<u>BREAK-EVEN ANALYSIS OF MCDONALDS</u>

INTRODUCTION

<u>Break-even analysis</u> is the comparison of a firm's revenue and it fixed and variable costs, to identify the minimum sales level needed to achieve break even point. <u>Break-even point</u> is the level of output at which total revenue equals total cost.

A business to achieve break-even is so important. A business usually fail down because put all the money in, and can't get the money back in the short term of time, which they can cost the cost. Break-even is an important objective of a business to survive in the short term.

To break-even, that means the revenue needs to cover all the cost of the business, which is variable cost and fixed cost. The revenue is means the money which make from to sell the products. <u>Variable cost</u> is means the cost that directly go to make each product. For example raw material, and staff wages. It call variable cost is because they are depend on how many product are produce. <u>Fixed cost</u> is the cost of running the business, it doesn't affect by how many product are produce. Fixed cost include the rent of the shop, business taxes, fuel bill, insurance, staff salary etc. The business revenue is needed to cover the fixed cost or it will make a loss.

BREAK-EVEN OF MCDONALD

Calculate Break-even point, can either show on a chart or use equation

Equation : Break-even = Fixed cost/ contribution

Contribution= sale price – variable cost

I get the data to calculate break-even of McDonald, which show as below:

Average selling price of product: £1.50

Average variable cost of a product: £0.4

Fixed costs in an average outlet per annum: £1 000 000

Now I calculate the break even point by the equation:

Contribution: £1.50- £0.40= £1.1

Break-even: £1 000 000/ £1.1= 909091

That show McDonald need to sell 909091 products in a year to make the break-even. And it can also show as chart:

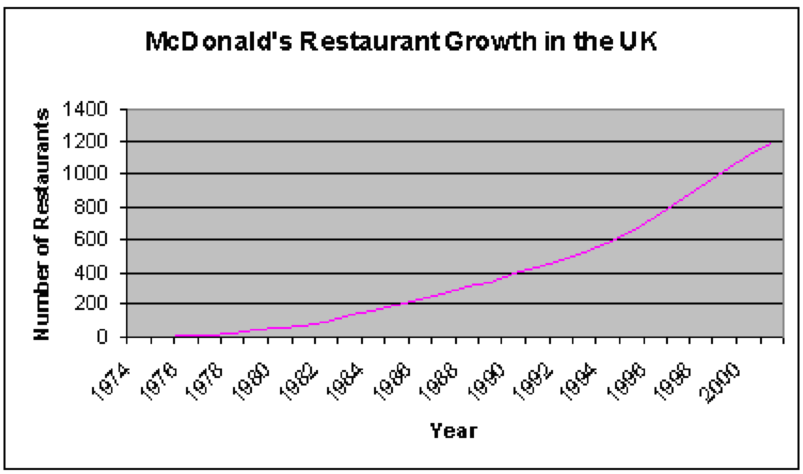
Output	total variable cost	total fixed cost	total cost	total revenue
100 000	40 000	1 000 000	1 040 000	150 000
200 000	80 000	1 000 000	1 080 000	300 000
300 000	120 000	1 000 000	1 120 000	450 000
400 000	160 000	1 000 000	1 160 000	600 000
500 000	200 000	1 000 000	1 200 000	750 000
600 000	240 000	1 000 000	1 240 000	900 000
700 000	280 000	1 000 000	1 280 000	1 050 000
800 000	320 000	1 000 000	1 320 000	1 200 000
900 000	360 000	1 000 000	1 360 000	1 350 000
1 000 000	400 000	1 000 000	1 400 000	1 500 000

There is the break even chart next page:

AIM AND OBJECTIVE OF MCDONALD

McDonald's aim to be the UK's best fast service restaurant experience.

- To be the best, McDonald need to maintain the quality of food, so McDonald is aim to create a long term relationship with limit numbers supplier partners. The supplier need to ensure they can meet McDonald required standards. And their standards are based on quality, value and cleanliness.
- Also McDonald want to expand and growth in UK. It grows rapidly in UK in these 25 years, the graph below show us:



- To be the best fast food service, they need to be better than the main competitor. Such as, Burger King, but in the USA, competitors also include Wendy's, Taco Bell and Subway.

THE STRUCTURE OF MCDONALD is oversees on five major areas:

- Operations (equipment and franchising)
- Development (property and construction)
- Finance (supply chain and new product development)
- Marketing (sales marketing)
- Human Resources (customer services, personnel, hygiene and safety)

HOW CAN BREAK-EVEN ENABLE MCDONALD TO MEET AIM & OBJECTIVE

Every business aims to make a profit to expand and don't want to make a loss. Because the entire objective such as expand the company, improves the quality etc are need money to achieve. First step to make a profit is covering the cost of business to survive. That needs to meet the break-even point. Because the company can't get the money back to cover the cost in the short term, it will be fail. Most of the reason of a company fail are they pay all the money in the business, but can't make profit in short term to cover the cost. So we need to have break even analysis that is a financial plan for a company. After calculate break-even, we may know how many product we need to sell to cover the overall cost of a company.

On above, I calculate we need to sell at leases 909091 product to cost the cost. Sell less than that, we will make a loss. If sell more, we will make a profit. Lower 909091, which is a loss-making zone. And more 909091 is the profit-making zone of McDonald. So, McDonald want to growth in UK, it needs to make a profit, and use the money to expand the company. And the break-even analysis shows a plan of how many product we need to sell. Have a finance plan that will be help to make the profit, which is help us to achieve the objective. Below is the five year analysis of the number of McDonald's UK retail outlets and their pre-tax profits:

	1997	**1998**	**1999**	**2000**	**2001**
No of restaurants	836	928	1016	1117	1184
Pre-tax profit (£m)	100.2	82.3	127.9	137.5	141.4

This show in five years the finance plans if McDonald is achieving good result.

HOW TO MAKE THE MAXIMUM PROFIT

If we want to raise the profit to the highest possible level, we can achieve in two ways: lower the cost and raising the avenue. If we increase the selling price, we can sell fewer products to meet the break-even point. If we lower the cost, we can sell fewer products to cover the cost.

Raising the revenue- we can do it in those ways below:

- Improving the quality of the product, e.g. make the food more fresh and clear than the competitors
- Successful promotion and advertising
- Open a new market, e.g. find which town in UK hasn't had a McDonald yet.
- Producing a new product
- Increase the selling price of the product (most direct way to raise revenue).

Below will show if we raise the selling price to £2.50, when we will meet the break-even:

Output	total variable cost	total fixed cost	total cost	total revenue
100 000	40 000	1 000 000	1 040 000	250 000
200 000	80 000	1 000 000	1 080 000	500 000
300 000	120 000	1 000 000	1 120 000	750 000
400 000	160 000	1 000 000	1 160 000	1 000 000
500 000	200 000	1 000 000	1 200 000	1 250 000
600 000	240 000	1 000 000	1 240 000	1 500 000
700 000	280 000	1 000 000	1 280 000	1 750 000
800 000	320 000	1 000 000	1 320 000	2 000 000
900 000	360 000	1 000 000	1 360 000	2 250 000
1 000 000	400 000	1 000 000	1 400 000	2 500 000

That will show as the black line in graph1.

We can also calculate in the equation:

Contribution: £2.50- £0.40= £2.1

Break-even: £1 000 000/ £2.1= <u>476190</u>

That show after increase the selling price, we meet the break-even earlier. But there are also got some disadvantage of increase the selling price. If increase the price too high, customer won't come back because too expensive. So we need to be careful don't add the price too high.

<u>Lower the cost</u>- a firm like McDonald can lower the cost by those ways:

- Buying the raw materials from cheaper sources
- Pay less salary to the staff
- Product more efficiently, minimum the waste
- Increase output to benefit from economic of scale

A big company like McDonald can increase the output to benefit from economic scale, because they can

- arrange a big discount from the supplier of food,
- able to raise finance far cheaper then small company,
- Mass production techniques using specialist machinery, such as the produce of the toy in "happy meal" can use a big scale machine and more efficient. Also the cost of research and invest for a new type of food can divide to big amount of products. That make the cost of food won't be too expensive.

But there also got the disadvantage of cutting the cost. For example: cut the cost on buy cheaper raw material may cause to decrease the quality of food. But in the objective of McDonald shown the good way of lower the cost of raw material also won't decrease the quality, that is make a relationship with limit suppliers.

The other example of disadvantage of lower the cost is pay less to the staff. This can reduce the fixed cost directly, but it may let to lose of the staff. Because the wages of McDonald's staff nearly touch the lower wages in UK. So I think if need to lower the cost, it should be work on increase the output to benefit from economic scale.