An Investigation of the Determinants of Investment Risk Behavior in Employer-Sponsored Retirement Plans

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This paper presents the results of an investigation of the determinants of investment risk behavior in employer-sponsored retirement plans. Using a field survey of 795 college and university employees, I examined the significance of demographic and attitudinal/dispositional variables on employees’ risk behavior in selecting among investment allocation options provided by defined contribution pension plans. The results identified primary causes of risky investment behavior including income, age, other retirement plan participation, self-efficacy, knowledge of investment principles and general risk propensity. © 2002 Elsevier Science Inc. All rights reserved.

A majority of public and private sector companies in the US provide their employees with pension plans as a form of indirect compensation (Kramerich, 1999). The salience of employer-sponsored retirement plans to American employees has grown in recent years as a result of a number of factors including the graying of the labor force and the increasing concern regarding the future solvency of social security (Dulebohn, Murray & Sun, 2000). Widespread agreement exists today among scholars and public policy makers that the retirement income security of future retirees will increasingly depend on their participation in employer-sponsored retirement plans and their own savings, rather than on social security (Bajtelsmit, 1996; Kramerich, 1999).

Defined contribution (DC) pension plans represent a major type of employer-sponsored pension plans. DC pension plans are similar to savings plans and provide a benefit based on annual contributions, as a percentage of pay made on behalf of the employee, and accumulated investment earnings on the employee’s account. Since the early 1980s, there

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has been tremendous growth in the use of employer-sponsored DC plans by public and
private sector organizations (Gustman & Steinmeier, 1993; Kruse, 1995). This growth has
been driven by employer efforts to reduce pension liability and to attract employees who
desire the portability and investment choice features of DC plans (Mitchell & Rappaport,
1993; Sollinger, 1993).

DC pension plans often place the investment decision responsibility on the individual
participant. Participants in these plans may be required to make choices among invest-
ment alternatives, representing varying levels of risk and potential investment return, that
will largely determine the amount of their final retirement benefit. Concern exists regard-
ing the investment choices DC plan participants are making because overly conservative
pension investment by plan participants may have extreme consequences for retirement in-
come security by providing smaller investment returns and savings accumulations than
riskier investment choices (Bajtelsmit, 1996). This concern is consistent with a major
premise of the classical approach to risk taking that contends that risk and return are pos-
itively correlated, and therefore if an individual wants to obtain higher returns, he/she
should, on average, choose investments with higher risks (Levy & Sarnat, 1984; Shapira,
1995).

The purpose of this paper is to report the results of an investigation of causes of risk
taking behavior in the investment decision process of DC pension plans. A field survey was
conducted that involved the administration of surveys to college and university employees.
The objective of the research was to identify determinants of risky behavior in the individu-
al investment allocation process of DC pension plans. Towards this end, the direct effect of a
number of hypothesized risk determinants were tested.

Background, Conceptual Model, and Hypotheses

A large amount of research attention has been given to risky decision-making among
various groups such as managers and executives (MacCrimmon & Wehrung, 1986, 1990;
Shapira, 1995; Sullivan & Kida, 1995), negotiators (Ghosh, 1992); gamblers (Rhoda,
Olson & Rappaport, 1999); financial planners (MacGregor, Slovic, Berry & Evensky, 1999),
entrepreneurs (Brockhaus, 1980), and students (Sitkin & Weingart, 1995). In addition, re-
search on risk taking has primarily focused on issues including preferences for risk (Arrow,
1965; Pratt, 1964; Ross, 1981), perceptions of risk (cf., Geweke, 1992), the reflection effect
(cf., Lewin, Schneider & Gaeth, 1998) and individuals’ determination of probable outcomes
in risky decisions (cf., Shapira, 1995; Slovic, 1967). Less research attention has been given
to the individual investment decision process and a dearth of research exists that has focused
on identifying determinants of risky behavior in the individual investment allocation process
of DC pension plans. Towards this end, the direct effect of a
number of hypothesized risk determinants were tested.

The importance of examining risky decision-making behavior among retirement
plan participants is underscored by a general conclusion among researchers that risk
behavior does not necessarily generalize across situations and may vary across individuals
(Bromiley & Curley, 1992). Specifically, research has found that individuals may be
risk-takers in certain situations (e.g., making financial decisions at work) while risk-averse
in other situations (e.g., making investment decisions with personal assets) (MacCrimmon
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