

ARE FINANCIAL RISKS RELATED TO OTHER FORMS OF RISK TAKING BEHAVIOR? EVIDENCE FROM SURVEY DATA

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ABSTRACT

An interesting question has existed in the finance literature for a number of years. Is there a correlation between a person's risk taking propensities in the area of personal finance and other areas in their personal life? There are a number of ways that this question can be approached and reasons why an answer is valuable. If there are some forms of standardized psychological tests that correlate well with financial risk taking, then this could be used to construct likely risk taking profiles for individuals. This type of information could be used, for example, by financial planners to test up front the particular risk taking propensities for their clients. This could do two things: it could more effectively match preferences to products, and it could help to lower liability by helping planners make fewer mistakes with clients. It could also focus clients in on their own preferences and help them to be more effectively educated in the process.

In many studies, testing for risk taking involves comparisons between financial decision making activities, such as banking, buying a home, or other activities. Often, the "comparison" risk taking activity used is gambling. Wong and Carducci (1991) examined the link between sensation seeking behavior, as identified by gambling, and everyday financial planning activities. They used survey data to classify their sample into high and low sensation seekers. They found a pattern of correlation between groups that they identified as high sensation seekers and riskier financial decision making. This also held up across gender in their tests. This research was extended in Morse (1998). The results presented here, with a different sample group, found no significant link between sensation seeking and riskiness of investments. Individuals did not match up their reported risk taking with financial risk taking. Grable, Joo, and Adityavarman (GJA 2002) used a multivariate analysis to test whether financial risk taking, as measured by equity ownership, was correlated with other risk taking behaviors. Specifically, they looked at participation in sporting events as a risk taking measure. Their results mirrored those of Morse in that they found no evidence of such "cross-domain" risk taking.

This study is an extension of this line of research to incorporate three slightly different measures of risk outlook. The first is a sensation seeking scale. This looks at a variety of behaviors associated with sensation seeking, such as putting one's foot in a pool of water to test or simply jumping right in. This is a very broad and general scale, and we will test this against a survey similar to Wong and Carducci dealing with personal financial decisions. The second measure is a measure of generalized unique invulnerability developed by Bodner, Cochran, and Blum (2000). Generalized unique

invulnerability is the feeling that bad things will not happen to me, regardless of what activities I participate in. The GUI index measures the degree to which individuals feel insulated from the outcomes of risky behavior. Skydivers, for example, have high self reported GUI levels. Another instrument that we will utilize is an “optimism” scale developed by Hale et al (1992). It measures the degree to which people view their life circumstances. This points out whether they generally feel safe and good about their life circumstances or whether they are more pessimistic about them. Once again, we will attempt to discern whether or not individuals’ outlook on life affects the degree of financial risk they are willing to undertake.

The study compares the scores on these instruments with a portfolio preference survey. This survey was administered to a group of undergraduate students that have a high degree of financial knowledge. They currently are managing a student-managed investment portfolio that is valued at over \$3 million. This was done to control for significant variables noted in GJA: income, financial literacy, and age. The study compared the scores on the psychological assessment vehicles with the scores on the portfolio preference survey. An evaluation of Pearson correlation coefficients showed no consistent significant relationships. This could imply that the portfolio preference questions were not accurately measuring financial risk taking propensities, so further evaluation of this instrument is necessary.

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