Regulatory Requirements and Financial Inclusion in FinTech Companies

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ABSTRACT

The general objective of the study was to establish the influence of regulatory requirements on financial inclusion in FinTech companies. Specifically, the study assessed the effects of customer protection and investor protection regulations on financial inclusion. This study adopted a descriptive research design. The target population was 38 FinTech companies. A population of 435 managers in FinTech companies were targeted. Stratified random sampling method was used to select the sample of 218 respondents. Primary data was collected using questionnaires. Pearson correlation coefficient and multiple regression was used in data analysis to establish the relationship between the variables. The study found that customer protection and investor protection regulations had significant relationships with financial inclusion. The study concluded that customer protection and investor protection were key attributes in financial inclusion in FinTech companies and recommended that stakeholder regulations need a special focus in the management of FinTech companies.

KEYWORDS
Credit Allocation Regulation, Customer Protection Regulation, Financial Inclusion, FinTech Companies, Investor Protection Regulation

INTRODUCTION

Regulatory requirements play essential roles in society through regulation of market integrity, mitigating information asymmetry, minimizing negative externalities as well as prevention of distortions. These regulation requirements have the capacity of presenting unpleasant consequences through indirectly hampering the process of intermediation in the financial institutions as well as impeding the ability to provision of financial services (Kodongo, 2018). Countries attain market stability through establishing strong financial regulation. Although it is an essential move, it may be done at the cost of inclusive growth in most developing countries.

Financial systems cannot exist without effective regulation since this might cause instability in the financial sectors. The main goal of financial regulation is to ensure maintenance of financial stability as well as spurring of economic growth (Tobias, 2017). Ozili (2020) observed that regulation guards against irregularities and unfair actions. The main aim of ensuring consumer protection is to mitigate discriminative lending by financial entities. Investors who purchase securities either directly or indirectly through investment in mutual funds are protected by investor protection laws. One important focus of credit regulation is the general inclusion of the unbanked at the base of the pyramid (Anarfo, Abor & Osei, 2020). In essence it catalyses economic growth and development.
Globally, financial inclusion has been facilitated by the treasury department through ensuring expansion on the access to financial services for all individuals regardless of their status. This has been facilitated by dealing with the digital divide, fostering community development, ensuring financial capability, and encouraging partnerships (Baker & Wurgler, 2015). Regionally, financial inclusion has been a key policy objective to very many countries. Government agencies have shown interest through ensuring that they play an active role to facilitate financial inclusion with specific areas of rural finance availability, ensuring consumer protection and easing access to credit facilities by Small and Medium Enterprises (SMEs) (Sarma & Pias, 2012). In East African region, financial inclusion continues to deepen. With the high rate of financial inclusion, the focus is now based on how the private sector and the public sector can facilitate digital financial services as well as products (Spratt, 2015). Among the key catalysts for financial inclusion include technology, innovation and creativity.

A large percentage of people across the globe do not use formal financial services. According to World Bank (2020) approximately 42% of adult Kenyans had a financial account of some kind in 2011. According to the Global Findex database, the number had risen to 75%, including 63 percent of the poorest two-fifths (World Bank, 2017). Poor regulation is a major obstacle to financial inclusion. This is because, regulatory changes are often needed to enable the successful adoption and adaptation of innovations in digital finance, encourage their use, and increase competition among their providers, so that those new technologies can benefit the poor. Maina (2015) noted that progress in improving financial inclusion has to be compatible with the traditional mandates of financial regulation and supervision namely, safeguarding the stability of the financial system, and protecting consumers. On the same note Kumar, Rama and Rupayan (2019) noted that maintaining high integrity is one of the key roles of financial regulation.

Many studies have been done on financial inclusion. Zwedu (2014) did a study on financial inclusion, regulation, and inclusive growth in Ethiopia. He found out that despite huge progress in the last ten years, financial inclusion is still very low. Odongo (2018) researched on financial regulations, financial literacy, and financial inclusion focusing on insights from Kenya. The study revealed that agency banking regulations and financial literacy could improve formal financial access while know-your-customers rules capital and liquidity and macro-prudential regulations could harm financial inclusion. Though some of the studies have focused on financial regulation and financial inclusion, they have failed to establish how regulatory requirements influence financial inclusion. There is limited empirical evidence on regulatory requirements and financial inclusion in Fintech companies. Therefore, this study sought to fill this knowledge gap and establish the influence of regulatory requirements on financial inclusion. Specifically, the study seeks to assess the influence of customer protection regulation and investor protection regulation on financial inclusion in the Fintech companies.

LITERATURE REVIEW

Customer Protection Regulation and Financial Inclusion

Customers are important stakeholders that help establish the firm’s reputation and identification. Competition, asymmetry of information, the occurrence of transaction costs and inequality of consumer agreements constitute the theoretical basis of the contemporary consumer policy (Hirshleifer, 2008). The relationship between a customer and a firm exists because of mutual expectations built on trust, good faith, and fair dealing in their interaction. Not only is this an ethical requirement but it has been legally enforced in some states. Market orientation focuses on an understanding of customers’ expressed and latent needs and development of superior solutions to the needs. Such an approach seeks to elevate the interests of the customer over those of others (Ferrell (2004). Ethically, questionable
actions toward consumers can be addressed in civil litigation and are punishable by law as a regulation within the business environment.

Information is a key asset in financial management. As far as transaction between buyers and sellers is concerned, information is a powerful tool to the customer (Mujeri, 2015). Furthermore, the providers of the financial services try to scrutinize financial information on the customers which include their credit history, financial decision-making modes, and their level of market assessments (Atakli & Agbenyo, 2020). The knowledge gap between the customers and the suppliers of financial services becomes wider when the financial products offered are more sophisticated. As a result of competition, information imbalance can easily be reduced since consumers prefer the financial institutions that offer more clear information while the financial entities try to please their customers through offering the best services which entails provision of adequate information (Bharat, 2014). However, in situations where the market forces fail to result in high level of information disclosure, provision of information to borrowers facilitates financial literacy of the customers and make it easier for new customers to enter the market (Terfa, 2015). By demanding financial information, consumers facilitate transparency in the sectors and business transactions. Nanziri (2020) noted that in the turbulent market environmental situation where important disclosures are not attained to the maximum it is only regulation which informs and protects the financial market (Nanziri, 2020).

The borrowers of financial services have less information concerning the financial transactions as compared to the financial institutions that provide the financial services. Consumer protection ensures equality between the lenders and borrowers (McClure, 2015). This therefore can lead to payment of high interest rates, inadequate knowledge on the available financial options as well as the inadequate means for redress (Karpowicz, 2014). This kind of information asymmetry occurs where the products offered are more sophisticated and when the beneficiaries are less experienced. The push for financial inclusion through reaching the unbanked facilitates more borrowers to enter the financial market every year. Even though most of the financial institutions have incorporated practices for ensuring their customers are well served, other financial institutions have gained advantage of this information to benefit themselves at the expense of the borrower who may be under-insured or over-indebted (Lewis & Lindley, 2015).

There are a variety of financial challenges in the business environment. The financial harm ranges from loss of saving due to unscrupulous actors encountering market for short term benefit to over indebtedness because of very high prices and predatory lending (Peake, 2016). Under the hard to serve markets, there is warranting of high prices, but this ends up unchecked since some of the lending institutions charge high prices. In free and regulated markets, over indebtedness comes because of predatory lending which at the long last have high rates of defaulters. Unscrupulous actors steal collaterals or customers money less frequently which result to emotional and physical abuse of clients (Dabla-Norris, Yan & Filiz, 2015). The journey to customer-centricity for financial service providers to the different segments begins with understanding how access to financial services can add value to the lives of lower-income customers. Kilara and Rhyne (2014) noted that well-tailored services can help customers meet daily needs, achieve personal and business goals, and build resistance against vulnerability.

Ethical responsibilities to consumers have a strong foundation of legal protection. Customers normally evaluate the ethical practices of companies, environmental issues, level of service quality, and other responsibility issues that impact the purchasing and consumption of products. The regulatory framework is the foundation for a broad and complex consumer protection (Goodhart, 1998). It needs to be implemented because of the weaker position of consumers in economic relations with professional entities. Janine and Monica (2018) posited that in the financial service industry, the consumer protection framework is evolving along with increasing complexity with products, and a greater number of people using financial services. Despite a rising awareness of customers’ rights and numerous activities focused on customers’ protection, there are many indications that on financial inclusion, customer interests are still threatened. Thus, we propose the first hypothesis as follows;
H1: Customer protection regulation has no significant relationship with financial inclusion.

**Investor Protection Regulation and Financial Inclusion**

Agency theory highlights the problems encountered by investors who cannot avoid the services of agents in managing their businesses. Jensen and Meckling (1976) developed the classical agency theory that views managers as agents of the shareholders, who are driven by the motive to maximize their interests and fail to act in the best of the interests of the shareholders. In the last four decades, Mamun, Yasser & Rahman, (2013) postulated that agency theory has been predominantly used to explain relationships between management and ownership and has been used as the bedrock for the development and application of corporate governance principles.

Léon and Zins (2020) noted that due to no disclosures of the true position of the financial statements, investors benefit from regulation as a mitigation against risk. Protection of the investors is very essential since in most countries, there is high rate of expropriation of the creditors as well as the minority shareholders by the controlling shareholders. Cherednychenko (2015) observed that due to exploitation by the controlling shareholders, investors who are outside the finance firms are faced with the risk of return on investment. Financial inclusions refer to the means through which the external investors protect themselves from being exploited by the investors within the finance firms (Lagarde, 2015).

Expropriation occurs in different forms. On some occasions, the insiders just steal the realized profits from the organization. Other ways of expropriation include the selling of securities, assets as well as outputs from the firm to other firms they own at a lower price. These actions (transfer pricing and investor dilution) are somehow legal, but they have the same impact as theft. Other instances of expropriation include diversion of corporate opportunities from the organization, taking in family members to occupy the top management position illegally as well as overpayment of executives during meetings and business travels (Giannetti & Zhao, 2016).

Among the key benefits of legal protection is the fact that it ensures less efficiency of expropriation using technology. In instances of little or no protection of the external investors, the inside investors can effectively and efficiently steal the realized profits in the firm. External investors would therefore not finance such firms without a very strong reputation (Wardhani, 2021). Through improving the investor protection mechanisms, some of the inside investors come up with wasteful diversions whereby they can come up with intermediary firms where they channel all the realized profits. The implemented mechanisms are also effective enough to allow the insider investors to consider diverting profits extensively. In instances of effective investor protection mechanisms, the only left option of the insiders is to give themselves excess salaries, ensure the management is full of family members as well as adopting wasteful projects. At certain points it becomes better to just pay dividends. Through ensuring diversion technology is less efficient, the benefits to the insiders diminish and the options to expropriate become less.

Empirical studies conclude that without close monitoring by shareholders, managers adopt self-seeking behaviour and make value destroying decisions (Ramaswamy & Veliyath, 2002). Moreover, the changes in business environment and the presence of self-seeking managers forces shareholders and regulators to develop ethical responsibility, codes of conduct to control behaviour of managers and managerial incentives following the stipulations of the agency theory (Mumin et al, 2013). Thus, we propose the second hypothesis as follows;

H2: Investor protection regulation has no significant relationship with financial inclusion.
METHODS

This study adopted a descriptive research design to analyse the effect of regulatory requirements on financial inclusion. Data was collected from Fintech companies in Kenya. The target population for this study were the three cadre of managerial positions, the top level, the middle level and the lower-level managers in the Fintech companies. Managers were chosen for the study because they are the custodians of customer and investor regulation policies and documents. From the human resources registry in the companies it was established that there are 435 managers. Therefore, the target population was 435 respondents. From the total population, stratified random sampling was done in each stratum of managerial levels in each of the participating company which gave rise to a sample size of 218 respondents for the study.

The study utilized primary data which was collected using structured questionnaires. The questionnaires were first pretested through a pilot study to determine the suitability of the tool. The pretesting was done by administering the questionnaire to 13 respondents who were selected simple random sampling from the population. Data was analysed using both descriptive and inferential statistics. Pearson Correlation was used to establish the existence, nature, and strength of the relationships between customer regulation and investor regulation and financial inclusion. Regression statistical analysis was done to establish magnitude of variation caused by customer regulation and investor regulation on financial inclusion using the coefficient of determination. The P-value was used to determine the significance in relationship between customer protection regulation and investor protection regulation and financial inclusion.

RESULTS AND FINDINGS

Correlational of Customer Protection and Financial Inclusion

The first objective of the study sought to find out the relationship between customer protection regulation and financial inclusion. This was achieved through both correlation and regression analysis. This objective was achieved by testing hypothesis

H1: Customer protection regulation has no significant relationship with financial inclusion.

| Table 1. Correlation of Customer Protection Regulation and Financial Inclusion |
|---------------------------------------------------------------|
|                                    | Financial Inclusion | Customer Protection Regulation |
|---------------------------------------------------------------|
| Financial Inclusion                                               | Pearson Correlation | 1 |
| Sig. (2-tailed)                                                    |                           |  |
| N                                                              | 206                     |
| Customer Protection Regulation                                    | Pearson Correlation     | .814** |
| Sig. (2-tailed)                                                    | .000                    |
| N                                                              | 206                     | 206 |

From the findings, customer protection regulation and financial inclusion had a correlation coefficient of 0.814 and significance value of 0.000. This therefore implies that customer protection
has a strong positive correlation with financial inclusion. Also, customer protection and financial inclusion had a significant relationship because the p-value is less than selected significance level (p=0.000<0.01).

**Regression of Customer Protection Regulation on Financial Inclusion**

Regression analysis was done to determine the influence of customer protection regulation and financial inclusion. The findings were presented in three tables. The first table was the model summary which shows the amount of variation in financial inclusion because of a change in customer protection regulation. The second was the ANOVA table which indicated the level of significance while the last was the coefficients table which shows specific rate of change in the variables.

Table 2 shows that the $R^2$ value was 0.376, an indication that a 37.6% variation in financial inclusion in the Fintech companies can be explained by customer protection regulation. The remaining 62.4% are explained by other factors not considered in the study and the error term. The findings also suggest that customer protection regulation and financial inclusion are strongly and positively related as indicated by the correlation coefficient (R) value of 0.613.

**Table 2. Model Summary for Customer Protection Regulation and Financial Inclusion**

| Model | R  | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|----|----------|-------------------|---------------------------|
| 1     | .613a | .376    | .367             | .21507                    |

a. Dependent Variable: Financial Inclusion  
b. Predictors: (Constant), Customer Protection Regulation

ANOVA was used to test whether the model was significant. The significance of the model was tested at a 5% level of significance. The findings indicate significance of the model was 0.002 which is an indication that the model was significant. From the results, the null hypothesis was therefore rejected, and the alternate adopted. Therefore, the study concluded that customer regulation has a significant relationship with customer regulation.
From the beta coefficients table, the following regression equation was fitted.

\[ \text{Financial Inclusion} = 1.309 + 0.574 \times \text{Customer Protection Regulation} + \text{Error Term} \]

From the above equation it is observed that when customer protection regulation is held to a constant zero, financial inclusion will be at a constant value of 1.309. The findings indicate that a unit increase in customer protection regulation will cause an increase of 0.574 units in financial inclusion in the Fintech Companies.

**Influence of Investor Protection Regulation on Financial Inclusion**

The second objective focused on establishing the influence of investor protection regulation on financial inclusion. This was achieved through testing hypothesis two as follows.

H2: Investor protection regulation has no significant relationship with financial inclusion.

This hypothesis was achieved through two statistical tests of correlation and regression analysis.

**Correlational of Investor Protection Regulation and Financial Inclusion**

The findings show that investor protection regulation and financial inclusion had a correlation coefficient of 0.835 and significance value of 0.000. This therefore suggests that investor protection has a strong positive correlation with financial inclusion. Also, the relationship between the investor and financial inclusion was significant because the p-value is less than selected significance level (P=0.000<0.01).

| Model       | Unstandardized Coefficients | Standardized Coefficients | t    | Sig.  |
|-------------|-----------------------------|---------------------------|------|-------|
|             | B                           | Std. Error                | Beta |       |
| (Constant)  | 1.309                       | 0.161                     | 8.130| .000  |
| Customer Regulation | 0.574                  | 0.111                     | 0.528| 5.171 | .001  |

* Dependent Variable: Financial Inclusion

| Financial Inclusion | Pearson Correlation | N |
|---------------------|---------------------|---|
| Sig. (2-tailed)     | .835**              | 206|
| N                   | 206                 |    |

| Investor Protection Regulation | Pearson Correlation | N |
|-------------------------------|---------------------|---|
| Sig. (2-tailed)               | .000                | 206|
| N                             | 206                 |    |
Regression of Investor Protection Regulation on Financial Inclusion

Regression analysis was done to determine the influence of investor protection regulation and financial inclusion. The findings were presented in three tables as shown below.

The findings indicate that R² value was 0.299, an indication that a 29.9% variation in financial inclusion in Fintech companies is explained by changes in investor protection regulation. The remaining 70.1% is explained by other factors not considered in the study and the error term. The findings also suggest that investor protection regulation and financial inclusion are strongly and positively related as indicated by the correlation coefficient (R) value of 0.547.

ANOVA was used to test whether the model was significant. The significance of the model was tested at a 5% level of significance. The significance of the model was 0.002 an indication that the model was significant since it was less than the level of significance (0.05). From the results, the null hypothesis was rejected, and the alternate adopted. Therefore, investor protection regulation has a significant influence on financial inclusion.

ANOVA was used to test whether the model was significant. The significance of the model was tested at a 5% level of significance. The significance of the model was 0.002 an indication that the model was significant since it was less than the level of significance (0.05). From the results, the null hypothesis was rejected, and the alternate adopted. Therefore, investor protection regulation has a significant influence on financial inclusion.

Table 6. Model Summary for Investor Protection Regulation and Financial Inclusion

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|---|----------|-------------------|---------------------------|
| 1     | .547a | .299     | .291              | .22081                    |

a. Predictors: (Constant), Investor Protection Regulation
b. Dependent Variable: Financial Inclusion

Table 7. ANOVA for Investor Protection Regulation and Financial Inclusion

| Model  | Sum of Squares | df | Mean Square | F   | Sig. |
|--------|----------------|----|-------------|-----|------|
| 1      | Regression     | 0.439| 1 | 0.439 | 9.244 | .002a |
|        | Residual       | 9.688| 204 | 0.047 |       |      |
|        | Total          | 10.107| 205 |       |       |      |

a. Dependent Variable: Financial Inclusion
b. Predictors: (Constant), Investor Protection Regulation

Table 8. Coefficients for Investor Protection Regulation and Financial Inclusion

| Model       | Unstandardized Coefficients | Standardized Coefficients | t   | Sig. |
|-------------|----------------------------|---------------------------|-----|------|
|             | B | Std. Error | Beta |     |     |
| 1 (Constant)| 1.418| 0.196 |      | 7.235 | .000 |
| Start-Up Cost | 0.502| 0.120 | 0.487 | 4.183 | .003 |

a. Dependent Variable: Financial Inclusion
b. Predictors: Investor Protection Regulation
From the coefficients table, the following regression equation was fitted:

\[ \text{Financial Inclusion} = 1.418 + 0.502 \times \text{Investor Protection Regulation} + \text{Error Term} \]

From the above equation it is observed that when customer protection regulation is held to a constant zero, financial inclusion will be at a constant value of 1.418. It implies that a unit increase in investor protection regulation causes an increase of 0.502 units in financial inclusion in the Fintech Companies in Kenya.

**DISCUSSION**

**Customer Protection Regulation on Financial Inclusion**

The study established that customer protection regulation has a strong and positive correlation with financial inclusion. This finding resonates with Kilara and Rhyne (2014) who concluded that a customer-centric organizational approach is critical for solving a core challenge in financial inclusion and filling the access-usage gap. To further support these findings, Within the region, the results are also consistent with evidence from South Africa, as reported by Nanziri (2016), which shows that there are no significant differences in the welfare of financially included men and women, while financially included women, on average, enjoy higher welfare outcomes than their excluded female counterparts. In the study both the men and the women being safely guarded customers of the institutions.

The study found that financial education provides information on consumer protection. It focuses on increasing the level of knowledge regarding financial products and services and financial education programs. The findings concur with Feng and Wang (2018) who indicated that governments undertake massive finance education campaigns to help people manage money more effectively. To achieve financial well-being regulation ensure accessing appropriate financial products and services through regulated entities with fair and transparent machinery for consumer protection and grievance redressal. Gardena and Rhyne (2015) found that low levels of financial literacy are most likely to be considered a major barrier to financial inclusion. Financial literacy is seen as an enabling factor that unlocks other key dimensions of financial inclusion. According to Remmele (2016) financial education can improve levels of financial literacy, help individuals to overcome financial vulnerability caused by personal circumstances and potentially breakdown psychological barriers.

A positive significant relationship was established between customer protection regulation and financial inclusion by this study. Lewis and Lindley (2015) noted that although many financial institutions adopt practices to ensure customers are well served, some have used their information advantage (often abetted by regulatory loopholes intended to promote financial inclusion), to increase profits at the expense of consumers who may find themselves over-indebted, under-insured or without a return on their investment, this adversely affects financial inclusion. It was also revealed that disclosure rule require providers to use clear language and present information in a format that is easily visible, to ensure transparency, regulators publish a list of all rates in newspapers or other freely accessible medium and financial institutions provide schedule of fees and charges to customers. According to Love and Pería (2015) to improve financial inclusion, disclosure rules requiring providers to use clear language and present information in a format that is easily visible can help to ensure that disclosed information is comprehensible, particularly for low-income consumers. Shukla (2015) indicated that where literacy rates are low, it is particularly important that information be orally communicated to consumers.

It was also established that, financial service providers must ensure that sales promotion materials are not misleading, financial service providers must ensure that the terms of contract are fair to consumers. Brown (2016) explained that financial service providers must ensure that the terms of contract are fair to consumers, and market practices are sound. Even when activities are outsourced, financial service providers remain accountable and must ensure that outsourced agents perform their functions in a reliable and professional manner.
Investor Protection Regulation on Financial Inclusion

The study established that investor protection had a significant influence on financial inclusion. Daehyun and Starks (2016) on the same note observed that the legal approach to inclusion holds that the key mechanism is the protection of outside investors, whether shareholders or creditors through the legal system. Wardhani (2017) explains that one way to think about legal protection of outside investors is that it makes the expropriation using technology less efficient. At the extreme of no investor protection, the insiders can steal a firm’s profits perfectly and efficiently. Without a strong reputation, no rational outsider would finance such a firm. According to Mhlongo (2019) insider transactions which modify the ownership structure statement give investors relevant information regarding future opportunities of prosperity for the firm. Boot and Thakor (2017) concluded that investors in the market can be business experts and having more information about the variation in the preferences of customers and the industries is normally an added advantage.

It was also established that agency problems can be eliminated through disclosure, because they arise due to conflict of shareholder funds and financial intermediaries. The agency frameworks present a variety of mechanisms to eliminate the agency problem such as contracts, disclosure, financial intermediaries, corporate governance, and market for corporate control (Cheong & Zurbruegg, 2016). Busch (2019) noted that optimal contracts such as compensation agreements and debt contracts seek to align the interests of insiders to the external equity and debt claimants. The study found that some organization mislead third parties by only disclosing good news about their company. Financial institutions are required to disclose their financial information to shareholders. The flow of information is an essential requirement for free-market economics. Chu and Nguyen (2019) found out that the expanded flow of information is an essential requirement for free-market economics. This flow of information facilitates transparency and encourages competition, which leads to the improvement of the work at hand. Without this flow of information, it would be impossible for companies to grow and survive within the competitive business environment.

CONCLUSIONS AND RECOMMENDATIONS

In a nutshell, the study concluded that customer protection regulation more strongly and significantly influenced financial inclusion in Fintech companies. Customer protection was measured in terms of financial education, enhancement of disclosure policies and creation of an enabling environment and ethical environmental responsiveness for the company to the environment and the customers. Therefore, an enhancement of the regulatory framework which focus on the customers within the Fintech industry plays an important role in financial inclusion. The study contributes to the literature on agency theory by establishing the strength and direction of the relationship between the two regulations and financial inclusion. As a result of this study agency theory can be seen through the lens of financial inclusion.

The study recommends that the government should ensure that the customers are educated promptly, disclosure policies are enhanced to create an enabling environment for financial inclusion. This can be ensured by punishing those who fail to adhere to the customer protection regulations. This would ensure that the consumers are not harmed through excessively high prices and predatory lending, to loss of savings and hence ensure financial inclusion. For the practitioners of the Fintech industry, since the study ties regulation to financial inclusion, it means that for policy makers to achieve sustainable development goals of poverty reduction and economic development the society needs empowerment through protection for the consumers and protection of the investors.

FUNDING AGENCY

The publisher has waived the Open Access Processing fee for this article.
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