Li & Fung:
Strategic Role of E-Commerce
Defensive posture of Li & Fung to the Internet at the beginning

“Would the Internet disintermediate us? Would we get Amazoned by someone who will put together all of the information about buyers and factories online?”

Answer: The Internet facilitates supply chain management and Li & Fung were not going to be disintermediated

Key: have the old economy know-how and yet be open to new economy ideas
Internet Issues

- August 2000, beta launch of the new Business-to-business (B2B) e-commerce portal
- Important issues:
  - Was there any chance of channel conflict or cannibalization between the offline business and the start-up?
  - How would the market reach to the start-up once it was launched the following year?
  - How specifically would e-commerce ultimately transform his family’s century-old company?
Company Background

- 2000 – Li & Fung
  - a $2 billion global export trading company
  - 3,600 staff worldwide
  - Sourcing and managing the global supply chain for high-volume, time-sensitive consumer goods
  - Product mix – hard and soft goods
    - Soft goods – apparel, including woven and knit garments
    - Hard goods – fashion accessories, festive or holiday products, furnishings, giftware, handicrafts, home products, furnishing, home products, fireworks, sporting goods, toys, and travel goods
Exhibit 2. Li & Fung Total Value-added Services
Company Background

- Holistic Supply Chain Management
  - Provided value-added services across the entire supply chain in a so-called borderless manufacturing environment
  - Benefits to clients:
    - Supply chain customization
      - Shorten order fulfillment from 3 months to 5 weeks
      - Faster turnaround – reduce inventory costs
      - Reduced matching and credit risks
      - Quality assurance
      - Lower cost and flexible sourcing
      - Provided up-to-date fashion and market trend information
  - Since Camerley acquisition (1999), offering clients virtual manufacturing or product design services
Li & Fung does not own any of the components in the supply chain but manage and orchestrate it.

Holistic conception of the value chain
- creation of value
- Improve operations by controlling or owning strategic links in the chain
  - Raw material sourcing

Corporate Culture & Compensation
- Culture – Humble, agile and responsive
- People – externally focused
- Foster communication across the Group
  - Biannual retreats, senior management meetings between division-level managers
- Worldwide separate and individual management teams
  - Product specialists
- Li & Fung corporate umbrella
  - Provide centralized IT, financial and administrative support
Tripartite Growth Strategy

- In 2000, Li & Fung saw its future growth coming from
  - Organic growth
    - Backwards planning – recognize where they want to be, identify the gaps, see what they have to do to get there
      - “3-year plan” system
        - Filling in the gaps in its network of offices to cover new sourcing markets
  - Expansion through acquisition
    - By the end of 1999,
      - became the only listed supply chain management company in Hong Kong
    - By August 2000,
      - became five times the size of its two closest local competitors
  - Extension of its supply chain to new markets via the Internet (E-commerce)
E-commerce

- IT division – 60 people in Hong Kong
- Software development was outsourced
  - Intranet – 1995 – launched an intranet to link the Group’s offices and manufacturing sites around the world
  - Extranet – 1997 – launched secure extranet sites
    - Linking the company directly to key customer while customized to that customer’s individual needs
      - Online product development and order tracking can be carried out
      - Platform for the manufacturers and retailers to interface
      - Streamlining communications as the order moved through the supply chain
      - Promoted quick response manufacturing
E-commerce

- Both Intranet & Extranet
  - the initial building blocks to e-commerce solution
  - Aware of the extent to which integration of Internet technology enhanced internal efficiency and improved communication
Competitive Threats

- Li & Fung’s old economy retail customers felt seriously threatened by Internet pure plays.
- Internet companies could use the money that was pouring in to damage offline competitors, often by acquiring them or their key people.
- Other possible threats came from
  - online companies acquiring an old economy trading company,
  - offline companies partner with a dot-com
- William Fung, “Internet is just another technology that affects the way information is transferred and people communicate with each other … It may be the most significant change until now but it is probably not the last.” Similar to fax and telephone but reduce the lag even more significantly.
- Victor Fung, “The Internet is a revolutionary technology, but new technology is nevertheless still technology.”
“Bubble In”

- Questions on e-commerce strategy for Li & Fung
  - How and in what shape it would emerge?
  - How specifically e-commerce would eventually add value to Li & Fung?
  - Whether it would use the existing IT department of 60 or absorb a new team of “entrepreneurs”?
  - Victor Fung, “I’m not interested in starting a dot-com … spinning it off.”
  - William Fung, “We were an information and knowledge-based services company, anything to do with information technology is crucial to us. We keep up with what’s happening with board members who can help us scan the horizon.”

- “Bubble In, not bubble out”
  - The e-commerce strategy should come from within the company, not outsourcing it.
  - To be certain that “the technology would pervade the entire organization”
  - ‘Outsourcing e-commerce implementation to a third-party consultant for a $10 million fee as “putting the fox in the chicken coop.”’
    - Risky dependency on outsiders
    - Provide outsiders with proprietary information, strategy and the entire business model
Combination of technology and supply chain reform to transform retail

- Castling Group – an internet start-up company to defend the offline against online companies’ threat to their marks while extending their online presence
- Evolution of Castling from B2C to B2B and Li & Fung’s needs complemented each other nicely
- Co-invested in an initial round of financing for lifung.com
Moving first and fast

- 3 stages of launching an online venture
  - The business strategy
  - The design-build-test phase
  - Actual execution
- Requires fundamental trust
  - Openness and constant communication are essential to success of a dot-com
- Before execution
  - Balance of the old economy & new economy
    - Different from most dot-coms, traditional market researches are performed before fully embarked the e-commerce venture
      - Top down old economy market research to find out how high the target market is
      - Bottom-up focus group research to identify retailers’ real need
SME Target Market: “B to small b”

- Market research on target SME market by industry analysts
  - Given the proliferation of B2B portals in early 2000
  - Defined target SMEs in US as
    - retailers with annual sales under $100 million
    - Wholesalers with turnover of less than $50 million
  - Pinpointed SME needs and determined the extent of demand for a “B2b” portal like lifung.com
  - Characteristics of B2B:
    - Finite number of customers
    - Know whom to target
    - Know the names and address of these retailers
    - Know how to reach them
SME Target Market: “B to small b”

- Determined 20,000 retailers and 2,800 wholesalers in US with a total market size of $54 billion were potential customers
  - Traditionally
    - SME orders were small & lacked economies of scale
    - SMEs had to pay importers high margins (25% to 30% of the total order)
    - SMEs were served the least
      - Were offered a limited range of options in product specifications
      - Overlooked by suppliers who are more concerned with serving larger clients
    - SMEs lacked current information and lagged far behind large retailers in identifying fashion trends
    - Not cost-effective for Li & Fung to trade with SMEs
      - Small orders and were often below factory minimums
## Needs and Realities for SMEs

<table>
<thead>
<tr>
<th></th>
<th>Needs</th>
<th>Realities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product</strong></td>
<td>Differentiation of product at competitive price</td>
<td>No purchasing power</td>
</tr>
<tr>
<td><strong>Service</strong></td>
<td>Reliable procurement</td>
<td>No supplier leverage, no logistics for direct sourcing</td>
</tr>
<tr>
<td><strong>Information</strong></td>
<td>Up-to-date news, information</td>
<td>Starved for information</td>
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However, via B2B portal, Li & Fung

- Aggregate SMEs’ smaller orders
- Profitably offer SMEs an array of products with the option of limited mass customization
- “Capture economies of scale by concurrently manufacturing the aggregated orders while giving SMEs enough differentiation of embellishment choice to enable them to each have a different product.”
- Planned to charge SMEs a 10-15% commission, far less than these small retailers were used to paying
- Limited mass customization – further extension of Li & Fung’s supply chain customization and innovation, critical in the Internet age in which customers expected even greater speed and reliability of order fulfillment.
- Not requiring minimum order
  - Add further value by allowing SMEs to reduce their inventory levels and use the system for replenishment buying
  - Make it easier for SMEs to respond to changing market conditions and fashion trends
## SMEs’ Sourcing Possibilities

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<thead>
<tr>
<th></th>
<th>Product Differentiation</th>
<th>Competitive Price</th>
<th>Reliable Procurement</th>
<th>Information Flow</th>
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<tbody>
<tr>
<td><strong>Importer</strong></td>
<td>Poor</td>
<td>Poor</td>
<td>Strong</td>
<td>Poor</td>
</tr>
<tr>
<td><strong>Small agent</strong></td>
<td>Fair</td>
<td>Fair</td>
<td>Poor</td>
<td>Poor</td>
</tr>
<tr>
<td><strong>Small buying office</strong></td>
<td>Fair</td>
<td>Fair</td>
<td>Poor</td>
<td>Fair</td>
</tr>
<tr>
<td><strong>Internet exchange</strong></td>
<td>Poor</td>
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<td>Poor</td>
<td>Fair</td>
</tr>
<tr>
<td><strong>Lifung.com</strong></td>
<td>Strong</td>
<td>Strong</td>
<td>Strong</td>
<td>Strong</td>
</tr>
</tbody>
</table>
“B2B” Parameters

- Second atypical thing for lifung.com
  - The way it approached financing
    - old economy-style financing
    - Raised $250 million by placement of 60 million shares through Goldman Sachs
      - $200 million for lifung.com
      - $50 million for acquisitions in the core business start-up
2 of the 3 guiding principles behind lifung.com were old economy standards:

- Adopt a “business-to-business” model
- Took a “back-to-basics” approach by implementing Li & Fung’s supply chain management know-how to SMEs on a “back-to-back” order basics
- No inventory risk for Li & Fung

Expected earnings

- First 2 years – operating margin of ~ 6%, 14% of total revenue
- 2004
  - $2 billion in sales, ~1/3 of the Group’s total revenues
  - 7 – 8% operating margins

Follows the 3-year planning system

- focused on the bottom line
Risk of channel conflict between the SMEs and key client business

- Customers’ direct competitors working with the Group in an old fashioned way
- Compartmentalize in Li & Fung
  - Segregate customers with dedicated accounts and management
E-commerce Execution

- Lifung.com
  - offered a wide array of customization options to clients
  - Developed and operated independently of Li & Fung's IT department
    - Mapping the connection between lifung.com & Li & Fung
    - Designed to interact with Li & Fung same way as one of the Group’s key customers
    - But enjoy a closer interaction with its parent, Li & Fung
  - Difficult to integrate an online venture into the corporate culture
    - "Demystify" the technology
      - Internal training courses and daily exposure to the new technology for the offline staff
Not only a defensive move
An offensive thrust at new markets
B2B exchanges not a threat

- Only Offered a trading platform matching buyers and sellers
- Can Not add value in the same way that Li & Fung could
Future Ventures

2001

- Expand its online B2B penetration
  - A new platform – “Electronic Stock Offer” (eSO)
  - Target the other side of the butterfly model
  - Aggregate suppliers
  - Aimed at creating an efficient system for
    - reaching out into Li & Fung’s supplier base
    - Posting surplus stocks on the internet
  - A more efficient and cost-effective platform for Li & Fung to sell to buyers primarily interested in purchasing seconds
  - Bring buyers & suppliers together
  - Buyers don’t have confidence at anonymous suppliers
  - Intermediate the virtual exchange
  - Add value to e-commerce transaction by
    - virtue of the old economy network, brand, and reputation

Exploit e-commerce

- An integral constituent of its strategy of expanding and diversifying traditional, offline business
Exhibit 7: lifung.com Market Positioning

Small Suppliers

Li & Fung Trading

Lifung.com

Large Buyers

Small/Medium Buyers
EXHIBIT 6  Li & Fung Competitive Positioning

Outlook and Prospects

Questions

- What if the 1,000 SMEs projected did not flock to the B2B portal?
- At what point would Li & Fung cut its losses and shut it down?
- If the beta launch was a failure, would this undermine investor and SME confidence?
- Was there a risk Li & Fung not able to see who was chasing them, e.g. copycat old economy sourcing company?
- What was the chance that Li & Fung’s offline operations would migrate online?
  - What are the possible channel conflict?
  - How would it be perceived by old economy Li & Fung veterans?
  - What would be the future of the inhouse e-commerce team?
  - Would Li & Fung eventually spin off the clicks-and-mortar hybrid?