

Endowment effect

The **Endowment Effect**, an emotional bias, is the hypothesis that people will value something they already own more than a similar item they don't own. This happens even when there is no cause for attachment or even if the item was only obtained literally minutes ago.¹

One of the most famous examples of the endowment effect in the literature is from a study by Daniel Kahneman, Jack Knetsch & Richard Thaler.² This involves participants who were given a mug and then offered the chance to sell it or trade it for an equally valued alternative (pens). They found that the amount of money the participants required as compensation for the mug - once their ownership of the mug had been established ("willingness to accept" or WTA) - was approximately twice as high as the amount they were willing to pay to acquire the mug ("willingness to pay" or WTP).

In behavioral finance, the endowment effect is sometimes referred to as *divestiture aversion*. The perceived greater value of ownership occurs merely because the individual possesses the object in question. Investors, therefore, tend to stick with certain assets because of familiarity and comfort, even if they are inappropriate or become unprofitable.³

The endowment effect has been raised as a possible explanation for the lack of demand for reverse mortgage opportunities in the United States (contracts in which a home owner sells back her/his property to the bank in exchange for an annuity) (Huck, Kirchsteiger & Oechssler, 2005).⁴

Next: [Availability bias](#)

¹ Morewedge, Carey K.; Giblin, Colleen E. (2015). "Explanations of the endowment effect: an integrative review." *Trends in Cognitive Sciences*. 19 (6): 339–348.

² Kahneman, Daniel; Knetsch, Jack L.; Thaler, Richard H. (1990). "Experimental Tests of the Endowment Effect and the Cause Theorem." *Journal of Political Economy*. 98 (6): 1325–1348.

³ <http://www.investopedia.com/terms/e/endowment-effect.asp>.

⁴ Huck, Steffen; Kirchsteiger, Georg; Oechssler, Jörg (2005). "Learning to like what you have – explaining the endowment effect." *The Economic Journal*. 115 (505): 689–702.

Also:

<http://endowment-effect.behaviouralfinance.net/>.