CHAPTER I
INTRODUCTION

1.1 Research Background

One of the crucial financial decision is whether to invest or not (Rieger, 2022). Furthermore, the question goes on consideration of investment option, it's important to consider the best plan of action and the extent to which historical price movements in the stock market can predict future price movements (Madaan & Singh, 2019). Recent developments in financial markets highlight differences between traditional and behavioral finance. Optimal portfolio investment as explained by Markowitz (1952) highlight the importance of diversification and optimization of portfolio, and assumed all investors are rational individuals in making a decision by generating decision through a variety of rational analysis processes. Investors are trusted to be able analyzing new information appropriately and accurately and selecting best alternative or option based on calculation, concepts and theories, and appropriate approach. Investors knowledge, analysis, and ability to selecting best option for investment are trusted to develop appropriate investment decision.

However, it’s important to keep in mind that a good investment decision can be vary based on the individual. Investment decisions are influence by many factors. Recent studies had found several factors that can influence investment decision. Although investors make investment decision based on their needs and requirements, certain behavior might negatively impact their end game (Banerji et al., 2020).

Numerous studies have demonstrated that investors sometimes depart from their idealized, rational counterparts. The study by Tversky & Kahneman (1974) adding behavioral tendency of individual that can effect individual decision making. Based on the assessment, individual have tendency to making decision based on belief and rely on heuristics which simplified the decision-making process. Especially when investor suffering in uncertainty market and risky investment. G (2024) stated investment decision as psychological and cognitive process, and not always about fundamental and technical investment analysis. Behavioral finance explained the presence of psychological factors in investors (Sattar et al., 2020). The process of decision making involves investors psychology, characteristics, and behavior which directly effects investors investment decision (Waheed et al., 2020). Talking about the factors influenced investment decisions, study by Vukovic & Pivac (2024) has found behavioral factors can influence the investment decision of investors.

Behavioral finance provide enhancement of decision-making process by investors by focusing on the practice of psychology and economics in investors decision making process (Al-Dahan et al., 2019). The behavioral economic described individuals as satisfaction seekers who making an unpredictable and inconsistent decision influenced by cognitive and psychological biases (Raut, 2020). Behavioral finance sometimes lead investor to bias which may sometimes drives investors to perceptual alteration, inaccurate judgment, illogical interpretation (Mittal, 2022). Investment decision as a set of process of allocating fund to various products or assets by selecting the best option that need consideration and evaluation made by investors with expectation of generating return or profit in the future while minimizing risk (Rahman & Gan, 2020). The complexity of investment decision leads investors to looking for a shortcut in investment decision. Furthermore, lack of resource such as information, time, power, and cost drives investors subject to behavioral bias (Sharma & Kumar, 2020).

Behavioral finance highlight investors as human being, involves psychological factors in investment decision making. Even when investors have maximized the analysis on the most recent data before investing, the possibility they can behave irrationally or using heuristics indwell (Jain et al., 2020). The reason of this possibility are the linkages of investment decision to potential and emotional outcomes (Zahera & Bansal, 2018). The uniqueness and unpredictable individual behavior that can be different in any situations makes it necessary to integrate the concepts of psychology and investment decision.

The high complexity and abundant investment options as an impact of the growing of science have led to the complex investment decisions making than ever before. There are many options for investment activities. According to Levisauskaite (2010) investment can be divided into two categories namely, financial assets investment and physical assets investment.

1. Physical assets investment

Physical assets investment involves purchasing actual objects or properties with expectations the increase in value over time and provide revenue. Usually, this type of investment possess long holding period. Physical assets investment provide diversification, inflation protection, and the opportunity for financial appreciation. The common categories of physical assets investment are real estate, precious metals, commodities, collectibles, natural resources, and infrastructure.

2. Financial assets investment

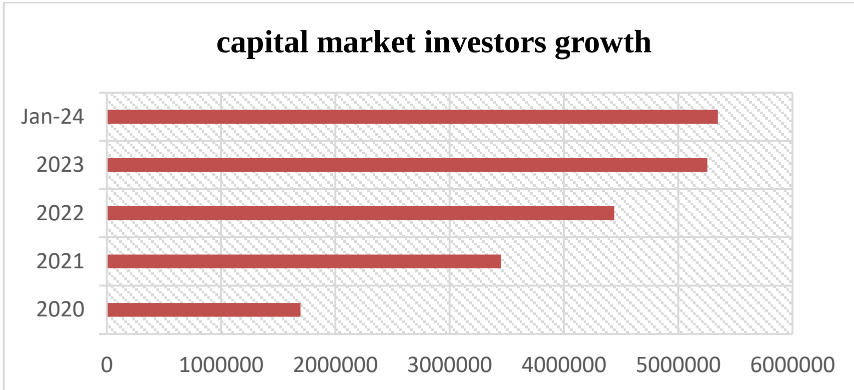
   Investing in financial assets entails acquiring instruments or allocating cash to intangible instruments that indicate a claim on future cash flow, ownership or claims to underlying assets, revenue streams, or contractual rights. Financial assets are intangible and encompass a wide range of products exchanged on financial markets. The holding period consider much shorter than physical asset. Here are the five main types of financial investment:

   a. money markets instrument including certificates of deposit, treasury bills, commercial papers, bankers' acceptances, and repurchase agreements.
   b. Fixed-income securities which include long-term debt securities and preferred stock
   c. Common stock
   d. Options, futures, and commodities

e. Other investment such as mutual funds, life insurance, pension funds, and hedge funds.

Of the many investment options, stock is one of the investment options. Stock or shares allowed investors for having participation in a company in the form of equity. When a person own shares in a company or limited liability company, this indicates their ownership on the company, the bigger shares he owns the greater his power in the company, and the profit will be obtained from dividend and capital gain (Kurniawan, 2021). This kind of investment are direct investment and liquid investment where investors maintain the investment by themselves and allow them to buy or sell it anytime (Levisauskaite, 2010).

In recent years, in Indonesia, the number of individual investors continues to growth. According to figure 1 by KSEI, there are an increase in individual investors namely 1,30% in 2024. Data in January 2024 show the growth of individual investors in stock the number of 1,76% growth, from 5.255.571 investors in December 2023 to 5.348.006 in January 2024. Sumatera become the second island with the largest number of investors after java in 16,76%, java in 67,99%, followed by Kalimantan in 5,32%, Sulawesi 5,13%, Bali, NTT, and NTB in 3,59%, and last Maluku and Papua in 1,21%.



Source: KSEI (Indonesia Central Securities Depository)

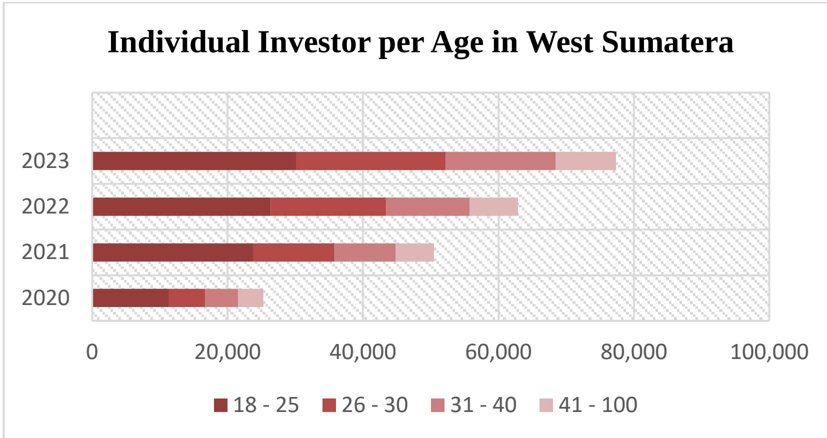
Figure 1.1 – Number of individual investors in capital market

In Indonesia, young investor participations dominate the share market. 56,29% of total investors in Indonesia dominate by young people aged less than 30, followed by investors with age range 31 – 40 with 23,66% from total investors, 11,59% investor with age 41 – 50, 5,54% investor aged 51 – 60, and 2,92% investors from age range higher than 60. This dominance highlights young adult interest in stock market. Indonesian Stock Exchange doing a campaign called 'Aku Investor Saham' to increase youth pride as investors and influence their surroundings to be an investor. This campaign intended to increase the number of Indonesian individual investors.

Investors make investment with the prospect of profit in the future and as a strategy to mitigate the negative effects of inflation. Stock become one of the best investment options for young investors. Stock represents investors part ownership in a firm (Levisauskaite, 2010). Stock as an investment vehicle provide profits through capital gain and dividend which beneficial for investors as additional income. This type of investment allow investor for obtaining return from dividends and capital gain. Stock investment is high liquidity allow investor to trade it easily. Moreover, relatively low transaction cost and the convenience of stock investment make it suitable for young investors investment option.

Young adults take greater responsibility of their financing from the previous stage of life. Most of these young people begin to deal with financial challenges such as paying bill until financial planning. The financial habits acquire during this period will support their future, as they may affect their life financially (Aydin & Akben Selcuk, 2019). Investment become the instrument for individual in generating wealth, protection against inflation and risks, and as social security in the future (Atmaningrum et al., 2021).

According to data in figure 2, it can be seen the growth of young investors in past four years in West Sumatera. Young investors in age 18 – 25 show significance growth years by years. This level of young investors pointing out youth are concern to the importance of investment. Young people have a desire to become financially independent and gaining financial freedom at an early stage, which makes them more inclined to invest (Ma, 2023). Moreover, the growth of internet also makes abundant spread of information allowed young investors to get information support investment decision making process.



Source: IDX (Indonesia Stock Exchange)

Figure 1.2 - Individual Investor per Age in West Sumatera

Investment decision refers to the process of allocating money to various products or assets that need full consideration and evaluation made by investors with expectation of generating return or profit in the future while minimizing risk (Rahman & Gan, 2020). Making an investment decision involves deciding to invest in one or more assets with the intention of profiting in the future (Tasman et al., 2023). Collecting sufficient information and doing research on investment option could help investor obtaining optimal investment decision (Khan & Tan, 2020). Furthermore, the sufficient knowledge also needed in making decision. Moreover, the decision of the investor to invest is subjective. Investor decision depends on the expected costs, knowledge of the improved techniques and risk perception, which is entirely a subjective factor (Virlics, 2013).

Investment decisions are influence by many factors. Recent studies had found several factors that can influence investment decision. According to rationality theory, people make partially rational or irrational decisions due to biases and cognitive limits (Madaan & Singh, 2019). Although investors make investment decision based on their needs and requirements, certain behavior might negatively impact their end game (Banerji et al., 2020). Numerous studies have demonstrated that investors sometimes depart from their idealized, rational counterparts. G (2024) stated investment decision as psychological and cognitive process, and not always about fundamental and technical investment analysis. Behavioral finance explained the presence of psychological factors in investors (Sattar et al., 2020). The process of decision making involves investors psychology, characteristics, and behavior which directly effects investors investment decision (Waheed et al., 2020).

Talking about the factors influenced investment decisions, study by Vukovic & Pivac (2024) has found behavioral factors can influence the investment decision of investors. The behavioral economic described individuals as satisfaction seekers who making an unpredictable and inconsistent decision influenced by cognitive and psychological biases (Raut, 2020). Behavioral finance sometimes lead investor to bias which may sometimes drives investors to perceptual alteration, inaccurate judgment, illogical interpretation (Mittal, 2022). When talking about behavioral finance, as many cases happen, it was found that sometimes investors doesn’t act rationally in their financial decision, sometimes they make an irrational decision by following others investment decision (Başarir & Yilmaz, 2019). From this explanation, we can conclude that investors often making investment decision based on their psychological effect and behavior. Their decision not always based on research and analysis, sometimes their makes judgement based on psychological bias and behavior which individual has different, unique, and unpredictable psychological side and behavior. One of the problem of this psychological and behavioral factors is they created bias.

Investors should be mindful of cognitive biases that might leads to a favorable or negative outcome (Kartini & Nahda, 2021). Investors sometimes making decision used mental shortcut which know as heuristics. Heuristics or also known as rule of thumb provide a shortcut for investor in decision making (Ogunlusi & Obademi, 2021). Heuristics refers to the concept and practices that allow people to make rapid and spontaneous reasonable judgements without relying on conscious analysis, measurement, or methodology (Kamoune & Ibenrissoul, 2022). The used of heuristics lead investors to bias. The bias appeared as the consequences of heuristics namely anchoring, availability bias, representativeness, and overconfidence.

Representativeness bias occurs when investors make decision based on stereotypes. Stereotypes used by investors to forecast or make judgements on the possibility or frequency of an occurrence resembling which causes people to ignore elements that have contributed to the real frequences of likelihoods (Jaiyeoba et al., 2020). Study by Baker et al. (2018) found the existence of representative bias is most found on young investors. Elder investors tend to less likely display herding bias and representativeness prejudice than younger ones. This study indicate young investors are prone to experience representativeness bias than the older. Less experienced investors are more susceptible to representativeness bias (Baker et al., 2018). They often make judgement based on the generalized data that often bring misleading information. This cannot be denied since most of new investors are more relate to low level of knowledge and especially experience. This low level of knowledge and experience leads investor to make decision based on how closely an event resembles other events, rather than considering the actual probability or statistics research.

Furthermore, information defines as one of the stimulant influenced investors investment decision making (Sha & Ismail, 2021). As social creature, sometimes investors make decision based influenced by external inputs such as social media, friends, and other factors called social bias (Baker & Puttonen, 2017). As human being investors often tend to follow the trend in order to avoid the risk of being loss or taking the wrong decision (Panja, 2021). The exchanging of information among investors leads to herding behavior as one of biases, they pretend to ignore their capability and rely on the other investors which considered has better analysis (Rahayu et al., 2021). Adequate information and knowledge are needed to minimize bias and optimize financial decision (Hani et al., 2020). Young investors tend to have herding behavior, especially young investors with low level of financial literacy (Baker et al., 2018). This study reveals that young investors are more likely to feel confident in their investment decision after discussing their decision with colleagues and friends. Young investors tend to rely on information and decision produced by others as the consequences of lack of experience and knowledge.

Besides of heuristics and herding, prospects theory by Kahneman & Tversky (1979) show the evidence of investors as loss averse individual. Loss aversion refers to the propensity of investors to saving money from losses rather than focus on the probability of gaining profit (Jain et al., 2020). Rational investors give more attention on the chance of losses than compatible gains, choosing decisions based on the potential worth of both, rather than the outcome itself (Silwal & Bajracharya, 2021). Loss aversion drives investors to feel pain of loss twice as severely as they experience pleasure with equal gain (Kartini & Nahda, 2021). This bias proved the behavior of investors in making decision to more overreacting loss rather than profit. In risky or unpredictable conditions, investors are more afraid of losing rather than have regard for any predictable gain, causing investors to hold losing share more longer and sell stocks which are rising (Banerji et al., 2020). Loss aversion is common emotional bias that stems from human intuition and emotions, influences thinking and decision making. The presence of loss aversion in stock investment decision, lead to investor tendency to avoiding risky assets and loss averse when it come to stock movement. Study by Xie et al. (2018) study the presence of loss aversion around the world using Hofstede's cultural dimension and found individualistic countries are more loss averse than collectivistic countries.

The different in object, culture, and behavior variable from previously tested evidence of latest study render this research interesting. This study will focus to investigate the influence of representativeness bias, loss aversion, and herding behavior on investment decision among young investor in stock market. The sample are chosen since this bias found on young investors in stock market. Moreover, characteristics of young investors found to be appropriate with characteristics of investors who subjected to this behavioral bias.

The uniqueness and unpredictable behavioral and psychological of human make this research more interesting to investigate. The different on research findings and phenomena makes a further investigation about the influence of behavioral bias on investment decision needed. The principal contribution of this study is the examination of representativeness bias, loss aversion, and herding on investment decision. This study will focus on the influence of these variable on young investors in West Sumatera. In connection with the background that has been described, the researcher wants to compile a study entitled **"The Influence of Representativeness bias, Loss Aversion, and Herding Behavior on Young Investor Investment Decisions in West Sumatera".**

1.2 Problem Statement

Based on research background above regarding behavioral bias, several problems that can be formulated in this research namely:

1. How does representativeness bias influence young investor investment decision in West Suamtera?
2. How does loss aversion influence young investor investment decision in West Suamtera?
3. How does herding behavior influence young investor investment decision in West Suamtera?

1.3 Research Objective

According to the formulation of research problem, the objective of this research as follows:

1. To analyze the influence of representativeness bias on young investor investment decision in West Sumatera
2. To analyze the influence of loss aversion on young investor investment decision in West Sumatera
3. To analyze the influence of herding behavior young investor investment decision in West Sumatera

1.4 Research Contribution

The results and contribution of this research as follows:

1. Theoretical benefits

The results of this research purposed to provide information as well valuable insight into previously existing theories related to behavioral bias especially representativeness bias, loss aversion, and herding behavior on stock investment decision.

2. Practical benefits

a. For the investors

The results of this research is expected to giving insight for investors in understanding of existing bias on investment decision process and help investors to be aware of bias in attempt to minimizing behavioral bias in investment decision, especially on young investor.

b. For the researcher

This research is expected to help researcher to gain more information and knowledge related to behavioral bias especially representativeness bias, loss aversion, and herding bias on stock investment decision, especially on young adults.

c. For other researchers

Results and contribution of this research is expected to be a references and source of information for future research, especially in discussing the effect of representativeness bias, loss aversion, and herding behavior on young adult stock investment decision process.

d. For Company

This research could help the company in getting information related to the existing bias in investor investment decision and aware against risk which arise as the consequences of bias.

e. For the readers

The results of this research are expected to giving information and new knowledge from different perspective of behavioral bias on young investors stock investment decision.

1.5 Scope of Research

The scope of this research will focus on representativeness bias, loss aversion, and herding behavior as independent variable. Investment decision as dependent variable with young investor in West Sumatera as the object of this research.

1.6 Outline Research

CHAPTER I: Introduction

Encompass research context, definition of problem, research objectives, benefit of research, research limitations, and systematic writing.

CHAPTER II: Literature Review

This section come up with clarification of variable sourced from previous theory and studies, characteristics of the research to be carried out, along with hypothesis development in answering research problems.

CHAPTER III: Research Methods

This section provides an explanation of methodology used on research, sample and population, a conceptual and systematic description of the variables, and data analysis technique.

CHAPTER IV: Results and Discussion

This chapter describes the characteristic of respondents, results of hypothesis analysis, descriptions of research variable, data testing, and also results and discussion to answer research problem and also the comparison with previous study.

CHAPTER V: Closing

This section providing the conclusion of the study, the important result of the study, implications, limitations of this study, and suggestions that can be concluded from the study.