

# Hong kong style

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HONG KONG STYLE An Interview with Victor Fung BY JOAN MAGRETTA UPPLY CHAIN MANAGEMENT is Working its Way onto the strategic agendas of CEOs in an expanding list of industries, from autos to personal computers to fashion retailing. Propelling that change is the restructuring of global competition. As companies focus on their core activities and outsource the rest, their success increasingly depends on their ability to control what happens in the value chain outside their own boundaries. In the 1980s, the focus was on supplier partnerships to improve cost and quality.

In today's faster-paced markets, the focus has shifted to innovation, flexibility, and speed. Enter Li et) Fung, Hong Kong's largest export trading company and an innovator in the development of supply chain management. On behalf of its customers, primarily American and European retailers, Li et) Fung works with an ever expanding network PORTRAIT BY LANCE HIDY 103 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE of thousands of suppliers around the globe, sourcing clothing and other consumer goods ranging from toys to fashion accessories to luggage.

Chairman Victor Fung sees the company as part of a new breed of professionally managed, focused enterprises that draw on Hong Kong's expertise in distribution-process technology—a host of information-intensive service functions including product development, sourcing, financing, shipping, handling, and logistics. Founded in 1906 in southern China by Victor Fung's grandfather, Li &) Fung was the first Chinese-owned export company at a time when the China trade was controlled by foreign commercial houses. In the early 1970s, Victor was teaching at

the Harvard Business School, and his younger brother, William, was a newly minted Harvard

M. B. A. The two young men were called home from the United States by their father to breathe new life into the company. Since then, the brothers have led Li & Fung through a series of transformations. In this interview with HBR editor-at-large Joan Magretta, Victor Fung describes how Li & Fung has made the transition from buying agent to supply chain manager, from the old economy to the new, from traditional Chinese family conglomerate to innovative public company. Victor and William Fung are creating a new kind of multinational, one that remains entrepreneurial despite its growing size and scope.

Victor Fung is also chairman of a privately held retailing arm of the company, which focuses on joint ventures with Toys R Us and the Circle K convenience-store chain in Hong Kong. He is also chairman of the Hong Kong Trade Development Council and of Prudential Asia. How do you define the difference between what Li & Fung does today—supply chain management—and the trading business founded by your grandfather in 1906? "In the early days, when quotas have been used up in Hong Kong, for example, tells you when you have to start buying from Taiwan. Understanding products was also more complex. We knew that in Taiwan the synthetics were better, but that Hong Kong was the place to go for cottons. We could provide a package from the whole region rather than a single product from Hong Kong. By working with a larger number of countries, we were able to assemble components; we call this "assortment packing." Say I sell a tool kit to a major discount chain. I could buy the parts from one country and the

screwdrivers from another and put together a product package. That has some value in it-not great value, but some. In the second stage, we took the company's sourcing-agent strategy one step further and became a manager and deliverer of manufacturing programs.

In the old model, the customer would say, " This is the item I want. Please go out and find the best place to buy it for me. " The new model works this way. The Limited, one of our big customers, comes to us and says, " For next season, this is what we're thinking about-this type of look, these colors, these quantities. Can you come up with a production program? " Starting with their designers' sketches, we research the market to find the right type of yarn and dye swatches to match the colors. We take product concepts and realize them in prototypes. Buyers can then look at the samples and say, " No, I don't really like that, I like this. Can you do more of this? " We then create an entire program for the season, specifying the product mix and the schedule. We contract for all the resources. We work with factories- When my grandfather started the company in Canton, 90 years ago during the Ching dynasty, his " value added" was that he spoke English. In those days, it took three months to get to China by boat from the West; a letter would take a month. No one at the Chinese factories spoke English, and the American merchants spoke no Chinese. As an interpreter, my grandfather's commission was 15%. Continuing through my father's generation, Li &

Fung was basically a broker, charging a fee to put buyers and sellers together. But as an intermediary, the company was squeezed between the growing power of the buyers and the factories. Our margins slipped to 10%, then 5%, then 3%. When I returned to Hong Kong in 1976 after teaching at

Harvard Business School, my friends warned me that in ten years buying agents like Li & Fung would be extinct. "Trading is a sunset industry," they all said. My brother and I felt we could turn the business into something different, and so we took it through several stages of development. In the first stage, we acted as what I would call a regional sourcing agent and extended our geographic reach by establishing offices in Taiwan, Korea, and Singapore. Our knowledge of the region had value for customers. Most big buyers could manage their own sourcing if they needed to deal only with Hong Kong—they'd know which ten factories to deal with and wouldn't need any help. But dealing with the whole region was more complex. In textiles, quotas govern world trade. Know104 HARVARD BUSINESS REVIEW September-October 1998 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE tries to plan and monitor production so we can ensure quality and on-time delivery.

This strategy of delivering manufacturing programs carried us through the 1980s, but that decade brought us a new challenge - and led to our third stage. As the Asian tigers emerged, Hong Kong became an increasingly expensive and uncompetitive place to manufacture. For example, we completely lost the low-end transistor-radio business to Taiwan and Korea. What saved us was that China began to open up to trade, allowing Hong Kong to fix its cost problem by moving the labor-intensive portion of production across the border into southern China. So for transistor radios we created little kits—plastic bags filled with all the components needed to build a radio. Then we shipped the kits to China for assembly. After the labor-intensive work was completed, the finished goods came back to Hong Kong

for final testing and inspection. If you missed a screw you were in trouble: the whole line stopped cold. Breaking up the value chain as we did was a novel concept at the time. We call it "dispersed manufacturing." This method of manufacturing soon spread to other industries, giving Hong Kong a new lease on life and also transforming our economy. Between 1979 and 1997, Hong Kong's position as a trading entity moved from number 21 in the world to number 8. All our manufacturing moved into China, and Hong Kong became a huge service economy with 84% of its gross domestic product coming from services. So dispersed manufacturing means breaking up the value chain and rationalizing where you do things? That's right. Managing dispersed production was a real breakthrough. It forced us to get smart not only about logistics and transportation but also about dissecting the value chain. Consider a popular children's doll-one similar to the Barbie doll. In the early 1980s, we designed the dolls in Hong Kong, and we also produced the olds because sophisticated machinery was needed to make them. We then shipped the molds to China, where they would shoot the plastic, assemble the doll, paint the figures, make the doll's clothing-all the labor-intensive work. But the doll had to come back to Hong Kong, not just for final testing and inspection but also for packaging. China at that time couldn't deliver the quality we needed for the printing on the boxes. Then we used Hong Kong's welldeveloped banking and transportation infrastructure to distribute the products around the world. You can see the model clearly: the labor-intensive

HARVARD BUSINESS REVIEW September-October 1998 middle portion of the value chain is still done in southern China, and Hong Kong does the front and

back ends. Managing dispersed manufacturing, where not everything is done under one roof, takes a real change of mind-set. But once we figured out how to do it, it became clear that our reach should extend beyond southern China. Our thinking was, for example, if wages are lower farther inland, let's go there. And so we began what has turned into a constant search for new and better sources of supply.

Li & Fung made a quantum leap in 1995, nearly doubling our size and extending our geographic scope by acquiring Inchcape Buying Services. IBS was a large British firm with an established network of offices in India, Pakistan, Bangladesh, and Sri Lanka. The acquisition also brought with it a European customer base that complemented Li & Fung's predominantly American base. This Hong Kong model of borderless manufacturing has become a new paradigm for the region. Today Asia consists of multiple networks of dispersed manufacturing-high-cost hubs that do the sophisticated planning for regional manufacturing.

Bangkok works with the Indochinese peninsula, Taiwan with the Philippines, Seoul with northern China. Dispersed manufacturing is what's behind the boom in Asia's trade and investment statistics in the 1990s-companies moving raw materials and semifinished parts around Asia. But the region is still very dependent on the ultimate sources of demand, which are in North America and Western Europe. They start the whole cycle going. What happens when you get a typical order? Say we get an order from a European retailer to produce 10,000 garments. It's not a simple matter of our Korean office sourcing Korean products or our Indonesian office sourcing Indonesian

products. For this customer we might decide to buy yarn from a Korean producer but have it woven and dyed in Taiwan. So we pick the yarn and ship it to Taiwan. The Japanese have the best zippers and buttons, but they manufacture them mostly in China. Okay, so we go to YKK, a big Japanese zipper manufacturer, and we order the right zippers from their Chinese

SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE LI & FUNG'S GLOBAL REACH

Li & Fung produces a truly global product by pulling apart the manufacturing value chain and optimizing each step.

Today it has 35 offices in 20 countries, but its global reach is expanding rapidly. In 1997, it had revenue of approximately \$1.7 billion. San Francisco Paris Oporto, Portugal San Pedro Sula, Honduras • Brussels • Istanbul • Cairo Mauritius plants. Then we determine that, because of quotas and labor conditions, the best place to make the garments is Thailand. So we ship everything there. And because the customer needs quick delivery, we may divide the order across five factories in Thailand. Effectively, we are customizing the value chain to best meet the customer's needs. Five weeks after we have received the order, 10,000 garments arrive on the shelves in Europe, all looking like they came from one factory, with colors, for example, perfectly matched. Just think about the logistics and the coordination. This is a new type of value added, a truly global product that has never been seen before. The label may say "made in Thailand," but it's not a Thai product. We dissect the manufacturing process and look for the best solution at each step. We're not asking which country can do the best job overall. Instead, we're pulling apart the value chain and optimizing each step - and we're doing it globally. 106

Not only do the benefits outweigh the costs of logistics and transportation, but the higher value added also lets us charge more for our services. We deliver a sophisticated product and we deliver it fast. If you talk to the big global consumer-products companies, they are all moving in this direction toward being best on a global scale. So the multinational is essentially its own supply-chain manager? Yes, exactly. Large manufacturing companies are increasingly doing global supply-chain management, just as Li & Fung does for its retailing customers. That's certainly the case in the auto industry.

Today assembly is the easy part. The hard part is managing your suppliers and the flow of parts. In retailing, these changes are producing a revolution. For the first time, retailers are really creating products, not just sitting in their offices with salesman after salesman showing them samples: " Do you

HARVARD BUSINESS REVIEW September-October 1998 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE Beijing Dalian Qingdao Shanghai Liuyang New Delhi Karachi Guangzhou . Shantou Dhaka Hanoi f" Bombay Bangalore • Taipei Zhanjiang Bangkok Manila Saipan Colombo JohorBaharu . . Singapore Jakarta want to buy this?

Do you want to buy that? " Instead, retailers are participating in the design process. They're now managing suppliers through us and are even reaching down to their suppliers' suppliers. Eventually that translates into much better management of inventories and lower markdowns in the stores. Explain why that translates into lower markdowns for retailers? Companies in consumer-driven, fast-moving markets face the problem of obsolete inventory with a vengeance. That means there is enormous value in being able to buy " closer

to the market. " If you can shorten your buying cycle from three onths to five weeks, for example, what you are gaining is eight weeks to develop a better sense of where the market is heading. And so you will end up with substantial savings in inventory markdowns at the end of the selling season. HARVARD BUSINESS REVIEW September-October 1998 Good supply-chain management strips away time and cost from product delivery cycles. Our customers have become more fashion driven, working with six or seven seasons a year instead of just two or three. Once you move to shorter product cycles, the problem of obsolete inventory increases dramatically.

Other businesses are facing the same kind of pressure. With customer tastes changing rapidly and markets segmenting into narrower niches, it's not just fashion products that are becoming increasingly time sensitive. Several years ago, I had a conversation about ladies fashion garments with Stan Shih, CEO of Acer, the large Taiwan-based PC manufacturer. I jokingly said, " Stan, are you going to encroach on our territory? " He said, " No, no, but the PC business has the same basic problems you face. Things are changing so fast you don't want to wind up with inventory. You want to plan close to the market. He runs his business to cut down the delivery cycle SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE and minimize inventory exposure by assembling PCs in local markets. So what I have to say about supply chain management for fashion products really applies to any product that's time sensitive. Supply chain management is about buying the right things and shortening the delivery cycles. It requires " reaching into the suppliers" to ensure that certain things happen on time and at the right quality level.

Fundamentally, you're not taking the suppliers as a given. The classic supply-chain manager in retailing is

Marks & Spencer. They don't own any factories, but they have a huge team that goes into the factories and works with the management. The Gap also is known for stretching into its suppliers. Can you give me an example of how you reach into the supply chain to shorten the buying cycle? Think about what happens when you outsource manufacturing. The easy approach is to place an order for finished goods and let the supplier worry about contracting for the raw materials like fabric and yarn. But a single factory is relatively small and doesn't have much buying power; that is, it is too small to demand faster deliveries from its suppliers. We come in and look at the whole supply chain. We know the Limited is going to order 100,000 garments, but we don't know the style or the colors yet. The buyer will tell us that five weeks before delivery. The trust between us and our supply network means that we can reserve undyed yarn from the yarn supplier. I can lock up capacity at the mills for the weaving and dying with the promise that they'll get an order of a specified size; five weeks before delivery, we will let them know what colors we want. Then I say the same thing to the factories, "I don't know the product specs yet, but I have organized the retailer hold off before having to commit to a fashion trend. It's all about flexibility, response time, small production runs, small minimum-order quantities, and the ability to shift direction as the trends move. Is it also about cost? Yes. At Li & Fung we think about supply chain management as "tackling the soft \$3" in the cost structure. What do we mean by that? If a typical consumer product leaves the factory at a price of \$1, it will invariably end up on retail

shelves at \$4. Now you can try to squeeze the cost of production own 10 cents or 20 cents per product, but today you have to be a genius to do that because everybody has been working on that for years and there's not a lot of fat left. It's better to look at the cost that is spread throughout the distribution channels-the soft \$3. It offers a bigger target, and if you take 50 cents out, nobody will even know you are doing it. So it's a much easier place to effect savings for our customers. Can you give me an example? Sure. Shippers always want to fill a container to capacity. If you tell a manufacturer, " Don't fill up the container," he'll think you're crazy.

And if all you care about is the cost of shipping, there's no question you should fill the containers. But if you think instead of the whole value chain as a system, and you're trying to lower the total cost and not just one piece of it, then it may be smarter not to fill the containers. Let's say you want to distribute an assortment of ten products, each manufactured by a different factory, to ten distribution centers. The standard practice would be for each factory to ship full containers of its product. And so those ten containers would then have to go to a consolidator, who would unpack and repack all ten containers before shipping the assortment to the distribution centers. Now suppose instead that you move one container from factory to factory and get each factory to fill just one-tenth of the container. Then you ship it with the assortment the customer needs directly to the distribution center. The shipping cost will be greater, and you will have to be careful about stacking the goods properly. But the total systems cost could be lower because you've eliminated the consolidator altogether. When someone is actively managing and organizing the whole supply chain, you can save costs like

that. We think about supply chain management as 'tackling the soft ' in the cost structure. " nized the colors and the fabric and the trim for you, and they'll be delivered to you on this date and you'll have three weeks to produce so many garments. " I've certainly made life harder for myself now. It would be easier to let the factories worry about securing their own fabric and trim. But then the order would take three months, not five weeks. So to shrink the delivery cycle, I go upstream to organize production. And the shorter production time lets 108 HARVARD BUSINESS REVIEW September-October 1998

SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE So when you talk about organizing the value chain, what you do goes well beyond simply contracting for other people's services or inspecting their work. It sounds like the value you add extends almost to the point where you're providing management expertise to your supply network. In a sense, we are a smokeless factory. We do design. We buy and inspect the raw materials. We have factory managers, people who set up and plan production and balance the lines. We inspect production. But we don't manage the workers, and we don't own the factories. Think about the scope of what we do.

We work with about 7, 500 suppliers in more than 26 countries. If the average factory has 200 workers - that's probably a low estimate - then in effect there are more than a million workers engaged on behalf of our customers. That's why our policy is not to own any portion of the value chain that deals with running factories. Managing a million workers would be a colossal undertaking. We'd lose all flexibility; we'd lose our ability to fine-tune and coordinate. So we deliberately leave that management challenge to

the individual entrepreneurs we contract with. Our target in working with factories is to take anywhere from 30% to 70% of their production. We want to be important to them, and at 30% we're most likely their largest customer. On the other hand, we need flexibility-so we don't want the responsibility of having them completely dependent on us. And we also benefit from their exposure to their other customers. If we don't own factories, can we say we are in manufacturing? Absolutely. Because, of the 15 steps in the manufacturing value chain, we probably do 10. Our basic operating unit is the division. Whenever possible, we will focus an entire division on serving one customer. We may serve smaller customers through a division structured around a group of customers with similar needs. We have, for example, a theme-store division serving a handful of customers such as the Warner Brothers stores and Rainforest Cafe. This structuring of the organization around customers is very important - remember that what we do is close to creating a customized value chain for every customer order. So customer-focused divisions are the building blocks of our organization, and we keep them small and entrepreneurial. They do anywhere from \$20 million to \$50 million of business. Each is run by a "

What we do is close to creating customized value chain for every customer order. " / The way Li & Fung is organized is unusual in the industry. Can you describe the link between your organization and your strategy? Just about every company I know says that they are customer focused. What, in fact, does that mean? Usually it means they design key systems that fit most of their customers, they hope, most of the time. Here we say-and do-something different: We organize for the customer. Almost all the large trading

companies with extensive networks of suppliers are organized geographically, with the country units as their profit centers.

As a result, it is hard for them to optimize the value chain. Their country units are competing against one another for business. HARVARD BUSINESS REVIEW September-October 1998 lead entrepreneur-we sometimes call them "little John Waynes" because the image of a guy standing in the middle of the wagon train, shooting at all the bad guys, seems to fit. Consider our Gymhoree division, one of our largest. The division manager, Ada Liu, and her headquarters team have their own separate office space within the Li & Fung building in Hong Kong. When you walk through their door, every one of the 10 or so people you see is focused solely on meeting Gymhoree's needs. On every desk is a computer with direct software links to Gymhoree. The staff is organized into specialized teams in such areas as technical support, merchandising, raw material purchasing, quality assurance, and shipping. And Ada has dedicated sourcing teams in our branch offices in China, the Philippines, and Indonesia because Gymhoree buys in volume from all those countries. In maybe 5 of our 26 countries, she has her own team, people she hired herself. When she wants to source from, say, India, the branch office helps her get the job done.

In most multinational companies, fights between the geographic side of the organization and the product or customer side are legendary - and predictable. From the product side, it's "How can I get better service for my customer? It may be small for you in Bangladesh, but it's important for my product line globally." And from the country side, it's "Look, I can't let this product group take unfair advantage of this particular factory, because it

pro109 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE duces for three other product groups and I'm responsible for our relationships in this country overall. Here's our solution to this classic problem: Our primary alignment is around customers and their needs. But to balance the matrix, every productgroup executive also has responsibility for one country. It makes them more sensitive to the problems facing a country director and less likely to make unreasonable demands. Can you tell us more about the role of the little John Waynes? The idea is to create small units dedicated to taking care of one customer, and to have one person running a unit like she would her own company. In fact, we hire people whose main alternative would be to run their own business.

We provide them with the financial resources and the administrative support of a big organization, but we give them a great deal of autonomy. All the merchandising decisions that go into coordinating a production program for the customer-which factories to use, whether to stop a shipment or let it go forward-are made at the division-head level. For the creative parts of the business, we want entrepreneurial behavior, so we give people considerable operating freedom. To motivate the division leaders, we rely on substantial financial incentives by tying their compensation directly to the unit's bottom line.

There's no cap on bonuses: we want entrepreneurs who are motivated to move heaven and earth for the customer. Trading companies can be run effectively only when they are small. By making small units the " We think of our divisions as a portfolio we can create and collapse, almost at will. " heart of our company, we have been able to grow rapidly without becoming

bureaucratic. Today we have about 60 divisions. We think of them as a portfolio we can create and collapse, almost at will. As the market changes, our organization can adjust immediately. What role, then, does the corporate center play?

When it comes to financial controls and operating procedures, we don't want creativity or entrepreneurial behavior. In these areas, we centralize and manage tightly. Li & Fung has a standardized, fully computerized operating system for executing 110 and tracking orders, and everyone in the company uses the system. We also keep very tight control of working capital. As far as I'm concerned, inventory is the root of all evil. At a minimum, it increases the complexity of managing any business. So it's a word we don't tolerate around here. All cash flow is managed centrally through Hong Kong.

All letters of credit, for example, come to Hong Kong for approval and are then reissued by the central office. That means we are guaranteed payment before we execute an order. I could expand the company by another 10% to 20% by giving customers credit. But while we are very aggressive in merchandising - in finding new sources, for example-when it comes to financial management, we are very conservative. I understand<sup>^</sup> though, that Li & Fung is involved in venture capital. Can you explain how that fits in? We've set up a small venture-capital arm, with offices in San Francisco, London, and Brussels, whose primary purpose is corporate development. If you look at a product market grid, Li & Fung has expertise in sourcing many types of products for many types of retailers, but there are also holes in our coverage. A big piece of our corporate development is plugging those holes-the phrase we use is "filling in the mosaic" - and we use venture capital to

do it. Let's say Li & Fung is not strong in ladies fashion shoes. We'll have our venture group look for opportunities to buy into relatively young entrepreneurial companies with people who can create designs and sell them but who do not have the ability to source or to finance.

That's what we bring to the deal. More important, doing the sourcing for the company lets us build presence and know-how in the segment. At the same time, we think it's a good way to enhance our returns. All venture capitalists will tell you that they bring more than money to their investments. In our case, we are able to back the companies with our sourcing network. One of our biggest successes is a company called Cyrk. We wanted to fill a hole in our mosaic in the promotional premiums business—clothing or gift items with company logos, for example. We bought a 30% stake in Cyrk for \$200,000 in 1990. We ended up doing all the M&M gum ball dispensers with them, but the real coup was a full line of promotional clothing for Philip Morris. After five years, we sold our investment for about \$65 million. We're more than happy with our investment results, but our real interest is in corporate development.

HARVARD BUSINESS REVIEW September-October 1998 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE SUPPLY CHAIN MANAGEMENT: HOW LI & FUNG ADDS VALUE

LI & Fung does the high-value-added front- and back-end tasks in Hong Kong: front-end design, engineering, production planning, back-end quality control, testing, logistics. It organizes the over-value-added middle stages through its network of 7,500 suppliers, 2,500 of which are active at any one time. raw material and component sourcing, in filling in the mosaic. We're not looking to grow by taking over whole companies. We know we can't manage a U. S. domestic company very well

because we're so far away, and the culture is different. By hacking people on a minority basis, however, we improve our sourcing strength and enhance our ability to grow existing client relationships or to win new ones. That's real synergy. You've grown substantially both in size and in geographic scope in the last five years.

Does becoming more multinational bring any fundamental changes to the company? Since 1993, we've changed from a Hong Kong-based Chinese company that was 99.5% Chinese and probably 80% Hong Kong Chinese into a truly regional multinational with a workforce from at least 30 countries. We used to call ourselves a Chinese trading company. (The Japanese trading companies are very big, and we wanted to be a big fish in a small pond, so we defined the pond as consisting of Chinese trading companies.) As we grow, and as our workforce becomes more nationally diverse, we wonder how Koreans or Indians or Turks will feel about working for a Chinese multinational. HARVARD BUSINESS REVIEW September-October 1998 managing production We're torn. We know that if we call ourselves a multinational, we're very small compared to a Nestle or a Unilever. And we don't want to be faceless. We are proud of our cultural heritage. But we don't want it to be an impediment to growth, and we want to make people comfortable that culturally we have a very open architecture. We position ourselves today as a Hong Kong-based multinational trading company. Hong Kong itself is both Chinese and very cosmopolitan. In five years, we've come a long way in rethinking our identity. As we grow and become more multinational, the last thing we want to do is to run the company like the big multinationals. You know - where you have a corporate policy on medical

leave or housing allowances or you name it. How do you avoid setting policies, a path that would seem inevitable for most companies? We stick to a simple entrepreneurial principle. For the senior ranks of the company, the mobile executives, we "encash"-that is, we translate the value of benefits into dollar figures-as much as we can. Cash gives individuals the most flexibility. I cannot design a policy to fit 1,000 people, so when UI SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE in doubt we give people money instead. You want a car? You think you deserve a car? We'd rather give you the cash and let you manage the car. You buy it, you service it. The usual multinational solution is to hire experts to do a study. Then they write a manual on car ownership and hire ten people to administer the manual. If you ask yourself whether you would rather have a package of benefits or its equivalent in cash, maybe you'll say, I don't want such a nice car, but I'd prefer to spend more money on my home leave.

Cash gives individuals a lot more freedom. That's our simplifying principle. The committee of 30 not only shapes our policies but also translates them into operating procedures we think will be effective in the field. And then they become a vehicle for implementing what we've agreed on when they return to their divisions. There are few businesses as old as trading. Yet the essence of what you do at Li & Fung-managing information and relationships-sounds like a good description of the information economy. How do you reconcile the new economy with the old?

At one level, Li & Fung is an information node, flipping information between our 350 customers. Since you operate in so many countries, do you and our 7,500 suppliers. We manage all that today have to index cash equivalents to

local economies? with a lot of phone calls and faxes and on-site visits. That's the guts of the company. Soon we will need Wherever we operate, we follow local rules and best practices. We do not want uniformity for lower- a sophisticated information system with very open architecture to accommodate different protocols level managers. If they say in Korea, " We don't come from suppliers and from customers, one robust want bonuses but everybody gets 6 months enough to work in Hong Kong and New York-as salary," that's the market. What we do would probably as in places like Bangladesh, where you can't really drive the HR department in a multinational crazy. But it works for us: for the top people, we figure always count on a good phone line. figure out a cash equivalent for benefits, and for the low have a picture in my mind of the ideal trader for local staff, we follow local best practices. It's fine if today's world. The trader is an executive wearing a pith helmet and a safari jacket. But in one hand is a And remember, we are an incentive-driven company and in the other a very high-tech company. We try to make the variable component of compensation and communication device. From one compensation as high as possible and to extend that side, you're getting reports from suppliers in newly principle as far down into the organization as possible- emerging countries, where the quality of the information may be poor. That's the entrepreneurial approach. From the other side, you might have highly accurate point-of-sale information from the United States that allows you to reach as you spread out geographically, how do you hold everything together automatically. In other words, you're managing the organization together? The company is managed on a day-to-day basis by maneuvering between areas that

have a lot of catching the product group managers. Along with the top up to do-you're fighting through the underbrush, so to speak-and areas that are already clearly from management, they form what we call the policy committee, which consists of about 30 people. We closed on the twenty-first century. meet once every five to six weeks.

People fly in As the sources of supply explode, managing information around the region to discuss and agree on polimation becomes increasingly complex. Of course, cies. Consider, for example, the topic of compliance we have a lot of hard data about performance and ance, or ethical sourcing. How do we make sure our about the work we do with each factory. But what suppliers are doing the right thing-by our cuswe really want is difficult to pin down; a lot of the tomers' standards and our own-when it comes to most valuable information resides in people's issues such as child labor, environmental protection.

What kind of attitude does the owner have? tion, and country-of-origin regulations? Do we work well together? How good is their interCompliance is a very hot topic today-as well it nal management? That kind of organizational memory is a lot harder to retain and to share. We should be. Because our inspectors are in and out of see the capturing of such information as the next the factories all the time, we probably have a better frontier. You could look at us as a very sophisticated window on the problem than most companies. If IT system. So that's the modern side of who we are. we find factories that don't comply, we won't work with them. However, because there is so much subcontracting, you can't assume that everyone is doing what about the more traditional side? ing the right thing. That is, you have to make sure In the

information age, there is an impersonality that a supplier that was operating properly last that seems to say that all the old-world thoughts 112 HARVARD BUSINESS REVIEW September-October 1998 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE about relationships don't matter anymore. We're all taken with the notion that a bright young guy can bring his great idea to the Internet, and it's okay if no one knows him from Adam. Right?

Maybe. But at the same time, the old relationships, the old values, still matter. I think they matter in our dealings with suppliers, with customers, and with our own staff. Right now we're so big, three of our divisions could be scheduling work with the same factory. We could be fighting ourselves for factory capacity. So I'm in the process of creating a database to track systematically all our supplier relationships. We need something that everyone in the company can use to review the performance history of all our suppliers. One of my colleagues said, " We'd better guard that with our lives, because if somebody ever got into our system, they could steal one of the company's greatest assets. " I'm not so worried. Someone might steal our database, but when they call up a supplier, they don't have the long relationship with the supplier that Li & Fung has. It makes a difference to suppliers when they know that you are dedicated to the business, that you've been honoring your commitments for 90 years. I think there is a similar traditional dimension to our customer relationships. In the old days, my father used to read every telex from customers. That made a huge difference in a business where a detail as small as the wrong zipper color could lead to disastrous delays for customers. Today William and I continue to read faxes from customers-certainly not every one, but enough to keep us

in personal touch with our customers and our operations on a daily basis. Through close attention to detail, we try to maintain our heritage of customer service. As we have transformed a family business into a modern one, we have tried to preserve the best of what my father and grandfather created. There is a family feeling in the company that's difficult to describe. We don't care much for titles and hierarchy.

Family life and the company's business spill over into each other. When staff members are in Hong Kong to do business, my mother might have tea with their families. Of course, as we have grown we have had to change. My mother can't know everyone as she once did. But we hold on to our wish to preserve the intimacies that have been at the heart of our most successful relationships. If I had to capture it in one phrase, it would be this: Think like a big company, act like a small one. A TRADITION OF INNOVATION In the company's early years, Li & Fung dealt in porcelain and other traditional Chinese products, including bamboo and rattan ware, jade and ivory handicrafts and fireworks. Li & Fung's invention of paper-sealed firecrackers in 1907 to replace the traditional mudsealed firecracker was a major breakthrough. At that time, the U. S. import duty on firecrackers was based on weight. The paper-sealed firecrackers not only incurred lower import duties by being lighter but also eliminated the problem of excessive dust produced by the discharge of the mud-sealed variety. Li & Fung's paper-sealed manufacturing process has become the industry's standard. Is the growing importance of information technology good or bad for your business?

Frankly, I am not unhappy that the business will HARVARD BUSINESS REVIEW September-October 1998 113 SUPPLY CHAIN MANAGEMENT, HONG KONG STYLE be more dependent on information technology. The growing value of dispersed manufacturing makes us reach even further around the globe, and IT helps us accomplish that stretching of the company. As Western companies work to remain competitive, supply chain management will become more important. Their need to serve smaller niche markets with more frequent changes in products is pushing us to establish new sources in less developed countries.

We're forging into newly emerging centers of production, from Bangladesh to Sri Lanka to Madagascar. We're now landing in northern Africa - in Egypt, Tunisia, Morocco. We're starting down in South Africa and moving up to some of the equatorial countries. As the global supply network becomes larger and more far-flung, managing it will require scale. As a pure intermediary, our margins were squeezed. But as the number of supply chain options expands, we add value for our customers by using information and relationships to manage the network. We help companies navigate through a world of expanded choice. And the expanding power of IT helps us do that. So the middle where we operate is broadening, making what we do more valuable and allowing us to deliver a better product, which translates into better prices and better margins for our customers. In fact, we think export trading is not a sunset industry but a growth business. Was the professional management training you and William brought with you from the United States helpful in running an Asian family business? It's an interesting question. For my first 20 years with the company, I had to put aside-unlearn,

in fact a lot of what I had learned in the West about management. It just wasn't relevant. The Li & Fung my grandfather founded was a typical patriarchal Chinese family conglomerate. Even today, most companies in Asia are built on that model. But a lot has changed in the last five years, and the current Asian financial crisis is going to transform the region even more. Now, instead of managing a few relationships the essence of the old model- we're managing large, complex systems. It used to be that one or two big decisions a year would determine your success.

In the 1980s, for example, many of the Asian tycoons were in asset-intensive businesses like real estate and shipping. You would make a very small number of very big decisions- you would acquire a piece of land or decide to build a supertanker- and you were done. And access to the deals depended on your connections. 114 The Li & Fung of today is quite different from the company my grandfather founded in 1906. As it was in a lot of family companies, people had a sense over the years that the company's purpose was to serve as the family's livelihood. One of the first things William and I did was to persuade my father to separate ownership and management by taking the company public in 1973. When our margins were squeezed during the 1980s, we felt we needed to make dramatic changes that could best be done if we went back to being a private company. So in 1988, we undertook Hong Kong's first management buyout, sold off assets, and refocused the company on its core trading business. Later we took our export trading business public again. I'm sure some of our thinking about governance structure and focus was influenced by our Western training. But I'm more struck by the changes in the company's decision making.

Right now in this building, we probably have 50 buyers making hundreds of individual transactions. We're making a large number of small decisions instead of a small number of big ones. I can't be involved in all of them. So today I depend on structure, on guiding principles, on managing a system. Of course, I think relationships are still important, but I'm not managing a single key relationship and using it to leverage my entire enterprise. Instead, I'm running a very focused business using a systems approach. That's why I say that in the last five years, everything I learned in business school has come to matter. Li &