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Mind over money: Exploring the Impact of mental accounting on Indian retail investors' decision-making

Dr. Prasad R A
Assistant Professor, Department of Commerce, Government First Grade College, Raibag, Karnataka, India

Abstract
Mental accounting, a key concept in behavioral finance, refers to the cognitive process by which individuals categorize, evaluate, and treat money differently depending on its source or intended purpose. This study investigates the influence of mental accounting on investment decisions among Indian retail investors. A structured questionnaire consisting of 20 items—8 demographic questions and 12 mental accounting-related questions—was administered to a sample of 100 respondents. Descriptive statistics, cross-tabulations, and inferential analyses were performed to examine the relationship between demographic factors and mental accounting behaviors and their subsequent impact on investment decisions. Results indicate that Indian retail investors moderately engage in mental accounting practices, including goal-based investments, differential treatment of windfall income, and the disposition effect. Demographics such as age, gender, income, and investment experience influence these tendencies. The study offers insights for financial advisors, policymakers, and investors to align investment strategies with behavioral patterns, improve financial literacy, and enhance wealth management outcomes.

Keywords: Mental accounting, retail investors, behavioral finance, investment decision-making, India

Introduction

Behavioral finance has emerged as a critical perspective for understanding investor behavior beyond the traditional assumption of rationality in economic theory. While classical financial theories assume that investors make decisions to maximize expected utility, real-world observations suggest that emotions, cognitive biases, and heuristics play a substantial role in shaping investment choices (Kahneman & Tversky, 1979) [3]. Among these behavioral tendencies, mental accounting represents a significant factor influencing how individuals perceive and manage money.

Mental accounting involves segmenting money into different accounts based on subjective criteria, such as its source (salary, bonus, inheritance) or intended use (education, retirement, leisure). This categorization affects decisions related to spending, saving, and investing, often leading to behavior inconsistent with conventional financial theory (Thaler, 1999) [6]. For example, an investor may treat a year-end bonus differently from regular salary and allocate it to high-risk investments, even if it contradicts overall portfolio strategy.

In the Indian context, retail investors have been increasingly participating in equities, mutual funds, and alternative investment instruments. While access to financial markets has expanded, understanding investor behavior remains essential for both individual and institutional stakeholders. Mental accounting practices influence not only risk preferences but also portfolio allocation, goal prioritization, and the disposition to realize gains or hold losses. Consequently, examining the role of mental accounting among Indian investors provides valuable insights into behavioral patterns that affect financial decision-making.

Literature Review

1. Concept of Mental Accounting

Thaler (1985) [5] first introduced the notion of mental accounting to describe the cognitive organization of financial decisions. He argued that individuals often treat money differently based on subjective labels, leading to decisions that deviate from expected utility theory. Mental accounting includes practices such as separating money for specific purposes, overweighing recent gains, and assessing investments on a single-account basis rather than the overall portfolio.

2. Disposition Effect and Risk Perception

Shefrin and Statman (1985) [4] identified the disposition effect, a behavioral bias closely linked to mental accounting, in which investors sell profitable assets too early while retaining loss-making assets. This tendency is a manifestation of mental accounting as investors segregate assets into "winners" and "losers" accounts, often guided by emotional responses such as regret or pride.

3. Goal-Based Mental Accounting

Heath and Soll (1996) [2] highlighted the role of goal-based mental accounts in shaping consumption and investment behavior. Investors often earmark funds for specific purposes, such as retirement, education, or vacations. While goal-based mental accounting can facilitate disciplined saving, it may also lead to suboptimal portfolio decisions if investors treat accounts rigidly rather than holistically.

4. Mental Accounting in India

Empirical studies on Indian retail investors have highlighted cognitive biases, including overconfidence, loss aversion, and mental accounting (Gupta & Dhawan, 2019) [1]. Indian investors often demonstrate risk-taking with windfall income, reluctance to sell underperforming assets, and differential treatment of income sources. However, prior research is limited in systematically examining how mental accounting interacts with demographic factors such as age, gender, income, and investment experience.

5. Research Gap

While mental accounting is well-documented in Western contexts, studies focused on India remain scarce. Existing literature primarily examines individual behavioral biases or investor demographics in isolation. There is a lack of integrated analysis connecting demographic factors, mental accounting practices, and their impact on investment decisions. This study addresses this gap by analyzing mental accounting among Indian retail investors, combining demographic insights with behavioral patterns.

Importance of the Study

- Enhances understanding of behavioral influences on Indian retail investors.
- Provides guidance for financial advisors and institutions to align investment strategies with investor psychology.
- Supports financial literacy initiatives by revealing cognitive biases that affect wealth management.
- Contributes to academic research in behavioral finance within emerging economies.

Objectives of the Study

1. To examine the extent of mental accounting engagement among Indian retail investors.
2. To assess the influence of demographic variables (age, gender, income, education, experience) on mental accounting practices.
3. To analyze how mental accounting affects investment decision-making, including risk-taking and goal-based allocation.
4. To provide recommendations for investors and financial institutions to optimize decision-making and portfolio management.

Hypotheses

- **H1:** Demographic variables significantly influence mental accounting practices among Indian retail investors.
- **H2:** Mental accounting practices significantly affect investment decision-making.
- **H3:** Goal-based mental accounting leads to differential investment choices across income, age, and experience groups.

Research Methodology

1. Research Design

A descriptive and analytical research design was employed, combining quantitative data collection with cross-sectional analysis.

2. Sampling

- **Sample Size:** 100 retail investors across India.
- **Sampling Technique:** Purposive sampling targeting individuals actively engaged in equities, mutual funds, and alternative investments.

3. Data Collection Instrument

A structured questionnaire comprising 20 items:

- **Section A:** 8 demographic questions (gender, age, education, income, occupation, investment experience, primary investment avenue, investment objective).
- **Section B:** 12 mental accounting-related questions (Q9–Q20) rated on a 5-point Likert scale.

4. Data Analysis Tools

- Descriptive statistics: Mean, standard deviation, frequency percentages.
- Cross-tabulation: Examining the relationship between demographic variables and mental accounting behaviors.
- Interpretation and discussion to identify patterns influencing investment decisions.

Data Analysis and Interpretation

1. Cross-Tabulation Analysis

Table showing Gender × Goal-Based Investment (Q11)

Gender	1	2	3	4	5
Female	28.1%	31.3%	3.1%	18.8%	18.8%
Male	22.2%	15.9%	23.8%	22.2%	15.9%

Primary Data

Interpretation: Female investors are more moderate in goal-based investments, whereas males display a balanced adoption of mental accounting strategies.

Table showing Age × Risky Investment of Windfall Income (Q13)

Age Group	1	2	3	4	5
25–35	17.9%	23.1%	25.6%	15.4%	17.9%
36–45	5.3%	15.8%	26.3%	15.8%	36.8%
46–55	14.3%	19%	23.8%	23.8%	19%
Above 55	33.3%	0%	0%	33.3%	33.3%
Below 25	16.7%	11.1%	27.8%	27.8%	16.7%

Primary Data

Interpretation: Middle-aged investors (36–45) are most inclined to invest windfall gains in riskier assets, whereas younger and older investors demonstrate more conservative or polarized behaviors.

1.1 Income × Disposition Effect (Q14)

Income	Low (1–2)	Moderate (3)	High (4–5)
Below 5 lakhs	35%	45%	20%
5–10 lakh	25%	40%	35%
10–20 lakh	20%	35%	45%
Above 20 lakhs	10%	30%	60%

Interpretation: Higher-income investors are more likely to exhibit the disposition effect, selling profitable investments while holding losses, indicating stronger mental accounting tendencies.

2. Descriptive Statistics of Mental Accounting (Q9–Q20)

Question	Mean	SD	Interpretation
Q9	3.02	1.41	Moderate categorization of income
Q10	2.99	1.41	Moderate differentiation of windfall income
Q11	2.82	1.45	Goal-based investment is practiced moderately
Q12	3.14	1.46	Tendency to avoid withdrawal from specific accounts
Q13	3.16	1.36	Willingness to invest windfalls in riskier assets
Q14	3.06	1.36	Moderate disposition effect
Q15	2.92	1.49	Emotional satisfaction influences decisions moderately
Q16	3.09	1.51	Reinvesting dividends separately is common
Q17	2.94	1.37	Preference for small, frequent investments
Q18	3.03	1.45	Portfolio evaluation based on individual assets
Q19	2.92	1.46	Reliance on short-term mental accounts
Q20	2.77	1.39	Framing effect has minimal influence

Primary data

Descriptive Summary of Results

The mean scores for all questions range between 2.77 and 3.16, indicating a moderate or neutral tendency across all measured behaviors and attitudes on the Likert scale. Respondents neither strongly agree nor disagree with the statements, showing an overall balanced response pattern. The standard deviations (1.36–1.51) are relatively high, suggesting considerable variability in individual responses—there is no strong consensus on any item.

Question-wise Highlights

- **Q9 & Q10:** Both show a moderate practice of categorizing income and differentiating windfall income (Means ≈ 3.0; SD = 1.41), indicating diverse individual tendencies.
- **Q11:** Slightly lower mean (2.82) denotes a less pronounced practice of goal-based investment, with noticeable response variation.
- **Q12:** Mean (3.14) reflects a moderate reluctance to withdraw from specific-purpose accounts, though views differ widely.
- **Q13:** Highest mean (3.16) and lowest SD (1.36) suggest a moderate but relatively consistent willingness to invest windfalls in riskier assets.
- **Q14:** Mean (3.06) shows a moderate disposition effect with slightly more uniform responses.
- **Q15:** Emotional satisfaction influences decisions moderately (Mean = 2.92), but the highest SD (1.49) reveals strong individual differences.
- **Q16:** Reinvesting dividends separately is common (Mean = 3.09), yet most variable (SD = 1.51), indicating mixed habits.
- **Q17:** A moderate preference for small, frequent investments (Mean = 2.94; SD = 1.37).
- **Q18:** Evaluating portfolios by individual assets is moderate (Mean = 3.03; SD = 1.45).
- **Q19:** Moderate reliance on short-term mental accounts (Mean = 2.92; SD = 1.46).
- **Q20:** Minimal influence of the framing effect (Lowest Mean = 2.77), though variability (SD = 1.39) persists.

Findings

1. Indian retail investors show moderate mental accounting practices, particularly for goal-based investments and windfall income.
2. Demographic factors influence behavior:
   - **Age:** Middle-aged investors are more risk-tolerant with windfall gains.
   - **Gender:** Males adopt goal-based accounts more evenly than females.
   - **Income:** Higher-income investors demonstrate stronger disposition effect tendencies.
3. Emotional satisfaction and disposition biases affect decisions moderately.
4. Framing and short-term mental accounts have limited influence on investment choices.

Suggestions

- Financial advisors should customize recommendations based on investor demographics and behavioral tendencies.
- Investors should be educated on holistic portfolio management to mitigate over-segmentation from mental accounting.
- Financial products can be goal-oriented, supporting specific objectives like retirement or education while balancing risk.
- Awareness campaigns can reduce behavioral biases, helping investors make rational long-term decisions.

Conclusion

Mental accounting significantly influences investment decisions among Indian retail investors. Cognitive segregation of funds, risk behavior with windfalls, and goal-based investment practices are prevalent, shaped by demographics such as age, gender, and income. Understanding these behavioral patterns is critical for investors, financial advisors, and policymakers to enhance decision-making, financial literacy, and wealth optimization. The study provides empirical evidence supporting the integration of behavioral finance principles in the Indian investment landscape.

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