THE EFFECT OF AFFECTIVE STATES ON RISK PREFERENCES: AN EXPERIMENTAL EXAMINATION WITH MONETARY INCENTIVES

Abstract

Using a capital budgeting case, Moreno et al. (2002) report that affective reaction exerts a strong influence on accounting decision making that can negate prospect theory’s predictions, resulting in risk taking in gain contexts and risk aversion in loss contexts. We extend their study by examining the effect of moods on individuals’ risk preferences and subjecting their decisions to monetary consequences. Two hundred and twenty four participants took part in a two-part experiment with mood and frame as two between-subjects treatments. In the first part of the experiment, we manipulated three mood states – positive, neutral, and negative - by requiring our participants to read one of three different passages. In the second part of the experiment, participants were required to make 21 decisions between a riskless and a risky choice with the expected values that were higher and lower than the value of the riskless choice. The results suggest that the impact of moods on individuals’ risk preference is not straight forward. Specifically, while results from the pooled data provide general support for the findings of Moreno et al. (2002), they indicate that such findings hold only at the extremes. Implications of this finding are discussed.

Acknowledgements: The authors gratefully acknowledge the financial support provided by the Schulich School of Business, York University. The authors thank Alan Richardson for his helpful comments on an earlier draft of the paper.