



Roland Berger
Strategy Consultants

INNOVATION IN THE MARKET EXPANSION SERVICES INDUSTRY: THE NEW GROWTH IMPERATIVE – UNLOCKING VALUE FOR CLIENTS AND CUSTOMERS

Second Global Market Expansion Services Report

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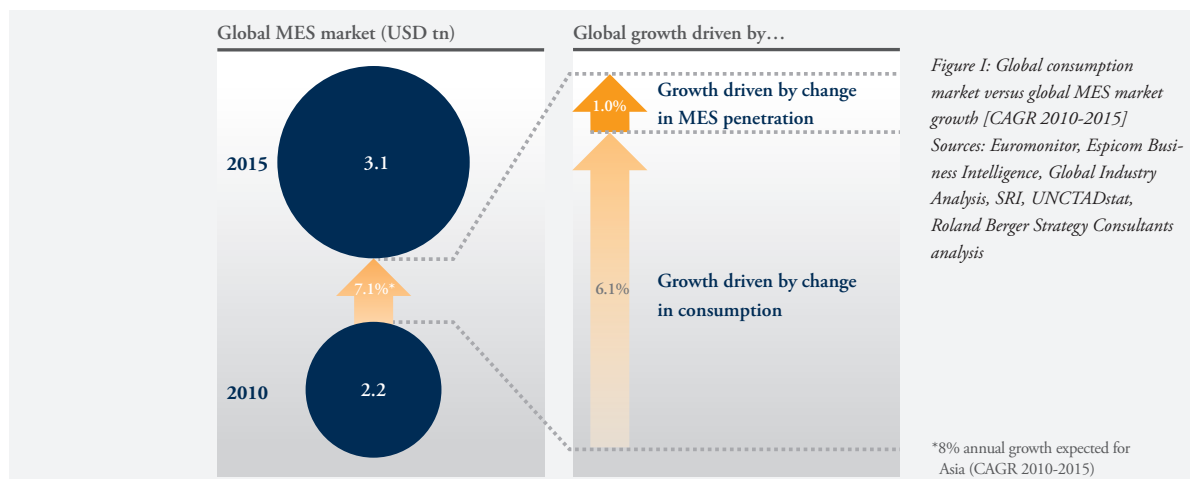
STUDY HIGHLIGHTS

Creating value through innovation

1

Continuous growth of the market expansion services industry

Market expansion services (MES) are continuously growing and remain one of the most promising sectors in the outsourcing industry, with an annual global growth rate of 7.1%.



2

Service innovation is a must for a superior competitive position

To stay successful in a competitive growth environment such as the Asia Pacific region, companies (and specifically MES providers) must continuously improve their service offerings.

3

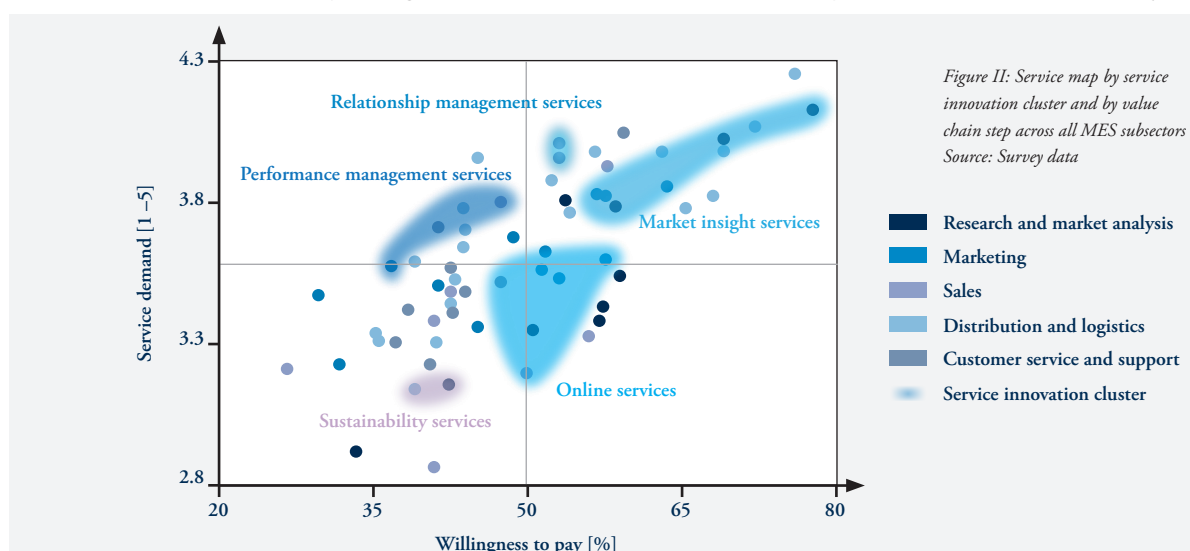
A strong backbone of core services is required as a platform for successful service innovation

Providers must demonstrate a strong capability to deliver core MES services to engage in the service innovation process.

4

Market insights and relationship management are in strong demand to close the MES information cycle

The highest client demand is for market insight services (market reports, consumer insights, etc.) and relationship management services (KAM and CRM). These help to close the MES information cycle.



5

Benefits of service innovation need to be tangible

Clients and customers expect tangible value from service innovation, with 48% seeking a higher level of service customization and 37% tangible top line benefits from service innovation.

6

There is no “one-size-fits-all” approach to service innovation

The service innovation process must give consideration to the nature of the decision maker. Regional or pan-Asian managers have a more strategic view on service innovation, while country managers approach it more operationally.

7

Industry matters – potential for successful best practice transfer

Consumer industries, such as consumer goods or healthcare, show a high level of experience in consumer-oriented services, such as customer insights. Industrial sectors bring a higher understanding of service as a business enhancer to the table. That distinct orientation can be mutually leveraged.

8

Service innovation at different pace across Asia Pacific

With service sophistication levels differing strongly across the Asia Pacific region, as indicated by the Service Development Index (SDI), local customization of the service offering is crucial for service providers to meet client and customer needs.

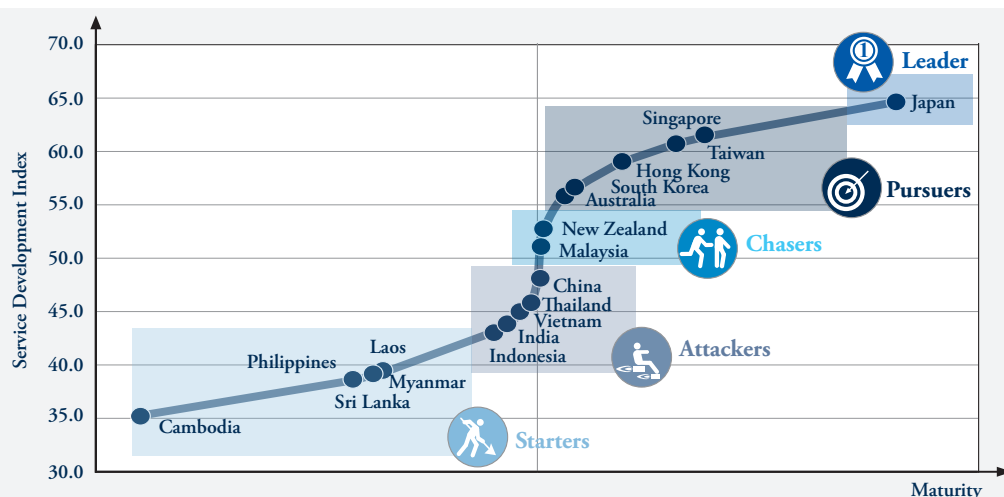


Figure III: Service Development Index across Asia Pacific (conceptual illustration based on SDI)
Sources: World Economic Forum, survey data, Roland Berger Strategy Consultants analysis

9

Collaboration is the key success factor for service innovation

The vast majority of clients and customers expect to be involved by the service provider, which shows that collaboration is a key success factor. To flourish, service innovation requires a close and trusting dialog between provider and its client and customer.

10

Platform, exposure and relationship – the formula for success

Regional and international cross-industry MES providers prove to be best positioned for successful service innovation. Due to their regional market coverage, in-depth market knowledge, and necessary resources, they provide the required platform, exposure, and relationships.

PREFACE

The market expansion services industry has achieved another year of strong performance that provides a counterpoint to the fears and uncertainties that characterize perceptions of the global economy. Increasing numbers of companies are making use of market expansion services, and emerging economies remain the industry's major growth markets.


The focus of this year's report is the Asia Pacific region, where economies have made a successful transition from low-cost sourcing markets to emerging consumer and industrial markets of global standing. Steady growth in their middle classes is one of several factors that position them to continue driving this trend.

Across markets, companies stay ahead of the curve in such a competitive environment by improving the effectiveness and efficiency of their business activities on the ground. They turn to MES providers for the innovative service solutions needed in this dynamic and at the same time complex region. Service innovation can take MES providers and their clients and customers to the next level of success. To achieve this goal, all of these parties must build relationships of trust, collaborate closely, and engage in intense dialog to refine service offerings and break through to a new level of customization and shared success.

In response to the positive feedback on last year's report, DKSH and Roland Berger Strategy Consultants have teamed up again to present the second global report on the MES sector in a series that we trust has the potential to become an industry standard.

This year's report reflects the latest extensive research and includes the findings of over 350 survey responses and from more than 25 interviews with industry executives and thought leaders. The study is designed to help decision makers gain a deeper understanding of this dynamic industry, reveal the impact service innovation is having and will have on it, and show you how you can benefit from this development.

We trust that you will enjoy reading this study, and look forward to your suggestions and comments.



Dr. Joerg Wolle
President & CEO DKSH Holding Ltd.



Dr. Martin C. Wittig
CEO Roland Berger Strategy Consultants

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A. MARKET EXPANSION SERVICES – AN INDUSTRY ON THE RISE

"There is an increased urge for companies to pursue a 'fast-track internationalization', demanding full-service integrated MES providers with broad international coverage."

Regional Director Asia Pacific, European business
facilitation agency

Market expansion services – taking outsourcing to a new level

A new industry emerging

Companies these days want to focus on core competencies and farm out everything that others can do more efficiently. This is nothing new. But what started out as the outsourcing of isolated processes such as IT or payroll accounting has now evolved to encompass entire front-end activity packages, including marketing, sales, distribution, and customer care. The day of market expansion services has dawned – and Asia is its epicenter.

Outsourcing originally grew out of companies' desire to concentrate on their core competencies and, in so doing, to cut costs. When companies also began to exploit cost differentials by sourcing materials and production in emerging markets, for example, globalization became another take on the same theme. The growing prosperity of emerging markets in general and Asian ones in particular, coupled with stagnation and market saturation in industrialized economies, subsequently added a new variable to the equation: global players realized that emerging markets are not simply "extended workbenches," but lucrative sales markets, too. Since then, emerging markets themselves have begun to turn the tables and are increasingly selling their own goods throughout Asia and beyond.

These developments have particularly compounded the need for market expansion services, or MES. Companies engage MES providers to help them not just understand local practices, market specifics, local regulations, legal issues, and cultural differences but also execute on the ground. MES providers can also assist in overcoming language barriers, gaining access to local customers, and providing insider market knowledge.

In theory, companies could manage these tasks themselves, if they had the necessary time, experience and resources – but often they do not. The risks associated with entering unfamiliar, far-flung markets are dishearteningly high. MES providers offer value by easing companies' entry into these markets or by effectively further developing existing

Market expansion services – outsourcing for growth

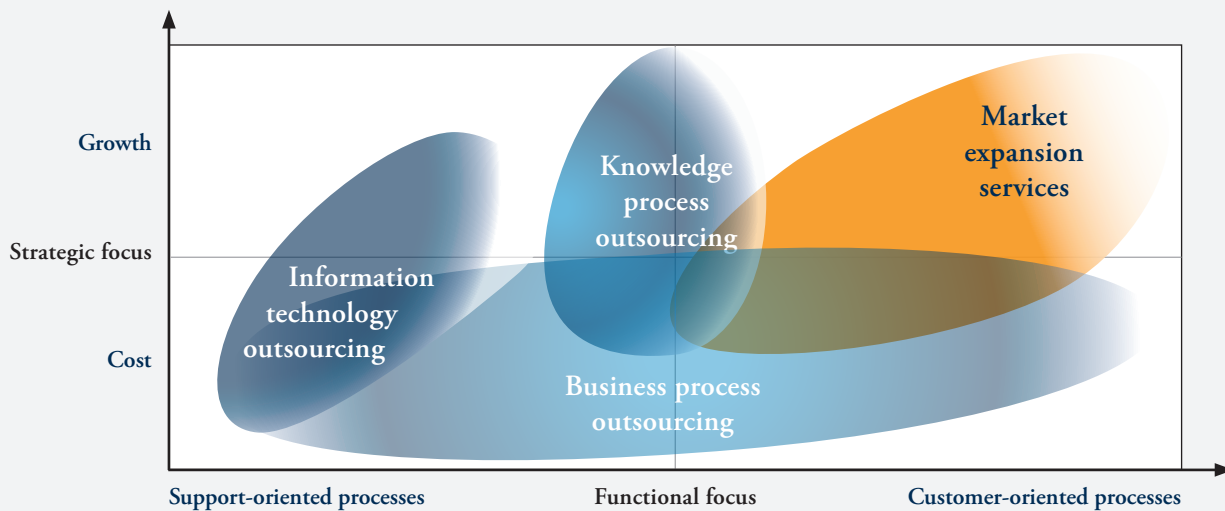


Figure 1: Market expansion services within the outsourcing landscape

business. They provide front-end processes in areas such as marketing, sales, distribution, customer services and support, and logistics – areas in which customer proximity is essential. As companies pursue entry and growth in new and existing markets, MES providers organize and run their entire value chain for their products – and market expansion services is now recognized as an established industry in its own right.

It is important to clarify exactly where traditional outsourcing ends and market expansion services begin. Traditional outsourcing breaks down into three categories:

1. Business process outsourcing (BPO) involves outsourcing specific business processes, such as payroll accounting
2. Information technology outsourcing (ITO) involves outsourcing IT-related processes, such as IT maintenance services, software engineering, and software testing
3. Knowledge process outsourcing (KPO) involves outsourcing R&D, analytical tasks, legal services, and services in the area of market and/or clinical research

Traditionally, providers offer outsourcing services in one or more of these categories. Their value proposition is that they can cut clients' costs by carrying out certain tasks more efficiently (see figure 1).

MES providers go beyond their traditional counterparts in their aim to reduce costs and at the same time improve revenue for clients. They ease their clients' access to new markets and assist them in exploiting markets in which they are already present. Their point of focus is front-end processes such as marketing and sales or customer services. With their help, companies are able to increase their market share, improve market coverage, and enhance their market penetration and simultaneously cut fixed costs and reduce operational complexity. In this way, MES providers do considerably more than companies providing only traditional outsourcing services.

Market expansion services – an integrated service offering

With the help of MES providers, companies can broaden and deepen their market penetration. By offering understanding of the local market, spotting sales opportunities and supporting with physical distribution, MES providers help companies to increase their existing market share and expand into new territories. Above all, MES providers help companies by delivering front-end business processes that involve a substantial level of direct customer contact – a significant improvement in value over traditional outsourcing providers.

Integrated front-end service solutions along the value chain

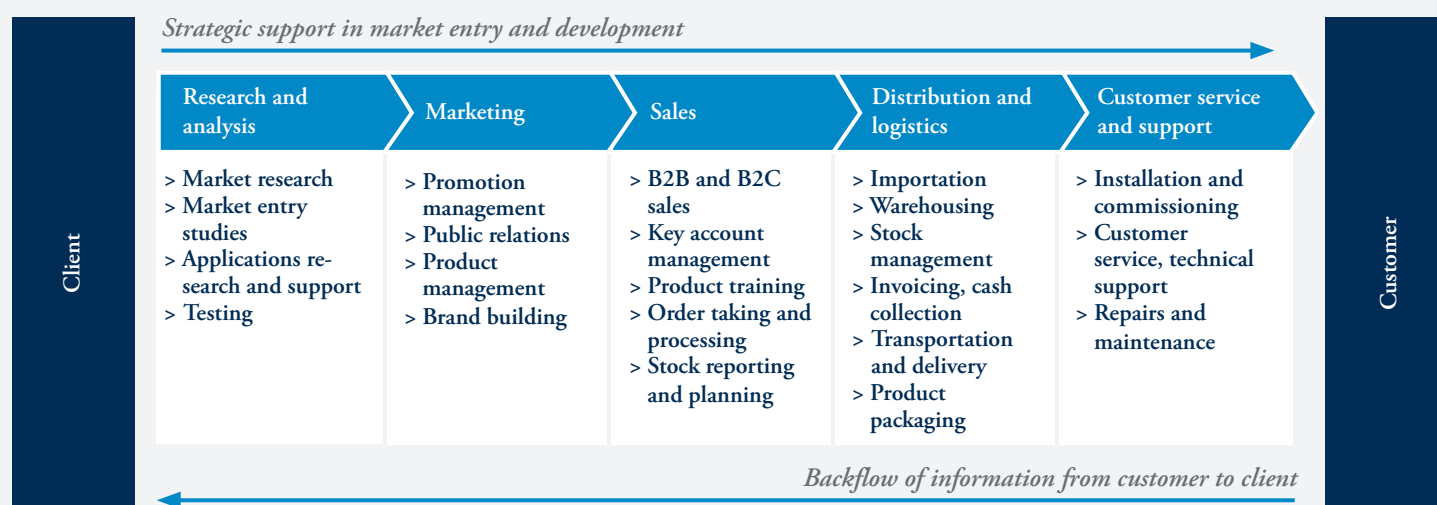


Figure 2: Market expansion services along the value chain

Examples include marketing and sales, logistics and distribution, and customer services. These activities are predominantly driven by specific local needs (such as cultural factors and regulatory requirements) that companies must take into account when entering new markets. But there are also industry-specific services, such as scouting for suppliers and testing products in regulated markets. Since most MES providers deliver services across the entire value chain, they can be considered full-service providers (see figure 2).

Although there are a variety of MES providers profiles, they all focus on integrating numerous services in end-to-end solutions. This distinguishes them from single-service contractors. Market research firms, sales agents and pure-play logistics providers are examples of such contractors: each of these players focuses on a specific link in the value chain. While MES providers offer wide-ranging service packages, many of them also give

companies the option of selecting modular services, which allows them to compete with more traditional single-service contractors as well.

These two business models – single-service contractors and MES providers – differ in terms of their value propositions. MES providers help companies reduce complexity and cut coordination costs. Moreover, by providing a one-stop shop, they channel information from customers to the company, often giving the company new market insights (see figure 2).

MES – different dynamics by industry and region

Seen from both industrial and regional perspectives, the global market for expansion services is highly diverse and fragmented.

Market sizes and penetration rates vary by industry, as do the specific requirements at the various links in the

Consumer markets lead the way

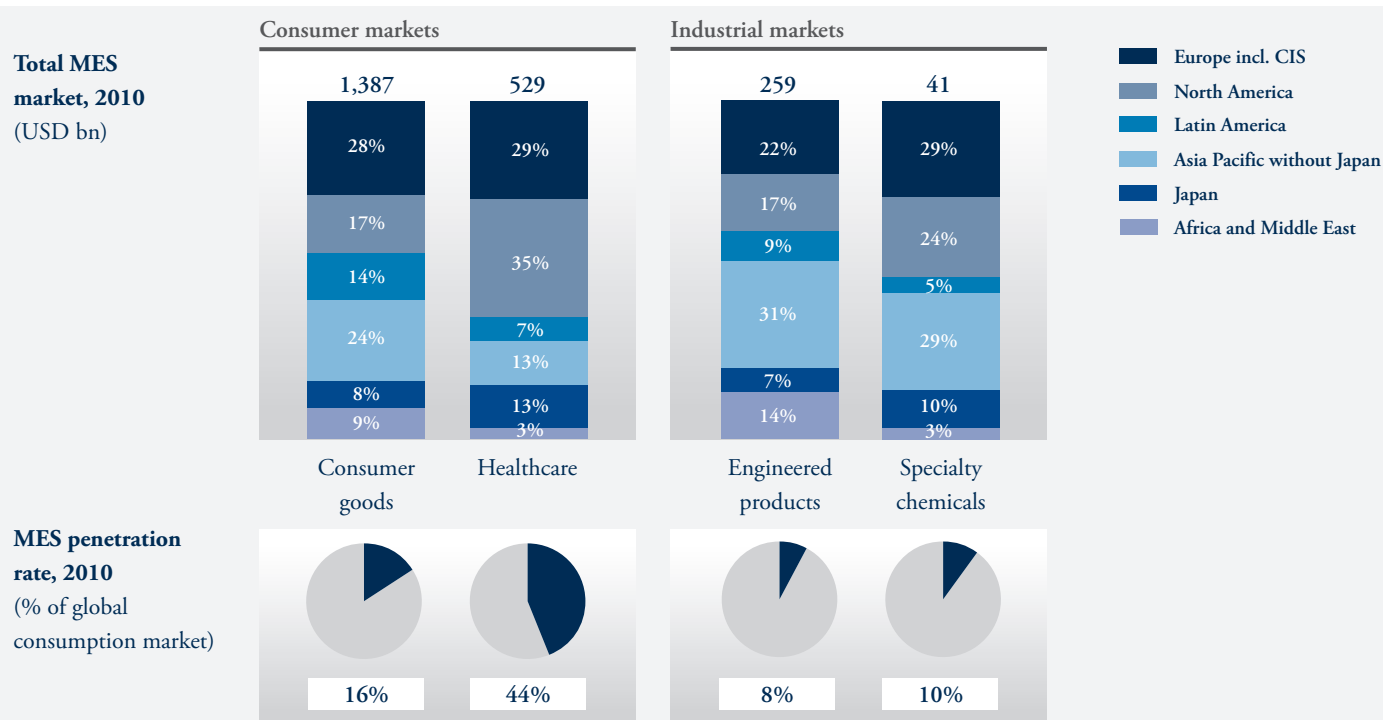


Figure 3: Global market expansion services market and penetration rates by industry (2010)

Sources: Euromonitor, Espicom Business Intelligence, Global Industry Analysts, SRI, UNCTADstat, Roland Berger Strategy Consultants analysis

value chains. Industries that demand MES usually require a local marketing and sales platform, a strong network and customized services (relating to sales, marketing, and technical product specifications, for example). Our focus here is on the consumer goods, healthcare, engineered products, and specialty chemicals industries (see figure 3).

These industries require on-the-ground personalized sales and after-sales support as well as capillary distribution capabilities. Variations lie essentially in the proportion of value-added services.

Globally, consumer goods (worth USD 1,387 billion) account for the largest proportion of MES transaction value, followed by healthcare (USD 529 billion), engineered products (USD 259 billion) and specialty chemicals (USD 41 billion).

MES enjoys a penetration rate of 44% in the healthcare industry. MES providers offer significant benefits by bundling sales and distribution activities for companies. This enables substantial economies of scale.

Next in importance is the consumer goods industry. Here, the global penetration rate of MES is 16%, again due largely to fragmented retail markets in emerging countries. Engineered products have a penetration rate of less than 10%. Companies in this industry keep much of the value chain for their complex products in-house. The penetration rate of MES is growing, but many companies still use MES providers only for individual parts of the value chain, such as logistics.

The chemical industry in general does not lend itself to MES because it needs dedicated distribution networks geared toward bulk quantities. Specialty chemicals, on the other hand, are often sold in low volumes at high prices and require a capillary network and specialized services,

Asia Pacific on the rise

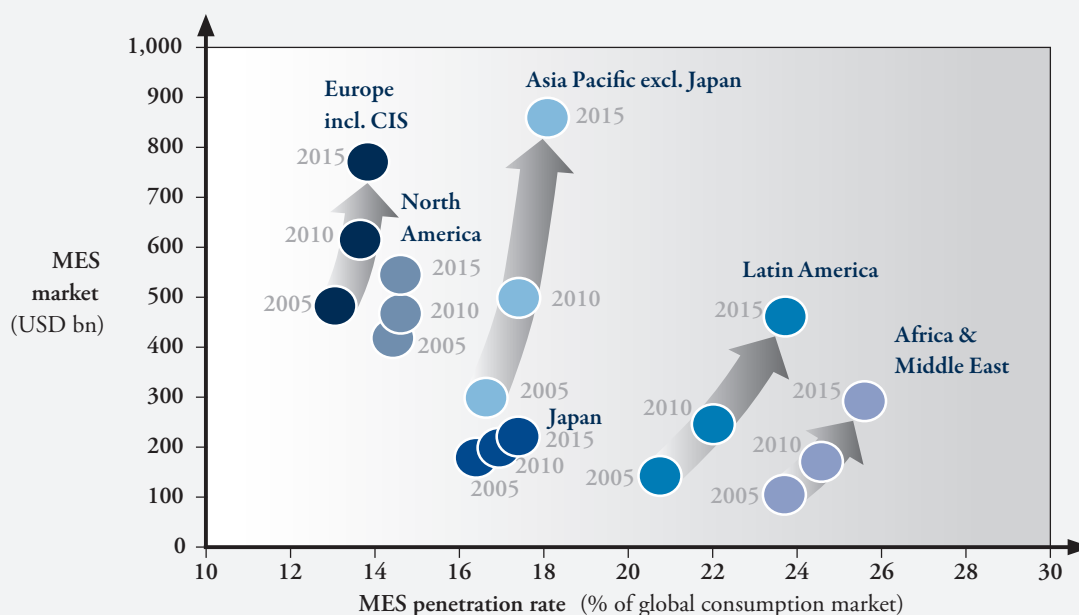


Figure 4: Growth of global MES by region (2005-2015)

Sources: Euromonitor, Espicom Business Intelligence, Global Industry Analysts, SRI, UNCTADstat, Roland Berger Strategy Consultants analysis

such as testing, formulation, compliance management, and product innovation. MES providers can be very helpful here, and the global MES market for specialty chemicals has a penetration rate of approximately 10%. Particularly in the specialty chemicals industry, integrated providers offer important benefits such as value-added services (e.g. formulations, product development, or applications support).

Overall, the most attractive markets in terms of growth rates and size are consumer-driven markets – consumer goods and healthcare – which also show higher outsourcing rates than their industrial counterparts. In 2010, they already accounted for more than 85% of the global MES market, with the remaining 15% divided among the industrial markets, specialty chemicals, and engineered products. Consumer markets show higher demand for expansion of services than industrial markets because they typically present greater challenges in terms of establishing a local presence (sales and marketing) and accessing the often highly fragmented local customer base.

In terms of regions, Europe enjoyed the biggest volume of MES sales in 2010 – some USD 615 billion. It was followed by Asia Pacific (excluding Japan) at USD 499 billion, North America at USD 472 billion, Latin America at USD 252 billion, Japan at USD 205 billion, and finally Africa and the Middle East at USD 174 billion combined. So far, emerging regions have grown fastest at over 9% a year; they also enjoy the highest penetration rates.

Growth is projected to continue in a similar fashion through 2015, with the largest gains once again being realized in the Asia Pacific region (excluding Japan). By 2015, Asia Pacific will likely have outstripped Europe as the world's largest MES market (see figure 4).

Promising growth opportunities

Worldwide, the market for expansion services is forecasted to grow to USD 3.1 trillion in transaction value by 2015. There is therefore no shortage of opportunities for providers to participate in healthy growth in this up-and-coming industry. MES is expected to grow globally around 7.1% annually, one percentage

MES to outperform global consumption

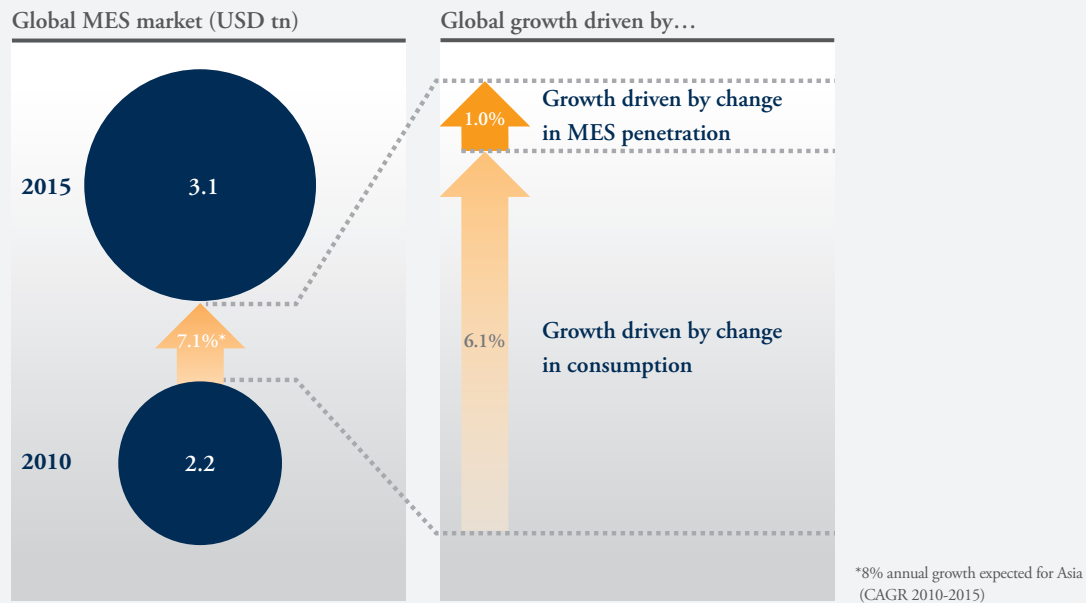


Figure 5: Global consumption market versus global MES market growth (CAGR 2010-2015)

Sources: Euromonitor, Espicom Business Intelligence, Global Industry Analysts, SRI, UNCTADstat, Roland Berger Strategy Consultants analysis

point faster than the overall market between 2010 and 2015 (see figure 5). This is driven by a change in the MES penetration rate.

Penetration rates – the total transaction value handled by MES providers as a percentage of the total market – naturally vary across different regions and industries, but also across different links in the value chains. Europe, North America, and Japan, which are considered developed markets, have approximately 15% penetration; in Asia Pacific, the rate is 17%; and it is over 20% in both Latin America and the combined region of Middle East and Africa. Emerging markets enjoy higher penetration rates, as companies need more support from MES providers there because the markets are fragmented, complex, and often unfamiliar to manufacturers. Small and medium-sized firms, in particular, lack the resources to carry out the level of investment that would be necessary to fully acquaint themselves with all the markets in which they are active, so they rely heavily on the services of MES providers.

Going forward, the outlook is that penetration rates in Asia Pacific will increase even further, and rapidly. Latin America and the combined Middle East and Africa region are growing on par with Asia Pacific, albeit from a significantly lower baseline.

Summary

MES providers help companies tap into substantial market potential at relatively low cost and risk. Manufacturers do not need to invest heavily in local assets and resources. Instead, they can draw on the infrastructure of the MES provider. MES providers thus offer major benefits compared with other forms of market entry or development. It comes as no surprise that the MES market, irrespective of differences by industry and region, shows promising growth opportunities globally, with growth rates outperforming the global consumption market.

Trade within Asia shows tremendous growth opportunities

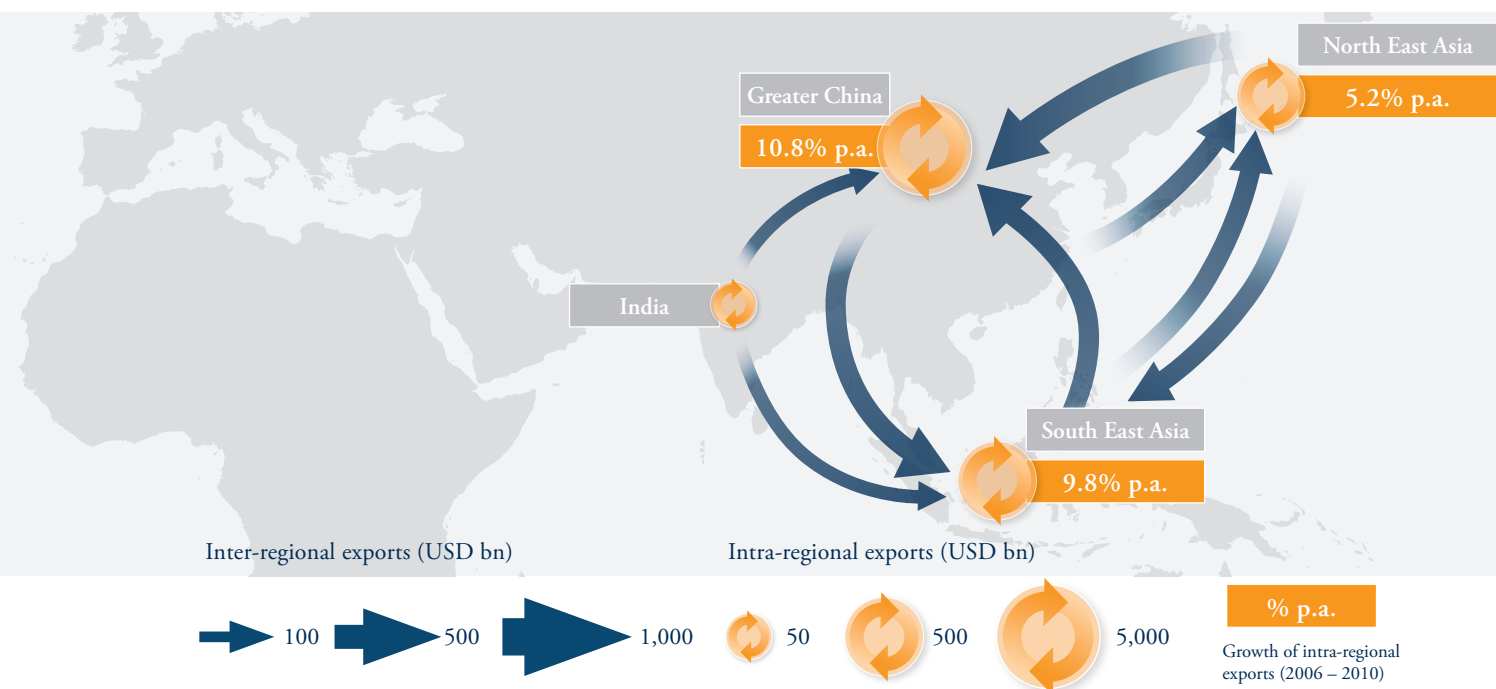


Figure 6: Inter- and intra-regional merchandise exports within Asia (absolute figures 2010, annual growth rates for intra-regional exports in 2006-2010)

Sources: UNCTADstat, Roland Berger Strategy Consultants analysis

Market expansion services in Asia Pacific – an industry set for further growth

Three megatrends will play a large part in shaping the future of the MES market, both globally and even more so in Asia Pacific. The first is the growth of emerging markets fueled by the rise of the middle class leading to further consumption and industrialization. Second, strong growth in intra-Asian trade leads to a higher demand for MES. Third, companies are focusing more and more on their core competencies in response to the increasingly complex nature of business, greater cost pressures, and the fact that today's IT makes it possible to share data cheaply and almost immediately.

These three megatrends affect the key drivers of the MES industry: growth in consumption markets and industrial demand and increasing MES penetration rates:

1. This rapid growth of the Asian economies is driven by their emerging middle classes, rising demand and consumption for high-quality consumer, luxury and healthcare products in the region. The emerging markets

are evolving from being the extended "workbench for the West" to focusing more on the growth of local markets and indigenous industries such as their own manufacturing and car industries to cater to the needs of the fast growing middle class. To do so, new production facilities have to be established in Asia, and those new facilities need Western technologies and ingredients. Much higher growth rates in these economies are naturally attracting the attention of many Western companies, causing them to channel more and more business toward emerging markets as they attempt to offset the stagnating consumer markets and heavy competition that prevail in Europe and North America. Ultimately, this pattern also drives growth in the market expansion services industry.

2. In recent years, growing trade and foreign direct investment (FDI) flows in the Asia Pacific region are among other things the reaction of Asian economies to the difficult macroeconomic environment in the USA and EU, in order to seek new growth opportunities. This shift of economic gravity has given a major boost to the MES industry (see figure 6).

Growth in intra-regional trade is particularly explosive in South East Asia (approximately 9.8% p.a.) and Greater China (approximately 10.8% p.a.). At the same time, exports from Greater China, India and North East Asia to South East Asia are also posting double-digit growth, driving a constant rise in MES business in South East Asian countries. In 2010, total exports to South East Asia exceeded half a trillion US dollars, reflecting the increasing importance of intra-regional trade between developing Asian countries. The share of emerging Asia's inter-regional exports increased from 39.6% in 1999 to 44.2% in 2010, while exports to the EU and the USA declined from 33.8% to 24.5% in the same period. Given the clear link between growing cross-border trade volumes and demand for MES, the outlook for MES remains bright. In addition, trade grows in terms of both quantity and quality of the goods. A higher share of high-value and more sophisticated products leads to increasing demand for corresponding MES services.

Certain geopolitical and business strategy factors, as well as the rise of production networks across Asia, are instrumental in leading to an increase of intra-Asian trade volumes and driving huge business opportunities for MES providers in the Asia Pacific region. China and Japan, in particular, have cultivated a strong outward orientation in terms of both exports and FDI in new production facilities. India is also strengthening its position in Asia.

- Uncontested as the region's superpower, China is seeking to consolidate its influence throughout Asia. A huge trade surplus has left the country awash in investable capital. More and more of that capital is being invested abroad as Chinese firms, wary of rising labor costs at home and now enjoying greater freedom to look further afield, move to exploit the rising quality of human capital in other Asian countries
- Japan's outward focus, assisted recently by the strong yen, is due in part to limited growth opportunities at home. Yet competition from low-cost producers has also forced many Japanese companies to concentrate production elsewhere in South East Asia. Japan has thus become the second-largest source of FDI in Asia, ranking directly after the US. Unlike the US, whose FDI is frequently linked to market access considerations, Japan has traditionally moved lower-skilled and labor-intensive activities offshore to exploit factor price differentials while keeping highly skilled jobs at home

- Another up-and-coming regional superpower often overlooked in the context of Asia is India. While in the past decade India has missed out in the contest for Asian, and specifically South East Asian, supremacy, the recently signed ASEAN-India Free Trade Agreement reveals the country's determination to catch up, and quickly. India relies specifically on its strength in services, with particular emphasis on its renowned expertise in IT services, making it a player whose impact on the region in the years to come must not be underestimated

ASEAN countries are more open for a balanced portfolio of relationships in light of trade and FDI flow interests driven by current geopolitical considerations. This is also reflected in South East Asia, where trade volumes are also driven by the forceful expansion of ASEAN economies such as Thailand and Vietnam. The region's fast-growing industrial sectors are developing a big appetite for imports of raw materials to feed this growth. At the same time, trade flows have been facilitated by the low and even zero rates introduced since the China-ASEAN Free Trade Agreement took effect in January 2010.

3. Companies' increased focus on core competencies is another main driver of outsourcing in all its forms, and specifically in market expansion services. The trend is nurtured by corporate leaders' desire to concentrate on those elements of the value chain that they master best and delegate everything else to specialized third-party service providers. New information technologies are opening up more ways for companies to purchase and source these services while also allowing them to control outsourced value chains in real time and gain relevant customer insights. MES providers that can scale up their IT platforms as required stand to profit the most from this trend, which will grow in the coming years.

Summary

Taken together, these factors are compelling more and more Western and Asian companies to seek growth – in both production and sales – beyond their home markets. Both aspects constitute an open invitation to MES providers, whose services can be invaluable in setting up industrial bases throughout Asia and establishing infrastructures that will sell products and support customers.

"One partner for an entire region – that's exactly what we are looking for."

.....

President Taiwan, Asian pharmaceuticals company

Service innovation – driving further growth in market expansion services

The growth patterns described in the previous section will directly affect the industry's structure and dynamics. Three major developments are likely to shape the MES industry and lead to further consolidation in the years ahead.

From local to regional

Manufacturers increasingly seek regional solutions to achieve higher levels of efficiency and harmonization across country operations and to be able to rely on a single, consistent business partner. This works, however, only if their MES provider can offer excellent country-level services in the form of in-depth market knowledge and coverage, backed by the resources required to deliver these services on a regional level. At the same time, with a new, regional client focus, new needs emerge (such as benchmarking services) that require innovative service solutions.

From isolated to integrated

Companies keen to reduce complexity tend to prefer buying a full set of services from one service provider rather than working with several single-service contractors. In many emerging markets, the complexity of doing business increases exponentially with every new country that is added. Manufacturers find it easier to turn to a single MES provider for access, sales, and

support services. Working with just one partner gives them a better overview of their global activities and eases their expansion into other countries. For this reason, integrated MES providers represent the preferred model.

From standard to more value-added

In the future, MES providers are likely to develop more value-added services. As manufacturers become more professional, they will demand precisely the value-added services that MES providers, with their customer knowledge and market intelligence, are best positioned to deliver.

How much MES providers shift from standard to more value-added services in the future depends on the maturity of the market. In Europe and North America, for instance, many companies already offer such services (alongside their standard services). Providers in emerging regions are also seeking to add more value in a similar way. For MES providers that are already in a position to offer strategic and value-added services, these regions offer tremendous growth opportunities – which, in turn, often require service innovation.

To meet the demand for more regional and more integrated services that add more value, MES providers must anticipate changes in the market. This will make it possible for MES providers to pursue the opportunities that arise and to be flexible in their responses to subsequent client and customer needs. Again, this translates into the need for service innovation; only innovative service offerings will distinguish a service provider from other players in the fiercely competitive Asia Pacific market.

Summary

As the focus inevitably shifts from local to regional services, from isolated to integrated services, and from standard to value-added services, service innovation will become more important than ever. Sophisticated information solutions will be key to delivering integrated service offerings. MES providers that stay ahead of the curve by anticipating these developments and tailoring their offerings to them will gain a crucial competitive advantage – especially in the still comparatively highly fragmented Asia Pacific markets.

B. SERVICE INNOVATION – MORE IMPORTANT THAN EVER

Service innovation strengthens competitive advantage



Figure 7: Key drivers of business growth

Always a step ahead – service innovation improves competitive position

To stay competitive as outsourcing partners for their clients and customers, MES providers must engage in service innovation. In the long term, a company will find it feasible to outsource steps in the value chain only if its MES provider continuously stays ahead of the game and maintains high operational benefits through innovative service offerings. Generally speaking, new and innovative services are the primary factor driving long-term success in any service industry.

Service innovation is therefore the key lever for business growth in the MES industry – and for MES clients (companies expanding into new markets) and customers (retailers, wholesalers, industrial customers and even consumers in local markets) (see figure 7). Service innovation leads to organic growth, business development, and efficiency gains. With service innovation, the provider, client, and customer can develop new service offerings, reach out to new clients and customers, and eventually achieve additional sales and profits. As such, service innovation in MES proves to be a three-fold approach to a strengthened competitive advantage in the market.

"In terms of service offering, innovation is expected [of MES providers], as more than the standard has to be brought to the table in order to stay attractive."

Head of Channel Management Asia, European
consumer goods company

Yet service innovation delivers more than business growth: it also creates a competitive edge based on a long-term client-customer relationship and a more tailor-made and needs-focused service offering.

New information technologies offer promising opportunities – now is the time for innovation

Big data – big opportunity?

Companies nowadays, especially in consumer markets, collect nearly unlimited amounts of information on their customers' needs and desires. From buying patterns tracked through retail loyalty programs to insights into specific needs discerned via social media, customer service, and support offerings, companies receive a never ending flow of data that must be handled, stored, and sorted with care to optimize its utility. Technology in general, and information technology in particular, serves this objective and the more mission-critical goal of extracting, visualizing the most important information from that raw data, drawing conclusions, and acting upon them. When applied successfully, this information allows companies to offer innovative products and services designed in accordance with their customers' needs. Moreover, increased efficiency in generating ideas for innovation promotes strong improvements in time-to-market. For MES providers, the ability to handle and make use of big data as such proves to be highly valuable for both clients and customers, which seek to develop innovative strategies based on their business data. Technology solutions such as electronic data integration between client, MES provider and customer enable the efficient use of business data. The MES provider, linking clients with customers, is particularly well positioned to play a pivotal role in mastering big data and creating tangible value from it.

In the past few years, service innovation has played an increasingly important role in the MES industry. Providers that are innovating and improving their services find ample incentive to do so, and their productivity has thus strongly increased. Fast growth, especially in Asia Pacific, has intensified both demand for innovative MES service offerings and competition in the market. This has shored up the position of large, full-service providers that are able to push service innovation.

One of the key enablers of service innovation is technological progress. Information technologies that launched in recent years allow MES providers to explore new, innovative service offerings to better meet their clients' and customers' current and emerging needs. For example, the increased transparency of digital information has allowed data for nearly all links in the value chain to be transmitted in real time. Technology as a key enabler of MES service innovation cannot be overemphasized.

MES providers are therefore advised to pursue scale and establish close customer relations, as large full-service providers will find themselves best placed to attain successful service innovation.

Summary

MES providers must continuously stay ahead of their clients and customers by performing value chain steps more effectively and efficiently. Service innovation is thus a key to improving the competitive positions of all parties involved. With current technological advancements, now is the time for service innovation in MES.

Spotlight on Tesco – big data enable accurate targeting

UK retail giant Tesco's "Clubcard Program," with 14 million adherents, provides billions of data items every week that help the company build sophisticated profiles of its customers. With its intimate knowledge of customer buying patterns, Tesco can therefore target promotions much more accurately based on hard data, a strategy that results in 20% response rates from direct mailings. It also allows Tesco to win important pricing and distribution concessions from its suppliers. With its efficient handling and evaluation of customer data, Tesco gains a competitive advantage because it can tailor innovative customer offerings and offer innovative partnership solutions to its suppliers.

Source: Public company information

C. SERVICE INNOVATION – A MULTI-FACETED CHALLENGE

Service innovation is more than service excellence and process re-engineering

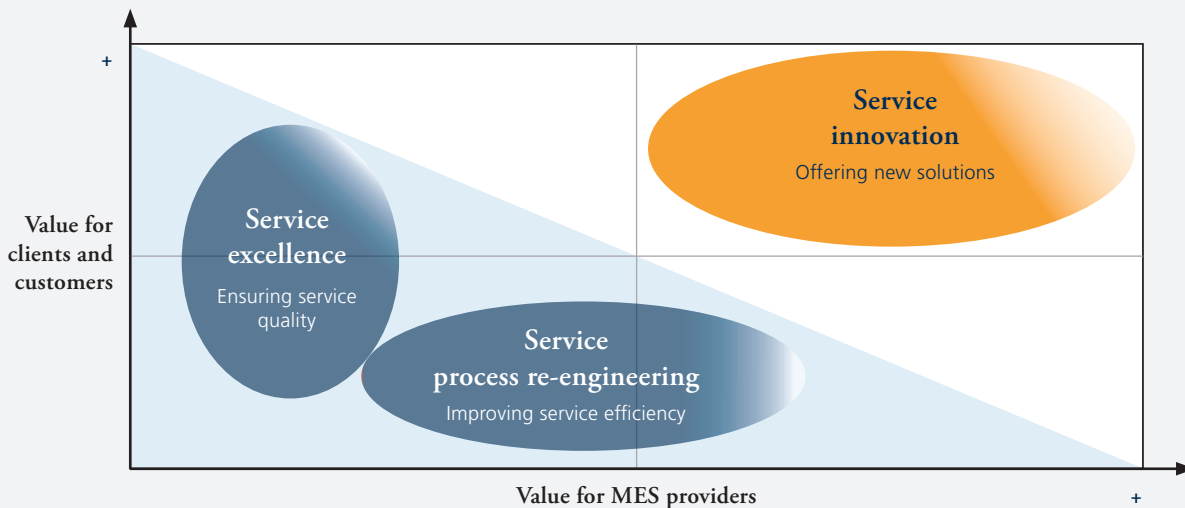


Figure 8: Value proposition of service innovation

Client and customer benefits determine the value of service innovation

Service innovation is defined in many ways, but it is ultimately analogous to product innovation in the manufacturing industry. Innovators opt to improve existing services or develop new ones. The outcome is either a better solution to an existing need or a new solution to a new need.

With service often being interpreted as the quality of delivery (and thus often as the mentality of the personnel providing that service), service innovation must be clearly separated from service excellence. While service excellence aims at ensuring that a pre-defined service is delivered according to a given set of rules, service innovation in the context of this study refers to an improvement or new development of the entire scope of a service offering. Furthermore, service innovation goes beyond pure re-engineering of service processes (see figure 8).

"Many [MES] service providers are still approaching distribution in typical ways: they just want to sell.

But we want more: we need support and service innovation to become more efficient together."

Division Director, Asian retail chain

Service innovation – from evolution to transformation

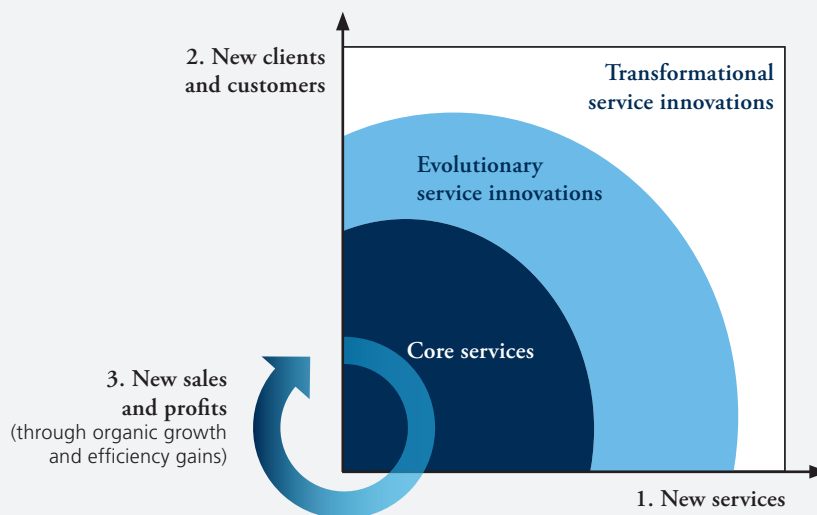


Figure 9: Service types – core services and service innovations
Source: Adapted from Nagji and Tuff (2012)

To qualify as an innovation in this sense, such new services must be:

- New solutions for the service provider and client and customer – or at least significantly better ones than those afforded by the existing process
- Part of an interaction process that involves the MES provider and/or client and customer

Advances in services are genuine innovations only if they provide a new solution to a client's or customer's need – and hence add new value for the client or customer. At the same time, service innovations must also add value for the provider, meaning that the client or customer is willing to pay for them. Thus, service innovation requires a form of interaction between the MES provider and/or the customer and client, as only then can it be tailored to add value to the operations of all parties involved.

When looking at the services provided by MES players, we must therefore distinguish between existing services, referred to as core services, and new services, referred to as service innovations (see figure 9). Core services, i.e. traditional service offerings, represent the provider's core competence. Here, the provider delivers its primary service value to the existing client and

customer. Examples include product demonstrations in the field of sales services, product delivery, market research, product customization, testing, certification, pricing, and cash collection.

With service innovations, there is a distinction between evolutionary and transformational service innovations. Evolutionary service innovations are close to the provider's core services and are therefore not entirely new in the sense that both provider and its client and customer are already accustomed to the concept of the service. The provider supplies an improved existing service and/or a new service that is close to its core service. Examples include sales performance management in the field of sales services, brand building/management, promotion management, product licensing, and key account management. On the other hand, transformational service innovations refer to entirely new service concepts not directly related to the provider's core services. Examples include online sales in the field of sales services, loyalty programs, online marketing, and green logistics, such as CO₂ compensation programs.

All you need is trust

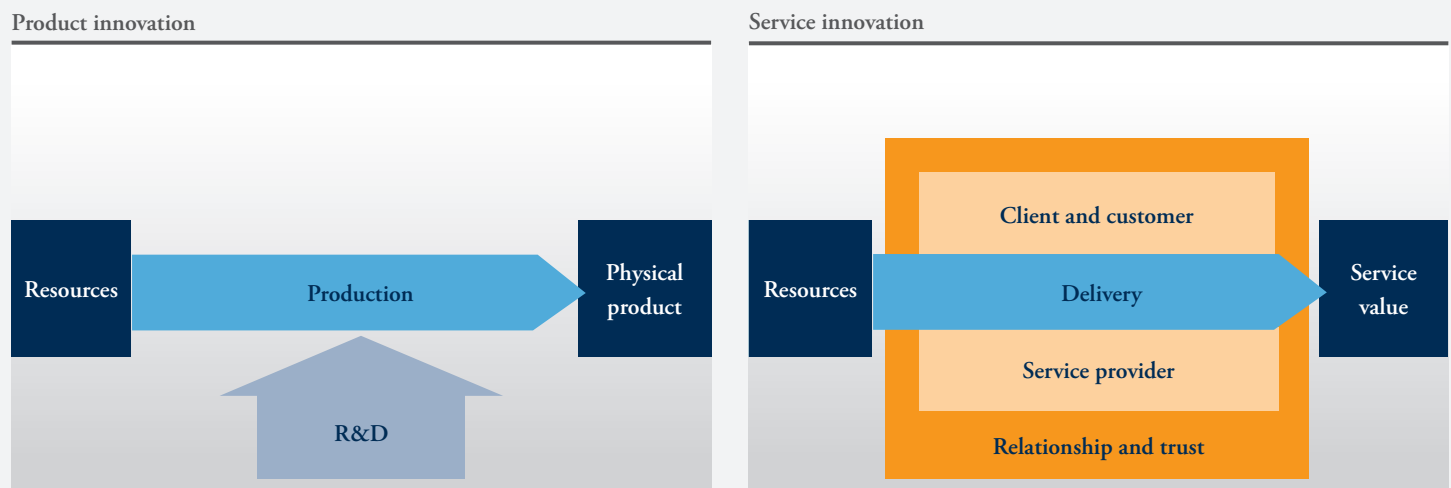


Figure 10: Product innovation versus service innovation

Managing client and customer interfaces is crucial to successful service innovation

Traditionally, manufacturing companies have dedicated R&D departments to invent new ideas and push the product innovation process. This concept is foreign to service companies, however, largely due to the nature of services: they are intangible, they are subject to varying degrees of quality, and their production and consumption occur simultaneously.

Service innovation thus follows a more complex trajectory, differing from product innovation in three important ways. First, the actual provider of the service – say the service delivery staff – is part of the customer experience and thus part of the innovation itself. Second, services that require the physical presence of the customer also create a need for decentralized, "onsite" production capacity. Third, unlike the one-way communication that channels customer feedback into R&D outcomes in manufacturing contexts, service innovation is very heavily dependent on mutual and close interaction between the service provider and the client and customer.

It is difficult to overemphasize the importance of this last point. Successful service innovation is the result of intense

"A high degree of trust, openness and transparency is necessary for successful service innovation."

Professor of Service Innovation, University of Glasgow, United Kingdom

dialog between client and service provider. As outlined above, "success" is contingent on value being added for both the provider and the client and customer, so both must be deeply involved in development.

The process is made even more complex by the fact that specific needs differ greatly depending on client and customer size, industry, markets and core competencies. Moreover, in an industry where market conditions – and with them clients' needs – are changing all the time, service innovation is absolutely vital if clients are to get the tailor-made solutions they need to grow their businesses. It is therefore crucial to perfect the art of managing client and customer interfaces.

The MES platform – linking clients with customers for service innovation

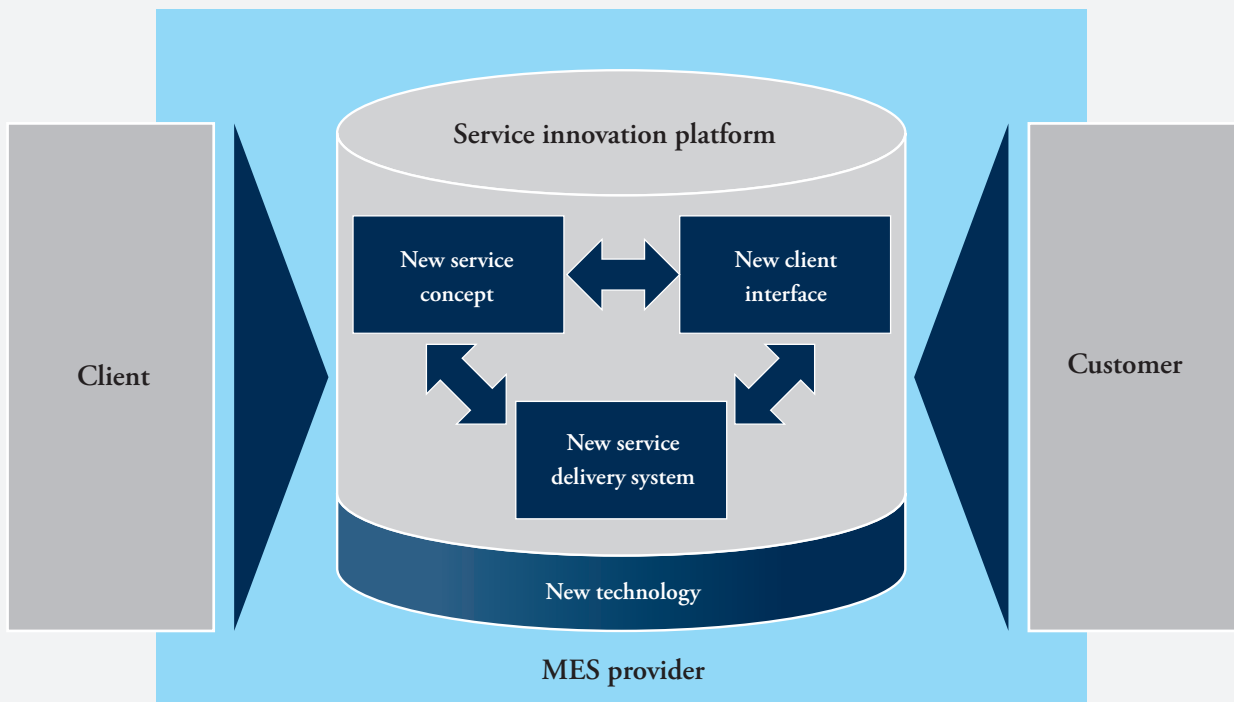


Figure 11: Dimensions of service innovation
Source: Adapted from Den Hertog (2000)

"The innovation platform has to stay aligned with the clients' and customers' needs over time for the [MES] provider to be continuously successful at service innovation."

Professor of Service Innovation, University of Glasgow, United Kingdom

Four service innovation levers can be applied

Companies can realize service innovation by applying four levers (see figure 11):

- **New service concept:** creating an entirely new service concept as the solution to a new client need. In recent years, for example, companies in industrialized countries that source their manufacturing in low-cost countries have experienced quality management problems on a large scale. However, most do not have the local capacity to assure consistent quality levels. Providing quality management services to manufacturers that source production in low-cost countries would thus present an innovative solution to a new client need

- **New client interface:** changing the client's role in service production and effectively developing a new client interface. For instance, automating and integrating the flow of information between MES provider, client and customer makes the client interface more efficient and adds value for all parties. Neither clients nor customers have to deliver to or request data from the service provider because everything now happens automatically and in real time
- **New service delivery system:** introducing a new service delivery system by changing processes on the service provider's side. Service providers that work with standardized information delivery platforms can explore new ways to customize content and automatically deliver made-to-measure business intelligence reports to each client in the form of a newsletter
- **New technology:** applying new technological options to increase efficiency, effectiveness, and accessibility for both provider and client and customer. Advances in technology can now be harnessed to permit the real time, 24/7 tracking of each and every shipment, for instance. The result is greater transparency and efficiency for the customer, client, and service provider alike

The fact that services target both clients and customers of MES providers adds a further level of complexity to the process of service innovation in the MES industry. It is therefore essential to implement an integrated client and customer process in which innovative services provide new solutions to clients or customers or, preferably, to all parties involved. Electronic interfaces, for example, enable business data to be exchanged transparently and in real time between all parties, thereby generating efficiency gains and faster response times for the MES provider, the client, and the customer alike.

D. SERVICE INNOVATION – NO ONE-SIZE-FITS-ALL APPROACH

Core services – the breeding ground for service innovation

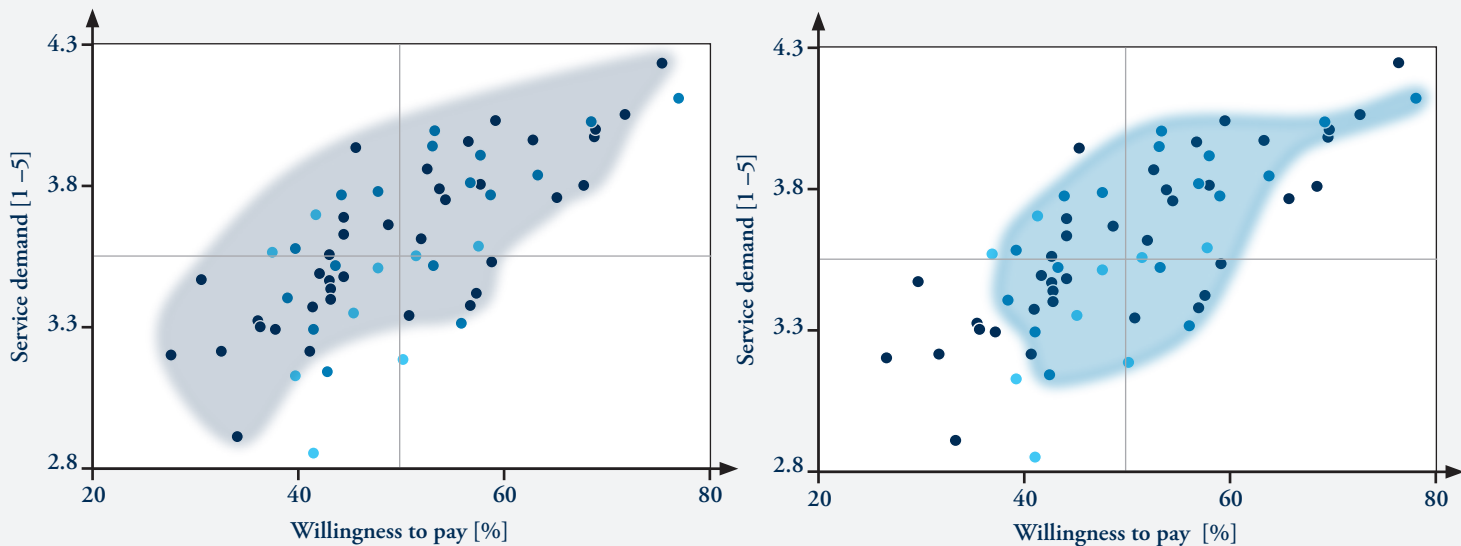


Figure 12: Service map by service type across all MES subsectors
Source: Survey data

What clients and customers want most – and what they are prepared to pay for

Clients and customers want to see both service and monetary value

There is no such thing as an off-the-shelf MES service. Every single service in this market is made to measure. It is therefore vital that each one delivers value in two dimensions:

"Innovation is not of evolutionary concern; rather, necessary improvements to the current [core] service offering are to be considered."

Managing Director Thailand, Asia Pacific
consumer goods company

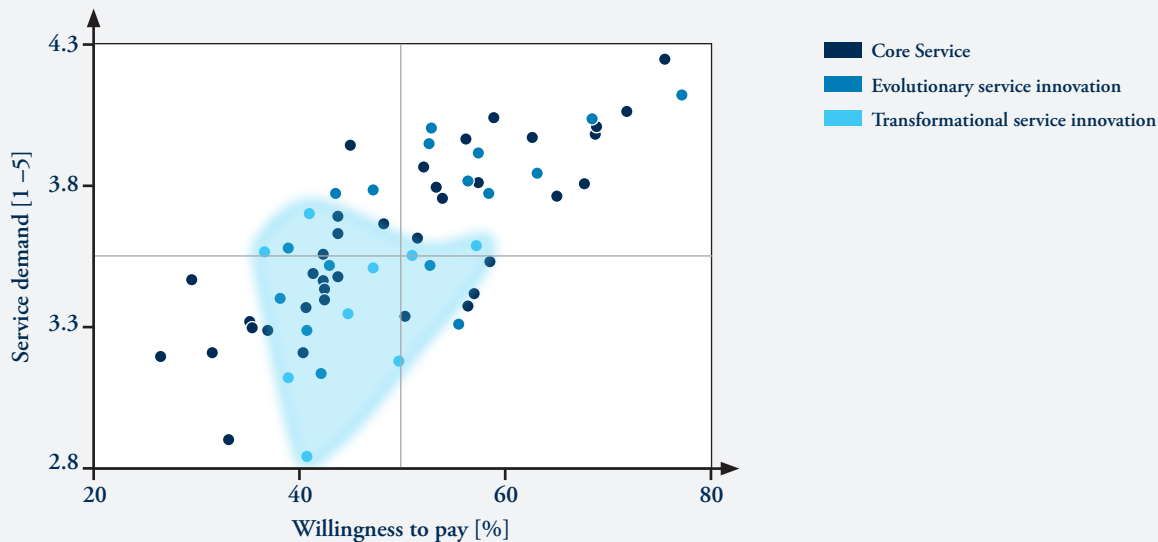
The service value is the intrinsic or qualitative value a service represents to the client, customer and/or MES provider. Does it simplify decision-making, for example? Do the tailor-made customer insights it yields help streamline product strategy development? If clients and customers perceive such value in a given service, they will also demand it.

The monetary value is the financial gain that a service delivers directly or indirectly. This gain may be attributed to superior efficiency, for example, but may also be due to a larger market share that resulted from better information as a basis for product strategy development. This perception of value thus translates into clients' and customers' willingness to pay for a service.

Both aspects – demand for a service and a commensurate willingness to pay for it – must naturally go hand in hand.

Strong backbone of core services – a prerequisite for effective service innovation

While service innovation is important to MES clients and customers, they remain focused on MES providers' core competencies and traditional service offerings. Throughout the value chain, demand for these core services is strongest,



which indicates the enormous scale of demand for integrated MES services – a trend that has been ongoing in recent years and that has brought substantial growth to large full-service MES providers.

The logic behind this tendency toward core services is compelling and intuitive. Innovation does not happen in a vacuum: it is driven by perceived needs and "points of pain", and companies experience this pain primarily in those areas that are most important to them. It is thus self-explanatory why high demand levels and high willingness to pay are concentrated in core services, which constitute the fertile soil in which service innovation grows in the MES industry. For this reason, it is essential that MES providers maintain a strong capability to deliver core services; without it, continuously successful service innovation is impossible.

There is also significant demand for service innovation among MES clients and customers. As stated above, however, a distinction must be made between evolutionary service innovations (which relate to core MES services) and transformational service innovations (which touch on more peripheral and thus non-core

service competencies). Demand for service innovation differs noticeably between these two categories (see figure 12):

- Stronger demand (and a greater willingness to pay) for evolutionary service innovation is consistent with the observation that MES clients and customers are primarily targeting further development of their core services and related offerings. It also underscores the powerful appeal of full-service MES providers
- Both demand and the willingness to pay for transformational service innovations are significantly lower, for two key reasons. The first is that MES clients and customers currently tend to focus more on service innovations that enhance their efficiency and revenue. The second has to do with the current state of economic growth in Asia Pacific that is leading to a different market dynamic: strong growth and increasing competition are shifting the focus of market players to performance-enhancing services. By contrast, in the rather stagnating Western economies topics addressed by transformational service innovations are more in demand

Market insight and relationship management services in high demand

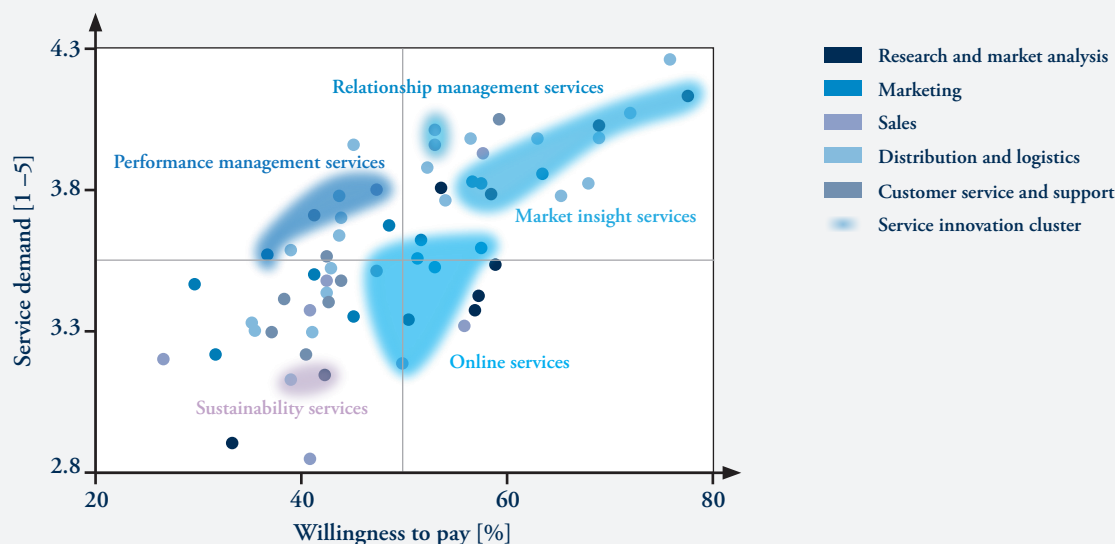


Figure 13: Service map by service innovation cluster and by value chain step across all MES subsectors
Source: Survey data

"The importance of business data and its KPIs is again and again underestimated – business success is largely dependent on their visibility."

Division Director, European engineered products company

Market insight and relationship management services are at a premium for clients and customers

In terms of demand and willingness to pay, clients and customers attach widely varying importance to different types of services (see figure 13). One common feature across clients and customers, though, is that market insight and relationship management services are regarded by both as the most valuable complements to existing services.

1. Market insight services are services for which strong demand is generally backed by an equally strong willingness to pay. These services comprise innovative forms of market data and intelligence that are prepared and delivered by the MES provider. Examples include market (entry) studies, customer insights, brand analyses, and field marketing. These services give clients' top management easy access to the information they need to make well-founded strategic decisions. Demand is especially high for market insight services, as information resulting from these services typically enables growth; this is consistent with the focus on performance-enhancing services of clients and customers in Asia Pacific.

2. Relationship management services are offerings such as key account management and customer relationship management – services that, when outsourced to an MES provider, allow clients to maintain close relationships with their customers and benefit from subsequent information flows. Demand for these services also generally runs high, though MES providers have to do more work to persuade clients to invest accordingly. The growth and development of the Asia Pacific market can be linked to high demand levels

Service innovation – closing the MES information cycle

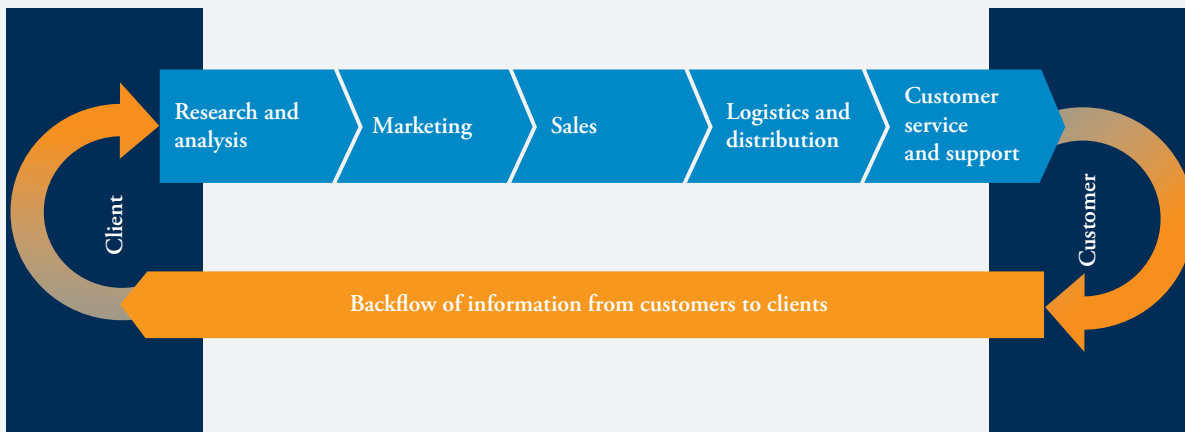


Figure 14: Full-service market expansion services information cycle

here as well; more and more customers in the region are reaching the critical sizes necessary to be considered key accounts, thus increasing the emphasis on the client-customer relationship.

3. Online services span new and emerging sales, marketing and customer service channels based on Web 2.0 and other online technology features. Willingness to pay for these services is surprisingly high and tends to be roughly on par with that for relationship management services, even though demand has so far been less pronounced. In all industries, willingness to pay is rather high due to the service offering's novelty – only a few manufacturers are experienced enough in innovative online features.

4. Performance management services include performance assessments, such as KPI reporting, performance analysis, or performance monitoring, across all links in the value chain, albeit with a strong focus on sales, logistics, and customer service aspects. Unlike online services, vigorous demand for these services is rarely matched by a willingness to pay, as clients and customers clearly rate performance management services as more of a commodity.

5. Sustainability services, which are on the rise in parts of the world, still experience low demand and command little willingness to pay among companies in Asia Pacific. This phenomenon can be explained by the state of strong economic growth in which the latter region finds itself. Given the fiercely competitive market growth environment in Asia Pacific, transformational innovations that do not add immediate, visible value in terms of efficiency or growth are not yet priorities for top management.

Existing demand patterns clearly reveal clients' and customers' desire and need for services that will help them gain better insight into their target markets and to forge stronger relationships with customers in those markets. Demand is especially pronounced for those insights and relationship enablers – market data, customer service, and customer insights, for example – that, in many cases, have been lost as value chain links were outsourced. Full-service MES service providers are therefore now giving these "lost insights" back to clients, channeling information about customers to them (see figure 14) – and establishing market insight and relationship management services as one of their own core competencies in response to such forceful (and lucrative) market demand.

This backflow of information to the client is seamless and involves zero losses thanks to full-service integration in the offerings of large MES providers. As a result, everyone – MES provider, client, and customer – can achieve full business data transparency and reap the benefit of greater efficiency as strategies are defined along the value chain. For example, MES providers that deliver customer service and support services to the client are uniquely positioned to pass on valuable information on about how to improve the product and its positioning with both the client and the customer. At the same time, MES providers can help ensure that marketing, sales, and distribution strategies adjust quickly, efficiently, and constructively to changing and emerging market environments.

Spotlight on Rakuten – generating tangible benefits from mastering data

With its innovative B2B2C (business-to-business-to-consumer) model, Japanese electronic commerce provider Rakuten has taken market leader Amazon on for the battle for global leadership in the industry. Unlike Amazon, Rakuten does not sell products direct to consumers; rather, it rents out “store space” within its “digital shopping mall” to more than 4,000 retailers who offer more than 8 million products to its customers. By providing retailers with a platform for direct interaction with their customers, Rakuten brings back the long-lost pleasure of browsing through stores in online shopping. This way, Rakuten supports the preservation of smaller retailers and concurrently maintains a high level of customer-focus in its virtual shopping arena.

Source: Public company information

Service innovations need to be customized and yield top line benefits

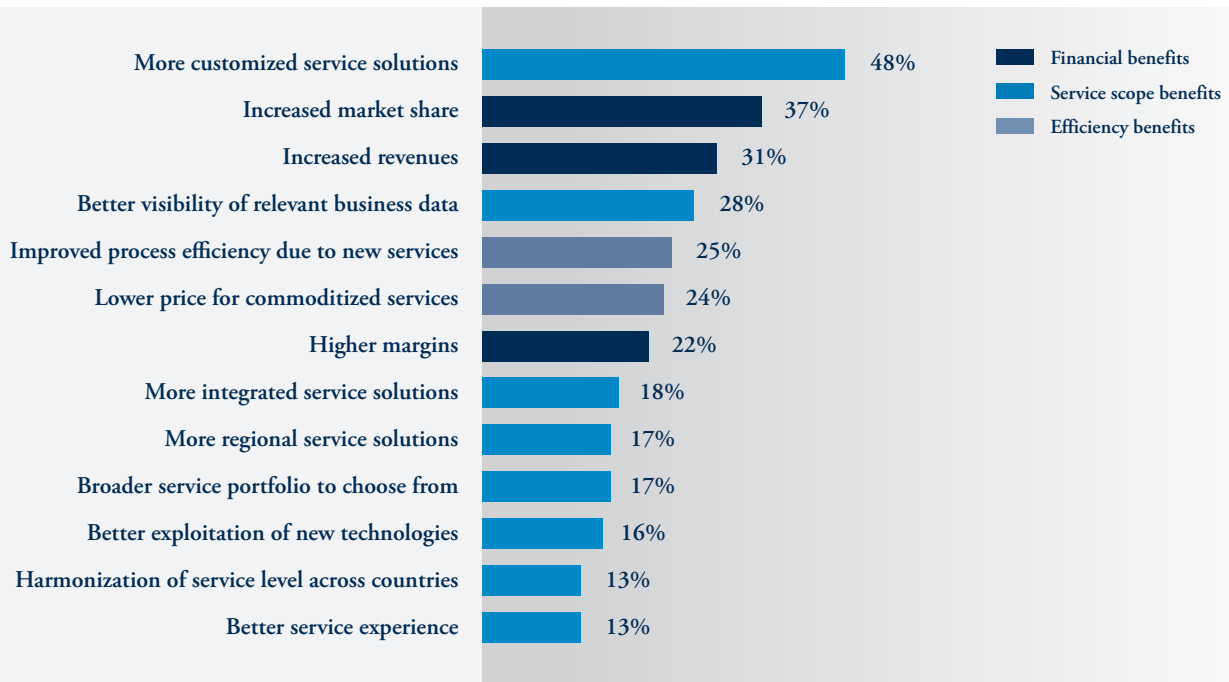


Figure 15: Benefits from service innovation for clients and customers [%, multiple answers possible]

Source: Survey data

Clients and customers expect tangible value from service innovations

In terms of the key benefits from service innovation, clients and customers clearly want to see tangible, measurable results from customized services that support top line growth (see figure 15).

Across all industries, clients and customers say that the most important element of service innovation is its ability to deliver more customized services. When it comes to top line improvements, clients and customers rate tangible benefits above pure service scope benefits, which refer to the width, depth and level of customization of the service offering. The top line focus is vital to the long-term profitability – and thus viability – of clients and customers alike. Interestingly, while efficiency gains related to more streamlined processes and lower prices for commodities are also considered important, they are less so than for top line drivers. The strong focus on top line growth is a reflection of the service offering of MES: helping companies expand in existing and new markets.

"The level of customization in the MES industry will continuously increase in the future at the request of both clients and customers."

Director General, European specialty chemicals association

As observed in the demand levels for core services in contrast to service innovations, clients and customers recognize the connection between the expected benefits from innovative service offerings and Asia Pacific market growth. Clients and customers expect performance-enhancing services that will allow them to take part in or even outperform that market growth. Sustainability and long-term performance, based on top line benefits and subsequently core services, are the basis for service innovation and its other benefits.

Every industry has its profile

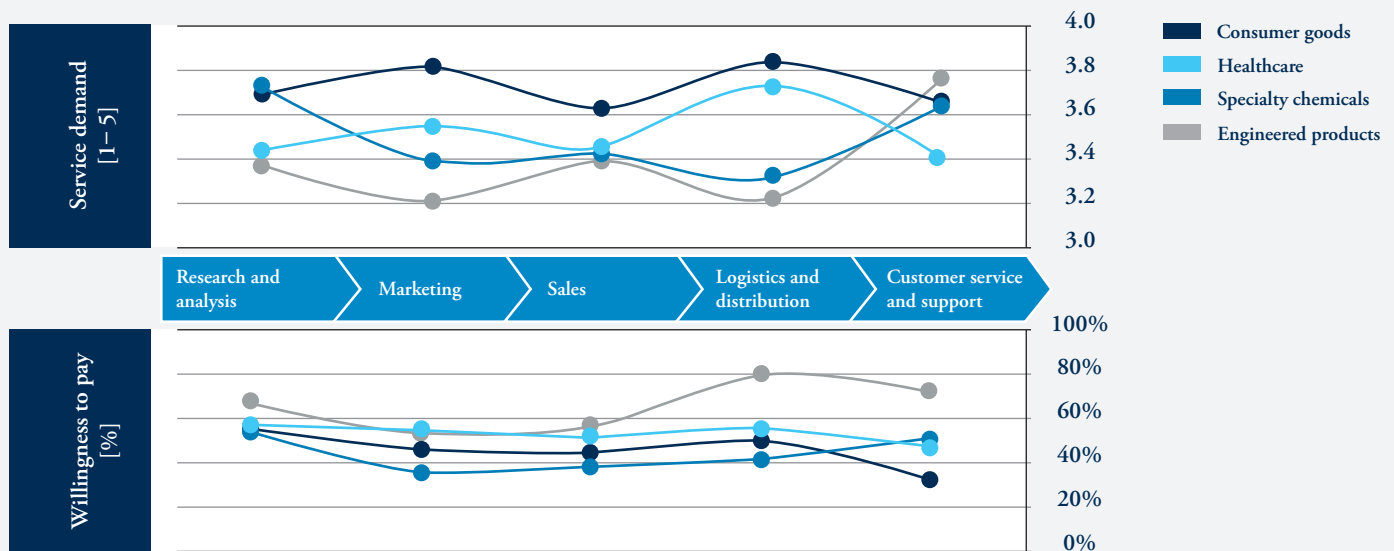


Figure 16: Service demand and willingness to pay by industry and value chain step

Source: Survey data

Sector-specific differences – demand and the willingness to pay for services vary from industry to industry

Each industry with its preferences

The sheer complexity of service innovation in the MES market is once again highlighted by significant variations in demand for different services in different industries (see figure 16).

In consumer-facing markets such as the consumer goods, pharmaceuticals, and healthcare sectors, demand is strongest for marketing, distribution, and logistics services. The need for local platforms and capillary networks means that this demand peaks in the consumer goods industry in particular, although there is a similar phenomenon in pharmaceuticals and healthcare.

By contrast, customer service, support services, research, and market analysis are most in demand in industrial markets such as specialty chemicals and engineered products. Legal barriers to market entry and varying circumstances surrounding product approval in different

markets drive strong demand among specialty chemicals firms for research and analysis services as well as for product registrations and regulatory compliances services. The situation is different, however, in engineered products. Here, customer service and support are much in demand due to generally high margins and the difficulty of providing these services efficiently across different markets using in-house resources.

These variations in demand and willingness to pay are also reflected in varying preferences, as clients and customers in different industries expect service innovation to yield different benefits. For example in pharmaceuticals and healthcare industry, companies see superior process efficiency as a main benefit. In engineered products, the greatest perceived need is for lower prices for commoditized services. The specialty chemicals industry shares this particular focus but also strongly targets the better use of new technologies.

With service priorities along the value chain depending on the clients' and customers' industry, it is essential that the MES provider be familiar with the industries, understand their specific needs and preferences, and know how to customize service offerings and tailor service innovation efforts accordingly.

The sections that follow provide a more detailed examination of and useful insights into the reasons for these industry-specific variations.

Summary

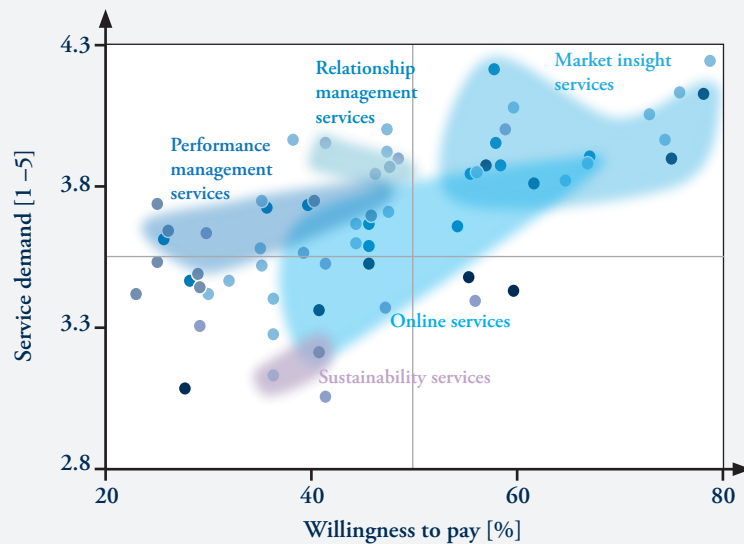
The disparate levels of demand for various services at different points in the value chain illustrate the complexity of delivering services in general – and in particular service innovation – in the MES industry. As the examples above clearly show, one-size-fits-all solutions will not work in this context. The answer from full-service MES providers must take the form of customization that accommodates the individual needs of each client, customer, industry, and value chain link.

"My [MES provider] partner has to understand me and my needs as a producer in my industry, my segment, my niche; because only then is there an added value for me and my business."

.....

Regional Director Asia Pacific, European business facilitation agency

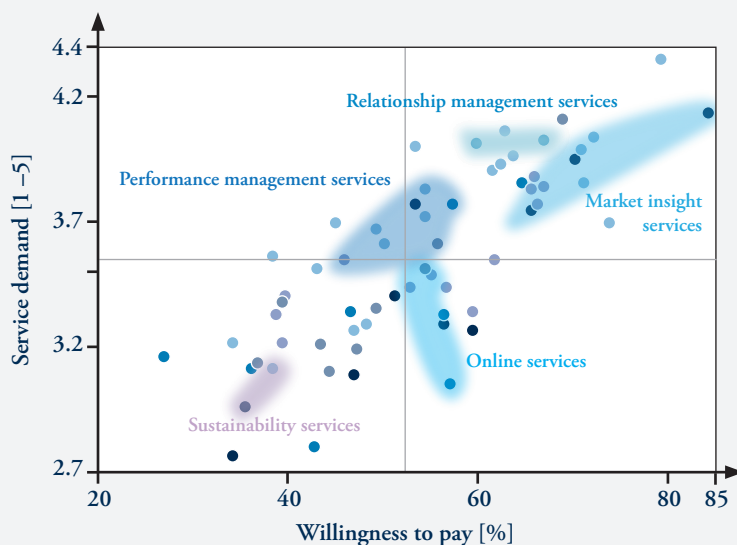
Consumer goods – strong demand for market insight and online services



While demand for service innovation reveals a considerable overlap between the consumer goods and the pharmaceuticals and healthcare industries, there are also a number of significant differences. Consumer goods companies value highly relationship-oriented service innovations, such as key account or customer relationship management, but are also cost-conscious. On the other hand, close proximity to end-consumers makes it very important for these players to gain incisive insights into the markets they serve. The same considerations drive above-average demand for online services that can deliver large-scale marketing to the consumer market.

Figure 17: Service map by service innovation cluster and by value chain step for consumer goods
Source: Survey data

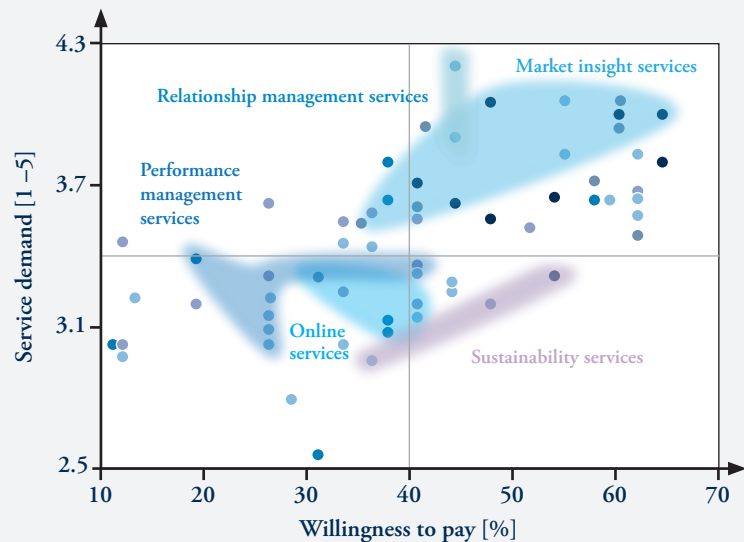
Healthcare – innovation focused on market insights and relationship management



As in all industries, market insights are the object of heavy demand in the pharmaceuticals and healthcare sectors. Unlike the consumer goods industry, however, these sectors attach considerable importance to performance management services, essentially due to the complex and sophisticated nature of this market. Companies in these industries find themselves farther removed from end-consumers than consumer goods manufacturers, for example, which also explains why pharmaceuticals and healthcare firms exhibit lower demand for online services. High demand levels and willingness to pay for market insight and relationship management services in the pharmaceuticals sector also result from companies' strong focus on R&D as a core competence.

Figure 18: Service map by service innovation cluster and by value chain step for healthcare
Source: Survey data

Specialty chemicals – formulation, testing, certification, and registration services are more important than in other sectors

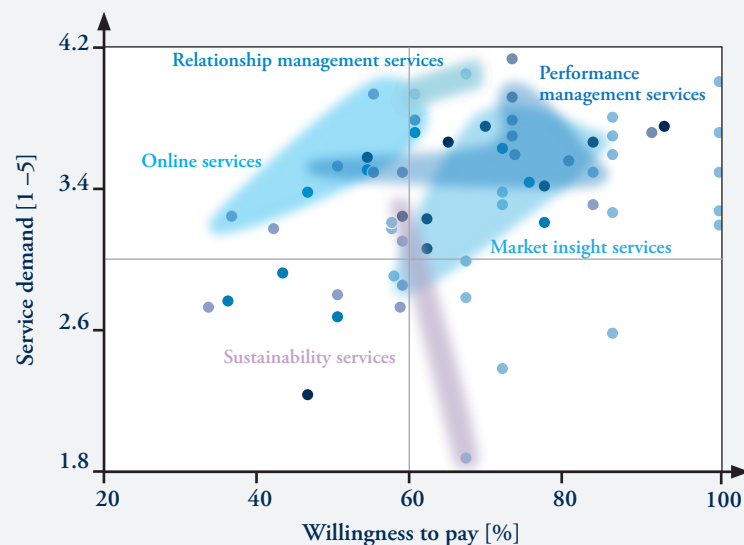


Specialty chemicals accord the highest priority to service innovations that deliver market insights and superior relationship management. Testing and certification services that underpin companies' sustainability are likewise key – a logical focus, given the strict regulation that necessitates a strong emphasis on quality assurance and compliance. The industry's highly specialized nature and heavily fragmented market structure further distinguish it from other industries; notable are its lower demand for online services and performance management and strong demand for relationship management services. Markets drive strong demand among specialty chemicals firms for research and analysis services as well as for product registrations and regulatory compliances.

Figure 19: Service map by service innovation cluster and by value chain step for specialty chemicals
Source: Survey data

- Research and market analysis
- Marketing
- Sales
- Distribution and logistics
- Customer service and support
- Service innovation cluster

Engineered products – the need to deliver and pay for – superior service



The engineered products industry exhibits a number of distinctive characteristics that correlate closely with its demand for MES services. Small and medium-sized enterprises make up the vast majority of firms in this sector, and many are keen to outsource performance management, market insight, and relationship management services for which they lack sufficient internal resources. Many companies also operate in very specialized niche markets, which further increases the importance of cultivating close relationships with MES providers. Given such special needs, the engineered products industry as a whole has long since grasped the importance of service. It has thus fostered a strong customer service and support culture for which companies are also willing to pay.

Figure 20: Service map by service innovation cluster and by value chain step for engineered products
Source: Survey data

- Research and market analysis
- Marketing
- Sales
- Distribution and logistics
- Customer service and support
- Service innovation cluster

"Every industry has its specific needs: in healthcare for example information on the regulatory environment is far more important than in other sectors."

Country Manager Vietnam, European pharmaceuticals
company

Differences by decision maker – two lenses on service innovation

Demand for certain MES services differs not only by industry, but also by the type of manager and the level of strategic or operational focus on the client and customer side. The more regional, and thus the more strategic, a manager's role is, the higher their demand for top-level services on the strategic decision-making level will be. Conversely, managers on the country level, who are closer to country-specific operations, primarily demand services related to execution including local distribution and customer service and support. These managers thus seek service offerings that address issues that arise once a product has reached national borders.

Executives who participated in our online survey have been grouped into three categories according to the number and geography of countries under their responsibility.

Country specialists manage business operations in a single country. Their primary interest is in operational services that can improve local efficiency and business performance, safeguard local distribution channels, and establish brands on the market within their jurisdiction. Country specialists, therefore, are a source of greater demand for operational services such as just-in-time delivery, public relations, and technical customer support in addition to core sales services. Process efficiency gains and more customized services are the key benefits these specialists expect.

Regional experts are responsible for business operations in a defined number of countries that typically belong to a clearly delineated sub-region such as South East Asia. These experts are most keenly interested in services that help them manage relationships with key customers in different markets and establish a flourishing distribution network. More so than other types of managers, regional experts therefore focus demand on services such as key account management, customer relationship management and an assortment of distribution and logistics services (including order fulfillment, supply chain management, cash collection, and credit control). The key benefits they expect include increased revenue, service solutions with a more regional focus, and harmonized service levels across national borders.

Strategy and operations – two lenses on service innovation

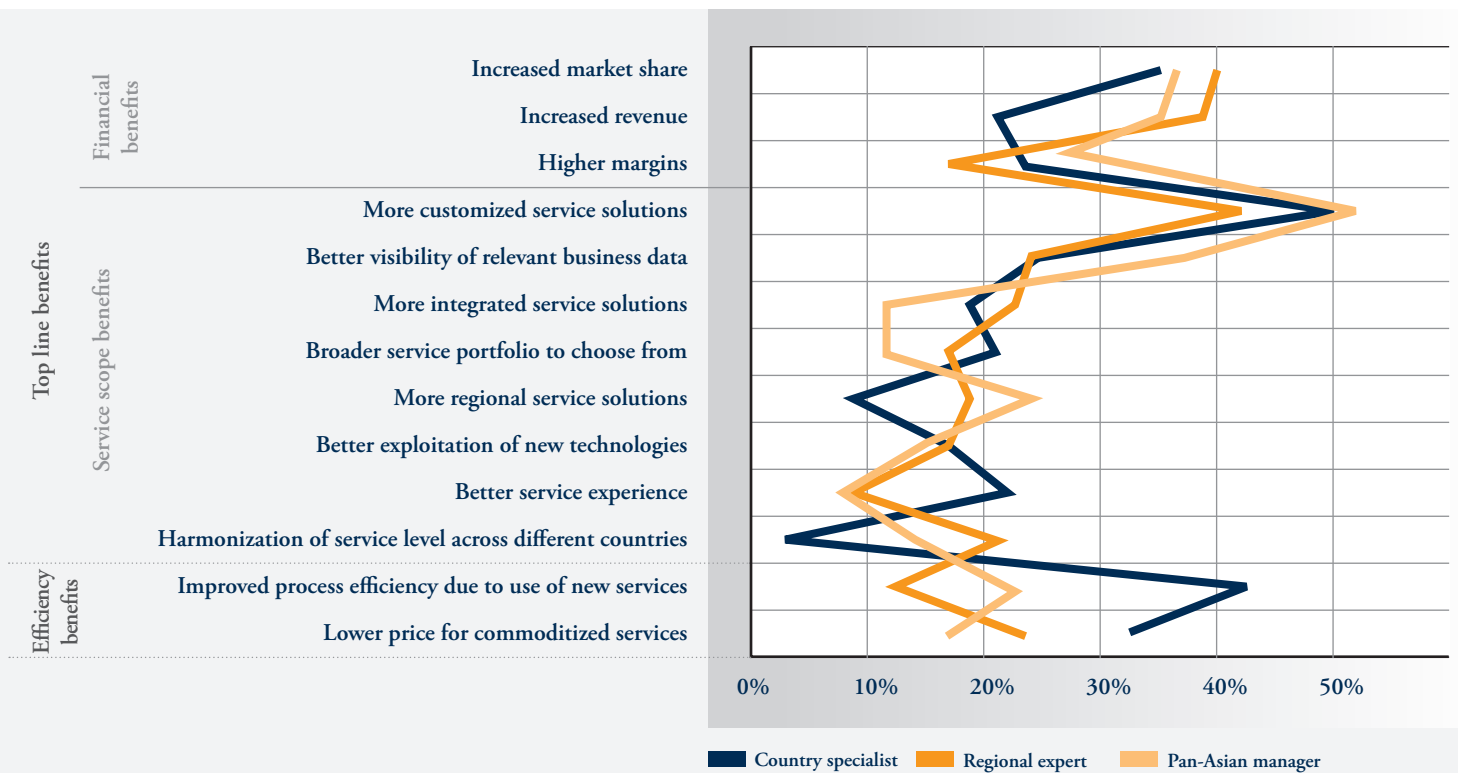


Figure 21: Client and customer benefits by type of manager [% , multiple answers possible]

Source: Survey data

Pan-Asian managers oversee business operations in the entire Asia Pacific region. Their need to focus on strategic topics gives rise to strong demand for top-level services with little operational emphasis. In line with the nature of their roles, strategic marketing, sales, distribution, and logistics services take precedence for them over operational research, market analysis, and customer service and support issues. The strategic services that interest them most include channel management, brand building and management, customer relationship management, sales performance management, and compliance in the field of distribution and logistics. While they show little interest in research and market analysis in general, pan-Asian managers are the strongest source of demand for market entry studies. They are also the most willing to pay for market data and business intelligence in general. Their focus is on service innovation that delivers higher margins and revenue, regional service solutions, and better business data visibility as the basis for strategic decision-making.

Summary

For MES providers, customization is an imperative that drives service innovation and success. Their customization strategies therefore must align with clients' industry and size-specific differences, and they must deliver solutions tailored to the level of management with which they are dealing. Diversity reigns – and providers must adapt themselves and their service offerings to that diversity, not vice versa. In each of the specific situations we have examined, customization is the key that unlocks the potential to deliver successful service innovation that adds value for all parties.

E. SERVICE INNOVATION IN ASIA – LOCAL CUSTOMIZATION IS CRUCIAL

Mapping service development in Asia Pacific – a dynamic environment



Figure 22: Service Development Index (SDI) across Asia Pacific 2012 – geographic overview
Sources: World Economic Forum, survey data, Roland Berger Strategy Consultants analysis

Sophistication levels vary from country to country – five distinct development clusters have been identified

Service demand and expectations differ not only by manager type and their industries, as seen in Section D, but also at the national level. MES providers eager to tailor their service offerings to local needs must be mindful of varying levels of sophistication in the services required by country within the Asia Pacific region.

Close analysis based on the Service Development Index (or SDI, see box) reveals different service sophistication clusters within this region. A glance at the breakdown of these clusters (see figure 22) shows that the level of service sophistication correlates strongly to a country's level of economic development. While the SDI views every country individually and consequently reflects the average level of service development in each, it is important not to overlook differences, especially in larger countries like China and India. In terms of service innovation, MES providers must therefore align their offerings to the stage of development

reflected in each of these clusters, but also within the respective countries themselves.

The Service Development Index

The Service Development Index (SDI) measures the level of service sophistication of an economy by combining generally established macroeconomic indicators on the one hand and market experts' opinions on the other.

This assessment of the level of service sophistication in different countries is based on the average score for four equally weighted key parameters – a survey of executives and market experts (1), plus scores of countries' innovation levels (2), and their business sophistication (3), and technological readiness (4) as measured by the World Economic Forum. Using this information, the Service Development Index identifies each country's overall level of service sophistication.

The resulting scores permit identification of groups of countries that share similar levels of service sophistication (see figure 23). While the SDI depicts only the state of the economies in focus at a certain point in time, it will allow the observation and analysis of the dynamics in their service development levels over time.

The five clusters identified by this approach are:

- **The leaders – highly sophisticated markets:** Japan occupies a cluster all its own. Historically the most advanced economy in the Asia Pacific region, this country can be considered the "leader" in terms of service sophistication, largely due to its strong and proven commitment to service and customer orientation
- **The pursuers – sophisticated markets:** Singapore, Taiwan, Hong Kong, and South Korea – the Asian tiger economies – all experienced rapid economic growth between the 1960s and the 1990s and are today regarded as highly advanced economies. Each has its own specific economic history and key success factors, and each is able to provide a level of service sophistication that reflects their global status as advanced economies. Australia, with its strong position in raw materials, is slightly lagging behind the other pursuers
- **The chasers – advanced markets:** New Zealand and Malaysia are considered chasers as they show strong levels of development of their service sectors in recent years, chasing Asia's leading countries. One reason for their slightly weaker position is that their level of service sophistication has not yet come into line with their high level of economic development. The economy of

Frugal service innovation – when less is more

While innovation is associated primarily with the development of new features and capabilities, as well as technological progress, it can also refer to the development of new, simplified solutions for markets with different needs. Frugal innovation, also referred to as reverse innovation, addresses the needs of emerging markets and is often linked to providing similarly effective solutions to customers with different economic possibilities and a different infrastructural environment. The list of opportunities is close to endless, and the concept can serve as an example for the customization of MES service offerings depending on a market's stage of development. MES providers therefore not only need to be aware of the differences by region and country in terms of economic development and consequently customer and consumer needs, but can also offer further added value to their clients by addressing those needs in their service offerings. For example, by means of innovative distribution channel strategies for a client in the consumer goods industry, the MES provider can help reach the masses despite a rather undeveloped retail market.

Spotlight on Narayana Hospital – assembly line heart surgeries

Indian cardiac surgeon Dr. Shetty of the Narayana Hospital, famous for having operated on Mother Teresa, revolutionized heart surgery by offering the critical procedure for USD 2,000 on average, compared with the USD 20,000 to 100,000 that American hospitals typically charge. The Narayana hospital has more than 1,000 patient beds, and with its factory-like approach, it carries out more than twice as many of the delicate surgeries annually than leading US clinics. Dr. Shetty thus provides access to cutting-edge medical care for the masses and the less well-off. Without cutting surgeon salaries or decreasing the quality of patient care, Dr. Shetty's clinic enables these "discount prices" through synergies between several large specialized hospitals in close proximity to one another. These hospitals share services such as laboratories and a blood bank. The Narayana group reports a 7.7% profit after taxes – more than its average counterpart in the US.

Source: Public company information, WSJ

New Zealand continues to depend on strongholds in agriculture. Malaysia has a similar gap to close due to the fact that economic diversification from the agricultural sector did not begin until the 1970s, a decade after it had started in Singapore, South Korea, Taiwan, and Hong Kong

- **The attackers – advancing markets:** China, Thailand, India, Vietnam, and Indonesia, the region's advancing markets and growth leaders, are considered attackers in terms of their service development levels. In line with their economic development, they still have some catching up to do, though in recent years they performed more quickly and have broken more ground than expected by most experts. The sheer size of China, India, and Indonesia also makes development difficult. Although many urban areas in these countries already boast a highly sophisticated service landscape, the corresponding infrastructure in rural areas can be described only as negligible
- **The starters – frugal markets:** With the exception of Sri Lanka, which is situated in the Indian Ocean, all of the starter countries – which also include the Philippines, Cambodia, Myanmar, and Laos – belong to South East Asia, the region with the lowest overall level of economic development in Asia. Development of the service sector is therefore still in its early days in these countries, although they have witnessed significant growth in recent years

The race toward service sophistication in Asia Pacific

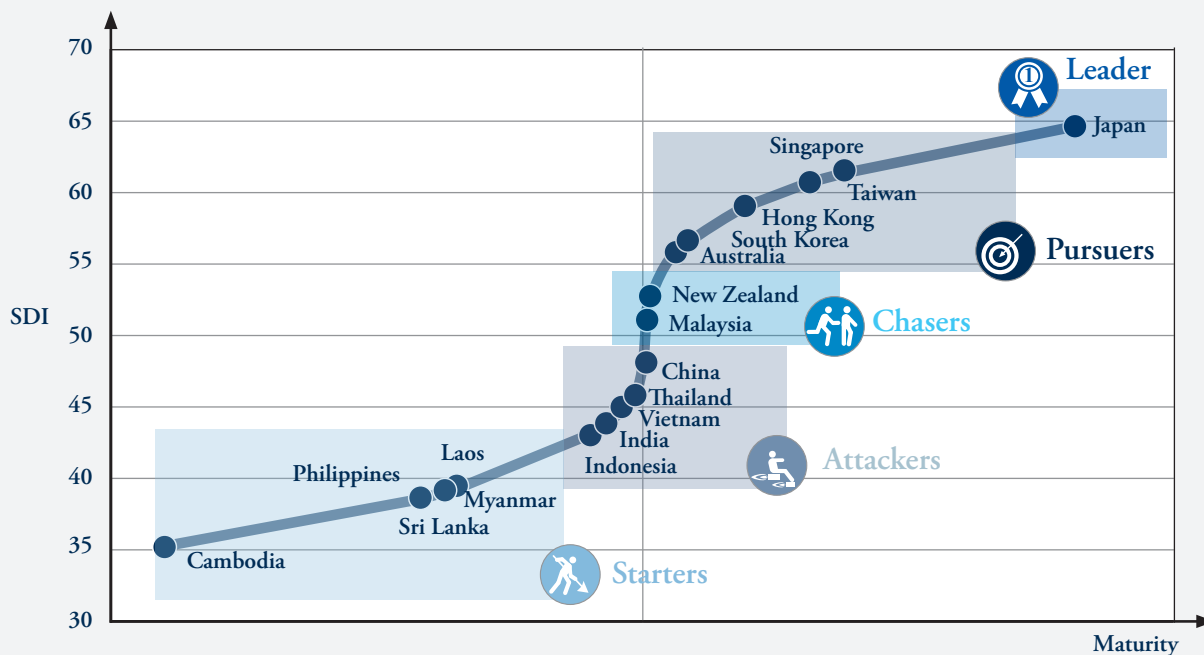


Figure 23: Service Development Index (SDI) across Asia Pacific 2012 (conceptual illustration based on SDI)

Sources: World Economic Forum, survey data, Roland Berger Strategy Consultants analysis

"Asian countries don't look to go through the process of improving – they will try to jump right to that developed stage."

Channel Manager Asia Pacific, Asian specialty chemicals company

The service development landscape will remain dynamic – the latecomers are catching up fast

The Service Development Index is useful in that it shows exactly where different countries are in terms of their level of service sophistication. Its weakness, however, is that it does no more than that: it is merely a snapshot, a static record of a given status. The whole picture changes, however,

when we grasp the forceful dynamism with which service landscapes are developing and evolving in different countries and clusters. Figure 23 provides a graphic illustration of the "race toward service sophistication", in which countries are portrayed on the classic innovation s-curve in order to picture the dynamism and stages in the ranking. Representing the adoption rate of an innovative product over time in the context of innovation, the s-curve can also be applied to the level of service development of a country, standing for the different development stages a country has to go through. The shape of the curve constitutes the slow initial phase of development, requiring lots of initial time and investment, while the steep turning point of the curve stands for the drive resulting from the strong growth countries experience once their infrastructural and educational basis is set for service development. Lastly, once a high level of service development has been reached, the curve flattens again, representing the slowdown in growth that occurs at a certain level of service development, with only service innovation then leading to further development. While being a semi-conceptual illustration (rather than purely empirical), this

Economic development goes hand in hand with the SDI

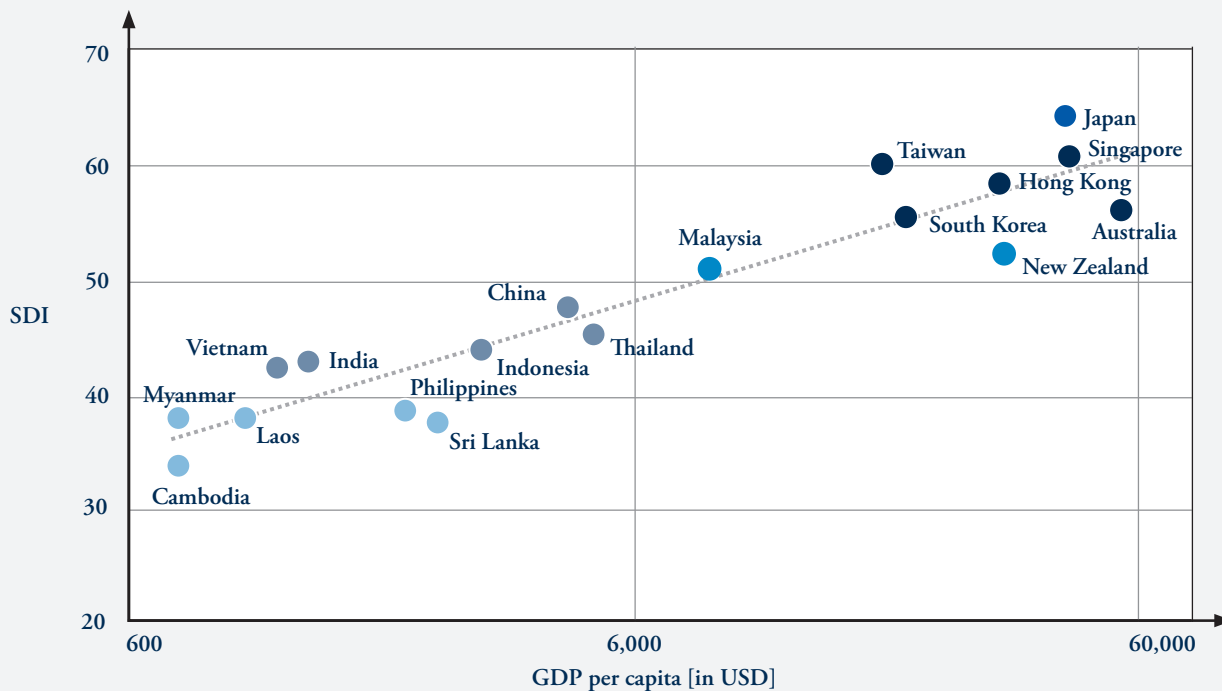


Figure 24: Asian countries by GDP per capita (2011) and Service Development Index (SDI)

Sources: International Monetary Fund, survey data, Roland Berger Strategy Consultants analysis

way of plotting the countries visualizes the dynamic nature of service development in the region, a situation underlined in the vast majority of market expert interviews conducted in the course of our study. By means of the s-curve, often applied in the context of innovation, countries are grouped along the horizontal axis according to the proximity of their SDI values and the qualitative assessment of market experts.

Resulting from these observations it becomes clear, that a country's level of service development needs to be watched closely. The proximity between countries and clusters, especially chasers and attackers, indicates that the ranking, and with it local service needs, can change very quickly. The blurring boundaries become evident when comparing the attackers, chasers and pursuers cluster in particular.

The correlation assumed between a country's level of service sophistication and its economic development also holds true under investigation of other variables, such as per capita GDP. The correlation with the SDI is manifest. Its correlation with the countries' economic development

underscores the SDI's value and validity and indicates that the historical economic roles in the region have, combined with foreign political influences, strongly affected the development of many countries in the Asia Pacific region.

Summary

Varying levels of sophistication in Asia Pacific countries' service levels and the economic indicators depicted and explained above, again underscore the fact that MES services can never be commoditized or standardized successfully. Adapting to local needs is no easy task, however. Expectations can change rapidly, so properly and continuously assessing them requires a profound understanding of local needs and markets.

MES providers must therefore repeatedly align their service offerings and service innovation activities with the level of service sophistication of each individual market. In the process, they must consider the needs of both clients and customers in each case and accommodate local expectations and preferences in terms of service portfolios and priorities.

F. COLLABORATION – THE KEY SUCCESS FACTOR

Service innovation in MES requires market knowledge more than anything else

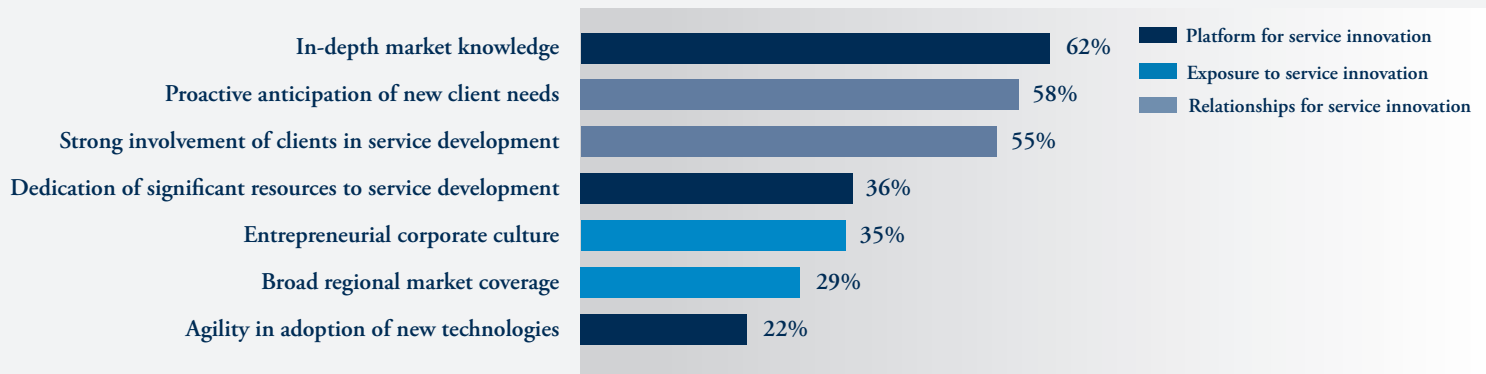


Figure 25: Requirements for successful service innovation [%]
Source: Survey data

"MES providers need to have an entrepreneurial culture, identify with the client brand, and view opportunities as if it was their own business."

General Manager South East Asia, Asian
pharmaceuticals and healthcare company

The formula for success – a strong platform, broad exposure, and strong relationships

How can MES providers meet all the clients' and customers' needs given the vast regional differences?

Existing studies on service innovation point to a deep customer focus as the most important factor behind the success of service innovation. And the MES industry is no exception (see figure 25). Bearing in mind the nature of this industry, it is no surprise that clients and customers regard "in-depth market knowledge" as the most vital factor contributing to successful service innovation. The second and third most important aspects from client and customer perspectives, however – "proactive anticipation of new client needs" and the "strong involvement of clients in service development" – are equally revealing. Indeed, regions such as North East Asia and Greater China, where business is traditionally rooted in trust-based relationships, attach even greater importance to these considerations.

Clients' and customers' emphasis clearly indicates that the MES industry needs to further incorporate the importance of client and customer focus and provide tailor-made services and solutions. But it must also grasp the significance of close relationships between service provider, client and customer – even to the point

Clients and customers want to take an active part

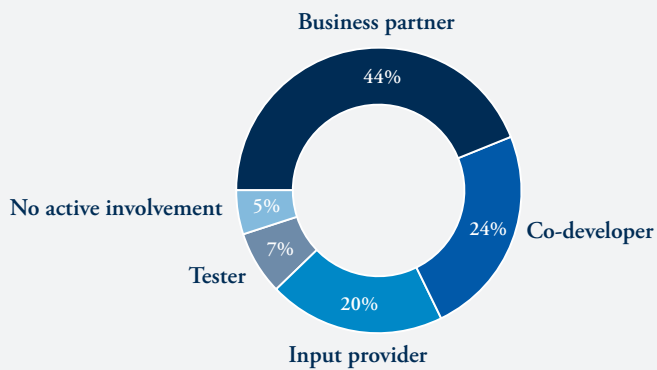


Figure 26: Preferred client role in the service innovation process [%]

Source: Survey data

of engaging in shared service development efforts.

As crucial as it is to invest and adopt new technologies, survey results indicate that clients and customers alike attach even greater importance to intensive interaction with their MES providers. This desire for dialog and participation proves that market expansion services are regarded as a long-term strategic partnership in which provider, client and customer share and pursue common goals. It can be concluded that service innovation is built on three pillars: platform, exposure, and relationships.

The platform for service innovation consists of know-how, resources and access to technology. Only strong capabilities, such as sales and marketing competence or a capillary distribution network, supported by a strong IT backbone can provide the right environment for service innovation.

Exposure to service innovation refers to the required entrepreneurial culture combined with the necessary market and industry coverage. As seen above, the inspiration for service innovation comes from the market. Exposure to different industry and geographic markets is essential to be able to transfer and leverage ideas.

Lastly, but undoubtedly most important for the long-term success of service innovation, are the necessary relationships, referring to the proactive anticipation of new clients' needs on one hand, and strong involvement of the client in the development process on the other. This requires a strong sense of trust and tradition.

Summary

Clients and customers rightly expect MES providers to offer a robust platform in the form of both in-depth market knowledge and the resources they need to be able to provide innovative services. On top of this, however, they also expect providers to commit to building and maintaining a trustworthy relationship with the client – and to grant sufficient exposure to ensure success.

Client and customer country managers in particular want to shape service innovation

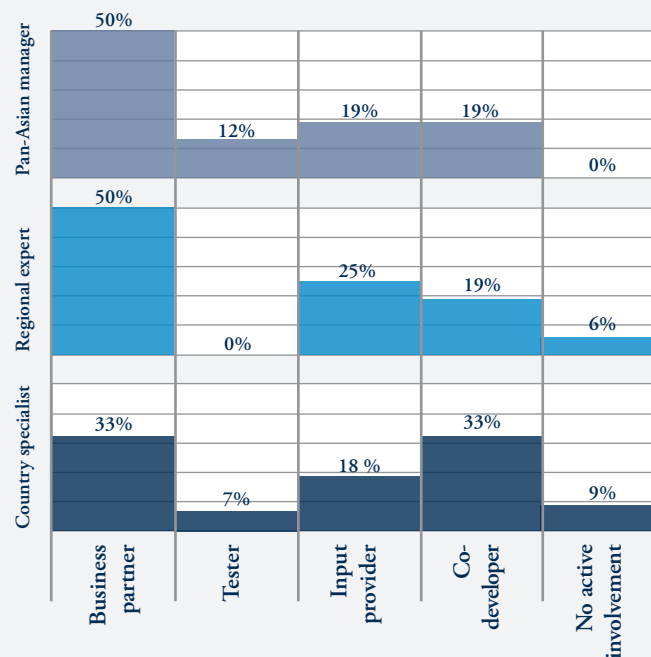


Figure 27: Preferred client role in the service innovation process by type of manager [%]

Source: Survey data

"Market expansion is by nature entrepreneurial. Consequently, MES providers can only be successfully serving their clients with an entrepreneurial corporate culture."

Business Director Indochina, European consumer goods company

The industry is ready for open service innovation

Having identified the vast differences in demand and expectations in the context of service innovation depending on industry, management perspective, functional expertise as well as the level of service development of a respective country, it became clear throughout the course of the study that service innovation in the MES industry cannot work as a monolog.

As initially established, successful service innovation requires a high level of interaction between service provider and client and/or customer. The full potential of service innovation can only be reached when the MES provider heavily involves its clients and customers in the service development process. Consequently it does not come as a surprise that clients and customers in the MES industry are certain concerning their preferred role in the service innovation process (see figure 26):

- 95% would like to be involved in the service innovation process in some capacity, which confirms the importance of provider-client/customer relationship in the industry

Open service innovation – opening up for new opportunities

Open innovation has been a focal point of manufacturers and service providers over the past decade, with newly emerged opportunities such as mass innovation, user innovation, and know-how trading through social media. These opportunities allow companies to innovate outside the company and closer to the market. But what exactly does open innovation mean for service firms? Open innovation in service industries, and specifically the MES industry, implies close interaction between a service provider and its clients and customers in the service innovation process. Service providers need to open up the innovation process to their clients and customers to be able to precisely and efficiently address their needs. To meet the objective of engaging in and successfully maintaining service innovation, service providers need to build and sustain a platform for clients and customers to connect and collectively develop innovative solutions. This proves to be specifically important in the MES industry due to the increased complexity resulting from the interface with both client and customer: in order to meet the needs and expectations of both, the MES provider must maintain the open innovation process by means of a close and trusting dialog.

- 51% would like to play an active part in the service innovation development process to the extent of engaging in close dialog with the service provider, underlining the relevance of the topic of open innovation for the industry
- 24% would like to see themselves as co-developers of service innovations

These preferences shift depending on the type of manager. Country managers, for example, see themselves in an active role as co-developers, whereas regional and pan-Asian managers put "providing input" ahead of "co-development" in order of importance, underlining their strategic rather than operational role (see figure 27).

Similar variations are observable across different corporate functions. While 51% of respondents would like to play an active part in the service innovation process, 62% of managers in research and market analysis functions would prefer an active role versus only 44% of general managers.

The obvious conclusion is that service innovation can only succeed in an atmosphere of trust between the service provider and its client and customer. This is not only due to the need to customize every solution in an industry that has no room for one-size-fits-all approaches. It is also due to the simple fact that, by its very nature, service innovation requires intensive dialog between service provider and client and customer if value is to be added successfully and sustainably for all parties.

Spotlight on Lufthansa – innovation platform shaping the future of the business

Europe's largest airline, Lufthansa, recently launched the first open innovation platform in the aviation industry: an online portal for the collection and discussion of innovative ideas, ecological solutions, and future approaches to their business in the air cargo industry. Air cargo clients, as well as logistics experts from academia and industry, were invited to participate in the discussion and present their ideas. A total of around 250 ideas were collected and evaluated by an expert jury, with the best ideas being rewarded with attractive prizes and considered for implementation by Lufthansa's top management.

Source: Public company information

These criteria for successful service innovation in the MES industry are also reflected in approaches to open innovation in general and open service innovation in particular. Open service innovation stresses the importance of co-creating innovations in order to successfully satisfy the needs of all parties. It also notes that, by themselves, service providers can only make value propositions, whereas it is clients and customers who must ultimately shape and co-create value in accordance with their own needs. The reason is that, since services are intangible, knowledge about possible improvements or necessary solutions to emerging problems is often implicit. It can thus become explicit only through close dialog between the service provider and the client and customer.

Summary

In the MES industry, service innovation is most successful when it takes the form of open innovation. Open innovation is rooted in relationships of trust between the service provider and both the client and the customer. The outcome is lasting added value for all parties thanks to innovative, tailor-made service offerings.

International MES providers well-equipped to master the service innovation challenge

	Platform for service innovation			Exposure to service innovation		Relationship for service innovation
	Local knowledge	IT backbone	Investment in service R&D	Cross-country	Cross-industry	Exposure to international clients and customers
International cross-industry	✓	✓	✓	✓	✓	✓
International single-industry	✓	✓	✓	✓	—	(✓)
Regional cross-industry	✓	✓	✓	✓	✓	—
Regional single-industry	✓	✓	(✓)	✓	—	—
Local cross-industry	✓	—	—	—	✓	—
Local single-industry	✓	—	—	—	—	—

Figure 28: Types of MES provider and their service innovation capabilities

International MES providers are best positioned to realize the full potential of service innovation

With MES clients and customers seeing themselves in an active role in the service innovation process, and the industry's trends towards customization, and regional, integrated, added-value service offerings evolving, one key question arises: "How will this affect the industry and what does it mean for MES providers?"

Based on the three identified requirements for successful service innovation – platform, exposure and relationships – it is of utmost importance for clients and customers equally to partner with an MES provider that can nurture from the changing market environment and fulfill these requirements. Only this way they can reap the benefits of successful service innovation and also in the long-term grow in their business through tailor-made service offerings.

In terms of the different types of existing MES providers, two dimensions need to be applied: geographic scope and industry reach. Accordingly, players range from locally focused cross-industry MES providers to internationally focused cross-industry MES providers. Their positions in the market differ, as do their strengths and weaknesses, as well as the conditions for each of them to successfully develop and offer innovative services (see figure 28).

The full-service, cross-industry international MES providers unquestionably occupy the best position to meet and master the challenges described above - only they can:

- Build a robust platform for service innovation, exploiting their full local knowledge, providing integrated service offerings, leveraging a high-performance IT backbone, and investing in service research and development
- Employ the scale of exposure to service innovation that allows them to quickly leverage services and best practices across entire industries and regions
- Implement the resources and the commitment to build lasting relationships and engage in the intensity of long-term dialog that is critical to the delivery of successful service innovations – innovations that add lasting value for customers, clients, and themselves
- Exercise the capabilities and expertise necessary to quickly and appropriately respond to different levels of service sophistication in different markets and tailor solutions to the developmental stage of each country

"To bundle within and outside of regions is very important to us – we try to work with our MES partner across country borders. This is of advantage for both sides, in terms of trust, resources and efficiency."

.....

Head of Business Unit, European specialty chemicals company

ARE YOU READY FOR INNOVATION IN MARKET EXPANSION SERVICES?

Needs	Innovation of...	Client and customer expectations	MES provider offering
Growth with tangible value 1	...existing services	Are you looking for an outsourcing partner to help you achieve your business objectives along the value chain more efficiently? <input type="checkbox"/>	Can the company provide a full-range core service portfolio, offering valued-adding solutions to all steps of the value chain? <input type="checkbox"/>
	...new services	Do you want to continuously add value to your operations and stay at the forefront of your industry? <input type="checkbox"/>	Can the provider serve its clients and customers with the necessary platform for successful service innovation? <input type="checkbox"/>
Customized solutions 2	...existing services	Do you consider service solutions customized to your company, industry, as well as specific markets and regions as essential? <input type="checkbox"/>	Can the provider flexibly address client-specific needs in an entrepreneurial manner while providing the necessary market coverage? <input type="checkbox"/>
	...new services	Are you looking for new innovative service solutions specifically tailored to your currently emerging needs? <input type="checkbox"/>	Is the provider able to ensure the necessary exposure to service innovation to develop tailor-made service solutions? <input type="checkbox"/>
Efficiency 3	...existing services	Are you looking for a partner not only providing you high quality services, but opting to continuously seek improvement? <input type="checkbox"/>	Can the provider ensure expertise and experience in long-lasting relationships with high-demanding global clients and customers? <input type="checkbox"/>
	...new services	Is it of priority for you to be able to purchase state-of-the-art service innovations further increasing your operational efficiency? <input type="checkbox"/>	Is the provider capable of engaging in a close dialog with client and customer in order to identify levers of efficiency improvement in your business model? <input type="checkbox"/>
Transparency 4	...existing services	Are you seeking full business data transparency in all your operational processes among the value chain? <input type="checkbox"/>	Does the provider have the scope, resources and experience to ensure transparency in services and client and customer interfaces? <input type="checkbox"/>
	...new services	Are you interested in services enhanced by new technologies allowing real time data transparency? <input type="checkbox"/>	Does the provider have the platform for technological advancements leading to innovative services? <input type="checkbox"/>
Openness and trust 5	...existing services	Are you interested in close interaction with your partner in order to improve service solutions and enhance business performance? <input type="checkbox"/>	Does the provider have the necessary resources and experience to ensure a fertile dialog with its clients and customers? <input type="checkbox"/>
	...new services	Would you like to be closely involved in the development of innovative service offerings to benefit you and your customers? <input type="checkbox"/>	Does the provider have and nurture the necessary client and customer relationships to maintain successful service innovation? <input type="checkbox"/>

METHODOLOGY

Survey

Roland Berger Strategy Consultants conducted an online survey leading to more than 350 responses from market and industry experts, as well as executives of (potential) clients and customers of MES providers. The survey was focused on demand levels for MES and specifically service innovation, the preferred client/customer role and expectations towards the MES provider in the context, and the perceived level of service development of countries in the Asia Pacific region.

Interviews

Roland Berger Strategy Consultants additionally conducted more than 25 interviews with industry leaders, experts and academics. The interview participants were executives of (potential) clients (i.e. manufacturers) for MES providers, evenly spread across industries (consumer goods, specialty chemicals, pharmaceuticals/healthcare and engineered products), geographic regions and company size. The case studies are based on public company information.

Market sizing and market breakdown

The market sizes have been derived from a detailed market model independently developed by Roland Berger Strategy Consultants. Total market sizes are based on industry-specific data (e.g. Euromonitor, Espicom Healthcare Intelligence, GIA, SRI) and publicly accessible reports from leading institutes (e.g. IMF, WHO, Worldbank, UNCTADstat). Roland Berger Strategy Consultants established a detailed market model, first calculating the size of each total market, and then estimating the size of the market for expansion services in a multistage approach. The input for this step-by-step market breakdown was a combination of market data and expert opinions.

Market projections

The market projections have been derived from a detailed market model independently developed by Roland Berger Strategy Consultants. The market projections distinguish between market demand forecasts and forecasts on how the penetration rate for MES is expected to develop. All market projections are reported in current prices and based on fixed exchange rates. The projections (for the demand side) and historical data were derived from market databases published by the relevant research institutes.

Limitations

The market breakdown is the result of our analysis of quantitative and qualitative information consolidated from quantitative sources (market reports) and interviews with experts. Qualitative information is necessary for a realistic market breakdown. As a consequence, the methodology includes estimates that may result in best approximations. Actual market sizes may vary.

The market forecasts are projections into the future and can never fully take account of all eventualities. Despite these significant restrictions, Roland Berger Strategy Consultants are convinced that the analysis presents a true and fair picture of the markets in question.



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The company offers a tailor-made, integrated portfolio of sourcing, marketing, sales, distribution, and after-sales services. It provides business partners with expertise as well as on-the-ground logistics based on a comprehensive network of unique size and depth. Business activities are organized into four specialized Business Units that mirror DKSH fields of expertise: Consumer Goods, Healthcare, Performance Materials, and Technology.

With strong Swiss heritage, the company has an almost 150-year-long tradition of doing business in and with Asia, and is deeply rooted in communities and businesses across Asia Pacific.

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At Roland Berger, we develop customized, creative strategies together with our clients. Providing support in the implementation phase is particularly important to us, because that's how we create real value for our clients. Our approach is based on the entrepreneurial character and individuality of our consultants – "It's character that creates impact".

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