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The Effect of Overconfidence Bias and Herding Bias on Investment Decisions in the Millennial Generation in Surabaya

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ABSTRACT

Millennials who are typically adaptable are able to see investment opportunities that are easily done through the world of digital technology. Millennials see investment instruments as one of the opportunities for future income or income related to passive income that influences their investment decisions. The covid-19 event has encouraged investors, especially young people, to invest in stock instruments. One of the reasons is that stock trading transactions can be done anywhere, without requiring high mobility. This is shown by the increase in the number of investors dominated by the Millennial generation, especially during the pandemic. On the other hand, stock decision making based on limited knowledge has resulted in bias. Generally, novice investors tend to make investment decisions based on emotions rather than available data and information. This study used a sample of 100 millennials in Surabaya using a Likert scale. This research was conducted to examine the influence of Overconfidence Bias and Herding Bias on investment decisions of millennial generation in Surabaya. Data was collected using a questionnaire survey, and SmartPLS was used for analysis. The results of this study indicate that Overconfidence Bias and Herding Bias have a significant effect on the investment decisions of millennials in Surabaya.

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1.INTRODUCTION

Financial hardship can result from poor financial decisions and include trouble affording daily expenses including food, shelter, and medical care. Additionally, it may lead to increased debt and ongoing financial stress. Therefore, an individual's decisions about investments are essential because they have an enormous impact on their finances and financial objectives. Someone who makes an investment certainly expects a profit from the invested capital. Everyone's goal of investing is so that in the future they can improve their welfare. According to (Chaurasia, 2017), People invest in order to accomplish financial objectives such as safety of principal, capital growth, regular income, tax saving, and liquidity.

The number of stock investors in Indonesia is currently growing rapidly. The Indonesian Central Securities Depository (KSEI) recorded the number of investors in the capital market. It can be seen in table 1.1 of KSEI data that in 2020 the number of SIDs increased by 1,695,268 or around 53.47% and became 3,451,513 or 103.60% in 2021 and in semester 1 of 2022 the number of Single Investor Identification (SID) has reached 4,002,289 or 15.96%. The increase in the number of SID shows that there is an increasing interest of the Indonesian people to invest, especially in the stock market. This increase in interest is due to the motivation or desire to obtain increased income from passive income.

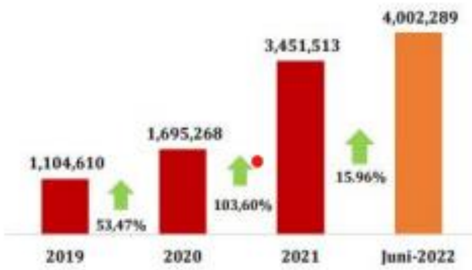

Figure 1. Graph of Growth in The Number of Indonesian Capital Market Investors
Source: Publication data conducted by the Indonesian Central Securities Depository (KSEI)

In the demographics of investors as of September 2021, KSEI recorded the dominance of millennial investors, namely 59.23 percent of total investors in Indonesia (KSEI, 2022). This shows the development of interest in the millennial generation regarding the prospects for investing in stocks. The millennial generation are people with birth years 1980-2000 and aged between 22-42 years in 2022. The characteristics of technological literacy and confidence have encouraged the millennial generation to choose to become stock investors. Transactions carried out by stock investors are synonymous with technology, this is considered easy for the millennial generation. On the other hand, the characteristic of confidence makes this generation more daring to become stock investors, even though stock investment instruments have a higher level of risk than other instruments. The millennial generation sees stock investment instruments as a future income or income opportunity that can generate passive income. Therefore, several characteristics of the millennial generation are factors that influence investment decisions.

Millennials can prepare for their future by making the right investment decisions, which should be done since they are students (Pertiwi et al., 2020). The investment decision itself is defined as a decision that refers to a delay in consuming the income that is being earned (Mwathi et al., 2017). For example, during periods of high income, individuals will tend to expedite their spending, whereas during low income levels, individuals will tend to use their savings to meet their daily needs. A person's decision to make investment decisions,

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especially stocks, is based on the investor's attitude, whether the investor is rational or irrational in making investment decisions (Rasheed et al., 2018). A rational investor attitude is the attitude of investors who make investment decisions based on clear sources of information and data that are adjusted to the investors' preferences and risk profile. An investor who makes judgments about their investments based only on gut feeling and convictions without consulting a reliable source of information or data is said to have an irrational investor mentality (Rasheed et al., 2018).

Prospect theory is a decision-making process carried out by individuals whose results are unpredictable or uncertain in one situation (Tversky & Kahneman, 1974). This theory emphasizes that not all individuals make decisions based on existing financial theory. Psychological factors and erratic behavior will affect individuals in making rational decisions. The theory argues that there are inherent biases in individuals and are influenced by psychological factors that affect individual decisions under uncertainty. Prospect theory also explains the variables overconfidence, optimism and herding as biases in investment decision making (Cao et al., 2021).

An individual with overconfidence bias overestimates their own skill, knowledge, aptitude, and capacity for making decisions (Parhi & Pal, 2022). According to Javed & Marghoob (2020) overconfidence is a person's tendency to exaggerate in making unplanned investment decisions. So, overconfidence can be described through behavior that shows excessive self-confidence, related to abilities and knowledge possessed, being able to analyze investments with the best offers with confidence in the investment experience that has been made. Previous research found that there is an effect of overconfidence on investment decisions (Malik et al., 2019; Rahman & Gan, 2020). Investors overconfidence, such as buying too many investment instruments. Investors have confidence that this instrument will provide large profits, so they do not diversify investment instruments to share investment risk. It is important for investors to understand the concept of herding bias order to be able to predict various possibilities that may occur, especially to analyze risk in investing.

A person's tendency to follow instructions or behaviors is known as the herding bias (Rahman & Gan, 2020). Academic scholars and industry professionals will always look at the possibility of herding in the financial market. Herding bias is a conditions when people or investors tend to follow the majority's lead or the behavior of others in the financial markets, despite the fact that their personal knowledge would betray a different strategy (Cao et al., 2021). Biased herding usually shown by investors who have the belief that investing is based on solicitation or recommendation of others, with the reason that the investment will definitely provide a profit. The millennial generation is considered a generation that easily follows trends and developments in the digital era, so it is considered easy to carry out herding bias when making investments, because they tend to see information from other parties and other investors' decisions as a basis for investment considerations. Various problems related to biased behavior and investment decisions are often made by the millennial generation. Therefore, this study aims to determine the effect of overconfidence bias and herding bias on millennial generation stock investment decisions.

2. RESEARCH METHODOLOGY

The type of research used in this research is associative research. This study aims to explain and describe the effect of exogenous variables. The method used in this research is a quantitative approach method. Quantitative data is a type of data that can be measured directly as a number or number variable to produce a conclusion. The population used in this study is the millennial generation based on data from Central Bureau of Statistics, with the

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city of Surabaya totals 350,000 people. The sampling in this study used the pusposive sampling method. The criteria for this research are the millennial generation who have owned shares in the last 1 month and the millennial generation who have been active in investing in the last 1 month. This research will use a questionnaire in its data collection, where the questionnaire is distributed using the Google form via line, WhatsApp, and Instagram to the research object, namely the millennial generation in the city of Surabaya. In this study the data analysis technique used by researchers is Structural Equation Modeling (SEM). Questionnaires are a method of collecting data by providing a list of questions or statements to respondents, both closed and open questions or statements. The questions or statements used in this study are closed, measured using an internal scale of 1-5, namely: strongly agree (5), agree (4), neutral or average (3), disagree (2), and strongly disagree agree (1).

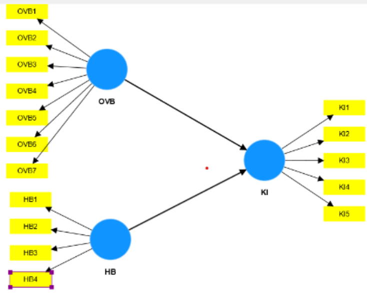

Figure 2. Path Diagram
Source: data processed by researchers

3.RESULTS AND DISCUSSION

This study discovered that the millennial generation in Surabaya is significantly influenced by overconfidence bias while making investment decisions. This shows that high self-confidence will affect investment decisions. Judging from the results of data analysis of respondents' answers, when making stock investment decisions, respondents rely on their experience and knowledge so that respondents are able to very quickly analyze prices on the stock market by relying on statistics on the market to get the expected return. This is supported by respondents' answers that they need a quick time to analyze and rely on available market statistics, which means that millennial generation investors agree that they don't need a long time to analyze the market in making their investment decisions. It could be argued that overconfidence bias influenced the study participants' decision-making when they reacted rapidly and ignored the degree of danger.

People that have become overconfident in their abilities or forecasts may disregard facts that could challenge their beliefs or take unwarranted risks. Making more sensible and balanced investing decisions therefore requires being aware of the potential for overconfidence bias and working to combat it. Overconfidence bias can be lessened by taking an objective approach, diversifying your portfolio, being receptive to new information, and having the capacity to accept the realities of the market. Previous research conducted by Adil et al., (2022); Jain et al., (2022); Rahman & Gan, (2020) found that there is an effect overconfidence on investment decisions.

The study's findings demonstrate that herding bias had an important effect on Surabaya's millennial generation's stock investment decisions. This shows that investors tend to react quickly to change their stock investment decisions when other investors make changes to their stock investment decisions. Judging from the data analysis of respondents' answers, when making stock investment decisions, respondents depend on other people's decisions when an investor makes changes to his decision. Then individuals and groups will follow the

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decision of the majority. This is supported by respondents' answers that they react quickly (follow) when other investors change their stock investment decisions which means that millennial generation investors agree that investors react quickly to changing their stock investment decisions when other investors change their investment decisions. Therefore, in this study, respondents can be said to be affected by herding bias when their stock investment decision making still depends on other people's stock investment decisions.

Social pressure, unpredictability, FOMO (Fear of Missing Out), inexperience, and mistrust of financial authorities could potentially lead investors to blindly follow investment popular trends. Herding may provide investors a momentary sense of security, but it can also result in risky investments and illogical choices. As a result, it's critical that millennials learn how to analyze information independently and refrain from involuntarily adhering to trends. Previous research conducted by Ahmad & Wu (2022) and Qasim et al. (2019) showed results that herding bias has a significant effect on investment decision making.

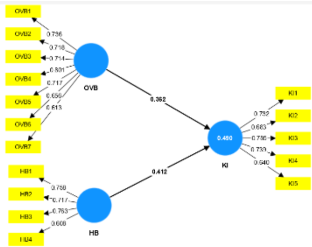

Figure 3. Path Diagram
Source: data processed by researchers

4.CONCLUSION

This research was conducted to examine the effect of overconfidence bias and herding bias on investment decisions, the results of this study can be concluded that overconfidence bias significant effect on investment decisions of the millennial generation in Surabaya and herding bias has a significant effect on millennial generation investment decisions in Surabaya. As for suggestions for beginner millennial investors who are in Surabaya, it is hoped that they can better understand and understand the influence of irrational factors, especially overconfidence bias and herding bias when making stock investment decisions. Beginner investors are expected to be able to define investment objectives clearly, gain knowledge about investment analysis in the stock market, such as: fundamental analysis and technical analysis through training and books. Researchers hope that securities, government, and issuers will provide innovation, education, training to the millennial generation.

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