Network Orchestration for a Flat World

Preparing for a Future of "Defining Moments" at Li & Fung*

Looking at and learning from the defining moments of the past may be less important than preparing for the unknown defining moments of the future. This preparation requires the right mental models, platforms and organizational architecture to meet the unseen inflection points that lie ahead.

Founded in 1906, the Li & Fung Group is one of the oldest trading companies in Hong Kong. Over its more than 100-year history, it has transformed itself several times as the world changed and new opportunities emerged. It has had many defining moments that shaped its history and allowed it to become a global company with a total staff of over 25,000 across 40 countries worldwide and more than US$10 bn in revenue in 2006.

In a fast-changing world, Li & Fung ultimately created a philosophy, a structure and processes that allow it to continuously transform itself in response to customer demands and shifts in the world. This has prepared the company for a continuous series of ìdefining momentsî in the years ahead. Its current role as a ìnetwork orchestratorî is uniquely designed for a world that is increasingly flat and rapidly evolving.

Li & Fung is a multinational group of companies driving strong growth in three distinct core businesses ñ export sourcing through Li & Fung Limited, distribution through IDS Group (Integrated Distribution Services Group Ltd.) and retailing through CRA (Convenience Retail Asia Ltd.) and other non-listed entities. In this article, we examine the defining moments in the evolution of Li & Fung, primarily focusing on the export

* This article is based on Competing in a Flat World: Building Enterprises for a Borderless World, by Victor K. Fung, William K. Fung and Yoram (Jerry) Wind, Upper Saddle River, NJ: Wharton School Publishing, 2007. It is based on the experiences of Li & Fung, a pioneering "flat world" company that developed the principles of network orchestration discussed in this article

sourcing business of Li & Fung Limited, and its current flexible model as a network orchestrator.

A Canton-Based China Trader (1906 - 49)

Founded in Canton (Guangzhou) in 1906 by Fung Pak-liu and Li To-ming, Li & Fung was one of the first companies financed solely by Chinese capital to engage directly in exports from China. Initially it traded largely in porcelain and silk before diversifying into bamboo and rattan ware, jade, ivory, handicrafts and fireworks. At this point, the primary role of the company was to connect customers in the West to factories in Asia. A command of English and local languages was essential, as well as relationships with buyers and sellers.

Even in the early days of China trade, Hong Kong had always been the deep water port for South China as the river port of Canton was too shallow for ocean-going clippers. Fung Pak-liuís second son, Fung Hon-chu, was sent there to establish the firmís first branch and to handle the shipping of its goods.

A Hong Kong-Based Exporter (1949-1979)

Fung Hon-chu was instrumental in leading the company into a new era. With the influx of refugees after 1949, Hong Kong developed as a manufacturing economy exporting labor-intensive consumer products. Li & Fung began to export garments, toys, electronics and plastic flowers on top of its original product lines. A wide range of products now made Li & Fung one of Hong Kongís biggest exporters in dollar terms.

In the early 1970s, the third generation of the Fung family, Victor and William, returned from education in the US to enter the family firm. They worked with their father to modernize and rebuild Li & Fung into a structured business run by professional management at all levels. In 1973, the company was listed on the then Hong Kong Stock Exchange and the new issue was oversubscribed 113 times, a record that remained for 14 years.

Emergence of a Regional Company (1979-95)

With the opening up of China in 1979, Hong Kong regained its hinterland and Hong Kong manufacturers relocated factories to Southern China. The rapid industrialization of the relatively less developed Asian countries was also gathering momentum, widening the choice of sources of supply. Li & Fung quickly appreciated the benefits from these developments and it was no longer possible to manufacture in Hong Kong and remain competitive. The company made heavy investments in these years in establishing a regional network of offices that created the foundation for its present strength in servicing its customers.

In 1989, as part of a reorganization of the familyís interests, Li & Fung was taken private in one of the first management buyouts in Hong Kong. As it expanded its retail businesses, it restructured in two core businessesóexport trading and retail. In 1992 the export trading business was listed on The Stock Exchange of Hong Kong in its present form.

A Network Orchestrator for a "Flat-World" (since 1995)

In the 1990s, Li & Fung continued to expand on the sourcing sideótraditional strengths in the Far East were complemented by a growing presence in the Indian subcontinent as well as the Caribbean and Mediterranean basinsówhich were gaining importance as quick-response production bases for North American and European markets respectively.

With its network of thousands of suppliers around the world, company leaders realized that different parts of the supply chain could be sourced from different areas rather than keeping them within a single factory. Developments in IT allowed for better coordination across many different suppliers, as well as with customers. This created flexibility to allow for shifts in exchange rates, changes in regulatory restrictions such as quotas or the capabilities of specific regions or factories. A supply chain could be developed from a network of suppliers after the order was placed by the customer. This was a flexible, networked supply chain.

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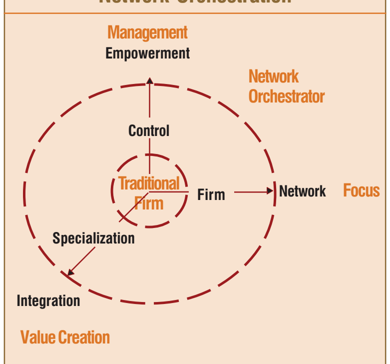
For example, if an order comes in from a European customer for 300,000 pairs of menís twill cargo shorts, the buttons might come from China, the zippers from Japan, the yarn might be spun in Pakistan, woven into fabric and dyed in China and sewn together in Bangladesh. Because the customer needs quick delivery, the order might be divided among three factories. Li & Fung owns no factories, no weaving machines, no dye, no cloth, and no zippers. It does not directly employ a single seamstress. Yet one month later, the order is shipped.

If the order had come in two weeks later, it could have resulted in a completely different supply chain, using different partners drawn from a network of more than 8,000 suppliers around the globe. Like a message routed through the Internet, the project moves along the best specific path chosen from a broader network. In a world that Thomas Friedman has described as increasingly ìflat,î Li & Fung has created a flat-world enterprise designed to be reconfigured almost overnight.

Principles of Network Orchestration

As discussed in more detail in our book *Competing in a Flat World: Building Enterprises for a Borderless World*, which I coauthored with Victor and William Fung,the network orchestrator plays three primary roles related to the focus, management and value creation of the firm and network, as shown in Exhibit I. Each of these roles is the expansion of the role of a manager within a more limited fixed factory or traditional firm.

Exhibit I
Network Orchestration



Role #1 ñ Design and Manage Networks

First, the network orchestrator needs to shift focus from viewing the firm as the center of the universe to looking at the network. Companies donít compete against other companies. Networks compete against networks. Two retail stores on opposite corners

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in New York City may appear to be direct competitors, but this is an illusion. They are not competing against each other in isolation. Each store has a supply chain stretching from its shelves out to the world. The best supply chain will win. Before a customer walks into the store, often the game is over due to the superiority of one supply chain over the other. The best supply chain is drawn from a robust universe of suppliers. It is no longer possible to compete by looking at a company in isolation from the network. The orchestrator creates the broader network and then draws supply chains from it. The challenge for managers is balancing the firm view, which defines the current world, with a networked view, which is increasingly defining the future.

Role #2 ñ Control Through Empowerment

Second, in a world in which orchestrators do not own the means of production, a different form of leadership and control is required. A dispersed global network can devolve into chaos. What holds this network together? In contrast to rigid control systems used to manage factories, the network orchestrator relies not just on rewards but also upon a combination of empowerment and trust, as well as training and certification, to manage a network that it does not own. In addition, it empowers its own managers and suppliers to act entrepreneurially. In contrast to command and control systems, the orchestrator works like a guest conductor in an orchestra. The conductor may not have the ability to hire, or fire people but coordinates a highly skilled set of independent musicians. Empowered end consumers demand more customization and flexibility, which makes it more challenging to orchestrate networks, but can also create opportunities for companies that have the flexibility to meet these rising demands. Consumers want more transparency from networks and more control over both the end product and the process used to create it.

This empowerment is created by using ìloose-tightî relationships with suppliers that are used to design supply chains around customers. For example, Li & Fung has set a target of having at least 30% of the business of a given supplier but not more than 70% (the 30/70 rule). Li & Fung also established units headed by ìLittle John Waynesî who can act entrepreneurially within a large organization, creating a ìbig-smallî company. Loose relationships and tight controls allow an orchestrator such as Li & Fung to take responsibility for the whole chain, even though it doesnít own it. Finally, Li & Fung uses a planning process built around three-year stretch goals to balance stability and renewal. In a world that is not completely flat, the challenge is balancing control with empowerment.

Role #3 - Create Value Through Integration

Orchestrators have a different way of creating value. Value in the traditional firm came from specialization, honing skills in specific areas, protecting trade secrets and keeping out rivals and even partners. Value comes from fighting for a piece of a limited pie and protecting specialized core competencies. Value in the flat world, in contrast, comes from integration, bridging borders, as well as from leveraging the companyís value and intellectual property across the network. This integration means spanning the separate steps of the supply chain to create and capture more value after the product leaves the factory. For a typically $4 stuffed toy, the in-factory costs might be $1 while the ex-factory costs would be $3. In a world in which almost every penny has been squeezed from factory costs, the ìsoft $3î may be the most attractive target for finding value. In addition, value is created by spanning borders between functions within the company, such as looking to manufacturing in developing markets to identify new opportunities for marketing and salesóto ìsell to the source.î Orchestrators need to know when to open the doors wide to create value as integrators and when to produce value by focusing on the specialized resources of the firm, balancing integration with specialization.

The three roles of orchestrators are interconnected and they work together. The more dispersed networks become, the more there is a need for empowerment rather than direct control. The more empowerment is given to suppliers and customers, the more managers need to look across the network rather than focusing on their own firms. The more organizations move toward orchestration, the more they need to be able to build and capture value across the network rather than within the firm. All together, these three roles move companies from the center circle of the figure to the broader outer circle of the networked enterprise.

This shift toward network orchestration changes the core competencies that are needed for success. In a firm-centric world, the core competencies are within the firm. Value is created by the skills and capabilities that provide a distinctive advantage and are not easily copied by rivals. In a networked world, many of the core competencies are located outside the firm. The essential core competencies in this world are network orchestration and learning. With these competencies, companies can gain access to any other competency in the world that they need to create a specific customer solution. Since the world is not completely flat, companies still create value from the competencies within the firm, but network orchestration is becoming increasingly important. This is illustrated by Li & Fung, where one of its core activities is manufacturing yet it does not own manufacturing plants.

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Renewing the Company

These principles, in effect, create a flexible platform that prepares the company to renew itself and respond to a series of defining moments in the years ahead. In particular, the three-year planning process, during which stretch goals are established, creates a systematic process for renewal. The process was described by a Li & Fung executive as ìlike working for a new company every three years.î Rolling plans in the West may be for three or five years on the surface, but they are updated every year, or more frequently, so the goals may change in mid-course. This creates a moving target. Unlike rolling plans used in the West, Li & Fungís fixed goalsówhich are true stretch goalsóoffer enough stability for business leaders to truly develop strategies and organizations to reach them. This approach and the entire system for network orchestration has propelled Li & Fungís rapid growth and allowed the company to respond flexibly to many shocks along the way, including the tragedy of the 9/11 terrorist attacks and the crisis of SARS in Asia. Both of these, along with many other changes, created significant disruptions in retail and in global supply chains. Li & Fungís ability to weather them and continue to grow is a testament to the power of its flexible global supply chains, and its mindset of network orchestration.

The future ahead is filled with risk and uncertainty. In an increasingly networked world, the interdependencies among economies and companies have become much more complex and often more volatile. To meet the challenge of these accelerating ìdefining moments.î Looking at and learning from the defining moments of the past may be less important than preparing for the unknown defining moments of the future. This preparation requires the right mental models, platforms and organizational architecture to meet the unseen inflection points that lie ahead. In this context, harnessing the network through orchestration is an important part of the solution, no matter what new ìdefining momentsî emerge.

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