

Mental Accounting Biases in Corporate Decision-Making: Evidence from Indian Managers

Sruthi S G^{1*}, Irshad V²

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^{1*} Sruthi S G, Assistant Professor, Department of Commerce, Sree Narayana Trusts Arts and Science College, Pambanar, Idukki, Kerala, India.

² Irshad V, Assistant Professor, Department of Commerce, Muhammed Abdurahiman Memorial Orphanage (MAMO) College, Mulkam, Calicut, Kerala, India.

Mental accounting describes the manner in which individuals mentally structure and evaluate financial information by assigning monetary outcomes to separate cognitive categories. Although this behavioural tendency has received considerable attention in studies on individual investors, its relevance in organizational decision-making has not been adequately examined, particularly within emerging market contexts. This study explores the existence and influence of mental accounting biases among Indian managers, with specific reference to budgeting, investment evaluation, and resource allocation decisions. Adopting a quantitative survey-based approach, primary data were gathered from managerial professionals representing diverse sectors in India. Statistical tools such as descriptive analysis, reliability testing, correlation, and regression were employed to examine the association between mental accounting bias and managerial decision-making quality. The results indicate that managers frequently engage in mental compartmentalization of financial decisions, even in the presence of formal controls, resulting in departures from optimal decision outcomes. The study extends behavioural corporate finance literature by contextualizing mental accounting within managerial roles and offers governance-oriented insights for improving decision-making effectiveness.

Keywords: Mental Accounting, Behavioural Finance, Corporate Decision-Making, Indian Managers, Managerial Bias

Corresponding Author	How to Cite this Article	To Browse
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1. Introduction

Conventional corporate finance frameworks are built on the premise that managers act as fully rational agents who systematically process financial information and make decisions aimed at maximizing organizational value. In practice, however, managerial decision-making is often influenced by psychological constraints and cognitive simplifications. Behavioural finance challenges the traditional rationality assumption by highlighting the role of mental shortcuts and biases that shape financial judgments.

One such cognitive tendency is mental accounting, which refers to the practice of classifying financial resources into separate mental categories rather than viewing them as interchangeable. While this approach may reduce cognitive complexity, it can distort evaluation processes and lead to inefficient allocation of organizational resources. In corporate environments, where managers exercise discretion over budgets, investments, and strategic priorities, mental accounting can significantly affect decision outcomes.

In the Indian corporate environment, managerial decision-making is shaped by formal governance structures as well as cultural norms, hierarchical systems, and risk perceptions. Despite increasing professionalization and the adoption of sophisticated financial tools, managerial decisions often reflect behavioural tendencies that deviate from rational economic models. However, empirical research examining mental accounting biases among Indian managers remains limited. This study addresses this gap by empirically examining the role of mental accounting in corporate decision-making within Indian organizations.

2. Review of Literature

Mental accounting, originally conceptualized within behavioural economics, explains how individuals internally organize and evaluate financial outcomes by assigning them to distinct mental categories. This process often results in differential treatment of money based on subjective classifications rather than objective economic value. Empirical studies have demonstrated that such compartmentalization influences financial behaviour across consumption, savings, and investment contexts.

Within organizations, behavioural corporate finance scholars argue that managers are similarly prone to cognitive biases that affect policy decisions. Biases such as mental accounting, overconfidence, and loss aversion have been shown to influence budgeting rigidity, project continuation decisions, and capital allocation efficiency. Despite increasing governance oversight, these behavioural tendencies often persist, indicating that formal controls alone may be insufficient to ensure rational decision-making.

Behavioural corporate finance extends these ideas to managerial decision-making within organizations. Scholars argue that managers, like individual investors, are subject to cognitive biases such as overconfidence, loss aversion, anchoring, and mental accounting. These biases influence corporate policies related to investment, financing, and budgeting. Empirical evidence suggests that behavioural biases can persist even in organizations with strong governance mechanisms.

Existing literature on mental accounting in corporate contexts is limited but indicates that managers often treat departmental budgets as rigid mental accounts and evaluate investment projects independently rather than from a portfolio perspective. In the Indian context, behavioural finance research has largely focused on retail investors, leaving a significant gap in understanding managerial behavioural biases. This study contributes to the literature by providing empirical evidence on mental accounting biases among Indian managers.

3. Objectives of the Study

1. To examine the prevalence of mental accounting biases among Indian managers.
2. To analyze the impact of mental accounting on corporate budgeting and investment decisions.
3. To assess the relationship between mental accounting bias and the quality of managerial decision-making.
4. To suggest governance and managerial interventions to reduce behavioural biases in corporate decision-making.

4. Research Hypotheses

- H1: Mental accounting bias has a significant influence on corporate budgeting decisions.
 H2: Mental accounting bias significantly affects investment appraisal decisions.
 H3: Mental accounting bias negatively influences the quality of corporate decision-making.

5. Research Methodology

The present study employs a quantitative research design to examine behavioural influences on managerial decision-making. Primary data were collected through a structured questionnaire administered to managers employed in Indian organizations. Due to practical constraints, a non-probability convenience sampling technique was adopted. Out of the responses received, 150 completed questionnaires were found suitable for analysis.

The questionnaire consisted of statements measuring mental accounting tendencies and corporate decision-making behaviour, rated on a five-point Likert scale. The collected data were analyzed using descriptive statistics, reliability analysis, correlation analysis, and regression analysis.

6. Data Analysis and Interpretation

This section presents the empirical results of the study and interprets the findings in relation to the stated objectives and hypotheses. The analysis proceeds in a systematic manner, beginning with the demographic profile of respondents, followed by reliability testing, descriptive analysis of mental accounting behaviour, and finally inferential analysis to examine relationships and causal effects.

6.1 Demographic Profile of Respondents

Table 1 presents the age-wise distribution of the sampled managers.

Table 1: Demographic Profile of Respondents

Category	Frequency	Percentage
Age 30–40	62	41.3%
Age 41–50	48	32.0%
Above 50	40	26.7%

Source: Primary Data

It shows that 41.3 per cent of the respondents belong to the age group of 30–40 years, followed by 32 per cent in the 41–50 years category, while 26.7 per cent are above 50 years of age. This distribution indicates that the sample largely consists of experienced managerial professionals who are actively involved in organizational decision-making.

6.2 Reliability Analysis

Before proceeding to further analysis, the internal consistency of the measurement scale was examined using Cronbach's Alpha. Reliability analysis ensures that the items used to measure mental accounting bias consistently capture the intended construct.

Table 2: Reliability Statistics

Construct	Cronbach's Alpha
Mental Accounting Bias	0.81

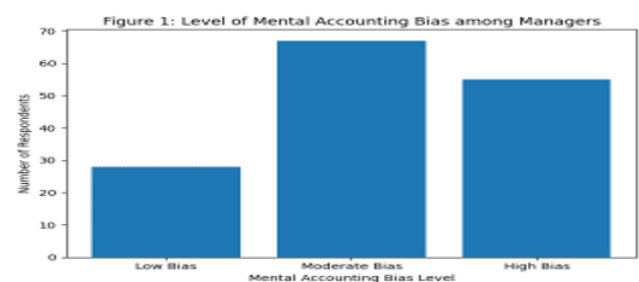
Source: Primary Data

As shown in **Table 2: Reliability Statistics**, the Cronbach's Alpha value for the mental accounting bias scale is **0.81**, which exceeds the acceptable threshold of 0.70. This indicates a high level of internal consistency and confirms that the questionnaire items reliably measure mental accounting tendencies among managers. Therefore, the data are suitable for further statistical analysis.

6.3 Descriptive Analysis of Mental Accounting Bias

Descriptive statistics were employed to examine the extent to which managers exhibit mental accounting behaviour in corporate decision-making. Respondents were classified into low, moderate, and high mental accounting bias categories based on their mean scores.

Figure 1: Level of Mental Accounting Bias among Managers



Source: Primary Data

Figure 1: Level of Mental Accounting Bias among Managers illustrates that a majority of respondents fall within the moderate and high bias categories. Specifically, 67 managers exhibit moderate levels of mental accounting bias, while 55 managers display high levels of bias. Only 28 respondents fall under the low bias category.

This distribution suggests that mental accounting is a prevalent behavioural tendency among Indian managers. Despite their professional training and access to formal financial systems, managers often rely on mental categorization of budgets and projects. Such behaviour may simplify decision-making but can also result in fragmented evaluation of financial outcomes.

6.4 Correlation Analysis

To examine the relationship between mental accounting bias and corporate decision-making quality, correlation analysis was conducted. The results are presented in **Table 3: Correlation Analysis**.

Table 3: Correlation Analysis

Variable	Decision-Making Quality
Mental Accounting Bias	-0.46**

Source: Primary Data

The correlation coefficient between mental accounting bias and decision-making quality is **-0.46**, which is statistically significant at the 1 per cent level. This negative correlation indicates that higher levels of mental accounting bias are associated with lower quality of corporate decision-making. In other words, as managers increasingly rely on mental accounts, their ability to make economically rational and holistic decisions diminishes.

The correlation results provide preliminary support for **Hypotheses H1 and H2**, suggesting that mental accounting significantly influences budgeting and investment-related decisions.

6.5 Regression Analysis

While correlation analysis establishes the existence of a relationship, regression analysis was conducted to assess the extent to which mental accounting bias predicts corporate decision-making quality.

Table 4: Regression Results

Predictor	Beta	t-value	Significance
Mental Accounting Bias	-0.42	5.87	0.000

Source: Primary Data

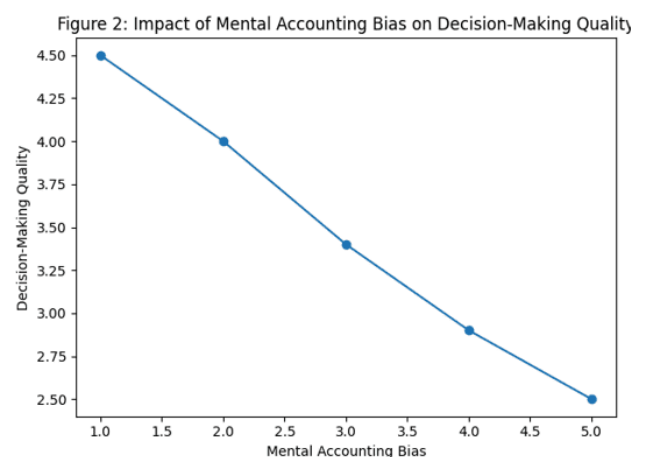
Table 4: Regression Results presents the outcome of the regression analysis, where decision-making quality is treated as the dependent variable and mental accounting bias as the independent variable.

The regression coefficient (β) for mental accounting bias is **-0.42**, and the result is statistically significant ($p < 0.01$). This indicates that mental accounting bias has a significant and negative impact on corporate decision-making quality. The t-value of 5.87 further confirms the robustness of the relationship.

These findings provide strong empirical support for **Hypothesis H3**, confirming that mental accounting bias adversely affects managerial decision-making. Managers who excessively compartmentalize budgets and investments tend to evaluate decisions in isolation rather than from an organizational or portfolio-level perspective.

6.6 Graphical Interpretation of Regression Results

To enhance interpretability, the regression relationship is visually represented in Figure 2: Impact of Mental Accounting Bias on Decision-Making Quality.



Source: Primary Data

The downward-sloping trend line clearly demonstrates the inverse relationship between mental accounting bias and decision-making quality.

The graphical representation reinforces the statistical findings by illustrating that higher levels of bias correspond to lower perceived effectiveness of managerial decisions. This visual evidence strengthens the argument that behavioural biases operate even in structured corporate environments.

7. Discussion of Findings

The empirical findings indicate that mental accounting bias is not confined to individual financial behaviour but is also prevalent among managerial professionals.

Despite access to structured financial information and formal decision-making frameworks, managers frequently rely on cognitive categorization to simplify complex financial judgments. This tendency contributes to fragmented evaluation of alternatives and reduces overall decision effectiveness.

The observed negative association between mental accounting bias and decision-making quality reinforces behavioural corporate finance arguments that psychological factors continue to influence managerial behaviour even in professionally governed environments. The results underscore the need to complement formal controls with behavioural awareness mechanisms.

8. Recommendations of the Study

Organizations should integrate behavioural finance training into managerial development programs. Decision-making frameworks should emphasize portfolio-level evaluation, and governance professionals should recognize behavioural biases as strategic risks.

9. Conclusion

This study provides empirical evidence on the influence of mental accounting biases in corporate decision-making among Indian managers. By extending mental accounting theory to managerial contexts, the study contributes to behavioural corporate finance literature and highlights the need for behavioural awareness in governance frameworks.

10. Limitations and Scope for Future Research

The use of convenience sampling limits generalizability. Future studies may adopt larger samples, sector-specific analysis, or examine moderating variables such as financial literacy and organizational culture.

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