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# Institutional Ownership, Managerial Ownership and Dividend Policy in Bank Holding Companies

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**Abstract:** We study the dividend policies of bank holding companies (BHCs) which have dispersed ownership in a regulated environment. The results show that dividend is a countermeasure against agency problems in the banking industry. BHCs with higher agency costs tend to have higher dividend yields. Dividend is negatively related to ownership dispersion, indicating that firms with greater ownership dispersion use dividends to reduce the agency problems caused by the lack of collective shareholder actions. Dividend is negatively related to CEO ownership, CEO incentive pay and institutional ownership, suggesting that dividends work as a substitute for these corporate governance mechanisms in counteracting agency problems.

## 1. Introduction

Miller and Modigliani's (1961) groundbreaking paper suggests that dividend is irrelevant for firm value. Following the paper, there have been numerous studies that try to explain corporate dividend policies. However, there is little work that examines the dividend policies of bank holding companies (BHCs). This paper intends to investigate the dividend policies of BHCs, particularly in the context of agency conflict between managers and shareholders, an increasingly important problem in corporate finance. Dividends payout has been regarded as an effective measure for reducing agency costs. Rozeff (1982) points out that payouts to shareholders reduce the resources under manager's control, thereby reducing manager's power, and making it more likely that managers will incur the monitoring of the capital markets (Rozeff, 1982; Easterbrook, 1984). Low dividends may suggest an expropriation of small shareholders by colluding large shareholders and managers. Faccio, Lang and Young (2001) find that in East Asia, the dividend payout is significantly lower for business firms controlled by large shareholders with 10% to 20% shareholdings.

The banking industry has been excluded from most of the studies on dividends in the context of agency costs on the ground that regulations on banks to a large extent serve as a substitute for shareholder monitoring. The finance literature suggests that US regulations have traditionally weakened the incentives for market-based monitoring of bank CEOs (Roth and Saporoschenko, 2001). Flannery (1998), for example, argued that the regulatory monitoring of banks, which was designed to limit taxpayers' liability, decreases the incentives of outside investors to monitor and discipline bank managers. Furthermore, there are numerous