

Internal control issues in Shanghai Jahwa under the normalization of novel coronavirus prevention and control Research

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Abstract. With the normalization of the novel coronavirus, the internal control system of the company will also produce some changes to adapt to the changes of the external environment. In this paper, Shanghai Jahwa United Co., Ltd. will be selected as the subject of study to discuss three aspects of internal environment, business activities, and risk assessment to point out its strengths and weaknesses and identify its changes. This paper compares Shanghai Jahwa with the industry average thus making a comparative judgment, on the premise of concluding that Shanghai Jahwa's novel coronavirus is normalized and the industry average can also be judged.

Keywords: Internal control; Shanghai Jahwa United Co.; Beauty and Cosmetics Industry level; normalization of the novel coronavirus.

1. Internal environment category

1.1 Development Strategy

With regard to the development strategy, I will give a more concise account of the part of Shanghai Jahwa from 2017 to 2019, followed by a detailed analysis of what specific changes have occurred in Shanghai Jahwa's development strategy under the normalisation of novel coronavirus prevention and control, in order to provide a contrast.

1.1.1 2017 to 2019

From 2017 to 2019, Shanghai Jahwa Group will continue to improve the industry's profitability development capacity as a strategic development goal: the medium-term performance development capacity goal is determined as the level of corporate profitability growth capacity to reach the national average profitability level within the industry, and the long-term performance development capacity goal is positioned as the overall profitability growth capacity level to reach above the average growth level in the industry, and each year sets a unique Each year, a unique strategic pathway is set to accommodate the development of the business in that year in order to achieve the strategic objectives.

For example, in 2018, Shanghai Jahwa concluded four new strategic development paths to achieve its strategic goals, which were identified as the following four: brand development, category value mining and enhancement, precise marketing strategy, and channel management innovation.

As an example, Shanghai Jahwa has adopted the four paths of brand development to illustrate the specific measures taken by Shanghai Jahwa. In terms of brand development, Shanghai Jahwa Group's brands are actively involved in cross-brand and cross-border cooperation promotions to gain the attention of brand customers, such as the unique cocktail of flower lotion jointly launched by Liu Shen and the brand RIO, which entered the market after a week of sales and was well received by consumers, and the lip balm with milk sugar cream flavour jointly launched by Megaman and the brand White Rabbit, which was highly sought after by female consumers. All of these products achieved high sales as they were often more appealing to consumers as a result of cross-border collaborations.

It can be seen that from 2017 to 2019, Shanghai Jahwa has set maximising shareholder wealth as its goal, with most of its strategic paths serving to improve profitability. In turn, Shanghai Jahwa's return on net assets from 2016 to 2019 was selected as a measure of its profitability to determine

whether its medium to long-term strategic objectives were set reasonably and how well they were achieved.

Table 1. Return on net assets of Shanghai Jahwa from 2016 to 2019

	2016	2017	2018	2019
Net profit (\$ billion)	2.01	3.90	5.40	5.57
Owner's equity (\$ billion)	52.62	53.77	58.13	62.86
Return on net assets	3.82%	7.25%	9.29%	8.86%

Table 2. Industry average return on net assets for 2016 to 2019

	2016	2017	2018	2019
Net profit (\$ billion)	1.62	2.25	2.94	3.26
Owner's equity (\$ billion)	15.73	17.16	20.89	24.57
Return on net assets	10.30%	13.11%	14.07%	13.27%

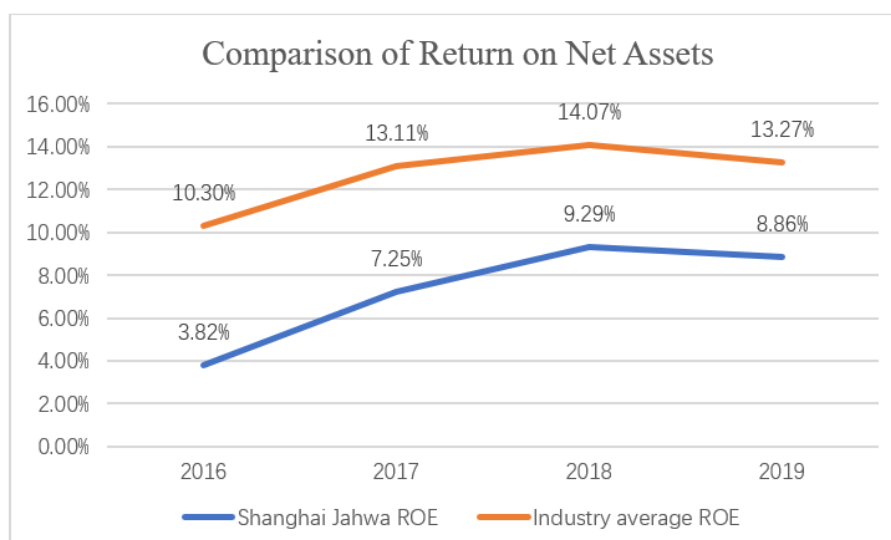


Fig. 1 Shanghai Jahwa versus industry average return on net assets from 2016 to 2019

As can be seen from the table, Shanghai Jahwa's profitability was lower in 2016, 6.48% lower than the industry level, a large gap, with profitability levels well below the industry average.

However, since 2017, when Shanghai Jahwa made improving profitability a mid- to long-term strategic objective, it has shown a year-on-year upward trend in its return on net assets, with the gap between it and the industry average return on net assets decreasing year-on-year, and by 2019 the gap between the two was only 4.41%, which is already a significant improvement compared to 2016.

It is evident that Shanghai Jahwa has not only set its strategic goals properly, but has also accurately recognised its shortcomings and improved them. In addition, Shanghai Jahwa has also adopted a strategy to keep up with the times in achieving its strategic objectives, such as collaborating with crossover brands to achieve Pareto improvements, exploring new areas of colour cosmetics out of its comfort zone, and promoting itself on different social media platforms to meet trends, which has effectively contributed to the achievement of its strategic objectives.

1.1.2 2020 to 2022

Although Shanghai Jahwa is more aware of the importance of strategy and announces its development strategy every year until 2020, it never mentions the Strategy Committee and its actions in its annual reports until 2020, and only discloses its medium and long-term strategic objectives and strategic path.

However, in the normalised state of the novel coronavirus, the previous strategy did not meet the actual needs of the company. With the arrival of the novel coronavirus and the rising industry standards for beauty and cosmetics in China, sustainability and resilience to risk were clearly more important, so Shanghai Jahwa further strengthened the role of its strategy committee and updated its strategy. In particular, in April 2020, Pan Qiusheng succeeded Zhang Dongfang as the new Chairman of Shanghai Jahwa, bringing a new wind to the company and changing the corrupt culture and decadence of Shanghai Jahwa in the past.

Even in 2021, in order to reflect more deeply the special nature and importance of highlighting Shanghai Jahwa's development strategy and the company's control ability at the strategic level, Shanghai Jahwa officially renamed its Strategy Committee as the Strategy and Sustainable Development Committee, with the main purpose of further strengthening the company's risk prevention ability, establishing a sound early warning mechanism, improving the company's governance system in terms of future development strategy and enhancing the company's modern decision-making capability and overall governance level, in order to adapt to the more intense competition under the normalisation of the novel coronavirus and to improve the core competitiveness of the company.

Since 2020, Shanghai Jahwa has not only disclosed its Strategy and Sustainability Committee in its annual report, including its composition and organisational purpose, but has also described its actions and the strategies it has developed in detail, clearly giving more attention to the strategic dimension.

The Strategy and Sustainability Committee consists of three senior Board members, of which Mr. Pan Qiusheng, the current Chairman of the Board, assumes the responsibility of the Chairman, under the Board. The importance and leadership of the Strategy and Sustainability Committee is high and authoritative. As a former General Manager Commercial Asia Pacific of L'Oréal, the Chairman has ample experience and competence in strategy development and possesses strong leadership.

It is clear that the Strategy and Sustainability Committee covers a comprehensive range of aspects, with environmental, social and governance being the most important concerns not only for Shanghai Jahwa but also for the daily chemical industry.

From 2020 onwards, Shanghai Jahwa has set the overall strategic objective of "pursuing the most beautiful products and services with the best of intentions to create the greatest value for consumers, shareholders, employees and society", compared to the previous strategic objective of "enhancing profitability". Shanghai Jahwa has transformed its business strategy from maximising shareholders' wealth to maximising stakeholders' value. It is indisputable that maximising stakeholders' profit is not only conducive to the economic and social benefits of Shanghai Jahwa, but also to its long-term and stable development, which is in line with Shanghai Jahwa's overall goal of sustainable development. Shanghai Jahwa does not focus on itself, but rather enlarges the picture and places Shanghai Jahwa in the industry, in society and in the country.

It is known that maximising stakeholder interest is difficult to weigh up all stakeholders, and it is not known whether Shanghai Jahwa's new strategy of not focusing on improving profitability and focusing on creating corporate value will affect its own profitability, so Shanghai Jahwa's return on net assets from 2020 to 2021 was chosen to measure its profitability.

Table 3. Return on net assets of Shanghai Jahwa from 2019 to 2021

	2019	2020	2021
Net profit (\$ billion)	5.57	4.3	6.49

Owner's equity (\$ billion)	62.86	64.99	69.63
Return on net assets	8.86%	6.62%	9.32%

Table 4. Industry average return on net assets from 2019 to 2021

	2019	2020	2021
Net profit (\$ billion)	3.26	3.57	4.34
Owner's equity (\$ billion)	24.57	27.32	35.47
Return on net assets	13.27%	13.07%	12.24%

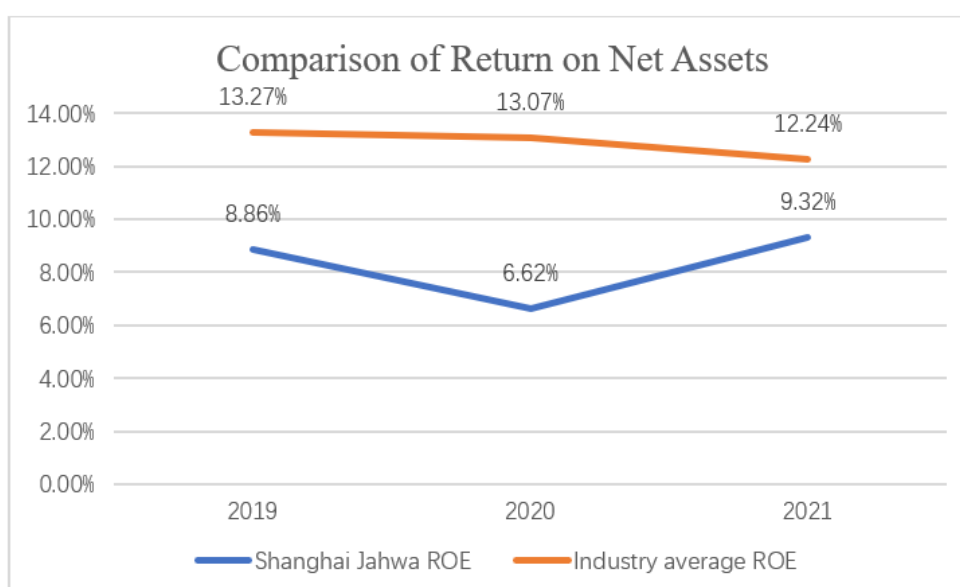


Fig. 2 Shanghai Jahwa vs. industry average return on net assets for 2019 to 2021

As can be seen from the table, in 2020 Shanghai Jahwa was hit hard by the novel coronavirus, with a 2.24% lower NAV compared to 2019 and an industry average of only 0.2%, but most of this was caused by a significant decline in sales in the first quarter of 2020 before the implementation of the new strategy. In the first quarter of 2020, Shanghai Jahwa's total revenue was RMB 1.665 billion, down 14.8% compared to The first quarter of 2019 was down 14.8%; while net profit after deductions was only RMB 130 million, down 19% compared to the first quarter of 2019. It can therefore be seen that the implementation of new strategies and guidelines has allowed Shanghai Jahwa to maintain a more appropriate range of NPAT for the subsequent year 2020.

However, the advantages of Shanghai Jahwa's new strategy are fully realized in 2021. Firstly, in 2021, Shanghai Jahwa's actual revenue reached 7.65 billion yuan, an increase of 8.73% compared to 2019, the highest growth in recent years. At the same time, Shanghai Jahwa's net profit was RMB 649 million, an increase of 50.92% compared to 2019, which shows that Shanghai Jahwa also tightened its expenses quite a bit, thus resulting in a huge increase in net profit. On top of this, Shanghai Jahwa's net profit after deductions was RMB 676 million, an increase of 70.76% compared to 2019, which also reached the highest level in recent years. Turning to cash flow, Shanghai Jahwa's operating cash flow increased significantly by 54.34% to RMB 993 million compared to 2019. Finally, in terms of return on net assets, while the average Chinese beauty and cosmetics brand industry continued to be hit by the novel coronavirus, with a 0.83% decline in return on net assets, Shanghai

Jahwa's return on net assets increased by 2.7%, significantly improving profitability and converging to the industry average.

It is clear that as Shanghai Jahwa broadens its strategy to look at the industry as a whole, at society and at almost all stakeholders, its own profitability will also increase significantly.

As an example, Shanghai Jahwa has established a climate change management system, organised a climate change management structure, identified climate change risks and developed a climate change strategy to help achieve the country's dual carbon goal: reducing the carbon footprint of its products and setting climate change targets and performance. With detailed strategies and guidelines, Shanghai Jahwa has not only reduced its greenhouse gas emissions, but also reduced many expenses and costs.

It can be seen that the strategy of maximizing the interests of Shanghai Jahwa's stakeholders has positively contributed to the development of Shanghai Jahwa, helping it to achieve its goal of sustainable development and reducing the negative impact of the novel coronavirus.

1.2 Social responsibility

During the novel coronavirus, a number of issues such as shortage of supplies and inadequate funding became a sore point for the community. Although the State made financial allocations, the impact of the New Crown novel coronavirus was far greater than people could have imagined and the State's efforts alone were not enough. As a result, many companies have been brave enough to take on social responsibility and do their best to help the country through the difficulties. Shanghai Jahwa is one of them.

In addition to the public welfare projects conducted by Shanghai Jahwa before the novel coronavirus, Shanghai Jahwa donated a total of over RMB4 million in cash and materials to support the country's fight against the novel coronavirus; and through the China Youth Development Foundation, Shanghai Jahwa donated nearly 7,000 pieces of anti-bacterial shower gel, anti-bacterial soap and other daily necessities to four schools in Qinghai Province with a total of more than 3,000 students, helping to protect the local novel coronavirus and prevent and treat buntings. The donation helped to improve the hygiene environment for teachers and students. [1]

The New Crown novel coronavirus shows that Shanghai Jahwa is a company with a sense of national responsibility, and it is for this reason that Shanghai Jahwa has been trusted by consumers for many years.

2. Business activities category

2.1 Sales operations

2.1.1 Impact of the new crown novel coronavirus on the offline brick-and-mortar economy and retail sector

The new crown novel coronavirus sweeping China in late 2019 and early 2020 has led to a huge blow to the offline brick-and-mortar economy and retail sector, facing huge challenges and even attracting the attention of the state.

According to statistics, in the first quarter of 2020, the offline retail sector suffered an estimated economic loss of \$300 million. During the novel coronavirus, the country's offline retail sector has not only seen a general decline in offline customers, but also a hindrance in the flow of capital. [2]

Firstly, the offline brick-and-mortar economy was hit by e-commerce even before the outbreak. E-commerce took over a large market with better deals, convenience and variety, attracting most of the traffic. As a result, the offline brick-and-mortar economy had less traffic and users were unstable. Moreover, the operating costs of the offline brick-and-mortar economy are too high, with brick-and-mortar shops requiring both higher rents and excessive human resource costs. As a result, the operating costs of the offline brick-and-mortar economy are much higher than those of the e-

commerce economy. In addition, the offline brick-and-mortar economy is limited in the services it can offer and some are less professional than e-commerce.

However, the sudden outbreak of the novel coronavirus has certainly added fuel to the fire for the offline brick-and-mortar economy and retail sector. As a result of the outbreak, centralised quarantines and home quarantines were commonplace and consumers had to be restricted in their scope of movement and were unable to go out and spend money. In addition, shopping outside is a congregational activity and many safety conscious people would not gather to shop even if the novel coronavirus had not spread in the city. In the novel coronavirus environment, the e-commerce economy did not suffer a major impact and even saw an increase in sales as most of the offline brick and mortar traffic moved online. This shows that the e-commerce economy is more resilient to the risks of the novel coronavirus, which is a key factor in maintaining sustainable business growth.

During the novel coronavirus, the structure of consumer demand for goods has changed significantly, particularly in the near-field sector and in the medium- and far-field sector. The near-field format refers to convenience stores, supermarkets and traditional retail formats in the community, close to urban areas or residential areas, while the far-field format usually refers to large commercial shopping centres, department stores, supermarkets or large specialist retail outlets for mothers and babies, generally in commercial areas and at a certain distance from residential areas.

The near-field businesses, which deal in essential goods that are essential to consumers' daily lives, were not only less affected by the novel coronavirus, but also saw an increase in business conditions compared to the pre-novel coronavirus period when consumers were limited in their range of activities, and were largely unaffected. The impact of the novel coronavirus was more pronounced in the far-flung sector, where consumers were not only unable to shop due to the restricted range of activities, but also because the far-flung sector did not deal with essential goods and was not very necessary. As a result, sales in the far-flung sector took a bigger hit than before the novel coronavirus.

2.1.2 The impact on Shanghai Jahwa and its response (comparative analysis with Proya)

On 16 January 2020, the former chairman of Shanghai Jahwa, Ge Wenyaoyao, released a microblog saying that the market value of Proya's shares exceeded that of Shanghai Jahwa. It is clear that Proya is a strong competitor for Shanghai Jahwa, so I have chosen to compare Proya with Shanghai Jahwa for analysis.

The first analysis is made from the sales model of Shanghai Jahwa, which uses a combination of online and offline sales.

On the offline front, Shanghai Jahwa's offline channels mainly include commercial supermarkets, department stores, cosmetic franchise shops and mom-and-pop shops, etc. Most of these offline channels are operated through a combination of distributor and self-operated models. [3] By the end of 2019, Shanghai Jahwa had nearly 200,000 commercial supermarket shops, nearly 90,000 rural outlets covered by rural direct sales vehicles, nearly 1,500 department stores, about 13,000 cosmetics franchise shops, nearly 6,000 mom-and-pop shops, etc. [4]

On the online front, Shanghai Jahwa's online channels are mainly e-commerce and special channels. The e-commerce channel is operated in partnership with excellent third parties to enhance the capabilities of its own team, drive brand awareness and convert purchases, while the special channel is used to enhance channel and customer penetration through wave marketing, live streaming and training, thereby achieving rapid business growth.

Table 5. Basic information on the Company's main business by sales channel in 2019 by Shanghai Jahwa

Sales channels	Operating income	Increase or decrease in operating income over the previous year (%)
Online	2,582,828,700.00	30.01
Offline	5,008,031,200.00	-2.62

The table of basic information of the Company's main business by sales channel in 2019 also shows that Shanghai Jahwa's online operating income is only 50% of its offline operating income, and the income from offline sales is much larger than that from online sales. It is obvious that Shanghai Jahwa has put its sales centre on offline sales, while the online sales channel has not been fully developed and the online operating income is relatively small. However, online operating revenue grew at a faster rate, with Shanghai Jahwa's online operating revenue increasing by 30% compared to 2018.

Looking at Proya, Proya has also adopted a sales model that combines offline and online channels.

Proya's offline channels are currently operated through distributors, mainly in the form of supermarkets, cosmetic shops and single-brand shops, similar to Shanghai Jahwa; online channels are mainly operated through distribution and direct operation. The main channels are Taobao, Tmall, Jingdong, Vipshop, Jindoduo and Yunji, which are more abundant than Shanghai Jahwa.

Table 6. Basic information on the Company's principal activities by sales channel in 2019 for Proya

Sales channels	Operating income	Increase or decrease in operating income over the previous year (%)
Online	1,654,545,644.57	60.97
Offline	1,461,907,997.06	9.82

As can be seen from the table above, Perlaiya's online operating income is basically the same as its offline operating income, with online operating income being approximately RMB200 million higher than offline operating income. It can be seen that the development of Proya's online and offline channels is more balanced, with a focus on online sales, and the growth rate of Proya's online operating revenue is much higher than that of Shanghai Jahwa, reaching 60.97% in 2019 alone. Therefore, it can be inferred that there are areas where Shanghai Jahwa's online business model can be enhanced.

After the above analysis, the impact of the New Crown novel coronavirus on the offline real economy is huge, so I will analyse the impact of the New Crown novel coronavirus on Shanghai Jahwa's operating income in 2020.

As the outbreak broke out at the end of 2019, Shanghai Jahwa has reacted quickly to this in the beginning of 2020. Shanghai Jahwa has improved its offline channels. Shanghai Jahwa has improved its offline channel sales by increasing the share of new retail in offline and empowering the entire organisation by implementing new retail.

At the same time, in 2020, Shanghai Jahwa also conducted in-depth reflection and analysis on the design of its own channel strategy based on the changing trends of the overall consumer environment and the behavioural trends and changing conditions of the end-shopper group, and made appropriate adjustments to a certain extent on this basis; identified opportunities for category development in the industry, a typical example of which is Jia'an below; gradually reduced the long-tail products in existing products to increase production capacity.

As a result, Shanghai Jahwa has resolutely shut down and transferred some of its sub-channels whose profitability has dropped significantly: strategic shop closures and downsizing were carried out for the department store channel, with a total of 462 low-unit-production counters and shops closed in 2020, bringing the total number of existing counters and shops to 977 at the end of the year. It is evident that Shanghai Jahwa stopped its losses in time and did not put all its eggs into offline sales, but switched to online sales in time.

During an novel coronavirus disinfection and sterilisation become an essential part of people's daily lives and the importance of personal care and household cleaning products is magnified. Beauty products and skin care products may not be necessary, but anti-bacterial laundry detergent and hand sanitizer have become essential products. As a result, Shanghai Jahwa Group's brand Home Security has launched a number of professional anti-bacterial and anti-bacterial products to help millions of

families fight the risk of the novel coronavirus, and its brand sales have grown by almost double digits. Before the novel coronavirus, Jia'an was just an obscure brand under Shanghai Jahwa, but with the new novel coronavirus norm, Jia'an, which focuses on personal care and household cleanliness, emerged as part of Shanghai Jahwa's core competencies. Shanghai Jahwa also realised this in time and invested more money in Jia'an.

Although the domestic business has been more restricted, Shanghai Jahwa has relied on its overseas business to generate some revenue, such as the rapid growth in sales of its overseas business through e-commerce sales of Shanghai Jahwa's brand Thomexin. Tomaxin is mainly responsible for the mother and baby business, which has been hit very hard by the novel coronavirus abroad, with a severe supply chain shortage and mother and baby products being a necessity for some families. As a result, Tommiesing's sales will see higher growth in the foreign business area. The importance of the current e-commerce and online channels for the development of Shanghai Jahwa can also be seen in this.

Table 7. Basic information on the Company's main business by sales channel in Shanghai Jahwa 2020

Sales channels	Operating income	Increase or decrease in operating income over the previous year (%)
Online	2,976,395,500.00	15.24
Offline	4,051,847,400.00	-19.09

Although Shanghai Jahwa has made greater strategic adjustments in response to the novel coronavirus, actively changing the offline channel business model, but under the impact of the novel coronavirus offline channel operating income compared to 2019 still decreased by 19.09%, a large decline, the amount of decline, it is clear that under the impact of the novel coronavirus, the far field business has suffered a huge impact.

However, the table also shows that Shanghai Jahwa's online sales were not affected by the novel coronavirus and grew at a steady rate, gradually becoming the mainstay of Shanghai Jahwa's efforts to maintain higher operating income.

Table 8. Basic information on the Company's principal activities by sales channel in 2020 for Proya

Sales channels	Operating income	Increase or decrease in operating income over the previous year (%)
Online	2,624,020,700.00	58.59
Offline	1,123,903,900.00	-23.12

Contacting Proya's basic table of the company's main business by sales channel in 2020 shows that online sales are not affected by the novel coronavirus, on the contrary, the growth rate is very fast. The growth rate of Proya's online sales is still high in absolute terms, although it is lower than in 2019. However, it can also be seen that the offline real economy, offline retail, was really hit hard by the novel coronavirus. In 2019, Proya still had a 9.82% increase in offline operating income, and in 2020 it fell dramatically by 23.12%, which shows how hard the offline real economy was hit.

2.2 Funding activities

In the face of the novel coronavirus, Pan Qiusheng decided to subtract on one side and add on the other in terms of capital activities. Subtractions were made to reduce the operating costs of the company, and additions were made to strengthen the competitiveness of the company.

In particular, due to the impact of the novel coronavirus beauty and daily chemical industry sales are affected by the decline, resulting in a decline in total operating income. If Shanghai Jahwa wants

to maintain a certain net profit, then reducing the cost category is a quicker and simpler way to do so. In terms of subtraction, Shanghai Jahwa focused on reducing expenses, so in 2020 Shanghai Jahwa tried to reduce both selling expenses and administrative expenses with great success. And in 2020, Shanghai Jahwa strategically reduced its R&D expenses to combat risk, and then increased them in 2021.

2.2.1 Reducing selling and administrative expenses

Table 9. Shanghai Jahwa selling expenses versus industry average from 2017 to 2021

Unit: billion	2017	2018	2019	2020	2021
Shanghai Jahwa	27.78	29.01	32.04	26.38	29.47
Industry average	8.57	10.07	12.11	12.6	16.46

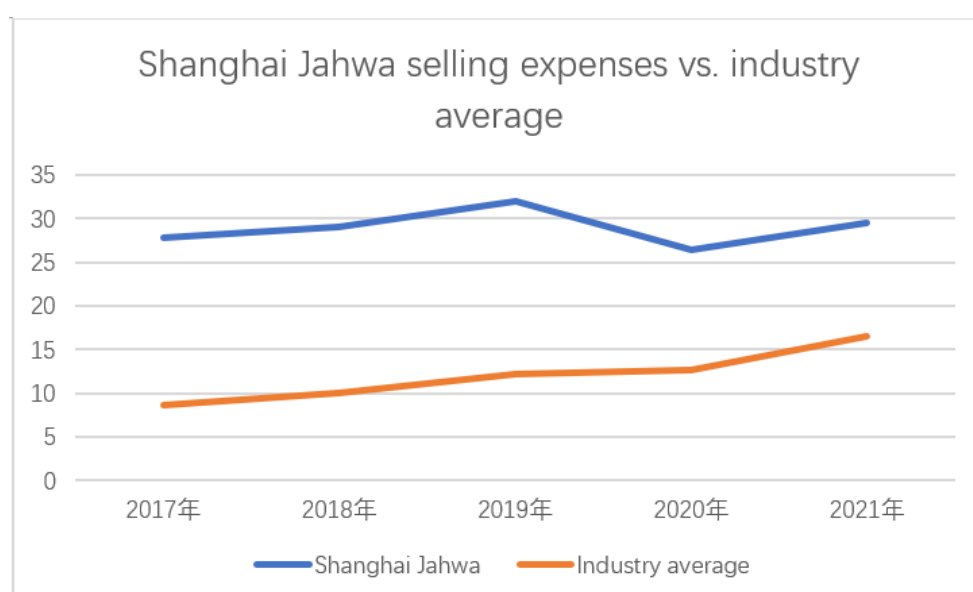


Fig. 3 Shanghai Jahwa selling expenses versus industry average from 2017 to 2021

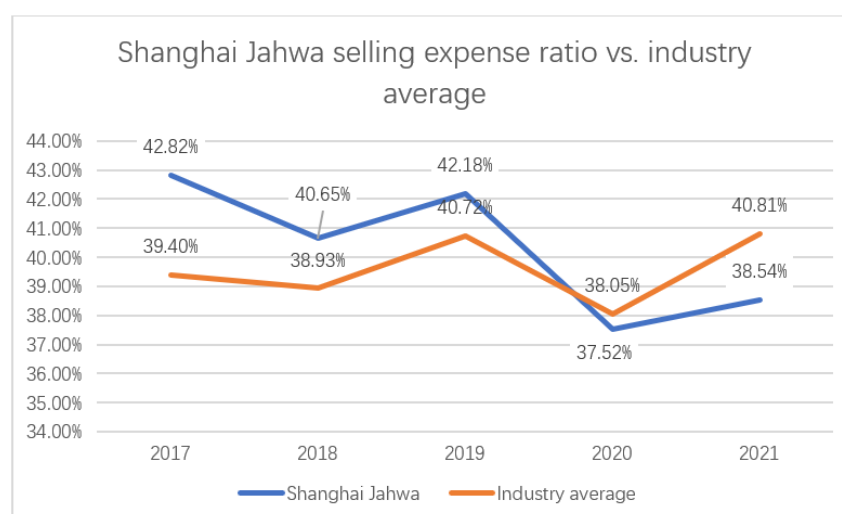


Fig. 4 Shanghai Jahwa selling expense ratio versus industry average from 2017 to 2021

As there are many brands under Shanghai Jahwa, each of them requires high sales expenses, and Shanghai Jahwa attaches great importance to the sales process. Especially since the time of Chairman Xie Wenjian, Shanghai Jahwa's culture of emphasising marketing over R&D has continued. This,

coupled with the fact that Shanghai Jahwa's scale of operation is large and its total revenue is approximately three times the industry average, means that Shanghai Jahwa's sales expenses are understandably much higher than the industry average, with higher sales expenses often leading to larger sales, which are often proportional.

However, Shanghai Jahwa's sales costs are clearly too high and its total revenue is not as high as it should be due to the impact of the novel coronavirus. The marginal effect of marketing campaigns was diminishing, and excluding the impact of the Black Swan incident, Shanghai Jahwa was also in such a state that it was urgent to reduce its sales expenses. Immediately after taking office, Chairman Pan Qiusheng started to reduce the company's marketing expenses from all aspects.

In 2019, selling expenses rose by 10% and operating income rose by 6.4%, the increase in selling expenses was significantly greater than the increase in operating income, the selling expense ratio was 42.18%, the conversion efficiency of selling expenses was low; in 2020, selling expenses fell by 8.7% and total operating income fell by 7.4%, the decrease in selling expenses was significantly greater than the decrease in total operating income, the With a selling expense ratio of 38.54%, the conversion rate of selling expenses was high. The normal retailer's selling expense ratio is around 30%, and Shanghai Jahwa is gradually buying its way from a high selling expense ratio to a normal level. The graph also shows that by 2020, Shanghai Jahwa's selling expense ratio will already be below the industry average.

It can be seen that although Shanghai Jahwa has reduced the amount of sales expenses, it has used them in more effective ways, such as the transformation of online marketing channels. Sales costs are very important to companies and there is nothing wrong with investing a larger amount, but at the same time companies should also pay full attention to the sales cost rate. If the total revenue does not rise higher even after investing a larger amount of sales costs, then companies should consider whether the capital is invested in the wrong direction.

Table 10. Shanghai Jahwa overheads versus industry average from 2017 to 2021

Unit: billion	2017	2018	2019	2020	2021
Shanghai Jahwa	8.51	8.83	9.42	7.21	7.91
Industry average	2.12	2.34	2.52	2.24	2.72

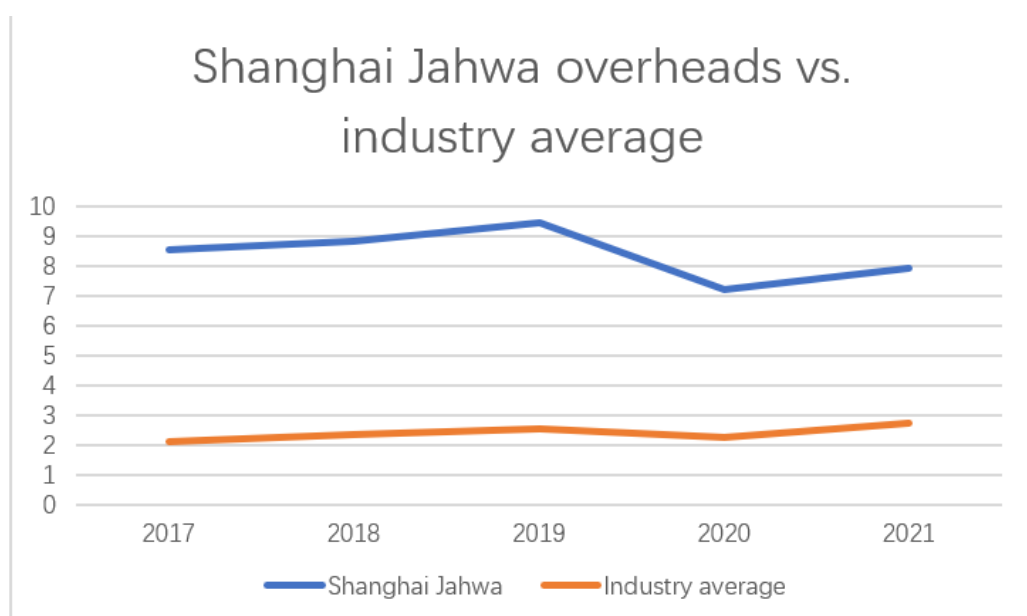


Fig. 5 Shanghai Jahwa overheads versus industry average from 2017 to 2021

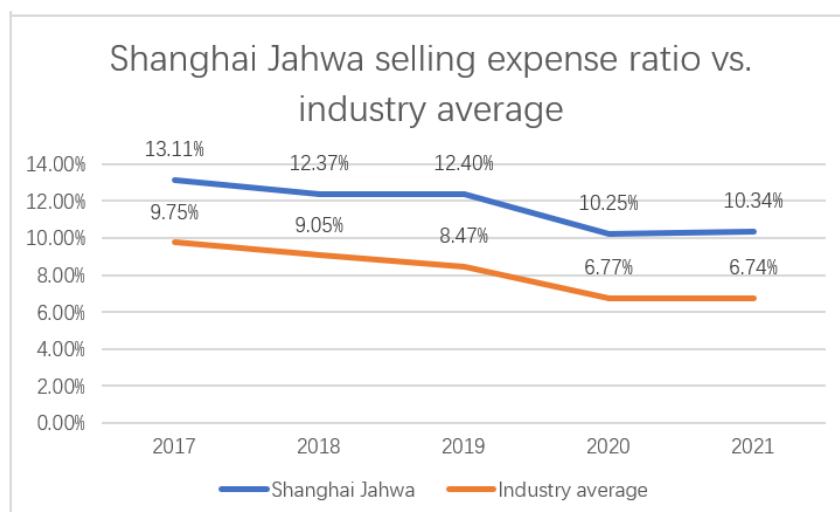


Fig. 6 Shanghai Jahwa overhead rate versus industry average from 2017 to 2021



Fig. 7 Breakdown of administrative expenses incurred by Shanghai Jahwa in 2020

Overall, the difference between Shanghai Jahwa's overhead expenses and the industry average is relatively flat, as the overhead line items are all relatively fixed. Given that Shanghai's scale of operations is much larger than the industry average, it can be inferred that Shanghai Jahwa's overhead expenses are more reasonable. However, compared to the industry average overheads, Shanghai Jahwa has a vastly superior control over overheads. While there was a small increase of 6.6% in 2019, in 2020, overhead expenses decreased by approximately 23.5%. In other words, while Shanghai Jahwa's total operating revenue is nearly three times the industry average, overheads are only about less than two times the industry average. The main reason for the significant decline in administrative expenses was the year-on-year decline in expenses such as salaries and benefits. Since salaries and benefits are a major part of administrative expenses, then reducing salaries and benefits effectively reduces administrative expenses, which is a more effective approach used by many companies.

The management expense ratio of good companies is basically maintained at around 10%. Like the sales expense, Shanghai Jahwa's management expense ratio is also approaching 10%, especially in 2020, and it is not easy to reach the lowest ever sales expense ratio of 10.25% by reducing the sales expense in the face of the novel coronavirus.

In terms of selling and administrative expenses combined, it is worth learning that Shanghai Jahwa was able to reduce its selling and administrative expenses in time to maintain a high net profit in the

novel coronavirus environment. Shanghai Jahwa also achieved the first double reduction in selling and administrative expenses in 2020.

2.2.2 Strategic reduction in R&D costs in 2020 to face novel coronavirus risks and increase in R&D costs in 2021 to improve Core competencies

Table 11. Shanghai Jahwa R&D expenses versus industry average from 2017 to 2021

Unit: billion	2017	2018	2019	2020	2021
Shanghai Jahwa	1.53	1.5	1.73	1.44	1.63
Industry average	0.54	0.6	0.71	0.69	0.84

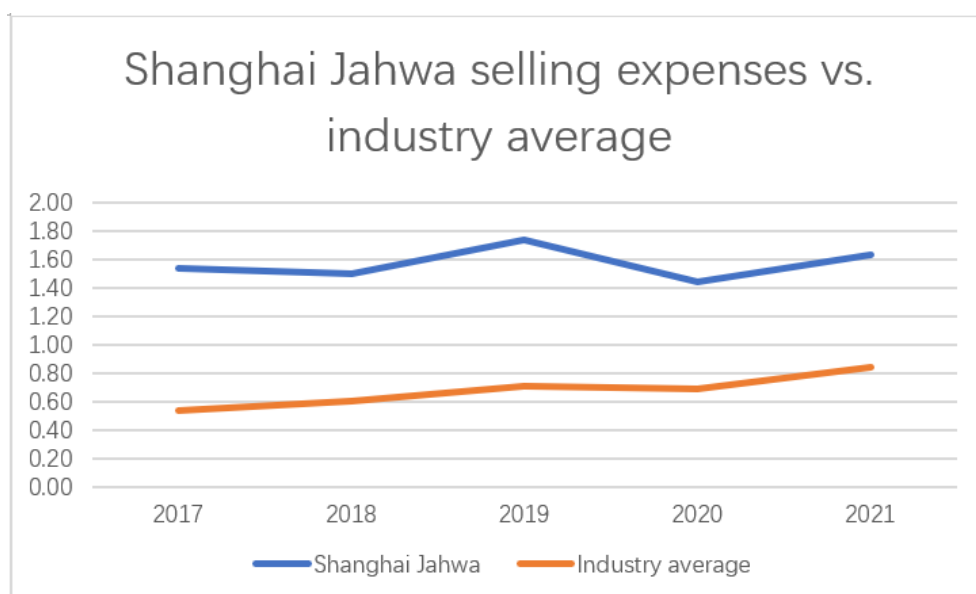


Fig. 8 Shanghai Jahwa R&D expenses versus industry average from 2017 to 2021

Shanghai Jahwa's R&D expenditure is much greater than the industry average, about 2.5 times higher than the industry average, which shows how much it invests in R&D. Of course, Shanghai Jahwa has also achieved considerable R&D results.

It is due to Shanghai Jahwa's high investment in research and development that it has not only gained a leading position in the industry, but also received no less government subsidies. As an example, in 2021, Shanghai Jahwa set up a special group to participate in the development of 5 national or industry standards and participated in the release or development of 19 group or local standards, an increase of 280% year-on-year. From this, we can see that Shanghai Jahwa, as a long-established beauty and daily chemical company, has a strong influence on the industry. Shanghai Jahwa was repeatedly awarded the "National Intellectual Property Advantage Enterprise" project and other awards, which resulted in a high level of government subsidies.

In 2020, Shanghai Jahwa had to reduce its R&D expenses by 16.5% to counter the risk due to the impact of the novel coronavirus. In line with administrative expenses, the reduction in R&D expenses relied heavily on the year-on-year decrease in salary and benefits and research project expenses. Compared to 2019, expenses in the salary and benefits category fell by \$8,781,649.04 and research project expenses shrank by \$89,122,213.68. However, it is easy to see from Pan Qiusheng's actions that reducing R&D expenses is only a momentary move by Shanghai Jahwa to weather the novel coronavirus. For Shanghai Jahwa, R&D is the foundation of the company, and only new technologies and products can bring new vitality to the company.

Table 12. Breakdown of Shanghai Jahwa's R&D projects in 2021

Subjects	Amount
Expensed R&D investment for the period	144,274,796.69
Capitalised R&D investment for the period	6,818,222.10
Total R&D investment	151,093,018.79
Total R&D investment as a percentage of operating revenue (%)	2.15
Number of company R&D staff	210
Number of R&D staff as a percentage of total company headcount (%)	3.82
Share of R&D investment capitalised (%)	4.51

(Breakdown of Shanghai Jahwa's R&D projects in 2020)

Subjects	Amount
Expensed R&D investment for the period	163,127,112.92
Capitalised R&D investment for the period	10,178,599.39
Total R&D investment	173,305,712.31
Total R&D investment as a percentage of operating revenue (%)	2.27
Number of company R&D staff	5.8
Number of R&D staff as a percentage of total company headcount (%)	3.84
Share of R&D investment capitalised (%)	5.87

The current beauty and cosmetics industry is extremely competitive, with many new brands emerging, and Shanghai Jahwa has repeatedly raised this risk in its risk identification process. As a result, Shanghai Jahwa has significantly increased its R&D expenses to improve its core competencies as soon as the novel coronavirus prevention and control process is well established. Compared to 2020, Shanghai Jahwa has increased its investment in research and development expenses by 13.07%, which can be considered a rather high amount.

Of course, Shanghai Jahwa did not just increase its expenses without output, as the breakdown of R&D projects shows that in 2021, Shanghai Jahwa's share of capitalised R&D investment increased by 1.36%, bearing in mind that most companies in the beauty and cosmetics industry may have a capitalised share close to zero in some years.

In 2021, Shanghai Jahwa filed 82 new patent applications, an increase of 68% compared to 2020, and published 21 papers in leading industry journals. As at the end of the reporting period in 2021, Shanghai Jahwa had 374 granted patents in force.

3. Risk assessment

Firstly, I will give an overall assessment of the state of Shanghai Jahwa's risk assessment process. The risk assessment process is goal setting, risk identification, risk analysis, risk response and finally an evaluation of the whole process for improvement.

Goal setting is naturally the growth strategy of the company, and the proper management of risks allows the growth strategy to be realised. The development strategy of Shanghai Jahwa has been described in detail above and will not be repeated here.

In terms of risk identification, Shanghai Jahwa discloses the risks it may face in its annual report every year. For example, at the end of 2019, Shanghai Jahwa has already anticipated the arrival of the new crown novel coronavirus and thus prepared for it. From 2020 onwards, Shanghai Jahwa will make better disclosure of risks, identifying risks at various levels, such as engineering management, asset management, R&D management, etc.

In terms of risk analysis, Shanghai Jahwa organises internal meetings to analyse risks and formulate risk response measures accordingly, but the results of the analysis are not disclosed in the statements.

In terms of risk response, although Shanghai Jahwa did not disclose risk response measures in its financial statements prior to 2020, the financial statements of Shanghai Jahwa for the following year give a vague indication of what Shanghai Jahwa has done in response to risks. From 2020 onwards, Shanghai Jahwa discloses its risk response measures in its annual report.

3.1 Identifying risks at the end of 2019

At the end of 2019, Shanghai Jahwa identified four possible risks that it could face in 2020.

Table 13. Shanghai Jahwa 2019 Identification of Potential Risks and Countermeasures

Potential risks	Response
Progress in creating a star product has not met expectations	Shanghai Jahwa needs to increase its investment in the marketing of its star single product, strengthen the promotion and marketing of the product, stop investing and choose other single products for promotion and marketing when necessary.
Risk of channel transformation, slowdown in offline growth, rapid iteration of online traffic and marketing methods	Shanghai Jahwa will adjust its channel layout in line with the new channel structure and development trend, consolidating and strengthening its existing channel advantages on the one hand, and seizing the potential of cosmetics franchise shops and online opportunities for rapid development on the other, so as to expand into new channels and regions.
Intensified competition from high-end foreign brands and new local brands that continue to increase their investment	Shanghai Jahwa needs to maintain and enhance its strengths in various brands and implement a differentiated brand strategy; focus on Chinese cultural elements and apply them to various products; expand the target customer segment, grasp the high-end, young and segmented consumption trends and continue product innovation; and focus on "digital empowerment and quality marketing We will continue to promote the development of our brand around "digital empowerment and quality marketing".
Uncertainty over the impact of the Newcastle pneumonia outbreak on operations	It is expected that the New Crown novel coronavirus and the preventive and control measures will have a certain temporary impact on the production and operation of Shanghai Jahwa. Shanghai Jahwa will continue to closely monitor the situation of the New Crown novel coronavirus and actively respond to the adverse impact of the New Crown novel coronavirus on the financial position and operating results of Shanghai Jahwa. Shanghai Jahwa will also close its offline shops as appropriate and reduce its cooperation with department stores and hypermarkets.

[5] In 2018 and before Shanghai Jahwa will disclose in its annual reports the risks it may face and the measures to address them, so although the response measures in the table above are not disclosed by Shanghai Jahwa, it is possible to draw on previous years' annual reports to observe the measures taken by Shanghai Jahwa to address the risks. On this basis I have also drawn on the measures taken

by Proya in response to similar risks and the specific measures undertaken by Shanghai Jahwa in 2020 to make a broad guess as to what Shanghai Jahwa will do in response to the risks.

Shanghai Jahwa identified the risk posed by the new crown novel coronavirus at the end of 2019 and therefore from the end of 2019 Shanghai Jahwa has set out to hedge that risk as much as possible. The department store channel was strategically closed and downsized, with a total of 462 low unit production counters and shops closed in 2020, with a total of 977 counters and shops existing at the end of the year, far fewer than the number in 2019. It is evident that Shanghai Jahwa not only has a very good identification of risks, but also can implement effective measures to avoid risks and reduce the impact of risks on the company's operations. Many companies have also identified the risk of the new crown novel coronavirus and designed measures to address it but have not implemented them effectively, so Shanghai Jahwa's execution is also commendable.

3.2 Identifying risks at the end of 2020

In the general environment of the normalisation of the novel coronavirus, in order to further strengthen the company's risk prevention capability and improve the corporate governance system, Shanghai Jahwa renamed the Audit Committee of the Board of Directors as the Audit and Risk Management Committee of the Board of Directors in 2021.

In the Audit and Risk Management Committee consists of three independent directors and one director. As the independent directors do not hold positions in the company other than as directors and are unlikely to be hindered from exercising independent and objective judgement by the major shareholders of Shanghai Jahwa and Shanghai Jahwa with whom they are employed, it can be said that the independent directors can be accountable to the listed company and all shareholders and that the conclusions reached by the Audit and Risk Management Committee are neutral and impartial and the possibility of fraud in the review process is very low.

I will analyse selected items from the risks identified by Shanghai Jahwa 2020 in relation to the outbreak.

Table 14. Shanghai Jahwa 2020 Identification of Potential Risks and Countermeasures

Potential risks	Response
The risk of the company operating new businesses and channels if the corresponding management system is not established in a timely manner, which may have an impact on the company's operation	Shanghai Jahwa will formulate process specifications for the live broadcast business at the beginning of its launch, regulating the requirements including contract signing, commission approval and financial review; Shanghai Jahwa has formulated the "Guidelines for the Selection of Daredevils" system for the Daredevil cooperation business on the Jitterbug platform, with relevant regulations on the selection of daredevils and the approval process of commission ratio, in order to achieve the purpose of risk prevention and control. At the same time, Shanghai Jahwa will monitor and control the new risk points brought about by operating new businesses and channels through regular audits, self-inspection and self-correction, external audits and other coverage methods.
Uncertainty over the impact of the Newcastle pneumonia outbreak on operations	Shanghai Jahwa will improve its sustainability and risk resistance, further improve its online sales channels and operate new businesses. At the same time, Shanghai Jahwa will pay close attention to its financial situation and be fully prepared for the normalisation of the novel coronavirus.

The risks identified by Shanghai Jahwa at the end of 2020 show that it has not only prepared countermeasures against the uncertain impact of the new crown novel coronavirus on its operations,

but has also made corresponding countermeasures to optimise marketing channels for operating new businesses, which can be considered more comprehensive.

4. Summary

In general, Shanghai Jahwa has a strong ability to cope with risks, both in the sense that it can accurately identify risks before they come, and in the sense that it can formulate more detailed countermeasures after analysing the risks, and in the sense that it implements the countermeasures formulated with a high degree of execution. As a result, in the face of the novel coronavirus, Shanghai Jahwa's profitability has grown against the industry average, and the capital market has praised this.

The analysis of the beauty and cosmetics industry and Proya also shows that most of the companies in the industry have adjusted their internal controls to achieve the goal of profit maximization under the normalization of the novel coronavirus prevention and control. What's more, the adjustment of internal control for companies is necessary because the analysis shows that the novel coronavirus is a very big blow to the economy so it is very necessary to change internal control measures when the external environment is not controllable. It is believed that the net profit of the beauty and daily chemical industry is still maintaining a good profit despite the normalization of the epidemic, and there is a part of the reason for this.

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