



Competing in a Flat World

THE PERILS AND PROMISE OF GLOBAL SUPPLY CHAINS BY VICTOR FUNG, WILLIAM FUNG AND YORAM (JERRY) WIND

Mattel's recent recall of nearly 20 million toys, followed by the company's public apologies to both consumers and the Chinese government, is a sign of the new "flat world" challenges facing many firms. It is clear that the complexities of modern supply chains extend far beyond mastering work flows and logistics. As supply chains are broken apart and stretched around the world, companies are faced with the challenge of managing processes by partners that they don't own. At the same time, in a world of greater transparency, any missteps will be recognized more swiftly and have global repercussions. This is just one more sign of how we need to redesign our management, enterprises and thinking for this new "flat world."

In his defining book, *The World is Flat*, Thomas Friedman succinctly identified some of the forces that are flattening the world and some of the implications of these changes. But companies are just beginning to understand how to compete in this world. If you accept that the “world is flat,” what do you need to do next?

Li & Fung has been focused on these “flat world” challenges for decades. Over more than 100 years, it has evolved from a Chinese trading company to what we now call a “network orchestrator.” Li & Fung Trading produces more than \$9 billion in clothing, toys and other goods for some of the best known brands in the world, yet we don’t own a single factory or employ a single seamstress. Instead we tap into a network of small to mid-sized suppliers around the world, often handling different stages of production in different factories and different locations.

When an order comes in, the supply chain is designed to best deliver the right product at the right time, right place and right price. If an order comes in for 300,000 men’s twill cargo pants, for example, the buttons might come from China, the zippers from Japan and the yarn from Pakistan. The weaving and dyeing of the fabric might be done in China, while the garment is sewn together in Bangladesh. If the customer needs quick delivery, the order might be divided among three factories, but the final product needs to be the same. If the same order were to come in a few weeks later, it might lead to a completely different supply chain. In contrast to Henry Ford’s assembly line, where all the manufacturing processes were under one roof, the entire world is our factory. We don’t own this supply chain. We orchestrate it.

This is just one way that we have rethought and redesigned our business for the flat world. We have also changed our focus (concentrating on both firm and network), our management (balancing control and empowerment) and our value creation (building value with both specialization and integration). In each of these areas, we have developed new approaches to our business and learned important lessons about competing in a flat world. While these approaches were initially developed at Li & Fung, we also examine examples of how these principles of network orchestration are applied in diverse contexts.

FOCUS: FIRM AND NETWORK

The firm has been the focus of most of our thinking about organizations and strategy. But in an interlinked world, the network is becoming more important. We need to expand our thinking from concentrating on managing firms to orchestrating networks. This leads to two key principles:

→ **Orchestrate the Network:** The rise of global networks has created a demand for orchestration, as well as an opportunity for improving orchestration. Ecko Unlimited, for example, reduced manufacturing costs by 15 percent, improved on-time shipments, raised quality and reduced lead times by an average of 21 days just by improving its orchestration. While companies have built networks, they have often overlooked the need for orchestrating these networks. This orchestration might be supplied by one of the players in the network or by an independent orchestrator.

→ **Compete Network Against Network:** The traditional view of competition is that a retailer competes against a rival on the opposite street corner. But each of these stores has an entire supply chain stretching out the back door. They are actually competing supply chains, and the best supply chain will usually win. Companies used to see competition as firm against firm. But a networked world is like a team sport—the final score depends not on one player, but on the strength of the entire team. This means leaders of enterprises need to focus not only on their own firms but also on the quality of the network they are connected with and how these networks are orchestrated.

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MANAGEMENT: CONTROL AND EMPOWERMENT

As the Mattel case shows, command and control is difficult in a flatter, networked world, and there is a need for a different kind of control within networks. This requires a balance between control and empowerment to ensure that the network remains fluid enough to respond to changes and remain flexible, yet still get the job done. Among the principles of balancing control and empowerment are:

- **Take Responsibility for the Whole Chain (Whether You Own It or Not):** As progress in improving working conditions has shown, it is possible for companies to manage offshore processes. Network orchestrators need to go beyond inspection to create a broader set of systems to take responsibility for the entire supply chain. These include rigorous compliance auditing, prevention, certification and training.
- **Empower “Little John Waynes” to Create a Big-Small Company:** In a flat world, large companies increasingly face competition from nimble competitors. To successfully compete, the large companies need to act like a small company while utilizing the resources of a large company. At Li & Fung, we have set up entrepreneurial leaders, called “Little John Waynes” who can circle the wagons and fight their battles on the ground. At the same time, they benefit from the flow of resources of the large company, like a chain of supplies running through the center of the wagons.
- **Establish the Three-Year Stretch to Balance Stability and Renewal:** Classical Western business planning sets goals that are revised every year, creating a moving target that can be hard. Too much stability, on the other hand, can lead to complacency. Li & Fung uses three-year fixed plans, built around stretch goals, to balance stability and renewal. During the plan, the goals are fixed so business units have a consistent target in a changing world, but every three years the organization challenges itself to move in new directions.

- **Build the Company Around the Customer:** Companies that own factories are often looking for customers for their output or capacity. In contrast, the network orchestrator builds the entire business and supply chain around the customer. The orchestrator is an extension of the customer's organization and creates and manages the links that tie the customer to the broader supply chain. For Li & Fung, the customer is usually the retailer or owner of the brand, but this also can apply to the end consumer.
- **Follow the 30/70 Rule to Create Loose-Tight Organizations:** In working with a network of suppliers, the relationship needs to be tight enough that the supplier takes it seriously but not so tight that the supplier becomes a de facto part of the orchestrator's business. In practice, Li & Fung tries to gain at least 30 percent of a key supplier's business but not more than 70 percent (the 30/70 rule). This creates a relationship that is loose and tight, and allows the supplier to work with other companies to enhance the learning of the overall network.

If there is no one orchestrating the network, or it is not orchestrated effectively, then this is a critical need.

VALUE CREATION: SPECIALIZATION AND INTEGRATION

In the past, companies have created value primarily through specialization—either by focusing on one part of the supply chain or by having highly specialized functions within the firm. In a networked world, however, value is increasingly created by integration across stages of the supply chain and functions within the firm.

→ **Capture the Soft Dollars by Looking Beyond the Factory:** Manufacturing efficiency improvements have squeezed most of the excess out of the factory. The greatest opportunities for improvements are beyond the factory door, and these opportunities are now significant in a flat world. For a typical plush toy that retails for \$4, the “hard” cost within the factory might be about \$1. This means that there are \$3 outside the factory in “soft dollars.” By focusing on these soft dollars, improving logistics and reducing markdowns for example, companies can realize much greater opportunities for gains than those within the factory.

→ **Sell to the Source by Bridging Marketing and Operations:** As companies outsource and offshore, they create connections with emerging economies that are also promising future markets. Operations, which is sourcing from these regions, and marketing, which is looking for geographic growth opportunities, are in separate silos in many organizations. Bridging these silos companies can utilize the knowledge and connections built through sourcing to build markets by “selling to the source.”


UNDERSTANDING REGULATIONS

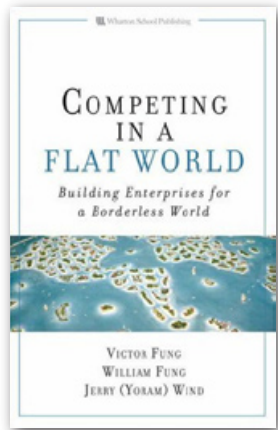
Although we have focused on business enterprises, the rise of the flat world has implications for policy and regulations as well. In a world in which different stages of making a single garment can be handled in different countries, is “country of origin” still a meaningful concept?

We also need to rethink our regulations. One of the biggest challenges to the rise of networked organizations is the complex patchwork of global trade regulations. Global restrictions have been replaced by an ad hoc system of bilateral agreements that create obstacles to trade between certain countries and trade “superhighways” between others. While these market distortions may create opportunities in the short run for companies that understand them, in the long run they interfere with the emergence of optimal networks and supply chains. This ultimately hurts companies and their customers by dampening productivity. As our organizations reshape themselves for the flat world, we also need to address the global playing field on which they play.

ORCHESTRATE OR BE ORCHESTRATED

While companies have focused in the past on building their own core competencies, the flat world presents different challenges and opportunities. It is not only the competencies that you have but also the competencies that you can connect to. In the evolving flat world, competencies in network orchestration and learning can give you access to other competencies that you might need for a specific challenge, or to fill a specific order. At the same time, they will allow you the flexibility to respond to future challenges.

We are in a networked world, and networks require orchestration. You need to understand the networks that are a part of your company’s success—or could be. You also need to understand who is orchestrating these networks. If there is no one orchestrating the network, or it is not orchestrated effectively, then this is a critical need. If you don’t have capabilities for network orchestration, how can you build them? 



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ABOUT THE AUTHOR

Dr Victor K Fung is the Group Chairman of the Li & Fung group of companies, which includes major subsidiaries in Trading, Distribution and Retailing, including publicly listed Li & Fung Limited, Integrated Distribution Services Group Limited and Convenience Retail Asia. **Dr William K. Fung** is Group Managing Director of Li & Fung Limited, and has held key positions in major trade and business associations. Currently, Dr Fung is a member of the Trade Development Council. **Yoram (Jerry) Wind** is the Lauder Professor and Professor of Marketing at The Wharton School. He is founding director of The SEI Center for Advanced Studies in Management, the founding academic director of The Wharton Fellows Program and founding editor of Wharton School Publishing. Visit [competinginaflatworld](#) for more.

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