The Endowment Effect and Its Reversal: Examining Possession Loss Aversion and Focus of Attention

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The endowment effect, a well-known phenomenon in behavioral decision research, is typically described as a consequence of loss aversion. Recently a new type of loss aversion, namely possession loss aversion (PLA), has been proposed as an additional explanation for the effect. An important consequence of PLA is the reversal of the endowment effect for unattractive items. I extend this investigation examining the predictions of an attention-based mechanism when unattractive items are under consideration. Results from a series of pricing studies suggest that the effects due to possession may not be due to a psychophysical property like PLA, but rather to a heightened attention to the possessed item.

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EXTENDED ABSTRACT

The endowment effect (Thaler 1980), a well-known phenomenon in decision research, refers to people’s tendency to demand much more to give up an object than they would be willing to offer to acquire it. This asymmetry in valuations of an object based on whether it is under one’s endowment or not has been explained as a consequence of loss aversion (Kahneman and Tversky 1979). The basic idea of loss aversion is that losses have a greater hedonic impact than gains, so the pain of giving up an item is greater than the joy of acquiring it.

Recently, Brenner, Rottenstreich, Sood and Bilgin (2007) proposed a new psychological mechanism, termed possession loss aversion (PLA). PLA posits that the value of items leaving one’s possession is exaggerated relative to the value of items entering one’s possession. In other words, the value of an endowed item is exaggerated regardless of its valence, such that attractive items are perceived as more attractive, and unattractive items are perceived as more unattractive. As a consequence, PLA predicts the endowment effect for attractive items, but its reversal for unattractive items. Consistent with PLA, in a series of experiments, Brenner et al.’s results showed a tendency to keep attractive items, but to trade unattractive items.

There is another line of research that brings important insights to choices between unattractive items. Dhar and Simonson (1992) investigated the effects of having an option as the focus of attention in a comparison task. They showed that when two attractive options are being compared, simply making one of the options the focus of attention increases its preference. Conversely, Dhar, Nowlis and Sherman (1999) showed that when two unattractive options are compared, making an alternative the focus of attention decreases its preference. If one can argue that the endowed item receives greater attention than the non-endowed item, this focus of attention principle should predict the endowment effect for choice between attractive items and its reversal for choice between unattractive items, just like PLA.

In fact, this exactly what Carmon and Ariely (2000) showed. They argued that buyers and sellers focus on what each stands to forgo in an exchange, such that sellers are more sensitive to aspect of the item, whereas buyers are more sensitive to the expenditure. Although, they used pricing tasks, it seems reasonable to expect that this attention asymmetry would also occur in choice tasks, such that more attention would be paid to the endowed item (i.e. the item that one would forgo in a transaction).

Given that PLA and an attention-based mechanism predict the same pattern for choice tasks, more research is needed for a better understanding of this effect. In order to contrast the two theories, I turn to pricing tasks. Following one of the scenarios used by Brenner et al. (2007), consider two jobs that only differ in one aspect, such that one involves working on some weekends and the other does not. How much would one demand to switch to the job with the weekends requirement? How much would one offer to switch from the job with the weekends requirement? From a PLA standpoint, a negative item seems more unattractive when it is under one’s possession, so people should tend to offer more to part with a negative item than they should demand to acquire it, as the hedonic impact of items that leave one’s possession are greater than the hedonic impact of items entering one’s possession.

At first, a prediction based on an attention-based principle might not be clear, as in one condition a person forgoes both money and the item, while in the other condition, the person receives both. In this case, for each person, there seems to be no difference in the amount of attention paid to the item and the expenditure. I propose that pricing of the negative items can be viewed in an alternative and perhaps more natural way. Reexamining the jobs scenario (and any other scenario involving pricing of an unattractive item), I argue that a person that is paying to part with the weekend requirement is actually buying his/her weekend time. Similarly, a person setting a price to accept the working on weekends requirement can be said to be selling his/her weekend time. In this sense, this scenario becomes a clear buying and selling situation and as such, buyers are expected to focus on the money and sellers on the item (weekend time). Considering weekend free time, instead of working on weekend requirement as the item being bought or sold, following an attention-based mechanism we should expect selling prices to be higher than buying prices.

Two experiments showed consistent support for an attention-based mechanism over PLA. In experiment 1, using the job scenarios described above, participants were willing to accept a 10.4% reduction in their salaries to part with the weekend requirement. On the other hand, participants required a 23.9% raise to accept the weekend requirement (z=4.23, p<.01). In experiment 2, participants were asked to consider a task consisting of a few hours of a tedious work as a punishment for losing a library book. Participants that could pay not to do the work were less sensitive to the amount of work ($18.9 vs. $36.7) than participants that would get paid to do the work replacing a friend ($30.0 vs. $98.9), F(1, 69)=10.0, p<.01. These results validate the proposed view of selling and buying time, as sellers were more sensitive than buyers to changes in the item (amount of work).

In conclusion, the present research suggests that the reversal of the endowment effect for unattractive items observed in choice tasks may be the result of heightened attention to the endowed item, which in turn decreases its attractiveness and not due to a psycho-physical property inherent to how people make evaluations as suggested by PLA.

References


