# CHAPTER I
INTRODUCTION

1.1   Research Background

As a species, humans are synonymous with development and progress. These two things are a hallmark of our species, which constantly seeks, pushes, and breaks the boundaries that previously existed, both in the fields of science and technology. These efforts are carried out for the welfare of mankind, where every invention, innovation, and new creation is expected to facilitate and bring prosperity to mankind. In the last few decades, innovation in technology, especially communication and information technology is the latest thing that drives progress and raises the standard of living for people around the world (asianetbroadband.in, 2021). The advent of the internet has allowed people from different parts of the world to communicate instantly, whether through text messages, voice calls, or video calls. This ease of communication certainly makes the flow of information easier, leading to advances in the field of science, due to scientists being no longer limited by geographical areas to share and cooperate in their research. The internet is not only beneficial for scientists, but all people in society. As the general public's understanding of the use of the internet increases, the benefits of the internet also expand, ranging from entertainment, community creation, to learning.

Nowadays, the existence of educational content on the internet is widespread and abundant, and almost all of it can be accessed for free by anyone (bbvaopenmind.com, 2014). For example, platforms such as YouTube, Wikipedia, and forums such as Reddit provide a means to exchange information and knowledge informally, while platforms such as Skillshare and Masterclass provide learning and educational content from experts in their fields through a more formal environment. This ease of access makes the general public more knowledgeable in various fields, including finance. Starting from personal finance, to the capital market, the general

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public now have a better understanding in these areas than before the presence of the internet.

This phenomenon occurs all over the world, including Indonesia. INDEF (Institute for Development of Economics and Finance) economist, Eko Listyanto, assesses that financial understanding in Indonesian society, both in terms of literacy and financial inclusion, has increased from 2016 to 2019 (CNN Indonesia, 2020). This claim is supported by a survey conducted by the Financial Services Authority (Otoritas Jasa Keuangan) in 2019, entitled the National Survey of Financial Literacy and Inclusion (Survey Nasional Literasi dan Inklusi Keuangan). The results of the survey are shown in the following infographic:
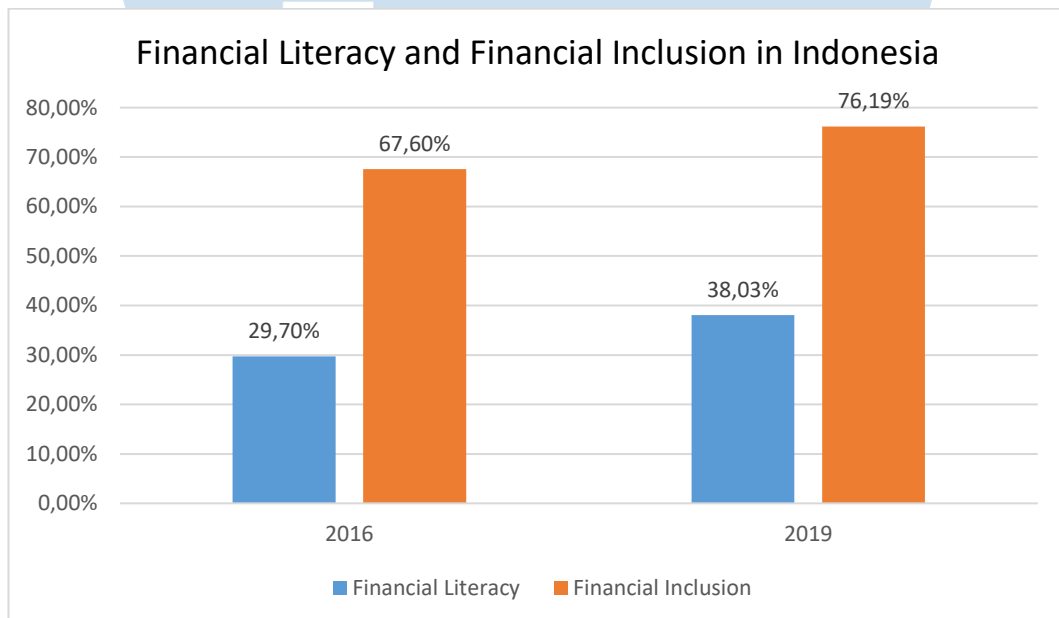
Source: Financial Services Authority, 2020

Figure 1.1 Results of the 2019 National Survey of Financial Literacy and Inclusion

Based on Figure 1.1 above, it can be seen that both the financial literacy and inclusion index of the Indonesian people continued to increase from 2016 to 2019. The financial literacy index in Indonesia reached 38.03% and the financial inclusion index reached 76.19% in 2019. This figure shows an increase since 2016 by 16.19%

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for the financial literacy index and 16.45% for the financial inclusion index. The survey results indicate that Indonesian's general understanding on finances has improved. Related to financial literacy, Widayanko and Dewi (2021) found that financial attitude and financial knowledge could influence an individual's financial management behavior. Therefore, it is very important for the general public to have the proper financial attitude and knowledge in order to impact their financial management behavior in a good way.

Along with the increasing understanding of general finance in Indonesia, the Indonesian public's understanding on the benefits and importance of financial management has also increased, indicated by the increase of investor numbers. One of the steps for proper financial management is to have a financial plan to achieve financial goals and financial prosperity (Pan and Statman, 2012). With a structured and clear plan, one's financial goals can be achieved more effectively and with a higher chance of success. This plan can be prepared by yourself, or with the help of a professional financial planner. Of course, each individual's financial plan will be different from one another, due to various factors that are unique to each individual (Rahman, 2019). These factors can be in the form of goals to be achieved, current income, current financial condition, and the level of risk tolerance that a person has. When these determinants are not taken into account properly, there can be a mismatch between the client and the plan created by the financial planner, which likely results in the failure of the financial plan. One example of a failed financial plan is the Jouska incident in 2019 (CNBC Indonesia, 2020). Their clients have filed complaints and reported losses, as a result of Jouska's financial recommendation and advice. This happened because Jouska did not recognize the risk tolerance level of their client, then proceeded to give recommendation and took actions that are not suitable for their client's goals and risk tolerance level, resulting in their client's loss and disappointment.

In addition to financial literacy and inclusion, the number of capital market investors in Indonesia has continued to increase since 2018. The increase was quite

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significant, as the Indonesian Central Securities Depository (Kustodian Sentral Efek Indonesia) reported growth in the number of investors by 53.41% in 2019 and 56.21% in 2020. Meanwhile, through the first 6 months of 2021, the number of Single Investor Identification (SID) in the Indonesian capital market has reached 5,597,760, growing 44.24% from the end of 2020.

Source: Indonesian Central Securities Depository, 2021

Figure 1.2 Capital Market Investor Growth 2018-2021

In addition to investors in the capital market, based on Figure 1.2 above, mutual funds and bonds investors in Indonesia have also grown rapidly over the last 3 years. According to Indonesian Central Securities Depository, the number of mutual fund investors's SID in Indonesia has grown by 395.28% from 2018 to June 2021. Meanwhile, the number of government bond investors has grown by 175.91% from 2018 to June 2021.

THE EFFECT OF PROPENSITY FOR REGRET, PROPENSITY FOR OVERCONFIDENCE, INCOME LEVEL, AND STOCK OWNERSHIP ON STOCK INVESTORS' FINANCIAL RISK TOLERANCE IN GREATER JAKARTA AREA, Ignatius Raymond, Universitas Multimedia Nusantara

Source: Indonesian Central Securities Depository, 2021

Figure 1.3 Growth of Mutual Funds and Government Securities Investors 2018-2021

These increasing number of investor shown in Figure 1.3 above is also an indicator that there is a rise in the financial risk tolerance level in the Indonesian general public. The stats above indicates that the general public is now more willing to take financial risk in order to gain an increase in financial returns by investing, with the riskier investment option of stocks (or capital market) experiencing the largest amount of investor increase, when compared to a less riskier option such as mutual funds and government securities.

In investing, there will always be a risk of loss. However, the level of risk will be different and varies, depending on the type of investment instrument. When investing in stocks, investors should pay attention to the corporate actions such as dividend payouts, as Dewi (2019) found that the change or volatility in stock prices are influenced by dividend yield. Investors can determine their preferred choice of investment product based on various reasons, but one of the most important reasons is the level of risk associated with the investment. Investors are likely to prefer instruments that match their risk tolerance.

One's risk tolerance is one of the most important factors that must be known when preparing a financial plan and investing. Carr (2014) states that when a

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financial planner is able to create a financial plan that fits their client's risk profile, they tend to be more disciplined in following the plan, and the chance of achieving the financial goals of the plan is also greater. Pan and Statman (2012) also found that client risk tolerance is crucial for financial advisors in guiding their clients in dealing with various financial decisions. However, until now there has been no universally accepted and recognized measurement of risk tolerance (Rahman, 2019).

The process of measuring a person's risk tolerance level is very complicated, because a person's risk tolerance can be affected by various other factors that exist in the individual's personality. One of these factors is the behavioral factor of the individual. Rahman (2019) revealed that behavioral factors have a role in the process of measuring a person's risk tolerance level. Some examples of behavioral factors are propensity for regret and propensity for overconfidence. In addition to behavioral factors, several studies have also found that demographic factors such as the amount of individual income also affect the level of risk tolerance, as found by Shah *et al.* (2020). A person's portfolio allocation can also be related to his level of risk tolerance, as found by Shin and Kim (2018), which stated that individuals with high risk tolerance have a high percentage of share ownership in their portfolio.

In addition to one's income level, other demographic factors, namely marital status will also affect the level of individual risk tolerance (Leon and Aprilia, 2018; Zeeshan *et al.*, 2021). They found that marital status had a significant influence on financial risk tolerance, and in their research, Leon and Aprilia (2018) found that single individuals tend to have higher financial risk tolerance than married individuals. Based on these findings, there is a difference between the risk tolerance possessed by married and single individuals. This study will focus on the level of risk tolerance of unmarried individuals. To ensure that the target respondents meet the desired sample criteria, at the beginning of the questionnaire, there will be a question about the respondent's marital status as a screening process,

with the purpose of sorting out respondents to fit the sample criteria. Other sample criterias include adult male and females with monthly income, working and living in the Greater Jakarta area, and have invested in stock, in order to measure the stock ownership variable.

Based on the reasons above, as well as the relevance and importance of financial risk tolerance in today's society, this research will study the effects of two behavioral factors, namely propensity for regret and propensity for overconfidence, a demographic factor, namely the individual income level, and stock ownership to financial risk tolerance.

1.2   Problem Formulation

Based on the research background, the following questions are the problem formulation for this research:

1. Does Propensity for Regret have an effect on Financial Risk Tolerance?
2. Does Propensity for Overconfidence have an effect on Financial Risk Tolerance?
3. Does Income Level have an effect on Financial Risk Tolerance?
4. Does Stock Ownership have an impact on Financial Risk Tolerance?

1.3   Research Objectives

Based on the formulation of the problem above, the objectives of this research are as follows:

1. To determine the effect of Propensity for Regret on Financial Risk Tolerance.
2. To determine the effect of Propensity for Overconfidence on Financial Risk Tolerance.
3. To determine the effect of Income Level on Financial Risk Tolerance.

4. To determine the effect of Stock Ownership on Financial Risk Tolerance.

1.4 Research Benefits

This research is expected to provide benefits for those who are directly or indirectly involved in this research. The following are the expected benefits of this research:

1. **Academic Benefits**

This study aims to determine how Propensity for Regret, Propensity for Trust, Income Level, and Stock Ownership can affect a person's Financial Risk Tolerance. This research can be used as a reference for other researchers who want to study related topics.

2. **Practical Benefits**

This research is expected to provide practical benefits as follows:
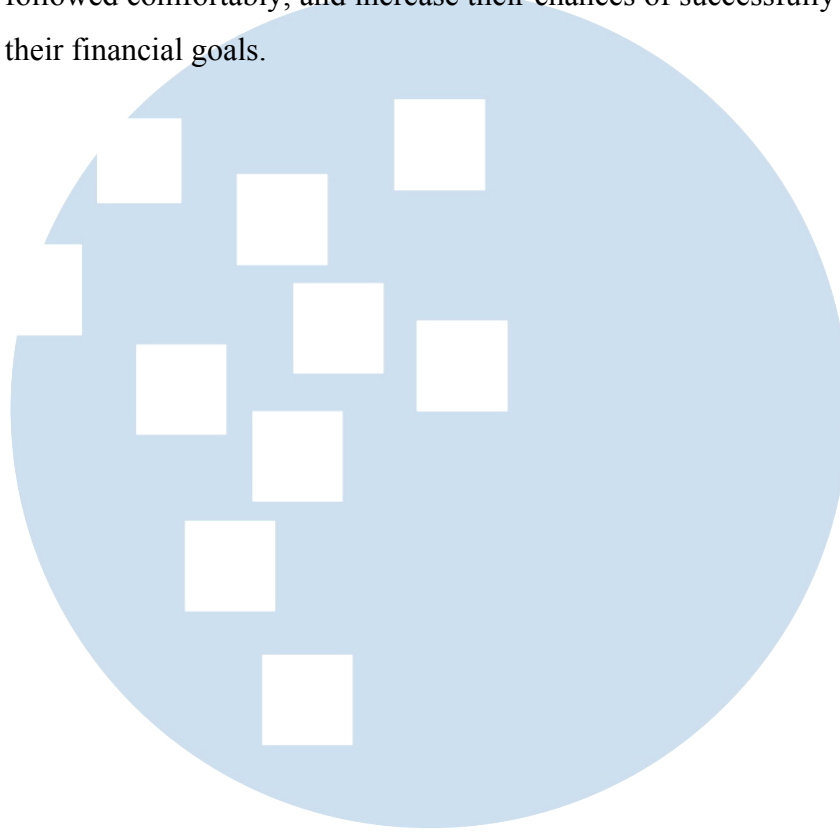
a. Benefits for financial planners:

This research is expected to be used as a reference to identify and determine the financial risk tolerance of clients through behavioral factors, namely propensity for regret and propensity for overconfidence, demographic factors namely income level, and stock ownership, so that financial planners can prepare financial plans that are more appropriate and suitable for their clients.

b. Benefits for clients of financial planners:

This research is expected to help clients to get a suitable and appropriate financial plan from their financial planner, so that they can be

followed comfortably, and increase their chances of successfully achieving their financial goals.