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Title: Capital Change and Stability when Dividends Convey Signals

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Highlights:

- We present an optimal-control type continuous-time model which shows that dividend signaling results in an equilibrium expansion rule which slightly violates the classical equality of internal rate of return with the cost of capital, and the difference is shown to be calculable.
- We derive the conditions under which the dividend-payout ratio signaling function can convey correct signals as to future revenue.
- We show how signaling could be affected by coincident capital changes and when it could lead to a stable equilibrium.
- The empirical questions posed by the analysis sheds light on recent mixed evidence as to the relation between dividend changes and future profitability.

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