THE IMPACT OF FINANCIAL DISTRESS RISK TO MALAYSIAN STOCK RETURN

by

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ABSTRACT

If financial distress risk can be accurately predicted, the stock price of high distress risk companies should be discounted so as to enable investors to earn higher expected returns. Investors which have invested in high risk companies should be rewarded with high returns as the compensation in baring the risk due to the theory of risk and return trade off. This study set out a direct approach to examining the risk-return relationship of Malaysian companies. By applying Z-Score bankruptcy prediction model as the proxy of distress risk and the realized stock returns of the companies, this study found that the distress risk is not statistically significant enough to explain the expected stock returns. This result is contradicted with past research such as Shumway (1996) and Griffin and Lemmon (2002) which is firm with distress risk earn higher positive returns. However the size and book to market equity have shown significant relationship in explaining the stock returns of the companies. The theoretical expectations of the size and book to market equity effect on stock returns are supported in the Malaysian companies. These results are consistent with by Chan and Chen (1991), Fama and French (1992, 1995), Dichev (1998), Chen and Zhang (1998) and Griffin and Lemmon (2002) which found that size and book to market equity can be used in explaining stock returns.
ABSTRAK

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<td>PN17</td>
<td>Practice Note 17 of the Listing Requirements</td>
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<td>BMV</td>
<td>Book-to-market equity ratio</td>
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<td>Bursa Malaysia</td>
<td>Bursa Malaysia Berhad</td>
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<td>BMV</td>
<td>Book to Market value</td>
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<td>Z-Score</td>
<td>Altman's (1968) Z-Score bankruptcy prediction model</td>
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<td>MKT CAP</td>
<td>Market Capitalisation</td>
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<td>MAR</td>
<td>Monthly Average Returns</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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CHAPTER 1

INTRODUCTION

1.0 Introduction

This chapter attempts to provide an overview of the study and market condition which is related to this study. This chapter also states the problem statement, research question, research objective, significant of the study and also the limitation of the study.

1.1 Overview of the Study

Company failures are common in a competitive business environment. This is synonymous for an event of default refers to the events associated with other places, including the inability to meet the financial difficulties of debt payments, apply for bankruptcy protection or even closure. Risk of financial difficulty is the uncertainty introduced by the method by which the finance company investments. If a company uses only common stock to finance the investment, the company may bare business risk only. It is difference for a company borrows money to finance an investment the company will bare business risk and financial risk in the form of interest and principal which is obligate for them to meet. Thus, the ability to meet financial obligations to creditors determines the company's financial difficulties. In addition, financing costs have priority on the distribution of earnings to shareholders and hence increased uncertainty back to the common equity. Uncertainty of returns will result in increased risk premiums required by investor to the particular stock.

As conjectured by the risk and return trade off theory and asset pricing theory
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Misnен Ardiansyah and Abdul Qoyum (2010), Default Risk in Islamic Equity Return (the Case of Kuala Lumpur Stock Exchange), journal of Global Business and Economics, vol 1, no 1.


