The Role of Anticipated Regret in the Endowment Effect

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EXTENDED ABSTRACT - Numerous studies have demonstrated that people persistently demand more money to give up one object than they're willing to pay to purchase the same object (e.g. Kahneman, Knetsch, and Thaler 1990; Knetsch 1989). This violation of economic norms, commonly known as the endowment effect, is generally explained by loss aversion, the fact that pain from loss exceeds the happiness from acquisition. However, existing literature devoted little attention to the emotional experience individuals have in determining an acceptable price for purchasing or selling an item. This research sets to explore the role of anticipated feelings of regret in creating the persistent disparity between individuals' willingness to pay (WTP) and willingness to accept (WTA). We propose that people anticipate intense regret if their decisions to buy or sell later turn out bad, and therefore set extreme threshold to both buying and selling to avoid possible regret.

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**EXTENDED ABSTRACT**

Numerous studies have demonstrated that people persistently demand more money to give up one object than they’re willing to pay to purchase the same object (e.g., Kahneman, Knetsch, and Thaler 1990; Knetsch 1989). This violation of economic norms, commonly known as the endowment effect, is generally explained by loss aversion, the fact that pain from loss exceeds the happiness from acquisition. However, existing literature devoted little attention to the emotional experience individuals have in determining an acceptable price for purchasing or selling an item. This research sets out to explore the role of anticipated feelings of regret in creating the persistent disparity between individuals’ willingness to pay (WTP) and willingness to accept (WTA). We propose that people anticipate intense regret if their decisions to buy or sell later turn out bad, and therefore set extreme thresholds to both buying and selling to avoid possible regret.

Based on previous research we assumed that people constantly anticipate their feeling if certain outcome materializes and this has significant impact on various choices. To minimize potential regret, individuals not only switch to safer and more expensive options (Simonson 1992) but also reject options with greater expected utilities in some occasions (Bar-hillel and Neter, 1996). We propose, in the endowment effect situation, individuals demand high prices (offer low prices) in order to minimize the potential regret from acquiring an item (parting with an item). The artificial gap between people’s willingness to pay (WTP) and willingness to accept (WTA) is thus a result of this conservative pricing strategy that is meant to eliminate possible regret.

Three studies were conducted to put this hypothesis into empirical test. In all 3 studies, participants first completed some survey tasks using a brand new Uni-ball pen. After the surveys, half of the participants (sellers) were told that the pen was theirs to keep and were then asked the minimum price they would sell the pen for; the remaining half (buyers) were not given the pen but were asked the maximum price they’d offer to purchase the pen. To ensure the elicited price actually reflects the value of the pen in their minds, participants were told that a pre-determined price of the pen will be revealed after they indicate their prices. If their buying price is higher than the pre-determined price or selling price lower than the pre-determined price, the actual transaction will take place immediately.

Study 1 examines how mood moderates the endowment effect. Compared with people in negative or neutral mood, people in positive mood are generally less concerned with possible negative outcomes, which they can better handle (Trope and Fishbach 2003). We therefore hypothesize that individuals in positive mood are more willing to trade and show smaller difference between their WTP and WTA. We primed positive and negative mood by asking the participants to describe life experiences that have made them really happy or sad respectively. As predicted, our results suggest that individuals in positive mood were more willing to trade and the disparity between WTP and WTA diminished. Study 2 looks into how the transaction is framed influences the difference between individual’s WTP and WTA. Various studies have demonstrated that compared with inaction, action is associated with more regret (e.g. Baron and Ritov 1994; Landman 1987). All previous endowment effect studies presented the transaction as action. We propose that when transactions are presented as inaction rather than action, people are less concerned with potential regret and thus the endowment effect should be eliminated. The results supported our hypothesis: when the act of buying was framed passively as “not returning the pen to the experimenter” and the act of selling was framed passively as “not keeping the pen”, the WTP-WTA disparity was eliminated. Finally, Study 3 tested whether the type of anticipated regret changes the valuation of an endowed object. Compared with omission regret (failure to act), commission regret (taking the wrong action) is usually associated with more intense regret (Baron and Ritov 1994). We proposed that when people are primed with omission regret, they become more willing to trade and set lower threshold for transaction. Participants in this study were primed to consider commission regret by describing things they wish they had done and of omission regret by describing things they wish they had done. The results confirm our hypothesis, showing that only participants in the commission regret displayed the traditional endowment effect. By contrast, among participants primed with omission regret, the buying and selling prices were trivially different.

Together, the 3 studies demonstrated that anticipated regret plays a critical part in producing the persistent disparity between people’s willingness-to-pay and willingness-to-accept. The goal to minimize potential regret increases the threshold individuals set to change their status quo by buying or selling an object. Understanding of people’s valuation of an object process is of critical importance for all marketing practices and our finding provides insights into the emotional experience individuals have in determining acceptable prices for them to make a transaction.

**REFERENCES:**


