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# Effects of Investment Knowledge on Investment Decision: Mediating Role of Financial Literacy

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**Abstract**

**Background and Aim:** The importance of investment knowledge and financial literacy on inurement behavior is not well recognized. Moreover, there is a notable lack of research addressing the mediating role of financial literacy in this context. Consequently, this study aims to investigate the effects of investment knowledge on investment decision with considering the mediating role of financial literacy.

**Methods:** This study employs a quantitative methodology to explore the research topic. A cross-sectional survey design was utilized to gather primary data from individual investors. This approach was deemed suitable as it enables the efficient collection of data from a substantial number of respondents within a relatively brief timeframe. Furthermore, it offers a structured framework for evaluating the constructs under examination. The research implemented a non-probability sampling method, specifically purposive sampling, to select a sample of 259 individual investors. Standard questionnaires were used to collect data. Pearson correlation test and the structural equation modeling were used for data analysis.

**Results:** The results indicate that investment knowledge has a significant impact on investment decisions, with a T-value of 6.284. Additionally, investment knowledge was found to significantly influence financial literacy, as evidenced by a T-value of 5.176. Furthermore, financial literacy was shown to affect investment decisions, with a T-value of 5.738. Notably, financial literacy serves as a significant mediator in the relationship between investment knowledge and investment decisions, with a p-value of less than 0.001. The model fit results suggest that the research model demonstrates a good fit.

**Conclusion:** The results indicated that investors with a solid foundation in financial knowledge tend to make sound investment choices, and this relationship is further reinforced by their level of financial literacy. Consequently, financial literacy plays a crucial role in empowering individuals to make informed investment decisions, thereby facilitating effective financial management.

**Keywords:** Investment, knowledge, decision, literacy, investor

## Introduction

The process of making investment decisions is a crucial endeavor shaped by a variety of factors that can vary significantly among individuals. In different contexts, people demonstrate a range of behaviors when confronted with decision-making scenarios. While some individuals depend on their personal judgment, others consider a multitude of factors that assist them in arriving at well-informed decisions (Ahmad & Shah, 2020). The decision-making process becomes notably more efficient when investors can recognize and comprehend all

pertinent variables. These variables are essential in facilitating sound decision-making, which in turn helps to reduce or alleviate potential future losses. Furthermore, the responsibility of making investment decisions is paramount for individuals, as the results of these choices have a profound impact on future circumstances and long-term stability (Asmara & Wiagustini, 2021). Decision-makers must adeptly manage uncertainty, a plethora of options, associated risks, and complex contractual agreements, all of which add to the intricacy of the task. A significant challenge encountered by management in state-owned enterprises (SOEs) is the imperative to make investment decisions regarding projects that are essential for driving economic growth. Such decisions necessitate the allocation of considerable resources and are instrumental in determining the direction and sustainability of economic development (Hendrawaty et al. 2020). Committing to long-term investments in large-scale projects involves substantial risk, coupled with inherent uncertainties concerning the successful execution of all project phases and the operational performance following construction, including the achievement of anticipated profitability. Specifically, uncertainty can arise in five critical domains related to project execution: market returns, project budgeting, project performance, market demand, and project timelines. Some SOE entities base their decisions on their investment knowledge and capabilities (Hidayat & Moin, 2023).

Investors encounter a complex array of factors when making investment decisions, including risk, uncertainty, and a vast array of options. These challenges can be particularly overwhelming for financial professionals, experienced investors, and especially for average households. Navigating the risks associated with financial choices is essential, as these decisions can lead to potential profits (Eko, 2022). Conversely, choices made based on flawed or inadequately analyzed information may result in less-than-optimal outcomes. Investments initiated today have the potential to generate future returns. Corporations may collaborate with international entities such as the World Bank, the European Commission, and the European Bank for Reconstruction and Development, which set forth specific guidelines for managing investment decisions. Investment expenditures are directed towards achieving returns, which can be realized through two main channels (Iqbal et al. 2023). The first channel involves the acquisition of fixed assets, such as buildings, machinery, or plants. The second channel relates to financial investments, including stocks and bonds. Both categories of investment can significantly contribute to a corporation's overall success. Furthermore, investment knowledge and financial literacy can be regarded as two influential factors impacting investment decision-making (Lim et al. 2018).

Knowledge refers to the collective information that is acknowledged or understood by an individual, often stemming from an intrinsic sense of curiosity. This knowledge emerges when an individual employs their cognitive abilities to identify phenomena or particular occurrences that they have not previously encountered (Sabir et al. 2021). Investment knowledge constitutes a foundational understanding or a synthesis of theories pertinent to investment practices. The metrics utilized serve as indicators of the conditions necessary for investment, encompassing fundamental knowledge of stock evaluation, as well as an awareness of risk levels and potential returns associated with investments (Sobaih & Elshaer, 2023). It is crucial for prospective investors to possess a fundamental understanding of investment principles to safeguard themselves against unethical investment practices, such as fraud, herd behavior, or superficial stock selection. Several factors contribute to the necessity for adequate knowledge, including experience and business acumen, which are essential for analyzing which stocks an investor should acquire. Investment knowledge is essential for making informed financial choices within a corporation, as it involves competencies in analytical reasoning, practical experience, ethical standards, and teamwork (Khan et al. 2021). A solid understanding of risk management is fundamental for supervising all security protocols, systems, and professionalism in construction initiatives. This knowledge underpins the assessment of a company's operational performance, which is incorporated into computational models that inform the decision-making process. Individuals possessing robust financial knowledge are inclined to explore strategies for risk mitigation to boost profitability, while also demonstrating a readiness to engage in calculated risks to reduce potential losses, in line with prospect theory, thus aiding in effective financial forecasting (Prabowo et al. 2023). The evaluation of financial instruments, including Net Present Value (NPV), Internal Rate of Return (IRR), discounted cash flow, and duration analysis, is vital for investment decision-making within organizations. This claim is supported by previous studies that highlight the significant impact of advanced financial knowledge on decisions that can lead to favorable results for the enterprise (Raut, 2020).

Financial literacy encompasses the knowledge required to comprehend financial issues, which involves analyzing financial phenomena, their characteristics, regulations, and interconnections. It is plausible to assert that numerous individuals engage in decision-making that does not serve their best interests. Within the realm of personal finance, the caliber of these decisions can have enduring implications for financial stability (Pratiwi et al. 2020). Poorly informed choices can lead to severe repercussions. Consequently, it is evident that financial decision-making holds critical significance. Financial literacy integrates awareness, knowledge, skills, attitudes, and behaviors essential for making informed financial choices, ultimately contributing to an individual's financial well-being (Wawo & Kalsum, 2018). A lack of financial literacy may lead to erroneous financial

decisions that adversely impact individuals' lives and diminish their financial security. Financial well-being refers to the extent of economic adequacy or security experienced by individuals and families. In essence, it represents the level of resilience individuals possess when confronted with everyday challenges such as unemployment, health issues, bankruptcy, poverty, and the need for support in later life (Tanuwijaya & Setyawan, 2021). Financial literacy is of paramount importance in the realm of investment. The significance of information is pivotal in shaping decision-making processes. Positive indicators can empower investors to make judicious choices. It is crucial for investors to evaluate their investment risks in light of the signals they encounter (Kristanto, 2021). Information can exert a substantial influence when specific indicators affect decisions, yet it may also be rendered irrelevant. The value of information is contingent upon the decision-maker's ability to utilize it effectively in the context of their investments. A well-informed decision-maker might opt to overlook certain information, thus acting in a manner akin to that of an uninformed individual. A skilled investor can reach a sound investment decision by fostering confidence, drawing on experience, or adeptly managing risk (Sadiq & Khan, 2019).

Making sound investment choices poses significant challenges for individuals who possess limited knowledge or experience in the field of investing. Poor decision-making can lead to substantial financial losses, as investment inherently involves risk, which is a crucial factor influencing an investor's decision to engage in investment activities (Jain et al. 2023). High-risk investments can yield exaggerated results, whether in the form of profits or losses. Conversely, investments with lower associated risks typically result in modest gains, which serve to offset the lower risk involved. A comprehensive understanding of various factors and prior investment experience plays a vital role in shaping risk perception, which subsequently affects investment decisions. Therefore, financial literacy and investment knowledge are essential elements that significantly influence risk tolerance and the choices made by investors (Khan et al. 2019).

Research on decision-making has been undertaken in the past, revealing that project investments continue to present challenges that introduce various risks for organizations. Behavioral Finance serves as a foundational framework for making decisions, particularly in situations characterized by risk. Prospect theory emphasizes corporate strategies aimed at risk minimization to enhance organizational benefits (Bai, 2023). Nevertheless, this approach may lead to losses if investment values deviate from the company's intended plans concerning expected benefits. The outcomes of profits and losses are contingent upon a company's ability to effectively manage its finances, taking into account multiple factors within its financial system. Moreover, it is clear from existing literature that financial literacy encompasses both mathematical skills and an understanding of financial terminology. Research indicates that individuals aged 50 to 60, as well as professionals, business owners, farmers, and university or college graduates, tend to exhibit higher levels of financial literacy (Hamza & Arif, 2019). This literacy can be defined as the ability of individuals to make informed financial decisions that align with their short-term and long-term interests. Furthermore, it is apparent that financial experience contributes to the development of financial knowledge, thereby enhancing the importance of self-education and the effectiveness of financial literacy programs. Additionally, participation in stock market simulations offers valuable opportunities for gaining practical experience and exposure (Ademola et al. 2019). Literacy can be improved by individuals who possess sufficient resources and effectively leverage these resources to acquire financial information, thereby leading to more favorable investment outcomes. Affluent households have the capacity to invest more in obtaining financial insights. With access to this information, they typically experience reduced uncertainty regarding risky assets, as they are well-informed about the financial market. As an investor's wealth grows, their absolute risk tolerance tends to increase, as they can afford to access a wide range of information. Conversely, individuals with fewer financial resources often face uncertainty due to their limited ability to acquire such information (Dinarjito, 2023).

The importance of investment knowledge and financial literacy on inurement behavior is not well recognized. Moreover, there is a notable lack of research addressing the mediating role of financial literacy in this context. Consequently, this study aims to investigate the effects of investment knowledge on investment decision with considering the mediating role of financial literacy.

## Methods

This study employs a quantitative methodology to explore the research topic. A cross-sectional survey design was utilized to gather primary data from individual investors. This approach was deemed suitable as it enables the efficient collection of data from a substantial number of respondents within a relatively brief timeframe. Furthermore, it offers a structured framework for evaluating the constructs under examination. The research implemented a non-probability sampling method, specifically purposive sampling, to select a sample of 259 individual investors involved in various investment activities, including stock market investments, currency trading, bank investments, savings, and fixed-term deposits. This sampling strategy was justified as it allowed for the identification of participants who met the predetermined inclusion criteria. Data collection was carried out using a structured questionnaire, which was designed following a comprehensive review of the existing

literature. The questionnaire consisted of two main sections: the first aimed at collecting demographic information about the participants, such as gender, age, income, education level, occupation, and investment experience. The second section focused on gathering data related to the financial literacy, financial behavior, and financial satisfaction of the participants. A 4-item questionnaire was employed to assess investment knowledge, utilizing a 5-point Likert scale for scoring, which demonstrated a reliability coefficient of 0.90. Additionally, a separate 4-item questionnaire was used to evaluate investment decision-making, also scored on a 5-point Likert scale, with reliability analysis indicating a Cronbach's alpha of 0.92. Lastly, an 18-item questionnaire was administered to measure financial literacy, employing a 5-point Likert scale for scoring, and the reliability of this instrument was assessed, yielding a Cronbach's alpha of 0.94. Data analysis was performed using SPSS-27 and Lisrel software. Descriptive statistics, including means and standard deviations, were used to define the characteristics of the variables. To evaluate the relationships among the variables, a Pearson correlation test was executed. Additionally, the structural equation modeling approach was utilized to explore the influence of investment knowledge on investment decisions, taking into account the mediating effect of financial literacy. A significance threshold of $P < 0.05$ was established.

## Results

Descriptive statistics are presented in Table 1. The results reveal that, on the whole, the level of investment knowledge is above the average threshold. In contrast, both investment decision-making and financial literacy were assessed to be at a moderate level. The Kolmogorov-Smirnov tests confirmed that all variables adhered to a normal distribution (all $P>0.05$). Furthermore, the outcomes from Independent t-tests showed no significant differences between male and female participants concerning any of the study variables.

**Table 1.** Descriptive data

| | investment knowledge | investment decision | financial literacy |
|---|---|---|---|
| Mean | 2.75 | 2.49 | 2.51 |
| SD | 0.48 | 0.44 | 0.50 |

The relationships among investment knowledge, investment decision-making, and financial literacy are depicted in Table 2. The results reveal a strong direct correlation between investment knowledge and investment decision-making ($P<0.001$). Furthermore, a direct and significant relationship is observed between investment knowledge and financial literacy ($P<0.001$). Finally, financial literacy is also found to be directly and significantly associated with investment decision-making ($P<0.001$).

**Table 2.** Results of bivariate relationships between variables

| | 1 | 2 | 3 |
|---|---|---|---|
| 1. investment knowledge | - | | |
| 2. investment decision | r=0.628<br>P<0.001 | - | |
| 3. financial literacy | r=0.517<br>P<0.001 | r=0.573<br>P<0.001 | - |

Table 3 and Figure 1 present the findings from the structural equation modeling analysis. The results indicate that investment knowledge has a significant impact on investment decisions, with a T-value of 6.284. Additionally, investment knowledge was found to significantly influence financial literacy, as evidenced by a T-value of 5.176. Furthermore, financial literacy was shown to affect investment decisions, with a T-value of 5.738. Notably, financial literacy serves as a significant mediator in the relationship between investment knowledge and investment decisions, with a p-value of less than 0.001. The model fit results, detailed in Table 4, suggest that the research model demonstrates a good fit.

**Table 3.** Results of structural equation modelling

| | Path | β | T-value |
|---|---|---|---|
| 1 | investment knowledge => investment decision | 0.558 | 6.284 |
| 2 | investment knowledge => financial literacy | 0.586 | 5.176 |
| 3 | financial literacy => investment decision | 0.471 | 5.738 |
| | | Z | P-value |
| 4 | investment knowledge => financial literacy => investment decision | 6.527 | P<0.001 |

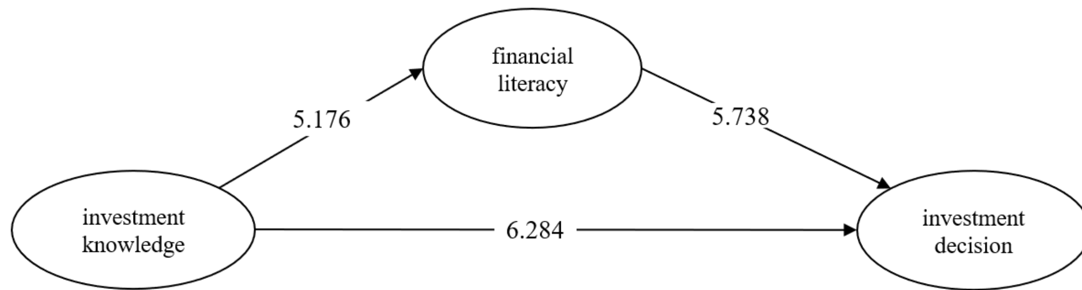


**Figure 1.** Structural equation modelling in the form of T-values

**Table 4.** Results of model fit

| Index | Optimal Range | Obtained Value | Conclusion |
|---|---|---|---|
| RMSEA | < 0.08 | 0.07 | Good fit |
| $X^2$ / df | < 3 | 2.98 | Good fit |
| RMR | Closer to 0 | 0.01 | Good fit |
| NFI | > 0.9 | 0.98 | Good fit |
| CFI | > 0.9 | 0.98 | Good fit |

## Discussion

The importance of investment knowledge and financial literacy on inurement behavior is not well recognized. Moreover, there is a notable lack of research addressing the mediating role of financial literacy in this context. Consequently, this study aims to investigate the effects of investment knowledge on investment decision with considering the mediating role of financial literacy. The results indicate that investment knowledge has a significant impact on investment decisions. Additionally, investment knowledge was found to significantly influence financial literacy. Furthermore, financial literacy was shown to affect investment decisions. Notably, financial literacy serves as a significant mediator in the relationship between investment knowledge and investment decisions. To interpret these findings, it can be stated that enhanced financial knowledge significantly enhances the quality of project investment decisions within subsidiaries of state-owned enterprises. Proficient financial analysis capabilities among management enable a more precise evaluation of investment choices (Antony & Selvarathinam, 2022). A robust understanding of financial principles empowers individuals to effectively manage finances by critically evaluating, assessing, and contemplating investment opportunities. Furthermore, it equips individuals with the necessary insights to exhibit financial behaviors that are informed by their beliefs and understanding of financial concepts (Iram et al. 2023). A person's proficiency in advanced finance significantly enhances management's capacity to address challenges in investment decision-making. A comprehensive understanding of a project's financial model is crucial for effective decision-making, which includes the necessity of conducting simulations to explore various potential outcomes related to project performance (Waheed et al. 2020). When making investment decisions, company management consistently utilizes project feasibility analysis tools, such as Net Present Value (NPV), with the objective of maximizing project profitability. The net current value of a project investment is derived from cash flow projections, which are determined through methodologies like free cash flow analysis. In the context of project finance, both cash inflows and outflows are taken into account, alongside the total investment value and associated financing costs, all of which are assessed using present value calculations that incorporate discounting techniques (Jain et al. 2023; Niazi & Malik, 2019). Theoretical advancements in prospect theory and behavioral decision theory can be informed by the findings of this study. The data suggest that a higher level of financial knowledge plays a crucial role in shaping investment decisions, particularly through the lenses of risk tolerance and perception within the context of infrastructure project investments in state-owned enterprises (SOEs) (Rehmat et al. 2023). Notably, risk tolerance emerges as a more significant factor than risk perception in the decision-making processes of management regarding investments. Furthermore, the development of a conceptual framework utilizing a second-order model, which delineates risk tolerance into two dimensions—risk preference and risk composition—and risk perception into two dimensions—risk cushion and risk knowledge—can effectively elucidate the interplay between advanced financial knowledge and investment decision-making (Muslich, 2023; Wangzhou et al. 2021). The management of state-owned enterprises (SOEs) exhibits a pronounced inclination towards risk, resulting in an elevated overall risk tolerance. This characteristic significantly influences their decision-making processes concerning project investments. A pronounced acceptance of risk correlates with a greater capacity to endure substantial risks, distinguishing those with high-risk preferences from their low-risk

counterparts. Furthermore, the depth of financial acumen within management is often shaped by prior experiences with challenges encountered in earlier investment endeavors. Managers who have navigated through complex situations and obstacles in past projects typically exhibit a composed demeanor towards risk, maintaining confidence in their investment choices (Putra, 2021; Yanti & Endri, 2024). Consequently, a robust analytical understanding enables management to favor investment opportunities characterized by higher risk, even when such choices necessitate a readiness to accept considerable potential gains or losses. This tendency to embrace risk is further reinforced by the perception that returns and risk preferences are contingent upon the backing of shareholders or ownership structures (Bhatia et al. 2024; Majeed et al. 2022). Therefore, the high-risk tolerance profile of management, underpinned by both risk preferences and a sense of composure, facilitates rapid adjustments in decision-making related to project investments, particularly in areas such as capital expenditure and project viability. It is essential for management with a high tolerance for financial risk to meticulously design project investment plans to mitigate potential adverse outcomes (Ahmed et al. 2021).

Individuals with limited financial literacy tend to engage in irrational investment behaviors due to their inadequate understanding of financial management. When equipped with financial knowledge, individuals are better positioned to identify the critical factors influencing their investment choices, thereby enhancing their potential for achieving substantial returns through informed decision-making (Hidayat & Selviyanti, 2023). Research indicates that those who possess a solid grasp of financial management principles are adept at making effective decisions regarding savings plans. Furthermore, the positive impact of financial literacy on fostering a constructive savings attitude and behavior has been substantiated, which can subsequently facilitate sound investment practices (Kasoga, 2021). These observations are consistent with earlier research that has established a favorable correlation between financial literacy and investment decision-making. Additionally, it was found that individuals with lower levels of financial literacy tend to shy away from investing in complex, high-risk financial products that offer the possibility of greater returns, underscoring the necessity for a robust level of financial literacy to promote improved investment outcomes. The results of our initial hypothesis corroborate these prior findings (Kanagasabai & Aggarwal, 2020).

## Conclusion

The primary objective of this research was to explore the influence of investment knowledge on investment choices, with a particular focus on the moderating effect of financial literacy. A significant deficiency in financial knowledge is observed worldwide, particularly in developing nations. This underscores the necessity of examining the elements that contribute to the enhancement of investment knowledge and decision-making, as well as the degree to which financial literacy can amplify this relationship. The study aimed to assess the state of investment knowledge among individuals. The results indicated that investors with a solid foundation in financial knowledge tend to make sound investment choices, and this relationship is further reinforced by their level of financial literacy. Consequently, financial literacy plays a crucial role in empowering individuals to make informed investment decisions, thereby facilitating effective financial management. Conversely, individuals or investors who lack financial literacy are prone to making poor investment choices, which can result in financial setbacks.

The research acknowledges several limitations. The participant pool was limited to 259 individual investors, which may hinder the generalizability of the results to a broader demographic. Moreover, the study concentrated solely on individual investors, overlooking the influence of investment knowledge on decision-making processes among institutional investors. The analysis predominantly examined the role of financial literacy as a mediating factor, without taking into account other relevant variables such as income, age, and educational attainment. Furthermore, the dependence on self-reported data introduces the possibility of biases. Notwithstanding these constraints, the study offers significant insights into the interplay between financial literacy, behavior, investment choices, and investment knowledge. Future investigations could improve the comprehension of these dynamics by incorporating a more varied participant base and exploring additional factors that may affect investment decisions.

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