

The Effect of Financial Goal and Wealth Level on Risk Tolerance: An Experimental Investigation

Yi Cai, California State University, Northridge¹

Yali Yang²

Abstract

The current study aimed to investigate how different kinds of financial goals influence individuals' financial decisions under risk and how individuals adjust their risk preferences when their wealth level changes. Research hypotheses about consumer risk tolerance as related to financial goal, wealth level, and financial gains/losses were proposed based on three descriptive theories. An investment game was employed in an experiment. The results showed a significant effect of financial goal on risk tolerance in the gains domain, indicating that individuals with an achievement financial goal are more risk seeking than those without a financial goal. In the losses domain, however, there was no significant difference in risk tolerance between individuals with and without a security financial goal. The results also revealed a significant effect of wealth change on individuals' risk tolerance. The pattern of the change of risk tolerance supported the research hypotheses regarding the wealth change effect, that is, individuals with an achievement goal will become increasingly risk seeking before reaching the goal; whereas individuals with a security goal will become increasingly risk averse before reaching the goal. Implications to financial planning also were discussed.

¹ Assistant Professor, Department of Family and Consumer Sciences, California State University, Northridge.

² Ph.D. in Housing and Consumer Economics