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CONTENTS

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   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

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CORPORATE GOVERNANCE PRACTICES AND ITS IMPACT ON DIVIDEND POLICY: A STUDY ON SRI LANKAN LISTED MANUFACTURING COMPANIES

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ABSTRACT
The objective of this paper is to examine the relationship between corporate governance and dividend policy of Sri Lankan listed manufacturing companies. Corporate governance refers to a set of rules and incentives by which the management of a company is directed and controlled. There is a great awareness among the researchers to carry out the researches in "corporate governance'. Very little researches on "corporate governance" are available in Sri Lanka and need to be empowered companies to pay a special attention on corporate governance. The main objective of this study is to examine the relationship between corporate governance practices and dividend policy in listed manufacturing firms in Sri Lanka. The present study is initiated on "corporate governance practices and dividend policy "with the samples of 20 manufacturing companies using the data representing the periods of 2008 – 2012. Leadership structure, board committee, board meeting, board size, board composition, were used as the determinants of corporate governance practices whereas dividend payout and earning per share were used as the measures of dividend policy. The statistical tests were used includes: descriptive statistics, correlation and regression analyses. The study found that determinants of corporate governance are correlated to the dividend policy measures of the organization. Regression model showed that corporate governance affect companies' dividend policy. Further recommendations are also put forwarded in the research. The study only used data from the 2008-2012 annual reports. However, the findings have highlighted the effects of corporate governance of the dividend policy. The study contributes to literature in Sri Lanka. Furthermore, the finding of the paper can be considered as helpful for managers and users that are anxious to develop financial description quality and practices of corporate governance.

KEYWORDS
Corporate Governance, Leadership Structure, Board Committee, Board Meeting, Board Size, Board Composition, Dividend Policy, Dividend Payout, Earning Per Share, Sri Lanka.

INTRODUCTION
Corporate governance, the system by which companies are directed and controlled (Cadbury 1992), has succeeded in attracting a good deal of public interest over the years because of its apparent importance for the economic health of companies and society in general in both developed and developing countries. The roots of the modern corporate governance movement dates back to the publication of 'The Modern Corporation and Private Property', by Adolf A. Berle and Gardiner C. Means in 1932, which argued that dispersion of equity ownership in the modern corporation had separated ownership from control. Based on this seminal summary of Berle and Means (1932) and extensions made by agency theorists (Jensen and Mackling, 1976), scholars normally describe the evolution of corporate governance in terms of changes in the relationship between ownership and control (Chandler, 1977; Galbraith, 1967; Fligstein, 1990).

However, corporate governance received much attention during the last two decades owing to certain economic reforms in countries and accidents of economic history such as regional market crisis and large corporate debacles. Becht, Bolton and Roell (2005) identify these reasons as worldwide wave of privatization of the past two decades; pension fund reform and the growth of private savings; the takeover wave of the 1980s; deregulation and the integration of capital markets; East Asian crisis in 1998; and a series of recent scandals and corporate failures in United States of America (USA). During the East Asian financial crisis, a lot of the attention fell upon the corporate governance systems of developing countries (emerging markets), which tend heavily into cronyism and nepotism. Claessens and Fan (2002) find that lack of protection for minority rights from expropriation of controlling shareholders as the major corporate governance issue in Asia as in many other emerging markets.

STATEMENT OF THE PROBLEM
Mostly, corporate governance has been taken as an independent variable in previous researchers and it is discussed here as a dependent variable on a dividend policy. Meanwhile, corporate governance rules have been mandated by the Securities and Exchange Commission of Sri Lanka. But, we have seen the differences between the practices and mandatory issues on the corporate governance in the listed companies except listed manufacturing companies in Sri Lanka. In the case of board structure, the first issue that the Sri Lankan code required for effective corporate governance was separation of the top two positions of the board (CEO and Chairman). And also, in the case of board committee, listed companies should form the three committees as audit, remuneration and nomination (Code of best practice on corporate governance, 2008). According to our study, in the practice, separate leadership style has been utilized by twelve listed manufacturing firms in the study sample as twenty manufacturing firms. And rest of the eight firms has utilized the combined leader ship in the board structure. In the board committee perspective, Out of twenty listed manufacturing firms, three firms have formed the all three committees as Audit, Remuneration, and Nomination. And rest of the seventeen manufacturing companies has formed the one or two committees. So this study tries to fill research gap by examine the following research question:

"To what extent the corporate governance depends on dividend policy of the listed manufacturing companies"

SIGNIFICANCE OF THE RESEARCH

The introduction of corporate governance practices in Sri Lanka aimed to provide a mechanism to improve investor confidence and trust in management and promote economic development of the country. However, efficiency of the corporate governance structures and practices on corporations operating in the highly volatile environment of Sri Lanka has not been empirically investigated.

The present study will contribute to the existing body of knowledge concerning corporate governance practices and dividend policy by examining the corporate governance structures of Sri Lanka, and how these structures can reflect the accountability of the board to shareholders and other stakeholders through dividend policy.

However, the relationships between corporate governance and dividend policy have not been investigated in a single study in previous research. In addition, studies of the above relationships in the particularly unstable situation of Sri Lanka have not been studied in the research.

REVIEW OF LITERATURE

Corporate Governance is the system by which corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as; boards, managers, shareholders and other stakeholders and spells out the rules and procedures and also decision making assistance on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of obtaining those objectives and examining the value and the dividend policy of the companies. Corporate governance refers to a set of rules and incentives by which the management of a company is directed and controlled.

According to Alchian (1950) and Stigler (1958), competition among firms takes care of corporate governance. In the long run, the product market forces the competitors to minimize cost. In order to minimize cost, external finances are generated at lower costs. Monopolies are illegal. Corporate policies and strategies are dependent upon a single decision making authority: the Chief Executive Officer (CEO). Good corporate governance practices are important in reducing risk for investors, attracting investment capital and improving the performance of companies (Velnampy and Pratheepkanth, 2012). Other shareholders seem power less in these systems. Shliefer and Vishney (1997) termed corporate governance as the ways through which suppliers of finance assure themselves of getting the return on their investments.

CORPORATE GOVERNANCE

Corporate governance in developed market economies has been built gradually over several centuries as a consequence of the economic development of industrial capitalism (Chowdary 2003). As a result, different corporate governance structures evolved in different corporate forms to pursue new opportunities or resolve new economic problems.

Magdi and Nadereh (2002) stress that corporate governance is about ensuring that the business is running well and investors receive a fair return. Core corporate governance institutions respond to two distinct problems, one of vertical governance (between distant shareholders and managers) and another of horizontal governance (between a close, controlling shareholder and distant shareholders). The results drawn by different researchers about the impact of corporate governance on firm performance are positive and direct but some researchers also had drawn negative and indirect results, on the other hand there are also some results which vary variable to variable.

Corporate governance regimes are distinguished between the outsider system and the insider system. The insider system prevails in relationship-based economies such as countries in Europe and Asia that are characterized by a concentrated ownership model with controlling shareholders, moderately liquid or weak securities markets, low transparency and disclosure standards, and dependent on loans from banks and support from close business networks (Banks 2004; Clarke, 2007).

Today corporate governance is complex and mosaic, consisting of laws, regulations, politics, public institutions, professional associations and a code of ethics. However, in the emerging markets of the developing countries many details of these structures are missing. For them developing a system of good corporate governance is difficult because such governance is complex and vague due to the confusing relationships between state and financial sectors, weak legal and judicial systems, absent or underdeveloped institutions, corrupt political systems, and scarce human resource capabilities (Chowdary, 2003), which can negatively affect the return on investment (Dallas & Bradley, 2002).

DIVIDEND POLICY

Dividend policy is one of the important components of firm policies and has been viewed as an interesting issue in the literature. Dividend payout decisions effect on the firm's valuation. Moreover, cash dividend has a special position among the shareholders. However, the main problem is the reasons for adopting a policy of divided payout. Dividend policies depend on several factors. One of these factors is corporate governance (MehraniSasan, MoradiMohamad and EskandarHoda (2011). Corporate governance has recently received considerable attention due to the financial scandals. The reason for the attention is the interest conflicts among shareholders in the corporate structure (Gillan S, J. Hartzell, L. Starks (2003). Using an Iran panel data set, this paper examined the possible relationship between corporate governance and dividend policy that was analyzed within the context of the dividend models of Lintner (1956), Waud (1966) and Fama and Babiak (1968).

CORPORATE GOVERNANCE AND DIVIDEND POLICY

A variety of definitions have been put next for corporate governance, stressing for example accountability and shareholder democracy. Jensen (1993) argued that the preference for smaller board size stems from technological and organizational change which ultimately leads to cost cutting and downsizing. Hermalin and Weisbach (1991) argued the possibility that larger boards can be less effective than small boards. When boards consist of too many members agency problems may increase, as some directors may tag along as free-riders. Lipton and Lorch (1992) recommended limiting the number of directors on a board to seven or eight, as numbers beyond that it would be difficult for the CEO to control. However, Linck et al (2008) provides evidence that smaller boards are not necessarily better than larger boards.

Sing and Ling (2008), document that independent directors in Malaysian firms generally play a passive role as their appointment is merely to fulfill listing requirement rather than as a measure at improving CG or to bolster the capability of the firm. Board size has been a particular area of focus for CG researchers. One of the key duties of the board of directors is to hire fire and compensate the Chief Operating Officer (CEO).

Shleifer and Vishny (1997): governance is a mechanism that the suppliers of finance use to ensure a proper return from the enterprise¡±. At the firm level, it encompasses several mechanisms that serve to protect shareholders. Interests and reduce agency conflicts arising from the separation of ownership and control, such as: board independence, proper audits, nomination and remuneration committees; as well as capital structure and dividend payout policies. Corporate governance is primarily concerned with finding a solution to the principal-agent problem (Ehikioya, 2009). Advocates of corporate governance have identified internal and external governance mechanisms that reduce the agency problem (Agarwal and Knoeber, 1996). The corporate governance structure such as ownership structure, Board composition, Board size, and CEO duality have a great influence on performance and corporate decisions. In a series of papers, La Porta, et al. (1997, 1998, 1999, 2000a and 2000b) demonstrate that across countries corporate governance is an important factor in financial market development, firm value and dividends. Yermack (1996) reported that firms are more valuable when the CEO and Chairperson's positions are held separately. Firms where the position of CEO and chairperson are clearly separated are likely to employ the optimal amount of debt in their capital structure (Fosberg, 2004).

Winter (1977), Fama (1980) and Weisbach (1988), the percentage of nonexecutives on the firm.s board, NONEXPCT, is also included to account for the possibility that such outside directors may act as management monitors. Thus, the expected sign for this coefficient is negative, unless the same observations referred about INSTIT apply, in which case a positive relationship might emerge. Fama and French (2001) and Grullon and Michaely (2002) documented that firms with more assets have higher dividend payout. However, Gugler and Yurtuglu (2003) and Farinha (2003) showed that dividend payouts are negatively associated with firm size.

OBJECTIVES OF THE STUDY

The main objective of the study is to analyze the impact of corporate governance on dividend policy in Sri Lanka. To achieve this objective the study first reviews the theoretical and empirical literature on the impact of corporate governance on dividend policy in Sri Lanka. According to the previous literature the corporate governance have a positive impact on dividend policy oh host countries.

The following objectives are taken for the study.

1. To identify the relationship between corporate governance and dividend policy.
2. To find out the impact of corporate governance on dividend policy.
3. To suggest the organization to adopt good governance practices towards dividend policy.

RESEARCH QUESTION

- ✓ Is there any relationship between dividend policy and corporate governance practices of manufacturing companies listed on CSE?
- ✓ Does dividend policy of manufacturing companies listed on CSE have an impact corporate governance practices?

METHODOLOGY

The purpose is to describe the research methodology of this study. Since the aim of the study was to test the effect of corporate governance practices on dividend policy, the design of the methodology was based on prior research into these relationships. This chapter describes the method of data collection, the variables used to test the hypothesis and statistical techniques employed to report the results.

These methods included,

Descriptive statistics: - To collect, summarize and present data. This analysis has given the information for the data through the frequency distribution, central tendency, and the dispersion.

Correlation Analysis: - To find the relationship between corporate governance and dividend policy.

Regression Analysis: - To help to impact of corporate governance on dividend policy.

Model 1) DIP = $\beta_o + \beta_{1LSS} + \beta_{2BC} + \beta_{3BM} + \beta_{4BZ} + \beta_{5PNED} + \beta_n$

Model 2) EPS = $\beta_o + \beta_{1LSS} + \beta_{2BC} + \beta_{3BM} + \beta_{4BZ} + \beta_{5PNED} + \beta_n$

DATA COLLECTION

Data on corporate governance practices and dividend policy were collected from secondary sources as Annual reports of the manufacturing companies, Colombo stock exchange publications and URL of the Colombo stock exchange for the period of 2008 to 2012.

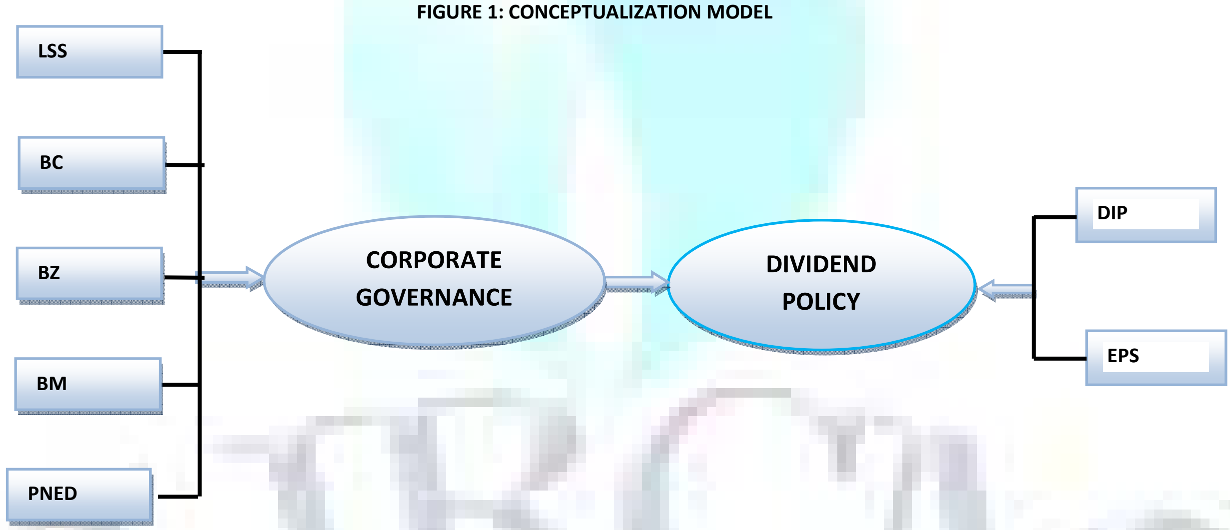
SAMPLING

The Colombo Stock Exchange (CSE) has 287 companies representing 20 business sectors as at 31st January 2013. Out of 37 Manufacturing companies 20 companies were selected for the present study.

CONCEPTUAL FRAME WORK

Based on the purpose of the study, the following conceptual model has been constructed. This model of corporate governance practices and dividend policy introduces new constructs and uniquely combines them in specifying that the dividend policy are a function of leadership style, board committee, board size, board meeting and board composition.

FIGURE 1: CONCEPTUALIZATION MODEL



Where

LSS	-Leadership Style	BC	-Board Committee	BM	-Board Meeting	PNED	-Board Composition
BZ	-Board Size	DIP	-Dividend Payout	EPS	-Earning per Share		

OPERATIONALIZATION

The variables used to operationalized the constructs include the corporate governance variables (board leadership (if the positions of chairman and the CEO were held by single person or two separate persons), composition of the board (number of non-executive directors), board activity intensity (number of board meetings), board committees (number of board appointed committees), board size (number of directors in the board) and debt ratio. The corporate performance of this study was measured dividend policy.

TABLE 1: OPERATIONALIZATION

Concept	Variables	Indicators	Measurement
Corporate Governance	Leadership Style	Number of Leadership Style	Increasement (Number)
	Board Committee	Number of Board Committee	Increasement (Number)
	Board Size	Number of Board Size	Increasement (Number)
	Board Meeting	Number of Board Meeting	Increasement (Number)
	Board Composition	Number of Board Composition	Increasement (Number)
Dividend Policy	Dividend Payout	Ratio	Dividend Per Share (DPS) / Earning Per Share (EPS)*100
	Earnings per Share	Ratio	Net Income - Dividends on Preferred Stock /Average Outstanding Shares

HYPOTHESES

The following are the hypotheses formulated for the study.

H_1 : There is a significant relationship between corporate governance and dividend policy.

H_1a : There is a significant relationship between leadership style and dividend policy.

H_1b : There is a significant relationship between board committee and dividend policy.

H_1c : There is a significant relationship between board size and dividend policy.

H_1d : There is a significant relationship between board meeting and dividend policy.

H_1e : There is a significant relationship between board composition and dividend policy.

H_2 : There is a significant impact of corporate governance on dividend policy.

H_2a : There is a significant impact of leadership style on dividend policy.

H_2b : There is a significant impact of board committee on dividend policy.

H_2c : There is a significant impact of board size on dividend policy.

H_2d : There is a significant impact of board meeting on dividend policy.

H_2e : There is a significant impact of board composition on dividend policy.

Hypotheses $_1$, $_1$a, $_1$b, $_1$c, $_1$d and $_1$e are evaluated based on the correlation analysis while regression analysis the basis of evaluation of hypothesis $_2$, $_2$a, $_2$b, $_2$c, $_2$d and $_2$e.

ANALYSIS AND INTERPRETATION

Descriptive statistics were carried out to obtain sample characteristics. Output of the descriptive statistics is presented in table 02

TABLE 2: DESCRIPTIVE STATISTICS

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Leadership Structure	20	1.00	.00	1.00	.4000	.50262
Board Committee	20	2.00	1.00	3.00	2.0500	.51042
Board Meeting	20	10.00	2.00	12.00	7.3000	3.45040
Board Size	20	9.00	2.00	11.00	7.3500	2.39022
Board Composition	20	.55	.00	.55	.3900	.12716
Dividend Payout	20	232.24	-144.47	87.77	20.8980	45.64585
Earnings per Share	20	78.06	.14	78.20	10.0447	16.60505

According to the descriptive statistics in Table 2 for the independent variables indicate that average number of leadership structure, board committee, board meeting, board size, and board composition. The descriptive statistics, data are well set further leadership structure, board committee, board meeting, board size, board composition, dividend payout ratio and earnings per share are in the same level approximately among all the listed manufacturing companies in Sri Lanka.

Correlation analysis was carried out to find out the relationship between determinants of corporate governance and the measures of dividend policy.

TABLE 3: CORRELATION FOR MANUFACTURING COMPANIES

		LSS	BC	BM	BZ	PNED	DIP	EPS
LSS	Pearson Correlation	1	.533*	-.012	-.123	-.231	.548*	.700**
	Sig. (2-tailed)		.015	.959	.606	.328	.032	.001
	N		20	20	20	20	20	20
BC	Pearson Correlation		1	-.129	-.015	-.162	.673*	.772*
	Sig. (2-tailed)			.589	.950	.495	.043	.024
	N			20	20	20	20	20
BM	Pearson Correlation			1	.216	.351	.718**	.809*
	Sig. (2-tailed)				.360	.129	.002	.018
	N				20	20	20	20
BZ	Pearson Correlation				1	.324	.589*	-.320
	Sig. (2-tailed)					.164	.016	.133
	N					20	20	20
PNED	Pearson Correlation					1	-.260	.676*
	Sig. (2-tailed)						.268	.028
	N						20	20
DIP	Pearson Correlation						1	-.026
	Sig. (2-tailed)							.913
	N							20
EPS	Pearson Correlation							1
	Sig. (2-tailed)							
	N							

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

LSS: Leadership Style, BC: Board Committee, BM: Board Meeting, PNED: Board Composition, BZ: Board Size, DIP: Dividend Payout, EPS: Earning per Share

According to the Correlation in Table 3: The results of the correlation analysis in Table 3 show that the determinants of corporate governance such as leadership style, board committee, board meeting, board size, and board composition, are significantly correlated with DIP and EPS as the measures of dividend policy. The

Table shows the relationship between leadership style and dividend payout. From the above table it can be observed that there is a positive relationship between leadership style and dividend payout. The correlation value is 0.548 and which is significant at the level of 5% because the p value (0.032) is less than the significant level of 0.05. The above mentioned Table shows the relationship between leadership style and earnings per share. The correlation value is 0.700 and which is significant at the levels of 1% because the p value (0.001) is less than the significant level of 0.01.

The Table shows the relationship between board committee and dividend payout. From the above Table it can be observed that there is a positive relationship between board committee and dividend payout. The correlation value is 0.673 and which is significant at the level of 5% because the p value (0.043) is less than the significant level of 0.05. At 95% confident level the Table illustrates that there is positive correlation between board committee and earnings per share according to the correlation value of 0.772. The p value (0.024) is less than the significant so there is a significant relationship between board committee and earnings per share.

The Table shows the relationship between board meeting and dividend payout. From the above table it can be observed that there is a positive relationship between board meeting and dividend payout. The correlation value is 0.718 and which is significant at the level of 1% because the p value (0.002) is less than the significant level of 0.01. At 95% confident level the table illustrates that there is positive correlation between board meeting and earnings per share according to the correlation value of 0.809. The p value (0.018) is less than the significant so there is a significant relationship between board meeting and earnings per share.

The Table shows the relationship between board size and dividend payout. From the above table it can be observed that there is a positive relationship between board size and dividend payout. The correlation value is 0.589 and which is significant at the level of 5% because the p value (0.016) is less than the significant level of 0.05. At 95% confident level the table illustrates that there is negative correlation between board size and earnings per share according to the correlation value of -0.320. The p value (0.133) is greater than the significant so there is an insignificant relationship between board size and earnings per share.

The Table shows the relationship between board composition and dividend payout. From the above table it can be observed that there is a negative relationship between board composition and dividend payout. The correlation value is -0.260 and which is insignificant at the level of 5% because the p value (0.268) is greater than the significant level of 0.05. At 95% confident level the table illustrates that there is positive correlation between board composition and earnings per share according to the correlation value of 0.676. The p value (0.028) is less than the significant so there is a significant relationship between board composition and earnings per share.

According to the correlation for manufacturing company's helps to test the hypothesis here the significant P value is less than the 0.05 significant level therefore the alternative hypotheses can be accepted. The result of my study is in line with findings of Kumar (2006), Alii, Khan, & Ramirez, (1993).

The regression analysis was performed to recognize the impact of corporate governance on dividend policy.

The results of the analysis are given in Table 04.

The purpose of regression analysis is to find out the significant impact or influence of independent variable on dependent variable (Ndubisi, 2006). The regression analysis was performed to recognize the impact of corporate governance on dividend policy.

The results of the analysis are given

IMPACT OF DIVIDEND POLICY ON CORPORATE GOVERNANCE

TABLE 4: REGRESSION ANALYSIS FOR MANUFACTURING COMPANIES

Model	B		Sig.(Coefficients**)**		Independent Variable	
	DIP	EPS	DIP	EPS	DIP	EPS
Constant	124.640	22.621	.079	.339		
LSS	34.193	13.039	.028	.017		
BC	-30.444	-9.060	.046	.031		
BM	-1.633	1.762	.036	.015		
BZ	-3.448	.223	.013	.056		
PNED	-45.487	-35.168	.041	.031		
R Square					.233	.298
Sig. (ANOVA)					.036	.047

According to the Regression in Table 4.4 include Model Summary, ANOVA in regression and coefficient in regression analysis. Model summary the specification of the five variables is leadership style, board committee, board meeting, board size, and board composition in the model revealed the ability to predict dividend policy. R2 Value of .233 and .298, which are in the models denote that 23.3% and 29.8% of the observed variability in dividend policy can be explained by the differences in the independent variables namely leadership style, board committee, board meeting, board size, board composition. Remaining 76.7% and 70.2% of the variance in dividend policy is related to other variable which is explained, because they are depicted in the model. R2 values of that 23.3% and 29.8% indicate that there may be number of variables which can have an impact on dividend policy that need to be studied. Hence this area is indicated as a scope for future research.

According to the ANOVA in regression helps to test Model 1 and Model 2 the hypothesis here the significant P value is less than the 0.05 significant level therefore the alternative hypotheses can be accepted.

From the Table 4.10, the regression model can be retrieved as follows.

Model 1) DIP = $\beta_o + \beta_{1LSS} + \beta_{2BC} + \beta_{3BM} + \beta_{4BZ} + \beta_{5PNED} + \beta_n$

DIP = 124.640 + 34.193LSS + (-30.444) BC + (-1.633) BM + (-3.448) BZ + (-45.487)PNED+β_n

Model 2) EPS = $\beta_o + \beta_{1LSS} + \beta_{2BC} + \beta_{3BM} + \beta_{4BZ} + \beta_{5PNED} + \beta_n$

EPS = 22.621+ 13.039LSS + (-9.060) BC + 1.762BM + .223BZ + (-35.168) PNED+β_n

The results of the regression analysis in Table 4.4 shows that the coefficient for all five variables such as leadership style, board committee, board meeting, board size, and board composition are significant. It can be inferred that board committee including independent non-executive directors and executive director should have an effective and complete role in controlling the opportunistic behavior in management and also they should have regular meeting to discuss and monitor the activities of the firms. Further t values for all five variables of corporate governance are significant event at 5% level. It means that these variables are contributing to the dividend policy measures of dividend payout and earning per share. The result of my study is in line with findings of Samuel Kwaku Agyei, Edward Marfo-Yiadom (2011), Kumar (2006) and Alii, Khan, & Ramirez, (1993).

CONCLUSION AND RECOMMENDATION

To conclude, listed companies under the Colombo stock exchange (CSE) are practicing corporate governance system. The results of the study provide evidence that the corporate governance measures are significantly correlated with dividend payout and earning per share as dividend policy. So that hypotheses are accepted. R2 Value of dividend payout and corporate governance and also dividend payout, corporate governance and earning per share .233 and .298, which are in the models denote that 23.3% and 29.8% of the observed variability in dividend policy can be explained by the differences in the independent variables namely leadership style, board committee, board meeting, board size, and board composition. Further corporate governance measures contribute to dividend policy of dividend payout and earning per share.

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