Limits of Unraveling:

Evidence on Voluntary Information Disclosure

Franziska Brendel*

University of Duisburg-Essen, Germany

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In an otherwise ideal market with private quality information on the sellers' side, sellers should disclose their private information voluntarily. As high-quality sellers disclose in order to distinguish themselves from competitors, lower quality sellers will also have an incentive to disclose in order to distinguish themselves from competitors with even lower quality. Hence, all but the seller with the lowest quality should ultimately disclose quality information, a phenomenon known as unraveling. Unraveling is a simple prediction derived from theory. However, it hinges on a number of assumptions, some of which are not quite trivial. Empirical evidence from the field and from the lab suggests that not all sellers disclose. The aim of this paper is to review existing studies for reasons thereof. Which *crucial* assumptions of the theory are not met in reality? I find that one essential violation is limited rationality on the buyers' side. Buyers systematically fail to correctly judge sellers' non-disclosure as a sign for bad quality, especially when the market situation becomes more complex. Sellers, in turn, mostly act quite rational and best respond.

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* Faculty of Economics and Business Administration, Berliner Platz 6-8, 45127 Essen, Germany; email: franziska.brendel@ibes.uni-due.de.