**Strategic Financial Management**

**NMIMS Centre for Distance and Online Education (NCDOE)**

**Internal Assignment Applicable for April 2025 Examination**

**Q1. You are the Chief Financial Officer of a mid-sized manufacturing company that has consistently generated stable profits over the past five years. Recently, the board of directors is considering a change in the company's dividend policy to enhance shareholder satisfaction while ensuring sufficient funds for future growth. Analyse the potential impacts of adopting a stable dividend payout ratio policy versus a residual dividend policy.**

**Answer:**

**Introduction:**

Dividend policy is a critical financial decision that impacts shareholder wealth and the company’s future growth. As the Chief Financial Officer of a mid-sized manufacturing company with stable profits, evaluating the right approach to dividends is essential. The board is considering changes to enhance shareholder satisfaction while maintaining financial stability. Two primary options are a stable dividend payout ratio policy and a residual dividend policy. A stable payout ratio ensures predictable dividends, boosting investor confidence but may limit flexibility. A residual dividend policy, on the other hand, prioritizes reinvestment, distributing only leftover earnings, leading to variable dividends. This analysis will compare the financial and strategic implications of both policies, examining their effects on shareholder value, growth prospects, and overall corporate financial health.

**This is partially solved sample answer**

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**Q2. Using the binomial model, calculate the value of a European call option with the following parameters: a stock currently priced at INR 100, It is known that in the first 6 months of current year from now prices will either move up to by 10% or go down by 10%, a strike price of INR 110, and a risk-free interest rate of 5%. Assume the option expires in one year. Calculate showing all the step in tabular format.**

**Answer:**

**Introduction:**

Option pricing is a crucial aspect of financial decision-making, and the binomial model provides a structured approach to valuing options. This model breaks down the option’s life into discrete time periods, allowing stock prices to move up or down at each step. Given a European call option with a current stock price of INR 100, an upward movement of 10% and a downward movement of 10%, a strike price of INR 110, and a risk-free interest rate of 5%, we will determine its value over a one-year period. Using a two-step binomial model, we will calculate the potential stock price movements, option payoffs, risk-neutral probabilities, and the present value of expected payoffs to derive the fair value of the option. The calculations will be presented in a tabular format for clarity.

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**Q3a. A large pharmaceutical company, Pharma Corp, is considering acquiring a smaller biotech firm, Bio Tech Innovations, which has developed a promising new drug that is currently in the clinical trial phase. The management believes that the acquisition could create significant synergies. Identify and explain the types of synergies that could result from this acquisition.**

**Answer:**

**Introduction:**

Acquisitions in the pharmaceutical industry often aim to create synergies that enhance efficiency, innovation, and profitability. Pharma Corp’s acquisition of Bio Tech Innovations presents an opportunity to leverage synergies, particularly as Bio Tech has a promising new drug in clinical trials. By combining resources, expertise, and market reach, Pharma Corp can maximize the drug’s potential while optimizing costs and operational efficiency. This analysis explores the key synergies that could arise, including cost synergies, revenue synergies, financial synergies, and operational synergies, which can drive long-term value creation.

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**Q3b. Young Ltd pays INR 8 as annual preference dividends and has a required rate of return of 12%. Compute the market price of the preference shares of Young Ltd? Additionally, explain the concept of preference shares.**

**Answer:**

**Introduction:**

Preference shares are a type of equity that provides shareholders with a fixed dividend before any dividends are paid to common shareholders. They offer a hybrid structure, combining features of both debt and equity, and are preferred by investors seeking stable returns. Young Ltd’s preference shares pay an annual dividend of INR 8, and investors require a 12% return. To determine the market price, we apply the valuation formula for perpetual preference shares. This calculation will help assess whether the shares are fairly priced based on expected returns.

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