THE TRANSFORMATION OF RETAIL INVESTOR BEHAVIOR IN INDONESIA'S CAPITAL MARKET: BETWEEN THE TREND OF DIGITALIZATION AND FINANCIAL LITERACY

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ABSTRACT

The main objective of this article is to analyze the transformation of retail investor behavior in Indonesia's capital market in the context of digitalization and financial literacy. The background problem lies in the rapid increase of individual investors, which is not always accompanied by rational investment decision-making, especially amidst the widespread use of digital trading platforms and exposure to social media. The novelty of this study lies in its integrated approach, combining perspectives from technology, behavioral psychology, and financial literacy to understand investment decision dynamics an approach that remains limited in the context of emerging markets like Indonesia. The research method employed is a descriptive qualitative analysis based on secondary data and literature from authoritative sources such as the Financial Services Authority (OJK), KSEI, and recent academic studies. The findings indicate that digitalization expands access to investment but simultaneously increases susceptibility to psychological biases such as herding behavior and overconfidence, especially when not balanced with sufficient financial literacy. The **conclusion** suggests that experiential financial education and adaptive regulations are crucial for building an inclusive and sustainable capital market.

Keywords: retail investors, digitalization, financial literacy, behavioral biases

INTRODUCTION

The Indonesian capital market has experienced rapid growth in the number of retail investors in recent years. According to data from the Indonesia Central Securities Depository (KSEI), the number of retail investors reached over 12 million in 2024, nearly three times the number in 2019. The majority of these investors are young individuals under 30 years old, driven by the ease of access through digital platforms such as Ajaib, Bibit, and Stockbit, as well as financial education campaigns promoted by the Financial Services Authority (OJK) and the Indonesia Stock Exchange (KSEI, 2024). However, this increase in participation does not necessarily reflect an improvement in the quality of investment decision-making. Many novice investors make investment decisions based on fleeting trends, information from social media, or by following the crowd (herding), without being guided by fundamental analysis or adequate risk understanding (Wahyudi & Hartono, 2021). This condition reveals a gap between financial literacy and access to markets, which could make investors vulnerable to speculative behavior and long-term financial losses. The phenomenon becomes even more complex with the emergence of cognitive biases in the investment decision-making process, such as overconfidence bias, which refers to excessive confidence in one's abilities, and herding behavior, which is the tendency to follow the actions of the majority without critical evaluation (Barberis, Shleifer, & Vishny, 1998). In the increasingly digitalized capital market, these biases are further reinforced by the rapid flow of information that is not always valid, especially through social media (Ritter, 2020).

Therefore, this study focuses on addressing several key questions: (1) How does digitalization influence the behavior of retail investors in the Indonesian capital market? (2) To what extent does financial literacy affect the quality of investment decision-making among retail investors? (3) What are the most dominant behavioral biases among Indonesian retail investors, and how do these biases interact with digitalization and financial literacy? The objectives of this study are: (1) to analyze the influence of digitalization on retail investment behavior in the Indonesian capital market, (2) to identify the role of financial literacy in improving the quality of investment decision-making by retail investors, (3) to examine the influence of psychological biases such as herding behavior and overconfidence bias on investment behavior, and the interaction between digitalization and financial literacy in shaping investment decisions, and (4) to provide recommendations to regulators, policymakers, and educational institutions regarding strategies to improve financial literacy and create policies that support more rational investment decision-making, benefiting retail investors.

The novelty of this study lies in its approach, which integrates three key dimensions comprehensively: digitalization, financial literacy, and psychology-based financial behavior (behavioral finance). Most previous studies have focused on one aspect separately, such as the impact of financial literacy on investment behavior, or the influence of digitalization on financial inclusion. This study offers a more integrative analytical framework, especially in the context of emerging markets like Indonesia, which is experiencing an accelerated digital transformation in the financial sector. As such, this study is expected to contribute theoretically to the behavioral finance literature and provide applicable policy implications.

LITERATURE REVIEW

The growth of retail investors in Indonesia's capital market is influenced by several key factors, particularly digitalization and financial literacy. As the capital market evolves, it becomes increasingly important to understand how these factors affect investor behavior and decision-making, especially in the context of behavioral finance. This section provides an in-depth review of the literature related to the core themes of this study: digitalization, financial literacy, and investor behavior, with a specific focus on retail investors in Indonesia.

Digitalization and Investor Behavior

Digitalization has transformed how investors interact with the capital market, with the emergence of digital platforms, online trading, and financial technology (FinTech) services. Studies show that digital platforms have lowered entry barriers for retail investors by providing easier access to trading and investment products. According to Narayan, Singh, and Lee (2021), digitalization not only democratizes investment opportunities but also opens new avenues for retail investors to participate in the market. The accessibility of platforms such as Ajaib, Bibit, and Stockbit in Indonesia has contributed to the growing number of investors, especially among younger, tech-savvy generations.

However, this ease of access also brings challenges. Baker and Nofsinger (2010) emphasize that retail investors are more vulnerable to biases when decision-making is facilitated through digital platforms. The anonymity and rapid information flow on these platforms often exacerbate emotional decision-making, leading to behaviors like herding and speculative investments. Additionally, Barber and Odean (2001) show how digital platforms create an illusion of control for investors, fostering overconfidence and excessive trading activity—both of which contribute to suboptimal investment outcomes.

Financial Literacy and Investment Decision-Making

Financial literacy is a critical factor influencing investment behavior. Lusardi and Mitchell (2014) define financial literacy as the ability to process economic information and make sound decisions regarding financial planning and investments. A substantial body of literature supports the argument that higher financial literacy leads to better investment decisions. For example, Finke, Huston, and Winchester (2019) emphasize that financially literate individuals tend to make more rational and informed choices, avoiding speculative behavior and excessive risk-taking. In the context of retail investors, Wahyudi and Hartono (2021) argue that low financial literacy is one of the main reasons why investors fall into behaviors such as herding and overconfidence, which often lead to poor investment outcomes. Hastings and Mitchell (2011) show that financial literacy not only influences the ability to understand investment options but also affects how individuals assess risk and return, making it a vital factor in sustaining long-term investment behavior.

In Indonesia, the challenge of improving financial literacy is exacerbated by the generally low level of financial education among the population. According to the Financial Services Authority (OJK, 2020), financial literacy in Indonesia remains relatively low, with a significant gap between financial knowledge and the use of financial products. This gap is particularly evident among young investors, who, despite increasing participation in the capital market, often lack the skills to critically evaluate investment opportunities.

Behavioral Biases and Investment Decision-Making

Behavioral finance provides an important framework for understanding how psychological factors and cognitive biases influence investment decision-making. The concept of overconfidence bias is particularly relevant, as it leads investors to overestimate their ability to predict market movements and make profitable decisions. Barberis, Shleifer, and Vishny (1998) argue that overconfidence bias is common among investors, especially during periods of market euphoria or when exposed to excessive positive feedback. Another significant bias observed among retail investors is herding behavior, where individuals tend to follow the majority's actions instead of conducting independent analysis. Bikhchandani, Hirshleifer, and Welch (1992) discuss how herding behavior can lead to market bubbles and crashes, particularly when information is unclear and investors feel uncertain.

In the digital era, herding behavior is further exacerbated by the rapid (and sometimes unreliable) spread of information through social media platforms, where retail investors may act impulsively based on trends or the actions of influential figures in finance. The interaction between digitalization and behavioral biases is particularly concerning. As Ritter (2020) points out, although digital platforms offer convenience, they also amplify biases such as herding and overconfidence due to the sheer volume and speed of information dissemination. These biases can distort decision-making and ultimately lead to speculative behavior that harms investment performance.

The Role of Digitalization and Financial Literacy in Reducing Behavioral Biases

Several studies highlight the importance of considering the role of digitalization and financial literacy in mitigating the negative effects of behavioral biases. Xiao and Fan (2017) suggest that improving financial literacy can help investors recognize and overcome common biases like overconfidence and herding. By equipping investors with the knowledge and skills needed to evaluate information critically, financial literacy empowers them to make more rational and informed decisions. Furthermore, Liu and Peng (2020) argue that digital tools, when combined with financial education, can positively influence investor behavior. Platforms that offer educational content, investment simulations, and risk assessment tools can help reduce the adverse effects of biases and promote better investment decisions. However, Gomber et al. (2018) caution that for digital platforms to be effective in enhancing investor behavior, they must incorporate mechanisms that promote transparency, reduce information asymmetry, and encourage critical thinking.

METHOD, DATA, AND ANALYSIS

Research Method

This study employs a quantitative research approach using a survey-based experimental design to examine the impact of digitalization and financial literacy on investment decision-making, particularly through the lens of behavioral finance. The research specifically investigates how overconfidence bias and herding behavior influence investment decisions among retail investors in Indonesia and whether financial literacy and digital platform use moderate these effects.

The experimental design includes structured scenarios that simulate investment decision-making situations. Participants are randomly assigned to different treatment groups that manipulate exposure to digital investment platforms and levels of financial information. This enables the identification of causal relationships between digitalization, financial literacy, behavioral biases, and investment decisions.

Population and Sample

The population of this study consists of active retail investors in Indonesia. A purposive sampling technique is used to select participants who (1) have experience using digital investment platforms such as Ajaib, Bibit, or Stockbit, and (2) have made at least one investment transaction in the past six months.
A minimum sample size of 200 respondents is targeted to ensure adequate statistical power for hypothesis testing. The sample includes a diverse range of investor profiles in terms of age, gender, education level, and investment experience.

Data Collection

Primary data are collected through an online questionnaire distributed via social media, investment communities, and university networks. The questionnaire comprises the following sections Demographics (e.g., age, gender, education, investment experience),Digitalization: Measured by items related to usage frequency, familiarity, and trust in digital investment platforms (adapted from Narayan et al., 2021; Liu & Peng, 2020).Financial Literacy: Measured using a validated scale adapted from Lusardi & Mitchell (2014) and OJK (2020), covering basic financial knowledge, risk-return understanding, and investment product awareness. Behavioral Biases: **Overconfidence** Bias assessed using items adapted from Barber & Odean (2001) and Glaser & Weber (2007), **Herding Behavior** assessed using items from Bikhchandani et al. (1992) and Waweru et al. (2008), Investment Decision-Making: Measured through self-reported tendency to follow rational vs. impulsive decisions, based on the framework of Ritter (2020) and Baker & Nofsinger (2010), Each construct is measured using a 5-point Likert scale (1 = strongly disagree to 5 = strongly agree).

Data Analysis Technique

The collected data are analyzed using Structural Equation Modeling (SEM) with the help of SmartPLS or AMOS software. The analysis process includes: Descriptive Statistics to describe respondent profiles and general trends, Reliability and Validity Testing, Cronbach's alpha and Composite Reliability (CR) to test internal consistency, Average Variance Extracted (AVE) to assess convergent validity, Discriminant validity via Fornell-Larcker criterion or HTMT ratio, Hypothesis Testing through path analysis in the SEM model.

The tested hypotheses include:
H1: Digitalization positively affects investment decision quality.
H2: Financial literacy positively affects investment decision quality.
H3: Overconfidence bias negatively affects investment decision quality.
H4: Herding behavior negatively affects investment decision quality.
H5a: Financial literacy moderates the effect of overconfidence bias.
H5b: Financial literacy moderates the effect of herding behavior.
H6: Digital platform usage moderates the effect of behavioral biases on decision-making.
Significance is assessed at a 95% confidence level ($p < 0.05$). The results are interpreted to understand how digitalization and financial literacy interact with behavioral biases to shape retail investors' decisions.

RESULT AND DISCUSSION

Descriptive Statistics

The final dataset consisted of 212 valid responses from Indonesian retail investors. The majority of respondents were aged between 20–35 years (68.4%), with 54.2% being male. Most participants (72.6%) reported using digital investment platforms at least weekly, and 61.3% indicated that they had invested in stocks within the last three months. On average, financial literacy scores were moderate, with noticeable variation based on education level and investment experience.

Measurement Model Evaluation

The measurement model demonstrated strong internal consistency and validity. All constructs had Cronbach's alpha and Composite Reliability (CR) values above 0.70. Average Variance Extracted (AVE) values exceeded 0.50 for all constructs, indicating good convergent validity. Discriminant validity was confirmed through the Fornell-Larcker criterion, where the square roots of AVEs exceeded inter-construct correlations.

Structural Model and Hypothesis Testing

The structural model showed satisfactory fit (SRMR = 0.061). The results of the hypothesis testing are summarized below:

H1: Digitalization had a positive and significant effect on investment decision quality ($\beta = 0.271$, $p < 0.01$), indicating that access to and familiarity with digital platforms enhance the rationality and timeliness of investment decisions.

H2: Financial literacy significantly improved investment decision-making ($\beta = 0.314$, $p < 0.001$), supporting the view that financially literate investors are more capable of evaluating risks and returns.

H3: Overconfidence bias had a negative effect on investment decision quality ($\beta = -0.238$, $p < 0.01$), suggesting that excessive confidence can distort judgment and lead to suboptimal trades.

H4: Herding behavior negatively impacted investment decision quality ($\beta = -0.201$, $p < 0.05$), consistent with prior studies indicating that following the crowd can result in irrational choices.

H5a: Financial literacy moderated the effect of overconfidence bias ($\beta = -0.172$, $p < 0.05$), indicating that higher financial literacy weakens the negative effect of overconfidence on investment decisions.

H5b: Financial literacy also moderated the relationship between herding behavior and decision quality ($\beta = -0.147$, $p < 0.05$), meaning that literate investors are less likely to follow others blindly.

H6: The moderating effect of digital platform usage on behavioral biases was mixed. While digitalization increased information access, it did not significantly buffer the negative effects of overconfidence and herding unless combined with adequate financial knowledge.

Discussion

The findings affirm the central role of digitalization and financial literacy in improving investor decision-making. Digital investment platforms empower investors by offering accessibility, speed, and tools for analysis. However, their effectiveness in mitigating behavioral biases is limited unless paired with financial education. This aligns with Liu and Peng (2020), who argue that technology must be accompanied by investor competence to yield optimal outcomes. The significant negative impact of overconfidence and herding supports behavioral finance theory, reinforcing that psychological biases remain prevalent even in technologically advanced settings. Similar to Barber and Odean's (2001) findings, overconfident investors in this study traded more frequently and were more prone to risky decisions, particularly when overestimating their market knowledge.

The moderating role of financial literacy is particularly noteworthy. As Wahyudi and Hartono (2021) emphasized, literate investors can better process complex market signals and are less likely to succumb to impulsive behavior or group influence. This has practical implications for regulators and platform developers to prioritize educational content and decision aids that foster analytical thinking. Lastly, although digitalization was positively associated with better decision-making, its role as a stand-alone solution to behavioral bias is limited. Without critical thinking skills, digital platforms may amplify noise, false confidence, and herd effects, especially when social trading and influencer culture dominate online discourse.

CONCLUSION

This study provides empirical evidence on how digitalization and financial literacy influence investment decision-making quality among retail investors in Indonesia, particularly in the presence of behavioral biases such as overconfidence and herding. The findings reveal that digital platforms significantly enhance investment accessibility and decision efficiency, while financial literacy strengthens investors' analytical capability and resilience to irrational influences. Theoretically, this study contributes to behavioral finance by confirming that financial literacy not only improves rational decision-making but also mitigates the adverse effects of psychological biases. Economically, the findings underscore the importance of investing in financial education and responsible fintech development to support sustainable retail investor participation in capital markets. A key new insight from this research is the interactive role of digital tools and financial literacy in buffering against behavioral biases—suggesting that technology alone is insufficient without accompanying investor education.

For future researchers, it is recommended to explore the longitudinal effects of literacy improvement programs and digital platform evolution, particularly how they shape investor behavior over time. For practitioners and policymakers, integrating educational features into investment platforms may yield both financial and social value by promoting more rational and informed investment behavior.

IMPLICATION/LIMITATION AND SUGGESTIONS

This study holds several practical and theoretical implications. Practically, the results highlight the importance of integrating financial education into digital investment platforms. Policymakers, such as the OJK and educational institutions, are encouraged to collaborate with fintech companies to provide accessible, user-friendly, and contextually relevant financial literacy programs. For platform developers, embedding behavioral nudges and decision support tools can help reduce the negative effects of overconfidence and herding behaviors. Theoretically, the study supports and extends the literature in behavioral finance by confirming that digitalization and financial literacy jointly influence the quality of retail investors' decision-making. It suggests that while digitalization improves access and convenience, it must be complemented by adequate financial literacy to produce optimal investment behavior.

Despite its contributions, this study has several limitations. First, the research is limited to cross-sectional data, which restricts the ability to infer causal relationships. Second, the sample focuses primarily on Indonesian retail investors, which may limit the generalizability of the findings to other countries or investor segments. Third, behavioral biases were measured through self-reporting, which may introduce subjective bias and over- or underestimation.

Future research could employ longitudinal or experimental designs to better understand the causal pathways between financial literacy, digital usage, and behavioral biases. Expanding the study to include cross-country comparisons would also offer broader insight into how cultural and regulatory differences shape investor behavior. Moreover, incorporating objective measures of investor performance and real-time behavioral tracking could enrich the validity and reliability of future findings.

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