evaluation of alternative purchase decision and post purchase behaviors (Wamae, 2013).

Small and Medium enterprises (SMEs) contributes huge to the economy of any country that is contribution to Gross Domestic Product (GDP) and creation of job opportunities to citizens (European Commission, 2015). They promote innovation and are able to boost growth in the economy through job creation which in turn leads to the expansion of the taxable income (Ngui, 2014). They cut across all sectors of the Kenyan economy and the government recognizes this as one of the strongest pillar’s to its economic growth (Government of Kenya, 2007). The government has promoted a favorable operating environment for SMEs in both developing
and developed economies because of their huge role in economic development (Andoh & Nunoo, 2011).

According to Ongolo & Awino (2013) SMEs in Bomet county face major challenges attributed to limited access to finance despite the existence of various financial institutions. Ongolo & Awino (2013) attribute these challenges faced by SMEs to the stringent conditions set by financial institutions on the SMEs before they can access financial support. In a study with its focus on factors influencing growth of small scale businesses in Bomet Constituency by Bett (2016) found that small business entrepreneurs face challenges of accessing funds to be put to their enterprises since there are just few facilities to offer the products.

Small and Medium Size Enterprises in Kenya

The SME Sector has continued to play an important role in the economy of this country. The importance of SMEs in Kenya was first recognized in the International Labor Organization report (ILO) in 1972 on ‘Employment, Income and Equity in Kenya’ (ILO, 1972). The report underscored the SMEs as engines for incomes and employment growth. The sector’s contribution to the GDP increased from 13.8 per cent in 1993 to about 40 per cent in 2008. The sector provided approximately 80% of total employment and contributed over 92% of the new jobs created in 2008 (Economic Survey 2009). The SME sector’s contribution to GDP declined from 40% in 2008 to 33% in 2013. Out of the 742,800 jobs created in the year 2013, SMEs created 625,900 of them which constituted 84.3 percent of all new jobs (Economic Survey of 2014).

The revolution of government strategies on SMEs can be traced back after the ILO report of 1972 on Employment, income and equity in Kenya which recognized the sector’s importance in economic development was singled out in Sessional Paper No.1 of 1986, Economic Management for Renewed Growth (Government Of Kenya (GOK), 1986), which set out mechanisms for enhancing an enabling environment for SMEs. The Government’s commitment in Sessional Paper 1 of 1986 was reinforced in the 1989 GOK report, ‘the strategy for small Enterprises, which delineated the mechanisms for removing the constraints to growth and the development of the SME sector.

Despite the SMEs importance in the Kenyan economy, Sessional Paper No. 2 of 2005 indicates that three out of five businesses fail within the first three years of operation (GOK, 2005). The decline in the contribution of SMEs could also be linked to the risks they face. Smit & Watkins (2012) assert that failure of SMEs can be attributed to lack of management skills. Risk management is one of such skills. In addition, the SMEs sector in Kenya being synonymous with poor funding may find it difficult to invest in a robust risk management program and as a result negatively affect their performance.

The research objective of the study is to determine the influence of herding on investment decision of SMEs in Bomet County. The null hypothesis [Ho]: states there is no relationship between herding and investment decision of SMEs in Bomet County.

LITERATURE REVIEW

Theoretical Framework

The theory was developed by Kahnema and Tversky (1970). Heuristics are defined as the rules of thumb, which makes decision making easier, especially in complex and uncertain environments (Ritter, 2003) by reducing the complexity of assessing probabilities and predicting values to simpler judgments. In general, these heuristics are quite useful, particularly when time is limited, but sometimes they lead to biases (Waweru et al., 2008). The decision process by which the investors find things out for themselves, usually by trial and error, lead to the development of rules of thumb. In other words, it refers to rules of thumb which humans use to make decisions in complex, uncertain environments (Ritter, 2003). In reality, the investors decision making process is not strictly rational one. Though the investors have collected the relevant information and objectively evaluated, mental and emotional factors are involved. It is very difficult to separate. Sometimes it may be good, but many times it may result in poorer decision outcomes. Representativeness may result in some biases such as people putting too much weight on recent experience and ignore the average long-term rate (Ritter, 2003). A typical example for this bias is that investors often conclude a company’s high long-term growth rate after some quarters of increasing (Waweru et al. 2008).

Herding behavior

Herding has been given attention by academic researchers because its impact on stock price changes can influence the attributes of risk and return models and thus have an impact on the view point of asset pricing models (Mason & Nelling, 2008). Investors tending to show herd behavior generally have low self-confidence, they consider the signals in the market and benefit from the decisions of professional investors in order to increase professional competences in their investment decisions (Lin, 2011).

Across situations and cultures, psychologists have found that humans employ social comparisons to inform their beliefs and decisions even when it

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contradicts facts or their better judgment (Gounaris & Prout, 2009). People are influenced by their social environment and they often feel pressured to conform. Gounaris & Prout, (2009) argued that humans are deeply social beings and dependent on each other for survival. When they make decisions especially when they feel unsure or threatened, they watch what others do and then copy them. Kimani (2011) on his study found out that herding behavior is among the behavioral factors that affect investment decisions of individual investors at the NSE.

Waweru et al. (2008) proposed that herding can drive stock trading and create the momentum for stock trading. However, the impact of herding can break down when it reaches a certain level because the cost to follow the herd may increase to get the increasing abnormal returns. Waweru et al. (2008) identify stock investment decisions that an investor can be impacted by the others: buying, selling, choice of stock, length of time to hold stock, and volume of stock to trade. He concluded that buying and selling decisions of an investor are significantly impacted by others’ decisions and herding behavior helps investors to have a sense of regret aversion for their decisions.

Ndiege (2012) investigated factors influencing investment decision in equity stocks at the NSE among teachers at the Kisumu municipality. The study adopted a descriptive survey design with a sample of 253 teachers from a target population of 2530 teachers used for the research. Data was collected using questionnaires and subsequently analyzed using factor analysis and descriptive statistics techniques. The results indicated that decisions to invest in equity stocks were influenced by economic and behavioral factors. Among behavioral factors was herd behavior depicted by decision to invest based on popular opinion or shares in high demand based on recommendation from friends and co-workers. Ho3: Herding factors has no significant influence on investment decision among investors in NSE.

METHODOLOGY

Explanatory research design was used in this study. Explanatory research seeks to account for what has happened, or for how things are proceeding, or what something or someone is like (Punch, 2005). This type of research documents causes, tests theories and provides reasons (Neuman, 2007). As Punch (2005) points out, explanatory knowledge is more powerful than descriptive knowledge; however, the descriptive approach is still important, since any explanation requires description first. Population refers to any group of institutions, people or objects that have common characteristics (Ogula, 2005). According to Cooper & Schindler (2014) population in a study is the collection of people or elements onto which a measure is subjected in order to make inferences. The target population of this study was 4196 SMEs registered in Bomet County the year 2018.

Sample size was calculated using the following formulae:

$$n = \frac{N \times [C]^2}{[C]^2 + [N - 1][e]^2}$$

Where:

$n =$ sample size;

$N =$ target population size;

$C =$ coefficient of variation (0.21)

$e =$ standard error (0.02)

Calculating the sample size,

$$n = \frac{4196 \times [0.21]^2}{[0.21]^2 + [4196 - 1][0.02]^2} = \frac{185.0436}{0.0441 + 1.678} = 108$$

A sample 108 was as from the above formulae.

DATA ANALYSIS AND PRESENTATION

Data analysis was carried out in order to inspect, clean, transform and model data with the aim of identifying and highlighting useful information that can be used to support in decision making process (Adre et al, 2008). Before the actual data analysis, data obtained through questionnaire will be validated, edited and then coded (Mugenda & Mugenda, 2003). The returned instruments were scrutinized to determine correctness and accuracy through a sequence of operations which includes editing, coding, classification. The quantitative data obtained was coded and entered into Statistical Packages for Social Sciences (SPSS) and analyzed using descriptive and inferential statistics which involves the use of frequencies and percentages. Data presentation was done using tables.
Multiple regression analysis model was used to test the relation between variables, the analysis of variance (ANOVA) test and chi-square were also applied to check for any significant differences between the means of different groups.

The influence of herding behavior on investment decision of SMEs

The aim of the study was to determine the influence of herding behavior on investment decision of SMEs in Bomet County. Table below shows the results obtained from the study

<table>
<thead>
<tr>
<th>Statement</th>
<th>SA Freq %</th>
<th>A Freq %</th>
<th>N Freq %</th>
<th>R Freq %</th>
<th>D Freq %</th>
<th>σ²</th>
<th>p value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opinions from other professional investors are considered when making investment decision</td>
<td>25(24)</td>
<td>66(62)</td>
<td>6(6)</td>
<td>2(2)</td>
<td>7(6)</td>
<td>2.30</td>
<td>0.084</td>
</tr>
<tr>
<td>The volume of goods bought by others determine the quantity to be bought in the enterprise</td>
<td>12(11)</td>
<td>32(30)</td>
<td>16(15)</td>
<td>8(8)</td>
<td>38(36)</td>
<td>3.17</td>
<td>0.098</td>
</tr>
<tr>
<td>Prices of goods in the enterprise is determine on what others charge in the market</td>
<td>20(19)</td>
<td>38(36)</td>
<td>21(20)</td>
<td>9(8)</td>
<td>18(17)</td>
<td>2.64</td>
<td>0.012</td>
</tr>
<tr>
<td>Group decisions is preferred to protect the enterprise from current status</td>
<td>18(17)</td>
<td>49(46)</td>
<td>15(14)</td>
<td>8(8)</td>
<td>16(15)</td>
<td>2.45</td>
<td>0.032</td>
</tr>
<tr>
<td>Changes in political decision influences herd behavior</td>
<td>24(23)</td>
<td>58(55)</td>
<td>12(11)</td>
<td>2(2)</td>
<td>10(9)</td>
<td>12.32</td>
<td>0.018</td>
</tr>
<tr>
<td>Most enterprises which arise due to influence by others have succeed</td>
<td>13(12)</td>
<td>35(33)</td>
<td>27(26)</td>
<td>12(11)</td>
<td>19(18)</td>
<td>2.79</td>
<td>0.01</td>
</tr>
</tbody>
</table>

The study findings in table 1 suggests that (χ² = 2.300, p ≤ 0.084) opinions from other investors are considered when making investment decision, (χ² = 3.170, p ≤ 0.098) the volume of goods bought by others determine the quantity to be bought in the enterprise, (χ² = 2.64, p ≤ 0.012) prices of goods in the enterprise is determine on what others charge, (χ² = 2.45, p ≤ 0.032) group decisions is preferred to protect the enterprise from current status, (χ² = 12.32, p ≤ 0.018) changes in political decision influences herd behavior and (χ² = 2.79, p ≤ 0.01) most enterprises which arose due to influence by others have succeed. At 95 % level of significance the results are in disagreement with Lin (2011) who found that investors consider the signals in the market and benefit from the decisions of professional investors in order to increase professional competences in their investment decisions but concurs with Gounaris & Prout (2009) who argued that humans are deeply social beings and dependent on each other for survival, when they make decisions especially when they feel unsure or threatened, they watch what others do and then copy them. The findings concurs with Waweru et al (2008) who concluded that market information and fundamentals of underlying stocks impacted highly on investment decisions making at Nairobi Stock exchange.

Hypothesis Testing

Ho1: There is no relationship between herding behavior and investment decision of SMEs in Bomet County. (H01: p> 0.05)

Hypothesis testing was determined using multiple regression analysis. It was found out that herding behavior is an insignificant factor in influencing investment decision of SMEs in Bomet County (β = -0.146, ρ< 0.05) hence the null hypothesis was not rejected. The study concurs with Ndиеge (2012) who found out that herding has no significant influence on investment decision among investors in NSE however differs with findings by Kимani (2011) who found herding factors affect investment decisions of individual investors at the NSE.

SUMMARY OF FINDINGS

The findings on the relationship between herding and investment decisions in SMEs reveal that herding behavior was not a significant factor in investment decision in SMEs. Regression results showed that it had no linear relationship and that it was not important factor in the multiple regression model therefore it should not necessarily be considered by investors in their investment decisions. It was found out that 8.49% strongly agreed, 19.81% agreed, 16.98% gave a neutral opinion, 26.42% strongly
disagreed and 28.31% disagreed that it is to imitate others to be successful in an investment.

Conclusions of the Study

Herding behavior was found in the study to be an insignificant influence in decision making though it disagrees with findings by other researchers, investors of SMEs in Bomet County should trust themselves the most and make decisions basing on their own individual judgments and not that of others. They should be able to set own prices of goods, volume of goods to be bought in the enterprise and not to imitate the other investors.

Recommendations

Investors should make their own decision basing on their interest, capabilities or efforts and not to imitate others because they might not make proper decisions and their enterprise might fail. The government should come up with training programmes that guide potential investors to make proper decision without the influence of others or copying others since herding behavior is insignificant in influencing investment decision.

Recommendations for Further Research

The study only focused on a single population that is SMEs therefore further research should be done to target different population across all geographic locations since people behave different in a given environment and research need to be done on other factors which influence investment decision. The study recommends also a study to be done on the effects of herding behavior on growth on SMEs.

REFERENCES


