Chapter 9

Moderating Effect of Demographic Variables on the Relationship Between Personality Traits and Financial Risk Tolerance

Sasmita Mishra
C. V. Raman College of Engineering, India

Manit Mishra
International Management Institute, India

ABSTRACT

This paper explores the relationship between financial risk tolerance and its determinant—the personality traits of retail investors. This paper also explores the moderating effect of major demographic variables like gender, age and income on the relationship between financial risk tolerance personality traits of retail investors. Stepwise multiple regression analysis and Hierarchical regression analysis was used to identify patterns in the data obtained from 261 respondents. The Stepwise multiple regression analysis established a negative association of Conscientiousness with financial risk tolerance of retail investors. The hierarchical regression analysis suggested a major impact of conscientiousness on financial risk tolerance among young Indian investors.

INTRODUCTION

Money management by an individual may be reasoned, deliberate, conscious or non-conscious, unplanned or impulsive but the way he/she handles his/her financial situation affects his/her social and personal significance. Further, mismanagement of money increases the probability of experiencing financial stress. Therefore, it is always important to understand the consequences of money management. Negative consequences are resulting in financial stress. Avoiding financial stress as a consequence plays an
important role in shaping policy and in the development of tools and techniques that can be used to cater to the investors more effectively. The objective of individuals in managing money is to make profit and to increase wealth but the saying that there is no reward without risk is well known. Hence, we can say that risk is inherently associated with every economic decision. It is believed that willingness to take risk i.e. higher financial risk tolerance is a prerequisite for accumulating wealth. However, there is a possibility that wealth may decrease if an individual mismanages his/her financial environment. Therefore, understanding and assessing financial risk tolerance is essential in making optimal decisions in terms of risk-reward trade-offs. The construct of financial risk tolerance, or an individual’s attitude towards accepting risk, has implications for financial service providers because a proper assessment of a prospective investor’s financial risk tolerance enables them to design a heterogeneous but appropriate product mix of investment options (Jacob and Levy, 1996).

The present study offers a unique perspective on financial risk tolerance, on account of two aspects. First, it has been emphasized that risk tolerance is a complicated process, going beyond demographic and socio-economic factors (Grable and Lytton, 1999b), and researchers have seldom forayed beyond the demographic determinants. This study includes personality traits of individuals to investigate their financial risk tolerance. It is pertinent to mention here that personality effects on risk-taking behaviour can be understood in terms of individual differences in dispositional motivations. People will take or avoid risks to achieve goals consistent with their personality traits. Second, the relationship between personality traits and financial risk tolerance may not same for different groups of demographic variables. As gender, age and income are considered as the major demographic variables, the moderating effect of these three variables on the relationship between personality traits and financial risk tolerance is measured in the present study. This broadens the horizons of risk tolerance research by taking it beyond the normally used demographic and socioeconomic determinants. The present study intended to fulfil two objectives:

1. To determine whether personality influences financial risk tolerance; and
2. To empirically investigate the moderating effect of gender, age and income on the relationship between personality traits and financial risk tolerance.

REVIEW OF LITERATURE

Determinants of Financial Risk Tolerance

Demographic parameters such as gender, age, education, income, occupation etc. have been of particular interest to researchers as independent variables shaping the investor’s financial risk tolerance (MacCrimmon and Wehrung, 1986; Riley and Chow, 1992). An individual’s ability to tolerate risk has been found to be contingent upon characteristics such as age, time horizon, liquidity needs, income, investor knowledge and attitude towards price fluctuations (Fredman, 1996). Despite a plethora of research upon the relationship of various socio-economic factors with risk tolerance of individual investors, a brief assessment of the results indicates a clear lack of consensus on the issue.

Grable and Lytton (1999b) carried out an exhaustive investigation to assess the role of demographic, socioeconomic and attitudinal factors as determinants in shaping financial risk tolerance. The authors concluded that the two most effective risk tolerance differentiating factors are education and financial knowledge, with investor’s education explaining the greatest amount of variance in the risk tolerance.