How do people allocate risks between themselves and others?

February 23 2024, by Jovina Ang

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Whether you are conscious of it or not, the decisions you make every day involve risk.

Risks in the context of decision-making refer to uncertain outcomes of a decision.

People can either be risk-seeking (i.e., prefer options with uncertain outcomes) or risk-averse (i.e., prefer options with certain outcomes).

Previous research has shown that people often make more risk-averse decisions for themselves compared to when they are making decisions for others.

"Although research has indicated that people tend to be more risk-averse when making decisions for themselves than for others, my collaborator and I wanted to investigate whether this tendency still holds true in risk allocation situations between two people," Associate Professor Tsai Ming Hong told the Office of Research.

"An example of risk allocation can be seen in the allocation of compensation. If the supervisor decides that compensation should carry an element of risk, stock options or restricted stocks would be included as part of the total compensation package. However, if the supervisor decides to go for a risk-free compensation package, the entire compensation package would be entirely cash-based," he continued.

Previous research also found that people tend to exhibit different levels of risk preferences based on whether they perceive decision outcomes as gains or losses.

These findings are consistent with what Prospect Theory prescribes.

Prospect Theory states that when people are faced with a risky choice leading to gains, they tend to be risk-averse. For example, when given a choice between getting $1,000 with certainty or having a 50 percent chance of getting $2,000, most people tend to opt for the $1,000 option.

However, when people are faced with a risky choice leading to losses, they tend to be risk-seeking—which explains why even after losing a lot of money at the casino, people are extremely tempted to gamble bigger to recoup losses.

That said, the effects of gain-loss domains on risk allocation between two people have not been studied.

Another aspect that has not been studied is the influence of social value orientation (SVO).

SVO is a concept that describes and categorizes people according to their personal attitudes about the distribution of resources.

Prosocial people pursue equal distributions and the best joint outcomes between themselves and others, whereas proself people seek to maximize their personal gains.

Thus, when it comes to risk allocation in decision-making, it is likely that prosocial people would allocate risks equally between themselves and others. In contrast, pro-self people are more likely to allocate risks to avoid potential losses and pursue gains.

The research

The research project with three experimental studies was led by Associate Professor Tsai and his collaborator, Professor Verlin B. Hinsz, from the Psychology department at North Dakota State University.

The research investigators chose an adult sample for all the studies to mimic risk allocation in real-world situations.

The research participants were sourced from CloudResearch (formerly known as TurkPrime). CloudResearch is an online platform for researchers to post studies and crowdsource participants for a small fee.

A total of 1,124 participants were recruited from the US. They were given a small incentive to participate in the studies.

All the studies were conducted entirely online using the Qualtrics survey tool.

Results

The results of three experiments demonstrated that participants were more likely to share the risks equally between themselves and the other party than to distribute risk unequally.

The studies also show that prosocial people tend to allocate risks equally regardless of them facing a risky choice, leading to either gains or losses.

In contrast, pro-self people tend to allocate fewer risks to themselves when faced with a risky choice leading to gains versus losses.

Implications of the research

Professor Tsai and Hinsz's research offers novel real-world implications for risk preference, suggesting that prosocial people prefer options with moderate risk for themselves and others.

In contrast, previous research has suggested that people make more risky decisions for others than themselves. For example, people may encourage another person to purchase risky stocks or join a blind date as they themselves may be reluctant to engage in these risky activities.

The study is published in the journal *Thinking & Reasoning*.

More information: Ming-Hong Tsai et al, Gain-loss domain and social value orientation as determinants of risk allocation decisions, *Thinking & Reasoning* (2023). DOI: 10.1080/13546783.2023.2259543

Provided by Singapore Management University