

## **Multi-National Financial Management**

\$17 billion worth of toys are sold each year with 2/3 of the sales occurring during the last quarter. Every year as Christmas nears, parents are bombarded with pressures to fulfill their children's every toy related desire. From increased advertisements on Saturday mornings (cartoon day) to sitting on Santa's lap at the mall, toy companies see the last three months of the year as their make or break time.

Tyco Toys, Inc. is the third largest toy company in the United States. They produce and sell radio control toys, dolls, electric racing sets, view-master 3-D viewers, playschool toys, and much, much more. Their most recent success is a product called Doctor Dreadful. Tyco had noticed a recent trend in toys that are designed to push the outer limits on grossing kids out.

From candy that turns your tongue different colors to edible candy snot that is dispensed from a toy nose, kids were ready to push the (disgusting) envelope. Doctor Dreadful is a small-scale scientist's laboratory that kids use to create candy warts, brains, and other vile corporal creations. The product is mainly geared towards boys, but none the less, it sold over \$50 million in its first quarter.

Tyco is not only a domestic seller, but it has several foreign operations as well. Many of its products are sold in the United Kingdom, Canada, Mexico, Australia, Thailand, the People's Republic of China, Belgium, France, Spain, Austria, Switzerland, and Germany. Since Tyco has been able to penetrate the western European market it has been contemplating an entrance into the Netherlands. With the success of Doctor Dreadful, Tyco feels this is the ideal time.

Cees Van Der Lelij, Senior Vice President of Tyco International in Europe, is responsible for determining the feasibility of establishing a factory in the Netherlands. Cees noticed that the current exchange rate between the United States and the Netherlands is \$1 = 1.6 Guilders. Based on this rate, it will cost approximately \$13,000,000 (20.8 million guilders) to build the factory.

In order to raise funds for the foreign direct investment, Tyco felt that raising funds domestically would be much less risky than listing securities

in a foreign stock market. Tyco decided the funds should be raised with 50% debt and 50% equity. Additionally, working capital would also have to be dedicated to the project in the amount of \$1.5 million. To fulfil the need for the net working capital, Tyco could either raise the entire amount in dollars in London's Eurodollar market at a 6% annual rate or the entire amount could be borrowed in the Netherlands at 9% locally. Tyco's domestic cost of equity is 11.4% and its after-tax cost of debt is 5.6%. Initially, Tyco will ship major toy components from the United States. Accordingly, roughly half of the costs will be in dollars and half will be in guilders. All of the revenues, however, will be in guilders. If exchange rates remain constant, Tyco feels profits from the Netherlands market will be 17% of sales.

### **Questions**

1. Calculate the cost of capital for Tyco's proposed foreign direct investment.
2. If sales are generated in the amount of \$35,000,000 over the next four years and exchange rates do not change, what is the present value of profits from the Netherlands?
3. If the dollar were to appreciate relative to the guilder over the next four years, how would this affect the profits of Tyco?
4. What steps can Tyco take to reduce their exposure to foreign exchange rate risk from a financing standpoint?
5. What steps can Tyco take to reduce their exposure to foreign exchange rate risk from a production standpoint?

### **Note: Case References**

**Case Studies in Finance, by Dr. Michael J. Seiler, Associate Professor of Finance, Hawaii Pacific University.**