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Financial Risk Tolerance & Investment Decisions of Retail Investors

Nidhi Shekhar

Research Scholar, Banaras Hindu University, Varanasi
Neharai2195@gmail.com

ABSTRACT:

Making decisions on investments is a difficult process. Several factors influence the decisions made when making investments. When compared to practitioners of behavioural finance, traditional finance practitioners hold distinct perspectives. Advocates of behavioural finance hold a different position, arguing that investors are not always rational and might be swayed by illogical decisions. They have feelings and prejudices because they are human. One behavioural component that has been identified is financial risk tolerance, and investors' investing decisions typically change depending on their level of risk tolerance. Individuals who have a high financial risk tolerance level will invest in riskier portfolios, whereas those who have a low risk tolerance level are considered risk averters and will invest in less risky portfolios such as government securities, T-bills, and fixed deposits. The current study used an empirical technique to investigate the relationship between the annual investment decision variable and financial risk tolerance. According to the study's findings, annual investment and investment decision-making are related to financial risk tolerance.

Keywords: Financial Risk Tolerance, Investment Decisions, Retail Investors, Traditional Finance, Behavioral Finance

1. INTRODUCTION

Investors are the backbone of capital market. A developing economy, like India, needs a growing amount of savings to flow to corporate enterprises. The level of equity market participation of the retail investors has been increasing over the past few years. Investment is the flow of capital which is used for productive purposes. There is a great emphasis on investment for being the primary instrument of economic growth and development for a country. There are a large number of investment instruments available today. Some of them are marketable and liquid while others are non-marketable and illiquid. There are instruments which are highly risky while others are almost riskless. The investors choose avenues, depending upon their specific need, risk appetite, and return expected. Investment avenues can broadly be categorized into two spheres, namely, economic investment and financial investment. Purchasing of a physical asset such as a building or equipment is an economic investment. Economic investments contribute to the net additions to the capital stock of a society. Financial investments, on the other hand, refer to investment in financial instruments like shares, debentures, insurance policies, mutual fund units etc. Financial investments help in creating the capital stock of the country. In the long term, investment is important for improving productivity and increasing the competitiveness of an economy. Without investment, an economy could enjoy high levels of consumption, but this creates an unbalanced economy. The states having more commitments to investment are more progressive. This study will explore the impact of financial risk tolerance factor affecting the investment decisions.

2. LITERATURE REVIEWS

Literature for the present study have been collected from prominent data bases such as Google Scholars, Journals of Science Direct, and other literatures have been collected related to objectives of study and present need of study.

(Sulaiman, 2012) investigated the financial risk tolerance and asserted that it should be measured as these plays prominent role in influencing the expected utility. In the present study the association and relationship has been explored further the sophisticated result have been found some of the findings agrees with previous studies and some tends to denying.

(Kumar et al., 2015) investigated the factor which influences the investment decision making of individuals. It is essential to understand the financial risk tolerance influence and at same time how to manage the same. The present study has adopted the questionnaire method for collection of data and found that some of the personal characteristics tends to influence the financial risk tolerance education and wealth are found to be highly correlated**.** The study provides evidence to the investor’s government, policymakers and several other participants.

(Simon, 1955) investigated the irrational behavior of investors and critics are provided on previously explored studies that investors are rational being and makes decision by fully verifying the information in reality it was observed that investors are influenced by emotions. However, the present study has supported the behavioral notion of study.

(Bhavani & Dutta, 2017)

The primary purpose of this study is to investigate how investment choice gets affected by the demographics and perceptions of the investor. Investor's behavior is influenced by many factors at the time of investment decision making. Demographic profile and perceptions play an important role to select a particular choice of investment. This paper helps to enhance the knowledge on different investment avenues like bank deposits, life insurance policies, mutual funds and equity which in turn will be highly useful to the financial advisors as it will help them advise their clients regarding these avenues with respect to their demographic profiles. The study also highlights the evidences that the investment choice depends on and is affected by the demographic variables and perceptions. However, the results of this research shows that the most investors have little knowledge on the investment avenues for their investments. Mann Whiteny 'U' test, Kruskal- Wallis has been conducted to test the hypotheses with the help of SPSS. Logistic regression results of this study proves that investors' age, gender, education and occupation significantly influence the selection of investment avenues. Wealth Management professionals emphasizes that customer behavior and psychology play a vital role in successfully building and sustaining a wealth management relationship. Behavioral finance is new emerging science which focuses on understanding the psychology effects on investment decision.

(Chaudhary, 2013) explored that human beings are susceptible to numerous behavioral anomalies which became counterproductive to the wealth maximization principles leading to irrational behavior. This paper examines the meaning and importance of behavioral finance and its application in investment decisions. This article has also discussed some trading approaches for investors in stocks and bonds to assist them in manifesting and controlling their psychological roadblocks.

(Boda & Sunitha, 2018) investigated behavioral finance relies on research of human and social recognition and emotional tolerance studies to identify and understand the investment decisions. This article aims to report the research of individual investor's financial behavior in a historical perspective. This article uncovers the investor's psychology in investment decision making focusing on the investor's rationality by explaining psychological and emotional factors that affect investing. The results of the study are revealed by means of Graphical visualization.

(Kannadhasan, n.d.) investigated that in the present scenario, behavioral finance is becoming an integral part of the decision-making process, because it heavily influences investors' performance. They can improve their performance by recognizing the biases and errors of judgement to which all of us are prone. Understanding the behavioral finance will help the investors to select a better investment instrument and they can avoid repeating the expensive errors in future. The pertinent issues of this analytical study are how to minimize or eliminate the psychological biases in investment decision process.

3. OBJECTIVES OF STUDY

Through the literature reviews it has been identified that previous studies were conducted for assessment of financial risk tolerance and its impact on investment decisions have been less explored. The study will fulfill two objectives

1. Firstly, the Financial Risk Tolerance of retail investors will be measured.
2. To check the association of Financial Risk Tolerance and Annual Investment.

4. HYPOTHESIS

- **Null Hypothesis:** "There is no association between Financial Risk Tolerance and Annual Investment"
- **Alternative hypothesis:** "There is association between Financial risk tolerance and Annual Investment"

5. RESEARCH METHODOLGY

Research methodology provides framework to study. It is a blueprint discussing on the aspects that how the data collection, coding of data, analysis, and presentation of data will be proceeded. For the present study the empirical approach has been adopted and primary method of data collection for collecting the responses from respondents and further for additional data relating with the conceptual clarity the data has been collected from secondary sources that is books, magazines, previous literatures.

- **Data**

Primary and Secondary Method of Data has been chosen. The primary method through survey method by adopting the previously scale used in measuring financial risk tolerance.

- **Secondary Data:** Secondary Data of study has been collected from important books and websites.

- **Samples:** Samples of the present study were the retail investors from Gorakhpur city. Retail investors are those investors who vary from institutional investors. They are those investors who rely upon their own capabilities in order to make investment decisions. Generally, the investment made by them involves value of Rs. 2 lakhs and less.
- **Sampling Method:** As the study is relating with financial decisions which involves the money and mostly the investors and people hesitate in answering the money related questions, they are very sensitive to it. And also, the exact location of respondents was known therefore the present study have chosen the nonprobability method for collection of data. Data has been collected from convenience method of
- **Analysis Tools**

The data has been analyzed by Excel and SPSS. Firstly, the inconsistency of data has been checked in excel and Spas to identify whether there is any duplicate data or outliers relating to variables and thereafter the coding of data to make them fit for the analysis. The method of analysis which has been chosen was as per the objectives and need of data. It has been found that Chi-square test and cross tabulation will cover the objectives of study. The present study adopted cross tabulation of data for presenting the categorical data and Chi square statistics has been used for hypothesis testing of study.

6. DATA ANALYSIS

Table 1

Descriptive Statistics of Financial Risk Tolerance

	N	Minimum	Maximum	Mean	Std. Deviation
FRTTOTAL	48	16.00	45.00	32.4375	6.97688
Valid N (listwise)	48				

Table 2

FRT CATEGORY

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1.00	26	54.2	54.2	54.2
	2.00	22	45.8	45.8	100.0
	Total	48	100.0	100.0	

Table 3

Chi-Square Tests

	Value	do	Aseem. Sig. (2-sided)
Pearson Chi-Square	8.805[a]	4	.006
Likelihood Ratio	10.829	4	.029
Linear-by-Linear Association	1.289	1	.256
N of Valid Cases	48		

The analysis of study has been conducted and it is found that financial risk tolerance influences the annual investment. Firstly, the result obtained from Table 1 stating that in first category that is lower financial risk tolerance there were 22 investors and higher financial risk category there were 28 investors. Further it is found through the analysis of Chi square test that financial risk tolerance is associated with Investment Decisions. The result of study is consistent with the findings of previous studied.(Onesome et al., 2017),(Zhang & Zheng, 2015)

6. FINDINGS

The most prominent finding of the present study is assessment of financial risk tolerance category in Low Financial risk Tolerant & High Financial Risk Tolerant. Further these significant association of financial risk tolerance and investment decision making.

7. CONCLUSION

The result provided a better evidence that retail investors of Gorakhpur city who have been selected for present study have demonstrated the higher level of financial risk tolerance and falling in category. Further, they have been also making greater investment when their financial risk tolerance level was increasing. The study will help the investors and other financial market participants in area of financial decision making and also understand that behavioural finance influences the investment decisions. The limitations identified for present study is that the study is limited in scope by covering only the retail investors and further of Gorakhpur city, and with regard to variables chosen for study investment. Further, scope can be extended through inclusion of those variables which were left and not covered in the present study.

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