Research on the motivation and economic benefit of LBX Pharmacy Chain Joint Stock Company

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Abstract. In recent years, with the relaxation of policies, private placement has gradually become the main channel of corporate financing. Taking LBX Pharmacy Chain Joint Stock Company as an example, this paper studies the motivation and economic benefits of its two private placement. The purpose is to provide experience reference for the company and other listed companies in the same industry to choose financing methods. This paper finds that although private placement can improve the company's financial index and bring many benefits, such as improving the equity structure, enhancing the company's reputation, meeting the expansion needs and even promoting intelligent transformation, in the short term, if the company cannot make efficient use of the raised funds, it cannot really optimize the company's development index in the long run. Therefore, this paper holds that for the managers of the company, improving the core competitiveness of the company is the fundamental way, and issuing fixed increase can only be used as an auxiliary means to alleviate the urgent needs.

Keywords: Financing drivers, intelligent transformation, strategic investors, economic benefits, ownership structure, reputation.

1. Introduction

Private placement refers to the behavior that listed companies with financing needs raise funds through non-public offering of shares to a few specific investors. Private placement has been introduced into the Chinese market for the first time since the China Securities Regulatory Commission (CSRC) issued the Administrative Measures for the Issuance of Securities by Listed Companies in 2006. In February 2020, the CSRC issued the Decision on amending the Administrative Measures for the Issuance of Securities by Listed Companies, the Decision on Amending the Interim Administrative Measures for the Issuance of Securities by Listed Companies on the GEM, and the Decision on Amending the Implementing Rules for the Non-Public Offering of Shares by Listed Companies [1]. With the relaxation of the fixed increase policy, the financing demand of the pharmaceutical and biological industry brought about by the previous policy restrictions has erupted, and the scale of additional issuance has been increasing. In addition, domestic and foreign enterprises are affected by the epidemic, and the demand for financing has greatly increased, making the current private placement become the main channel for corporate financing.

Based on the above background, this paper takes the private placement of large pharmacies, a leading enterprise in the field of biomedicine in China, as an example, and focuses on analyzing the motivation and economic benefits of the two private placement in 2020 and 2022. It can provide reference and basis for the directional placement in the biomedical field, and further promote the development of the industry. This paper first analyzes the motivation of LBX Pharmacy's private placement from two perspectives: financing motivation and the introduction of strategic investors, and makes a specific analysis from three perspectives: meeting expansion needs, optimizing financial structure, and intelligent transformation and upgrading of the company. Further, this paper from the financial index, ownership structure, reputation and other three aspects of the company's economic benefits in-depth and comprehensive analysis. Through the analysis of this case, this paper provides experience reference for LBX Pharmacy and other listed companies in the same industry to choose refinancing methods.

2. Motivation

2.1. Financing Motivation

2.1.1. Raise Capital Resources to Meet Expansion Needs

To meet expansion needs, LBX Pharmacy plans to raise capital resources. In 2021, LBX Pharmacy's operating income was 15.696 billion yuan, showing a 12.38% increase from the previous year. Yifeng Pharmacy's operating income was 14.807 billion yuan, representing a 15.56% increase from the previous year. Dashan Lin had an operating income of 162.92, with a growth rate of 14.23% compared to the previous year. LBX Pharmacy faced market space constraints due to competitors' market expansion strategies, causing a slowdown in revenue growth. Despite this, LBX Pharmacy plans to raise 573 million yuan in funds in 2022 for the construction of new pharmacies, with the aim of exceeding 10,000 stores by June 2022. The company opens stores in 15 provinces and cities to maintain its leading position in the industry [2]. This helps to further expand the company's business scale and procurement scale, form a scale advantage, improve the bargaining power of upstream enterprises, and thus reduce production costs to a certain extent. Chain and scale can enhance the competitiveness of the company, and ultimately improve the profitability of the company.

2.1.2. It is Used to Supplement Working Capital and Optimize Financial Structure

Despite its rapid expansion and improving profitability, the company faces challenges such as high goodwill and asset-liability ratio. In the first half of 2020, LBX Pharmacy completed eight acquisitions, leading to significant impairment risks for goodwill in adverse environments or major company changes. In the first quarter alone, LBX Pharmacy generated goodwill of 3.45 billion yuan, a significant increase compared to the previous year, with the peer company Great Forest only having 1.472 billion yuan. Furthermore, no provisions for impairment have been made in the last three years, raising the risk of goodwill impairment. Such impairment could not only threaten the company's financial status but also erase recent profits and impact the enterprise's development and operations [2]. In addition, as of the end of September 2020, the company's asset-liability ratio was 57.18%, and the current financial expenses were 39.2923 million yuan, which was at a higher level than the other three listed pharmacies, Dashen Lin, Yifeng and Yixintang. Therefore, the people plan to use 30% of the raised funds to supplement the working capital and reduce financial costs, so as to optimize the company's financial structure, improve capital liquidity and reduce financial risks. The 600 million yuan raised by the issuance of fixed additions to Linzhi Tencent in 2020 is all used to repay bank loans.

2.2. Provide Financial Security for the Company to Intelligent Transformation and Upgrading

With the continuous development and expansion of the company's business scale, the requirements for highly information zed systems are getting higher and higher. LBX Pharmacy urgently needs to realize the transformation under the help of the industrial Internet, comprehensively upgrade the traditional information system, and improve the digital level of the enterprise. The improvement of the efficiency of the logistics system and marketing system helps the head office to collectivize, comprehensively control all channels in the supply chain and rationally allocate resources in different market segments of the company. On the one hand, the quality and efficiency of the company's operation and management have been greatly improved, and the problem of information asynchronism that may exist in the management decision-making has been reduced. At the same time, from the perspective of the company's own business practice, the application of multiple digital products has brought significant help to the performance. For example, the company's APP "People Pass" comprehensively improves the work efficiency of employees by about 15% in various aspects such as punching in, taking inventory, visiting stores, reporting repairs, submitting utilities, management feedback, real-time tracking of store operating performance, etc., which means the reduction of labor costs [3].

On the other hand, the application of integrated intelligent system improves the transparency of the comprehensive management of business performance, reduces the hidden costs in the operation of business management, contributes to the integration and intelligent development of the company, and ultimately improves the market competitiveness.

2.3. Introduction of Strategic Investors (Improved Shareholding Structure)

An example of the introduction of strategic investors is the private placement in 2020, where Linzhi Tencent was brought in. Linzhi Tencent's legal representative is also currently serving as the Assistant General Manager of the Investment and M&A Department of Tencent and as the executive director of Tencent Industrial Win-win Fund. Consequently, Tencent has officially invested 600 million yuan in LBX Pharmacy [4].

The decision to involve LBX Pharmacy in Tencent War Investment is based on the advantages of Linzhi Tencent as a Tencent-owned enterprise in the Internet+ domain. The aim is to leverage these advantages to enhance LBX Pharmacy's core competitive edge, facilitating its business development through smart retail, cloud computing, cloud services, and other related areas. This collaboration also supports the development of the "new retail" strategy.

The introduction of Tencent brings more than just synergistic effects and complementary advantages. It also reduces the shareholding ratio of major shareholders to a certain extent. This reduction is beneficial for improving the comprehensiveness and the scientific nature of decision-making processes, enhancing the internal mechanism of the enterprise, and facilitating long-term development [5].

3. Analysis of Economic Benefits of Two Directional Additional Issuance by Ordinary People

3.1. Analysis of Financial Indicators

3.1.1. Profitability

According to Figure 1, the changes of main financial indicators (main business income, net profit) in 2020, 2020, 21, 2022 are compared. it is clear that the main business income of the three years has shown an upward trend, of which the increase is more obvious after the second issue of fixed increase in 2022. The change trend of net profit is similar to that of main business income. From the scale of the fixed increase landing, the raised funds in 2021 are only 600 million yuan, and the raised funds in 2022 reach 1.74 billion yuan. It shows that the scale of private placement has a certain positive correlation with the main business income and net profit. Due to the expansion of the scale of raised funds, LBX Pharmacy has more funds for the opening of stores in various towns and counties, meeting the medical needs of rural residents, and bringing more economic benefits.

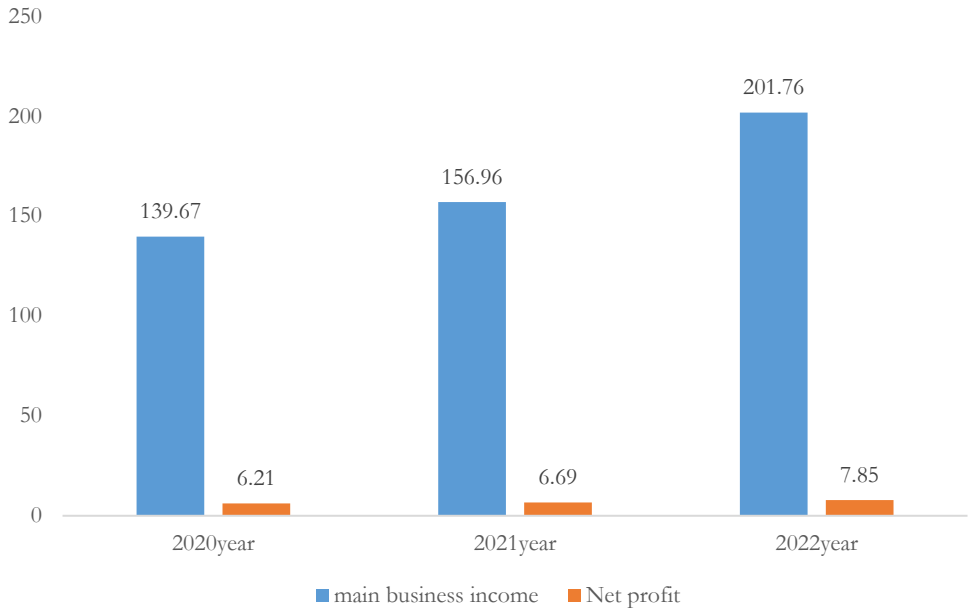


Figure 1. Main business income and net profit attributable to parent company from 2020 to 2022
Data source: http://www.cninfo.com.cn/
Photo credit: Original

The change of the profitability of the company is seen from the return on equity. Return on equity is the ratio of net assets to the total average owner's equity, reflecting the ability of the owner's equity to obtain net income, and is the core index to evaluate the capital operation efficiency of an enterprise. According to the data of the relevant annual reports of the people, the return on equity of 2020-2022 is shown in Figure 2.

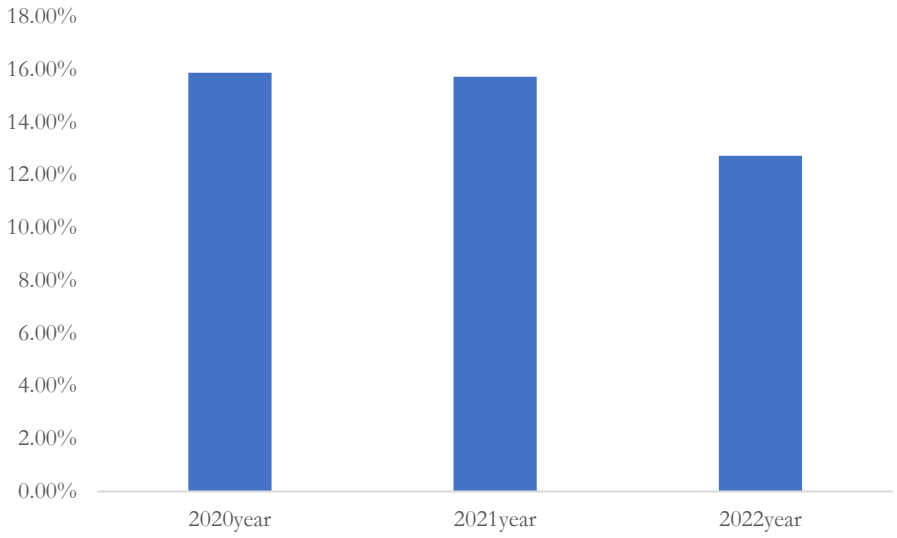


Figure 2. ROE from 2020 to 2022
Data source: SINA finance and economics
Photo credit: Original

After the landing of the first private placement in 2020, the return on equity of the company increased slightly, and the return on equity began to decline slightly one year later. After the landing of the second private placement, that is, two years after the first private placement, the return on equity fell sharply. Compared with Figure 3, it can be seen that the return on equity and the net profit on sales move in the same direction. This indicates that the decline in ROE is due to the decrease in gross profit on sales, the serious lack of profitability of the new projects introduced by the private

equity offering (specifically, many newly opened stores), the large amount of capital investment in the early stage of the new projects [6], and the high cost brought about by the expansion of LBX Pharmacy through a large number of mergers and acquisitions. Lead to the decline of enterprise development ability index.

To sum up, although private placement can improve the revenue and profits of enterprises in the short term, and bring certain economic benefits, it cannot fundamentally solve the problem of capital shortage of enterprises, and its effect on the improvement of profitability is limited and greatly affected by the efficiency of the company's use of funds. Therefore, in order to obtain long-term benefits, enterprises must enhance their core competitiveness and equip themselves with risk coping mechanisms to maximize benefits while minimizing costs [7].

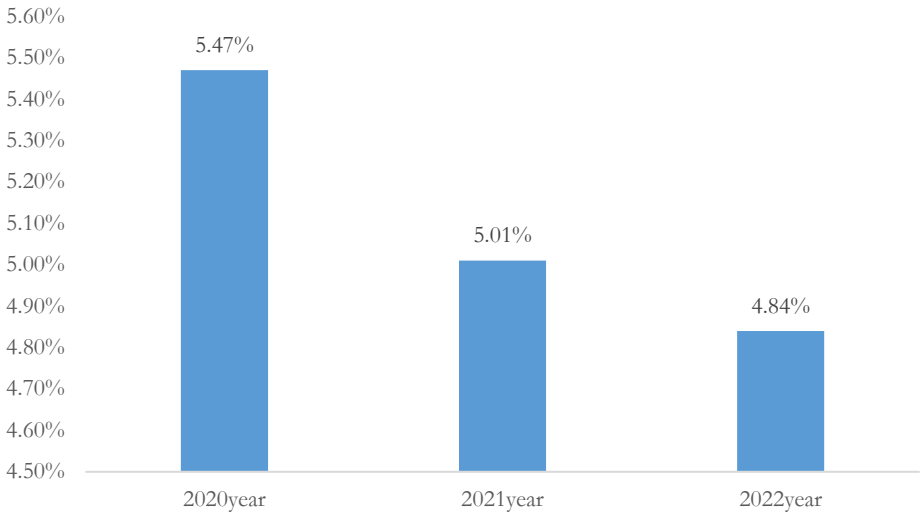


Figure 3. Net profit margin on sales
Data source: SINA finance and economics
Photo credit: Original

3.1.2. Debt Paying Ability

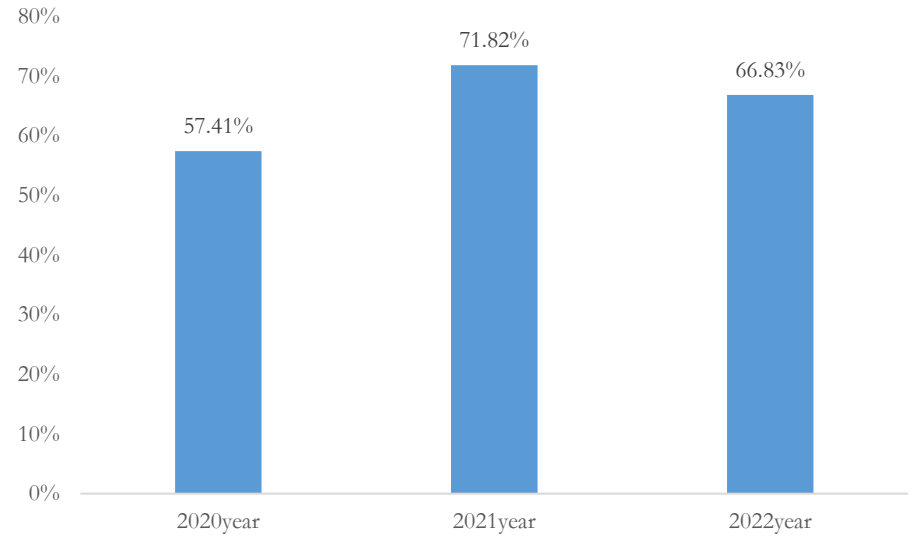


Figure 4. Asset liability ratio
Data source: SINA finance and economics
Photo credit: Original

The asset-liability ratio is chosen as the key index of debt-paying ability evaluation. The higher the value of asset-liability ratio, the higher the ratio of liabilities, which also indicates the worse the solvency of the enterprise. As shown in Figure 4, when the two private placement in 2020 and 2022 are landed, the asset-liability ratio has decreased compared with last year. This indicates that the private placement is conducive to the enhancement of the solvency of enterprises, because the implementation of private placement raises a large amount of funds, the liquidity of enterprises is enhanced, and the reserve funds that can be used to repay debts increase after part of the raised funds are used to repay bank loans and invest in new projects, so the solvency after the private placement is stronger than that in other years. With the passage of time, as enterprises use the raised funds for the development of new projects, the cash flow decreases and the solvency declines significantly [8].

3.2. Ownership Structure

As can be seen from the comparison in Figure 5, after the first private increase, Linzhi Tencent also became one of the top ten shareholders of the company, accounting for 1.07%. After the second private increase, the shareholding ratio of the top four major shareholders of the company all decreased, so the company's equity concentration decreased and the equity balance of the top four major shareholders was enhanced. It is conducive to enhancing the creativity and initiative of the company, enhancing the liquidity of the stock, strengthening the external management mechanism, and ultimately enhancing the value of the company [9]. In addition, due to the enhanced equity checks and balances, the equity is more dispersed than before, and effective checks and balances can be formed among various shareholders to reduce the arbitrary behavior of controlling shareholders and protect the legitimate rights and interests of minority shareholders, which is conducive to improving the decision-making efficiency of the company, ultimately improving the anti-risk ability of the company and accelerating the process of maximizing the value of the company [10].

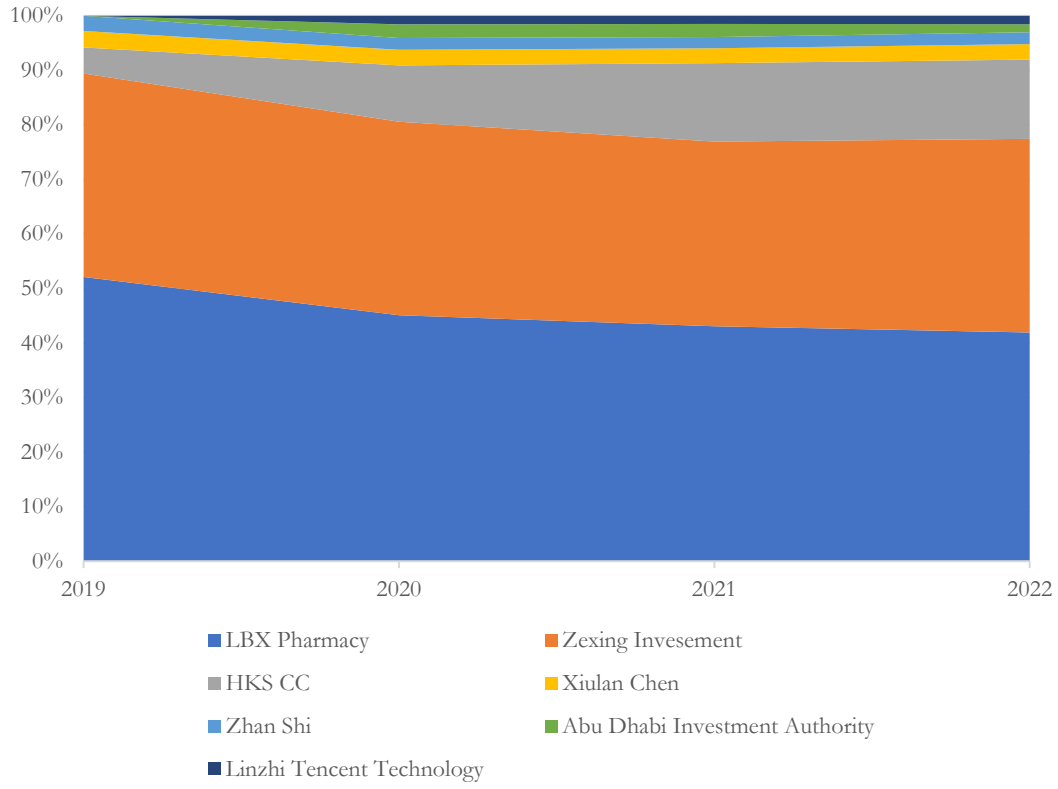


Figure 5. Ownership structure from 2019 to 2022
Data source: http://www.cninfo.com.cn/
Photo credit: Original

3.3. Reputation

The first private placement in 2020 introduced Linzhi Tencent as a strategic investor to gain more attention from investors and the public and improve the company's reputation. In 2021, 1.74 billion yuan will be issued to further increase the number of people's stores, improve the quality of store operation, and more accurately lock the company's customer base. At the same time, it will create space for cooperation with more small and medium-sized pharmacy chains, accelerate the sinking of the county market with the "join + alliance" strategy, make up for the lack of medical resources in backward areas, and meet the basic health care needs of the masses. It is beneficial to improve the company's reputation in the sinking market.

4. Conclusion

Based on the historical background that private placement has become a major financing channel for enterprises in recent years, this paper takes LBX Pharmacy, a leading enterprise in the pharmaceutical field, as an example to study the internal motivation of its two private placement and the economic benefits it may bring to enterprises, hoping to provide certain references for enterprises in the same industry to choose financing methods. This paper mainly finds that (1) LBX Pharmacy, in order to compete with other leaders in the same industry, issued additional funds to accelerate the opening of stores, expand market share, and establish a digital comprehensive information platform to promote the company's transformation from traditional to intelligent and establish competitive advantages. In addition, due to its own problems of high goodwill and asset-liability ratio, LBX Pharmacy not only wants to supplement the liquidity of funds and optimize the financial structure in the private placement, but also wants to introduce strategic partners for in-depth cooperation, give play to their respective advantages, and promote multi-directional collaborative development. (2) After the private placement, LBX Pharmacy's profitability and solvency improved temporarily, but it could not really improve the company's financial indicators in the long run due to insufficient returns brought by capital investment. (3) The private placement of LBX Pharmacy is conducive to the diversification of the company's equity and the improvement of decision-making efficiency and anti-risk ability. It can also improve the company's reputation among people in various markets.

Therefore, although the private placement can play a positive economic benefit to a certain extent and optimize the company's various development indicators, if the company cannot efficiently use the raised funds, it cannot fundamentally solve the problem of the company's shortage of funds and insufficient profits in the long run. Therefore, the key to solve the problem is still to improve the core competitiveness of the company.

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