
Co-Location Is Key To Integrating Cultures (1181)

Dr. Victor K Fung

*Group Chairman
Li & Fung*

One of the most important things to look at in an acquisition is not so much the analysis stage but the integration stage. As we all know, a lot of studies show that a good 30-40 percent of acquisitions end up in failure, or sometimes maybe even more. Some studies show that as many as 60-70 percent end up in failure. The reason they fail is always in the integration stage. Two years ago, we had the opportunity to acquire the buying organization of the largest retailer in Germany, a company by the name of Karstadt. This involved about 1,200 people around the world, which is their buying network, and involved about 10 countries. It's a massive thing, and it was more than 1 billion euros of business. We concluded the deal, and we thought that since it was such a large acquisition, we needed to work on this carefully. One of the things that we were confronted with was how to take this 10-country network--now as Li & Fung, we're in 40 countries--and integrate that in a seamless manner into our global network so that we not only take over the book of business but also we take the people whom we had acquired and made them important members of the Li & Fung team. The Karstadt operation in Hong Kong was quite large, and we were concerned about co-location from day one, and in fact they had a very large office in Harbour City, which is a posh part of town. Our offices are in Cheung Sha Wan, and what we met with was a lot of initial resistance to move the offices to get this co-location to mesh the cultures. We took the drastic steps of doing two things. One is that even though the lease did not run out, we paid money to get out of the lease, in order to make the co-location. At the same time, our present offices were full because we had to accommodate about 500 people. We took some of our existing divisions, which obviously have been part of Li & Fung for a long time, and moved them out in order to accommodate our newly acquired company so that we could make an important point: we think co-location is essential to the integration of culture. Often you get a lot of pushback from line management. "Why do you need to co-locate? We can always go over for meetings." We don't believe that. We think that the culture absorption, the interchange, and the way you get to know people is on informal context. You're having a cup of coffee together at a break. Or you're walking to the men's room together, and you're trying to have a quick conversation. Formal meetings do not do it. Co-location is very important, and sometimes I wonder how many of the world's acquisitions failed because the integration wasn't done properly. Many things could have been helped by the fact that you co-located early. I wonder how many mergers and acquisitions failed because a manager said, "Let's wait two years before co-location, because we want to let the lease run out."

Consumers Demand Environmentally Friendly Products (1182)

Dr. Victor K Fung

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For a number of years, I've been on the International Advisory Board of the Tsinghua Business School, and there's an annual meeting. One of the members of the advisory board is Lee Scott, who is the CEO of Wal-Mart, and in fact, he's now the chairman of the Tsinghua Advisory Board. I remember specifically two years ago, we had a chance to talk in between sessions during the advisory board meeting, and we looked at how important it is now for the consumer to be presented with products that are environmentally friendly. As we were talking, I realized how deep a commitment Wal-Mart had to the whole idea of addressing the environmental issue. In fact, what we concluded out of that whole session is that the consumer today is now defining quality not just in terms of the physical attributes of the products that you're putting in front of him or her, and the value proposition of those physical attributes, but they're also very concerned about the process with which that product was made. They want to make sure that the product was produced in an environmentally friendly way, in a way that has satisfied all the social norms. This links into--for Li & Fung's standpoint, what we do as a company--what we call ethical sourcing. In the process of producing the product, our compliance procedures are such that we ensure conformance with all the things that we should be worried about. Are the environmental aspects being looked at? Are the labor laws being obeyed? Are you using underage labor? We have more than 10,000 suppliers in over 40 countries around the world, and it's not always easy to keep track of everything and to make sure that we are putting enough discipline onto the whole system. This is a never-ending battle, but we work very hard at it. We are becoming increasingly an expert at doing different aspects of this. This will become an important competitive advantage for Li & Fung as a company. We feel that not only is this good business, but also it is good from a corporate social responsibility standpoint. We feel that we can contribute to the wider society in making sure that the process of producing all the products that the consumers see on the shelf is actually done in an ethically sourced way.

Extending The Supply Chain (1183)

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About three years ago, we were looking at the fact that our customers are now requiring Li & Fung to help more in the product development stage. We don't really generate the ideas per se, because that has to be done by our customers with their designers and so on

close to the market. However, we are very much a part of the design process by supporting that. If you have research and development (R&D), we don't do the R, but we certainly do the D. When a designer gives us a sketch, we concentrate on within a very short period of time--within days--coming back with four different ways of realizing that particular design with different fabrications and with different sets of factories in different parts of the world. Then with that feedback, the designer can say, "Of these four options, I really want to explore this one. Give me more options on this one." In that sense we're part of the design process. What we have confronted was the idea of how we put together a product design capability within the whole Li & Fung organization to inculcate that into our own culture and how we then transmit all that into our network of factories around the world. Much of this is in the direction of improved manufacturing practice--better quality, more sustained quality. Increasingly we're finding that we're really now adding value from the standpoint of design and innovation. Li & Fung used to talk about end-to-end supply chains a lot. Our earlier definition of end-to-end supply chain was from raw material to consumer--all the way from starting with a raw material and then all the way to the consumer. We have now expanded that definition of end-to-end supply chain from idea to consumer. There's a piece between the idea that you have and deciding exactly what you want to produce, which is the whole product design stage. As we ourselves develop that product design capability within Li & Fun globally, we're able to share more and more of that with our supplier base, with our partners in this global network. That has helped them also develop, and we're inculcating a lot of those design concepts and design know-how and, indeed, a design culture to the whole thing. Over time, what we see is that in many countries that we work with, including China, the whole manufacturing base is being upgraded from one of pure contract manufacturing to spec, of OEM, to one that is adding more and more design. We encourage them also to feed into the network by giving us their designs. We will help them improve it and then get that capability marketed properly.

Intelligent Supply Chain (1184)

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What we have found at Li & Fung is that almost every consumer product that you can come up with, if it leaves the factory costing \$1, by the time it ends up in the hands of the consumer, it would cost \$4. This ratio won't vary much across all product categories. This leads us to the conclusion that if you want to optimize the total cost in delivering a product to the consumer, not only must you concentrate on the manufacturing stage of physically making the product, but it's what happens after the product leaves the factory and it gets into the hands of the consumer—the \$3 there in the supply chain—that is important. Another way of saying this is if you want to take five cents out of the \$1 production cost, you got to be pretty smart because people have pretty much optimized

that production process. However, if you take fifty cents out of the soft \$3 in the supply chain, nobody will know that you're really doing it. At Li & Fung, we concentrate a lot on the soft \$3. How do you optimize? Obviously, what is in that supply chain and the inefficiencies has a lot to do with what you would normally think about, which is all the cost of shipping, logistics, warehousing, customs clearance, causing delays and so on. If you go deeper, most of this soft \$3 is really in a mismatch between what you buy, and what you're able to sell. What's happening is that the whole world now is that the customer demands in the markets are being fragmented, and you're seeing the development of larger and larger numbers of smaller and smaller niche markets. As you go into small niche markets, it's very hard to predict the demand, and so the only way to remove uncertainty is to have a fast reorder cycle. We used to sort of take three months from the time of order to the time of shipment. We are really squeezing that and squeezing that down to four weeks, five weeks, and sometimes even shorter, so that you're able to allow the buyer to wait as long as he or she can before placing the order so that the uncertainty and predicting the demand is taken out of the equation as much as possible. This shortening of the reorder cycle has taken a leap only in the last ten years or so, since the advent of the IT revolution, the Internet, and the advent of monologistics--the idea of being able to take goods from here to there just in time. Because we have these enablers, we're able to take the entire production process and dissect it into different stages of production and put each stage of production in a different location, sometimes in different countries. How do you take all the stages that you've dispersed and reassemble, reintegrate the goods so that it looks like it comes from one factory? The only way you can do it is with IT and modern logistics.