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FINANCIAL SERVICES FOR SMES PROGRAM

QUARTERLY REPORT

JANUARY 1, 2007 – MARCH 31, 2007

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EXECUTIVE SUMMARY

The past quarter showed continued progress in the Program's individual work plans with its partners, as well as special events on matters of interest and importance to USAID, Program partners, and other stakeholders.

Technical assistance entered a further "tactical" phase with partner banks, that is, a phase that focuses largely on design and implementation of new credit risk methodologies and products geared to the SME segment specifically. This approach is a logical extension of earlier phases involving the creation or upgrading of SME business units, strategies and business plans. The overall idea is to create the business platforms needed for partner banks to become "SME operational". These business platforms incorporate the commercial, product and risk areas, along with their supporting infrastructure in the systems and human resource units of the respective banks.

Special events included two workshops with a focus on the importance of proper SME credit risk management. These workshops, which were carried out for both financial institutions and the regulatory authorities (the Salvadoran Financial System Superintendence, or SSF), highlighted the importance of developing a more effective and tailored risk management and supervisory process respectively for the Salvadoran SME segment. This workshop was complemented by smaller, special purpose activities involving some of the forum's key foreign participants, including a breakfast for representatives of the local media, and a visit by these guest experts and representatives of the project/USAID to the Superintendent of the SSF. This visit was to discuss key conclusions of the event as well as desirable next steps for making the local financial regulatory regime for the SME segment more up to date and effective.

These forums and related activities were geared to continuing the development and reinforcement of the themes of earlier activities, such as the work study trip to Colombia, the SME client culture workshop and SME FTA/Finance special events over the course of 2006. Collectively, these activities are aimed at demonstrating the importance of the SME segment and at highlighting ways of better addressing the SME finance challenge. Additionally, they are intended to complement and make more broadly meaningful individual SME efforts at Program partner institutions.

As a result of all the preceding, including individually tailored consultant interventions at the institutional level, and special purpose forums and other activities for program partners and other stakeholders, an SME banking dynamic continues to gain ever greater momentum in El Salvador. Continued and intensifying interest in project technical assistance, on the part of partner banks, underscores the preceding observation. The fact that banks are also starting to contribute meaningfully to project cost mitigation further demonstrates the seriousness of their commitment.

I. INTRODUCTION TO USAID'S FINANCIAL SERVICES FOR SMES PROGRAM

Chemonics International Inc. in conjunction with our consortium members Crimson Capital, Enterprising Solutions Global Consulting, International Consulting Consortium (ICC), Shorebank International, and Skol & Associates, is pleased to present our quarterly report for the Financial Services for SMEs program for the period January 2007 through March 2007. In Section I, we provide an overview of the objectives of the project and activities to date. In Section II, we provide a detailed summary of the main activities and accomplishments during the period.

A. Background

While El Salvador has developed a strong macroeconomic framework that has encouraged stability, allowed for dollarization, and encouraged lenders to make funding available, it has been unable to attract much investment, create new jobs, and make further inroads to reduce poverty. Growth and job creation will likely come from the diversification and expansion of more competitive SMEs in manufacturing, services, and agriculture. With the introduction of CAFTA, these SMEs are well positioned for significant growth and even greater contributions to El Salvador's economy over the next decade.

Despite their potential, however, SMEs face a number of challenges to reach new markets and grow their businesses. In a 2002 survey conducted by FUNDAPYME, an overwhelming number of SMEs cited the lack of access to financial services as the major constraint to the growth of their businesses. USAID/El Salvador has identified two major developmental challenges in the financial sector:

- SMEs lack access to appropriate financial products and services.
- Non-bank financial institutions (NBFIs) lack access to commercial sources of funds and savings.

USAID's Financial Services for SMEs program is addressing these problems by working with commercial financial institutions to increase access to credit and other financial services for small and medium enterprises as well as further strengthen the provision of microfinance in El Salvador by assisting two microfinance institutions (MFIs) to become regulated non-bank financial institutions (NBFIs) under the SSF.

B. Program Objectives

The specific objective of the Financial Services for SMEs Program is to enable no less than nine financial institutions (FIs) to expand lending and other financial services to underserved markets and introduce viable loan products that better serve the financing needs of SMEs. The Program is expected to increase the number of new SME borrowers by at least 10 percent. In addition, the program will increase the volume of loans to SMEs by at least 20 percent.

Bearing in mind USAID’s SO 2, *Economic Freedom: Open, Diversified Expanding Economies* and IR 2.3 *Broader Access to Financial Markets and Services*, the Program will work to achieve two project intermediate results (PIRs) based on program objectives and the tasks identified in the scope of work.

Figure 1. Financial Services for SMEs Revised Results Framework



The program has provided direct technical assistance and training to six commercial financial institutions and one federation of credit unions and workers’ banks to increase productivity and reduce the costs of serving SMEs as well as facilitate the development of more demand-driven financial solutions for the SME market. The Program will also find opportunities to link SMEs receiving technical assistance directly with our FI partners. The Program will increase the number of SMEs with access to finance, the volume of financial services delivered to SMEs, and the quality of financial products and services directed at SMEs.

In addition, the program is working with two MFIs to ensure they will become regulated NBFIs within the first two years of implementation of this task order.

II. PROJECT ACTIVITIES AND ACCOMPLISHMENTS

This past quarter the project continued to operate actively with its partner entities, closely following on earlier technical assistance activities that were covered in prior quarterly reports. Technical assistance geared to improving SME risk management and product portfolios was initiated with most partner financial institutions. Special purpose forums focused on SME risk management and banking supervision were held in March that were deemed by participants to be extremely useful in furthering their SME business growth efforts. In summation, positive momentum continues to develop with partner entities as technical assistance and other activities move forward. There seems to be growing awareness not only of the strategic importance of this sector, but of increasing competition for this segment's business among the country's major banks.

During this period, the team proactively organized and implemented a participatory work planning exercise for Year Two (March 2007-March 2008) of the Program. The two-day work planning exercise involved all members of the Program team, Chemonics' home office director, the USAID CTO and Strategic Objective team leaders, Chemonics' subcontractors, and short-term consultants actively involved in project initiatives. The purpose of this exercise was to achieve consensus as to priority activities, objectives and resource allocations for all partner institutions for the following year, with particular emphasis on the period ending September 30, 2007 (fiscal year end). This exercise took into account what we have done with each institution, the level of commitment and reciprocity they have shown, anticipated impacts in terms of new clients and loans extended, and similar factors. Activities described in the following sections largely conform to work plan parameters for each institution.

Several important findings and recommendations resulted from the work planning exercise that will influence project implementation going forward:

Results framework. An extended Project Intermediate Result (PIR) 1 was included to reflect both the direct results of the project in creating or consolidating dedicated SME capacity and the indirect effects of this reflected in the expansion of credit and other financial services offered to SMEs. Existing Key Results Areas (KRAs) were redefined in simpler and more concrete terms, and the two original KRAs under PIR 2 have been eliminated to reflect a more accurate basis for performance evaluation and one that is more closely aligned with the current perception of USAID;

Focus. In order to maximize available resources, priority will be given to those banks offering the highest potential for goal achievement. In practice this will mean that: (i) no additional work will be undertaken with FEDECREDITO¹; (ii) limited interventions will

¹ As indicated in our Year One work plan, technical assistance to FEDECREDITO was always intended to be limited to the development of a series of workshops on best practices in SME lending, designed to be Training of Trainers for both bank managers and FEDECREDITO training staff. The goal of the training program was to build the capacity of the banks as well as FEDECREDITO to replicate the training series on their own. FEDECREDITO is currently replicating the courses in SME lending developed by the Program, ensuring that Program efforts to build capacities in SME lending in Workers' Banks and cooperatives continue.

be undertaken with Banco Agrícola and Banco Hipotecario²; (iii) emphasis will be placed on Banco de América Central (BAC), Banco Cuscatlán, Banco Salvadoreño and Banco Promérica, and (iv) in the case of the two NBFIs, priority will be given to a limited number of areas considered essential to the regulation process. Available LOE will be distributed in proportion to the above ranking, with the largest allocations going to BAC, Cuscatlán, Promérica and Salvadoreño. This redistribution of LOE will allow us to focus technical assistance on those institutions with the most potential for significantly increasing loans to SMEs in the short-term (six to twelve months).

Systemic activities will be limited to those considered essential to improve the overall enabling (including legislative/normative) environment in which FI SME activities operate. We have reprioritized activities with Banco Agrícola and Banco Hipotecario in order to redistribute level of effort to these systemic efforts.

Performance monitoring. Results indicators were reduced from the current list of 35 indicators to 17 indicators more reflective of the Program's capacity to support the development of SME lending capacity in Salvadorian banks, and to help two NBFIs to become regulated.

The Year 2 work plan has been included as an annex to this report.

A. PIR 1: Increased Access for SMEs to Credit and other Financial Services

Work plan implementation continued this past quarter involving technical assistance for seven approved FI partners geared specifically to increasing and improving their engagement with local small and medium enterprises through improvements to their SME organizations, products and risk management. Our FI partners include:

- Banco Agrícola
- Banco Salvadoreño
- Banco Cuscatlán
- Banco de América Central
- Banco Hipotecario
- Banco Promérica.

The specific details of activities with these partners are provided in the following sections.

A1. SME Risk Workshops for Major Stakeholders of the Program

Two major events were carried out by the project from March 6-9, 2007. The first, a one-day workshop on March 6 with the title "Risk Management Related to SME Finance" involved participants from the SME risk management and commercial areas of partner institutions. Approximately 57 people attended from partner banks Banco Salvadoreño, Banco Hipotecario, Banco Cuscatlán, Banco Agrícola, Banco de América Central and

² Planned interventions with Agrícola and Hipotecario are limited based on their demonstrated interest and capacity in expanding lending to SMEs. However, should either bank show a marked increase in interest in working with the Program, we may consider additional interventions.

Banco Promérica. Non-bank partners who also sent participants included Apoyo Integral and FEDÉCREDITO. The program was officially inaugurated by the executive director of ABANSA (Salvadoran Banking Association), Carlos Cáceres, as well as the Program CTO, Sandra Duarte, and COP, Michael McNertney. Key presenters included Chilean credit risk authority Max Errázuriz, Peruvian consultant Jorge Daly, and Colombian risk modeling expert Lilian Simbaqueba. In addition to formal presentations, a number of inter-active sessions were held involving moderated discussion and audience participation. Copies of all presentations as well as basic SME risk management “tool kits” were provided to all participants. Key conclusions arising from this event included:

- SME risk management should be approached on a specialized basis; it is not appropriate to apply either corporate or micro-credit methodologies to this segment, though elements common to both other methodologies may be appropriate in certain cases.
- It is critical that both the commercial and risk areas work in partnership in carrying out an effective SME credit initiative, both in establishing risk criteria and monitoring portfolio behavior.
- SME risk classification involves both quantitative and qualitative elements, and while a certain element of standardized grading (or “credit scoring”) may be applicable (based on economic sector risk and other such “macro” elements), human intervention is indispensable – both for quantitative (including construction of reliable financial statements, cash flows and other such elements, where these are lacking in small borrowers) and qualitative (including character and reputation evaluation) aspects.
- Repayment capacity (based on firm cash flow) and commitment (based on credit history) are key considerations in SME risk classification; physical collateral and guarantees are only secondary protections, and should not be the primary basis for credit approval and extension.

Participant feedback to this event was highly positive, and a strong consensus that such elements should be adopted in El Salvador was apparent. It should be noted that the project is also collaborating with focused, bank-by-bank technical assistance geared to developing or improving SME credit risk management systems in most of its partner institutions (see below). These methodologies will incorporate elements such as those mentioned above.

A final point: feedback was solicited as to obstacles or impediments in the current financial regulatory regime in San Salvador, which is discussed in the following section.

The second event held on March 7 and 8, involved a two-day workshop for personnel from the banking regulatory authority, the Superintendency of the Financial System (SSF) titled “The Role of the SSF in SME Risk Management.” This was seen as a complementary event to that for financial institutions mentioned above and focused on the role the SSF can play to facilitate local SME access to credit, while preserving systemic integrity and maintaining a high level of credit quality on the part of financial intermediaries in the system.

This event was officially opened (and closed) by the head of the SSF, Superintendent Luis Armando Montenegro, as well as USAID Director, Deborah Kennedy. Forty-two

people from various areas of the SSF who have a role in SME regulation and supervision attended. Speakers included Colombian SME authority Juan Carlos Ramírez, former Bolivian Superintendent Jacques Trigo, Peruvian consultant Jorge Daly, and Colombian banking supervisory official Juliana Lagos. The event again included inter-active sessions involving discussion with, and feedback from, participants as well as formal presentations.

Feedback from participants as well as Superintendent Montenegro was highly positive and encouraging. Participants expressed a much clearer understanding of SMEs as a distinct and critical segment of Salvadoran business enterprises, one that requires specialized and high priority treatment and business/risk management by the banks. Other key conclusions arising from this event included:

- There is a compelling need to transition to a regulatory and supervisory regime more compatible with the principles of Basil II; one that is predicated on “risk based supervision” and that requires supervisors to assume the role of risk analysts rather than traditional “checklist” auditors.
- This new regulatory regime, in keeping with Basil II principles, should be one that allows for banks and other financial intermediaries to develop their own SME risk management models and methodologies, depending on their targeted SME clientele and their risk characteristics; these credit risk management systems (or “SARCs” as they are known), should be subject to analysis and validation by the SSF, but the key point is that the banks be given the flexibility to develop their own proprietary models.
- Current SSF regulatory norms are extremely rigid and restrictive when it comes to SMEs; credits above \$100,000 effectively require “large corporate” treatment in terms of documentary and collateral requirements, which are infeasible for most small enterprises to satisfy (comments from participants in the bank event were conveyed to the SSF in this connection).
- There is a need for much more fluid communication between the SSF and regulated entities, especially in the increasingly important SME context.

As a consequence of this event and the conclusions that arose from it, certain understandings were achieved with Superintendent Montenegro as to next steps that might be jointly considered with the Program, with a view to improving the SME financial regulatory regime. These include:

- A work-study trip to visit the innovative Colombian banking supervisory body by prominent officials of the SSF, with a view to studying SME related supervisory activities aligned with “supervision by risk” principles of Basil II.
- Closer coordination and more regular discussion on normative challenges (such as those mentioned in the third bullet above) of the current regulatory regime between the banks and SSF, using the recently established ABANSA SME Committee as a vehicle for such discussions.
- Visits to the SSF by visiting project SME risk consultants, for purposes of better grounding its people in the elements of SARC and sound risk management for SMEs.

A letter summarizing the above conclusions was subsequently provided to the Superintendent.

A2. SME Technical Assistance with Partner Banks

The most recent phases of technical assistance with partner banks were carried out over the course of this past quarter. Seasoned external consultants were deployed for these latest interventions focused on Program KRAs 1.2 and 1.3: improved credit risk management and SME product development. Having evaluated partner banks' current SME organizational configurations, client management practices, business goals, target market niches, credit procedures, product ranges, MIS systems, and related factors during previous quarters, technical assistance in this phase was geared to jointly developing and implementing new product and credit risk methodologies for the most part.

The Program's first phase "higher level" interventions exposed our FI partners to solid SME banking models in order to demonstrate the viability and profitability of serving this segment. Second phase activities set the stage for developing integrated SME financial services delivery platforms, or business units within our FI partners. Third (current) phase activities focused on developing or improving SME delivery platforms directly, emphasizing SME product and credit risk approval capabilities.

A brief summary of highlights of technical interventions, and impacts of same where pertinent, with individual bank partners follows below:

Banco Promérica. Due to strategic planning, reorganization and other internal initiatives within this institution, they requested that we defer technical assistance interventions to the second quarter of the year. One consequence of their internal realignments was to reassign program counterparts Emilio Lopez and Ana Vilma de Bolaños to other parts of their organization, meaning that program activities will henceforth be coordinated by Ingrid Durán. We are assured by them nonetheless that they remain firmly committed to the program at the bank's most senior levels and we are actively planning with them specialized consultancies in the product and risk areas for the upcoming quarter. It should furthermore be noted that Ingrid Duran will head up a new SME business unit, currently in process of formation. This unit will have dedicated staff, support systems, and field operations in cities such as Santa Ana, Sonsonate and San Miguel, in addition to San Salvador. Much of the impetus for the creation of this unit came from earlier activities with the project (as documented in prior quarterly reports).

Banco Salvadoreño. Consultants Manuel Alegre and Max Errazuriz worked on parallel SME product and risk management initiatives at the bank over this past quarter. Manuel Alegre (of Shorebank International, a project consortium partner) did an evaluation of the bank's product portfolio geared to adjusting it for the SME segment specifically. This consultancy is largely complete, requiring only a final focus group session with bank SME customers (this is being undertaken by the bank) to validate, adjust and finalize the recommended short list of SME products. Consultant Max Errazuriz has worked on developing both a new SME credit and risk policy for the SME segment, as well as a parametric model for SME client risk classification, a first draft of which is now complete. Mr. Errazuriz will return to San Salvador in May to make any further

adjustments that he and the bank deem appropriate. This consultancy will therefore continue into the next quarter.

Banco Agrícola. Banco Agrícola is in process of acquisition by Bancolombia, which has been one of the major regional allies of the program as well as Latin American leaders in SME finance. This has necessitated a rethinking of our work plan with this institution, inasmuch as a great deal of what the program might have provided could be done by Bancolombia directly. We are currently seeking to define where we might collaborate most effectively with the bank at this point in time. Interaction with them during this past quarter has been limited for this reason.

Banco de América Central. Beginning late last year, consultant Juan Carlos Ramirez has undertaken a comprehensive strategic realignment of the bank so as to enable Banco de America Central to create an effective SME unit and comprehensive business initiative. During his prior interventions Mr. Ramirez aided the bank to design an integrated SME platform involving the marketing, client management, technology, product, and risk areas. He has also developed a schedule of tasks to be undertaken by the project, the bank, or jointly, so as to enable the bank to implement this new initiative. This bank appears quite committed and to be moving energetically to make this happen. They have invested themselves in developing a new SME credit risk methodology, using consultant Lilian Simbaqueba (identified by the project, and a guest speaker at our recent SME risk workshop for partner banks) for this purpose. Juan Carlos has focused largely on product development during his most recent interventions, and will be coordinating with local consultant Idalia Portillo on standardizing SME client management and risk classification procedures on his upcoming visits.

Banco Cuscatlán. The bank, which has had a corporate banking orientation heretofore, continues to show a strong commitment at its senior executive level to developing its SME business. They have furthermore assured us that our joint SME initiative will not be affected by their imminent acquisition by Citigroup, the latter having explicitly endorsed their SME business initiative as a corporate priority in El Salvador as elsewhere in Latin America. We deployed consultants Patricia Lopez and Esteban Salazar this past quarter to work on upgrading their SME product portfolio (and related client management practices) and risk management areas respectively. These consultancies, to be concluded in the quarter upcoming, will provide them with a new SME product menu, customer service protocol and risk management methodology.

Banco Hipotecario. Consultant Gonzalo Paz was deployed to develop a new business strategy for this institution. While his final report was concluded and his findings formally presented to the bank, local program consultants Alfredo Otero and Jose Basagoitia have continued to work with bank representatives to help develop a more effective and focused utilization of their resources, which it is generally felt could be better exploited than is currently the case.

In addition to the all the preceding consultancies, managing director Michael Gold and senior consultant Greg Jacobs of Crimson Capital (a project consortium member) held extended meetings with all six project partner banks as well as a number of other parties, including the SSF, ABANSA, BMI, SME Business Development Service (BDS)

providers, as well as individual SMEs. The purpose of their visit was to explore the current market and scope for products such as pre-export financing and leasing geared to SMEs. We will be seeking to further this initiative in the upcoming months, focusing on those parties that show the best potential for undertaking this activity.

A3. Training and Capacity Building for Workers' Banks through FEDECREDITO

While the Shorebank program for Fedecredito (described in detail in prior quarterly reports) has concluded, it should be noted that Fedecredito trainers have begun to replicate it for other members of the federation not involved in the original trainings, ensuring that Program efforts to build capacities in SME lending in Workers' Banks and cooperatives continue. This continuation has been verified by program technical experts who attended the Fedecredito sessions to ensure it adhered to the sequences and content of the original Shorebank training modules.

A4. Major Successes and Lessons Learned

The program has advanced in SME business growth initiatives with its partner banks in a range of areas, building on technical assistance efforts of the preceding quarters, while adjusting and adapting work plans as jointly agreed with our local partners wherever appropriate. Our TA programs, focused on the creation or development of SME areas, product portfolios and risk management methodologies are intensifying. A factor we are detecting in the building momentum of our program is a heightened sense of competition, actual or potential, among SME focused financial institutions. The banks appear to be realizing this segment is attractive and potentially remunerative, and that if they do not pursue it more aggressively, their competitors surely will. The imminent arrival of Bancolombia (via its acquisition of Banco Agrícola), an SME powerhouse in Colombia, is one of the factors fuelling this perception. This development clearly works to the advantage of the project and USAID, by creating a greater sense of urgency toward SME activity at partner banks.

Further, highly successful special events (the risk workshops detailed in this report), as well as a number of focused newspaper articles, press releases and radio/TV segments continue to create a positive image of the project in its stakeholder community in El Salvador.

As highlighted in prior quarterly reports, it is proving useful to leverage regional centers with advanced SME expertise, such as Colombia and Chile, in order to further our efforts here in El Salvador. It is clear that there is SME cultural compatibility with those centers; SME experiences and lessons learned there are highly relevant to the Salvadoran context and SME access to finance challenge. Our relationships with individuals and entities based there, such as SME consultants, major financial institutions and banking regulatory bodies, have borne fruit, as is clear from Max Errázuriz, Juan Carlos Ramírez, and Juliana Lago's contributions to our workshops this past quarter. We shall continue to tap and develop our relationships and broader strategic alliances in the region as we move forward.

It has also become clearer to us that the impediments to SME access to finance reside not only in banks and SMEs, but in El Salvador's legal, tax and financial regulatory regimes,

not to mention the broader enabling environment in such areas as SME technical assistance, second story banks, and guarantee funds. We have begun to play a more active role with the SSF, as previously described in this report. The Program has started to investigate, with another USAID project focused on tax administration, certain problems the banks are encountering in obtaining timely tax data for credit approval purposes. In addition to the preceding, we have helped provide the impetus for the creation of an SME Committee at ABANSA, comprised of senior representatives of the country's major banks, which is geared to discussing and lobbying for improvements in areas of general concern to the SME oriented actors in the industry — areas such as the regulatory and tax regimes, among others. In the upcoming quarter, we anticipate broadening this systemic support to such areas as guarantee funds and SME advisory service providers and their linkages to finance.

B. PIR 2: Two NBFIs Newly Regulated

As with partner financial institutions, the program has been providing technical assistance to MFI partners, Apoyo Integral and AMC to assist them in becoming regulated NBFIs under the SSF. We continued to consult and coordinate closely with personnel from the Inter-American Development Bank (IDB) office in San Salvador, who share our interest in seeing these two MFIs become fully regulated. We describe below in greater detail initiatives undertaken with both participating entities during this reporting period.

B1. Technical Assistance with AMC

International consultant Miguel Rivarola was mobilized late last year to conduct an in depth diagnostic of AMC in San Miguel, to identify critical needs in order to attain regulated status, and to develop a road map that might serve as the basis for a transformation work plan for 2007 and beyond. This intervention was highly effective in surfacing a number of key issues across a diverse range of areas that AMC will need to deal with in order to achieve regulated status. Findings of this analysis included weakness in the corporate governance area (both of an organizational configuration and professional quality nature) and the need for improvements in such areas as systems, security and controls. This analysis also highlighted the need to develop a liability management plan and internal controls, among other things.

Mr. Rivarola returned to El Salvador to work with AMC this quarter, to conduct a feasibility study for achieving regulated status. He reviewed a number of areas and issues that are germane to the regulation effort, including the various components of the feasibility study for conversion, and provided a specific task list to be done before his next visit. He will return in June to complete the feasibility study. AMC appears to be fully committed to achieving this status as soon as is feasible.

B2. Technical Assistance with Apoyo Integral

A multi-faceted work plan has been refined in collaboration with Apoyo Integral, encompassing such areas as software development, deposit and/or credit product design/implementation, internal audit and controls, management information systems, liability/treasury management, risk management and personnel development.

Recent technical assistance has focused on development of Apoyo Integral's management information systems (MIS) in TOPAZ to support accounting and portfolio management functions appropriate for a regulated entity. Salvadoran consultants Idalia Estela Portillo Perez and William Castro successfully concluded their interventions in these areas, while Norma del Carmen Cabrera Rodriguez is currently developing certain IT technical manuals as well as a security system for use post-regulation. Apoyo Integral considers these elements essential to making a successful transition to fully regulated status, hence asked that they be priorities in our joint collaboration. They anticipate attaining fully regulated status by the beginning of the last quarter of this year, as things now stand.

Technical assistance to both Apoyo Integral and AMC are being closely coordinated with the Inter-American Development Bank (IDB) to avoid duplication of efforts and ensure maximum synergies are realized between our two programs.

C. Work Plan and Performance Monitoring Plan Development

One of the first activities carried out on January 2007 was the gathering, processing, and finalizing of December 2006 indicators. Beginning with the quarter ending in December, it was agreed with the CTO that modifications would be made to the adjustments done to certain indicators. More specifically, it was agreed that the number of new credits would not be brought in line with the number of new clients, (until September 2006, the real value of new credits was adjusted so its result was never less than the number of new clients). This adjustment will not be made from this point forward, leaving the numbers as they originally stand in new credit and client totals.

In January visits were carried out to Banco Salvadoreño and Banco Hipotecario to verify the methodology being used to capture data for the indicators. It was found that the processes used comply with Program requirements, except for Banco Salvadoreño in that they are still unable to segregate their data by gender. Some alternatives have been suggested to them by the Program, but implementation of these alternatives has been delayed due to the acquisition process the bank is currently facing with HSBC.

During February, the M&E specialist participated in the preparation of the 2007 Work Plan. In these sessions it was suggested that the concepts of Program Intermediate Results (PIR 1 & PIR2) be redesigned by modifying the KRAs to focus on qualitative results as well as quantitative ones. Additionally, it was also recommended that the number of indicators to be measured by the Program be reduced leaving only the most critical and relevant. Finally, four new qualitative indicators that will be monitored starting March 2007 were created.

Once the exercise of creating the new work plan was complete, several modifications to the Performance Monitoring Plan (PMP) were done, so as to make it compatible with the new work plan. The modifications to the PMP will include the indicator reference sheets for the new qualitative indicators that will be measured starting in March 2007.

The Data Quality Assessments (DQAs) were started by mid-February; the Program CTO carried out several visits to check the mechanisms being used to generate program indicators, the manner in which the banks send information, and if procedures used are reliable, accurate and standardized. The DQAs will be completed in April.

At the beginning of March, the M&E specialist presented the consolidated indicators as of December 2006 in a risk workshop for the partner banks. The presentation helped the participant institutions to realize the potential SME market that still exists and the importance of sending complete and timely data to the Program. As a practical example, Banco Promérica, which has heretofore been late in sending data, has satisfactorily responded and become the first institution in sending information for the quarter just passed.

III. ACTIVITIES PLANNED FOR NEXT QUARTER

This next quarter we plan to advance all technical assistance initiatives with partner institutions that are currently underway, refining and adapting these to each institution's evolving needs and objectives as we move forward. These initiatives will be conducted not only by external consultants, but increasingly by permanent technical staff of the project here in San Salvador. This quarter will also see a continuation of our systemic support efforts on a parallel track with individual bank partner initiatives. Areas of focus with our institutional partners and other parties will include the following:

A. PIR 1: Increased Access for SMEs to Credit and other Financial Services

Definition of target segments/re-alignment for effective penetration and management. To assist certain FI partners, consultants will continue to work with their SME units to identify attractive and bankable niches within that segment. The program will help partner banks to develop or refine the business strategies, products and/or risk management methodologies appropriate for the customer bases selected.

Adjustment of SME organizational structure. The program will continue to assist certain bank partners, including Banco de America Central, Banco Hipotecario and Banco Cuscatlan, to more clearly define and/or implement specialized SME units, and possibly incentive schemes, to focus on the expansion of SME lending and other activities.

Risk management. The program will continue to provide targeted technical assistance geared to developing more effective SME oriented credit risk analysis and management methodologies in all partner banks.

Product development. The program will continue to assist all FI partners to develop new products for SMEs, based on careful analysis and identification of SME customer financial needs and deficiencies.

Special events. A work/study trip for the SSF with a focus on SME banking supervision/risk management is contemplated for this upcoming quarter. It is envisioned that a select group of senior supervisory personnel will travel to Colombia, to spend time observing the practices in those places, both at the Colombian Superintendency and major SME focused commercial banks.

Guarantee fund development. We are actively planning to assess the possibility of creating a more effective guarantee fund capability here in El Salvador, as a means of catalyzing more accelerated SME credit expansion. Consultant Gabriel Reyes (former president and architect of the highly successful Colombian National Guarantee Fund system) is expected to collaborate in this effort, foreseen in June.

Cost sharing with partner banks. We have developed a proposal for a payment and accounting mechanism that should enable us to share costs of technical assistance with partner banks in a straightforward and transparent fashion. We have received USAID approval for this mechanism, and it is now in operation with partner banks.

B. PIR 2: Two NBFIs Newly Regulated

AMC conversion. We propose to continue to implement the following activities, among others, in the upcoming quarter:

- A broad based feasibility study and business plan relating directly to the institution's conversion and the requirements of same.
- Elaboration of a prospectus geared to attracting foreign investors.

These items will focus on developing realistic financial projections for a post conversion period, as well as on qualitative issues such as internal controls, marketing, public relations and corporate governance, among others.

Apoyo Integral conversion. We anticipate the following activities in the quarter upcoming:

- Continued support in adapting TOPAZ 5.0 liability management modules;
- Continued support in the design of security and controls systems in the operating, facilities and technical areas, as well as in the IT and data communications systems among the head office and agency network;
- Support in the development and testing of liability products on a pilot basis.

C. Performance Monitoring

Monitoring and evaluation activities to be undertaken next quarter include:

- Completion of Data Quality Assessments;
- Audits of FI to review data gathering methodologies and improve their system's routines to generate required data;
- Continued work on the Program's indicator system;
- Training of Program operation's assistant in M&E and indicator generation.

ANNEX A. QUARTERLY INDICATORS

Key Indicators as of March 2007 and % of FY07 target reached

USAID Code	Indicator	Name		Target for FY06 (4 months)	Target for FY07	Target for FY08	Target for FY09 (9 months)	Actual as of March-07	% of FY07 target reached
			10,939	11,377	13,439	15,439	17,839		
3a	OI.6	Number of active new small and medium enterprise borrowers		438	2,500	4,500	6,900	996	40%
			16,612	18,362	20,637	23,857	27,712		
3b	OI.7	Number of active new loans to small and medium enterprises		1,750	4,025	7,245	11,100	3,323	83%
				\$ 48,993	\$ 146,973	\$ 323,343	\$ 534,988		
3c	OI.5	Total value of active new loans to small and medium enterprises (SMEs) in thousands		\$ 48,993	\$ 97,980	\$ 176,370	\$ 211,645	\$ 81,615	83%
			-	2%	2%	2%	2%		
3d	RE.4	Delinquency rate of USAID-assisted regulated financial institutions (FIs) - 90 days	less than	2%	2%	2%	2%	1.79%	
			-	200	600	1,000	1,500	518	86%
3e	T.1	Number of people trained under USAID financial services programs		200	400	400	500		
			19,779	22,779	24,779	26,779			
3f	OI.9a	Number of active new borrowers of USAID-assisted microfinance institutions (MFIs)		3,000	5,000	7,000		8,347	167%
			26,144	29,644	32,144	34,894			
3g	OI.9	Total number of active new loans by USAID-assisted microfinance institutions (MFIs)		3,500	6,000	8,750		7,361	123%
			9,065	10,115	11,865	14,315			
	OI.10	Number of active micro loans ≤ \$400.00		1,050	1,750	2,450		1,382	79%

C:\M&E work folder\Indicadores\Alcance\Marzo 2007\Key indicators & % of target reached as of March 2007.xls

- Indicator 3a., “New SME Borrowers” increased 102% from the past quarter, and as of March 2007 is 996 new firms. This represents 40% of the target to be reached by September 2007. Historical patterns indicate this to be the slowest seasonal period of the year, and we anticipate pickup in growth levels in upcoming quarters.
- Indicator 3b., “New Loans” increased this quarter by 17.6%, from 2,825 to 3,323 new loans. The percentage of target reached is 83% of that set for September 2007.
- Regarding indicator 3c., there has been a decrease of 19% from \$100,994 to \$81,615 in total of active new loans. The decrease is due to the exclusion of the SME portfolio of the two MFIs, which will not be counted in any of the SME indicators from this point forward, but were considered previously.
- Indicator 3d. remains below the 2% ceiling. As of March 2007 there was a consolidated average of 1.76% for our partner institutions.
- As a result of the two Risk Workshops conducted by the program, the indicator 3e. grew from 419 to 518 people trained, which represents a growth of 23% and equals 86% of the proposed target for September 2007.
- Indicator 3f. has increased 10% from previous quarters (7,530 to 8,347 new borrowers) which is 67% above the target set for September 2007.
- Indicator 3g. shows a similar situation to that of the previous indicator, presenting an increase of 6.99% of new loans from the previous quarter. It is 23% more than the final target set for September 2007.
- Finally the indicator representing number of credits of \$400 or less reflects 1,382 new credits, that represents a decrease of 45% from previous quarter (2,520 to 1,382 new loans). This is equal to 79% of target set for September 2007.

ANNEX B. MONITORING AND PROGRESS REPORT

The following tables show change in SME borrowers and loans from baselines, segregated by institution, gender and enterprise size. Since there are no targets set quarter by quarter, the indicator reference sheets will not be presented in this report.

Also Banco Salvadoreño has not been able to send data for the DCA indicators, they will be annexed as soon as the program receives the figures.

Indicator OI.3 Number of Loans disaggregated by Gender and Enterprise size
As of March 31, 2007

Banco Cuscatlán	Male	1,418	79%	Small	Male	233	73%
					Female	85	27%
					Total Small	318	
	Female	388	21%	Medium	Male	1,185	80%
					Female	303	20%
					Total Medium	1,488	
Totals	1,806				1,806		
Banco Agrícola	Male	3,512	65%	Small	Male	1,907	62%
					Female	1,155	38%
					Total Small	3,062	
	Female	1,853	35%	Medium	Male	1,605	70%
					Female	698	30%
					Total Medium	2,303	
Totals	5,365				5,365		
Banco de América Central	Male	462	75%	Small	Male	236	75%
					Female	77	25%
					Total Small	313	
	Female	157	25%	Medium	Male	226	74%
					Female	80	26%
					Total Medium	306	
Totals	619				619		
Banco Hipotecario	Male	3,159	82%	Small	Male	2,500	80%
					Female	610	20%
					Total Small	3,110	
	Female	679	18%	Medium	Male	659	91%
					Female	69	9%
					Total Medium	728	
Totals	3,838				3,838		
Banco Salvadoreño	Male	4,286	73%	Small	Male	2,797	72%
					Female	1,088	28%
					Total Small	3,885	
	Female	1,558	27%	Medium	Male	1,489	76%
					Female	470	24%
					Total Medium	1,959	
Totals	5,844				5,844		
Banco Promerica	Male	379	71%	Small	Male	227	71%
					Female	93	29%
					Total Small	320	
	Female	156	29%	Medium	Male	152	71%
					Female	63	29%
					Total Medium	215	
Totals	535				535		
FEDECREDITO	Male	725	38%	Small	Male	725	38%
					Female	1,203	62%
					Total Small	1,928	
	Female	1,203	62%	Medium	Male	-	0%
					Female	-	0%
					Total Medium	-	
Totals	1,928				1,928		
Totals	Male	13,941	70%	Small	Male	8,625	67%
					Female	4,311	33%
					Total Small	12,936	
	Female	5,994	30%	Medium	Male	5,316	76%
					Female	1,683	24%
					Total Medium	6,999	
Totals	19,935				19,935		

Baseline Number of SME loans	16,612
Number of New SME Loans	3,323

Indicator OI.3 Number of Borrowers disaggregated by Gender and Enterprise size							
As of December 31, 2006							
Banco Cuscatlán	Male	767	79%	Small	Male	166	73%
					Female	60	27%
					Total Small	226	
	Female	209	21%	Medium	Male	601	80%
					Female	149	20%
					Total Medium	750	
Totals	976				976		
Banco Agrícola	Male	2,350	64%	Small	Male	1,502	61%
					Female	956	39%
					Total Small	2,458	
	Female	1,306	36%	Medium	Male	848	71%
					Female	350	29%
					Total Medium	1,198	
Totals	3,656				3,656		
Banco de América Central	Male	268	77%	Small	Male	166	81%
					Female	40	19%
					Total Small	206	
	Female	78	23%	Medium	Male	102	73%
					Female	38	27%
					Total Medium	140	
Totals	346				346		
Banco Hipotecario	Male	1,819	81%	Small	Male	1,584	80%
					Female	395	20%
					Total Small	1,979	
	Female	424	19%	Medium	Male	235	89%
					Female	29	11%
					Total Medium	264	
Totals	2,243				2,243		
Banco Salvadoreño	Male	1,973	73%	Small	Male	1,303	72%
					Female	507	28%
					Total Small	1,810	
	Female	719	27%	Medium	Male	670	76%
					Female	212	24%
					Total Medium	882	
Totals	2,692				2,692		
Banco Promerica	Male	196	71%	Small	Male	138	71%
					Female	56	29%
					Total Small	194	
	Female	80	29%	Medium	Male	58	71%
					Female	24	29%
					Total Medium	82	
Totals	276				276		
FEDECREDITO	Male	647	37%	Small	Male	647	37%
					Female	1,099	63%
					Total Small	1,746	
	Female	1,099	63%	Medium	Male	-	0%
					Female	-	0%
					Total Medium	-	
Totals	1,746				1,746		
Totals	Male	8,020	67%	Small	Male	5,506	64%
					Female	3,113	36%
					Total Small	8,619	
	Female	3,915	33%	Medium	Male	2,514	76%
					Female	802	24%
					Total Medium	3,316	
Totals	11,935				11,935		

Baseline number of SME Borrowers	10,939
Number of new SME Borrowers	996

Indicator OI.5 Total value of active new loans to MSEs As of March 31, 2007		
	SME Portfolio	%
Banco Cuscatlán	\$ 164,508	20.1%
Banco Agrícola	\$ 251,800	30.8%
Banco América Central	\$ 25,206	3.1%
Banco Hipotecario	\$ 132,352	16.2%
Banco Salvadoreño	\$ 190,853	23.4%
Banco Promerica	\$ 40,806	5.0%
FEDECREDITO	\$ 10,966	1.3%
Total	\$ 816,492	100.0%
Baseline Value	\$ 734,877	
Total Value of New loans	\$ 81,615	

Overall partner FIs presented consistent growth in their portfolios. Banco Agrícola, Banco Salvadoreño and Banco Cuscatlán have somewhat higher portfolios; Banco de América Central, Promérica and FEDECREDITO presented the lowest SME portfolios.

As of March 31, 2007				
Institution	Size	Average amount disbursed	Average Interest rate	Average loan term in months
Banco Cuscatlán	Small	\$ 70,738.38	9.49%	66.87
	Medium	\$ 124,359.14	8.75%	56.71
Banco Agrícola	Small	\$ 28,839.92	10.61%	105
	Medium	\$ 102,177.03	9.02%	82
Banco América Central	Small	\$ 18,844.58	10.25%	28
	Medium	\$ 75,567.02	9.24%	29
Banco Hipotecario	Small	\$ 22,653.41	8.68%	55.6
	Medium	\$ 85,027.99	8.54%	37.5
Banco Salvadoreño	Small	\$ 13,575.29	10.14%	N/A
	Medium	\$ 92,857.92	9.74%	N/A
Banco Promerica	Small	\$ 61,284.48	10.74%	N/A
	Medium	\$ 105,629.17	10.02%	N/A
FEDECREDITO	Small	\$ 7,573.81	23.26%	36
	Medium	\$ -	0.00%	N/A

The previous table segregates loans by the average amount disbursed the average interest rate and average loan term, for the banks and FEDECREDITO. To present a valid average, both the highest and the lowest loans in each institution were checked and removed to avoid distortion of the average.

Event list - FY 2006

The following table shows a detail of the two Risk Workshops held on March 2007. The cumulative figure is also presented.

Evento: SSF's Risk Workshop			
Date: March 7-8, 2007	Male	Female	Total
SSF	21	19	40
Totals	21	19	40
	53%	48%	

Evento: Banks' Risk Workshop			
Date: March 6, 2007	Male	Female	Total
Agrícola	4	7	11
Promerica	3	3	6
Salvadoreño	6	4	10
Cuscatlán	2	3	5
BAC	2	3	5
Hipotecario	2	4	6
AMC	2	1	3
Apoyo Integral	4	0	4
FEDECREDITO	4	0	4
Otros (Clientes and other institutions)	1	4	5
Totals	30	29	59
	51%	49%	

People trained for quarter Jan-Mar 2007	Male	Female	Total
	51	48	99
	52%	48%	
Number of events	2		

Cummulative People trained (Feb 2006 - March 2007)	Male	Female	Total
	281	237	518
	54%	46%	
Number of events	8		

Other Indicators

The following tables present information about Loans and borrowers of MFIs and loans to the poor of less than \$400 made by our partner microfinance institutions.

Indicator OI.9a Number of Active New loans of USAID-assisted microfinance institutions (MFIs) As of March 31, 2006			
AMC de RL	Micro Credits		%
	Male	4,152	35%
	Female	7,554	65%
	Sub Total	11,706	100%
Apoyo Integral	Micro Credits		
	Male	5,458	25%
	Female	16,341	75%
	Sub Total	21,799	100%
Totals	Micro Credits		
	Male	9,610	29%
	Female	23,895	71%
	Totals	33,505	100%
Baseline Value		26,144	
Number of New loans		7,361	

Indicator OI.9a Number of Active New Borrowers of USAID-assisted microfinance institutions (MFIs) As of March 31, 2006			
AMC de RL	Micro Borrowers		%
	Male	3,676	36%
	Female	6,549	64%
	Sub Total	10,225	100%
Apoyo Integral	Micro Borrowers		%
	Male	4,552	25%
	Female	13,349	75%
	Sub Total	17,901	100%
Totals	Micro Borrowers		%
	Male	8,228	29%
	Female	19,898	71%
	Totals	28,126	100%
Baseline Value		19,779	
Number of New borrowers		8,347	

Indicator OI.10 Number of active microloans <= \$400 As of March 2007			
AMC de RL	Micro Loans <= \$400		%
	Male	1,208	31%
	Female	2,701	69%
		3,909	100%
Apoyo Integral	Micro Credits <= \$400		%
	Male	1,178	18%
	Female	5,360	82%
		6,538	100%
Total	10,447		
Number at baseline	9,065		
New Loans	1,382		

The following table shows the DCA indicators as of March 2007.

Indicators DCA As of March 2007	
Utilization Rate	64.16%
Number of new loans placed under the guarantee	41
Amount of new loans placed under the guarantee	\$ 2,208,075.00
Cumulative Loans placed under guarantee	56
Cumulative amounts placed under guarantee	\$2,566,475.00
Average number of SME employees	8
Amount of SME sales	\$ 76,940.00

The following table shows the Operational and financial indicators for the two MFIs.

MFIs Financial Indicators As of March 2007		
AMC de R.L.	Operational Efficiency	112.50%
	Financial Self-Sufficiency	110.80%
Apoyo Integral	Operational Efficiency	116.50%
	Financial Self-Sufficiency	113.80%

ANNEX C. SUCCESS STORIES

Please see attachments.



SUCCESS STORY

Superintendencia con enfoque PYME

Superintendencia del Sistema Financiero y banca salvadoreña se informan sobre la PYME, para ajustar medidas.



Las PYME son el motor de generación de empleo estable y por ende del desarrollo económico. El financiamiento es clave para el crecimiento de las mismas..

FOTO: PROGRAMA DE EXPORTACIONES DE USAID.

Las nuevas tendencias de Supervisión en Latinoamérica, el rol del supervisor en relación al financiamiento PYME, definición de PYME, los retos de la SSF y de la banca, sistemas de administración de riesgo PYME, entre otros, fueron los temas que la Superintendencia estudió bajo la asesoría de expertos internacionales.

Con la firma del Tratado de Libre Comercio con los Estados Unidos, así como los otros Tratados vigentes, El Salvador le ha apostado a la Pequeña y Mediana empresa, sector que debe crecer ordenadamente con el apoyo de la banca, en el área de financiamiento.

La banca salvadoreña ha encontrado en la PYME un mercado potencial de negocio, que a la fecha, no ha sido bien atendido. Una de las áreas de mayor dificultad de evaluar es el riesgo crediticio de este sector. En este tema, la Superintendencia del Sistema Financiero de El Salvador (SSF) juega el rol más importante.

Considerando lo anterior, el Programa de USAID de Servicios Financieros para las PYME, inició acciones de apoyo a la SSF. En el mes de marzo realizó un taller de primer nivel con altos funcionarios de la Superintendencia para compartir prácticas exitosas de supervisión, comparar sistemas de administración de riesgo crediticio, analizar modelos e identificar los retos de la Institución para atender a la PYME.

El éxito de la actividad se evidencia con las palabras del Superintendente del Sistema Financiero, Luis Armando Montenegro, quien afirmó que la Superintendencia está en la mejor disposición de conocer al sector y ajustar la normativa a la realidad PYME, un avance enorme que permitirá que el segmento pueda encontrar más apertura crediticia en la banca.

“El Programa de USAID de Servicios Financieros ha iniciado esta asistencia técnica a la SSF, con el objetivo que se determine el riesgo real de trabajar con créditos para PYME, de modo que se cree y alimente las bases de datos que permitan trabajar con modelos de pérdidas esperadas más ajustados y con tasas de interés acordes al riesgo del sector”, afirma Sandra Duarte, Gerente de Servicios Financieros de USAID El Salvador.

Lograr que la Superintendencia del Sistema Financiero revise su normativa con un enfoque PYME es un progreso importante, que una vez realizado, permitirá incrementar el acceso de financiamiento de las PYME a corto y largo plazo; una necesidad apremiante que tiene el sector para poder aprovechar los beneficios de los Tratados de Libre Comercio.



SUCCESS STORY

NACE COMITÉ PYME EN ABANSA

La estrecha relación del Programa con ABANSA promovió la creación del Comité.



El acceso a financiamiento de las PYME es indispensable para el crecimiento del sector.

Algunos de los temas que el Comité revisa son:

- **Factoraje.**
- **Normativa de riesgos.**
- **Definición riesgo PYME.**
- **Nuevos productos para el segmento PYME.**
- **Reservas de saneamiento.**

Desde su creación en 1965, la Asociación Bancaria Salvadoreña, ABANSA, ha reunido al sistema bancario asociado con la misión de representarlos mediante la coordinación de acciones e ideas, así como la producción de estudios e información que les permitan dar un mayor aporte al desarrollo del país.

Durante más de 40 años, ABANSA ha apoyado al Sistema Bancario y las diversas políticas económicas de El Salvador, pero no ha sido hasta este año 2007 que ha puesto énfasis en el sector PYME.

“Veníamos desarrollando esfuerzos aislados, pero la relación con el Programa de USAID de Servicios Financieros para las PYME, nos influyó de una manera tan positiva que iniciamos una encuesta con nuestros 11 bancos miembros con relación a los servicios que ofrecían al sector”, afirma el Director Ejecutivo de ABANSA, Carlos Cáceres.

La puesta en marcha de esta iniciativa y acciones posteriores de la Asociación, dieron como resultado el COMITÉ PYME de ABANSA, el cual reúne a los 11 bancos miembros, quienes están conociendo más sobre la PYME para poder atenderla de acuerdo a su naturaleza.

El Comité PYME está en la fase de formación, “estamos trabajando con el Programa de Servicios Financieros de USAID y CONAMYPE para conceptualizar el problema y poder plantear posibles soluciones”, agrega Cáceres.

Dentro de los objetivos de ABANSA está el representar a los miembros en sus relaciones con el Gobierno de la República, autoridades monetarias, financieras, fiscalización, Banco Central de Reserva, en la búsqueda de soluciones a los problemas que esas áreas pudieran tener.

Este objetivo permitirá al Comité adentrarse el tema PYME y poder en un futuro cercano, plantear las medidas necesarias para poder apoyar desde el Sistema Financiero a las pequeñas y medianas empresas.

El Programa de USAID de Servicios Financieros continuará su apoyo al Comité PYME de ABANSA, en el área de capacitación y diseño de información y estadísticas.