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Investigating the Preference to Invest in Real Estate Investment Trusts

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Abstract

Recently, studies on behavioral finance have gained interest among academicians. The study of investors' behavioral perspective is deemed important to understand the decision-making process pertaining to investment. Decision making processes involve factors that influence investor's behavior to invest. Various topics and areas have been discussed to further understand the behavior of investors. However, only a few researches have actually been conducted in the area of behavioral finance resulting in a lack of conclusive findings. Findings gained thus far are insufficient to specifically identify investors' intention to invest in certain investment portfolios. Therefore, the objective of this paper was to identify the factors that influence investor's behavior to invest in Real Estate Investment Trusts (REITs). This paper reviews literatures on factors that influence investors' decision-making process and proposes a model of influencing factors. The findings from this paper would aid and facilitate future research on investors' behavior to invest in REITs. This paper is expected to add to the current literature on behavioral finance of REITs.
Keywords: Preference, Real Estate Investment trusts, REITs, Investment, Behavior.

1.Introduction

Real Estate Investment Trusts (REITs) will be celebrating its 54 years of establishment on September 14, 2014. It was first traded in the United States (US) on September 14, 1960 when President Eisenhower signed the REIT Act Law contained in the Cigar Excise Tax Extension of 1960 (NAREIT, 2010). REITs were created to give all investors the opportunity to invest in large-scale and diversified portfolios of real estate rental income producing investment (Brady, 2013). Currently, more than twenty countries have passed laws to allow REITs to be as one of the investment choices. The United States has the most mature REIT market and as at 2009, its market capitalization was 30 times larger than in 1990. The REITs market in Asian countries such as Malaysia, Singapore, Hong Kong, Thailand, Taiwan and Korea have also experienced rapid growth and have immense potential to be looked into (I-Chun, 2013).

REITs have been a popular and established investment vehicle in United States and Australia (Hamzah and Rozali, 2010). The scenario is quite different in Malaysia. Investors see Malaysia REITs as unfavorable investment (Ong, Teh and Chong, 2011). Here in Malaysia, REITs were not popular

and their public listings had received mild responses from investors (Ooi, Newell and Sing, 2006). This can be seen on the lower market capitalization for Malaysian REITs (Bursa Malaysia, 2014). There is still lack of awareness on REITs among Malaysian and demand is still at a lower point on Malaysian REITs compared to other regions (Suhana et al, 2013).

Currently, Malaysia has a total of 17 REITs with a combined market capitalization of about RM24 billion. The average distribution yields for Malaysian REITs (M-REITs) are moving on a downturn trend from 7.1 percent in 2011 to 6.2 percent in 2012. Similarly, the top four retail M-REITs (by market capitalization) were trading at distribution yields of 5.7 percent in 2011 and reduced to 5 percent in 2012 (Jefry, 2013).

As a comparison, the size of Malaysia's capital market has more than tripled to RM2.5 trillion since 2000, which is 264% of the country's gross domestic product. The local market's outstanding sukuk and debt securities stood at RM1 trillion and the market capitalization for unit trust is RM338.337 billion (Nik, 2013). These figures show that currently investors are more interested in other investment instruments compared to REITs.

In this study the concept of behavioural finance will be explored in order to understand the behavioural preferences of investors. Using the factors discovered in the previous studies, the new conceptual framework will be developed in order to understand the investor's preference towards REITs investment. Behavioural finance focuses on how investor interprets and acts on information in order to make investment decisions. It shows that most of the times investors do not act rationally in their financial decisions and that their behaviours cause them to make different choices about their financial decisions (Madhavi, 2014).

The objective of this conceptual paper was to identify the factors that influence investor's behavior to invest in Real Estate Investment Trusts (REITs). This paper reviews literatures on factors that influence investors' decision making process and proposes a model of influencing factors. The findings from this paper would facilitate future research on investor's behavioral factors to invest in REITs. This paper is expected to add to the current literature on behavioral finance of REITs which are still lacking.

2. Past Research

The study on understanding the behaviour of investors has been gaining interest among academicians. However so far, only few papers explain investors' investment behaviour. Although the relevant literature suggests that there are many factors affecting people's behaviour, the emphasis was to explore the most important psychological biases and personality traits affecting investment behaviour.

This paper reviews some of the significant and reliable concepts in understanding investors' categories, their personal characteristics and trading behaviour. The behavioural characteristics selected are Overconfidence (OV), Risk Tolerance (RT), Self-Monitoring (SM) and Social Influence (SI).

This paper examines whether different psychological characteristics lead to differences in investment behaviour. The proposed conceptual framework will help investors to understand how their personal traits affect their investment decisions.

2.1. Overconfidence

One of the attribute for attitude is investor's overconfidence. Investors' overconfidence plays an important role in the determination of the overall investor's behavior (Nadeem et al, 2014). The attitude of being overconfidence causes investors to be very confident with their decision and tend not to accept others' opinion (Dimitrios, Zeljko and Prodromos, 2011). Most of the time these overconfident investors always did not react to any new information and they also had unrealistic goals on how much their returns will be (Barber and Odean, 2000).

Chen et al. (2004) evaluated major brokerage accounts in China and found that individual investors demonstrated overconfidence. Some studies have found no difference in overconfidence between men and women (Deaves et al., 2003; Biais et al., 2005). Though men normally will do more trading than women, their performance is lower than women (Shu et al, 2004).

Overconfidence can also lead to higher trading frequency and volume. Deaves et al. (2003), and Grinblatt and Keloharju (2009) found that overconfidence causes additional trading frequency. One of the research found that the higher the degree of overconfidence; the higher the trading volume (Glaser and Weber, 2007). Research has also shown that overconfidence leads not only to increased trading activity but also to increased probabilities of taking wrong decisions (e.g. buying the wrong stocks).

Philip (2007) have analysed that overconfidence has a negative impact on trading performance. The subsequent feeling of compliance is shown to boost individual confidence regardless of the actual conformity of decisions (Ross et all, 1977). This abnormality normally arises under economic conditions (Engelmann and Strobel, 2012).

Overconfidence is regarded as a social bias. A simple real effort task was given to an individual and the result show that economic conditions effectively prevent overconfidence. The introduction of a very basic, purely observational social setting fostering overconfident self-assessments showed that observing others' actions effectively eliminates under-confidence compared to individual setting (Till and Lukas, 2014).

Individuals who have a very high level of confidence along with a low level of intelligence are likely to be extremely overconfident when comparing the perception of ability to their actual ability in carrying out tasks. This type of overconfidence is referred to as false confidence (Swarn, 2014).

2.2. Risk Tolerance

Financial risk tolerance is defined as the maximum amount of uncertainty that someone is willing to accept when making a financial decision, reaches into almost every part of economic and social life (Grable, 2000).
Demographics influence risk tolerance behaviour. Recent study by Jorge et al (2014) found that respondents from the Turkish sample were more likely to be categorized inconsistently from the American sample. The consistency across measures could be the result of contextual factors for each country.

Hira et al. (2007) found that higher age decreases risk tolerance, while higher income increases risk tolerance. People with high incomes also found to have higher risk tolerance than people with lower incomes and men are also found to have more risk tolerant compared to women (Grable et al., 2004). The highest risk tolerance experienced by single males, married males experienced high risk tolerance, the moderate risk tolerance experienced by unmarried females and the lowest risk tolerance was married females (Yao and Hanna, 2005).

Keller and Siergist (2006) argued that financial risk tolerance is a significant positive predictor of willingness to invest in stocks. They have found that highly risk-tolerant investors have high-value portfolios and they trade securities frequently (Keller and Siergist, 2006). There are quite number of research studies have found that people who are risk tolerant trade more often than less risk-tolerant people (Clark-Murphy and Soutar, 2004; Wood and Zaichkowsky, 2004; Durand et al., 2008).

Investors are risk aversion when they were making profit and will be risk seeking when they lost their money in the investment (Fenghua, Zhifang and Xiaohong, 2014)

2.3. Self Monitoring

Self-monitoring is a personality trait, a sort of social intelligence. It is a disposition to attend to social cues and to adjust one's behaviour to one's social environment (Biais et al., 2005). It is the expressive behaviour in different situations and the ability to control and modify this behaviour (Snyder, 1974). Those people who have high self-monitoring have greater social sensitivity than people low on self-monitoring (Snyder, 1987). Individuals with high self monitoring are able to be present at public gathering and very responsive to their surrounding (Snyder and Gangestad, 1986). Those individual with low on self-monitoring are not able to control their expression. Therefore, most of the time their express behaviour did not show how is their own feelings and thoughts.

High self-monitoring can influences investors' trading behaviour. Normally, highly self-monitored people did not underestimate other investor's actions and this finding is correlated with their information thus the self-monitored investor's should avoid the winner's curse (Eyster and Rabin, 2005). Biais et al. (2005) have found that investors with high self monitoring are unlikely to fall into winner's curse traps and behave strategically, achieving high stock returns. Alemanni and Franzosi (2006) also found that self-monitoring increases trading frequency.

Investors also wanted to have latest information without relying to their stock brokers or remisiers and the need for self monitoring was crucial because of speed purposes. Senanu and Daniel (2014) have introduced P-Stock, an application for monitoring stock market investment which not only gave the real-time information regarding their investment but also the firsthand information.

2.4. Social Influence

Social influence is a concept that explains behavioural dispositions. Social influence has found to give an impact on investors' trading behaviour. Individual investors normally have done the discussion with their family members, neighbours, colleagues and friends and they are normally being influenced by these people to make decision on their investment (Nofsinger, 2005). Sometimes investors in financial markets imitate each other and this phenomenon is called herding (Hirshleifer and Teoh, 2003).

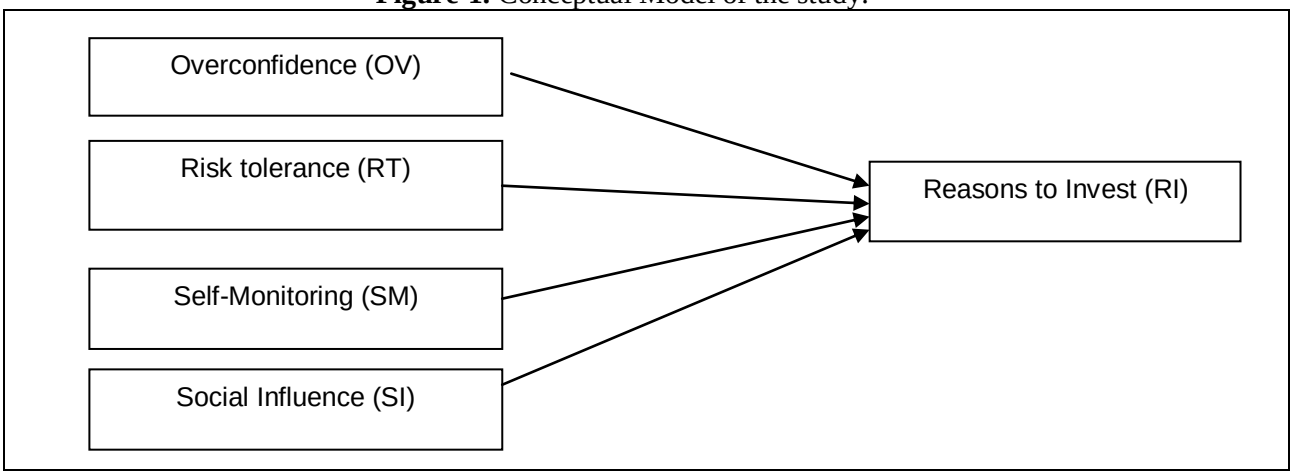
The participation of households in the stock market and they have concluded that social households are 4 percent more likely to invest in the stock market than non social households (Hong et al, 2004). Individuals normally form their opinions by interacting with others and it is normal if the investors' decisions are affected by the recommendations made by friends and/or analysts (De Marzo et al, 2003).

3. Conceptual Framework

The study concerning the behavioral of the person has gained interest among academician as is the time to know the needs of the consumer before any new products being introduced to the market. The introduction of new investment instrument in any country play important role to enhance the economic growth of the country. However, if the new product introduce did not received good response from the investors, it defeats the purpose of its introduction. It is not easy to develop new investment product as it requires time and money invested by the key personnel of any investment company.

Based on the behavioral finance factors discussed and discovered in section 2.0, the conceptual model to understand the behavioural preferences of investors was developed. By applying this model, it is hope that half of the work is worth it and the company can attract the public to invest in REITs. Therefore, the conceptual model for this study can be seen in the diagram below:

Figure-1. Conceptual Model of the study:



4.Conclusion

It is not easy to understand the behavior of an investor. Behavior is able to control any person whether to do or not to do anything. This study illustrates how investors react based on their behavior at any one time. Understanding the investor's behavior is crucial for any REITs market player and it is needed to be able to react accordingly.

The huge potential in the domestic property sector through the initiation of the Government's Economic Transformation Plan (ETP) which targets the domestic property sector to increase in the medium to long-term range, provides the stimulus for this research to be conducted in the future.

Besides these behavioral factors, there are other factors that may attract the investors to choose an investment. It is suggested that in the future, the researcher also test factors such as return potential, liquidity, flexibility, transparency and affordability to further understand the behavior of the investors (Rajkumar and Venkatramaraju, 2013).

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