THE IMPACT OF FINANCIAL INNOVATION ON STOCK MARKET DEVELOPMENT IN KENYA

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Abstract
This study examines the relationship between financial innovation and stock market development exploiting Generalized Method of Moments (GMM) framework and time series annual data over the period between 2000 and 2015. Financial innovation is measured by three indexes: currency-money ratio (CMR), e-money (EM) and e-payment (EP), whilst stock market development is measured by four indicators: financial risk (FNR), stock market capitalization (SMC), stock market turnover rate (SMTR), and stock market trading deals (SMTD). Based on the empirical results, evidence shows significant impact of financial innovation on stock market capitalization and stock market trading deals (except for CMR) and insignificant effect of financial innovation on financial risk and stock market turnover rate. On average, financial innovations have significant influence on stock market development hence boosting liquidity and market efficiency. Financial innovation indicators can work for or against developmental effect via the transmission mechanism, hence impacting stock market development. Therefore, the concerned authorities should be able to implement essential reforms (financial-economic), critical measures and forward-looking policies in order to combat implications associated with the changing financial environment for a viable stock market and sustainable financial development.

Key words: Financial innovation, stock market development, financial risk, GMM approach, Kenya