McDonald's Valuation through Financial Ratios for Decision Making by Chinese Investors

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Abstract. The use of financial statements and ratios has been noted to be essential in the determination of the position of a company in the market. While McDonald's is sitting in the global space as big incorporation in the catering industry, it is essential for its competitiveness and financial performance to be known. The topic of this research is an analysis of McDonald's Company valuation based on multiple financial ratios for investors in the Chinese market. From the results, China registered a growth trajectory in the catering industry making them easy for new entries to be realized. While this can be seen as an unattractive market, McDonald's has been using the situation for its expansion in the country. Further, from its financial strategies and statements, the company has been using better approaches to manage its operations and maintain its status in the market. The significance of this research is that it gives an insight to academe and professionals on how a company can design strategies to influence a new market and attract investors.

Keywords: Financial ratios, Valuation, McDonald's, investors, catering industry, financial performance.

1. Introduction

The valuation of companies based on various methods creates the space in which decision-making can be made. The analysis of the financial statements is equally essential in determining the value and possibly the prospect of the operations of such a company [1]. McDonald's is considered one of the most highly valued food chains in the world. The company has been on a profit-making spree thereby attracting investors from various parts of the globe. Based on different valuation methods, it is probable that the report herein will be able to ensure the correct valuation of the company. Financially, McDonald's is standing out in the industry as one of the companies that have a bigger concentration of assets and investment in the world. McDonald's company recorded approximately $ 7.55 billion in net income [2]. On the same note, the company had a revenue of 24.8 billion Yuan in its Chinese market. This research entails a comprehensive analysis of McDonald's Company valuation based on multiple financial ratios for investors' decision-making in the Chinese market. Notable is that this paper is endeavoring to verify the reports by various academic and media outlets on the position of McDonald's Company.

1.1 Background Introduction

In the valuation of the business organizations such as McDonald's, most technocrats use three approaches mainly, cost, market, and intrinsic value techniques. In the case of the determination of the value and the possible decision-making, the market approach and intrinsic value approaches are more profound. The valuation process is essential to the company because it allows the investors and owners to determine their cause of action [3]. The companies like McDonald's are developing their profiles and statuses in the global space to attract stakeholders. Notable is that the stakeholders especially the investors use the two approaches namely the forecast future cash flows and precedent transactions. In the recent past and current financial status of McDonald's, it has been recording net profits of more than 20% making it to be lucrative for investors [4]. Notable is that when a company soars to this level, it is likely that it will reach its intrinsic value. Further, most of the investors in the company are confident in their decisions because of the recession-proof business model. From the model, McDonald's has strong free cash flows in its conversation. Consequently, it has steady and ever-increasing dividends, which are attractive to its investors.

Financially, McDonald’s is standing out in the industry as one of the companies that have a bigger concentration of assets and investment in the world. Most companies and big corporates found the means to ensure stability during the Covid-19 pandemic [5]. Regardless of the financial and economic turmoil, the world is embroiled in, the company has been endeavoring to maintain its financial stability and be competitive in the global space. Additionally, McDonald’s is proving to be a stable organization that can be considered by investors for the purposes of investments. It is worth learning that regardless of the scores that a company registers in its annual earnings, the financial ratios provide the most appropriate figures for analysis. For instance, it is expected that the liquidity ratios are the most suitable to indicate the budgetary allocations [6]. Further, through the evaluation of the financial statements, it is possible to identify the best time for specific decisions. Concerning the situation in this research, the interest is in the analysis of the financial ratios, particularly those that are inclined to indicate excellently the return on investment. The use of the two approaches by the investors for McDonald’s valuation has proved to be effective in their decision-making.

1.2 Research Objective

The objective of this research is to analyze McDonald’s Company valuation based on multiple valuation methods for investors in the Chinese market. This research is geared at developing an insight into the operations of McDonald’s and the way its financial scores can be used in the creation of understanding for better investments. It extends to include the position of the company in the global space and Chinese market. The identified opportunities in the said market are that it will support the activities of the catering industry and the company in the end. The competitiveness of McDonald’s is of equal importance in the quest to identify the shrewdness of its position in the market, which will be part of the research objectives. Considering the research goals, the point out is geared at ensuring that the financial status of the McDonald’s Company is known. Further, the research is aimed at achieving the goal of identifying the financial position of the company in the Chinese market for the purposes of analysis. On the same note, the third goal is to create insight into the manner in which the financial ratios can be used to identify better decision-making approaches for investors. Lastly, the research through the analysis of McDonald’s is geared at creating concise knowledge of the market mechanisms and how McDonald’s is using the same for its stability.

2. Literature Review

Business valuation has been identified and noted to determine the financial state of the organization. The performance of the business valuation and analysis is essential for a number of reasons including the establishment of the partnership and acquisition. Further, valuation is vital for credit analysis, mergers, and management [7]. In the corporate finance world, business valuation is discussed with the topic taking most of the center stage talks. From the financial analysts’ point of view, capital is an essential component of analyzing and arriving at the value of a company. However, some literature asserts that capital depends on income distribution, which contributes to heterogeneous production [8]. Thus, some scholars prefer market capitalization as the most appropriate method of analysis as it is arrived at by multiplication of the company’s total number by the share price. Thus, in the analysis of the valuation techniques, the most appropriate approach has not been arrived at effectively. Regarding the research method, the use of secondary materials including financial statements is appropriate because it creates an enabling environment for analysis and projection of future engagement. On the same note, it is possible to predict the possible performance of a company such as McDonald’s.

Considering the research topic, the catering industry has been on an upward trajectory not only in China but globally. The political stability in China has been instrumental in ensuring that the industry expands and builds outlets in various parts of the country. Political instability is responsible for the decline in the catering business particularly during the anti-corruption campaign launched by the Chinese government [9]. Economically, factors such as interest rates and inflation are responsible for determining the progress of the industry. Notable is that the economic negativities such as crisis and post-crisis trends in the market have pitfalls for the thriving catering industry [10]. Socially, the demographic and cultural factors are contributing immensely to the growth and development of the catering industry. The consumer preference for catering activities in China has been crucial in the progress of the industry [11]. Technologically, the catering industry has greatly benefited from the advancement in technology with people being in the position to order food online [12].

2.1 Working Capital

One of the financial ratios used in determining the status of the company is the working capital. In determining the working capital, the current liabilities are deducted from the current capital as shown in the formula [Working Capital=Current Assets-Current Liabilities] [13]. In essence, working capital is the money available for meeting the current short-term liabilities in the company as shown in Fig. 1. The company's working capital for the past three years has been averaging -$282.4 million. However, for the last quarter the company recorded a net working capital of $190.2 million. Working capital can be a financial advantage to major corporations thereby they should invest more in the streams of current assets [14]. In the case of McDonald's working capital can be used by the investors for decision-making. The working capital at McDonald's is vital for prospecting and potential investors in that it gives the avenue through which the money is likely to be earned. In the same breath, it is through the working capital that the operations and the company can be actualized and stable. Therefore, in line with the research objective, it is precisely that it is a financial ratio that should be considered.

Current Assets:	
Cash	$ 20,000.00
Accounts Receivable	15,000.00
Inventories	45,000.00
	80,000.00
Current Liabilities	
Accounts Payable	$ 25,000.00
Short-term Borrowings	5,000.00
Acccrued Liabilities	10,000.00
	40,000.00
Working Capital	**$ 40,000.00**

Fig 1. Working capital Formula (Photo Source: https://www.google.com/imgres?imgurl=https%3A%2F%2Fcdn %2Fassets%2FWorking)

2.2 Quick Ratio

Apart from working capital, there is the quick ratio which is aimed at measuring the capacity of a company to pay its current liabilities without necessarily going through selling its inventory. There are cases where the company might obtain liquidity through additional financing. However, in the case of a quick ratio, the company is not compelled to have such obligations or endeavors. In the current financial world, quick liquidity is viewed as a more conservative measure than most financial ratios such as current assets which cover the current liabilities. In addition, known as the acid test ratio, the quick ratio measures the ability of a company such as McDonald's to use quick assets or near cash. In calculation, [Quick Ratio=Current assets –inventory/current liabilities]. The liquidity ratio has been identified as one of the factors that determine and applied to profitability and decision-making [15]. Thus, as a potential investor, it is essential that the quick ratio at Mcdonald's is considered as the factor for the decision-making. In addition, in ensuring that there is Return on Investment, the investors should consider the quick ratio. On the same point, it is through the quick ratio that the investors can tell the operational value of the financial status of the company for their involvement.

2.3 Earning per Share (EPS)

Further, earning per share is crucial for Chinese investors who are interested in investing in the McDonald’s chain in the country. As per the description, Earning per Share (EPS) is the monetary value that the organization or a company earns per the outstanding share of the common stock company. For the investors, the EPS is important in that it gives the avenue and presents itself as the key measure of corporate profitability. On the same note, it is used for the price of stocks particularly in the calculation and determination of profitability. In terms of calculation, [EPS=Net Income profit/Average outstanding shares]. While the other financial ratios can have a slight effect on the stock returns, the earnings per share are the most sorted in case there are such situations [16]. According to the earnings registered in the first half of 2022, the earnings per share for McDonald's stood at $1.6 a figure that showed a 45.76% decline from the previous year. According to the trends and the trajectory of search Eps, it can be risky for investors to put their capital in such shares. However, the observation should be based on the possible reasons for such trends including the external eventualities.

3. Basic Description of the Company

3.1 Background of the Company

Historically, McDonald’s was founded in 1`940 by brothers named Maurice and Richard. At first, the company was dealing with various items in the period of 1948. Currently, McDonald’s is a renowned food chain company in the global space with its presence on almost every continent. Since its establishment, the company has proved its exemplary performance and in building its reputation. In the global space, McDonald’s has been on a positive trajectory whereby the expansion has been immensely consuming other food chains and other competitors within the market. China has been one of the countries that have proven to be essential for the series of its outlets and operations. However, there is a gap on whether the potential and prospective investors should invest their money in Mcdonald’s activities in China. The company has grown to higher heights positioning itself at the high ranks in the global space. In 2017, McDonald’s was ranked as the twentieth most successful brand in the world [17]. The development status of McDonald, the company did an operational development in 2017. Specifically, it started a technology boost where they created a smartphone order. The app was an addition to the earlier and previous functionality, which has seen it progressing in the past five years.

3.2 Development Status and Research Goals

Additionally, McDonald’s has been focusing on the self-service Kiosks that are complemented by the digital menu boards. For two years in the period of 2017 and 2019, the company has been on a technology buying spree making the evolution of different components. The company was noted to be progressive in its endeavor to the extent that it was accused of eliminating the human workforce. However, the management denied such claims stating that they were in the urge of improving their services through the information technology fronts [18].

3.3 Financial Information and Analysis

Through the financial statements, the stakeholders are privileged to observe the situation and the position of the company. The Balance sheet provides one of vital insights to the interested parties on how the business performs in the market from the internal records.

(Figures are in Millions of USD Except for per Share Items)

Table 1. The Balance Sheet for McDonald's 2021/202

Period Ending	31/03/2022	31/12/2021
Total Current Assets	**4656.4**	**7148.5**
Cash and Short term investment	2335.7	4709.2
Cash	-	-
Cash & Equivalents	2335.7	4709.2
Short Term Investments	-	-
Total Receivables, Net	1674.1	1872.4
Accounts Receivables-Trade, Net	1674.1	1872.4
Total Inventory	49.6	55.6
Prepaid Expenses	597	511.3
Other Current Assets, Total	-	566.9
Total Assets	**50877.7**	**53854.3**
Property/Plant/Equipment/,Total-Net	37813.3	38272.6
Property/Plant/Equipment/,Total-Gross	41773.1	41916.6
Accumulated Depreciation Total	-17338.4	-17196
Goodwill, Net	2813.9	2782.5
Intangibles, Net	-	-
Long Term Investments	1177.2	1201.2
Note Receivables-Long Term	-	-
Other Long Term Assets, Total	4416.9	4449.5
Other Assets. Total	-	-
Total Current Liabilities	**4234.6**	**4020**
Accounts Payable	718.6	1006.8
Payable/Accrued	-	-
Accrued Expenses	2922.5	2652.5
Notes Payable/ Short term Debt	-	-
Current Port. Of LT Debt/Capital Leases	-	-
Other Current liabilities, Total	593.5	360.7
Total Liabilities	**56868.5**	**58455.3**
Total Long-term Debts	33988.8	35622.7
Long Debt	33988.8	35622.7
Capital Lease Obligations	-	-
Deferred income Tax	2048.5	2075.6
Minority Interest	-	-
Other Liabilities, Total	16596.6	16737
Total Equity	-5990.8	-4601
Redeemable Preferred Stock, Total	-	-
Preferred Stock-Non Redeemable, Net	-	-
Common Stock, Total	16.6	16.6
Additional Paid-In Capital	8307.1	8231.6
Retained Earnings (Accumulated Deficit)	57614	57534.7
Treasury Stock-Common	-69286.6	-67810.2
ESOP Debt Guarantee	-	-
Unrealized Gain (Loss)	-	-
Other Equity, Total	-2641.9	-2573.7
Total Liabilities & Shareholder’s Equity	50877.7	53854.3
Total Common Shares Outstanding	739.5	744.8
Total Preferred Shares Outstanding	-	-

3.3.1 Financial Strategy Analysis

McDonald's has three fundraising strategies including the savings from the owners which can be identified as the initial source of the capital. However, the two other strategies include the proceeds from franchises and sales proceeds in its outlets. The two strategies are mainly used for expansion purposes which have been steady as they depend on the annual sales. Concerning the investment strategies, the company is applying two main approaches including international market expansion and cost leadership strategies. Cost leadership theories are mostly used by companies to create competitive advantage [19]. The McDonald's Company has been on the market echelon due to its investment strategy aimed at creating a competitive advantage (Fig.2). Further, McDonald's has been at the forefront of expanding its operations in various parts of the world including China. The operations strategy for McDonald's is centered on five elements including flexibility, cost, quality, speed, and dependability. The elements are all aimed at creating better relations with the customers.

Fig 2. One of McDonald's Restaurants (Photo Source: https://nairobinews.nation.africa/mcdonalds-denies-nairobi-outlet/)

3.3.2 Analysis of Cash Holdings

Considering the Balance sheet in Table 1, it is deducible that the company has cash held in various assets apart from the shares and bonds. The total assets as identified from the Balance sheet are posing positive figures against the liabilities. In most industries including competitive ones, cash holdings are used as the hedging risks in the market [20]. For the stakeholders including the potential investors, cash holdings are vital for ensuring that the company is not losing funds in the process of transaction costs. It is possible that the shares of the company will remain constant and the possible investment will stay stable. From the review of their capitation, McDonald's is identified to be in possession of fixed and current assets. Further, it is through savings that the company is able to stabilize its financial stability and prevent the volatility of cash from being spent.

3.3.3 Accounting Performance Analysis

In line with the interest of the investors, it is essential that consideration is given to Price-Earnings Ratio as it is the instrument used for the determination of the worth of the company. As shown in figure 2 the media can throw praise on a given company or organization in terms of its worth as the latter can influence the former on that, the PE will be essential for the identification of facts. In terms of calculation, the P/E is the Stock price divided by the company earnings. [P/E=Share Price/Earnings per share] as shown in Fig 3. Noteworthy is that the calculation should be within a given period mostly within a year or months. The most important point is that the Price-Earnings Ratio is valuing the company at the current price. Considering the past three years, McDonald's P/E for the company has been in a stable state with the rate standing at 9.20% per year. There is a trend marked by an increasing percentage of the same with 2021 registering 10.00% the current financial statement state that the company has scored the Price-Earnings Ratio of 11.6% [21]. From this figure 3, it is precise that investors from the Chinese market can safely invest their capital in the company.

Fig 3. Accounting Analysis Process (Source: https://online.hbs.edu/blog/post/financial-statement-analysis)

4. The Marketing and Competitiveness of the Company

4.1 Supplier Power

The use of Porter's Five Forces Model, the catering industry is the best suit for the analysis using this approach. The first component of the model is supplier power which entails the assessment of how easy it is for the suppliers to dictate the prices of the commodities. In its eleven years of existence in China, McDonald's has found it challenging to expand its business to various parts of the country. Notable is that the company lowered its price in 2009 to compete with KFC. The collective strength of the forces demonstrates the influence of a given firm in the industry [22]. The idea that McDonald's could dictate the price to enter the market showed its competitiveness.

4.2 Buyer Power

This entails how it is easy for the buyers to determine the prices and make decisions over the same. In determining the power of the buyers in the market, their number plays an important role. The buyer power determines the attractiveness of the industry to the investors especially the new entries [23].

Further, the difficulty the buyers have to switch from one company to the other is another factor. Considering the current state of the McDonald's Company in the Chinese market, it is notable that it is dictating the better chunk of the market. However, the people glued to their specific companies for the purposes of services mark the catering industry.

4.3 Competitive Rivalry

The force of competitive rivalry stands as one of the main elements in the model because the many producers with differentiated products will reduce the market attractiveness (Fig. 4). Concerning the Chinese catering market, it is realized that there are many companies that offer the services. However, the differentiation is the issue with McDonald's coming out as a unique outfit with distinct services. The winning the competition in the intense and formidable market, the company should be innovative and differentiated. Currently, the Chinese catering market is dominated by KFC and McDonald's whose competitiveness has boosted innovation in the industry.

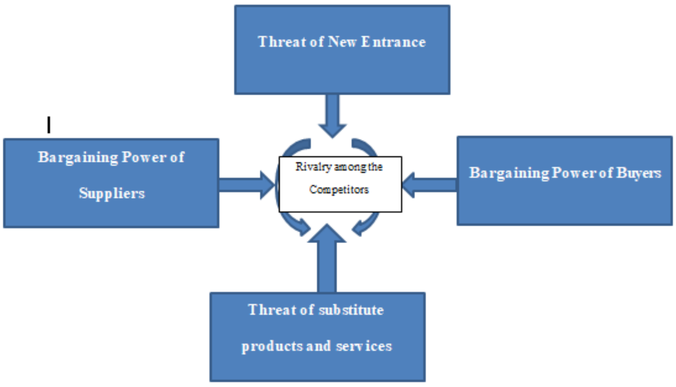

Fig 4. Porta's Five Forces Model (Photo credit: Original)

4.4 Threat of Substitution

When there is a close substitute in the market, it is possible and easy for the consumers to switch from one company to another. Notable is that such ease lowers the power of the supplier in such markets and industries as shown in Fig.4. Consequently, such markets and industries and markets are not attractive to suppliers or the producers of the services. It is deducible that the existence of other health products is a threat to substitute the organic food catering in China [24]. However, the case is different for McDonald's which has designed its strategies to include a formidable network to prevent substitution threats through differentiation it employs.

4.5 The threat of new entry

Profitable markets are attractive to new companies that are interested in profit-making ventures. Nevertheless, the existence of formidable companies in such industries is likely to influence the entry of new companies as shown in Fig.5. From 2015 to 2019, there was a steady increase in the number of companies joining the catering industry in China as shown in figure 6 [25]. However, the emergence of the Covid -19 pandemic saw a sharp decline in the trend. Nonetheless, it can be inferred that the market is attractive making it easier for new entries. Notable is that McDonald's and other big companies have been at the forefront to shape the moves.

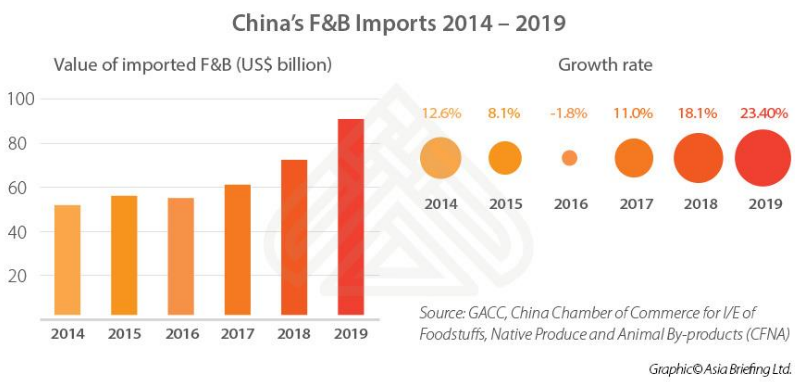

Fig 5. The Growth of the China Food Industry (Picture Source: https://www.google.com/url?sa=i&url=https%3A%2F%2Fwww.china-)

5. Suggestions

From the findings, it is suggested that the research involving the bigger incorporations like McDonald's should be holistic to include their operations outside accounting records. On the same note, it is suggested that such research activities should be compounded and projected between professionalism and academics. On the other breath, it is suggested that the company should conform to the consumer's preference for healthy food. In ensuring that they attract the bigger stakeholders including the consumers and investors, they should maintain the upward trajectory in profits. Notable is that the balance sheet of the company is giving a clear indication of its journey and possible excellence. Further, it is suggested that the company should endeavor to improve its stability in the Chinese market by developing better marketing approaches. Additionally, the company should increase and sharpen its formidability by creating better differentiation through creativity. Moreover, it is suggested that McDonald's should utilize its innovativeness prowess in the 21s t century to improve its productivity. Lastly, the company should convince the investors in their operations on their cash holdings and accounting performance through yearly adjustments.

The inspiration gathered from this research endeavor is that the analysis of the company and the catering industry can give an excellent insight into the management and investment considerations.

From the findings, inspiration is gathered from the manner in which McDonald's is carrying out its activities. Specifically, the entry into the Chinese market that was dominated by the KFC outlet is a creative means of ensuring that they displace them. These findings are not only essential for academic purposes but for the potentially upcoming investors who are still in school and in the employment bracket. A more prominent concept is that research of such magnitude is creating the space in which the students are able to start their own startups and enter the market with some formidability. On the same note, it has been identified that the application of the various models and analysis tools provides the space in which the audience can view the market and create their own competencies. Lastly, inspiration has been developed from this research process in that I can preside over an excellent and prosperous research activity and draw conclusions on such findings and processes.

In the future, the prospects are high in that such research activities will enlighten people regardless of their status in society. With the emergence of information technology in the current century, it is expected that the research processes will be more advanced and will be comprehensive. Regarding McDonald's, it is possible that the investors will reap more significant rewards as the company is expanding greatly in the Asian country with a bigger economies. The large Chinese population is creating the space for higher rewards in ensuring that the profits and revenue are higher. The competitiveness of McDonald's is a clear indication of the prosperity the company is likely to gain in the future. Still, in future prosperity, it is precise that the company will be accorded the rightful place in the Chinese market likely to displace the rest.

6. Conclusion

In conclusion, the application of the valuation tools in determining the value of McDonald's in the Chinese market has borne fruits as insight into its future prospects has been identified. Further, the position of the company in the Chinese market has given insight into the manner in which the brand reputation and its financial statement are complementary. From the results, it is precise that McDonald's has been in the Chinese market and has been excellently executing its strategies including cash holdings to ensure prosperity. Another finding is that McDonald's has stretched its dominance in the Chinese catering market from the humble inception of price reduction to the current state of supplier power. The Chinese catering market has been on a growth trajectory before the Covid-19 pandemic making ease of entry possible. However, through the strategies set forth by McDonald's, it is possible to create space expansion. The significance of this research is that it creates understanding and develops knowledge in the academic field on how financial statements can be used for valuation. Consequently, the significance of this research is noted from the manner it builds the complementarity between the market position of a corporation like McDonald's and their financial performance thereby giving a comprehensive understanding to investors.

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