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The Effect of Financial Literacy and Risk Tolerance on Investment Decisions

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Abstract

This study aims to determine the effect of financial literacy and risk tolerance on investment decisions. This research was conducted on 64 students who joined the capital market study group at the Bali State Polytechnic. The sampling method used is saturated sampling. Based on the results of the multiple regression analysis that has been carried out, it was found that financial literacy has an effect on investment decisions and risk tolerance has an effect on investment decisions.

INTRODUCTION

The number of capital market investors in Indonesia has increased from year to year. Based on KSEI data on November 3, 2022, the number of capital market investors referring to the Single Investor Identification (SID) has reached 10,000,628. The COVID-19 pandemic has had a significant impact on increasing the number of capital market investors, this can be seen from the significant increase in 2020-2021. OJK found that since 2020 the growth in the number of investors in the capital market has increased by more than 2.5 million every year. The current growth in the number of investors is dominated by young investors, on average under 30 years old. This is a good sign for the Indonesian economy because from an early age people have started to be literate about investing. However, the increasing number of young investors in the capital market also needs more attention so that investors and potential investors can decide which is the best among the choices. Any decision taken by the investor without proper information or with misleading information may generate unexpected outcomes (Sharma, 2020).

Before making an investment, it is necessary to pay attention to several important things before determining the types of investments and all the consequences. During the period of investment it is a challenge for financial professionals, experienced investors, and especially the ordinary private households make a investment decision due to highly complex factors such as risk, ambiguity, and choice overload. Any decision made by investors on the basis of poor or misleading information or on the basis of poorly analyzed information may lead to unexpected outcomes (Novianggie & Asandimitra, 2019). The process of decision making becomes easy when all the confounding variables are well recognized by investors. The variables which direct them to make the right decision so that the losses can be avoided or reduced in the future (Awais. et al 2016).

For this reason, good financial literacy is needed. Financial literacy is considered as a base on which investors can make rational decisions. It helps investors to match the requirements with all the alternatives available for investment that can strengthen the expected outcomes (Sharma, 2020). Financial Literacy as the fundamental of finance is a strength that can be used as the skill and ability of a person in managing financial resources that they have effectively.

The existing studies also show that so many young and old age people remain unknown about the very basic concept of economics which seriously affects investment decisions (Sharma, 2020). In general, investors who are financially literate and know the limits of their risk tolerance when investing tend not to be easily influenced by investment decisions made by other investors or publicly available news, so they are not easy to make wrong investment decisions (Tamara. et al., 2022).

Many studies regarding financial literacy on investment decisions still show inconsistent results, such as the research conducted by Tamara et al. (2022) shows that financial literacy has a significant effect on investment decisions, while research conducted by Pradikasari & Isbanah (2018) financial literacy has no effect on investment decisions. Research on risk tolerance for investment decisions also shows inconsistent results where the results of research conducted by Zahida (2021) found that risk tolerance has a significant effect on investment decisions, while research conducted by Simangunsong (2021) has no effect on investment decisions. So, the research for these variables still needs to be done.

LITERATURE REVIEW

Decision Theory

Decision Theory as put forward by Hansson (1994) is a theory of a decision that describes how a person decides something as his freedom. In making a decision, a person will be faced with several choices that he must choose and take one of them as material for consideration, which will lead to the achievement of a desired goal. It can be interpreted that decision theory is related to behavior that is directed to achieve a goal with various choices.

Behavioral Finance Theory

According to Bodie et al (2016) behavioral finance is a financial theory about the attitude of people ignoring everything in decision-making and deliberately making a difference. One of the factors in decision-making is psychological factors. Psychological factors influence the investment decision-making of an investor and the results to be achieved. Psychological factors tend to influence a person to act irrationally.

Prospect Theory

Prospect theory based on Kahneman and Tversky (1979), is a theory regarding the decision making of a person in a condition that led into uncertain result. It also can be said that an individual cannot always move as the finance theory by considering the risk and uncertainty, but the person will give additional uncertainty factors (psychology and behavior) to get a rational choice.

HYPOTHESIS

The Influence of Financial Literacy to Investment Decision

Financial literacy defined as an individual ability to obtain, understand, and evaluate information which is relevant to the decision making by understanding of the financial consiquence that occur as the effect of the development in the complexcity of the global finance (Danes &Haberman, 2007). Individuals that involved in making complex financial decisions, will be trapped in financial problems, If they are not wise in understanding this problem. That is why financial literacy is important because individuals have a responsibility for financial security in their lives (Herawati, et al. 2018).

The higher the *financial literacy* of an investor, the more understanding they are about the finance field, from knowing the risks that they will deal in the future, having skills and abilities of the fund they have. For this reason, it will increase the possibility of making a decision about the investment they made. Those possibilities may happen due to their skills in predicting the possible opportunity in making the investment. Otherwise, if a person has a poor skill in *financial literacy*, they will be more careful in making an investment decision (Novianggie & Asandimitra, 2019). Research conducted by Darwati el al. (2022), Zahida (2021) shows that financial literacy has a significant positive effect on investment decisions.

H_1: financial literacy has a significant positive effect on investment decisions.

The Influence of Risk Tolerance to Investment Decision

Risk tolerance has been conceptualized separately, as well as measured and evaluated in many recent empirical studies. It is defined as the maximum uncertainty that will be received when making personal financial decisions, or as the willingness to take risks on opportunities to achieve more profit (Grable, 2008; Grable and Joo, 2004). Investors who have high risk tolerance are more willing to bear the risk of loss from an investment as long as the investment provides an opportunity to provide a higher level of profit. If an investor is afraid of risk, the investor might try as much as possible to minimize risk so that he would prefer to allocate funds to assets that are low in risk. Investors will align the form of investment chosen based on the investor's tolerance for risk (Aina & Lutfi, 2019). Based on research conducted by Budiarto & Susanti (2017), Lathifatunnisa & Wahyuni (2019) shows that risk tolerance has a significant effect on investment decisions

H_2: risk tolerance has a significant positive effect on investment decisions.

METHODS

The type of study used conclusive causality research that has a function in exploring the relation of cause and effect in the independent variable and dependent variable. This study also used quantitative data by using a questionnaire. The population of this research is the university students who joined the capital market study group at the Bali State Polytechnic, totaling 64 peoples. The sampling technique of the research is saturated sampling. The technique of data analysis of this study used multiple linear regression analysis.

RESULTS AND DISCUSSION

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Table 1. Multiple Linear Regression Results

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	8.676	4.392		1.976	.053
	Financial Literacy	.191	.073	.284	2.600	.012
	Risk Perception	.797	.186	.466	4.274	.000

a. Dependent Variable: Investment Decision

Source: Processed Research Data (2023)

The results of the multiple linear regression equation between financial literacy and risk tolerance variables on investment decisions can be concluded:

1. **The Effect of Financial Literacy on Investment Decisions**

   Based on the results of multiple linear regression between the effect of financial literacy on investment decision, a regression coefficient of 0.191 is obtained with a t-statistic value of 2.600 and a significance value of 0.012. These results indicate a significant positive influence, meaning that the better the financial literacy, the better the individual will be in investment decisions. This means that H1 is accepted.

   These results support research conducted by Asmara & Wiagustini, (2021) stated that financial literacy has a significant positive effect on investment decisions. Investors that understand financial literacy, will cause investors to be more effective in making stock investment decisions. Investors who have a high level of education and a good level of financial literacy will be more considerate of risks, concepts, knowledge, and understanding of finance which will make investors able to prevent or avoid possible risks of loss in investing in stocks such as capital loss. In addition, by understanding financial literacy, investors will be able to obtain benefits such as more optimal capital gains so the role of financial literacy in stock investment will be very important to optimize profits and minimize the risks of losses that may occur (Asmara & Wiagustini, 2021).

2. The Effect of Risk Tolerance on Investment Decision

Based on the results of multiple linear regression between the effect of risk tolerance on investment decisions, a regression coefficient of 0.797 is obtained with a statistical t-value of 4.274 and a significance value of 0.000. These results indicate a significant positive effect, meaning that the higher the risk tolerance, the higher the investment decision. This means that H2 is accepted. These results support research conducted by Nguyen et al. (2016) which shows that risk tolerance has a significant positive effect on the allocation of risk assets. Investors who have high risk tolerance are more willing to bear the risk of loss from an in- vestment as long as the investment provides an opportunity to provide a higher level of profit. If an investor is afraid of risk, the investor might try as much as possible to minimize risk so that he would prefer to allocate funds to assets that are low in risk. Investors will align the form of investment chosen based on the investor's tolerance for risk (Aina & Lutfi, 2019).

CONCLUSION

This study aims to determine the effect of financial literacy and risk tolerance on investment decisions. Where it was found that financial literacy has a significant positive effect on investment decisions Investors who have a high level of education and a good level of financial literacy will pay more attention to risks, concepts, knowledge, and financial understanding which will enable investors to prevent or avoid possible risks of loss in investing in stocks such as capital losses. Based on the results of hypothesis testing 2 in this study it was found that risk tolerance has a significant positive effect on investment decisions Investors who have high risk tolerance are more willing to bear the risk of loss from an investment as long as the investment provides opportunities to provide higher returns. profit rate.

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