



An investigation of the endowment effect in the context of a college housing lottery



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ABSTRACT

The endowment effect was examined in a two-part study in the context of a college housing lottery. Students who were awarded their first choice of residence hall were asked the lowest dollar amount they would be willing to accept (WTA) to give up their first choice hall whereas students who were denied their first choice were asked the highest dollar amount they would be willing to pay (WTP) to obtain their first choice. Results from the initial assessment showed the presence of the endowment effect regarding students' valuation of their first choice residence hall immediately after the housing lottery (i.e., WTA price was significantly higher than WTP price). The follow-up surveyed participants from the initial assessment who responded when contacted a second time after they had experienced two months of life in the residence hall they were awarded in the lottery. Results from the follow-up showed that the endowment effect was still present after experiencing life in the residence hall. Moreover, further analyses revealed that the endowment effect was, in fact, enhanced after the living experience. These findings demonstrate that within the context of a housing lottery, a highly-valued commodity, long-term experiences substantially increase the magnitude of the endowment effect, even when controlling for other factors that have been shown to impact this effect.

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1. Introduction

Numerous studies in behavioral economics have investigated the endowment effect, a term coined by Thaler (1980). This robust effect refers to the finding that people expect more compensation to give up a good/service that they own than they would be willing to pay to acquire that same good/service if they did not own it. The typical laboratory investigation of the endowment effect (e.g., Kahneman, Knetsch, & Thaler, 1990) involves two groups—those participants who are given a coffee mug, or some such product, by the experimenters and those participants who are not. Subsequently, the participants with the newly acquired mug are asked what would be the lowest price they would accept to give up their coffee mug (selling price or WTA). In contrast, the participants who are not given a coffee mug are asked what would be the highest price they would be willing to pay to acquire the coffee mug (buying price or WTP). Typical results (e.g., Kahneman et al., 1990) show that the average selling price is more than double the average buying price (see Hoffman & Spitzer, 1993 for a review).

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Although many of these laboratory studies have revealed an array of factors that impact the endowment effect, a number of them are limited by the fact that the experimental commodity/goods (e.g., mugs, pens, chocolates) may not be particularly meaningful to the participants or are absent of any uniqueness and therefore readily available outside the constraints of the research studies. Others have noted that goods with the following attributes are important contributors to the endowment effect: high involvement goods (Saqib, Frohlich, & Bruning, 2010), high quality goods (Azar, 2011), and attractive goods (Brenner, Rottenstreich, Sood, & Bilgin, 2007). Carmon and Ariely (2000) investigated the endowment effect in a frequently cited field study using a commodity that would seem to contain all of these attributes. That study was conducted at Duke University during the NCAA Final Four men's basketball tournament where students vie for eligibility to purchase tickets to attend these highly contested games through a lottery system. Students were randomly selected from the ticket lottery list (a list to which students needed to apply, thus demonstrating their desire to attend the event) and asked a series of questions including the highest price they would pay for a Final Four ticket, assuming they did not have one and the lowest price they would agree to sell their ticket, assuming they had one. Results showed that participants' selling price was significantly higher than their buying price (median prices: \$1500 versus \$150).

The Carmon and Ariely field study is significant in that it focused on a highly meaningful and relevant commodity for the participants. However, this study utilized a within-participants design, that is, participants responded as both a seller and a buyer (in other words, participants who actually owned a ticket estimated both a selling price and a buying price; likewise, participants who did not own a ticket estimated both prices as well). Although within-participants designs are not uncommon in the endowment effect literature, they do not as closely resemble real world exchanges, where an individual is either a buyer or a seller but not both simultaneously.

The present two-part study attempted to extend the research on the endowment effect by addressing several issues related to the ecological validity of previous research: (1) some studies used goods that were likely not particularly meaningful to participants and (2) some studies employed within-participants designs so that participants were in the role of both buyer and seller. We addressed these issues by studying the endowment effect in a between-participants design and in the context of a College Housing Lottery, whose outcome was both meaningful and relevant for students. By nature of the lottery system, some students were awarded their first choice of residence hall and some students were denied; these naturally occurring groups served as the between-participants variable for these studies. Students were surveyed after the Spring housing lottery (initial assessment) and then again in the Fall after they had a chance to experience the residence hall they chose in the lottery (follow-up). The follow-up was important because it allowed us to focus on the impact of experience and knowledge on the endowment effect. Casey (1995) noted that in many instances there is "informational asymmetry" between buyers and sellers (p. 980). That is, sellers often possess more information than buyers. By surveying students again in the Fall, sellers (students who got their first choice) and buyers (students who did not get their first choice) both gained valuable information about their current residence hall. Moreover, this series of assessments allowed us to investigate the effect of future possession (winning the right to the residence hall) compared to actual possession (the experience of living in the residence hall). Studies that simply suggest the endowment effect is due to one's possession may fail to distinguish between possession with and without actual experience (Brenner et al., 2007).

What might the effect of experience be on the endowment effect? Most prior research seems to suggest that experience will enhance the endowment effect. For example, Strahilevitz and Loewenstein (1998) found that valuation of goods increased with the duration of the ownership in the short term. And Reb and Connolly (2007) found that the endowment effect was mediated by participants' feelings of ownership, which were enhanced by physical possession of the good. Studies such as these lead us to predict an enhanced endowment will occur after students' have experienced life in the residence hall they selected in the housing lottery. The follow-up empirically assessed this hypothesis.

In summary, this two-part study, arranged in a between-participants design allowed us to address several questions:

- (1) Is there an endowment effect immediately after housing selection when one compares students who were awarded their first choice in residence hall (sellers) compared to students who were denied their first choice (buyers)?
- (2) What effect does experience and knowledge have on the endowment effect? More specifically, after students have experienced the residence hall they selected in the housing lottery, does this experience enhance the endowment effect?

2. Initial assessment

2.1. Method

This study was approved by the College Institutional Review Board (IRB) and all procedures were performed in compliance with these institutional guidelines.

2.1.1. Participants

All students who registered for the Spring Housing Lottery were eligible for participation in this study. Of the 1509 registered students, 289 responded to the survey (19.15% response rate). Of this group, 66% indicated that they had been awarded their first choice residence hall in the lottery and 34% indicated that they were denied their first choice residence hall in the lottery.

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