



# The Influence of Behavioral Biases and Islamic Financial Literacy on Investment Decisions of Young Investors in Malaysia

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## Abstract

*This study aims to analyze the influence of behavioral bias and Islamic financial literacy on students' investment decisions as a representation of young Muslim investors. An explanatory quantitative approach was used by collecting data through an online questionnaire distributed to 48 students at Universiti Malaysia Kelantan (UMK). Data analysis was carried out using multiple linear regression through SPSS version 27. The results showed that of the three dimensions of overconfidence, only overplacement had a significant positive effect on investment decisions, while overprecision, overestimation, loss aversion, and anchoring bias did not show a significant effect. On the other hand, Islamic financial literacy has the strongest positive influence on investment decisions, indicating that understanding of Islamic financial principles is able to suppress behavioral bias and increase investment rationality. Theoretically, these findings expand the perspective of behavioral finance by including Islamic values as a controlling factor for cognitive bias. Practically, the results of this study provide input for educational institutions and financial authorities to strengthen Islamic financial literacy to form rational, ethical, and sustainable investment behavior among young investors.*

### Keywords:

overconfidence, loss  
aversion, anchoring bias,  
Islamic financial literacy,  
investment decisions

## INTRODUCTION

The development of financial technology (fintech) has revolutionized the way people manage finances and invest. The emergence of sharia-based digital platforms such as Wahed Invest, Bursa Anywhere, and Bareksa Syariah opens up new opportunities for the younger generation to participate in the capital market (Rahim & Amin, 2021; Securities Commission Malaysia, 2023). The younger generation, especially students, is now the fastest-growing investor segment in the ASEAN region, driven by wide access to information and ease of digital transactions (Lim et al., 2022). However, this increase in the number of investors is not always accompanied by the ability to make rational and informed investment decisions (Lusardi & Mitchell, 2020; OECD, 2022).

According to Behavioral Finance theory, investment behavior is not entirely determined by objective information, but also by psychological and cognitive factors (Kahneman & Tversky, 1979; Barberis, 2018). Young investors often exhibit various forms of behavioral bias, such as overconfidence, anchoring bias, and loss aversion, which affect the way they assess risk and make investment choices (Statman, 2019; Bakar & Yi, 2016). Research by Khan et al. (2021) and Younas et al. (2020) found that overconfidence was positively related to the frequency of transactions, while loss aversion decreased the tendency to sell losing stocks. On the other hand, anchoring bias causes investors to get too fixated on starting prices

or old predictions (Toma, 2020). This phenomenon is common among young investors who are new to the capital market (Raut, 2020; Abreu & Mendes, 2021).

In addition to the psychological aspect, Islamic financial literacy is an important element that shapes the financial behavior of the younger generation of Muslims. Islamic financial literacy includes an understanding of Islamic financial principles such as the prohibition of usury, gharar, and maysir as well as the ability to manage finances based on ethical and sustainability values (Antara et al., 2016; Hassan et al., 2022). Several studies have found that the level of Islamic financial literacy among Muslim students is still moderate and uneven (OJK, 2022; MES, 2023; Amin & Rahman, 2022). Lack of understanding of Islamic financial products can make young investors vulnerable to behavioral biases and decisions that are contrary to Islamic principles (Saiti et al., 2019; Karim et al., 2021).

Based on these conditions, this study seeks to answer the question of the extent to which behavioral bias and Islamic financial literacy affect students' investment decisions as young Muslim investors in Malaysia. This question is important because it provides an empirical understanding of how psychological aspects and religious values play a role in the financial behaviour of young people in Malaysia.

Theoretically, this study contributes to strengthening the perspective of behavioral finance by adding the dimension of Islamic financial literacy as a controlling factor for behavioral bias. From a practical perspective, the results of the research are expected to provide input for educational institutions and financial authorities in Malaysia to strengthen Islamic values-based financial literacy programs. Thus, this research helps build a generation of young investors who are not only financially savvy, but also ethical and oriented towards the sustainability of Islamic values in their investment decisions.

## **LITERATURE REVIEW**

### **Behavioral Finance**

Behavioral finance theory explains that financial decision-making is not only based on information and rational logic, but is also influenced by human emotional, social, and cognitive factors (Barberis, 2018; Statman, 2019). This approach is a critique of the efficient market hypothesis that assumes investors always act rationally. Kahneman and Tversky (1979) through Prospect Theory argue that individuals tend to value profits and losses relative to reference points, rather than from the absolute end result. Research in various countries shows that young investors are more vulnerable to this bias because their experience and financial literacy are still limited (Khan et al., 2021; Raut, 2020).

### **Overconfidence**

Overconfidence bias occurs when an investor is overconfident in his ability to assess market information, predict stock prices, or beat the market (Barber & Odean, 2011). As a result, investors tend to overtrade, incur high fees, and ignore the real risks (Bakar & Yi, 2016).

Empirical research shows that overconfidence has a significant influence on investment behavior, especially among young investors (Younas et al., 2020; Khan et al., 2021). Individuals who are overconfident in their predictions often ignore new information that contradicts their initial view (Statman, 2019). In the context of students, overconfidence can also be triggered by social media exposure and the euphoria of digital investment (Pontoh, 2023).

**H1:** Overconfidence has a positive effect on young investors' investment decisions.

## **Loss Aversion**

Loss aversion describes an individual's tendency to feel more suffering from loss than the enjoyment of an equal amount of gain (Kahneman & Tversky, 1979). Investors who experience this bias are usually reluctant to sell loss-making stocks and are too quick to sell stocks that provide small profits (Barberis, 2018).

Research in the Malaysian and Indonesian capital markets shows that loss aversion influences the tendency of retail investors to delay the decision to sell assets (Bakar & Yi, 2016; Sharma & Prajapati, 2022). Additionally, this bias often hinders portfolio diversification and lowers the potential for long-term returns (Younas et al., 2020).

**H2:** Loss aversion has a negative effect on young investors' investment decisions.

## **Anchoring Bias**

Anchoring bias arises when investors rely too much on initial information such as stock purchase prices or initial projections as the main reference in decision-making (Toma, 2020). As a result, investors become less responsive to new, more relevant information.

Previous research has shown that anchoring bias plays a significant role in investment behavior in various cultural contexts (Khan et al., 2021; Abdullah et al., 2023). Among students and young investors, this bias often arises due to limited experience in analyzing financial data and the influence of social media or peer recommendations (Wulandari & Hermawan, 2021).

**H3:** Anchoring bias negatively affects young investors' investment decisions.

## **Sharia Financial Literacy**

Islamic financial literacy refers to a person's understanding of Islamic financial principles, including the avoidance of usury, gharar, and maysir, as well as the ability to manage finances according to sharia values (Antara et al., 2016). This literacy also includes moral and spiritual dimensions in economic decision-making (Hassan et al., 2022).

Research by Karim et al. (2021) and Amin & Rahman (2022) confirms that a high level of Islamic financial literacy can improve the quality of investment decisions because individuals are more cautious, rational, and long-term oriented. On the other hand, low literacy causes students to be more easily affected by behavioral biases and short-term trends (Saiti et al., 2019).

**H4:** Islamic financial literacy has a positive effect on young investors' investment decisions.

## **Investment Decision**

Investment decisions are defined as the process of determining the choice of financial instruments by considering the level of risk and profit (Lusardi & Mitchell, 2020). In the context of students, these decisions are not only influenced by rational aspects such as fundamental or technical analysis, but also by psychological factors and religious values (Roemanasari et al., 2022).

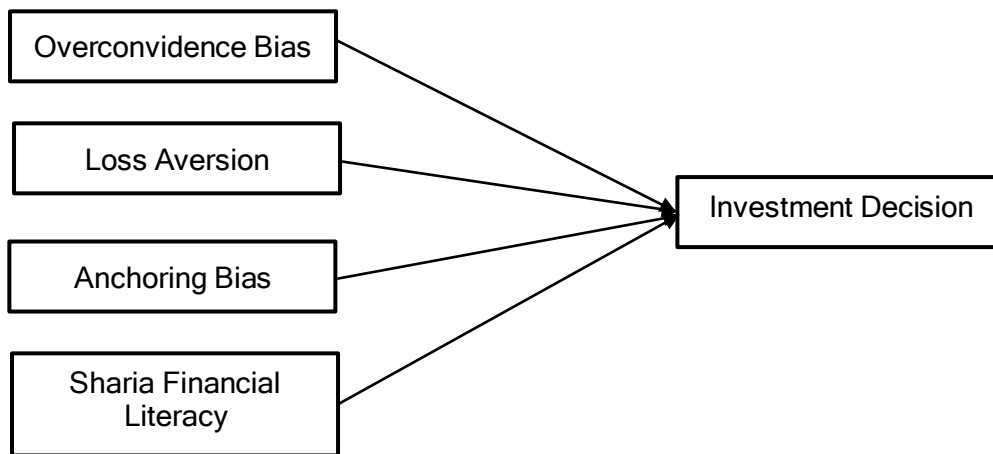
Young investors who have high Islamic financial literacy and are able to recognize behavioral biases are expected to be able to make more rational investment decisions, in accordance with sharia principles, and are sustainable (Abdullah et al., 2023; MES, 2023).

## **CONCEPTUAL FRAMEWORK**

This research is based on Behavioral Finance Theory which explains that investment decisions are not always rational, but are influenced by psychological

and cognitive factors such as overconfidence, loss aversion, and anchoring bias. These biases affect the way investors assess risk, process information, and make decisions. In the context of Islamic finance, investment behavior is also guided by moral values and sharia principles, so that Islamic financial literacy can play an important role in suppressing the negative impact of behavioral bias and encouraging more rational and ethical decision-making.

Based on the theory and results of previous research, this study develops a conceptual model that links overconfidence, loss aversion, anchoring bias, and Islamic financial literacy as independent variables that influence investment decisions as dependent variables. This model assumes that behavioral bias has a direct effect on investment decisions, while Islamic financial literacy serves to strengthen rationality in decision-making among young Muslim investors.



## RESEARCH METHOD

This study uses a quantitative approach with an explanatory research type to examine the influence of overconfidence, loss aversion, anchoring bias, and Islamic financial literacy on young investors' investment decisions in Malaysia. The study population was young investors aged 18–35 years who were actively investing, using purposive sampling techniques. Based on the criteria of investment experience of at least six months, 48 respondents were obtained. This number is considered feasible because it exceeds the minimum limit of 30 respondents for quantitative analysis (Sekaran & Bougie, 2016), although it is relatively limited so the results of the study are exploratory. The research instrument is in the form of a five-point Likert scale questionnaire, with indicators compiled based on the latest literature on each variable. Data analysis was carried out using SPSS through multiple linear regression tests.

## RESULT AND DISCUSSION

Before conducting regression analysis, tests were carried out on the validity and reliability of the instruments to ensure the quality of the data. The results showed that all statement items had an item-total correlation value above 0.30 and Cronbach's Alpha exceeded 0.70, indicating that the research instrument was reliable and worthy of use for further analysis.

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Overprecision	48	7.00	15.00	10.4167	1.71145
Overestimation	48	8.00	15.00	10.2083	1.58394
Overplacement	48	6.00	15.00	10.0417	2.07270

Loss Aversion	48	8.00	15.00	10.3750	1.94198
Anchoring Bias	48	8.00	15.00	10.7708	1.89332
Sharia Financial Literacy	48	8.00	15.00	11.4792	1.81001
Investment Decision	48	8.00	14.00	10.9167	1.72384
Valid N (listwise)	48				

Descriptive analysis of 48 respondents showed that most variables had an average value above 10 out of a maximum scale of 15. The sharia financial literacy variable had the highest average score ( $M = 11.48$ ,  $SD = 1.81$ ), followed by anchoring bias ( $M = 10.77$ ,  $SD = 1.89$ ), which indicated a relatively good level of financial understanding and awareness of investment behavior among students. Meanwhile, the dimensions of overconfidence, namely overprecision, overestimation, and overplacement, were at a moderate level, indicating that respondents had a reasonable sense of confidence in investing.

Coefficients <sup>a</sup>					
Model		Unstandardized Coefficients		Standardized Coefficients	Sig.
		B	Std. Error	Beta	
1	(Constant)	1.414	1.552		0.368
	Overprecision	-0.022	0.145	-0.022	0.881
	Overestimation	0.128	0.147	0.118	0.389
	Overplacement	0.316	0.109	0.380	0.006
	Loss Aversion	-0.099	0.151	-0.111	0.517
	Anchoring Bias	0.298	0.149	0.327	0.053
	Sharia Financial Literacy	0.267	0.132	0.280	0.049

a. Dependent Variable: Investment Decision

The results of multiple linear regression showed that the research model partially, overplacement ( $\beta = 0.380$ ; sig. = 0.006) and Islamic financial literacy ( $\beta = 0.280$ ; sig. = 0.049) had a significant positive effect on young investors' investment decisions. This indicates that the higher the confidence relative to other investors and the better the understanding of Islamic financial principles, the better the quality of the investment decisions taken. In contrast, the dimensions of overprecision, overestimation, loss aversion, and anchoring bias did not show a significant influence on investment decisions.

These findings confirm the theory of behavioral finance (Kahneman & Tversky, 1979; Statman, 2019) that investment behavior is not completely rational, but is influenced by cognitive and psychological factors. However, the significant influence of Islamic financial literacy confirms that religious values can play a role as a mechanism for controlling behavioral bias (Antara et al., 2016; Karim et al., 2021). Students with a good understanding of sharia tend to be able to balance rational and moral aspects in making investment decisions, resulting in more mature and sustainable financial behavior.

## DISCUSSION

The results of this study show that not all dimensions of overconfidence have a significant effect on students' investment decisions. Of the three dimensions, only overplacement showed a significant positive influence. This suggests that confidence relative to the abilities of others can encourage students to make more

active investment decisions. These findings are consistent with research by Bakar and Yi (2016) in Malaysia and Kumar and Goyal (2016) in India, which showed that young investors with high levels of confidence tend to be more risk-taking and more frequent transactions. However, the other two dimensions of overprecision and overestimation did not have a significant effect. This condition indicates that students are not fully confident in the accuracy of their assessments or personal estimates, possibly due to limited investment experience.

The findings that loss aversion and anchoring bias had no significant effect showed that the behavior of young investors in this study was relatively more rational than traditional investors. These results are in contrast to the research of Toma (2020) and Barberis (2018) who found that behavioral biases such as fear of loss and reliance on initial information are still strong in influencing investment decisions. This difference can be explained by the context of young investor respondents who are the object of the research have gained a basic understanding of modern financial theory and Islamic investment principles, so that they are better able to suppress emotional influences in the decision-making process.

Another important finding is the significant positive influence of Islamic financial literacy on investment decisions. This reinforces the research results of Antara et al. (2016) and Karim et al. (2021) which affirm that understanding of Islamic principles such as *riba*, *gharar*, and *maysir* plays an important role in increasing the rationality and prudence of Muslim investors. In the context of this study, students with high sharia literacy are more likely to choose halal investment instruments, assess risks more critically, and avoid speculative behavior. These results are also in line with Lusardi and Mitchell (2020) who emphasized that financial literacy is the main foundation for sound investment decision-making.

Theoretically, these results reinforce the framework of Behavioral Finance Theory put forward by Kahneman and Tversky (1979), that financial decision-making is not merely economic rationality, but rather the interaction between individual cognition, emotions, and values. In the context of young Muslim investors, the integration of realistic confidence and financial literacy based on Islamic ethical values appears to be the dominant factors shaping investment behavior. Thus, it can be concluded that strengthening Islamic financial literacy can function as a mitigation tool against behavioral bias, creating a balance between economic rationality and value compliance.

## **CONCLUSION**

This study confirms that students' investment behavior is influenced by a combination of psychological factors and the level of Islamic financial literacy. Of the three dimensions of overconfidence, only overplacement has a significant positive effect on investment decisions, showing that confidence relative to the ability of others drives the courage to make investment decisions. In contrast, overprecision, overestimation, loss aversion, and anchoring bias had no significant effect, indicating that young investors were becoming more rational and adaptive in dealing with market information. Meanwhile, Islamic financial literacy has proven to be the most powerful factor that improves the quality of investment decisions for Muslim students, because understanding Islamic principles helps to suppress behavioral biases and form more rational and ethical decisions.

Theoretically, the results of this study strengthen the framework of behavioral finance by showing that value-based financial literacy can function as a control of psychological bias. Practically, these findings provide direction for educational institutions and financial authorities to expand Islamic financial literacy programs among students to form a generation of young investors who are smart and have

integrity. Future research is suggested to involve a broader sample and mediating variables such as religious belief or financial self-efficacy to better understand investment behavior across cultural and religious contexts.

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