

Financial Behavior and Risk Tolerance as Determinants of Investment Decision Making among Young Adults in Urban Areas

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Received: 07/07/2025 | Accepted: 25/08/2025 | Publication: 30/08/2025

Abstract : This study investigates the relationship between financial behavior, risk tolerance, and investment decision-making among young adults in urban Indonesia. Using a quantitative approach, primary data were collected from 250 respondents aged 20–35 years residing in five major urban centers through an online survey. The study employs Structural Equation Modeling–Partial Least Squares (SEM–PLS) to analyze the interrelationships among financial literacy, budgeting habits, saving behavior, risk tolerance, and investment decision quality. The findings reveal that financial behavior significantly affects investment decision-making, both directly and indirectly through the mediating effect of risk tolerance. Respondents with disciplined saving and budgeting habits exhibit higher risk tolerance and tend to make more rational and goal-oriented investment choices. The study highlights the need for targeted financial education programs that address behavioral factors and risk profiling in order to improve the quality of investment decisions among urban youth.

Keywords : *financial behavior, risk tolerance, investment decisions, young adults, SEM–PLS, urban Indonesia.*

How to Cite : Rizky, A., Wulandari, L., Azizah, N., & Walsh, F. (2025). Financial Behavior, Risk Tolerance, and Investment Decision-Making among Young Adults in Urban Areas. *Journal of Economics and Management*, 3(2), 52–60. <https://doi.org/10.70716/ecoma.v3i2.249>

INTRODUCTION

In the context of growing economic complexity and expanding financial product availability, understanding the financial decision-making behavior of young adults has become increasingly important. Urban areas, as hubs of financial innovation and consumerism, present unique opportunities and challenges for the financial inclusion of the youth. The ongoing shift toward digital finance, coupled with increased access to online investment platforms, has significantly empowered young individuals to participate more actively in capital markets. Yet, such participation is often influenced less by careful planning and more by external factors such as peer recommendations, social media trends, and the fear of missing out. As a result, many investment choices among the youth tend to be speculative in nature rather than grounded in rational financial analysis. This trend-following behavior, if not accompanied by sufficient knowledge, can expose young investors to substantial risks and long-term financial

setbacks. The lack of financial literacy and practical experience also increases the likelihood of impulsive decision-making, undermining the potential benefits of early exposure to investment opportunities. Therefore, examining how these behavioral tendencies shape the financial outcomes of urban youth is critical in determining effective strategies for fostering long-term financial well-being (Lusardi & Mitchell, 2014).

Financial behavior encompasses the daily management of money, which includes budgeting, saving, spending, and managing debt. A substantial body of literature highlights that individuals who engage in positive financial behaviors such as disciplined saving, long-term goal setting, and careful spending tend to make better investment decisions over time. These behaviors not only contribute to greater financial stability but also foster a mindset that is more resilient to market fluctuations and speculative trends. In the case of young adults, particularly in urban settings, financial behavior is shaped by a unique blend of factors including income volatility from gig work, high living costs, social expectations related to lifestyle, and heavy reliance on digital tools. This complexity means that their financial management practices often involve trade-offs between short-term consumption desires and long-term wealth-building strategies. In many cases, pressures from peers or exposure to consumerist culture may undermine savings discipline, resulting in weaker investment capacity. Therefore, financial behavior should be understood not only as a reflection of knowledge but also as a dynamic interplay between social, economic, and psychological influences that determine how effectively young adults can build and manage their financial portfolios (Saputra, 2024).

Risk tolerance, defined as an individual's willingness to accept uncertainty in financial decisions, is another critical factor in shaping investment outcomes. It plays a central role in asset allocation, investment horizons, and portfolio diversification strategies. Generally, younger investors are believed to exhibit higher levels of risk tolerance due to their extended time horizon for recovery and fewer family or financial obligations. This assumption, however, cannot be applied universally, particularly in countries or communities where economic security is fragile, unemployment risks are high, or where social safety nets are limited. In such contexts, even young investors may demonstrate conservative financial behavior, prioritizing capital preservation over risky investments. Furthermore, cultural factors and personal experiences such as exposure to past financial crises or family financial difficulties can lower willingness to take risks, regardless of age. Understanding these nuances allows for a more realistic evaluation of investment decision-making, highlighting that risk tolerance is not merely a demographic trait but rather a reflection of broader socio-economic realities. By examining the variation in risk tolerance among youth, researchers and policymakers can identify patterns that may inform the development of more tailored financial education programs and investment strategies (Grable & Joo, 2004).

In Indonesia, the rapid growth of digital financial services, combined with the increasing popularity of retail investment platforms, has introduced millions of new investors to the market. The majority of these investors are drawn from the millennial and Gen Z demographic, reflecting a generational shift toward more active participation in financial markets. According to the Indonesia Stock Exchange (IDX), more than 70% of new retail investors in 2023 were under the age of 35, demonstrating the speed at which young Indonesians are engaging with investment opportunities. Despite this encouraging trend, challenges remain evident: many young investors lack the foundational knowledge, critical thinking skills, and behavioral discipline required to sustain long-term investment success. Without these capabilities, participation can lead to poor decision-making, speculative trading, or exposure to fraudulent schemes. The absence of adequate financial

literacy, combined with high enthusiasm for fast returns, often results in vulnerabilities that may erode long-term financial security. For policymakers and educators, this underscores the urgency of designing interventions that promote financial discipline, enhance digital literacy, and encourage informed decision-making, ensuring that the momentum of increased participation translates into sustainable financial growth (OJK, 2023).

Several studies have sought to explain the link between financial literacy and investment decisions, often concluding that knowledge alone is insufficient to guarantee sound practices. While financial literacy provides the foundation for understanding financial products, behavioral tendencies frequently dominate decision-making in practice. Psychological factors such as impulsiveness, present bias, or short-term orientation can override rational analysis, leading to decisions that deviate from the individual's long-term best interests. This observation supports the idea that actual financial behavior serves as a more accurate indicator of investment practices than literacy alone. For example, someone may fully understand the risks of borrowing to invest in speculative assets but still proceed due to impulsive behavior or social pressures. Hence, the observable actions reflected in budgeting, saving, and spending habits provide a clearer picture of how individuals approach investment in reality. This perspective broadens the scope of financial research by moving beyond cognitive knowledge toward a behavioral lens that accounts for attitudes, self-control, and decision-making processes, offering deeper insights into the financial lives of young adults (Shefrin & Thaler, 1988).

Moreover, the relationship between financial behavior and investment decision-making is unlikely to be straightforward or linear. Risk tolerance often functions as a mediating variable that alters how financial behavior translates into actual choices. For instance, individuals who exhibit strong saving and budgeting habits may nonetheless avoid growth-oriented investments if they possess low risk tolerance, thereby limiting wealth accumulation potential. Conversely, those with higher levels of risk tolerance may be willing to engage in aggressive investment strategies, even when their financial discipline is moderate. This interplay highlights the importance of examining risk tolerance in conjunction with financial behavior to fully understand decision-making patterns. Integrating risk profiling into behavioral models provides more predictive accuracy and allows for the design of strategies tailored to diverse investor types. Such integration is especially critical in the context of young investors, whose financial futures are strongly influenced by early investment decisions that compound over time (Mahat & Lau, 2023).

Socioeconomic and psychological influences further complicate the financial landscape faced by urban youth. Peer influence, particularly through social media, often plays a decisive role in shaping perceptions of investment opportunities. Platforms designed to democratize financial knowledge can simultaneously spread misinformation, creating a confusing environment for inexperienced investors. In addition, financial anxiety stemming from high debt levels or uncertain income prospects can distort rational decision-making, leading individuals to either avoid investments altogether or pursue overly risky options in search of quick gains. The tension between maintaining a desirable urban lifestyle and building long-term savings adds another layer of complexity. Therefore, analyzing investment decisions among young adults requires attention not only to their individual attributes but also to the broader ecosystem of digital, social, and cultural forces that shape their financial attitudes and behaviors. This holistic approach provides a more realistic and context-sensitive understanding of why investment outcomes among youth vary so widely, even within similar economic environments.

Empirical studies from emerging economies reveal inconsistent results regarding the relationship between financial behavior and investment decisions. Some findings suggest a strong correlation, indicating that individuals with positive financial habits are more likely to invest wisely and achieve better outcomes. Other studies, however, emphasize that external factors such as family financial background, marketing strategies from financial service providers, or access to formal financial institutions may outweigh behavioral influences. These mixed results highlight the importance of conducting context-specific studies that account for the distinctive characteristics of each market. In rapidly growing urban areas, where digital financial services are widely available but not equally accessible, the interplay between individual behavior and external conditions becomes particularly significant. As such, nuanced and localized research is essential to uncover how financial behavior interacts with structural factors to shape investment practices, thereby avoiding overly generalized conclusions that may not apply across different socioeconomic settings (Amri et al., 2022).

Urban Indonesia provides an especially compelling context for investigating these issues. The country's rapid smartphone penetration, expanding fintech ecosystem, and rising middle-class aspirations have created unprecedented access to investment products for young urbanites. At the same time, the eagerness of young people to engage with financial markets often exceeds their readiness in terms of knowledge, discipline, and risk management. This gap between exposure and preparedness raises significant concerns about potential financial vulnerability, as youth may be drawn to speculative investments or fall victim to misleading marketing. Addressing these risks requires deeper empirical insights into the underlying behavioral drivers of financial decision-making. A focus on factors beyond income or education levels such as financial discipline, psychological biases, and risk tolerance provides a more complete understanding of youth investment practices in this context. By identifying these drivers, stakeholders can design more targeted interventions to promote sustainable financial engagement and protect young investors from avoidable risks.

Building on this background, the present study aims to empirically examine the role of financial behavior and risk tolerance in shaping investment decisions among young adults in urban Indonesia. Using structural equation modeling as the primary analytical tool, the study investigates both direct and mediated effects, thereby offering a nuanced account of how behavioral and psychological variables jointly influence financial choices. This approach contributes not only to theoretical debates in behavioral finance but also to practical discussions on how to design effective financial education and policy interventions. The findings are expected to provide actionable recommendations for regulators, educators, and financial service providers seeking to enhance financial inclusion, improve investor protection, and support the long-term financial well-being of Indonesia's young urban population.

RESEARCH METHODS

This study employed a quantitative approach with a cross-sectional survey design. The target population was young adults aged 20–35 years residing in major urban centers in Indonesia, including Jakarta, Surabaya, Bandung, Medan, and Makassar. A purposive sampling technique was applied to ensure demographic and geographic representation. A total of 250 valid responses were obtained through an online questionnaire distributed via social media and university networks.

The research instrument was developed based on validated scales from previous studies. Financial behavior was measured using indicators of budgeting, saving, debt

management, and spending control (Perry & Morris, 2005). Risk tolerance was assessed using the Grable & Lytton (1999) scale, which includes items on investment preferences and hypothetical risk scenarios. Investment decision-making was measured by self-reported indicators related to planning, portfolio diversification, goal orientation, and decision satisfaction.

All items used a five-point Likert scale (1 = strongly disagree to 5 = strongly agree). A pilot test with 30 respondents was conducted to validate construct clarity and internal consistency. Cronbach's alpha values exceeded 0.70 for all constructs, confirming reliability.

Data were analyzed using Structural Equation Modeling with Partial Least Squares (SEM-PLS) through SmartPLS 4.0. This method was selected due to its suitability for complex models with latent variables and small-to-medium sample sizes. The analysis followed a two-step approach: assessment of the measurement model (validity and reliability) and evaluation of the structural model (hypothesis testing and path analysis).

Ethical considerations included informed consent, anonymity of responses, and the right to withdraw. The study complied with institutional research ethics standards and posed minimal risk to participants.

RESULTS AND DISCUSSION

The descriptive analysis revealed several important characteristics of the respondents that provide context for interpreting the structural findings. A majority of participants had attained higher education (65%), which suggests that they possess a relatively strong academic background and the potential for better comprehension of financial concepts. Despite this educational advantage, the majority reported a monthly income in the range of IDR 3 to 7 million (58%), placing them in a moderate income bracket typical of early-career urban professionals. Interestingly, even with limited disposable income, 70% of participants reported ownership of at least one investment product. This finding indicates that financial market participation among young adults is not restricted to high-income groups but is gradually becoming a widespread phenomenon. It also highlights the increasing accessibility of investment products through digital platforms, where minimal capital is required to begin investing. Thus, the descriptive statistics point to a demographic that is well-educated, moderately resourced, and increasingly open to participating in financial markets, setting the stage for deeper behavioral analysis.

The measurement model results further confirmed the robustness of the research framework. Convergent validity was established as all factor loadings exceeded the threshold of 0.70, while Average Variance Extracted (AVE) values were consistently above 0.50, confirming that the constructs effectively captured their intended dimensions. Moreover, both composite reliability and Cronbach's alpha values exceeded the recommended cut-off, thereby ensuring internal consistency across indicators. Discriminant validity was assessed using the Fornell-Larcker criterion, which verified that each construct was empirically distinct from the others. This strong measurement validity ensures that subsequent interpretations of the structural relationships are grounded in reliable data. In short, the measurement model provides confidence that the observed patterns are not artifacts of measurement error but instead reflect genuine behavioral and psychological dynamics among urban young adults.

The structural model produced several noteworthy findings. First, financial behavior demonstrated a significant positive effect on investment decision-making ($\beta = 0.328$, $p < 0.001$). This result suggests that individuals who display consistent and

disciplined financial practices such as budgeting, saving, and prudent spending tend to approach investments in a more structured and goal-oriented manner. Respondents who actively planned and monitored their day-to-day financial management were more inclined to build diversified portfolios and pursue long-term investments rather than speculative short-term gains. This reinforces prior research asserting that behavioral patterns, rather than financial literacy alone, drive the quality of financial decision-making (Saputra, 2024). It also reflects the growing importance of cultivating sustainable financial habits among young urbanites, as their investment engagement is not simply determined by income levels but also by the way they discipline and control their resources.

Risk tolerance was another significant factor shaping investment decisions, with a positive and statistically strong effect ($\beta = 0.367$, $p < 0.001$). This aligns with earlier findings emphasizing the central role of risk attitudes in determining portfolio strategies (Grable & Joo, 2004). Participants with higher risk tolerance demonstrated a stronger inclination to invest in equity and cryptocurrency products, both of which are inherently volatile yet potentially rewarding. Moreover, these individuals displayed greater confidence in navigating uncertain financial environments, suggesting that psychological readiness plays a crucial role in sustaining market participation. For younger investors, the willingness to tolerate risk is often linked to their longer time horizon and relatively fewer financial obligations, allowing them to absorb potential losses. However, this finding also raises cautionary notes, as high risk tolerance, when not accompanied by strong financial discipline, may lead to impulsive and speculative decisions.

The mediating role of risk tolerance adds further nuance to the behavioral framework. The analysis revealed that risk tolerance partially mediated the relationship between financial behavior and investment decision-making (indirect effect $\beta = 0.144$, $p < 0.01$). This means that disciplined financial behavior not only directly fosters better investment decisions but also indirectly enhances investment outcomes by building an individual's psychological readiness to take calculated risks. In practical terms, individuals who practice budgeting, saving, and long-term planning are more likely to cultivate a mindset that views risk as manageable rather than intimidating. This finding suggests that financial education programs should emphasize the dual role of behavior: improving immediate financial discipline while simultaneously shaping attitudes toward risk. By understanding this mediation pathway, policymakers and educators can design interventions that reinforce both behavioral consistency and risk awareness among young investors.

At the same time, the findings also underscore the risks of imbalance between behavior and tolerance. Respondents with high risk tolerance but weak financial behavior tended to engage in impulsive investment activities, often influenced by peer pressure, social media hype, or fear of missing out (FOMO). Such individuals may lack the financial planning discipline to evaluate investment suitability, leading them to speculative choices that could undermine long-term financial security. This highlights the importance of anchoring risk-taking tendencies within a foundation of sound financial behavior. Risk tolerance alone, without behavioral discipline, may foster confidence but not necessarily competence. Therefore, financial guidance should target not only enhancing knowledge and risk-taking abilities but also ensuring that these are grounded in structured behavioral practices.

The explanatory power of the model was relatively strong, accounting for 47% of the variance in investment decision-making. This indicates that the two predictors financial behavior and risk tolerance are substantial determinants of investment choices

among young adults in urban Indonesia. While nearly half of the variance was explained, the remaining unexplained portion suggests that other contextual variables, such as peer influence, digital literacy, or marketing exposure, may also play important roles. Nonetheless, the explanatory strength of the current model confirms the centrality of behavioral and psychological factors in investment decision-making, thereby advancing the understanding of financial practices beyond traditional economic indicators.

Finally, the results carry important practical implications. For policymakers and educators, the findings highlight the need to go beyond financial literacy campaigns and instead focus on building positive financial habits and fostering awareness of risk tolerance. For financial service providers, particularly digital platforms, the integration of behavioral profiling tools could help guide young investors toward products that match both their behavioral tendencies and risk capacities. For example, robo-advisory platforms could be designed to assess an individual's budgeting discipline alongside their risk profile, thus offering more tailored investment recommendations. Ultimately, these results emphasize that effective financial inclusion for young urban Indonesians requires a holistic approach that combines knowledge, behavior, and psychological readiness.

CONCLUSION

This study concludes that financial behavior and risk tolerance are significant determinants of investment decision-making among urban young adults in Indonesia. Financial behavior influences investment decisions both directly and indirectly through risk tolerance. Individuals who manage their finances well are more likely to develop healthy risk attitudes and make informed investment choices.

The findings suggest that financial education efforts must move beyond literacy to include behavioral training and risk profiling. Programs aimed at youth should incorporate budgeting tools, simulations of risk scenarios, and personalized investment planning to enhance decision quality.

Policymakers and fintech companies can use these insights to develop digital financial services tailored to young users, incorporating nudges that promote saving, reduce impulsive spending, and align risk preferences with investment products.

Future research could explore additional psychological variables such as financial self-efficacy, peer influence, or the impact of digital media on investment behavior. Longitudinal studies would also be valuable in tracking behavioral changes over time.

In summary, enhancing the investment decision-making of urban youth requires a holistic understanding of their financial behavior and risk tolerance. By addressing these foundational elements, stakeholders can foster a financially responsible and investment-ready generation.

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