Inside the Minds of Buyers and Sellers: Mental Construals and Prospect Theory
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EXTENDED ABSTRACT - Research into decision-making has revealed an asymmetric response pattern towards losses as contrasted with gains (loss aversion) measured relative to any individual's initial status quo position (Kahneman and Tversky, 1979). One of the outcomes of such a response function is that sellers tend to overvalue objects relative to buyers. That is, the lowest price at which consumers agree to part from a good (selling price) is often considerably higher than the highest price at which they agree to acquire the same item. For instance, Heberlain and Bishop (1985) found that people were willing to pay $31 for a hunting permit but were not willing to sell it for less than $143. Thaler (1980) called this pattern the fact that people demand more to give up an object that they would be willing to pay to acquire it the endowment effect. The endowment effect has proved to be exceedingly robust (see, for e.g., Kahneman, Knetsch and Thaler, 1990). More recently, researchers have examined the underlying processes responsible for the endowment effect. Carmon and Ariely (2000) provide evidence that the endowment effect appears to reflect a differential attention to information, specifically a focus on the foregone.

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EXTENDED ABSTRACT
Research into decision-making has revealed an asymmetric response pattern towards losses as contrasted with gains (loss aversion) measured relative to any individual’s initial status quo position (Kahneman and Tversky, 1979). One of the outcomes of such a response function is that sellers tend to overvalue objects relative to buyers. That is, the lowest price at which consumers agree to part from a good (selling price) is often considerably higher than the highest price at which they agree to acquire the same item. For instance, Heberlein and Bishop (1985) found that people were willing to pay $31 for a hunting permit but were not willing to sell it for less than $143. Thaler (1980) called this pattern—the fact that willing to pay $31 for a hunting permit but were not willing to sell it for more than $31. The endowment effect appears to reflect a differential attention to information, specifically a focus on the foreground.

We extend this line of research by inquiring into the processes and mental representations in the minds of buyers and sellers. Specifically, we hypothesize a fundamental difference in the mental construals of the object being traded. A seller’s mental construal of the item being traded over-emphasizes the positive aspects of the foreground (i.e., the positive features of the item since that is what sellers stand to lose in a transaction) and under-represents the negative aspects of the foreground (i.e., the negative features of the item since that is not coded as a loss and does not loom as large). The valuation process is thus overly influenced by the positive features of the object and leads to an overvaluation of the object in question. We report herein the results of three experiments that tested predictions derived from such a process.

In Experiment One, we manipulated the foreground of the positive features associated with the trade. We provided buyers and sellers with mugs that they could buy (or sell). Some sellers however, were provided with two mugs and asked to sell one. Other explanations for the endowment effect (affection overvaluation, a focus on the foreground item) would not predict an elimination of the endowment effect. We hypothesized that, in the two-mug condition, the fact that the positive features of the mug could still be enjoyed in the other mug (that was not sold) would alter the mental construal of sellers such that the positive features would no longer be coded as lost (and thus over-emphasized). That is, we predicted an elimination of the endowment effect. Results were consistent with such an analysis.

In Experiment Two, we collected process measures to assess the underlying mental construals of the object. Specifically, participants were randomly assigned to be buyers or sellers and provided with a mug. They were asked to quote reservation prices and to generate a list of thoughts about the mug, code the thoughts as positive, negative or neutral and state how difficult the thought had been to generate. Results were consistent with our conceptualization. It was, in general, easy to generate positive thoughts (the pen was an attractive pen) and buyers and sellers tended to initially generate positive thoughts. Later, however, sellers tended to generate neutral rather than negative, thoughts while buyers tended to generate negative, rather than neutral thoughts. Again, this is consistent with an under-representation of negative features in the minds of sellers.

Experiment Three utilized response latencies to assess differential memory traces in the minds of buyers and sellers for the object being traded. Participants were randomly assigned to be buyers and sellers and provided with a mug. They were also exposed to four statements about the mug, two positive and two negative. They were then asked to state their reservation prices and after a time delay, were tested for their memory for the positive and negative attributes of the mug. Consistent with our conceptualization, there emerged significant biases in the mental representations of buyers and sellers, as evidenced in the error patterns and response latencies. Specifically, buyers made a similar amount of errors on positive and negative features, but sellers made more errors on negative features than on positive features (i.e., they were more likely to misremember negative features as not having been there). An analysis of the response latencies for facilitations and hindrances was also consistent with our conceptualization. Buyers experienced greater hindrance on positive (rather than negative) features when statements were presented as false, rather than true. Sellers experienced facilitation in denying false negatives, as compared to affirming true negatives. In other words, it was easier to accept the absence of a positive feature (since it was presumably offset by the other, over-represented positive features but accepting the existence of a negative feature was much more difficult).

In conjunction, the three studies provide a compelling picture of the differing mental construals of the item being traded that exist in buyers and sellers’ minds. It is these differing mental construals that seem to mediate the endowment effect.

REFERENCES