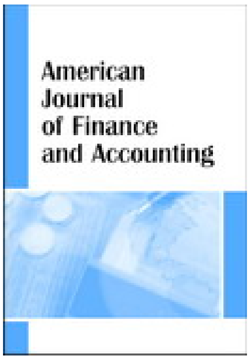

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Digital lending in emerging economies: the nexus between financial innovation and consumer protection

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Digital lending in emerging economies: the nexus between financial innovation and consumer protection

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Abstract: This study examines unregulated digital lending practices in Ghana, Nigeria, South Africa, and Kenya, and their impact on consumers. A triangulation approach was used, combining primary research in analysing 68 unlicensed digital lending apps and surveying 280 consumers and secondary research in reviewing academic and industry literature. Findings indicate that while digital credit improves access to finance, unlicensed instant digital lending firms pose risks such as high-interest rates, debt collector harassment, and over-indebtedness. Additionally, these apps sell or expose user data without consent, leading to manipulative loan advertisements by third parties. Although central banks have implemented some consumer protection measures, regulatory gaps remain. The study recommends that central banks strengthen regulations, collaborate with app distribution platforms to remove unlicensed apps, hold unregulated lenders accountable, and promote consumer education on responsible borrowing.

Keywords: consumer protection; digital finance; alternative finance; financial inclusion; predatory lending.

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1 Introduction

Financial technology (Fintech) has disrupted the traditional banking industry by enabling digital financial services that provide easy and affordable access to financial products and services to people who have been traditionally excluded from the formal financial system

(Digital Euro Association, 2023; Makridakis, 2021; Tampuri et al., 2019). The use of mobile phones and other digital devices has facilitated the growth of Fintech products such as mobile money, digital wallets, and online lending (Tampuri and Kong, 2019). One of the most popular Fintech products is digital quick loans or instant credit, which allows individuals to access credit quickly and easily using their mobile devices.

Quick loans or instant credit are financial products offered by Fintech firms or digital channels of financial institutions that allow individuals to borrow small amounts of money quickly and easily using their mobile devices. These loans are often marketed as a fast and convenient solution to meet emergency expenses, such as medical bills or unexpected car repairs, or to cover short-term cash flow gaps between paychecks. The application process is typically straightforward, requiring minimal documentation and providing instant feedback on loan approval.

In contrast to traditional banks, which require extensive documentation and often take several days to process loan applications, Fintech firms use digital platforms and machine learning algorithms to analyse customer data and assess creditworthiness. This allows them to offer quick loans to individuals who may not have a credit history or may have been excluded from the formal financial system.

However, the growth of unregulated digital lending firms or instant credit firms has raised concerns about consumer protection and financial stability. The emergence of unlicensed digital instant credit firms, which are not regulated by financial authorities, has led to predatory lending practices and other risks for consumers (Tampuri et al., 2021; Yap and Fayolle, 2020). These firms charge high-interest rates and fees, use aggressive debt collection tactics, and may use data in ways that infringe on consumers' privacy (Ahmed and Asim, 2020). Moreover, these firms collect a significant amount of personal information from their clients, raising concerns about data privacy and security. These issues threaten the financial stability of individuals and the wider financial system and underscore the need for robust regulatory frameworks.

Against this backdrop, this paper aims to study the nexus between financial innovation, financial inclusion, risk and consumer protection and the implications of predatory digital lending/quick credit activities on the use of digital financial services and Fintech products, with a focus on unlicensed digital instant credit firms.

The paper contributes to the understanding of the risks and consumer protection issues associated with unlicensed instant digital credit firms, providing insights for financial regulators and policymakers in their efforts to design evidence-based regulations that enhance inclusive finance and consumer protection for Fintech products. Specifically, the study evaluates the regulatory frameworks that apply to Fintech schemes engaged in the lending and examines their effectiveness in addressing issues of financial inclusion, consumer protection, privacy, and risk for individuals and the financial systems. Moreover, the study adds to the literature on Fintech regulation and policy by providing empirical evidence on the impact of regulatory frameworks on the development of responsible Fintech businesses and inclusive development.

While prior research has explored the implications of digital financial services and Fintech products, little attention has been given to the risks associated with unlicensed instant credit firms. This study addresses this gap by scrutinising the practices of these firms and assessing the financial regulatory environment in which they operate. Furthermore, this study contributes to the growing body of literature on financial inclusion and consumer protection in the context of Fintech. The study emphasises the need to ensure that Fintech products are designed with consumer protection in mind to enable accessible benefits for all individuals. It provides insights into how financial regulators and policymakers can design regulations that support the responsible development of Fintech businesses and ensure consumer protection.

The study's novelty lies in its comprehensive examination of the risks associated with unlicensed instant credit firms and its assessment of the regulatory environment applicable to Fintech lending. By adding to the literature on financial inclusion and consumer protection in the context of Fintech, this study aims to inform policymakers, regulators, and industry stakeholders in their efforts to design and implement effective regulations that support the responsible development of Fintech businesses.

2 Literature review

Instant loans have gained popularity in Africa, with the emergence of mobile money services and digital finance platforms providing quick and easy access to credit. The adoption of digital financial services in African countries has increased significantly over the past decade, with mobile money being the most popular form of digital financial service. However, the growth of unlicensed digital instant credit firms has raised concerns about consumer protection and financial stability. Studies conducted in Ghana, Nigeria, Kenya, and South Africa found that borrowers who used instant loan apps were charged high-interest rates and fees, and were subjected to aggressive debt collection tactics, leading to mental health problems and financial distress (Lahiri et al., 2021). Data privacy and security concerns were also raised due to the significant amount of personal information collected from borrowers. These risks highlight the need for evidence-based regulations and consumer protection measures to ensure responsible lending practices and mitigate risks for borrowers.

In Ghana, research has shown that the use of digital financial services has increased significantly over the past decade, with mobile money being the most popular form of digital financial service (Adom et al., 2020; Appiah et al., 2021; Dzansi et al., 2019). However, the growth of unlicensed digital instant credit firms has raised concerns about consumer protection and financial stability.

The benefit of digital financial services could be enormous (Kong et al., 2018). These services also have the potential to improve financial inclusion by extending credit to underserved populations who may not have access to formal financial services. For instance, a study conducted by the International Finance Corporation (IFC) found that digital finance platforms in Ghana have increased access to credit for women and small business owners (International Finance Corporation, 2021). But studies have shown also some of the risks that come with some licensed and unlicensed instant loans. A study conducted by the Ghana Statistical Service (GSS) found that high-interest rates were the most significant factor affecting access to credit in Ghana (GSS, 2018). Additionally, some instant loan providers in Ghana have been accused of engaging in predatory lending practices, such as using aggressive debt collection tactics and charging exorbitant interest rates. There have been attempts to address these challenges with the Bank of Ghana (BoG) developing a regulatory framework to govern these services. Under the Payment Systems and Services Act, 2019 (Act 987), instant loan providers are required to obtain a license from the BoG and comply with regulations on capital adequacy, liquidity management, and consumer protection. The BoG also requires instant loan providers to disclose their interest rates, fees, and charges to consumers clearly and transparently.

In Nigeria, digital lending is a growing phenomenon, with several providers operating outside of the regulatory frameworks established to govern financial services. The unlicensed instant loan market in Nigeria is growing rapidly, with several providers offering loans through mobile applications and other online platforms. According to the Central Bank of Nigeria (2018b), the number of Nigerians with access to mobile financial services increased from 45.4 million in 2014 to 90.4 million in 2018, with a significant proportion of these users accessing unlicensed instant loan services. And consumers are being exposed to privacy violations and predatory lending practices observed in other countries.

Afolabi and Afolabi (2020) observed that there are certain opportunities for financial inclusion that digital lending brings to individuals in Nigeria while Ibrahim et al. (2019) explored the dynamics of digital lending in Nigeria, observing the growth of unlicensed online lending apps and noted the potential risks for borrowers (Ajibade and Ogunyinka, 2019) including concerns of digital privacy (Nwokoye and Balogun, 2020); therefore, calling for increased regulation and consumer education to protect vulnerable borrowers in the Nigerian digital lending market.

Research conducted in South Africa has revealed that unlicensed online lending applications frequently engage in practices that exploit borrowers, commonly referred to as predatory lending. The study of National Credit Regulator (2018) on the Assessment of the Credit Market in South Africa found that many of these lenders charge excessive fees and interest rates, leading to cycles of debt for borrowers. Moreover, these firms often engage in aggressive debt collection tactics, such as harassment and threats, further exacerbating the financial difficulties faced by borrowers. Overall, the growth of unlicensed online lending apps in South Africa highlights the need for increased regulation and consumer protection to ensure fair and transparent lending practices and protect vulnerable borrowers from exploitation.

According to Mutema's (2019) research on predatory lending in South Africa, many lenders, including unlicensed online lending apps, engage in exploitative lending practices. Such practices include charging high-interest rates and fees, which have a detrimental effect on borrowers, especially those from low-income households. Mashiqa and Chigunta (2020) highlight the urgent need for increased regulation and consumer education to protect vulnerable borrowers from exploitation. The study reveals that many lenders, including unlicensed online lending apps, impose exorbitant interest rates and fees that have a detrimental impact on borrowers, especially those from low-income households. Consequently, there is a pressing need for policymakers, regulators, and industry stakeholders to work collaboratively to promote responsible lending practices and safeguard consumers from predatory lending. This can be achieved through the establishment of robust regulatory frameworks that ensure transparency and fairness in lending, coupled with consumer education initiatives that raise awareness of the risks associated with predatory lending practices. Such efforts will go a long way in protecting vulnerable borrowers and promoting financial inclusion in South Africa.

Unlicensed digital lending firms often charge exorbitant interest rates and fees, resulting in borrowers falling into debt traps. A study conducted by the Center for Global Development found that unlicensed lenders in Kenya charged interest rates as high as 520% per annum, leading to borrowers taking out additional loans to repay previous ones

(Aker et al., 2018). These loans can also be associated with aggressive debt collection tactics, such as harassment, threats, and violence.

Akuffo et al. (2020) found that borrowers who used instant loan apps were charged high-interest rates and fees, and were subjected to aggressive debt collection tactics. The study also found that borrowers who defaulted on their loans were harassed and threatened with legal action, leading to mental health problems and financial distress. Also, Minna et al. (2020) found that instant loan apps collect a significant amount of personal information from borrowers, raising concerns about data privacy and security whiles Ayittey and Ackah (2018) examined the impact of mobile money services on financial inclusion and found that while mobile money has increased access to financial services, however with concerns about the high costs of digital credit and the potential for over-indebtedness. The study also highlighted the need for consumer protection and financial education programs to mitigate the risks of digital credit.

The use of instant loan apps in Nigeria has increased significantly over the past few years, with borrowers being able to access credit quickly and easily using their mobile devices. However innovative digital lending is still in its infancy, with mobile money adoption being relatively low (Adeoye et al., 2020; Ayittey and Ackah, 2018). Borrowers who used instant loan apps in Nigeria are charged with high-interest rates and fees and were also subjected to aggressive debt-collection tactics (Adebayo et al., 2019). The study also found that borrowers who defaulted on their loans were harassed and threatened with legal action, leading to mental health problems and financial distress. Also, Olumuyiwa et al. (2021) observed that instant loan apps collect a significant amount of personal information from borrowers, raising concerns about data privacy and security while Olojede et al. (2020a) revealed that instant loan lending in Nigeria often results in high-interest rates and aggressive debt collection tactics, leading to borrower default and financial distress. The study also identified data privacy concerns, as instant loan lenders often collect sensitive personal information from borrowers without clear consent or protection measures.

In Kenya, some study has shown that the use of digital financial services has increased significantly over the past decade, with mobile money being the most popular form of digital financial service (Wambua et al., 2018; Wambugu et al., 2020). However, the growth of unlicensed digital instant credit firms has raised concerns about consumer protection and financial stability, especially concerning Gathogo et al. (2020) high-interest rates and fees, and aggressive debt collection tactics which digital borrowers face. The study also found that borrowers who defaulted on their loans were harassed and threatened with legal action, leading to mental health problems and financial distress. On the other hand Mwangi et al. (2020) observed that instant loan apps collect a significant amount of personal information from borrowers, raising concerns about data privacy and security, therefore showing concerns which were related to Kariuki et al. (2019) observed a study on the use of digital financial services among small and medium-sized enterprises (SMEs) improved access to finance, however there are challenges related to high-interest rates, inadequate credit history, and insufficient financial literacy among borrowers and recommends the development of alternative credit scoring models and financial education programs to address these challenges.

In South Africa, research has shown that the use of digital financial services has increased significantly over the past few years, with mobile money adoption being relatively low (Muzenda and Bonga-Bonga, 2019; Owusu et al., 2021). However, the use of instant loan apps has increased significantly, with borrowers being able to access credit quickly and easily using their mobile devices but with several serious concerns including Nsiah-Asamoah et al. (2021) defaulters being subjected to aggressive debt collection tactics. The study also found that borrowers who defaulted on their loans were harassed and threatened with legal action, leading to mental health problems and financial distress supporting an earlier study. Olojede et al. (2020b) observed a link between some instant loans, causing health problems and financial distress. Also, Mzenda and Bonga-Bonga (2019) analysed the impact of digital credit on financial inclusion and found that while digital credit has expanded access to finance, there are concerns about the high costs of credit, data privacy, and the potential for over-indebtedness. The study recommends the development of consumer protection regulations and financial education programs to ensure responsible lending practices and mitigate risks for borrowers.

Overall, the literature suggests that while digital credit has the potential to improve financial inclusion and access to finance in African countries, there are significant risks associated with unlicensed instant credit firms, including high-interest rates, aggressive debt collection tactics, data privacy concerns, and the potential for over-indebtedness. These risks highlight the need for evidence-based regulations and consumer protection measures to ensure responsible lending practices and mitigate risks for borrowers.

3 Methodology

The research design used in this study is a mixed-methods approach, which involves the collection and analysis of both qualitative and quantitative data. This approach provides a more comprehensive understanding of the research topic, allowing for a more robust analysis of the findings. The study employed a purposive sampling technique. The researcher targeted unregulated instant loan apps/firms operating through the use of payment systems in Ghana, Nigeria, South Africa, and Kenya. The sample size included 68 unregulated digital lending apps. The sample size was determined based on the availability and accessibility of loan apps under study. Also, a survey was conducted among 280 digital lending consumers who were asked about their experiences with default, including the reasons for default, whether it was intentional or unintentional, and any contributing factors. The survey was conducted anonymously with email accounts and was distributed online to ensure a wide range of responses.

The data collection process involved primary and secondary data sources. Primary data was collected through, in-depth interviews with representatives from selected unlicensed and licensed instant credit firms operating in Ghana, Nigeria, South Africa, and Kenya. These interviews were conducted in person, online, or via telephone. Also, there was an observation of the loan application and disbursement processes, loan recovery, and governance of selected unlicensed and licensed instant credit firms through the participation of the researchers in the loan application processes. Also, there is a collection of responses and reviews online by users of these loan apps. Secondary data was collected through an extensive review of academic and industry literature on the topic.

Qualitative data collected from the in-depth interviews and observations were analysed using thematic analysis. The data were transcribed, coded, and categorised based on emerging themes. Quantitative data collected from the user responses and reviews were analysed using descriptive statistics.

To ensure the validity of the study, the researchers used a triangulation approach to collect data from multiple sources. This approach enhances the credibility and trustworthiness of the findings. The researchers also used member checking, where participants were asked to review the transcripts of their interviews to verify the accuracy of the data collected. Reliability was ensured by using a standard data collection protocol, where all interviews and observations were conducted using the same procedures and questions. The researchers also conducted a pilot study to test the data collection tools before the actual study.

The study was conducted in compliance with ethical guidelines for research involving human subjects. Informed consent was obtained from all participants before the interviews and observations. Participants' identities were kept confidential, and data were stored securely to protect participants' privacy.

Overall, this mixed-methods approach allowed for a more comprehensive analysis of the operations of unlicensed instant credit firms and their impact on consumers in Ghana, Nigeria, South Africa and Kenya.

4 Findings and analysis

4.1 The concerns in digital lending by unregulated platforms

While assessing digital lending practices of unlicensed firms' operations, several concerns were observed. These unregulated digital lending or quick credit firms operate through mobile applications and other online platforms, with the loan application process taking only a few minutes. Unlicensed firms typically require borrowers to provide personal information, such as their name, address, phone number, and bank details, which are used to assess the borrower's creditworthiness. With licensed firms, the requirement to onboard usually public data and few private information with options of not providing if the consumer chose.

4.1.1 ESG financing

Sustainable development and social impact are increasingly becoming crucial considerations for businesses around the world. In Africa, M-KOPA is one example of a mobile-based platform in Kenya and other African countries providing pay-as-you-go solar energy systems to households. They have embraced a business model that considers sustainable development and social impact by lending with a focus on providing clean energy and inclusive finance on the continent.

The study found that none of the unregulated digital lending app firms operating in the market had an environmental, social and governance (ESG) framework in place. While seven of the companies claimed to have such a framework during the onboarding process, there was no evidence to support these claims. This means that these companies did not have any formal policies or practices in place to address environmental, social, and governance issues in their operations. This could potentially have negative impacts on the stakeholders, including customers, employees, and the wider community, who may be affected by the lending activities of these companies.

4.1.2 Security and privacy of data: sale and theft of data

All of the unlicensed services collected personal information from borrowers during the app installation process and the loan application process and some were found to engage in the sale of this data to third-party companies for profit. The apps when accessed collected several personal data including access to SMS messages, call logs, and GPS location data, Valid identification data, some of which are without the borrowers' knowledge or consent whiles for some, you cannot access their service until these data are consented to. This raises concerns about the safety and privacy of borrower data in the hands of unlicensed loan apps and firms.

After registering on the app and applying for a loan from one such unlicensed digital credit app, some borrowers started receiving an SMS, emails, and targeted advertisements on social media platforms. These are often unsolicited and can be a result of the loan app selling the borrower's data to marketing companies without their consent. This can be a significant threat to borrowers, as their data can be used for fraudulent activities such as identity theft, unauthorised access to financial accounts, and even blackmail. The unauthorised sharing of personal information can also result in a loss of privacy, leaving borrowers vulnerable to potential cyber-attacks and other online threats.

Moreover, using software, it is noticed that some of the operations of the unlicensed digital credit firms gain access to data and consolidate other data on certain activities of consumers outside of the app. The use of AI by these firms to collect and process personal data can pose additional risks to borrowers. AI algorithms may be used to analyse borrower data and make decisions about loan approvals or denials based on factors such as creditworthiness, income, and other financial data. However, these algorithms as observed comes with a bias, leading to unfair loan decisions and further exacerbating financial vulnerability for borrowers through the targeting of specific borrowers with high-interest rates, which is the business model of the firms as observed. In one app, consumers reported different interest rates offered for the same amount and duration depending on factors unknown to the consumers.

Licensed instant loan firms typically may have more stringent data privacy policies in place and are subject to government regulations on data collection and sharing. They are required to obtain explicit consent from borrowers before collecting or sharing any personal data and are held accountable for any breaches of privacy or security. In addition, they often use secure data storage and encryption methods to protect borrower data from theft or unauthorised access.

Borrowers need to exercise caution when dealing with unregulated digital credit apps and companies that gather personal information. It is important to thoroughly review the terms and conditions of any loan agreement before signing it which many consumers (up to 82%) did not.

4.1.3 Dishonest advertising by unlicensed digital credit firms: the cautionary tale

Unlicensed digital credit firms have been under scrutiny and observed dishonest advertising practices. The firms, often target financially vulnerable individuals some of which may have tried applying for a loan either from the firm or another firm online, use misleading advertising to lure them into taking out loans with high-interest rates and hidden fees.

One common tactic used by these firms is to advertise low-interest rates, which can be as low as 6%. However, the actual interest rates can be much higher. For example, one firm advertises a 6% interest rate, but in reality, its two-week loan repayment can be as high as 38%, using a bizarre calculation method. This can lead to borrowers paying back much more than they anticipated.

Moreover, these firms often deduct various fees from the loan amount, which can add up to as much as 42% of the total loan amount approved. These fees can include processing fees, insurance fees, and administrative fees, among others. However, the interest rate is calculated on the total loan amount approved, rather than the amount received by the borrower after these deductions.

These dishonest advertising practices can lead to financial ruin for many borrowers, particularly those who are financially incapable of repaying the loans. In some cases, borrowers are unable to repay the loans, leading to a cycle of debt that can be difficult to break out of. An example of such dishonest advertising was observed when an unlicensed instant loan operating for Ghana and Nigeria markets, advertising a low-interest rate of 8.6% for the duration of the loan of two weeks. However, the actual interest rate was as high as 66% for the same period, with hidden charges that were not disclosed to borrowers.

Borrowers should exercise caution when dealing with unlicensed instant loan firms and should carefully review the terms and conditions of any loan agreement before signing it. Regulatory authorities should also monitor the practices of these firms and take appropriate action to protect the interests of borrowers and ensure that borrowers are not taken advantage of by unscrupulous lenders.

4.1.4 Interest rates

The instant credit firms, both licensed and unlicensed, were observed to charge high-interest rates and fees to borrowers which supported the findings of the World Bank report that the average interest rate charged by microfinance institutions (MFIs) in Sub-Saharan Africa is around 25–40% while the interest rates charged by these unlicensed digital lenders can range from 20% to as high as 800% per the duration of the loan but not more than a year.

Unregulated digital lending firms or instant credit firms, therefore operating outside of regulatory frameworks, charged exorbitant interest rates and fees that can easily trap borrowers into a cycle of debt. For instance, in Ghana, and Kenya, some unlicensed lenders charged interest rates exceeding 550% per year, which can result in borrowers paying back over six times the amount they borrowed due to default and delinquency.

Therefore, the interest rates and fees charged by instant credit firms can be very high, leading many borrowers to fall into debt traps. Regulatory authorities need to monitor the practices of these firms, and for borrowers to carefully read the terms and conditions of any credit agreement before borrowing, to avoid falling into financial difficulties.

4.1.5 Debt collection techniques

While digital lending or instant credit firms in Africa are known for providing quick loans to individuals who need them, there are concerns over the aggressive debt collection tactics employed by some of these firms, particularly the unlicensed ones. The debt collection tactics varied widely between licensed and unlicensed instant credit firms.

While the licensed firms are subject to regulatory oversight and expected to comply with ethical standards when collecting debts, the unlicensed firms who operates outside of the regulatory framework used very aggressive tactics to collect debts should there be a delay.

Whiles license digital credit firms are not immune to using unethical debt collection tactics and in some cases, licensed firms explore the use of third-party debt collection agencies to recover outstanding debts, they are however better in their approach than the unlicensed digital credit firms. For the unlicensed instant credit firms, it is observed that to recover their outstanding debts, all reported to often used extremely aggressive and illegal debt collection tactics that can result in psychological distress, loss of income, and even loss of property for borrowers. One such tactic employed by almost all unlicensed instant credit firms studied is harassment. Some borrowers received incessant phone calls and messages, sometimes at odd hours of the day, pressuring them to pay back their loans. In some cases, these phone calls and messages may contain threats of violence, causing borrowers to fear for their safety and well-being.

Another tactic used predominantly by all unlicensed firms studied is debt shaming aimed at shaming and intimidating the borrower into repaying their debts. The unlicensed firms publicise borrowers' debt status on social media especially Facebook and other public platforms. While the firms believe these can help in the repayment as they shame the borrower, the publicising of a borrower's debt status can have severe consequences, including loss of reputation and social standing, which can further exacerbate the borrower's financial difficulties.

In extreme cases observed, unlicensed and instant credit firms have been known to resort to physical violence to recover their outstanding debts. Borrowers have reported incidents of assault and battery, with some losing their income or property as a result. One example of such aggressive debt collection tactics is reported in Ghana by a consumer, where unlicensed instant credit firms tried to use fake police officers to intimidate borrowers into repaying their debts.

While instant credit firms have provided a lifeline to many individuals in need of quick loans, there is a need for regulatory authorities to monitor the practices of these firms, particularly the unlicensed ones, and take appropriate action to protect the interests of borrowers. Borrowers, on the other hand, should be cautious when taking out loans and avoid unlicensed instant credit firms that use aggressive and illegal debt collection tactics. Borrowers in the majority as observed are not adequately aware of their rights and protections under the law, such as the right to fair and transparent lending practices, the right to dispute and report illegal debt collection activities, and the right to seek legal recourse and compensation for damages.

4.2 Causes of default by consumers of online credit

The survey of 280 digital loan borrowers revealed that default was a significant problem among online or digital credit users, with 32.1% of respondents (90 people) reporting that they had defaulted on their credit obligations, either intentionally or unintentionally. Of this group, 14.3% (40 people) reported intentionally defaulting on their credit obligations, with the most common reasons being dissatisfaction with the product or service (35.0%, 14 people) and a desire to avoid paying the debt (30.0%, 12 people). Other reasons for intentional default included financial instability (21.0%, 8 people), over-borrowing (8.0%, 3 people), and fraud (5.8%, 2 people).

Respondents who reported unintentional default (18.2%, 51 people) cited financial instability (35.3%, 18 people), unexpected expenses (25.5%, 13 people), and job loss (19.6%, 10 people) as the main reasons for their inability to meet their repayment obligations. Additionally, respondents reported payment processing issues (10.0%, 5 people) and a lack of understanding of credit terms (5.0%, 2 people) as contributing factors to default.

4.3 Legal, policies and regulatory regime of digital credit

The regulatory landscape for online credit in emerging economies is diverse, with varying degrees of legal frameworks and regulatory oversight. Some countries have specific laws that govern online lending, while others rely on existing financial regulations to govern digital lending.

In Ghana, the Bank of Ghana (BoG) regulates online lending activities through the Payment Systems and Services Act (Act 987) of 2019. The act requires all digital lenders to register with the BoG and comply with know your customer (KYC) requirements, data protection regulations, and consumer protection rules. In Nigeria, the Central Bank of Nigeria (CBN) is the primary regulator of online lending activities, with oversight provided through the Banks and Other Financial Institutions Act of 2020. The act mandates that digital lenders register with the CBN and comply with KYC requirements, data protection regulations, and fair lending practices. Kenya has one of the most robust regulatory frameworks for online lending in Africa, with the Central Bank of Kenya (CBK) regulating the sector through the Banking (Amendment) Act of 2016. The act requires digital lenders to register with the CBK and comply with KYC requirements, data protection regulations, and consumer protection rules. South Africa has yet to introduce specific legislation that regulates digital lending activities. However, the National Credit Act of 2005 provides some legal framework for digital lenders, requiring them to register with the National Credit Regulator (NCR) and comply with KYC requirements, data protection regulations, and fair lending practices.

The legal frameworks governing online credit in African countries are still evolving, with varying degrees of regulatory oversight and consumer protection measures in place. However, the increasing prevalence of digital lending platforms and the potential risks associated with unregulated lending activities highlight the need for stronger legal frameworks and consumer protection measures in this area.

4.3.1 Regulatory environment for digital lending

Unregistered firms that engage in providing financial services, including lending, without obtaining the necessary licenses and approvals from regulatory bodies violate financial regulations and may face legal repercussions. In many countries, the provision of financial services is a regulated activity that requires licenses and approvals from regulatory bodies such as central banks, financial regulatory authorities, or government agencies.

In Nigeria, the CBN issued a circular in 2018 warning the public against unlicensed financial institutions and imposing a penalty of ₦100,000 per day for every day the entity continues to operate without authorisation. The penalty for directors and management of such institutions is ₦10 million and may lead to imprisonment or both (Central Bank of Nigeria, 2018a). Similarly, in Ghana, the Bank of Ghana (BoG) regulates financial services and requires all financial institutions, including Fintechs, to obtain licenses and approvals from the bank before commencing operations. The BoG has issued a directive to financial institutions and payment service providers to stop the provision of unapproved digital products and services (Bank of Ghana, 2020a). Unregistered digital lending firms that engage in providing financial services without the necessary approvals are considered illegal and may face legal action from the bank. In Kenya, the Central Bank of Kenya (CBK) regulates financial services and requires all financial institutions, including digital lenders, to obtain licenses and approvals from the bank before commencing operations. Unlicensed digital lenders are considered illegal and may face legal action from the bank. In 2020, the CBK issued a notice to digital lenders warning them against engaging in unethical practices and imposing penalties on lenders who violate regulations (Central Bank of Kenya, 2020).

Table 1 The regulatory environment of four countries

Characteristic	*Kenya*	*South Africa*	*Ghana*	*Nigeria*
Regulatory body	Central Bank of Kenya (CBK)	National Credit Regulator (NCR)	Bank of Ghana (BoG)	Central Bank of Nigeria (CBN)
Registration requirements	Yes	Yes	Yes	Yes
KYC requirements	Yes	Yes	Yes	Yes
Data protection regulations	Yes	Yes	Yes	Yes
Consumer protection rules	Yes	Yes	Yes	Yes

The repercussions of engaging in providing financial services without proper registration and approval may include penalties, fines, imprisonment, and legal action. Additionally, unregistered firms may not have adequate systems and controls in place to protect consumers, which can result in consumer harm. The lack of consumer protection measures can lead to high-interest rates, hidden fees, aggressive debt collection tactics, and the unauthorised sharing of personal data. Therefore, unregistered firms need to comply with regulations and obtain the necessary approvals from regulatory bodies to ensure responsible lending practices and consumer protection.

4.3.2 Data protection: regulatory regime on privacy

Data protection laws in African countries aim to safeguard the privacy of individuals and regulate the use of personal data by digital lending firms. In many African countries, borrowers are required to provide personal information, including their identification cards or national identification numbers, to digital lenders when applying for loans. However, the use of such information is strictly regulated by data protection laws.

For example, in Ghana, the Data Protection Act 2012 (Act 843) regulates the collection, processing, and use of personal data, including data collected by digital lenders. The act stipulates that personal data should be processed fairly and lawfully and that data subjects have the right to access and correct their data. Moreover, data controllers (in this case, the digital lenders) must take appropriate technical and organisational measures to ensure the security of personal data. In Kenya, the Data

Protection Act 2019 governs the collection, use, and processing of personal data by all entities, including digital lending firms. The act requires data controllers to obtain the consent of data subjects before collecting their data and to use such data only for the specific purpose for which it was collected. Additionally, data controllers must ensure the security and confidentiality of personal data and must notify the relevant authorities in case of a data breach. In Nigeria, the National Information Technology Development Agency (NITDA) issued the Nigeria Data Protection Regulation (NDPR) in 2019, which applies to all data controllers and processors operating in Nigeria, including digital lending firms. The regulation requires data controllers to obtain the consent of data subjects before collecting their personal data and to ensure the confidentiality, integrity, and availability of such data. The Nigeria Data Protection Regulation (NDPR) also outlines the rights of data subjects, including the right to access and correct their personal data and the right to request the deletion of their data.

Data protection laws in African countries are crucial in regulating the collection and use of personal data by digital lending firms. These laws are designed to safeguard the privacy of individuals and ensure that their personal data is not misused or disclosed without their consent.

4.3.3 Consumer protection: responsibility of the central banks

Consumer protection is one of the key roles of central banks in African countries. The central banks are responsible for ensuring that financial service providers comply with regulations and that consumers are protected from unfair and fraudulent practices. In the four African countries mentioned earlier (Ghana, Nigeria, Kenya and South Africa), the central banks have implemented various consumer protection measures to safeguard consumers' interests.

In Ghana, the BoG is responsible for regulating financial institutions, including digital lenders. The BoG has issued guidelines for digital financial services providers, including digital lenders, to ensure that they comply with consumer protection regulations. The guidelines require digital lenders to provide transparent and accurate information to borrowers, disclose all fees and charges, and ensure that borrowers can repay their loans (Bank of Ghana, 2020b). In Nigeria, the CBN has issued guidelines for digital lenders to ensure that they comply with anti-money laundering and consumer protection regulations. The guidelines require digital lenders to disclose all fees and charges to borrowers, provide clear and accurate information, and ensure that borrowers can repay their loans (Central Bank of Nigeria, 2021). In Kenya, the CBK has implemented various measures to protect consumers, including capping interest rates charged by digital lenders at 4% per month and requiring digital lenders to be licensed and regulated by the CBK. The CBK has also established a consumer complaints mechanism to address consumer grievances. The South African Reserve Bank (SARB) (n.d.) has implemented various measures to protect consumers, including requiring digital lenders to be licensed and regulated by the SARB and capping interest rates charged by licensed digital lenders at 5% per month. The SARB has also established a complaints mechanism for consumers to report predatory lending practices.

Despite the implementation of consumer protection measures by central banks in Ghana, Nigeria, Kenya, and South Africa, gaps in the regulations persist, and consumers continue to encounter challenges such as high-interest rates, debt collector harassment, and over-indebtedness. The central banks have faced criticism for not doing enough to shield consumers from debt collector harassment and for failing to tackle the problem of over-indebtedness. Therefore, central banks must enhance their regulatory frameworks to ensure that consumers are well-protected from predatory lending practices.

4.3.4 Privacy and data protection

Issues of online privacy have become a significant concern in the context of digital lending in African countries. Digital lending platforms often require borrowers to provide sensitive personal information such as location, contacts, and ID cards, which may be misused if not handled with care. This poses a significant threat to the privacy and security of borrowers, who may be unaware of how their data is being used or who it is being shared with.

In Ghana, the Data Protection Act (2012) provides a legal framework for the protection of personal data, and the BoG is responsible for regulating the banking and payments sector whiles the Data Protection Commission is responsible for enforcing the regulations on data protection. In Nigeria, the National Information Technology Development Agency (NITDA) is responsible for data protection, but there are no specific regulations governing the use of personal data by digital lending platforms. The CBN guidelines require digital lenders to comply with anti-money laundering and consumer protection regulations but do not provide specific guidelines on data protection. In Kenya, the Data Protection Act (2019) provides a legal framework for the protection of personal data, and the Data Protection Commissioner is responsible for enforcing the regulations. However, the Act does not provide specific guidelines on the use of personal data by digital lending platforms. South Africa's Protection of Personal Information Act (2013) regulates the use of personal information by companies and provides for the establishment of an information regulator to oversee compliance.

Generally, there is a lack of specific regulations governing the use of borrowers' personal data by digital lending platforms in the countries and this is a significant gap in consumer protection. The responsibility for enforcing data protection regulations falls on various government agencies, and there is a need for collaboration and coordination among these agencies to ensure that borrowers' data is protected.

4.4 The opportunities: why do people use unlicensed loan apps?

Though the emergence of unlicensed digital credit firms has become a concern for regulators, as these apps are often associated with predatory lending practices, a significant number of individuals still prefer to use unlicensed loan apps. As observed there are very good reasons why people use unlicensed loan apps, whiles there are certain opportunities that these apps present.

Prominent reasons for using unlicensed loan apps

1. Easy and fast access to credit: the unlicensed loan apps offered fast and easy access to credit, which is highly beneficial to individuals who require urgent financial assistance. Unlike traditional financial institutions, unlicensed loan apps do not require extensive documentation and collateral, or use of the service for long before approving a loan application. Borrowers can easily access loans from these apps by simply downloading the app, filling out an application, and submitting the required documents.

2 Financial inclusion: a significant number of people in the countries of interest do not have access to formal financial institutions. This could be due to factors such as limited physical access, stringent requirements, or lack of financial literacy. Unlicensed loan apps have filled this gap by providing financial services to individuals who are excluded from formal financial institutions.

3 Flexibility: unlicensed loan apps offer flexibility in terms of loan amounts and repayment terms. Borrowers can choose the loan amount that suits their needs, and also choose a repayment period that is convenient for them. This flexibility is highly beneficial to individuals who require customised loan products that are not offered by formal financial institutions.

4 Anonymity: some individuals prefer the anonymity provided by unlicensed loan apps. They may not want their financial activities to be recorded in a formal financial institution's records and instead opt for the privacy provided by these apps.

5 Lack of alternatives: in some areas, unlicensed loan apps are the only option for individuals seeking financial services. A reason observed was due to the limited availability of other options.

6 Convenience: unlicensed loan apps can be accessed from anywhere and at any time, making them highly convenient for individuals with busy schedules or limited mobility.

7 No collateral required: unlicensed loan apps typically do not require collateral for loan approval, which has been beneficial for individuals who do not have assets to use as collateral.

8 Low minimum loan amount: some unlicensed loan apps offer low minimum loan amounts, which can be useful for individuals who only require a small amount of credit.

9 Lack of credit check: unlike formal financial institutions, unlicensed loan apps usually do not conduct credit checks, making them accessible to individuals with a poor credit history or no credit history at all. However, it is observed that some of the firms do a credit history check.

10 Lack of credit history: many of the individuals who use unlicensed loan apps do not have a credit history, which makes it difficult for them to access credit from formal financial institutions. Unlicensed loan apps do not require a credit history, making it easier for these individuals to access credit.

Gaps are being exploited by predatory digital lending platforms including:

1 Financial inclusion: unlicensed loan apps present an opportunity for financial inclusion, as they provide access to credit for individuals who are excluded from formal financial institutions. By providing financial services to underserved communities, unlicensed loan apps can help reduce poverty and promote economic growth.

2 Innovation: unlicensed loan apps are highly innovative, as they use certain technology to offer financial services to customers. These apps are constantly

evolving, with new features and products being added to meet the needs of customers.

3 Job creation: unlicensed loan apps can create job opportunities, as they require a workforce to develop and maintain the app, as well as customer service personnel to handle customer inquiries and loan processing.

4 Access to alternative data: unlicensed loan apps may have access to alternative data sources, such as mobile phone usage or social media activity, which can be used to assess creditworthiness. This can benefit individuals who may not have a formal credit history but have demonstrated responsible financial behaviour in other areas.

5 Data-driven insights: unlicensed loan apps generate a large amount of data on borrower behaviour and repayment patterns. By analysing this data, the firms can gain valuable insights into consumer behaviour, credit risk, and other factors that can be used to improve lending practices and develop new products.

6 Access to new markets: unlicensed loan apps can provide financial services to individuals and businesses in areas where formal financial institutions are not present or are limited in their reach. This presents an opportunity for firms to expand their business into new markets and increase their customer base.

7 Financial education: unlicensed loan apps have the opportunity to provide financial education to borrowers, helping them to better manage their finances and understand the costs and risks associated with borrowing. This can lead to improved financial literacy and better financial decision making.

8 Greater efficiency: unlicensed loan apps have the potential to improve the efficiency of the lending process, reducing the time and cost involved in loan approval and disbursement. This can lead to lower costs for both lenders and borrowers and a more streamlined lending process.

9 Customised loan products: unlicensed loan apps can offer customised loan products that meet the specific needs of individual borrowers, such as loans for education, health care, or business development. This allows borrowers to access credit that is tailored to their unique circumstances.

5 Conclusions and recommendations

5.1 Conclusions

Our analysis shows that unlicensed digital lending or quick credit operators present both opportunities and risks for consumers in sub-Saharan Africa. On the one hand, these apps provide easy and convenient access to credit, which is often lacking in these economies. They are often designed to be user-friendly, with simple interfaces and quick approval processes. This can be particularly important for people who are time-poor and lack access to traditional banking services. On the other hand, unlicensed loan apps are often associated with high-interest rates, hidden fees, aggressive debt collection tactics, and unauthorised sharing of personal data. These risks can be particularly damaging for vulnerable consumers who are unable to repay their loans.

From the findings, digital lending has the potential to positively impact financial inclusion by providing underserved individuals with access to credit, particularly in regions with low levels of formal financial services. In these countries, many individuals lack access to traditional banking services and are excluded from the formal credit market. Digital lending can provide a solution by enabling individuals to access credit using their mobile devices, thus making financial services more accessible and convenient. Digital lending can also contribute to financial inclusion by facilitating financial literacy and education. Digital lenders can provide borrowers with information on how to manage their finances, improve their credit scores, and access other financial services. This can be particularly beneficial for individuals who have never used traditional banking services before, as it can help them understand the importance of financial planning and budgeting. Moreover, digital lending can increase transparency in the lending process. By using algorithms and data analytics, digital lenders can make lending decisions based on objective criteria, such as creditworthiness and repayment history. This can reduce the risk of bias and discrimination in lending decisions and ensure that credit is allocated based on merit, rather than social status or personal connections.

However, there are also potential negative impacts of digital lending on financial inclusion. One concern is the high-interest rates and hidden fees associated with some digital lending platforms, particularly those operated by unregulated firms. This can lead to borrowers taking on debt that they cannot repay, which can further exacerbate their financial vulnerability. Another concern is the potential for privacy and security breaches. Digital lenders typically collect a significant amount of personal data from borrowers, including financial and identification information. If this data is not adequately secured, it can be vulnerable to theft or misuse, potentially putting borrowers at risk of identity theft or other forms of fraud. Moreover, there is a risk that digital lending can perpetuate inequality by creating a new form of financial exclusion. Individuals who lack access to mobile devices or the internet may be excluded from digital lending platforms, even if they are eligible for credit. This can create a digital divide between those who have access to technology and those who do not, further exacerbating existing social and economic inequalities.

Based on the findings of this study, it is evident that unlicensed instant credit firms operating in Ghana, Nigeria, South Africa, and Kenya pose significant risks to borrowers as well. These risks include the sale of data and exposing data to third parties without consent, high-interest rates, aggressive debt collection tactics, data privacy concerns, and the potential for over-indebtedness. The study revealed that borrowers who use instant loan apps in these countries are often charged high-interest rates and fees, which leads to financial distress. The situation is further complicated by the fact that many of these unlicensed firms operate outside the regulatory frameworks set up by the central banks in these countries.

The consequences of unregulated firms not prioritising ESG considerations could be dire. They may engage in unethical practices, which could lead to environmental damage and negative social impacts. Additionally, they may not have adequate systems and controls in place to protect consumers, leading to consumer harm, such as high-interest rates, hidden fees, aggressive debt collection tactics, and unauthorised sharing of personal data.

The findings also suggest that both intentional and unintentional defaults are significant problems among consumers of online credit. Borrowers may intentionally default for various reasons, including dissatisfaction with the product or service, a desire to avoid paying the debt, financial instability, and overborrowing. Unintentional default may occur due to unforeseen circumstances such as financial instability, unexpected expenses, and job loss.

The study highlights the need for evidence-based regulations and consumer protection measures to ensure responsible lending practices and mitigate risks for borrowers. The central banks in these countries have implemented various consumer protection measures, but there are still gaps in the regulations, and consumers continue to face challenges. The central banks have been criticised for not doing enough to protect consumers from harassment by debt collectors and for failing to address the issue of over-indebtedness. Therefore, central banks need to strengthen their regulatory frameworks to ensure that consumers are adequately protected from predatory lending practices.

5.2 Recommendations

The study underscores the urgent need for evidence-based regulations and consumer protection measures to ensure responsible lending practices and mitigate risks for borrowers. The central banks in Ghana, Nigeria, Kenya, and South Africa must strengthen their regulatory frameworks and take action to address the risks associated with unlicensed instant credit firms. Financial education programs are also essential in improving financial literacy and enabling borrowers to make informed decisions about their borrowing activities. By implementing these measures, it is possible to promote financial inclusion and access to finance while safeguarding the interests of consumers. Comprehensive recommendations are discussed below:

1. Strengthen regulatory frameworks: central banks in Ghana, Nigeria, Kenya, and South Africa need to strengthen their regulatory frameworks to ensure that consumers are adequately protected from predatory lending practices. This can be achieved by reviewing and updating existing regulations to address gaps and loopholes in the current regulatory landscape. By doing so, it would be possible to protect borrowers from excessive interest rates, fees, and debt collection practices that can lead to financial distress.

2. Promote financial education: financial education programs should be developed and promoted to help consumers better understand the risks associated with instant digital credit and how to manage their finances responsibly. This can be done through partnerships between governments, financial institutions, and non-governmental organisations (NGOs). By improving financial literacy, consumers would be better equipped to make informed decisions about their borrowing activities and avoid the risks of over-indebtedness.

3. Enforce compliance: the central banks should enforce compliance by unlicensed firms with existing regulations and ensure that all instant credit firms are registered and licensed to operate. This will help to reduce the risks associated with unlicensed instant credit firms, including high-interest rates, aggressive debt collection tactics, data privacy concerns, and the potential for over-indebtedness. By ensuring

compliance, borrowers can have greater confidence in the legitimacy of digital credit providers.

4 Improve transparency: instant credit firms should improve transparency in their operations, particularly in their lending practices, fees, and interest rates. This will help to build trust with consumers and reduce the risk of over-indebtedness. By providing clear and concise information about their products and services, borrowers can make informed decisions about their borrowing activities.

5 Foster responsible lending practices: instant credit firms should adopt responsible lending practices, such as conducting affordability checks before granting loans, and providing flexible repayment plans. This will help to mitigate the risks of over-indebtedness and promote financial inclusion. By providing responsible lending practices, digital credit providers can support the financial well-being of their borrowers and promote sustainable economic growth.

6 Central banks should establish a continuous engagement with the management of Google Play Store, App Store and other mediums first verifying the status of digital loan firms from financial regulators before approving apps on their platform and removing unlicensed instant credit apps from their platforms. This would help to protect consumers from predatory lending practices and reduce the risks of over-indebtedness and financial distress.

   However, this approach may not be sufficient on its own, as unlicensed firms could simply migrate to other platforms or find new ways to operate. It would need to be complemented with stronger regulatory frameworks and consumer protection measures, as well as financial education programs to ensure responsible borrowing practices. Furthermore, it is important to strike a balance between protecting consumers and promoting innovation and competition in the financial sector, as digital credit has the potential to expand access to finance and promote financial inclusion in African countries.

7 To reduce the risk of default: the seventh recommendation is for online credit providers to focus on improving their products and services, providing clear information about credit terms and fees, conducting more thorough credit checks, and implementing effective payment processing systems. Additionally, increased financial education for borrowers may help to reduce default and promote more responsible borrowing practices. By reducing the risk of default, digital credit providers can ensure the long-term sustainability of their operations while protecting the interests of their borrowers.

8 Implement ESG guidelines and requirements: the eighth recommendation is for regulatory bodies to implement guidelines and requirements for ESG considerations for all financial institutions, including unregulated firms. This could include mandatory reporting and disclosure of ESG practices and impacts, as well as third-party verification and monitoring. Moreover, consumers can also play a role in driving change by choosing to do business only with financial institutions that prioritise ESG considerations. By supporting firms that prioritise ESG considerations, consumers can promote sustainable and socially responsible financial practices. This means looking for financial institutions that prioritise sustainable

investments, support renewable energy, reduce their carbon footprint, promote diversity and inclusion in their workforce, and have transparent and ethical governance practices.

By choosing to do business with these institutions, consumers can signal to the financial industry that there is a demand for sustainable and socially responsible practices. This can encourage financial institutions, including unregulated firms, to adopt ESG considerations as part of their business models.

To further incentivise financial institutions to prioritise ESG considerations, regulatory bodies could implement guidelines and requirements for ESG considerations for all financial institutions, including unregulated firms. This could include mandatory reporting and disclosure of ESG practices and impacts, as well as third-party verification and monitoring. Ultimately, promoting sustainable and socially responsible financial practices can help to ensure that financial institutions operate in a way that benefits society as a whole, rather than just their bottom line.

9 The importance of competition and anti-trust authorities: competition and anti-trust authorities are responsible for promoting competition in markets and preventing anti-competitive practices that harm consumers. In the context of digital lending, competition and anti-trust authorities can play a critical role in promoting fair pricing and reducing the prevalence of predatory lending practices. By ensuring that the market is competitive and that no one firm dominates, competition and anti-trust authorities can help to prevent firms from charging exorbitant interest rates and engaging in other predatory lending practices.

Moreover, competition and anti-trust authorities can also help to ensure that consumers have access to a wide range of digital lending options, which can help to promote financial inclusion and access to finance. By promoting competition, these authorities can help to ensure that consumers have access to a variety of digital lending options that offer fair and transparent terms.

However, these measures must be complemented with other measures such as strong regulatory frameworks, financial education programs, and consumer protection measures to effectively address the complex issue of predatory lending by unlicensed digital lending firms

10 Conduct further research: digital credit has the potential to expand access to finance and promote financial inclusion in African countries. However, as highlighted in the study, there are also risks associated with digital credit, particularly when it comes to predatory lending practices and consumer protection. To better understand the impact of digital credit on financial inclusion and consumer protection in other African countries, further research is needed. This research could include:

- Data collection: researchers could collect data on the usage of digital credit in different African countries, including the number of borrowers, loan amounts, interest rates, and repayment terms. This data could be used to identify trends and patterns in digital credit usage and to better understand the risks and benefits associated with the product.

- Consumer surveys: researchers could conduct surveys with digital credit borrowers to understand their experiences with the product, including their awareness of the risks and benefits, their borrowing behaviours, and their satisfaction with the product. This could help to identify areas where consumer protection measures could be strengthened and inform financial education programs.
- Case studies: researchers could conduct case studies of digital credit providers in different African countries to understand their business models, lending practices, and regulatory environments. This could help to identify best practices for promoting responsible lending practices and to inform regulatory frameworks.
- Comparative analysis: researchers could conduct a comparative analysis of digital credit usage and regulation in different African countries to identify similarities and differences in consumer protection measures and regulatory frameworks. This could help to inform policy decisions and regulatory frameworks that can promote responsible lending practices and financial inclusion in the region.

By conducting further research on the impact of digital credit on financial inclusion and consumer protection in other African countries, policymakers and regulatory bodies can better understand the risks and benefits associated with the product and develop evidence-based regulations and consumer protection measures that can promote financial inclusion while safeguarding the interests of consumers.

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