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“What is Risk? How Investors Perceive Risk in Return Distributions”

Abstract

We investigate the determinants of risk perception and investment propensity in a financial context. In a series of experiments, participants are presented with a series of return distributions. Our study design allows to separate various risk measures such as variance of returns, skewness, probability of losing or the maximum possible loss. Our results hint to the probability of losing being the main driver of risk perception and investment propensity. Volatility, which is typically used by researchers, financial advisors and the regulator, does not play a major role. Our insights should allow financial advisors and regulators to support an effective and understandable communication of investment risks to prevent suboptimal investment decisions.