Convergence of Behavioural Finance with the Real Estate Sector : An Integrative Research Framework

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ABSTRACT

Behavioural financestudies human psychology and how they behave and react while taking investment decisions.This field is the integration of psychology,economics, and sociology.It is impossible to predict the human mind, when it will react and how it will react. From its origin, Behavioural Finance established that neither markets are efficient nor investors are rational. Investors' psychology and behaviours are not objective; they are subjective and hence vary from area to area, region to region, and country to country. Not only in terms of geography, butinvestment avenues also influence this. This paper aims to give an integrative research framework of behavioural investing with the most hyped sector of the Indian economy,i.e.,the real estate sector. Further, this study establishes a link between investment decisions and the type of investors.

Keywords : Behavioural Finance, Real Estate, Investor's Behaviour, Investment Decision.

Introduction

Behavioural finance attempts to explain the what, why, and how of finance and investing from a human perspective (V Ricciardi et al., 2002). Sulphey(2014), in his book behavioural finance, writes about behavioural finance as a study of how investors make common errors in financial decision-making due to their emotions. This discipline emerged due to certain inherent flaws in traditional finance theory. It explains why markets and investors do not behave rationally as they are expected to behave. Behavioural finance integrates psychology, Sociology, and traditional finance also termed standard finance. Behavioural finance has made essential contributions to investing by focusing on the cognitive and emotional aspects of the investment decision-making process. (Statman, 2008) The uniqueness of behavioural finance is its integration and foundation of many different schools of thought and fields.

Human Behaviour, judgement, and decisions are the exploration result of human psychology. Hence, they differ from person to person. There may exist a variance between individual investor behaviour and market behaviour. In a broad sense, behavioural finance is branched into macro and Micro behavioural finance (Pompian,2006). Macro behavioural finance discloses and describes anomalies of standard finance models that models of people's behaviour could explain. Micro behavioural finance analyses the behaviour and deviations of individual investors. This study is concerned withthe theme of micro-behavioural finance.

The Conceptual Framework : Real Estate Investment

One of the industries with the highest level of recognition on a worldwide scale is real estate. Housing, retail, hotel, and business are the four sub-sectors included in this industry. The rise of this sector is nicely supported by the increase in the business environment and the need for commercial space along with urban and semi-urban accommodations. Both of these factors contribute to the expansion of the real estate market. When looking at the direct, indirect, and induced impacts across all areas of the economy, the construction industry comes in at number three out of the 14 main economic sectors.After the agricultural industry, India's real estate industry is the sector that generates the second-most jobs in the country. Additionally, it is anticipated that this industry would attract greater investment from non-resident Indians (NRIs) in the short and long term.

A Real Estate Investment Trust, more often abbreviated to REIT, is a corporation that owns, manages, and finances income-producing real estate. In the same way, mutual funds own a portfolio of stocks, and real estate investment trusts (REITs) maintain and run a portfolio of commercial properties that generate rent. REITs are a relatively novel idea that made its debut in the Indian market in 2019, with Embassy Park REIT being the first to be publicly traded in the nation.There are four fundamental types of real estate investment trusts: Publicly traded equity (indirect ownership through claims), Private equity (direct ownership), Publicly traded debt (securitised mortgages), and Private debt (direct mortgage). Investment in real estate is much preferred overother options because of location, lease structures, price appreciation, tax benefits, and Source of current income. However, it is more complicated than the other investing options.

Review of Literature

In the Indian context, Some Demographic inputs like age, income, marital status, and educational qualifications were related to factors affecting investment decisions (Saloni Raheja, 2018; Priyanka Jain, 2019). While in the western context, Qiujun Lan et al., 2018 stated that Demographic factors are closely related to decision behaviour, and even without sufficient data on behavioural characteristics, the prediction model can be built based on demographic variables. Further (Mark KY Mak1 & WH Ip, 2017) studied differences in financial investment behaviour between Mainland Chinese and Hong Kong investors. Their behaviour can be predicted based on psychological, sociological, and demographic factors. While Metawa et al. 2018, established thatinvestment decision is positively influenced by age, gender, and level of education.

In contrast, experience does not affect the investment decision significantly. Kritika Batra &Vibhas Kumar, 2018studied two internal and external factorsabout the individual investor to measure the level of financial satisfaction. Internal factors consist of Overconfidence, Loss aversion, regret aversion, mental accounting, Illusion of control, hindsight, status quo, self-control, availability, representativeness, and conservatism ; and External /contextual factors'; family members, peers, friends, advisors' recommendations, the possibility of quick returns, tax benefits/ rebate, etc. can explain 'financial satisfaction' only up to 13%.For more exploration, traditional factors like risk, return, investment amount, etc., must be explored to form a portrait of the individual investor. A psychometric analysis was conducted by Richa Pandey &V. Mary Jessica (2018) toinvestigate the behavioural biases influencing the real estate market in India and found that the real estate market is neither rational nor irrational, but something in between.

The heuristic model is a better predictor than the prospect model to examine the influences of behavioural constructs on real estate agents' investment decisions. Among Heuristics, gambling and availabilityare the strongest positive predictors, while in the prospect model, loss and regret aversion are significantly most robust. (Syed Zain-ul-Abdin et al., 2019)Branigan &Brugha, 2013,examined the presence of framing effects, escalation of commitment, and over confidence in the behaviour of residential property purchasers when choosing an alternative property and derived that decision tool improves the decision-making capabilities. The real estate market is highly uncertain as overconfidence, collective irrationality, emotions, blindness, conformity, and herding influence real estate investors.(Qi Ruoxi, 2019) while Anu Antony & Ansted Type Joseph, 2017 stated that overconfidence bias and regret aversion have more effect, Herd behaviour has less impact on decision-making. Diego Salzman Hult& Remco C.J. Zwinkels (2017)have givenan Overview of the current state of affairs of the main themes in which the behavioural approach intersects with real estate.

Objectives

This paper intends to analyse behavioural finance theory and uncover property constraints for behavioural research to build a model depicting the convergence of real estate and behavioural finance. The evidence that the property market is inefficient implies that property investors do not always act rationally but are persuaded by emotions. Hence, behavioural finance theories have a significant contribution in terms of analysing property investments.The following are the objectives required for this study:

1. To illuminate the interdisciplinary domain of behavioural finance with Real Estate investment and to contribute to the works of literature on the Dimensions of Investment decisions.
2. To establish a link between investment decisions and investor personality.
3. To propose a new conceptual framework to explain further the behavioural finance domainconcerning Real estate investment.

Research Methodology

The present study is a theoretical reflection established on existing practices of the above-specified topic, which unify existing and comprehensive literature in the exploration and investigation of the gaps and problems associated with the case with the help of specific objectives. It provides a conceptual framework for the study, builds the appearance of the research problem, identifies research gaps that further contribute to future new challenges to the accumulated knowledge, and substantiates the approaches or methods pre-owned in the study. The study conducted is combined of secondary facts. The author cautiously studied the existing secondary sources according to their objectives. The sources were collected from books, journals, and blogs and were interpreted accordingly to make the study applicable to the readers.

Findings and Discussion

Investor: Institutional and Retail

Investors are persons or organizations that invest their savings in various financial and non-financial avenues to achieve an optimum return on the funds invested. Based on fund size, risk appetite, and professional knowledge, investors are classified mainly into institutional and Retail investors. The investment goal of both categories is the same, but there is a difference in the path. Institutional investors invest on behalf of their clients and members. They are a group of specialists forming an institution, like pension funds, insurance companies, mutual funds, etc.

Individual investors could not perform well because of a lack of information since informed traders take out their limit orders. **(Linnainmaa, 2010)** Individual investors generally could not perform as better as institutional because the former suffered from economic myopia. In an emerging economy financial market is driven by the institutional investor. However, retail and institutional investors are likely to be affected by psychological biases **(Fisher & Statman, 2002; Shiller, 2015; and Nofsinger, 2014).**

Types of Investors: As a Function of Behaviour

Cognitive capacity and emotional characteristics are the fundamental elements of human beings in determining a person's actions. Behaviour is what always distinguishes one person from another. The development of behavioural finance showed that if something is standardised, there should be equal peaks and troughs, in contrast to standard finance, which suggests that investors are entirely rational. Instead, investors look at market sentiments to predict the value of their investments before actually making them. Investors are categorised as follows, tailored to their individual behavioural and psychological characteristics. Risk and return on investment are interdependent. How much return one can anticipate on investment is proportionately counterpart to investors' risk appetite and tolerance level. Risk appetite is fixing a standard level of risk that one is accepted to take, whereas risk tolerance redirects an acceptable level of deviation from the standard. Active and passive are two types of investors as categorised based on investors' risk tolerance level.

Investors with low to moderate risk appetite are categorised under the umbrella term Passive investor; moderate to high are referred to collectively as Active Investors.

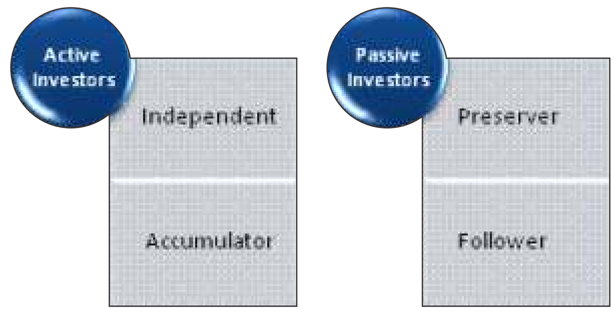

Fig 2 : Classification of Investors
Source: MichelPompian, 2006

Michel pompian, in his behavioural model, gives four categories of investors under two main heads;

Preserver; Low-risk tolerance, affected by emotional bias.

Follower; Low to moderate risk tolerance, influenced by cognitive bias.

Accumulator; High-risk tolerance, affected by emotional bias.

Independent; Moderate to High-risk tolerance, influenced by cognitive bias.

Investment Decisions

Investment decisions generally seem to be objective; rather, they are subjective. They vary from person to person in terms of cost, knowledge,

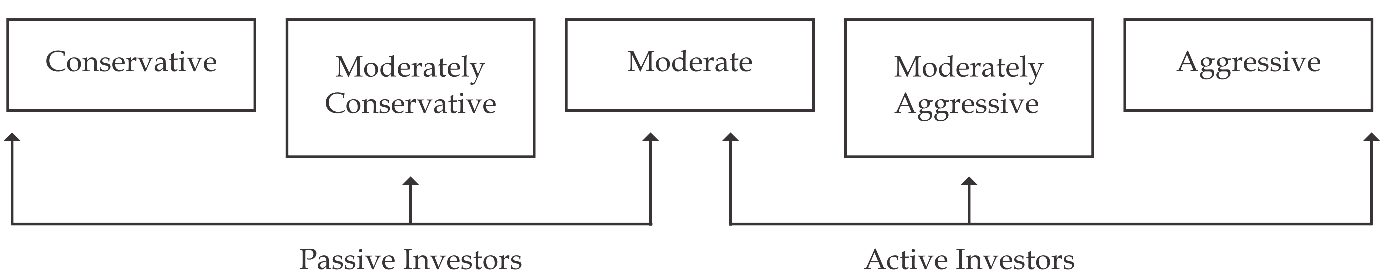

Fig:1 Investors Risk- Profiling based on Risk tolerance level and risk perception. Investment decisions should be made only after evaluating every possible opportunity. A wrong decision can make you bankrupt. Behavioural factors largely influence investment decisions irrespective of the type of investor. Individual investor's decisions are influenced by herding (Lee et al., 2010; Mayoral & Santos, 2011; Lim, 2012; Bakar & Yi, 2016; Keswani, Dhingra, and Wadhwa, 2019), and institutional investors are also influenced by herding bias (Wylie, 2005; Toshino, 2005; Waweru, Munyoki, and uliyana, 2008; Areiqatet al., 2019).However, Individual investors are influenced to a great extent in comparison to institutional investors. Here Decision implies quality decision. Quality investment decisions are one of the crucial factors; quality means the best decisions in the contextof a particular investment (Jacoby et al., 1974). According to Lorenz and Lutzkendorf,2011in the real estate sector, Quality investment decision means, Investors are allocating capital to the most strategically important projects.A good quality decision helps to boost earnings and progressively increase the value of the investment. (Nguyen, 2018).Various parameters influence investment decisions in real estate sectors, and standards of these parameters vary from person to person, area to area, and region to region. Real estate investments are subject to high risk (Demong& Lu, 2012).

Simon's Decision theoryplays an important role while taking an investment decision. It is considered one of the best quantitative methods to reach an optimal decision among the various alternative options. Simon has stated four phases for this; Intelligence, choice, design, and implementation.

Approaches of Decision Making

Decision-making is the product of certain-variables; understanding the situation, deve-loping a responsive environment, enume- rating the alternatives, and selecting optimal alter-natives. Reflexive and Reflective are two approaches borrowed from the psychology domain, used in the behaviourism and behavioural finance world.

Reflective approach advocates 'learning through and from experience towards gaining new insights of self and practice' (Finlay, 2008). This approach is assumed to be logical and methodical, requiring a cognition ability. Investors following this approach gain command over the market anomalies. Being reflective develops confidence as gradual decision-making moves towards optimal. However, biases and anomalies cannot be offset fully.The reflexive approach advocates that one should take an instant decision depending on prior information and inherent beliefs. Here investors do not make decisions based on the present phenomenon; rather, they follow their perception and gut feeling. The reflexive approach creates a space for behavioural anomalies likeself-deception biases and heuristics; behavioural finance is an in-depth study of these patterns and creates a crucial place among investors and investment managers. To mitigate against automatic decision-making, it is vital to set up processes. Consider setting up processes that guide you through a logical decision-making approach and help reduce reflexive decision-making.

Reflection has the potential to bring new insights regarding things that were not seen at the time, possibly revealing when a particular detail was overlooked. Challenging our attitudes, cognitive processes, beliefs, assumptions, biases, and habitual behaviours is an important part of practising reflexivity. This helps us work toward a better understanding of the complicated roles we play in connection to other people. An individual may reflect by engaging in an in-depth analysis, either alone or with the assistance of others, of events or circumstances that are external to themselves. The reflector makes an effort to determine what took place, how they experienced it, how they consider it, why it occurred, who was involved, and what other people may have experienced, thought, and felt about it. It involves looking at entire settings from as many different perspectives as possible, such as individuals, relationships, circumstances, places, times, chronology, causation, linkages, and so on, to better understand people and the situations they find themselves in. This may be done by reflecting on the incident or even reliving it to bring it back into focus. Unimportant things may turn out to be crucial, yet it is also possible that supposedly important elements will not matter at all.

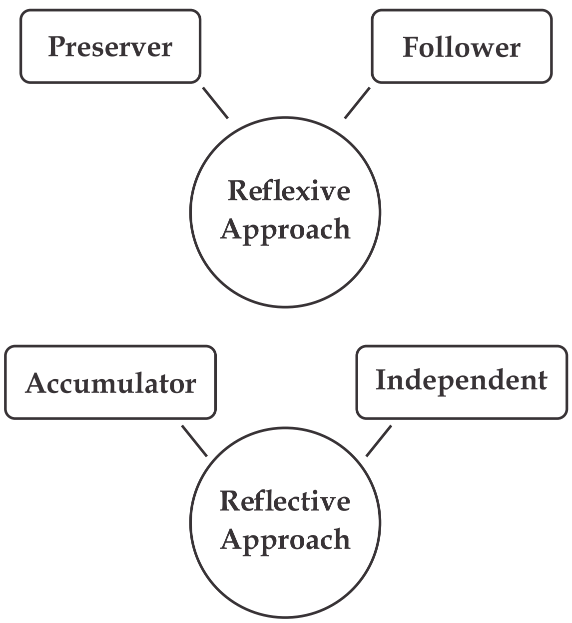

Fig: 3 Decision approach followed by investors

Active investors follow the reflective approach of investment decision-making as they are well-informed about market information, trends, reactions, and anomalies. In contrast, passive investors generallyfollow the reflexive approach to investment decision-making.

Dimensions of Investment Decision

Past Investment decisions act as a roadmap for the future of the invested. Due to the multifaceted nature of investment choices, it is up to the individual investor to choose which factor is most influential at any given time. The investment will be successful if it generates a higher return than the market average. In order to accomplish this goal, one must consider the many facets of making financial selections.

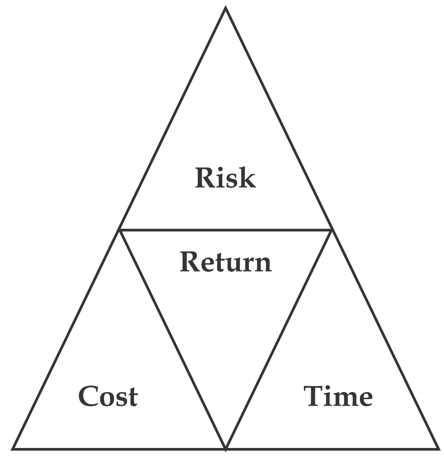

Fig:4. Four dimensions of Investment decision

Risk and return these two are the soul of an investment. The extent of the risk-bearing capacity of the investors highly influences investment decisions. Risk appetite plays a pivotal role in portfolio determination. Risk appetite categorizes investors into three main categories: Risk seeker, Risk neutral, and Risk averse. Risk-averse investors seek low-risk assets and are ready to accept alower return to safeguard their capital. They prefer investments with a sure return and having minimum or almost no ups and downs.

In contrast, a risk seeker takes a risk as a challenge and is always willing to take it to get a higher return. Risk and return are two ends of the same rope; the length of one depends on the others. Hence, investors should understand their risk appetite and measure it before making investment decisions. Another two important dimensions are Cost, i.e., the quantity of the investment, and Time. How much capital do investors want to invest, and for how long? This question also needs to be clarified, as long-term investments lack liquidity but have a better return and less risk. Short-term investments have liquidity and fewer funds needed but can save you on risk or return. If there is a higher return, risk will also be higher as these two moves in the same direction. These four, risk, return, capital, and time are interdependent.

Conclusion

Most of India's ultra-wealthy would rather invest in real estate and gold than stocks and bonds.(Iyyer, 2016 b) High-net-worth individuals would be better off putting their money into real estate or gold than the stock market. Non-financial assets are based on actual net value rather than the ephemeral nature of the stock market, making large-scale investments in the stock market risk. According to a housing.com and NAREDCO (National Real Estate Development Council) study, 35% of respondents chose real estate as their top investment option, 28% chose gold, 22% fixed deposits, and equity products were preferred 16%. A random sample poll of over 3000 potential clients was carried out in April and May, just when the COVID issue was at its peak. (Outlook India, 2020)

After doing a thorough literature search on behavioural finance and investing behaviour, it has become clear that much research has been undertaken to investigate the many facets of this fascinating field. Many researchers have also examined the role of human psychology in the financial markets. The behavioural approach to real estate investing and financing integrates theories and concepts from psychology and sociology. A comparatively little behavioural study has been conducted on the real estate market, in contrast to the stock market (Kishore, 2006). Real estate experts must center on the regional market (Das & Sharma, 2013). They also highlighted the need for a local network and skilled instruction in real estate. In addition, India lags significantly in both areas. Most published work on Indian real estate may be seen as a reductive remark on prospects.

Consequently, the inevitable results of this research reveal theoretical benefaction in terms of scientific review able to assess the hidden mediating factors heuristic, anchoring, availability, market information, and risk appetite are how strongly and directly affect the real estate market. Countable and very limited researchhas been conducted in the domain of the real estate sector in the Indian context. It is evident from the western literature exploration that Real estate investors' psychology, investment pattern, and behavioural biases are much differentfromthoseof stock market investors. Hence a scientific, integrative, comprehensive study should be conducted based on this theoretical structure.

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