When Losses Loom Even Larger: the Moderating Role of Relationship Norms

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Prospect theory states that people interpret outcomes not as end-states but as gains and losses relative to a reference point. Removing a good from the endowment reflects a loss while adding the same good (to an endowment without it) reflects a gain. Furthermore, the value function for losses is steeper than the value function for gains, \( v(x) < -v(x) \), where \( v \) is the value of \( x \). As such, losses loom larger than gains resulting in people generally being averse to losses (Kahneman and Tversky 1979). Thaler (1980) termed this increased value of a good when it becomes part of the individual’s endowment the endowment effect. Recent research has identified factors that moderate the strength of the loss aversion and endowment effect, for example, source dependence (Loewenstein and Issacharoff 1994), transaction demand (Mandel 2002), and symbolic value of products (McGraw, Tetlock, and Kristel 2003). The present research proposes one other potential moderator of loss aversion: the type of relationship that consumers form with the product.

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EXTENDED ABSTRACT

Prospect theory states that people interpret outcomes not as end-states but as gains and losses relative to a reference point. Removing a good from the endowment reflects a loss while adding the same good (to an endowment without it) reflects a gain. Furthermore, the value function for losses is steeper than the value function for gains, \( v(x) < v(-x) \), where \( v \) is the value of \( x \). As such, losses loom larger than gains resulting in people generally being averse to losses (Kahneman and Tversky 1979). Thaler (1980) termed this increased value of a good when it becomes part of the individual’s endowment the endowment effect. Recent research has identified factors that moderate the strength of the loss aversion and endowment effect, for example, source dependence (Loewenstein and Issacharoff 1994), transaction demand (Mandel 2002), and symbolic value of products (McGraw, Tetlock, and Kristel 2003). The present research proposes one other potential moderator of loss aversion: the type of relationship that consumers form with the product.

A growing body of literature in marketing has drawn upon social psychology to understand consumer-brand relationships, and has noted that people differ in how they relate to brands (Fournier 1998; Muniz, Jr. and O’Guinn 2001). In particular, Aggarwal (2004) finds that consumers use norms of relationship as a lens to evaluate a brand: consumers’ evaluations differ depending on the type of their relationship with the brand. Two types of relationships are examined: exchange relationships in which people provide benefits to others to get something back from them; and communal relationships in which benefits are given to take care of others’ needs and to demonstrate concern for their well being (Clark and Mills 1993).

In this research, we propose that the distinctive norms of exchange and communal relationships will also lead consumers to demonstrate different magnitudes of loss aversion. Norms of a communal relationship, relative to those of an exchange relationship, will result in a stronger loss aversion. Two reasons argue for this hypothesis. First, relationship norms lead consumers to treat gains and losses differently. Norms of exchange relationship suggest that people be attentive to the net balance of inputs and output in the relationship. This means that people are more likely to compute the net of gains and losses. Given that the value function of losses is steeper than that of gains, aggregating losses with gains is likely to result in the subsequent behavior being consistent with lower loss aversion levels. Second, different relationship norms may lead to the experience of loss being different for the two sets of consumers. When communal norms are salient the endowed option is akin to a friend or a family member and hence more likely to be incorporated into the consumer’s extended self (Belk 1988). Due to self-enhancing bias that leads to enhanced evaluation of others with whom people have an association (Beggan 1992), an endowed product is likely to be enhanced in valuation more in a communal relationship. Furthermore, since people in a close relationship tend to devalue alternatives relative to their existing option (Johnson and Rusbult 1989), people are likely to demand larger dollar amount (due to devaluing of the alternative—the monetary value) to give up their current endowment.

Three studies test this overall thesis: norms of a communal relationship relative to those of an exchange relationship will make consumers more loss averse. The first two studies use standard endowment effect experiments while the third study uses a direct measure to assess participants’ perceived loss aversion.

Study 1 uses students as participants and measures their relationship with the university. Participants are divided into communal and exchange groups based on a median split. Participants then go through the standard endowment effect experiment using a coffee mug with the university name and logo on it. Results show that both sets of participants show significant endowment effect. Further, even though there were no differences in their buying prices ($4.08 vs. $4.22), participants in the communal relationship stated a significantly larger selling price for the mug displaying stronger loss aversion than those in the exchange condition ($9.12 vs. $6.23).

Study 2 replicates the results of study 1 but instead of measuring the relationship norms study 2 manipulates them by using a scenario description of a social interaction. Endowment effect experiment using a plain mug conducted subsequent to this relationship manipulation shows that, as before, there were no differences in the stated buying prices of participants in the communal and exchange conditions ($1.88 vs. $2.04). However, loss aversion experienced by participants in the communal condition was significantly larger than that in the exchange condition, as revealed by their stated selling prices ($5.52 vs. $3.60).

Study 3 tests the overall hypothesis by more directly examining the participants’ loss aversion coefficient. Adapting from prior research (Schmidt and Traub 2002), participants were administered two tasks that required them to provide dollar values that made two particular gambles worth playing. Greater loss aversion would suggest that participants should require greater dollar amounts to persuade them to gamble. Results show that participants in the communal condition indicated a significantly larger dollar amount ($884) than those in the exchange condition ($217) to play a gamble that had an equal likelihood to lose $100. Similar results were observed for a gamble that had an equal likelihood of losing $200 (Mcomm=$890 vs. Mexch=$312), further supporting the overall hypothesis. Furthermore, the three studies carefully ruled out alternative explanations like affect and perception of quality.

Our studies, to the best of our knowledge, are the first to demonstrate that mere salience of relationship norms makes consumers systematically more or less loss averse. Given that the salience of relationship norms can be influenced using different marketing tools, marketers can play a significant role in making consumers more loss averse towards their brand making them less likely to switch to competitive brands. This has huge implications on issues relating to brand loyalty—and opens up some exciting opportunities for future research.

REFERENCES


