



# SECTOR ANALYSIS

## Nutraceutical Industry

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### Strengths

- Strong supply chain with many different suppliers to choose from
- Regular growth is expected for the next ten years
- Minimal regulatory oversight at the product level

### Weaknesses

- More expensive than actual food
- High turnover of sales force
- Limited access to large domestic and foreign markets

### Opportunities

- Partnerships with pharmaceutical companies
- Large market & assortment of products within market scope
- High margin products

### Threats

- Poorly organized & consistently changing regulatory framework
- Heavy influx of small to medium sized enterprises
- Large firms entering the market & advertising

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### What are Nutraceuticals?

A nutraceutical is a concentrated nutrient that derives from a food source. The purpose of these products is to isolate foods that hold therapeutic or preventative qualities. Many of these products are currently available for sale, some examples include powders, vitamins, and nutritious beverages. Goods are typically distributed through grocery stores and specialty health and fitness retailers without the need for a prescription or medical waiver. Nutraceuticals are in concentrated form when manufactured and are designed to supplement nutrients gained from a regular diet. The purpose of these products is the prevention of medical ailments, treatment of destructive symptoms, and providing supplementary nutrients to support biological functions.

Nutraceuticals are not always intended for medical use. For example, supplements for sports and active living have grown to be a sizable market. A segment called “functional food” has also began to grow in popularity. For whatever the purpose, nutraceuticals have the fundamental benefit of being very safe to consume. If a consumer can eat the product that the supplement derives from, then they can likely consume said supplement as well.

Some products are known to assist in antioxidant defense and biological processes; thus, encouraging regular use as a preventative strategy. Moreover, some products have shown to have crucial roles in immune status and susceptibility. Under doctor supervision, nutraceuticals can be used in connection with pharmaceuticals to treat medical conditions.

### Regulations relevant to Nutraceuticals

One of the key regulatory advantages in the nutraceutical industry is the lack of Food and Drug Administration (FDA) oversight of individual products. However, a manufacturer does have to register a claim with the FDA when they release new merchandise (Chauhan, Kumar, Kalam, & Ansari, 2013). Since the finished product is intended to be consumed by humans, the FDA still has regulatory authority over its production and distribution. Furthermore, the FDA must be aware of any medicinal claims the manufacturer is making. All products that are available to the market must

have a disclaimer that reads, "This statement has not been evaluated by the FDA. This product is not intended to diagnose, treat, cure, or prevent any disease."

Regulations become tighter when a manufacturer wants to add a new ingredient to their product. The FDA requires the creator to provide reasonable evidence that proves the substance is safe for human consumption (NIH, 2011). The time it takes to complete this process has created challenges for producers competing against rival companies. Nonetheless, actual products are not subject to the same clinical trials as pharmaceutical medicines and food products. Thus, the production process tends to be substantially quicker and less costly (NIH, 2011).

### Sources of Demand

Demand originates from three product categories; Functional foods, dietary supplements, and herbal/natural products. These classes encapsulate the top three consumers of these products (Pharma.com). The global market in 2013 amounted to \$160.6 billion in annual sales with more recent estimates placing sales in 2019 at \$241.1 billion (Cumming, 2015). The growth rate equates to approximately 7% per annum, with the bulk of growth coming from an explosion in dietary supplements. Nutraceuticals are becoming increasingly popular in developed markets; the desire for healthier living is becoming more fashionable. Many of the ingredients found in the most popular commodities are not found in conventional foods. Consequently, many consumers desire these products to achieve a well-balanced diet.

In terms of geographic sales dispersal, the United States represents the largest customer base with 37% of overall demand. Europe is second largest with 33%, and the remainder is a mix of developing countries and smaller developed nations (Chauhan, Kumar, Kalam, & Ansari, 2013). Aggressive advertising strategies have widely penetrated the US and European markets. Many consumers are aware of the benefits offered by nutraceutical products, then again many have also been misled to believe these products are more valuable than they are.

Studies have shown that under the direction of a doctor, pairing nutraceutical products with pharmaceutical drugs helps to intensify therapeutic benefits (Anscombe, Stricker, Leone-Kammler, Thomas, & Hembert, 2014). Further investigation into these relationships will allow for partnerships with pharmaceutical companies and market expansion to reach patients using prescription drugs.

### **Growth Opportunities**

Most growth opportunities lay with younger consumers, who represent a growing market that is particularly interested in health products and dietary supplementation (Pharma.com). Some of the common trends for supplements include vitamins, antioxidants, and protein powder. All these products have high margins, making them extremely profitable. Likewise, they are relatively easy to manufacture and do not require specialty ingredients. This allows producers to avoid regulatory approval through Health Canada, the FDA, or similar.

Food makers are starting to enter the market by offering organic functional foods at a premium price (Nutraceuticals World, 2015). Although this equates to increased competition for smaller producers, the food makers can devote more resources to advertising. For smaller producers in substitute product markets, like vitamins or powders, they can benefit from the customer pipeline of the larger players. Increased advertisement will help to increase awareness, and sway customers who would typically avoid purchasing non-food products.

The overall market is dominated by regional firms; there are very few operating at a global scale. For example, local markets including: Japan, India, and Brazil are generating substantial growth, but only within domestic boundaries (Wadhwa & Charles). It is very difficult for a company to comply with the varying regulations worldwide, so many opt to stay in familiar regions. Companies who can successfully operate on a multi-national scale will be able to introduce quickly new products that have yet to be developed by a geographically restricted company.

### Challenges for Nutraceuticals

The foremost challenge facing nutraceuticals is the premium price versus the lower cost of food (Pharma.com). To overcome this problem, producers must either lower the cost of production or accept a lower margin. Alternatively, an intensified marketing campaign may encourage customers to substitute nutraceutical products for food. The higher price and potential for adverse reactions have discouraged customers from purchasing these products; they elect to buy food or organic products instead (Functional Foods Market Analysis, Segment, Trends and Forecasts to 2020: Grand View Research, Inc, 2015).

Market structure is presenting a challenge for producers looking to maximize their market penetration. Under the current structure, the self-pay and reimbursed markets are side by side. However, the reimbursed market is far more desirable due to its size and margin (Anscombe, Stricker, Leone-Kammler, Thomas, & Hembert, 2014). For a product to be eligible for reimbursement, it must qualify under the country's regulations. Thus creating a challenge for producers who want to avoid having their products tested by regulatory authorities, but want access to a larger market.

Existing regulatory frameworks, specifically those in the United States and Europe, do not inspire innovation. Moreover, recalls caused by poor quality ingredients and poor production practices have highlighted the significant regulatory flaws. The challenge facing the industry will be finding an appropriate level of regulation that ensures quality products reach the market, but does not impede the development process like with pharmaceuticals. Lastly, slow approvals of new ingredients, and a disorganized claim system is hurting production and further complicates an already difficult challenge. The industry does not necessarily need more or less government involvement, but rather a streamlined system that does not interfere with the manufacturing process.

### Looking Forward

Large companies like Coca-Cola and Pepsi have been buying up smaller firms that focus on functional beverages. Whether or not they plan to grow the product lines or eliminate competition is still unknown (Anscombe, Stricker, Leone-Kammler, Thomas, & Hembert, 2014). Even so, more firms are entering the market and are helping to increase growth and public knowledge. Joint ventures with pharmaceutical companies have led to nutraceutical over-the-counter products that treat common conditions. Partnerships with existing companies will help grow the product range and find new and more profitable business opportunities. The past seven years have seen an average of 7.3% growth (Wadhwa & Charles). A conservative estimate for future growth is 5% per annum resulting in annual sales of \$300 billion by 2025.

Investors should look for innovative firms that produce one of a kind products that will draw attention. The broad scope of this industry's product lines make it more attractive for manufacturers with unique ideas. For smaller firms that plan to put their products against those of larger firms, they face substantial risks and a relatively low likelihood of survival. This is an industry slowly approaching the end of its growth phase, so strategy is key for firms aiming for long-term success.

### Opportunities for Risk

There are many corporate structures being used in the nutraceuticals industry. One of the more common styles among large firms is a network of independent sales contractors. The advantage is the savings gained from not paying salaries or providing benefits as you would with full-time employees. However, this strategy does not place the company in a position that can provide oversight and direction. The turnover rate for sales people is very high; due in large to the commission based structure that many find undesirable. Another risk linked to this strategy is the limited potential for further distribution. Companies that choose to distribute through independent contractors agree to not pursue other networks or means for distribution, in other words, they offer exclusivity. Thus, they forgo any opportunities that may be superior.

As previously indicated, consumer demands and trends are consistently changing. Companies in the nutraceutical industry must be able to respond promptly, or in a commercially appropriate way. With the amount of competition, they cannot afford to lose the first-to-market advantage. Competitors make it difficult to retain customers. Very few companies have strong brand loyalty, so customers are very likely to switch brands. This also applies to the sales staff; if a competitor is offering a better compensation package then the company will lose much of its salesforce. E-commerce is starting to become an increasingly noticeable risk. The web platform is ever more attractive for manufacturers because many of their products have long shelf lives, allowing them to be easily stored and shipped. Companies that developed a web infrastructure present substantial competition as their capacity for growth is higher.

For firms that do business with foreign markets, whether through their supply line or sales operations, they are subject to currency risk. Moreover, they are also subject to the political climate in the countries they do business. Arguably the most significant risk is inconsistent regulation across the global market. Meeting the demand of the domestic market does not necessarily carry over to the foreign market. The likelihood of supply chain disruptions will have an adverse impact on a company's level of production. Fortunately, there are many suppliers who can service the industry, but at a higher switching cost. For staple ingredients, many vendors request manufacturers to enter supply contracts for added security (Herbalife Inc, 2014).

### Summary

The nutraceutical industry is vast and provides opportunities for firms of all sizes to enter and complete. Given the high degree of market saturation, and the maturity of the market, the best strategy is to develop a new type of product. Competing with the existing products will prove to be very difficult, unless the entrant is capable of providing a strong brand to help improve recognition. In closing, the nutraceutical industry is growing. For investors, the firms to investigate are those who are trying to bring a new category of products to market.

## SWOT Analysis

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