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Relationship between Risk Perception and Employee Investment Behavior

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Abstract: Investment behavior of an investor depends on his/her risk perception and risk attitude. This paper attempts to explore that how the perception of an investor who is also the employee of that organization differs from other investors. Does he/she perceives risk similarly as other common investors or his relationship with the organization as an employee has any impact his/her risk perception, attitude and investment behavior. This research study is conceptual in nature and mainly based on previous literature findings and evidences. Findings of this study suggested that employees risk perception is directly related with investment behavior and there is strong relationship between them. This can help the management to make special offers of shares to employees, this will further strength the bond of employees with the organization.

Key Words: *Employees Risk Perception, Employees investment Behavior*

1. Introduction

Study of risk perception and its impact on investment behavior is one of the core investigation issues of behavioral finance research. Numerous studies have been conducted to explore, investigate and measure this link. However, very few of them attempt to find this link in the context of an employee of a corporation. As per modern portfolio theory risk taking of an investor depends on his risk attitudes (risk seeking, indifferent or averse). His/her decision to invest or not will depend on his risk/return expectations and his/her risk attitude. Perception is the first step in decision-making followed by considering various options and making choice out of them and then taking the action, which is behavior of the investor. Some researchers

Weber (1997) considered risk attitude as stable personality trait but others had different point of view. Kahneman and Tverskey (1979) found that investors show risk-averse behavior with respect to gains and risk seeking behavior with respect to losses. Samulson (1963) found that subjects preference for lottery depend whether they are played repeatedly or not. Behavior scientists argue that two subjects perceive the risk of an investment opportunity differently and it depends upon their personal and situational characteristics (Sarin and Weber, 1993). Traditional risk return models assume that risk expectations are almost similar, individuals only differ in attitude. However, modern researchers found through experiments that there are significant differences in the level of risk perception as well as returns expectations that explain inconsistent risk taking behavior. According to Singh and Bhawal (2010), perception of risk is manageable if investor is very much aware of every aspect of risk and fluctuations occurs levels of risk. Anderson et al. (2005) found that individuals who place the most orders and have the highest number of transactions enjoy higher returns than those with fewer order and transactions. Bundle of studies have been conducted on issue of risk perception and investment behavior but almost all studies were only focusing on traditional investors like individual investor and institutional investors.

Moreover very few researchers tried to explore the sentiment of an employ as an investor, however, a couple of studies attempted to explore the risk perception attitude of an employee but they left the exploration of link between risk perception and investment behavior of an employee of the company for future research. This paper attempts to bridge this gap. Realizing the significance that an employee gets more committed to his organization when he owns the shares of his organization, similar kind of steps has been taken by the present Government of Pakistan that started a scheme of share allotment named as “Benazir Employee Stock Option Scheme”, named after late Prime Minister of Pakistan. This study will help the management to keep in mind the investment needs of the employees of their corporation and their keenness and inclination towards their own corporation when it come s to making investment decision. When making IPO management should keep the investment needs of its employees in mind. This study also sheds light on the loyalty aspect of employees towards their corporation while making investment decision. Investment in their own corporation further strengthen bond with their own organization. Risk perception can be managed, and policy makers should try to manage the risk perception if one is aware about his/her level of risk perception. Personal macroeconomic experiences influence the personal decision-making and risk taking behavior. This study highlights the fact that management can take double advantage by offering shares to employees. It will help to make stronger the link between employees and organization and help the organization to raise equity at the same time.

2. Literature Review

Risk is a widely used term in cross disciplines of knowledge and holds various meanings in different contexts. In behavioral finance, it is one of the key variables that is observed, measured and analyzed. For an investment professional the risk is the probability of losing a client, while the client may view risk as the possibility of losing their principal investment or a portion of it, or even a variation in return(Victor Vicciardi, 2004). After a careful examination of the literature we found that the previous empirical literature was focused on the relationship between risk perception, attitude towards risk and investment decision of individual investors; it is obvious that investment decision largely depends on risk perception and risk attitude. Behavioral Finance literature assumes that decision of asset allocation in risky and riskless assets relies on the risk-taking attitude of investor (Nosic and Weber, 2007). Researchers have always been interested in the factors that determine the risk. Broadly, these factors have been classified into three groups: i.e.

- Factors that Affect Individual Behavior,
- Presentation of Risk and the
- Factors Regarding Characteristics of Risk

Factors that Affect Individual Behavior: We can further classify the Individual Investor's factors into:

- Cultural Background,
- Past Experiences
- Educational Level,
- Maturity Level, and
- Personal Tendencies

Cultural Background: Investor's cultural background bears heavy impact upon his/her attitude towards risk perception. Hence, when analyzing individual investor's risk attitude, we should think of his ethnic and religious background as well as his/her family context to understand his/her risk attitude (Noon, 2000). In this era of globalization, several social researchers conducted research across the boundaries and determined that individual investor show different behavior in his investment in different types of culture and society (Ricciardi, 2006).

Experience: It plays a very vital role in investment decision making; while calculating risk, one reviews experiences regarding similar situations. Therefore, it is critical to assess ones previous experiences while analyzing his risk attitude (Haam, Grimes, Popkin and Smith, 2001). Personal past experience has a great impact on individual risk taking behavior, greater the frequency and degree of experience of risk taking the more risk will he/she take (Hayward et al, 2006).

Education Level: Psyche of investor heavily depends upon his level of education. It affects investor's perception of risk. Less educated people are more skeptical in their perception of risk, whereas, educated people tend to take rather greater degree of risk (Grimes and Snively, 1999). Investors having higher education tend to invest in risky asset i.e. level of education have an impact on individual's tendency to bear risk (Chen & Tsai, 2010).

Age or Maturity Level: Age or Maturity Level of Individual is another investment factor. Young investors lack in analytical skills to precisely evaluate risk (Mann, Harmoni and Power, 1989). Hence, lack of abstract and deep thinking, hampers young investors to perceive things in broader context resulting higher risk attitudes (Steinberg 2004, 2005). A number of studies have been conducted and concluded that there is an inverse relationship between maturity level and risk forbearance i.e. low age high risk and vice versa(Frijns et al., 2008).

Personal Tendencies: In addition to these factors, individuals have certain set patterns of psyche like optimism or pessimism. Optimistic people tend to take higher degree of risk than the pessimists do. They tend to overlook certain risk factors and over-simply risk environment (Bowling and Ebrahim, 2001). An investor's social factors also affect the individual decision process, the investor rationally, analytically search the market efficiency, and then determine the investment alternative.

Factors Affecting Presentation of Risk: Risk Presentation has heavy impact on risk perception. Within presentation of risk, researchers are interested in designing of risk and the credibility of information source. The way risk information is framed affects its perception (Edwards, Elwyn and Mulley, 2002). Positive framing, as telling that half glass of water is full rather saying that half is empty, effects perception of risk. However, in some cases negative framing could also be helpful. For example, if you have to convince people to undergo a screening test for detection of some disease, you have to negatively frame the chances of risk to convince the people to take the test. In addition, investors tend to magnify risk if they do not trust the source fully as a precautionary measure (Benett, 2006). Similarly, degree of uncertainty causes people to view risk as larger than actual.

Factors Regarding Characteristics of Risk: Nature and characteristics of risk have impact on perception of risk. Harvard Centre of Risk Statistics, 2003 shows that individuals are more concerned about the risks that are beyond their control, are involuntary, have some uniqueness or novelty, are a consequence of other humans' mistakes or deliberate actions or could be more easily recalled.

Employees Investment Behavior: Decision of Employee Investment Behavior depends on the following constructs as frequently in behavioral finance literature (Rayan and Zaichkowsky, 2010):

- Investor Confidence
- Time horizon
- Risk Attitude
- Control

Investor Confidence: Investor Confidence is a state that shows chosen option/action is very affective. Most of the researcher and scholars agreed that, to determine the investment decision making of an investor confidence plays a crucial role. Conventional school of thought recommends that investor's behavior is more confident when stocks are lifting upward, and lack of confidence behavior when stock is facing downfall. Investors react differently to positive price shocks than negative shocks in prices. Investor's confidence on decision-making can be pointed by immense fluctuations in stock prices (Ray & Sturm, 2003).Confidence of investor also stimulates investor towards more and more frequent trading. More confidence of investor also tends to more frequent trading behavior (Barber and Odean's, 1999).

Time Horizon: A time spans in which an individual investor expected to invest his wealth. Some recent research and studies conducted a more extensive debate on relationship between investment time horizon and investment behavior. Empirically research concluded that individual investor who invests for longer period of time they behave towards the more risky investment and vice versa (Klos, Langer, and Weber, 2003). The experts of investment recommended that if individual investor invests for longer period they invest in risky assets. Siebenmorgen and Weber (2004) have conducted research on investment horizon and its effects on investment behavior. The result shows that investment horizon has a direct impact on behavior of the individual investor. Benartzi and Thaler (1999) determine the influence of time horizon on investment behavior. They work on taking different times i.e. one-year investment and thirty-year investment.

Risk attitude: Different people react differently when they perceive risk in a certain situation. Their psychological reaction is called attitude. It could be an attempt to avoid the negative fallout of that situation or they may attempt to take advantage of that situation i.e. they may think of exploiting the situation in their own favor. Risk taking attitude could be termed as risk seeking or propensity to take risk and risk avoidance is usually called risk aversion (Rohrmann, 2008). Weber (2003) stated that risk attitude is a reaction that results from the subjective perception of risk. Some people perceive risk as something enjoyable and then try to take advantage of it by putting themselves in risky situations. They try to enjoy the uncertainty and want to explore what could be the outcome of this uncertain situation. Others may like to avoid such a situation and they take safe position and thus avoid the risk. Markowitz (1952), in his classical portfolio theory stated that investors are compensated for taking systematic risk. Therefore, risk attitude depends that whether one is interested to increase his returns by taking a certain degree of risk.

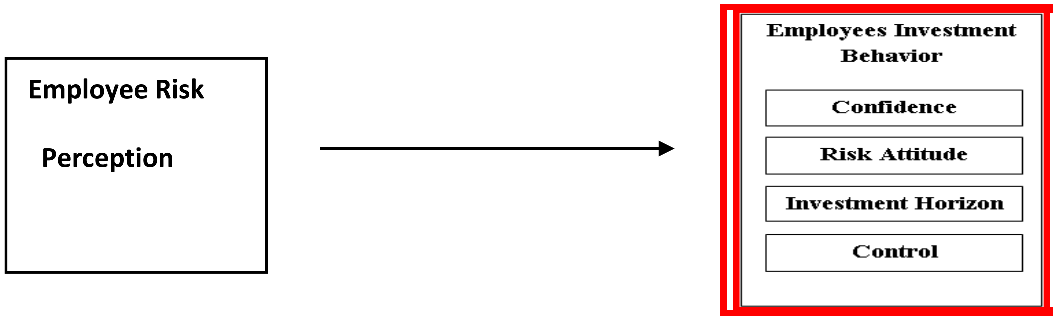
Investor control: Control is the key factor of investor behavior. Many behavior researchers found the relationship between individual investor behavior and control. Individual investors that trade quickly and watch their investment carefully they have high level control about their investment decision. Investor involvement and control increase the confidence and choice of investor behavior (Langer and Roth, 1975). Rayan and Zaichkowsky (2010) found that there is a significant relationship between investor behavior and their investment control.

3. Risk Perception and Investment Behavior

The decision making behavior of an individual is affected by the attitude towards the risk as well as the way in which the risky investment risk is subjectively perceived by the individual such as decision making behavior of an investor is influenced by the stocks. Sitkin and Pablo (1992) and Sitkin and Weingart (1995) discussed that taking action on risk is affected by both perception of risk and attitude towards risk. A number of empirical researches have been conducted on this bond and concluded that investor decision-making process according to his investment is majorly affected by risk perception (Weber and Hsee, 1998). Chen and Tsai (2010) investigated empirically the relationship between perception of risk and decision making of investment particularly they consider the individual investor factors. Asset allocation is crucial part of decision making of an individual investor who requires more return from investment and less loss (Veld and Markoulova, 2008; Frigns et al, 2008).

A lot of researchers, academicians and experts conducted research under simple investment choice but some psychologists and researchers also conducted research and make decision under uncertainty. Some researchers indicate that decisions of investments largely depend on how much individual take risk financially (Grable et al, 1999) and risk forbearance (Veld and Veld Markoulova, 2008). It is important for individual investor to notify the crucial factors that play significant role in portfolio choices especially when he/she perceives risk (Grable et al, 1999: Hallahan et al, 2004). The contribution of our paper is to make a bond between perception towards risk and individual investor decision making who makes investment in different equity shares options. Tolerance of risk is the individual behavior towards the decision making so this a significant factor that is used by management and other service providers at the time of investment. On this factor an individual investor trades off between risky and risk less assets in his portfolio and after this he invests in that asset that gives him more return according to his requirement (Hallahan et al, 2004). If the level of perception towards risk and forbearance of risk is different, the individual investor thinks differently about his investment, based on economic position and his psyche; for this reason, different investors within different concepts about risk make his choice in investment differently.

Model:



P1: There is direct relationship between employees risk perception and employees investment behavior.

4. Discussion and Practical Implications

Section of this research study depicts the findings of research work. All findings are based on past literature results and evidences. Mainstream objective of this study is to examine and present relationship between employee's perception about risk and their investment decision making. Previously only employee's risk perception was studied by different and very few researchers' .this research study tries to explore and finds the risk perception and its relationship with investment behavior taking the employees prospective. Investors behavioral about risk perception changes about 25% to 30% in all cases. Sitkin and Pablo (1992) found that there is a direct relationship between risk perception and investor behavior. Past experience, positively or negatively influence investor behavior regarding risk perception. Bhowal and Singh (2010) also suggested that risk perception can be managed, and policy makers should try to manage the risk perception if one is aware about his/her level of risk perception. The degree of risk taking depends upon the extent the type of individual investor's behavior. Segments of individual investors: 1) risk-intolerant traders; 2) confident traders; 3) loss-averse young traders; and 4) conservative long-term. Risk perception & return perception is directly affected individual investor behavior. In previous researches, many studies found the direct relationship between employees risk perception and employees investment behavior.

The main key constraints of individual investor are (i) risk attitude (ii) control (iii) confidence (iv) time horizon. Investor always focuses on these key attribute many researchers found different relations of these constraint with investor behavior. Investor behavior directly influence by investor confidence, previous Investor behavior attribute are the key constraints that enhance the investor behavior found that confidence stimulate about 80 percent investor to invest more (Barber and Odain, 2003). Weber (2003) suggested that risk attitude is a reaction that results from the subjective perception of risk when investor invests. Some individual perceive risk is enjoyable and then try to take advantage of it by putting themselves in risky situations. Siebenmorgen and Weber, (2004) found that individual investor invest for longer period they invest in risky assets. Investment in shares is in fact making a choice between risk and return. More you go for return, more you have to take risk (Fischer and Jordan, 2006). Earlier studies found that investment behavior of investor depends on their perception of risk. High they perceive risk; more return will they demand (Singh and Bhowal, 2008).

This study help managers to make such policies that facilitate employees. In modern era employee treated as a capital of any organization. Every one discussing about the delightness of customers, but in reality employee satisfaction is more important than customers. This research work helps management to make their employees more committed by going beyond the traditional ways to make employees more satisfied than ever i.e. When manager provide financial information to their employee, employee is willing to invest in their own company. He or she is also a customer of that company. Employee is more committed with his or her organization. They perform their duties with profession and honest way. Therefore, when organization offers IPOs, they must take care their employee; especially in large organization, they have huge number of employees.

5. Conclusion and Future Recommendations

After discussing lot of behavioral finance literature, we conceptualize that individual decision-making process with respect to equity shareholders is affected by the variety of factors. If investor is more confident than his investment, behavior will be more frequent towards investment and he will take more risk. It is find that if time horizon will be enormous investor will invest in risky assets. The way investors perceive risk and react to it depends on his/her personality traits, level of confidence and return level. The more return he/she requires the extra systematic risk he/she would have to bear. Like other research, studies this research work also have some limitations and constraints .Firstly this is a conceptual study mainly based on previous persisting literature and findings. It provides an opportunity to various researchers to empirically test and measure this relationship, because empirically testing of these variables and relationships can give more accurate picture of this research work. Secondly, investors risk propensity can be used as predictor or moderator of risk perception towards their investment decision making.

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