

Starting from a Cottage, One Will Succeed in Ten Thousand Bones, Pleading Guilty to the Thorn, Huigen has Already Repaired the Golden Body

-- Analysis based on the Case of Ruixing Bottoming Out and Rebounding

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Abstract

In recent years, financial fraud incidents in the capital market have occurred frequently. Among them, not only the "Shuangkang incident" that caused a sensation in the Chinese capital market, but also the counterfeiting incident of Ruixing Coffee, a Chinese concept stock that caused a sensation in the US capital market. While the fraudulent amount of 2.2 billion yuan exploded, it also sounded the alarm for all listed companies. In the face of major risks and setbacks, and facing a market that is also full of uncertainties, Ruixing quickly took the blame, adjusted its strategy and recharged, and bottomed out after going through the trough. For this reason, this article conducts an in-depth analysis and research on the case of Ruixing's financial fraud after bottoming out, and analyzes Ruixing's defects in handling financial issues from the aspects of financial compliance, financial management, strategic accounting, and corporate governance. Provide corresponding reference and reference for other listed companies in my country in dealing with financial aspects. This article first analyzes the status of Ruixing Company and the case study of financial fraud to provide a background basis for the following analysis, and then analyzes the internal reasons of the company and the external environmental factors of the overseas market that caused Ruixing's financial fraud from the perspective of financial compliance, and finally combines the above reasons Carry out corresponding suggestions and countermeasures for financial compliance in the process of overseas listing of Chinese companies; then from the perspective of financial management, combine financial management theory with Ruixing's solution to bottoming out and rebound, and finally come up with relevant responses from regulatory agencies, creditor's rights, and shareholders Measures; From the perspective of strategic management accounting, first compare with Starbucks' five-force model, and draw the corresponding measures taken by Ruixing in terms of market analysis and departmental cooperation; Deal with the demands of internal contention, and then provide corresponding policy recommendations from four aspects.

Keywords

Financial Fraud; Financial Compliance; Financial Strategy.

1. Scattered Flowers Gradually Become Charming Eyes--Case Introduction

1.1. Company Profile

1.1.1. Shareholder Structure

The "Shenzhou Department" occupies a dominant position in Ruixing Coffee: Lu Zhengyao and Qian Zhiya, who have worked together for decades in UCAR, hold 30.53% and 19.69% of Ruixing Coffee's shares respectively, and Lu Zhengyao's sister Wang Suying holds 9.72%. Therefore, the Shenzhou Department owns more than 60% of the shares. The remaining 18.65% is in the hands of the Shenzhou family.

1.1.2. Development Trend

Shenzhou Chairman Lu Zhengyao led his own army to start the uprising, forming an "iron triangle of combat", and introduced foreign aid Li Hui (founder of Centurium Capital) and Liu Erhai (founder of Joy Capital) to form an "iron logistics triangle". The luxurious lineup laid the foundation for Ruixing's early visionary business form and strategy. In June 2018, Luckin received Series A financing from Centurium Capital and Joy Capital. But in fact, a year ago, Li Hui and Lu Zhengyao were planning the Ruixing project, and this time it was justifiably entered the game. After gathering grain and supplementing ammunition, Ruixing Coffee began to accelerate financing and expansion. Rui Xing thus broke the circle and became famous everywhere.

1.2. Financial Fraud Incidents

1.2.1. Exposure of Violations

On January 31, 2020, Muddy Waters, a well-known international short-selling company, released a short-selling report, claiming that Ruixing Coffee had inflated its income and expenses in some financial statements in 2019, which was fraudulent, and its business model had serious flaws. On July 31, China's Ministry of Finance audited the quality of its domestic business department's accounting data, and announced on its website that Luckin had carried out financial fraud by fictitious commodity income and other means. On December 16, the US Securities and Exchange Commission (SEC) filed a complaint against Ruixing Coffee. The SEC alleges that Luckin Coffee previously misled investors by misreporting the company's revenue, expenses and net operating loss. Luckin Coffee agreed to pay a \$180 million fine to resolve SEC charges.

1.2.2. Means of Financial Fraud

From the perspective of the average daily sales volume of a single store, according to the official data released by Ruixing Coffee, the average daily sales volume of a single store in the fourth quarter of 2019 is expected to be 495 cups. However, the actual calculation from Muddy Water's tracking survey is only 263 cups, and the difference between the two is huge. This means that Luckin Coffee's sales in the third and fourth quarters of 2019 may have been inflated by at least 69% and 88%, respectively.

2. Eat Your Own Fruit, Adjust Your Strategy and Recharge Your Strength--Fall into a Trough

The fundamental external reason why Ruixing can conduct financial fraud is to take advantage of the differences in the listing access conditions of companies in the Chinese and American markets, and to use some loopholes in the US listing to conduct black-box operations. The following distribution analyzes the external and internal reasons of the US listed market and the internal of the enterprise.

2.1. Multi-view Analysis

2.1.1. External Cause Analysis

Sanctions and costs for violators are very different for listed companies and intermediaries in China and the US. In order to show the counterfeiting sanctions in China and the United States more intuitively, this article makes a horizontal comparison between Luckin Coffee and Kangmei Pharmaceutical, and analyzes the difference in counterfeiting costs between China and the United States. In May 2020, the Securities and Futures Commission (SFC) imposed fraud penalties on Kangmei Pharmaceutical. It found the company falsified bank accounts to boost deposits, falsified work orders to boost sales, and conducted illegal transactions with related parties worth 36.2 billion yuan. Tingyi is one of the most notorious frauds in China in recent years, and since the fraud was discovered and the sanctions imposed relatively close to Rising Coffee, it is useful to draw a comparison.

2.1.2. Internal Cause Analysis

This paper selects the 2022 China Securities Regulatory Commission's corporate announcements issued by listed companies with violations in the violation case database in Wind, and finds that the representative financial violations of listed companies are mainly concentrated in four aspects.

(1) Fraudulent accounting and financial controls

In terms of accounting and financial control, first of all, the recording of income and expenditure is not standardized, and profits are exaggerated, including false reporting of income, early recognition of income, and delayed transfer of expenses. Second, the accounting treatment and presentation of financial report data are inaccurate, including insufficient basis for including subsidiaries in the scope of consolidated financial statements, and inaccurate net calculation of consolidated financial statements.

(2) Insufficient capital and risk management.

In terms of capital and risk management, first, it provides external guarantees in violation of regulations; second, it fails to carry out necessary approval procedures and reporting requirements for external guarantees; third, it obtains non-operating funds from major shareholders or related parties; fourth, it has violations.

(3) Weak corporate governance and internal control

In terms of corporate governance and internal control, first, the rules of procedure of the general meeting of shareholders and special committees of the board of directors are not perfect; second, the operation of the general meeting of shareholders and special committees of the board of directors is not standardized; , non-standard records, non-standard financial management, etc., are defects in the control process.

(4) Flawed information disclosure

In the preparation of public reports outside the company, there are mistakes such as providing false information and concealing real information, or providing wrong information, omitting important information, and delaying important information.

2.2. Financial Compliance

Strengthening financial compliance management is the cornerstone of developing high-quality business. For listed companies, strengthening financial compliance management not only directly affects the market value of listed companies, but also affects the efficiency of modern state-owned enterprise system construction and capital market construction. In view of this, based on the internal and external reasons analyzed above, this paper puts forward four suggestions for listed companies to systematically strengthen financial compliance management:

2.2.1. Understand the Listing Rules

Judging from the listing rules of the NASDAQ market in the United States, the three markets all implement a soft access policy and treat them strictly. The listing requirements for companies are not strict, but once a listed company enters the trading market, management and supervision become the focus. Chinese companies need to understand the trading rules and procedures of the United States, and be familiar with relevant regulatory requirements, so as to avoid being too passive. It is relatively easier to list Chinese stocks in the United States than domestic stocks, but it is necessary to study the relevant laws of the United States and understand the US securities laws.

2.2.2. Optimizing Shareholder Structure

The struggle for power leads to corruption. Without effective oversight and control, power becomes the privilege of interests. A good shareholder structure is key to "balancing" power within the company. Ruixing Coffee's shareholder structure is unbalanced, which tilts the balance, allowing major shareholders to expand their power in the form of "one vote", which eventually corrodes power and makes it a pure profit tool. Therefore, for large listed companies, it is necessary to optimize the company's shareholding structure, rationally divide shares, form a situation where shareholders are interconnected, effectively limit the power of major shareholders, and avoid major shareholders who are "hard to get a vote" like Ruixing Coffee. The phenomenon of using power for personal gain happened again. Care should be taken to avoid this phenomenon. Reduce the possibility of corporate fraud.

2.2.3. Develop Internal Audit

The failure of internal audit has a large impact on a company's ability to protect itself from fraud. Therefore, there is an urgent need to improve the status of internal auditing and improve relevant systems. First, since independence is the key to establishing an internal audit system, the company needs to establish a set of incompatible positions, separate from the operating system, to give internal auditors more power, reduce management intervention, and prevent internal auditors from being controlled by others. On the one hand, this creates a situation where management and internal audit can control and restrict each other, which can effectively limit the abuse of power by management to a certain extent.

2.2.4. Establish Financial System

In response to the dynamic changes in laws and regulations, quickly organize and carry out the integration of major management systems such as accounting, financial reporting, cash management, asset management, collateral management, taxation, and budget management. Compliance standards, standardized implementation, and improved standards. Establish and improve the financial compliance punishment system, clarify the scope of responsibility for financial violations, clarify the principles and standards of punishment, cooperate with internal control and discipline inspection and supervision, and standardize the responsibility for financial violations.

3. Survive Hardships, Buddhas Do not Cross, People Cross by Themselves - Bottoming Out and Rebounding

3.1. Strategy Method

3.1.1. Corporate Governance

According to the report released by Ruixing Coffee, the main reason for financial violations is that the team headed by Liu Jian fabricated sales of about 2.2 billion yuan in the last three quarters of 2019, exaggerated sales performance, and increased costs and expenses. There is no explanation in the financial report released by Luckin Coffee, in most cases, the culprit of

financial irregularities is the management team[1]. Internal controls need to be strengthened. Excessive concentration of equity leads to the lack of independence of the board of directors and the board of supervisors, thus losing the power of supervision and management. Improve the internal control system, actively attract the participation of external professional investors, break the dominance of some directors and executives, and protect the interests of small and medium shareholders. Strengthen the accountability and supervisory responsibilities of the board of directors, supervisory board and management to ensure that financial fraud is not detected.

3.1.2. Auditors

In this financial fraud case, on the second day after Ruixing Coffee was exposed as a fraudulent company, Ernst & Young, one of the four major auditing companies, announced that some transactions of listed companies were false. The committee explained the situation and called for an internal investigation to be launched. Improve the professional ability and moral level of auditors. Auditors have sufficient professional ability and professional ethics. Auditors combine big data technology with audit work to analyze and predict, thereby reducing audit risks and improving the correctness of analysis results. When obtaining audit evidence, the correct method should be adopted to obtain sufficient and appropriate audit evidence to ensure the relevance and reliability of the audit evidence [2].

3.1.3. Accountants

Financial statements are an important source of information for investors of listed companies to understand the company's profit and loss status and predict the company's development capabilities. In the fraud case, the accountants of Rising Company overestimated the advertising expenses in 2019 by more than 150%, and falsified accounting records. At the same time, the accountants of Rising Company compiled financial statements containing seriously inaccurate financial data based on forged original bills and accounting records, which made the financial statements lose their credibility and traceability, and led investors to make wrong decisions and suffer losses. Entities should be punished more severely, uphold the authority of accounting laws, protect accountants, and allow them to exercise management and supervisory powers. The legal responsibility system of the entity should be clarified, the main force of the accounting law should be finally determined, and accountants who violate accounting standards or produce false information should be held accountable first. Accountants who cause serious consequences should be investigated for their legal and criminal responsibilities.

3.2. Theoretical Methods

3.2.1. Financial Fraud Theory

The object of financial fraud violates accounting standards and relevant laws and regulations, and implements false accounting behaviors. The specific behavior refers to financial fraud that undermines the principle of authenticity of financial statements, uses various means to transmit false accounting information to users of financial statements, misleads their judgments, and affects their economic decisions. In practice, this mainly involves falsifying real financial data and falsifying or distorting material accounting facts. According to the classification of financial fraud objects, financial fraud can be divided into two categories: employee fraud and management fraud. Employee fraud refers to the company's accountants forging or manipulating accounting data and preparing false financial statements for personal benefit or the benefit of an external interest community. Management fraud is when a company's management uses its power to conceal or falsify accounting transactions for its own benefit.

3.2.2. Stakeholder Theory

Stakeholders include not only the company's shareholders, creditors and other business partners, but also government agencies, residents and other subjects directly or indirectly affected by the company's activities, such as the natural environment and future generations. These stakeholders are closely related to the survival and development of the company. Some share the company's operating risks, some pay the company's operating costs, and some supervise and control the company. The company's operating decisions must consider their interests or accept their restrictions.

3.3. Combination of Strategy and Theory

3.3.1. Regulators

Strengthen the supervision of listed companies, especially to further clarify the scope, authenticity and legality of their disclosure. Regarding the information disclosure of listed companies, the current legislation is not precise enough and needs to be further developed and deepened. Regulatory departments can elaborate on this aspect according to the actual situation in order to strengthen the supervision of listed companies. Take advantage of the extraterritorial applicability of recently revised securities laws, if necessary. Promote the establishment of common cross-border regulatory arrangements to facilitate the exchange of information. In view of the fact that some companies are listed abroad, the jurisdiction is not clear, the laws and regulations of different countries are not the same, and cross-border supervision is also very complicated. It is necessary for the financial regulatory agencies of various countries to promote information exchange and strengthen cooperation to protect the rights and legitimate interests of investors. Luckin Coffee's listing in the United States is a good example. Its development and listing requires the cooperation of Chinese and American regulators to effectively fulfill their obligations and responsibilities to protect the interests of investors.

3.3.2. Creditors

The rights and interests of creditors must be protected, and social interests must be balanced. The main goal of corporate bankruptcy and reorganization is to realize the overall interests of society. From this perspective, the interests of creditors, debtors and others must be protected. If the interests of creditors cannot be effectively protected, a series of market transactions will occur, which will not only cause economic and legal problems, but also increase the risk of affecting the balance of social interests [3]. Avoid information asymmetry and damage the interests of creditors.

3.3.3. Shareholders

Reform the shareholding structure: Appropriately reduce the proportion of state-owned shares. Most of the major shareholders of listed companies in our country have certain non-tradable shares, but most of the small and medium shareholders have floating shares, which will directly cause the major shareholders of our country to have no way to obtain arbitrary benefits in the stock market. This general situation will directly result in the different interests obtained by various shareholders in our country, and it is easy to generate conflicts of interest. It is necessary for the board of directors to fundamentally represent all types of shareholders and independently perform the functions of governing the company. Establish and improve the performance evaluation system for independent directors [4].

4. Plead Guilty, Repack Your Bags and Start Again--Learn from the Scriptures and Set Off

4.1. Luckin Coffee VS Starbucks

As a newly developed coffee brand, Ruixing has grown faster than people expected. In the face of a market that is also full of uncertainties, Starbucks has shown signs of weakness, while Ruixing has grown rapidly. The following is a relevant analysis from the perspective of strategic management accounting.

4.2. Strategic Management Accounting

Strategic management accounting was proposed by Simmonds in 1982. It is an external-oriented method to supplement the deficiencies of management accounting practice. Highly analytical and reflective to raise awareness of sustainable development. Specifically, it can include market analysis and departmental cooperation [5].

4.2.1. Market Analysis

According to the data of Toubao Research Institute, the freshly ground coffee market will enter a period of acceleration in the next 3-5 years, and China's coffee consumption level will rapidly approach the international level. During Ruixing's year of "cutting down on food and clothing", the overall external market has undergone earth-shaking changes. The new tea and coffee tracks are hot, and more giant capitals are beginning to support their respective coffee brands. The competitive landscape has become more complicated, which is not only the choice of investors and consumers for this big track, but also a challenge for Ruixing itself. After the initial formation of the new tea market structure, more capital has found the potential track of coffee.

(1) Preemptive penetration into sinking markets

In order to maintain the brand potential, Ruixing Coffee and Starbucks have taken two different routes. Starbucks has upgraded its stores, explored high-end products, and created the Zhenxuan series. Unlike Starbucks, which has built a high-end pace, Ruixing Coffee has set its sights on the sinking market. At the same time, in order not to dilute the mid-to-high-end brand image that Ruixing Coffee has formed in the first- and second-tier cities, Ruixing Coffee has launched a new sub-brand-Xiaolu Tea, which undertakes the task of sinking the brand and adopts an innovative franchise method. In order to quickly open up the market and seize business opportunities [6].

(2) Formulate a marketing private domain strategy

After Ruixing's capital was limited, Ruixing gave up the money-burning fission in marketing and continued to use the private domain marketing method after the epidemic. Ruixing's own model is a set of online process and offline contract fulfillment model. It is much easier than many brands to start the road of private domain.

5. The Road Ahead is Long, and the Road is Long and Difficult, and it Still Takes Courage to Overcome Thorns and Thorns

5.1. Policy Recommendations

5.1.1. Limiting the Pay Gap

Studies have shown that the current salary gap for executives of listed companies in China is already too large and is at a psychologically high level. Further widening the gap at this level will only increase the inequality among team members and induce a "negative incentive" effect. In companies with a high likelihood of management fraud, the "negative incentive" effect is more pronounced, not only having a severe impact on company performance, but also leading

to “political intrigue” and actual fraud. Corporate governance should aim at establishing a relatively flat executive compensation system and strive to narrow the pay gap [7].

5.1.2. Analyze Sources of Opportunity

Since increasing compensation incentives to prevent management from taking advantage of fraud opportunities is undesirable, companies should address increased fraud opportunities by strengthening oversight, streamlining governance systems, and improving internal controls. First of all, a comprehensive assessment of the company's fraud risk should be carried out, especially to maintain sufficient vigilance against potential fraud in the governance framework. It is recommended to form a task force or group of independent external experts to conduct a comprehensive and objective assessment of the corporate governance system and internal controls. Based on the results of the assessment, specific measures should be taken in areas with a high potential for fraud. Regarding the potential for fraud in corporate governance, efforts should be made to establish a good corporate governance system to ensure the independence and authority of the board of directors and the board of supervisors; for the potential for fraud in equity, an appropriate concentration of equity should be established to avoid the absence of shareholders. With regard to the possibility of fraudulent holdings, an appropriate concentration of holdings should be established to avoid the absence of shareholders.

5.1.3. Strengthen Equity Incentives

For companies with major opportunities for fraud, the policy of increasing the diffusion of equity incentives can have a very good incentive effect. For these companies, it is best to develop incentive programs, strengthen equity incentives, and widen the incentive gap between core team members and other team members. Since equity-based incentives are long-term in nature and are a "no-fund" incentive, using the incentive gap as a "competition award" can effectively activate the long-term competition mechanism within the team, thereby encouraging managers to work harder, work more willingly. This incentive prevents management from taking advantage of unfair opportunities without increasing control costs.

5.1.4. Choose a Flexible Policy

Policies that widen the pay gap do little to improve business performance for firms with few opportunities for fraud. Likewise, policies that widen the pay gap are inappropriate for firms with high opportunities for governance and shareholder fraud. Only companies with a high potential for fraud in their operations can pursue large pay gap policies. Companies with multiple opportunities for fraud need to choose the appropriate compensation structure policy on a case-by-case basis.

5.1.5. Adjustment of Salary Policy

Faced with more and more possibilities of fraud, the decision makers of China's listed companies have chosen to widen the wage gap and narrow the equity incentive gap in terms of remuneration policies. This complementary policy mix manages to balance incentives in the short and long run, but the incentive effect is actually negative because of the disincentives implemented. As mentioned earlier, keeping the pay gap low and incentives high makes sense given the growing scope for fraud. The combination of the two should continue to cultivate a good team spirit by maintaining a relatively equal base salary, while at the same time stimulating competition among managers through the huge dividends of the company's future development, thereby reducing the possibility of fraud and at the same time achieving the continuation of the company's value increase.

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