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# Toyota Recall Financing Dilemma



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# Toyota Recall Financing Dilemma

*"Toyota Motor Corporation is a Japanese multinational corporation and the world's second largest automaker making automobiles, trucks, buses and robots and providing financial services. Based in Toyota, Aichi, Japan, the company boasted a total vehicle production of 9.018 million vehicles in 2006. It is also the world's eighth largest company with revenue of \$179 billion as of 2006. Toyota is the world's most profitable automaker Toyota sells its vehicles in Japan, North America, Europe and Asia. The company was founded in 1933 and is based in Toyota City, Japan."*

**(Toyota)**

Dealing with a recall is never a positive situation and will cost Toyota \$925 million dollars which it will most likely borrow from its future earnings at nominal discount rates. However, given Toyota's positioning as the world's eight largest and most profitable automobile company they will be able to take this problem in stride. The biggest danger associated with the recall will not be short term capitalization. To maintain its impressive rate of growth Toyota will have to conduct effective public relations damage control in an attempt to safeguard its pristine reputation as a manufacturer of highly reliable automobiles.

The Toyota Motor Corporation has been around for greater part of last century. It really started to make a strong entry in the North American and European car markets in the mid 1970's. Their successful product offering combining low prices and high reliability have been huge factors in its successful profitable market-share growth ever since.

*"For more than a quarter of a century, we at Toyota have relied on the talents of American designers and engineers to help ensure that our vehicles meet local tastes and standards" (Toyota)*

Toyota is increasingly becoming a more dangerous competitive threat to European and North American car manufacturers. During the 1970's their North American product line focused mainly on economy cars and pickup trucks. Today they are present in practically every key American automotive demographic with competing products. They also entered what was once the domain of the European luxury sedan manufacturers by introducing its line of luxury "Lexus" automobiles. Although American and European car manufacturers have improved their product reliability and they still have not managed to catch up with Toyota.

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Japanese and European automobile manufacturers benefit from a higher degree of degree of intra-governmental cooperation than their American counterparts. Many of the worker benefits provided by US auto manufacturers are provided to European and Japanese auto workers by their respective governments. Furthermore, Japanese and European corporations are more heavily subsidized than in North America. This allows them to operate at a higher rate of return and gives them access to more expansion and contingency capital which in situation like the aforementioned Toyota recall can come in quite handy.

The costs of Japanese government subsidies to Toyota are passed onto Japanese and European citizens via higher income and sales taxes. This diminishes their purchasing power and negatively affects the size of their automobile markets. Despite some of its drawbacks, this system has given Toyota a significant competitive advantage abroad which it has been slowly building upon over the course of the past 50 years.

Although borrowing against future earnings is the most financially sound option available to solve the recall dilemma, Toyota can avail of other options. Toyota could repeal some of its sales incentive programs thereby raising the price on some of their automobiles in an attempt to generate cash in the short-term. This would have a negative effect on overall sales in the long term substantially reducing market-share.

*"In the United States, Toyota Motor Corporation's stock is offered in the form of American Depositary Receipts (ADRs) on the New York Stock Exchange (NYSE). The ADRs are traded under the symbol TM on the NYSE and are based on Toyota shares traded in Japan. Each ADR represents two shares of Toyota common stock"*

**(Toyota)**

Toyota could increase its capitalization by selling some of its stock off of any of the international markets. The drawback of such a strategy would be reduced leveraged control over any of its international subdivisions. Toyota could also request, however unlikely, that the Japanese government invest or provide Toyota a industrialization grant. The money could be moved around eventually find its way towards paying for the recent recall.

Dealing with a recall is never a positive situation and will cost Toyota \$925 million dollars which it will most likely borrow from its future earnings at nominal discount rates. However, given Toyota's positioning as the world's eight largest and most profitable automobile company they will be able to take this problem in stride. The biggest danger associated with the recall will not be short term capitalization. To maintain its impressive rate of growth Toyota will have to conduct effective public relations damage control in an attempt to safeguard its pristine reputation as a manufacturer of highly reliable automobiles.



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