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

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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.*

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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.

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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

Respondent Characteristics and Investment Participation

The descriptive profile of respondents provides important contextual grounding for the interpretation of the structural model. Most respondents possessed higher education qualifications, indicating sufficient cognitive capacity to understand financial products and investment mechanisms. However, income levels remained relatively moderate, reflecting early-career employment conditions commonly experienced by young adults in urban Indonesia.

Despite income constraints, investment participation was notably high. A large proportion of respondents reported owning at least one investment instrument, suggesting that entry barriers to investment have declined substantially. Digital investment platforms and low minimum capital requirements appear to enable broader market participation. This pattern confirms that investment behavior among young adults is not solely income-driven, but is closely associated with financial attitudes and behavioral discipline.

Table 1. Respondent Investment Participation

Indicator	Percentage (%)
Own at least one investment product	70
No investment ownership	30
Moderate monthly income (IDR 3–7 million)	58

Measurement Model Evaluation

The evaluation of the measurement model confirms that all constructs meet established validity and reliability thresholds. Indicator loadings exceeded the recommended minimum, confirming that observed variables reliably represent their latent constructs. Average Variance Extracted values above 0.50 further indicate strong convergent validity.

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Composite reliability and Cronbach's alpha values also exceeded acceptable limits, ensuring internal consistency across indicators. Discriminant validity assessment confirmed that financial behavior, risk tolerance, and investment decision-making are empirically distinct constructs. These results indicate that the measurement model is robust and suitable for subsequent structural analysis.

Table 2. Reliability and Validity Summary

Construct	AVE	Composite Reliability	Cronbach's Alpha
Financial Behavior	> 0.50	> 0.80	**> 0.70**
Risk Tolerance	> 0.50	> 0.80	**> 0.70**
Investment Decision-Making	> 0.50	> 0.80	**> 0.70**

Direct Effects on Investment Decision-Making

The structural model results indicate that financial behavior has a positive and statistically significant effect on investment decision-making ($\beta = 0.328$, $p < 0.001$). This finding demonstrates that young adults who practice consistent budgeting, saving, and spending control tend to make more deliberate and goal-oriented investment decisions. Financial discipline enables individuals to evaluate investment options more carefully and reduces susceptibility to impulsive or speculative choices. This result aligns with empirical evidence that financial behavior serves as a strong predictor of decision quality in investment contexts (Saputra, 2024).

Risk tolerance also exerts a significant positive influence on investment decision-making ($\beta = 0.367$, $p < 0.001$). Respondents with higher tolerance for uncertainty are more willing to engage in investment instruments with variable returns. This psychological readiness supports portfolio diversification and long-term investment engagement. The result reinforces the view that risk tolerance is a central determinant of how individuals translate financial intentions into actual investment behavior (Grable & Joo, 2004).

Table 3. Structural Path Coefficients

Path	β	p-value
Financial Behavior → Investment Decision	0.328	< 0.001
Risk Tolerance → Investment Decision	0.367	< 0.001

Mediating Role of Risk Tolerance

The mediation analysis reveals that risk tolerance partially mediates the relationship between financial behavior and investment decision-making. The indirect effect is statistically significant ($\beta = 0.144$, $p < 0.01$), indicating that financial behavior contributes to investment decisions both directly and indirectly through enhanced risk tolerance.

This result suggests that disciplined financial management fosters a more structured perception of financial risk. Individuals who regularly plan and monitor their finances are more likely to view investment risk as manageable rather than threatening. As a result, they demonstrate greater confidence when making investment decisions, without resorting to excessive risk-taking. The partial mediation also indicates that financial behavior remains influential even in the absence of high risk tolerance, underscoring its foundational role in investment decision-making.

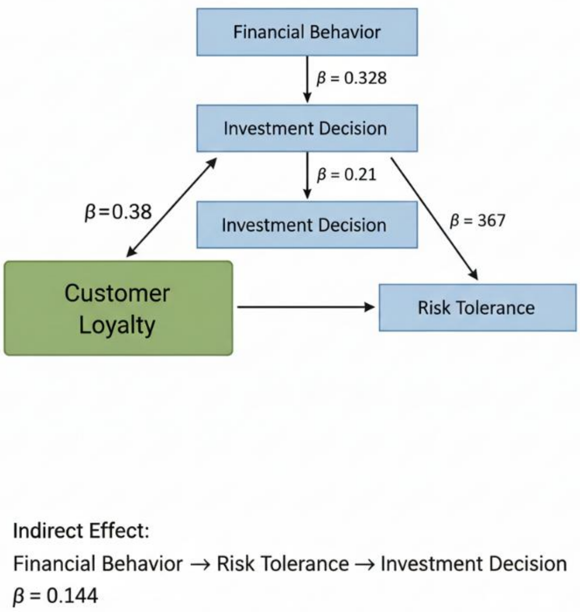

Figure 1. Mediation Structure of the Model

Integrated Discussion of Findings

Taken together, the results demonstrate that financial behavior and risk tolerance jointly shape investment decision-making among young adults in urban Indonesia. The model explains 47 percent of the variance in investment decision quality, indicating substantial explanatory power for behavioral and psychological factors.

The findings highlight that financial discipline provides structural stability in decision-making, while risk tolerance determines the degree of engagement with uncertain financial outcomes. Importantly, the results show that high risk tolerance alone does not guarantee sound investment decisions. Without disciplined financial behavior, high risk tolerance may increase exposure to impulsive or poorly planned investments. Conversely, disciplined financial behavior without adequate risk tolerance may limit portfolio growth potential.

This balance underscores the importance of integrating behavioral discipline with calibrated risk acceptance. Investment decision-making among young adults is therefore best understood as the outcome of an interaction between how individuals manage their finances and how they perceive financial risk..

CONCLUSION

This study confirms that financial behavior and risk tolerance are key determinants of investment decision-making among young adults in urban Indonesia. Using a SEM–PLS approach, the findings demonstrate that financial behavior exerts a significant direct influence on investment decisions and also affects decision quality indirectly through risk tolerance. Young adults who consistently practice budgeting, saving, and spending control tend to make more rational, goal-oriented, and structured investment choices.

Risk tolerance functions as an important psychological mechanism that strengthens the effect of financial behavior on investment decisions. Respondents with disciplined financial habits exhibit higher readiness to accept calculated financial risk, which enables them to engage more confidently with investment instruments involving uncertainty. At the same time, the results show that risk tolerance alone does not guarantee sound

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investment decisions. Without strong financial behavior, higher risk tolerance may lead to impulsive or speculative investment activities. This finding underscores the complementary roles of behavioral discipline and psychological readiness in shaping investment outcomes.

The explanatory power of the model indicates that financial behavior and risk tolerance together account for a substantial proportion of variation in investment decision-making among urban youth. This highlights the relevance of behavioral and psychological factors beyond income or demographic characteristics in understanding investment practices.

From a practical perspective, the findings suggest that financial education and inclusion programs should prioritize behavioral development alongside risk profiling. Interventions aimed at young adults should focus on strengthening daily financial management practices while enhancing awareness of risk preferences. For financial service providers, especially digital investment platforms, integrating behavioral and risk-based assessments can improve the alignment between investor profiles and investment products.

Overall, this study emphasizes that improving investment decision-making among young urban adults requires an integrated approach that combines financial behavior and risk tolerance as foundational elements of sustainable financial participation.

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