**Strategic Financial Management**

**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. Analyze the potential impacts of adopting a stable dividend payout ratio policy versus a residual dividend policy. (10 Marks)**

**Ans 1.**

**Introduction**

Dividend policy is a strategic financial decision that significantly impacts shareholder satisfaction, stock price stability, and a company’s growth trajectory. As the Chief Financial Officer of a mid-sized manufacturing company that has consistently generated stable profits, revisiting the company’s dividend policy is a timely consideration. The board of directors aims to enhance shareholder satisfaction while ensuring sufficient funds for future growth. Two primary approaches are under consideration: the stable dividend payout ratio policy and the residual dividend policy. The stable payout ratio focuses on maintaining consistent dividends relative to earnings, fostering predictability and investor confidence. In contrast, the residual dividend policy prioritizes reinvestment in growth, distributing dividends only after meeting

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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. (10 Marks)**

**Ans 2.**

**Introduction**

The binomial option pricing model is a powerful and widely used method for valuing financial derivatives, particularly European call options. This model provides a flexible framework for assessing the potential value of an option by considering the possible movements of the underlying stock price over a specific period. In this case, we are analyzing a European call option for a stock currently priced at INR 100, with the possibility of the price moving up or down by 10% over the next six months. The option has a strike price of INR 110 and expires in

**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. (5 Marks)**

**Ans 3a**.

**Introduction**

Pharma Corp's potential acquisition of Bio Tech Innovations presents an opportunity to leverage synergies that can enhance operational efficiency and financial performance. Synergies are the additional value generated by combining two companies, enabling cost savings, revenue growth, and improved competitive positioning. Understanding these synergies is crucial for maximizing

**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. (5 Marks)**

### **Ans 3b.**

### **Introduction**

Preference shares are a type of equity that offer fixed dividends to shareholders, giving them priority over common shareholders in terms of dividend payments and claims on assets in case of liquidation. Young Ltd pays an annual preference dividend of INR 8, and the required rate of return is 12%. To determine the market price of these preference shares, we need to use the