



The Relationship between Ownership Structure and Dividend Policy: Evidence from Licensed Commercial Banks in Sri Lanka

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Abstract

In today's dynamic business environment, ownership structure and dividend policy are increasingly recognized as critical financial concepts. This study aims to examine the impact of ownership structure on dividend policy in licensed commercial banks in Sri Lanka. The research considers Managerial Ownership, Institutional Ownership, and Foreign Ownership as independent variables, while Dividend Policy serves as the dependent variable, with Firm Size included as a control variable. The study utilizes annual data from 2019 to 2023, covering a sample of 20 licensed commercial banks. Data analysis was conducted through applying descriptive statistics, correlation analysis, and multiple regression analysis to assess the relationships among variables and the influence of ownership structure on dividend policy. The correlation analysis indicates a significant negative relationship between Institutional Ownership and Dividend Policy, while Foreign Ownership exhibits a significant positive relationship with Dividend Policy. Multiple regression results further confirm that Institutional Ownership negatively impacts Dividend Policy. However, the study finds no significant impact of Managerial Ownership, Foreign Ownership, or Firm Size on Dividend Policy. The findings of this study provide valuable insights for investors and companies, enabling them to make informed investment decisions. Understanding the relationship between ownership structure and dividend policy enhances investor performance and contributes to corporate governance practices.

Keywords: Managerial Ownership, Institutional Ownership, Foreign Ownership, Dividend Policy.

Introduction

Dividend policy is a crucial financial decision for firms, influencing shareholder wealth, market valuation, and capital structure (Baker & Powell, 2012). In the banking sector, dividend decisions are even more significant due to regulatory constraints, risk management considerations, and the need to maintain financial stability (Miller & Modigliani, 1961; Thanatawee, 2013). Ownership structure particularly institutional ownership, managerial ownership, and foreign ownership plays a pivotal role in determining a firm's dividend policy, as different shareholders have distinct preferences regarding dividend payouts (Jensen & Meckling, 1976; Khan, 2006).

The relationship between ownership structure and dividend policy has been widely examined in financial literature. Agency theory suggests that dividend payments serve as a mechanism to reduce agency conflicts between managers and shareholders (Jensen & Meckling, 1976). Institutional ownership, which includes investment funds, insurance companies, and pension funds, often leads to stable dividend policies as these investors prefer steady returns. Baker et al. (2019) found that institutional investors in Sri Lanka continue to favor conservative dividend policies due to regulatory constraints and risk aversion. In contrast, firms with high managerial ownership may retain earnings rather than pay high dividends, as managers prioritize reinvestment for growth and personal control over resources (Rozeff, 1982). Azeez (2019) found a negative association between managerial ownership and dividend policy in Sri Lanka, suggesting that managers prefer to reinvest earnings. Additionally, foreign ownership can significantly impact dividend policies, as international investors often demand higher payouts due to concerns over weak investor protection and limited reinvestment opportunities in emerging markets like Sri Lanka (La Porta et al., 2000). Banks with significant foreign ownership in Sri Lanka exhibit higher dividend payouts to maintain investor confidence amidst economic uncertainty (Baker et al., 2020).

In the Sri Lankan banking sector, dividend policy is influenced by both ownership structure and external economic factors. Research indicates that institutional ownership in Sri Lankan banks tends to result in conservative dividend policies due to regulatory requirements and risk-averse strategies (Perera & Thrikawala, 2010). Meanwhile, banks with significant foreign ownership often exhibit higher dividend payouts, aligning with findings from Faccio et al. (2001), who argue that firms with foreign investors tend to distribute more dividends to maintain investor confidence. Foreign investors continue to demand higher dividends due to concerns over economic instability and currency volatility in Sri Lanka (Baker et al., 2019). The ongoing economic challenges in Sri Lanka, including inflation, exchange rate volatility, and regulatory changes, further complicate dividend decisions, making it crucial to understand how ownership structure affects these policies.

Statement of Problem

In the wake of Sri Lanka's severe economic crisis, the banking sector has faced heightened financial stress, regulatory constraints, and investor uncertainty, all of which have critical implications for dividend policy decisions. Ownership structure comprising institutional, managerial, and foreign ownership plays a key role in shaping these decisions, especially in times of economic instability.

While traditional literature suggests predictable patterns in dividend preferences among different ownership types, recent studies indicate that such relationships may change significantly during periods of macroeconomic distress (Fernando & Samarasinghe, 2022; Jayarathne & Premaratne, 2023). However, there is limited empirical evidence addressing how the recent economic crisis has influenced the ownership–dividend policy relationship in Sri Lanka’s licensed commercial banks (LCBs). This research aims to bridge that gap by examining how varying ownership structures have impacted dividend policies in LCBs during the economically turbulent period from 2019 to 2023, providing relevant insights for policymakers, regulators, and stakeholders in the banking industry.

Research Question

How does Ownership structure impact on Dividend policy of licenced commercial banks in Sri Lanka?

Research Objectives

“To find out the impact of Ownership Structure on Dividend policy of licenced commercial banks in Sri Lanka”.

Literature Review

The literature review explores existing research related to ownership structure and dividend policy. It helps identify theoretical foundations, key variables, and find-

Theoretical Review

Agency Theory (Jensen & Meckling, 1976)

Agency theory explains the conflict of interest between managers (agents) and shareholders (principals). In firms with dispersed ownership, managers may retain more earnings rather than paying them out as dividends, to increase their control over the firm. However, in firms with concentrated ownership, shareholders are more likely to monitor management closely, leading to higher dividend payouts to reduce agency costs. In the context of Sri Lankan commercial banks, institutional ownership, which often holds a larger proportion of shares, may demand more regular and stable dividends, while managerial ownership could result in lower dividends to retain earnings for growth.

Signaling Theory (Bhattacharya, 1979)

Signaling theory suggests that dividend decisions send signals to the market about a firm’s financial health and future prospects. High dividends may signal strong financial performance, while low or irregular dividends could indicate financial distress. Foreign investors, who are sensitive to market signals, often prefer higher dividend payouts as they perceive them as a signal of firm stability, especially in emerging markets like Sri Lanka where investor protection might be weaker. This theory suggests that foreign ownership could push banks to distribute higher dividends.

Bird-in-the-Hand Theory (Gordon, 1959)

According to this theory, investors prefer dividends over potential capital gains because dividends provide immediate returns and reduce uncertainty. Institutional investors in Sri Lanka, who are risk-averse and require stable returns, might prefer a higher dividend payout. This preference for immediate cash returns is especially relevant in times of economic uncertainty, where capital gains are perceived as less reliable.

This study draws on three main theories to develop its hypotheses. Agency Theory (Jensen & Meckling, 1976) highlights conflicts between owners and managers affecting dividend choices. Signaling Theory (Bhattacharya, 1979) explains how dividends communicate firm information to investors. Bird-in-the-Hand Theory (Gordon, 1959) suggests investors prefer dividends over uncertain future gains. Together, these theories provide a comprehensive framework to understand the impact of ownership structure on dividend policy.

Empirical Review

Managerial ownership is generally associated with lower dividend payouts due to the tendency of managers to retain earnings for reinvestment in the firm's growth. According to a study by Al-Najjar and Kilincarslan (2019), banks with higher managerial ownership in Turkey were found to have lower dividend payout ratios, as managers sought to retain control and funds for expansion. This aligns with the free cash flow theory (Jensen, 1986), suggesting that managers with significant ownership prefer internal financing and are less inclined to distribute cash as dividends. In the Sri Lankan context, Perera and Thrikwala (2010) found that state-owned and managerially controlled banks exhibit more conservative dividend policies, prioritizing liquidity and capital retention due to regulatory and financial stability concerns. A more recent study by Jayawardena and Yapa (2022) also confirms this trend, noting that in Sri Lankan commercial banks, higher managerial ownership correlates with lower dividend payouts, especially in periods of economic uncertainty, as managers focus on safeguarding capital to navigate market volatility.

Foreign ownership, conversely, is often linked to higher dividend payouts. Foreign investors tend to seek immediate returns in the form of dividends due to concerns about weaker investor protection in emerging markets. A study by Ghosh (2021) on South Asian banks revealed that firms with significant foreign ownership distributed higher dividends, as foreign investors press for more tangible returns, especially during economic instability. Similarly, in Sri Lanka, foreign-controlled banks such as the Commercial Bank of Ceylon have been observed to maintain stable dividend payouts, even in the face of economic volatility, reflecting the preferences of foreign investors for consistent cash returns (Gamage, 2022). This is consistent with findings by Fakhfakh and Gassab (2023), who reported that foreign ownership positively influences dividend payouts in emerging markets, including Sri Lanka, as foreign investors are typically more focused on the short-term cash returns rather than long-term reinvestment. Their study also emphasized the need for foreign investors to mitigate risks by receiving regular dividends, particularly in volatile economic environments.

Institutional ownership also plays a significant role in shaping dividend policy. Institutional investors, including pension funds, insurance companies, and mutual funds, are generally more risk-averse and prefer stable dividend payments to ensure predictable returns. In a study by Shah and Butt (2009), institutional ownership in Pakistan's banking sector was found to positively influence dividend payout ratios, as institutional investors actively press for higher payouts. Similarly, in Sri Lanka, institutional investors in commercial banks are seen to prefer conservative dividend policies, particularly when economic conditions are unstable, to ensure long-term financial stability and shareholder confidence (Wijesinghe & Weerakoon, 2021). More recent studies, such as those by Mendis and Weerasinghe (2022), reinforce this view, indicating that institutional investors in Sri Lanka prefer a stable dividend policy, especially during periods of economic stress, to protect their long-term investment returns. Their study highlighted that institutional investors in Sri Lankan banks prioritize liquidity and stability, pressuring management to adopt lower payout ratios during uncertain times.

Firm size, often included as a control variable, is an important determinant of dividend policy. Larger firms tend to have more stable cash flows and better access to capital, allowing them to pay higher dividends. In Sri Lanka, larger commercial banks with diversified portfolios, such as Hatton National Bank, have been able to maintain higher dividend payout ratios, even in challenging economic times (Central Bank of Sri Lanka, 2023). This is consistent with findings by Rani and Reddy (2018), who showed that firm size is positively correlated with dividend payouts due to greater financial flexibility. A recent study by Fernando and Gamage (2023) further supports this view, finding that larger Sri Lankan banks with diversified operations and international exposure tend to have more stable dividend payout ratios, even during periods of economic crisis. They also observed that larger firms tend to be less affected by liquidity constraints and regulatory pressures, enabling them to maintain consistent dividend distributions.

Methodology

This study utilizes a quantitative research design, employing secondary data to analyze the impact of ownership structure on the dividend policy of licensed commercial banks in Sri Lanka. The research follows a deductive approach, testing hypotheses based on established theories such as agency theory and signaling theory. The sample consists of 20 out of the 24 licensed commercial banks listed on the Colombo Stock Exchange (CSE), selected through purposive sampling to ensure a representative cross-section of the banking sector. Data for the analysis were collected from the annual reports of the selected banks for the period 2019-2023, supplemented with relevant scholarly articles, academic journals, and textbooks to provide contextual insights.

To analyze the data, descriptive statistics are first employed to summarize key characteristics such as Managerial ownership, Institutional ownership and foreign ownership (independent variables), and dividend payout ratio (dependent variable). Firm size is included as a control variable in the analysis.

Correlation analysis is then used to determine the strength and direction of the relationships between the ownership structure variables (managerial ownership, foreign ownership, and institutional ownership) and the dividend payout ratio. Finally, multiple regression analysis is conducted to examine the impact of these ownership structures on dividend policy, controlling for firm size. This comprehensive methodology allows for a robust investigation of the relationship between ownership structure and dividend policy in the context of Sri Lanka's commercial banking sector.

Conceptualization Framework

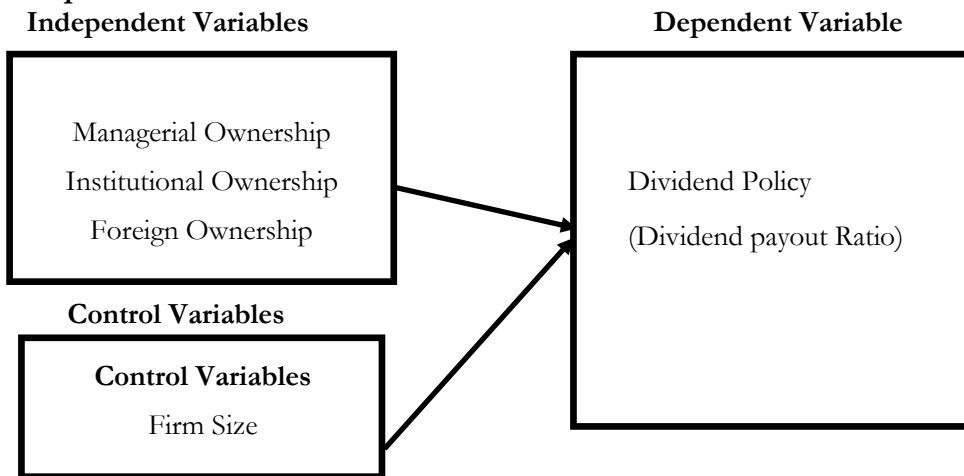


Figure 1 - Conceptual Framework

Source – Developed by Researcher

In this study, the dependent variable is Dividend Policy, which is measured using the Dividend Payout Ratio (DPO) calculated as the ratio of total dividends paid to net income. The independent variables include Managerial Ownership, measured as the percentage of shares held by directors and executive managers, Institutional Ownership, measured as the proportion of shares held by institutional investors such as pension funds, insurance companies, and mutual funds, and Foreign Ownership, which is assessed based on the percentage of total shares owned by foreign investors. The control variable, Firm Size, is measured using the natural logarithm of total assets, which helps account for the scale effect in comparing banks of different sizes. These variable measurements align with prior empirical studies and ensure consistency and accuracy in analyzing their impact on dividend policy within licensed commercial banks in Sri Lanka (Shah & Butt, 2009; Faccio et al., 2001; Chen & Dhiensiri, 2009; Amidu & Abor, 2006).

Hypothesis of the Study

H₁: There is a significant impact of Managerial ownership structure and dividend policy in licensed commercial banks in Sri Lanka.

H₂: There is a significant impact of institutional ownership structure and dividend policy in licensed commercial banks in Sri Lanka.

H₃: There is a significant impact of foreign ownership structure and dividend policy in licensed commercial banks in Sri Lanka.

Results and Discussion

In order to achieve the objective of this study the analysis of descriptive statistics, correlation analysis and panel data analysis have been employed.

Descriptive Analysis

Descriptive Statistics exhibit behavioural pattern of the gathered data. Table 1 shows the descriptive statistics.

	MOS	INOS	FGOS	FZ	DPO
Mean	0.1421	0.8578	0.2260	21.7359	0.4990
Median	0.1584	0.8416	0.2215	21.8695	0.5546
Maximum	0.2258	0.9954	0.6112	24.6600	1.2254
Minimum	0.0047	0.7742	0.0001	16.6800	0.1234
Std. Dev.	0.0580	0.0520	0.1367	2.16055	0.3977
Skewness	-0.8486	0.8488	0.6663	-0.56084	0.9590
Kurtosis	2.6200	2.6206	3.6867	2.18138	4.3515
Observations	100	100	100	100	100

The descriptive statistics for the variables in this study reveal notable insights into the ownership structure, firm size, and dividend payout ratios of licensed commercial banks in Sri Lanka. The mean value of Managerial Ownership is 0.1422, with a median of 0.1584, suggesting a relatively modest proportion of ownership by managers in the sampled banks. The Managerial ownership values range from a minimum of 0.0047 to a maximum of 0.2258, with a standard deviation of 0.058, indicating a moderate variation in managerial ownership across the sample. Institutional Ownership, on the other hand, shows a mean of 0.8578 and a median of 0.8416, reflecting a high level of institutional ownership in the sample. The minimum value is 0.7742, and the maximum value is 0.9954, with a low standard deviation of 0.052, indicating limited variation among banks in terms of institutional ownership.

In terms of Foreign Ownership, the mean is 0.2261, with a median of 0.2216. The foreign ownership values vary widely, from a minimum of 0.0001 to a maximum of 0.6112, which is reflected in the higher standard deviation of 0.1367, indicating significant variation in foreign ownership levels across the banks. Regarding Firm Size, the mean value is 21.7359, with a median of 21.8695. The firm size ranges from a minimum of 16.68 to a maximum of 24.66, with a standard deviation of 2.1605, pointing to a moderate level of variation in the size of the firms within the sample.

Finally, the Dividend Pay-out Ratio shows a mean of 0.4990, with a median of 0.5546. The dividend

payout ratio spans a wide range, from a minimum of 0.1234 to a maximum of 1.2254, with a standard deviation of 0.3977, indicating substantial variation in the dividend policies adopted by the banks. Overall, these descriptive statistics provide a comprehensive understanding of the key characteristics and variation in ownership structures, firm size, and dividend payout practices among Sri Lanka's licensed commercial banks.

Correlation Analysis

To identify the relationship between the variables, correlation analysis was carried out

Table 2: Results of Correlation Analysis

Correlation	MOS	INOS	FGOS	FZ	DP R
MOS	1.000000				
INOS	-0.990000	1.000000			
FGOS	0.164644	0.164715	1.000000		
FZ	0.364715	-0.364688	0.208366	1.000000	
DPO	-0.079258	-0.505272	0.108627	0.117106	1.00 00 0
	0.4331	0.0433	0.0120	0.2459	-----

The correlation matrix presented above includes data from 100 observations and illustrates the relationships between the key variables in this study. The correlation coefficient between Managerial Ownership and the Dividend Pay-out Ratio (DPO) is -0.07925, with a p-value of 0.4331, indicating a weak and statistically insignificant negative relationship between these two variables. Regarding Institutional Ownership, the correlation with DPO is negative, with a moderate and statistically significant relationship, reflected by a correlation coefficient of -0.5052 and a p-value of 0.0433. This suggests that higher institutional ownership tends to be associated with lower dividend payouts. For Foreign Ownership, there is a positive correlation with DPO, with a weak but statistically significant relationship, as indicated by a correlation coefficient of 0.1086 and a p-value of 0.0120. This implies that higher foreign ownership is linked to a higher dividend payout ratio.

When considering the control variable Firm Size, it is positively correlated with the Dividend Pay-out Ratio, it shown by the correlation coefficient of 0.1171 and a p-value of 0.2459.

Regression Analysis

This section presents the regression analysis conducted to examine the relationship between ownership structure and dividend policy. It aims to identify the extent and significance of the impact of different ownership types on dividend decisions.

Table 3: Multiple Regression Analysis

In statistical modelling, regression analysis is a set of statistical processes for estimating the relationships between a dependent variable and one or more independent variables.

Variable	Pooled regression		Fixed effect model		Random effect model	
	Coeffi- cient	Prob.	Coeffi- cient	Prob.	Coeffi- cient	Prob.
C	-0.529827	0.1181	-0.297492	0.0894	-0.429823	0.1016
MOS	0.528314	0.0569	0.303200	0.0874	0.528311	0.0723
INOS	-1.489365	0.0184	-2.965641	0.0298	-1.293144	0.0518
FOS	2.469731	0.0634	4.771345	0.0890	3.46973	0.0595
FZ	2.716736	0.1817	-1.280968	0.1373	3.736132	0.1872
R-squared	0.42060		0.48588		0.40050	

Hausman Test

Table 4: Hausman Test for Model DPO

Test Summary	Chi-Sq. Statis- tic	Chi-Sq. d.f.	Prob.
Cross-section random	9.885679	3	0.0424

Null Hypothesis (H0): Random Effect model is appropriate.

Alternate Hypothesis (H1): Fixed Effect model is appropriate.

To determine the appropriate model between fixed and random effects, a Hausman test was conducted (Table4). The null hypothesis (H0) assumes that the random effects model is appropriate, while the alternative hypothesis (H1) suggests that the fixed effects model is more suitable. The Hausman test yielded a chi-square statistic of 9.8857 with 3 degrees of freedom and a p-value of 0.0424. Since the p-value is less than 0.05, we reject the null hypothesis and accept the alternative hypothesis. This indicates that the fixed effects model is more appropriate for this study, as it better captures the relationships between the independent and dependent variables.

In the fixed effects model, the coefficient for Managerial Ownership is 0.3032 with a p-value of 0.0874, which remains insignificant. Institutional Ownership has a coefficient of -2.9656 (p=0.0298), indicating a significant negative impact on DPO. Foreign Ownership shows a coefficient of 4.7713 (p=0.0890), which remains insignificant. Firm Size has a coefficient of -1.2810 (p=0.1373), which is also insignificant. The R-squared value for the fixed effects model is 48.58%, implying that the independent variables explain 38.59% of the variance in dividend payout ratio.

The results from the fixed effects model show that Institutional Ownership has a significant negative impact on the dividend payout ratio, which aligns with previous studies indicating that institutional investors prefer reinvestment over dividend distribution to support long-term growth (Shah & Butt, 2009; Wijesinghe & Weerakoon, 2021). The insignificant effect of Managerial Ownership is consistent with literature suggesting that managerial shareholders may not strongly influence dividend policy in the banking sector (Jensen & Meckling, 1976). Similarly, the positive but insignificant coefficient for Foreign Ownership contrasts with some prior findings where foreign investors typically demand higher dividends (Faccio et al., 2001), possibly due to the specific economic and regulatory context in Sri Lanka during the study period. The insignificant impact of Firm Size also corresponds with research showing that firm scale may be less relevant than ownership structure in determining dividend policies within regulated industries like banking (Rani & Reddy, 2018). Overall, these findings reflect both global and local dynamics influencing dividend policy decisions.

Conclusion

This study examines the impact of ownership structure on the dividend policy of licensed commercial banks in Sri Lanka from 2019 to 2023. The results show that institutional ownership has a significant negative influence on dividend pay-out ratios, indicating a preference for reinvestment and long-term growth over immediate cash returns. In contrast, managerial and foreign ownership do not exhibit a significant impact on dividend decisions, suggesting that these ownership types may have a limited role in influencing payout behavior within the Sri Lankan banking context. Additionally, firm size, used as a control variable, also does not significantly affect dividend policy, highlighting that larger banks do not necessarily pay higher dividends. These findings suggest that dividend policy in Sri Lankan commercial banks is more closely aligned with institutional ownership strategies and broader regulatory and economic considerations, rather than ownership by managers or foreign investors, or the size of the firm itself.

Recommendation

Based on the findings, it is recommended that policymakers and bank management in Sri Lanka closely consider the role of institutional investors when formulating dividend policies, as their influence tends to favour earnings retention for long-term growth. Regulatory bodies may also need to ensure that dividend guidelines balance the interests of different shareholder groups while safeguarding financial stability. For foreign and managerial shareholders, increased transparency and engagement may help align their expectations with the bank's strategic goals. Furthermore, as firm size does not significantly influence dividend decisions, banks should focus more on strategic and regulatory factors rather than relying on scale when determining dividend payouts. Encouraging a balanced dividend policy that supports both reinvestment and reasonable shareholder returns could enhance investor confidence and promote sustainable growth in the banking sector.

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