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Investor's Risk Preference and Tolerance Behaviors about Their Investment Decisions of Highly Risky Investment

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Abstract

The basic purpose our research paper is to examine the different patterns of behaviors shown by investors about their investment decisions when the investment opportunity possesses high risk. Some of the characteristics of the investors explored in our research paper that can affect their investment decisions and their risk averse and risk seeking behavior depends on that given factors which are Age, Cultural differences, Gender, Marital status, Employment status, Level of education and Home ownership. After conducting the interviews from 20 investors having different characteristics discussed above we conclude our result that these factors can greatly affect the investment decisions of the investors when they have to invest in highly risky investment opportunity.
Keywords: Risk averse, Risk seeking, financial planners, portfolio management

1. Introduction

Financial planner's basic goal is to assess the risk related to the particular investment. Risk assessment process is not fully considered by the practitioners and academic researchers in investment decisions. Impact of risk tolerance of the investors and their particular choice of suitable portfolio on their investment decision is elaborated in this paper. Some of the very important factors like investor's education, age and gender are take into consideration about their investment decision making.

We explored the fact that male investors are more likely to take risks about their investment decision and making their portfolios which can earn them higher returns as compared to female investors. There is a significant impact of age, gender, education of the investors on their risk tolerance behavior explored in the previous studies conducted in Irish adult's investors.

Decision making of the investors about the particular investment may be affected by their risk aversion or risk taking behavior as well as their risk tolerance behavior. Risk aversion behavior of the investors about their investment decision can also be affected by the cultural differences of the investors explored in our research. Risk aversion behavior of the investors can be affected by the different culture differences of the investors proved by the German socio-economic panel (GSOEP). Some researches prove that as compared to other religions or nationalities atheists and Protestants investors are less risk averse investors. We will try to find out the relationship between risk tolerance behavior of the investors and entrepreneurship process in this paper. Entrepreneurs are considered to be the individuals who are mostly exhibiting the risk seeking behavior about their investment but perform worst.

In order to assess risk tolerance behavior for the investors a development process of designing reliable tool is conducted with the help of previous studies in this paper. The investors with high level of risk tolerance behavior are giving much importance to the portfolio management process showed by the some research paper using chi-square analysis. In order to assess the level of risk tolerance behavior of the investors some research papers using the methodology of testing the risk tolerance by the use of psychometric questionnaires.

The particular questionnaires are designed to develop the insights about the risk tolerance behavior of the investors and their performance related to that, the questionnaire results revealed that individuals are subjected to poor performance because of the less investment knowledge and lack of individual decision making skills. Investment decision making process and savings decisions are highly dependent upon the level of risk tolerance and preference behavior of the investors.

Education level, gender and income level are the most important factors that can determine the investors risk preference and tolerance behavior about the particular investment explored after the interview conducted from the 20 randomly selected individuals having different characteristics.

2. Literature Review

The term risk can be defined as the uncertainty about the events. As we are concerned about the risk prevailing in our investment which can be defined as probability about our investment that we may earn less actual return than our expectations. There are two types of behaviors shown by all the investors: risk aversion and risk seeking behavior. Risk aversion behavior can be defined as the investors who are willing to take risk in their investments in search of higher returns as they are investing in small-cap stocks and International stocks. Risk seeking behavior can be defined as the investor's behavior that are not willing to take any risks and feels comfortable in low but consistent returns.

Some of the variables that can influence the investor's decisions about risk aversion or risk seeking behaviors are age, gender, cognitive ability and financial knowledge. As Prabhakaran & Karthika (n.d.) explored that in order to understand investor's different investment behaviors first you have to identify some important factors that can affect investor's decision making process about the particular investment opportunity. It can be inference from above mentioned statement that it is very important to first determine the variables that influence the different investment behaviors of the investors to evaluate that how they can develop their portfolio of investment either they are showing risk aversion or risk seeking behaviors.

The term portfolio can be defined as the grouping of some particular but different stocks or other financial assets having the objective of attaining maximum returns and minimize the risk concerned with the investment. Prabhakaran & Karthika (n.d.) revealed that the process of maintaining the collection of investment opportunities in suitable way for the investors is known as portfolio management process. Investors expecting maximum return from their investment by minimizing the risk related to their investment while investing in different securities. The primary focus of the Portfolio management process is to minimize the risk related to the investment.

To analyze the investor's preference towards risk we have to examine the emerging concept of behavioral finance. Behavioral Finance focuses on the psychological behaviors and personal different attitudes towards the investment risk preference and tolerance. The term Risk tolerance can be defined as the degree to which an investor can face the risk in their particular investment. The investors having the greater risk tolerance are showing the behavior of risk seeking and the investors having less degree of risk tolerance are showing the risk aversion behavior.

According to Prabhakaran & Karthika (n.d.) the level of investor willingness to take risk for increasing their return is known as risk tolerance behavior of the investor. There is a general statement about the risk in finance that higher the risk higher the return, so the investors that are having the behavior of risk seeking have the higher returns by taking the risk in investing in the stocks that are low performing stocks. The concepts of portfolio management have the greater importance as you should not put all your investment in the one stock that has risk of losing your investment.

The type of investors that are risk seekers can be said entrepreneurs and having the greater risk of having the worst returns from their investments. Cultural differences have also affects the investment decisions of individuals having the different cultures. The investors from Asian countries tend to show the risk aversion behavior and investors from European countries tend to show the risk seeking behavior.

According to Larkin (n.d.) an individual who accepts a greater degree of financial risk does so with a goal of generating higher returns in the future and thus accumulating a greater amount of wealth overtime.

It can be inference from the above given statement that the investors who are willing to take risk and their risk tolerance degree is high are taking higher returns as well as this risk taking behavior is also contributes to the wealth maximization of the investors over time.

Some of the other factors that influence the risk tolerance and preference of the investors emerged from different researches are as follows.

- Age
- Gender
- Education level
- Employment Status
- Marital Status

- Home Ownership
- Cultural Differences

Moreschi (2005) revealed that the gender and formal education are most important factors for the investors about their investment behavior.

Moreschi (2005) explored that gender, age, income, education and marital status are some of the factors that are evolved in previous researches can affect the investors risk tolerance behavior about the decision making process of the investors for investing in particular security.

Investors who are risk averse are using the portfolio management tool to minimize their risk associated with their investment. In portfolio they are selected some high risk stocks and some low risk stocks having the consistent returns to overcome their lose if happened from to high risk stocks.

There are certain investors financial advisor individuals who help the investors to make portfolio decisions and help the investors to decide in which stock they are willing to invest after analyzing their risk related behavior either they are risk seeking investors or the proponents of risk aversion. Investors financial advisors are also look at the some of the characteristics described earlier to give them an advice like age gender and educational level.

Goals, risk tolerance, time horizon and financial stability are the most important factors for the investment management decision making model and taking in to consideration by the managers when developing suitable investment plans. (Grable & Lytton, 1998).

In above given statement investment managers that are involving in the decision making process that in which stock they should invest their money dependent on some certain inputs like goals of the investor either they are concerned with the short-term return by investing in high profile consistent performing stock or taking risk and go for the wealth maximizing decisions by investing in the risky stocks.

Another input discussed is time horizon means investors are either want to invest for shorter period of time or longer period of time to get maximum return. Financial stability of the investor also contributes in the investment decisions of the investors, investors that are financial stable are tends to invest in the risky assets and investors that are not financial stable are tends to invest in less risky assets or showing the behavior of risk aversion. Lastly level of risk tolerance that an investor possesses also affects the investor decision about the particular investment.

The degree to which an investor accepts the uncertainty about the outcome of the particular investment and willingness of taking risk is expressed as risk tolerance. (Hadrovic, 2012).

2.1 Problem Statement

- There are different attitudes possesses by the investors having the different demographic characteristics which are quite difficult to separate from each other for Financial advisors of investment to properly guide their investors client that want to made an effective portfolio.
- There is a measurement problem associated with the risk tolerance of the investors.
- Investors showing different behaviors about risk towards the investment and portfolio decisions which are difficult to analyze for effective investment decisions.

3. Variable Identification

3.1 Independent Variable

- Risk Preference
- Tolerance

3.2 Moderate Variable

- Age
- Gender
- Education level
- Employment Status
- Marital Status
- Home Ownership
- Cultural Differences

3.3 Dependent Variable

- Investment Decision

4. Methodology

In this paper researchers used the methodology of looking at the previous literature about the risk preference and risk tolerance levels of individuals and group of investors and try to analyze the different factors that influence the risk taking behavior of the investors. We also conducted interviews from the investors about their risk tolerance level and their risk perception.

4.1 Sample

We have selected the sample of 20 investors having different age group, culture, marital status, employment, education level and gender to which we have done interviews to find out their particular behaviors about the risk taking and risk aversion process.

5. Hypothesis

Following hypothesis are devised to check our research aim and basic objective of analyzing the investor's different behaviors towards risk. Followings are these hypotheses.

H: There is a relationship between age of investors and level of their risk tolerance and perception.

H^2: There is no any relationship between age of investors and level of their risk tolerance and perception.

Ha: There is a relationship between Gender and Educational level and level of their risk tolerance and perception.

Ha^2: There is no any relationship between Gender and Educational level and level of their risk tolerance and perception.

Hb: There is a relationship between Employment and Martial Status and level of their risk tolerance and perception.

Hb^2: There is no any relationship between Employment and Martial Status and level of their risk tolerance and perception.

Hc: There is a relationship between Cultural differences and level of their risk tolerance and perception.

Hc^2: There is no any relationship between Cultural differences and level of their risk tolerance and perception.

Hd: There is a relationship between Home ownership and level of their risk tolerance and perception.

Hd^2: There is no any relationship between Home ownership and level of their risk tolerance and perception.

By using the above mentioned methodology researchers try to accept or reject the hypothesis to draw results from the research.

6. Findings and Discussions

By conducting the interviews from different investors having different age group, culture, marital status, employment, education level and gender to analyse their risk tolerance and preference about their investment we explore some of the factors like age, gender, formal education, culture, marital status, home ownership and employment status that affect the decision of the investors about their investment.

While conducting our interviews we explored following factors that can affect the investors risk taking and their preference towards any investment.

Marital status of the individuals also affects the investor risk taking behavior towards particular investment. The investors who are not married are tends to show the risk seeking behavior because they have no any responsibility of others to support that is why they are very much comfortable in taking risk. Moreschi (2005) revealed that in support of our result financial advisors tend to believe that marital status affects risk tolerance.

The young investors are tends to take risk as compared to aged or old investors because they are energetic and innovators tends to show the entrepreneur behavior by taking maximum risk and hence gain higher returns on their investment.

Another factor that can affect the investor's behavior about the risk taking or risk seeking behavior is the employment status. The investors who are employed in some job are more tends to take risk because they have the income to support their investment, but if we talk about the unemployed investors they are not able to take risk as they have no such income to support their investment.

According to Larkin (n.d.) Employment status is another factor that may have an effect on the financial risk tolerance of an individual. A common assumption would be that those who are working in a job would have a higher risk tolerance than the unemployed since they are likely to have a higher disposable income and such can afford to take on more risks than the unemployed who may be quite restricted in some of the financial risks they wish to engage in.

The level of education that an investor possesses is also the one of the factor that is relevant to the risk aversion or risk taking behavior. The researches shows that the investors who are higher education level are tend to take risks and their risk tolerance degree is quite high as compared to the investors having the low level of education.

Moreschi (2005) revealed that most of the studies show the relationship between risk tolerance and formal levels of education is positive. An individual investor can assess the risk and return associated with their investment in a proper way if they have more level of formal education.

The process of home ownership also has some of the effects on investor decision about their investment. The investors who have their home ownership are tends to show the risk aversion behavior as compared to the investors who do not have home ownership.

Investment decisions of any investors can be affected by the risk preference and risk tolerances that can an investor possesses.

Weber (2013) revealed that previous studies have already partly revealed the role of nationality, ethnicity, and religion on risk preferences. The author explored that the black community present in the US economy are less

risk tolerant as white community. So there is an impact of different ethnicity groups on the investor's decision making process.
After above given discussion we accept the following hypotheses H, Ha, Hb, Hc and Hd.

7. Conclusion

Researchers conducted this research to find out the different behaviors shown by the investors about the risky investment and analyzing their level of risk preference and tolerance about the risky investment opportunity. Researchers tried to explore different specific characteristics of the investors that can greatly impact their investment decisions. The investors having different age groups, gender, culture, educational level tends to exhibit different behaviors like risk averse and risk seeking behavior about their investment and their level of risk tolerance and preference highly dependent on these factors. Investors having different marital status, Employment status and Home Ownership also affect their investment decisions.
Researchers conduct interviews from different investors having different characteristics to analyze the impact of these factors on the investment decisions of the investors. Investors having the age group of 20 to 25 are more risk taker and hence can become an entrepreneur who take risks and get higher returns. The investors having higher level of formal education are tends to decide in a better and calculated way about their investment decisions when investing in highly risky opportunity. After doing the survey researchers concluded that the male investors are tends to exhibit more risk seeking behavior as compared to female investors that is the reason why male persons are more successful entrepreneur than females. Marital and Employment status have also affected the investment decisions of the investors. Researchers also conducted previous literature survey about that topic to present their results in evidence of our research results.

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