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DETERMINATION OF FINANCIAL RISK TOLERANCE AMONG DIFFERENT HOUSEHOLD SECTORS IN SRI LANKA

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Abstract

This study examined the financial risk of tolerant behavior at the household level with particular emphasis on different household sectors in Sri Lanka. The analysis measured, the household willingness to take financial risk or risk tolerance based on a questionnaire survey. Financial risk tolerance was measured with the help of a likert-scale and a composite index was developed using the values for the answers. The study used descriptive statistics and also the one-way analysis of variance (ANOVA) test to compare the risk tolerance between the three main household sectors, i.e. urban, rural and estate. The effects of socio-econ-demographic factors upon financial risk tolerance of households were investigated using Tobit regression analysis. The results revealed that a majority of respondents exhibited an above average (high) risk tolerance as a whole and demonstrated significant differences in risk tolerance preferences of households at sectoral level. The results indicate that gender, age, education, occupational status, income, income diversification, distance to a financial institute and financial literacy are significant in the determination of the financial risk tolerance. The findings provide inputs for designing policies for the development of the financial markets in the Sri Lankan context.

Keywords: Financial risk tolerance, risk assessment, financial planning

1. INTRODUCTION

Understanding financial risk tolerance behavior within the context of developing countries is vital for policy making and implementation towards the development of financial markets. This paper reviews the financial risk tolerance behavior at household level with particular emphasis on different household sectors in Sri Lanka. Generally, risk refers to the uncertainties that are detrimental or disadvantages to the well-being of the households while it can remain in different forms. Hence, household will make certain decisions in anticipation of risk or in order to minimize the threat of failure to his (and his dependents) well-being. The behavior of risk taking individuals is such that they tend to work more in risky environments (Shaw, 1996). Theoretically, individuals who are more risk tolerant can earn more money and become more productive people like entrepreneurs who can contribute to the national income (Cramer *et al.,* 2001). The rationale behind this is that a country needs more risk tolerant people to activate the economy towards a higher economic growth. When the people are not naturally risk tolerant, there should be some ways of bringing them to such a behavior.

The economy of Sri Lanka is more often divided into three socio-economic sectors or communities such as urban, rural and estate. The people for different economic activities which need risk tolerance should come from these three different sectors. Although the prime concern of human

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