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From Scandal to Sustainability: Luckin Coffee's Journey Through the "Burn-for-Growth" Model — Financial Risk and Sustainable Pathways in Venture-backed Startups

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Abstract. In the entrepreneurial ecology dominated by venture capital, "money-burning growth" has become a typical path for the rapid expansion of high-growth enterprises. This model relies on external capital injections to seize market share, yet it is prone to triggering structural risks such as tight money flow, governance imbalance and valuation bubbles. Taking Luckin Coffee as a case study, this research draws on startup financing theory, enterprise life cycle theory, and the dynamic capability framework to explore the antecedents of financial risks of enterprises in the model of "burning money growth" and their transformation mechanism to sustainable development. The study argues that while capital-driven growth can accelerate expansion, over-reliance on external financing erodes financial discipline and amplifies governance failures arising from information asymmetry. Based on Luckin's development trajectory, this paper constructs a three-stage mechanism model of "capital convergence-governance repair-financial resilience restructuring": capital convergence emphasizes returning to cash flow constraints from disorderly expansion, governance repair focuses on rebuilding internal control and incentive mechanisms after the crisis, and financial resilience restructuring reflects the enterprise's ability to establish a stable profit model on the foundation of improved governance.

Keywords: Burn-for-Growth Model, Venture Capital, Corporate Governance, Financial Resilience, Business Model Transformation

1. Introduction

In recent years, as high-growth enterprises have expanded their presence in global capital markets, the burn-for-growth model has become a key topic in entrepreneurial financing and firm expansion research. Existing studies examine its effectiveness, financial risks and governance effects. Research from the past three years shows that in venture-capital-dominated ecosystems, continuous external funding accelerates early expansion and user acquisition but also weakens budget constraints, reinforces short-term incentives and elevates financial vulnerability and governance pressure, including declining profitability, cash-flow volatility and increased fraud risk. Despite these advances, several research gaps remain. First, theoretical discussions largely emphasise capital scale, subsidy strategies or network effects, but lack systematic analysis of how firms adjust

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financial structures, restore governance discipline and return to profitability when capital inflows contract. Second, research on firms' business-model restructuring and financial resilience after major governance crises is fragmented, with limited dynamic frameworks describing the full cycle from expansion and collapse to recovery. Third, empirical work on China's high-growth enterprises is still insufficient, especially the lack of longitudinal case studies to verify how external capital, governance structures and financial outcomes interact. Against this backdrop, this paper examines Luckin Coffee's trajectory of capital-driven expansion, governance crisis following financial fraud, and subsequent profitability reconstruction. It investigates how high-growth firms can achieve governance repair, cost control and cash-flow optimisation in tightening financing environments, shifting from burn-for-growth to sustainable operations. By developing a dynamic analysis framework of "capital convergence–governance repair–financial resilience restructuring," this study reveals the micro-level interactions among capital structure, governance mechanisms and financial resilience, offering a new perspective on sustainable growth in new-economy enterprises. Its core contribution lies in providing actionable insights for financial management and governance reconstruction under capital constraints, while supplying dynamic, institutionally grounded evidence for academic debates on the sustainability of capital-driven growth.

2. Theoretical framework

2.1. The economics of the burn-for-growth model

In the modern entrepreneurial ecology, the "burning money for growth" model has become an important strategy for high-growth enterprises to quickly occupy market share. The core logic of this model lies in leveraging large-scale financing and market subsidies to drive user expansion and achieve economies of scale, and securing long-term valuation and competitive advantages by sacrificing short-term profits. From an economic perspective, this behavior can be interpreted as a market entry strategy under the conditions of imperfect competition. Enterprises rapidly expand their production capacity or store density in the early stage through continuous investment, thereby reducing marginal costs, expanding market share, and establishing entry barriers and network effects [1]. This staged loss is regarded as a rational investment behavior, which is in line with the "J-curve effect" often mentioned in the venture capital industry — that is, start-ups invest huge and negative cash flow in the early stage, but if they can successfully cross the break-even point, their long-term returns will witness a significant upturn [2].

However, this strategy of "loss for growth" is also accompanied by significant financial risks. Venture capital investors tend to prioritize growth rate and market penetration over short-term profitability, resulting in an unbalanced state of financing-driven capital allocation of enterprises [3]. As enterprises continuously boost their valuations through multiple rounds of financing, the management is prone to the cognitive bias of "growth is success", overlooking the robustness of the profit model and the health of cash flow. Furthermore, from the perspective of enterprise life cycle theory, the "burning money for growth" model exhibits positive externalities in the early stage; its vulnerability gradually manifests as enterprises scale up and the capital environment tightens. Research shows that the capital efficiency and capital turnover of start-ups deteriorate significantly during the expansion phase, while changes in investors' risk tolerance and exit channels directly affect whether enterprises can maintain the high rate strategy [1].

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2.2. Venture capital, financial discipline, and growth dynamics

Venture capital plays a dual role in promoting the growth of start-ups: it is both an accelerator and a potential risk amplifier. The infusion of external capital enables enterprises to overcome capital constraints and achieve rapid scale expansion, but it also strengthens short-term growth targets and investment return expectations [4]. Under such incentives, entrepreneurs often regard the success of financing as a core indicator of enterprise development, rather than business performance itself, thereby undermining the binding force of financial constraint mechanisms [5]. Both theoretical and empirical studies show that the "stage supervision" of venture capital will strengthen financial transparency in the early stage, but supervisory intensity may diminish as enterprises enter the overvaluation phase [6]. This makes enterprises prone to the phenomenon of "capital constraint delay" during the high-speed expansion period; that is, the continuous growth of investment and the profit structure has not yet been formed, resulting in a mismatch between cash flow and financing rhythms [3]. If the financing environment suddenly changes or external capital withdraws, enterprises' high-growth burn-for-growth models may rapidly escalate into liquidity crises. Therefore, the growth logic driven by venture capital is essentially a "self-reinforcing cycle fueled by external capital".

2.3. Financial sustainability and transition to profitability

The risks of the "burning money for growth" model—amplified by venture capital's short-term incentives and weakened financial discipline—underscore the necessity of transitioning toward financial sustainability. For high-growth enterprises, moving from financing-dependent expansion to profitability supported by operating cash flow is not just a strategic choice but a survival imperative in their life cycle. Financial sustainability occurs when income exceeds expenditure and reflects an enterprise's ability to maintain homeostatic resource allocation and stable cash-flow dynamics [7]. As firms enter maturity, growth slows while capital costs rise. Without improvements in cash-flow management and cost control, achieving profit targets becomes increasingly difficult [8]. Therefore, financial strategies should shift from "scale-driven" to "cash-flow-driven," emphasizing investment-return balance and free cash flow [9]. This transition typically involves product-line optimization, supply-chain streamlining and cost restructuring, enabling firms to maintain positive cash flow and stable profitability under market fluctuations. Sustainable profitability is also a continuous learning process. Enterprises must cultivate "financial resilience" between growth and stability by strengthening governance, enhancing disclosure transparency and maintaining a steady financing rhythm, thereby establishing long-term capital trust mechanisms [10].

3. Case study: Luckin Coffee's growth and financial crisis

3.1. Overview of Luckin Coffee's development trajectory

The development timeline of Luckin Coffee is shown in Table 1. Founded in 2017, Luckin entered China's chain coffee market with a digital retail model and rapidly expanded through a "burning money for growth" strategy supported by external capital. Statista shows that its stores increased from 2,000 in 2018 to over 4,500 in 2019, a growth rate above 120%. By 18 July 2024, the number of stores reached 20,000 [11]. In the same year, Luckin completed its NASDAQ listing and raised about $561 million. However, dependence on external financing and pursuit of overvaluation created financial risks. In 2020, the firm was found to have inflated revenue by 2.2 billion yuan

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(about $310 million), causing a 90% stock price collapse and delisting that June. After bankruptcy restructuring, Luckin returned to profitability in 2021 and adjusted its business and financial model. Its latest financial report shows a net profit of RMB 8,865.4 million (US$1,220.7 million), up 41.2% YoY, surpassing Starbucks in total store count in China [12]. This shift from “capital-driven” to “cash flow-driven” marks Luckin’s transition from radical expansion to sustainable operations [13].

Table 1. Luckin Coffee’s financial performance, operational scale and key events (2018-2023)

Year	Net Revenue (CNY billion)	Operating Loss/Profit (CNY billion)	Net Stores (Year-end)	Notable Event
2018	1.03	–1.62	2,073	Series B financing; rapid expansion phase begins
2019	3.02	–3.16	4,507	IPO on NASDAQ (raised US $561 million)
2020	4.03	–3.65	3,929	Accounting scandal; NASDAQ delisting
2021	7.97	+0.19	6,024	Restructuring; first profit since founding
2022	13.29	+1.56	8,214	Expansion resumes; improved cash flow
2023	24.88	+2.60	13,273	Surpassed Starbucks in store count

Sources: Luckin Coffee Inc. Annual Reports 2018–2023. Currency: CNY.

3.2. Financial fragility under the burn-for-growth model

The "burn money for growth" strategy exhibited distinct financial fragility. According to the company's 2019 annual report, although its operating income increased by 293% year-on-year, its operating cash flow stood at -336 million yuan, with a cash burn rate significantly exceeding the industry average. This shows that Luckin's rapid growth mainly relies on external financing rather than internal cash flow. An overly rigid fixed cost structure and substantial promotional outlays further exacerbate financial risks [14]. When the average investment recovery cycle of a single store of similar coffee brands is about 18 to 24 months, the break-even period of some Luckin stores exceeds 36 months, reflecting suboptimal capital utilization efficiency [15].

Additionally, after its 2019 listing, Luckin undertook three rounds of debt and convertible bond financing, with a total amount of more than $1.2 billion, resulting in a marked increase in its financial leverage ratio. The combination of venture capital and debt financing temporarily masked operational losses while increasing debt-servicing pressure and information asymmetry risks. Luckin’s 2020 revenue inflation of RMB 2.2 billion was an extreme manifestation of such inherent fragility. As the financing environment cooled and external supervision tightened, the firm was unable to sustain its high-growth trajectory and was forced to enter the restructuring stage. This process shows that once the "burning money" model is out of cash flow support, its financial structure will rapidly unravel.

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3.3. Governance failure and capital misalignment

The failure of corporate governance under the "burning money for growth" model stems from the misalignment between capital and operational objectives. Luckin Coffee's fraud was not an isolated incident but the result of structural imbalances within a capital-driven governance framework. Venture investors and management formed a "growth incentive alliance" pursuing overvaluation and financing success, while financial oversight and internal control systems were marginalized [16]. This imbalance aligns with the delegation–agent model: when information asymmetry and short-term performance assessment coexist, management is more inclined to maintain capital-market confidence through false signals [17]. Luckin's management relied on quarterly sales growth as the core performance metric and lacked independent financial audit and risk-assessment functions, meaning decisions were oriented toward securing capital-market recognition rather than stable financial performance. Such incentives are common in venture-capital environments, where investors seek short-term exits while enterprises require long-term cash-flow support; this temporal mismatch often generates governance distortions [6].

A broader "financing-oriented" culture in Chinese start-ups further reinforces this tendency, where financing scale is treated as the primary measure of success [18]. As a result, firms like Luckin may fall into capital dependency—continually raising funds to sustain a growth narrative rather than improving profitability. Once financing tightens or external supervision strengthens, governance fragility is quickly amplified.

3.4. Mechanism model: from capital dependence to sustainable growth

To shift from capital dependence to sustainable growth, enterprises must build a dynamic balance among governance mechanisms, capital structure and financial strategy [19]. This transition can be understood through a three-tier framework: capital convergence, governance repair and resilience restructuring. In the stage of capital convergence, firms move from external-financing reliance to internal cash-flow sufficiency. Research shows that replacing external financing with free cash flow significantly improves capital efficiency [2]. Luckin's turnaround reflects this shift: operating cash flow became positive in 2021 and capital expenditures were controlled, signaling an optimized capital structure [20]. Governance repair then acts as the mediating mechanism that enables such transformation. By enhancing board independence and strengthening audit oversight, firms can redefine financial discipline in investment decisions and better align growth targets with financial sustainability [6]. Resilience restructuring represents the final stage, marked by a shift from "speed-centric" to "quality-oriented" logic. Firms embed situational budgeting and risk-buffer schemes into financial strategies to cope with capital-market volatility [21]. Growth thus becomes dependent not on capital inflows but on cash-flow soundness and governance transparency. Accordingly, the three-stage process of "capital dependence–governance repair–financial resilience" forms an evolutionary pathway from financing-centric growth to sustainable development.

4. Conclusion

The research findings indicate that capital-driven growth can generate early economies of scale, yet lacking financial discipline leads to cash-flow deficits and valuation bubbles. Luckin's case shows that after a financial crisis, firms can transition from capital dependence to profitability by strengthening internal controls and optimizing capital structure. Academic attention has also shifted from a financing-constraints view to a financial-resilience perspective, which emphasizes the need

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for dynamic capabilities to navigate capital-market volatility. Luckin's restructuring demonstrates that by reshaping governance, improving capital structure, and reinforcing internal cash-flow circulation, firms can convert crises into opportunities for institutional repair. This transformation not only restored financial stability but also enhanced adaptability to external uncertainties. However, because the research relies on public information, the detailed internal governance adjustments cannot be fully observed, and some mechanism inferences remain limited. Future studies may extend this topic in two ways: testing governance-repair mechanisms on financial resilience using larger samples with quantifiable indicators, and comparing recovery paths across firms with different business models and capital structures to examine how financing environments, investor preferences, and cost restructuring jointly shape post-crisis sustainable growth. These directions can further refine the theoretical framework of transitioning from "burning-money growth" to sustainable development and offer broader insights for new-economy enterprises.

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