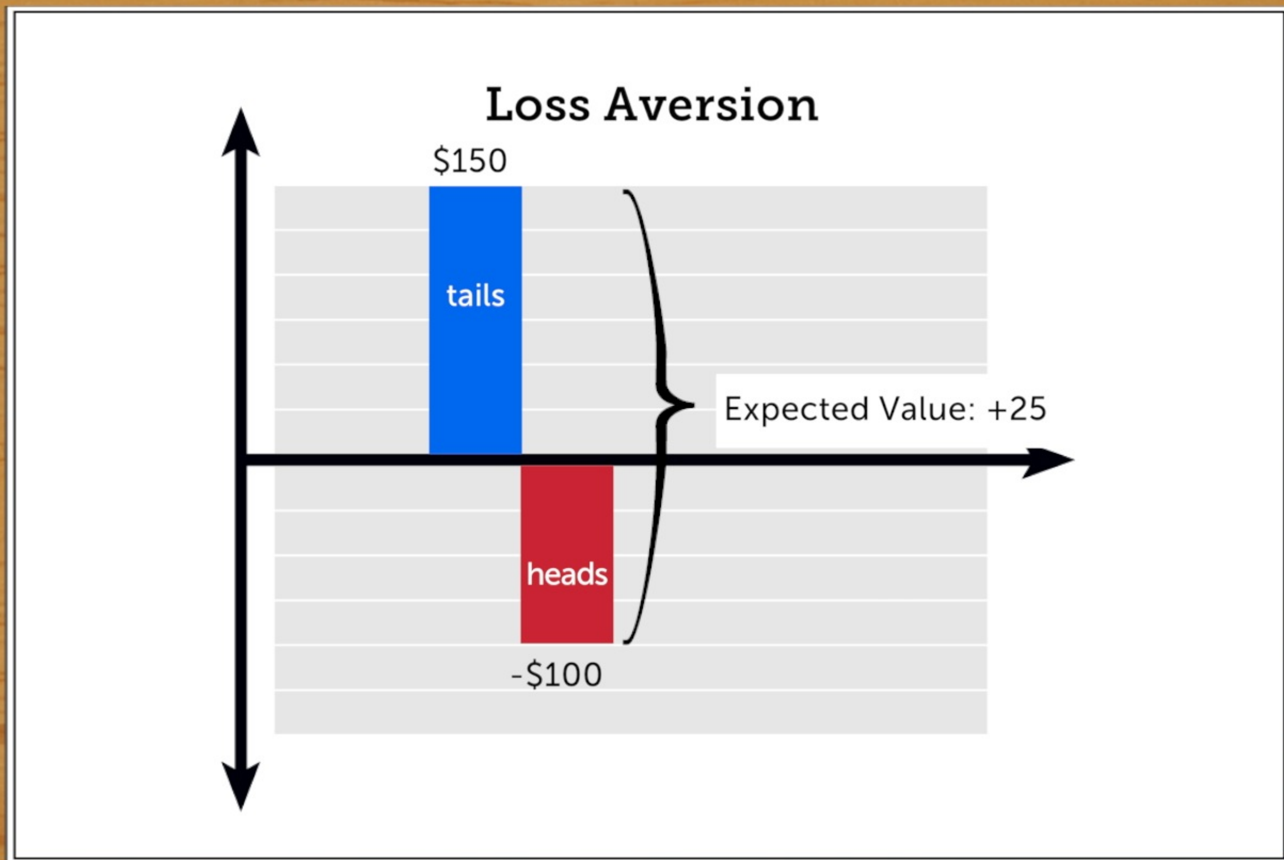
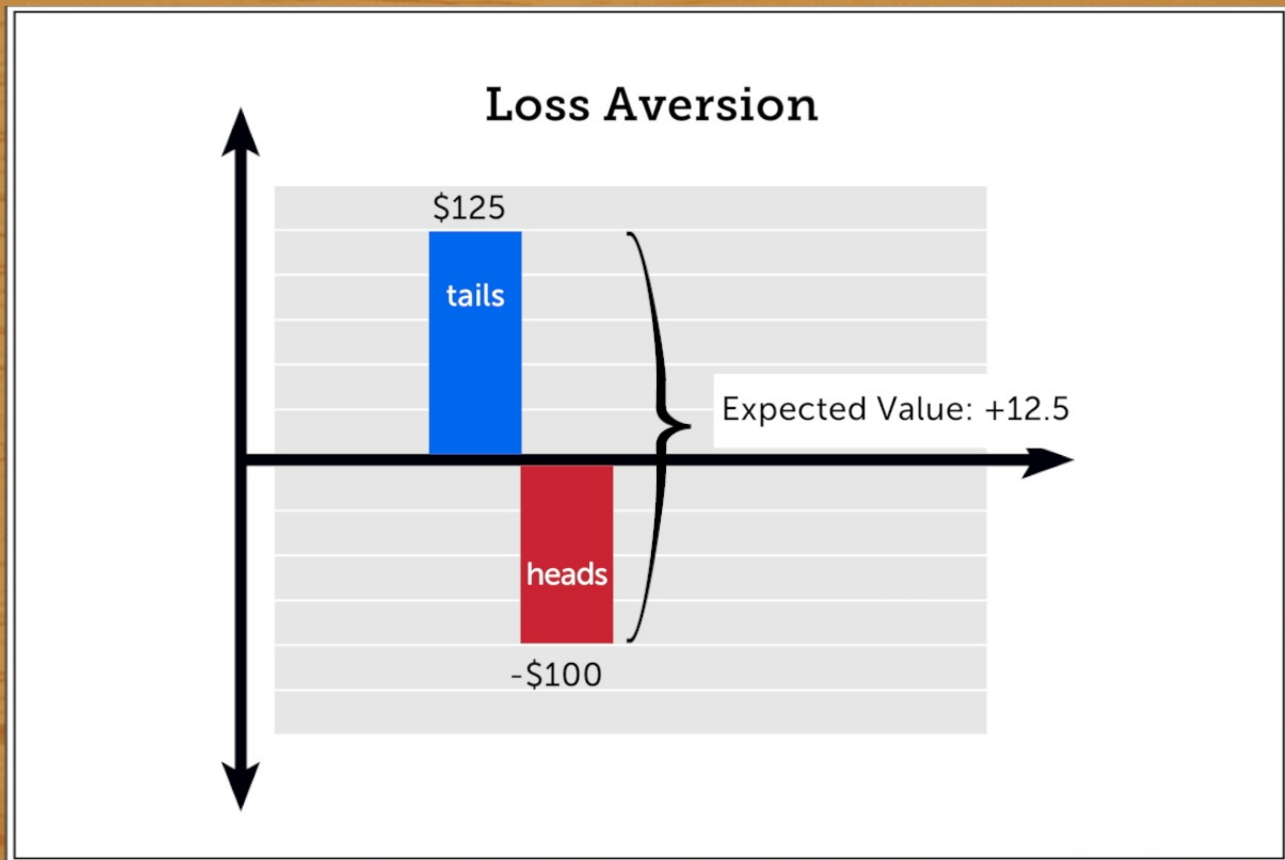
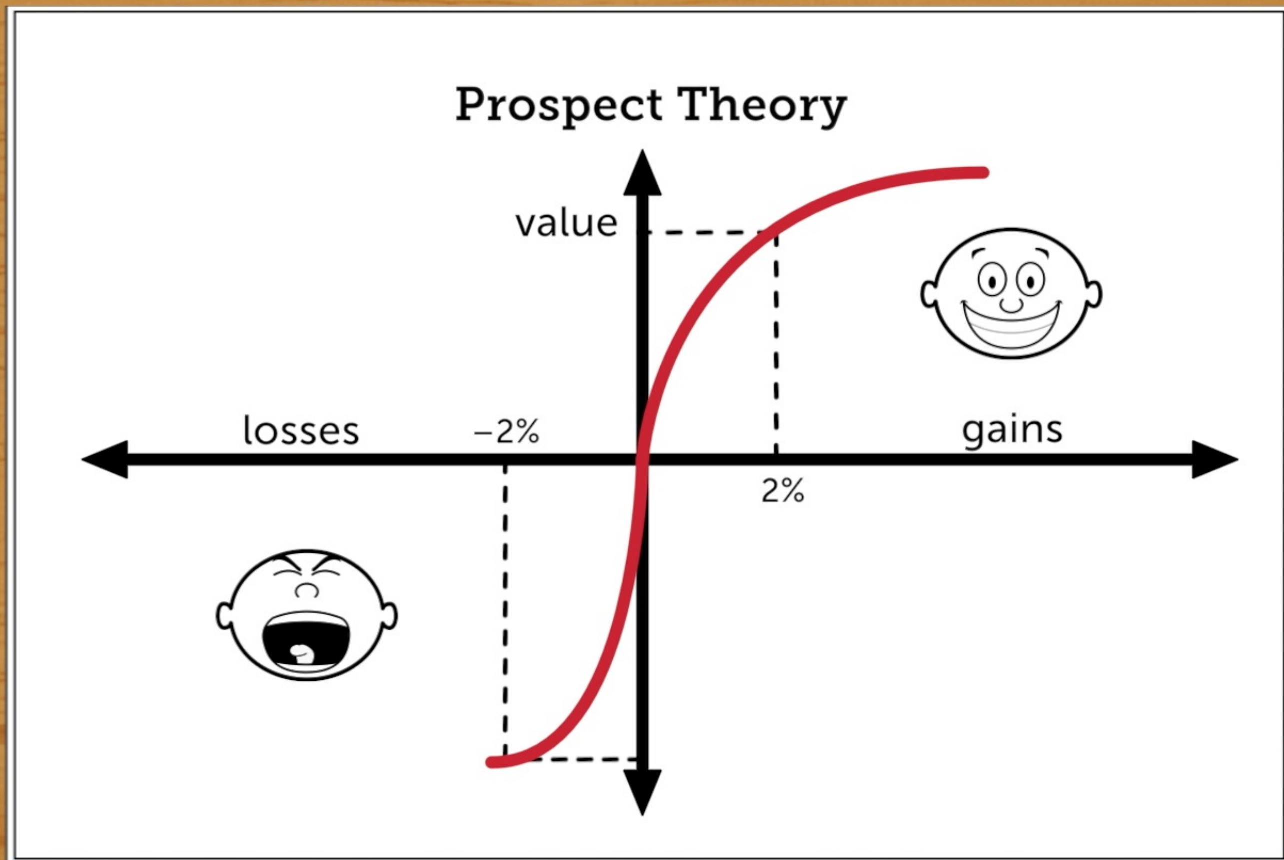
Part 6:
Loss Aversion and The Endowment Effect


Loss Aversion
$150
tails
Expected Value: +25
heads
-$100


Loss Aversion
$125
tails
Expected Value: +12.5
heads
-$100



Prospect Theory
value
losses
−2%
gains
2%

Loss Aversion:

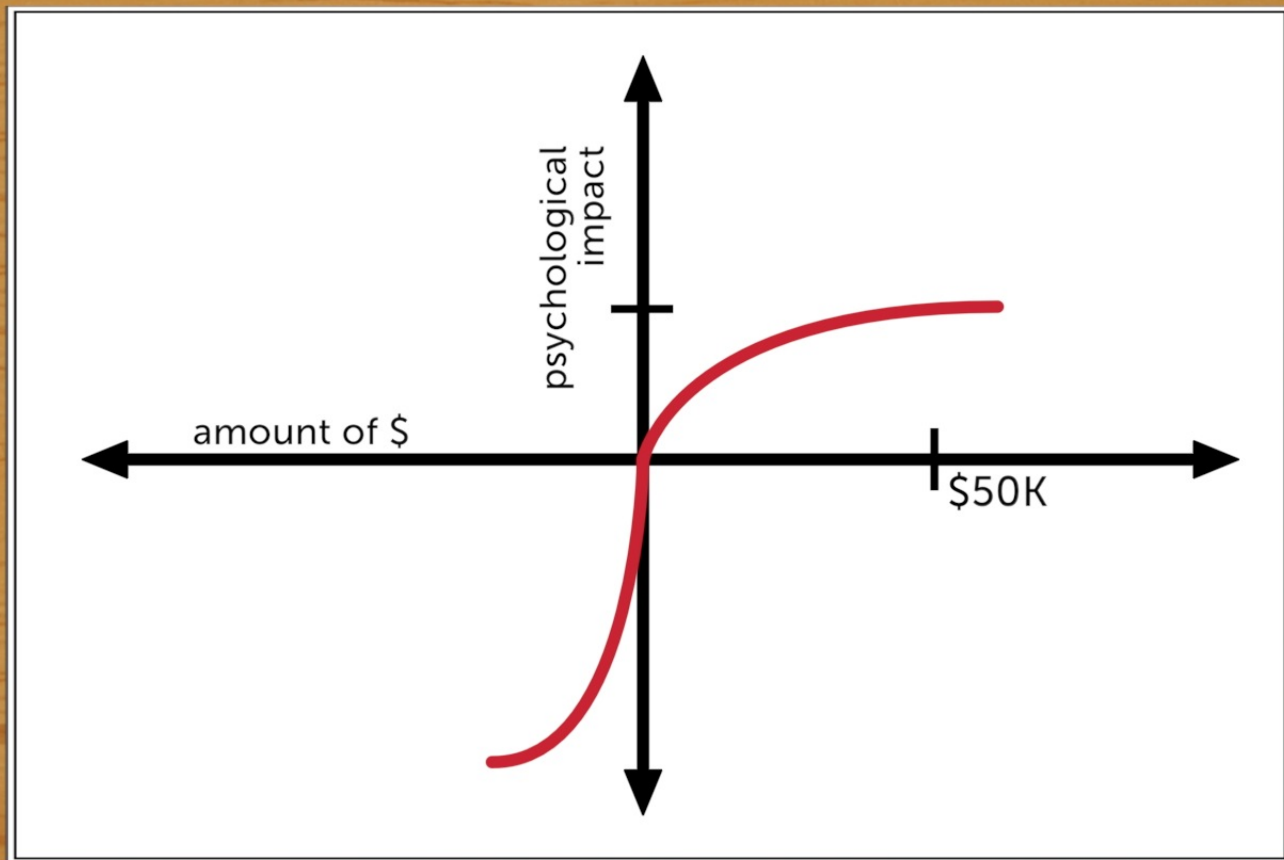
asymmetry around

a neutral point,

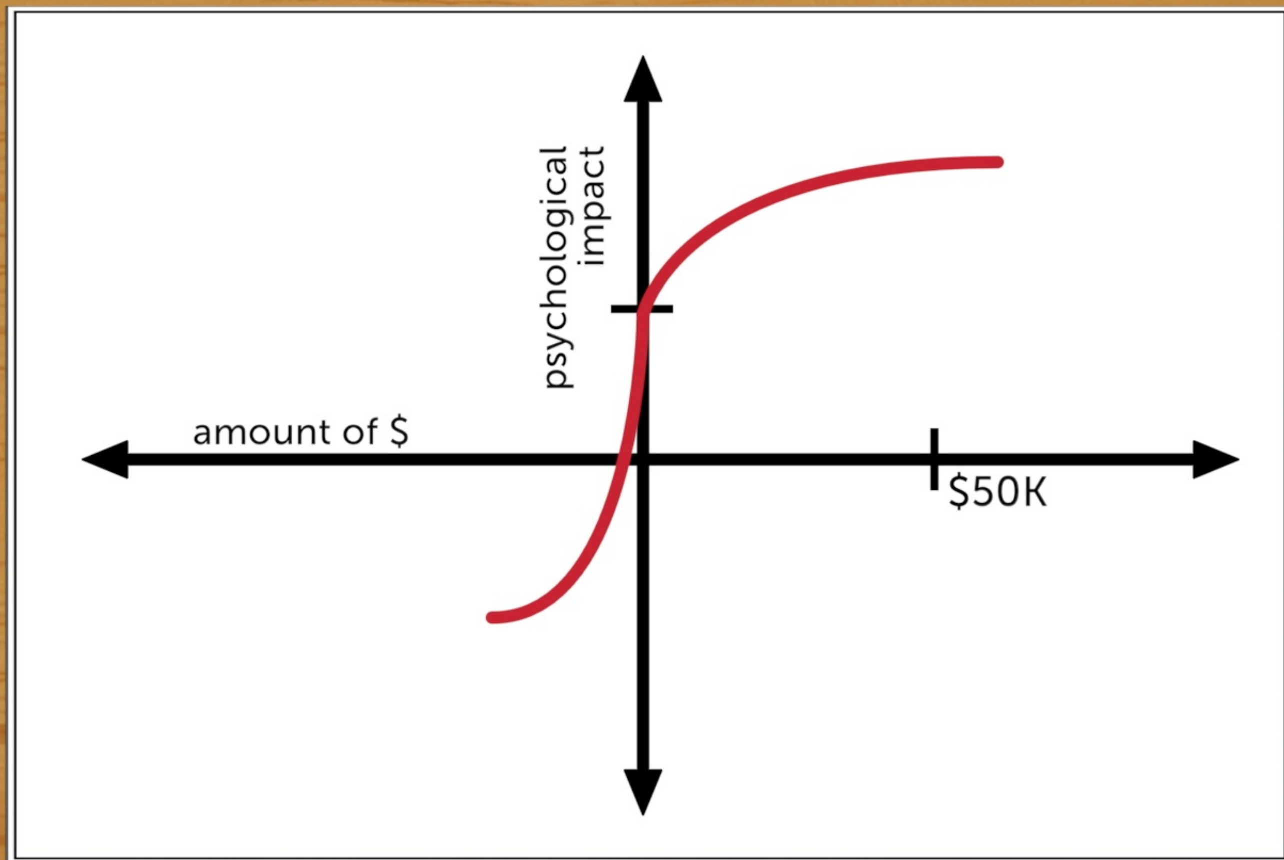
where losses are

perceived as ~2.5 times

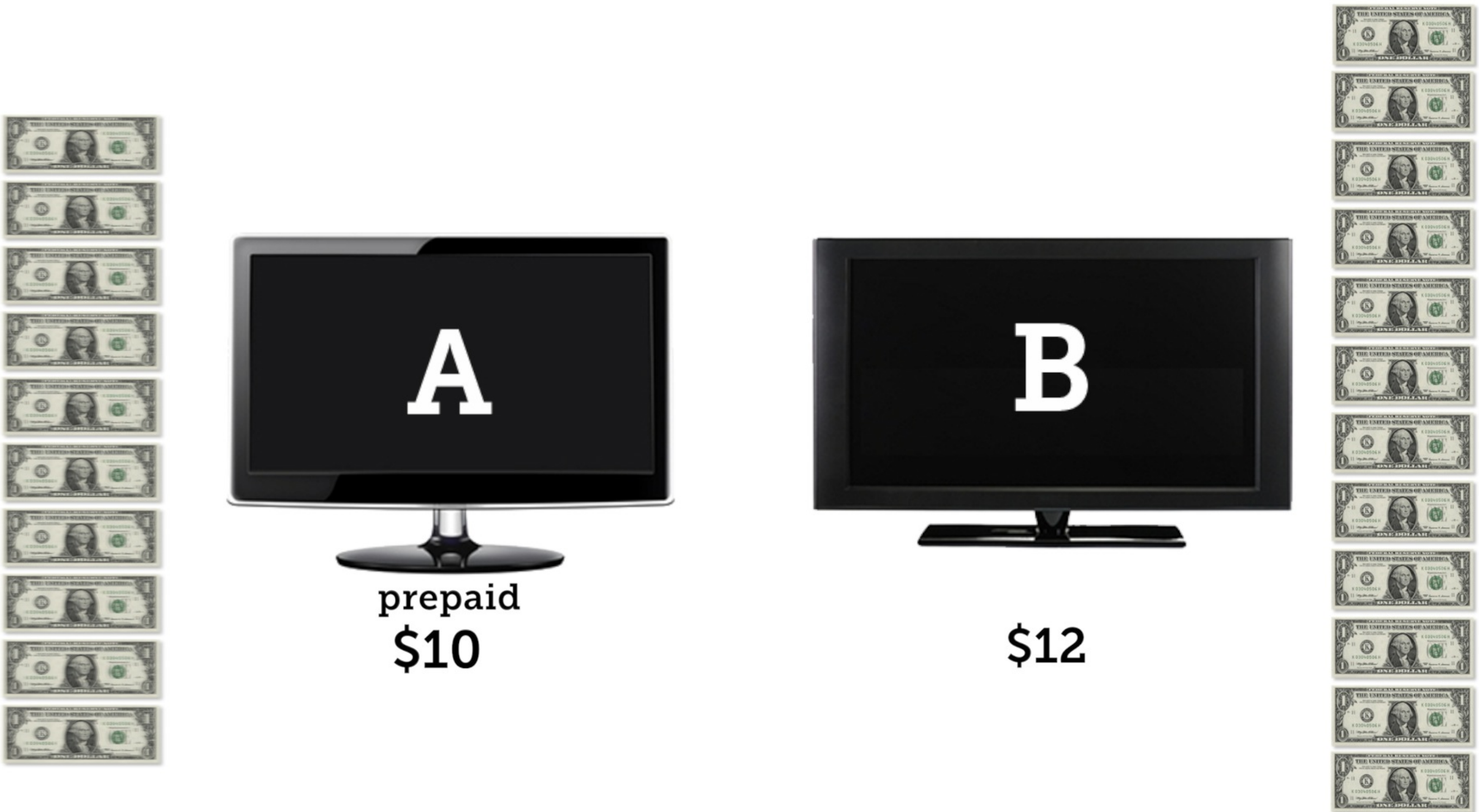
more powerful than gains.



psychological impact
amount of $
$50K


psychological impact
amount of $
$50K


A
B


A
B
prepaid
$10
$12

Selling B instead of A would require you to pay back $10, but you would still net $2 more.

prepaid
$10

$12

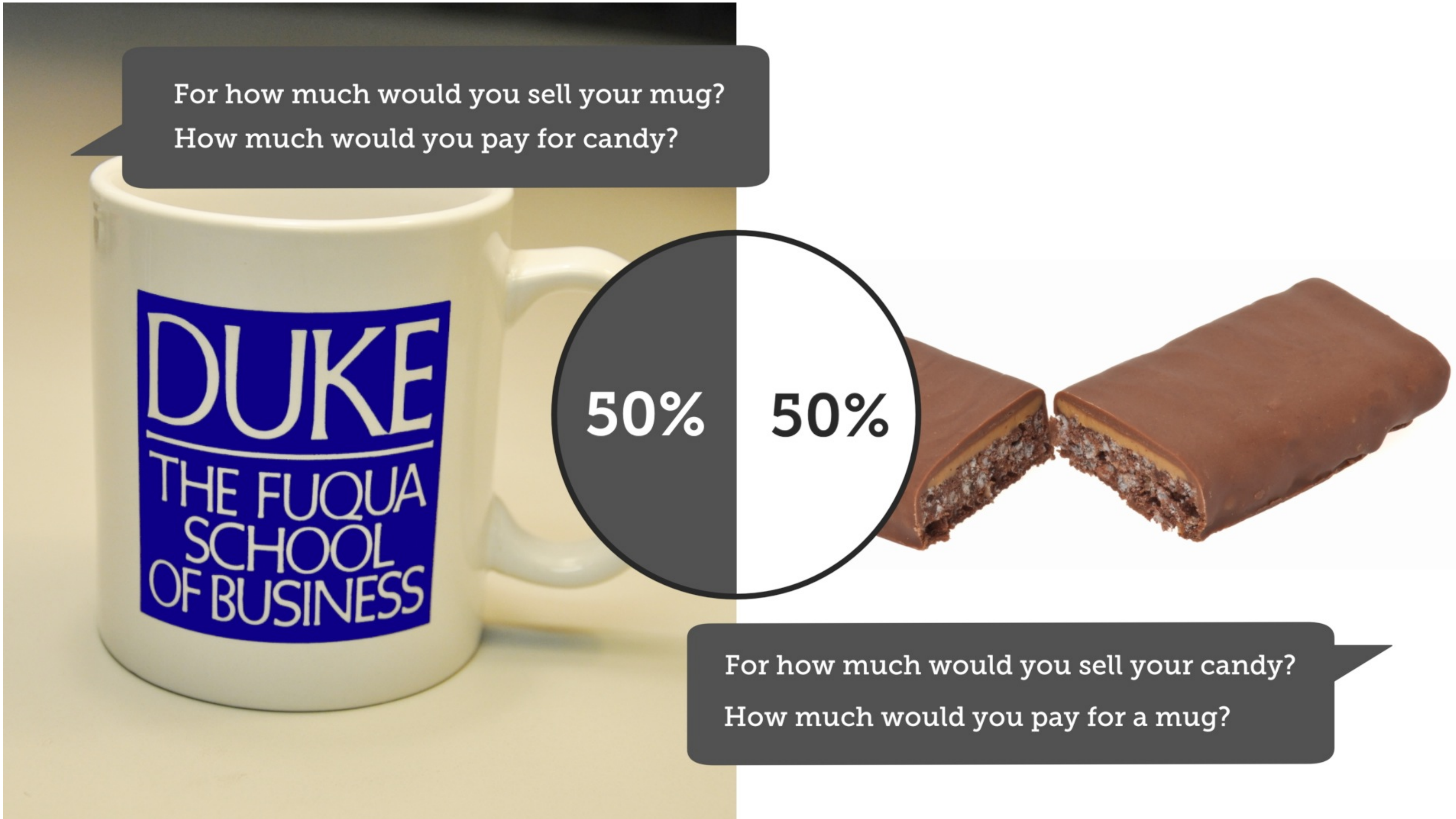
People sell more TVs when their commission is prepaid, because they don't want to give back $10 (even though they will make $12).

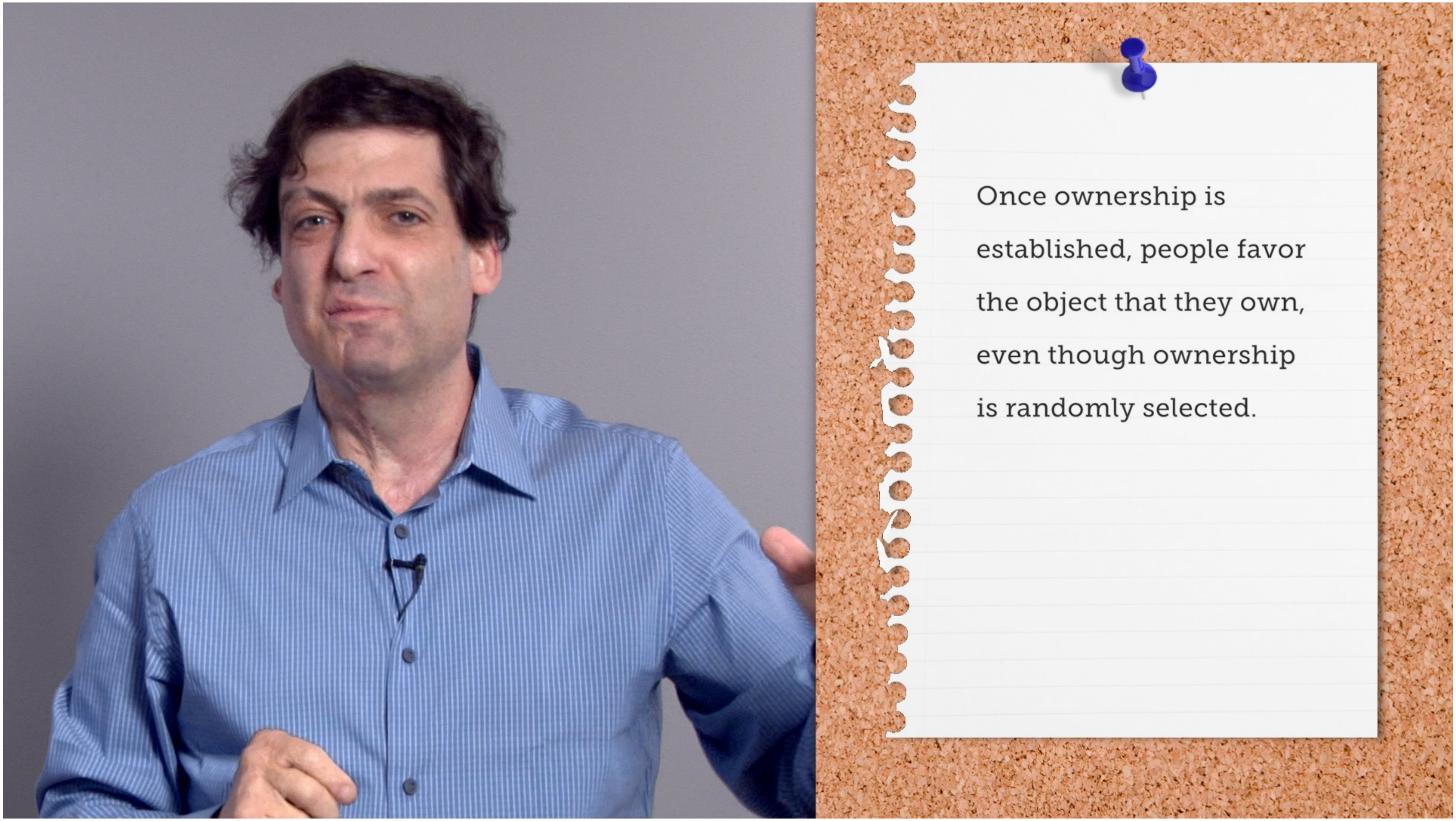

5%
employee

5%
employer

Endowment Effect:

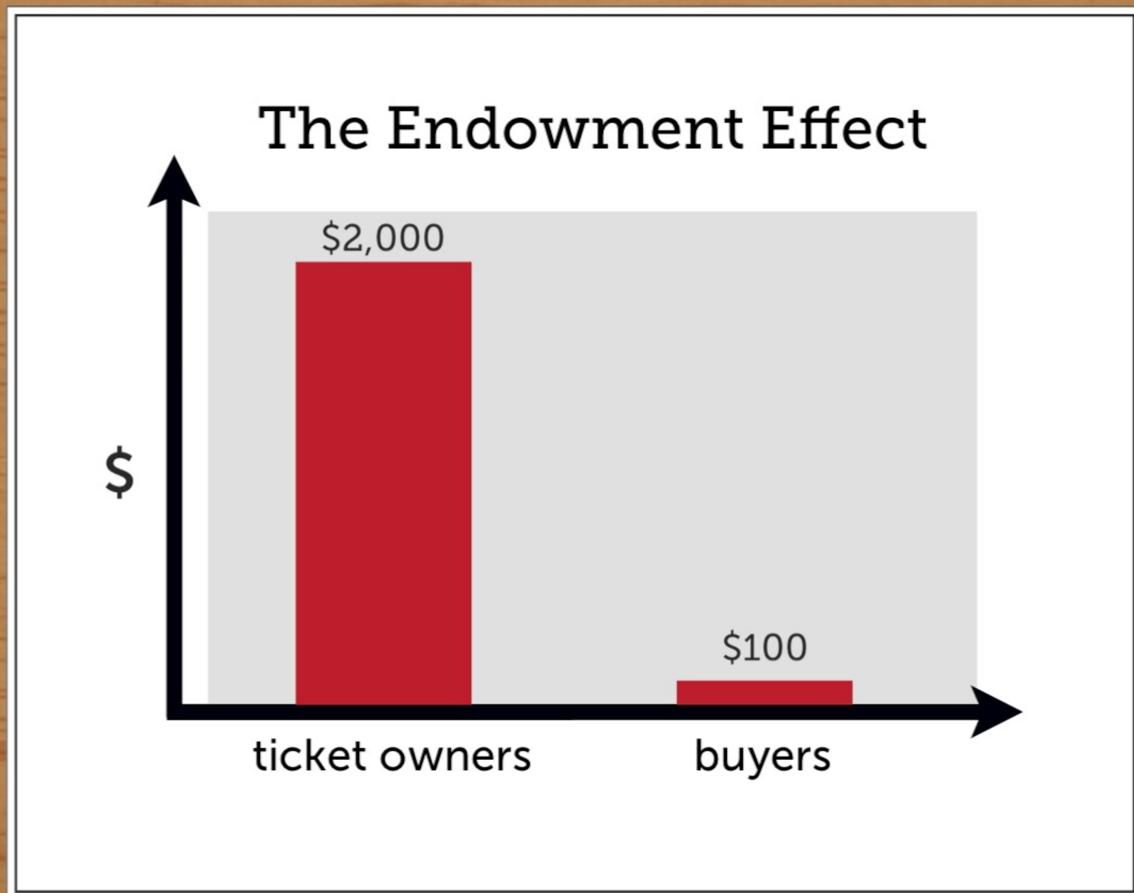
We adjust to our level of ownership, and it becomes the baseline by which we judge future gains and losses.

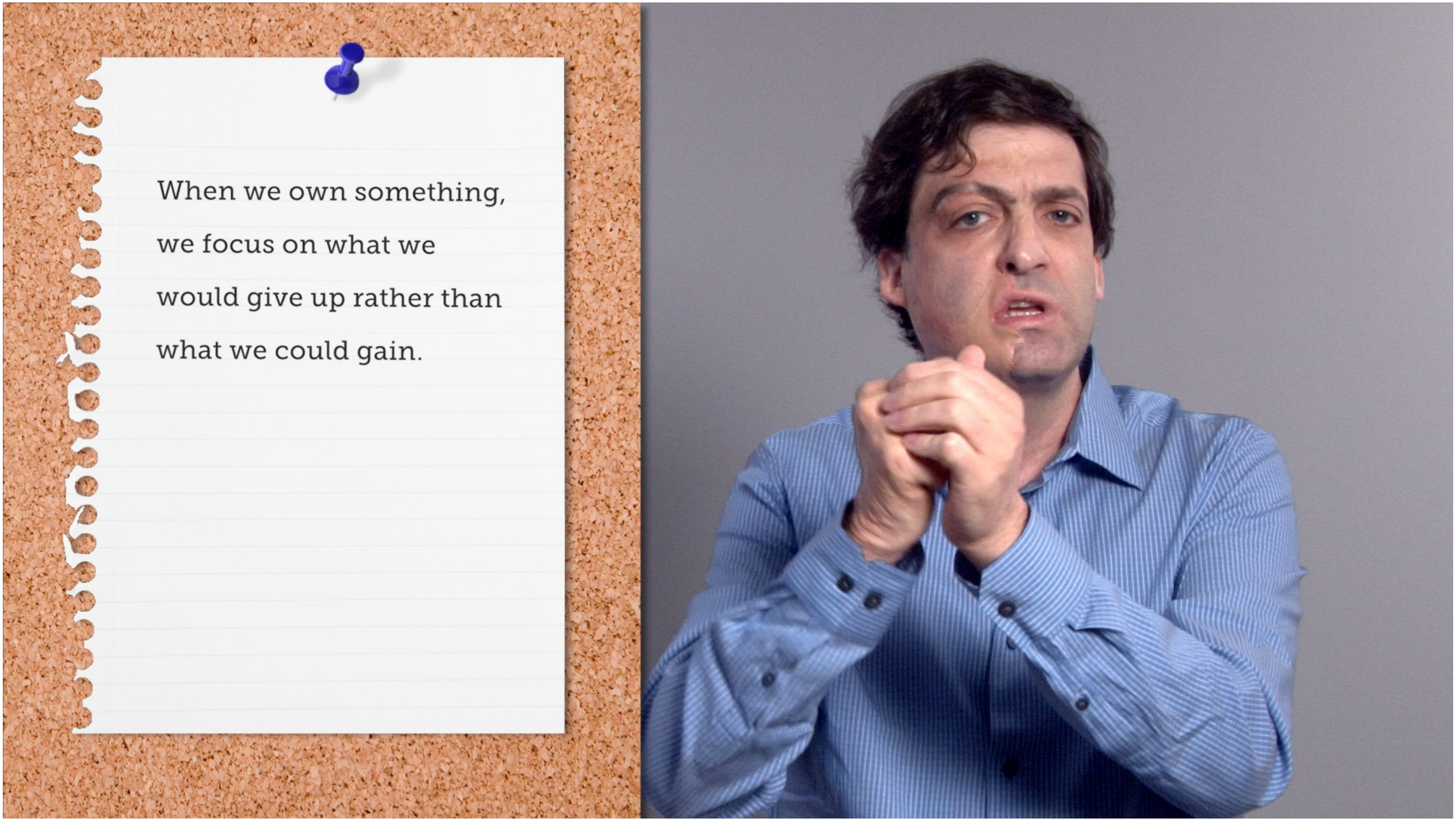

For how much would you sell your mug?
How much would you pay for candy?
DUKE
THE FUQUA SCHOOL OF BUSINESS
50%
50%
For how much would you sell your candy?
How much would you pay for a mug?


Once ownership is
established, people favor
the object that they own,
even though ownership
is randomly selected.


For how much would you sell us your ticket?


How much would you pay for a ticket?


The Endowment Effect
$2,000
$100
$
ticket owners
buyers


When we own something,
we focus on what we
would give up rather than
what we could gain.

After taking possession of an object, people consider themselves owners and like the object more, making it difficult to give up.