**ADDRESS BY DR VICTOR K. FUNG, CHAIRMAN OF THE FUNG GROUP, AT THE HARVARD CLUB OF HONG KONG INAUGURAL CONFERENCE, 24 0CTOBER, 2015**

***The Next Wave of Globalisation - Opportunities for Innovation***

**Professor (Forest) Reinhardt, Albert (Hui), Rita (Pang), Ladies and Gentlemen:**

**INTRODUCTION**

**It is an honour to be here and I warmly congratulate the Harvard Club of Hong Kong for organising this inaugural event. You could not have chosen a better topic.**

**Innovation is indeed everywhere. And never have we needed it more…for disruptive change is *also* everywhere – from the world of retail, where customers now shop with smart phones, all the way up the supply chain, where advanced industrial robots are now able to thread needles.**

**"Innovation" means many things to many people. For some it equates to technology. I see technology not as an end in itself but as a catalyst. Innovation, for me, is about how companies allow new thinking to change the way they create and capture value, in other words, to change their business model. It is that business model change, more than technology per se, which has real impact on the way people work and live.**

**Over the past two decades, we have witnessed unprecedented innovation that has caused disruption and even havoc among many established companies, whilst also inspiring new ones to emerge. Companies that failed to innovate either sank into oblivion or are struggling today; those that embraced innovation have re-energised or re-invented themselves.**

**Professor Clayton Christensen of Harvard Business School and the world's expert on disruptive innovation went further. He observed that disruption typically enables new markets to emerge. And this is the underlying theme which I wish to present this morning in the context of two converging trends which, I believe, will create tremendous opportunities to innovate with business models, especially in this part of the world.**

**First, is what I consider the single biggest trend reshaping the global economy – I call it the globalisation of consumption. Second is China's vision and commitment to build a "21st Century Silk Road", which brings an additional dimension to various regional trade groupings – including the recently-announced Trans-Pacific Partnership (TPP).**

## 1. GLOBALISATION'S NEXT WAVE

### Globalisation's First Wave: 1.5 Billion New Workers

**Allow me to start by offering a perspective on the past 35, which takes us back to 1980 and the opening up of China, and the next 35 years, which will take us to the middle of this century. In my mind's eye, these two periods can be depicted as two gigantic waves.**

**This first wave has been all about the globalisation of *production*, made possible by the entry of 1.5 billion new workers into the global workforce in China, in other parts of Asia, and in Eastern Europe.**

**Working with factories in the Pearl River Delta and other emerging economic regions, companies based in Hong Kong, like Li & Fung, gradually developed an orchestrated production process that became known as global supply chain management. Looking back, it was a relatively simple world, then. Consumption was concentrated in the West; production was dispersed in the East. Yet this business model innovation disrupted the vertically-integrated production system that had previously prevailed.**

**The fact that distributed manufacturing is typically an asset-light model for supply chain orchestrators has also facilitated the entry of developing countries and small-and-medium-sized enterprises (SMEs) to the global economy. Among other positive outcomes has also been an environment conducive to advancements in technology and communications, the two enablers of the Internet and modern logistics.**

**While elements of the globalisation of production will continue, I believe a new era is dawning on the global economy with the rise of a new global middle class.**

## Globalisation's Second Wave: 3 Billion New Middle-class Consumers

**This trend, which I see as globalisation's second wave, is driven by higher wages and rising prosperity in China and the emerging markets which are the new engines of global economic growth. It is creating a new global middle class. According to the OECD, in 2009 there were 1.8 billion members of the global middle class, with about 500 million of them in Asia. This group will grow to 3.2 billion by 2020 and 4.9 billion by 2030. By this time, Asia will account for over 66% of this population; in other words, Asia will have added nearly 3 billion people to the new global middle class.**

**This emerging global middle class will be a major consuming force, and will singlehandedly push Asia's share of global consumption to over 33% of the global total, by which time it will be larger than that of the US or Europe.**

**I foresee supply chains becoming much more nuanced, complex and multi-directional. China, for example, will be both a production country – with markets across the developing as well as the developed world - and a consumption country, importing consumer goods from everywhere.**

**This rising global middle class is personally empowered as never before by digital technology and mobile communications. Consumers have become more knowledgeable, more demanding and, more than ever, inspired by user experiences. As I noted earlier, all of this is reshaping the future of retail.**

## Globalisation - and Mass Customisation - of Consumption

**Driving this new paradigm is the globalisation of *consumption*, (as opposed to production). At the same time, mass standardisation of products is morphing into mass *customisation* at a very local level. Already, we are seeing trends.**

**The Fung Group has a business research lab in Shanghai called Explorium. With our partners IBM, Pico and our own Fung Academy, we conduct rapid experiments to test different retail models. This is done in a controlled setting of 250,000 sq ft of retail space designed to allow us to observe how shoppers interact with new technologies, products, and experiential retail environments. One experiment, for example, involves 3D printing, the ultimate customisation tool.**

**It has become clear to me that the future is about omnichannel, in other words, bricks and clicks, or O2O (online-to-offline), rather than conventional brick-and-mortar retailing or pure e-commerce.**

**No-one knows, yet, what the winning omnichannel business model will be, or what success will look like. For instance, in three to five years, what will be the role of a flagship store in relation to a shopping website? What are the implications for shopping malls? How should retailers adapt? What will be the future for brands as more consumers chose to individually customise what they buy?**

**The search for answers to these and related questions is an opportunity for business model innovation on a global scale.**

## 2. A 21ST-CENTURY SILK ROAD

### A Visionary Concept

**But the future will not be shaped by market shifts or industry dynamics alone. Especially in Asia, policy will continue to play a big role, particularly with initiatives such as China's "21$^{st}$ Century Silk Road Project", otherwise known as the "One Belt, One Road". I believe this initiative promises to be a significant driver not just of the next era of economic development in China, but also of regional and global economic growth.**

**I say this mindful of the justifiable excitement over the TPP deal, subject, of course, to the ratification process which may be rather lengthy.**

**Last March, President Xi Jinping elaborated on this 21st Century Silk Road vision to transform China's connections with Europe, plus the vast tracts of land and sea in between. A top priority is infrastructure connectivity, for which the US$40 billion Silk Road Fund has been established. This is in addition to the new Asian Infrastructure Investment Bank (the AIIB), whose initial capital base is US$100 billion.**

**Together, the "Belt and Road" will link about 60 countries and 4.6 billion people. According to research by the Fung Business Intelligence Centre, these countries jointly account for 37% of global GDP.**

## ***Two* "Silk Roads"**

**In actual fact, we should be talking about *two* Silk Roads.**

**As you may know, one road is overland, to the north - the traditional Silk Road of Marco Polo's travels. As in ancient times, it starts in Xian, traverses Central Asia all the way through Turkey up to Russia and across to the Baltics, then down through Europe all the way – notionally - to Venice, where the original Silk Road terminated. This is the stretch referred to as "One Belt."**

**The "Road" is to the south. It is basically the maritime route travelled by the famous Chinese Admiral Zheng He during the Ming Dynasty, some 600 years ago. It goes from eastern China, down the coast of southern China to Hong Kong, then to Vietnam, Singapore and other ASEAN countries, through the Malacca Strait, across to the Indian coast, then further across to East Africa, up through the Middle East, partially overland to Turkey and also ending up in Venice.**

## **Inward and Outward Flows**

**The broader significance of the Belt and Road is that the Silk Roads (especially the Maritime) integrate the majority of the non-OECD markets, where the new global middle class is most firmly anchored. With total global consumption projected almost to double in the 25 years to 2038[1], the re-balancing to non-OECD consumption – enabled in large part by the 21st Century Silk Road - will have a major impact on the global economy. The northern Belt is rich in resources and commodities. I foresee that its strongest trade flows will be *inbound* to China, namely raw materials and commodities from Central Asia.**

**The maritime Silk Road is home to almost 90% of the 4.6 billion people I referred to a moment ago. I foresee that the strongest flows will be *outbound* from China, namely Chinese products and services moving south, southwest and west to new markets.**

**Once the physical infrastructures are upgraded and expanded, they will be open to everyone. We can expect all economies along the route to benefit from this enhanced infrastructure and to trade more with each other. I hope Hong Kong will play a vital role being located at the beginning of the Maritime Silk Road.**

## 3. INNOVATING WITH BUSINESS MODELS

**With so many discontinuities in the global economic environment, the world has reached another turning point. If we wish to succeed in the future, we cannot simply continue doing what we have done in the past.**

### Iterative Innovation

**This need to innovate now goes all the way back to the ideas stage, even before a product exists. In the era of mass customisation, innovation is no longer about perfecting a single prototype in a laboratory to be used in subsequent mass production. It is all about what Silicon Valley calls "test and trash."**

**Creating that first prototype in the laboratory –the "0-to-1" phase – is usually followed by the "1-to-50" phase, of getting dozens of hand samples made. In the "test and trash" era, however, the emphasis is on getting to the "50-to-50,000" phase, quickly and affordably. This allows you to solicit copious consumer feedback from test markets then re-design and test again – to the point of re-starting the entire process. All the way from the beginning, there is a series of continuous feedback loops. Our business models need to incorporate this iterative innovation phenomenon.**

**At the Fung Academy, we call it "leading with learning" in that the networks which win will be those which learn the fastest.**

**Companies in Hong Kong have a huge advantage because of our proximity to a valuable test market embedded in a rapid production centre, right next door. The Greater PRD area, including Shenzhen – which has become a global hotspot for the "maker" movement- is now a combination of 11 tightly-integrated cities with a combined population of 65 million. Its tech-savvy lifestyle and consumer culture reflect long exposure to Hong Kong and international business.**

**B-to-*Small* B**

**We need to innovate not just with how we create products but, as trade-expanding initiatives bring greater numbers of SMEs into the global economy, with business models for distribution and retailing.**

**In traditional OECD markets, companies like Li & Fung are used to distribution and retailing sectors that are mature, organised and to a significant degree consolidated into large structures with well-established channels. Access to a few hundred major retailers and brands therefore affords almost complete coverage of OECD markets.**

**By contrast, in non-OECD markets - home to the new global middle class - there are now myriad, web-enabled domestic wholesalers and retailers. The question is not how do you go from B-to-B – we already have that business model - but how do you go from B-to-*Small* B? I believe this is the new economy's new frontier.**

**For example, as a conventional manufacturer or distributor, how do you go from servicing dozens or hundreds of wholesale and retail customers across the US or Europe, to servicing – potentially – millions of micro wholesalers and retailers in China and India? Even with new technology solutions to longstanding credit and payment hurdles, this leap presents huge challenges for inventory management and logistics.**

**The "last mile" question is perhaps the most complex. Conventional business calculations that work for large integrated markets simply do not add up on such a small scale. The best answer may be not even to try and solve the question oneself. Personally, I believe the future lies in forward-deployment of merchandise to strategically-located depots, then letting "small B" customers**

**select and transport their own goods through "uberised" local networks. This hyper-localisation trend is already happening all over the world.**

**IN CLOSING**

**Ladies and gentlemen, the saying "if it ain't broke, don't fix it" cannot apply to business models. Companies with excellent business models today risk failure tomorrow if they do not continuously innovate in the face of accelerating change.**

**That change includes, as I have described, the converging mega trends of a rising global middle class in non-OECD countries and a bold vision to integrate future consumption in these new markets through better infrastructure connectivity.**

**There are long-term implications, too for how we build the right kind of soft infrastructure to enable continuous innovation, including how we encourage and reward innovative entrepreneurs.**

**My own sense of the future is, in a nutshell, that we need increasingly to take account of omnichannel, B2smallB and uberisation. But while such digitally-enabled phenomena are surely transforming the way we do business, I believe nobody can yet say with any certainty how they will transform actual enterprises. This means the future remains wide open to new breakthroughs in business model innovation. For a room full of Harvard grads, that can only be good news and opportunity.**

**Thank you.**