

SCREENING AND RISKS OF INFORMATION ASYMMETRY

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ABSTRACT

In situations of asymmetric information, the allocation of resources will not be economically efficient. When the distribution of information is asymmetric, one or more parties will have imperfect information and hence bear risk. The asymmetry can be resolved directly through appraisal or indirectly through screening, signaling or contingent payments. Screening is an initiative of the party with less information, while signaling is an initiative of the party with better information.

Information asymmetry usually works in favour of the seller, because the seller normally has more knowledge about the product than the buyer. However it can also work in favour of the buyer. An example of buyer advantage could be a situation in which a buyer agent deliberately distorts a market on a temporary basis in order to purchase assets at a lower price, which then rises after the market manipulation exercise is terminated, creating profits for the buyer.

This article cites how in 2011 two parties, one being a European Union Institution and the other a Government Ministry, remedied information ambiguities before signing the Memorandum of Understanding for a major building development in the Netherlands. In this article the authors also analyzed the example of trucking industry in 2010 Spain with government interference based on imperfect information and the very high cost of such information imperfections. Finally, the impact of information asymmetry on equity market, is discussed.

The screening models are contrasted with the government interventionism policy. Such policy is of limited value if screening is carried out prior to any direct government intervention.

Key Words: Information Asymmetry, Screening, Risk, Decision Problem, Case Study