



Outclassing Sourcing Champions

With increasing specialization, technological complexity, and globalization, firms now buy a long list of products and services from many outside providers. In industries like automobiles, consumer electronics and retail, reliably sourcing a multitude of products from supply chain partners is the key to success.

Li and Fung limited, one of the worlds fastest growing companies, is fundamentally altering this sourcing landscape and is simultaneously changing the game in these industries which rely deeply on sourcing. It is a company which owns no production, transportation or retail facilities, but by becoming the key link in the sourcing practices of some of the worlds best known companies like Gap, Benetton and Walmart, has found a novel winning formula. So how has this firm created a multi-billion dollar business for itself by outclassing companies like established sourcing champions like Walmart at the game of sourcing?

Traditional sourcing relied on floating tenders and other competitive rituals that ensured low prices with acceptable quality. As more strategic components and services were sourced externally, buyers would change specifications often, benefit from jointly developing products with supplier and in such a context, competitive rituals became more and more cumbersome and impractical for most items but simple commodities. And these rituals were increasingly replaced with long-term partnerships with suppliers. Firms designate a small number of favoured suppliers and stick to sourcing from them, replacing competitive bidding rituals with evergreen partnerships. With an evergreen partnership, firms felt more confident sharing their key secrets and integrating the suppliers ever more into their operations. Companies like Toyota and Ikea mastered this long-term sourcing approach.

This model served many industries well, but in a fast changing world, this model also has an evident disadvantage. By its very nature, a long-term sourcing arrangement, restricts firms to employ new suppliers too often. In a rapidly changing environment, this can make firms less responsive, In a [recent article](#), Elena Belavina and I explain how Li and Fung, a sourcing intermediary has created a world-beating business out of relieving just this constraint of long-term partnerships.

Li & Fung Ltd. provides sourcing services to major brands and retailers worldwide, including Walmart, Target, Zara and Levis. Typically, it completely

takes over the sourcing function– it selects, verifies and approves suppliers, allocates business between different suppliers, and manages the relationship with each supplier, including provision of incentives for investments, performance and compliance. Li & Fung has grown at a compounded annual rate of 23% for the last 14 years to achieve annual sales of over HK\$ 120 Billion. While best known for sourcing apparel and toys from the low-cost economies of Asia, the group today operates in an expanding range of categories. It is present in over 40 economies across North America, Europe and Asia, with a global sourcing network of nearly 15,000 international suppliers, as well as thousands of buyers. It has abilities to provide both low-cost and quick, responsive sourcing. Yet, Li & Fung does not own any means of production or transport, nor is it in the business of directly retailing the vast majority of the products it sources. The company provides only an interface between multiple buyers and suppliers.

Instead of entering into long-term sourcing arrangements with one suppliers, firms like Li and Fung encourage buyers to enter into long-term sourcing arrangements with an intermediary firm like themselves. It then pools the sourcing needs of different buyers and using the pooled demands it is better positioned than individual buyers at incentivizing suppliers and at encouraging suppliers to also enter into long-term arrangements. Interestingly, while Li and Fung enters into long-term relationships with many buyers and sellers, it can still provide some flexibility. Within its network of buyers and suppliers, it can keep changing the suppliers that are matched to different buyers at any point, thus providing a modicum of flexibility while maintaining uninterrupted relationships with different buyers and sellers. Essentially, sourcing for multiple buyers provides intermediaries with a certain flexibility in meeting the commitment to provide future business to a supplier– the flexibility of choosing which buyer to match to which supplier.

Firms like Li and Fung Ltd. have exploited this [relational advantage of intermediation](#) to create

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a new business model, a business model based on simultaneously providing the flexibility of competitive sourcing and the confidence of long-term relationships. As with many other organizations that we discuss on this blog, Li and Fung did not invent any new products or services, but by rethinking the business model around one of the world's oldest services, it has created a new billion-dollar business model, a true renaissance innovation

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