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Research impact summary

Transparency in the financial sector: is it possible to have too much?

Studies by the Centre for Decision Research and Experimental Economics are helping to inform thinking on the contentious issue of transparency in the financial sector. A key consideration to emerge from this work is that too much transparency could discourage risk-taking to such an extent that the quality of decisions is adversely affected and the economy suffers as a result.

The global economic meltdown of 2007 and 2008 laid bare the issue of financial institutions' willingness to take risks. With policymakers determined to avoid future crises, the debate over whether the collapse would have occurred if banks and investment companies had been subject to greater scrutiny remains every bit as relevant today.

"It goes without saying that little or no transparency is a bad thing," says Dr Dennie van Dolder, a Research Fellow at the Centre for Decision Research and Experimental Economics (CeDEx). "A meaningful degree of scrutiny is essential to protect against misconduct and the threat of fraud, and it's obvious that in some cases this was lacking. Yet it's just as important to consider the other end of the spectrum – that is, what could happen in the event of too much transparency."

Dr van Dolder set out to examine this question by conducting a series of experiments based on Deal or No Deal, the popular game show in which contestants can either accept a cash offer or hold out for a mystery amount hidden in a box pre-selected at random. With prizes ranging from €0.01 to €500 up for grabs, study respondents played either in a laboratory setting or in a simulated game-show environment with an audience, a host and cameras.

It was found that lab-based contestants demanded a much higher offer than those in the game-show setting before agreeing to a deal. Further analysis attributed this finding to players in the limelight having a greater fear of losing, relative to earlier expectations, in the event of a risky gamble not paying off.

"Our results suggest making decisions in public increases the fear of going out on a limb," says Dr van Dolder. "This might seem desirable, but at the same time it's vital to remember that you have to take risks to make profits. On the whole, people tend to overweight potential losses when evaluating risky prospects, and this is a tendency we should resist rather than encourage. There has to be some limit to transparency, because the bottom line is that the economy is unlikely to benefit from a financial sector that's overly bureaucratic and unnecessarily timid."

Cynics might be surprised that a primetime TV show could serve as an inspiration for research intended to shape policymaker thinking. In fact, Deal or No Deal offers revealing insights into prospect theory, the psychologically plausible description of decision-making developed by Nobel Prize winners Daniel Kahneman and Amos Tversky. Although the casual viewer might not know it, every episode provides valuable illustrations of how people choose between probabilistic alternatives that involve risk.

Dennie van Dolder

"Interesting, important and extremely varied work – that's what economics is really about. My research combines laboratory experiments, field experiments and naturally occurring data to better understand human decision-making, primarily in the areas of decision-making under risk and uncertainty and strategic interaction."

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