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Discuss the Reason Why Luckin Coffee and Wirecard Face Different Market Outcomes Despite Both Engaging in Financial Fraud

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Abstract: Financial fraud is a major challenge in the capital market. This study used case study methods through the collection of market data, the introduction of financial theory, and the collation and analysis of relevant literature to explore why Luckin Coffee and Wirecard both faced financial fraud scandals, but in the end, Luckin Coffee came back to life while Wirecard quickly went bankrupt. The main reason for comparing the companies is that the scandals of the two companies were exposed at a similar time, during the COVID-19 pandemic, which has led to uncertainty in the global economic environment. In addition, with the increasing supervision of companies in today's market and society, the different fates of the two companies are even more significant. The research results are diverse, and the reasons are not single. Different levels of fraud and whether to build investor confidence directly determine the future of the company. More practical operating models, proactive regulation, and transparent management will give companies more opportunities to recover from fraud. The differences in the four perspectives of the two companies' fraud, regulators, investors, and internal companies led to their different fates.

Keywords: Financial Fraud, Financing, Case Study.

1. Introduction

With the rapid economic development and widespread popularity of social media around the world, financial fraud has become a hot topic of social discussion in recent years, as companies in various countries have been exposed to fraud scandals. It has also caused tremendous pressure on investors and companies themselves. Most of the research in recent years has been a discussion and summary of a single case, lacking comparison. This study is committed to deeply exploring why Luckin Coffee and Wirecard, two once-thriving companies, have different fates when facing financial fraud through comparisons from four perspectives: fraud itself, investor confidence, regulatory authorities, and internal companies. By exploring its causes, the goal is to find out what kind of inspiration can be given to existing companies to avoid causing devastating damage to themselves.

Financial fraud refers to the act of a company or individual intentionally misleading investors, creditors, regulators, or other stakeholders by manipulating financial information, falsifying accounts, or other deceptive means to obtain illegal benefits [1]. Luckin Coffee is a Chinese coffee chain with more than 20,000 stores, making it the country's largest coffee retailer. Under US securities regulations, Luckin Coffee must file audited annual reports with the US Securities and Exchange

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Commission by March 2020 [2]. Failure to file the reports led to the release of a report by Luckin Coffee's internal investigation team on April 2, 2020, admitting that it had falsified 2.12 billion yuan ($310 million) in earnings from the second quarter of 2019 to the fourth quarter of 2019, sending stock markets and social media into a frenzy [3]. Despite the scandal, Luckin Coffee's revenues improved a few months later.

Wirecard is a company that provides payment services (online banking, credit card payments) to businesses and consumers around the world. Since its inception, the company has been subject to accounting fraud allegations, which peaked in 2019 after the Financial Times published a series of findings and whistleblower complaints. In June 2020, the company announced that 1.9 billion euros in cash were missing. It owes 3.2 billion euros in debt. In November 2020, Wirecard declared bankruptcy [4].

2. Qualitative analysis based on three dimensions

The analysis part of this article is devoted to a detailed qualitative and quantitative study of the two companies and draws conclusions on why the two companies face different results by summarizing and deducing existing literature and data.

2.1. Types of fraud based on the two business models

Although the scandals of the two companies both fall under the concept of financial fraud, the inflated revenue (Luckin Coffee) and the disappearance of a large amount of money reserves (Wirecard) are essentially of different severity, and the types of companies they are involved are also different.

Luckin Coffee's display of fraudulent activity imperfectly enhanced its sales revenue by around $300 million in 2019 (CNY 2.2 billion) [2]. This dishonest activity fooled the investors into believing the company was getting faster than ever. The company's share price was progressively driven up much faster than the reality of the situation. Despite the made-up scenarios, virtually everything in Luckin Coffee's business was 'real'—renting physical outlets, having real clients, employing real staff, and operating under a fully functional supply-chain framework. This means that even if the company's fraud is exposed, Luckin Coffee still has a stable revenue model [5].

The failure of Wirecard fraud was, however, much greater and more damaging. Their financials reflected €1.9 billion ($2.1 billion) in money reserves, which they said did not exist [6]. This caused a spurious impression of liquidity, as well as of financial stability, that influenced investors and regulatory authorities. Unlike Luckin Coffee, Wirecard is a company focusing on financial technology and payments. Almost all of its transactions are conducted online, and all of its revenue comes from its transaction processing fees and financial services. This means that the company's operations are highly dependent on the authenticity of its balance sheet. This also directly led to the exposure of financial fraud, causing Wirecard to lose credit and collapse.

2.2. Regulatory response and effectiveness

The enthusiasm of regulatory authorities and the rationality of their handling plans when scandals break out directly determine the survival of a company. The parameters of regulation effectiveness on the market results can be seen from the case study of how the US Securities and Exchange Commission (SEC) responded to the scandal involving Luckin Coffee, and the German Federal Financial Supervisory Authority (BaFin) did the same in the case of Wirecard. How the SEC immediately reacted after the Luckin Coffee company was found to be fraudulent is revealed [2]: Firstly, stock trading was interrupted from April 2020 to prevent any further losses from investors. Also, the company was given a penalty of $180 million in addition to improving its governance. Finally, although the SEC imposed significant penalties on Luckin for the violations, they also agreed

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to allow the company to restructure, thus giving the company a window of opportunity for recovery with the presence of stricter regulations.

BaFin, in contrast, failed to take early action even though it had a lot of reasons to act quickly. Investigative reports from the Financial Times, even in 2016, started raising concerns about the company Wirecard's accounting practices, but BaFin took the caution lightly [7]. Secondly, while Wirecard was under the spotlight, BaFin did not see it as their job to investigate the company; instead, the authority targeted journalists and whistleblowers who had raised the alarm about the company's finances [8]. It was the SEC's timely response and 'reward and punishment' solutions that directly helped Luckin Coffee "come back to life." The company received the fine it deserved but was able to continue operating. On the other hand, Bafin's negative performance at the first moment of the scandal led to Wirecard's bankruptcy.

2.3. Corporate governance and leadership decisions

Corporate governance and executive relations are critical to determine whether the company can successfully recover from fraud or completely destroy everything. The reactions by Luckin Coffee's top-class leadership and the ultimate fate of Wirecard's management show the visible difference between proactive and negative crisis management.

After the fraud was exposed, Luckin Coffee rapidly removed the main executives who were involved in:

(1) CEO, Ms Jenny Qian, and Mr. Lu were forced to resign [9].

(2) A new leadership was hired and molded around financial transparency and efficiency of operations of the firm [5].

(3) The company went through a cleaning process of closing underperforming stores and restructuring itself and regained partial investor trust [9].

This method worked out well by aligning investor protection and enforcement measures, which made Luckin suffer the consequences yet not lose its operating capability completely, leading to a return to profitability in 2023.

Wirecard's leadership, in contrast, failed to acknowledge wrongdoing, worsening the company's downfall:

(1) CEO Markus Braun publicly rejected all the accusations despite the growing evidence [4].

(2) Even after the fraud was exposed, Wirecard executives failed to secure emergency financing, leaving the company no choice but to declare insolvency on June 25, 2020 [6].

3. Quantitative analysis based on investor confidence & stock price recovery

By combining stock price data with market efficiency, information asymmetry, and market sentiment theory, it shows that part of the reason why the two companies had different outcomes was that Luckin Coffee still had investor confidence after the scandal broke out, while Wirecard did not. The stock price information for both companies six months before the scandal broke out and one year after is shown in Table 1.

Table 1: List of stock prices of the two companies

Date	Price	Date	Price
04/01/2021	7.97	05/01/2021	0.39
03/01/2021	8.7	04/01/2021	0.33
02/01/2021	6.36	03/01/2021	0.4
01/01/2021	10.88	02/01/2021	0.4
12/01/2020	8.4	01/01/2021	0.5

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Table 1: (continued)

11/01/2020	4.51	12/01/2020	0.31
10/01/2020	4.41	11/01/2020	0.5
09/01/2020	3.06	10/01/2020	0.59
08/01/2020	3.12	09/01/2020	0.8
07/01/2020	2.38	08/01/2020	0.61
06/01/2020	2.33	07/01/2020	1.89
05/01/2020	2.16	06/01/2020	6.4
04/01/2020	4.39	05/01/2020	93.5
03/01/2020	27.19	04/01/2020	91.59
02/01/2020	39.56	03/01/2020	102.9
01/01/2020	32.49	02/01/2020	114.1
12/01/2019	39.36	01/01/2020	129.4
11/01/2019	30.15	12/01/2019	107.9
10/01/2019	19.58	11/01/2019	119.6

Since the two events occurred at different times, for better comparison, The time of occurrence is set as T=0, the first six months of the month as T=-6, and the last twelve months as T=12. The stock prices of the two tables are summarized in a line chart:

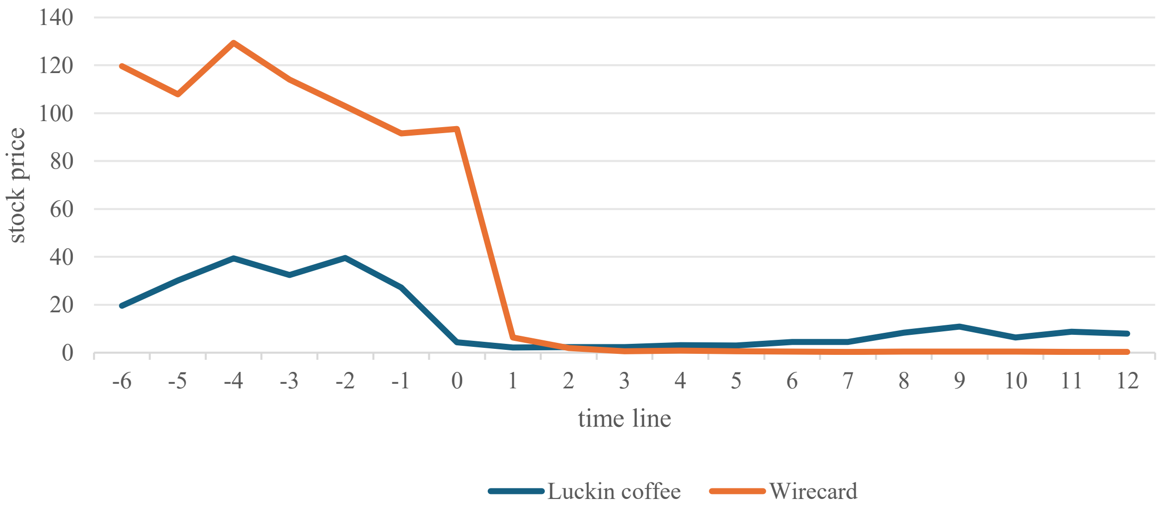

Figure 1: Comparative graph of stock price

Figure 1 clearly shows that the stock prices of both companies fell sharply after the scandals, which is consistent with the efficient market hypothesis; stock prices reflect all available information, and the consequences of being exposed are reflected in the decline of stock prices in a timely manner [10]. Luckin Coffee reached its lowest point (2.16 USD) two months later, with a maximum decline of 92%. However, it showed an upward trend four months later, which makes the market sentiment theory valid. The mood of the market is affected by crowd psychology [11]. Investors' emotions are often reflected in stock prices. The rebound and recovery of Luckin Coffee's stock price prove that consumers have not lost confidence in it.

However, for Wirecard, the collapsing trend of stock prices is more serious, even exceeding 99%, and bankruptcy was declared immediately afterward. Moreover, the financial fraud had existed for a long time before it was exposed. The company's concealment and the inaction of the regulatory

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authorities delayed the time of the "collapse," which is a typical information asymmetry; consumers cannot receive authoritative information before being exposed by the media, which also means that the longer the information asymmetry lasts, the greater the negative impact on the company and consumers.

4. Discussion

The reason why the two companies end up in different ways is not monotonous, but multi-dimensional, because the two companies have different fraudulent natures, business models, regulatory situations, consumer feedback and internal management.

Luckin Coffee is lucky. Its fraudulent nature, retail-based business model, and timely supervision and reasonable solutions from the SEC are the keys to its revival, which Wirecard does not have. However, the two companies' different outcomes are not only due to different external factors. Wirecard also lacks a leadership team with excellent decision-making ability and a sense of responsibility. A combination of diverse factors led to different results for the two companies.

Although Luckin Coffee has a large-scale fraud problem, it does not affect its most important business logic. The actual stores, products, and customers are all behind it. This difference shows that due to its good operating foundation, Luckin Coffee still has the opportunity to rebuild despite being exposed to fraud. Investors and regulators are willing to give it a chance (consumers are more concerned about the coffee they drink later than the scandal). However, Wirecard's fraud is not just exaggerating revenue but fabricating cash reserves and building the company on fiction. The disappearance of a large amount of money directly caused the collapse of the entire cash flow.

At the same time, the enthusiasm for supervision also affects the company's future development path. The SEC quickly punished Luckin Coffee shortly after the scandal was exposed and, at the same time, allowed Luckin Coffee to re-transform its internal structure. At the same time, Bafin did not respond in time during the "golden period" and did not take effective measures until it was too late. Such a slow feedback mechanism led to the closure of Wirecard. The two different fates reflect the greater the chance of a company's revival with active supervision.

Real-time management and changes in leadership are also necessary. Executives explained to the public the first time the people involved in the scandal were laid off, and institutional reforms were carried out. Such measures helped restore investors' confidence in the company's prospects and consumers' trust. However, Wirecard's board of directors not only indulged in fraud but also denied the allegations made by the news media, which invariably worsened Wirecard's development prospects.

This study also has limitations. First, the quantitative part of this study mainly shows investor confidence through changes in stock prices, but changes in stock prices are also affected by other external factors, such as COVID-19 and changes in economic trends in different countries. The theoretical framework of this study is too one-sided. The market efficiency theory and behavioral finance mentioned in the paper are not deep enough and lack support for theories such as corporate governance and corporate fraud motivation. The qualitative part only compares different regulatory agencies (SEC and Bafin) and does not conduct a macro analysis of the financial systems of different countries. There are only two research subjects in this study, which also lacks universality, which means that the conclusions of this study may not apply to the general public.

5. Conclusion

This study emphasizes the diversity of reasons that led to the two companies' different outcomes. The summary of literature and data processing summarizes the essential differences behind the frauds of Luckin Coffee and Wirecard. The different fates of the two companies can give more inspiration to

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enterprises and regulators; more tangible operating models, active regulatory measures, and transparent management will give companies more opportunities to recover from fraud. Different levels of fraud types and whether or not investor confidence is established also directly determine the future of the company. In the future, financial fraud will become more detailed and developed over time, and with the advancement of artificial intelligence, how to integrate artificial intelligence into financial fraud will become a hot topic. Regulators can use artificial intelligence to effectively review corporate financial reports and trends, and companies can also use it to avoid similar scandals. I believe that future financial fraud will be reduced.

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