SPEAKER ABSTRACTS

Magellan's Guide to the Diamond Universe

Elliot Tannenbaum

Ferdinand Magellan's voyage 485 years ago physically proved that the world is a globe and thereby forced a change in the way people looked at the universe and their place in it. Yet it took hundreds of years for the general populace to fully understand the ramifications of this discovery.

This can be used as a metaphor for the diamond industry, which has changed over the past 25 years from a small operation centered in a few cities into a truly global business. But the assumptions and attitudes of the industry have not kept pace with its growth, and it functions much as if it has not yet discovered that the "earth is round." So in order to have a meaningful discussion of diamond distribution, we have to challenge our assumptions about the diamond pipeline in particular and the diamond industry in general.

Challenging Assumptions

Knowing the Consumer. Our understanding of consumers is obsolete in terms of their numbers, spending power, geographic location, and access to information. Today's consumer has been empowered by technology to take control of the transaction.

Reaching the Consumer. The single vertical pipeline is obsolete, and today there is a multi-channeled path to the consumer. Coupled with a growing globalized market, this forces us to redefine such concepts as standardization vs. variation, globalization vs. localization, large companies vs. small. The result will be a forced rearrangement of companies into specialties that maximize their individual strengths.

Defining the Product. Our past understanding of the nature of the product we sell has become obsolete as a result of the introduction of branding, which redefines our product and therefore who our competition is. As part of the wider luxury goods category, diamond manufacturers and retailers will have to invest much larger sums of money on branding—on the scale of other luxury goods industries.

This can be looked at as a threat or an opportunity, as can other changes in the industry, for example:

1. The multiplicity of certification labs is often seen as a threat or a nuisance, but it actually provides an opportunity to give consumers a multi-dimensional understanding of diamonds, and create a more effective price-point system.
2. The upcoming movie about conflict diamonds is seen as a threat, but it should be considered an opportunity to improve the public image of the legitimate diamond industry by publicizing the industry's effective activities against the trade in conflict diamonds. The role of diamonds as the engine of Africa's growth is already evident to nations such as Botswana, and this is the time to carry the message to the world at large.

Rough Diamond Supply. Control of rough is shifting from the DTC to a larger group of mining companies and governments. Increased government involvement will lead to price increases, putting pressure on manufacturers from one direction. From another direction, manufacturers will be pressured by consumers to provide impeccable provenance. Combined, the two pressures will force manufacturers to come up with innovative solutions. This has already been done successfully by the food industry on the levels of supply, distribution, and retailing.

Conclusion

The changes required by our evolution into a global industry will be all-encompassing at every level of the trade. These changes will be as threatening, and as promising, to our industry as Magellan's discovery was to his generation.

Mr. Tannenbaum is partner of Leo Schachter Diamonds in New York.

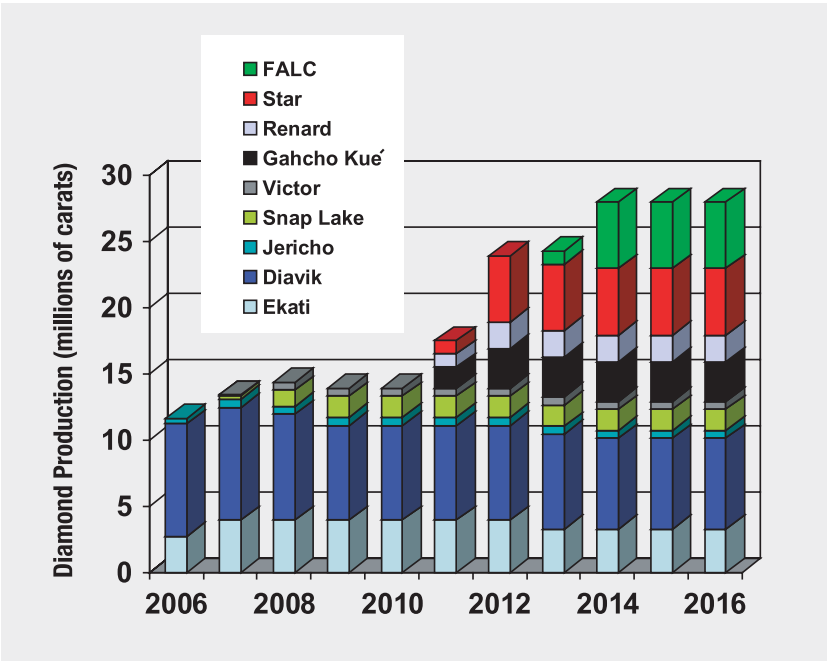
The Canadian Diamond Industry: Where to Now?

Martin Irving

Canada's appearance in the diamond world was sudden and unexpected, both by the industry and by Canadians themselves. Yet this impact has been impressive, and the country's potential is immense. The 1991 discoveries by Chuck Fipke and Stewart Blusson led to the first wave of diamond activity in Canada, the opening of two world-class mines in the Northwest Territories (NWT): Ekati (1998) and Diavik (2003). The second wave consists of production from smaller mines: Jericho (Nunavut, 2006), Snap Lake (NWT, 2007), and Victor (Ontario, 2008). Canada is the number-one target for global diamond exploration expenditures, which should ensure a third and fourth wave of production in the future. The third wave will likely include production from Saskatchewan, Quebec, and additional localities in the NWT and Nunavut. By 2016, it is estimated, Canada will be producing approximately 27 million carats a year for a total value of about US$3.5 billion. The province of Saskatchewan will likely be an important player in the future of Canadian production, since it encompasses the world's largest diamondiferous kimberlite field (with an estimate of more than 1.2 billion tonnes of ore).

However, the Canadian industry is more than just diamond mining. Canada's financial markets have become critical sources of equity funding for global diamond exploration companies, and its geoscience community is a key source of knowledge and expertise. Canada-based diamond companies have taken new and innovative approaches to the diamond business. The development of "Canadian" brands has impacted polished diamond marketing. Canadian companies are involved in diamond-related research and development, security, publications, training, and tourism. Canada is now truly a diamond jurisdiction—and its role will continue to evolve as the industry grows.

Mr. Irving (mirving@ir.gov.sk.ca) is manager of the Minerals Sector, Strategic Sector Branch, Industry and Resources for the Government of Saskatchewan in Saskatoon.



Over the next 10 years, diamond production from Canada will more than double, as several new mines come on line. Sources are respective company data from web sites and "Economic Impact of Diamond Mining" in Current Analysis by RBC Financial Group, June 2006.

Developments and Challenges of the China Diamond Market

Lawrence Ma

China's diamond industry has three facets: diamond processing, jewelry manufacturing, and domestic consumption. China processes around 4.5 million carats of diamonds each year, which translates into almost $1 billion in cut stones. In 2005, the country exported more than $6 billion in jewelry; diamond jewelry represented more than $1.25 billion of that total. By 2010, China is expected to account for 10% of global diamond jewelry exports. And China is now one of the few countries whose annual domestic consumption of jewelry exceeds $10 billion. With an average growth rate of 8%, China's jewelry market is predicted to surpass $20 billion by 2010, which would account for 10% of the world market.

Driving Forces for Growth

The Chinese diamond market has experienced great changes in the past decade, including the shift from a small manufacturing base to the world's second largest polishing center and most promising consumer market. The strong performance is a consequence of economic growth plus geographic and demographic strength, supplemented by suitable policy adjustments.

China has the world's fastest expanding major economy; it has grown at an annual rate of about 10% for the past two decades, which continued at 9.9% in 2005. By 2025, urban households in China will make up one of the largest consumer markets in the world, spending about $2.5 trillion annually—almost as much as all Japanese households spend today.

In addition, China is a vast country, with 27 cities that exceed 3 million in population. Understanding the cultural as well as tax differences between provinces is crucial to the success of a business in China. Among the overall Chinese population of more than 1.3 billion, the largest age groups are 20–29, followed by 30–39. These figures alone reflect the enormous growth potential of China's diamond market.

Policy adjustments following China's accession to the World Trade Organization and the establishment of the Shanghai Diamond Exchange (SDE) and the Shanghai Gold Exchange provided more stimulus for growth of the Chinese jewelry industry.

Today, foreign enterprises are allowed to 100% own and operate retail businesses in China. And after years of lobbying by the Shanghai Diamond Exchange for a reduction in the value-added tax (VAT), the government finally approved a VAT adjustment effective July 1, 2006. The VAT rate for polished diamonds imported through SDE was cut to 4% (from 17%). With these moves, the Chinese government is creating one of the world's most favorable markets for diamonds.

Challenges and Opportunities Ahead

The size of China's population, the increase in wealth and income, and the growing awareness of western lifestyles promise a bright future for the diamond market in China. There are opportunities for growth and development in which local companies and foreign enterprises can take part. However, much work remains to be done and care has to be exercised, especially given the many different consumer markets that China encompasses. As the jewelry retail market continues to grow, there is a lack of expertise and management to support this rapid expansion. Finding the right partner is vital to the long-term, healthy growth of the diamond industry.

China is evolving from a relatively monolithic, poor country into a vibrant marketplace with complex and rapidly developing consumer segments. Price competition alone will no longer be the best means of survival. After years of rapid market development, consumers are becoming more sophisticated and demand for unique designs and branded jewelry is rising.

There are many challenges in the Chinese diamond market, but for companies that anticipate the changes that lie ahead, the opportunities will be as vast as the country itself.

Mr. Ma is executive director of Lee Heng Diamond Co. Ltd. in Hong Kong.

Battle of the Minds

Glenn Rothman

Why did so many of us come from all over the world to San Diego, to the GIA symposium? Well, some of us came to see friends and colleagues, learn something new, find a potential customer, or be seen or, better yet, heard. But all of us came to figure out "Where am I going to end up in all of this massive change? How will it affect me personally, my family, my business, my job, my customers, and the entire diamond world?"

This is a very unifying thought. We may be a heterogeneous group—vendors, customers, competitors, service providers, trade organizations, and publications—but we're all in the same boat: "Where will I be in my career in seven years, at the next Symposium?" Can we continue to grow, learn, and thrive through these market changes?



I can hear some of you asking "How tough is the business environment out there? Maybe I'd be much better off if I liquidated my inventory and placed my capital in tax-free bonds. At least I know I could safely earn 4% net profit a year, without any risk, and without working. Or perhaps I could use my skills to prosper in another industry. My intuition is telling me the playing field is going to get harder. Low margins (so I don't have room to make any real mistakes), tough supply, my customers don't want to pay me, and my expenses are going up, including the cost of money."

These are huge challenges and they are industry wide, because we all depend on each other in some way to continue growing consumer demand.

What we have lost sight of is the magical life of our precious diamond. Life is light, and the power and magic of light is what a diamond does. It is a magical crystal that captures all the light, bounces it around internally like no other material, and sends it back to your eyes in a rainbow of colors. It is many millions of years old. That is continuance! A diamond symbolizes and acknowledges all of life's stages, all of our changes in identities. Diamonds are indeed forever, as they become part of a family legacy from generation to generation—my mother's diamond, my grandmother's diamond.

When you really think about, a diamond is a brand in itself. It has a brand promise, intrinsic meaning, and iconic status; emotional value is created in the mind of its owner. And this is where the challenges and opportunities arise. Brands need to focus on the brand's promise, its emotional value. Every time we think outside or contrary to that promise we have problems. We are off-brand. Our minds have wandered to price or supply. We are transaction motivated, when the focal point should be on the diamond and the life it brings.

DTC, retailers, manufacturers, and an entire trade have spent many hundreds of millions of dollars creating the brand meaning, creating the emotional desire, and yet we act off-brand and sell price. What we need to do as an industry is strengthen this brand, with true enthusiasm and excitement at every level of the pipeline.

Many of you think you can't change so you don't change. Yet it starts with you. I have a good friend, Gary Hill, who calls it "the Battle of the Minds." Our primary focus is on a good deal: How much back of Rap can I buy it for and how many Rap points can I make when I sell it? This is a description of a commodity-based, transaction-driven business model. The only profitable level of this business model is in the mining end. If you are an extremely sophisticated, cutting-edge manufacturer, you have a chance at a decent return on capital. Everyone else in the middle is challenged by no real margins. The real success stories have developed niche business models and have overcome the "Battle of the Minds." When we begin to embrace the business practice of being "on-brand," in focusing on the meaning of the diamond, we start to believe in margin.

The battle of the minds over margin at retail starts with the store owners, who define themselves as expert price specialists. The battle is with their own identity.

The battle for salespeople is a little easier, because they believe in the owner and the business. They can be trained and given incentives to overcome their mindset. And then it goes to the consumer, which is even easier.

My personal theory is that the diamond-buying public wants to pay more for their diamond and its life-changing experience. It is a measure of who they are and how much they love the recipient. If a man is really in love, he wants to pay more. Of course, there will always be the bottom 20% of consumers who are not buying the diamond's brand promise. They are only purchasing because they have to. They will buy price, and most likely on the Internet if at all possible.

Our goal as an industry should be to strengthen the passion, excitement, and meaning of our precious diamond. Do you know what will happen if each and every one of us contributes to the excitement? Instead of all the luxury dollars going to adventure travel, home entertainment centers, and expensive handbags, shoes, and clothing, the dollars and margins will flow back to the meaning and passion of diamonds.

Mr. Rothman is CEO and founder of Hearts On Fire in Boston.

Diamond Industry of the Future

Martin Rapaport

The diamond industry is undergoing a period of fundamental restructuring. All segments of the distribution pipeline are under severe pressure.

African governments are asserting control over diamond resources, demanding black ownership of mining companies and questioning why African jobs are going to Indian cutters. De Beers sightholders, forced to establish downstream marketing channels or lose their rough diamond allocations, are destroying vital middlemen and competitive markets, resulting in an almost total lack of liquidity and a financial crisis.

Retailers are also under pressure as higher oil prices and interest rates diminish the middle-class luxury wallet. Profits are low, competition is fierce, and liquidity is very tight or nonexistent.

In my view, mining companies with their overpriced rough and downstream demands have turned diamond cutting into a losing business. How can cutters pay cash for rough and sell polished on long-term credit only to have retailers return the diamonds they fail to sell? Our first-class cash diamond business has been reduced to a beggar's market, where cutters beg retailers to take diamonds on memo. The industry is losing its pride and confidence in diamonds.

And now let us consider the movie "The Blood Diamond." While industry organizations and their PR firms tell us and our customers that the Kimberley Process has taken care of the conflict diamonds problem, the fact is that Sierra Leone is today the second poorest country in the world. The problem is not the movie or holiday sales. It is the fact that one million diamond diggers in West Africa are suffering and the diamond industry does not care. How can it be that over the years more than one billion dollars of diamonds have come out of Sierra Leone, and yet it is the poorest country with one of the highest infant mortality rates in the world? Does anyone care? Do you care?

Figure 1. These diamond diggers are panning for rough in the Kono region of Sierra Leone. Diggers are paid anywhere from 60 cents and a cup of rice to $2.30 per day. Photo by Aryeh Rapaport.





Figure 2. Some diggers in the Kono region are financed by "supporters" who pay the digger's medical bills, plus a cup of rice and a dollar a day, in exchange for diamonds found by the digger. Diggers often go into debt to their supporters, creating a cycle of poverty and indenture. With Fair Trade diamonds, the diggers can operate independently of supporters and have a chance to create a better income. Fair Trade diamonds will give money back to the diggers' communities to develop schools, hospitals, and wells. Photo by Aryeh Rapaport.

The time for change has come. While solutions including the establishment of cash commodity diamond markets and Fair Trade diamonds from West Africa exist, the core issue challenging our industry is our ethics.

We must recognize that large firms do not have the right to use their market power to willfully destroy efficient smaller firms. That we need fair competitive markets that provide equal opportunity for all. That not paying a bill on time is dishonest and unethical.

We must recognize that the diamond dream must be shared by all and that we must be responsible for what we buy. The diamond dream cannot be only for mining companies, their large clients, and western women. The dream must be shared with African diggers who are as much a part of our industry as anyone else. We must accept the fact that no matter how good our intentions, our dream must never be someone else's nightmare.

Mr. Rapaport (rap@diamonds.net) is chairman of the Rapaport Group of Companies in New York.