Determinants of the Low SME Loan-Application Approval Rate in Croatia: A Latent-variable Structural Equations Approach

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Non-Technical Summary

The paper proposes a new methodological framework for investigating consistency in loan assessment decisions and determinants of loan approval based on structural equation modelling and covariance structure analysis. We focus on a governmental SME loan programme in Croatia and investigate possible reasons for low loan approval rate that occurred in spite of interest rates subsidisation and sufficient supply of the loan funds.

The novelty of the methodological approach taken is that it enables simultaneous investigation of the determinants of the loan approval and testing for consistency in the loan assessment decisions, which need not be assumed. We test several hypotheses about consistency in the loan approval decisions and lending preferences in Croatia. The empirical findings reject overall consistency of criteria but indicate a preference toward smaller loans. Among all SME loan requests, banks preferred smaller firms that requested smaller loans. The results suggest that individual banks differ in their criteria and in their loan-size preferences and that there is no positive correlation between the bank's size and its loan-size preference.

KEY WORDS: commercial banks, credit rationing, latent variable models, loan assessment, small and medium enterprises