Impact of Risk Behaviour and Demographics on Financial Decision Making Moderated by Financial Sophistication

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Research Highlights

The research fall in between the traditional finance and cognitive domain of financial decision making by applying the behavioural finance to practical decisions, having overall impact on the economy when applied to the whole community. Research proposed three hypothesis, 1st to test impact of Risk behaviour and demographics on financial decision making, investigate the correlation between financial sophistication and financial decisions and 3rd the impact of risk behaviour and demographics on financial decisions moderated by financial sophistication. Survey questionnaire responses from 775 respondents has been used for analysis using Andrew Hayes process of moderation. Results indicated that Financial Sophistication significantly moderates the correlation between risk behaviour and demographics, demographics were significantly and positively, while risk behaviour was negatively correlated to financial decisions, however when moderated by financial sophistication the correlation of risk behaviour changes to positive indicating that even Risk seeker would also diversify investment when moderated by financial sophistication.

Graphical Abstract
Research Objectives

Studies examined that financial decision making can be correlated with rationality (Han, Hirshleifer, & Walden, 2018) and individual biases were found to be dominant characteristics, having significant relationships with the investor’s behaviour. Aim of this research was to investigate the same by concentrating on larger segment of society i.e. common household, prone to making investment mistakes and affect the economic health of the society (Calvet, John, & Sodini, 2009). Objective of this research is to investigate whether demographic factors, risk behaviour impact financial decision making and to what extent financial sophistication moderates the relationship, questions for this study are (1) Whether Demographics and Risk behaviour influence investment decisions and is the relationship moderated by financial sophistication? (2) Does financial sophistication affect investment decisions as predictor? (3) Does impact of risk behaviour upon choices change when moderated by financial sophistication? The purpose of this study was to look for reasons behind faulty investment decisions, follow general trend or hearsay despite available information on pros and cons of the financial products. The findings of this study can shape the direction of the economy and gain significance to suggest the decision makers to educate the people and enable them to process the available information to an informed and rationale decision, resulting in improving overall health of an economy keeping profitability in control and help the economy to grow at healthier pace (Kadoya & Khan, 2016).

Methodology

Data has been collected from non finance, non-professional, diverse and multinational household respondents. Out of 2100 survey instruments only 775 responses have been received i.e. 36%, unfilled and incomplete questionnaires were rejected. Questionnaires were distributed in eight cities of Pakistan with diverse cultures and literacy level, however 150 questionnaires have been collected from people of Canada, Tunisia, Romania, Jordan, Moldova, USA and UK including 85 military personnel, moreover 775 response also include personal interviews of 18 respondents in Pakistan. Questions included Socio-demographics, risk propensity and basic / sophisticated financial literacy related questions. Risk behaviour has been studied in two domains i.e. Risk seeker and risk avoider to determine the personality, financial sophistication has been observed as literate or illiterate, these questions were numeracy and basic financial questions which were either correct or incorrect, irrespective of the options, so the outcome was “sophisticated” or “non-sophisticated”.
data has been analysed using Andrew F. Hayes process of moderation (Hayes, 2012) analysis. Risk Behaviour has been taken as independent variable, demographic variables as control variables, financial sophistication as moderating variable and investment decisions as dependent variable, for effect of moderation an interaction term has been created between risk behaviour and financial sophistication.

**Results**

Financial sophistication (FS) significantly correlated to dependent variable (DV) i.e. Investment choices with p-value of 0.0525, however the coefficient of relationship is negative that would mean financially sophisticated people tend to be less diverse and their basket of investment is restricted to fewer options as compared to Non-sophisticated people. As regards Risk behaviour (RB) the correlation is negative with DV, therefore it would depict that Risk Avoiders tend to make diverse investments as opposed to the Risk Seekers, however p-value of 0.000 reflects RB as very strong predictor of DV as independentg variable and it’s ability to explain changes in the behaviour of DV. Moderating effect of RB on DV has been tested by creating an interaction term between Risk behaviour and Financial sophistication (RBxFS), the correlation is significant with p-value of .0028. Controlled variables of Gender, age, marital status, work status, educational qualification, professional studies, and savings pattern were found to be significantly correlated, however except for gender and marital status, the coefficient of all other controlled variables were found to be negative. Negative status does not necessarily reflect negative effect, it was due to values taken in the questionnaoire and the results were in line with the literature. The correlation of income status and life span (urban / rural) were found to be insignificant with p-value of 0.5836 and 0.1055 respectively.

**Findings**

The model for the study is significant with financial sophistication as moderator, however financial sophistication significantly moderated the correlation of risk behaviour and decision making. The capacity to diversify the investments increases with age, moreover married, widowed, and educated people have better diversified investments. Female and uneducated
have less diversified investments, in line with another study female respondents were found to take more risk (Kumar & Babu, 2018).

References


