The Influence of Financial Risk on Stock Returns

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Abstract

The decline in stock returns and the increasing financial risks at the stock market in Kenya has solicited discussions at the academic and regulatory circles to find solutions on challenges facing investor's capacity to reliably predict stock returns volatilities. This study sought to investigate the influence of financial risk on stock returns. Annual data for period 2006 to 2015 has been used. The stock return data of 9 banks listed from 2006 to 2015 was used as dependent variable while credit risk, market risk, liquidity risk and capital risk was used as independent variables. Bank size was used as a control and moderator variable. The study adopted a multivariate generalized least square regression modeling. The study focused on two dimension regression approach. Individual impact of financial risk on stock return and collective multivariate impact of financial risk on stock returns. Individual regression of credit risk, market risk, liquidity risk and capital risk show a statistical significant positive relationship with stock returns. Collective multiple GLS regression of financial risk with a control variable of bank size indicated financial risk is negatively significant on stock returns while bank size had a positive significant influence on stock returns. Moderating effect of bank size on the influence of financial risk on stock returns was found positively significant. The overall conclusion of study was held that financial risk influences stock returns of at Nairobi Securities Exchange. This research is a spatial extension of the previous researches. Unlike other studies that focus mainly on macro-economic variables, this research factored the influence of systemic and bank specific factors financial risk on stock returns.

Key Words- Financial risk, Stock returns, Credit risk, market risk, Liquidity risk, Capital risk, Bank size.

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