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"Evolution of contract manufacturing and global value chains with special reference to the continuing sources of competitive advantage of Li & Fung."

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Accademic year 2009-2010

To all my family and friends

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Abstract

The thesis starts with a quick analysis of how in the last decades globalization has shaped dramatically the world economy causing two interrelated phenomena: the disintegration of production and the integration of trade.

The work presents the relevant economic literature dealing with these phenomena, with special references to the global value chain framework, as the most exaustive and comprehensive theoretical elaboration to explain the changes in the way global business in conducted nowadays.

Particular attention is also devoted to the theoretical justification of loosely coupled business relations, as the right approach to effectively manage fluid and global networks of companies ensuring flexibility, efficiency and innovation.

Is then presented the case of the “Li & Fung Trading” an Hong Kong based multinational leader in the supply chain management. The evolution of this old Chinese trading firm into a succesful global company is very interesting under many perspectives.

The capacity of reinventing itsefl to face market’s changes, the genius of its business model, the innovation in its internal organization and the capacity of vision of its top management are all distinctive characteristics of this firm, that can be definitely considered part of that bunch of companies, defined by professor J. A. Mathews as “dragon multinationals” that coming from the periphery of the world quickly become fundamental players of today’s global markets.

Keywords

Globalization - supply chain management - global value chain – loosely coupled business processes - network orchestrator - Li & Fung.

Acknowledgements (I will write them after your final approval of the thesis)

Chapter 1

Introduction

The aim of my thesis is to study the increasing diffusion of the global value chain models and the emergence of several forms of production networks that are dramatically reshaping the manner in which business is conducted around the world.

This topic is particularly interesting because in the last ten years global value chains have become more and more elaborate with a complexity that marks a qualitative difference with the international operations or trading relationships that firms traditionally undertook in the past.

I will present evidence that in today's contest of globalization, the disintegration of production and the integration of trade are creating new challenges for companies in terms of coordination and integration of activities along given value chains.

At the same time these challenges constitute big business opportunities in a variety of industries because they create room for the emergence of a new kind of companies called network orchestrators. These new firms basically are service companies in charge of organizing the supplier processes for the lead firms. Compared to traditional companies they require less capital because they own fewer assets and leveraging the resources of partner firms they can generate higher returns.

Through the analysis of one of today's most successful network orchestrator, an Hong Kong based multinational called Li & Fung, I will explain in detail how such companies operate focusing in particular on the business model and on the sources of competitive advantage.

1.1. Keywords

1.1.1. Globalization

Giving an exaustive definition of globalization is challenging because it is a phenomenon that spans across economy, policy, sociology, geography etc and most of all because it is still an ongoing process.

On the broadest level the term refers to the growing global scale interconnection and integration of human activities.

From an economic perspective we can make a distinction between the globalization of markets, brought by the free trade and the globalization of production, caused on the contrary by a restriction of trade.

It is also important to point out the difference between internationalization and globalization. The first one is the simple extension of economic activities across national boundaries and is a quantitative process. Globalization instead is qualitatively different because involves not only the geographical extension of economic activity but also the functional integration of such international dispersed activities.

Within the economic perspective, globalization encompasses a wide range of phenomena that include foreign direct investments, international joint ventures and strategic alliances, global scale market competition and cross border contracting and global scale production networks. It is specifically on this last point that will be the focus of the thesis.

Globalization is also cited in the work as the process responsible for the continuing shift in the locus of power from producer to retailers to consumers. The bottom line is that nowadays the consumer is the new axis around which the economic world revolves, requiring the creation of business models able to deliver products and services taliored more and more to his needs.

1.1.2. Supply chain management (SCM)

Supply chain management consists in coordinating and integrating flows of materials, informations and finances in a process that goes across suppliers, manufacturers, wholesailers, retailers and consumers. The ultimate goal of any SCM model is to reduce inventory without losing the capacity to quickly respond to market changes. Supply chain management has greatly benefitted from the development of information technologies and dedicated softwares. The outcomes have been a consistent improvement of time to market of products and a relevant cost reduction. The refinement of supply chain management techniques we are assisting nowadays can be summarized then as the tendency to substitute inventory with information.

1.1.3. Global value chain (GVC)

The two complementary dynamics of disintegration of production and integration of trade has been named by the scholars "global value chain". This theoretic framework aims to explain the different ways in which production and trade are spread and integrated among group of firms in geographically dispersed locations.

The analysis offered by the GVC framework covers three main elements: firm level chain governance, power distribution among all the actors in the chain and role of institutions. This last point will be treated highlighting the crucial role played in this new scenario by the emergence of developing countries. The increased number of new ties and relations between economic actors around the world have widened the spectrum of the form of business governance beyond the simple dichotomy between markets and hierarchies into a variety of network forms of industrial organization. Many types of networks have been developed depending on the determinants of value chain governance pattern that are basically three: complexity of transactions, codifiability of informations and capability of suppliers.

Under the specific characteristics and interactions between these three determinants, business processes can be still traditional relying on an hard-wired design, or more collaborative using a loosely coupled design.

1.1.4. Loosely coupled business processes

This term refers to a very different design and management approach related to the emergence of collaborative business processes. Traditional business relations rely on hard wired design implying that activities throughout a process are defined with great precision and tightly integrated. On the contrary, in a world becoming more and more "flat"[1] where companies are organizing around fluid and globally dispersed networks, traditional principles of management are not enough effective. The ability to dictate top down standardized activities especially across multiple enterprises has become much more limited. Loosely coupled designs face this challenge employing a modular approach where the focus is on defining standardized interfaces across modules of activities. The primary differences with hard wired design are along three dimensions. The first one is a shift in the focus from the firm to the network, the second one a shift in the management from control to empowerment and the third one a shift in the value creation from specialization to integration. Ultimately the strenght of this approach is to accept diversity at the activity level, focusing on ensuring that modules can flexibly connect with each other and be easily modified to accomodate changing business needs.

1.1.5. Network orchestrator

Companies participating into process networks can play one of two roles: orchestrator or service providers. Service providers are all the companies involved in the various stages of the process where they are responsible for performing specific modules of activity without selling directly the outcomes but producing them as a service. The orchestrator instead is the single entity in charge of governing and coordinating all the actors. For example an orchestrator of a global production chain does not produce any products on his own nor directly participates in any of the stages of production within the chain. Nonetheless it performs a set of activities that are crucial for the good functioning of the

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[1] This definition comes from the journalist T. Friedman that coined it in his book "The world is flat". In this work the author uses this terms to stress the effects of globalization that especially in the last decades thanks to the development of internet, the diffusion of high speed fiber optic cables and workflow software, has shrunk the world "from a size small to a size tiny".

network. It is in charge of recruiting and evaluating potential network participants, coordinating their activities for particular projects, creating appropriate incentive structure to improve performance, defining standards and last but not least assuming ultimate responsibility for the end product. It is clear that to perform this role a company have to master a new range of skills and capabilities. It has to develop closer relationships with customers, to build detailed operational knowledge of the practices and activities that aims to coordinate and to understand the economic drivers of each participant in the process to effectively attract and motivate them. In a sense the only product of a network orchestrator is the process.

1.1.6. Li & Fung

Li & Fung is an Hong Kong based multinational global leader in the supply chain management for consumer goods, serving brands such as JC Penney, Liz Claiborne, Tommy Hilfiger, Talbots, Marks & Spencer etc. in the soft goods sector or Coca Cola, Disney, Kohls, Walmart etc. for the hard goods.

This company founded 100 years ago in Ghuangzhou (Canton) by Fung Pak- liu and his partner Li To-ming, thanks to the smart Western style management of the two brothers Victor and William Fung, an agressive strategy of acquisitions and a sophisticated and innovative internal organization, in the last 40 years has transformed itself from a Chinese family company into a giant multinational, operating in more than 40 economies with a network of 12,000 suppliers.

Li & Fung is a pure global network orchestrator, that means when it receives an order from a customer for the supply of a quantity of garments for example, it might purchase yarn from Korea that will be woven and dyed in Taiwan, cut in Bangladesh, then shipped to mainland China for final assembly where it will be matched with zippers from a Japanes company and finally delivered to the client that could be a major retailer in US or Europe.

Li & Fung therefore in its role of supply chain orchestrator does not produce anything on its own, neither directly participate in any of the stages of production

within the supply chain. It just orchestrates all these passages and actors assuming full responsibility with the customer for the final delivery of the orders.

Quoting one top manager of the company: "Li & Fung keeps it simple for the customer while mastering in great detail the complexity of understanding the specific capabilities and economics of each suppliers."[2]

This business model has proven to be not only innovative but also very profitable. Since 1995 the company has been able to double its revenues and operating profits every three years, with very good chances to reach the projected goal for 2010 of $20 billion of turnover.

In the last twentyfive years it has experienced a compound annual growth rate of turnover and net profits of more than 20 per cent and the return on equity has exceeded 30 per cent a year. These results are impressive especially because it operates a low margins business in an industry growing on average 2 per cent a year.

This company case even though is little known outside its industry is very interesting and will be discussed trying to address the following key questions:

What is the business model of Li & Fung?

What is its competitive advantage, how did it get it and for how long will it last?

Where is the value added of its activity?

How did it manage to transform itself from a regional middleman to a global sourcing giant in such a short period of time?

Is its fortune tied too much to the booming growth of the Chinese manufacture or will it have a future also when China's growth rate will slow down?

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[2] Hagel, J. III and J. S. Brown, 2002, Orchestrating Business Process – Harnessing the value of Web Services Technology, p. 12.

Chapter 2

Global value chains (GVCs)

"Ripping the roof off the factory"

2.1. GVCs and main drivers.

The famous claim of Henry Ford that referring to the buyers of his cars used to say: “They can have any color they want as long as it is black” sounds as ironic as out of date.

Nowadays when the consumer walks into a store, he finds all sort of goods tailored more and more precisely to his desires at a lower and lower price.

How did it happen? Well, to answer this question we have to do some steps back because much of that is due to the globalization and precisely to the changes that took place in the last decades.

“The playing field is being leveled”[3] told the CEO of Infosys Technologies, Nandan Nilekani in a conversation with Thomas Friedman to explain the success of his IT Indian company. In a very short period of time the convergence of personal computers, high speed fiber optic cables and work flow software created a sort of rudimentary platform on which others factors developed, steadily flattening and making smaller the world even more.

One of these factors is global value chain,[4] a method of collaborating horizontally among suppliers, retailers and customers to create value drawing parts and products from every corner of the world.

The bottom line is that now companies can look for the best producers at the lowest price not just in their region or continent but anywhere they can be found. There are two basic implications for that. The first one is that the most efficient way to run a business is not anymore to put everything under the roof of your factory, the genius of Henry Ford’s success with his famous

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[3] Friedman, T. L., 2006, The World is Flat: the globalized world in the twenty-first century, p. 7.

[4] The concept of “global value chain” has taken over the years several names in the economic literature like “global supply chain” or “global commodity chain”. Although they are often used interchangeably, there are little differences among them. Global supply chain is traditionally referred to the inbound and outbound logistics of particular firms. The differences between global commodity and global value chain will be explained later on in the chapter.

assembly line. Today your factory is the world and the principle of the division of labor has been replaced by a new one: the dispersion of labor.

A powerful example is the Boeing's 777 jet, which is made up of three million parts from more than 900 suppliers spread in 17 countries. What Boeing is still doing under its roof is the fuselage and the wings while the rest of plane's components are outsourced around the globe.[5]

The second implication is that under the pressure of an increasing and global competition, companies naturally tend to specialize focusing on their distinctive capabilities and sheding those that are better performed by others. To continue with the past example and not surprisingly then, Boeing is also outsourcing to an Indian company the key system for collision avoidance and landing in zero visibility installed on all its aircrafts.[6]

The trend to reorganize the corporation around its core competences actually is not just an effect of globalization, but in this period it has coupled with the development of collaborative business processes.

The topic of the defining competences of a company and of the vertical disintegration of transnational corporations was first studied by transaction costs economics, that mainly used the variable of frequency to explain the phenomenon. If an imput even an important one is required infrequently, then it will likely to be acquired externally.

The subject has been discussed further, under a strategic perspective by Prahalad and Hamel who demonstrated the crucial importance for the management of cultivating a core-competency mind set.[7] In their reasoning they brought the example of NEC, the Japanese giant competing succesfully in different businesses as semiconductor, telecommunications, computing and consumer electronics, versus the American GTE corporation.

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[5] http://www.boeing.com/commercial/777family/pf/pf_facts.html.

[6] Ibid.

[7] Prahalad, C. K. and G. Hamel, 1990, The Core Competence of the Corporation.

They explained how NEC emerged as a world leader in almost all its businesses surpassing and beating GSE that was starting from a much stronger position. The success was in the capacity of NEC's management to identify the core competencies of their organization and articulate a clear strategic intent, that in their case was: "exploiting the convergence of computing and communications". The other merit was the enhancement of their defining competences through focused investments and the forging of a broad network of alliances with strategic partners. Such a clarity of vision and focus was missing at GSE that was incoherently diversified and in less than ten years lost all its competitive advantage being overcame by NEC. To put it as Prahalad and Hamel, the problem of GSE and many others firms was in the way the company was conceived, as a "portfolio of businesses" instead of a "portfolio of competences".[8]

The processes of outsourcing and offshoring related to the redefinition and relocation of companies' activities, leaded to the emergence of global value chains as the organizing framework for production, investment and trade for a range of product groups such as garments, consumer electronics, automobiles and automotive parts, telecommunications, agro-industry etc.

Global commodity chains (GCCs) in the beginning and global value chains (GVCs) later on are also the names for the corresponding theoretical frameworks eaborated by scholars to refer to this range of activities (design, production, marketing, distribution and support to the final consumer) that firms and workers do to bring a product from its conception to its end use and beyond. It is a systemic perspective that incorporates all key activities some involving tangible outputs others intangible services that are more and more divided among multiple firms and spread across wide geographic areas.

[8] Ibid. p. 4.

The global commodity chain perspective (GCC) was first introduced by Gereffi in a work of 1999 [9] to analyze the social and organizational dimensions of international trade networks. He identified a critical distinction in this approach between producer-driven and buyer-driven commodity chains.

The producer-driven commodity chain was the initial type of chain network to emerge as a major force in reorganizing international production. It exists when there is a large multinational manufacturer that plays a central role in shaping the production network. Normally that happens in capital and technology intensive industries such as aircrafts, automobiles, telecommunications and semiconductors. These manufacturers generally retain control of R&D, basic product design, and innovation, exerting relatively close control in coordinating a geographically distributed network of suppliers, subsidiaries and affiliates from raw materials and components provision to distribution and retailing. They have this power because in a producer-driven chain profits derive from scale, volumes and technological advances.

Fig 1: The organization of producer-driven and buyer driven global commodity chains.

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[9] Gereffi, G., 1999, International trade and industrial upgrading in the apparel commodity chain.

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Source: *International trade and industrial upgrading in the apparel commodity chain*, Journal of International Economics

Buyer-driven commodity chains instead are a relatively more recent development in international production. In this case, large retailers, branded manufacturers or branded marketers play a crucial role in setting up and coordinating decentralized production networks, usually located in developing countries, defining product, process specifications and standards. They are typical of labor intensive, consumer goods industries such as garments, footwear, toys, consumer electronics, agro industry, etc.

Buyer-driven commodity chains are characterized by highly competitive and globally dispersed production systems. In this contest the main leverage is in the hands of retailers, manufacturers and marketers that shape mass consumption and acts as strategic brokers linking factories in developing

countries with the evolving products niches in the Western consumer markets. Because the participation requirements are relatively low, this type of chains offers many opportunities also for SMEs located in remote areas but capable of meeting buyers' requirements.

Some years after the definition of the global commodity chain, Gereffi and other scholars superseded this concept with the introduction of the global value chain framework.

The main differences between the two concepts can be found in the special efforts made by the scholars to explain in a more refined way, how these global value chains are organized, how they work and in general their governance. This issue is central to the global value chain approach because a chain without governance would be just a string of market relationships.

Governance is defined as the set of interfirm mechanisms and relations through which non-market coordination of activities is achieved. Normally the coordination required is about what is to be produced, how, when and how much. If governance in value chain is basically setting parameters along the chain, the simple question that arises is why companies would want to do this.

The answer is to contain performance risks that are problems with the quality of products, response time, reliability of delivery ect. that are even more crucial when a company is engaged in a non price competition.

The lead firm or in general the buyer has a better understanding of the market than the supplier. Usually the supplier is a latecomer firm to the global economy, dislocated from the mainstream international markets it wishes to supply.[10] It has limited knowledge of market demands and

[10] Hobday, M., 1995, *Innovation in East Asia: the challenge to Japan,* Edward Elgar Publishing, p 34.

characteristics and so the buyer has to convey this kind of requirements chosing case by case the needed degree of specifications.

Gereffi, Humphrey and Sturgeon[11] come to a classification of different types of global value chains that even though is more analytical than empirical, is still useful to have some insighs on the determinants of these processes. They identified a spectrum of five typologies of global value chains: markets, modular, relational, captive and hierarchy. We briefly analyze each of them.

Markets: in markets linkages the main points are that the cost of switching to new partners is low for both parties and transactions requires little explicit coordination. This is because the complexity of informations exchanged is relatively low, products' specifications are simple and so suppliers have the capability to make products with little imputs from buyers. In syntesis market exchanges are primarily based on price.

Modular: when products' architecture is modular, technical sandards reduce component variations and process specifications, suppliers are able to provide full packages and modules, buyers' need for direct monitoring and control is reduced. Complex informations can be exchanged with little explicit coordination, keeping the cost of switching to new partners still low.

Relational: here there is a complex interactions between buyers and sellers. An exchange of tacit knowledge that creates mutual dependence and can be regulated by strong reputation, or families and ethnic ties. The high level of explicit coordination and suppliers' capabilities makes the costs of switching to new partners very relevant.

Captive: when products specifications is high but suppliers' capabilities are low the value chain will tend to be captive type. Low supplier's competence requires great deal of intervention and control by the lead firm, which by its side will try to confine the suppliers to a narrow range of tasks and make it

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[11] Gereffi, G., J. Humprey and T. Sturgeon, 2005, The governance of global value chains.

dependent on the lead firm for the complementary activities. They try to control opportunism and at the same time provide enough resources to the subordinate firm to make the exit from the partnership an unattractive option.

Hierarchy: when product specification cannot be codified and competent suppliers cannot be found, lead firm has to develop and manufacture products in house. It is the classic case of vertical integration. This choice is usually driven also by the need to control resources, expecially intellectual property.

Fig 2: Global value chain governance types.

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Source: *International trade and industrial upgrading in the apparel commodity chain*, Journal of International Economics

The extremes of the spectrum, market and hierarchy represent the opposite cases of externalization, when transactions take place exclusively in the market and internalization, when on the contrary everything is kept in house.

What we find in the middle are different kind of network arrangements that depending on the quantity, quality and type of interactions between members may be more tight or loose.

Specifically what is crucial in determining the network format is the complexity of transactions, codifiability of informations and capability of suppliers. The five types of global value chains bear these variables in different degrees as shown in the table below:

Table 1: Key determinants of global value chain governance.

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Source: *International trade and industrial upgrading in the apparel commodity chain*, Journal of International Economics

On one side complexity is enhanced when the lead firm places new demand and increase products differentiation. On the other side this effect is mitigated by the adoption of technical or process standards. When standards are widely known moreover, parties can be easily linked and de-linked resulting in a very fluid and flexible network structure.

While it does not make sense to argue that there is one best model for all the situations, because every governance types provide a distinct set of advantages and disadvantages, it is useful to map them to konw where they

stand in terms of agility which is intended as “geographic agility” and “output agility”.[12]

Fig 3: GVCs governance types: geographic vs output agility.

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Source: Sturgeon, T., 2001, *How do we define Value Chains and Production Networks.*

[12] The names in figure reflects a more recent classification of global value chain governance types made by Sturgeon. This classification basically corresponds to the five typologies that I already described above. There is just a terminology difference as follows: Spot transactions stand for market, vertical integration is hierarchy and virtual production network is modular. Captive and relational are exactly the same.

As emerges from the figure, the best typology of global value chain in terms of agility, is the modular one (or virtual production network). This is due to the relatively loose governance style of the modular model, which consists in a limited interdependence between lead firms and suppliers which is in turn enabled by a heavy reliance on standards.

Ultimately is precisely in a modular flexible and fluid network structure that resides the secret of a profitable and successful collaboration according to the studies of Brown, Durchslag and Hagel.[13]

The main points of these scholars are two: first of all the benefits of collaboration can be fully reaped when this is anchored in specific business processes that span across multiple entreprises driving the economic performace of their participants.

Secondly, to unlock this economic value a new and different approach to manage business processes is required. The business processes they identified are supply chain management, customer relationship management and production innovation and commercialization.

Enhancing the coordination of activities across these processes would fully realize the potentials of the collaborative approach with a performance improvement that is not just a one time event, but it steadily grows as is happening for companies like Li & Fung and Nike (for the supply chain management) or Cisco (for the customer relationship side).

The starting point of their global value chain analysis is the main trade off that conversely a tight management of business relations implies: the number of suppliers has to be cut to a minimum.

This is an obliged outcome for a company, given that a tight integration requires resources, lengthy negotiations, detailed contracts and an extensive monitoring of performance, making coordination costs steep.

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[13] Hagel, J. III, S. Durchslag and J. S. Brown, 2002, Loosening up: How process networks unlock the power of specialization.

It also inevitably reduce the flexibility of processes and limit the innovative thinking that a more loosely management of partners' work might yield.

A loosely coupled design as a matter of fact is focused on defining standards across modules of activity in order to create a plug and play system to tailor processes and functions and to easy accomodate changing business needs.

Ultimately the difference between tightly and loosely coupled business processes is the difference in the potential economic value creation of the two models.

Tightly coupled business processes basically tend to improve based on experience with particular tasks. Nonetheless because they are afflicted by high coordination costs, an increase of the number of participants in the process is necessarily also the root cause of diminishing returns for the entreprises.

Conversely, loosely coupled business processes enjoy too the benefits of experience, but also allow firms to specialize more and more on activities where they have truly distinctive capabilities.

Since they do not incur high coordination costs if the number of participants in the process growths, rather than encountering diminishing returns they develop an increasing returns dynamic.

The enhancement of specialization for each single participant offers to the customer potential access to world-class services for its entire set of needs.

In other words in a loosely coupled business process the more the number of participants increases, the more are the benefits for customers as well as for service providers.

In the right management approach for a loosely coupled business process the traditional principles of management need to be augmented with skills that belong to the field of the network orchestration. The main differences are along the three dimensions of roles, rules and renewal.

To put it simple, the role of management also in a conventional business is exactly about managing the diverse activities, focusing on competition strategies and enhancing company's capabilities of value creation.

For each of these activities as shown in the figure below, the network orchestrator takes a different approach.

Fig 4: The three roles of the network orchestrator.

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Source: *Competing in a Flat World,* Wharton School Publishing.

The lead company needs a form of leadership that cannot be exercised with traditional methods as command, rewards or a rigid control systems, for the simple reason that it does not have the ownership of the network that aims to manage. Instead it has to rely on a combination of empowerment and trust as well as training and certifications to hold the network together.

It should encourage participants to act entrepreneurially creating an incentives structure that is crucial for the success of a loosely coupled business process.

From the strategy standpoint, the network orchestrator has to shift the focus from the company to the overall network. Competition for example is not anymore just between two retail stores on the same street. It would be a big mistake consider the company in isolation from the network: networks compete against networks. Competition then would be among the supply chains that strech from the shelves of each store to their universe of suppliers spread around the world.

Also the value creation in a network contest has different implications. The change here for the network orchestrator is from specialization to integration. In a traditional business, the value for the lead company came from holding specific skills or more in general from enhancing its specialization keeping out rivals and even partners.

On the contrary value creation for the orchestrator is coming from the ability to leverage companies' competences across the network, always broadening its borders to identify new opportunities.

Its a delicate balance between the istances of focusing firm's resources on its core competences and leveraging on the potentials offered by the network.

Ultimately we can define orchestrators as learning organizations that thanks to priviledged relations and refined incentives systems, mobilize other's companies assets and capabilities to deliver value to customers.

2.2 GVCs in the global system.

If the international division of labor and the geographic dispersal of economic activities is nothing new, what is unprecedent is the high degree of fragmentation that it has reached, together with the complexity of the pattern of production sharing.

“Production processes are sliced thinner and thinner into many stages, and the resulting production fragments are carried out in different locations. The production of a finished good thus involves the participation of many economies, with countries specializing in different fragments of the vertical production chain….”.[14]

This trend finds its complementarity in the increasing integration of trade that allowed companies to reorganize themself around their core competences advantageously outsourcing and offshoring to other firms domestically or abroad all their non core functions. The wider use and diffusion of global value chains explains the steep increase of the intermediate trade that causes a mismatchment in the macroeconomic statistics where global trade is experiencing larger changes than the world GDP (figure below).

Fig 5: World merchandise exports and GDP from 1960 to 2008.

[14] Dean, Judith M., Fung, K.C. and Wang, Zhi, 2007, Measuring the Vertical Specialization in Chinese Trade, p. 1.

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Such a model of production implies that each time goods cross the frontier, an

Source: WTO, *"International Trade Statistics 2009"*.

international transaction is recorded. When a global production chains include a number of tasks, unfinished goods may cross frontiers several times during the assembly process. The compilation of merchandise trade statistics by customs administrations results in the recording of these goods more than once. The impact of this "double counting" is significant. The share of intermediate manufactured products in non-fuel world trade was around 40 per cent in 2008, but it can vary among countries depending on their export specialization.

Fig 6: Shares of intermediate goods in non-fuel merchandise trade, 2008.

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Source: WTO, *"International Trade Statistics 2009"*.

There are no doubts indeed that the rapid increasing industrial capabilities of East-Asian countries, particularly China, that reside both in local firm and in the affiliates of multinationals is one of the forces that thanks to the increasing diffusion of the global value chain models is playing a fundamental role in reshaping world economy. China's booming growth is boosted precisely by this trade in intermediate products also called processing trade. As shown in figure this kind of trade accounts for more than 55 per cent of China imports from the world and the 40 per cent of its exports. The dynamic of this trade is also very clear: 77.2 per cent of China's processing imputs originate from East Asia regions while the majority of its exports, 61.3 per cent is destined to OECD countries, in primis US and Europe.[15] In general the entire South East Asia is interested by this dynamic that is strictly related to the large adoption of global value chains as a model of production. Chinese Taipei has an import share of 65 per cent and an export share of 71 per cent (thus in 2008, roughly two-thirds of its trade was in intermediate goods). Similar percentages are true for Malaysia, Indonesia and Hong Kong.

Nonetheless macroeconomic trade data alone mask the important organizational shifts that actually happened in the last decades, because they do not differentiate between intrafirm or interfirm trade nor they do between the several ways in which global outsourcing relationships were being constructed.

The first important change took place in the national development strategies of developing world and has witnessed a shift from import-substituting industrialization (ISI) to export-oriented industrialization (EOI). This transition from ISI to EOI strategy has affinities with the shift happened in the world economy from producer driven to buyer driven global value chains. In the ISI strategy which prevailed until the seventies, transnational corporations were the dominant economic actor. They were invited to establish advanced manufacturing industries in developing countries, through the operations of wholly owned subsidiaries. Foreign direct investments made by these transnational corporations were the main driver in the evolution of producer driver chains. This happened in

[15] Ibid. p. 12.

countries like Brazil, Mexico, Argentina etc. and in industries such automobiles, pharmaceutical, petrochemicals etc.

From the sixties to the mid-nineties the experience of East Asian "miracle economies" (the boom of Japan first and the "four tiger" Hong Kong, Taiwan, Singapore and South Corea later) launched the strategy of export oriented industrialization as a sort of "development orthodoxy". The centre of gravity for the production and export of many manufactures particularly in "light industries" as apparel, footwear, toys, consumer electronics etc. has moved to an ever expanding bunch of newly industrialized economies in the Third World.

Value chains have been progressively sliced up, relocating to areas with low wages the most labor intensive stages of production processes. The pyramidal structure of producer driven chains, where power is concentrated in the headquarters of transnational firms with a vertical chain of command, has seen the emergence of another model of global production network consisting in a web of indipendent but yet interconnected entreprises.

Major changes in the structure of these global value chains and production processes have significant impact especially on the upgrading possibilities of developing countries. That is because global value chains do not exist in a vacuum but within a complex environment of institutions and supporting industries (figure 7).

In every stage and location they are sustained by several critical imputs like human resources, infrastructures capital equipment and services. Different mixes of these imputs are associated with upgrading success.

Upgrading is intended as the process by which economies move from low value to relatively high value activitites in the contest of production networks. This happens basically because global value chains put firms on potentially dynamic learning curves. Evidence of this phenomenon can be found in several sector, but one of the clearest example is the apparel industry.

Fig 7: Generic extended value chain model with imputs.

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Source: Sturgeon, T., 2001, *How do we define Value Chains and Production Networks.*

Apparel is one of the oldest and largest export industries in the world and is the typical starter one for countries engaged in export oriented industrialization. It is a buyer driven chain where lead firms are retailers marketers and branded manufacturers that are tied to numerous contractors through sophisticated logistics and performance trust.[16] It has undergone several migrations of production since the 1950s, always within Asia.

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[16] See appendix for a detailed figure of a generic global apparel value chain.

Fig 8: Migrations and industrial upgrading in the Asian apparel value chain.

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Source: Gereffi, G., 2005, *The Global Economy: Organization, Governance, and Development.*

The first one was from North America and Europe to Japan with a sharp increase of textiles and clothings imports from this country. The second migration has been from Japan to Hong Kong, Singapore and South Corea and permitted to the "big three" Asian apparel producers to dominate the exports along the '70s and '80s. In the eighties the shift has regarded mainland China and others South East Asian nations. Lastly in the '90s new important suppliers has come from South Asia, Latin America and the Caribbean. All these migrations cannot be adequately explained just with the cheap labor argument, because production has also moved to places as Caribbean or the Mediterranean basin where wage rates are considerably higher than

mainland China for example. Trade policies like quotas and exchange rates are other critical factors in determining these patterns.

A comprehensive understanding of the migrations comes from looking at the changes happened at lead firms level that have shaped also the sourcing side causing different patterns of industrial upgrading among developing countries. Retailers, marketers and branded manufacturers[17] all play the structural role of big buyers, but what differs is the kind of buyer-seller links established by them, the kind of information they transmit to the suppliers and thus the local learning that can take place.

Key markets like Us and Europe are experiencing an increasing concentration with the creation of large entreprises that are developing greater specialization by product (specialized stores) and by price (discount chains). For example in the late 1990s five largest retailers in the Us accounted for almost the 70 per cent of all apparel sales. In 2000 the two top discount retailers, Wal-Mart and Kmart controlled about 25 per cent (by volume) of all apparel sold in Us and today Wal-Mart alone hold around the 21 per cent of this market.[18] These entreprises are all global buyers, but they place different kind of demands to their overseas suppliers.

Branded manufacturers engaged in production sharing arrangements, require the lowest level of expertise from their suppliers and consequently the knowledge exchange is relevant only to the first stages of production process. Retailers and branded marketers instead need suppliers with the capability to make garments and the logistical expertise to find all the parts needed in the finished product. They look for "full package companies" that have to be able to organise production networks, but also to know the marketing side of the business.

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[17] See appendix for a detailed description of each of these three typologies of big buyers.

[18] *Linking Greater Mekong Subregion Enterprises to International Markets: The Role of Global Value Chains, International Production Networks and Enterprise Clusters*, p. 34.

This phenomenon can be seen also as a sort of hierarchical succession in the following way. Discount chains frequently are the first buyer to develop capabilities in new export sites, because they ask for relatively simple and standardized goods and they start from lowest cost suppliers. But when specialty stores for example are willing to pay more money for higher quality version of the same garments, the mass merchandiser are pushed out of these factories, because new customers bring a more profitable business. Then manufacturers in developing countries under the succession of these foreign buyers that ask for more sophisticated products can over time upgrade their facilities and capabilities.

CHAPTER 3

THE LI & FUNG TRADING

“The consumer never really sees our name. We are behind a lot of the things that you wear and see within your home."

3.1. Origins and developments.

Li & Fung started its activity in 1906 in Guangzhou (Canton) when it was founded by Fung Pak- liu a young entrepreneur and his partner Li To-ming a porcelain merchant. It was a trading company, one of the fewest financed exclusively by Chinese capital in a field controlled by foreign merchants.

Fung Pak-liu a former English teacher, acted as an intermediary between Chinese factories and English speakers buyers, charging a 15 percent commission for his translation services. The company traded mainly Chinese handicraft products especially porcelain, silk, bamboo and rattan ware, all commercialized in the Western markets.

Particularly interesting to mention was their fireworks business. The company came up with a new way of making fireworks that used paper instead of mud seals. This was a quite important innovation because in this way the firework was lighter and allowed consistent savings of tariff costs, since the US import duty was based on weight. As a matter of fact the new design became the standard for the fireworks industry.

The Guangzhou river port was too shallow for the huge clippers that were doing the transoceanic service and the deep water port of the British colony of Hong Kong increasingly became the commercial hub of the entire South China. Fung Pak-liu's son, Fung Hon-chu, was sent there to establish a branch of the company responsible for handling the shipping of goods.

The outbreak of the Sino-Japanese war in the 30's forced the company to move its headquarter in the more convenient site of Hong Kong, where the 28 December of 1937 it was formally established as a limited one.

In 1943 Fung Hon-chu after the death of his father Pak-liu and the retirement of Li To-ming became the only owner of the company.

Despite the absence of the Li family the original name was kept because of the auspicious meaning of the two Chinese characters forming the company name: Li meaning profit and Fung meaning abundance.

In those years thanks to the migration of many refugees who were escaping from mainland China because of the rise of the Communist Party, Hong Kong became a very important manufacturing centre for labour intensive consumer goods, namely garments, toys, electronics etc. making of Li & Fung the biggest Hong Kong exporter in dollar terms.

Between the sixties and the seventies the company diversified into several businesses from shipping to property and in 1968 opened an office in Taiwan, its first outside mainland China.

In the seventies the two sons of Hon-chu, Victor and William, went back to the British colony to take an active role in the company after several years of education in the US. They understood that the business needed to be reshaped and redefined to face the new challenges of the market.

The so called Asian Tigers economies were emerging rapidly as cheaper labor places and the Western retailers were increasingly dealing directly with this Asian suppliers cutting out Li & Fung's business. The company's margins were rapidly decreasing from ten, to five and even three percent, challenging the same existence of the middleman role in trading.

The entrance of Hon-chu's sons in the management of the company brought a new perspective. Both of them were educated in the best US universities.

The oldest son Victor had attended the Massachusset Institute of Technology and achieved a Ph.D in applied mathematics from Harvard.

The youngest William had studied computer science at Princetown getting an M.B.A. from Harvard Business School.

Such a Western business education crashed with the structure of a traditional patriarcal Chinese family company as Li & Fung was at that time. The business was seen as the livelihood for all the family.

About 30 cousins had stakes in the company, many occupying management positions just to be entitled to shareholder benefits without having any kind of business experience.

Under such conditions any radical transformation was not doable. Changing the ownership structure was the first step towards a general reorganization of the business.

But the olny way to do so was taking the company public in the hope also to professionalize management and to free it from family control.

In April 1973, Li & Fung was listed on Hong Kong Stock Exchange. In that occasion the new issued stocks were oversubscribed 113 times, a record that lasted for 14 years.

In 1979 with the opening up of China, Hong Kong manufacturers could relocate their factories to mainland Southern regions. China became once-again the core sourcing point of the company, while Hong Kong was switching from a manufacture economy to a services one.[19]

As more and more East Asian countries industrialized, Li & Fung created a network of offices to widen and diversify its manufacturing sources. It expanded first in Taiwan, Korea and Singapore spreading all over the region. With such a broad buying network Li & Fung acquired a valuable regional expertise and was able to offer to its customer a more value added service.

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[19] The relocation of industries to the Chinese mainland let to a dramatic decay of Hong Kong's manufacturing sector especially in texile and apparel. Employement in this sector fell from 67,000 in 1984 to 36,000 in 1994, a drop of 47 per cent in ten years. On the other side, trading activities experieced a fivefold increase in the number of firms from 1978 to 1991 when it reached the number of 70,000. Trading companies had had replaced factories as the key economic agent in Hong Kong's export oriented growth.

In 1985 Li & Fung Retailing Limited was created as a company fully owned by Li & Fung Limited.

The retailing business was made up of two chains: Circle K Convenience Store and Toys “R” Us that operate in Mainland China, Taiwan, Singapore, Malaysia and other Asian countries.

In 1986 Victor Fung the oldest brother, left the position of managing director to start-up an investment bank, but remained in the company as a non executive one. The guidance of the company went to the youngest brother William, who saw the need of further restructuring.

However, the major shareholder of the company a family trust that retained the 75 per cent of the shares, was reclutant over the future path to follow and no possibility of agreement was seen possible.

To get out from this impasse, the two brothers formed an holding company and with a management buyout acquired all the outstanding family shares taking back the company to a private one.

The privatization was needed in order to get the flexibility necessary to make all the changes to refocus the business on its core trading activities. All the other unrelated entreprises or stakes in insurance, real estate, shipping etc. were sold off.

The company was divided into two main businesses, the export trading and retailing. From the beginning of the ‘90s, Li & Fung undertook a period of exceptional rapid growth.

In order to raise money to further fuel this expansion, the trading branch was relisted on Stock Exchange in 1992 under the name of Li & Fung Limited and with the issuance of 25 percent of its equity.

The organization inside the company also was changed, establishing an innovative setting. The geographic rationale typical of international firms was kept, establishing branch offices located near concentrations of suppliers, with native

born staff so that they could better indentify the best factories in the area and establish good relationship with them.

At the same time this geographic rationale was overcame with the creation of dedicated divisions to best serve customers. Every division was made responsible for a specific customer, or a group of, and the branch offices enabled all divisions no matter where they were based, to fully benefit of a world wide suppliers network. Branch offices existed to serve any division that needed them and they were not evaluated on the base of the office's profitability.

A decision made to avoid a useless competition between geographic areas and to incentive all the offices to advise division managers impartially about the capabilities of their suppliers relatively to a specific order.

In addition to its trading operations in the mid eighties Li & Fung also established a venture capital arm called LF Investments (LFI). Rumors want this decision coming out from the regret of the two brothers for not having taken advantage of an early chance to invest in The Gap Inc. a successful US cloths retailer and actual clients of Li & Fung. Nonetheless there were also good strategic reasons behind this move.

First of all top management realized that the textiles and some hard goods industries were overlooked by most venture capital firms, leaving a wide field of opportunities to enhance group's returns.

Secondly they thought the venture capital branch as a tool to "filling in the mosaic", that is to build presence and know how in segments where the company did not have experience, plugging those holes in its coverage.

After ten years they were managing two funds with investments in Us and European companies. They targeted mainly young and entrepreneurial companies with good design ideas and strong marketing talent that did not have the ability to finance or to source.

Without taking control of the companies LFI were backing them with minority stakes and with its broad sourcing network. The biggest success of LFI was its

$200,000 investments in the promotional company Cyrk Inc. for a 30 per cent stake in 1990. The company was a promotional premium business doing clothing or gift items with company logos. It did for example all the M&M gum ball dispensers and a full line of promotional clothing for Philip Morris. The business was so successful after five years that LFI was able to sold its stake for $65 million.

Today LF Investments is active in the three continents, Asia, US and Europe and has broaden its focus from clothing and accessories to the entire consumer good sector including cosmetics, pharmaceuticals, healthcare but also supply chain and technology providers.

It is open to invest in both minority and majority stakes opportunities that beyond offering the usual venture capital requirements as large and growing markets and proven and sustainable business model, have to bring meaningful synergies with the Li & Fung Group.

The rise of the internet age in the last decade of the century seemed to pose a serious threat to the exhistence of companies such Li & Fung. Buyers and suppliers would have dealt directly enjoying the potentialities of the web informations sharing, buying on line and bypassing any kind of middleman. The so called "frictionless economy".It was to keep up with such a perspective that in 2001 Li & Fung decided to set up an e-commerce venture in the US.

This subsidiary called Studio Direct was thought for smaller and medium size retailers to let them build their own brand on a web site without having to place large orders. As shown in the table and figure below Li & Fung was trying to leverage on the unmet needs of this small companies gaining a special market positioning as the connector for both large and small-medium buyers with its universe of suppliers.

Table 2: Needs and realities for small and medium entreprises.

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Source: *Li & Fung: strategic role of E-Commerce,* www.aect.cuhk.edu.hk.

Unfortunately the venture failed to catch on and was shut down after one year. In reality the fear that the company could have been disintermediated never became actual.

Fig 9: Li & Fung market positioning.

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Source: Li & Fung: strategic role of E-Commerce, www.aect.cuhk.edu.hk.

The internet revolution, apart from the Studio Direct failure, turned out indeed as an asset for Li & Fung to better manage the flow of informations, data and connections and to better supervise the manufacturig of customers' items across its network of offices spread around the world.

The management soon discovered that the internet could not replace the long and personal relationships with suppliers build along decades by Li & Fung and also its profound and practical expertise in managing textile quotas and quality control on products.

Strenghtened by a huge and constant growth in 1995, Li & Fung was able to more than double its size with the acquisition of Inchape Buying Services, an Hong Kong export company also known as Dodwell.

Thanks to that it broadened its sourcing network to South Asia in the Indian subcontinent, the Caribbean and the Mediterranean area. It widened also its customer base adding to its portfolio more European customers that complemented its well established presence in the US.

From the turning point year of 1995, William Fung started to use the policy of three years planning to achieve more ambitious targets of growth. The idea behind the three years plan was to combine the best of Chinese and Western planning theory.

The formulation of the plan involved a deep analysis of macroeconomic situation, regulatory and market trends, business environment and scenario forecasting. After that the stretch goals for the following three years were established, with the assurance of staying the same for the entire period.

Such a system balancing stability and renewal, pushed all the indipendent divisions to change and rethink strategy and organization, giving them a sufficient period of time to accomplish these goals. So, although the goal setting was centralised, the execution was not. This strategy proved to be successful and in 1998, the goal of doubling net operating profits was met: HK$ 470 million against the 1995 level of HK$ 242 million.

The series of acquisitions continued in 1999 when the company took over two trading firms: Swire & Maclaine Limited and Camberley Entreprises Limited broadening further its US and European customer base.

The following year it was able to acquire its main competitor, Colby Group Holdings Limited, a company particularly strong on the sourcing business for private label consumer goods with a strong brand name among department store customers, remaining basically with no direct competition.

The main problem at that time for Li & Fung was indeed the high degree of dependence to US clothing retailers. About 80 per cent of its revenues came from that industry. Even though it was a very profitable company, the lack of diversification in its customers base was a factor of great vulnerability.

In this view the company tried to expand the business in the hard goods sector, signing a deal with Coca Cola (2002) for promotional items[20] and acquiring Janco Overseas Limited (2002), an Hong Kong based company specialized in the supply of non food hard goods to supermarkets in US and Canada. These strategic moves rebalanced a little the business portfolio of Li & Fung, making the hard goods accounting for 32 per cent of its turnover.

In 2004 its wholly-owned subsidiary, Li & Fung Trading (Shangai) was granted an export company licence by the Ministry of Commerce of PRC.[21] With such a licence the company was authorized to export China sourced goods directly to customers worldwide and also import raw materials for manufacturing in China. Until then Li & Fung was dependent on its Chinese partners for exporting from China and after that it became the first wholly owned foreign trading firm in PRC to be awarded a licence with direct export rights.

Many other acquisitions and important licence agreements followed, (Disney, Tommy Hilfiger, Levi Strauss, JC Penny, Liz Claiborne[22] etc.) all contributing to the great expansion of the company and to meet its goal of dubling operating profits every three years.

Probably the recent deal with the US giant retailer Wal-Mart,[23] will represent another turning point for Li & Fung, given the huge dimension of volumes that this sourcing agreement implies.

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[20] See apendix.
[21] See appendix.

[22] See appendix.
[23] See appendix.

3.2. The Li & Fung today.

The Li & Fung Group of companies is controlled by the Li & Fung (1937) Ltd, a privately held company incorporated in 1937 in Hong Kong.

Fig 10: Shareholding structure.

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Source: Interim Report 2010. www.lifung.com

Fig 11: the Li & Fung Group.

The Group is made of 4 listed entities and one privately held company. Here there is the organigram of the group.

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Source: www.lifung.com

The Li & Fung Trading which will be deeply analyzed in this thesis, is the trading arm of the group and one of the largest supply chain management company in the world. It manages the supply chain of high-volume and time sensitive consumer goods throughout a network of 80 offices in over 40 economies across North America, Europe and Asia.

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Second listed entity is IDS, Integrated Distribution Services which provides business distribution services. It covers nine main economies in the Asean Region integrating to the classic concepts of marketing and manufacure also the logistic element. Such a structure with the logistic acting as a unifying element is called “value chain logistics” and represents the unique value proposition of this company to its customers.

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The third listed company of the group is Convenience Retail Asia, which operates a network of over 500 outlets under two brands: Circle K convenience store and Saint Honore cake shops. These outlets are located in Hong Kong and Southern China.

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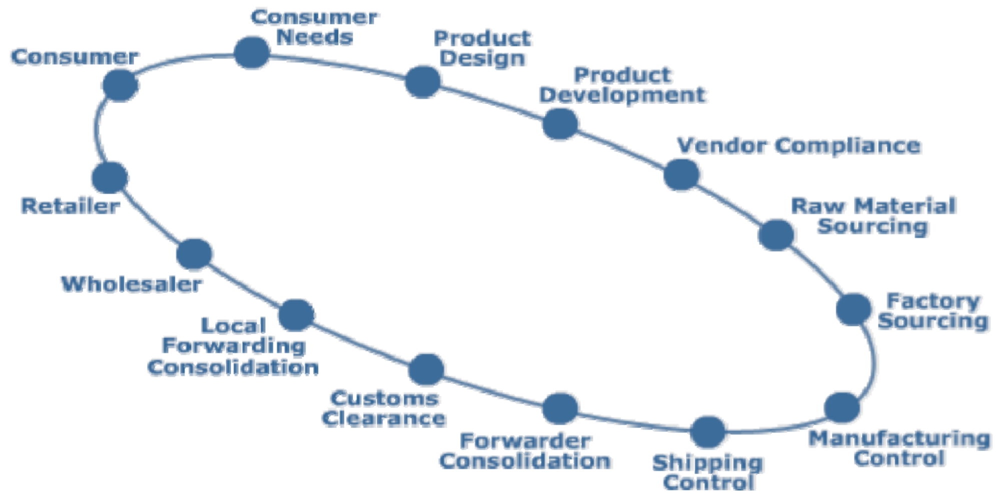
The last listed company is Trinity group, a high-end menswear retailing chain managing a portfolio of six luxury international menswear brands such as Cerruti 1881, D’urban, Kent & Curwen, Altea, Salvatore Ferragamo etc. The network is made up of about 350 monobrand retail stores the majority of which are located in Mainland China.

The privately helded company is Toys Li & Fung. It operates a specialty chain store, Toys “R” US of toys and children products. Its presence is made up of 107 stores usually located in high traffic shopping malls over 8 Asian markets.

A graphical representation of the set of services performed by Li & Fung for its clients.

Fig 12: Integrated Suply Chain Management.



Source: www.lifung.com

The key financial highlights for the year 2009.

Table 3: Financial results for the years 2008 – 2009.

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Source: Annual Report 2009. www.lifung.com

Li & Fung presence around the globe. 80 offices in more than 40 economies with a network of nearly 12,000 suppliers.

Fig 13: Li & Fung network of offices around the world.

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Li & Fung's turnover by product and by export market in 2009.

Source: www.lifung.com

Fig 14: Turn over by product for the last five years.

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As it is shown softgoods still represent its main business accounting for the 70 per cent, while hardgoods are suffering from a little decrease compared to 2008 due to the negative impact of certain customers insolvencies.

Source: www.lifung.com

Fig 15: Turn over by export markets for the last five years.

Geographically the Us still represents by far the key export market with the 64 per cent of turnover. Europe continues to be the second with a percentage a little below the 30, while other markets are very marginal ones.

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Source: www.lifung.com

Chapter 4

Li & Fung business model

The first chapters have been dedicated to outline the relevant economic literature on the topic of global value chains. We have presented how the scholars have tried to explain these phenomena, conceptualizing its threats and potentials and elaborating theoretic frameworks to synthesize them. We have analyzed also the impact of GVCs in the global economy, how they are modified by the shift of power from producer to retailers and how they shape industrial organization especially in developing countries.

In chapter three we have presented Li & Fung, starting from the origins to show its evolution over time. We have detailed particulary the fundamental changes brought by the entrance in the management around the seventies of the two brothers Victor and William, because much of the success of Li & Fung is due to their capacity of vision and to the transformations that they have been able to implement time by time.

We have then described how Li & Fung presents itself nowadays, with its actual structure, the network of regional offices spread around the world, the several subsidiaries, its turnover by products and by market, the financials and the initiatives of corporate social responsibility that make of this Hong Kong based multinational a cutting edge company of the 21st century.

Now chapter four is dedicated to see how Li & Fung really operates in its nature of a pure network orchestrator. There will still be some theoretic references, most of the time to see how theories correspond to real business situations.

4.1. Li & Fung strategy of customized global value chains.

When interviewed about the secret of their success with Li & Fung, the two brothers Victor and William use to say that most of it comes from a precious heritage of their father: his teachings about loyalty and the value of relationships. The sentence sounds weird because a company managing supply chains for hundreds of clients and interacting with thousands of suppliers all around the globe, should probably see the key of its success in the sofistication of the IT system being thankful first of all to its IT engineers.

Of course in complex and fluid networked organizations as Li & Fung, information technologies is an essential and powerful tool to make the network functioning and to hold it together. Nonetheless information technologies as pointed out by the Fung brothers are an enabler, because the heart of the network is still made of human judgements, human relationships and trust.

The need for solid relationships, trust and also physical interactions explains why virtual business places such as Alibaba or more in general e-commerce web sites have had success, but were not able to dismantle completely the usual way to do business.

Another key point to understand the importance of trust and relations for the success of the network is the mutual dependence that exists among all the players. One of the key role indeed of the network orchestrator well mastered by Li & Fung, is to keep well balanced this level of interdependence in order not to create asymmetries that generate conflicts and mistrust.

Interdependence can be seen as the evolution for the flat world of the concept of ownership, giving that from the viewpoint of a pure network orchestrator as Li & Fung, ownership represents more a constraint than an asset. Ownership here is not just intended in its legal meaning, but is conceived as opposed to flexibility. There are situations of de facto ownership for example when all the output of a factory is purchased by a

unique buyer with zero flexibility both for the suppliers and the buyer, leaving the legal property of the plant a question of little relevance.

The “ownership risk” is clear: when you own your production facilities your first concern become utilizing your capacity instead of answering a customer’s need. The choice ends to be between fully meet your customer requests or maybe avoid an idle factory limiting necessarily your degree of freedom in serving clients. A natural corollary of ownership is that somehow the creation of a supply chain starts with the factory instead of the customer.

But this mechanism is reversed by Li & Fung that not only does not own one single factory, but also have a special approach with its suppliers based on the so called 30/70 rule. Under such a rule the company targets between the 30 and the 70 per cent of the production capability of a supplier to be relevant and important for that supplier, but on the other hand not having it completely dependent on them.

Thanks to this business model freed from the ownership constraint, endowed with a wide network of suppliers all around the globe and with a deep knowledge of each of them’s capabilities that comes from long term relationships, Li & Fung is able to build supply chains exclusively around customers’ needs. This is ultimately the true competitive advantage of Li & Fung and the source of it does not lie in the sophistication of its IT, but has more to do with the human judgements and expertise of its managers that drawing from a global network of suppliers are able to tailor the value chain to each client’s business model, creating customized solutions.

Each time they start from the customer need and build the most suitable chain to achieve his desired results. To put it with the Fung’s words, they precipitate from their universe of suppliers the demanded supply chain, that

in the end is a customized one and has transformed itself into a "demand chain".[24]

So from "supply chain management" which is focused on optimizing a fixed set of assets we have passed to the more appropriate definition of "network orchestration" which is optimizing the response to a customer's need leveraging on the assets of the partners' network.

Networks can be fixed or flexible depending on what is the final aim to achieve. A fixed network is build to gain access to specific capabilities in order to deliver a specific final product or service. Flexible networks instead are planned to deliver a range of capabilities that has to be as wide as possible in order to serve customers' needs of today but also of the future.

Whereas till some decades ago quotas and cost savings were the major drivers in the network formation nowadays the logic of the networks is also determined by other factors as improving service quality, boosting speed, accessing best in world capabilities, move around global trade restrictions etc. These are exactly the potentialities inherent the Li & Fung network that are offered to customers in order to meet their requirements.

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[24] Ibid. p. 8.

4.2. Findings: is Li & Fung doing this successfully ?

The best way to explain how Li & Fung works and to prove the potentialities inherent its business model is citing some significant cases from the history of its daily operations. An example of the bumps that come along the way in this type of business and that are worked out more easily if there are personal connections and trust, is what happened to Li & Fung in a negotiation process for a sheet and towel program with a new customer.

There had been a miscommunication regarding the "in store date" for the products that was not correctly mentioned. The problem came up in September when the buyer said it was expecting the items on the shelves for the end of November. At that point all the production process resulted to be in delay. The Li & Fung manager responsible for that project then called the suppliers and thanks to the special relationship and mutual trust built over the years with them, could ask to modify their production schedule and give maximum priority to the fulfillment of that order. Then worked with the CEO of the retailer to estimate the exact quantity of the product needed in store for the end of November and reached a new deal sending by air the first load to be able to meet the November deadline (with the additional cost splitted between Li & Fung and the retailer) and the rest by water.[25]

The worldwide network developed and orchestrated by Li & Fung over the years allows the company to draw parts and products from where they are best manufactured under a logic that is not just about squeezing costs, but on the contrary is based on the specialization of its suppliers. Thus is not unusual for Li & Fung if a client asks for example porcelain dinnerware to take the decals for the decorations from Japan where they are best made, to ship them to mainland China, the place for the finest and cheapest porcelain, obtaining a final product of outstanding quality at a reasonable price. Following the same logic Li & Fung goes to India for casual cotton shirts

[25] Fung, Victor K., Fung, William K., Wind Yoram, 2007, Competing in a flat world - Building entreprises for a borderless world, p. 63.

while when finer white cotton dresses are needed, it knows that China or Korea are better place.

Such refinement in the hunt for the best-in-class capabilities is especially evident in the hard good sector. The baby talk doll, a breakthrough toy very popular in the eighties is one of the many examples of the best components from the best source: the computer chip that allowed the doll to be animated and to pronounce small phrases was from Taiwan, the vinyl body from China and the fabrics from Korea.

Another interesting case is that one of Topper the Trick Terrier, a mechanical dog able to respond to voice commands in several languages and to perform many tricks. What is special about this toy is the fact that from the conception to the development until the manufacture it is the result of the collaboration and interactions between the best specialists brought together by the Li & Fung network. An American company, Original San Francisco Toymakers Inc, envisioned the toy specifying the features and the price target. Then worked with Li & Fung for developing and sourcing the product. Li & Fung identified the best factory to hande this order, in Qualiman Industrial Co Ltd, a company outside Ghuanzou with a set of skills in electronics, plastic molding and soft toys that was the best skills' assortment needed to create hybrid product like Topper. As a matter of fact, its plastic parts came from Malaysia and Taiwan where also its chips were made, while its stuffing came from Korea and the remaining components from other parts of mainland China. The entire project resulted from a global collaboration was completed just 12 weeks after the initial discussion. This case shows also that network logic can be about improving speed in production process.

A masterpiece example of time optimization through network orchestration is how Li & Fung handled an order for two million Christmas Trees gadgets coming from Coca Cola.

The gadget was a quite complex one: a small green polystyrene tree with a toy train running around its base, flashing colored LED lights in its branches,

with Coca Cola bottles and polar bears as decoration and a small white light in the interior that rotates as the tree played Christmas melodies. A project that would have take a year to complete was instead finished in four and a half months.

Li & Fung decided to split the manufacture of the trees among three factories located near one another to facilitate the sharing of components. The electronic chips came from Taiwan, the world leader in chip making. Sometimes to avoid the risk of shortages the chips were send by plane, accepting higher transportation costs but avoiding the much higher cost of temporarily shutting down the production line for lack of components. While running the production in parallel in the three factories, Li & Fung was constantly monitoring the quality to ensure that products looked always the same. Thanks to this huge organization-orchestration effort the two million pieces were ready on schedule and in October 700 containers were shipped to Coca Cola.[26]

A typical characteristic of a network structure greatly mastered by Li & Fung is the capacity to respond to unforeseen events and to move around unfavourable changes in global trade regulations leveraging on the network broadness.

The best proof of that has been the outbreak of SARS in 2003, when the World Health Organization issued a warning against travels to Hong Kong and South China. That event could have caused big damages and losses to Li & Fung which has its headquarter in Hong Kong and many suppliers in South China. Nonetheless the company registered just a 5 per cent reduction of orders compared to the previous year because it was able to quickly relocate part of the production made in the South to factories in Norther China and moved half of its top management team to Us and European offices. It also arranged to conduct videoconferences with customers limiting the travels to and from Hong Kong.

[26] Ibid. p. 55.

Another episode where the Li & Fung network proved to be broad and flexible enough to face unfavourable and sudden changes was in September 2006 when the South African government announced that it would have imposed strict quotas on Chinese imports in two weeks.[27] Li & Fung that was having orders for South African retailers already ongoing in Chinese factories decided to move the last stage of production of these existing orders in different end countries in order to satisfy non China country of origin rules and so move around the quotas restriction.

[27] See appendix.

4.3. Li & Fung manager of GVCs: 30/70 rule, global customer groups.

If the benefits of a wide network structure and loosely coupled relations are undoubted and clearly proved, its time now to discuss how the orchestrator can keep control over the entire structure and how he can ensure it is working at the best. The topic is not just a matter of efficiency because it is particularly important also from the viewpoint of corporate social responsibility (CSR).

In today's flat world informations spread fast, there is greater transparency and consumers are quite sensitive towards labour standards, treatment of workers in the factories, pollution, global warming etc. Ensuring that suppliers follow proper compliance standards is up to the network orchestrator or to the company with the brand on the label, because even though very often they do not own the factories, they are reliable in front of the public opinion for every step of the manufacturing process.

The bottom line then is keeping the supply chain loosely linked but with a tight compliance systems. That is what Li & Fung is doing, with a control that is achieved through education, rigorous monitoring and testing, but preserving at the same time the indipendence of suppliers.

This is a challenging task that very often, as said by a Li & Fung manager is more about carrots than sticks.

The first step is setting clear guidelines, that take into account global standards as well as local laws. For this purpose Li & Fung has developed a manual called: "Labor Standards and Local Law Guidelines" covering 20 different countries.

The manual is based on International Labor Organization (ILO) conventions and treaties, best practices and national labor laws. It specifies the treatment of workers, minimum wages, health and environmental protection, noise pollution etc.

Sometimes certain clients have specific demands for CSR that goes beyond the minimum standard of expectations in areas as recycling, minimizing of packaging waste or sustainable development. In these cases Li & Fung uses the deep knowledge of its suppliers to select which supplier has the capabilities that match at the best these specific customer's requirements.

Creating guidelines is just the first step and to be effective it has to come with a system of monitoring.

Li & Fung carries out a program of annual certification for all its suppliers because factory conditions can change over time and just in this way an ongoing and active compliance can be ensured.

The annual certification process is articulated in a preliminary audit, a corrective action plan to fix possible problems and a final audit to check the actual compliance with all the parameters. In addition to this practice that is compulsory for all the vendors once a year (around May), Li & Fung reserves the right to unannounced audits to the factories.

The primary focus in the Li & Fung approach towards CSR is helping suppliers meet expectations respecting their indipendence. Although those who fall short in areas particularly sensitive can be cut off the network. Li & Fung has zero tolerance especially in three primary fields: country of origins, labor standards and supply chain security. If a problem is identified in the middle of filling the order, the production is stopped and merchandising teams are blocked from placing other orders to that supplier.

To guarantee a real enforcement power in Li & Fung the monitoring division is kept indipendent from the business units. This is fundamental not to influence decisions about compliance with business istances.

The compliance office in Li & Fung has the resources and ability to act autonomously and rapidly adress problems, because the group recognize the significance of compliance issues for the company's reputation and long term success.

After the delicate issue of the control of suppliers in a network system we have to discuss how Li & Fung get their commitment in such a loosely coupled contest. As anticipated before, the company uses an approach called 30/70 rule which has benefits for Li & Fung itself but also for the members of its network.

The 30/70 principle is quite straightforward: the goal is having more than 30 percent of the business of a given supplier to be meaningful and ensure commitment, but no more than 70 percent of its capacity to ensure flexibility and encourage learning. It is a delicate balance between sufficient commitment and sufficient flexibility to meet the challenge of fluctuating demand.

Having many other clients besides Li & Fung became a point of strenght for a supplier not only because its destiny is not dependent just on Li & Fung's will, but also for the possibility of learning from interactions with other partners.

In a fixed supply chain the same players interact with one another usually in the same way. This enhance greatly processes efficiency and bring to incremental improvements, but does not facilitate innovation and learnings.

While dealing with many partners suppliers learn about innovations in design and production and also develop their own innovative solutions to customers' challenges, widening their solution set when it comes to adress new problems. In other words a 30/70 network creates room for creativity and learning that can be smartly leveraged by suppliers. There are moreover many other advantages brought by a loosely coupled network for the suppliers.

Aggregation of demand, that is when the network orchestrator drawing together many small to mid-size factories gives the possibility also to a small supplier to serve big clients that it could not serve on its own.

The reputational asset brough to the network by Li & Fung is also a benefit for the suppliers. The high commitment of the group to quality and CSR, can

give a good factory without long history access to important customers that also in this case it would not otherwise attract.

Some members of the Li & Fung network enjoy also another important benefit brought by the action of the network orchestrator namely demand smoothing. What Li & Fung does to keep its best suppliers always occupied is redirect orders from another part of the business to them in case their actual one has been cancelled. There is no formal long term commitment to respect by Li & Fung in doing so, but this is just a smart strategy to reward the good suppliers and to keep them always active in the network.

Another service specifically provided by Li & Fung to the members of its network under some circumstances is financing. Especially in the clothing industry suppliers are exposed to considerable upfront investments and when an order is confirmed the factory has to wait months before receiving the letters of credits.

Li & Fung managing the entire process and having a better understanding of the risk associated with this industry can provide financing to its suppliers lowering their financing cost in sourcing raw materials etc. In addition unlike a financial institution Li & Fung has a strong interest to help financially its suppliers, to improve the overall supply chain performance and ultimately lowering the total cost of production.

There is of course a great advantage in a 30/70 network structure also for the Li & Fung itself and can be summarized in two words: leveraging capital.

What Li & Fung has done in the last decades ultimately is expanding its capacity and customer base very rapidly with a capital light strategy, leveraging on the asset of other companies.

To achieve its actual structure and size, Li & Fung would have needed unimaginable investments in factories, wharehousing and logistic support. While with this strategy of leveraged growth it has reduced the risk involved in fixed asset, mantaining its adaptability and flexibility towards changes in

business environment and increasing its capacity of quickly enter in new markets.

Such capital light strategies are also associated with higher performance. As demonstrated by a McKinsey study, an average Asian company need $4 of asset to produce $1 of sales, while companies with the best performance need just $1 in asset.[28]

The spectacular growth of Li & Fung in the last decades, made possible by this capital light strategy, has been pursued and built on three pillars: the entrepreneurial spirit of its business divisions, the absolute centrality of the customer as the main focus for all company's activities and the three years stretch plans.

The entrepreneurial spirit of the business divisions is a very strategic characteristics of Li & Fung that allows the company to face the challenge of the flat world "to act small", without sacrificing the benefits of being a large organization. A typical Li & Fung business division is made of 20 to 50 employees doing on average $20 to $70 million annually. These divisions act like small companies but draw upon the resources of a big one.

The division leader can concentrate all the efforts on growth opportunities and on serving at the best his customers, without thinking about human resources, information technology, accounting etc. tasks that are managed by the company headquarter.

These business leaders that the Fung brothers jokingly define as "little John Wayne" are individuals who share a strong entrepreneurial spirit, are self starters, indipendent and able to take decisions and live with the consequences. They are given the ability to hire, fire and reorganize their divisions. They are put in conditions to react quickly to changes on the

[28] Hoschka, T. C. and J. Livingston, 2002, *Winning Asian Strategies*, The McKinsey Quarterly, p. 5.

ground and being close to customers they can sharply focus on the business, shaping time by time their own network from the large universe of Li & Fung suppliers, to adapt it to client's demands. For these reasons they are compared to John Wayne that in the old films western plays the role of the cowboy who lead his fellows to circle their vagon against an enemy attack and stands in the middle shouting orders. They share a sort of frontier spirit but at the same time they still have the ability to operate in a broader organization.

The central organization then works as the back office of this small entrepreneurial division. While the goal of the division is ensuring enough flexibility to meet market demand, the goal of the back office is standardize processes and reap economies of scale. With this purpose in the Hong Kong headquarter there is the Operation Support Group (OSG) that manages four functions: IT, finance, human resources and general and administrative services.

Such a structure with a high degree of autonomy is also crucial to fully integrate acquired businesses and to retain skilled managers from other companies. About 60 per cent of actual Li & Fung top management come from acquired companies. Even more significant is the fact that in 1995 when the company acquired its main competitor a British trading firm called Dodwell all the top management of this company, primarily Western expatriates, chose to remain after the merger.

Li & Fung then presents itself as a sort of plug and play entreprise, a modular system that can effectively integrate new acquisitions and facilitate organic growth. An open architecture that also allows to absorb the best practices of acquired firms and systematize them to improve its overall business.

It is also peculiar the type of compensation of these business leaders that in line with the entrepreneurial principle is a flexible one, to reward good performance. On average just the 30 percent of Li & Fung top management compensation is fixed, leaving a 70 percent variable and tied to results. Such

an incentive is enhanced even more because there is no cap to the compensation if the business of the division is doing good. Quoting Tom Haugen, an executive director at Li & Fung with past experience in US corporations: ”Here we get a direction and the job is to go and execute. Your ability to earn money is not restricted in any way. It is not dependent on anyone else’s opinion other than the customer. It can be daunting for people who like rules but if you have just a tad of creativity and you can be ethical and legal, you can make money here.”

The second pillar on which Li & Fung based its success is the capacity of building the company around the customer. In today’s economy where suppliers can be in any part of the world, manufacturing processes are spread across multiple countries and informations flow everywhere, the new axis around which the flat world revolves could be the customer and his changing needs.

A proof of that is the garment industry where we assist to an increasing level of customization and a demand for instantaneous satisfaction of consumers’ changing needs.

Nowadays in the fashion industry there are six or seven seasons a year while till some decades ago they were two or three. A change that has transformed this sector in a very time sensitive business.

The garment industry also is probably the only industry that has seen a request for increasing quality and flexibility without a joint rise in prices, mostly thanks to process and location innovation in manufacturing.

The need for flexibility otherwise erodes the advantage of scale in manufacturing putting small factories in a comparatively stronger position. What Li & Fung is able to do is mantaining a tight and deep relationship with its customers that comes from having business division specifically dedicated to each of them, or to a group of, in case their dimension is too small to fully occupy one single division. These relationships are not “one contact point”

relationships maybe just between the two CEOs, but are multilevel ones, involving the CEOs as well as managers, merchandisers till the shipping clerks of both the clients and Li & Fung.

We better understand the fundamental importance of these personal connections if we think who are the clients of Li & Fung. Typical Li & Fung clients in the soft good sector are retailers or brand owners that in turn sell their products to the public, the end consumers.

Then it is clear that the key actor of the entire system is the end consumer who shapes the product needed by the retailers depending on his tastes and desires. Obviously the customization required by the end customer has implication also in the design of the supply chains of the retailers or brand owners and consequently on the business of Li & Fung.

What is the advantage for a retailer or a brand owner to hire Li & Fung given that this means adding another layer to the system and require greater coordination between the two parts ?

The answer is that in this way the retailer has access to a broader network of suppliers, giving him more choice and resulting more cost effective from an overall point of view.

Li & Fung also provides a one-stop shop for the retailer thanks to the total value added package of services that it is able to offer. From collaboration in the product design and development to raw material and factory sourcing, from production planning and management to quality assurance, export documentation and shipping consolidation. Taken to the highest its customer centric nature Li & Fung develops initiatives that go beyond serving customers at the best and tries to anticipate their decisions. As a matter of fact it studies the target market of every customer and its positioning, providing them reports on the latest trend of their market. This works as an early warning systems for possible shifts in the industry.

The third pillar on which Li & Fung is building its success is the system of three years stretch plans. The rationale of this approach as explained by the Fung brothers is combining the best of Chinese central planning and Western planning theory. The goal remains the same throughout the entire three years period as it happens in the Chinese central planning system. But as required by the best Western planning theories the conception of the plan starts every time from zero and involves a refined process of scenario forecasting and backward planning.

This process of plan formulation usually consists of five steps. The first one is scenario forecasting because the plan has to be based upon the current environment and an understanding of how it will evolve in the future. This analysis takes into account the macroeconomic situation, regulatory and market trends, impacts of future technologies on the business, impact of currency fluctuation etc. and tries to paint the situation three years down the road. The second point is setting a vision that guides in the definition of the stretch goals. The actual Li & Fung vision is to be the premier global consumer product trading company and as the scenario provides the external context for planning, the vision and mission provide the internal one.

The aim of the stretch goals then is to set ambitious targets that cannot be reached using the current mindset or small incremental improvements on usual operations. In this way managers are forced to exit from the comfort zone offered by routine and are encouraged to come up with innovative solutions. Stretch objectives push everybody in the company, from managers to employees to do more they think is possible.

Third step is called backward planning and serves for filling the gap between the stretch goal which is the destination point and the origin. Obviously the path will be very different from the one that has taken the company to that stage of development and for that reason performing a SWOT analysis is also a way used to indentify these gaps.

Fourth step is redesign the organizational architecture of the company. Stretch goals involve broad changes in the culture, structure, processes, governance, people, performance measures etc. that has to be rethinked to translate stretch objectives into successful actions.

The last point is clearly a specific implementation plan that answers to the key questions as where are resources needed, what are the milestones for measuring progresses etc. Is part of the company practice in Li & Fung to assign the supervision of the implementation process and the coordination of cross-department efforts to executive directors. Besides their daily operational responsibilities they are in charge of a specific strategy and responsible of making adjustments along the way based on outcomes and changes in the business environment.

Ultimately the three years stretch plan is a balance between stability and renewal. Stability avoids the so called problem of moving targets for the management and ensure a long term commitment against the pressure of financial markets to focus just on the next quarter.

Stability is needed also to build and mantain relationships, that is more than fundamental for a network orchestrator as Li & Fung. Also because a stretch growth target involves creating or expanding the network to fill in missing capabilities and strenghten weaknesses of the organization.

A clear example in this sense is the already mentioned acquisition of Dodwell by Li & Fung that bringing a European customer base rebalanced the strong position of the company in Us and Asian markets.

On the other hand the renewal every three years does not consist just in incremental improvements but represents a total change, a transformation of the company in a new organization. Although the goal setting is centralized, there is no centralized execution leaving the business leaders freedom and autonomy to reach the defined stretch objectives.

Nonetheless, there are no penalties for those who are not able at the end of the plan to reach the goal. This is in line with the definition of a stretch goal, something possible but not easily achievable. The bonuses that constitute the variable part of top management compensation as a matter of fact are tied to business results, but no specific incentives as well as penalties exist for achieving or not the final three years plan goals. The rationale of such Li & Fung behaviour is that the company will be better off by setting very ambitious targets that might not be reached within the three years period, but that anyway are a strong push for growth than following systems that encourage routine and bound innovation efforts.

Having described the strategic approach of Li & Fung in enlarging the focus from the company itself to its broad network of suppliers and having presented how it balances empowerment and control to hold together this network and to assure the best functionning of the entire system, it is time now to offer some insights on how it builds value.

The value creation in Li & Fung is a delicate balance between the enhancement of functional excellence and specialization and the benefits coming from integration across the entire supply chain process and across the different functions within the firm.

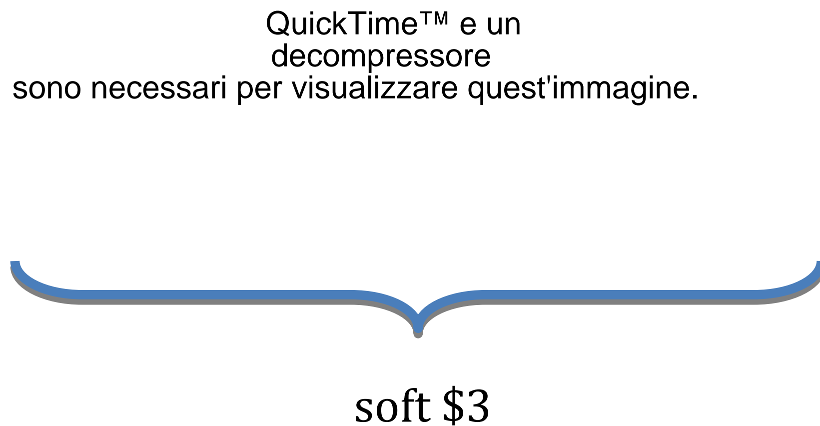
A greater integration of the entire supply chain process has been identified by Li & Fung as a source of profits little exploited up to now. The idea comes from the observation that manufacturing processes have improved dramatically in the last decades. Companies have focused on squeezing the last penny out of manufacturing, reaching such a refinement of processes that leaves no more room for other savings in this sector.

But big opportunities for cost improvements exist beyond the factory in the passages that bring the product from outside the manufacture to the shelves of the stores. This is evident giving a quick look at the costs. In an interview William Fung CEO of the company explains the concept giving the example of

a plush toy that cost $1 to produce and $4 at the retail. This price difference that he named “the soft $3” is the true source for profit opportunities.

The same reasoning is valid for many other products, from garments to hard goods with a differential that can be three, four or five times higher than manufacturing costs. The fundamental principle understood by Li & Fung is that nowadays more value or cost is added after the product leaves the factory than when it is inside.

Fig 16: The soft $3 concept.



Source: ***Innovation in Operations: Globalisation at Li & Fung,*** **www.london.edu.**

The strategy to profitably eat into this soft $3 is taking an integrated view of the entire chain instead of focusing just on one step.

Following this logic Li & Fung has moved over the years from a FOB (Free on Board) arrangement, which required taking responsibility for the shipment only to the departure point from the source coutry, to a LDP (Landed Duty Paid) model that implies the responsibility up to the shipment’s arrival at the port after the payment of duties in the customer’s market.

Taking responsibility for the whole supply chain allows to lower the total cost and not just one piece of it. In the interview W. Fung brings the example

of the shipper who always wants to fill up the container to use at best its capacity and be efficient from his perspective.

Nonetheless when someone is managing and organizing the entire supply chain and for example he have to distribute an assortment of products each done by a different factory, he might decide not to fill up each container with just one product but to move more containers from factory to factory and get each factory to fill just one part of every container with its product.

This in order to send them directly to the customer's distribution center, jumping the intervention of a consolidator to unpack and repack all the containers getting the right assortment in each.

Another example regards a more refined collaboration undertaken by Li & Fung between retailers and suppliers to better face changes in demands.

Being extremely responsive to market fluctuations is one of the most challenging but important things in the apparel industry nowadays, because demands and prices are extremely time sensitive. An increased collaboration between the actors greatily help to tackle this problem. That's why customers in Li & Fung private label business allow Li & Fung managers to have access to sales data at the retail store level. Trough tracking these informations they can see retail trends for every product, cut off those selling poorly, plan for reorders of fast selling merchandise and anticipate demand. This reverses the old adversarial view of the relationship between retailers and suppliers in favour of a more profitable collaboration for both.

Another path for value creation that represents a small portion of Li & Fung activities nowadays, but underlies a huge growth potential for the company in the years to come is "selling to the source".

As pointed out by a Goldman Sachs study, in the next decades the economies of Brazil, Russia India and China could be larger than the G6 in US dollar terms

leaving only Japan and United States among the group of six larger economies in 2050.[29]

This means that the sourcing markets will become soon, but in some cases they already are the major selling markets and the sourcing activities of today can offer precious insights to build consumer businesses tomorrow.

If a company is able to take a more integrated view of its internal organization, bringing together marketing and operations, it can leverage the deep knowledge of these markets that it has developed through its sourcing activities.

Some big companies like GE, Wal-Mart or IBM already started to do so and also the Li & Fung group has undertaken this strategy.

Having sourced for many years merchandise for Toys "R" Us from Asia, the company recently has build a network of 108 Toys "R" Us outlets just in China, Singapore, Malaysia, Thailand, Philipines etc. The same is happening with its Trinity Group that manages about 350 monobrand retail stores mainly located in China for Ferragamo, Cerruti 1881, Altea, Gant etc. all clients of the Li & Fung trading for which the sourcing operations are primarily in Asia.

The selling to the source story indeed, it is not just a matter of companies' strategy and organization, because other macroeconomic factors as trade regulations and taxation systems have considerable impact on this process.

For example the simple fact that export production receives special tax breaks leads to the creation of complicate path that apparently are non-sense. Many of the toys made in mainland China for Toy's "R" Us, that will be sold in the stores of the same mainland are first exported to Hong Kong and then reimported to China at substantial costs, to end maybe on a shelf not far from the original factory just to benefit from the exportation tax breaks.

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[29] *Dreaming with BRICs: The path to 2050*, Goldman Sachs-Global Economic Paper n.99.

Nonetheless there are no doubts that selling to the source will represent a great challenge of the next years and a big opportunity for companies that today are sourcing from emerging countries if they will be able to integrate and translate their sourcing knowledge into selling genius.

Chapter 5

Discussion

5.1. Why Li & Fung is so successful in creating and managing GVCs.

It time now to start a deeper analysis to get an overall view of the causes and effects of the increasing presence of networks structures and loosely coupled relations in global value chains and to refine our understandings of the mechanisms that underlie the emergence and the success of "network orchestrator" companies as Li & Fung.

The disintegration of supply chains observed in the last few decades in many industries like automotive, electronics and textile saw more and more the emergence of a new figure, the aggregator or as the Fung brothers like to say the "network orchestrator", to fill the gap in control, governance and a wide range of services that the fragmentation of the supply chain has created. This fragmentation has particularly brought its impact on the so called "original equipment manufacturers" (OEMs) and on small and medium entreprises (SMEs).

In the textile industry the change in the supply chain structure and the increasingly keen competition have lead to a massive migration of the manufacturing process from developed to developing countries. Asian economies are now dominating textiles and apparel exports constantly gaining market share relatively to their remaining European and Us competitors. As a matter of fact, many OEMs especially US ones have divested themselves of their labor-intensive and expensive manufacturing facilities, concentrating on more value added and upstream functions as design, development and marketing activities.

The drivers of this fragmentation are many. Costs reduction has been the main incentive for moving labor intensive activities in Asian regions where salary differentials are very consistent. However cost savings istances has coupled with the ability to invest in better processes and technologies with a consequent industrial upgrading of developing countries that has brought to lowering costs and at the same time increasing quality. The emergence of

information technologies has been a powerful enabler for an effective management of such disintegrated networks.

As shown in the figure below the main effect of disintegration has been an incredible complexity of the new network configuration, even when the number of layers in the supply chain remained the same.

Fig 17: Effects of disintegration on the network structure.

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Source: Emerging Trends in Supply Chain Management - MIT Sloan School of Management

The level of interaction increased dramatically requiring stronger coordination efforts. Ownership and control of assets have been dispersed along the chain with a sub division and redistribution of responsibilities that creates ambiguity and have a negative impact for all the players in the network.

In this scenario emerges clearly the need for an actor that enables the coordination and the governance of the various chain segments and ensures that they are all in line with the ultimate scope of the entire global value chain. To be more specific what is needed is a full set of services, a service company for the supply chain that primarily has to deal with three tasks.

Enable and sustain the different models of collaboration between all the decentralized supply chain agents is the first. The second is providing for a rapid and effective integration of new players into existing chains. The third

is helping the coordination and communication between all the different actors to successfully achieve end-customer objectives. All that matches perfectly with what Li & Fung is and with the value added of its activities.

The figure below[30] is very intuitive and describe the phenomenon taking the perspective of OEMs. Using the circles it offers a clear graphical understanding of where is required the intervention of the aggregator and where big growth opportunities for such companies potentially stand.

Fig 18: needs and opportunities from OEMs' perspective.

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Source: Emerging Trends in Supply Chain Management - MIT Sloan School of Management

[30] Figures 18 and 19 are taken from a study of the MIT Sloan School of Management on the impact of the disintegration process on OEMs and SMEs. The study has been conducted analysing companies like GM, Boston Fuel Cell, BOSE etc that belong to industries different from the textile one. Nonetheless it still makes our case because the needs and the opportunities related to the supply chain fragmentation are basically common to industries like automotive, electronics, textiles etc.

The aggregator or the network orchestrator is called to play a crucial role in two moments along the process: in the inbound flow and in the outbound flow.

The inbound flow is critical especially for smaller OEMs that due to their size could be not enough significant for the production capabilities of the contract manufacturer. Conversely it could also happen that the OEM finds himself to deal with a variety of smaller contract manufacturer not very reliable and hard to deal with. In both cases the solution is to have a third party that stands in a kind of neutral position to enforce the discipline among the suppliers, to ensure deadlines are respected, or to aggregate them in order to serve large customers' demands.

The outbound flow is critical for larger OEMs. Normally they can better handle the relations with suppliers because of their market power and influence, but they likely benefit from assistance in the diversification of the distribution channels. Also in this case the role of a neutral third party that takes care for logistics enhancing efficiency and reliability of products delivery or that came with new ideas for distribution channels is very valuable.

This other figure depicts the perspective of the SMEs and presents the needs to meet and the opportunities to catch for an aggregate player in its interaction with suppliers world.

To remain competitive SMEs need four fundamental services that the aggregator can offer. Smooth out capacity fluctuations selling excess production, sales force assistance to reach customers that due to their size they could not otherwise reach, financial support for work in progress and lastly an increase of their sourcing scope.

Fig 19: needs and opportunities from SMEs' perspective.

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sono necessari per visualizzare quest'immagine.

Source: Emerging Trends in Supply Chain Management - MIT Sloan School of Management

It is clear that the sensitive nature of the informations shared by the supplier, require the aggregator to be a third party neutral and unbiased and creates a kind of interaction that is not just serial communication, but a deep and trustful relationship.

As demonstrated, the complexity of the network fragmentation requires high coordination costs in order to pull products together making it more challenging for the company.

In such a contest the role of the network orchestrator come in as the fundamental neutral third party that takes responsibilities for the overall functioning of the network structure and aligns incentives for all the participants.

All this theoretical analysis is functional to justify and to explain the success of the network orchestrator companies and as such of Li & Fung itself from a systemic perspective. In other words what has been proven until now is the

tight link between the global value chain model of interfirms networks and the role of the aggregator that is essential and irreplaceable. Is the evolution of the supply chain model into global value chains that has created the Li & Fung model.

What is still to explain is in a sense the toughest question that is why just Li & Fung emerged as global leader and apparently nowadays there are no other companies that can challenge his supremacy. This is due to a series of factors more than to a single element.

More than 100 years of history and presence in the East Asian region certainly are a precious heritage of suppliers' knowledge that constitutes a relevant advantage over for example the Western trading firm competitors of Li & Fung with bases in Asia. The restructuring of the company, made by the two brothers played a key role in changing its profile from a Chinese firm to a multinational company listed on the Hong Kong stock exchange. The series of agressive acquisitions have been another key tool to gain market share and supplier base outside the Asian region in a fast and effective way. As a matter of fact the important element of these acquisitions aside from the financial aspects, has been the high level of integration attained that allowed to exploit at the best the synergies between firms, retaining and integrating as part of Li & Fung, best practices of other companies or for example the human capital. The very high degree of retention of other companies' middle and top management has been also crucial to rapidly and successfully expanding all around the globe assuring continuity with the customer base.[31]

Other fundamental elements are its cutting edge IT system to stay connected both with suppliers and customers constantly sharing information and its internal organization of indipendent and etrepreneurial customer based divisions. Lastly, as I mentioned in the previous chapters, a pivotal role in

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[31] An illustrative example is the today's president of Li & Fung, Bruce Rockowitz that was the co-founder and CEO of Colby International Group, aquired by Li & Fung in 2000.

making successful Li & Fung and assuring a durable source of competitive advantage is the capacity of creating value chains customized to customers' demand. Li & Fung managers assemble suppliers, manufacturers and logistic people together to build what they consider to be the best value chain for a specific customer. Not owning a single factory the focus of Li & Fung is what the customer wants to buy and not what the factory wants to make. A credo that proved to be winning.

5.2. Companies doing things differently from Li & Fung.

In this paragraph the analysis is enlarged to make some comparison with other successful companies that are either adopting strategies similar to Li & Fung either following completely diverse paths in managing their value chain and relationships with suppliers. The aim of this part of the thesis is to show that even though the Li & Fung approach has proven to be very successful, it is not the one fitting all the situations. Pros and cons of every case will be presented.

5.2.1 Flextronics

Flextronics International is a leading electronic manufacturing services company based in Singapore and operating in 32 countries and 5 continents. What this company does in syntesis is providing complete design, engineering and manufacturing services vertically integrated with components capabilities in order to optimize responsiveness to market and operations of its customers that are mostly OEMs.

The manufacturing structure of Flextronics is organized around six industrial parks located in developing regions. Each park includes also the manufacturer of components for the final assembly in order to function as a complete and autonomous manufacturing center. Strategic suppliers are also located on site, close to the park to reduce procurement costs and to speed up the entire production process.

As Li & Fung, Flextronics organizes its teams around customer divisions not following a pure geographic rationale. As the Hong Kong giant it has centralized information technolgies, business process applications for quality control and the integration of the supply network, trying also to standardize manufacturing processes along its variuos units.

The first big difference between the two companies is their asset ownership strategy because Flextronics unlike Li & Fung owns all its factories and facilities. Its consequent the fact that owning the production facilities

Flextronics does not have such a keen interest in cultivating rewarding relationships with their suppliers that conversely is one of the distinctive characteristics of Li & Fung.

But the most crucial difference regards the ultimate nature of the two companies and partly derives from different industries' dynamics. The success of Flextronics is strictly related to the choice of most electronics companies to increasingly outsource all their inefficient processes to remain competitive. As a result Flextronics is undergoing a fundamental transformation from being just a contract manufacturer to a final product designer ending up eventually as a formidable competitors of its actual clients. Its relationship with OEMs then is somehow tricky, because it can hardly configure itself as a true partnership and Flextronics' growth in skill set is thus perceived as a threat.

The nature and the state of the textile industry indeed lends itself better to Li & Fung. Outsourcing in this industry is common place since many decades especially for US companies and at present the apparel industry has evolved into one which focuses more on marketing and themes for the upcoming seasons. So there is no competitive frictions between Li & Fung and its customers and a true partnership is possible.

Then even though both companies control a portion of the supply network, the relationship models with suppliers and customers are different. Ultimately I think that Li & Fung's model freed from the ownership constraint has an higher flexibility not only to survive to eventual future shifts in the apparel business, but to quickly adapt to catch new opportunities coming out from them. In addition the restructuring undergoing in the apparel industry is creating a systemic need for aggregator companies like Li & Fung, prospecting a long endurance of their success.

The fortune of Flextronics otherwise seems too tied to the abuse of outsourcing made in the last years by many companies especially Us and

European ones and from my point of view the core nature of its business model on the long run is more vulnerable for two reasons.

The first one is that the company is stuck with the ownership of a huge apparatus of industrial facilities that if enhances process efficiency today, will slow down its adaptation capacity of tomorrow. Secondly the role played by Flextronics in the electronic industry system even though nowadays is welcome because it allows consistent savings in production costs, is destined to be competitive with incumbent companies. As mentioned before Flextronics soon could turn out to be a very powerful competitor of its actual clients, so the seeds of a potential disruption are already embedded in its future development perspective. The outcome seems to depend very much on its ability to win the competition and ultimately replace its today's customers.

5.2.2. Nike

Another interesting comparison with Li & Fung is Nike because also this company has developed a significant process network of production partners and logistic providers to cover the multiple stages of shoes production, from sourcing of materials to assembly of finished shoes and delivery to distribution centers. The problem faced by Nike is the great deal of uncertainty that affects its business, due to the rapid shifts in fashion trends and changes in trade regulations. To manage this risks it also chose to develop a loosely coupled supply chain mostly based in Asia.

Both Li & Fung and Nike then are focused on orchestrating supply chain processes in the apparel industry, but if Li & Fung has created an open network offering its services to apparel designer and retailers, Nike orchestrates a captive process network focusing on its own line of athletic shoes and clothes.

However they have both developed a similar approach in managing loosely coupled supply chain pocesses. Thus also Nike broadly specifies outcomes for

each milestone of the process and coordinates suppliers activities with no attempt anyway to micromanage these activities. As Li & Fung it has to build operational knowledge of the broad range of activities being coordinated, but the way it does so is particularly interesting. Nike have ideated and is actually running an expatriate program through which it sends its own employees to live and work with its key production partners for three or more years at a time. These employees are not intended to direct activities of production partners, but they have to focus on understanding how they operate. As in the case of Li & Fung, the aim of Nike is to develop a deep and refined knowledge of suppliers' capabilities in order to make intelligent choices about which production partner to deploy for particular process tasks.

All the other skills requested to a network orchestrator as recruiting participants into the process, structuring incentives, defining standards for communication and coordination and assuming ultimate responsibility for the end products are well mastered by Nike that ultimately operates similarly to Li & Fung, but in the contest of a closed process network that focuses just on its products.

5.2.3. Cisco Systems

Another company that is adopting some forms of network orchestration and loosely coupled business processes is Cisco Systems. If Li & Fung and Nike are reshaping supply chain management relationships, Cisco is experimenting the potentials of a loosely coupled approach from the side of customer relationships management. What Cisco does is orchestrating thousands of specialized product and service partners that offer value added services to its customers. The medium for these interactions is a web platform called Cisco Connection Online (CCO) created to provide customers with detailed information about its rapidly changing product line. But more importantly this site helps the customer to find complementary products and

services developed by Cisco's external partners that would increase Cisco's products[32] and also let him shops for them directly from this platform .

Also in this case, Cisco cannot dictate on its partners in terms of how they do their job, but it ensures appropriate actions through a process of certifications, training and selection of the right partners to involve. Once it ensures they have the requisite capabilities to help customers, Cisco invests in training anf information to help these service providers to keep up with Cisco's rapidly changing strategic initiatives and complex product lines.

The incentive structure in this kind of network is different from the one implemented by Li & Fung and Nike. These last as a matter of fact directly pay their supplier for the service rendered while in Cisco's process network, the customers and not the company pay the service providers. It is true nonetheles that Cisco is indirectly paying them by investing in marketing programs to draw customers to CCO. Clearly in this way service providers find new sources of revenues that they might not otherwise have been able to generate on their own.

As in the other cases of network orchestration also Cisco tracks customers satisfaction with the service rendered rewarding with more business service providers who perform well, while those who do not find themself increasingly marginalized within the CCO platform. In syntesys also in Cisco's process network suppliers have significant economic incentives to participate in the network and to perform well.

Ultimately the fundamental difference between the Li & Fung model from one side and Nike and Cisco from the other is the kind of network they manage. The first one is an open one and its expansion is linked with the overall performance of a specific industry. Potentially Li & Fung could serve all the

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[32] An example of these complementary products from third parties could be a specialized integration service to help connect Cisco's product to the customer's existing communication network.

actors in a particular industry, expanding in this way the broadness of the network and assuring service providers a constant growth of their business. On the contrary Nike and Cisco manage captive process networks whose growth is strictly linked with the growth of orchestrator's core business. Developing and expanding such networks clearly is more challenging and complicated.

5.2.4. Nokia

This case in interesting because represents a model of interaction with suppliers quite diffferent from the global value chain and associated production networks analysed until now. It regards the formation in Beijing, China, of one of the few mobile telecommunications manufacturing clusters known as the Xingwang Industrial Park and have Nokia as the lead firm of this cluster.

Nonetheless, without entering into the details of the cluser theory, we can define this cluster as an unconventional one because it originates from the strategic agglomeration of a lead firm and its global suppliers in a highly localized area, Beijing Economic and Technological Development Area (BDA), configuring itself not as an endogenous and self organized form of cluster but as an intentional one. Its a purpose specific cluster made of the lead firm, Nokia (in a joint venture with Capitel) and 17 major suppliers within an area of 50 hectares.[33] What is interesting is the kind of relationships Nokia-Capitel has with these suppliers. As Li & Fung, it takes an integrated view of its supply chain and to ensure it is overall profitable it prefears to take a partnership approach instead of a competitive sourcing strategy. It makes so however without any contractual agreement to guarantee certain volume of production to the suppliers, setting in addition the target of not exceding the 40 per cent of their net sales, not to have them excessively dependent on

[33] After the completion of the park, the area will contain 30 major suppliers. See appendix for a map of the site and a list of the suppliers located on it.

Nokia's business. On the other side, physical and spatial proximity entails substantial transportation and logistical advantages and reduces production and information uncertainties regarding the transactions between Nokia – Capitel and its suppliers. Since Nokia does not make long term production plans, suppliers have to estimate on their own the outsourcing needs and so the possibility of sharing market information via informal meetings between suppliers and Nokia's managers is crucial. To facilitate such exchanges Nokia – Capitel even opens its catering center to all the managers of the industrial park that can in this way share tacit knowledge on markets and technologies.

Suppliers from their side enjoy a series of benefits that comes from being part of the Nokia production network in the Xingwang Park. Some of them are purely economic as a great collective bargaining power when they negotiated with the central government and BDA for the rigth to utilize the area of Xingwang Park.[34] Other benefits are of administrative kind and derive from being close to a giant such as Nokia that working in collaboration with the BDA authority and central government was able to obtain electronic customs procedures and the payment of duties after finished products are sold and shipped. A preferential beaurocratic treatment implying consistent savings of money and time that without Nokia's presence, suppliers could hardly expect. Being part of the Xingwang Park enhance also suppliers' reputation and credibility when dealing with other firms not belonging to the cluster or institutions. The Nokia-Capitel cluster's participation is used by suppliers as a powerful marketing lever to seek new customers nearby and to fill that 60 per cent of their production that Nokia committed itself not to take up.

Ultimately the Nokia-Capitel case of Xingwang Park evidences some similarities with Li & Fung, particularly in the relationships with suppliers that tend to be loosely coupled modeled and based on mutual benefits and

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[34] Nokia ensured that all the tax benefits and privileges accrued to it were also available to all its Xingwang park suppliers.

incentives. Also the logic of pursuing the overall efficiency of the supply chain and not optimising just parts of it is a common element. What marks the difference is the spatial proximity that in the case of Nokia is deliberately searched, because it brings advantages in terms of information exchanges and production processes coordination. For sure this model of "intentional cluster" is a smart solution to tackle the increasing business complexity due to the disintegration of prodcution. However the fact that it is anchored in a specific location whose choice was partly depended on government's policies is a factor of weakness that could turn out to be a future constraint if major changes in business geography will happen. For this reason I still think that the structure of Li & Fung business model, based on a suppliers network with a global scope is in prospect at least theoretically superior with respect to the the Nokia-Capitel cluster of Xingwang Park.

Chapter 6

Conclusions

The reasoning structure of the thesis started with the recognition that two interdependent dynamics are transforming international trade and global economy: the reorganization and the relocation of the production of goods and services. These dynamics are leading to the emergence of value chains with a global character that involves the coordination and reintegration of production activities along global networks of firms, tied together by non-equity linkages through a variety of relationships as subcontracting, licencing, common standards etc.

Globalization, progresses in logistics and information technologies and a semplification in trade regulations are enabling the transformation of over-engineered supply chains into highly fluid and global dispersed marketplaces.

The work followed explaining how the disintegration of supply networks has created an environment of business complexity that has intensified the basic managerial challenge of the coordination of activities along the value chain. This state of complexity and disintegration creates inefficiencies and enhance coordination costs. Both the buyers side, so for example large Western OEMs, but also the supply side where many small and medium entreprises can be found, have difficulties in repositioning in this new scenario and are not able to sustain a global competition. This state has called for the emergence of a new tipology of economic actors, whose role is managing a process of reintegration of all the players.

This reintegration is a phenomenon still ongoing in many industries and is taking the form of global operational webs or networks, governed mainly through a model that has little to do with tight management, but resambles more to an orchestration of all its participants. That is why an appropriate definition for this kind of aggregator companies has been found in the term of "network orchestrators".

Their task of configuring and orchestrating these global operational networks is pivotal in allowing businesses to operate with speed and agility,

to manufacture in remote low costs regions, to access specialized design talents, to distribute with close to the customer efficiency and to get to the market faster with innovative products and services.

The thesis presented evidence that all these actions are mastered by Li & Fung which represents the purest example of network orchestrator. The company founded 100 years ago has evolved from a regional sourcing agent to a manager and deliverer of manufacturing programs and from a dispersed manufacturer to a network orchestrator. The specific success of Li & Fung is even more striking because the company does not operate in an high margins or innovative business, but in the textile sector that is one of the oldest and lowest growing industry.

The work has stressed the concept that these emerging aggregate players are not bubble firms, but will become companies of the future because they are intimately linked with the rise and diffusion of these global value chain models.

They play the crucial role of filling the gap in the relations between big and small economic actors spread all over the globe, a necessity that is present not just in the textile industry, but in many others from automotive to electronics. Their nature of neutral third parties that coordinate and align incentives for all the network participants, is becoming more and more fundamental and irreplaceable.

From its side Li & Fung has benefitted particularly from the historical advantage of its location, in the middle of the East Asian region and from a broad and always expanding network of suppliers. Nowadays it is the leader in global sourcing and I explained that its competitive advantage is based on the unique capacity of creating customized supply chains for its clients and being a "one stop shop" for them taking up not just some portions of their value chain, but the overall process. It does so implementing an innovative managerial approach called network orchestration that consists in creating loosely coupled relations with all the indipendent actors of the chain and

establishing a system of incentives to reward them and to make their participation in the network attractive.

Finally I reasoned on the fact that Li & Fung destiny is not too much tied to the persistence of this regions as a cheap labor source, because its network of suppliers is well diversified and already covers keys areas such as the Indian subcontinent, the Caribbean, South America and the Mediterranean basin. Even though China remains its major sourcing country Li & Fung can count on a comprehensive supplier base whose strenght is not just being an alternative source for those looking for cheap production places, but being a global reservoir of specialized suppliers. That is also why eventual future wage increases in East Asian countries will not dismantle the competitive advantage of Li & Fung business model.

Conversely as a future perspective I foresee that the potential upgrade of China and other developing countries and their gradual transformation into consumer markets, will offer to Li & Fung incredible growth potentials for "selling to the source". The development of Chinese consumers market will find Li & Fung in a position of competitive advantage compared to Western companies, because it can leverage its deep and refined knowledge of business dynamics of this country to sell products to a huge public. A benevolent perspective that seems already embedded in the Chinese characters of its name "Li" and "Fung", that stand for profits and abundance.

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APPENDIX

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BIG BUYERS'S DETAILED DESCRIPTION

Retailers

Retailers (as Target, Marks & Spencer, J.C. Penny, The Limited etc.) are going through a process that is transforming them from apparel manufacturers' main customers to their competitors especially in the US and European markets. The trend started because as consumers demanded better value, retailers had increasingly turned to imports competing directly with national brand name of apparel producers by expanding their sourcing of "private label" merchandise. The private label business has proved to be very profitable for retailers, because even though is sold more cheaply than the national brand, it entails higher margins. The success of private label programs have inceasingly led retailers to take on the functions of normal apparel manufacturers, as fabric selection, product design and garment production and sourcing.

Branded Marketers

One of the most important features of buyer-driven chains is the creation since the seventies of prominent marketers whose brands are extremely popular worldwide, but that are not involved at all in the production. Examples of such companies are Nike, Tommy Hilfiger, Polo Ralph Loren, Adidas, Liz Claiborne and many others. Since their birth they engaged themself in global sourcing developing an extensive and deep expertise in such a strategy and gaining the definition of "manufacturers without factories". Under the pressure of an increasing competition they are adopting several responses that go beyond the traditional scope of their global sourcing networks. For example they are discontinuing certain support functions as pattern grading or sample making reassigning them to contractors instructing them where to obtain the needed components reducing their purchase and redistribution activities. In syntesis their strategy of global sourcing initiated decades ago has brought an upgrading effect of their contractors, that now have enough capabilities to manage all the aspects of the production processes which in turn allow marketers to concentrate competition on design and brands.

Branded Apparel Manufacturers

Since some decades apparel manufacturers in developed countries (as Philips-Van Heusen, Levis Strauss & Co. etc.) have been caught in a squeeze given that foreign producers became able to provide similar quantity, quality and services as domestic ones but at a much lower price. Given the huge price differentials the response to this challenge has not been whether to engage in foreign production, but how to do it. The solution most of the time has been that these firms supply intermediate imputs to offshore factories that work mainly as assembler. This has been facilitated by special trade agreements (generally called "production sharing") existing in every region of the world that allows goods assembled off-shore to be re-imported with a tariff charged only on the value added by foreign labor. A significant countertrend is also emerging among these established apparel manufacturers that are de-emphasizing their original production activites in favour to enhance their marketing operations and to capitalize on brand names and retail outlets. We are assisting then to the de-verticalization of production and a re-verticalization of brands and stores.

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LI & FUNG LIMITED

(Incorporated in Bermuda with limited liability)

For Immediate Release

Li & Fung becomes the first wholly-owned foreign trading company in China issued a license granting direct export rights Company announces new business initiatives

Hong Kong, 7 January 2004 - Hong Kong-based global consumer goods exporter, Li & Fung Limited ("Li & Fung", "the Company", or "the Group"; HKEx: 494) today announced that Li & Fung Trading (Shanghai) Limited, a wholly-owned subsidiary of the Group, has been granted an export company license by the Ministry of Commerce of the People's Republic of China. It is the first time such a license has been granted to a wholly-owned foreign trading company.

This license enables the Group to export directly the goods it sources from Mainland China. The Group is now allowed to import raw materials and components for its exports, and is also entitled to a portion of the Value Added Tax rebates.

Group Managing Director, Mr William Fung said, "With the ability to directly export products from China to our customers worldwide, Li & Fung is now able to offer an even more complete supply chain service. "

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PRESS RELEASE

LI & FUNG LIMITED   LIZ CLAIBORNE INC

LIZ CLAIBORNE INC. AND LI & FUNG ENTER INTO LONG TERM BUYING AGENCY AGREEMENT

Hong Kong, 23 February 2009 – Hong Kong-based global consumer goods exporter Li & Fung Limited ("Li & Fung" or "the Group", SEHK: 494) and Liz Claiborne Inc. (NYSE: LIZ), today announced that they have agreed to enter into a long-term, exclusive Buying Agency Agreement whereby Li & Fung will act as the primary global apparel and accessories sourcing agent for all brands in the Liz Claiborne Inc. portfolio, including Lucky Brand, Juicy Couture, Kate Spade, and Isaac Mizrahi designed Liz Claiborne New York with the exception of the jewelry product lines. Li & Fung will continue as the sourcing agent for Mexx as previously announced and will be Mexx's exclusive sourcing agent going forward. Completion of the arrangements is expected to take place in the first quarter. Liz Claiborne Inc. will pay going forward an agency commission of its product purchases through Li & Fung.

William McComb, CEO of Liz Claiborne Inc., commented on the announcement, "Liz Claiborne Inc. was one of the first apparel companies to source product in Asia, building a robust, global sourcing organization that quickly became a competitive advantage that was leveraged for many years. The manufacturing world has changed dramatically in recent years with the elimination of quota and other globalization factors. Liz Claiborne, Inc. is now changing as well. Managing our large, complex sourcing strategies and teams throughout Asia in a cost effective and brand appropriate manner from the U.S. does not offer the flexibility we need to meet the demands of our consumers efficiently and to deliver to them the best designs with the best price-value and quality. Given this reality, we have made the decision to reconsider what our core competencies are across our entire business and determined that our 'one size fits all' sourcing model does not align well with our brand-centric strategy – a strategy that requires each brand to build separate and unique sourcing plans based on specific requirements. In

addition, our experience with Li & Fung from Mexx Canada and more recently Mexx Europe validates that an organization like this will intensify our ability to execute our brand-centric strategy."

Mr. McComb continued, "With Li & Fung as a partner, our brands will have access to a vast, worldwide network of manufacturing partners and best-inclass systems, management and talent – all of which give us more flexibility and a better competitive position. Greater buying power will enhance our going in margins, and disciplined execution will improve our speed-to-market. Bottom line, this is the optimal way to address the issues with our current sourcing infrastructure and a significant strategic opportunity that will enable us to deliver high quality, irresistible product to our consumers and retailers around the world."

Mr. Bruce Rockowitz, President of Li & Fung, commented: "We are very excited to see the successful execution of this strategic partnership with Liz Claiborne. Last year's Mexx outsourcing deal has proven the extraordinary value Li & Fung can add to one's supply chain of products and services. In this case, not only are we confident that Li & Fung will contribute to more efficient sourcing through our global sourcing network of over 80 offices in over 40 economies, we are also equally confident that Li & Fung's dedicated teams of sourcing professionals which comprise a wide spectrum of expertise will help address the specific needs of each brand, and enable us to deliver quality and attractive products to further strengthen the positioning of these brands.

"This is a very strategic outsourcing deal for Li & Fung. Our overall sourcing platform in the brands business will be further enhanced as this deal brings in a number of prestigious brands like Kate Spade, Juicy Couture and Lucky Brand. This is one of the best portfolios of high profile brands in the world, and a great addition to Li & Fung's existing customer base. In addition, the deal helps us to continue to gain market share and contribute to our bottom line in a very difficult market. Undoubtedly, we expect it will attract more outsourcing deals to Li & Fung in the future."

Pursuant to the arrangement, Li & Fung will take over the sourcing operations of Liz Claiborne and pay to Liz Claiborne an amount equal to US$75 million on completion and an amount not exceeding US$8 million to be payable within 14 days after completion.

Ends

About Liz Claiborne Inc.

Liz Claiborne Inc. designs and markets a global portfolio of retail-based premium brands including Kate Spade, Juicy Couture, Lucky Brand and Mexx. The Company also has a refined group of department store-based brands with strong consumer franchises including the Liz Claiborne and Monet families of brands, Kensie, Kensiegirl, Mac & Jac and the licensed DKNY® Jeans Group. For more information visit www.lizclaiborneinc.com.

About Li & Fung

Li & Fung is the world's leading consumer goods supply chain management company, managing the supply chain for retailers and brands worldwide. Headquartered in Hong Kong, the Group services its customers globally through a sourcing network of over 80 offices in more than 40 economies. Corporate website: www.lifung.com

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LI & FUNG LIMITED

(Incorporated in Bermuda with limited liability)

SOURCING ARRANGEMENT WITH WAL-MART STORES, INC.

The Directors are pleased to announce that on 28 January 2010, the Group entered into a series of agreements with Wal-Mart with a view to establishing a mutually beneficial sourcing arrangement with the Wal-Mart Group. The sourcing arrangement is non-exclusive, does not contain any sourcing volume commitments by the Wal-Mart Group and will continue until terminated by mutual agreement.

This announcement is made pursuant to Rule 13.09(1) of the Listing Rules.

SOURCING ARRANGEMENTS

The directors (the "**Directors**") of Li & Fung Limited (the "**Company**", together with its subsidiaries, the "**Group**") are pleased to announce that on 28 January 2010, the Group entered into a series of agreements (the "**Agreements**") with Wal-Mart Stores, Inc. ("**Wal-Mart**", together with its subsidiaries, the "**Wal-Mart Group**") with a view to establishing a mutually beneficial sourcing arrangement with the Wal-Mart Group. The sourcing arrangement is non-exclusive, does not contain any sourcing volume commitments by the Wal-Mart Group, and will continue until terminated by mutual agreement.

Under the sourcing arrangement, it is anticipated that WSCM Pte. Ltd. (to be renamed WSG Pte. Ltd.) (“**WSG**”), a wholly owned subsidiary of the Company, will be a sourcing agent for the Wal-Mart Group on a non-exclusive basis (to the effect that the Wal-Mart Group may source through other agents and continue to buy direct from suppliers). Under the buying agency agreements to be entered into between WSG and the Wal-Mart Group, WSG would provide buying agency services exclusively to the Wal-Mart Group. Remuneration would be payable by the Wal-Mart Group to WSG for the sourcing activities undertaken by WSG. WSG is expected to build a capacity which would enable it to act as a buying agent for US$2 billion (HK$15.6 billion) of goods in the first financial year in which it commences operations, although there is no commitment or obligation on the part of the Wal-Mart Group to any sourcing or shipment volume.

As part of the sourcing arrangement, the Company has granted a call option (the "**Option**") where Wal-Mart would have the right but not the obligation to require the Company to transfer 100% of the shares of WSG and/or the subsidiaries running the sourcing function to Wal-Mart pursuant to a call option agreement (the "**Option Agreement**"). The Option is exercisable by Wal-Mart after 1 January 2016 subject to the terms, provisions and conditions under the Option Agreement. The exercise price would be determined based on mutually agreed mechanisms. No premium is payable for the grant of the Option.

The exercise price of the Option is not determinable unless and until Wal-Mart exercises the Option. The exercise of the Option is subject to compliance with The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**") then in force, and this may include disclosure and/or shareholders' approval requirements, depending on (among other things) the size of WSG at the time. If the exercise of the Option is subject to shareholders' approval of the Company according to the Listing Rules and the relevant resolution is not passed such that the Option cannot be exercised, the Company would be required to pay Wal-Mart a break fee in an amount equal to the lower of: (i) 10% of the exercise price; or (ii) US$75 Million (HK$585 Million).

REASONS FOR THE TRANSACTIONS

It is expected that the Group will benefit from the sourcing arrangement described through an enhancement of profitability. The transactions contemplated under the Agreements (other than the Option Agreement) are of a revenue nature in the ordinary and usual course of business of the Company. The Directors, including the independent non-executive Directors, consider that the terms of the Agreements are fair and reasonable and are in the interests of the Group and the shareholders of the Company as a whole.

To the best of the Directors' knowledge, information and belief having made all reasonable enquiry, Wal-Mart is a third party independent of the Company and connected persons of the Company.

The Group is the world's leading consumer goods supply chain management company, managing the supply chain for retailers and brands globally. The Group operates from over 80 offices around the world and works with a sourcing network of nearly 15,000 international suppliers in more than 40 countries serving approximately 2,000 customers. Recently, the Group opened its European hub in Istanbul, Turkey to further strengthen its sourcing in Europe, the Mediterranean, Middle East, Northern Africa and the former Soviet Union republics.

IMPLICATIONS UNDER THE LISTING RULES

This announcement is made pursuant to Rule 13.09(1) of the Listing Rules.

BOARD OF DIRECTORS

As at the date hereof, the board of Directors comprises the following:-

*Non-Executive Directors:-Executive Directors:*Victor Fung Kwok King *(Chairman)* William Fung Kwok Lun *(Managing Director)* Paul Edward Selway-Swift* Bruce Philip Rockowitz Allan Wong Chi Yun* Annabella Leung Wai Ping Franklin Warren McFarlan* Spencer Theodore Fung Makoto Yasuda* Martin Tang Yue Nien*

** Independent Non-executive Directors*

Unless otherwise stated, all references in this Announcement to HK$ stated in brackets are for illustration only and are referenced to Hong Kong Dollars based on an approximate exchange rate of US$1 = HK$7.8. No representation is made that any amount in US$ had been or could be converted at the above rate or at any other rate or at all.

By Order of the Board
Victor FUNG Kwok King
Chairman

Member of the LI & Fung Group

Hong Kong, 28 January 2010

Websites: *www.lifung.com*
www.irasia.com/listco/hk/lifung

For further investor information, please contact Mable Chan at Tel: (852) 2300 2365 or Sue So at (852) 2501 7984 for media enquiries.

Financials highlights from the 2009 Annual Report.

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Ten Year Financial Summary – consolidated profit and loss account

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Source: information for investors, www.lifung.com.

Ten Year Financial Summary – Consolidated Balance Sheet

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Source: information for investors, www.lifung.com.

Li & Fung (Trading) Limited Code of Conduct For Vendors

This Li & Fung (Trading) Limited Code of Conduct ("Code of Conduct") outlines the basic requirements concerning working conditions that must be satisfied by all vendors ("Vendors") to principals of Li & Fung (Trading) Limited ("Li & Fung"). Li & Fung and its principals are free to supplement these requirements at any time.

Child Labor

Vendors shall not use child labor. "Child" is defined as a person who is not older than the local age for completing compulsory education but in no event is less than 15 years of age. Vendors must verify the age of their workers and maintain copies of their workers' proof of age. Vendors must follow all applicable laws and regulations regarding working hours and conditions for minors.

Involuntary Labor

Vendor shall not use involuntary labor. "Involuntary Labor" is defined as work or service which is extracted from any person under threat or penalty for its non-performance and for which the worker does not offer himself or herself voluntarily, and includes all manner of prison, bonded, indentured and forced labor.

Disciplinary Practices

Vendors shall not use corporal punishment or any other form of physical or psychological coercion or intimidation against workers.

Non-discrimination

Vendors shall employ workers solely on the basis of their ability to do the job, and shall not discriminate on the basis of age, gender, racial characteristics, maternity or marital status, nationality or cultural, religious or personal beliefs or otherwise in relation to hiring, wages, benefits, termination or retirement.

Health and Safety

Vendors shall maintain a clean, safe and healthy workplace in compliance with all applicable laws and regulations. Vendors shall ensure that workers have access to clean drinking water, sanitary washing facilities and an adequate number of toilets, fire-extinguishers, and fire exits and that workplaces provide adequate lighting and ventilation. Vendors shall ensure that the aforementioned standards are also met in any canteen and/or dormitory which is provided for workers.

Environmental Protection

Vendors shall comply with all applicable laws and regulations in respect of protecting the environment and maintain procedures for notifying local authorities in the event of an environmental accident resulting from Vendors' operations.

Wages and Benefits
Vendors shall provide wages and benefits that comply with all applicable laws and regulations or match the prevailing local manufacturing or industry rates, whichever is higher. Overtime pay shall be calculated at the legally required rate, regardless of whether workers are compensated hourly or by piece rate.

Working Hours
Vendors shall not require workers to work, including overtime, more than 60 hours per week or more than any maximum number of hours per week established by applicable laws and regulations, whichever is less. Vendors shall guarantee that workers receive at least one day off during each seven-day period.

Freedom of Association
Vendors shall respect the right of workers to associate, organize and bargain collectively in a legal and peaceful manner.

Familiarization and Display of This Code of Conduct
Vendors shall familiarize workers with this Code of Conduct and display this Code of Conduct, translated in the local language, at each of their facilities in a place readily visible and accessible to workers.

Legal Requirements
Vendors shall comply with all legal requirements applicable to the conduct of their businesses, including those set out above.

Contractors and Suppliers
Vendors shall ensure that their contractors and suppliers adhere to this Code of Conduct.

Monitoring of Compliance
Vendors authorize Li & Fung and its principals to conduct scheduled and unscheduled inspections of Vendors' facilities for the purpose of ensuring compliance with this Code of Conduct. During these inspections, Li & Fung and its principals shall have the right to review all employee-related books and records maintained by Vendors and to interview workers.

Corrective Action
When violations are found, Li & Fung and the Vendor concerned will agree on a corrective action plan that eliminates the problem in a timely manner. If it is determined that a Vendor is knowingly and/or repeatedly in violation of this Code of Conduct, Li & Fung and its principals shall take appropriate corrective action, which may include cancellation of orders and/or termination of business with the Vendor in question.

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Vendor Agreement

Li & Fung (Trading) Ltd. is dedicated to full and complete compliance with all laws and regulations applicable to the conduct of its business and expects its vendors, and buying agents utmost cooperation and commitment with such efforts. It is therefore requested that the owner, president, managing director, or chairperson for your company sign and return a copy of this letter thereby confirming your understanding of its contents and agreement to undertake the obligations it sets fourth.

Please return a signed copy within (30) days of this letter. If Li & Fung (Trading) Ltd. does not receive a timely response, it will be forced to review its relationship with your company.

In closing, we highly value the relationship with your company and believe that you share our compliance concerns. Thank you in advance for your cooperation and we look forward to continually strengthening our relationship for years to come..

Name: ___________________________ Title: ______________________

Date: ____________________________ Signature: __________________

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