Behavioral Biases and Financial Judgment: A Study of Indonesian Investors on the Role of Risk Perception and Dividend Policy

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ABSTRACT
This study examines the influence of behavioral biases—specifically herding behavior and the disposition effect—on investment decision-making among Indonesian investors in the Indonesia Stock Exchange (BEI). The research investigates how these biases shape investors' risk perception and preferences toward dividend policy, which in turn affect their overall investment decisions. By focusing on psychological tendencies that deviate from traditional rational models, this study contributes to a more comprehensive understanding of investor behavior in emerging markets.The target respondents were Indonesian investors aged between 18 and 60 who have prior experience in capital market investment. Data were collected using a structured questionnaire and analyzed with SPSS to test six proposed hypotheses concerning the direct and indirect relationships among herding behavior, disposition effect, risk perception, dividend policy, and investment decisions. The results confirm the significant role of cognitive and emotional factors in financial decision-making, highlighting the importance of psychological influences on market outcomes. The findings offer practical insights for financial institutions, policymakers, and advisors seeking to improve investor literacy and develop more behaviorally informed strategies. Understanding how biases influence decision-making can help tailor investment products, reduce irrational behavior, and foster more stable participation in capital markets.

Keywords: *Investment Decision, Behavioral Finance, Herding Behavior, Disposition Effect, Risk Perception, Dividend Policy, Indonesia Stock Exchange.*

1. INTRODUCTION

Investment choices are fundamental to an individual's financial security, yet the factors influencing these decisions are intricate and multifaceted. Traditional financial theories often assume that investors make decisions based on logical analysis, fully understanding risks and returns. However, behavioral finance challenges this assumption, highlighting that real-world investors are frequently influenced by cognitive biases, emotions, and social factors, leading to decisions that deviate from purely rational expectations (Kahneman & Tversky, 1979). One of the most prominent psychological biases that affects investor behavior is herding behavior, where individuals tend to mimic the decisions or actions of others, often without independent analysis. This phenomenon can lead to market inefficiencies, as investors collectively push asset prices beyond their intrinsic value based on collective behavior rather than sound financial reasoning (Raafat, Chater, & Frith, 2009). In emerging markets like Indonesia, where financial literacy may vary and market information can be limited, herding behavior can be especially pronounced, as individuals are influenced by social dynamics and groupthink, amplifying market trends and volatility.

Another significant bias in investment decisions is the disposition effect, which refers to the tendency of investors to sell winning investments prematurely while holding onto losing ones too long, driven by the emotional desire to avoid realizing losses and to lock in gains (Shefrin & Statman, 1985). This bias often leads to suboptimal portfolio management, as investors fail to cut their losses or rebalance their portfolios effectively. In the Indonesian context, where market participation is growing and the investor base is increasingly diverse, understanding the disposition effect can shed light on how investors make decisions based not solely on financial performance but also on emotional and psychological factors that impact their perceptions of risk and reward.

The interplay between herding behavior and the disposition effect becomes even more complex when considered alongside risk perception and dividend policy, two additional factors that significantly influence investment decisions. Risk perception refers to the way investors assess and respond to the uncertainty surrounding potential outcomes,

particularly in volatile market conditions. This perception is influenced not just by objective measures such as volatility and historical returns but also by subjective factors like individual risk tolerance and emotional reactions to market fluctuations (Bélanger, Hiller, & Smith, 2002). In emerging markets like Indonesia, where investor confidence may be more sensitive to external factors such as economic instability or political uncertainty, risk perception plays a crucial role in shaping investment behaviors.

Similarly, dividend policy—the decision by companies to distribute profits as dividends or reinvest them in the business—also affects investor decision-making, particularly in terms of expected returns. Dividend policy can act as a signal to investors about the financial health and future prospects of a company. A stable and predictable dividend policy often leads to higher investor confidence, while inconsistent or absent dividend payments may trigger concerns about a company's stability or growth prospects (Fama & French, 2001). In Indonesia, where many companies may prioritize reinvestment over dividend payouts, investors may rely more heavily on their own perceptions of risk and herding behavior when making investment decisions, rather than on fundamental company performance.

This study focuses on understanding how these cognitive biases—herding behavior and the disposition effect—interact with risk perception and dividend policy to influence the investment decisions of Indonesian investors. More specifically, it aims to examine how herding behavior and the disposition effect directly impact risk perception and dividend policy, which in turn affect the final investment decisions made by individuals in the Indonesian stock market (Bursa Efek Indonesia, BEI). Given that many investors in emerging markets, such as Indonesia, are still developing their financial decision-making skills and often rely on social cues and emotions to guide their choices, understanding the psychological drivers behind their investment behaviors is essential for developing strategies to improve investment outcomes.

The Indonesian stock market, in particular, presents a unique environment to study these factors. While it has seen significant growth in recent years, the market is still largely shaped by individual investors who often lack formal financial education and rely on informal sources of information, such as social media, friends, or family, when making investment decisions. As such, the study of herding behavior, the disposition effect, and other behavioral finance phenomena in this context is timely and valuable. By identifying the underlying factors that shape investor decision-making, this research seeks to provide a clearer understanding of how psychological biases impact financial outcomes in the Indonesian market.

The ultimate goal of this research is to offer insights that can help investors, financial institutions, and policymakers better understand the dynamics that drive investment decisions in Indonesia. By uncovering how risk perception, dividend policy, and biases like herding behavior and the disposition effect influence investor choices, the study aims to provide practical recommendations for improving investment strategies, enhancing market efficiency, and supporting sustainable financial growth in Indonesia.

Herding behaviour refers to the tendency of individuals to mimic the actions and decisions of a larger group, particularly under conditions of uncertainty (Bikhchandani, Hirshleifer, & Welch, 1992). In the context of investment, herding can cause investors to follow market trends or rely on peer behaviour rather than conducting independent analysis. This behaviour can reduce perceived uncertainty, as individuals gain psychological comfort from aligning with the majority. However, it also increases susceptibility to market bubbles and volatility, as investors may overlook fundamental indicators in favor of social cues.

Herding behaviour significantly influences how investors perceive risk. When many individuals are making similar investments, it can lead to a reduced perception of risk, even in high-risk environments, because the consensus provides a false sense of security (Raafat, Chater & Frith, 2009). Moreover, it can shape attitudes toward dividend policy, as investors may favor companies with consistent dividend payouts if peers are doing so, regardless of personal risk assessments or financial analysis.

H1: Herding behaviour has a significant effect on risk perception.

H2: Herding behaviour has a significant effect on dividend policy.

The disposition effect is a behavioral bias where investors tend to sell assets that have gained value too early, while holding on to losing investments too long (Shefrin & Statman, 1985). This tendency is rooted in loss aversion and the desire to avoid the psychological pain of realizing a loss, even if it leads to long-term suboptimal outcomes. The disposition effect disrupts rational decision-making and alters portfolio management behavior, often leading to lower returns and inefficient rebalancing.

This bias significantly impacts risk perception. Investors influenced by the disposition effect tend to misinterpret actual risk levels, underestimating the risk of holding onto declining assets. It also influences dividend policy

preferences, as investors may view regular dividend payments as a way to compensate for unrealized losses, preferring companies with predictable dividend structures that offer psychological reassurance.

H3: Disposition effect has a significant effect on risk perception.

H4: Disposition effect has a significant effect on dividend policy.

Risk perception refers to an investor's subjective evaluation of the potential negative outcomes of an investment, often influenced by emotional and cognitive biases rather than objective analysis (Slovic, 2000). Unlike actual risk, which can be measured statistically, perceived risk varies from person to person and is shaped by personal experiences, media exposure, and psychological traits.

Investors who perceive higher levels of risk are likely to adopt more conservative investment strategies, such as favoring bonds or dividend-paying stocks over growth-oriented equities. Conversely, low perceived risk can lead to aggressive investment behavior and a willingness to allocate capital toward volatile or speculative assets. As such, risk perception acts as a critical intermediary in shaping investment decisions.

H5: Risk perception has a significant effect on investment decisions.

Dividend policy refers to the strategic decisions a company makes regarding the size and frequency of dividend payments to shareholders (Lintner, 1956). From the investor's perspective, dividend policy can serve as a signal of a company's financial health and stability. For risk-averse investors, consistent dividend payouts reduce uncertainty and provide a sense of income security.

Investor preferences regarding dividend policy influence their investment decisions. Some may prioritize companies with regular dividends for their perceived lower risk, while others may prefer reinvestment of profits for growth. Behavioral finance suggests that these preferences are not always based on rational financial analysis but are often guided by psychological comfort, expectations, and heuristics.

H6: Dividend policy has a significant effect on investment decisions.

One critical psychological factor influencing investment decisions is risk perception, which is the subjective evaluation of potential losses or uncertainty. Unlike objective risk, which can be calculated using statistical models, risk perception varies among individuals and is often influenced by cognitive biases. For example, herding behavior can cause individuals to perceive less risk in following collective decisions (Raafat, Chater, & Frith, 2009), while the disposition effect may distort perceptions of risk by encouraging investors to avoid realizing losses (Shefrin & Statman, 1985). As noted by Slovic (2000), perceived risk—rather than actual risk—plays a decisive role in shaping financial decision-making.

Another determinant of investment behavior is dividend policy, which investors often interpret as a signal of company stability and profitability. Lintner (1956) found that investors prefer companies with stable dividend policies, viewing them as safer and more predictable. This preference may be amplified by behavioral influences, such as a tendency to follow popular market sentiment (herding) or a bias toward retaining assets that offer steady income (disposition effect). According to Baker and Powell (1999), dividend-paying firms are often perceived as less risky, thereby making them more attractive investment options. Thus, both risk perception and dividend policy act as influential intermediaries through which behavioral biases impact investment decisions.

2. RESEARCH METHODS

This research investigates the influence of behavioral finance factors—specifically herding behavior and the disposition effect—on investors' perceptions and decisions. The study examines how herding behavior and disposition effect serve as independent variables influencing two key intermediary variables: risk perception and dividend policy. In turn, these mediating variables are analyzed for their effect on the ultimate dependent variable: investment decision-making. The goal is to understand how psychological biases and financial policy preferences shape the investment behavior of individual investors in the Indonesian capital market.

The object of this research is individual Indonesian investors who invest in the Indonesia Stock Exchange (Bursa Efek Indonesia/BEI). The population was limited to individuals aged between 18 and 60 years with experience in stock market investments. Data collection was performed through the distribution of structured questionnaires to ensure the standardization and comparability of responses. The characteristics of the sample show that out of 135 respondents, 62% were female and 38% were male. In terms of age distribution, the largest age group was 31–40 years old (43%), followed by those aged 18–30 (35%), 41–50 (15%), and 51–60 (7%). This demographic spread reflects a broad cross-section of active investors in Indonesia's retail investment space.

The analytical approach employed in this research involved statistical testing using SPSS version 25.0. This software was used to conduct descriptive analysis, validity and reliability tests, as well as inferential analysis such as t-tests and regression coefficient analysis. These statistical methods were used to examine six hypotheses concerning the relationships between herding behavior, the disposition effect, risk perception, dividend policy, and investment decisions. The findings aim to contribute to a deeper understanding of how psychological and policy-related factors influence investor behavior in an emerging market context such as Indonesia.

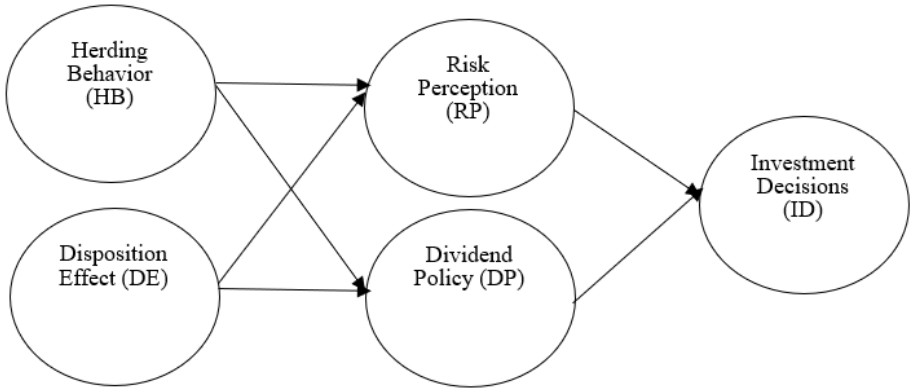

Figure 1. Research Model

3. RESULTS AND DISCUSSIONS

3.1. Validity and Reliability Test

As shown in Table 1, the corrected item-total correlation values for all indicators exceed 0.196, which confirms that the indicators are valid and suitable for further analysis. Furthermore, the reliability test results reveal that all variables have Cronbach's alpha values above 0.60, indicating strong internal consistency and reliability.

The tolerance values for all variables are above 0.1 and VIF values are below 10, suggesting there are no multicollinearity issues in the model. This means that each variable contributes uniquely to the analysis and is appropriate for inclusion in the regression models.

Table 1. Validity, Reliability, and Multicollinearity Test

Variable	Indicator	Validity Test	Reliability Test	Tolerance	VIF
Herding Behavior (HB)	HB1	0.567	0.712	0.345	2.896
	HB2	0.532			
	HB3	0.489			
Disposition Effect (DE)	DE1	0.621	0.789	0.342	2.921
	DE2	0.598			
	DE3	0.553			
Risk Perception (RP)	RP1	0.674	0.803	0.328	3.048
	RP2	0.612			
	RP3	0.589			
Dividend Policy (DP)	DP1	0.645	0.792	-	-
	DP2	0.611			
	DP3	0.577			
Investment Decision (ID)	ID1	0.589	0.797	-	-
	ID2	0.707			
	ID3	0.646			

3.2 T-Test and Coefficient Regression

The results from the t-test and Coefficient Regression analysis provide valuable insights into the relationships between the variables studied in this research. As shown in Table 5, the t sig values for all six hypotheses—HB*RP, HB*DP, DE*RP, DE*DP, RP*ID, and DP*ID—are all below 0.05, which indicates that all relationships are statistically significant. This suggests that the variables have meaningful interactions that impact investor behavior and decision-making.

Specifically, Herding Behavior (HB) significantly influences both Risk Perception (RP) and Dividend Policy (DP), with t sig values of 0.023 and 0.045, respectively. The regression coefficients (0.567 and 0.432) confirm a positive relationship between these factors, indicating that investors' tendency to follow the crowd influences how they perceive risk and interpret dividend policies. Similarly, the Disposition Effect (DE) has significant impacts on both Risk Perception (RP) and Dividend Policy (DP), with t sig values of 0.032 and 0.016, respectively, and coefficients of 0.389 and 0.524. This suggests that emotional biases, like the disposition effect, shape how investors view risk and influence their decisions regarding dividend payouts.

Finally, the results also reveal that both Risk Perception (RP) and Dividend Policy (DP) play a significant role in shaping Investment Decisions (ID). With t sig values of 0.005 and 0.007 and coefficients of 0.675 and 0.560, the data demonstrate that the way investors perceive risk and interpret dividend policies strongly impacts their final investment choices. These findings emphasize the importance of psychological biases and subjective factors in shaping investment decisions, particularly in the context of the Indonesian stock market.

Table 2. T-Test

Variable	Sig.	Coefficient Regression	Information
HB*RP	0.023	0.567	Hypothesis accepted
HB*DP	0.045	0.432	Hypothesis accepted
DE*RP	0.032	0.389	Hypothesis accepted
DE*DP	0.016	0.524	Hypothesis accepted
RP*ID	0.005	0.675	Hypothesis accepted
DP*ID	0.007	0.560	Hypothesis accepted

4. CONCLUSION

The results of this study confirmed all six proposed hypotheses, offering valuable contributions to understanding how behavioral biases and perception-based factors influence investment decisions among Indonesian investors. The research establishes that Herding Behavior and the Disposition Effect significantly affect both Risk Perception and Dividend Policy, which in turn strongly influence Investment Decisions. These findings reinforce the critical role of psychological and behavioral factors in shaping individual investment behavior, especially in emerging markets like Indonesia, where investor sentiment and social influence are highly prevalent.

First, the study found that Herding Behavior has a significant impact on both Risk Perception and Dividend Policy, as shown by the regression results. This suggests that investors who are heavily influenced by others tend to adjust their perception of risk and dividend preferences based on crowd behavior rather than independent analysis. For financial institutions, this highlights the need to improve investor education, particularly on the importance of making data-driven decisions. Platforms can integrate behavioral nudges and personalized notifications that encourage users to validate trends with fundamental analysis rather than simply following the crowd.

Second, the research demonstrated that the Disposition Effect—the tendency to sell winning stocks prematurely and hold onto losing ones—also significantly influences Risk Perception and Dividend Policy. This implies that emotionally driven behavior leads to skewed evaluations of both risk and expected returns. Financial advisors and brokerage firms should develop tools to help investors manage emotional biases, such as loss aversion calculators or automated portfolio rebalancing features. Investor training programs that focus on recognizing and mitigating the disposition effect can also promote more rational financial behavior.

Third, both Risk Perception and Dividend Policy were shown to have a direct and statistically significant impact on Investment Decisions. This finding emphasizes that perceptions and preferences—rather than purely objective data—play a central role in financial decision-making. To address this, financial services should enhance transparency in risk assessment and provide clear, comprehensible dividend information to investors. Educational modules explaining the true implications of dividend policy choices could also help investors align their strategies more closely with their financial goals.

Based on the findings above, this study proposes several practical recommendations. For Herding Behavior, regulators and platforms should implement safeguards—such as trading alerts or risk disclosures—when a sudden surge in buying or selling activity indicates a herd-driven pattern. For Disposition Effect, features that present hypothetical outcomes of alternative decisions (e.g., "What if you had sold earlier?") can help investors reflect on their biases. Regarding Risk Perception, providing tools for personalized risk profiling and scenario analysis can help users understand the implications of their decisions under various market conditions. For Dividend Policy, offering clearer dividend forecasts and historical payout trends may guide investors toward more informed decisions.

In conclusion, this study deepens the understanding of how behavioral factors—specifically Herding Behavior and Disposition Effect—indirectly shape investment decisions via Risk Perception and Dividend Policy. By addressing these psychological dynamics, financial institutions and advisors can better support investors in making rational, long-term investment choices. These insights can also guide regulators and fintech developers in crafting strategies that promote financial literacy, reduce behavioral biases, and foster healthier capital markets in Indonesia.

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