Asymmetric information

Asymmetric Information Asymmetric information is a concept where one person has a thorough knowledge about the transaction where as the other person is left clueless. This situation is trickier in financial markets. Since the financial markets deal with money borrowing, lending, stock exchange and other money related transactions, the probability of asymmetric information is higher. People involved in financial transactions must be provided with prior information which will avoid unnecessary problems that may arise during the transaction. Asymmetric information leads to various risks as the one who has previous knowledge about the transaction tends to take advantage of the situation.

The various forms of asymmetric information include adverse selection, cost monitoring and moral hazard. (Bebczuk, 2003). The financial market is mostly affected by any of these forms which in turn lead to problematic financial transactions.

Opportunistic behavior

Asymmetric information leads to various problems out of which the opportunistic behavior is the most risky situation. Opportunistic behavior is a situation in which executives and managers of a company tend to differentiate the information. The original information is conveyed in two different ways to the people working in the organization and to the outsiders. (Karuratna, 2000). This is done to improve their contacts and financial transactions through which they can maximize their utilization of funds. This in turn affects the investors as they are not provided with proper information. Since the information is misinterpreted by the managers it leads to the predicament called as the opportunistic behavior. (Sharpe, 1990). The managers make use of this opportunity and their reported earnings get gradually increased. The opportunistic behavior shows desire of the managers and their urge to move on with the financial transactions. Managerial discretion may add up to the already sustaining problems there by resulting in loss to the people involved in the contract. In addition to that, it eventually increases discretion among the managers which also leads to loss in the amount of shares. (Sun, 2008). The shareholders tend to invest more money in a particular company and managers take advantage of this situation.

In a competitive financial market, opportunistic behavior poses greater risk to exporters as well as the party involved in transaction. The terms of contract are also not specified properly in the financial document. There are also two types of opportunistic behavior prevalent in financial markets. Opportunism concerned with products and goods are known as adverse selection. (Fu, 1996). Behavior related to legal proceedings and price of a product are called as moral hazard.

The negative consequences of opportunistic behavior include reduction in the price of goods and shares and reduction in profit of the concerned firm. As the numbers of financial problems have increased in comparison to the past, the government has proposed certain policies to counteract the negative impacts of asymmetric information. As a result of it, the companies implement various strategies to explain the investors about shares and products. This will certainly reduce the numbers of opportunistic behavior in the financial markets.

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