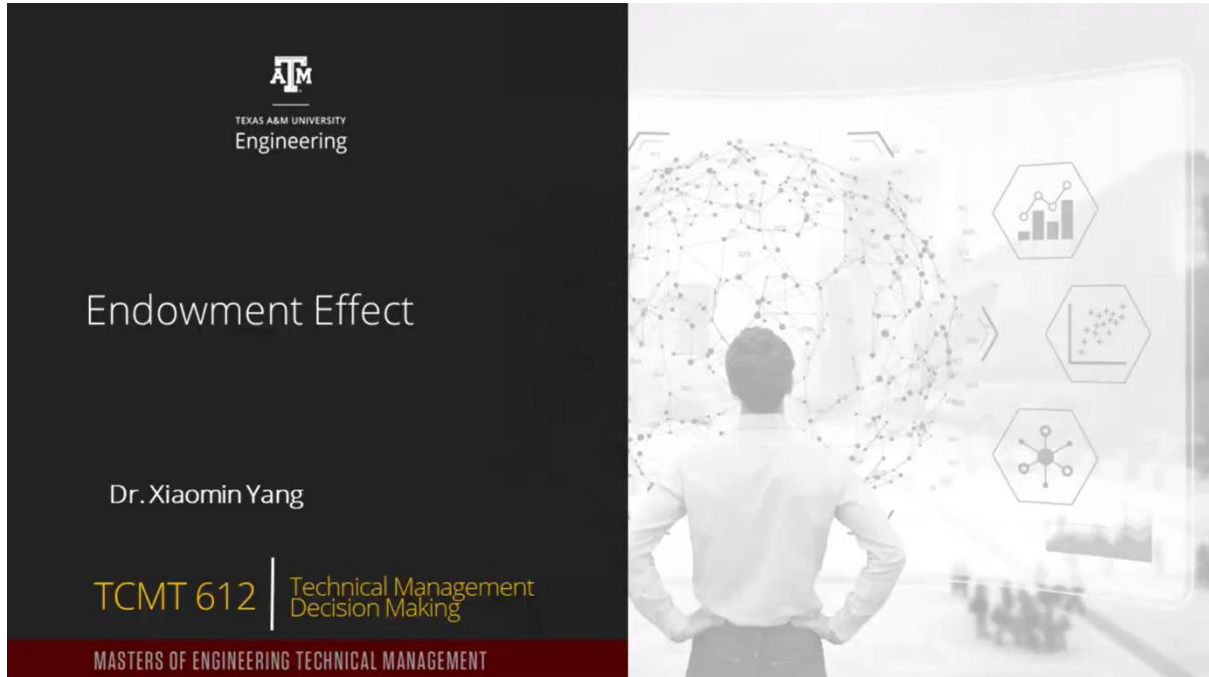


M2L12. Endowment Effect

Slide #1



The slide cover is divided into two main sections. The left section is a dark grey rectangle containing the Texas A&M University Engineering logo at the top, followed by the title 'Endowment Effect' in a large, white, sans-serif font. Below the title is the name 'Dr. Xiaomin Yang' in a smaller white font. At the bottom of this section, the course code 'TCMT 612' is displayed in a bold, yellow font, followed by a vertical line and the text 'Technical Management Decision Making' in a smaller yellow font. A red horizontal bar at the very bottom of the left section contains the text 'MASTERS OF ENGINEERING TECHNICAL MANAGEMENT' in white. The right section of the slide features a background image of a person in a white shirt standing with their back to the camera, looking at a large, curved digital display. The display shows a complex network of nodes and lines, along with several hexagonal icons containing different data visualizations like bar charts and line graphs.

In this topic, we will discuss the endowment effect.

Slide #2



How many of you have had one of the following experiences?

How many of you have had one of the following experiences?

Slide #3

You want to buy a custom-design house.

Seller described in great detail
house's unique design and quality,
add significant value to the property

You did not think custom-designed features
are worth the price the seller asked.



First, you want to buy a custom-design house.

The seller describes in great detail the house's unique design and quality, which adds a significant value to the property.

But you do not think these custom design features are worth the price that the seller asked.

Slide #4

Competitive price for a consulting project

Client pushed back, cut price 25%.

You feel your client is unreasonable



Another scenario, you offered a very competitive price for a consulting project to your client.

But your client pushed back very hard and cut the price by 25%.

You feel your client is unreasonable.

Slide #5

Technology Department
solve technical problem
with your product.

Cost estimation.

You feel price
is way too high.



Example number three.

You are asking your technology department to help you solve a technical problem with your product.

They give you a cost estimation and you feel their price is way too high.

Slide #6

Common theme:

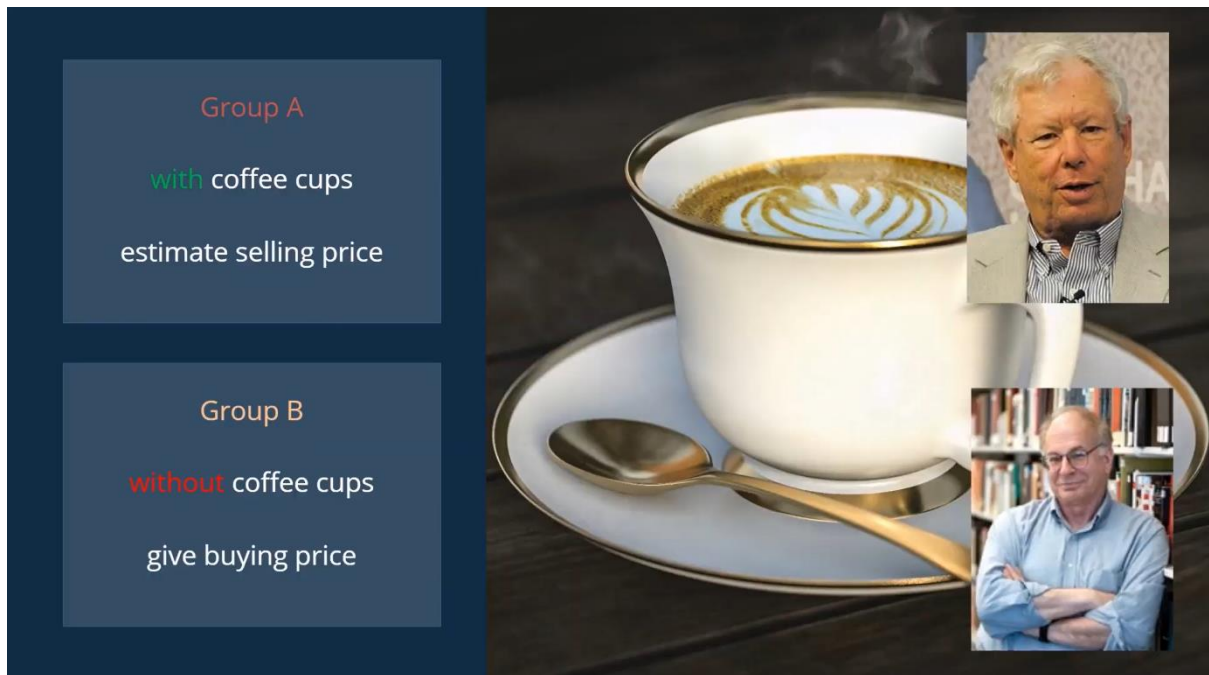
Buyers and owners
follow different standards
to assess value of object.



All of those examples share a common theme.

Buyers and owners follow different standards to assess the value of an object.

Slide #7



In the late 70s, economist Richard Thaler of the University of Chicago teamed with Daniel Kahneman to conduct a clever experiment involving Cornell undergraduate students.

The social scientists separated those students into two groups, group A and group B. They gave each student in Group A a coffee cup, but left students in Group B empty handed.

The researchers did not tell the students what would happen next.

After a while, the researchers asked the students in Group A, the students with coffee cups, to estimate a selling price.

Then they asked Group B, the students without coffee cups, to give a buying price.

Slide #8

Seller's asking price should be lower or even par with buyer's offer because sellers got cups for free.

Similar experiments conducted by other social scientists.

Seller's irrational tendency to overprice what they own.



From the observer's perspective, the seller's asking price should be lower, or even on par with the buyer's purchase offer, because the sellers got the cups free. They did not pay for the cups.

Surprisingly, the scientists found that the seller's asking price was 5.25, and the buyer's purchase offer was half of that.

Similar experiments were conducted many times by other social scientists.

Most observe the seller's irrational tendency to overprice what they own.

Slide #11

Seller's emotional attachment
drive them to overprice the object.

One of the most important behavioral principles
to be aware of and manage
when making price-related decisions.

We all tend to overvalue what we own.

Value = intrinsic value + attachment value

Buyers are on objective ground.

Buyers tend to focus on money that they are going to spend.

Buyers market research biased toward commodity price.

Their reference price heavily influences their purchasing price.



The seller's emotional attachment to the object drives the sellers to overprice the object.

This kind of behavior is called endowment effect, and it is one of the most important behavior principles that we need to be aware of and manage when making price related decisions.

We all tend to overvalue what we own.

The value that we as sellers place on a commodity often includes not only the intrinsic value of the object, but also the value based on our attachment to the item.

However, buyers have different perspectives.

Buyers are on the objective ground.

The buyers tend to focus on the money that they are spending.

Buyers market research is biased toward the price of the commodity, and their reference price heavily influences their purchasing prices.

Slide #12

Sellers emphasize improvements,
custom design.

Sellers add experience value
into selling price.

Buyers do not have emotional
attachment to the house.

Buyers always give commodity price,
Sellers want price of custom-designed house.



The endowment effect is very obvious in real estate transactions.

When selling a house, sellers cannot help emphasizing the improvements they have made to the house and their efforts to the custom design.

It is understandable and predictable that sellers add those experience values into the selling price of the property.

However, the buyers do not feel those items the same way.

They do not have an emotional attachment to the house. In their view, the kitchen, the pool, and the living room of the house are not different from those in any other property.

They do not value the custom design of those items.

So, the buyers always give a commodity price to the property, but sellers want the price of a custom-designed house.

Slide #13

Endowment effect is common
in the business world.

We price a new product
that we developed,
tendency to include
experience cost
in final price.



In the business world, the endowment effect is also very common.

When we price a new product that we developed, we all have the tendency to include the experience cost into the final price offer.