

The Influences of Anchoring Effect Toward the Decision Making of People in the Realty Business and Related Industries in China in the Last Two Decades

Haoyang Sun

Beijing Royal School, Beijing 101121, China

Abstract. In these two decades, realty business and its related industry has been becoming the mainstay industry of economy of China. From the upstream such as the purchasing of house to the downstream such as the material purchase, anchoring effect is used by so many people and its great influence cannot be ignored. This article aims to investigate that how the anchoring effect acts and affect the decision making in the whole industrial chain of real estate and construction industry and its influence in these industries. The article will provide specific examples in real life to show the use of the anchoring effect vividly and points out its limitation in the practical use.

Keywords: Anchoring Effect; Real Estate; Chinese Realty Market; Decision Making.

1. Introduction

In several decades, the great economic growth of China was incredible and changed the world pattern of politics and economy significantly. In such dramatic economic take-off, realty business and its related industry, inevitably, have obvious contribution. Realty business is the mainstay industry of Chinese economy. From the data shown in the National Bureau of Statistics in China which is the authoritative websites of data analysis, it showed the data of property market and national gross domestic product. As the graph below, we can clearly discover the essential role of realty market in Chinese gross domestic product. The role of realty market was gradually solidified in Chinese economy in recent years. In this huge market, the information is so massive and confusing that people who want to invest or purchase are complicated to distinguish the credibility of each information. This phenomenon also happens in the real estate-related industry such as construction material market. Abundant material producing factories will offer highly different product and offer. Under this chaotic situation, people would likely to rely on the initial offer that seller provide, which can be called anchoring effect. This article aims at the process that anchoring effect affect the decision making of people in the property market and related industry and the exact influence in China. Moreover, the article will state the limits or drawbacks of this cognitive bias, then give possible solution for existed problem and prevention of risk.



Fig. 1 The Percentage of Realty Market in Chinese Gross Domestic Product

2. Literature Review

As the day darkens, Jim went out to dinners. When he ordered a bowl of noodles, the waitress asked that how many eggs did he need, one or two? In this occasion, the information given by waitress is specific number of eggs Jim needed rather than whether he needed the eggs. If the waitress directly asked that whether Jim needed egg, Jim probably refused this request. However, this request intelligently evade this risk and unconsciously persuaded Jim to add egg. This is a classic example of anchoring effect. When the people talk about the definition of the anchoring effect, Adrian Furnham gives an exact explanation in his article. Anchoring bias is a process whereby people are influenced by specific information given before a judgement (Furnham, 2011). Or as common stated, this effect is about how the information or offer affect the decision-making of investors or purchaser. In fact, this effect was used in real estate industry universally. The key information that investor understands will highly affect their decision making. From the perspective of Chang in his article, they found that the anchoring effect prevails in the whole market and essentially affect the final decision or price they paid regardless of homebuyer's gender (Chang, 2016). This fact was showed more clearly in the article of Lambson. In his paper, the out-of-state buyers will be affected more by the anchoring effect than in-state buyers and pay much more price (Lambson, 2004). Out-of-state means a lot in this case. It can be literally stated that out-of-state is an information barrier or create a situation that investors are lack of some key information, which results in the dependency on this limited information. This is classical representation of the anchoring effect.

Furthermore, the whole market trend will inevitably affect the influence that the anchoring effect exerts on the investors. In the article of Beracha, he examined that the price will highly be related with the emotion of most investors and the market behavior such as bull or bear markets. These two factors will drastically cause the fluctuation of anchor in price range and results in irrational price paying (Beracha, 2014). During bull market, all the investors that predict or be expected to rise price in the short run will improve the price of the house in the market by increasing demand. Their blind optimism will give a long price for market. On the contrary, their emotion will be reversed in the bear market. Less confidence and consistent decrease in price will make it possible for anchor to move below the true value of the product. The fluctuation of position of anchor will also have profound influence in the property market. Besides the U.S. property market, Lee also provides persuasive evidence in Taiwan real estate market. They post online questionnaire to 272 members in Taiwan Real Estate Appraisers Association LINE group. The result reveals that the cognitive bias and the emotion of customers have clear impacts on anchoring. The market trend, overconfidence or pathetic view have significant and positive impacts on valuation variation (Lee, 2022). After examination about the relationship between two factors that information barriers and market behavior and anchoring effect in other area, this article will further explore the impacts of the anchoring effect on Chinese property market, which can fill the gap in the academic field. Moreover, the article will explain the drawbacks of the anchoring effect in Chinese property market and related market and the influence on Chinese economies since this market is so vital for Chinese economy. This gap will also be fill in the article.

3. Application

In 1978, Deng Xiaoping, as actual leader of China, decided to turn the table and started reform and opening up. The reform of market economy was gradually progressed and Chinese economy began to progress rapidly. Real estate, one of the most valuable assets from Chinese perspective, was inevitably changed by reform. In past 30 years, Chinese's saving accumulated in an incredible rate, so they need an outlet to invest by using their money. Real estate was a great financial product for them to invest. Because of tremendous demand in whole market, more and more real estate agency entered the property market and related industry such as construction industry started to boom. Since there are so many companies in the market, the competition was really strong. These companies had to develop new marketing strategy to sell their product. Anchoring effect was one of the most

universal methods in the property market and construction market. This article aims at introducing three extensive applications in the property market and construction market.

4. Information Barrier

Anchoring bias always happens in the early stage of negotiation of house purchasing. From the perspective of Scott in the article, he said that students or first-time buyers are more easily affected by anchoring effect (Scott, 2011). Since this group of people cannot access much more professional or real information about this industry, they are easily persuaded or interfered by information. This information barrier will be utilized by seller. In the purchase of real estate, the seller will deliberately create unveracious situation such as this house is wanted by many people, the competition is intense to get this house. Also, they will exaggerate the prospect of the area that the house exists. For instance, seller always states that the government will build more convenient transportation systems, or the commercial district will be built in the future which people will have convenience on shopping or hanging around. These descriptions will be highly relied by these first-time buyers since they have no chance to access this information. Afterwards, the possibility of purchase will be highly improved. Building sales center will make an elaborate plan for first-time buyer to create an anchor bias in purchasers' mind in order to stimulate the sales. This strategy is used over and over again, and the customers are difficult to escape this cognitive bias and think objectively. From the perspective of Cheung, non-local buyers paid 4.9 percent more than local buyers when they bought real estate, and non-local sellers would sell 1 percent less than local sellers in Hong Kong property market by using anchoring effect (Cheung, 2021). Although there isn't any specific data which is related to anchoring effect shown in the annual report of each property agency, the premium of each transaction could be sufficient to illustrate that these property agencies could earn a lot of money by using anchoring bias. From the perspective of agencies, using anchoring bias is an efficient way to increase in profit without paying extra cost. That's why most of companies would likely adopt this method in the negotiation with these 'amateur' which can be inferred as non-local customers or first-time buyers.

5. Sequential Occurrence of Products

Not only in the deal of new house, rental housing market and second-hand housing market are easily discovered the occurrence of the anchoring effect. How does it work in the selling process? In China, most of property companies will make some display board to exhibit on the street which display board will show 5-10 houses renting or selling. On this board, there are 7-8 houses with higher price and 2-3 house with lower price. They will put cheaper house on the showiest place in order to make sure that pedestrians will be attracted by these houses. When the pedestrians stop walking and watch carefully, they will notice other houses with higher price. Under the comparison of two price level of house, people will be more interested on those two cheaper houses since they gradually rely on the previous information of cheaper house by comparing them with more expensive houses. This sequential change is effective in the real selling process. From the article of Cho, he points out that the anchoring effect can be triggered by the order of information presented (Cho, 2017). In this case, this strategy will draw more attention from customer and attract them which will drastically take more sales for the real estate company. Nowadays, more and more real estate companies start to adopt this method. From the ranking shown in Southmoney which is one of the most famous financial news websites, three of the biggest real estate agencies are CENTALINE, LIANJIA and WOAIWOJIA. They have thousands of offline stores all over China. Through on-the-spot investigation of offline stores of these three companies in Beijing, they all use anchoring bias strategy in their display board. This fact can illustrate the feasibility of anchoring bias through display board and it does can create more revenue to each company, otherwise they don't have to make display boards which also create considerable cost.

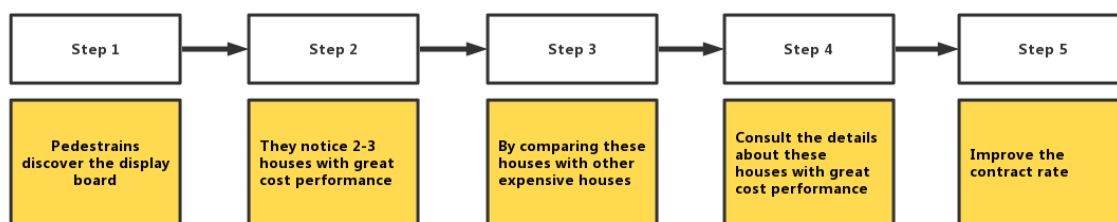


Fig. 2 Sequential Occurrence of Products

6. Correspondence between Offer and Specification

On the other hand, higher price will also create the anchoring effect to improve their competitiveness during the decision-making process of customers. This phenomenon both happened in the construction industry and the property market. In the construction industry, the initial price that the construction company offers is highly related with the specification of each program. In the advanced specification program, offer with higher price will easily win the bidding of first party. In this case, expensive price is symbolized that price is linked up with quality and service. The first purpose of these high specification programs is the quality of the whole construction, so they always have higher budget to construct, and they have to ensure high quality of whole construction. At this time, lower initial price will be less competitive in the bidding. On the contrary, one of the highest initial prices will be noticed firstly and is more easily winning. This expensive offer is an anchor for first party since they can get better product and services in the construction. On the other hand, the construction company will also gain more profit in this deal. Moreover, the anchoring effect acts similar in the property market. For the upper class or some middle class, whenever the price is not the most important constraint, higher price will gradually be competitive in the market since they demand more on the quality and better service. Comparatively, these deals always have more revenue and profitable space. From the research of Bucchianeri, higher initial price will result in higher selling price in housing transaction (Bucchianeri 2013). This selling strategy will be beneficial for the real estate company and construction company in specific cases.

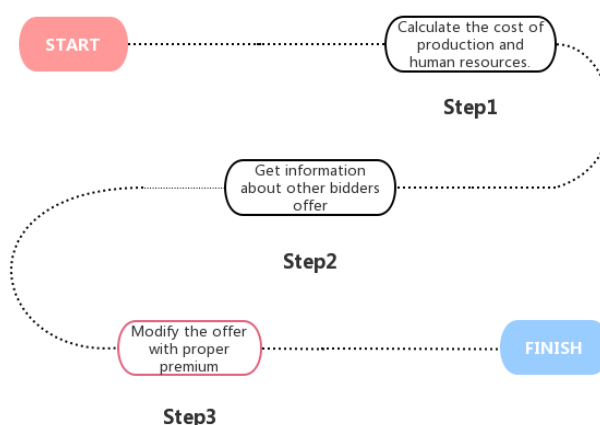


Fig. 3 The Process of Bidding for High Specification Program

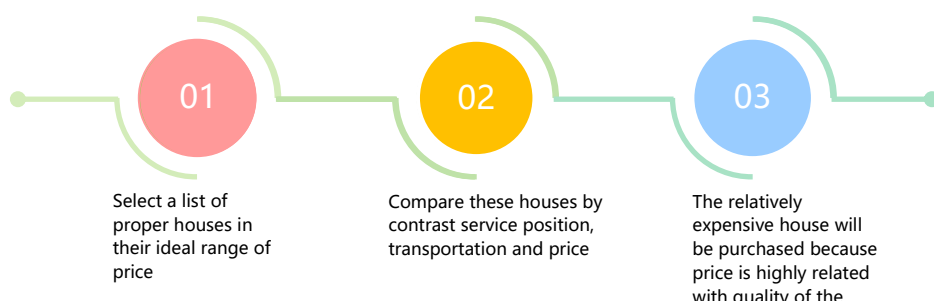


Fig. 4 The Process of Purchasing High-End House

7. Limits and Possible Solution

Apparently, anchoring effect will result in some negative effects in the property market. At the beginning, from the explanation of The Decision Lab, people who are affected by anchoring effect showed obvious irrationality in their decision making and relied on it (The Decision Lab, 2022). This fact will cause people to pay higher price or cost to purchase product, which is significantly clear in the property market or construction market. This is because the purchase in these two markets is tremendous and expensive.

Furthermore, higher price will specifically have two impacts to the economy. Firstly, higher price will create a false prosperity since long price will cost more money of investors. Since the house is necessity for most Chinese, they will still purchase the house even it's expensive at that period. The demand of house is inelastic and gradually increase, property bubble was created inevitably. From the data of financial news of IFENG which is one of the most famous and authoritative media in China, Chinese housing-price-to-income ratio was 12.0; however, the average range of other countries is 3-6 (IFENG, 2022). This data means that Chinese need to earn money for 12 years to buy a house without any other life expense. Under the pandemic and dynamic clearing policy of Chinese government, Chinese economy will be continuously affected negatively. Housing-price-to-income ratio will be further increased. The challenge for young people to purchase a house is more serious than before.

Secondly, it's also will enlarge the proportion of the property market in the economy, which makes it possible for economy of China to highly rely on the property market. However, excessive profit makes it possible for property agencies to adopt risky operation pattern will result in systematic financial risk. These companies have high turnover and leverage. Under the situation that price of house increases consistently, this pattern can work. On the contrary, if the demand to house purchasing decrease a little, the capital chain these companies will suddenly rupture even bankrupt. Meanwhile, their bankruptcy will result in financial gap of banks since these banks cannot get their loan back. This butterfly effect will cause serious economic crisis in China.

Thirdly, purchasing house is a really huge expenditure in China since their role is irreplaceable. Its extravagant price will cost the saving of several generation even borrow against future income just for a house. This action will deeply bind the income of purchaser to the payment of this house. Comparatively, they will reduce the expenditure on other area. If people all lose their power and desire of consumption, it's really hard to prosper other industry, specially tertiary industry will be destroyed dramatically. Furthermore, Chinese economy will encounter serious setback.

However, this complex problem still have solution. The most important thing is that Chinese government has to build an authoritative website to bring all the information of the property market into the open. Anchoring effect does create benefits to property agencies, but it also causes consumers to pay much higher price to purchase house. The key to the anchoring effect in the transaction is information imbalance. The negative effect will be erased dramatically by increasing the transparency of information. If the government can post the authoritative information of house price, position, environment and even future plan of construction, this effect will be eliminated significantly. Another policy is that Chinese government has to change their epidemic prevention policy. Dynamic clearing policy will significantly hinder the economic recovery under the pandemic. Dynamic clearing policy will cost governments at all level billions of money, which originally can be used in the subsidy to stimulate the economy. Under dynamic clearing policy, some cities still face lockdown and all the industries will be shutdown. If the policy can be changed, these problems will all be solved. A lot of government's funding will enter into the market and the investment will increase. In Macroeconomic, increase in investment will result in increase in growth rate of economy. Changing the policy can help Chinese economy to come back to regular speed of development.

8. Conclusion

After the analysis of the anchoring effect, this article points out three implications of the anchoring effect and how it acts in the process of house and construction selling. Information barrier will increase in the premium of price during the transaction; Sequential occurrence will increase the sales rate of property agencies; Correspondence between specification of program and offer will increase the possibility of winning the bidding and selling the house. In fact, these three applications will all improve the attractiveness of purchaser and make them stuck into the anchoring bias. Subsequently, these property agencies will have chance to earn much more profit in a biased way. However, this behavior will interfere the normal operation of whole market and create some cons for the development of the industry and whole economy. Using the anchoring effect as a commercial behavior will increase the inertance of the property market to result in more severe fluctuation. On the other hand, if the company use the anchoring effect universally, they will inevitably squeeze the future income of the people and restrict the development vitality of economy of China. In the future, the proportion of the property market will be further expanded in the gross domestic product of China. Furthermore, this article shows corresponding solution of existing problems. Chinese government should operate website of real estate information in order to ensure the credibility of information. This method can help people to prevent suffer from the anchoring bias and keep the house price in a proper range, which will not result in any negative effects on whole market even national economy. Chinese government also needs to modify the epidemic prevention policy and gradually keep same pace with other countries all over the world. Dynamic clearing policy will reduce the communication between China and whole world and slow down the speed of economic development of China, while opening up to the world will stimulate economy once again and make it possible for China to come back to the pace of development before the pandemic.

References

- [1] Bahník, Š., Englich, B., & Strack, F. (2016). Anchoring effect. In *Cognitive Illusions* (pp. 223-241). Psychology Press.
- [2] Beracha, E., & Skiba, H. (2014). Real Estate Investment Decision Making in Behavioral Finance. *Investor behavior: The psychology of financial planning and investing*, 555-572.
- [3] Bucchianeri, G. W., & Minson, J. A. (2013). A homeowner's dilemma: Anchoring in residential real estate transactions. *Journal of Economic Behavior & Organization*, 89, 76-92.
- [4] Chang, C. C., Chao, C. H., & Yeh, J. H. (2016). The role of buy-side anchoring bias: Evidence from the real estate market. *Pacific-Basin Finance Journal*, 38, 34-58.
- [5] Cheung, K. S., Chan, J. T., Li, S., & Yiu, C. Y. (2021). Anchoring and Asymmetric Information in the Real Estate Market: A Machine Learning Approach. *Journal of Risk and Financial Management*, 14(9), 423.
- [6] Cho, I., Wesslen, R., Karduni, A., Santhanam, S., Shaikh, S., & Dou, W. (2017, October). The anchoring effect in decision-making with visual analytics. In *2017 IEEE Conference on Visual Analytics Science and Technology (VAST)* (pp. 116-126). IEEE.
- [7] Furnham, A., & Boo, H. C. (2011). A literature review of the anchoring effect. *The journal of socio-economics*, 40(1), 35-42.
- [8] IFENG. (2022). 2022 Chinese housing-price-to-income ratio. Finance. FENG. Retrieved September 2, 2022, from <https://baijiahao.baidu.com/s?id=1739650239614155946&wfr=spider&for=pc>.
- [9] Lambson, V. E., McQueen, G. R., & Slade, B. A. (2004). Do out-of-state buyers pay more for real estate? An examination of anchoring-induced bias and search costs. *Real Estate Economics*, 32(1), 85-126.
- [10] Lee, C. C., Lee, H. Y., Yeh, W. C., & Yu, Z. (2022). The impacts of task complexity, overconfidence, confirmation bias, customer influence, and anchoring on variations in real estate valuations. *International Journal of Strategic Property Management*, 26(2), 141-155.
- [11] National Bureau of Statistics. (n.d.). Chinese Fixed Investment. Retrieved August 31, 2022, from <https://data.stats.gov.cn/easyquery.htm?cn=C01>.

- [12] National Bureau of Statistics. (n.d.). Chinese National GDP Since 2015. Retrieved August 31, 2022, from <https://data.stats.gov.cn/search.htm?s=GDP>.
- [13] Scott, P. J., & Lizieri, C. (2012). Consumer house price judgements: new evidence of anchoring and arbitrary coherence. *Journal of Property Research*, 29(1), 49-68.
- [14] South Money. (2022). The Rank of Chinese Real Estate Agency. South Money. Retrieved September 2, 2022, from <http://www.southmoney.com/paihangbang/202207/28638956.html>.
- [15] The Decision Lab. (2022). Anchoring bias. The Decision Lab. Retrieved July 29, 2022, from <https://thedecisionlab.com/biases/anchoring-bias>.