

FINANCIAL RISK ATTITUDE AND BEHAVIOR: DO PLANNERS HELP INCREASE CONSISTENCY?

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ABSTRACT

This study used the 1998-2007 Survey of Consumer Finances to investigate the effect of various sources of information on households' consistency in financial risk attitude and behavior. Categories of financial information sources were: 1) self and social network; 2) financial planner; 3) financial institutions; 4) media; and 5) other sources. Consistency was measured at two levels. The first level consistency was between being willing to take some versus no financial risks and investment ownership. Households were considered to be consistent at this level if they were willing to take some financial risks in exchange for some investment returns and had some investment assets or if they were unwilling to take any financial risks and did not have any investment assets. The second level of consistency was between being willing to take high versus low financial risks and equity ownership. Households were considered to be

consistent at this level if they were willing to take high financial risks and had some equity in their portfolio or if they were unwilling to take high financial risks but had some equity assets in their portfolio.

Findings from controlled and uncontrolled analyses showed that households searching information from various sources when making savings and investment decisions were not equally likely to be consistent in their risk attitude and behavior at either level. Results from the controlled analyses suggest that working with a financial planner increased households' likelihood of being consistent in their risk and attitude at the first level but decreased their likelihood of being consistent in their risk and attitude at the second level. It seemed at the second level of consistency financial planners may have influenced households to take on more equity exposure than was desired.

Study results indicate that a mismatch between a household's risk attitude and investment behavior was not rare. The outcome of mismatches could include opportunity cost for households that forgo higher returns typically associated with equity investments as well as adverse emotional reactions to market downturns that can lead to realized losses for households that had over exposure to equities.

The objective of a financial planner should be to make sure household members understand the risks of financial products in their portfolio, and how their portfolio would perform over time, not only during periods when the market is up but also during periods when the market is down. If using a financial planner adds value to households' financial wellbeing, those who use a financial planner would be expected to act consistent with their stated risk tolerance. Insofar as consistency is desirable, the implication would be

for consumers to consider using financial planners. If, however, using a financial planner does not make a difference or even decreases the probability of consistency between an individual's risk tolerance and risk behavior, then the financial planning industry should reassess their value proposition and/or improve their services.

This study examined efficacy of financial information sources, focusing particularly on financial planners. Study results are important because it is likely that, at some future date, a regulatory body might be responsible for not only assuring truth in investments but their efficacy as well. Having consistency in household risk attitude and behavior is important for households, their financial planners, consumer educators and researchers. A mismatch in risk attitude and behavior may cause opportunity cost or unnecessary realized financial loss, which is counterproductive to households striving to reach their financial goals. Although research has been conducted on household risk attitude and behavior, this research is the first to investigate the influence of various sources of information on the correlation between the risk level that households report they want and what they have.

Future research needs to examine how to accurately measure the financial risk tolerance for all household types, how to help households identify their true risk tolerance level, and how to help them act consistently with their risk tolerance when making savings and investment decisions.