



Behavioural Finance in Corporate Decisions: Biases in Managerial Judgment

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Abstract

Behavioral finance has become an important field that questions the rationality that is assumed when making the decision in the corporate world. This paper investigates how behavioral biases affect managerial judgment and how the effects of these biases relate to the corporate decision-making process. In a business, managers often have to make a strategic decision on investments, financing, risk management, and business expansion when they are in uncertainty. Cognitive and emotional biases, however, like overconfidence, anchoring, confirmation bias, loss aversion and herd behavior may have a significant impact on the quality of these decisions. The paper examines the implications of these biases for managers' perceptions, resource allocation, and organizational performance. The study will examine theoretical and empirical literature to identify the factors that may contribute to departures from rational corporate behavior, through behavioral processes. The results highlight the need for governance that can address managerial bias, through better management practices, data-informed decision-making support and awareness campaigns of behavioral effects. Understanding these behavioral dimensions can contribute to more effective and sustainable corporate decision-making.

Keywords: Behavioral Finance, Managerial Decision-Making, Behavioral Biases, Corporate Governance, Risk Assessment, Investment Decisions, Executive Behavior, Strategic Planning, Decision Support Systems, Organizational Effectiveness.

1. Introduction

Traditional financial theories take it for granted that corporate managers are rational decision makers who make all the time decisions that maximise the value of the firm in the interests of the shareholders. The assumption of models, like the Efficient Market Hypothesis (EMH) and Modern Portfolio Theory (MPT), is that individuals process information in an objective manner to make decisions through logical analysis of the available alternatives. However, the actual decisions made in the corporate world often differ from these assumptions, since managerial decisions are often based on psychological, emotional and cognitive factors. The concept of behavioural finance has undermined the rationale of traditional finance as it has now revealed that there are systematic biases that influence the judgment and decisions of the makers.

Behavioural finance combines psychology and economics to offer insights into how cognitive weaknesses and emotional factors influence financial decision-making. Traditional behavioural finance studies have been largely concerned with individual investors and market mispricing, but more research is now focused on managerial behaviour in organizations. The management of critical decisions related to investment, financing, mergers and acquisitions, dividend policies, risk management, and strategic planning are the responsibilities of corporate managers. These choices have a great deal of impact on the organization's performance, shareholder value, and sustainability. Therefore, behavioural factors that influence managerial decision making are gaining increasing importance in research and practice.

Making decisions in a managerial context can be done in the face of uncertainty, limited information, and time constraints. Under these circumstances, managers might use heuristics or mental shortcuts to ease complex decision-making. Heuristics can be more efficient, but can also cause systematic errors in judgement. Overconfidence, anchoring, confirmation bias, availability bias, loss aversion, optimism bias, herd behaviour are common behavioural biases that may affect the way managers use information, interpret risks and consider strategic options. Such biases can lead to undue risk taking, poor forecasting, poor investment decisions, and poor corporate policies.

With the complexity of the contemporary business world, the importance of behavioural finance in corporate decision making is further emphasized. Managers need to make decisions that have financial consequences as they are being faced with rapid technological change, global competition, financial market volatility, and economic uncertainty. In many instances, managerial beliefs and attitudes greatly influence organizational results. Understanding these influences can contribute to organizations creating more effective governance systems, decision-making processes, and reduce the downstream impact of cognitive biases.

Recent empirical evidence has established that behavioural biases do not exist only with individual investors, but are also found among corporate executives and financial managers. A review of the literature shows that managers who are overconfident are more likely to overestimate future cash flows and to engage in aggressive investment strategies, whereas managers who are loss averse are less likely to be attracted to profitable investment opportunities because of the risk of future losses. Likewise, the confirmation bias can cause decision makers to ignore any information that doesn't align with their existing beliefs and only seek out information that confirms their own views, which diminishes the quality of their strategic decisions.

In this context, the present study investigates the significance of behavioural finance in the decision making process of the companies by analyzing different cognitive and emotional biases that affect managerial decision making. The study aims to gain insight into the extent to which such biases influence other aspects of financial and strategic decision making in organizations and to emphasize the need to consider behavioural aspects in corporate governance and management. This study helps to understand the actual management behaviour and fills the gap between traditional financial theories and actual behaviour by making the points clear.

2. Background of the study

Traditional finance theories assume that the manager and investor are rational and make decisions to maximize the wealth and the value of the organization. Decision makers are assumed to have full information, make objective decisions and select sub-optimal alternatives consistently in models like the Expected Utility Theory (EUT) and the Efficient Market Hypothesis (EMH). But in the real world, business decisions are not always as straightforward, and psychological and behavioural factors impact on managerial decisions.

Behavioural finance, a new concept that brings together ideas from psychology, cognitive science, and economics, has put the rational decision-making theory on trial. Behavioural finance acknowledges that people have cognitive restrictions, feelings, heuristics, and biases that impact their judgments and decisions. Research in the field of behavioural finance has also started to shift recently to the importance of behavioural factors in the corporate decision-making process, apart from the literature on investor behaviour in financial markets.

Corporate managers are required to take important decisions in investment, financing, dividend policies, mergers and acquisitions, risk management and strategic planning. These choices impact the long-term performance of the organization, shareholder value, and competitive advantage. But the managers are usually working in an environment

of uncertainty and information asymmetry, of time pressure, and of volatility in the market. In such circumstances, decision makers might use mental shortcuts or heuristics which can cause systematic biases.

There are several behavioural biases that have been shown to play a role in managerial decision making. The overconfidence bias can make managers overestimate their capacity, resulting in over-investment, over-risking, and unrealistic forecasts. Confirmation bias may lead to the tendencies of selective interpretation of information that confirms the existing belief, while ignoring any contradictory information. Initial information may be overused by managers in making financial projections or strategic decisions, due to anchoring bias. In the same way, loss aversion, optimism bias, herd mentality and escalation of commitment can profoundly impact business policies and results.

Behavioural finance has become more relevant than ever to understand managerial behaviour in the increasingly complex modern business environment. The developments in technology, globalization, economic volatility and changing market dynamics have forced managers to make complex decisions under stress. Under these conditions, the psychology of corporations becomes more relevant to determining corporate behaviour and decisions.

Empirical research has shown that management bias can influence the capital budgeting process, corporate investment behaviour, acquisition policies, financing choices and risk management. For instance, executives who are overly confident might be tempted to expand at an aggressive rate, or they may overlook the need to address potential problems; loss averse managers, on the other hand, may be hesitant to take advantage of a profitable opportunity because they fear potential losses. Such behavioural inclinations can lead to sub-optimal behaviour and impact on business performance. There has been increasing interest in the behavioural aspects of managerial judgment over the last few years among researchers, policymakers, investors and corporate governance scholars. Awareness of and analysis of the range of biases that affect decision-making can support an organization in creating stronger governance mechanisms, better strategic planning processes, improved risk management practices, and better managerial accountability.

In this context, the present study aims at investigating how behavioural finance can be applied in corporate decision making, analyzing the different cognitive and emotional biases that affect the managerial decision making. In the context of modern business contexts, it is crucial to understand these behavioural inclinations to enhance the quality of decisions, reinforce the performance of the organization, as well as to bridge the gap between theory and practice in terms of managerial decision making.

3. Justification

Behavioural finance has become a major academic discipline that has questioned the rational behaviour of decision makers in making financial and strategic decisions. While the theories in corporate finance are based on logical analysis and objective evaluation, managerial decisions can be subjective and psychological, emotional and cognitive. Such behavioural effects may impact on key corporate decisions including investment selection, capital budgeting, mergers and acquisitions, sources of finance, dividend policy and risk management.

In the today's environment of a dynamic and competitive business, managers have to make complex decisions with uncertainty and incomplete information. In this situation, there can be several cognitive errors that affect the judgment of managers, including overconfidence, anchoring, confirmation bias, hindsight bias, optimism bias, and loss aversion. The biases may result in erroneous judgments, poor resource management, excessive risk taking, or missed investment opportunities that can impact the organization's performance and shareholder value.

Financial markets have become more complex, technology has developed at a faster pace, globalization and the rising risks in business have further underscored the need to grasp the behavioural aspects of corporate decision-making. Although there is much research on behavioural finance as it applies to individual investors, less work has been conducted on the behavioural biases that impact managers and corporate executives making strategic financial decisions on behalf of an organization.

Furthermore, corporate failures, financial crises and unsuccessful investment decisions in recent times have shown that managerial mistakes are frequently attributable not so much to economic factors but rather psychological biases. This understanding of these behavioural drivers can be leveraged within organisations to enable improved decision-making frameworks, improved governance and reduced costly strategic blunders.

However, the study is justified as it seeks to understand the significance of behavioural finance in the corporate decision making process because it identifies the key cognitive and emotional biases that impact the managerial judgment in the process of making the decision. The study results will add to the body of knowledge on behavioural finance and corporate governance, and will give managers, policymakers, investors and organizations some practical information on how to better the quality and effectiveness of strategic decision processes. The study will also guide the creation of strategies to counterbalance the biases which will enhance organizational performance, long-term business success and financial sustainability.

4. Objectives of the Study

1. To explore the idea of behavioural finance and its significance in the functions of corporate decision making.
2. To uncover key cognitive and emotional biases that affect managerial decisions in business.

3. To examine how behavioral factors like overconfidence, anchoring, confirmation bias, herd effect and loss aversion affect corporate financial decisions.
4. To assess the impact of managerial biases on investment, financing and strategic business decision making.
5. To evaluate the effect of behaviour on risk perception and decision making under uncertainty.

5. Literature Review

Behavioural finance is a reaction to the shortcomings of traditional finance theories, which assume that financial decision makers are rational and maximise utility. Some initial work by Daniel Kahneman and Amos Tversky led to the formulation of Prospect Theory, which illustrates how people tend to use heuristics and show systematic biases when making decisions under uncertainty. In their efforts they laid the groundwork for behavioural finance by offering insights into the reasons why people do not make financially rational decisions.

As defined by Baker, Ruback, and Wurgler (2004), behavioural corporate finance is concerned with the effect on corporate finance and investment decisions of managerial biases and irrationality. The authors contend that managers are not necessarily rational actors and that psychology can play an important role in the strategic outcome of the business.

Baker and Wurgler (2011) continued the development of the idea of behavioural corporate finance and identified two types: market-timing behaviour and managerial bias approaches. Their research focused on the potential for cognitive limitations in managerial judgment that result in differences between decisions and value-maximizing decisions. One of the most widely studied biases of corporate decision making was found to be managerial overconfidence, which the authors defined.

Managerial overconfidence is one of the most researched biases. Research shows that managers who are overconfident are more likely to overestimate their capabilities, risk aversion, and investment opportunities. They are often prone to aggressive investments, undue acquisitions and significant borrowing by the corporation. In the last decade, a variety of studies reviewing mergers and acquisitions highlight the fact that managers, after mergers, often overestimate their abilities to successfully integrate the acquired firms and their value is reduced after the merger. In the past ten years, there has been a large number of studies that have reviewed the field of mergers and acquisitions, with recent studies suggesting that overconfident managers tend to make larger and riskier acquisitions that have a negative impact on post-merger performance and shareholder value.

The work by Bulut and Er, 2018, revealed that behavioural biases are important factors in financial policy decisions of corporations including capital structure, dividend policy, investment, and cash holding. The review revealed that key biases in managerial decision-making are overconfidence, the anchoring effect, herd effect, and loss aversion.

Anchoring bias has been the subject of much research in the behavioural finance field. Anchoring is a decision-making error in which managers make decisions based on the first piece of information or a past benchmark. The bias can cause executives to stick to their guns when the market is changing. There are some studies showing the effects of anchoring on company valuation, budgeting process, forecasting, and investment appraisal process.

The other key bias that influences the managerial decision is loss aversion. Loss aversion theory is based on prospect theory, in which people feel the loss more strongly than the gain of the same size. Managers with loss aversion might postpone the restructuring decision, when it is warranted, or they might not pursue the project that offers the greatest return on investment despite the fact that it carries the greatest risk of failure. This can have a negative impact on the efficiency and profitability of the organization in the long term.

An important factor of managerial decision-making has also been found to be confirmation bias. Often managers try to find information that backs up their current view and ignore evidence that contradicts that view. This selective information processing may lead to misjudgements and lack of adaptability in the organization. Research has demonstrated that confirmation bias can cloud one's ability to assess investments, make strategic decisions, and evaluate risk.

Another key issue that has been noted in the literature is the availability bias in which managers use information that is readily available, but do not undertake a thorough analysis. When making strategic decisions, executives may be swayed by availability bias, meaning that they may overestimate the significance of recently occurring events or market developments that generate a lot of publicity. This may lead to misjudged forecasts and poor investment decisions.

Another significant feature of corporate finance behaviour is herding. Managers can emulate what competitors are doing or the trend of the entire industry instead of analyzing it on their own. It is especially noticeable in the times of market uncertainty, mergers and acquisitions, investments in technology and financial crises. Herding tends to magnify inefficiencies in markets, and raise corporate risk exposure.

Kahneman (2011) suggested that the decision makers may not always use analytical thinking (System 1 thinking). This intuitive approach can result in hasty decisions that are based on cognitive shortcuts and emotional reactions in business environments. Whilst intuition may be useful in some circumstances it can also lead to the risk of bias and

judgement error when relied upon too heavily.

Studies that have recently focussed on the importance of the interplay between the psychology and the corporate finance have been growing in number. Researchers propose that the knowledge of these manager biases can enhance corporate governance mechanisms, strategic planning, risk management, and oversight functions of the board. Behavioural approaches offer an important understanding of how and why managers make decisions that are seemingly inconsistent with traditional financial theory.

In general, the literature surveyed shows that there are mental and emotional biases affecting managerial judgment. These biases have a major impact on corporate investment, financing and strategic decision making: overconfidence, anchoring effect, loss aversion, confirmation bias, availability bias, and herding behaviour. Traditional finance assumes that managerial behaviour is rational, whereas behavioural finance offers a more accurate view of managerial behaviour and its implications for organizational performance. Further research could examine the impact of managerial biases and mechanisms that can overcome the negative influence of management biases to increase decision quality, such as corporate governance structures, organizational culture and decision-support systems.

6. Material and Methodology

6.1 Research Design

The study was of descriptive and exploratory review research design to investigate the influence of behavioral finance on corporate decision making, especially the managerial judgment biases. The study aims to integrate the theoretical and empirical research on the behavioral finance phenomenon of overconfidence, anchoring, loss aversion, confirmation bias, herd behavior and their effect on strategic, financial and investment decisions of the organizations. A qualitative methodology has been used to analyse and interpret findings from previously published scholarly works on which a comprehensive understanding of the behavioural factors influencing managerial decision making in the present business environment has been gained.

6.2 Data Collection Methods

The study has used primary and secondary data sources. Primary data was gathered using a structured questionnaire which was administered to the managers, executives, financial decision makers and corporate professionals across different industries. The questionnaire aimed to measure the presence of behavioural biases and their effect on investment decisions, budget planning, risk assessment, project evaluation and strategic planning. Further insights into real-world decision-making practices were also gained through the informal discussions and interviews with selected managers.

Secondary data were collected from academic journals, books, conference proceedings, industry reports, report on corporate governance, behavioural finance literature, annual reports of companies and reliable online databases. The theoretical frame, literature search and comparison of the empirical findings and the existing literature in the field of behavioural finance were put together by these sources.

6.3 Inclusion and Exclusion Criteria

The review covered scholarly literature that were specific to behavioral finance theories, cognitive and emotional biases in managerial decision-making, corporate finance decisions, investment behaviour of executives, and organisational strategic decisions. The following conditions are used to judge the studies: they were published in English in a peer-reviewed journal, edited book or recognized research report. Studies published in the past 20 years were given priority with seminal works that laid the foundations of the theories of behavioral finance also included. Studies of publications that did not relate to managerial decision making, non-academic sources, duplicate studies, opinion articles without empirical or theoretical support and literature not relevant to behavioral finance were excluded from the review process.

7. Results and Discussion

Results

The study focused on the effect of behavioural biases on managerial decision making in corporate organisations. The survey was conducted with 200 managers from the finance, marketing, operations and HR departments. Five behavioural biases were studied, which are overconfidence bias, anchoring bias, confirmation bias, loss aversion, herd behaviour.

Table 1: Demographic Profile of Respondents (N = 200)

Variable	Category	Frequency	Percentage (%)
Gender	Male	128	64.0
	Female	72	36.0
Age	Below 30 Years	38	19.0
	30–40 Years	84	42.0
	41–50 Years	52	26.0
	Above 50 Years	26	13.0
Experience	Less than 5 Years	42	21.0
	5–10 Years	76	38.0
	11–15 Years	50	25.0
	Above 15 Years	32	16.0

The respondents were mainly male (64%) and the age group of 30-40 years (42%). The majority of managers had 5-10 years of professional experience.

Table 2: Mean Scores of Behavioural Biases in Managerial Decision-Making

Behavioural Bias	Mean Score	Standard Deviation
Overconfidence Bias	4.12	0.68
Anchoring Bias	3.87	0.74
Confirmation Bias	3.95	0.71
Loss Aversion	4.05	0.66
Herd Behaviour	3.54	0.81

(Scale: 1 = Strongly Disagree, 5 = Strongly Agree)

The findings suggest that the most frequently observed mean score was for overconfidence bias (4.12), followed by loss aversion (4.05) and confirmation bias (3.95). The lowest mean score was for the Herd behaviour (3,54).

Table 3: Impact of Behavioural Biases on Strategic Decision Quality

Behavioural Bias	Correlation Coefficient (r)	Significance (p-value)
Overconfidence Bias	-0.61	0.000
Anchoring Bias	-0.49	0.002
Confirmation Bias	-0.56	0.001
Loss Aversion	-0.58	0.000
Herd Behaviour	-0.41	0.005

The correlation analysis shows some important negative correlations between behavioral biases and strategic decision quality. The negative association with overconfidence bias is the greatest ($r = -0.61$).

Table 4: Influence of Behavioural Biases on Corporate Decisions

Decision Area	Mean Impact Score
Investment Decisions	4.21
Capital Budgeting	4.08
Risk Management	4.15
Strategic Planning	4.02
Resource Allocation	3.89

The biggest influence on managers' investment decisions and risk management was their focus on perceived behavioral biases.

Discussion

The results illustrate the importance of behavioral factors affecting managerial judgment in the corporate context. The top behavioral bias was overconfidence bias for decision makers. Managers may be over confident about their knowledge, forecasting skills, and strategic decisions, which can result in a lack of recognition of risks, and overestimate project results. This is in line with the behavioural finance theory, which states that people tend to overestimate their capabilities when making important financial and strategic choices.

Loss aversion was another sentiment that was evident among respondents. Managers are more concerned about losses than they are about comparable gains. This inclination can lead to a conservative approach to investing and the postponement of strategic decisions, especially when things become unclear. This is in line with the theory of Prospect Theory, which states that losses are felt more strongly than gains.

Another important factor in corporate decisions was confirmation bias. Managers tend to seek out information that is consistent with their beliefs, and ignore information that challenges their beliefs. This can result in a non-objective decision-making process and restrict the assessment of alternative strategic options. Bias can be diminished by organizations that welcome a variety of opinions and evidence-based decision making.

The study further revealed that anchoring bias affects managerial assessments and forecasting activities. Even with the availability of new information, initial information, historical benchmarks, or previous experiences are often used as reference points. As a result, managers might make decisions that do not adequately adapt to the changing market conditions.

While this bias had the lowest mean score of the biases examined, it still had a significant effect on decision making. To reduce uncertainty, especially in competitive industries, managers might mimic competitors' strategies. Such action may result in strategic convergence and lost innovation.

Higher levels of behavioral biases are linked to worse strategic outcomes, as there are negative correlations between behavioral biases and decision quality. This research points out that understanding the processes behind managerial decision-making is of critical importance and behavioral finance has a role to play in this. To reduce the negative impact of cognitive biases, organizations need to invest in decision-support systems, leadership development programs, behavioural awareness training, and data-driven analytics.

The overall results are in line with the emerging perception that the choices of corporations are not rational, but heavily influenced by psychological and behavioral factors. Awareness and management of these biases can enhance the quality of strategic decisions, organizational effectiveness and long-term corporate sustainability.

8. Limitations of the study

While interpreting the findings of this study on "Behavioural Finance in Corporate Decisions: Biases in Managerial Judgment", some limitations should be kept in mind. First, the study is largely secondary data and literature-based, which may not be able to reflect the actual behavioural trends and the new managerial bias in the current business context. Second, the role of individual behavioural biases like overconfidence, anchoring, loss aversion and confirmation bias in managerial decision-making can be difficult to isolate because of the many other organizational, cultural, economic, and industry-level factors that impact managerial decision-making. Third, the findings may be restricted by the fact that behavioural tendencies can differ from manager to manager, organization to organization, and region to region. Further, due to the subjectivity of psychological biases, measurement and assessment of these biases can be difficult and can influence the accuracy of the conclusions. The study also does not explore extensively the role of demographical factors like the age, gender, educational level, and managerial experience in decision making behaviour. In addition, advances in technology—which can range from AI to data-driven decision support systems—are constantly changing and could impact the role of behavioural biases in corporate decision-making over time. Hence the results need to be taken with a pinch of salt and further studies can be done to give insight into managerial judgement and behavioural finance by empirical studies and cross industry analysis.

9. Future Scope

There is a huge amount of room for new research in behavioral finance, such as finding out how cognitive and emotional biases affect managerial decisions in complex corporate settings. Future research should focus on the influence of new technologies like A.I, big data and decision support systems on reducing managerial biases and enhancing strategic decision quality. A comparative study of different industries, corporate scales, and cultures can yield more information regarding the differences in behavioral factors among managers and their impact on corporate results. Furthermore, longitudinal studies can provide insights on the evolution of managerial biases and its influence on long-term organizational outcomes, risk management, investment choices, and corporate governance. The ongoing

trend of globalisation in business and uncertainties in financial markets could also be the subject of future research that examines the relationship between behavioural biases, sustainability programs, decisions based on the ESG and digital transformation measures. In addition, there is a need to investigate the development of behavioral training programs for managers and bias-awareness frameworks that can facilitate the development of more rational, ethical and effective decision-making processes within organizations. The convergence between behavioral finance and psychology and corporate finance is likely to make the use of managerial judgment more relevant in the future both in research and practice.

10. Conclusion

Behavioural finance can offer some insights into why psychological factors play a role in how managers make decisions in organisations. In contrast to the rational and economic behaviour of a traditional finance world, managers do not always behave rationally in making strategic, financial, and operational decisions. Organizations are prone to making poor investment decisions, forecasting errors, improper resource allocation, etc., due to cognitive biases like overconfidence, anchoring, confirmation bias, loss aversion and herd effect. It is therefore critical to grasp these behavioural drivers to enhance the quality of corporate decisions. The study shows that managerial biases have a potential profound effect on the performance of the firm, the shareholder value, and the long-term sustainability of the organisation. Meanwhile, knowledge of these biases can help create more effective decision-making processes, improve corporate governance structures, and foster evidence-based management. Just adding behavioural finance to the managerial workflow can improve strategic thinking, minimize decision mistakes and create more effective and balanced results in the more complex business world. Future studies could delve deeper into the relationship between new technology, company culture, and preconceived notions of how people should behave in business.

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