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COLUMBIA BUSINESS SCHOOL

Doing Business in China: Outsourcing and Supply Chain Management
Presented by Dr. Victor Fung, Group Chairman, Li & Fung

Sir Gordon Wu Distinguished Speaker Forum
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Victor Fung, group chairman of Li & Fung, one of China's most respected companies, addressed the evolution of supply chain management in East Asia on May 10 as part of the Sir Gordon Wu Speaker Forum. Columbia Business School's Dean Glenn Hubbard introduced Dr. Fung as "a model businessperson, someone whose interests combine business, government and the academy." In addition to his role as chairman of Li & Fung, which has subsidiaries in trading, distribution and retailing, Dr. Fung is chairman of the Greater Pearl River Business Council, the Hong Kong Airport Authority and the Hong Kong University Council. In this last capacity, he has helped further Columbia Business School's collaboration with the University of Hong Kong.

Dr. Victor Fung opened his presentation "Doing Business in China" by describing the evolution of Hong Kong industry. In the 1970s, Hong Kong was a center of low-end textile manufacturing. The emergence of neighboring economies like South Korea and Taiwan began to infringe on Hong Kong's economic dominance, and the city gradually became less competitive. All of that changed, however, when Deng Xiaoping opened China to the world in 1979. Deng created special economic zones in the Pearl River Delta region, which abuts Hong Kong. Once this happened, Dr. Fung asserted, global manufacturing changed and would never be the same again.

Hong Kong manufacturers saw the opportunity to "rationalize" their supply chains by moving labor-intensive functions across the border to China while leaving value-added front-end and back-end processes in Hong Kong. Dr. Fung gave the example of a child's doll. The doll would be designed in Hong Kong, and materials would be sourced there as well. Assembly would then occur in China, but the doll would be sent back to Hong Kong for quality control, packaging, marketing and distribution. Entrepreneurs would leverage China's low-cost labor with Hong Kong's sophisticated banking system and shipping infrastructure. Although an increasing volume of manufacturing moved from Hong Kong to China, Hong Kong's unemployment level stayed at 3 percent for much of the next 25 years because the front-end and back-end jobs remained there. Vast.

retraining occurred for Hong Kong's former laborers, who gradually took on more sophisticated positions. Over time, the "middle section" of Chinese workers began to migrate to the rest of the world.

By the 1990s, the production process had become fully globalized. Advances in logistics and IT enabled supply chain disbursement. When Li & Fung had an order for 10,000 shirts, the first question had once been "Which factory do we use?" Dr. Fung explained that that decision evolved to "Where do we source our dye?" and "Where do we do the actual dyeing, and then the cutting and sewing?" The answers rested on dependability of labor, product quality, ease of transportation and price. A single shirt's components could pass through three different countries before reaching final assembly in Hong Kong or China.

The crucial by-product of the globalized supply chain is faster cycle time. Marketing has become more complex and customer tastes more fragmented than ever. The entrepreneur or retailer who can delay as long as possible to estimate demand will have the competitive advantage. Dr. Fung argued that the compressed cycle time and the disbursed supply chain are the most important developments of our time.

Another great benefit of this mode of production is the democratization of the value chain. Small countries and businesses now have a place in international trade because they can specialize in small sections of the production process. In the previous days of single-factory production, these players were marginalized. While China is often the final point of "substantive transformation" for many goods, Dr. Fung reminded the audience that the majority of production is done by other countries higher up the value chain. China runs a trade deficit to many Southeast Asian countries that export raw or partially finished materials to China for final assembly. The U.S. trade deficit to China might therefore be looked upon in a different light.

Finally, Dr. Fung concluded that this great trade revolution is made possible only through the fruits of multilateralism. To continue these innovations in production, the world must sustain and expand multilateral agreements through the WTO. The recent spate of bilateral and regional agreements is both dangerous and counterproductive because the agreements go against the spirit of cross-border cooperation and value-adding. Dr. Fung gave the example of the proposed United States–Australia free-trade agreement. In an early version of the agreement, Australian goods had to be 100 percent made in Australia in order to be subject to the open U.S. market. Australian business leaders protested because it prevented them from sourcing any part of their supply chains from abroad. After much debate, components from New Zealand and Papua New Guinea were permitted in the deal.

Dr. Fung passionately urged that the world not degenerate into a mélange of bilateral agreements. This would create a "law of the jungle" in which businesspeople could not add value and small countries and businesses could not participate. The world has come too far, he argued, and it must not abandon multilateralism but rather rescue and improve it.

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