

Chapter 7

Determinants of the Risk–Taking Attitude among Small Equity Investors

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ABSTRACT

This study explores the personality traits, perceived personal control, behavioral biases, culture, and socio-demographics in determining individual equity investor's risk assumption attitude. The study uses a survey approach to collect responses from small equity investors. A conceptual model is developed and hypotheses are tested through structure equation model (SEM). The result identifies personality traits, perceived personal control, behavioral biases, cultural factor and socio-demographic variables as strong determinants of small equity investor's risk assumption attitude.

INTRODUCTION

Risk is a difficult construct to define. The outcomes of risk depend on the situation and the decision maker. Risk assumption attitude involves participation in certain activities that might results in harm, loss or undesired outcomes (Ricciardi, 2004). Risk assumption attitude often referred as risk appetite, risk tolerance, risk acceptance and risk propensity is decision maker's general disposition to a particular risk in a consistent way (Roskowitz and Davey 2010). Kahneman and Tversky (1979) also hold that individual investor tend to seek risk in loss realm and avoid risk in profit realm. Risk assumption attitude varies among different people depending their personality traits, personal control, behavioral

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factors, cultural factors and other socio-demographics including; age, gender, income level, financial needs, investment objectives, investment strategies. Slovic (1987) holds that the construct of risk means somewhat different among different people.

Identifying determinants of small investor's risk attitude is an important part of research in behavioral finance. It provides better understanding of various factors that influence risk assumption attitude of individual equity investors. It enables investment professionals to offer customized financial services and investment instruments that best match the risk assumption attitude of individual equity investors. It also facilitates regulatory authorities to improve legislations while having better understanding of investors' risk attitude.

The current study provides significant contribution by identifying the determinants of investor's risky attitude in a developing country's context. The study extends the model of investor's risk assumption attitude proposed by Dulebohn (2002). The study introduced some new variables in the existing models of individual investor's risk assumption behavior.

BACKGROUND, CONCEPTUAL MODEL AND HYPOTHESES

Personality Traits and Risk Assumption Attitude

Openness to Experience

Researches in behavioral finance provide ample evidence regarding influence of personality traits on investor's behavior, for instance Goldberg (1999), and Lin (2011) examined the role of personality trait on investor behavior. This study has used big five personality traits including, openness to experience, conscientiousness, extraversion, agreeableness, and neuroticism proposed by Costa & McCrae (1992). The first personality trait considered in this study is openness to experience. Openness to experience personality trait allows investors to come up with new ideas, and use active imagination in investment decision making. The investors who are open to experience are overconfident and tend to assume higher risk in their investment decision making (Barber and Odean, 1999). Nicholson et al. (2005) also noted the relationship between openness to experience personality trait and investor's risk behavior. Gullone and Moore, (2000); Markey et al. (2006); and Deck et al. (2008) also examined the role of personality traits (openness to experience, conscientiousness, agreeableness, extraversion and neuroticism) in understanding investor's risk propensity. The study also assumes significant association between openness to experience and investor's risk assumption attitude.

Conscientiousness

Conscientiousness investors believe more in themselves. They feel confident to perform job thoroughly and believe to produce results better than other investors. Conscientiousness investors exhibit overconfidence bias in investment decision making. Conscientiousness is considered as striving force for achieving excellence and competence (Costa and McCrae, 1992). Conscientiousness personality trait aspire investors to use money as a tool to impress and inspire others (Lim and Toe, 1997). Nicholson (2005) believe conscientiousness as a force that influence investor's risk investment behavior. Mayfield et al. (2008) also asserted conscientiousness as personality trait that influences investment behavior of

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