Ratio analysis of starbucks vs mcdonald’s

Business, Company

Running Head: RATIO ANALYSIS Starbucks Corporation & McDonalds Corporation McDonald's Corporation McDonald's Corporation operates in thefoodservice industry. The company has its restaurants in more than 100 countries of the world. McDonald's, the world's largest food chain is headquartered in U. S. having an employee population of 390000 (About McDonald's... , 2008). Starbucks Corporation Seattle based, Starbucks Corporation is the leading coffeehouse chain in the world. The company has its operations in more than 44 countries. The main products offered by Starbucks various kinds of drinks, snacks, coffee beans.

The company also operates in the field of marketing ofmusic, books (The Company, 2008). Ratio Analysis Ratio Analysis (2007) RatiosStarbucksMcDonalds Current Ratio0. 790. 80 Quick Ratio0. 300. 67 Debt Equity Ratio1. 340. 92 Proprietary Ratio0. 430. 52 Solvency Ratio0. 570. 48 Inventory Turnover Ratio12. 13118. 77 Gross Profit Ratio (%)23. 3434. 69 Net Profit Ratio (%)7. 1515. 67 Return on Proprietors' Funds (%)29. 4515. 67 Earning Per Share0. 912. 06 Current Ratio Current Ratio may be defined as the relationship between current assets and current liabilities.

It is also known as working capital ratio or 2: 1 ratio. It is calculated by dividing the current assets by current liabilities. The main components of this ratio are current assets and current liabilities. Current assets of a firm represent those assets which can be, in the ordinary course of business, converted into cash within a period not exceeding one year. Current liabilities mean those obligations which are to be paid within a period of one year of current assets or by creation of current liabilities (Van Horne, Wachowicz & Bhaduri, 2005).

Current ratio of the Starbucks Corporation and McDonalds Corporation is . 79 and . 80 respectively in the year 2007. There is little difference in the current ratio of both the companies. The ratio reflects weak liquidity position of both the companies and it shows that the companies do not have short term solvency. Liquidity position can be improved to some extent and can be made equivalent to industry average. The industry average of current ratio is . 90: 1. Quick Ratio This ratio is also helpful in analyzing short term financial position of a business.

Quick ratio is the measure of the instant debt paying ability of the business enterprise, hence it is called quick ratio (Van Horne, Wachowicz & Bhaduri, 2005). A quick ratio of 1: 1 is considered as an ideal ratio. If the liquid ratio is more than 1: 1, the financial position of the firm seems to be sound and good. On the other hand, if the ratio is less than 1: 1 the financial position of the firm is unsound. Quick ratio of Starbucks is . 30: 1 and McDonald's ratio is . 67: 1. There is high difference between the quick ratios of both the corporations.

McDonald's liquidity position is much better than Starbucks. Overall, the short term liquidity position of both the firms is quite poor because both the ratios are less than the desired norms. For instance, current ration should be 2: 1 whereas, it is 1: 1 approximately. Similarly the liquidity ratio is much less than 1 as compared to ideal standard of 1: 1. Therefore, the companies will face difficulties in current obligations on maturity. Debt Equity Ratio This ratio indicates the relative proportion of debt and equity in financing the assets of a firm.

Debt Equity ratio reflects the relative claims of creditors and shareholders against the assets of a firm. The industry average of ratio is . 42: 1. Debt equity ratio of McDonalds is . 92: 1 which is highly satisfactory as normally the ratio of 1: 1 is considered reasonable. The Starbucks ratio is 1. 34: 1 which is very high. A high debt equity ratio has serious implications from the firm's point of view. A high proportion of debt in the capital structure lead to inflexibility in the operations of the firm as creditors would exercise pressure and interfere in management.

Proprietary Ratio Proprietary ratio establishes relationship between proprietors or shareholder's funds and total assets of the business. This ratio highlights the general financial strength of the firm. It is of great importance to creditors since it enables them to find out the proportion of shareholder's funds in the total assets used in the business. The ratio of Starbucks is . 43: 1 and for the McDonalds it is . 52: 1. Though, ratios are quite similar but McDonalds again has a better position than Starbucks Corporation. Solvency Ratio

This ratio measures the long term solvency of the business. It reveals the relationship between total assets and total external liabilities. This ratio measures the proportion of total assets provided by creditors of the firm i. e. what part of assets being financed from loans (Van Horne, Wachowicz & Bhaduri, 2005). The total assets of Starbucks and McDonald's are more than total liabilities which indicates that the company is solvent. So, the higher the ratio, the grater is the amount of creditors that is being used to generate profit foe the owners of the firm.

The difference in both the companies' ratio is small but still Starbucks has better performance than McDonald's in terms of solvency. Inventory Turnover Ratio The ratio indicates the number of times inventory is replaced during the year. It measures the relationship between the cost of goods sold and the inventory level. The inventory turnover ratio measures how quickly inventory is sold (Van Horne, Wachowicz & Bhaduri, 2005). The inventory turnover ratio of Starbucks is 12 times while McDonald's ratio is 118 times. McDonald's has an efficient inventory management.

Whereas Starbucks has low inventory turnover ratio and it is unsatisfactory. In general, a high inventory turnover ratio is better than a low ratio. A high ratio implies good inventory management. A very low level of inventory has serious implications. It adversely affects the ability to meet customer demand as it may mot cope up with its customer requirements. Gross Profit Ratio The ratio expresses the relationship of gross profit on sales to net sales in terms of percentage (Van Horne, Wachowicz & Bhaduri, 2005). Goss profit is the result of the relationship between prices, sales volume and costs.

Gross profit margin of Starbucks Corporation is 23% whereas the ratio for McDonald's is 35%. McDonald's ratio is high as compared to Starbucks which is a sign of good management. It implies that the cost of production of the firm is relatively low. The McDonald's has reasonable gross margin which ensures adequate coverage for operating expenses of the firm and sufficient return to the owners of the business, which is reflected in the net profit margin. Net profit Ratio This measures the relationship between net profits and sales of a firm.

The net profit margin is indicative of management's ability to operate the business with sufficient success not only to recover revenues of the period, the cost of merchandise or services, the expenses of operating the business and the cost of the borrowed funds, but also leave a margin of reasonable compensation to the owners for providing their capital at risk (Van Horne, Wachowicz & Bhaduri, 2005). Net profit ratio of McDonald's and Starbucks is 15. 67% & and 7. 15% respectively. McDonald's is generating adequate returns for its owners.

On the other hand, Starbucks net profit margin shows inadequate returns to its owners. Overall efficiency and profitability of McDonald's is higher than Starbucks. Return on Proprietary Funds The ratio expresses the percentage relationship between net profit and proprietors funds or shareholder's investment (Van Horne, Wachowicz & Bhaduri, 2005). It is used to ascertain the earning power of shareholders investment. Return on proprietors' funds for McDonald's is 15. 7% and for Starbucks it is 29. 5%. Starbucks has better performance and higher return than the McDonald's. Earning Per Share

The rate of dividend on shares depends upon the amount of profits darned by the firm. Whatever profit remains, after meeting all expenses and paying preference share dividend, belongs to equity shareholders (Van Horne, Wachowicz & Bhaduri, 2005). These are the profits earned on equity share capital. The earning per share is calculated by dividing the profit available to equity shareholders by the number of shares issued. This is a popular ratio as it measures the profitability of a firm from owner's standpoint. McDonald's

EPS is higher than Starbucks which shows that the market price of the firm would be greater.

It will also help the company to raise additional capital without any difficulty. This ratio plays an important in comparison of two companies from investment point of view. Investment Decision I would like to invest in McDonald's Corporation as the overall performance and productivity is high for the firm. The liquidity analysis performed through current ratio and quick ratio reveals that the McDonald's is better in terms of liquidity position. The company also has satisfactory position in terms of long term solvency. Though solvency ratio of Starbucks is higher but overall McDonald's has good financial position.

Firm is able to quickly convert various assets into cash. McDonald's has high profit margins which is necessary for the higher returns to the shareholders. It shows that the resources are effectively utilized at the firm. EPS is very high which is necessary for the investment. Thus, investment in McDonald's Corporation is beneficial and it would give higher returns. References About McDonald's... (2008). Retrieved November 19, 2008, from http://www. mcdonalds. com/corp/about. html McDonald's Corp: Financial Statement. (2008). MSNMoney. Retrieved November 19, 2008, from http://moneycentral. sn. com/investor/invsub/results/statemnt. aspx? Symbol= US: MCD&lstStatement= Balance&stmtView= Ann Starbucks Corp: Financial Statement. (2008). MSN Money. Retrieved November 19, 2008, from http://moneycentral. msn. com/investor/invsub/results/statemnt. aspx? Symbol= SBUX&lstStatement= Balance&stmtView= Ann The Company.

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