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Planning Activities in Malaysia : An Empirical Study on Middle Income and Professional Group

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ABSTRACT

This study focuses on the factors that are likely to affect Malaysian investors decision on the choices of their investment vehicle. It also attempts to understand why portfolio preference differs between individuals. A questionnaire measuring three different dimensions was developed. It was also used as the primary data in this paper. A representative sample of investors from the Malaysian market was analyzed. Basic statistical descriptive analysis were employed in analyzing the data. In the process of reviewing the literature, this study had proposed an analytical framework which integrated three different dimensions that affected the investors portfolio preferences. The three dimensions are the demographic factors, risk profile and money profile. The findings had indicated that all three dimensions had an effect on the sample representative's portfolio preferences. However, the degree of which they were affecting the sample was not determine because it is beyond the scope of this paper.

Keywords: Psychological aspects, investors, behavior, risk assessment, portfolio management, behavioral finance, money personality, investor psychology, investor profiling.

APPROVAL PAGE

I certify that I have supervised/read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a project paper for the degree of Master of Business Administration.

....
Dr. Syed Musa Al-Habshi
Supervisor

Date :

DECLARATION PAGE

I hereby declare that this project paper is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

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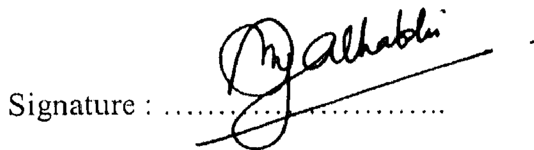
Signature : ....



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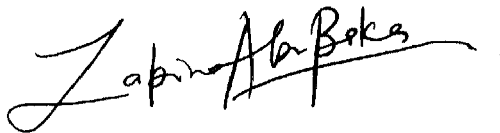

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CHAPTER ONE : OVERVIEW

1.1 Introduction

Jason Swig, the author of 'Will You Be Brave or Will You Cave'? wrote on January 1997 in MONEY,

> *"If I could give you only one piece of financial advice, it would be this: Spend less time studying your investment and more time studying yourself. This is because how much money you make in an investment often depends far more on how you behave than how the investment does"*

The above statement can be disturbing to some of us, as it can raise questions in our mind. Why should a person take time to study himself? What effect does it has on his investments? What does investing has to do with behavior? Is there any real and distinct correlation between an investor's behavior and the return on his investments?

In 1982, Dr.James Gottfurcht, a Los Angeles based consultant, speaker and clinical psychologist, developed the 'Psychology of Money Profile' to help assess his clients' strengths and weaknesses on money skills that can be associated with financial success and peace of mind.

His work is derived from a discipline called behavioral finance. In this field, one of the areas that are gaining attention and interest from researchers is called 'Psychological Money Skills'.

Psychological money skills are learned behavior that are psychological in nature and are associated with critical financial success factors such as realistic expectations and receptiveness to change. It was found that to be financially successful, people need to have relatively realistic expectations and also to maintain some degree of receptiveness to change. (Carol L Nowka, 2000, pg100)

To have a better understanding on this subject, lets ask ourselves some basic questions on investors' behaviors. Why do people trade, or invest? Is it because they believe in the saying 'making your money work for you'? Or perhaps the temptation of earning and making more money than their peers? Are the thrills received from risk taking the main drive for some investors? Is it simply because they do not want to be left out from the current investing trend?

According to an anonymous writer, people trade for both cognitive and emotional reasons. Thinking that they have all the information is one of them. They may also trade because others do it, or because they want to have fun, they trade because they do not know what to do with their money and they may even trade because they want to be seen as knowledgeable.

By knowing the reasons why people trade, another question emerges. What emotional issues or personality traits that is coloring a client's financial and investment choices? Financial advisors often run up against client's behaviors that obstruct the client's financial success (Carol L Nowka, 2000,pg100). Why does this person react negatively to good news and vice versa? The prices of stocks that come plumming down can be seen as good news by some investors. While some just panicked when the bear run starts. Why is that? Why some people has enough willpower to save while others just spend all of their income with nothing left to save?

What about the issue of risk tolerance? Each investor has their own perception and tolerances towards risk. Some investors can accept losing their investment over the possibility of higher returns while others prefer to see that their money safe in the bank without risking it. This is evidence in the risk profile

analysis. Different tolerances towards risk lead to investors having to choose different type of portfolio in their investments.

Another factor that could influence the portfolio an investor choose is his demographic factors such as age, sex, income group, education received, occupation, wealth and dependants.

Investors may choose to invest their money according to advises received from friends, their own knowledge, from experience or actually obtain the help of financial planners. Financial Planners[1] are those who help people to determine their financial goal objectives and to actually achieve them through proper management of financial resources (FPAM, 2001).

This paper explores the factors effecting investors decision on their choice of investment vehicle by understanding their money profile, risk profile, together with their demographic factors.

Let us now explore this new and exciting area together!

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[1] Financial Planner's Code of Ethics and Professional Responsibility guides the personal financial planning process. To enable planners to understand their clients as accurately as possibly, they have been practising various methods.

1.2 The Objectives of the Study

1 - To be able to have a general understanding of investors' behaviors and their reactions to changes in the market based on their personality traits

2 - To provide an insight of profile of investors in Malaysia according to their money personality traits, risk tolerances and demographic factors.

3 - To provide the financial planning industry with information that can be of a useful tool to them.

4 - To re-emphasize the importance of managing human behavior in investment activities.

5 - To identify any significant differences in demographic factors effecting risk profile.

6 - To identify any significant differences in demographic factors effecting money profile.

7 – To identify any significant differences in money profile effecting risk profile.

8 - To identify the relationship between investors' preferences according to the industry they are in.

1.3 The Rationale of the Study

Financial Planning, although is very new to Malaysia, has been in the United States for over 20 years. Singapore has embraced this practice for almost 6(six) years now. Since financial planning is at its infant stage in Malaysia, both planners and public need to be educated on the importance of financial planning in achieving their various financial goals, be it short term or long term.

The economic crisis in 1997 has shaken many Malaysian investors. Almost every type of investment vehicles were being hit. For the low risk - low return investments such as fixed deposit and savings accounts, the rate has dropped from 8% to 3.45% and 3% to 1.25% per year respectively. For the high risk-high return market such as equity, commodity and currency trading, the effect has been worse. Many Malaysian investors found that they do not have the understanding on the risks they are actually taking when they decided to take part in the high-risk investment vehicles. They do not even know their risk profiles. It is not just until recently, Malaysian investors began to understand the importance of using risk profile analysis before deciding on their portfolio.

Beside risk profile, the personality of the investors will definitely affect his investment choices. This has been proven in United States. Researchers found that there is a paradox in financial planning profession. Besides focusing on the clear-cut area such as numbers, technical and analytical side, planners seems to be facing issues that come in shades which is the area that have been neglected by the investors. It is called the 'human side' of the investment (Mell Mc Donnell, 2000, pg 56). How people reacts towards certain news, or why some people can ignore bad news while others jump up and down, why there are different behaviors in the event of crisis, why some investors can make money during bear run[2], etc.

This study will attempt to identify the differences of choices made by investors in Malaysia by analyzing their risk profile, money profile and demographic factors through empirical study. This will help financial planners to understand their clients more and at the same time understand how to manage their clients' attitudes especially when their investment returns did not perform as expected.

[2] A prolonged period of falling prices, usually by 20% or more, accompanied by widespread pessimism. Opposite of Bull Run.

1.4 Limitations of the Study

1- Unable to determine whether parents money behavior had either direct or indirect affect on investors money behavior.

2- Unable to study on the effect of method of upbringing on investors money behavior.

3- There is a factor of time constraint that allows the period of only 5 months to complete this research.

4- The cost conducting this research is also a limitation by itself. It has restricted the number of questionnaires being distributed.

5- The statistical tools used in this paper are restricted only to SPSS software and Microsoft Excel software.

CHAPTER TWO : REVIEW OF PERSONAL FINANCING LITERATURE

2.1 Literature Review

Behavior finance [3] has been a hot topic in the investment world particularly in the United States. Because finance spreads its wings over so many different aspects of the investment world, it is simply impossible to ignore. According to the finance dictionary, "behavior finance is the study of how humans interpret and act on information to make informed investment decisions. Its findings suggest that investors do not always behave in a rational, predictable and unbiased manner indicated by the quantitative models. In fact, investors make mistake."

There have been numerous examples proving irrational behaviors and repeated errors in judgment that have been documented. Amos Tversky [4], known as the forefather of the field of behavior finance, together with Daniel Kahnemanm

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[3] Used to describe the human condition as it pertains to investing. It is a study of how mere mortals interpret and act on information. Behavioral Science is a social science.

[4] Originally studied "cognitive illusions", which are biasing characteristics of human judgment. His later work included books on uncertainty, conflict resolution and statistical reasoning.

found out that contrary to the expected utility theory [5]people placed different weights on gains and losses and on different ranges of probability.

For an example, individuals are much more distressed by prospective losses than they are happy by equivalent gains. And a loss of a dollar is twice as painful than the pleasure received from a dollar gain.

Among theories available under behavior finance are junior high syndrome theory, touchy-feely syndrome theory, overconfidence syndrome theory, follow-the-crowd syndrome theory and psycholgraphics theory. To ensure that the objectivity of this paper is achieved, the psycholgraphics theory is most appropriate theory to be used.

Since this paper studies about the people's behaviors, characters and their investment choices, psycholgraphics theory perfectly complement the objective of this paper.

This theory describes the psychological characteristics of people and is particularly relevant to each individual investor's strategy and risk tolerance. An investor's background and past experiences can play a significant role in the decisions an individual makes during the investment process. For an

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[5] Within the expected-utility framework, the only explanation for risk aversion is that the utility function for wealth is concave. A person has a lower marginal utility for additional wealth when she is wealthy than when she is poor.

example, women tend to be more risk averse than men or accountants are usually risk averse.

Among models that are derived from the psycholgraphics theory are John Scott's Mind Over Money Model, Barnwell Two-Way Model, Bailard Biehl and Kaiser Five-Way Model (BB&K), The Nine Money Personalities Model, Psychonomic Investor Profile Model and Myers Britt Investor Test (MBIT) Model (Jonathan Myers[6], 2000)

All these models basically do the same thing, which is profiling and typographing the individuals by identifying their deficiencies in investment style and behavior. For an example in John Scott's model (Myers, Jonathan) he classifies investors, as 'I can't stop worrying investor, The Power Investor, The Inheritor, The Impulsive Investor, The Gambler, The Make Me Safe Investor and The Confident Investor'. The limitations of this model is that it greatly oversimplifies the different investor behaviors and has a problem of their meaning being similar to other models as well.

[6] Jonathan Myers lives in New York, is a member of the British Psychological Society and an independent investor. He advocates an approach to investing that relies heavily on his expertise in psychology.

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In 1987, Marilyn MacGruder Barnwell created a two-way model that classifies investors either 'passive' or 'active'. Passive investors are people who become wealthy passively - i.e. by inheriting wealth, by a professional career, by risking the money of others rather than their own, corporate executives, professional working in companies (lawyers, accountants) and non-surgical doctors. These people may not have high financial resources at the early stage of their careers; therefore, they are more careful with their money. It is important to them that they hang on to their money. Therefore, they are usually risk averse investors.

'Active' investors on the other hand are the ones to more likely to take risk in investing because their previous experiences of taking risks had resulted in their current wealth creation.

They usually need to feel in control of their investments. 'Active' investors include small business owners who develop their business instead of inheriting it, medical surgeons, and independent professional such as lawyers that work in their own firms, entrepreneurs and self-employed consultants.

Bailard Biehl and Kaiser Five Way Model approach on the other hand stresses the level of confidence an investor has and their preferred method of responding.

Level of confidence is reflected in the emotional choices made based on how much the investor would worry about a certain course of action or decision. This ranges from confident to anxious. Method of responding is reflected in how methodical an investor is, as well as how analytical and intuitive they are. This ranges from careful to impetuous. The five personalities are Adventurers, Celebrities, Individualists, Guardians and Straight Arrows (Myers, Jonathan)

Kathleen Gurney wrote in the Best's Review on August 1989, that, a person's attitude towards money and investments is governed by such personality traits as need for power, trust, self-determination, pride and anxiety. Investors according to Ms. Gurney fall into nine 'money styles'. These are the distinct personalities developed from her research concerning why people earn, spend, save and invest the way they do. They are Entrepreneurs- who put career over money, Hunters-who need financial advice, High Rollers-who get a thrill when risking their money, Safety Players-who want to avoid taking control of their money, Achievers-who want control over their investments, Perfectionists-who are critical and skeptical in money matters, Money Masters-who love managing money, Producers-whose focus is on other people's money and Optimists-who are happy with their finances.

Jonathan Myers had developed the Psychonomic Investor Profile based on the assumption that individuals will treat different aspects of their life in the same way. Lets take an example, if people are cautious by nature, they will always be avoiding danger, and therefore, they will also be cautious when investing their money. What we must understand here is that two investors with the same profile characteristic may make different financial choices. Also, in Psychonomic investor profile, individuals are assess according to whether they have a high, medium or low propensity for risk, within their particular balance of personal characteristics. The six types of investors are Cautious- very conservative, Emotional-easily attracted to 'hot' tips, Technical-screen watchers, hard facts, Busy-need to be involved in the market, trades on price movement, Casual- have a laid-back attitude, and lastly Informed-knowledgeable, confident investor.

The last model I am going to mention here is the Myers-Britts Type Indicator (Briggs, Myers). It is based upon the work of Swiss psychologist Carl Jung. Two American women, Katherine Briggs and Isabel Briggs Myers then elaborated and extended the work and ideas of Carl G. Jung and came out with MBTI. It is a self-report questionnaire. MBTI believes that exploring system, techniques and analysis alone does not cut it. An investor must know who he is. Their main idea is that in order to succeed financially a person has to have this important criterion, which is 'self-awareness'.