

On Listed Enterprises Favoritism, Financial Short-Selling Brought About by Various Warnings and Countermeasures-Example Based on Luckin Coffee Co.

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Abstract: With the rapid development of the global economy and the maturity of the capital market, the number of financial fraud incidents of listed companies is increasing, which has become the focus of the market. This not only makes us ponder — what are the reasons that drive enterprises to commit frequent fraud and what lessons such incidents can bring us. This paper analyzes the history of Luckin Coffee Co., LTD. (hereinafter referred to as Luckin or Luckin Coffee), the causes of fraud, and introduces relevant academic documents to analyze the various warnings and relevant countermeasures brought by the short selling of Rising Company.

Keywords: Warnings, Luckin Coffee Co., Financial fraud incidents, Relevant countermeasures.

1. Introduction

As a new coffee chain brand, Luckin Coffee provides diversified food services such as coffee, tea and some other snacks. The online Internet big data retail model of "making coffee accessible" has quickly become internationally famous and has become a rising star in coffee ring. However, with its short selling in early 2020 and the subsequent fraud incident, Luckin Coffee's stock price plummeted, and its market value evaporated significantly. This incident not only damaged the brand image of Luckin Coffee, but also caused panic in the whole range of companies, entrepreneurs, shareholders and other aspects. Its financial fraud has aroused widespread concern and deep reflection. At the end of January 2020, Muddy Waters pointed out that Luckin Coffee had falsified and cheated on its operating data, and issued a short selling report. This not only caused the company's share price to plunge and its market value to evaporate, but also triggered a wide discussion on the authenticity of information disclosure of listed companies, the effectiveness of supervision and investor protection mechanisms around the world. This article will start from the beginning and end of the short selling event of Luckin Coffee, explore the warning significance behind it and countermeasures.

2. Overview of the Luckin Company's Financial Fraud Events

2.1. The Introduction of Luckin Company and Muddy Waters Company

Luckin Company is a coffee chain company, the company's main products are coffee, tea and dessert as a supplement. Products are often co-branded with companies such as Moutai and NetEase. The company is committed to promoting the popularity and popularity of coffee in China. Luckin Coffee was incorporated in Xiamen, China, in mid-June 2017, and only two years later, it successfully listed on Nasdaq in May 2019, raising a total of 659 million US dollars, with a target financing of about 3 billion US dollars, surpassing Starbucks, and creating the world's fastest IPO record in only 18 months

[1]. Muddy Waters, founded by Carson Block, focuses on conducting in-depth investigations of publicly listed companies, collecting and analyzing public and non-public information, and releasing detailed research reports to expose their possible fraud, fraud and other behaviors, thereby triggering market attention and regulatory intervention. Since its inception, Muddy Waters has successfully shorted a number of mid-cap companies, such as New Oriental and Huishan Dairy, all of which have been severely punished.

2.2. The Procedure Event

that time, and its stock price reached its peak on January 17, 2020, with the highest intraday share price reaching \$51.38, and the market value was as high as about \$12.9 billion. However, at the beginning of 2020 [2], muddy water short-sellers spent Lucking "cheating the consumer market", and there were serious falsifications in financial data, store operations and other aspects. Luckin shares plunged 26.5% that day, even though Citron, another well-known short seller, said it was bullish on the company. On February 3 of that year, Luckin Coffee denied all the allegations in the short report, on the same day, Luckin's stock price rebounded up to 7% in the day, and rose 15.6% the next day, two days later, a research report called "Dust Light Research on Luckin Coffee's major financial data cost and business data cost" directly accused Luckin Coffee's financial data fraud. Thoroughly confirmed that Rising company there is favoritism and malpractice misconduct. Finally, Luckin Coffee issued an announcement on April 2, 2020, admitting that there had been fake transactions involving up to 2.2 billion yuan. The disclosure further exacerbated market panic, with share prices plunging nearly 80%.

2.3. Event Subsequent Processing

Due to the adverse impact of Luckin Coffee's short selling incident, Luckin Coffee's adjustment from internal personnel to external legal and regulatory penalties have been seriously dealt with and rectified. In terms of internal personnel adjustment, on May 12, 2020, Rising announced that the company's CEO Qian Zhiya and COO Liu Jian were

dismissed from their positions, and Guo Jinyi acted as CEO. In addition, the company also punished six employees who were involved or known by suspension or leave. In July 2020, Luckin Coffee held a special general meeting of shareholders, Luckin Chairman Lu Zhengyao, directors Li Hui, Liu Erhai and Shao Xiaoheng were dismissed, and subsequently Lu Zhengyao no longer served as a board member. In addition, Cao Wenbao and Wu Gang were appointed as directors, and Dajing Capital became the largest shareholder of Luckin Coffee. Finally, Rising Coffee's co-founder and chief sales officer, Yang Feiyang, was sentenced to 18 months in prison for illegal business operations.

3. Analysis of Causes of Luckin Coffee's Financial Fraud

3.1. External Supervision is Inadequate for Multiple Reasons

In the first place, the construction of Luckin Coffee is complicated, because Luckin Coffee Company is a chain enterprise located in China, but listed and listed abroad. Although overseas developed capital markets such as the United States have relatively strict relevant market mechanisms due to their early development, Luckin Coffee is still able to successfully fake, which reflects the loopholes in some aspects of external supervision. At the same time, domestic regulators also face certain challenges in cross-border regulatory cooperation. However, due to differences in politics, economy and culture, countries lack sufficient and effective communication. Second, external legal penalties are still not severe enough. If there are strong enough legal provisions to support the market to maintain a fair environment, it is certain that such cases of fraud will be greatly reduced. In addition, it is worth noting that the laws and regulations on cross-border supervision are not perfect enough, and there are legal gaps or conflicts in some areas. The basic order of the law is not still stability enough, then saying other is just fantasy.

3.2. Rapid Expansion Leads to Financial Pressure and Performance Drive

China is a country rich in tea culture. According to statistics, the per capita caffeine intake in China is less than 100mg per day, which is much lower than that in other Asian countries. As far as the target groups of Luckin are concerned, young people mostly choose fruit tea, milk tea and other products with rich taste. As far as the environment of Luckin is concerned, the decoration of most stores is relatively simple, and some even have no tables and chairs. The store is also not a prime location, it is difficult to attract traffic. Compared with Starbucks, after Starbucks realized that it is basically difficult to change the reality from the root, 70% to 80% of its stores are set in shopping malls, large traffic and conspicuous locations around subway stations, and are willing to pay high store costs, so it can become the leader of the industry. Such a development route is not replicable, because high-end brands themselves have some natural exclusivity. As a result, Luckin Coffee has at sometimes been unable to meet its projected financial needs to meet its strategic objectives. Therefore, Luckin Coffee is facing huge financial pressure and performance pressure in the process of rapid expansion. In order to attract investors and maintain stock prices and market share, companies may resort to improper means such as inflated revenues and profits.

3.3. The Moral Quality of Management and Employees is Not High

This is mainly reflected in the irresponsibility and violation of moral conscience of Luckin Coffee management. For further examples: First, the management of Luckin Coffee unrestrained financial fraud, inflated trading volume and income. According to the investigation, Luckin Coffee inflated the transaction volume by as much as \$310 million (about 2.2 billion yuan) between the second quarter and the fourth quarter of 2019[3]. In terms of inflated financial income, in addition to regular drinks, Luckin also sells mugs, desserts and other peripheral products to obtain income. But by analyzing invoices for a large number of transactions, Muddy Waters found that these "revenue through peripheral products" data were falsified. There is a huge difference between the 22% disclosed in Luckin's report and the actual 6.2%, which may be a phenomenon of financial fraud that falsely increases financial income. Secondly, according to the survey. From April 2019 to the end of 2019, Luckin Coffee increased its transaction volume by about RMB 2.3 billion and increased its fictitious revenue by RMB 2.119 billion through the fictitious commodity bond business. The fictitious revenue accounted for 41.16% of Luckin's disclosed revenue of RMB 5.15 billion in the same period. Its financial fraud led to the statement can not show the real financial status and real operating status of Luckin Coffee. And all these behaviors not only induced the broad masses of investors, but also seriously disturbed the entire market. Second, the management took the initiative to use employees' financial fraud and promoted financial fraud by employee incentive plan: the senior management of Luckin Coffee set up a high fund reward, named 5982 programs, to reward employees for achieving high sales targets. It gives employees an incentive to commit irregularities that contribute to inflated financial data. However, the specific fund data and the number of participants has not been publicly disclosed. As far as the employees themselves are concerned, although the number of their involvement has not been disclosed, for the directly involved employees, they may be directly involved in financial fraud, such as fictitious transactions, falsified sales data, etc. As for the indirect promotion employees, even if they did not directly participate in the fraud, they ignored the moral standards, so they did not remind their partners or expose the incident, which indirectly promoted the company's financial fraud.

4. Luckin Coffee Short-Selling Event Brings Enlightenment

4.1. Enterprises Should Focus on Long-Term Development

It is true that when the short-term market fluctuations are large and producers are uncertain about the future, the profits of shorting stocks can make up for the losses of the investment portfolio. It can also provide investors with more opportunities to participate in the market and enhance market liquidity. But if this kind of misconduct is found, there will be severe penalties. Enterprises should first set up the relevant internal reward and punishment system, establish a sound corporate governance structure, optimize the selection system of independent directors, enterprises should strictly comply with the requirements of relevant laws and regulations, fully and objectively disclose the financial situation, operating

results and major matters, avoid false publicity, sales fraud and other violations and strengthen the internal management and control system. The company should also avoid a single oligopoly and avoid being operated by shareholders. In addition, the company should continue to optimize the commodity structure, improve service quality, reduce management risks, actively adapt to consumers and adapt to a specific region of the business model, do not go wrong to achieve long-term progress. On the one hand, sincere treatment of shareholders and the market can not only establish a good brand image, promote their own sales and financial revenue. On the other hand, help to improve the core competitiveness of enterprises and market position, to achieve sustainable development.

4.2. Shareholders Should Improve Their Own Literacy

As an important participant in the capital market, investors can not only rely on the changes of enterprises, and the requirements for their own literacy are also extraordinary. The first is the mentality of the issue, investors should not be too eager to superficial results. The value of the company is not reflected by the capital premium and financial falsification during the period. The intrinsic value of a company is reflected in its corporate culture, internal atmosphere, service quality and other aspects that cannot be experienced with data. Shareholders should focus on the company's long-term prospects. At the same time, investors should also improve their own risk awareness, do not blindly follow the trend. In the process of investment, we should make full use of the Internet and newspapers to understand the basic situation, financial status and business performance of listed companies and other information, and carefully assess investment risks. At the same time, we should also pay attention to information such as market changes and regulatory developments, and timely adjust investment strategies and risk control measures. In addition, investors should also learn to use a variety of channels to obtain information and independent judgment, to avoid blindly following the trend and speculation.

4.3. Warning to Market Regulation

First of all, the top priority is to strengthen cross-border regulatory cooperation. With the development of the economy,

more and more domestic enterprises are registered overseas, so domestic regulators should strengthen cooperation with overseas regulators to jointly combat cross-border financial fraud. Countries should put aside other external factors in the market and work together to build a harmonious and healthy green market. Secondly, for the relevant legal provisions, we should try our best to improve the system as soon as possible. The supervision system should make full use of experience to continuously improve the supervision system and improve the pertinence and effectiveness of supervision. Only with good institutional support can we develop a series of further reforms. Only by laying a good foundation can a tall building be built. On this basis, it is necessary to increase punishment, severely crack down on fraudulent companies, and establish a dignified institutional image.

5. Summary

Through the analysis of Luckin coffee short history and factors analysis. It can be found that enterprises are driven by huge interests and choose to short. But behind the huge benefits, there are often serious penalties. The financial fraud incident of Luckin Coffee not only brought serious losses and negative effects to the company itself, but also brought profound warnings to the entire capital market. In all aspects of its shorting, the enterprise shorting not only reflects its own long-term market strategy error internally, but also reflects in the enterprise, from the top down, from managers to ordinary employees, and even the entire corporate culture atmosphere is problematic. Externally, it reflects that the majority of shareholders do not invest rationally, but only pay attention to the appearance, clinging to the "surface figure" and not paying attention to the internal core value of the enterprise. It also reflects the shortcomings of external regulators. These points need to be improved.

References

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