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How to revive after financial fraud is exposed--case study of Luckin

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Master of Business Administration

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PhD Rui Alexandre Henriques Gonçalves, Professor,

ISCTE- Instituto Universitário de Lisboa

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Marketing, Operations and General Management Department

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List of Abbreviations

TAM- Total Addressable Market

R&D- Research& Development

RBV- Resource-Based View

DTC- Direct To Customer

FMCG- Fast-Moving Consumer Goods

SEC- United State Securities and Exchange Commission

SAMR- China State Administration for Market Regulation

Executive Summary

Luckin's turnaround is a miracle in Chinese business history.

After self-reporting its underreported transactions in April 2020, Luckin underwent a series of significant corporate events, including delisting from NASDAQ, parting ways with its former management and repelling its comeback attempts, restructuring its corporate governance, experiencing and emerging from provisional liquidation, resolving investigations by the United States Securities and Exchange Commission (SEC) and other regulators, settling class action lawsuits, and more. At the same time, new management successfully restructured and turned around the company's business fundamentals, taking it from money-burning to profit-generating in less than two years. It is almost a business miracle that Luckin was able to turn around its business in such a short period of time under the most difficult circumstances. This turnaround was a perfect combination of tremendous effort and luck, and to sum up the situation with an old saying in China, "Right timing, right location, right people".

- The Right timing. Covid-19 in some way favored Luckin's grab&go store model, taking share from dominant players like Starbucks that used the "third place" model, which took a bigger hit. At this point, Starbucks' social public space becomes a totally burden to him.

- The Right location. Understanding of the local market: Based on a deep understanding of the Chinese coffee industry, Luckin invented beverage coffee and introduced it to the coffee industry, which greatly expanded total addressable market and enabled the entry of coffee chains in lower tier cities. Luckin used the franchise model to effectively penetrate lower tier cities and establish a significant first mover advantage there. And internally, they use the horse-racing mechanism of the Internet companies, with multiple teams working independently and competing against each other.

- The Right People. Centurium Capital became the controlling shareholder of the

company, helping the new management team to completely restructure the company. The new management team chose a different direction from the previous management. Instead of pursuing aggressive store expansion and a "new retail" model, it focused on building a sound offline business base, optimizing the store network, investing in Research & Develop, and leveraging data and technology for effective marketing campaigns.

This master's thesis is presented in the form of a case study, which aims to teach students the practical aspects of business operations, develop analytical skills, and apply theoretical knowledge to practical situations. In order to achieve this, the class should be presented in a lively manner to attract students' attention and make them actively participate in class discussions.

Therefore, as the local coffee brand with the largest number of stores in China, which has the largest potential market in the world, the performance of Luckin Coffee will have a significant impact on the Chinese coffee industry landscape and even the world coffee industry in the future. On this basis, students will not only be provided with a wealth of information to answer the questions, but also a variety of perspectives on the multiple reasons that produced this miracle.

Students will be divided into small groups and will discuss the questions.

Abstract

Luckin's seemingly tortuous development history may be a business epic that has never been seen before and will probably never be seen after in Chinese business history.

It was basically a rapid expansion in the early stages with the gimmick of becoming the Chinese version of Starbucks, only to be exposed to a financial fraud scandal after its U. S. IPO. However, while many people were waiting for the tide to recede and laughing at how the Luckin Coffee building was crumbling, two years have flown by and instead of being a flop as many experts predicted at the time, Luckin has bucked the trend of the financial fraud scandal and is even doing better and better now. As of June 2022, Luckin has over 7,000 stores, far surpassing Starbucks as the largest number of coffee shops in China. It covers 28 provincial administrative regions, including Beijing, Shanghai and Guangdong. The number of stores not only surpassed Starbucks, but also the penetration rate, with Luckin opening 1,171 stores nationwide in the first half of 2022 alone. It is worth noting that the coverage of Luckin coffee stores in third- and fourth-tier cities has long exceeded 80%, and even many small villages and towns have the presence of Luckin.

Explore why he was exposed to the financial fraud scandal, in the world capital and under the multiple pressure of the domestic top management, but still able to survive the secret.

Key words: Covid-19; Fast-Moving Consumer Goods; Private Domain Traffic;

JEL Classification: M-19

Resumo

A história do desenvolvimento aparentemente tortuoso da Luckin pode ser uma epopeia empresarial nunca antes vista e provavelmente nunca mais será vista na história empresarial chinesa.

Basicamente, tratava-se de uma expansão rápida nas fases iniciais, com o objetivo de se tornar a versão chinesa da Starbucks, mas que acabou por ser exposta a um escândalo de fraude financeira após a sua OPI nos EUA. No entanto, enquanto muitas pessoas esperavam que a maré baixasse e se riam da forma como o edifício do Luckin se estava a desmoronar, passaram dois anos e, em vez de ser um fracasso como muitos especialistas previram na altura, o Luckin contrariou a tendência do escândalo de fraude financeira e está cada vez melhor. Em junho de 2022, a Luckin tinha mais de 7 000 lojas, ultrapassando de longe a Starbucks como o maior número de cafés na China. Abrange 28 regiões administrativas provinciais, incluindo Pequim, Xangai e Guangdong. O número de lojas não só ultrapassou a Starbucks, mas também a taxa de penetração, com a Luckin a abrir 1.171 lojas em todo o país só no primeiro semestre de 2022. É importante notar que a cobertura das cafeterias Luckin em cidades de terceiro e quarto níveis há muito ultrapassou 80%, e mesmo muitas pequenas aldeias têm a presença de Luckin.

Explore a razão pela qual ele foi exposto ao escândalo de fraude financeira, na capital mundial e sob a pressão múltipla da alta administração nacional, mas ainda capaz de sobreviver ao segredo.

Palavras-chave: Covid-19; Bens de consumo rápido; Tráfego de domínios privados;

Classificação de JEL: M-19

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1. Background

1.1 Introduction

With about 20 percent of the world's population, China is a huge market for any industries. China's coffee industry started late, and as birthplace of the tea culture, the acceptance of coffee market is still at a lower level than that of Europe and the United States and other developed regions. For reference, Japan, which is a tea culture country like China, officially imported instant coffee in 1956, and the coffee industry developed from 0 to 1. With the gradual development of Japanese economy, coffee consumption increased from 250,000 bags in the 1960s to 7 million bags now. If China's coffee consumption habits develop at the same rate as Japan's, the size of China's coffee market will exceed one trillion yuan by 2050.

Finland has the world's most frequent coffee drinker in 2016, with an average of 1,240 cups per person per year. 800 cups for Switzerland; 400 cups for USA. As for some countries in Asia, 200 cups for Japan; 140 cups for South Korea; 40 cups in Taiwan, China. Currently, each Chinese person consumes only 4 cups of coffee per person per year. Some big cities in China such as Beijing, Shanghai and Guangzhou sell only 20 cups per person per year.

Top 25 Coffee Consuming Nations		
Rank	Country	Coffee Consumption (kg per Person Per Year)
1	Finland	11.99751819
2	Norway	9.897383986
3	Iceland	8.999271232
4	Denmark	8.699900314
5	Netherlands	8.400529396

6	Sweden	8.1646614
7	Switzerland	7.901577866
8	Belgium	6.8038845
9	Luxembourg	6.499977659
10	Canada	6.499977659
11	Bosnia and Herzegovina	6.200606741
12	Austria	6.100816435
13	Italy	5.8966999
14	Brazil	5.801445517
15	Slovenia	5.801445517
16	Germany	5.502074599
17	Greece	5.39774837
18	France	5.39774837
19	Croatia	5.098377452
20	Cyprus	4.89879684
21	Lebanon	4.799006534
22	Estonia	4.499635616
23	Spain	4.499635616
24	Portugal	4.300055004
25	United States	4.200264698

Kristine Bernard August 6, 2020 in Society

By chance, Lu Zhengyao read a report on the drinking habits of countries around the world. It said that everyone in North America and Europe currently drinks 400 cups of coffee a year on average, the Japanese drink 360 cups a year, and the Chinese drink less than 5 cups a year. The potential market is remarkably large. Even 300 cups for the Chinese, that's a 60-time increase. There is no doubt that this is a very attractive story for investors. However, the problem lies in the fact that today's leading coffee enterprises represented by Starbucks have occupied a huge market share. Lu Zhengyao

found that the cost of Starbucks is very high, so the price of coffee is very high , and the low-price coffee market still has a very huge market space.

In November 2017, Luckin Coffee was officially established under the lead of Lu Zhengyao. At the same time, Lu Zhengyao called his trusted follower in China Auto Renting Inc., Qian Zhiya, to become the company on the control. And this time to participate in the game also had invested in China Auto Renting Inc., Lenovo Investment important figure, Joy Capital, Liu Erhai; Li Hui, the head of Warburg Pincus Investment, has also invested in China Auto Renting Inc. Under the lobbying and encouragement of Lu Zhengyao, they also left their original old club and set up their own capital companies. Liu Erhai founded Joy Capital and Li Hui founded Centurium Capital. The three are ready to start something big together.

1.2 Financial Fraud

1.2.1 Muddy Waters Research

Just 18 months later, on May 17, 2019, Luckin Coffee was listed on NASDAQ as the Chinese version of Starbucks. At the moment before the listing, Lu Zhengyao held 30.53% of Luckin Coffee's shares. Combined with Lu Zhengyao's sister's 12.40% and Lu Zhengyao's trusted follower Qian Zhiya's 19.68% , Lu Zhengyao held more than 60 percent of Luckin Coffee's shares. His two co-owners have also shared the success, with Li Hui's Centurium capital holding 11.9% and Liu Erhai's Joy Capital held 6.75%.

On January 31, 2020, Muddy Waters Research released a shorting report in which Muddy Waters Research claimed that they received an anonymous report from an unknown person who gave them a report of 89 pages.

Muddy Waters Research, founded in July 2010, is a company registered in the United States. The word "muddy water" taken from one of the "Thirty-Six Stratagems" called "To fish in muddy water", which originally meant to first muddy the water in a pool so that the fish would be choked out in the murky water, and then take the opportunity to grab the fish without much effort; in modern Chinese, it means to first create confusion

within an enemy or opponent, and then take advantage of the confusion to gain profit. Before targeting Luckin, Muddy Waters had sniped a total of 15 companies, with three broad results. One is delisting, the second is pulling down the stock price, and the third is regaining momentum after a brief period of volatility.

Muddy Waters mobilized a large number of full-time and part-time staff to conduct field research on many of Luckin Coffee's stores, staring at one store after another to count how many customers went to buy coffee and how much money they spent. On February 3, Luckin Coffee denied all the allegations made by the reporting unit. Two months later, on April 2, numerous law firms in the U.S. issued a statement that it was Muddy Waters that issued a shorting report on January 31 before investors were able to issue a class action lawsuit under U.S. law, demanding that Luckin Coffee give compensation to shareholders. Luckin Coffee, which was still tough-talking, admitted to falsification that night. The stock price plummeted 85% that day and then dropped another 16% the day after. And in an extremely rare move, the China Securities Regulatory Commission issued an announcement condemning Luckin Coffee's financial fraud and urging it to comply with the financial systems and guidelines of the countries in which it operates, no matter where it is located. Soon after, on April 7, Luckin Coffee suspended its trading.

1.2.2 Inflated sales volume

The first step in the process is to inflate the revenue, such as taking the coffee that was given to you for free or the coffee that was discounted and booked at the original price. Suppose a cup of coffee was bought for 11 RMB with a 50% discount coupon, but he still booked it at the original price of 22 RMB. This is an inflation from the price.

Then there is the inflation from the quantity. Simply put, he actually sold 100 cups of coffee, but he claimed he sold 200 cups or more. This is easily detected by the data or research agencies, but Lu Zhengyao is a very smart businessman. He invented a feature called automatic number skipping. For example, if three people go to buy coffee together, normally the three people are number 101, 102 and 103. However, with this

feature, the first person is number 101, and the second person may be number 104. Therefore, if the due diligence agency is not always on the spot to do accurate research, just collecting the number of waiting position is not able to detect the tricks.

It is through these operations; the revenue did become higher but still easy to find the problem. Because the income has become higher, but the cost remains the same, profits should also rise.

$$\text{Revenue} - \text{cost} = \text{profit}$$

Fake is always fake; cash flow does not come out of nowhere. He can only say that although I earn more, but I also have a lot of expenses. The same way, they make the costs and expenses bigger. Lu Zhengyao found a particularly suitable reason, a particularly reasonable category, is advertising and marketing investment. Because Luckin has a large amount of advertising deployment. But advertising on multiple media is quite visible, he cannot inflate its quantity. If he claims to be working with a media, a brand or a platform to advertise. This can be easily detected. That leaves him with his only choice, using advertising suppliers to help him inflate advertising costs, and here it must require the B-party, that is, the outsourcing of advertising companies to cooperate.

1.2.3 Penalties

Luckin was listed on NASDAQ in the U.S., so naturally it would face penalties from the relevant U.S. government agencies. Meanwhile, a new coronavirus has just been identified in China, and the government is anxiously dealing with related matters. The central government was outraged to hear about this financial fraud. The central government wrote a lot of instructions, stating that this matter is too bad and humiliated. Not only defrauded the world, but also damaged the credibility of China, and the conclusion is to deal with the severe punishment. Soon the Chinese Ministry of Finance, China Securities Regulatory Commission and the China State Administration of Market Regulation, the three departments co-investigated this severe matter.

After everything was confirmed, it was natural to start facing penalties from the relevant governing bodies. Regulatory bodies' penalties:

- China State Administration for Market Regulation (SAMR): On Sep 23, 2020, China's State Administration of Market Regulation (SAMR) decided to fine the company and certain of its third parties, totaling 45 companies, RMB 61 million for violating China's anti-unfair competition law.
- US Securities and Exchange Commission (SEC): On Dec 16, 2020, the company reached a settlement with SEC regarding the SEC investigation of fabricated transactions. The company, without admitting or denying the allegations of the SEC, will be imposed a 180 million US dollar penalty, which shall be offset by any cash payments made by the Company to its security holders pursuant to any schemes of arrangement approved by the Cayman court in the proceeding for the Company's provisional liquidation.

Luckin Coffee completed its IPO in 18 months, with a market capitalization of over \$10 billion in seven months. And the fall was even faster, becoming a falling meteor in just a few hours on April 2. The general business to this end of the story. It is also the myth of Luckin Coffee capital that the vast majority of us believe is coming to an end. But to this day, we find that Luckin Coffee is doing better and better. As if nothing had happened, many experts and commentators had misjudged. At that time, everyone thought that there are only three endings waiting for Luckin: first, bankruptcy; second, acquisition by a giant; third, bankruptcy and reorganization followed by re-listing in a package. Now it seems that Luckin Coffee did not go bankrupt, nor was it acquired or even restructured.

2. The Case

2.1 Timeline of Luckin's History

In October 2017, Luckin Coffee was established in Xiamen, China. And its first store opened for trial operation. As a latecomer in the domestic ready-made coffee industry, Luckin has emerged in just a few years with strong financing ability and strategic positioning, almost reaching the same position as Starbucks. On the one hand, thanks to the continuous heating of the current coffee products market in China, and the hot financing, various new coffee brands emerge one after another, and the valuation is getting higher and higher. Some consumer investors were aware of the business opportunities and rushed in. Luckin took advantage of this momentum to achieve rapid and huge financing, and went public on the Nasdaq on May 17, 2019, setting the fastest record for a U.S. listing in 18 months. On the other hand, Luckin's rise is closely related to its strategic positioning. With the gradual improvement of people's living standards, the prospect of coffee in the Chinese market is increasingly broad, and the industry penetration space is large. According to statistics, the per capita coffee consumption in the Chinese mainland was only 9 cups in 2020, and there is still enough market space waiting for improvement. Looking at various coffee categories in China, high-end coffee is dominated by giants such as Starbucks, while low-end instant coffee is "scattered all over the floor", but it is difficult to form user engagement due to its low value. Luckin Coffee is aiming at the mid-end consumption range (about 15 to 25 RMB, 2 to 3 euro), positioning its service target as young people, frequently launching popular new products and issuing coupons, and actively creating a self-service model. On February 1, 2020, Muddy Waters Research issued a long investigation report, accusing Luckin of financial fraud. Luckin has denied the allegations. On April 2, the same year, the special committee composed of three independent directors of Luckin Coffee announced to the public that the company inflated sales of 2.2 billion yuan, the stock price plummeted 80%, several intraday suspension of trading, the fraud is

basically solid. Luckin's shares plunged 15.94 percent to close at \$5.38 on April 4 as the scandal continued to intensify. The China Securities Regulatory Commission has also strongly condemned the company's financial fraud. Under pressure, Luckin suspended its shares on April 7 until it fully satisfied Nasdaq's request for supplemental information, while the company was caught up in at least four shareholder class-action lawsuits. Luckin was delisted on June 29 with a share price of \$1.38 and a market value of \$321 million, moving to over-the-counter trading. In July, large shareholder Lu Zhengyao's shares went into liquidation due to the stock pledge loan explosion. Jing Capital became the most voting institutional shareholder of Jing Capital. After receiving a fine of Rmb61m from China's State Administration for Market Regulation on September 23, Luckin announced on December 17 that it had agreed to pay \$180 million in its first settlement with the US Securities and Exchange Commission.

On February 5, 2021, Luckin Coffee announced on its website that the company filed for bankruptcy protection in New York and that the company is in negotiations with stakeholders regarding the restructuring of the company's financial debt. In response, Luckin said on its official Weibo account: "Please calm down. This is a misunderstanding." In fact, this is good news, let Luckin's rebirth road further.

September 2021 news, Luckin Coffee in 2020 net revenue of 4.033 billion RMB, a year-on-year growth of 33.3%; As of December 31, 2020, Luckin Coffee had more than 64.9 million cumulative trading customers, compared with 40.6 million a year earlier.

On Feb 4, 2022, Luckin said it had fulfilled a \$180 million civil penalty. The penalty is a result of a previously disclosed settlement with the Securities and Exchange Commission.

On April 11, 2022, Luckin Coffee Company announced that its financial debt restructuring was successfully completed, and the company officially closed bankruptcy protection proceedings as a debtor. Luckin Coffee said that since then, Luckin Coffee has fully resolved the historical issues and returned to normal company status.

On May 24, 2022, Luckin Coffee announced its financial results for the first quarter of 2022 ended March 31. The company's total net revenue for the first quarter was 24.046

billion RMB, up 89.5 percent from 12.687 billion RMB a year earlier, the results showed.

2.2 Right Timing

2.2.1 COVID-19's impact

Novel coronavirus disease, or COVID-19, is an infectious disease caused by a virus known as SARS-CoV-2. The virus was initially identified in Wuhan, Hubei Province, China, in December 2019 and rapidly affected the world in the following months.

COVID-19 has had a profound impact on the global economy. The embargo led to disruptions in global supply chains and the suspension of production activities, which had a significant impact on various industries. Global stock markets have been hit hard, and companies around the world have announced layoffs and business closures. In addition, the global travel and hospitality industry has taken a huge hit due to a significant decline in travel and international trade.

In response to the COVID-19 pandemic, governments have taken a variety of measures to slow the spread of the virus. These measures included closing non-essential businesses, shopping malls and schools, imposing social quarantines and lockdowns. These measures resulted in the loss of jobs and income for many people. The market for offline sales had been suffering from the impact of online shopping before that, and the closure and other measures led to more difficult business conditions for offline stores.

Founded in 1976 in Manosque, France, L'OCCITANE 's product range includes facial care, hair and scalp care, body care, fragrance and essential oils, and household products. 1997 saw L'OCCITANE enter the international market through the development and acquisition of several brands and product lines. Through its local subsidiaries, L'OCCITANE now has boutiques in more than 90 countries on five continents.

On January 26, 2020, the U.S. subsidiary of French skin care brand L'OCCITANE filed

for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court with a view to reducing its increasingly difficult lease obligations in the wake of the new crown epidemic.

According to the filing, L'OCCITANE USA operates 166 boutiques in 36 states and the island of Puerto Rico, all of which are leased stores with annual lease payments of \$30.3 million. Yann Tanini, L'OCCITANE 's regional general manager, said in court documents that as of the filing date, the company owed more than \$15 million on its leases and the landlord held more than \$500,000 in security deposits. To reduce its increasingly heavy lease obligations, L'OCCITANE USA plans to close 23 stores. The company will determine the list of reductions based on dimensions such as the stores' recent and historical sales performance, geographic location, and room for negotiation of lease treaties.

Prior to the arrival of the new crown epidemic, L'OCCITANE 's sales at brick-and-mortar stores in the U.S. were already declining, while the share of e-commerce revenue was increasing. The continued spread of the epidemic has fueled this trend.

Store rent is an important operating cost for offline stores. Luckin sets up different types of stores to meet the needs of customers in diversified scenarios. The store types include: elite, relax, pick-up and kitchen. Not all stores provide extra space for customers to socialize. Compared with the same number of stores, the operating cost of Luckin will be lower than that of other brands. At the same time, the unit price of his product is relatively low, which can attract more caffeine users. Luckin has more single store efficiency.

2.2.2 Luckin was benefited by its grab &go mode.

As an offline business with over 70% of orders from non-delivery, Luckin is prone to negative impacts from mobility control measures to contain the spread of Covid-19. This is a general risk to the offline industry such as restaurants and hotels.

In the 1990s, Starbucks took the lead in introducing the concept of third space into coffee shops, providing people with cultural, spiritual and environmental experiences

through the use of coffee as a social glue. Starbucks Third Space cultivates consumers' lifestyle habits. Compared with other chain brands, Starbucks has the largest third space, which can accommodate more consumers and bring them a better experience. At the same time, the largest third space means the largest operating costs.

However, Luckin is less impacted than the general restaurant industry; and even has a chance of gaining market share from higher price, “third place” coffee shops such as Starbucks due to the spending power and behavior change of consumers during the pandemic.

Fresh drink shops are less impacted than restaurants in general as most drinks can be consumed alone, while dine-in occasions usually involve social gatherings.

Coffee shops are less impacted than freshly made tea drinks, as tea drinks are more common in leisure occasions such as shopping and watching movies, which are more negatively impacted in Covid than coffee's office and functional consumption.

Luckin's business model is more pick-up and delivery focused, which performs better in Covid than “third place” coffee shop models such as Starbucks and Tims etc.

2.3 Right Location

2.3.1 Market Environment

According to Luckin (2019 prospectus) and Starbucks (2022 Investor Day), in China, annual coffee consumption per capita is around 10 cups in various formats in terms of total population, compared to 200 cups in Japan and 380 cups in the US. Starbucks expects coffee consumption per capita to increase from 10 cups in 2019 to 14 cups in 2025. An increase of four cups per person in five years may not seem like much and may seem laughable when compared with 380 cups in the US and 200 in Japan. But China has more than 1.4 billion people. The 4-cup increase is already a quarter of the total market in Japan.

China has the largest population in the world, and based on the average population consumption, there is an extremely large potential market. And human beings cannot

resist the temptation of addictive consumer products. For example, the well-known and daily use cigarette, alcohol, tea, sugar and coffee. Among them, only coffee has a huge potential market in China.

Country	time
Colombia	44.8
Mexico	43.1
Costa Rica	42.3
Greece	41.3
Chile	40.9
Israel	40.8
Poland	40.3
Portugal	40.3
Korea	40.0
Slovak Republic	39.6
Slovenia	39.5
Czech Republic	39.5
Hungary	39.4
Lithuania	39.0
Latvia	38.6
Sweden	38.1
New Zealand	38.1
Luxembourg	38.1
Estonia	37.8
Iceland	37.4
Spain	37.4
Italy	37.2
France	36.9

Data extracted from
OECD.Stat

The table above shows the average weekly working hours of some countries with OECD statistics. China is not included in the OECD statistics. On the Internet, it is said that Chinese people work 46 hours a week. This figure is said to come from a report on China's labor force dynamics released by China's National Bureau of Statistics in 2021, but this report is no longer available. Meanwhile, the Chinese workplace has become popular with a "996" work pattern, where people work from 9am to 9pm, six days a week. Therefore, the figure of 46 hours seems trustworthy. Most people in the workplace now live in a state of high stress and fatigue every day. China's big cities have formed a white-collar class, and these tens of millions of brainiacs have a demand for coffee. What they want is nothing more than an affordable daily drink that can wake them up.

2.3.2 Use Beverage Coffee to Lower the Threshold

Non-coffee drinkers are unlikely to readily and naturally and immediately embrace the education of cheap classic coffee drinks. While caffeine is addictive, the bitter taste of coffee is rarely accepted by most non-coffee drinkers. In order to develop customer taste habits, initially Luckin gave away a large number of consumer coupons to attract consumers. Today, MIXUE's subsidiary Lucky Cup has brought the price down even more in terms of traditional coffee. MIXUE is also an amazing company, famous for its extremely low prices, with a 660ml glass of Chilled Lemonade costing 4 RMB(about 50cents euro), so low that consumers ignore its ingredients and food safety. In retrospect, it was fortunate not to have gone further and further in this direction at the time.

In China, consumer demand for coffee shops can be classified into five categories as below:

Space: coffee shops offer space for meeting, work or relaxation, similar to the “third place” concept introduced by Starbucks – a place outside the home and work where people can gather and build a sense of community.

Brand and lifestyle: stylish coffee shops, such as Starbucks, especially Starbucks

Reserve, % Arabica or boutique coffee shops in the eyes of Chinese consumers. Starbucks not only has the most valuable coffee brand name in China, but it is also perceived as a premium brand in China, representing a lifestyle people are longing for. Beverage: drinking coffee as beverage and can be replaced by tea or juices. This type of consumers often favors Mocha or flavored coffee with milk or syrup.

Functional use: people drink coffee for caffeine to stay awake for study or work; they often become addicted.

Coffee lover: the ones genuinely enjoy the tastes of a variety of coffees and normally hold high standard in the quality of coffee - this is the smallest portion of coffee consumers in China based on research.

In the coffee industry, Starbucks is a brand that can never be avoided. The competitiveness of Starbucks is not the quality of the coffee and the coffee beans, but the fact that it gives consumers an okay public space. That's why, challengers will always be there, and Starbucks will always be there.

Before the incident in 2020, Luckin only focused on catering to the demand from (D) functional use and (E) coffee lover by offering the same type of classic coffee products as Starbucks (e.g., Americano, Latte and Cappuccino, etc.) with lower prices. Their equity story is to acquire Starbucks' customers and to educate non-coffee drinkers by offering affordable classic coffee products. But Luckin only attracted price-sensitive customers with a low retention rate. Its strategy turned out to fail at this stage, because caffeine functional demand of coffee in China is not large enough.

On the other hand, Luckin's initial failure show that non-coffee drinkers can't be easily educated by low-priced classic coffee drinks. Even though in China. As people know, tea originated in China, and China has been drinking tea beverages for thousands of years. Tea has the same euphoric effect and has a bitter taste. This does not mean that China can accept the taste of coffee instantly.

Since China, south Korea and Japan all belongs to east Asia. And their history background has similarities. The table below shows a comparison of caffeine intake from tea and coffee in the three countries.

Daily caffeine (coffee + tea) intake per capita per day									
mg	2013	2014	2015	2016	2017	2018	2019	2020	2021
China	60	68	75	76	81	86	92	98	106
coffee	2	2.6	2.9	3.4	3.4	3.4	3.5	4.2	4.9
tea	58	65	72	73	77	82	99	98	101
Japan	145	146	145	146	148				
coffee	98	100	102	104	106	107	102	99	96
tea	47	46	43	42	42				
South Korea	62	73	77	82	90				
coffee	60	70	74	79	87	84	88	95	95
tea	2	2	3	3	3				

source: USDA, World Bank

Beveraged coffee was created by Luckin accidentally. In Sep 2019, Luckin launched its first beverage coffee product – Brown Sugar Boba Latte by combining ingredients of milk tea (Boba and brown sugar) with coffee latte. Then it also introduced Okinawa Brown Sugar Latte and Christmas Gingerbread Latte in Nov 2019. The first batch of unconventional beverage coffee became much more popular than classic coffee surprisingly. Luckin introduced Creamy Milk Latte in Sep 2020, and it recorded an average daily sale of 300k cups in the first 9 days after launch, implying sales contribution of 62 cups per store per day or 29% of total. After Creamy Milk Latte, Luckin determined its strategy to keep launching beverage coffee to tap into non-coffee drinkers. It stopped confining itself to the caffeine functional demand of coffee but switched to focus on creating incremental total addressable market of coffee. Below table sets forth the differences between classic coffee and beverage coffee:

	classic coffee and specialty coffee	beverage coffee
example	Americano, Latte, Espresso, Cappuccino, Vanilla Latte, etc.	Coconut Milk Latte, Coconut Cloud Latte, Creamy Milk Latte, Brown Sugar Boba Latte, Orange Latte, etc.

coffee bean	Emphasize on coffee bean's quality, flavor, place of origin, etc.	De-emphasize on coffee bean's flavor and place of origin
milk	pure milk or oat milk	more options like coconut milk and milk with sepic flavor, Tea, juice, sparkling water, alcohol
other ingredients	cream, syrup, caramel, vanilla, etc.	More options: fruit syrup, jam, fresh fruit, Boba and other ingredients used in freshly made tea drinks

Beveraged coffee has two main advantages. Firstly, beverage coffee is easily accepted by non-coffee drinkers because of the bitter taste of coffee. The bitter taste is covered by the some ingredients of beverageed coffee, like sugar, fruit, and fat. Coffee is transforming from a pure functional drink to a new type of beverage with plenty of flavors appealing to a larger customer base. Secondly, beverage coffee is in a good position to capitalize on the existing large customer base of freshly brewed tea beverages. In China the freshly made tea drinks is approximately 3-4 times of freshly brewed coffee.

Luckin began to focus on younger brands and intensively launched new products. Many people do not like the bitter taste of Americano, so Luckin has turned to milk coffee, fruit coffee and other coffee drinks. Use other ingredients to neutralize the bitterness in coffee. Luckin Senior Vice President Zhou Weiming once said, "A good product must first taste good and meet the subconscious needs of consumers." Heavy milk coffee, for example, fulfills consumers' subconscious need for milk."

Therefore, Luckin keeps on trying to lower the threshold of coffee, so that Luckin coffee becomes a daily drink for users.

2.4 Right People

2.4.1 Change in Company Control

After Luckin Coffee's financial fraud scandal was exposed in April 2020, Li Hui made a shocking move. The capitalist faction, led by Li Hui and represented by Liu Erhai, one of the three entrepreneurs, kicked Lu Zhengyao out of the company, the

representative of the founding operation, through a series of operations. Lu Zhengyao and his followers owned 62.6% of Luckin Coffee's shares, but through a series of operations they were able to make a big difference with a small one.

Just after the exposure of financial fraud, there was a huge shock at the stock market and company level. Luckin is a listed company with many public shareholders, and with so much happening, many people became dissatisfied with the management of Mr. Lu and his trusted followers. So just after the incident, the board of directors called for the removal of Lu Zhengyao and Qian Zhiya, and in this removal the three people who started out together finally had disagreement base on their own interests. Liu Erhai and Li Hui, who once supported Lu Zhengyao unconditionally, both turned out to be the opposing voice. The number of shares in Lu Zhengyao's hands was still dominant, plus there were many old employees in the company who had worked with Lu Zhengyao, so Lu Zhengyao kept his management position for the time being. So the first removal ended in failure.

But the stock kept falling and someone had to pay for the company's mistakes. And China's State Securities Regulatory Commission, the Ministry of Finance and China's State Administration of Market Regulation started their co-investigation. The two founding partners who had stood behind Lu Zhengyao were opposing his continued leadership of the company. On July 5, 2020, Lu Zhengyao offered to remove himself from office. But only if everyone, including Liu Erhai and Li Hui, was removed. The company was handed over to Guo Jinyi, his secretary during his time at China Auto Renting Inc., but in fact Lu Zhengyao was still the actual controller behind the company. However, Lu Zhengyao still underestimated the power of capital, trapping his business partners, but not the capital. Just two months later, all the directors appointed later were dismissed. At that time, Lu Zhengyao's shares were forcibly closed out due to the equity pledge. As a result, Lu Zhengyao lost most of his shares. Even Guo Jinyi, who was once loyal and trained by Lu Zhengyao all the way, fell to Li Hui.

After that, Li Hui's Centurium Capital took control of Luckin Coffee in four steps:

First: On December 16, 2020, Li Hui reached a settlement agreement with the U.S. Securities and Exchange Commission, simply paying a fine of \$180 million. The SEC

let bygones be bygones.

Second: Li Hui took care of the retail plaintiffs who were suing Luckin Coffee, and in September 2021 Li Hui and the representatives of the class action plaintiffs signed a letter of intent to settle for \$187.5 million. The U.S. retail investors also stopped pursuing Luckin.

Third: Li Hui took care of the creditors left behind by Lu Zhengyao. On January 17, 2022, Centurium Capital formed a consortium of buyers. The participating manpower included IDG Capital and so on. The previous Lu Zhengyao's shares were awarded to KPMG by the BVI and Cayman courts to do escrow liquidation, and Centurium Capital saw this opportunity to agree with KPMG to buy all the shares of Lu Zhengyao and Qian Zhiya at a price of more than \$8 per share.

Fourth: After the previous operation, Centurium Capital held 19.4% of Luckin Coffee's Class A shares, and 100% of Class B shares. Finally, it achieved absolute control over the voting rights of Luckin Coffee. Since then, Luckin Coffee has officially changed its ownership.

However, Lu Zhengyao was not satisfied with this result, and in January 2021, he joined 46 members of the management team to write a joint letter requesting the removal of Guo Jinyi. At this time, Centurium Capital chose to stand behind Guo's back and the removal was failed. He also took the opportunity to carry out a wave of management changes. Li Hui's had more control over the management team.

Centurium Capital became the controlling shareholder.

In April 2021, the company signed investment agreements with Centurium Capital and Joy Capital to subscribe for \$240 million and \$10 million of new shares of the company's senior preferred stock, respectively, with an enlargement option of \$150 million if the State Administration of Foreign Exchange does not approve the company's transfer of cash overseas to meet debt restructuring needs. The subscription price is \$6.50/ADS, a discount of approximately 30% to the pre-agreement deal price. Centurium Capital and Joy Capital completed their investments in December 2021 and January 2022, respectively, and the amplification option has lapsed with the approval of the cash transfer by State Administration of Foreign Exchange.

In January 2022, a consortium of buyers led by Centurium Capital (which also included IDG Capital and Ares SSG Capital Management) completed a secondary purchase of the entity controlled by former management Zhengyao Lu and Zhiya Qian. The sellers were ordered to wind up and liquidate under orders from the Cayman and British Virgin Islands courts after the former management pledged 49% of the company prior to self-reporting the falsification of the transaction and was unable to repay the money after the share price fell in April 2020. The buyer consortium purchased 47.9 million ADSs in the transaction at a price of \$8.76/ADS.

Following the completion of the above transaction, former management Lu Zhengyao and Qian Zhiya no longer hold any interest in Luckin, and Centurium Capital becomes the controlling shareholder of the company, holding at least 27.5% of the company's TSO and over 50% of the voting rights.

Luckin Coffee has quickly emerged from the haze of financial fraud and its operational efficiency is growing by the day. luckin Coffee's full-year revenue for 2021 was RMB 7.97 billion, up 98% year-over-year. Non-GAAP losses were reduced from RMB 2.49 billion in 2020 to only RMB 236 million. With more than 7,000 stores as of June 2022, the company has since taken the lead and completely crushed Starbucks.

2.4.2 Build Private Domain Traffic Pool to Attract More Customers

As Lu Zhengyao lost his dominance over Luckin, Guo Jinyi acquired the lead with the support of capital side. After he came to power, the business strategy of Luckin Coffee changed a lot, and the history of crazy endless new store opening in Lu Zhengyao's era was put to an end. Initially, Luckin took big steps, and the 2,000th store was born 14 months after the brand was founded, and the 3,000th store was opened in 21 months. It took Starbucks 20 years to open more than 4,000 stores in mainland China. According to the original plan in Lu's era, the number of stores was about to reach 10,000 by the end of 2021. Keep it going at this rate, there won't be enough place on earth in 20 years. Luckin's high-speed expansion strategy was pressed the pause button, a senior executive said that the company's strategy is to stabilize the excess, to make the

operating data up, to give investors an account. Since then, Luckin has started to focus on its main coffee business, hoping to achieve profitable growth through refined operations. Management began to focus more on single-store operating indicators. For example, reducing rents, closing loss-making stores, and increasing the average price per item.

In the crisis, Luckin first integrated brand marketing and user operations into one department (unity of product and transportation), allowing marketing to be invested through the orientation of user operations. The traffic obtained by marketing is effectively transformed through user operation. At the same time, in the app, WeChat applets and corporate WeChat group, establish a private domain traffic pool and personalize marketing and pricing according to user characteristics to improve user repurchase rate and activity. Through the operation of the private domain traffic pool, the brand is closer to the user, invisibly narrowing the distance between the user and the brand, finally achieving direct to customer (DTC).

In April of 2020, Luckin first placed eye-catching QR code signs at the pick-up points of 50 stores, which read "Scan the code to enter the community and receive a 52% discount coupon". In that sentence "the community" literally means for a Wechat group. The Wechat group can be regarded as a private domain traffic pool. Staffs in a corporate can communicate with each other in their corporate group, meanwhile their account can start a group and invite their customers in and form a private domain traffic pool for each store. In this group, employees can send event notifications to customers and regularly distribute coupons. At the same time, most of the people who choose to join the group choose to join the group because of work reasons or live nearby. Generally speaking, the customers who join the group are high-quality and stable customers, and they will generate a large number of repurchases.

In May, Luckin launched this initiative in its stores nationwide, and in July, its WeChat group had linked 1.8 million users. These users contributed more than 35,000 direct orders per day, increased monthly consumption frequency by 30%, increased weekly repurchase by 28%, and increased monthly user growth by 10%. These figures, when broken down to each store, increase sales by an average of 8-10 cups a day. Luckin is

not only driving traffic in its stores, but also using its social platforms such as WeChat, Bilibili, and Little Red Book to do so. In turning users into private domain traffic, Luckin also launched a "Invite friends and get 20 RMB" strategy to stimulate customer fission. As a result, by the end of the second quarter of 2022, there were more than 28 million private domain customers. The average number of users per month reached 20,712,000. Private domain operations not only retain and activate users but also reduce marketing costs. From 2018 to 2021, the ratio of marketing expenses to total revenue of Luckin dropped from 88.81% to 4.23%.

Although early Luckin had inflated marketing expenses, the overall cost reduction and increased sales were evident. This type of operation was a very successful way to reduce costs and increase efficiencies.

In the FMCG industry, the most important thing to ensure the development of publicity should be the product power. In terms of raw material supply, those who cooperate with RuiXing have always been the head enterprises of their respective industries. This can ensure the safety and taste of the product under the premise that it can also stabilize the quality of the product. Where the gap with rivals is opened at this point is in the development of new products.

2.4.3 Focus on Research& Development

While doing its best to stabilize the decline and retain customers, Luckin also began to target the rejuvenation of the brand with intensive new product launches. In 2020, 2021 and the first half of 2022, Luckin launched 77, 113 and 68 new ready-made drinks, respectively. The number of new products for the whole year of 2022 is around 140 stock keeping units (SKU). And its R&D expenses in 2020 and 2021 were 266 million yuan and 252 million yuan respectively. The important reason for the intensive new models is because there is no definitive conclusion on what kind of milky coffee consumers like, and the only way to find out what consumers like is to keep on getting new ones. Constantly test and explore consumer preferences with new products. Use the results of sales data to feed back public preferences. At the same time, sales data

can be retained to analyze taste preference differences across the whole country if they want in the future.

Research and development do not guarantee that a product must sell, at most to ensure that it meets the preferences of most people, that is, to improve the probability of popularity. This is a very simple question, since the market and consumer preferences are elusive, need more new products to touch. Then compared to making a pop-up, a process-oriented R&D system is the most important part. In Luckin's R&D system, various ingredients and flavors are identified by numbers. For example, 1 represents incense, 2 represents milk and so on. They put all the ingredients they can use on the list and the product solutions they develop are combinations of different numbers. The basis for choosing these numbers is the trend in the market. These trends are the data from the R&D team's continuous tracking of the market and survey questionnaires. Luckin's R&D system is divided into five parts: product analysis, menu management, product development, testing and optimization. The product analysis department is responsible for analyzing the underlying logic of the product to become a hit from the big consumer data. The menu management department will put forward the demand for product development based on the conclusion drawn by the product analysis department, combined with the menu on the APP. The product development department will develop new products for this demand through the horse race mechanism. That is, it will be developed by several R&D teams at the same time. One or twenty product solutions are proposed, and then internal employees are invited to select the best solution through multiple rounds of blind testing. The developed products are then transferred to the testing department for internal and external testing. After that, the optimization department will optimize the product production process. So that the store staff can make the product easily and stably. Once the product is optimized, it goes into the product library and waits for the right time to be launched. Luckin has launched four breakout products in the past two years with this mechanism, which has led to substantial growth.

3. Pedagogical Notes

3.1 The case's target audience

The case study lesson is designed for graduate students majoring in Management, Finance, Marketing, or Business administration. And students who tend to work in financing institution, consulting company or the FMCG area etc. in the future.

3.2 Educational Objectives

Generally, case studies are a good way to learn and allow students to gain cognitive knowledge as well as to improve their analytical and evaluation skills. Based on this, the basic educational objective of this case study is to help students understand the importance of data information and the principle of having a customer before making a product.

Specifically, students should acquire the following information:

It is extremely important to target customer preferences to make a product, with constant research and feedback in the process. It is also a way to keep introducing new products to try when customers do not have a clear fixed preference.

Sometimes the data and information you obtain is not always completely accurate. There may be misrepresentations and fraudulent information mixed in. It is more important to learn to look at trends while making sure there is no fraud in the data.

The supply chain is an important part of ensuring a healthy business. It can continuously meet the needs of customers, otherwise it will affect the customer's perception of the brand.

It is also important to develop students' analytical and synthesis skills by breaking down and bridging the clues presented in the case. Also, using their judgment to independently extract valuable information for the problem is an embedded goal. Finally, students should be able to actively participate in group and class discussions, listening and sharing ideas with each other, thus re-emphasizing the new theory in their

minds.

After learning about this case, students are encouraged to identify relevant problems in real-world situations for theory practice.

3.3 Literature Review

Humans will always need addictive consumer goods. The American sociologist Charles Wright Mills wrote "White Collar: The American Middle Classes", in which he said that white collar workers in the metropolis, who are engaged in manual labor, have a simple and repetitive life, and their personality and labor are doubly alienated, and they feel mentally exhausted every day. As a result, there is a high demand for sugar and coffee.

Addictive consumer goods have three characteristics: high frequency, high stickiness, and resistance to cycles. Other consumer goods generally go through several stages of boom, bust, recession and recovery. But like cigarettes, alcohol, tea, sugar, coffee is very little affected. All of them belong to the FMCG category. Alfred Rive, an economic historian, found that during the 40 years from 1860 to 1900, the British unemployment rate rose from 1% to 10%, while tobacco consumption only decreased by about 1%. That means they had no way out but to make money. Sidney W. Mintz, the "father of dietary anthropology," said that people eat addictive products energized, so they work harder. So they go back to buying. Products are anti-cyclical, and people will always be in the cycle. (Sidney W. Mintz , 1986) I'm afraid this is one of the most important thing that Luckin has not disappeared. Supply the demand.

3.3.1 Resource Base View

The publication of Wernerfelt's " A Resource-Based View of the Firm" in 1984 means the birth of resource-based theory. The resource theory assumes that the firm has different tangible and intangible assets, which can be transformed into unique capabilities. Resources are immobile and difficult to replicate among enterprises. These unique resources and capabilities are the source of enterprises' lasting competitive

advantage (Wernerfelt, 1984).

The resource-based view (RBV) emphasizes the need for firms to ensure sustainable competitive advantage (SCA) by developing superior resources, capabilities, competencies, and core competencies relative to their competitors (Park, Mezas & Song, 2004; Reed & DeFillippi, 1990). Differences in resources and competencies reflect the differences in competitive advantage among firms. Therefore, firms should seek cooperation with other firms that possess Valuable, Rare, Inimitable, and Non-substitutable (VRIN) resources and capabilities (Lin & Wu, 2014). Through the cooperation, firms can acquire free VRIN resources and capabilities because VRIN capabilities are the source of SCA. If a firm does not have VRIN resources and capabilities on its own, it can secure access to these resources and capabilities by building strong cooperation with other firms to secure SCA (Park, Mezas & Song, 2004). The companies Luckin works with are high quality and top ranked companies in their respective industries. Some of these companies have their own retail operations while supplying large companies. After Luckin's products became popular, their own retail sales bought better, and they received free publicity for their brand.

The resource-based view is that resources must satisfy four attributes to be classified as "resources" (Barney, 1995). These four attributes include:

1. valuable: resources can help a company gain access to opportunities and avoid potential threats. However, the value of a resource is usually not permanent, so the alignment between value and resource needs to be constantly reassessed.
2. rare: Even if the resource is very valuable, if many companies have the same resource, they may still be able to create value for customers in the same way. Therefore, the resource should be scarce for competitors.
3. inimitability: the resource must be difficult to be copied by other companies.
4. non-substitutability: the resources must be irreplaceable by substitutes to help other companies create similar value.

According to Barney (1995), a resource can only be a source of sustained competitive advantage if it meets these four conditions and can be used effectively by the organization.

Nowadays, the information of enterprises is more and more transparent, and the cooperation of companies and suppliers can be easily discovered. In an open market, suppliers can also supply to competitors. At this time, Luckin's new product creativity is a resource that meets VRIN conditions. Then it's time to focus on retaining customers and expanding sales.

3.3.2 Private domain operation

Private domain traffic is a kind of traffic resource owned by enterprises and individuals, as opposed to public domain traffic. Public domain traffic refers to the traffic purchased or directly obtained through public channels, such as major e-commerce platforms, social media platforms, etc. On those platforms such as Amazon, Taobao etc., enterprises or store owners can pay to deploy advertisements on the website homepage. Private domain traffic has the characteristics of enterprise independent control, direct access to users, free or low-cost repeated use, and is widely considered to be the direction of marketing breakthrough. At present, due to its low cost and direct user characteristics, all the FMCG industry attaches great importance to the establishment of private domain traffic pool.

With the development of the market economy, the Internet user growth is slow, the competition on the public domain platform is increasingly fierce, and user churn occurs from time to time. As a result, the focus of enterprises has shifted from how to get traffic and incremental volume to how to keep existing customers from churning. This has led to the concept of private domain traffic, which is a closed pool of traffic that a company or individual acquires by building a relationship chain. Private domain traffic can include user data from public domains and other domains to their own private domain platform, as well as traffic generated by the private domain platform itself. The core of building a private domain traffic pool is to build a customer base with a strong relationship chain.

In China, social platforms are the main channel to get private domain traffic, among which WeChat is the most massive social software. WeChat has more than one billion

users on China mainland alone. People can fulfill almost all their daily needs through wechat. Companies or individuals can get private domain traffic through personal WeChat, corporate WeChat, WeChat groups, public account, video numbers (similar to TikTok's function) and small programs. These channels are not paid for in China, so leveraging the WeChat platform is one of the most important ways to build and operate private domain traffic.

It is worth noting that similar behavioral activities already existed before the concept of private domain traffic emerged, such as WeChat in 2013. Microbusinesses created WeChat Mall and WeChat Small Shop for sales through the WeChat B-side, relying mainly on the circle of friends for product display and sales. However, the development of micro-businesses has been hampered by the emergence of chaotic micro-businesses, including unregulated operations, product quality issues and pyramid scheme fiascos. Many companies are now using WeChat for product marketing and promotion. This business model is developed on the basis of WeChat, which is more standardized and easier to gain users' trust.

With the development of private domain traffic, it has gradually become an industry consensus from strategic foresight. Companies rethink the value and direction of private domain traffic, product use and data become key factors. Private domain traffic is increasingly focused on matching content and scenarios, while engaging with users for Private domain traffic is becoming an important intangible asset for brands.

The key to realizing the transformation from public domain traffic to private domain traffic is to realize the transformation of operational thinking, that is, from "traffic thinking" to "user thinking". The greatest value of private domain traffic is to increase the lifecycle value of users, i.e., the value of users throughout their lifecycle multiplied by the number of repeat visits.

In the development of digital society, the value of private domain traffic is becoming more and more prominent, and the operation is increasingly important. In order to better grasp the concept, value and operation methods of private domain traffic, companies and individuals need to plan and lay out in advance, establish a membership operation system and build a data platform that integrates direct sales channels. This will enable

a better understanding of user needs and the provision of personalized services and content, thus driving the development of private domain traffic to achieve high quality in various fields.

According to Sun Linhui et al. the quality of relationships in the private domain operation model has a positive impact on customer loyalty and employee loyalty, which in turn increases customer loyalty to the brand and positively affects customer sentiment. This means that the operation of private domain traffic does not only focus on sales and realizations, but also on building good relationships and providing quality products and services to win the trust and loyalty of users.

Private domain traffic, as an important marketing resource, is of great significance in the current increasingly competitive market environment. By building private domain traffic pools on social platforms, companies and individuals can reach users directly, control traffic independently, and establish good relationships with them. By shifting operational thinking to achieve a deeper user mindset and focusing on relationship quality, private domain traffic can bring lasting growth for brand development and user experience. Therefore, whether in the e-commerce industry or other industries, the construction and operation of private domain traffic is a strategic direction that deserves attention.

3.4 Methodology

The research in this case is based on the qualitative methods, which can be divided into the following three stages.

3.4.1 Secondary Data Research

Researching amounts of relevant literatures such as books, journals and articles is the basic step. Useful information and data are extracted from the materials. And for more information and data can be found on national and other statistical organizations. Afterwards, preparing author's own literature review with pedagogical note can be the framework of the case.

3.4.2 Semi-structured Interview

Semi-structured interviews were conducted with some beverage and related industry experts, frontline employees and coffee enthusiasts to understand their views on the overall coffee industry development, the brands and their products.

The first interest relevant was the internal staff of the franchise. The good or bad of the brand and its products would be direct interest to him. The other interviewer was an expert from the beverage industry. He believes that the current frequent launch of new products is a test for their supply chain team, especially to their supply chain managers. And he complained that the youngsters' tastes are hard to get. Sometime a well-prepared beverage is not welcome at all, and a product that respond to KPI indicators is popular. He also expressed his approval of its continuous launch of new products as well as the speed of launching new products. There is also an expert from a relevant industry. He believes that the future of beverage coffee will be a trend, just like tea beverages. Tea originated in China, but compared to the middle-aged and elderly people like to brew tea, currently young people prefer fruit tea, milk tea and other tea drinks. For the time being, the beverage coffee represented by Luckin is not obviously competing with the beverage tea market, but in the future, they might be in a competitive situation. And it won't be long before tea giants, such as MIXUE and Nayuki, start to join the competition in coffee industry.

There were 12 coffee lovers in this interview. They all have a positive attitude towards the coffee industry and believe it will continue to grow in the coming years. Most had a positive attitude towards Luckin and its products. There are mixed reviews on various new products, but everyone has their own favorite new products in Luckin. As well as due to its procurement of coffee beans produced in China's Yunnan Province, out of the psychology of supporting domestic goods, there is even a slightly boycott situation. At the same time, some of them think that the coffee beans from Yunnan Province taste good and they actively recommend them to the coffee drinkers around them.

3.4.3 Data analysis and case study construction

After all the data of interview are collected and analyzed, considering some other interview about former management team did by the official media, the author integrated all useful information and refined this note.

3.5 Lecture issues and Case resolution

What are the reasons that Luckin Coffee come back after such a scandal?

1.The Capital side take in charge of the company and paid the penalties. Without the intervention from the capital, the fine alone is enough to send Luckin Coffee down another path - bankruptcy reorganization. Assuming that without the help of capital, Luckin Coffee's other several operations are running well, Luckin Coffee pays the penalty on its own. Total addressable market will also be occupied by other brands. Because it is the emergence of Luckin Coffee, so that various capital companies began to pay attention to the coffee market. At the same time, various brands, such as Tims and Manner, had only a few stores before, and also began to expand stores under multiple rounds of financing.

2.In the early stage, it opened a lot of stores. Within a few months, Luckin had more stores than Starbucks had opened in decades. And those were widely spread all over the country. Those are the foundation. Even though some store has geographical duplication issue. But still the widely spread provides the opportunity the reraise. After the change of management, they soon chose to close those stores with overlapping geographical locations and those stores with poor benefits that could not be self-financing.

3.The brand. In the early stage, it used lots of its money on sending coupons. This behavior makes consumers remember the brand. It's costing Wall Street investors money and lowering prices for consumers in China. The consumers were the guys who got benefited and received the promotion. Consumers who enjoy the benefits will not blame the brand for financial fraud, but will thank the brand for reaping the funds of

Wall Street for the welfare of their own people. The brand, a unique intangible asset, is a source of sustained competitive advantage for a company.

4. Beveraged coffee's success and its R&D ability. In-house staff knew enough about local tastes, or purely out of luck, to develop the beveraged coffee successfully. The invention of beveraged coffee really lower down the threshold. The resource-based view (RBV) emphasizes the need for firms to ensure sustainable competitive advantage (SCA) by developing superior resources, capabilities, competencies, and core competencies relative to their competitors. And resources must satisfy valuable, rare, inimitability and non-substitutability (VRIN) to be classified as "resources". The success of beverage coffee, while valuable, still can't be called a resource because it's so easy to imitate. The real valuable resource is the R&D ability. In 2022, they developed about 140 new products, an average of one new product in less than three days. It's this constant development of new products and testing of consumer preferences that makes Luckin better and better.

5. Through the build of private domain traffic pool to keep those loyal customers. Through private domain operation, direct to customers, improve customer re-purchase rate.

6. The influence was distracted by the Covid-19. It cushioned the impact.

What do you think which the more important decisions that Luckin Coffee made after the scandal?

Actually, I'd say a change in management. Because the change in management and ownership is not only related to the settlement of huge fines, but also changes the overall ownership structure. Breaking the absolute control of executives, led by Lu, over business decisions. So that management is no longer above the internal control of the enterprise.

But the management changes can't be entirely attributed to Luckin Coffee. It is due to the struggle between the corporate owners.

So for this answer I think it is their new creativity and private domain traffic operation. The early model of heavily subsidizing customers made it difficult to retain customers, which led to a significant increase in costs and high price sensitivity of customers. Lack

of product innovation and research and development, resulting in serious product homogeneity, lack of core competitiveness.

After the fraud incident, Luckin returned to the product itself in time, increased research and development efforts, and launched the explosive "raw coconut series". Make good use of Internet data, collect customer feedback, use technical support to achieve product customization and innovative design, meet customer personalized needs, obtain stable user traffic by optimizing products, and transform traffic into long-term consumption power, so as to improve core competitiveness.

what were the main implications for the Luckin Coffee business?

Weak internal control is often the root cause of financial fraud. Therefore, Luckin Coffee needs to improve its own governance mechanism from the following aspects, so that senior executives have no opportunity to commit financial fraud.

1. Improve the internal control system, actively introduce external professional investors, break the dominant situation of directors and senior executives, and protect the interests of minority shareholders.
2. Increase the supervisory responsibilities and obligations of the board of Directors, the Board of Supervisors and the management of the company. The directors and supervisors of Luckin Coffee shall maintain their due independence and professionalism, promptly detect financial fraud, and prevent fraud from taking place.
3. Senior executives enhance legal awareness to promote honest and trustworthy corporate culture, create a sincere and trustworthy corporate atmosphere, so that financial fraud has no hiding.

What advantages does a private domain traffic and private domain traffic pool have?

- 1.the cost is extremely low. We can even say it is free or as low as free. Comparing to public area, like Taobao or JD, to deploy an advertisement or promote a new product or discount to attract more customer on the corner of their homepage. The advertising fee would cost a fortune. Advertising in private domains is just a matter of moving fingers to typewrite.
- 2.the private domain traffic can achieve direct to customer. On public domain, it is

basically impossible to achieve. And the customer who noticed the advertisement might not be our target customer. This allows us to pinpoint our customers. In addition, there is an invitation reward mechanism, which encourages loyal customers to invite more customers. People who accept the invitation, their reasons for joining will generally be out of the psychology of helping friends get discounts and interested in the future of the brand's products. Interested people are more likely to complete the incubation of new customers, while those who are in the process of helping friends get discounts need to rely on the internal operation of the private domain, conduct consumer education, and continue to attract discounts and new product publicity to try.

3. With the application of private domain traffic pool, each store has its own pool. The customers who scan the QR code in the store and join the group of the store, That means the customer's work or life path intersects with this store's address. And that customer has achieved one purchase. Which has more possibility to achieve re-purchase in the future.

How can private domain traffic fit in the businesses in Europe in the future?

Next to the company's name will be the official certification logo of the APP. Normally it is a stamp or an icon right next to the name. Click on the other party's profile, you can see the information of the other party's company. This APP official authentication can place fake account imitation to carry out fraud. Indirectly protect the company's reputation. Currently no Apps in Europe can provide functions exactly like WeChat.

Currently on Chinese version Tik Tok has function like that. Previously, Tik Tok focused on building its mall function. Before really selling things, it has steps. The operator or owner of the account must post or upload videos on this App to attract traffic or fans. Those fans are the future potential buyers. So the content of the videos should be attractive to their target customer. To satisfy the need of our target customers. After the fans start to follow this account, they can start to sell products on the mall or sell their products in the form of live streaming. Then the operator of this account will invite the customers to join their fans group on this APP to build their own private domain traffic pool. Tik Tok can be thought of as common domain traffic. This is the current way to create private traffic on the Chinese version of Tik Tok.

At present, it seems that Tik Tok is a relatively fast way to implement this mode of private domain traffic operation APP

After reading everything of this case. Now we look back at the beginning of this case. Who might be the unknown person who turn in the report to the Muddy Water Research?

This is an open minded question. Students can take a guess. As long as they can provide reasonable explanations base on their answers.

Personally guess the unknown person was taking orders from the capital's side.

First, I am guessing by looking at the ultimate beneficiaries. Because finally the capital side take the power from Lu's interest group. And they gained de facto control of the company.

Second, the report was turned in to the Muddy Research in January. At that time, the annual report was not published yet. Only internal people can access to the data to form an 89 pages report.

4. Conclusions

4.1 The Right Timing, The Right Location, and The Right People

Luckin faced punishment from both Chinese and American government departments after such a serious scandal, and was still doing better and better has to be said to be a miracle. But it is also because of their deep understanding of the local market and customers, and support from the strong power of the capital companies behind.

The financial fraud was exposed in the first half of 2020, when the new coronavirus was first identified and spreading widely in the world. The public paid much more attention to the virus than to the scandal. Indirectly, that coincidence reduced the pressure and affection of public opinion.

In 2015, the maker of Oreo cookies closed some of its production sites in Shanghai, and according to British media reports, the Chinese have the world's most fickle tastes. Luckin solved this problem by launching new products frequently to test customers' preferences. The company also chose former supply chain manager Guo Zhanyi as CEO, which greatly relieved the pressure on the supply chain caused by frequent new product launches.

One of the core reasons for Luckin's huge losses in the past was overly aggressive expansion. Therefore, when the counterfeiting incident broke out, Luckin first stopped store expansion and closed those stores that were not self-sustainable or had overlapping locations. It also added store evaluation metrics and used big data to analyze the value of stores. In this way, some unnecessary expenses and costs were reduced instantly.

The capital intervention also renewed Luckin's life. The government's penalties were settled while compensation was made to the stock market retail investors who were harmed. Without help from the capital side, fines from both countries alone would be enough to bankrupt the business.

Another most important reason is the growth of the Chinese coffee market. the birth of Luckin coffee has changed the pattern of Starbucks dominance in the Chinese coffee market. While lowering the price, it has lowered the threshold of coffee and cultivated customers' drinking habits of coffee from beveraged coffee. The size of China's coffee market reached 381.7 billion RMB in 2021. The future will grow at an annual rate of 25%-35%, and the market size will reach 1 trillion RMB in 2025.

Looking at the entire history of coffee in China from a consumer perspective, three brands can be used to represent three phases - Nescafe, Starbucks and Luckin Coffee. each of the three started a new coffee market. Instant coffee; coffee shops in the third space; beverage coffee with good taste and low price, which is available everywhere. Luckin's history can also be divided into two phases. The first stage is the sudden emergence of rapid development, and then because of the sudden stop of fraud, the latter stage is the rebirth of the rebirth of Nirvana.

The previous phase cannot simply be attributed to failure, and the most important asset left from the first phase is the brand. Since its inception, a series of marketing and subsidy activities have penetrated into consumer habits. Opens up a broader TAM.

4.2 Intangible Loss

At Centurium Capital's public website, six out of ten articles are related to Luckin Coffee. When the scandal broke out, Luckin Coffee was even removed from Centurium Capital's official website, but now it has turned around and become the star company of investment incubation. And what will be the next step for Lu Zhengyao, who was kicked out. Although he was involved in a scandal that was big enough to shock China and abroad, it is a miracle and fortunate that Lu Zhengyao was able to leave the trap and keep his personal wealth and freedom. He has recently started his own business, his latest venture is a pre-made dish called Tongue Technology, and he has already opened 10 directly managed stores. And according to some rumors he seems to already have a plan to get back into the coffee business in the near future. He is still talking about his venture as if nothing had ever happened. It seems that neither Lu Zhengyao

nor Qian Zhiya, the originators of the forgery, have received the jail time people thought they would get. In the end the capital side has become the ultimate winner. But who is the ultimate loser? Retail investors and institutions in the U.S. were compensated accordingly and could not be counted as victims any more. Chinese consumers also bought the product at a low price and did not look like losers. So it seems there are no losers in this capital game, but is it really?

Although Luckin the business is still operating and developing normally, once and is related to the people are also each happy, rich, sprightly. At this point we might as well look at what the Chinese stocks have suffered in the United States in the past few years? Look at the economic and trade relations between the United States and China to see what exactly happens?

The Chinese company to the world to see the face of the bumpy hard. It's hard to say that no one is paying for the falsification of Luckin Coffee, and in fact the state and other Chinese companies are still paying for this thing in the end. Its bill is on the invisible negotiating table, outside the national border where we can't tell day or night, in the container floating on the sea.

And we, the spectators, as outsiders of this capital feast, can only lament the wisdom of the people doing the game, lament the strength of these producers. The so-called CEO and investors of the excellent combination, how vulnerable it is, in front of the power of capital.

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Supportive Material

The Top Coffee Consuming Countries:

<https://www.worldatlas.com/articles/top-10-coffee-consuming-nations.html>

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Luckin Coffee Singapore's Instagram(Contains picture of products):

<https://www.instagram.com/luckincoffeesg/>

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[https://www.worldcoffeeportal.com/Latest/News/2023/January-\(1\)/Luckin-Coffee-reportedly-targeting-international-e](https://www.worldcoffeeportal.com/Latest/News/2023/January-(1)/Luckin-Coffee-reportedly-targeting-international-e)