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Effect of Digital Lending Uptake, Regulatory Framework and Financial Stability of Nonbank Financial Institutions (NBFIs) in Kenya

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Abstract: This research investigated the effect of digital lending adoption, the *regulatory framework*, and the financial stability of nonbank financial institutions (NBFIs) in Kenya. *The regulatory framework mediates the relationship between digital lending adoption and financial stability. This study is based on two theories: The Technological Acceptance Model (TAM), which identifies factors influencing digital lending acceptance, and Public Interest Theory, which emphasizes regulation's role in correcting market inefficiencies and preventing exploitation. A comprehensive desktop review using Google Scholar and Boolean operators was conducted to gather relevant literature for this analysis. Findings suggest that digital lending does not inherently destabilize financial systems; rather, it has prompted regulatory improvements that protect consumers and maintain market integrity. A strong regulatory framework is crucial for ensuring financial stability and allowing non-bank lenders to operate safely. The Central Bank of Kenya's 2021 Digital Credit Providers Regulations have played a significant role in risk* *mitigation. Effective regulations are necessary to balance financial innovation with risk management. Policymakers should enhance regulations to support this balance, and future research should explore the long-term sustainability of digital lending models.*

Keywords: financial stability, digital lending uptake, regulatory framework, nonbank financial institutions

INTRODUCTION

The concept of financial stability is a cornerstone of economic health, playing a crucial role in ensuring that financial institutions can withstand economic shocks while continuing to provide essential services such as lending and investment. Financial stability is not merely a desirable trait; it is a fundamental requirement for the smooth functioning of an economy. When financial institutions are stable, they can maintain their operations even in times of economic distress, thereby supporting businesses and consumers alike. This stability fosters confidence among investors and the public, which is vital for economic growth and development(Ozili & Iorember,2024).To aid in the assessment of financial stability, the financial stability index (FSI) serves as a critical tool for policymakers and financial analysts. The FSI allows for a comprehensive evaluation of the resilience of the financial system, providing insights into its ability to absorb shocks and continue functioning effectively. The index incorporates various metrics that are pivotal in gauging the health of financial institutions, with particular emphasis on the performing loans ratio and the Z-score(Ozili & Iorember,2024).

Moreover, the performing loans ratio is a key metric that indicates the percentage of loans being repaid as agreed. This ratio serves as a direct measure of credit quality within the financial sector. A high performing loans ratio is indicative of effective credit risk management practices by banks, which is essential for maintaining trust and stability in the financial landscape. When banks manage their credit risk effectively, they are less likely to face significant losses from defaults, which in turn supports their overall stability and the broader economy.

Equally important, the Z-score provides valuable insights into the solvency of banks by quantifying the distance to default. A higher Z-score suggests that a bank is more likely to withstand financial distress, as it indicates a more substantial capital buffer relative to its risk exposure. This metric is crucial for understanding the financial health of banks, as it reflects their ability to absorb losses and continue operations in challenging economic conditions. The interplay between the performing loans ratio and the Z-score allows for a comprehensive evaluation of financial stability, as both metrics are interconnected and essential for the functionality of the financial system(Ozili & Iorember,2024).

Further reinforcing the importance of these metrics, research conducted by Chinoda and Kapingura(2023),highlights the significance of the non-performing loan (NPL) ratio alongside the

Z-score. The NPL ratio, which measures the proportion of loans that are in default or close to being in default, is a critical indicator of the credit risk faced by financial institutions. A high NPL ratio can signal underlying issues within a bank's loan portfolio, potentially jeopardizing its stability.

Non-bank lenders have increasingly been recognized for their vital contributions to the real economy, particularly in terms of expanding credit availability. As highlighted by Moloney et al. (2023), these lenders play a crucial role in enhancing the financial landscape by providing alternative sources of funding that can complement traditional banking institutions. By doing so, they not only increase the overall availability of credit but also foster a more competitive environment in the lending market, which ultimately benefits borrowers by broadening their options and potentially lowering borrowing costs. Cortes et al. (2023), further emphasize the significant impact of non-bank financial intermediaries (NBFIs) on facilitating access to credit and promoting economic development.

NBFIs serve as essential players in the financial ecosystem, particularly for individuals and businesses that may face challenges in securing loans from conventional banks. Their ability to cater to a diverse range of borrowers helps to stimulate economic activity and support growth in various sectors(Cortes et al., 2023). Recent survey by Ehrentraud and Mure(2024) revealed noteworthy trends within the retail NBFI sector.

For instance, a substantial 74% of retail NBFIs reported an increased reliance on digital platforms for loan distribution. This shift towards digitalization reflects a broader trend in the financial services industry, where technology is transforming the way lending is conducted. Moreover, an impressive 84% of these NBFIs anticipate further growth in non-bank lending through digital channels, indicating a strong belief in the potential of technology to enhance their operations and reach more customers(Ehrentraud & Mure, 2024).

Fintech companies have emerged as the leading players in the retail NBFI space, leveraging digital methods exclusively to provide loans. According to research by Ehrentraud and Mure (2024), these companies have revolutionized the lending process by utilizing advanced technologies, such as artificial intelligence and data analytics, to assess creditworthiness and streamline loan approvals. This innovative approach not only improves efficiency but also allows for a more personalized lending experience for borrowers.

Despite these advancements and the growing prominence of non-bank lending, it is important to note that this segment still constitutes a relatively small portion of Australia's total credit market, as pointed out by Hudson et al. (2023). While non-bank lenders are making strides in expanding their reach and influence, traditional banks continue to dominate the overall credit landscape. This dynamic suggests that there is still significant room for growth and development within the non-bank lending sector, as it seeks to carve out a larger share of the market and further contribute to the economy.

According to Aliza (2024), digital lending can be broadly characterized as a set of business models that enable potential borrowers to seek loans through online platforms, typically managed by non-bank financial institutions. The significant expansion of FinTech lending activities is largely attributed to the widespread integration of mobile technology and digital payment systems, which have facilitated the adoption of various digital financial services, fostering innovation and enhancing access to capital. This growth is further supported by increased investor interest and a rising demand from a predominantly unbanked population (Aliza, 2024). In Nigeria, there are more than 250 FinTech companies, with approximately half specializing in payment services, while around 15% are dedicated to lending for small and medium-sized enterprises (SMEs) (Aliza, 2024).

Digital lending in Kenya has undergone significant changes and developments, particularly following the implementation of the Central Bank Act (Digital Credit Providers) Regulations of 2021. This regulatory framework was designed to facilitate the extension of credit through digital platforms while ensuring that these providers do not engage in deposit-taking activities. This distinction is crucial as it helps to maintain the integrity of the financial system and protect consumers from potential risks associated with unregulated deposit-taking.

Problem Statement

The financial stability of nonbank financial institutions (NBFIs) in Kenya is widely regarded as strong and resilient, demonstrating the sector's ability to navigate various economic challenges and market fluctuations effectively(CBK, 2024a). In 2023, the NBFI sector witnessed substantial growth, achieving an impressive rate of 8.5%, which is more than double the growth rate of the banking sector, recorded at only 3.3%. This robust performance has led to an increase in the share of NBFIs within the total global financial assets, now standing at 49.1%. Such remarkable growth emphasizes the sector's rising significance in the global financial arena, indicating a shift in financial intermediation dynamics and the enhanced role of non-bank entities within the broader financial system (FSB, 2024).

The non-bank financial institution (NBFI) sector demonstrates considerable resilience; however, it is not immune to certain vulnerabilities that may threaten its stability(CBK, 2024a). Recent research conducted by(Mburu, 2024) indicates a remarkable fivefold increase in the number of Kenyans utilizing services from microfinance institutions, especially those offering digital credit. This notable rise can be largely credited to the rigorous regulatory measures instituted by the Central Bank of Kenya (CBK), which have created a safer environment for consumers and stimulated the expansion of these financial services.

Existing literature has primarily concentrated on the growth and adoption of digital lending. For example, Shema(2022) explored the effects of increased credit limits on digital lending practices throughout East Africa. Additionally, Kamau(2021)examined the costs, applications, and borrower considerations associated with loan uptake. Ogutu and Alouch(2023) highlighted the critical role of regulatory frameworks in influencing the digital lending landscape, particularly for small enterprises. The present study aims to synthesize literature regarding digital lending uptake, regulatory frameworks, and the financial stability of NBFIs in Kenya. The insights garnered from this review are invaluable for policymakers in both governmental and financial sectors, as they illuminate the interconnections between digital lending adoption, regulatory conditions, and the financial stability of non-bank financial institutions (NBFIs), thereby enriching the existing body of knowledge in the field of finance.

Research Objective

a) To examine the effect of digital lending uptake on financial stability of NBFIs in Kenya
b) To assess the relationship between digital lending uptake and regulatory framework of NBFIs in Kenya
c) To determine the relationship between regulatory framework and financial stability of NBFIs in Kenya.
d) To examine the mediation effect of regulatory framework between digital lending and financial stability of NBFIs in Kenya.

Theoretical Underpinning

This study is anchored in two theoretical frameworks: The Technological Acceptance Model (TAM) and Public Interest Theory.

Technological Acceptance Model (TAM)

The Technological Acceptance Model, introduced by Fred Davis in 1989, serves as a critical tool for understanding the factors that affect user acceptance and engagement with new technologies. As noted by Khatri et al.(2023),TAM highlights two key elements that play a crucial role in technology acceptance: perceived usefulness and perceived ease of use. Perceived usefulness is defined as the extent to which an individual believes that utilizing a specific technology will improve their job performance, while perceived ease of use refers to the belief that engaging with the technology will require minimal effort, thereby increasing the likelihood of its adoption.

In this research, TAM is utilized as a foundational framework to explore the adoption of digital lending practices among non-bank financial institutions (NBFIs) in Kenya. The investigation focuses on how stakeholders' perceptions of the usefulness and ease of use of digital lending solutions shape their intentions to adopt these technologies. This inquiry is particularly significant in light of the rapid growth of digital financial services in Kenya, which has positioned the country as a frontrunner in mobile banking and digital finance within Africa.

Additionally, the study extends beyond a mere evaluation of user acceptance; it also considers the broader consequences of adopting digital lending practices on the financial stability of these institutions. By examining the potential effects of digital lending integration on the financial health of NBFIs, the research seeks to offer valuable insights into how such innovations can promote economic empowerment and enhance overall financial stability in Kenya.

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Public Interest theory

According to Shleifer(2005)Public Interest theory posits that unregulated markets, due to their inherent fragility, are susceptible to inefficiencies, exploitation, and eventual collapse. This theory suggests that consumers might face adverse consequences within a market economy, thereby necessitating regulatory interventions to protect them from such negative impacts. In essence, the theory underscores the belief that markets, when left to operate without oversight, can lead to outcomes that are detrimental not only to individual consumers but also to the broader economic system.

The fragility of unregulated markets can manifest in various forms, including monopolistic practices, predatory lending, and a lack of transparency, all of which can undermine consumer trust and lead to financial instability. For instance, in the absence of regulatory frameworks, financial institutions may engage in practices that prioritize profit over consumer welfare, resulting in high-interest rates, hidden fees, and inadequate disclosures. Such practices can disproportionately affect vulnerable populations, exacerbating issues of inequality and financial exclusion(Shleifer, 2005).

In the context of the present study, this theoretical framework aids in elucidating the regulatory landscape surrounding Non-Bank Financial Institutions (NBFIs) and their role in moderating the interplay between the adoption of digital lending practices and overall financial stability. NBFIs, which include entities such as peer-to-peer lenders, microfinance institutions, and online credit providers, have gained prominence in recent years, particularly with the rise of digital financial services.

While these institutions can enhance access to credit and foster financial inclusion, they also pose unique challenges that necessitate careful regulatory oversight(Shleifer, 2005).The adoption of digital lending practices by NBFIs can lead to increased efficiency and convenience for consumers, but it also raises concerns regarding data privacy, cybersecurity, and the potential for over-indebtedness. Without appropriate regulatory measures, the rapid growth of digital lending could result in a scenario where consumers are inadequately protected from harmful lending practices, leading to a cycle of debt and financial distress.

Regulatory interventions, therefore, become essential in ensuring that NBFIs operate within a framework that prioritizes consumer protection and promotes financial stability. This may involve establishing guidelines for responsible lending, enforcing transparency in loan terms, and implementing measures to safeguard consumer data. By doing so, regulators can help mitigate the risks associated with unregulated digital lending practices and foster a more resilient financial ecosystem.

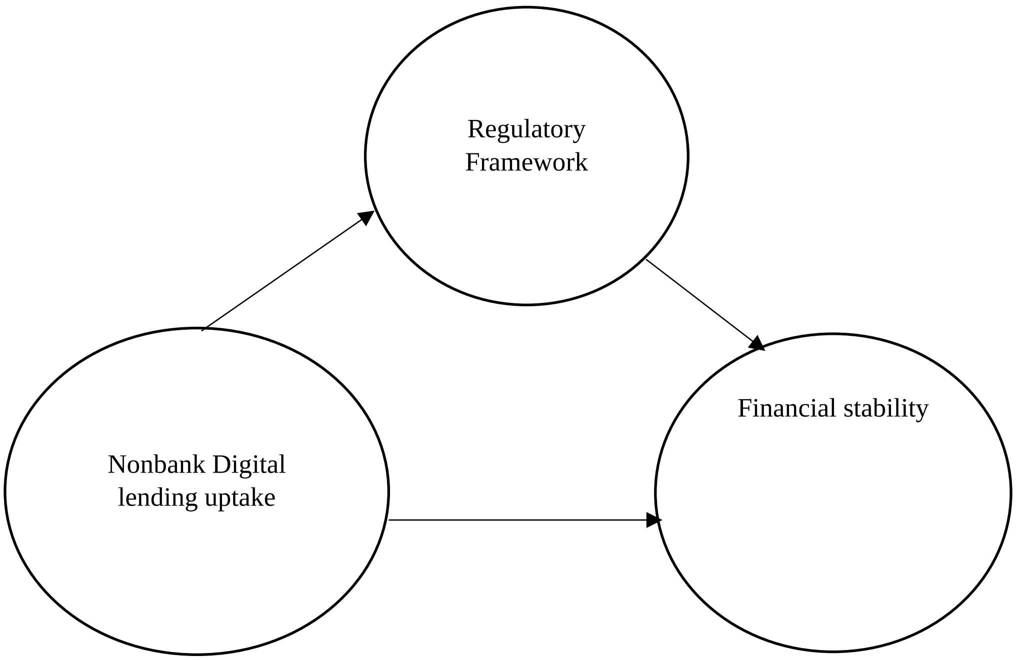

Figure1
Conceptual Framework
Source: Authors 2025

Financial Stability
The concept of financial stability is crucial for the overall health of an economy, as it ensures that financial institutions can withstand shocks and continue to provide essential services such as lending and investment. This concept is measured twofold, by performing loans ratio and the Z-score. The performing loans ratio, which indicates the proportion of loans that are being repaid as agreed, is a direct measure of the credit quality within the financial sector.

A high performing loans ratio suggests that banks are effectively managing their credit risk, which is vital for maintaining trust and stability in the financial system. The Z-score, on the other hand, provides insights into the solvency of banks by measuring the distance to default. A higher Z-score indicates that a bank is more likely to withstand financial distress, as it suggests a greater buffer of capital relative to its risk exposure(Ozili & Iorember, 2024).In this study financial stability was expected to have a significant relationship with digital lending uptake and regulatory framework.

Digital lending uptake
The landscape of digital lending has undergone profound transformations on a global scale. A new cohort of digital lenders has emerged, leveraging technological advancements to cater to customer segments that have historically been deemed underserved, capitalizing on enhanced connectivity and increased digital literacy(Stewart et al., 2018). Additionally, research by Ehrentraud et al.

(2024) highlights the pivotal role of non-bank financial institutions (NBFIs) as a crucial source of credit worldwide.

The Financial Stability Board's (FSB) annual global monitoring exercise revealed that, by the end of 2022, banks accounted for 65.5% of credit assets, amounting to USD 149.9 trillion. In contrast, other financial intermediaries (OFIs), which include NBFIs excluding insurers and pension funds, held the second-largest share at 22.5%, equivalent to USD 51.5 trillion. Specifically, in the realm of loan provision, banks possessed loan assets totaling USD 99.5 trillion, while OFIs held USD 15.4 trillion(Ehrentraud & Mure, 2024),. This study posits that digital lending is poised to have a significant impact on the financial stability of non-bank financial institutions.

Regulatory Framework.

The landscape of digital lending in Kenya has experienced notable transformations, especially after the introduction of the Central Bank Act (Digital Credit Providers) Regulations in 2021. This regulatory framework aims to promote the provision of credit via digital channels while explicitly prohibiting these providers from participating in deposit-taking activities. Such a distinction is vital for preserving the integrity of the financial system and safeguarding consumers against the risks linked to unregulated deposit-taking practices. In the present research, it is anticipated that the regulatory framework governing digital lending will serve a mediating function between the adoption of digital lending and the financial stability of non-bank financial institutions.

LITERATURE REVIEW

Nonbank Financial Institutions(NBFIs)

Globally, Nonbank financial institution contributes to the growth of the economy. In a study by Ehrentraud and Mure, Moloney et al.(2023) noted that non-bank lenders play a vital role in contributing positively to the real economy by expanding and enhancing the availability of credit. This increased access to credit can stimulate economic activity, enabling individuals and businesses to invest, grow, and thrive.

Similarly, Cortes et al.(2023) emphasized the critical function of nonbank financial intermediaries in the global financial landscape, as they facilitate access to credit and bolster economic development. By bridging gaps in traditional banking services, NBFIs help to ensure that a wider range of consumers and businesses can obtain the financing they need. Furthermore, research conducted by Hudson et al.(2023) revealed that non-bank lending constitutes a relatively minor segment of the total credit market in Australia.

While NBFIs are making strides in expanding their presence and influence, their overall share of the credit market remains limited compared to traditional banks. This finding suggests that there is still significant room for growth and development within the non-bank lending sector, as these institutions continue to innovate and adapt to the evolving financial landscape. Additionally, Kiarie and Munene(2024) observed that digital credit impacts financial well-being in diverse ways, with a marked inclination towards loans provided by mobile network operators, whereas loans accessed through websites and applications are employed to a lesser degree.

According to Ehrentraud and Mure(2024),nonbank financial institutions (NBFIs) that operate as retail lenders are subject to a variety of regulations that may specifically target certain lending practices, the sources of their funding, or a combination of both. This regulatory framework is essential for ensuring that these institutions operate within safe and sound parameters, protecting consumers and maintaining the integrity of the financial system. The authors further highlighted that these NBFI retail lenders predominantly utilize digital distribution channels to reach their customers.

In fact, a substantial 74% of surveyed individuals indicated that mobile applications and online platforms are commonly employed for lending purposes. This shift towards digitalization reflects broader trends in consumer behavior and technological advancements in the financial sector. Moreover, a significant 84% of respondents expressed optimism regarding the future, anticipating an increase in non-bank lending conducted through digital means.

This expectation underscores the growing reliance on technology in the lending process and the potential for further innovation in this space. Fintech companies have emerged as the most prominent players among NBFI retail lenders, as they exclusively offer credit through digital channels (Ehrentraud & Mure, 2024). This focus on digital platforms allows fintech firms to streamline their operations, reduce costs, and provide a more user-friendly experience for borrowers. The rise of these companies has transformed the lending landscape, making it more accessible and efficient for consumers seeking credit.

Financial Stability.

The concept of financial stability is crucial for the overall health of an economy, as it ensures that financial institutions can withstand shocks and continue to provide essential services such as lending and investment. According to Ozili and Iorember(2024) the financial stability index (FSI) serves as a valuable tool for policymakers and financial analysts to gauge the robustness of the financial system.Ozili and Iorember further indicates that performing loans ratio and the Z-score are used as metrics for financial stability. The performing loans ratio, which indicates the proportion of loans that are being repaid as agreed, is a direct measure of the credit quality within the financial sector.

A high performing loans ratio suggests that banks are effectively managing their credit risk, which is vital for maintaining trust and stability in the financial system. The Z-score, on the other hand, provides insights into the solvency of banks by measuring the distance to default. A higher Z-score indicates that a bank is more likely to withstand financial distress, as it suggests a greater buffer of capital relative to its risk exposure. This dual focus on loan performance and solvency allows for a comprehensive assessment of financial stability, as both factors are interrelated and critical for the functioning of the financial system(Ozili & Iorember, 2024).

In addition,Chinoda and Kapingura(2023) further emphasize the significance of the NPL ratio and Z-score in their research, reinforcing the notion that these metrics are foundational in evaluating the health of financial institutions. The consistent use of these indicators across various studies underscores their relevance and reliability in financial stability assessments

Digital lending Uptake

The research conducted by Shema (2022) sheds light on a significant trend in the financial landscape of Africa, particularly the remarkable increase in digital lending. This surge is largely attributed to the growing acceptance and integration of mobile money services, which have revolutionized the way individuals access financial products. Mobile money platforms have made it easier for borrowers to apply for loans, receive funds, and make repayments, thereby enhancing financial inclusion across the continent.

However, despite the innovative nature of these digital loan products, a critical challenge persists: many potential borrowers lack sufficient credit histories. This absence of reliable credit information poses a significant barrier for lenders, who are often cautious in their lending practices. Consequently, lenders tend to offer smaller loan amounts initially, with the possibility of incrementally increasing these amounts based on the borrowers' repayment behavior. While this approach allows borrowers to build their credit profiles over time, it also carries inherent risks. The gradual increase in credit limits may inadvertently lead to higher default rates, as borrowers may take on more debt than they can manage, ultimately threatening the financial stability of both the borrowers and the lending institutions.

The Financial Stability Board's annual global monitoring report indicates that, as of the end of 2022, banks accounted for 65.5% of total credit assets, amounting to USD 149.9 trillion. In contrast, other financial intermediaries, which include NBFIs excluding insurers and pension funds, held the second-largest share at 22.5%, equivalent to USD 51.5 trillion. When examining the provision of loans, a specific category of credit activity, banks reported loan assets totaling USD 99.5 trillion, while other financial intermediaries contributed USD 15.4 trillion. This data underscores the critical position of NBFIs in the financial landscape, particularly in their capacity to supplement traditional banking institutions in the credit market. The findings suggest a growing reliance on diverse financial entities to meet the credit demands of the global economy(FSB, 2023).

Robinson and Tornielli(2024) indicated that Lending by Australian non-banks remains small as a share of outstanding credit. Moreover, study by Djalilov and Yazdifar(2022) identified a non-linear, inverted U-shaped relationship between digital credit and financial stability. This implies that a proliferation of credit can lead to increased risk-taking by financial institutions hence affecting financial stability.

A recent investigation conducted by Cevik(2023) highlights that lending activities conducted through fintech platforms may carry heightened financial risks, primarily due to a concentration of resources and an excessive dependence on data-driven algorithms. The findings indicate that the extent and statistical relevance of fintech's influence on financial stability are contingent upon the specific financial instrument being analyzed, such as digital lending compared to digital capital raising. Notably, the study reveals that digital lending, when expressed as a percentage of GDP, exhibits a statistically insignificant negative impact on the z-score, suggesting a complex interplay between these variables(Cevik, 2023).Likewise, Digital credit improves borrowers' financial well-being(Chen et al., 2023) .

In the specific context of Kenya, research conducted by Kamau (2021) reveals that an individual's employment status plays a crucial role in influencing their loan application and subsequent uptake of loans. Employed individuals are more likely to secure loans, as their stable income provides lenders with a sense of security regarding repayment. In contrast, other demographic factors, such as the age of digital credit users, do not appear to have a statistically significant impact on loan uptake. This finding suggests that lenders prioritize income stability over other characteristics when assessing loan applications.

Additionally, Ogutu and Alouch (2023) emphasize the importance of regulatory frameworks in shaping the digital lending landscape, particularly for small-scale enterprises. Their research indicates that well-defined policies governing digital lending can enhance loan uptake among these businesses. Among the various factors influencing loan uptake, the duration of the repayment period emerges as the most significant. A longer repayment period may alleviate the financial burden on borrowers, making it more feasible for them to manage their repayments and, in turn, encouraging them to take out loans.

This highlights the critical interplay between policy, borrower characteristics, and loan terms in fostering a healthy digital lending environment in Kenya. Additionally, research by Muriuki (2021) and Murunga et al. (2024) suggest that while mobile lending has the potential to enhance access to credit, its relationship with non-performing loans is not straightforward. The positive yet statistically insignificant relationship indicates that mobile lending may not be a panacea for financial stability.

Regulatory framework

Under the Digital Credit Providers Regulations all digital credit providers are licensed and the regulatory framework not only addresses the urgent concerns around market conduct and consumer protection but also seeks to enhance financial stability in the face of rapid digital expansion. By bringing digital lenders under formal oversight, the CBK aims to create a more stable, ethical, and transparent credit market that can sustainably support Kenya's evolving financial landscape(CBK,2024).Moreover, in another study in Kenya indicates that digital lending has a positive influence on regulatory frameworks in Kenya(Githu, 2023)

METHODOLOGY

Document review approach was used in this study. To gather the relevant documents for this review, a systematic search was conducted using Google Scholar, employing Boolean operator techniques to refine and enhance the search results. This method allowed for a more targeted approach, ensuring that the literature reviewed was both pertinent and comprehensive. The data extracted from these various sources were meticulously synthesized, enabling the identification of emerging trends and patterns within the literature. This synthesis not only highlighted the current state of knowledge regarding the interplay between digital lending uptake, financial stability, and regulatory frameworks but also provided insights into potential areas for future research and policy development.

Target population

The research focused on 85 Non-Bank Financial Intermediaries (NBFIs) that were licensed as of September 30, 2024(CBK, 2024b). These entities specialize in offering private credit to both households and businesses. They operate under the regulatory framework established by the Central Bank of Kenya, specifically the Digital Credit Providers Regulations of 2021.

FINDINGS

A comprehensive examination of the literature yields several key findings that contribute to our understanding of the interplay between digital lending, regulatory frameworks, and financial stability.

Firstly, the research indicates that digital lending exerts a statistically insignificant negative impact on financial stability. This conclusion aligns with the results presented by Cevik(2023), who similarly found that while concerns about the potential risks associated with digital lending are prevalent, the empirical evidence does not support a significant detrimental effect on the overall stability of financial systems. This finding suggests that, at least in the context studied, digital lending may not pose the severe risks that some stakeholders fear, thereby allowing for a more nuanced discussion about its role in the financial ecosystem.

Secondly, it is observed that digital lending positively affects the regulatory frameworks in Kenya. This finding corroborates the research conducted by Githu(2023), which highlights how the rise of digital lending platforms has prompted regulators to adapt and evolve existing frameworks to better accommodate these new financial technologies. The positive influence of digital lending on regulatory practices indicates a proactive approach by regulators to harness the benefits of innovation while ensuring consumer protection and market integrity.

Thirdly, the regulatory framework is shown to have a beneficial effect on financial stability in Kenya, as supported by the Central Bank of Kenya CBK(2024). This finding underscores the importance of a robust regulatory environment in fostering a stable financial system. The CBK's research emphasizes that well-designed regulations can mitigate risks associated with financial innovations, thereby enhancing the overall resilience of the financial sector. This relationship highlights the critical role that effective regulation plays in maintaining stability, particularly in a rapidly evolving financial landscape.

Finally, it was determined that the regulatory framework serves as a mediator in the relationship between digital lending and financial stability. This suggests that the impact of digital lending on financial stability is not direct; rather, it is influenced by the strength and effectiveness of the regulatory measures in place. In this context, a strong regulatory framework can help to buffer any potential negative effects of digital lending, ensuring that its benefits can be realized without compromising the stability of the financial system. This mediating role of regulation emphasizes the need for ongoing dialogue between regulators, financial institutions, and digital lending platforms to create an environment that supports innovation while safeguarding financial stability.

DISCUSSIONS

A thorough review of the existing literature reveals several significant insights that enhance our comprehension of the relationship between digital lending, regulatory frameworks, and financial stability. Initially, the findings suggest that digital lending has a statistically insignificant negative effect on financial stability. This observation is consistent with the work of Cevik (2023), who similarly concluded that, despite widespread apprehensions regarding the risks linked to digital lending, empirical data does not substantiate a notable adverse impact on the stability of financial systems. This implies that, at least within the examined context, digital lending may not represent the substantial threats that some stakeholders anticipate. Consequently, this finding facilitates a more nuanced dialogue regarding its function within the financial ecosystem, encouraging stakeholders to reconsider their perspectives on digital lending and its potential benefits.

Furthermore, it is noted that digital lending has a favorable influence on the regulatory frameworks in Kenya. This assertion is supported by Githu (2023), who illustrates how the emergence of digital lending platforms has compelled regulators to modify and enhance existing frameworks to more effectively integrate these innovative financial technologies. The positive impact of digital lending on regulatory practices reflects a proactive stance by regulators, aiming to leverage the advantages of innovation while safeguarding consumer interests and ensuring market integrity. This dynamic interaction between digital lending and regulatory adaptation suggests that innovation can drive regulatory evolution, leading to a more responsive and effective regulatory environment that can better accommodate the rapid changes in the financial landscape.

Additionally, the regulatory framework is demonstrated to positively influence financial stability in Kenya, as evidenced by the Central Bank of Kenya (CBK) (2024). This finding highlights the necessity of a strong regulatory environment in promoting a stable financial system. The research conducted by the CBK emphasizes that well-structured regulations can alleviate risks associated with financial innovations, thereby bolstering the overall resilience of the financial sector. This connection underscores the vital role that effective regulation plays in sustaining stability, particularly in a financial landscape characterized by rapid technological advancements and evolving consumer behaviors. The interplay between robust regulatory frameworks and financial stability suggests that regulators must remain vigilant and adaptive, ensuring that they not only mitigate risks but also foster an environment conducive to innovation and growth.

Lastly, the analysis concluded that the regulatory framework acts as an intermediary in the interplay between digital lending and financial stability. This indicates that the relationship is not straightforward; instead, it is shaped by the robustness and efficacy of the existing regulatory measures. In this regard, a well-established regulatory framework can mitigate any adverse consequences associated with digital lending, thereby allowing its advantages to be harnessed without jeopardizing the integrity of the financial system. The mediating function of regulation highlights the importance of continuous communication among regulators, financial entities, and digital lending platforms to foster an ecosystem that encourages innovation while maintaining financial stability.

Implication to research and Practice

The results of this review provide valuable insights for policymakers in both governmental and financial sectors, as the research elucidates the connections between the adoption of digital lending, the regulatory environment, and the financial stability of non-bank financial institutions (NBFIs). Furthermore, these findings enhance the current understanding within the finance discipline.

CONCLUSION

In summary, the literature indicates that while digital lending may not pose significant threats to financial stability, it does necessitate a reevaluation of regulatory frameworks to ensure they are equipped to handle the challenges and opportunities presented by such innovations. The findings advocate for a balanced approach that embraces technological advancements while maintaining a strong regulatory foundation, ultimately contributing to a more stable and resilient financial ecosystem.

Future Research

The research suggests that additional investigations should be conducted to explore the factors influencing the adoption of digital lending and the financial sustainability of Nonbank Financial Institutions in Kenya.

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