

# Retail Investor Rationality: The Role of Financial Literacy and Experience Level in Moderating Overconfidence

Muhammad Ikhsan<sup>1</sup>

<sup>1</sup>STIE Indoenia Jakarta, Indonesia; <sup>1</sup>ikhshanbni84@gmail.com;

**Background:** The rise of retail investors in Indonesia has transformed the capital market landscape, yet the quality of their investment decisions remains a concern. While financial literacy and investment experience are assumed to promote rationality, there is limited understanding of how psychological biases, especially overconfidence, interact with these factors in influencing decision making.

**Purpose:** This research aims to analyze the influence of financial literacy and investment experience on rational investment decision making among retail investors, with overconfidence tested as a moderating variable. This study seeks to explore whether overconfidence strengthens or weakens the impact of cognitive competencies on investor rationality.

**Methodology:** The study employs a quantitative approach involving 269 active retail investors in the Indonesian capital market, selected via purposive sampling. Data were collected using structured questionnaires and analyzed using SPSS version 29. The main techniques included multiple linear regression to test direct effects and moderated regression analysis (MRA) to test interaction effects. Financial literacy, investment experience, and overconfidence were measured using validated instruments adapted from prior studies, and all constructs were tested for validity and reliability before analysis. Results: The

**Finding:** The analysis confirms that both financial literacy ( $\beta = 0.433$ ,  $p < 0.05$ ) and investment experience ( $\beta = 0.298$ ,  $p < 0.05$ ) significantly enhance rational investment decision making. Importantly, overconfidence significantly moderates these relationships. While it strengthens the effect of investment experience ( $\beta = 0.255$ ,  $p < 0.05$ ), it weakens the effect of financial literacy ( $\beta = -0.194$ ,  $p < 0.05$ ). These findings reveal a nuanced interplay between cognition and psychology in financial behavior. The originality of this study lies in integrating behavioral finance theory with psychological constructs in an emerging market context. The limitations include the use of self reported data and a cross sectional design, which may restrict causal interpretation. Nonetheless, the research contributes novel insights into how behavioral factors shape investment decisions in digitalizing economies.

**Limitation:** The information respondents obtain in the investment context is often partial or incomplete. This impacts how they make investment decisions. Bounded rationality theory suggests that individuals tend to rely on easily accessible or readily available information without conducting a thorough information search. This limitation can cause the research results to reflect decisions based only on limited information, thus underrepresenting the decision-making process under ideal conditions.

**Originality:** The novelty of this research lies in its attempt to examine the factors influencing rational investment decision-making by individuals. Research directly examining the factors that directly determine rational investment decision-making by individuals is rare. Mushinada (2020) empirically found that individual investors often exhibit irrational behavior in investing, including decision-making. Relatedly, Viryajaya & Handoyo (2022) attempted to examine the factors influencing irrational decisions by individual investors. The only study that examined the determinants of rational decisions by individual investors is Lu et al. (2020). However, that study examined the effect of consulting with an investment advisor on rational investment decision-making by individual investors. The proposed research attempts to examine 21 different factors influencing rational investment decision-making by individual investors, with financial literacy and experience level as independent variables, and overconfidence as a moderating variable.

**Keywords:** Behavioral Finance, Decision Making, Financial Literacy, Overconfidence, Retail Investors