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THE INFLUENCE OF OVERCONFIDENCE ON INVESTMENT DECISIONS: THE MEDIATING ROLE OF FINANCIAL LITERACY (A STUDY OF MILLENNIALS AND GENERATION Z IN THE SOLO RAYA AREA)

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ABSTRACT

This study aims to examine the influence of overconfidence on investment decisions, with financial literacy serving as a mediating variable. The population comprised Millennials and Generation Z residing in the Solo Raya Area, Indonesia. A total of 178 respondents were selected using a non-probability sampling technique with a purposive sampling approach. Data were analyzed using Partial Least Squares–Structural Equation Modeling (PLS-SEM) with SmartPLS 4 software.

The findings reveal that overconfidence has a positive and significant effect on financial literacy. Furthermore, both overconfidence and financial literacy positively and significantly influence investment decisions. The mediation analysis also demonstrates that financial literacy significantly mediates the relationship between overconfidence and investment decisions. These findings suggest that although overconfidence represents a behavioral bias, it can encourage individuals to improve their financial knowledge, ultimately leading to more rational and informed investment decisions.

Keywords: Overconfidence; Financial Literacy; Investment Decision; Millennials; Generation Z

INTRODUCTION

Finance plays a fundamental role in every individual's life, while structured investment in the capital market has become one of the most strategic instruments for achieving long-term financial prosperity. The enactment of Law Number 4 of 2023 concerning the Development and Strengthening of the Financial Sector (P2SK Law) has further reinforced Indonesia's capital market ecosystem by providing stronger investor protection and improving financial system resilience. Consequently, the number of individual investors has grown significantly, reaching approximately 14 million Single Investor Identification (SID) accounts, representing 96.91% of all investors. Generation Z accounts for 54.24% of these investors, followed by Millennials at 29%, collectively

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holding investment assets worth IDR 245.80 trillion in equities and IDR 54.12 trillion in mutual funds (KSEI, 2025).

Despite the remarkable increase in young investors, improvements in financial literacy and risk management have not kept pace with the growth in market participation. This imbalance creates a paradox in which easier access to investment opportunities is not accompanied by sufficient financial knowledge, potentially leading to poor investment decisions and threatening broader economic stability (OJK et al., 2025; Purnomo et al., 2025). The 2025 National Survey of Financial Literacy and Inclusion (SNLIK) further highlights this issue by revealing a substantial gap between financial inclusion and financial literacy. Financial inclusion among Generation Z reached 79%, whereas financial literacy stood at only 60%. Likewise, Millennials recorded a financial inclusion rate of 83% but a financial literacy rate of 72% (OJK & BPS, 2025). This disparity indicates that increasing accessibility to financial services has not been matched by an adequate understanding of investment principles, making young investors more vulnerable to social pressure and the Fear of Missing Out (FOMO) phenomenon when making investment decisions (Wahyuni & Andreana, 2025).

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Investment Decision

An investment decision refers to an individual's decision to allocate financial resources through investment activities with the objective of generating returns within a specific period while maintaining an acceptable level of risk. According to (Yanti & Endri, 2024; Badriatin et al., 2022), investment decisions involve the effective management of financial resources by balancing expected returns and investment risks. Investment decisions can be measured using several indicators, including capital allocation, investment horizon, investment methods, the amount of invested funds, and the selection of appropriate investment instruments.

Overconfidence

Overconfidence is a behavioral bias characterized by an excessive belief in one's own knowledge, abilities, and judgment when making investment decisions. This psychological tendency influences both the frequency and style of trading activities. When properly managed, overconfidence may serve as a positive psychological stimulus that encourages investors to seize investment opportunities with greater confidence. However, excessive overconfidence may reduce the quality of investment decisions because investors tend to underestimate hidden risks and overestimate their ability to predict market movements (Thesman & Wahyudi, 2024; Aulia et al., 2024).

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Financial Literacy

Financial literacy refers to an individual's ability to understand, evaluate, and apply financial knowledge and skills in managing personal finances. Adequate financial literacy enables individuals to make informed financial decisions, minimize investment risks, and improve long-term financial well-being (Mahwan & Herawati, 2021; Nada et al., 2023).

The Relationship between Overconfidence and Financial Literacy

Overconfidence reflects investors' confidence in their investment knowledge, analytical abilities, and understanding of financial markets (Thesman & Wahyudi, 2024). Within the context of investment behavior, overconfidence may motivate individuals to strengthen their financial literacy in order to validate their investment beliefs and decisions. Investors with higher confidence tend to conduct independent analyses by utilizing digital technologies and various financial information sources to support their investment strategies (Iram et al., 2023; Aulia et al., 2024; Dewi et al., 2024).

Accordingly, the following hypothesis is proposed:

H1: Overconfidence has a positive and significant effect on the financial literacy of young investors in Solo Raya Area.

The Relationship between Overconfidence and Investment Decisions

In capital market activities, overconfidence functions as a cognitive and psychological stimulus that encourages investors to act more decisively in exploiting investment opportunities and accepting calculated risks in pursuit of higher returns. Confidence reduces hesitation during the decision-making process and gradually develops into a major psychological driver of investment behavior. As investors gain more experience, overconfidence may further increase trading intensity and investment participation (Listiani & Soleha, 2023; Aulia et al., 2024; Wahyuni & Andreana, 2025). Therefore, the following hypothesis is formulated:

H2: Overconfidence has a positive and significant effect on the investment decisions of young investors in Solo Raya Area.

Financial Literacy and Investment Decisions

Financial literacy is a crucial factor influencing investment decisions in this study, serving as both an independent and a mediating variable by bridging the relationship between other independent variables and the dependent variable. Financial literacy enables investors to understand fundamental financial concepts and influences their evaluations, strategies, and investment decision-making processes in a rational and informed manner. It also helps prevent investment fraud while maximizing potential investment returns (Pambudi et al., 2024; Wahyuni & Andreana, 2025). Comprehensive and adequate financial literacy constitutes the primary foundation that determines the

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quality of every investment decision made by investors. It enables individuals to independently analyze available information before making investment decisions, thereby reducing the likelihood of speculative decision-making (Mahwan & Herawati, 2021; Nada et al., 2023; Wijayanti et al., 2024).

H3: Financial literacy has a positive and significant effect on the investment decisions of young investors in the Solo Raya Area.

The Mediating Role of Financial Literacy in the Relationship between Overconfidence and Investment Decisions

Individuals with higher levels of overconfidence are psychologically motivated to strengthen their financial literacy in order to validate their investment beliefs. This motivation encourages them to acquire financial knowledge through information-based learning, enabling them to make more rational and well-planned investment decisions rather than relying solely on speculation. Consequently, financial literacy serves as an important mechanism that transforms confidence into informed investment behavior.

Previous studies conducted by Yanti & Endri (2024) and Aulia et al. (2024) confirmed that financial literacy significantly mediates the relationship between overconfidence and investment decisions. Likewise, Wijayanti et al. (2024) argued that financial literacy directs overconfidence toward productive and well-informed investment confidence. Accordingly, the following hypothesis is proposed:

H4: Financial literacy mediates the relationship between overconfidence and the investment decisions of young investors in Solo Raya Area.

RESEARCH METHOD

This study employed a quantitative research design to examine the causal relationships among the proposed variables. Data were collected using a cross-sectional survey conducted between February and May 2026. The survey questionnaire was distributed online through Google Forms (Riyanto & Setyorini, 2024).

The target population consisted of Millennials and Generation Z residing in Solo Raya Area, Central Java, Indonesia. Based on data published by the Central Statistics Agency (berdasarkan data BPS 2024) (Peneliti, 2026), the productive-age population in the study area exceeds three million individuals. The research covered seven administrative regions within Solo Raya Area, namely Surakarta City, Sukoharjo Regency, Karanganyar Regency, Wonogiri Regency, Klaten Regency, Boyolali Regency, and Sragen Regency.

A five-point Likert scale was employed to measure all research variables, ranging from 1 = strongly disagree to 5 = strongly agree. The questionnaire consisted exclusively of positively worded statements (favorable items) (Riyanto & Setyorini, 2024).

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Most questionnaire items were adapted from Widyastuti & Murtanto (2024). Each construct which investment decision, overconfidence, and financial literacy was measured using five indicators, resulting in a total of 15 measurement items.

Sample and Sampling Technique

The minimum sample size was determined using the Rule of Thumb proposed by Ferdinand (2014), as cited in (Sehangunaung et al., 2023), which recommends multiplying the total number of indicators by five to ten.

$$\begin{aligned}n &= \text{indicators} \times (5 \text{ s/d } 10) \\&= 15 \times 5 \\&= 75\end{aligned}$$

n = number of indicators

Accordingly, the minimum required sample size was 75 respondents. However, to improve statistical power and enhance the robustness of the analysis, this study successfully collected data from 178 eligible respondents.

A non-probability sampling technique with a purposive sampling approach was employed. Respondents were selected based on the following criteria:

1. Belonging to the Millennial Generation (born between 1981–1996) or Generation Z (born between 1997–2012).
2. Residing in the Greater Solo Area.
3. Having an interest in capital market investment instruments, including stocks, mutual funds, bonds, sukuk, or other medium- to high-risk investment products.
4. Having invested in the Indonesian capital market.

Data Analysis

The collected data were analyzed using Partial Least Squares–Structural Equation Modeling (PLS-SEM) with SmartPLS 4.0 software (Riyanto & Setyorini, 2024). The analytical procedure consisted of several stages.

First, descriptive statistical analysis was conducted to describe respondents' demographic characteristics and the overall distribution of the data.

Second, the measurement model (outer model) was evaluated by assessing:

- Convergent validity, using outer loading values (>0.70) and Average Variance Extracted ($AVE > 0.50$).
- Discriminant validity, using the Heterotrait–Monotrait Ratio ($HTMT < 0.90$).
- Construct reliability, using Composite Reliability (>0.70) and Cronbach's Alpha (Hair et al., 2014).

Third, the structural model (inner model) was evaluated by examining:

- Standardized Root Mean Square Residual (SRMR) to assess model fit.

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- Variance Inflation Factor (VIF) to detect multicollinearity.
- Coefficient of Determination (R^2) to evaluate the model's explanatory power.
- Effect Size (f^2) to determine the contribution of each exogenous construct.
- Predictive Relevance (Q^2) using the blindfolding procedure (Hair et al., 2022).

Finally, the proposed hypotheses including both direct and indirect (mediating) effects were tested using the bootstrapping procedure. A hypothesis was considered statistically significant when the t-statistic exceeded 1.96 and the p-value was below 0.05, corresponding to a 5% significance level (Hair et al., 2014).

RESULTS

Respondent Characteristics

The study involved 178 Millennials and Generation Z respondents residing in the Greater Solo Area who had previously invested or were actively investing in the Indonesian capital market. Prior to the main survey, a pilot test involving 80 respondents was conducted using SmartPLS 4. The pilot results confirmed that all questionnaire items satisfied the required validity and reliability criteria, allowing the researchers to proceed with the full-scale data collection. The demographic profile of the respondents is presented in Table 1.

Table 1. Respondent Characteristics

Characteristic	Frequency	Percentage
Gender		
Male	70	39.3%
Female	108	60.7%
Age		
14–21 years	28	15.7%
22–29 years	86	48.3%
30–37 years	50	28.1%
38–45 years	14	7.9%
Education		
Junior High School	2	1.1%
Senior High School	80	44.9%
Diploma	8	4.5%
Bachelor's Degree	84	47.2%
Master's Degree or above	4	2.2%

Most respondents were female (60.7%), held a Bachelor's degree (47.2%), resided in Sukoharjo Regency (27.5%), and were students (49.4%), followed by private-sector employees (32.6%). All respondents had investment experience in the Indonesian capital

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market, with nearly half (48.3%) having invested for less than one year. Stocks (49.4%) were identified as the most preferred investment instrument.

Measurement Model Evaluation (Outer Model)

Convergent Validity

The convergent validity assessment was conducted using outer loading and Average Variance Extracted (AVE) values.

The initial analysis revealed that two indicators (ID3 = 0,665 and FL4 = 0,699) did not meet the recommended loading threshold of 0,70. Consequently, these indicators were removed from the measurement model. Following their elimination, all remaining indicators achieved outer loading values above 0,70, indicating satisfactory indicator reliability.

Furthermore, all constructs exhibited AVE values greater than 0,50, confirming adequate convergent validity as presented in Table 2.

Table 2. AVE Values

Construct	AVE
Investment Decision	0,510
Financial Literacy	0,567
Overconfidence	0,655

These findings indicate that each construct explains more than 50% of the variance of its indicators.

Discriminant Validity

Discriminant validity was evaluated using the Heterotrait–Monotrait Ratio (HTMT) criterion. The highest HTMT value was observed between Overconfidence and Financial Literacy (0,892), which remained below the recommended threshold of 0,90.

Therefore, all constructs demonstrated satisfactory discriminant validity, indicating that each construct measures a distinct theoretical concept.

Reliability Analysis

Construct reliability was assessed using Cronbach's Alpha and Composite Reliability.

Table 3. Reliability Analysis

Construct	Cronbach's Alpha	Composite Reliability (CR)
Investment Decision	0,760	0,839
Financial Literacy	0,809	0,867
Overconfidence	0,868	0,905

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Since all reliability coefficients exceeded 0,70, the measurement model demonstrated satisfactory internal consistency.

Structural Model Evaluation (Inner Model)

Multicollinearity Assessment/VIF

Variance Inflation Factor (VIF) values were used to evaluate multicollinearity among the predictor constructs. The highest VIF value was **2,313**, which is well below the recommended threshold of **5.0**. Therefore, multicollinearity was not considered a concern in this study.

Table. 4. Multicollinearity

	ID	FL	OC
ID			
FL	2,313		
OC	2,313	1,00	

Coefficient of Determination (R²)

The explanatory power of the structural model was assessed using Adjusted R² values.

Table. 5. R² Value

Endogenous Variable	Adjusted R ²
Investment Decision	0,517
Financial Literacy	0,565

These findings indicate that:

- 51.7% of the variance in Investment Decision is explained by the proposed predictors.
- 56.5% of the variance in Financial Literacy is explained by Overconfidence.

According to (Hair et al., 2022), these values indicate moderate explanatory power.

F-Square

The contribution of each predictor was evaluated using **effect size (f²)** as in **Table 6**.

Table 6. Contribution of each predictor

Relationship	f ²
Overconfidence → Financial Literacy	1,313
Financial Literacy → Investment Decision	0,143
Overconfidence → Investment Decision	0,126

The results indicate that Overconfidence exerts a large effect on Financial Literacy, whereas both Financial Literacy and Overconfidence have small-to-moderate effects on Investment Decision.

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Predictive Relevance (Q²)

The predictive capability of the structural model was examined using the blindfolding procedure. Since all Q² values were greater than zero, the model demonstrates satisfactory predictive relevance.

Table 7. Q² values

Construct	Q ²
Investment Decision	0,251
Financial Literacy	0,316

Hypothesis Testing

The hypotheses were tested using the bootstrapping procedure. A path was considered significant when the t-statistic exceeded 1,96 and the p-value was below 0,05.

Table. 8. Direct Effects

Hypothesis	Relationship	β	t-value	p-value	Decision
H1	Overconfidence → Financial Literacy	0,753	16,838	0,000	Supported
H2	Overconfidence → Investment Decision	0,374	3,640	0,000	Supported
H3	Financial Literacy → Investment Decision	0,398	4,044	0,000	Supported

The findings demonstrate that Overconfidence significantly enhances Financial Literacy. Moreover, both Overconfidence and Financial Literacy exert significant positive effects on Investment Decision.

Indirect Effect (Mediation Test)

The mediation analysis revealed that Financial Literacy significantly mediates the relationship between Overconfidence and Investment Decision.

Table 9. Indirect Effect

Relationship	β	t-value	p-value	Decision
Overconfidence → Financial Literacy → Investment Decision	0,300	3,972	0,000	Supported

These results indicate that Financial Literacy serves as an important mechanism through which Overconfidence improves Investment Decision. In other words, investors with higher confidence tend to strengthen their financial knowledge, which subsequently leads to better investment decision-making.

DISCUSSION

The Effect of Overconfidence on Financial Literacy

The findings indicate that overconfidence has a positive and statistically significant effect on financial literacy among Millennials and Generation Z in the Greater Solo Area. This result suggests that a higher level of self-confidence functions as a

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positive psychological stimulus that motivates young investors to improve their financial knowledge.

Individuals with strong confidence in their investment abilities tend to validate their decisions by independently learning about financial statements, market trends, and economic information. This self-directed learning process is particularly evident in the rapidly developing economic environment of the Greater Solo Area, where investors have easy access to financial information through digital platforms. Such behavior reflects confirmation bias, in which individuals actively seek information that supports their initial investment beliefs.

Interestingly, although overconfidence is generally regarded as a behavioral bias that may lead to irrational decisions, the present findings demonstrate that, when accompanied by continuous learning, it can contribute positively to the development of financial literacy. Rather than replacing objective knowledge, confidence encourages investors to acquire more information before making investment decisions.

This finding is consistent with the studies of Dewi et al. (2024) and Aulia et al. (2024), which concluded that overconfidence does not necessarily hinder financial learning but may instead serve as a psychological motivator that increases individuals' engagement with financial education.

The Effect of Overconfidence on Investment Decisions

The empirical results further reveal that overconfidence positively and significantly influences investment decisions among Millennials and Generation Z.

This finding suggests that self-confidence encourages young investors to make investment decisions more decisively and to capitalize on opportunities in the capital market. The abundance of investment-related information provided through digital investment platforms and social media may strengthen investors' belief in their ability to predict market movements accurately. Consequently, they become more willing to accept investment risks in pursuit of higher expected returns.

Moreover, the rapid economic development of the Greater Solo Area has created a dynamic investment environment where financial success stories shared by peers often reinforce investors' optimism. Such social interactions may generate an illusion of control, leading investors to believe that they possess superior forecasting abilities compared with other market participants.

The present findings support previous studies by Wahyuni & Andreana (2025) and Listiani & Soleha (2023), both of which reported that higher levels of overconfidence are associated with stronger investment intentions and greater willingness to allocate funds to financial assets.

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The Mediating Role of Financial Literacy in the Relationship between Overconfidence and Investment Decisions

The mediation analysis demonstrates that financial literacy significantly mediates the relationship between overconfidence and investment decisions.

This finding indicates that overconfidence alone is insufficient to improve investment decisions. Instead, confidence motivates individuals to strengthen their financial literacy by actively seeking reliable investment information, studying financial reports, and improving their understanding of market dynamics. Enhanced financial literacy subsequently transforms psychological confidence into more rational, systematic, and evidence-based investment decisions.

In other words, financial literacy acts as a filtering mechanism that reduces speculative behavior while maintaining investors' confidence. Investors who possess both high confidence and adequate financial knowledge are more capable of evaluating investment alternatives objectively and managing investment risks effectively.

These findings reinforce the argument that behavioral factors and cognitive capabilities should not be viewed as competing perspectives but rather as complementary determinants of investment decision-making. Psychological confidence encourages individuals to engage in financial learning, while financial literacy ensures that confidence is translated into sound investment behavior.

The results are consistent with those reported by Almansour et al. (2025) and Aulia et al. (2024), who concluded that financial literacy serves as a significant mediator in the relationship between behavioral biases and investment decisions. Accordingly, improving financial literacy among young investors may enhance the positive aspects of overconfidence while minimizing its potential negative consequences.

CONCLUSION

This study examined the influence of overconfidence on investment decisions, with financial literacy serving as a mediating variable among Millennials and Generation Z in Solo Raya Area, Indonesia.

The empirical findings lead to the following conclusions:

1. Overconfidence has a positive and significant effect on financial literacy. Individuals with higher self-confidence tend to enhance their financial knowledge by actively seeking investment-related information and improving their understanding of financial markets.
2. Overconfidence has a positive and significant effect on investment decisions. Investors with greater confidence are more willing to seize investment opportunities and accept calculated investment risks.

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3. Financial literacy has a positive and significant effect on investment decisions. A higher level of financial literacy enables investors to evaluate investment alternatives more effectively and make more rational financial decisions.
4. Financial literacy significantly mediates the relationship between overconfidence and investment decisions. This finding indicates that confidence alone is insufficient to produce high-quality investment decisions. Instead, confidence must be supported by adequate financial knowledge to encourage rational and informed investment behavior.

Overall, the study demonstrates that financial literacy transforms psychological confidence into more effective investment decision-making, thereby reducing speculative behavior while improving the quality of investment choices.

Research Limitations

Despite providing meaningful empirical evidence, this study has several limitations.

First, the respondent profile was dominated by Generation Z, female participants, residents of Sukoharjo Regency, and students, limiting the generalizability of the findings to other demographic groups. **Second**, the Adjusted R^2 values indicate that although the proposed model explains a moderate proportion of the variance in financial literacy and investment decisions, a substantial amount of unexplained variance remains. This suggests that additional behavioral or contextual variables may further improve the explanatory power of the model. **Third**, the questionnaire did not include detailed validation questions regarding respondents' investment platforms or actual investment activities. Consequently, future studies should incorporate more comprehensive verification measures to ensure respondents actively participate in the capital market.

Practical Implications

The findings of this study provide several practical implications for investors, financial institutions, policymakers, and financial educators.

For Young Investors

Young investors should balance psychological confidence with continuous improvement in financial literacy. Confidence should encourage learning rather than speculative behavior. Investors are advised to rely on credible financial information obtained from official institutions, professional investment platforms, and verified educational sources before making investment decisions.

For Financial Institutions and Financial Educators

Financial education programs should extend beyond technical investment knowledge by incorporating behavioral finance concepts, particularly psychological

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biases such as overconfidence, herding behavior, and Fear of Missing Out (FOMO). Interactive investment simulations and behavioral training programs may help investors recognize and manage cognitive biases more effectively.

Furthermore, financial education initiatives should reach broader segments of society rather than focusing primarily on students or individuals already familiar with investment activities.

For Policymakers

Government agencies, financial regulators, and the Indonesia Stock Exchange should continue strengthening financial literacy campaigns among young investors while integrating behavioral finance education into national financial literacy programs. Such initiatives may contribute to more sustainable investment participation and improve financial market stability.

Recommendations for Future Research

Future studies are encouraged to expand the present model by incorporating additional behavioral variables, including herding behavior, Fear of Missing Out (FOMO), risk perception, loss aversion, and the influence of financial influencers on social media.

Researchers are also encouraged to obtain a more balanced sample representing different age groups, occupations, educational backgrounds, and geographical regions. Comparative studies across provinces or countries may provide a broader understanding of investment behavior among young investors.

Finally, future research may employ longitudinal research designs to examine how financial literacy and behavioral biases evolve over time and influence long-term investment decisions.

Academic Contribution

This study contributes to the behavioral finance literature by demonstrating that overconfidence is not always detrimental to investment decision-making. Instead, when accompanied by adequate financial literacy, overconfidence can motivate individuals to acquire financial knowledge, leading to more rational and informed investment decisions.

The findings extend previous research by highlighting the mediating role of financial literacy, emphasizing that cognitive competence and psychological confidence should be viewed as complementary rather than contradictory determinants of investment behavior.

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