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Impact of Risk Tolerance on Investment Decision-Making Among Individual Investors

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Abstract

Risk tolerance plays a crucial role in determining investment behaviour among individual investors. Investors differ significantly in their willingness to accept financial risk, which influences their asset allocation and investment strategies. This study investigates the impact of risk tolerance on investment decision-making among individual investors. A survey was conducted among 225 respondents from different demographic groups. Statistical tools such as correlation and regression analysis were used to evaluate the relationship between risk tolerance and investment behaviour. The results indicate that higher risk tolerance significantly increases participation in equity and high-return investment options. Conversely, investors with low risk tolerance prefer safer assets such as fixed deposits and government securities. The findings emphasize the importance of understanding investor risk profiles for effective financial planning.

Keywords: *Risk Tolerance, Investment Behaviour, Individual Investors, Asset Allocation, Financial Decision-Making*

Introduction

Investment decisions involve a trade-off between risk and return. Investors must evaluate potential risks before allocating funds to different financial assets. Risk tolerance refers to an investor's ability and willingness to accept fluctuations in investment returns.

Understanding risk tolerance is essential for designing appropriate investment strategies. Investors with high risk tolerance are more likely to invest in volatile assets such as stocks, derivatives, and cryptocurrencies, while risk-averse investors prefer stable and predictable investments.

Behavioural finance research suggests that psychological factors, financial knowledge, and demographic characteristics influence investor risk tolerance. Therefore, studying risk tolerance helps financial advisors develop suitable investment portfolios.

This study examines the impact of risk tolerance on investment decision-making among individual investors.

Literature Review

Several studies highlight the importance of risk tolerance in investment behaviour.
Grable and Lytton (1999) developed a risk tolerance scale that helps measure investors' willingness to take financial risks.
Cohn et al. (1975) found that younger investors typically exhibit higher risk tolerance compared to older investors.
Barsky et al. (1997) identified demographic factors such as income, education, and wealth as key determinants of risk tolerance.
Additionally, Weber et al. (2002) suggested that risk perception varies across individuals, affecting their investment decisions.
More recent studies emphasize that behavioural biases and emotional factors also influence investor risk tolerance.

Research Objectives

1. To examine the level of risk tolerance among individual investors.
2. To analyse the relationship between risk tolerance and investment decisions.
3. To evaluate how risk tolerance influences asset allocation.
4. To determine the role of demographic factors in risk tolerance.

Research Hypotheses

H1: Risk tolerance positively influences investment decision-making.
H2: Investors with high risk tolerance prefer equity investments.
H3: Risk tolerance significantly affects asset allocation decisions.

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Research Methodology

Research Design

The study adopts a **quantitative research design** using survey-based data.

Data Collection

Primary data was collected through structured questionnaires distributed among individual investors.

Sample Size

225 respondents.

Sampling Technique

Convenience sampling.

Variables

Independent Variable

Risk Tolerance

Dependent Variables

Investment Decision

Asset Allocation

Data Analysis

Table 1: Risk Tolerance Levels

Risk Level	Respondents	Percentage
High Risk Tolerance	78	35%
Moderate Risk Tolerance	92	41%
Low Risk Tolerance	55	24%

Table 2: Preferred Investment Options

Investment Type	Percentage
Equity Shares	36%
Mutual Funds	28%
Fixed Deposits	20%
Government Securities	16%

Correlation Analysis

Table 3: Risk Tolerance and Investment Behaviour

Variables	Correlation Coefficient
Risk Tolerance – Equity Investment	0.64
Risk Tolerance – Portfolio Diversification	0.58
Risk Tolerance – Investment Decision	0.61

Interpretation:

Risk tolerance has a strong positive relationship with investment decision-making.

Regression Model

Investment Decision = $\beta 0 + \beta 1$(Risk Tolerance) + ε

Table 4: Regression Results

Variable	Coefficient	t-value	Significance
Risk Tolerance	0.71	8.03	0.000

$R^2 = 0.44$

Interpretation:

Risk tolerance explains **44% variation in investment decisions**.

Table 5: ANOVA

Source	F Value	Significance
Regression Model	64.12	0.000

Interpretation:

The regression model is statistically significant.

Discussion

The results indicate that risk tolerance significantly affects investment behaviour among individual investors. Investors with higher risk tolerance are more likely to invest in equity markets and diversify their portfolios.

Conversely, risk-averse investors tend to prefer low-risk assets with stable returns. These findings support behavioural finance theories suggesting that psychological and demographic factors influence risk perception and investment decisions.

Understanding investor risk tolerance helps financial advisors design suitable investment portfolios that align with investor preferences.

Conclusion

Risk tolerance is a critical determinant of investment decision-making. Investors with higher risk tolerance demonstrate greater willingness to invest in high-return assets such as stocks and mutual funds.

Financial advisors and institutions should assess investor risk profiles before recommending investment strategies. This approach can improve portfolio performance while ensuring alignment with investor preferences.

Practical Implications

Financial advisors should conduct risk tolerance assessments before portfolio construction.

Investment platforms should provide risk profiling tools.

Investor education programs should emphasize risk management strategies.

Limitations of the Study

The study is limited to a specific sample group.

Investor behaviour may vary across different economic conditions.

Future studies can examine behavioural factors influencing risk tolerance.

Future Research Directions

Future research may explore:

Behavioural biases affecting risk tolerance

Impact of financial literacy on risk perception

Cross-country comparison of investor risk profiles

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Conflicts of interest

The authors declare that there are no conflicts of interest regarding the publication of this paper.

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