

## Why Do They Walk Away:

### Understanding Microcredit Client Dropout in Egypt's Microfinance Sector from the Loan Officer's Perspective

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### **Abstract:**

Microfinance has been operating in Egypt since the early 1980s. This paper investigates the slight but significant decline in client numbers since the start of 2025. It adopts a mixed-methods approach combining both quantitative and qualitative analysis. Specifically, it utilises a quantitative survey administered to staff and loan officers, along with a semi-structured interview schedule conducted with experts in microfinance, poverty reduction, and economic empowerment. The theoretical framework primarily relies on three theories: Relational Lending Theory, Principal-Agent Theory, and Street-Level Bureaucracy. The main finding indicates that this dropout is likely to increase for several reasons, including factors related to the economic context and the legal framework of microfinance in Egypt. Other contributing factors include governance, client-loan officer relations, policy requirements, and legal awareness among both loan officers and clients, as well as inadequate training for loan officers and clients.

**Keywords: Microfinance, Microcredit, Poverty Reduction, Small Loans, Microfinance Institutions, Economic Empowerment.**

### **Introduction and Literature Review**

The idea of lending small amounts of money to poor people for business growth has a long history. In fact, informal lending predated microcredit and the existence of Microfinance Institutions (MFIs). However, “the advent of modern microfinance has been credited to several pilot projects that occurred roughly simultaneously. Most famously, Muhammad Yunus' experiments with microcredit in 1976 started in Bangladesh with \$27.00 from his own pocket and eventually led to the creation of the Grameen Bank.” It is claimed that the microcredit that Yunus initially offered targeted rural poor women. Since then, microcredit has expanded rapidly, along with other financial services such as savings and insurance, to meet the needs of the most disadvantaged populations with limited access to formal banking services. This development later became known as microfinance. Microfinance aims to alleviate poverty and provide access to financial products, seeking to economically empower clients, often called the “unbankable,” who lack the required collateral or live in areas without banks. Microcredit and microfinance are often used interchangeably, as microcredit was the first financial product offered to this demographic. Over the decades, microcredit—or microfinance—has been viewed as an effective tool for reducing poverty, empowering individuals, and creating jobs. Recently, the integration of microfinance into the formal sector through technology is known as "Financial Inclusion." This has created jobs for many years. Recently, the inclusion of Microfinance in the formal sector, utilising technology, is termed “Financial Inclusion”.

The critique of Microfinance for burdening the unbankable with financial debt and putting their lives at risk emerged in various parts of the world. Most of this critique stems from a practice some MFIs adopted that prioritises financial stability over serving their clients. Mission drift in Microfinance refers to a phenomenon in which Microfinance Institutions (MFIs) shift their mission towards profit-making at the expense of helping their clients. Muhammad Yunus claims that better-off clients, more privileged, tend to crowd out the least privileged clients in the market. (Mersland & Strøm, 2010). MFIs are struggling to achieve sustainability and fulfil their social mission. (Kar & Bali Swain, 2018). Reaching out to those experiencing poverty in remote areas where they live adds to MFIs' operational costs, and lending to such communities is also risky.

Mission drift is mainly measured by two indicators: breadth of outreach, which represents the number of clients served by MFIs, and depth of outreach, which indicates the average loan size. The more MFIs have offices and clients in rural, remote areas where the poor live, the broader their reach; likewise, the lower the average loan size they offer, the deeper their reach, because it means they serve those experiencing poverty who are often running micro businesses. These clients need microcredit that no other bank can provide. Mission drift occurs when MFIs serve a smaller percentage of the targeted population—usually concentrated around big cities—and increase the average loan size, indicating that they are not serving their initial target population, which contradicts the promise of microfinance.

The microfinance industry has promoted self-regulation as an efficient, market-based mechanism for oversight before government regulations come into effect. However, research on microfinance consumer outcomes shows that self-regulation is insufficient to ensure social justice. Without state oversight and accountability, competition among MFIs for consumers has led to significant increases in microfinance debt across many nations, with loan sizes surpassing many borrowers' repayment capacity. The limitations of microfinance self-regulation have prompted governments to introduce domestic regulations to organise microfinance markets better.

#### Client dropout from a gender perspective:

As previously noted, mission drift in microfinance refers to a situation in which MFIs stray from their goal of empowering clients economically to prioritise profit. Muhammad Yunus expressed concern about the commercialisation of MFIs (profit-making from the poor). He described them as loan sharks in an opinion piece in the New York Times on 14 January 2011. He stated: “In 1983, I founded Grameen Bank to provide small loans that people, especially poor women, could use to lift themselves out of poverty. At that time, I never imagined that microcredit would one day give rise to its own breed of loan sharks. The rapid increase in interest rates has turned MFIs into commercial entities, causing them to drift away from their primary social mission of aiding the poor.

In April 2008, Deutsche Bank convened several microfinance leaders to discuss the future of the sector. The meeting took place at Pocantico, just outside New York, where the leaders drafted the Pocantico Declaration, emphasising the importance of positioning the

microfinance brand as a dual-purpose development tool, both social and economic (Forster et al., 2010).

In its preamble, the declaration acknowledged the global success of the microfinance sector, as interest rates generally declined, provider efficiency increased, and profits fell due to rising competition. However, it also highlighted the growing risk of clients' indebtedness. A moment that was described as "a moment of great opportunity and great risk for the microfinance sector." This raised questions about the effectiveness of microfinance in achieving its social and economic development goals and emphasised the danger of mission drift among MFIs. The declaration affirmed that microfinance can and should raise clients' incomes, assets, and other benefits, and that this should be the sole purpose of providers (Abdelmoumni et al., 2008).

### **- Why loan officer and frontline staff perspectives matter:**

Since microfinance clients have unique characteristics, MFIs follow distinct approaches to recruiting and managing their operations compared to banks and other financial institutions. Microfinance clients are usually illiterate, lack access to banking services because either there is a shortage in physical bank presence where they live, or they do not have the required qualifications by banks to open an account, as they are mostly unemployed and seeking financial assistance to expand their income-generating activities, which is also called necessity entrepreneurship. (Hill et al., 2022; Canton, 2021; Bierbaum et al., 2009).

Moreover, MF clients usually seek financial services with features different from those offered by banks. This includes savings too small to maintain a bank savings account, or loans too small for banks to provide, versus the operational costs a bank incurs in providing such services. As MF clients fall off banks' radars, they remain invisible because they lack proof of their creditworthiness, widening the gap between MF clients and banks. Therefore, MFIs, since their emergence, have depended on "relationship lending" (Elyasiani & Goldberg, 2004; Uchida et al., 2006; Uchida et al., 2012). Loan officers in this model primarily provide MFIs with soft information to assess clients' worthiness and facilitate operations.

Since MFIs select their frontline staff from the same communities they target, it is easy to assume that MFIs frontline staff share many characteristics with their clients, except for a slight difference in education level either because of the job requirements, where each MFI has its own internal systems for data collection and bookkeeping or because of the requirements of the laws and regulations of microfinance. Staff from the same community as clients can build reliable soft information about their clients' reputations and financial capabilities by asking around the community and, in some cases, by observation (Rasel & Win, 2020). Relational lending in small businesses is highly effective, particularly in microfinance (Benvenuti et al., 2010; Uchida et al., 2012). Ties developed between borrower and lender in microfinance are strong and considered an asset for MFIs.

Frontline staff at MFIs often face numerous challenges in their daily work. These include job insecurity, financial struggles, housing issues, and family dislocation. In some contexts, these problems worsen when gender is taken into account. Although women loan officers

have an advantage in collecting more accurate and trustworthy soft information about their female clients because they are welcomed into women's households—unlike male loan officers, who are seen as strangers and may face social questioning if they speak with a woman outside her immediate family—women loan officers also face mobility restrictions outside their local communities. These restrictions further limit specific career development opportunities offered by their MFIs or elsewhere. Most professional development options are in cities, where travel can be difficult for women loan officers due to social norms (Ahmad, 2010).

#### - Study objectives and contributions.

The rapid expansion of Egypt's microfinance sector over the past decade has seen higher dropout rates for the first time since its early 1980s inception, particularly among women, whose share of the active microfinance portfolio declined from 69 per cent in 2016 to 54 per cent in 2025. While existing scholarship has examined outreach, repayment performance, and the commercialisation of microfinance as some of the underlying reasons for client dropout across the credit lifecycle, deeper institutional and relational dynamics also come into play. Loan officers and frontline staff, who operate at the intersection of institutional incentives and client relationships, represent a critical but underexplored source of insight into these dynamics. Loan officers shape how borrowers experience the onboarding process, navigate repayment obligations, access renewal opportunities, and ultimately decide whether to remain engaged with an institution. Their insights are therefore critical for understanding why microfinance clients disengage and why dropout patterns are concentrated at specific points of the lifecycle.

This paper uses Relational Lending Theory and Principal–Agent Theory to examine dropout as the byproduct of two correlated forces:

1. the reduced depth and quality of officer–client relationships, and
2. The institutional pressures that constrain officers' ability to serve clients in ways that support long-term retention.

Accordingly, the study pursues four core objectives:

- I. To identify where relational breakdowns occur: Drawing on Relational Lending Theory, the paper maps how weak onboarding interactions, insufficient monitoring, and transactional renewal practices undermine trust, communication, and client understanding. Loan officers' narratives help reveal how disruptions in relational processes contribute to dropout.
- II. To examine how institutional incentives shape officer behaviour and renewal decisions: Using Principal–Agent Theory, the study analyses how KPIs, caseload pressure, commercialisation, and digital reporting requirements influence the way loan officers screen clients, deliver information, and manage renewals. This framework helps explain how institutional structures produce patterns of dropout, especially when officers prioritise portfolio performance over relational quality.
- III. To quantify how officer-level and institutional factors predict voluntary and involuntary dropout: The mixed-methods design, combining survey data from 150 loan officers and frontline staff, qualitative interviews, and secondary MFI and Financial Regulatory Authority (FRA) data, allows the study to empirically test how relational and agent-based mechanisms correlate with client exits.

- IV. To generate policy-relevant insights that strengthen relational lending while correcting incentive distortions: The study aims to inform operational reforms within MFIs and supervisory guidance by the FRA. Insights from both theoretical lenses, relational and agent-based, are used to propose stage-specific interventions that improve onboarding quality, reduce workload burdens, redesign KPIs, and promote transparent renewal processes.

This study enhances both the theory and practice of microfinance in several significant ways.

**Theoretical Contribution:** Integrating Relational Lending, Principal–Agent Theory, and Street-Level Bureaucracy. By bringing together relational and institutional perspectives, this paper provides a layered understanding of client dropout that moves beyond borrower-focused explanations. It demonstrates that exit often arises from relationship breakdowns shaped by organisational pressures, rather than from client characteristics or repayment ability alone.

**Conceptual Contribution:** The study creates a lifecycle map of dropout, covering onboarding, first loan experience, renewal, and graduation, and demonstrates that distinct relational and incentive dynamics govern different stages. This structure provides a clearer understanding of why the first renewal cycle is the most vulnerable point for client attrition.

**Empirical Contribution:** New Evidence from Loan Officers and Frontline Staff in Egypt. The study offers one of the earliest systematic analyses of loan officer perspectives within Egypt’s microfinance sector. Through surveys and interviews, it uncovers how officers interpret client behaviour, handle organisational pressures, and negotiate renewal decisions. These insights address a significant gap in microfinance research across the MENA region, which has rarely focused on frontline staff.

**Policy Contribution:** Enhancing Client Protection and Retention. Findings inform policy recommendations for MFIs and regulators, including:

- Redesigning KPIs to balance growth and retention,
- Adopting simpler and more relational onboarding processes,
- Enhancing officer training to support trust and communication, and
- Promoting transparent renewal and exit codes throughout the sector.

Such reforms directly address the gender retention gap and can help reverse the declining outreach trends documented by the FRA.

## II. Theoretical Framework:

Microcredit delivery depends on a complex interaction of institutional incentives, frontline discretion, and relationship-building processes. To explain why clients disengage from microfinance in Egypt, this study employs three complementary theoretical approaches: Principal–Agent Theory, Street-Level Bureaucracy, and Relational Lending Theory. Collectively, these theories shed light on how organisational pressures influence loan officer behaviour, how officers interpret these pressures into discretionary frontline practices, and how these practices impact the quality of officer–client relationships that underpin retention.

### **1- Relational Lending Theory: soft information, trust, relational depth.**

Relationship lending is a financial concept primarily concerned with loans. It encompasses various factors such as the distance between borrower and lender, the length of their relationship, and the size of loans and collateral (Duqi et al., 2018; Elyasiani & Goldberg, 2004; Uchida et al., 2006; Udell, 2008), as well as other elements like soft information, qualitative inquiries, and non-codifiable insights obtained through repeated personal interactions to assess borrower reliability, business viability, and repayment capacity (Boot, 2000; Petersen & Rajan, 1994). Soft information includes observations on household conditions, business practices, spending habits, informal income streams, and borrower character. Unlike hard information (e.g., collateral, credit scores), soft information cannot be easily verified, standardised, or transferred across loan officers, making the quality of the relationship between officer and client vital for credit decisions. The key themes of relationship lending involve developing soft information and providing borrowers with improved financial products (Benvenuti et al., 2010). Since microfinance (MF) clients often lack collateral and a credit history, gathering soft information about their creditworthiness is critical to the lending process. With generally high illiteracy rates among MF clients, increased interactions and daily communication are essential for nurturing client relationships (Godfroid, 2019). To achieve these aims, MFIs need to visit their clients where they are and employ frontline staff capable of effective communication with clients and fostering a culture of trust between borrower and lender. The most marginalised groups depend heavily on their social networks; therefore, to reach these communities, MFIs recruit frontline staff from the same communities they serve, in line with relational lending theories.

The effectiveness of relational lending also relies on relational depth: the extent to which officers and clients engage in regular, meaningful, and high-quality interactions over time. Relational depth allows officers to accurately interpret client needs, identify early signs of repayment stress, and provide targeted support during shocks. Deep relationships boost the borrower's sense of fairness, reduce fear of punitive consequences, and enhance their willingness to renew loans. (Bester, 1985; Cassar et al., 2007). In contrast, shallow or transactional relationships, often caused by high caseloads, high turnover, or KPI-driven pressure, can erode client satisfaction and increase dropout risks even among creditworthy clients.

In the microfinance context, relational lending provides a valuable perspective on why clients disengage. When onboarding interactions are rushed, monitoring becomes merely procedural rather than supportive, or renewal decisions seem unclear, clients may interpret these relational failures as signs of institutional unreliability or disrespect. This is especially evident in Egypt's expanding microfinance market, where rapid growth, digitalisation, and performance pressures increasingly limit the time officers can dedicate to meaningful relationship-building. In these circumstances, relational lending theory suggests that dropout is not just a financial outcome but a relational one — occurring when trust, communication, and interpersonal support within microcredit relationships begin to weaken.

## 2- Principal–Agent Theory: incentives, KPIs, caseloads, organisational pressure.

With the intensive field work microfinance loan officers must undertake to build good relations with their clients, more authority related to client selection and the financial products offered has been given to field staff, loan officers, or frontline staff to accelerate the development of soft information and enhance the quality of the MFI's portfolio (Benvenuti et al., 2010; Uchida et al., 2006). However, this authority comes with considerable pressure on the field staff. One form of this pressure is tying loan officers' salaries and bonuses to their clients' repayment performance. Since microfinance serves communities of necessity entrepreneurs, who often operate in risky environments, they struggle with repayment. There are stories, like loan officers repaying parts of instalments themselves to avoid penalties imposed by their administration, or even worse stories — especially for women loan officers — such as a pregnant loan officer who had to spend the night at a defaulting client's home to collect the loan instalment until her water broke (Maître, 2018).

The principal-agent theory explores how misaligned incentives between an organisation (the principal) and its frontline employees (the agents) influence behaviour and decision-making. In microfinance institutions (MFIs), loan officers serve as agents who assess, onboard, oversee, and renew credit relationships on behalf of the organisation. Their actions, however, are shaped by the principal's incentive structures, performance metrics, and supervisory systems. When these institutional incentives emphasise rapid portfolio growth, high repayment rates, or strict adherence to operational targets, they may unintentionally alter loan officers' behaviour, thereby jeopardising client retention.

Principal–agent dynamics in microfinance are shaped by three structural features: asymmetric information, incomplete contractibility, and incentive misalignment (Jensen & Meckling, 1976; Holmström, 1979). Loan officers possess informational advantages regarding client characteristics, repayment risks, and relational cues that cannot be fully captured in monitoring reports. Since institutions cannot perfectly observe or assess these relational aspects, they rely on simplified performance indicators, such as the number of disbursements, portfolio-at-risk (PAR), or renewal conversion rates, as proxies for officer effort. However, these proxies often prioritise quantifiable outputs over relational quality, leading officers to behave in ways that meet institutional targets but may negatively affect client experience.

In commercialising microfinance markets, the problem is intensified by high caseloads, increased sales-focused KPIs, and digital reporting burdens. Evidence from various contexts shows that when loan officers face pressure to meet disbursement targets, they may rush onboarding processes, spend less time verifying client understanding, and underinvest in building relational depth (Hartarska & Nadolnyak, 2008; Aubert et al., 2009). Similarly, the pressure to maintain perfect repayment records can cause officers to deny renewals to “borderline” clients, even if temporary repayment issues could be resolved through flexible arrangements. These incentive-driven practices operate as mechanisms of involuntary dropout, where clients leave not by choice but because officer

discretion, limited by organisational pressure, reduces their capacity to continue borrowing.

Furthermore, principal–agent pressures influence how officers allocate their limited time among competing tasks. When caseloads are high, officers tend to prioritise clients who are easier to manage or more successful, giving less attention to new borrowers, low-income women, or clients with irregular cash flows—the very groups microfinance aims to serve. This selective focus reinforces gender and poverty-related disadvantages, resulting in higher dropout rates among vulnerable client groups. Digitalisation, while promising efficiency, may worsen this issue when digital tools increase reporting demands without reducing administrative workload, leaving even less time for personal engagement.

Viewed through the lens of Principal–Agent Theory, dropout is seen as an outcome shaped by institutions: a consequence of incentive systems that unintentionally discourage relational engagement and prioritise short-term performance metrics over long-term client sustainability. This theoretical perspective complements Relational Lending Theory by showing that relational breakdowns are not solely interpersonal failures but are often rooted in broader organisational structures influencing loan officers’ behaviour. Recognising these institutional pressures is therefore vital for understanding why dropout tends to occur at specific stages of the credit cycle, particularly during early renewals, and why women and first-time borrowers are especially vulnerable.

The study also draws on Street-Level Bureaucracy, which views frontline workers as independent actors who interpret and mediate institutional policies amid limited resources, high caseloads, and bureaucratic pressures (Lipsky, 2010). Loan officers in microfinance institutions share the traits of street-level bureaucrats: they interpret loan policies, manage competing performance demands, and reconcile institutional expectations with client needs. Their coping strategies, such as rationing time and prioritising, reflect their efforts to navigate these challenges. “Easy” clients, simplifying procedures, or withholding renewals, emerge as adaptive responses to workload intensity and incentive structures. Combining street-level bureaucracy with Relational Lending Theory and Principal–Agent Theory offers a more comprehensive understanding of how institutional constraints shape officer–client interactions and, ultimately, client dropout.

Microcredit dropout is a complex outcome resulting from how institutional incentive structures, as outlined by Principal–Agent Theory, influence frontline behaviours and coping strategies, explained by Street-Level Bureaucracy. These, in turn, impact the depth, trust, and quality of officer–client relationships, as theorised by Relational Lending Theory. When these layers interact under conditions such as resource pressure, commercialisation, or high caseloads, relational failures tend to occur at critical points in the credit lifecycle—particularly during onboarding and the first renewal—leading to increased rates of voluntary and involuntary dropout.

The principal-agent theory provides the institutional foundation for the framework. In microfinance institutions (MFIs), loan officers act as agents who implement the

organisation's goals. MFIs often rely on simplified performance metrics, such as disbursement volume, portfolio quality, or renewal conversions, to assess officer effort. While Principal-Agent Theory explains why institutional pressure exists, Street-Level Bureaucracy clarifies how officers respond to it. Loan officers serve as street-level bureaucrats: frontline workers who must interpret organisational rules, reconcile conflicting demands, and manage limited time and resources. Finally, Relational Lending Theory explains the relational consequences of these institutional and behavioural dynamics.

In combination, these theories suggest that microcredit dropout is not simply a borrower-side outcome but a systemic one, emerging from the interaction of institutional incentives, frontline coping strategies, and relational quality. This integrated framework provides a multi-layered explanation for why dropout is occurring, why women and first-time borrowers are disproportionately affected, and why understanding loan officer perspectives is essential for strengthening retention in Egypt's evolving microfinance sector.

### **Context of Egypt's Microfinance Market**

Egypt has had microfinance activities in various forms since the 1950s. It began in the agriculture sector by providing farmers with small loans through the Principal Bank for Development and Agriculture, a government-owned bank. In 1977, the Ministry of Social Solidarity launched the "Productive Families" project, targeting low-income families to offer microcredit, with a government employee serving as a guarantor (Barsoum, 2019). NGOs championed microfinance for a long time, especially for women, until the early 2000s when for-profit companies entered the market as service providers (Moussa, 2007). The first all-women microcredit programme was established in 1981, when most women did not have national ID cards. The programme was criticised, and questions were raised about loan repayment; however, all women repaid their loans successfully, proving their creditworthiness and making them attractive for investment (Bibars, 2019). Microfinance has long been viewed as a dual-purpose development tool designed for different communities.

A key milestone in the development of microfinance in Egypt was the founding of the Social Fund for Development in 1991, established in response to structural adjustment reforms and increasing unemployment. The SFD became the country's first large-scale microcredit coordinator, directing donor and government resources to NGOs and local development associations to improve financial access for low-income households and microenterprises. The SFD helped institutionalise microfinance practices by introducing standardised lending methods, offering capacity-building programmes for partner NGOs, and serving as the leading wholesale financier for community-based microcredit initiatives throughout the 1990s and 2000s. In 2017, the SFD was restructured into the Micro, Small, and Medium Enterprise Development Agency (MSMEDA).

In 2014, the Egyptian government enacted the first Microfinance Activities Law No. 141, which delegated the responsibility for regulating the market to the Financial Regulatory Authority (FRA). FRA is an independent government authority that reports to the cabinet and regulates Non-Banking Financial Services (NBFSS), including insurance, factoring, and the stock market. FRA regulates NGOs and Companies-MFIs. The regulations FRA adopted for microfinance categorised MFIs into four groups: for-profit companies form a

single group; NGOs are divided into three groups based on the size of their active portfolios: "A" category with active portfolios of EGP 50 million or more; "B" category with portfolios of EGP 10 million or more; and "C" category with portfolios of less than EGP 10 million. The fourth category comprises all for-profit companies. The regulations are distinguished by their licensing requirements accordingly, respectively<sup>1</sup>.

FRA issued the first nationwide microfinance report in March 2016 and continues to monitor the market on a quarterly and annual basis, with some key data released monthly as well.

	Active Borrowers	Active Portfolio	Number of NGOs (A)	Number of NGOs (B)	Number of NGOs (C)	Number of Companies
March 2016	1.5M	EGP3.6 billion	13	17	676	3
March 2025	3.7M	EGP 84.5 billion	23	34	956	25

Table 1

Figure 1 shows an exponential variance in active portfolio growth across microfinance provider types in Egypt between 2016 and 2025. For-profit microfinance companies experienced a steep and sustained expansion, with their active portfolio rising from approximately 1.3 billion EGP in 2016 to more than 56 billion EGP by 2025. This rapid acceleration, especially after 2020, reflects both aggressive market scaling and the growing dominance of the corporate model within the sector. NGO-A also demonstrated substantial growth, increasing its portfolio from around 2.3 billion EGP in 2016 to 26.5 billion EGP in 2025, though at a noticeably slower pace compared to companies. By contrast, NGO-B and C maintained relatively modest and gradual portfolio increases, remaining below the EGP2 billion threshold throughout the period. Overall, the trends highlight a structural shift in Egypt's microfinance landscape, with private companies emerging as the primary engine of portfolio expansion. At the same time, NGO-MFIs exhibit growth patterns aligned with more conservative outreach strategies, limited capital bases, and differentiated regulatory environments. To put things into perspective, here is a table with the growth rates for each MFI type:

MFI Type	March 2016	March 2025	Multiple	Total Growth %	CAGR (Annual Growth Rate)
Companies	1,295,044,932	56,169,113,130	43.38×	4,238%	≈ 52.2%
NGO-A	2,337,955,019	26,481,778,830	11.32×	1,032%	33.3%
NGO-B	312,981,292	752,755,770	2.40×	140%	10.0%

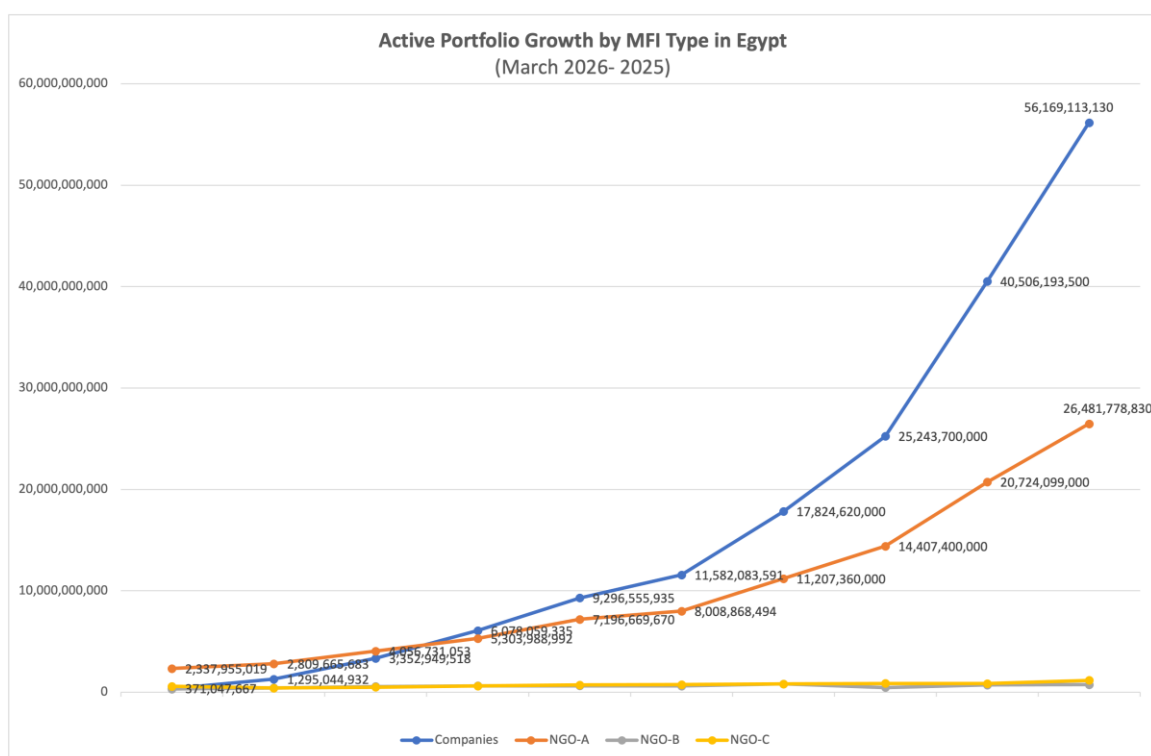
<sup>1</sup> Author's translation for Article No. 4 of rules and regulations of Microfinance for NGOs adopted by FRA under Board's decree No. 31 for 2015

MFI Type	March 2016	March 2025	Multiple	Total Growth %	CAGR (Annual Growth Rate)
NGO-C	586,192,564	1,175,652,270	2.01×	101%	7.9%

Table 2

Since the current Microfinance law permits both NGOs with social missions and commercial and investment companies to offer Microfinance services in line with regulations adopted by the FRA, this places the social mission of microfinance primarily on NGOs operating in this sector. Under the NGOs Law No. 84 of 2002 and Law No. 149 of 2019, NGOs are required to declare their social mission upon establishment and registration. All NGOs providing Microfinance services have missions focused on poverty alleviation and economic development.

With companies and NGOs providing microfinance services in the market, it is concerning to see a decline in the number of NGOs' clients. The rise in the number of companies in the portfolio is the most significant among the three tiers of NGOs combined. The average



loan size offered by companies is the highest across all MFIs.

Figure 1 - Portfolio Growth by Type of MFI

Source: Made by authors from FRA data

Egypt's recent macroeconomic environment has been characterised by persistently high inflation, which has reshaped the operating context for microfinance institutions (MFIs)

and placed increasing pressure on low-income borrowers. According to the Central Agency for Public Mobilisation and Statistics (CAPMAS), annual consumer inflation remained elevated at approximately 23.2% in August 2025, while monthly inflation reached 3.1%, reflecting continued price instability in food, inputs, and essential services. (CAPMAS, 2025). During earlier inflationary peaks, annual inflation rose as high as 38% in late 2023, underscoring the sustained loss of household purchasing power over the past several years. In this environment, the real value of microcredit declines rapidly unless MFIs adjust their loan sizes proportionately.

To assess the degree of institutional adjustment to inflationary pressures, average loan sizes (ALS) were calculated for each MFI type using administrative data for 2016 and 2025. The results show wide institutional variation in how MFIs responded to inflation.

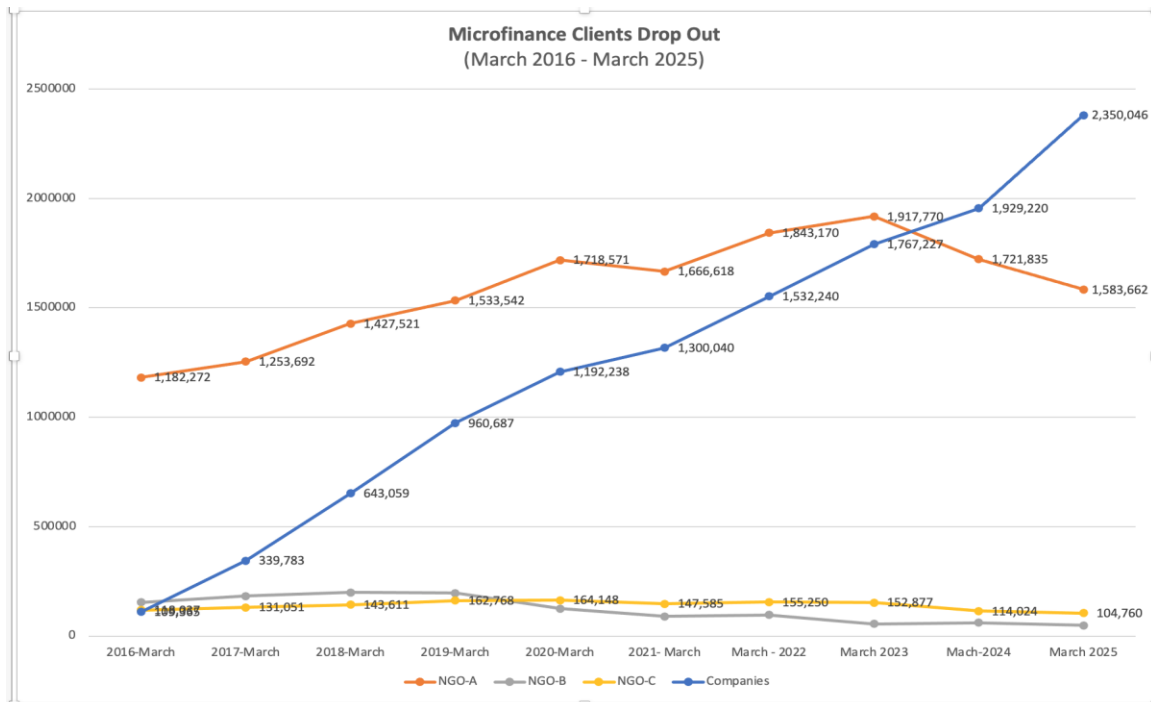
MFI Type	ALS 2016 (EGP)	ALS 2025 (EGP)	Absolute Increase (EGP)	Growth Multiple (×)	% Increase
Companies	3,393	23,892	+20,499	7.0×	604%
NGO-A	1,978	16,723	+14,745	8.45×	745%
NGO-B	2,029	15,700	+13,671	7.7×	674%
NGO-C	4,967	11,224	+6,257	2.26×	126%

**Table 2:** Average loan sizes increased significantly across all MFI types from 2016 to 2025

This variation in ALS trajectories has significant implications for client vulnerability and dropout rates. When MFIs do not adjust loan sizes to keep pace with inflation, borrowers' real working capital decreases, lowering their ability to purchase inputs, restock inventory, or sustain business margins. As business profitability declines, repayment capacity becomes strained, raising the risk of delinquency or exit. The relatively modest adjustments made by NGO-C, for example, suggest that borrowers received loans which lost substantial real value over time, potentially increasing repayment stress and dropout rates.

The interaction between inflation and loan sizing thus operates as a macro–micro transmission mechanism shaping client outcomes. High and volatile inflation reduces real incomes, compresses microenterprise margins, and magnifies the consequences of institutional decisions regarding loan product design. MFIs with greater financial flexibility or stronger capital bases can adjust lending amounts more readily, while others remain constrained by funding limitations, regulatory compliance costs, or conservative risk preferences. These structural differences help explain the varied client retention dynamics observed across provider types and underscore why inflation must be treated as a central factor in understanding microfinance vulnerability and dropout in Egypt.

### Figure 2- Evolution of Microfinance Client in Egypt by MFI Type (2016-2025)



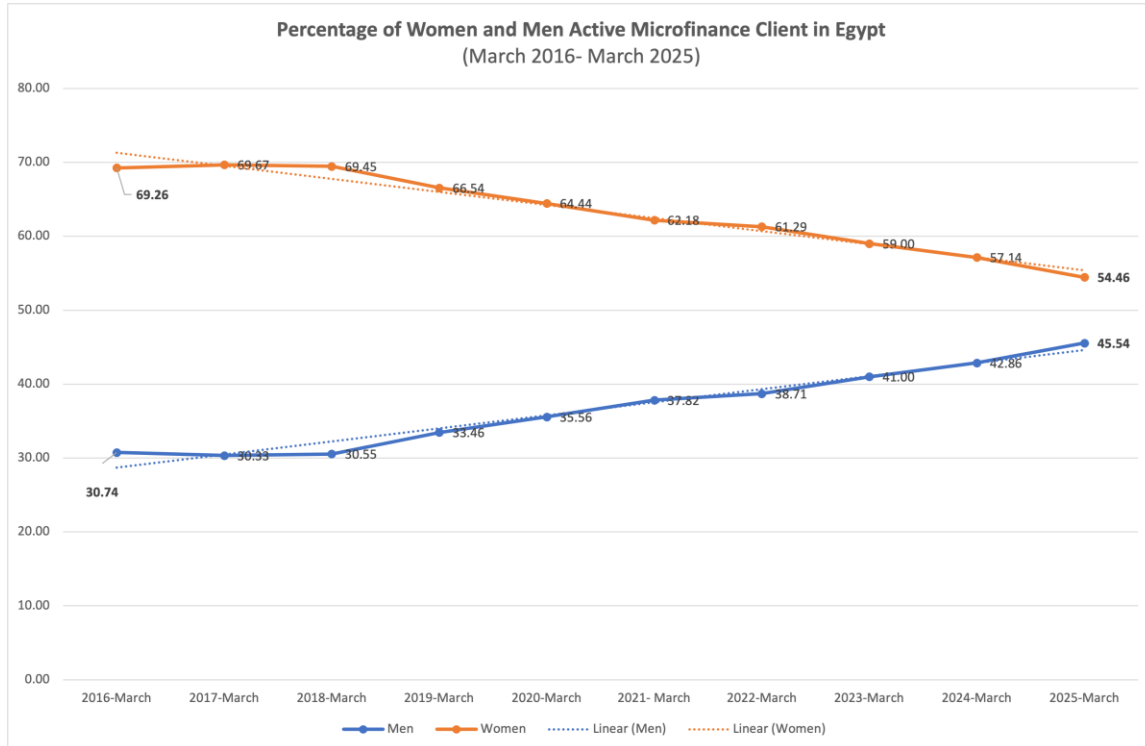
Source: Made by authors from the FRA datasets.

Figure 2 shows that the sharp increase in NGO-A’s average loan size, from 1,978 EGP in 2016 to 16,723 EGP in 2025, coincides with a notable upward trend in client dropout. In this sense, NGO-A’s aggressive loan-size growth, while intended to offset inflation, may have exceeded many clients’ repayment thresholds, thereby accelerated dropout and weakening the relational depth that once characterised its lending model. However, NGO-MFIs commonly use a graduation-based lending approach, in which clients start with small, introductory loans and gradually progress to larger amounts as they demonstrate repayment capacity and business stability. This model is rooted in classical microfinance methodology, which views incremental loan increases as a mechanism for building borrower discipline, mitigating default risk, and strengthening the lending relationship over time. (Helms, 2006; Ledgerwood, 1998). In practice, NGO-MFIs in Egypt typically enrol new borrowers, especially women, into small first-cycle loans that function as a screening tool, allowing loan officers to assess reliability, business feasibility, and household repayment dynamics before offering higher-value loans. As clients’ complete multiple cycles, they “graduate” into larger loan brackets, often moving from group or solidarity lending into individual microenterprise loans. Research on the Egyptian sector has shown that this graduation pathway is used both to manage portfolio risk and to retain clients by offering progressively more useful financial products aligned with business growth. (Rahman, 2010). With this approach and with NGOs-A active in the market for more than 20 years, preceding the 2014 Law, data suggests they had long-standing clients and preferred serving existing clients rather than extending new loans to new clients. Mission drift occurs when MFIs serve a smaller percentage of the targeted population (concentrated

in big cities) and increase the average loan size, meaning they are not serving the targeted population in the first place, which contradicts the Microfinance promise.

A closer look at the administrative data released by the FRA on the market shows a continuous decline in the proportion of women in Egypt’s microfinance sector, from 69.26% in 2016 to 54.46% in 2025, while the percentage of male borrowers rises from 30.74% to 45.54%.

**Figure 3- Distribution of active microfinance clients in Egypt (2016–2025).**



With women’s share declining from 69% to 54%, while men’s share rises from 31% to 46%.

This gradual convergence strongly indicates that women, who have traditionally been the primary clients of microfinance, are being pushed out of the sector. Several structural factors account for this change. As microfinance in Egypt becomes more commercialised and average loan sizes increase rapidly (especially among NGO-A and company MFIs), lending practices tend to favour clients perceived as less risky and more profitable, typically men.

Women, particularly those who are poor and rural, face numerous barriers, including limited financial literacy, limited availability of collateral, patriarchal restrictions on mobility and decision-making, and heightened vulnerability to overindebtedness. These conditions can cause MFIs to deprioritise them when offering larger and more individual loans.

Egypt’s regulatory framework is inadequate to protect women from predatory lending, unclear loan conditions, and hidden overindebtedness in group-lending schemes. These

issues increase their financial vulnerability and raise the likelihood of their withdrawal from the market.

The decline in women's participation, therefore, does not reflect a decreased demand for microcredit; instead, it highlights a structural market shift in which institutional incentives, regulatory gaps, and gendered vulnerabilities collectively marginalise women within a sector initially designed to include them.

### **Methodology**

Mixed-methods design: This paper adopts a mixed approach combining both quantitative and qualitative analyses. The quantitative component mainly depends on an online survey of 14 questions exploring various reasons for clients' dropouts. It was distributed among loan officers, company directors, NGO administrators, and Microfinance administrators. This survey was conducted among the target groups using snowball techniques to collect a non-random sample of 241 loan officers, NGO administrators, and company directors. The qualitative analysis primarily involves a desk review and a semi-structured interview schedule. Seven experts in microfinance and poverty reduction were interviewed. The criteria for selecting these experts included their over 25 years of experience in the field and their willingness to participate.

**Data sources:** this paper relies on a variety of data sources, as follows:

- 1- **Primary data sources:** this depends mainly on the online survey administered to staff and loan officers, and a semi-structured interview schedule with microfinance and poverty experts
- 2- **Secondary data sources:** this paper relies on a broad range of resources, including FRA reports, MFI portfolios, and studies.

### **Data collection tools:**

- Online Survey of staff and loan officers - Semi-structured interviews.

### **The sample:**

The online survey was conducted with 241 respondents, including loan officers and staff from both NGO (A-B-C) categories and private companies. 92.5% of those respondents were men, and 7.5% were women. 40.8% are thirty years old, 39.6% are younger than thirty, and 18.8% are over forty. 86% hold a university degree, and 11.3% have qualifications above university level. 81.3% of the respondents work for private companies, 14.6% represent NGOs (6.3% NGOA, 5.4% NGOB, and 2.9% NGOC), and 4.2% work for NGOs but do not know their classification. These respondents hold various positions: 60.8% are accountants, 17.9% are directors, 16.3% are loan officers, and 4.6% are administrative staff. 40.8% have more than 6 years of experience, 32.1% have between

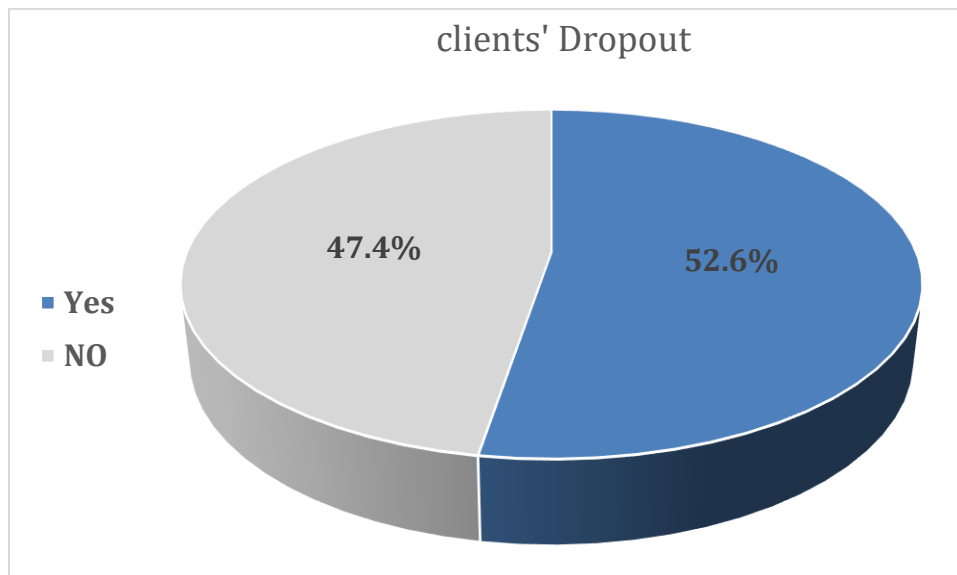
3 and 6 years, 17.9% have 1 to 3 years, and 9.2% have less than 1 year. When asked about the current dropout rate, 30% reported no dropouts. Meanwhile, 18.8% said there are fewer than 5% client dropouts, 17.1% indicated fewer than 10% dropouts, and 16.3% said fewer than 20% dropouts. Additionally, 17.9% said they do not know the actual dropout rate. As previously mentioned, only 15% of the total sample are loan officers. The portfolio sizes for those loan officers vary: 44.7% indicate a portfolio of 2 million EGP, 18.4% indicate a portfolio of more than 4 million EGP, 15.8% indicate a portfolio of less than 2 million EGP, and 13.2% did not specify the size. Furthermore, 7.9% did not know the total size of their portfolio.

- **Timeframe:** the fieldwork and data analysis spanned three months, from August to November 2025. It encompasses data collection tools, design, peer review, secondary data collection, analysis, and fieldwork. The online survey application took 1.5 months because the team encountered significant challenges in reaching women, NGO loan officers, and staff.

- **Limitations:** The fieldwork faced a significant challenge regarding the willingness of loan officers and staff to participate, especially among NGOs and women. This was reflected in the limited representation of women and loan officers in NGOs compared to private companies, as well as the familiar presence of men as loan/staff officers.

## Findings and Discussion

Figure 4:



As shown in Figure 4, 52.6% of respondents reported client dropout in 2025, while 47.4% reported no dropout.

Figure (5): Reasons behind dropouts in Microfinance:

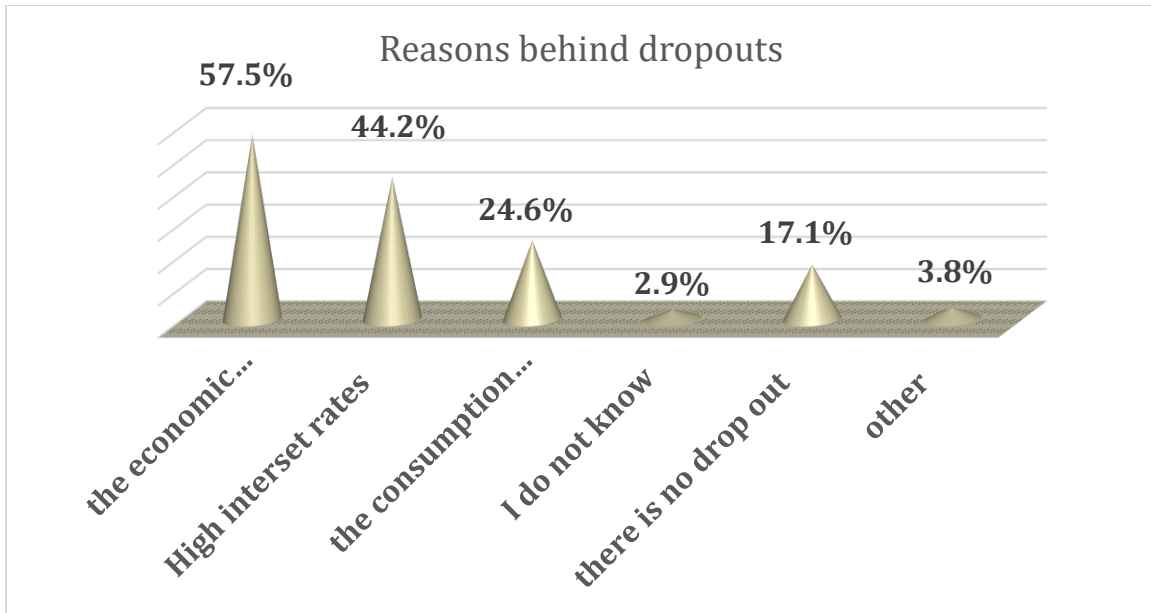
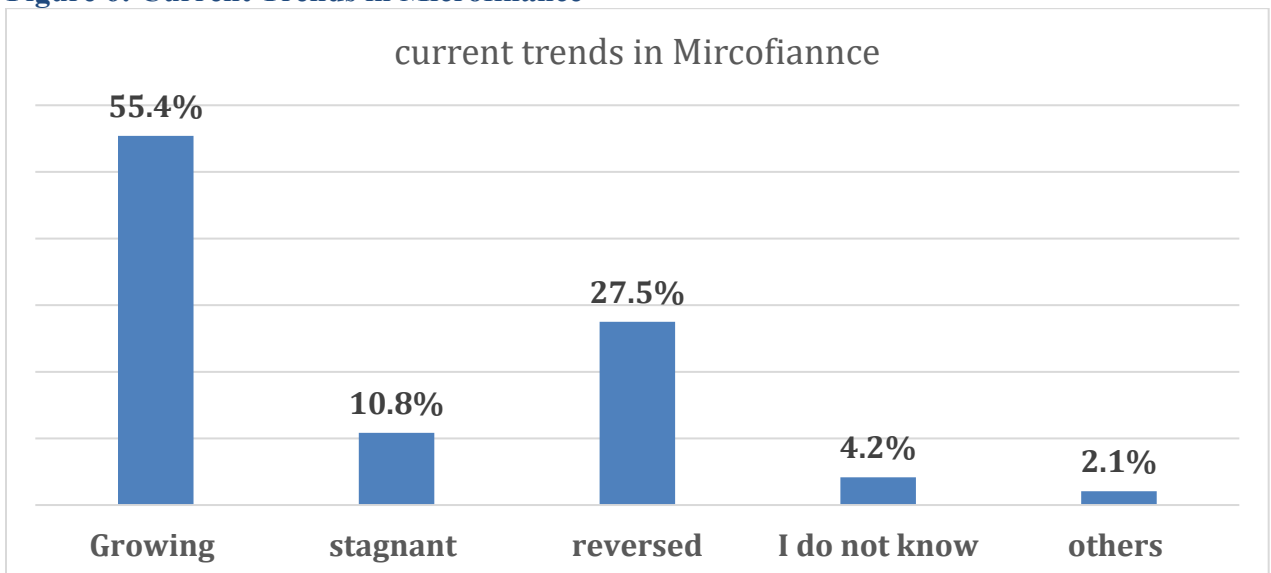


Figure (5) presents the key reasons behind this dropout from the loan officers/ staff perspective, 57.5% said that the main reason for this dropout is the economic conditions, and decrease of supply on products, and services of the projects, 44%.2% referred this dropout to the high interest rates signifies a crucial barrier for poor people to access microfinance services, 24.6% indicated that the increase of consumption loans with lower interest rates, and less required documents made people shy away from microcredit to consumption loans, Meanwhile 17,1% of the respondents said that there is no dropout.

**Figure 6: Current Trends in Microfinance**



As shown in Figure 6, when asked about the current trends in Microfinance, 55.4% of the respondents indicated that Microfinance in Egypt is growing, 27.5% said that it is reversing, 10.8% it is stagnant, and 4.2% do not know. At the same time, 2,1% said that 65% of the microfinance sector in Egypt has yet to be reached. The main finding of this

paper is that this dropout is projected to increase further; the following factors drive this increase.

- **Structural Market Shifts and Institutional Transformation:**

The KII highlights a major structural shift in the Egyptian microfinance sector from socially oriented NGOs to commercially driven companies. Before 2014, NGOs relied heavily on social lending models and informal rescheduling practices, which offered flexibility for vulnerable clients. After the 2014 law, companies expanded aggressively, supported by access to bank financing and stronger capitalisation requirements. According to one of the interviewees: *‘this was a shift from ‘social handling’ to ‘business-business’*—has contributed to stricter enforcement of repayment, the use of insurance payouts, and legal escalation in cases of default. These market transformations have increased the risk of client over-indebtedness, especially for low-income borrowers with volatile income streams, which directly links to rising dropout trends documented in recent years.

The same result

- **Economic Pressures and Erosion of Client Capacity**

The interview emphasises severe macroeconomic pressures—inflation, rising fuel and raw material costs, and the sharp increase in interest rates on bank deposits (reaching 27–30%). These pressures have *“pushed many out of small businesses”*, reducing their ability to absorb shocks or sustain loan repayment cycles. KII evidence shows that the sector is experiencing declining purchasing power, difficulty sourcing inputs, and reduced profitability for microenterprises. Under these conditions, clients increasingly drop out of microfinance either because:

1. Their businesses cannot generate income to sustain repayment.
2. They leave entrepreneurship entirely; or
3. They shift to consumer loans with lower declared interest rates.

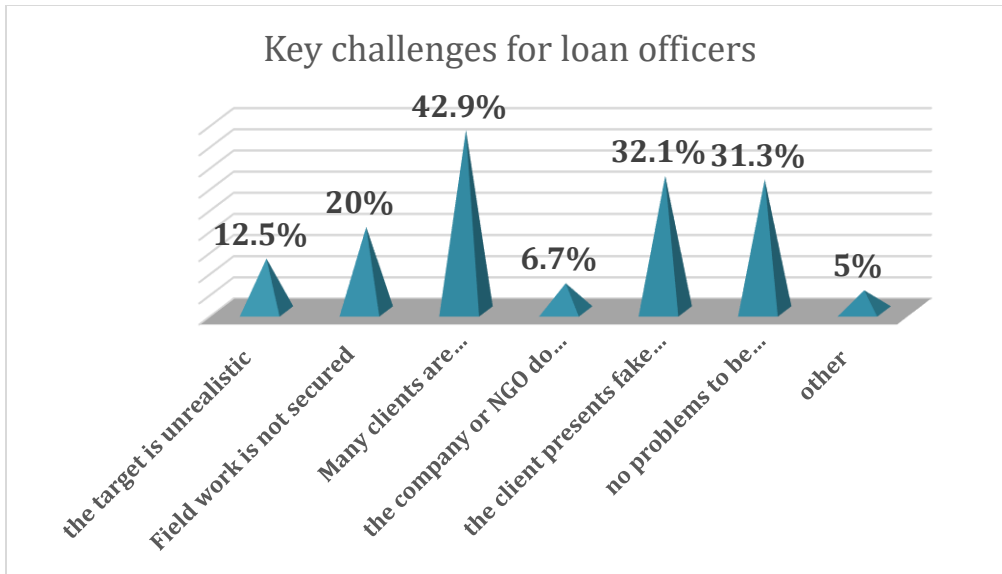
These dynamics help explain the increasing dropout rates across NGO-A and NGO-B, as well as the large fluctuations observed around 2022–2023 in your dataset.

- **Rise of Consumer Lending and Informal “Cash Extraction”**

A recurring point in the KII is the dramatic expansion of consumer finance, which is commonly used not for consumption but to obtain cash through merchants who “burn” or return goods. Because consumer loans have lower interest rates than microfinance loans, many micro-entrepreneurs strategically shift away from microfinance loans. This directly crowds out productive lending and increases dropout from microfinance institutions (MFIs). The KII describes this trend as a risk of a *“default bomb”* among low-income borrowers, especially as loan stacking increases. The prevalence of this workaround erodes MFIs' client base and distorts the sector's intended development function.

- **Operational Pressures and Loan Officer Incentives:**

**Figure (7): Key challenges for loan officers**



As shown in Figure 7, loan officers reported several challenges during their daily interactions with clients. 42.9% said clients are unable to pay interest, 32.1% said clients often provide false or misleading information, and 31.3% said they face no issues. In contrast, 20% indicated that no security measures are in place for them. Additionally, 12.5% found the target to be unrealistic, and 6.7% expressed concern that the company or NGO does not protect loan officers.

Loan officers face intense pressure to meet monthly targets and earn commissions, which leads to behaviour that increases portfolio risk.

- Issuing follow-on loans to cover arrears, creating hidden delinquency.
- Rapidly growing their portfolios when switching institutions.
- Limited capacity for quality assessment due to large caseloads.
- Exposure to high personal risk (mobility, assaults, unsafe areas).

These operational strains weaken portfolio quality and contribute indirectly to client dropout, as clients are pushed into unsustainable loan cycles and become unable to repay. This theme is closely linked to rising operational risk and the structural weaknesses of human resource systems within MFIs.

#### - **Weak Financial Literacy and Low Digital Readiness**

The KII repeatedly underscores the low financial literacy among clients. Many borrowers remain unable to use ATMs, understand loan terms, or manage multiple financial products. While national financial inclusion initiatives expanded account ownership, they did not strengthen financial capability, resulting in high numbers of inactive accounts and limited digital use. This gap worsens the vulnerability of microfinance clients—particularly women and rural borrowers—and contributes to the likelihood of dropout, especially when borrowing becomes more complex or costly.

#### - **Declining Social Impact and Mission Drift**

A crucial insight from the KII is the disconnect between microfinance portfolio growth and its social impact. Despite substantial increases in loan balances, the interviewee observes that improvements in poverty reduction, household stability, or business graduation are not

evident. There is little evidence that microfinance clients progress from micro- to small- or medium-sized enterprises over time. This mission drift—shifting from poverty-focused lending to profit-driven portfolio expansion—helps explain both:

- The lower retention among vulnerable groups (especially women), and
- Rising dropout due to the sector’s weakened relevance to low-income households.

#### - **Regulatory Gaps and Need for Updated Frameworks**

The KII emphasises that the legal definitions of micro, small, and medium enterprises no longer reflect Egypt’s economic reality. Loan size ceilings have not kept pace with inflation or business needs. As inflation rose sharply after 2016, clients required larger loans—but ceilings restricted MFIs’ flexibility. This gap contributes to dissatisfaction, reduced loan uptake, and dropouts as clients seek alternative financing channels (banks, consumer finance, informal lenders). It also disproportionately affects women, as they operate smaller, low-margin businesses that cannot absorb shocks.

#### **Policy Recommendations:**

When asked about the prospect of microfinance in Egypt, the respondents seemed optimistic despite all the constraints and challenges.

**Figure (8): The Prospect for Microfinance in Egypt**

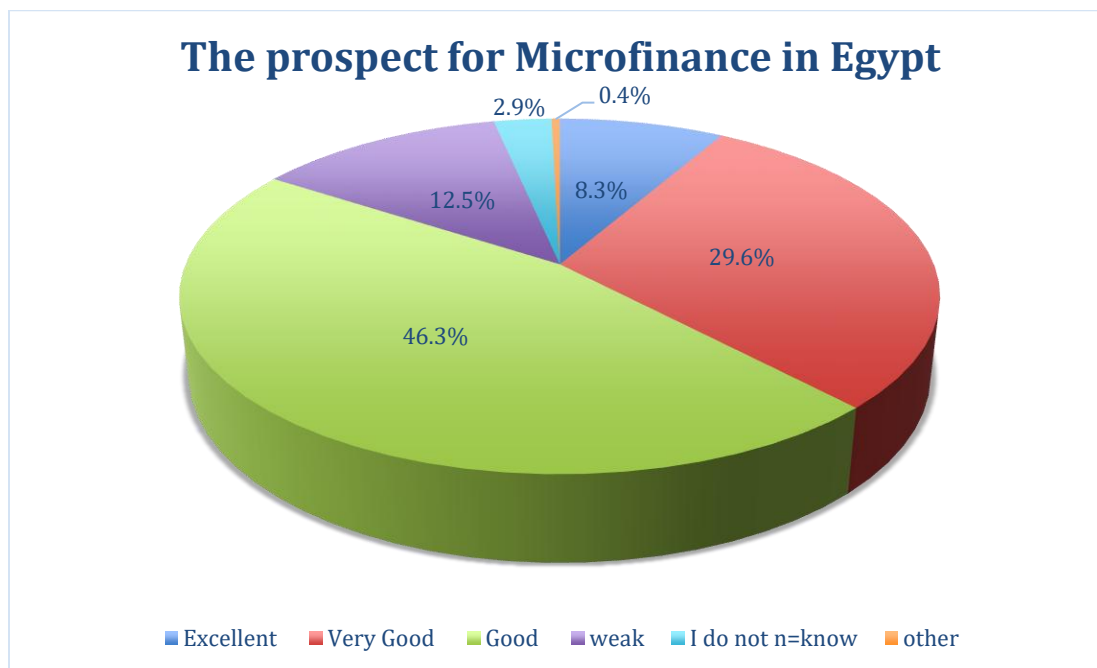


Figure 8 indicates that 46.3% of respondents regard the prospects for Microfinance in Egypt as good, 29.6% as very good, 12.5% as weak, 8.3% as excellent, and 2.9% are unsure.

This optimistic prospect is driven by some measures that should be in place, such as redesigning KPIs, reducing caseloads, building relational capacity, and supporting digital literacy.

- For Regulators (e.g., FRA): transparent exit codes, monitor renewal patterns, and onboarding standards.
- Sector-Wide: shared databases, standards for loan officers, gender-sensitive product designs.

**Conclusion:**

This paper concludes that the recent drop in the number of microfinance clients is an alarm for a profound setback in the microfinance sector in Egypt. These drawbacks require rigorous oversight and interventions from all stakeholders to ensure the sustainability of microfinance in Egypt as a tool for enhancing the economic empowerment of vulnerable segments of the population, especially women.

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