

Economic Analysis of McDonald's



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1. Introduction

McDonald's, a globally renowned fast-food company, is an opportune subject for analysis and discussion within the context of economics.

This research will examine the pricing of replacement goods and the primary competitors, as well as the supplementary items that contribute to the success of the business. The analysis of customers will involve several factors like their income levels, preferences, pricing expectations and demographic indicators.

This analysis will focus on the demand for McDonald's primary product, namely the Big Mac, to examine the impacts of both substitution and income.

Ultimately, following a thorough investigation, this study will offer recommendations about the pricing strategy that may be implemented to either boost or sustain the earnings.

2. McDonald's – business description

The initial McDonald's outlet was established in San Bernardino, California in the year 1940 by brothers Maurice and Richard McDonald. The little restaurant was built to get out a lot of cheap meals quickly. The brothers did this by offering simply hamburgers, french fries, beverages and pie and by developing a straightforward, effective system they called the Speedee Service System. McDonald's is a United States fast-food



Figure 1 Big Mac (McDonald's Corporate, 2022)

restaurant renowned for its global presence and recognised as one of the biggest in the industry. This establishment is particularly celebrated for its assortment of hamburgers, french fries and notably, the iconic Big Mac. This brand has achieved remarkable success, positioning it among the most effective in the history of marketing (Britannica, 2023).

Presently, the corporation has a global presence with a network of more than 36,000 restaurants stretching over more than 100 countries (McDonald's Corporate, 2022).

McDonald's has an extensive selection of food and beverages on its menu in the United Kingdom. This includes several burger options, such as the Big Mac, McChicken Sandwich, and Filet-O-Fish, as well as chicken-based offerings like Chicken McNuggets and Chicken Selects. In addition to its regular menu, McDonald's offers a selection of breakfast foods, including Egg McMuffins, pancakes and porridge. The side menu offers a selection of food items like fries, chicken wings, mozzarella dippers and apple pie. (Mcdonald's UK, 2023).

I have chosen the internationally popular Big Mac from McDonald's as the subject of my research due to its status as one of McDonald's most notable trademark products.

3. Demand and market equilibrium

3.1 Price of substitutes

According to Avgeropoulos and McGee (2015), substitutes refer to goods or services that are utilised instead of each other. The substitutability of two goods can be classified as either strong or weak, based on the level of ease with which one can transition between them. Nevertheless, it is important to note that substitutability is a quantifiable concept that exists on a continuum, and the categorization of strong and weak replacement is rather subjective and lacks a clear distinction.

While burgers are widely available from numerous local companies, an alternative to McDonald's famous Big Mac is the Whopper burger offered by Burger King. In the United Kingdom, the substitute product price is starting from £4.99, while the Big Mac is raging from £3.69 to £4.19 based on the finding from Walker et al. (2023).

The marketing aims of McDonald's comprise its goal of attracting a specific target demographic seeking quick meal service at affordable prices (build, 2023).

The sales figures provide evidence of McDonald's marketing approach. The revenue of the company is about three and a half times bigger due to its comparatively lower pricing in relation to its primary competition, Burger King. In the fiscal year of 2022, McDonald's declared a global revenue of \$23.18 billion, whilst Burger King's sales amounted to \$6.51 billion (Macrotrends, 2023).

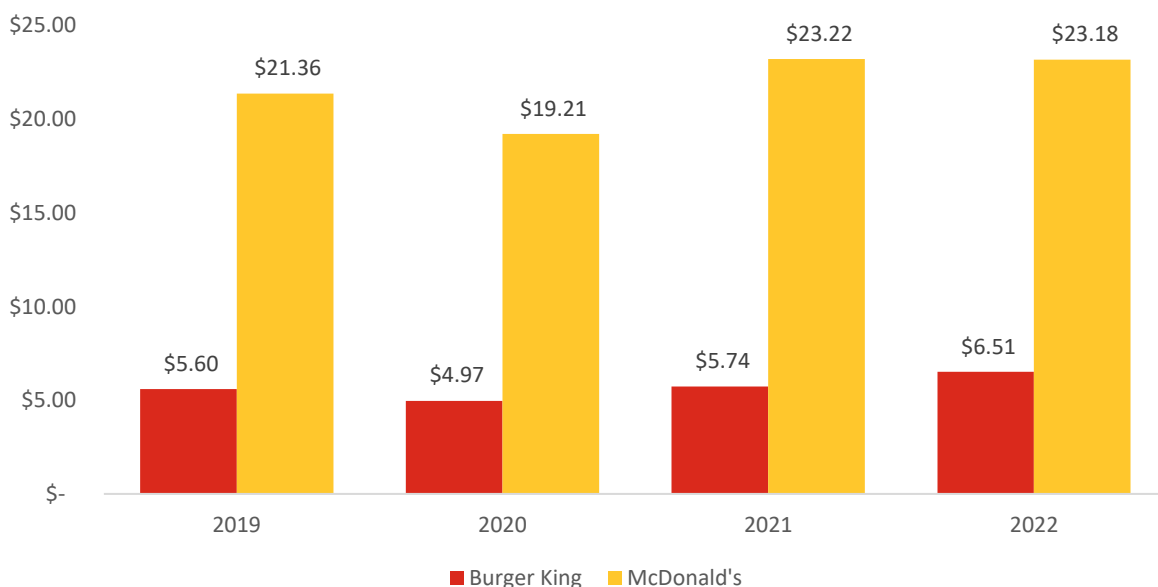


Figure 2 Revenue in billion for Burger King and McDonald's (Macrotrends, 2023)

3.2 Price of complements

Complementary items or services are used in conjunction with each other. Complementary items have demand patterns that display a high degree of similarity, where variations in the demand for one product result in a beneficial effect on the demand for the other product. An upward adjustment in the price of the initial good would result in a decrease in its demand, therefore putting downward pressure on the demand for the second product (Avgeropoulos, Sammut-Bonnici and McGee, 2015).

During the analysis of McDonald's, it is seen that the Big Mac is complemented by the successful inclusion of french fries and soft drinks as accompanying goods.

The complementary product, namely french fries, is priced at a minimum of £1.19. However, it is typically more cost-effective to choose for the bundled menu packages that include the purchase of a Big Mac, fries and a drink, as compared to buying each item individually. Additionally, as a result of their marketing approach, McDonald's provides discounted items within their application (Walker et al., 2023).

3.3 Consumers income

According to projections provided by the Office for National Statistics (2023), the median household disposable income in the United Kingdom for the financial year ending (FYE) 2022 was recorded at £32,300. This figure reflects a decline of 0.6% compared to the FYE 2021. This corresponds to a 2% rise observed between the fiscal years ending in 2020 and 2021, which encompasses the initial year of the coronavirus (COVID-19) outbreak. Over the course of the decade before FYE 2022 (specifically, from FYE 2013 to FYE 2022), there was a notable

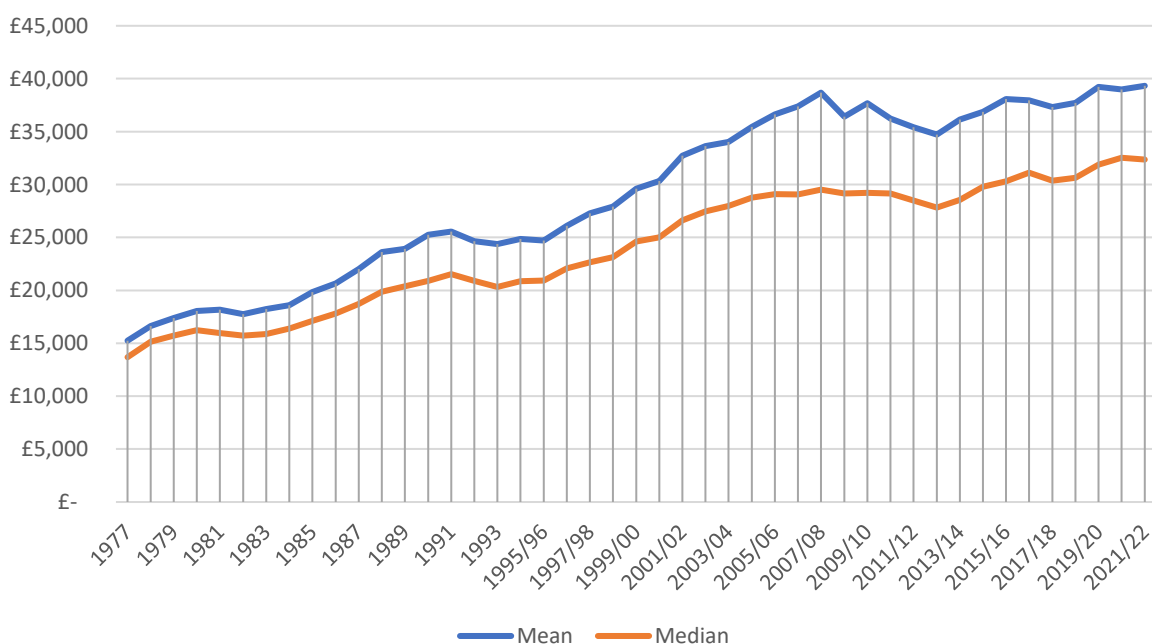


Figure 3 Median and mean real equivalised household disposable income of individuals (Office for National Statistics, 2023)

increase in median income, amounting to a growth rate of 16.2%. This growth was achieved by a consistent average annual rate of 1.7%. In contrast, the average income saw a very modest growth rate of 1.4% annually, resulting in a cumulative rise of 13.2% over a decade.

Based on the data provided by the Office for National Statistics, there has been an overall growth in income over the last decade. However, it is worth noting that there was a little drop seen in 2022. Despite this temporary decline, it is anticipated that the demand will remain relatively stable for Big Mac.

3.4 Consumers preferences

Consumer preference refers to the subjective inclinations of individual customers, which are assessed based on their level of pleasure with the things they have bought. Consumers engage in the process of distributing the limited funds they have among various available items to maximise their overall happiness (Saji, 2020).

In today's society, there is an increasing consumer desire for food products that not only offer the advantage of fast preparation but also possess qualities of nutritional value and taste good. Consumers may prefer using a mobile app to order food in advance and pick it up from a locker, rather than waiting in long lines at a physical counter. The COVID-19 pandemic has greatly increased demand for food delivery, expanding ordering and delivery options (Kidder, 2022).

Consumers increasingly recognize the link between food consumption and health, leading to alternative eating behaviours like increased fruits and vegetables and reduced meat and sweets. Food producers, restaurants and other stakeholders carry a significant responsibility towards offering a wider range of healthful and nutritional choices to customers (Deloitte, 2022).

McDonald's is demonstrating an increased dedication to promoting healthy eating by including fruit and vegetable choices in their meal packages and actively promoting more nutritious options to youngsters. This shift is in response to increasing demands from both government agencies and customers to address the issue of obesity (Parsons, 2013).

3.5 Consumer expectations of price

The development of consumers' price expectations is commonly recognised as a result of their analysis of observed pricing patterns over a specific timeframe. Consumers seem to formulate individualised predictive guidelines for pricing. Additionally, a consumer's purchasing choice may be influenced by the prevailing pricing expectations. Consumers engage in the process of price observation and acquisition of pricing information from many sources, through which they formulate decision-making principles. Therefore, the anticipated price might influence consumer buying behaviour, either by increasing the likelihood of immediate purchase or by causing a delay in the purchasing decision (Kwon and Schumann, 2001).

The United Kingdom is now experiencing a notable escalation in food costs, reaching the highest rate of increase observed in more than four decades. Specifically, the inflation rate for food and non-alcoholic beverages was at 16.8% on an annual basis as of January 2023. Low-income households are disproportionately impacted by the escalation of costs since they allocate a greater part of their budget towards expenditures on food and beverages. Elevated costs might potentially prompt certain households to choose more affordable alternatives, curtail their use of other commodities or services, or decrease their expenditure on food (ONS, 2023).

With the escalation in production costs, food producers and retailers are probably transferring a portion of these increased expenses to consumers through rising food prices, contributing to inflation. However, as seen in Figure 4, the price of the Big Mac displays a very modest rise, which may not have a substantial impact on reducing consumer demand.

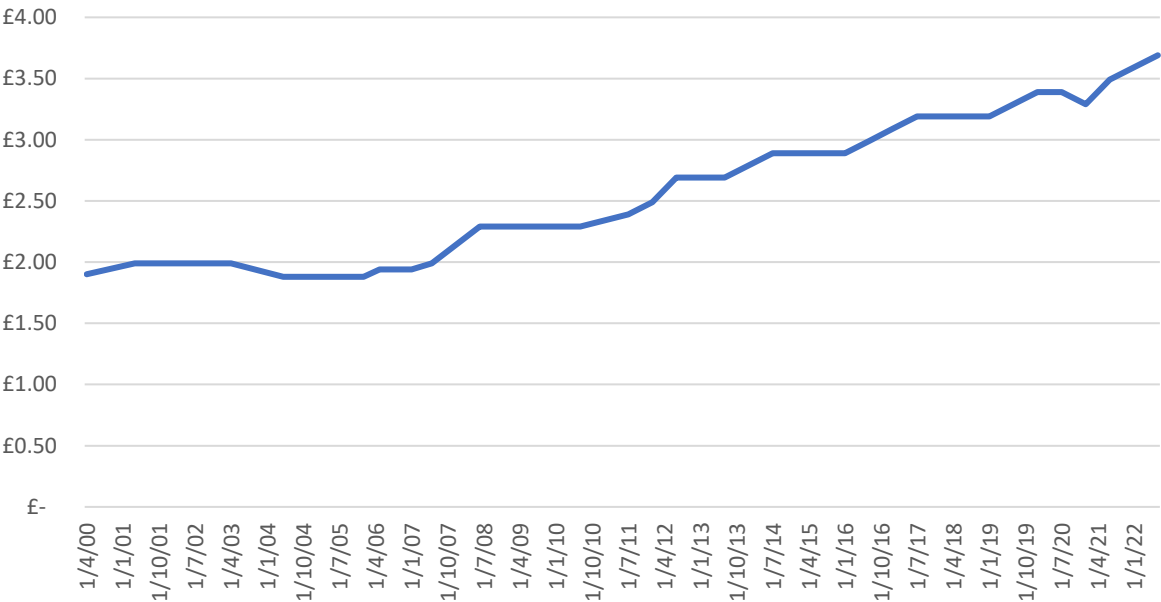


Figure 4 Big Mac Index - Britain (NASDAQ, 2023)

3.6 Numbers of consumers

The Big Mac, a burger meal offered by McDonald's, continues to maintain its status as the company's most famous and widely consumed item, with a global daily sales figure of 2.4 million units (Bob Cut Magazine, 2022).

The fact that the Big Mac sells more than 2 million units daily is indicative of the significant customer demand and lasting popularity that this burger has sustained over several decades. The persistent sales performance of the Big Mac, seen by its consistently high volume sold, shows its sustained popularity as a menu item that receives substantial consumer demand. Given the substantial levels of production and sales, it is quite probable that McDonald's has refined the cost structure and profit margins associated with Big Macs to effectively provide consumers with value on a large scale.

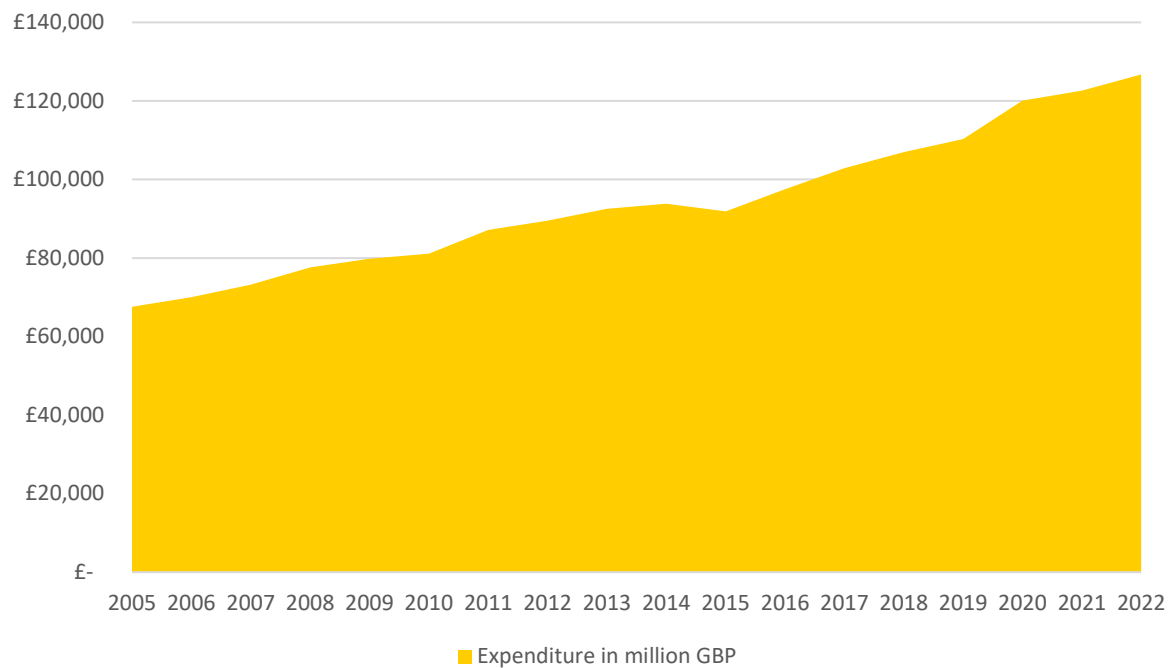


Figure 5 Consumer spending on food and non-alcoholic drinks in the United Kingdom from 2005 to 2022 (Bedford, 2023)

The massive volume of units sold, along with the observed rise in food expenditure, such as the case of the United Kingdom seen in Figure 5, is expected to provide favourable results for McDonald's in terms of revenue.

4. Price elasticity of demand

The concept of demand elasticity refers to the degree of responsiveness displayed by the consumer appetite for a particular commodity or service in relation to fluctuations in different significant factors. The determination of demand elasticity for an item or service is influenced by several significant aspects, including the current price level, the nature of the item or service, the presence of replacement options and the amount of revenue from consumers (Nickolas, 2022).

4.1 Substitution effects

In light of the current circumstances, it may be concluded that the Big Mac can be classified as a luxury product, representing a personal choice for the majority of customers. McDonald's operates in a very competitive market, along with other famous chains. Consequently, this competitive landscape necessitates adherence to pricing discipline. There is a wide variety of viable alternatives, namely other fast food burger options, which consumers may easily transition to in the event of an increase in Big Mac costs. This provokes a response of price sensitivity from them.

One strong argument is that McDonald's, due to the presence of elastic demand, is motivated to minimise or restrict price hikes, as seen in Figure 4, for Big Macs to optimise their income generation. In light of all of these factors, it can be concluded that the demand for Big Macs is

projected to demonstrate a higher degree of elasticity when compared to critical products and services. The sensitivity of demand for the product to changes in price is influenced by two primary factors: the presence of alternatives and the discretionary character of the product.

4.2 Income effects

Consumption habits often go through changes over time, influenced by various factors. For instance, an increase in income may lead individuals to adopt a healthier lifestyle, resulting in a decrease in the demand for Big Macs. On the other hand, during periods of lower income, consumers may seek more affordable food options, leading to an increase in the demand for burgers. The impact of income variations on demand, also known as income elasticity of demand, varies depending on consumer's sensitivity to price fluctuations, as well as their baseline income elasticity of demand and income levels (Komarek et al., 2021).

From February to April 2023, there was a notable increase in average regular pay growth within the private sector, reaching 7.6%. This growth rate stands as the highest seen outside the pandemic period. In comparison, the public sector saw a growth rate of 5.6%, which is the most recorded since the period of August to October 2003. From February to April 2023, there was a decline in the adjusted to account for inflation growth of both total and regular pay. Specifically, total pay saw an increase of only 2%, while regular pay saw an increase of 1.3%. Despite the adverse impact of inflation on consumers' income, there is an observable trend of total income growth (Office for National Statistics, 2023).

Considering the data on median income in the United Kingdom, as reported by the Office for National Statistics in 2023, it can be observed that the recorded value stands at £32,300. Based on this information, it can be estimated that the weekly income will come out to around £621. Based on the given information that the starting price of a Big Mac is £3.69, it can be estimated that an individual would allocate just 0.59% of their weekly income towards its purchase. Alternatively, one individual has the capacity to go through 168 Big Macs weekly.

It can be concluded that an increase in income is likely to result in a corresponding increase in the demand for Big Macs, suggesting an elastic demand. However, if income continues to rise, the demand may become inelastic, subject to the consumer's inclination towards healthier alternatives.

5. Recommendations

It is recommended that McDonald's adopt a pricing strategy that takes into account the many factors such as cost, demand, competition, and value of its goods across different regions.

The following are a few of McDonald's pricing techniques:

- The bundle pricing approach refers to the practice employed by McDonald's where they provide meal packages and other food bundles at a reduced cost compared to purchasing the individual items separately. The use of this particular technique has the potential to enhance sales volume, develop client loyalty and facilitate cross-selling efforts.
- The implementation of a psychological pricing strategy is observed in McDonald's pricing approach, wherein the price is fixed at £.99 rather than being rounded to the next whole unit of currency. This approach has the potential to enhance the perception of affordability and desirability of the items among buyers.
- The market-oriented pricing approach involves McDonald's adapting its prices in response to many factors common to the local market, including but not limited to income levels, lifestyle preferences, competitive landscape and consumer demand. This strategic approach has the potential to facilitate McDonald's ability to accommodate diverse consumer preferences and requirements.

6. Conclusion

McDonald's focuses its marketing efforts on target demographics that prioritise cost-effective and expeditious dining options, resulting in a revenue of nearly three times that of Burger King's, \$23 billion in 2022.

McDonald's employs a strategic approach by including French fries and drinks into its Big Mac offerings, therefore boosting demand through the utilisation of meal packages and capitalising on the perceived value they offer. Additionally, the COVID-19 epidemic has resulted in a notable increase in the demand for McDonald's Big Mac products.

The increasing awareness of the link between food intake and its influence on health has resulted in a change in consumer buying habits, as individuals are now embracing alternative dietary practices. McDonald's displays a commitment to expanding the promotion of good dietary habits by the incorporation of fruit and vegetable alternatives within their meal packages, as well as actively promoting the consumption of more nutritious options among teenagers.

In January 2023, food inflation in the United Kingdom escalated to 16.8%. However, the prices of Big Macs have only witnessed a marginal rise, reducing the potential repercussions on consumer demand. The Big Mac remains McDonald's most prominent offering, boasting a daily sales volume of 2.4 million units worldwide. This massive volume offers advantages in terms of economies of scale, but, it also exposes demand susceptible to fluctuations in incomes and economic variables. To maintain high sales volumes in the face of changing demand drivers, McDonald's may consider using price tactics such as discounts, packages and market-oriented approaches.

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