

Research on the Problems and Countermeasures of Internal Control Information Disclosure of Listed Companies under Short Selling Mechanism

-- Based on the Case Study of Luckin Coffee and Starbucks Coffee

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Abstract: As an important mechanism for safeguarding the stability and integrity of enterprises and resolving risks, the transparency and accuracy of internal control disclosure plays a crucial role in maintaining market order and protecting investors' interests. This study takes Luckin Coffee and Starbucks Coffee as case studies, examining the disclosure behavior of listed companies under the short-selling mechanism and makes suggestions on the problems of corporate internal control. The study finds that the quality of internal control disclosure of listed companies under the short-selling mechanism is generally characterized by problems such as inadequate and untimely disclosure. In order to address these problems, this study makes a series of feasible suggestions: listed companies should strengthen and improve their corporate governance structure and establish a complete and efficient internal control system.

Keywords: Short selling mechanism, Corporate internal control, Disclosure of information, Quality of disclosure, Internal control management, Luckin Coffee, Starbucks Coffee.

1. Introduction

With the development of the global economy and capital market, short selling is playing an increasing role in the financial market. In this context, the accuracy and completeness of internal control information disclosed by listed companies are of particular importance. As an important participant in the market economy, the operation, financial status and internal control mechanism of listed companies are subject to strict supervision by investors, regulators and the public. As the core of corporate governance, internal control is not only a line of defense to ensure the truthfulness and reliability of financial reports, but also the key to improving the operational efficiency and effectiveness of enterprises, ensuring that the daily operations of enterprises are legal and compliant, and laying the foundation for the sustainable development of enterprises.

On this basis, this paper adopts the case study method, selects Luckin Coffee and Starbucks Coffee as the research object, thoroughly discusses the problems in the disclosure of internal control information of these two companies, and puts forward corresponding suggestions to improve these problems. This study aims to provide useful references and guidance for listed companies to optimize the disclosure of internal control information under the short selling mechanism.

2. Domestic and International Literature Review

2.1. Studies on the Short Selling Mechanism

The relationship between short selling and corporate financial misconduct was examined in a 2010 research paper by Karpoff and Lou. The results of the study show that as

short selling activity increases, corporate financial misconduct decreases. The activities of short sellers contribute to the reduction of financial fraud, the improvement of corporate governance, and the transparency of financial reporting [12].

Sun Zhicheng examines the impact of short selling on corporate governance principles. He emphasizes that the short selling mechanism reduces information asymmetry within the firm by strengthening external monitoring, and improves the transparency and quality of corporate financial information. In addition, the short selling mechanism can mitigate management misconduct such as surplus management through market mechanisms, thereby enhancing the authenticity and reliability of corporate financial information [13].

2.2. Studies on Internal Controls

In examining the domestic and international literature on internal control effectiveness, Chen Lei identified a positive correlation between internal control effectiveness and the economic consequences of a firm. Nevertheless, this effectiveness is contingent upon the establishment of an appropriate level of intensity and the enhancement of the firm's risk management capabilities [1]. Zhang Jianying and Xiu Yuxing posit that the internal control system represents a pivotal component of contemporary enterprise management, serving as a vital instrument for averting and mitigating enterprise-level business risks [2].

2.3. Studies on Disclosure Quality and Firm Performance

Chen Junlan and Xie Chi conducted an empirical study on the disclosure quality of listed companies in Shanghai and Shenzhen. The results of the study show that the disclosure quality is greatly influenced by the industry and regulatory

environment in which the company is located. [9] Li Mengmeng focuses on listed companies in the manufacturing industry and finds that there is a significant positive relationship between internal control quality and financial performance, and the disclosure of social responsibility information also has a significant impact on financial performance [10].

In contrast, Fang finds that the long-term impact of accounting disclosure quality on firm performance is more pronounced. Moreover, the impact of disclosure on firm performance depends on the specific type of disclosure [11].

2.4. Studies on Internal Controls and Disclosure of Luckin Coffee and Starbucks Coffee

Song Hongjie's investigation revealed that Luckin Coffee was deficient in several key areas, including transparency and timely disclosure of information. These deficiencies ultimately led to the occurrence of financial fraud, which seriously damaged the company's reputation and reduced investor confidence [3]. Wang Chengyu's study concluded that the lack of internal control is an important factor leading to the occurrence of financial fraud [4].

Research shows that Starbucks pays special attention to the transparency of financial information and creates a good internal control environment [5, 6]. Starbucks' financial results show stable global operating results and increased consolidated net sales in the fourth quarter and full year of fiscal 2022, demonstrating the effectiveness of its internal controls and operating procedures [7]. Starbucks released its 2020 Year-End Summary, which further underscores the Company's commitment to transparency and accountability with respect to internal controls and disclosure [8].

3. Case Narrative

3.1. Introduction to Luckin Coffee

Since its establishment in 2017, Luckin's distinctive business model and market positioning have enabled it to stand out from fierce competition, with great potential for growth and market expansion. The company has established a comprehensive operating structure that includes store operations, coffee farming, processing, logistics and distribution. A review of publicly available financial data shows that Luckin Coffee's revenue growth has accelerated since its inception, and in 2019, Luckin successfully went public on the NASDAQ. Despite obstacles such as financial fraud and delisting, the company has demonstrated its ability to restore market confidence and achieve sustainable business growth through internal corrections and market strategy adjustments.

3.2. Introduction to Starbucks Coffee

Since its founding in 1971 in Seattle, USA, Starbucks Coffee has grown from a simple retailer of coffee beans to the world's preeminent coffee chain. In fiscal year 2023, Starbucks continued to be profitable, achieving the high end of its full-year guidance and driving revenue growth, efficiency improvements and margin expansion. To achieve its global strategic goals, Starbucks raised capital through the issuance of equity and debt securities. Despite volatility in its share price, Starbucks remained a top choice for investors due to its stability and favorable market outlook.

4. Status of Internal Control Disclosure of Luckin Coffee and Starbucks Coffee

4.1. Current status of Luckin Coffee's Disclosure of Internal Control Information

Following the financial fraud incident, Luckin Coffee has taken steps to strengthen its corporate governance and internal control system. In this regard, the company released "Change and Reinvention - Luckin Coffee Corporate Governance Report 2020-2022", which describes the company's initiatives and achievements in reshaping its value system, optimizing its governance system, and strengthening its internal controls. Luckin has also emphasized a corporate culture of integrity, revised its Code of Business Ethics and Morals, enhanced its accounting and financial reporting staff, and strengthened key business controls. In terms of information disclosure, Luckin has strengthened its information communication system to ensure the accuracy of data dissemination. In addition, the company has implemented strict controls through digital transformation to ensure food safety.

4.2. Current status of Starbucks Coffee's Disclosure of Internal Control Information

Starbucks excels in transparency and standardization of internal control information. The company is committed to its governance structure and has established independent boards and committees to ensure sound and effective decision-making. The company has implemented a stock option program to increase employee ownership and motivation. Starbucks is committed to corporate social responsibility. For example, the Beijing Starbucks Public Welfare Foundation leads a number of public welfare activities, such as the Yunnan Public Welfare Program and Star Embroidered Future. In terms of product innovation, Starbucks launched the "GOODGOOD Starfoodism" program, which uses environmentally friendly materials, promotes plant-based diets and encourages customers to participate in environmental protection and sustainable development.

5. Case Analysis

5.1. Specific Issues in Luckin Coffee's Internal Control Disclosure

Luckin Coffee is involved in a financial fraud scandal involving approximately RMB 2.2 billion, an incident that has seriously damaged the company's credibility and negatively affected investors' interests. First and foremost, the company's internal controls were inadequate. Specifically, Luckin Coffee's description of key control activities may lack sufficient detail, and the disclosure of corrective actions and consequences of internal control deficiencies may be inadequate. In addition, the company did not timely disclose relevant information in this financial fraud incident. Therefore, it reflects that Luckin Coffee failed to ensure the authenticity, reliability and timeliness of the internal control information it disclosed, and the information disclosure mechanism was not sufficiently sound before misleading investors.

5.2. Specific Issues in Starbucks Coffee's Internal Control Disclosure

Starbucks' internal control has deficiencies such as

inadequate segregation of duties, approval and inspection systems. In terms of information disclosure, the company may be found to have irregularities, thus affecting investors' and stakeholders' understanding and judgment of the company's internal controls. In addition, Starbucks has encountered food safety problems in its stores in China, which may be related to internal control deficiencies. Despite Starbucks' efforts in ESG, it is still unknown how ESG can be integrated into corporate governance and internal control. Increased competition in the market requires Starbucks to ensure the effectiveness of internal controls and avoid risks as it accelerates its expansion.

6. Strategies and Recommendations

6.1. Improvement of Corporate Governance Structure

In order to reinforce the corporate governance structure, guarantee the stable operation of listed companies, safeguard the rights and interests of investors, and enhance market confidence, it is crucial to accurately delineate the boundaries of authority and responsibility of the board of directors, the supervisory board, and management. Concurrently, the independent director system should be promoted in order to augment the number of independent directors on the board of directors and thereby enhance the board's independence and supervisory capacity. Furthermore, it is crucial to implement effective checks and balances of power to circumvent potential issues of domination or excessive centralization of power by major shareholders.

6.2. Strengthening the Internal Control System

The establishment of a comprehensive and effective internal control system serves as the foundation for strengthening the internal control structure. By conducting a risk assessment, the company can identify potential risk points and establish a foundation for developing appropriate control measures to ensure that the company's business activities are conducted in accordance with established procedures and regulations. This approach can prevent errors and fraud. The free flow of information within an organization facilitates the timely understanding and response to risks by departments and employees.

6.3. Strengthening Information Disclosure Mechanisms and External Audit

Improving the information disclosure mechanism will require stricter standards that require listed companies to disclose in a timely manner all information that may have a material impact on the financial condition, results of operations and decision-making of investors, and that the information be comprehensive, truthful and accurate, without misleading statements or omissions.

Strengthening external audit and oversight is an important strategy to ensure that the financial statements of listed

companies are true and reliable, that their internal control systems are effective and robust, and that the independence and professionalism of external auditors are strengthened so that they remain objective and impartial, are not subject to undue influence, and have sufficient expertise and experience to conduct a comprehensive and thorough audit.

7. Conclusion

By comprehensively examining the internal control information disclosure practices of Luckin Coffee and Starbucks Coffee under the short selling mechanism, this study presents the following key findings. First, the short-selling mechanism has a significant impact on the way listed companies choose to disclose internal control information. Under the short selling mechanism, companies are forced to disclose internal control information in a more transparent and timely manner in order to maintain market confidence and robust investor relations. Listed companies have shortcomings in the completeness, accuracy and timeliness of information disclosure and suggest improvements to strengthen corporate governance structures and information disclosure mechanisms to address these issues.

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