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The Impact of Financial Literacy and Risk Propensity on Retirement Plan Choice & Supplemental Contributions Made

Sanjay Gupta

Professor of Accounting, Department of Accounting, Valdosta State University, USA

Abstract

Retirement savings in an employer sponsored retirement plan will likely be the single largest retirement saving for an employee. While most institutions offer their employees an option to pick between a defined benefit or a defined contribution plan, more recently there has been a steady decline in the number of employers offering the defined benefit plan. This change places the burden of making appropriate investment choices on the employee. This change in the retirement landscape increases the importance of an employee's level of financial literacy and risk propensity since it can have a significant impact on their retirement income (Clark & Strauss, 2008).

Prior research has shown that there is widespread lack of financial literacy among employees with respect to the different retirement plans offered by their employers (Moore, 2020). This lack of financial literacy may prompt an employee to pick a defined benefit retirement plan (Godbout, 2020) and deter them from making supplemental contributions. Prior research has also shown that an individual's risk attitude has an impact not only on the investment choices they make within a retirement plan but in the choice of a retirement plan itself (Wong et al, 2018)

This research will examine the impact of financial literacy and risk attitude of an employee on the retirement plan chosen by an employee, defined benefit versus defined contribution. This research will also examine the impact of several variables, age, salary, gender, marital status, number of dependents, academic rank, academic discipline, and years to retirement on the risk attitude of an employee. Finally, this research will examine whether financial literacy and risk attitude of an employee drives the amount of supplemental contributions made by an employee.

Keywords: retirement planning, risk propensity, supplemental retirement, financial literacy