

# **Communication and Hidden Action: Evidence from a Person-to-Person Lending Experiment**

## **Abstract:**

We report the results of a laboratory experiment which examines the impact of precontractual communication in person-to-person lending. We show that potential hidden action undermines the positive effect of communication on repayment behavior and credit provision. In our baseline condition, where strategic defaults by borrowers are revealed to lenders, pre-contractual communication reduces strategic default and increases credit provision.

In our main condition, where strategic defaults are hidden behind a veil of uncertainty, we find a substantially weaker impact of communication. Borrowers are more likely to renege on repayment promises when they can hide opportunistic behavior from lenders.

The paper is joint work with Jan Schmitz (ETH Zurich) and Christian Zehnder (University of Lausanne)

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