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The Application of Endowment Effect on Marketing Strategies

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Abstract: In this paper, we provide a comprehensive review and analysis of the endowment effect through aspects. The endowment effect is one of the most famous findings in behavioral economics and has been used as a reference for evidence of dependent preference and loss aversion theories [1]. The endowment effect was first explained and proved in three aspects, loss aversion, psychological inertia, and psychological ownership. In addition, by analyzing the retailing techniques of Starbucks Corporation's stores showing the psychological ownership and endowment effect. The application value of the endowment effect is also demonstrated. Meanwhile, the free test drive mentioned in the marketing report of Tesla proves the application of the endowment effect of loss aversion to the automobile industry. The two examples illustrate that the endowment effect is widely present in daily transactions and consumption behavior, and therefore the study of the endowment effect is essential to improve economic efficiency and help make economic decisions from a microeconomic perspective.

Keywords: endowment effect, marketing strategy, starbucks, Tesla

1. Introduction

In this paper, we discuss three possible explanations for the endowment effect, including loss aversion, psychological inertia, and psychological ownership. In the application section, we explain the role played by the endowment effect in the two marketing cases through case studies of Starbucks' marketing strategy and Tesla's marketing strategy. This paper includes the several other researcher’s idea to support the view on the topic.

The endowment effect is one of the most well-known discoveries in behavioral economics and is used as support for the dependent preference and loss aversion theories, according to the article "The endowment effect" by KM Marzilli Ericson and A Fuster [2]. The dependent preference and loss aversion theories have both cited the endowment effect, one of behavioral economics' most well-known findings. The robustness of the effect in the lab and its applicability in the field are both called into doubt by current work. The writers present an evidence summary and a description of current theoretical advancements in this review. With an emphasis on expectation-based reference points, disparate data may be resolved. The authors also review contemporary psychological research that proposes modifications or alternatives to the conventional loss aversion rationale. The explanation of loss aversion. The dominating paradigm for comprehending the donation effect, according to the authors, is loss aversion. However, a version of the theory may incorporate several references due to the effect's deep psychology.

In the article "Experimental Tests of the Endowment Effect and the Coase Theorem" by Daniel Kahneman, Jack L. Knetsch, and Richard H. Thaler, it is mentioned that, contrary to theoretical expectations In contrast, measures of willingness to accept greatly exceed measures of willingness to pay [3]. The article details a number of tests that show this "endowment effect" endures even in competitive markets with educational possibilities. In one study, consumption items (such coffee cups) were distributed at random to half of the individuals. After then, a market analysis of these cups was done. When a market for "induced value" tokens is held, Coase's theorem predicts that around half of the cups would be exchanged, but the observed transactions are always significantly smaller. This shows that transaction costs do not account for consumer products' undertrading.

In James K. Beggan's article "On the Social Nature of Nonsocial Perception: The Mere Ownership Effect," it is hypothesized that ownership of an object causes the owner to perceive the object as a social entity [4]. This is so that a psychological connection may be made between the thing and the owner through ownership. Three studies looked at the question of whether Ss would esteem something more only because they possessed it. This mere ownership impact was verified in Study 1. Study 2 demonstrated that this impact was not brought about by Ss being exposed to owned things more frequently than unowned ones. According to Study 3, the result can be a judgment on a particular instance of people's propensity for self-reinforcing behavior.

In Katerina Huskova's study "Starbucks Marketing Analysis", every company needs to implement a successful marketing strategy in order to be noticed by consumers and develop a brand identity [5]. The article describes Starbucks' marketing strategy in this part using the idea of a core marketing strategy. Starbucks employs the idea of core marketing strategy, according to the authors, to decide on its positioning and marketing mix and to examine its operational and commercial environments. Strategic marketing will also be utilized in conjunction with tools like the Ansoff and BCI matrix in the future.

In Myles Edwin Mangram's study "The globalization of Tesla Motors: a strategic marketing plan analysis", it is mentioned that Tesla has profound marketing management implications because it is based on a "new technology" approach to automotive marketing with a unique methodology and relates it to the successful marketing model of Apple Computer [6]. This marketing strategy is opposed to the conventional marketing management strategy used in the car sector, which supports mass marketing and mass production. In their examination, the writers employed a qualitative, exploratory research methodology. The research involved significant secondary literature collecting, data analysis, and in-depth case study analysis, with a primary focus on Apple Computer. The major finding is that Tesla's current and future development depends on a "new technology"-based strategy to marketing management.

In the study "Loss aversion without the endowment effect, and other explanations for the WTA-WTP disparity" by Thomas C. Brown, it is mentioned that endowment effect-related limitations [7]. The verbal agreement approach is utilized in a real cash experiment employing random price auctions, according to the authors, in order to understand why WTA frequently exceeds WTP in economic experiments including inexpensive market items with adequate substitutes. The findings imply that participants' unwillingness to experience a net loss in any transaction, whether a buy or a sale, and their propensity to perceive a sale considerably below the projected market price as a loss, as the primary causes of this disparity. The endowment effect, which posits that selling causes losses while buying causes profits, does not support this view, which instead supports a loss aversion of a different type.

The main purpose of this study is to explore the application of the endowment effect in marketing strategy. The endowment effect is an important topic in behavioral economics, in which the relationship between consumers and products is analyzed from a psychological perspective. Therefore, the nature of the endowment effect is closely related to marketing strategy. This article is based on the research of several scholars, firstly, the endowment effect is introduced and analyzed and proved, then two marketing cases are used to illustrate the application of the viral effect, and finally, a conclusion and reflection are made.

2. Methodology

In extensive experiments, there are three general proofs for the endowment effect. The first proof exists in the gap between consumers' willingness to pay (WTP) and willingness to receive compensation (WTA) for the same good, where the ratio WTA/WTP is higher than imagined expectations [8]. The second graph is the exchange graph, which shows experimentally that experimenters randomly assigned to own the same value product are more likely than expected to reject the exchange product [9]. The third graph is illustrated by the simple ownership effect, which demonstrates that people who own goods are more likely to give high ratings to goods than those who do not [10].

Several explanations for the endowment effect have been proposed and studied separately, including loss aversion, psychological inertia, and psychological ownership.

2.1. Loss Aversion

Prospect theory states that people make decisions based on their reference dependent points and various risk preferences [11]. Generally speaking, the act of purchasing is regarded as a gain and the act of selling as a loss. Loss aversion is the idea that losing a thing is seen to have a higher psychological impact than getting a similar goods and was initially proposed by Kahneman and Tversky. The result is a WTP-WTA gap because sellers who lose a thing will value it more than purchasers who obtain it.

2.2. Psychological Inertia

David Gal (2006) utilizes a status quo premise to explain the shifting endowment effect graph in place of loss aversion. Due to the inaccuracy of the product's value, both parties' propensity to favor the status quo may result in a lack of incentives to engage in trade if the price is too low for sellers or the pace too sluggish for buyers [12]. The outcome is that the exchange rate is less than anticipated.

2.3. Psychological Ownership

According to research, people's opinions of a product are enhanced by both actual and hypothetical ownership [13]. People's favorable opinions of themselves encourage them to have a positive opinion of the things they possess because ownership creates a connection between the individual and the product [14].

3. Two Applications on Marketing Strategies

The endowment effect is now widely used in business strategies to increase transactions and thus profits. In this application section, we will focus on Starbucks' marketing strategy and Tesla's marketing strategy as case studies.

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3.1. Application 1: Starbucks' Marketing Strategy

The endowment effect can be used in the field of marketing to increase sales. Starbucks Corporation generates over $29.1 billion in revenue annually, mostly as a result of its effective application of the endowment effect in its marketing plan. Apple's marketing report states that all of the products sold in the shop have the customer's name printed on the product's exterior packaging, and the business designs its stores to give customers a personal touch [15]. Additionally, they deliberately train their staff members to increase the endowment effect. Such tactics aid Starbucks in increasing sales and bringing in significant sums of money.

Table1: Starbuck's coffee cups with customer's names.

	Cup1	Cup2	Cup3	Cup4	Cup5	Cup6
signature	Said	Shi	Al Sahid	Jerry	Richard	Kenova

Connecting customers to the product generates enormous money. Previous research has demonstrated that people can develop a sense of ownership even before they truly possess something. By connecting the two by printing the client's name on the item, Starbucks simply provides the buyer with a psychological sense of ownership. Customers that feel a feeling of ownership place a higher monetary value on the same goods than non-owners, in addition to the psychological difference that exists between the two groups of customers [16].

Starbucks exploited the endowment effect to establish a link between the product's user and the customer in order to foster a sense of customer ownership. The greater psychological feeling of ownership that was achieved in the trial simply by having the customer's name on the item led to a stronger propensity to purchase, even though it was distinct from actual physical possession of the object. (see table1) Additionally, the idea that customers will want a sense of ownership for as long as they want it will make them more likely to buy the goods again in the future. As a result, by putting their brand on their goods, Starbucks can raise the possibility of profitable and ongoing business relationships with consumers. Loss aversion can be used to further explain these tactics employed by Starbucks Corporation. Customers' sense of belonging to their items is strengthened as a result of merchants' heightened sense of ownership over their products. They will instantly place a higher value on a product if they feel as though they somehow own it, especially when compared to other similar products. This will give them a sense of superiority.

3.2. Application 2: Tesla's Marketing Strategy

The endowment effect is used by Tesla Inc.'s marketing department to boost sales. With approximately $18.8 billion in yearly revenue, Tesla has successfully incorporated the endowment effect into their marketing plan. The company's key online platforms offer customers an interactive experience where all products are visibly exhibited and touchable, and after that, customers may apply to experience its products offline, according to Tesla's marketing report. Additionally, Tesla staff members receive training to improve the endowment effect. First, as soon as the store opens, personnel proactively greet guests and offer them to use the test drive service while providing information about the products. Second, they are taught not to eject or pressure clients, allowing them an infinite amount of dwell time [17]. As a result, potential clients have plenty of time to inquire about the products and examine other options. Such a plan aids Tesla in increasing sales and bringing in a sizable sum of money.

Touch is used to promote sales through an experienced shopping experience. Previous research has demonstrated that when physical touch is unavailable, even an imagining touch can help people feel more ownership. In addition to a difference in psychological perspective, customers who have

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handled a product place a higher value on it financially than customers who have not [18]. According to research published in the Journal of Consumer Research, people who had really handled the product were more eager to pay than those who were instructed not to.

In the Tesla 4s store, the business makes use of the endowment effect to make customers feel like they own the Tesla product through their use of it. Offering test drives, for instance, allows customers to fully relate to the goods and gain driving experience beforehand, increasing their likelihood to purchase the product in order to preserve their sense of ownership. The idea that customers can keep having fun for as long as they like will also make them more likely to make a purchase.

According to one study, prolonged ownership can boost a product's value even after it has been physically lost [19]. Therefore, Tesla may raise the value of its goods to the customer by letting them stay longer, improving the likelihood of a successful transaction. Loss aversion offers a further justification for Tesla's policy. The interactive layout of Tesla's 4s stores and extended client visits reinforce the bond and sense of belonging that exists between the customer and the product. Once individuals begin to feel as though they possess the goods, they find it impossible to resist taking them with them because they are afraid of losing them [20].

4. Limition and Future Outlook

The endowment effect has thus been commonly attributed to loss aversion.

Loss aversion, however, displays a growing number of flaws as the research develops. First of all, gains and losses are relative to a reference point, and as the reference point is altered, so is the individual's assessment of the good. Second, researchers have argued that buyers do not perceive purchasing an exchange good as a benefit and sellers do not perceive selling an exchange good as a loss, i.e., loss aversion has little impact on routine economic transactions, and people do not have an endowment effect on exchange goods. Additionally, Brown (2005) demonstrates the endowment effect is not caused by loss aversion but rather by "seeking a good bargain" using a verbal reporting approach [21]. Finally, since loss aversion is merely a descriptive term and no researchers have outlined its nature and fundamental traits, it is still up for debate whether it is appropriate to use this descriptive concept of loss aversion to explain the endowment effect.

According to Irmak et al. (2013), the endowment effect arises because the buyer and seller roles differ in the level of interpretation of information, with the buyer interpreting the product at a low level and the seller interpreting it at a high level [22]. They also found that the level of explanation theory in psychology, i.e., high and low levels of explanation, affects the endowment effect. In an experiment, psychological distance affects the amount of explanation, which in turn affects how people perceive the role of pricing when evaluating goods. When evaluating items from a distant psychological distance perspective, people are more likely to use price to infer quality; conversely, when evaluating goods from a near psychological distance perspective, people are more likely to use price to indicate economic loss. This suggests that the dual role of price may be a particular mechanism for the development of the endowment effect. Different roles (buyer and seller) bring different psychological distances, which in turn influence people to use different levels of explanation for the dual role of price, leading to the development of the endowment effect. Therefore, based on the hypothesis of explanation levels, the next study may be able to experimentally assess whether price dual roles constitute a psychological mechanism for the endowment effect.

5. Conclusion

In this article, we provide a comprehensive study and explanation of the endowment effect by examining past experiments and graphs as well as explanations from psychological and biological foundations. Then, we focus on two applications in the marketing field. We examined how human

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and low-cost selling methods can be used in Starbucks stores to give customers an enhanced sense of ownership of the product and then increase sales, such as writing the consumer's name on the food package. This can guide retail stores to use endowment effects to attract customers. We then examine how interactive user experiences can be used at Tesla to enhance the sense of ownership and then increase sales. The analysis focuses on the association between the test drive service in Tesla's 4s stores and the endowment effect. This can guide retail stores to use experiential design to engage customers. These applications are worth exploring further to guide better marketing decisions, as these examples demonstrate that good use of the endowment effect in marketing strategies can increase a company's effectiveness.

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