Luckin Coffee scandal deals new blow to corporate China

The fallout from Luckin Coffee Inc.'s accounting scandal is spreading far beyond the high-flying Starbucks challenger, with renewed concerns about Chinese corporate governance dragging down stocks across industries and threatening to bring a halt to the country's overseas initial public offerings.

The Xiamen-based coffee chain said on Thursday that its chief operating officer and some underlings may have fabricated billions of yuan in sales, upending what was supposed to be one of China's best growth stories.

The coffee chain, founded in 2017, operated about 4, 500 stores by the end of 2019 in China. Chairman Lu Zhengyao and Chief Executive Officer Qian Zhiya employed a strategy: burning money from investors to quickly grab market share from rivals. That strategy has been successful in winning over investors.

Coffee consumption is only in its initial stages in China, and Luckin Coffee was trying to overtake Starbucks by opening more stores in two years than the industry giant has in two decades. Luckin pulled in Chinese consumers by offering generous discounts.

Trouble emerged earlier this year, however. The stock plunged after Muddy Waters Capital tweeted Jan. 31 that it had a short position after receiving what it called a "credible, " unattributed 89-page report that alleged accounting issues with the chain and a broken business model. Luckin Coffee denied the allegations.

"Luckin denied short sellers' reports earlier, and then it admitted wrongdoing, " said Kenny Wen, a Hong Kong-based wealth management strategist at Everbright Sun Hung Kai Co. "Lots of lawsuits will emerge."