



The Influence of Financial Literacy and Investment Risk Tolerance on Investment Decisions with Confirmation Bias as an Intervening Variable

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Abstract: This research analyzes the correlation of financial literacy and investment risk tolerance on investment decisions through confirmation bias as an intervening variable. This research obtained a sample of 100 students from Politeknik Negeri Semarang using purposive sampling, while data collection was performed by a judgmental sampling technique. This research utilized SmartPLS software to conduct data analysis using the Partial Least Squares (PLS) methodology. The findings indicated that financial literacy had a positive impact significantly on investment decision behavior, alongside with a positive association with cognitive bias. Similarly, investment risk tolerance was found to significantly and positively affect both investment choices and cognitive bias. In addition, confirmation bias was shown to mediate the correlation between financial knowledge and stock investment decisions, together with between the investment risk tolerance and investment decision.

Keywords: confirmation bias; financial literacy; investment risk tolerance; investment decision

Introduction

In recent years, public interest in investment activities has increased significantly. Through participation in the capital market, individuals seek to generate returns while simultaneously managing the inherent risks associated with their investment choices (Martia et al., 2020). This growing trend has been largely facilitated by immediate technological development and the increasing accessibility of financial information, particularly among younger generations. However, the expansion of investment participation has not always been accompanied by rational and well-informed decision-making. Numerous individuals take part in investment practices with lack of sufficient comprehension of fundamental financial principles, thereby increasing the likelihood of suboptimal outcomes.

Financial literacy has long been known as a critical driver of investment decision-making. A solid comprehension of financial perspective, combined with responsible financial attitudes and behaviors, enables individuals to evaluate investment alternatives more effectively. A previous study whose sample consisted of young investors aged 18 to 40 residing in Badung District, Bali showed

that financial literacy determining investment decisions (Kurniadi et al., 2022). This research yielded similar results to the research conducted by Sartika & Humairo (2021), which used a sample of members of investment galleries at UIN Maliki Malang, Brawijaya University, and Malang State University. However, another study with a sample of students enrolled in the Investment Gallery in DKI Jakarta, specifically South Jakarta, showed that financial literacy does not determine investment decisions (Ferli et al., 2022). These results correspond with those of Maheshwari et al. (2024), who studied individual investors in India. Thus, it can be concluded that there is inconsistency in the research, highlighting the urgency of the study to be conducted.

In parallel, investment risk tolerance also performs as an essential position in shaping decision-making behavior. Prior studies have consistently demonstrated that individuals with better degree of risk tolerance tend to exhibit stronger preferences for riskier investment instruments and more assertive decision-making patterns (Ferli et al., 2022). These results recommend that both financial literacy and risk tolerance are essential factors

influencing how individuals approach investment decisions.

Despite this, investment decision-making cannot be fully explained by rational factors alone. Behavioral finance highlights the crucial function of mental predisposition in forming how investors process and interpret information. One prominent predisposition is confirmation bias, where people are inclined to focus on findings that correspond with their prior beliefs while overlooking opposing fact. This tendency can distort judgment, reduce objectivity, and ultimately lead to less optimal investment decisions (Wang & Zou, 2024). In previous studies, none have used confirmation bias as a mediating variable, whereby financial literacy influences investment decisions through behavioral bias (Sartika & Humairo, 2021). This study introduces a novel finding, confirmation bias as a intervening variable, whereby financial literacy influences investment decisions through confirmation bias; the findings show that confirmation predisposition does indeed correlate to investment decisions.

Although previous studies have extensively examined the immediate effects of financial literacy and risk tolerance on investment decisions, most of them tend to treat these relationships as rational processes. Limited attention has been given to the underlying psychological mechanisms that may mediate these relationships, particularly in the context of cognitive biases. Furthermore, existing research often assumes that higher financial literacy reduces bias, while empirical findings on its potential to reinforce overconfidence and confirmation bias remain inconclusive. This indicates a critical gap in understanding how rational capabilities and behavioral tendencies interact in shaping investment decisions.

Therefore, this study offers a novel contribution by integrating financial literacy and investment risk tolerance within a behavioral finance framework, positioning confirmation bias as a mediating variable. By doing so, this research not only examines the direct influence of rational factors but also uncovers the indirect pathways through which

cognitive bias shapes investment decision-making. Focusing on the increasingly active Generation Z investors, this study provides a more comprehensive perspective on investment behavior by bridging the gap between rational financial knowledge and psychological bias in the decision-making process.

Literature Review & Hypothesis

Financial Literacy

Financial literacy could be defined as the ability of a person in understanding and implementing numerous concept of financial to generate correct and efficient financial decision. Maheshwari et al. (2024) emphasized that a person with higher level of financial literacy is tend to show the more rational way of investing. Corresponding with previous study, Adil et al. (2022) highlights that financial literacy acts to reduce cognitive bias during decision-making process. However, on certain condition, financial literact could also correlated with the feeling of low confidence, lead to confirmation bias.

Investment Risk Tolerance

Investment risk tolerance refers to the degree of comfort a person experiences with investment risk. Ferli et al. (2022) explain that individuals with high risk tolerance are generally characterized by a greater willingness to select aggressive investment instruments. Meanwhile, Kulintang & Putri, (2024) concluded that one of the fundamental factors in investment portfolio formation is risk tolerance. Preferred investment placement, preferred investments, and portfolio percentage in assets are indicators of risk resilience (Wardani & Lutfi, 2019).

Confirmation Bias

Confirmation bias is defined as a cognitive tendency in which information aligning with pre-existing beliefs is more readily trusted, while contradictory information is disregarded. This bias has the potential to hinder the objectivity of investment decision-making. Cheng (2018) show that suboptimal investment decisions may result from

confirmation bias due to insufficient critical evaluation of market information.

Hypothesis

Financial behavior refers to the activities or behavior of individuals when making financial decisions. People frequently have to make financial decisions in their daily lives, including decisions related to the allocation of income for savings and expenditures (Sorongan, 2022). People are said to have poor financial behavior if they are unable to manage their personal finance. This happens because finances are influenced by a person's financial behavior (Marsh & Alan, 2006).

Financial literacies representing the degree of expertise and ability of an individual in understanding financial concepts, assess several investing instrument, and correct financial decision-making. Empirical evidence from *Jurnal Ekonomi & Studi Pembangunan* by Annisa Rahima and Khoirina Noor Anindya (2025) highlighted that financial literacy, specifically in financial behavior and expertise related to category of investment, correlated significantly positive on the investing interest, lead to the improvement on the quality of investment decision making on Gen Z vocational students.

Based upon the theoretical foundations established above, the following hypotheses emerge:

H1: Financial literacy exerts a significant and positive influence on investment decision-making

Investment experience has been associated with investors exhibiting a risk-tolerant mindset and prior involvement in investment activities. For novice investors, high-risk portfolios are often considered more suitable. However, fear among investors may stem from negative past experiences, limited opportunities, and limited comprehension of how investment decisions are formulated (Kusumaningrum et al., 2019). Therefore, this study proposes the following hypothesis:

H2: Investment risk tolerance has a significant effect on the investment decision-making

Financial literacy reflects an individual's ability to understand financial concepts and evaluate investment risks objectively. Higher financial literacy encourages investors to process information more critically, yet it may also shape how they interpret past experiences and available data. The study by Mega Noerman Ningtyas et al. (2024) shows that financial literacy significantly interacts with cognitive biases in shaping investment decisions among Gen Z investors. Individuals with stronger knowledge tend to rely on their understanding when interpreting outcomes, which can reinforce selective judgment patterns. This condition indicates that financial literacy can strengthen confirmation bias tendencies in evaluating financial information. Financial literacy is expected to exert a significant positive influence on confirmation bias. Therefore, the following hypothesis is proposed:

H3: Financial literacy exerts a significant positive influence on confirmation bias

Investment risk tolerance reflects an investor's willingness to accept uncertainty in pursuit of higher returns. Individuals with higher tolerance for risk tend to rely more on personal judgments and selective information when evaluating investment alternatives. This tendency encourages them to seek evidence that aligns with their existing beliefs while ignoring conflicting data. Research by Sudirman et al. (2023) indicates that investment risk tolerance plays a considerable role in shaping psychological biases within investment decision-making, particularly through heuristic processes. When investors are comfortable with risk, they become more confident in their viewpoints, reinforcing confirmation bias. Higher investment risk tolerance is expected to positively and significantly influence confirmation bias. Therefore, this study proposes the following hypothesis:

H4: Investment risk tolerance has a notably positive influence on confirmation bias

This bias is consistent with the findings of (Rose & Armansyah, 2022) in which individuals were found to give greater attention to information that aligns with their existing views. Such biased behavior is often reflected in the tendency to consider only the perspectives and opinions of like-minded sources, while disregarding opposing viewpoints. As a result, investment decisions may be made based on selective information, potentially leading to unbalanced and less objective assessments of market conditions. Therefore, the following hypothesis is proposed:

H5: Confirmation bias exerts a significant positive influence on investment decision

Financial literacy provides individuals with knowledge of financial concepts, instruments, and risks, allowing them to interpret information confidently when making investment decisions. The research by Mandagie et al. (2020) shows that higher financial literacy significantly enhances investment decision-making among accounting students, indicating that informed investors assess opportunities more rationally. This understanding may also intensify confirmation bias, because individuals are inclined to seek information that aligns with their existing beliefs about investments. As a result, financially literate investors increasingly rely on confirming evidence, strengthening confidence in their judgments and encouraging more

assertive investment choices, thereby reinforcing the positive indirect effect proposed. Therefore, the following hypothesis is proposed:

H6: Financial literacy exerts a significant positive influence on investment decision-making through confirmation bias.

Investment risk tolerance reflects an individual's willingness to accept uncertainty in pursuit of higher returns. According to the study by Balaji Kanagasabai and Vaneeta Aggarwal (2020), risk tolerance plays a mediating role in linking individual characteristics with investment outcomes, indicating that higher tolerance encourages more decisive financial strategies. Investors with strong risk tolerance tend to rely on prior beliefs and selectively interpret information, reinforcing confirmation bias. This bias strengthens confidence in chosen alternatives, leading investors to maintain and justify their decisions. Consequently, individuals who tolerate higher risk are more likely to exhibit confirmation bias, which ultimately supports more assertive and consistent investment decision-making. Therefore, the study proposes the following hypothesis:

H7: Investment risk tolerance exerts a strong positive influence on investment decision-making through confirmation bias.

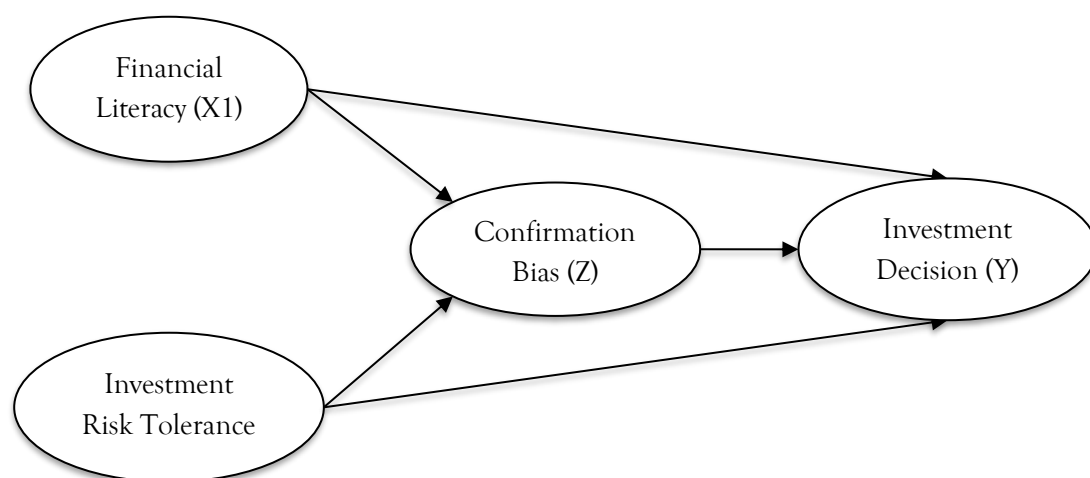


Figure 1. Research Design

Method

The approach used in this research is a quantitative descriptive. Then, Gen Z investors in capital market become the population in this research. Participants in this study were chosen through a purposive sampling method, based on specific criteria relevant to the research objectives. The criteria used are (1) Respondents are Gen Z, specifically active Politeknik Negeri Semarang students aged 17 years and above; (2) Respondents are Gen Z, specifically active Politeknik Negeri Semarang students who have an interest in investing and have previously made investments. And then for data collection in this study use the judgmental sampling technique (Yadav, 2025).

The data collection process utilized a structured questionnaire consisting of closed-ended questions, designed employed a Likert scale with four levels was implemented, where 1 represented strong disagreement and 4 indicated strong agreement, it was structured to capture the degree of respondents' attitudes, perceptions, and preferences toward statements representing each research variable. Financial Literacy (X1) serves as the independent variable in this research and is operationalized through the following indicators: financial knowledge, financial attitude, and financial behavior (Adil et al., 2022). Investment Risk Tolerance (X2) with the characteristics used are return and risk (Ferli et al., 2022). The dependent variable

used is Investment Decision with the indicators used, namely investment choices, capital management, and future investment expectations (Maheshwari et al., 2024). Confirmation Bias (Z) as an intervening variable with indicators, namely individual stance on the information obtained, individual thinking on the market conditions faced, and individual belief in investment-related information (Ashfaq et al., 2024).

After collection, the data was analyzed using descriptive statistics and Partial Least Squares-Structural Equation Modeling (PLS-SEM) to examine both direct and mediated relationships among the variables.

Result and Discussion

The table above shows that the respondents who participated were students at the Politeknik Negeri Semarang, aged between 18 and 27 years old. Overall, this research collected data from 100 participants. The demographic profile analysis of respondents has provided details, including: The majority of participants are female (58%), while 42% are male. The dominant age group is 21-24 years old, representing 53% of respondents, followed by the 18-20 age group at 46%. In terms of investment experience, a significant majority (70%) have invested for less than 3 months, while 17% have 3-6 months of experience, and 13% have more than 6 months of experience.

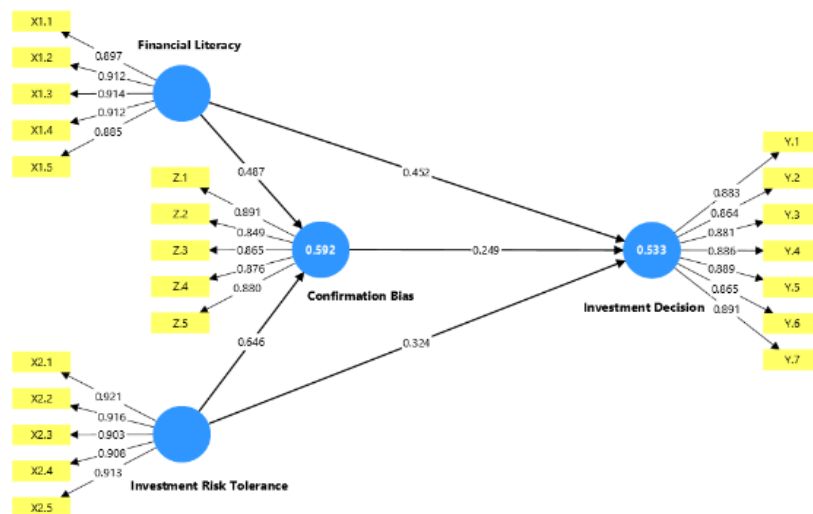


Figure 2. Partial least square model
Source: output analysis (2025)

Table 1. Respondent's Demographics Profile

Demographic Features	Category	Frequency	Percentage
Gender	Male	42	42%
	Female	58	58%
Age Group	18-20 years	46	46%
	21-24 years	53	53%
	25-27 years	1	1%
Investment Experience	< 3 months	70	70%
	3-6 months	17	17%
	> 6 months	13	13%
Income Sources	Parents' allowance	82	82%
	Working part time	33	33%
	Scholarship	27	27%
Monthly income	<Rp 500.000	44	44%
	Rp 500.001-Rp 1.000.000	32	32%
	Rp 1.000.001-Rp 2.000.000	13	13%
	>Rp 2.000.001	11	11%
Religion	Islam	95	95%
	Christian	3	3%
	Confucian	2	2%
Level	1	19	19%
	2	15	15%
	3	57	57%
	4	9	9%
Civil Engineering Major	D3 Building Construction	7	7%
	D3 Civil Construction	2	2%
	Bachelor of Applied Building Maintenance & Repair Engineering	2	2%
	Bachelor of Applied Road and bridge design	1	1%
Mechanical Engineering Major	D3 Mechanical Engineering	0	0%
	D3 Energy Conversion Engineering	4	4%
	Bachelor of applied mechanical engineering production & maintenance	0	0%
	Bachelor of applied energy generation engineering technology	4	4%
Electrical Engineering Major	D3 Electrical Engineering	2	2%
	D3 Electronics Engineering	3	3%
	D3 Telecommunication Engineering	2	2%
	D3 Informatics Engineering	5	5%
	Bachelor of applied telecommunication engineering	4	4%
	Bachelor of applied computer engineering technology	4	4%
	Bachelor of applied electrical installation engineering technology	2	2%
	Bachelor of applied electronics engineering technology	1	1%
Accounting Major	D3 Accounting	5	5%
	D3 Finance and Banking	7	7%
	Bachelor of applied computerized accounting	6	6%
	Bachelor of applied Islamic banking	3	3%
	Bachelor of applied financial analyst	16	16%
	Bachelor of applied managerial accounting	8	8%
Business Adm. Major	D3 Business Administration	3	3%
	D3 Marketing Management	2	2%
	Bachelor of applied international business management	5	5%
	Bachelor of applied business administration	2	2%

Source: primary data, processed (2025).

The primary source of income for respondents is parental allowance (82%), with the remainder earning money from part-time jobs (33%) and scholarships (27%). Accordingly, the majority of respondents (44%) have a monthly income of less than Rp 500,000. The findings also indicates that 95% of participants are Muslim. Academically, the majority of students are at Level 3 (57%). Respondents come from various majors, with the highest concentration from the Accounting Department, particularly the Applied Financial Analyst program (16%).

associated construct than on others, fulfilling the discriminant validity requirement. Additionally, Table 3 shows that all variables fulfilled the reliability standards, with both “Cronbach’s Alpha” as well as Composite Reliability values exceeding the minimum criterion of 0.7. This, the variables were confirmed to be reliable and deemed suitable for further hypothesis testing.

As presented in Table 3, the inner model test revealed that “R Square value” for variable “confirmation bias” (Z) was 0.583, while the “R Square value” for the “investment decision” (Y)

Table 2. Factor Loading

Latent Construct	Financial Literacy	Investment Risk Tolerance	Investment Decision	Confirmation Bias	Description
X1.1	0,897				Valid
X1.2	0,912				Valid
X1.3	0,914				Valid
X1.4	0,912				Valid
X1.5	0,885				Valid
X2.1		0,921			Valid
X2.2		0,916			Valid
X2.3		0,903			Valid
X2.4		0,908			Valid
X2.5		0,913			Valid
Y.1			0,883		Valid
Y.2			0,864		Valid
Y.3			0,881		Valid
Y.4			0,886		Valid
Y.5			0,889		Valid
Y.6			0,865		Valid
Y.7			0,891		Valid
Z.1				0,891	Valid
Z.2				0,849	Valid
Z.3				0,865	Valid
Z.4				0,876	Valid
Z.5				0,880	Valid

Source: primary data, processed by authors (2025).

Figure 2 shows that the collected data was then analyzed using SmartPLS software and the PLS method.

As presented in Table 2, all measurement indicators were found to be valid, with every indicator demonstrating factor loadings exceeding 0.7. Furthermore, findings from the discriminant validity assessment demonstrated each item had a higher cross loading on its

stood at 0.519. These figures suggest that 58.3% of the variation in “confirmation bias” (Z) is explained by “financial literacy” (X1) and “investment risk tolerance” (X2), with the remaining 41.7% is affected by external factors not captured within the framework. Similarly, 51.9% of the changes in “investment decisions” (Y) are attributed to (X1) and (X2), whereas the residual 48.1% is associated with other variables beyond the research’s scope.

Table 3. Validity and Reliability Model

Variable	Cronbach's Alpha	Average Variance Extracted	Composite Reliability	R Square
Financial Literacy	0,944	0,818	0,957	
Investment Risk Tolerance	0,949	0,832	0,961	
Confirmation Bias	0,921	0,760	0,941	0,583
Investment Decision	0,951	0,774	0,960	0,519

Source: primary data, processed (2025).

Table 4. Hypothesis Test Results

	Original Sample (O)	T Statistics (O/STDEV)	P values	Information
Financial Literacy -> Investment Decision	0,452	4,581	0.000	Accepted
Investment Risk Tolerance -> Investment Decision	0,324	2,943	0.002	Accepted
Financial Literacy -> Confirmation Bias	0,487	7,165	0.000	Accepted
Investment Risk Tolerance -> Confirmation Bias	0,646	12,009	0.000	Accepted
Confirmation Bias -> Investment Decision	0,249	2,062	0,020	Accepted

Source: primary data, processed (2025).

As shown in the table above, “financial literacy” exerts a significant positive influence on “investment decisions”, as indicated by a “P value” below 0.05 and a positive original sample estimate. Similar results were also observed for other hypothesized relationships “investment risk tolerance” on “investment decisions”, “financial literacy” on “confirmation bias”, “investment risk tolerance” on “confirmation bias”, and “confirmation bias” on “investment decisions”, all demonstrating significant positive effects (P values < 0.05 and positive original sample values).

As reflected in the table above, “confirmation bias” functions as a mediating in the relationship between “financial literacy” and “investment decisions”, as well as in the link between “investment risk tolerance” and “investment decisions”. The results suggest that “financial literacy” exerts a significant positive indirect influence on “investment decisions” through “confirmation bias”, and similarly, “investment risk tolerance” also demonstrates a significant positive indirect influence on “investment decisions” via “confirmation bias” (P values < 0.05; original sample values are positive).

Table 5. Mediation Test Results

Path	Original Sample (O)	T Statistics (O/STDEV)	P values	Information
Financial Literacy -> Confirmation Bias -> Investment Decision	0,121	2,043	0,021	Accepted
Investment Risk Tolerance -> Confirmation Bias -> Investment Decision	0,161	2,001	0,023	Accepted

Source: primary data, processed (2025).

The first hypothesis which posits that “financial literacy” has an impact on “investment decisions”, was supported by the analysis result. A significant positive influence was observed, indicating that increased financial literacy tends to be associated with more rational investment decisions. This outcome is consistent with more prior research. For example, a research by Maheshwari et al. (2024) demonstrated that individuals with advanced financial knowledge are more likely to make informed and prudent financial decisions. Similar finding were reported by Ferli et al. (2022) who found that stronger financial understanding contributes to more rational investor behavior. Supporting that’s research, Adwan and (Sartika & Humairo, 2021) concluded that adequate financial knowledge enhances the precision of selecting suitable investment instrument. Furthermore, Hilgert, (Kurniadi et al., 2022) also emphasize that financial literacy is positively linked to constructive financial behavior, with a specific emphasis on investment decision-making.

The second hypothesis is that “investment risk tolerance” exerts a positive influence on “investment decisions”, This finding implies that greater willingness to take risks correlates with increased assertiveness in investment decisions. This research is also in line with several previous studies which risk tolerance has been identified as a significant factor influencing investment decision. Ferli et al. (2022) state that a person's level of risk tolerance determines the preference for the type of investment chosen. Kulintang & Putri (2024) found that individual risk profiles are very influential in the formation of investment portfolios. In addition, (Sharma & Prajapati, 2024) showed that individual differences in risk tolerance have significant implications for decision-making behavior.

The third hypothesis shows that “financial literacy” exerts a positive and significant influence on “confirmation bias”. This suggests that a higher-level financial literacy is associated with an increased tendency to experience confirmation bias. This finding contrasts with several previous studies in which

financial literacy has been suggested to reduce the occurrence of cognitive distortions. However, this result can be explained through the overconfidence phenomenon, where individuals with high literacy feel more confident in their own judgment and thus more easily ignore information that contradicts their initial beliefs. This suggests that financial literacy alone is not enough to ensure objectivity in decision-making and needs to be balanced with awareness of cognitive biases.

The fourth hypothesis shows that “investment risk tolerance” has a significant positive influence on “confirmation bias”. Greater risk appetite is linked to a higher likelihood of experiencing confirmation bias during the decision process. This phenomenon may be attributed to the stronger confidence individuals with high risk tolerance exhibited in their investment choices, leading them to concentrate more on information that aligns with their decisions. Such persistence in confronting risk may indirectly reinforce the inclination to dismiss information that opposes what they initially believed.

The fifth hypothesis is that “confirmation bias” exerts an influence on “investment decisions”. The analysis results indicate that confirmation bias exerts a positive influence on investment decisions. This indicates that investors affected by confirmation bias are inclined to favor information that supports their current beliefs while ignoring evidence that contradicts them. The findings of this research are also consistent with previous research, in which confirmation bias has been shown to influence investment decision-making. Gulo & Cahyonowati (2024) found that information that aligns with investors’ initial beliefs tends to be selectively sought and prioritized while avoiding contradictory evidence, reducing decision objectivity. Rose & Armansyah (2022) explained that confirmation bias is a systematic cognitive distortion that frequently occurs even in high-stakes decision contexts like investing. Similarly, Qotrunada, Sofia & Hascaryani (2024) observed that investors who overly rely on belief-confirming information tend to persist in suboptimal decision paths.

The sixth hypothesis shows “financial literacy” exerts a positive influence on “investment decisions” indirectly through “confirmation bias”. Although financial literacy basically supports rational decision making, when individuals experience confirmation bias, investment decisions taken can be unobjective. Mediation of confirmation bias shows that high financial understanding does not necessarily directly result in the right investment decision. Decisions may be compromised if individuals continue to be inclined to favor information that supports their current beliefs while ignoring evidence that contradicts them. This indicates that cognitive bias still plays a role in disrupting the effectiveness of financial literacy in the context of decision making.

The seventh hypothesis shows that “investment risk tolerance” also exerts a significant positive influence on “investment decisions” indirectly through “confirmation bias”. Individuals with high risk tolerance are generally characterized by demonstrating stronger confidence in their investment decisions and a tendency to disregard information that contradicts their existing views, which then strengthens confirmation bias. Such bias ultimately influences the investment decisions taken, making them less objective. Then, this mediation mechanism implies that risk tolerance influences behavior not only directly through a more complex psychological pathway, specifically through biases in information processing.

Conclusion

The finding of the study emphasizes that financial literacy has positive correlation significantly toward the investor when making investment decision. This variable also shows the positive and significant correlation with confirmation bias. Investment risk tolerance is also been demonstrated giving positive and significant impact on investment decision or confirmation bias. Moreover, confirmation bias as intervening variables has been proven to mediate the relationship between financial literacy and investment decision making, also with investment risk tolerance and investment decision. However, the limitation

of this study lies in the sample size who were relatively limited. It may be limiting the generalization across findings. In addition, the design of this study limits the ability to observe changes on investor behavior from time to time. Further researches are recommended to include demographic factors and additional variables to explore differences on educational degree, risk perceptions, financial literacy, and another aspect.

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