

Investing Like My Parents: Do Parents Affect Children's Risk-Taking Behavior?

Ziwei Zhao
HEC Lausanne and SFI

Abstract

This paper shows that learning from parents explains heterogeneity in financial decisions later in life. Using parents' stock market experiences before parenthood as instrumental variables for parents' stock market decisions, I find that parents' participation and risk-taking positively affects children's stock market decisions.

More importantly, exploiting a finding that parents spend more quality time with their first child, I find that this parental effect is mainly driven by learning from parents through one's childhood interactions with parents. I also examine the wealth outcomes implied. Our results contribute to the understanding of how family traits passed down over generations could lead to wealth inequality across families.

Introduction

One of the most important topics in financial economics is the origins of risk-taking behavior. Most research focuses on examining how the individual investor's investing experience and genes shape their stock market decisions. Studies have shown that the more recent personal experiences with macroeconomic shocks (such as stock market depressions) change people's stock market participation decisions (Malmendier and Nagel, 2011). Another strand of studies argues that parents' genes affect children's risk-taking. And surprisingly, nurturing has very little explanatory power for financial risk-taking (Barnea, Cronqvist, and Siegel, 2010).

In this paper, I address this apparent conflict and extend the literature by focusing on a specific channel, learning from one's parents, which can be viewed as a type of "family traits" that get passed down in the family generation over generation. I ask whether parents affect their children through early-on interactions and have a long-lasting effect on their children's risk-taking behavior in adulthood. Specifically, I test whether parents pass their previous stock market experiences to their children through this channel.

Identification

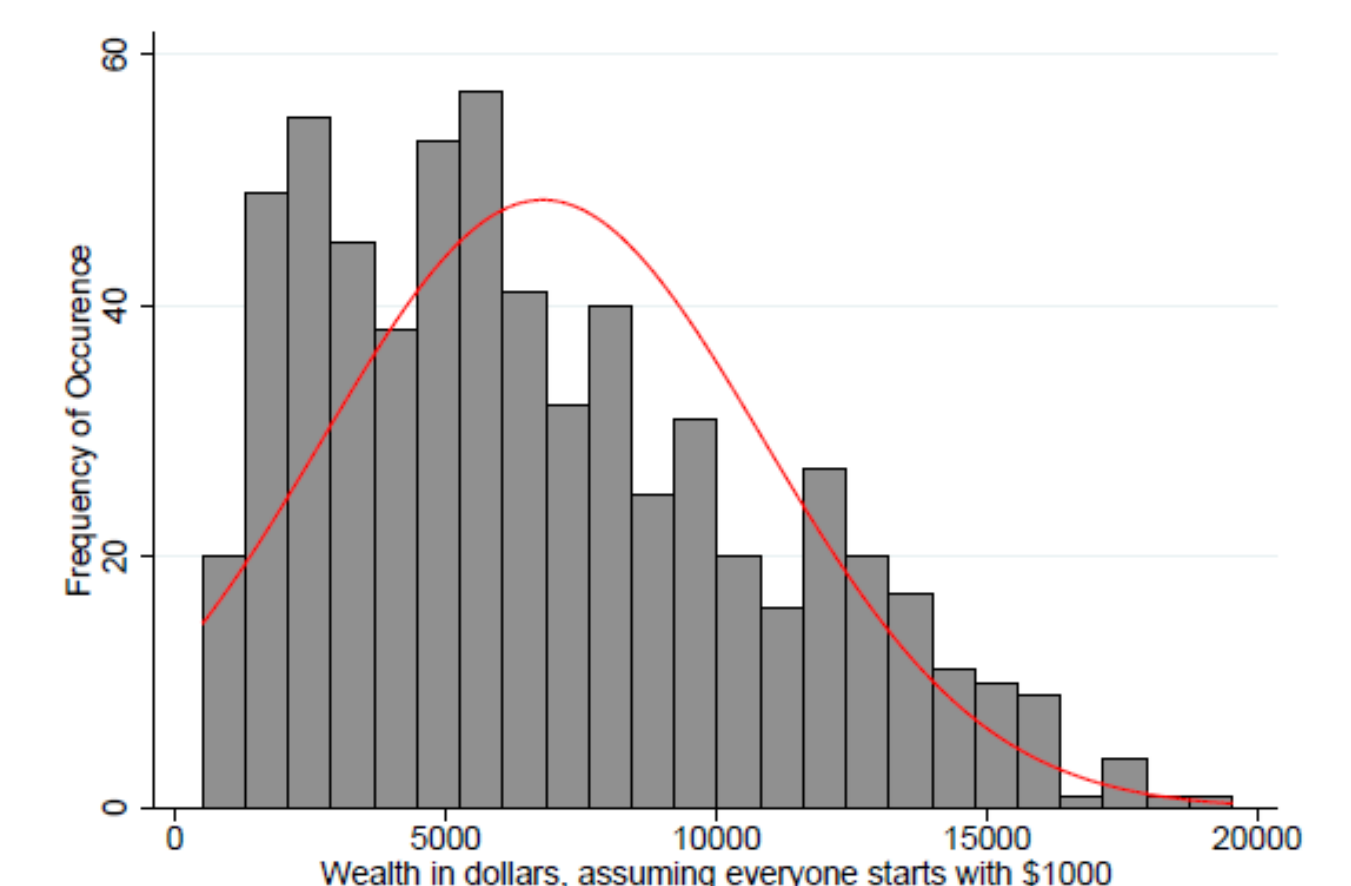
- Studying how learning from parents affects children's stock market decisions with available data requires:
 1. Detailed *personal financial data* linking parents with children;
 2. *Variations across parents risk-taking*, excluding factors that affect both children and parents;
 3. *Isolate the "learning-from-parents"* mechanism with variations within same family.
- I address 1. and 2. with IVs and data from Panel Study of Income Dynamics.
 - Measures of parents risk-taking: induced by moments of parents' stock market experience *before children were born*.
 - Experience measured by: *Stock Market Return, Income Growth, Capital Gain Tax*.
- I address 3. by exploiting a study that finds *first-borns receive 122-183 hours more quality time per year than other children in the same family* during formative years.
- Specifically, I evaluate whether child i 's stock market decisions are affected by her parents i 's instrumented stock market decisions.
 - 1st Stage : Parent Measure** $e_{i,t} = \delta + \lambda \text{Parent Exp}_i + \mu \text{Controls}_{i,t} + \eta_{i,t}$
 - 2nd Stage : Child Measure** $e_{i,t} = \alpha + \beta \text{Parent Measure}_{e_{i,t}} + \gamma \text{Controls}_{i,t} + \varepsilon_{i,t}$
- Parent or Child Measure $e_{i,t}$ represents: (1) if individual i participate in the stock market at time t ; (2) the percentage of individual i 's liquid asset that is allocated to the stock market at time t .
- Parent Exp i is the moments of parents' stock market experience before their child i was born.
- Controls i,t : child i 's experience, education, number of children, liquid asset, income, pension, retirement, ethnicity, marital status and year FE.

Results

1. Using parents' stock market experience before a child was born as IVs for parents' stock market participation (Measure 1) and risk-taking (Measure 2), I find that parents' stock market decisions positively affect children's stock market participation (Measure 1) and risk-taking (Measure 2).
2. The results show that learning from parents has a causal effect on children's stock market decisions. Specifically, children that enjoyed more quality time are more heavily affected by their parents.
3. This effect does not fade with the time that the child left home, or when the child moves to a different state.
4. This effect is long-lasting enough to have an impact on one's grandchildren. ⇒ Multi-Generation Wealth Inequality Implications

Main Results

	Children's Measure 1	Children's Measure 2
Parent's Measure 1 (Instrumented)	1.440** (2.52)	
Parent's Measure 2 (Instrumented)		0.269*** (2.65)
Child Exp Measures	Y	Y
Other Controls	Y	Y
Year Fixed Effects	Y	Y
Clustered at Birth Year Level	Y	Y
N	12,887	12,887



Discussion:
Wealth Inequality Driven by the Channel

Discussion

To explore the wealth inequality implications of these findings. I designed a simple back of envelope thought experiment. Specifically, I conduct a "back-of-the-envelope" 3SLS estimation of the wealth outcomes driven by the grandparents' stock market investment and the effects of grandparents on their children and grandchildren.

It is found that with the predicted percentage of assets allocated to the stock market each generation, the grandchildren generation households could end up with a wealth difference as high as about \$20,000 (every family starts with \$1,000). The sample ends with a Gini coefficient of 0.34.

Conclusions

This study shows a clear, significant and persistent learning-from-parents effect from parents to children in terms of risk-taking behavior. It also shows how past stock market experience shapes us through a multi-generation structure since the effect of grandparents before their children are born has a statistically significant effect on their grandchildren. I show that the multi-generational effect is potentially large enough to significantly affect wealth inequality.

Contact

Ziwei Zhao
HEC Lausanne and Swiss Finance Institute
E-mail: ziwei.zhao@unil.ch

References

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2. Barnea, A., Cronqvist, H., & Siegel, S. (2010). Nature or nurture: What determines investor behavior?. *Journal of financial economics*, 98(3), 583-604.