

VELVET INDUSTRY

FIVE YEAR STRATEGIC INTENT

2009 – 2014:

1 Vision

1. Finished, branded New Zealand deer velvet sought after in North Asian markets as an ideal ingredient in their traditional medicine cultures.
2. New Zealand velvet producers, processors and marketers have effective channel management of their products.
3. The New Zealand velvet industry is growing based on increasing demand and good returns to supply chain participants (in NZ and in markets).

2 Strategic Goal

To create sustainable, profitable businesses in the New Zealand velvet industry through the efficient production of quality deer velvet and successful marketing of it, by 2014.

3 Introduction

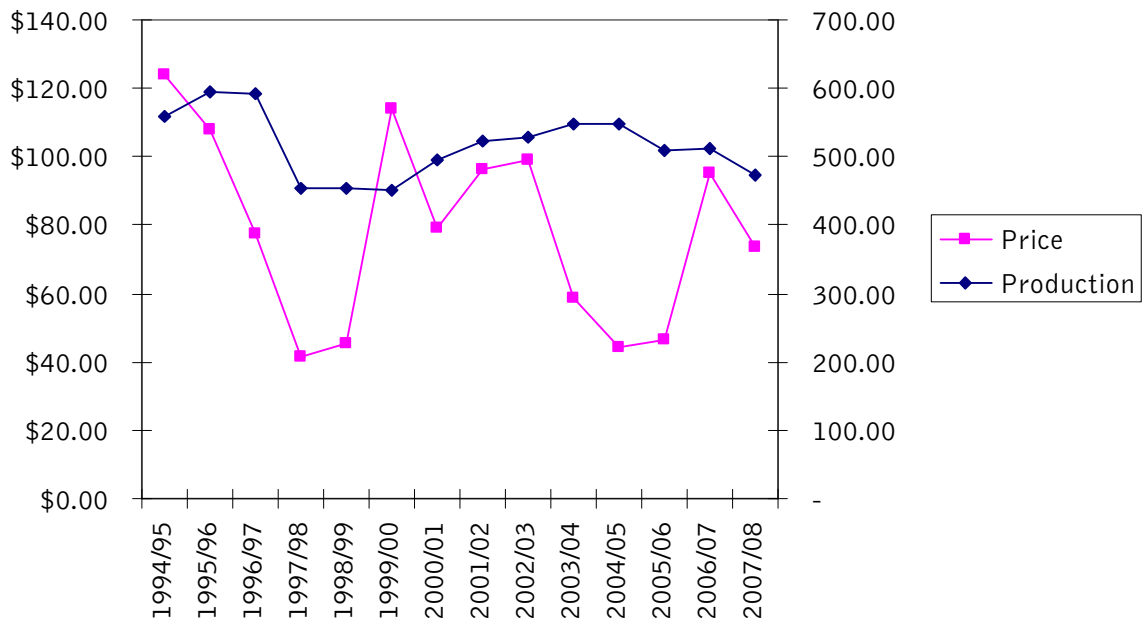
Being a large supplier of an unfinished commodity into a historically small, single market continues to result in volatility. This is made worse by a supply chain which does not value transparency, barriers to market access and industry fragmentation. While there may be other market opportunities emerging, as of today, this is New Zealand velvet's current situation.

The result is a shrinking velvet industry, both in terms of velvet production and processing capacity. Some indicators show New Zealand velvet production dropping to levels last seen in the early 1990s and a near complete loss of processing capability in New Zealand.

Over the recent past there have been some attempts to consolidate the sale and marketing of New Zealand velvet. This has given some producers better connectedness with the market, achieved a move away from auction selling and more coordinated selling. However, it has also left some important players (e.g. Korean processors and some independent agents) feeling disenfranchised. The supply chain is no more transparent, less velvet is processed in New Zealand and there is more risk of product quality challenges.

If history is consistent, a large decrease in supply would result in a large increase in returns to producers once the market is short of velvet. This would only mask the structural issues which the New Zealand velvet industry faces. In general terms the supply:price ratio of New Zealand velvet has been deteriorating over time.

Graph 1 price and production 1995 - 2008



To turn a good vision for New Zealand deer velvet into reality would require a conscious decision to ruthlessly achieve it. Deer Industry New Zealand can help co-ordinate it, deploy producer levy resources to achieve it and help drive and measure progress. However, the decision to change must be a commercial one, made by a majority of producers, processors and marketers.

Deer Industry New Zealand has not seen that level of desire. The current course is leading to an overall reduction in the size of the industry, i.e. fewer producers, less velvet leading to higher returns; less processing capacity, fewer exporters leading to greater opportunity to consolidate velvet and make reasonable returns for a few.

Given the current environment with forecast reduction in levy income, Deer Industry New Zealand sees its role being:

- Maintaining industry capability in terms of quality standards, velvet removal and freedom to operate generally;
- Gaining better access to markets, and assisting development of those markets as required by commercial participants (primarily China, South Korea and Taiwan);
- Protection of the core Korean oriental medicine market (Korean oriental medicine);
- Provision of base marketing materials for marketers; and
- On a small scale, continuing to grow base knowledge around the benefits of New Zealand deer velvet.

The strategy is based on input and comments from all sectors of industry including exporters, marketers, processors and producers. While the views may differ within and between the groups, the intent is to bring together common ideals. It is important to note, individual organisations will have their own strategies which will best suit their business models.

4 Executive Summary

Based on the existing situation, Deer Industry New Zealand recommends that a change in tactic is implemented for the next five years. The Velvet Industry Strategy 2005-2010 sought new markets and positioning for NZ deer velvet, while maintaining the traditional market. In reality, the industry strategy was not a shared vision for the New Zealand velvet industry and resulted in Deer Industry New Zealand sometimes acting in isolation from its industry and with limited success.

This paper aims to better align with the velvet industry's aspirations by ensuring that core industry functions are protected and the commercial sector has the opportunity to enter new markets by removing barriers to trade for New Zealand deer velvet. Deer Industry New Zealand anticipates that this will result in less resources being required by Deer Industry New Zealand.

5 Situation Analysis

5.a Current Situation

Exporters/processors: Most processors/exporters are in survival mode, with several having an expectation that they may cease operation in the next year. They generally lack capital, despite producing high quality processed velvet and having decades of experience.

Farmers: With the higher venison schedule and increasing pressure on land use, many farmers have taken the option to heavily cull their velvet herds. This is likely to result in significantly lower production over the short term.

Main customers: Korea has been hit very hard by the current global economic downturn. The South Korean economy was already deteriorating prior to the financial crisis hitting, only exacerbating the issue. Since then the South Korean won has devalued by over 33% (against the USD) resulting in job losses. South Koreans have been in similar crises before and the fundamentals of South Korea remain strong, but the near term is one of uncertainty and is dependent on global factors. While velvet is considered by many consumers and Oriental Medical Doctors (OMDs) to be an integral part of oriental medicine, overall visits to the oriental medicine doctor may decrease, prescribing methods may change to reduce the amount of velvet prescribed and/or OMDs may swap to lower grades of velvet.

5.b Market Environment

Deer Industry New Zealand estimates that over 65% of New Zealand velvet is eventually consumed in South Korea¹. This has reduced from a historical figure generally agreed of around 75%. However a recent increase in consumer wealth in China has lifted this markets importance. In both Korea and China, the focus is on the OMD market, where velvet is used as a significant prescription item in Oriental Medicine (OM). In Korea, the OMD profession has gained in popularity as Korea's wealth has grown. Academically it is a challenging profession to enter. A number of larger clinics are growing. Generally, New Zealand's velvet production has grown in line with the South Korean economy.

¹ Some exporters commented that the figure may be closer to 55% due to increased consumption in China, while others suggested that Korea still consumes around 75% of New Zealand velvet.

Historically Russian velvet is considered the best product, followed by Chinese then New Zealand. In recent times imported prices of New Zealand velvet have been higher than Chinese reflecting the quality of New Zealand velvet. One would expect this trend would flow through to OMDs over time. Although it is worth noting that there is value to OMDs in having a range of perceived qualities as it allows differential pricing.

Distribution channels of deer velvet in South Korea are complex, tend to rely on credit and (like the pharmaceutical industry) it is not easy for wholesalers to sell to OMDs.

Internal mechanisms do not encourage the entry of new importers and distributors. However, over the past five years, there has been growth in companies which have taken more of a 'marketing' approach rather than traditional, trading-based approaches.

Significant sales barriers remain in South Korea (high border costs, different treatment of frozen and dried velvet, different treatment of local and imported velvet, limited channels in which velvet may be sold, and limited product forms allowed to be sold). Deer Industry New Zealand understands there are trade barriers in China (based on independent market reports), however some industry feedback does not agree with this – further work is required. Taiwan limits frozen velvet imports severely and has difficult import protocols of further processed velvet products.

5.c Financial Environment

Due to its high value, traders of velvet require significant financial backing. Credit availability is an important component of velvet trading. This means that typically, the number of key importers is around 5 in Korea and 5 in China.

Chinese Government interests have helped investors through loans or grants to stimulate productivity in local regions in China.

5.d Political Environment

New Zealand's two core export destinations have important political considerations:

Korea: three key issues are 1) North Korean instability and aggression toward South Korea 2) the aggressive lobbying power of local agricultural industries. Although the Korean Deer Breeders Association has relatively small membership, they seem to have large political influence and 3) a possible FTA between South Korea and New Zealand is currently in the political arena. An FTA presents a significant opportunity for New Zealand deer velvet.

China: China operates firmly under a communist political environment. While it is clear that capitalism is the face of business in China, there is always the underlying reality of Government intervention which can result (and has) in trade barriers.

5.e Supply Environment

As velvet is a niche product, there are limitations on the quantity of velvet produced each year. However market development has been very slow over recent times so a static market dictates that once it is full, demand (and price) drops sharply away.

Historically New Zealand produced around 500 tonne of velvet for export in an export market of around 1,000 tonne. Being the dominant exporter, as soon as that target is passed, value drops away significantly. As mentioned, New Zealand's supply is likely to fall and generally speaking other velvet producers are likely to decrease production (with the possible exception of Russia). This may result in alternative products (such as reindeer velvet), and production is likely to increase if prices improve rapidly.

In New Zealand it is apparent that supply blocs are beginning to form as a result of processor weakness, producer dissatisfaction with returns and consolidation as the industry retrenches. The obvious victim of this consolidation is New Zealand's processing capability.

6 Core Strategies by Priority

The core priorities of this industry strategy are based on initial comments by a range of participants in the New Zealand velvet industry. It is important to note that these are industry priorities. Individual commercial operators will have their own commercial strategies and an industry strategy should support those strategies and not compete with them.

Table 1 Agreed Strategies: Roles and Responsibilities

Core Strategy	Processor/marketer/exporter	Producer	DINZ
1. Freedom to Operate	Meet regulatory requirements and industry standards which ensure product is fit for purpose and ethically produced	Meet regulatory requirements and industry standards which ensure product is fit for purpose and ethically produced	Operate NVSB and industry standard (eg Grading Guidelines). Ensure timely communication with industry. Timely resolution to any international or domestic issues which could impact industry
2. Improve Market Access	Communicate market access issues or opportunity to DINZ. Assist with achievement of market access objectives	Support market access initiatives as required	Continue to act for the industry to drive improved market access
3. Protect and Grow Traditional Markets	Continue to culture commercial relationships within core target market.	Velvet produced meets market requirements and is hygienically handled	Work with industry to identify and grow core markets where industry good work is required. Work with marketing companies where opportunities exist to capture emerging trends
4. Provide Efficacy Based Research	Identify new market opportunities where research may assist growth of products	NA	Co-ordinate and manage research alongside industry
5. Strengthen NZ Velvet Brand	Promote core benefits of NZ Velvet. Ensure product meets required standards and purchase experience through to the consumer is positive.	Velvet produced meets market requirements and is hygienically handled	Develop and promote a New Zealand velvet mark. Ensure costs are minimal and monitor the use to ensure it appropriate promotion
6. Western Based Markets	Develop any market potential where commercially appropriate	Ensure product meets the specifications for western markets	Support will be limited to material provision and communication of research outcomes. Lower resource than previous strategy.

6.a Ensure Freedom to Operate

Freedom to operate allows the continued, unfettered production and sale of velvet and co-products. This means that the Industry must have systems in place to ensure the ethical production of velvet and co-products and the capacity to make judgments on regulatory and market issues as they arise.

Tactics to support this strategy include:

Velvet Processors Association (VPA)

The VPA continues to be the primary forum through which processing issues are considered and debated. Deer Industry New Zealand has a role to play in supporting the VPA and assisting the implementation of its decisions where appropriate.

NVSB Programme

The NVSB programme provides a means to ensure the welfare of stags during velvet removal and verify that it is done properly and monitor hygiene levels. This gives the ability to monitor the Industry and respond quickly to any who do not meet these strict standards. This programme will remain.

Issues Management

Be able to respond to any domestic issues that may arise.

Market Monitoring

A need remains to ensure issues in the key markets are known and appropriately dealt with. There is always potential for damage to occur and the most effective way (in terms of speed and accuracy) to deal with such issues will determine the impact to the industry.

6.b Improve Market Access

At least 95% of velvet produced in New Zealand is destined for overseas markets. Improving the terms on which these velvet products may be sold is an important industry priority. It is important for NZ to ensure that opportunities to achieve better access to NZ velvet and co-products are taken advantage of. It is also important that industry prioritises market access opportunities (perhaps based on size of the 'prize', likelihood of success, risks to existing markets, and how 'enduring' the opportunity will be) because market access improvements can take time.

Tactics to support this strategy include:

Korean FTA

With the import duty at 20% and further taxes including individual excise tax, there is great benefit to a successful outcome of this FTA in New Zealand's core market. The Industry needs to work closely with NZ Government to ensure its voice is heard and manage the process for exporters as the FTA comes into effect. Conversely, if there are parts of the FTA that do not favour sections of the New Zealand deer industry, then the Industry needs to utilise the tools the FTA may offer as a vehicle for future negotiation.

China Access

A recent FTA signed between NZ and PRC has not yet had impact on freeing up trade in deer products. However the FTA could provide a tool to challenge current restrictions and improve trade access.

China's increasing dominance as a world economy is resulting in its enormous population rapidly improving individual wealth. While attitudes toward Traditional Chinese Medicine in China are strong, information will become more accessible as the population modernises. If velvet is not promoted correctly it could lose its place to competing natural remedies (such as glucosamine type supplements).

Taiwan Access

Keep working to free up the 5 tonne quota currently in existence for fresh product. Seek ways to expand processed market.

6.c Protect and Grow the Traditional, Core Market where Possible.

For at least 2,000 years, velvet has been used in TCM, to varying degrees in Asia. The degree has largely been dependent on the wealth or status of a country or individual. Since New Zealand's entry into deer farming, its primary market has been South Korea. South Korea has the largest demand for velvet, however as other countries increase their wealth they too open up opportunities. One country rapidly emerging as a strong market is China. Some believe that in the medium term, China could become the biggest consumers of NZ deer velvet. When selecting a target market, the market in Asia is already knowledgeable of the health benefits velvet can offer so should therefore be the primary target.

Tactics to support this strategy include:

Protect the Core Korean Market

Korean OMD's are clearly New Zealand velvet's current target audience. Reportedly, the Korean OMD industry is still a very sought after profession and growing. Recent years has seen focus for this industry change to more of a maintenance role. Through lifting emphasis on to this market, the industry can:

- Ensure that market share is maintained (or improved) within a (slowly) growing industry
- Continue to convince new OMD's that NZ velvet is the best due to strict QA standards, extensive farming systems and traceability.
- Work with an industry that understands velvet's role. Ensure they have the tools to promote velvet in an ever-increasing information demanding world.

Implement a China Strategy

Set and agree on an industry strategy for China. China has a strong belief in TCM. It is growing wealthier and is modernising. Economically, socially and politically China has risks associated with it, however, it is a logical target market to augment the South Korean market. New Zealand velvet sales (of Chinese grades) have grown significantly in recent years. If growth continues, China's middle class will grow. China's urbanisation strategy is to grow a large number of new cities (rather than making existing ones bigger). These are likely to provide niche marketing opportunities. While exporters believe they can sell New Zealand velvet legally in to China, Deer Industry New Zealand understands (through 2 independent reports) that this is not the case. There are still restrictions to export New Zealand velvet for consumption in China. The recently signed FTA between NZ and PRC could be a logical tool to challenge current access restrictions. However, this will take time and a logical process needs to be implemented.

Deer Industry New Zealand anticipates that a strategy would initially focus on market access and progressively move to market development.

Maximise Opportunity in Other Asian Markets, e.g. Taiwan

Taiwan has a population half the size of Korea, yet with similar attitudes toward TCM and a comparable GDP per capita. However Taiwan's velvet consumption per capita is considered to be only 10% of Korea's consumption at around 25 tonne (versus South Korea's 500 tonne). Although Taiwan is a warmer country, consumption should be 100 – 200 tonne based on their similarities with Korea. Ongoing work to free up this market should continue as we expect there could be good opportunities for the industry as a result.

6.d Provide Efficacy Based Research

Velvet may have been used in TCM for over 2,000 years but questions remain about its efficacy and whether it is based on tradition rather than clinical efficacy. The first question any new potential consumer asks generally is about science behind health benefits. Competing products such as ginseng and glucosamine-type supplements have some research in behind them. In a world of easy access to information, a level of base knowledge is required. Deer Industry New Zealand anticipates putting significantly less resources into research, but still generating some new knowledge. Given its position in world trade and production, New Zealand can capture the benefits of new knowledge.

Tactics to support this priority:

Market/Efficacy Based Research

Measurable research with market derived outcomes. Work alongside the commercial sector and those marketing product to the customer to ascertain research needed to increase demand. These projects could include immune function properties, joint function and research into blood conditions (including diabetes). Deer Industry New Zealand anticipates that trials would generally be either *in vitro* or small animal given the cost of human trials.

Prioritise Research on Main Items

With limited resources focus should be on the main priorities supporting the marketing of velvet. An example of this may be: year one: joint function; year two: immune function; year three: arthritis; year four: blood conditions. Obviously it may take longer than one year to properly undertake a project; therefore the major project may require a larger proportion of funding, but additional funding needs to go toward finishing off other projects.

Wound Healing

The industry has invested time and energy into the wound healing applications of deer velvet. Reviews have indicated that there is market opportunity and a good base data package on a wound healing product. Human clinical trials will be completed on the wound healing extract in 2009/10. A review will be undertaken upon completion of this work.

6.e Strengthen NZ Velvet Brand

Investing in the NZ velvet brand will help to break away from the commodity ingredient supply the industry is currently faced with. Expensive above the line advertising does not need to occur as awareness could be achieved through supplying sales and technical support and research.

Tactics to support this strategy include:

Promotion of a generic "NZ" brand

Potentially utilise existing logo/mark (e.g. NZ deer products tick) to promote NZ deer velvet in terms of guaranteed NZ product. This gives customers piece of mind that they are buying genuine product and may provide the ability of creating a premium for New Zealand velvet through promotion of QA schemes and traceability.

Control the Mark

Control distribution of the mark to ensure credibility to those who are genuinely supplying NZ product. Use this status as a tool to supply support for in-market activity.

6.f Other – Western Based Markets

Given the smaller size of these markets and a lack of sales at a critical mass (to date), DINZ may not support joint promotional funding with limited industry funds. However DINZ could provide base generic marketing collateral to support positioning and sales.

Companion Animal Market

Given the number of companion animals globally, uptake does not need to be widespread to make an impact on the industry. The companion animal sector may make sense as there is good scientific support in behind the pet material that gives some teeth to this sector. Due to the nature of velvet, it is also a palatable and natural Non Steroid Anti-Inflammatory Drug (NSAID) alternative.

Asian Immigrants

In a transient world there are opportunities for some work on the Asian population now residing in large western cities.

There are some companies successfully operating in this niche area and DINZ will support, where possible, marketing material. In terms of ability to influence the industry however, this tactic is pretty limited and therefore DINZ do not see it as an avenue to invest in Joint Promotional (JP) funding.

Western Markets

This is a strong/stable albeit niche market which DINZ recognises. Promoting velvet as a nutraceutical in western cultures provides opportunities in areas including:

- Athletes: to strengthen and help training recovery times; and
- Aged: to help with joint mobility issues and immunity, etc.

However, the market for deer velvet is yet to gain any real momentum.