CHAPTER I

INTRODUCTION

1.1 Background of the Study

In this modern age of globalization, the capital market is widely recognized as an effective means for stimulating economic advancement and promoting national growth. The World Bank (2022) proposes that capital markets have a crucial function in supporting economic expansion, upholding financial stability, facilitating economic funding, and reducing risk. Well-established capital markets offer several economic advantages, such as enhanced productivity growth and increased employment opportunities.

Indonesia, as one of the fastest-growing economies in Asia, presents a favorable environment for investors who are in pursuit of prospective returns. The capital market in Indonesia has experienced significant growth, rendering it an attractive investment destination for both domestic and international investors (Pradikasari & Isbanah, 2018). The level of optimism among investors towards the Indonesian economy has continued to be significant, mirrored by a notable public interest in engaging in investment activities inside the capital market.

According to the observed patterns from KSEI (2023), there has been a substantial rise in the population of individuals engaged in stock investment, with a notable growth of 188.4 percent since the year 2020. Specifically, the number of stock investors has ascended from 1,695,268 to 4,888,910 as of July 2023.

According to the same data, the capital market investors have experienced a significant increase of 194.3 percent since 2020, with the number rising from 3,880,753 to 11,420,074 as of July 2023. By July 2023, there has been a threefold increase in the number of investors in the Indonesian capital market, in comparison to the year 2020.

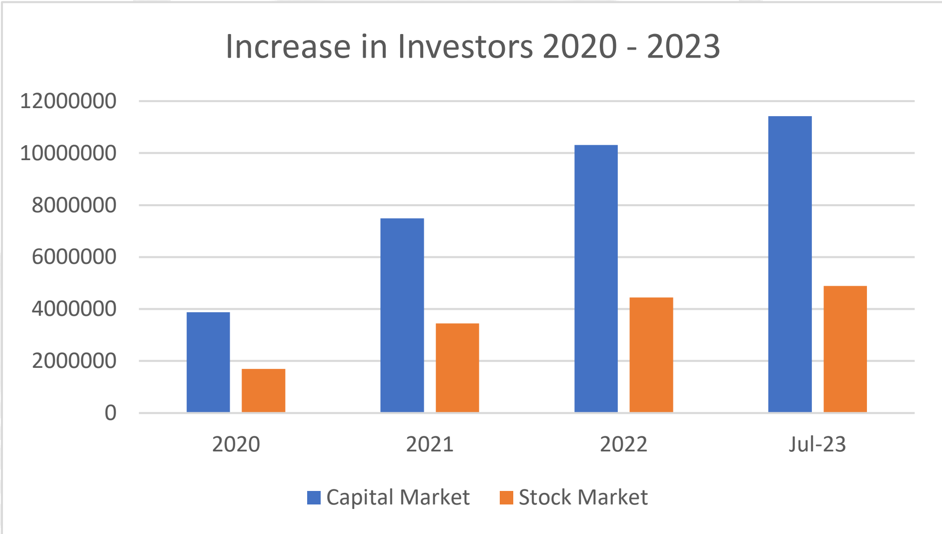

Figure 1.1 Number of investors in Indonesia from 2020-2023
Source: KSEI (2023)

The growing enthusiasm of young individuals towards investment has played a substantial role in this phenomenon. This is evident from the dominance of stock investors under the age of 30, namely belonging to the generational cohorts of Generation Z and Millennials, within the overall population of capital market investors. According to data from KSEI in 2023, over the course of the 46 years from the reopening of the capital market, individuals below the age of 30 had comprised 57.26% of investors.

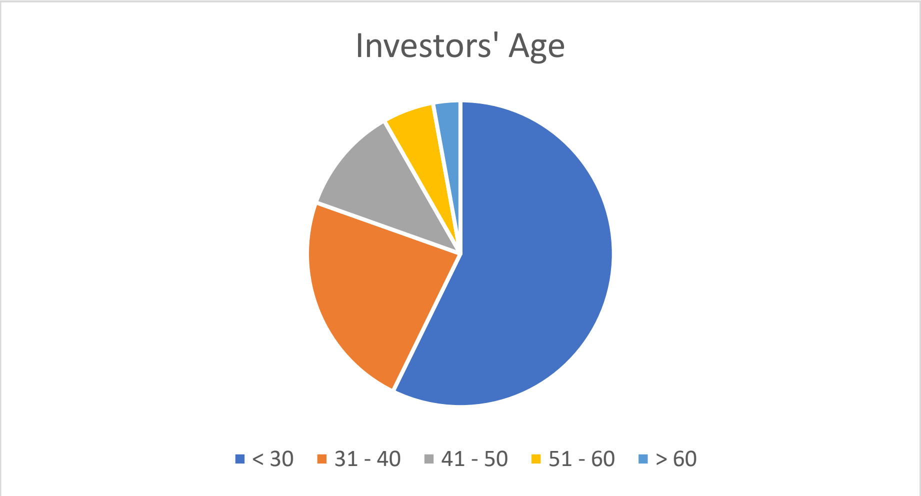

Figure 1.2 Number of investors in Indonesia from 2020-2023
Source: KSEI (2023)

During the Indonesia Knowledge Forum in 2021, the commissioner of the Indonesia Stock Exchange, Pandu Sjahrir, highlighted the significant role played by Generation Z and millennials in driving the growth of Indonesian retail investors where he said ”*Milenial dan Generasi Z adalah drivers dari ritel investor kita di pasar modal*” (Nafisah & Ariska, 2022). This can be seen by the constant rise of the number of investors aged below 30 since 2020 to 2023.

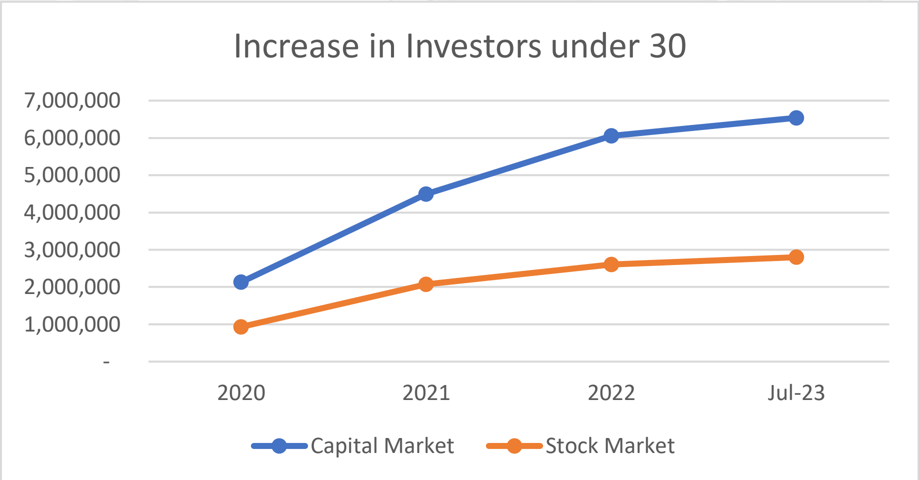

Figure 1.3 Increase in Investors under 30 from 2020-2023
Source: Calculated by witer based on data from KSEI (2023)

However, it is noteworthy that a mere 2 percent of the Indonesian population, which amounts to 277,861,527 individuals according to Worldometer

(2023), engaged in investment activities inside the capital market during the previous year. According to Harsono (2019), Indonesia lags behind its neighboring countries in terms of the ratio of investors in capital markets to the entire population, with Singapore at 26 and Malaysia at 7.8. Moreover, based on data released by the Indonesian Central Securities Depository (KSEI, 2023), foreign investors maintain a significant majority in terms of total share assets in Indonesia, even if it is evident that the capital market has witnessed a consistent growth in the number of investors over the years. The problem with financial literacy among Generation Z in Indonesia is one of the causes to that. The OJK Survey results show that generation Z has a poor financial literacy index of 13.53%. For Generation Z, this is an obstacle to investing because insufficient literacy might result in irrational investment choices (Arie Wibowo et al., 2023).

The rise in the number of investors in the capital market may be attributed to various factors, among which is the influence exerted by individuals who offer educational resources or stock personal narratives of successful experiences in stock investment. In recent times, there has been a notable surge in the prominence of stock influencers, which has played a role in the increased participation of young individuals in stock market investments. The emergence of the stock influencer movement is a current phenomenon that is experiencing significant growth on various social media platforms. These influencers typically educate individuals on the subject of financial literacy, encompassing topics such as the significance of investment and various investment instruments. Additionally, some influencers may highlight specific stocks that exhibit promising potential for substantial returns in the future. Equipped with this valuable knowledge, a considerable number of followers of these influencers, predominantly comprising young individuals belonging to Generation Z, are enticed and express a desire to experiment.

According to Budihardjo et al., (2023), a significant proportion of individuals belonging to the millennial and Generation Z cohorts who engage in stock market investments have a minimal level of financial literacy. Stock investment decisions are often influenced by recommendations from individuals with significant social media followings. This study investigates the return matrix associated with stock recommendations provided by influencers, focusing on certain holding periods. A total of 171 stock recommendations were examined, encompassing 107 stocks listed on the Indonesia Stock Exchange (IHSG), throughout the period spanning from the beginning of 2022 to November 2022. Based on the findings of the study, it was determined that the advice provided by investors failed to produce any statistically significant improvement in the overall worth of the investor's portfolio.

In addition to this, the study also derived findings relating to the characteristics of content based on the analysis of 171 influencer shares:

Table 1.1 Stock Influencer's content characteristics

No	Characteristics	Implications
1	Fear of Missing Out (FOMO)	Based on the analysis of 171 stock recommendations seen in this study, it can be inferred that some influencers consistently engage in discussions pertaining to trending stocks and initial public offerings (IPOs). Engaging in this course of action is highly rational due to the potential of these FOMO stocks to generate significant levels of web traffic. Regrettably, a subset of these equities associated with the Fear of Missing Out (FOMO) phenomenon is anticipated to exhibit subpar performance in both the short-term and medium-term periods during the year 2022.

2	Buy Recommendation	The vast majority of recommendations provided by influencers tend to be in favour of purchasing stocks. Updates on the sale of shares are infrequent, particularly in instances when there are significant alterations to the structure of the stock market or the basic aspects of a corporation. Consequently, in the event that viewers choose to purchase shares based on the influencer's suggestions, the likelihood of encountering a stagnant portfolio performance outweighs the likelihood of experiencing profits.
3	Margin of Safety	According to a study conducted subsequent to accessing this material, it has been determined that investors may potentially incur losses of up to 60%. This phenomenon may potentially lead to a decline in long-term investor engagement. Hence, the incorporation of the margin of safety idea is crucial in mitigating investor losses and sustaining investment appeal.

Source: Budihardjo et al., (2023)

One notable characteristic observed among a certain group of stock investors in Indonesia is their inclination towards becoming friendly followers (referred to as FFs). This behavior entails the act of adhering to suggestions and advice provided by those within their social circles, such as family members, friends, financial advisors, and numerous sources, including influential figures within the stock market. Passive stock investors, sometimes referred to as FFs, exhibit a long-term investment approach whereby they retain their stock positions for extended durations, unless they are presented with a selling recommendation from a prominent influencer (Deviyana, 2023).

Generation Z is a cohort that has a strong inclination towards social media and online forums, platforms that frequently serve as outlets for individuals to showcase their achievements in the realm of investments. The prevalence of narratives showcasing exceptional earnings may contribute to the reinforcement of overconfidence among Gen Z investors, encouraging the perception that comparable outcomes can be effortlessly achieved. Based on data from the

American Financial Industry Regulatory Authority (FINRA), it can be observed that younger individuals, specifically those between the ages of 18 and 34, exhibit a higher level of confidence compared to their older counterparts in the age categories of 35 to 54 and those over the age of 55 (Iacurci, 2023). This statement was supported by Das (2021) who stated that those belonging to Generation Z exhibit a notably higher level of overconfidence, surpassing even that of millennials and Gen Xers. In comparison to individuals with little bias, those who exhibited a greater amount of overconfidence demonstrated a twofold increase in the likelihood of facing financial difficulties, characterized by minimal savings, substantial debt, and unfavorable credit scores.

The presence of overconfidence bias has the potential to negatively impact investing outcomes as individuals tend to overestimate their level of knowledge and hence disregard important market information. According to Moore (2018), the phenomenon known as overconfidence bias refers to a cognitive bias observed in individuals, where they exhibit a tendency to overrate their own abilities, knowledge, and expertise in a specific domain. This inclination towards overestimation can result in inaccurate judgements and decision-making processes. The phenomenon of overestimation can emerge in diverse manners, including but not limited to an exaggerated perception of control, unrealistic levels of optimism, or a tendency to underestimate the inherent risks associated with a certain circumstance.

The table below presents the risks associated with overconfidence bias in financial decision-making, as identified by Hayes (2023):

Table 1.2 Risks associated with overconfidence bias in financial decision-making

No	Risk of Overconfidence in Investment Decision	Implications
1	Excessive trading	Excessive confidence may cause investors to engage in frequent transactions which elevates transaction expenses as well as reducing investment yields.
2	Under-diversification	Investors that exhibit excessive confidence may possess the belief that they own the ability to precisely forecast market fluctuations. Consequently, they may opt to focus their investments in a limited number of high-risk assets, rather than adopting a strategy of portfolio diversification.
3	Underestimating risk	The phenomenon of overconfidence can lead individuals to underestimate the inherent risks connected with specific investing opportunities, therefore exposing themselves to needless financial losses.
4	Ignoring contradictory evidence	Traders and investors who exhibit excessive confidence may have a tendency to minimize or disregard information or data that contradicts their initial choice, resulting in the persistence of holdings in underperforming assets and vulnerability to confirmation bias.

Source: Hayes (2023)

Students must have a fundamental understanding of the unique risks and returns associated with each saving and investment option. One of the riskiest investment options is the buying of stocks because there is no assurance of financial success. In order to mitigate the possible risks associated with investment, it is essential to thoroughly understand and put into practice solid and precise financial management techniques. Every person needs to be competent enough and have a thorough understanding of how to manage their financial resources and assets.

A company's share value may drop in the event of bad performance or a reduction in investor confidence, which could cause investors to suffer financial losses. Based on a report from Dore (2022), it has been observed that certain individuals belonging to the millennial and Gen Z generations are opting to close their investment accounts due to worries associated with inflation. The report cited research which shows that majority of consumers who had terminated an investing, trading, or brokerage account within the year 2021, were reported by individuals belonging to the millennial and Gen Z cohorts, which accounts for 21% of 900 investors. According to the survey, a significant portion of individuals, specifically 31%, opted to divest their assets as a result of concern regarding the risk of losing money amidst the unforeseeable fluctuations observed in the stock market.

Investors in financial markets may not consistently exhibit rational decision-making, given that their investment choices might be influenced by several factors outside basic rationality (Abul, 2019). Hence, the phenomenon serves as an inspiration for the writer to explore the determinants that might trigger irrational behavior among investors' investment decision.

The author is motivated to undertake a study on this subject, which are titled **"RISK PERCEPTION AS A MEDIATOR BETWEEN OVERCONFIDENCE BIAS AND HERDING BIAS ON INVESTMENT DECISION: EVIDENCE FROM GEN Z IN INDONESIA"**.

1.2 Problem Limitation

After determining the background and identification of the problems, the problem limitation to be addressed in this research are as follows:

1. This study examines only the four variables consisting of two independent variables, namely Overconfidence Bias (OB) and Herding Bias (HB) along with a dependent variable which is Investment Decision (ID). In addition,

Risk Perception (RP) serves as mediating variables, which is included to clarify the causes of the interactions between other variables.

2. The subject of this research is confined to people in the Generation Z cohort.
3. The object of this research is confined to the Indonesia Stock Exchange.
4. This research will be conducted using a questionnaire sent to Generation Z in Indonesia as a reference with the characteristics of male and female between the ages of 18 and 26 years who domiciled in Indonesia and have made stock investments in the Indonesia Stock Exchange.
5. The questionnaires are limited to investors in Indonesia Stock Exchange.

1.3 Problem Formulation

According to the background stated above, the problem formulation in this research is as follows:

1. Does Overconfidence Bias (OB) significantly influence Risk Perception (RP) of Indonesia Stock Exchange's Gen Z investor?
2. Does Herding Bias (HB) significantly influence Risk Perception (RP) of Indonesia Stock Exchange's Gen Z investor?
3. Does Overconfidence Bias (OB) significantly influence Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange?
4. Does Herding Bias (HB) significantly influence Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange?
5. Does Risk Perception (RP) significantly influence Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange?

6. Does Risk Perception (RP) mediate the influence between Overconfidence Bias (OB) and Investment Decision (ID) of Gen-Zs in the Indonesia Stock Exchange?
7. Does Risk Perception (RP) mediate the influence between Herding Bias (HB) and Investment Decision (ID) of Gen-Zs in the Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the problem formulation that has been outlined, the research objectives are as follows:

1. To identify whether Overconfidence Bias (OB) has significant influence on Risk Perception (RP) of Indonesia Stock Exchange's Gen Z investor
2. To identify whether Herding Bias (HB) has significant influence on Risk Perception (RP) of Indonesia Stock Exchange's Gen Z investor
3. To identify whether Overconfidence Bias (OB) has significant influence on Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange
4. To identify whether Herding Bias (HB) has significant influence on Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange
5. To identify whether Risk Perception (RP) has significant influence on Gen-Z's Investment Decision (ID) in the Indonesia Stock Exchange
6. To identify whether Risk Perception (RP) mediates the influence between Overconfidence Bias (OB) and Investment Decision (ID) of Gen-Zs in the Indonesia Stock Exchange

7. To identify whether Risk Perception (RP) mediates the influence between Herding Bias (HB) and Investment Decision (ID) of Gen-Zs in the Indonesia Stock Exchange

1.5 Benefit of the Research

1.5.1 Theoritical Benefit

The following are the theoretical benefits of this research:

1. This research is expected to contribute insights both in theory and concrete evidence that may be utilized as a reference material for information, discussion material, and future research information for readers about issues concerning Indonesian investors.
2. This study is expected to contribute to the advancement of management theory as a research material in the literature and to expand the scientific study at Universitas Pelita Harapan Medan Campus by undergraduates from the Faculty of Economics and Business, particularly in the field of economics related to investment.

1.5.2 Practical Benefit

The following are the practical benefits of this research:

1. For company (market place)

   The results of this study are expected to help develop strategies and interventions that will improve the financial security of Gen Z investors and the overall stability of the financial markets by assisting them in making more logical and informed investment decisions. For Writer to gain better understanding of overconfidence bias, herding bias, and risk perception on Gen Z’s investment decision in the Indonesia Stock Exchange.