

Chapter 6

An Integrated Model of Perceived Risk and Risk-Reducing Strategies in the Tunisian Stock Market: Risk-Behavior Model

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ABSTRACT

This chapter examines the antecedents and consequences of the perceived risk of investors towards the Tunisian stock market. A questionnaire was developed and distributed to 411 individual investors chosen by 24 brokerage firms. Using the structural equation model, we operationalize the risk following the psychometric paradigm according to subjective variables (i.e. familiarity and controllability). Results prove that controllability is a significant factor in the formation of perceived risk. We also show that several factors related to the investor, the listed companies and to the stock market can influence the perceived risk by the investor towards the Tunisian stock market. Similarly, we find that perceived risk leads to intensive information search, good performance and a strong reinvestment intention. These results attest the importance of the risk perception in the decision-making process.

INTRODUCTION

Risk is a very important topic of investing since apprehending what it is and how it is measured is crucial for developing an investing strategy (Ricciardi, 2004). For this end, many researchers continue to look for a more thorough understanding of what constitutes risk and how it should be measured and priced in

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financial markets. In spite of previous and subsequent researchers, there is no widely accepted definition in the extent literature. Earlier studies such as Lopes (1981) and March and Shapira (1987) consider risk as the product of the consequences of an event and its probability of occurrence whereas other studies like Kaplan and Garrich (1981) define risk as the sum of danger and opportunity. By emphasizing on a 'negative connotation', some researchers prefer to define risk as virtually expected loss after a decision making (Loppe, 1988), or everything that leads to involuntarily harm (Cuny and Gaillard, 2003), or the possibility of harm, loss, destruction or an undesirable event (Ricciardi, 2004). The lack of consensus about straightforward definition of risk is not without impact at the empirical level. Indeed, academic research in finance distinguishes two different approaches of risk namely: traditional and behavioral approaches. The traditional approach of risk is based on the Efficient Markets Hypothesis and the rationality of investors. Under these assumptions, investors process information instantaneously and the prices entirely reflect all existing information (Fama, 1965a and 1965b). Besides, investors make financial decisions based on their own approach toward risk and to the actual degree of risk (Ricciardi, 2004). In this regard, Garland (2002) pinpoints that persons focus on objective risk "they have in minds that have been confirmed scientifically utilizing the obtainable knowledge and data". Indeed, objective risk is quantitative which relies on past occurrences of an event and incorporates into numerical assessments to estimate risk. So, the traditional approach of risk is based on quantitative (or objectives) measures (e.g. beta, standard deviation, semivariance, skewness, and kurtosis) which rely on a number of observations (i.e. long-term data over a specific time period) and are generally computed from sophisticatedly statistical methods.

On the other hand, the behavioral approach of risk is based on the behavioral finance theory which is "an interdisciplinary field, developing theoretical basis, know-how, and research from the diverse making sciences of psychology and behavioral economics" (Ricciardi, 2008). Individuals make irrational decisions due to their limitations of capacity to process the information (Simon, 1986) and are influenced by heuristics, cognitive factors and affective issues. Moreover, behavioral finance scholars claim that the objective aspect of risk within decision-making and an individual's understanding of it, known as subjective (or perceived risk), are not necessarily the same (Ricciardi, 2004). So, the behavioral approach of risk attempts to pay more attention to a person and explore risk, not at the aggregate or market level, but at the individual level. In this respect, McDonald and Stehle (1975) pinpoint that "perceived risk is an ex ante measure which may be based on past returns, fundamental analysis, present hunches and all other information that portfolio managers and analysts believe to be germane". So, the behavioral approach of risk develops subjective measures of risk based on methods of experimental, exploratory, or survey research or psychometric paradigm.

Interestingly, the present research attempts to contribute to this line of research through an investigation of the risk perception of individual investors in the Tunisian stock market. In this respect, we study the risk perceived by investors toward the stock market by proposing a risk-behavior model which includes the antecedents and consequences of perceived risk. In the marketing literature, the perceived risk consists of two distinct components, namely: uncertainty and importance (or significance) of consequences (Mallet, 2000; Dandouau, 2000; Verhage et al., 1990; Mitchell and Gatreux, 1989) causing the information search and reduction of the amount at stake (risk-reducing strategies) in order to decrease risk (Cho and Lee 2006; Taylor, 1974; Cox, 1967a). For instance, Taylor (1974) claims that "uncertainty about the outcome can be reduced by acquiring and "handling" information. Uncertainty about the consequences can be dealt with by reducing the consequences through reducing the amount at stake or putting off the choice". So, we examine the information search and reduction of amount at stake as two

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