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Columbia Business School International Faculty Profile

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*Although he originally intended to become an engineer, **Professor Daniel Paravisini**'s experience starting a small business in Venezuela altered his course. In this interview, the assistant professor of finance and economics at Columbia Business School discusses how the challenges and successes of entrepreneurship led him into academia and continue to shape his research.*

You originally studied mechanical engineering?

Yes, I chose mechanical engineering because everyone in my family is an engineer and that was all I knew. Although, in high school I filled out a questionnaire that was supposed to tell you your vocation, and it told me that I ought to be in business or economics, which was funny at the time because I didn't know what business or economics was. So I said, "This is clearly wrong! Everybody becomes an engineer, so I have to become an engineer." But eventually everything turned around, and now it seems that the vocational test was right.

From engineering how did you decide to pursue an MBA?

I did well in engineering, but I wasn't super interested in it. I started a business with some friends, partly motivated by our hobby, rock climbing, [and] partly motivated by the fact that we had no money. We started importing climbing gear, then we started giving climbing lessons, then we started importing Merrill footwear, which at the time was a smaller brand than it is now. By the time I graduated from college, Merrill had given us the exclusive distribution of their brand in Venezuela and Colombia. So choosing between becoming an engineer and taking care of the business, both of which would have been full time, I decided to go with the business—much to the dismay of my parents, of course!

But, as the business started growing and thriving, my business partner and I very quickly realized that we couldn't handle it. I didn't have the tools, so I entered an MBA program. And there something clicked; I changed paths in the first semester. I realized that I really enjoyed thinking about business problems more than the day-to-day of actually running a business. I sold my portion of the business, finished the MBA and began to teach microeconomics and do research at the school where I received my MBA. From there I went to MIT for my PhD.

Is an MBA a popular degree in Venezuela?

The proportion of the Venezuelan population holding MBAs is a lot lower than in the U.S. But having an MBA is a must if you want to do business in a large corporation. Many of

my friends in Venezuela have completed MBAs because they couldn't advance anymore without it; it's similar to how it is here. Networks are important in the U.S., but they are super important in Venezuela—in emerging markets there is a general concern that skills are not rewarded by the market the way they should be.

How did you start to develop your specific academic interests in financial institutions and banking?

My interest in financial systems came from firsthand annoyance with the financial markets in Venezuela. It was a lot of work for our business to get financing, even though we were sure everything we were doing was right—as every entrepreneur is! And I just did not understand why. Banks are big. They have lots of capital sitting there buying government bonds, at least in Latin America. You go to a loan officer and present them with what you think is a good idea, and you get a 10th of the money you are asking for. I didn't understand why, and the answers in emerging markets are not that clear.

So I went looking for the data to answer the following question: “How does the liquidity of a bank affect the ability of banks to issue loans?” And to answer that question thoroughly I needed to be able to go to a bunch of banks, look at every single loan the banks issued, aggregate the data, and see how the quality of the loans change in time and when the cash on the bank's balance sheet changed. That is basically impossible in most countries, but not in Argentina. In Argentina you can type in a name in a Web page, and it will tell me how much you owe on each of your credit cards, on each of your mortgages and, if you have a business, how much each of your businesses owe to every bank in the financial system. And that was exactly what I needed to answer the question that I was posing.

Some of your other research addresses small businesses more specifically. Was that research also motivated by your specific experience with your business?

One of my interests was corporate development: how to use research to help poor countries grow. One paper that I wrote was about programs called “on-lending,” which means that the government wants to subsidize small firms, for example, through the banking sector. The idea is that banks have the expertise of lending money and the expertise of choosing good projects, so if the government wants to lend money to small businesses, why doesn't it just outsource the screening to the banking sector? The government lends money to a bank and the bank allocates the money to small businesses, and everyone wins. In fact, 30 percent of the money that the World Bank spends helping small industries is all done through local banks.

Given the size of this type of program and that in theory it sounds like a great idea, I wanted to do something empirical to test its success. Because the other side of the argument is that, in principal, if the bank is not financially constrained, the bank will have already chosen the good projects and will have little interest in expanding credit to the marginal ones that are not as good as the ones that they have lent to already. And since money is fungible—I can call a dollar that I was going to give you anyway a program dollar—the bank doesn't have to expend additional credit to fulfill this requirement. It is a hard question to assess empirically.

I looked at one of these programs in Argentina, and I found that when banks received a dollar of program money they took borrowers that met the target criteria—that were already getting money from them—and they relabeled those loans as program loans. The impact on access to credit by new borrowers was super small, at least within the target group.

What I did find, which I linked back to the other part of the research on liquidity I did, was that banks actually expanded credit. So when they received this dollar they didn't expand credit to the small guys, but they did expand credit. Immediately they expanded credit of around 70 cents per dollar, and within a year for every dollar that they received they expanded lending by even more than a dollar; there was a multiplier effect. So small banks—the program worked through small banks—in Argentina were actually constrained in their access to capital. They used the fungibility of money to avoid the targeting rules, but they did expand lending, and it went to other projects.

What research are you working on now?

I'm working on the notion that a lot of the information in credit markets, and in banking in particular, is soft—soft in the sense that it is very hard to put onto a piece of paper and transmit. That's why it is very hard to lend to small businesses, because the way to lend to these businesses is to visit the business and get some sort of “vibe”—if the people are responsible, if they are going to repay, if the idea is good. But these things are very hard to write down. And from the bank's perspective, there are limits on how much you can lend because the information is soft. And because the information is soft, it has to be attached to the bank's human capital, usually loan officers. But if you look at the tenure of loan officers at a specific firm, it is actually quite short. There is a lot of turnover and potentially an enormous loss of information every time there is turnover. There must be market forces that are pushing this. What I want to do is measure how loan-officer turnover affects a firm and its access to credit, given that we tend to believe that there is a big swath of information that is wiped out the moment the loan officer changes. We are using internal bank data to test this.

I'm also starting to look at financial contagion. The notion of financial contagion across countries is something that we have all read about in the news: Turkey has a problem, and then Brazil goes down and Argentina's bonds go down as well. But does anything that happens in Turkey contain any information that I didn't know about Brazil? You tend to think that it is unlikely. But the link that research has established is the financial institutions. The investors in emerging markets are a select few. They have a limited amount of cash and capital to allocate to a portfolio—for example, a portion in Turkey and part in Brazil. And once Turkey gets hit, the investors have a problem; they don't have enough money. So it has nothing to do with Brazil. Brazil wasn't ill, but because it is close to a particular person or financial institution, it gets sick.

The same idea can happen across sectors. Imagine you have the automotive industry and the food industry. The automotive industry might be sick, and the financial institutions that lend to them might be hit. And if the same financial institution is also lending to the food industry, then all of a sudden the food industry might have more difficulty. It is less obvious because it might be compounded by the pure business cycle—the economy could be cooling down, and all businesses could be doing poorly due to poor fundamentals. And one question that I want to answer is how to untangle these two effects and how to put a number on contagion and to look at how it has varied over time.

Do you stay connected with Venezuela other than in your research?

Yes, I teach in Venezuela, at the school where I received my MBA. I am there a couple of weeks each year, and I teach short programs on corporate finance. And I am always in touch with the researchers there, so I have a continuing link.

What are you interested in teaching in the future?

I would be very happy to teach a class on financial institutions and banking in general. There is an enormous variety in the type and way that financial institutions operate across developed and developing economies but also in the quality of regulation, as an example. These issues will be particularly important to understand, especially for students interested in doing business globally.

In your class you are famous for incorporating movie references into your lectures. Were you a big American movie junky growing up?

Yes, I am a big fan of movies, not only American but all films. But the more obscure references I can't use in the classroom. I have to keep it to *Pretty Woman* and *Wall Street* so that everyone will know what I am talking about.