The Impact of Financial Literacy and Investor Behavior on Investment Decision Making in the Capital Market

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Abstract. This study explores how investor behavior and financial literacy influence capital market investment decisions. Using a quantitative approach, the study collects data via questionnaires from investors registered at the IDX investment gallery of Muhammadiyah University of Makassar. Purposive sampling is applied to select individuals actively investing in the capital market. Multiple linear regression analysis, conducted with SPSS software, is used for data analysis. Results reveal a positive and significant effect of financial literacy on investment decisions, as indicated by a significant value of 0.000 < 0.05 and a t-value of 4.201, exceeding the t-table value of 1.985. Additionally, investor behavior characteristics positively and significantly impact investment choices, with a t-value of 5.448, also greater than 1.985, and a significant level of 0.000. Thus, both financial literacy and investor behavior play crucial roles in shaping investment decisions.

Keywords: Financial Literacy, Investor Behavior, Investment decision

1 Introduction

The capital market is crucial in raising money to support profitable investments and economic expansion. Nonetheless, a number of variables, such as investor behavior and financial literacy, frequently affect capital market investing decisions. Financial literacy refers to an individual's understanding, skills, and confidence in making prudent financial decisions. Investor behavior, on the other hand, describes the attitudes, feelings, and behaviors that guide an investor's choice of investments. Making sensible investing selections requires having a solid understanding of financial and investment principles. Investors with inadequate financial literacy typically don't comprehend the risks and rewards of their investments and have trouble doing accurate financial information analysis. Losses and less-than-ideal investing choices may result from this.

Nevertheless, investor conduct also significantly influences the decision that investors make. Investor decision-making and information interpretation can be influenced by psychological elements such as emotions, social influences, and cognitive biases. Overconfidence, for instance,

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can lead to investors taking unwarranted risks, while herding behavior, or imitating the behaviors of other investors, can lead to illogical investment decisions.

The way that investor behavior and financial literacy affect investing choices is related. High financial literacy investors typically possess superior knowledge and abilities for evaluating financial data and coming to sane investing decisions. However, even investors with sound financial literacy may be negatively impacted by psychological and emotional biases during the process of preparing a proposal.

Examining how investor behavior and financial literacy impact capital market investment decision-making is the aim of this study. Investors can lower their risk of loss and make better judgments by having a thorough awareness of these issues. The results of this study can also help financial institutions and regulators understand the dynamics of investor behavior in the capital market and develop successful financial education programs. The researcher is interested in carrying out research under the heading "The Impact of Financial Literacy and Investor Behavior on Investment Decision Making in the Capital Market," departing from the previously mentioned circumstances.

2 Theoretical Foundation

2.1 Financial Literacy

Because financial products and services are so complex in today's society, financial literacy is becoming more crucial. Individuals with limited financial literacy might make unwise financial decisions, like overspending, accumulating too much debt, or mismanaging their budgets.[1–3]

Additionally, a person's degree of financial literacy also affects how they invest. Greater financial literacy is often linked to more active involvement in capital markets and to holding more diversified investment portfolios [4–6]. This suggests that people can make wiser investing decisions if they are financially literate.

In many nations, governments and financial institutions place a high premium on the advancement of financial literacy. Effective financial education programs can enhance people’s financial literacy and promote more responsible financial behavior. [7–9].

Nonetheless, the strategy employed in financial education initiatives must be customized to the unique requirements and traits of the intended audience. Increasing financial literacy across cultural barriers might not be possible with a one-size-fits-all strategy [10–12].

2.2 Investor Behavior

The topic of investor behavior is growing more and more significant in the fields of finance and investment. Research indicates that investors frequently act irrationally and depart from the presumptions of conventional finance theory. Investors often face various cognitive and emotional biases that can negatively impact their decision-making, including overconfidence, regret aversion, and representativeness bias [13,14].

A well-researched phenomenon in investor behavior is herding behavior, which is the propensity of investors to mimic the actions of other investors rather than making their own choices. Herding behavior can result in mispricing and increased volatility within financial markets [15].

Investor behavior is also significantly influenced by psychological variables. Emotions such as fear, greed, and euphoria can cause investors to behave irrationally. Designing more successful investment strategies and lowering the possibility of losses from irrational decisions can both be aided by a deeper comprehension of investor behavior. The behavioral finance approach provides an alternative perspective that can account for market anomalies unexplained by traditional financial theory [16,19].

2.3 Investment Decision

Choosing investments is a crucial part of managing one's finances, both personally and professionally. According to Setiery, Investment decisions entail allocating current resources with the expectation of gaining future benefits [20–22]. Therefore, investment decisions must be carefully considered.

Investors should take their investment time horizon into account while making decisions. The risk lover investor has a longer time to recover from the losses. [17].

The expected rate of return is a crucial consideration when choosing an investment. Investors, within their risk tolerance, continually seek to maximize returns. Additionally, factors such as inflation, economic growth, and government regulations can influence their investment choices. When the economy is stable and shows promise, investors are generally more inclined to take risks and invest in high-risk assets like stocks and shares [23] .

Making wise financial decisions also heavily depends on having access to reliable and pertinent information. Some investors who have limited access to market research result in improper preferences. [25–27].

In recent years, technology has also played a significant role in influencing investing choices. The availability of real-time information and the accessibility of online investment platforms have provided investors with new opportunities to make faster and more informed investment decisions. [28,29] .

3 Research Methods

Investigating the causative relationship between the independent and dependent variables is the goal of conclusive causality research, the type of study that is used. This study takes a quantitative approach, employing numerical data obtained through questionnaires and other techniques of data collecting. Investors registered at Muhammadiyah University of Makassar's IDX investment gallery made up the study's population. Purposive sampling, which makes investments in the capital market, is the sample strategy used in this study. The technique employed in this study's data analysis process is multiple linear regression analysis, which is made possible by SPSS software. Data analysis techniques include traditional assumption tests, which include heteroscedasticity, multicollinearity, and normality tests, as a study model. Testing hypotheses is another component of the data analysis method. Predicting immediate results from past research is the goal of hypothesis testing. The significance test is carried out using the T Statistical Test and the coefficient of determination (R2).

4 Results and Discussion

The majority of the investors in the research were students who were registered at Muhammadiyah University of Makassar's IDX investment gallery. Regression analysis was used to determine empirically whether financial literacy influences investing decisions in a statistically significant way. As seen in the following summary table:

Table 1. Summary of Multiple Regression Analysis

Variable Regression Coefficient T count Sig.	Regression Coefficient	T Count	Sig.
Constant	7,154		
Financial Literacy (X1)	0,319	4,201	0,000
Investor Behavior (X2)	0,535	5,448	0,000
F	38,531		
R Square	0,453		

The statistical test analysis yields a constant value of 7.154, indicating a good value for the investor behavior and financial literacy variables. This suggests that if the variables of investor behavior and financial literacy increase or have an effect on one unit, the investment choice variable will also increase or be satisfied.

The financial literacy regression coefficient value (X1) is 0.319, meaning that a one-unit increase in the financial literacy variable will lead to a 31.9% increase in investment decisions. Additionally, the investor behavior regression coefficient value (X2) is 0.535 and positive, meaning that there will be a 53.5% rise for every unit increase in investor behavior. The R Square value shows that the combined impact of the Investor Behavior and Financial Literacy variables on Financial Literacy is 45.3%, with a magnitude of 0.453, or 45.3%. However, the remaining 54.7% are impacted by characteristics that were not examined.

Data analysis findings show a favorable correlation between investor behavior and financial literacy. With a t count of 4.201> T table of 1.985 and a sig. value of 0.000, financial literacy supports the study's initial premise. Additionally, the acceptance of hypothesis 2 is supported by the investor behavior variable's tcount value of 5.448> 1.985 sig. value of 0.000. Therefore, it can be concluded that investor behavior and financial literacy have a favorable and considerable impact on investing decisions.

4.1 The Effect of Financial Literacy on Investment Decisions

The t value of 4.201> t table 1.985 and a significant value of 0.000 <0.05, which are based on study findings and the outcomes of statistical tests using linear regression, show that the financial literacy variable has a significant impact on investment decisions. This indicates that the financial literacy indicators have, in this instance, sufficiently influenced investment decisions in relation to their role. Consequently, it can be said that H1 is acknowledged or that financial literacy has a major favorable impact on investing decisions.

Therefore, financial literacy has a positive effect on investment decisions; that is, the more financially literate a person is, the better their investment decisions will be. Financial literacy has a big impact on investment choices. Individuals' degree of financial knowledge influences their decision to make an investment. People who possess a high degree of financial literacy are generally more prudent and astute in their money management, enabling them to offer valuable assistance in bolstering personal finances. People who have good financial literacy tend to better understand various investment instruments, risks, and associated potential returns. They are better able to analyze financial information, plan their finances strategically and make smarter investment decisions. In contrast, individuals with low financial literacy may have a poor understanding of investments, making them more prone to investment mistakes, such as placing funds in high-risk instruments without adequate understanding or getting caught up in deceptive investment schemes. Good financial literacy also helps individuals manage their investment portfolios more effectively, thereby increasing potential gains and reducing the risk of losses.

This study is consistent with studies carried out by [30-33], they concluded that financial literacy-related factors had a big impact on investing choices. People who have a strong foundation in finance are more equipped to make prudent and well-considered investment decisions, which can ultimately increase their financial stability.

4.2 The Effect of Investor Behavior on Investment Decisions

The results showed that investor behavior significantly and favorably influences investment choices. This suggests that investors' financial decisions are positively impacted by changes in their behavior. The outcomes of the linear regression statistical test provide evidence of this influence. The predicted t value of 5.448 is more than the t value of 1.985 in the t table. Additionally, a lower degree of significance than the predefined 0.05 threshold is shown by the obtained significance value (sig.), which is 0.000. This illustrates how important the findings of the statistical test are. Thus, it may be concluded that investor behavior has a positive and substantial impact on investment choices. This implies that factors related to investor behavior have significantly influenced investment decisions in this scenario.

Investor behavior has a significant impact on investment decisions. Factors such as emotions, risk perception, and psychological tendencies can influence how investors choose assets, investment timing, and overall investment strategy. For example, excessive optimism may encourage investors to take greater risks, while fear may cause them to avoid profitable investment opportunities. Behavioral biases that influence investing decision-making include herd mentality, overconfidence, and loss aversion. These biases frequently cause decisions to deviate from entirely logical ones. Studies indicate that investors who behave in a more measured, informed, and reasonable manner typically make better and more successful investing choices. On the other hand, illogical or emotional behavior—like fear or greed—can result in less-than-ideal and expensive choices.

This study is consistent with studies carried out by [34] which claims that overconfidence (an exaggerated sense of self-worth) and herding tendency (following the actions of other investors) are the two characteristics that affect investor behavior. When investors mimic the moves of their peers without conducting independent research, this is known as herding behavior. They frequently cause asset bubbles and market crashes by buying assets when many others are buying and selling when many others are selling. Because judgments are made based more on mob action than on fundamental reasoning, this conduct can result in enormous losses. Overconfident in their skills, investors typically take on more risk. Even when data suggests otherwise, they could choose to stay invested and disregard warning signs. Irrational financial decisions and potentially significant losses might result from overconfidence. A few additional researchers are [42]; [38]; [43]; [44] which came to the conclusion that a variety of investor behaviors, including herding behavior, loss aversion, confirmation bias, and recency bias, affect the way that money is invested.

5 Conclussion

The results showed that investing decisions are strongly and favorably influenced by financial literacy. A significant value of 0.000 <0.05 and a t value of 4.201$>$ t table 1.985 are revealed by the linear regression statistical test findings, suggesting that financial literacy has a considerable impact on investing decisions. Strong financial literacy makes a person more capable of handling their money and making wise investment decisions. High financial literacy helps people make more informed investment decisions and lower risk of loss by helping them comprehend investment instruments, risks, and potential returns. Apart from financial knowledge, the actions of investors have a noteworthy and favorable influence on investing choices. The calculated t value of 5.448 is greater than the t table of 1.985, according to the linear regression statistical test, with a significant value of 0.000, which is less than 0.05. This suggests that alterations in the conduct of investors have a favorable impact on investing choices. A number of factors, such as psychological predisposition, overconfidence, emotions, herding behavior, and risk perception, influence the assets and investing methods that investors choose. While impulsive or emotional activity might result in less-than-ideal and harmful decisions, reasonable and calculated behavior typically leads to better investing decisions.

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