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Influence of Overconfidence, Illusion of Control, and Availability on Debt Decision Making in Micro, Small, and Medium Enterprises in Klaten Regency

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Abstract

This study aims to investigate the impact of of overconfidence, the illusion of control, and the availability heuristic on debt decisions using a sample of 100 Micro, Small, and Medium Enterprises (MSMEs) in Klaten Regency. The results indicate that overconfidence and the illusion of control variables have a significant positive impact on debt decisions. Meanwhile, the availability variable does not affect debt decisions. This study shows that debt decisions among MSMEs in the Klaten Regency are generally relatively incapable of making rational judgments and thus trapped in bias.

***Keywords**: overconfidence, illusion of control, availability, debt decisions*

Introduction

Micro, Small, and Medium Enterprises (MSMEs) are a component of business actors that make a significant contribution to job creation in Indonesia. The role of MSMEs is essential in society because they provide a means of earning income and developing potential and skills. In their development, most MSMEs face a common problem of limited funding sources or capital. This problem makes it difficult for business owners to expand their businesses. For business owners, funding sources, whether from debt or owner-generated capital, have a significant impact on business continuity (Reid, 1997). These two funding sources have a complex relationship because the owner's assets will be used as collateral for debt, and the owner faces an uncertain return (Gibson, 2001).

Behavioral financial theory explains that individuals often behave irrationally when making decisions involving money because psychological factors play a greater role in financial decision-making (Hirchey and Nofsinger, 2008). A greater dominance of psychological factors in decision-making will lead to biased decisions because a person's feelings outweigh rational considerations. Nofsinger (2005) categorizes three sources of bias in decision-making. First, self-deception occurs because a person tends to think that he/she has higher abilities than he/she has, so the person behaves too confidently *overconfidence*. Second, heuristic simplification, occurs because of limited cognitive abilities, so a person will use shortcuts in processing information. Third, Mood. Shefrin (2007) suggests that bias is a psychological phenomenon within each individual that can lead to making the wrong decision. Shefrin identifies four categories of bias: excessive optimism, excessive self-confidence, confirmation bias, and illusion of control.

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This study uses financial behavioral bias as an independent variable that influences debt decision-making, which is the dependent variable. The biases used are overconfidence, illusion of control, and availability. These three biases were chosen because they are considered to be the most dominant biases influencing the results of financial decision-making (Shefrin, 2007).

Overconfidence indicates a condition where someone is overly confident that their views are correct and believes they possess above-average abilities and knowledge (Nofsinger, 2005). According to Friedman (2007), overconfidence in decision-making can also be seen in the decisions of entrepreneurs to start a business. They do not use external funding to run their business. Ramiah et al. (2017) stated that overconfidence is one aspect of bias that when used correctly can increase the efficiency of working capital and does not always have a negative meaning.

Illusion of control is the tendency of people to believe they can control or at least influence outcomes, but in reality, they are unable to do so. In general, a person feels able to control the outcome of the decisions they make. This belief can have an influence on the outcome, causing a person to overestimate their control over the outcome (Nofsinger, 2005). According to Nofsinger and Marbun (2010), there are six things that trigger the illusion of control: choice, outcome sequence, task familiarity, information, active involvement, and past success. Making an active choice will lead to good control (choice). Early positive outcomes have a greater illusion of control than negative outcomes can provide (outcome sequence). The more familiar a person is with deciding on a product, the greater the feeling of control proportionally (task familiarity). The more information obtained, the greater the illusion of control (information). When a person is actively involved in decision-making, the feeling of control will be greater (active involvement). The more success a person experiences, the more they will attribute it to their abilities (past success).

Availability is a bias that encourages someone to make decisions based on what they remember so that they are not thorough in conducting analysis to make financial decisions (Hidayati, Wahyulina, and Suryani, 2018). Availability bias can influence decision-making because people may base their choices on the most readily available information, rather than considering all available options. This can lead to poor decisions or missed opportunities. In stock trading, this bias reflects a self-serving bias, as investors are highly familiar with the situation and therefore readily acquire information, despite the fundamental principle that portfolio management is an optimization effort (Luong & Ha, 2011).

In general, MSMEs source their funding through debt. MSMEs can obtain capital by applying for credit from the government or investors, among other ways., capital loans from banks, capital loans from non-bank financial institutions, and capital loans from *financial technology.* According to the 2010 BPS micro and small industry survey (VIMK), it was reported that only 17.36% of small businesses and 3.25% of micro-businesses received funding from banks, while medium-sized businesses on average had received funding assistance.

In 2020, the Financial Services Authority (OJK) implemented a policy of restructuring bank credit and providing installment relief for customers, as outlined in POJK No. 48/POJK03/2020. This policy is expected to help restore the economy impacted by the coronavirus pandemic and profitable for business actors, especially MSMEs, and helps people who are just starting a business.

This study aims to examine the influence of overconfidence, illusion of control, and availability on debt decision-making in Micro, Small, and Medium Enterprises (MSMEs) in the Klaten Regency. This study was conducted to determine whether MSMEs have adequately considered these three factors when making decisions about using debt to fund their working capital.

Literature Review

Financial Behavior

Pompian (2006) defines behavioral finance as a science that studies how humans act to make financial decisions, including decisions about taking on debt. According to Ricciardi and Simon (2000), financial behavior or behavioral finance is divided into four, namely: Overconfidence Theory, Financial Cognitive Dissonance Theory, Regret Theory, And Prospect Theory.

Overconfidence theory is a feeling of excessive self-confidence. Griffin & Varey (1996) divide overconfidence theory into two types, namely someone who acts overconfident because he is too confident in the knowledge he has and someone who acts overconfident. After all, they believe in their abilities. Cognitive Dissonance Theory (Festinger) in explaining the theory of financial cognitive dissonance or financial cognitive dissonance that humans feel internal pressure and doubt or fear when faced with clashes or differences in beliefs (Monica, et.al. 2015). One way to reduce internal conflict within oneself is to change past values, feelings, or opinions, and try to rationalize choices.

The theory of regret or regret theory states that individuals evaluate their expected reactions to future events or situations. Bell (1982) describes regret as(regret) as an emotion caused by a comparison of a certain output (a given outcome) or an event with something that was not chosen (foregone choice). The prospect theory (prospect theory) relates to the idea that humans do not always act rationally. Prospect theory assumes that inherent and persistent biases driven by psychological factors influence people's choices under conditions of uncertainty. This theory considers preferences as a function of decision comparisons and assumes that these comparisons do not always correspond to probabilities. Specifically, prospect theory argues that comparisons tend to be higher for low probabilities and lower for moderate or high probabilities.

Overconfidence

Overconfidence is a psychological bias in decision-making related to a person's belief in their above-average abilities and knowledge. According to Nofshinger (2005), overconfidence stems from two psychological sources: the illusion of knowledge and the illusion of control. The illusion of knowledge is a condition in which a person feels more confident in their predictions due to having a wealth of information. The illusion of control, on the other hand, is a condition in which people often believe they have influenced the outcome of uncontrollable events. According to Shefrin (2007), overconfidence is a prediction error regarding how well a person understands their abilities and the limits of their knowledge. For micro, small, and medium-sized businesses, debt decisions are made based on considerations of the interest burden they must bear and the repayment period, which must be timely.

Illusion of control

Nofsinger (2005) describes the dilution of control It is the human tendency to believe they can control or influence outcomes when, in reality, they cannot. Generally, people feel they can control the outcomes of their decisions. Entrepreneurs' beliefs can influence outcomes, leading investors to overestimate their control over outcomes.

Availability

Entrepreneurs who experience availability bias tend to trust only the information they remember. Some air rifle entrepreneurs borrow money for business capital from relatives. They do not process the information adequately but instead rely solely on spontaneous information, namely borrowing money from their relatives. Air rifle MSME entrepreneurs who experience this heuristic tend not to seek and compare the information they obtain. Entrepreneurs will trust the information they get from people they trust. In line with the opinion of Baker and Nofsinger (2002), who explain that people often prefer something familiar to them. Consequently, entrepreneurs will make debt decisions for people they know. In this case, entrepreneurs will seek as much information as possible and base themselves on the information that is more readily available.

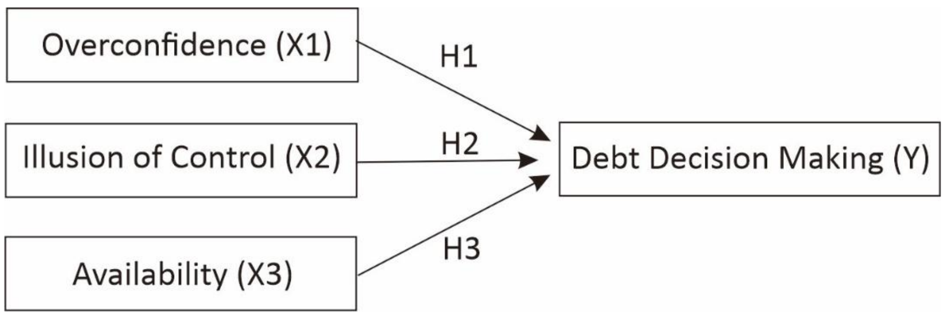

Figure 1. Research Model

Hipothesis

The hypothesis is written as follow:

H1. Overconfidence has positive effect on MSME debt decision making.

H2. Illusion Of Control has positive effect on MSME debt decision making.

H3. Availability has positive effect on MSME debt decision making.

Methods

Sampling and Procedures

The sample in this study was a portion of Micro, Small, and Medium Enterprises (MSMEs) in Klaten Regency, with a total of 100 respondents. The sampling technique used in this study was non probability sampling, considering that the sampled

MSMEs were those with capital loans exceeding Rp1,000,000 with a term of more than one year, the data collection procedure was carried out by distributing questionnaires to MSME owners or managers.

Measures

Debt decision-making is the process of selecting from several alternatives related to debt as a source of funding to achieve desired results. Debt decision-making is measured using five indicators, namely: financial support, productive and disciplined attitudes, debt benefits, trust of other parties, and prudence in managing and using money (Supramono & Nancy Putlia (2010).

Overconfidence is a feeling of excessive self-confidence. Overconfidence will make MSME actors *overestimate* the knowledge possessed by the MSME actors themselves and underestimate the predictions made because MSME actors overestimate their abilities (Nofsinger, 2005). Supramono & Putlia (2010) explain three indicators can be used to measure overconfidence, namely: the ability to repay debt, the ability to bear interest, and the belief in being able to repay according to the agreed repayment period.

The illusion of control is the human tendency to believe that they can control or influence outcomes but in reality, they cannot (Nofshinger, 2005). There are three indicators to measure *the illusion of control*, namely: involvement in actively determining choices, familiarity with debt, and having fairly complete debt information (Supramono & Putlia, 2010).

Availability is a form of error *hueristic*, where decision-makers rely more on what they remember (Dreman, 2000). This bias will encourage investors to make decisions based on what they remember, preventing them from fully engaging and analyzing financial decisions. Investment decisions are made solely based on convenience and availability. *Availability is* measured using three indicators, namely: not searching for information from many parties, basing oneself on information that is already available, and immediately relying on parties that are already known (Supramono & Putlia, 2010).

Data Analysis

Instrument testing in the study was conducted using validity and reliability tests. The results of the validity test showed that all questions showed significant results, namely $\alpha \leq 5\%$ (0.05), so it can be concluded that the questions were declared valid. From the results of the reliability test, all question items on the debt decision-making variable had an Alpha value of 0.680; the Alpha value of the overconfidence variable was 0.779; the Alpha value of the illusion of control variable was 0.694; and the Alpha value of the availability variable was 0.583. The Alpha value of all instruments was more than 0.6 so it was concluded that all variables were declared reliable.
The data analysis technique used in this study is multiple linear regression analysis with the equation:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Hypothesis testing is conducted using the F-test and the t-test. The F test is used to examine the effect of the independent variable (X) simultaneously on the dependent variable (X) on the dependent variable (Y) partially.

Result and Discussion

Result

The results of the descriptive analysis of respondents to describe each variable in this study are presented in Table 1.

Multiple linear analysis was conducted to determine the effect of independent variables, namely overconfident, illusion of control and availability on the dependent variable, namely debt decision-making. The results of multiple linear regression tests can be seen in Table 2.

From the results of the multiple linear regression analysis, the equation can be obtained as follows:

$$Y = 3{,}817 + 0{,}208X_1 + 0{,}397X_2 + 0{,}10X_3$$

The results of testing the influence of overconfidence, illusion of control, and availability on debt decision-making in MSMEs in Klaten Regency in Table 2 show that the F value is 92.444 with a significance level of 0.005. Thus, there is a joint influence of the variables of overconfidence, illusion of control, and availability on debt decisions. The results of the partial influence test on debt decisions show a constant value of 3.817, which means that if the variables of overconfidence, illusion

Table 1. Descriptive Statistics of Measured Variables

	N	Min	Max	Mean	Std. Dev
Over Confident	100	9	15	13.27	1.722
Illusion of Control	100	6	15	11.95	2.076
Availability	100	4	15	10.51	2.505
Debt Decision Making	100	5	15	11.42	2.085
Valid N (listwise)	100				

Table 2. The Effect of Overconfidence, Illusion of Control and Availability on Debt Decision Making

Model		**Unstandardized Coefficients**		**Standardized Coefficients**		
		B	**Std. Error**	**Beta**	**t**	**Sig.**
1	(Constant)	3.817	1.573		2.426	.017
	Over Confident	.208	.124	.172	1.682	.096**
	Illusion of Control	.397	.107	.395	3.712	.000*
	Availability	.010	.077	.012	.127	.899
	R^2	0.508				
	Adjusted R^2	0.278				
	F	92.444				.005

** Sig at 0.10 level (1 - tailed)
* Sig at 0.05 level (1-tailed

of control, and availability remain or do not change, then the debt decision-making variable is worth 3.817. The regression coefficient value of the overconfidence variable is 0.208 with a significance of 0.096. This means that overconfidence has a significant positive effect on debt decision-making at a significance level (α) = 0.10. The regression coefficient value of the illusion of control variable is 0.397 with a significance of 0.000, which means that the illusion of control has a significant positive effect on debt decision-making. Meanwhile, the regression coefficient value of the availability variable is 0.010 with a significance of 0.899 which is greater than α = 0.05, indicating that availability does not influence debt decision-making. R Square Value (R^2) of 0.508 indicates that the variables overconfidence, illusion of control, and availability influence debt decision-making by 50.8%, while the remaining 49.2% is influenced by other factors outside the variables studied.

Discussion

The results of the study show that the variables *of* overconfidence has a positive and significant effect on debt decision among MSMEs in Klaten. This means that the individual feels capable of repaying the debt, is confident in covering the interest burden, and believes they can repay within the specified repayment period. In this case, MSMEs were quite rational in making debt decisions, supported by the respondents' background, most of whom were still quite productive, ranging from 36 to 40 years old, and had a college education. According to Ramiah et al. (2012), overconfidence is a bias that, when used correctly, can increase working capital efficiency. This means that overconfidence does not always have a negative connotation. This research aligns with Fachrudin et al. (2017a), Madaan and Singh (2019), and Vukovic and Pivac (2024).

Variable Illusion of control has a positive and significant effect on Debt Decision Making. This positive influence is due to the Illusion of Control, a customer need that focuses on active involvement in making choices, feeling familiar with debt, and feeling they already have sufficient debt information. The greater the confidence of MSMEs in influencing decisions, the greater their role in debt decision-making. The more actively MSMEs are involved in making choices, and the more familiar they feel with debt, supported by sufficient information, the more likely they are to make informed decisions about debt as a source of funding. This research aligns with research by Manuel and Mathew (2017) and also research by Bashir et al. (2013), which showed that the illusion of control has a significant positive effect on investment decisions.

The availability variable does not affect debt decisions. Before making a decision to take on debt, MSME entrepreneurs in Klaten Regency sought sufficient information about debt from various parties and did not rely solely on available information. Debt decisions were made without simply choosing a known party. This demonstrates a fairly rational approach among MSME entrepreneurs in making debt decisions. This research aligns with research by Loris and Jayanto, Sudani, and Pertiwi (Loris & Jayanto, 2021; Suci Sudani & Putri Pertiwi, 2022), which found that availability bias does not affect investment decisions.

Conclusion

Based on the research findings and discussion, the conclusions that can be drawn are as follows:

- ☑ Overconfidence, illusion of control, and availability have a simultaneous influence on debt decision-making in MSMEs in the Klaten district.
- ☑ Overconfidence has positive and significant effect on debt decision-making in MSMEs in the Klaten district.
- ☑ Illusion of control has positive and significant effect on debt decision-making in MSMEs in the Klaten district.
- ☑ Availability does not affect debt decision-making in MSMEs in the Klaten Regency

Limitation

The variables studied were limited to debt decision making which was measured using only three variables, namely *overconfidence, illusion of control dan* availability and the study was limited to small and medium-sized business actors in Klaten. Therefore, future researchers are advised to use other variables such as financial literacy, risk tolerance, and emotions.

Management Implication

The results of the study on the availability variable indicate that availability does not influence debt decisions in small, micro, and medium enterprises in the Klaten Regency. This indicates that there is still little information collected regarding debt decision-making in micro, small, and medium enterprises in the Klaten Regency. The decision to take out debt only relies on available information and loans are often made to parties that are already known previously, so MSME actors are generally relatively unable to make rational considerations and are trapped in bias (irrational) which can ultimately affect the running of the business if it turns out that the information obtained is inaccurate and misleading, thus potentially leading to business losses.

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