



## **AWI's WOOL SELLING SYSTEMS REVIEW**

**September 2015**

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### **NSW Farmers' Association Background**

The NSW Farmers' Association (the Association) is Australia's largest State farmer organisation representing the interests of its farmer members – ranging from broad acre, Livestock, wool and grain producers, to more specialised producers in the horticulture, dairy, egg, poultry, pork, oyster and goat industries.

## **Executive Summary**

The challenge facing the review panel lies in proposing and developing a well targeted response to the failure of the market to adopt innovative methods. This response needs to be appropriately coordinated with all levels of the supply chain.

With its proposal of the Wool Exchange Portal (WEP), AWI has an opportunity to actually drive a new vision for the industry. NSW Farmers is completely supportive of this but urges the panel to specify how they think that their proposal will be implemented. The importance of this review lies not only recommending improved transparency but, more particularly, identifying the available means and the opportunities to do so.

The fact that the vast majority of wool is sold via the 'open cry' system underlines the conservative nature of the industry but it is also a result of the lack of leadership across the industry. Future use of new technologies to achieve improved operational efficiency is dependent on all players in the supply chain recognising and championing the value of the opportunities available.

Therefore, success will depend upon the panel's ability to identify and recommend constructive advances. If the panel fails to put forward vehicles for change, through the WEP model or otherwise, it will have failed in its duty. The final report of the panel must not be limited to the WEP and describing only the nature of existing services that are currently available to growers.

The panel should articulate how the WEP (the substantive recommendation to come from the review) will drive any change into the future and what opportunities it may create if it is to be supported. Further, a number of ideas have been put to the panel about the selling of wool. Are any of these worthy of further investigation or have the possibility of being validated with further research?

Finally, as advocates for wool tax levy payers we had hoped that this review would deliver to wool growers a starting point for industry discussion and ultimately reform. At this point it is unclear if tangible benefits will result from the review, i.e. in greater competition for wool or savings in logistic costs. It could be argued that a WEP may lead to greater transparency of costs and information which will benefit growers. As the final days of the review process draw near, we urge the panel to more clearly articulate the value of the review to assure growers that AWI is spending their money wisely.

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## **1. Approach**

### **1.1 Background**

The NSW Farmers' Association thanks Australian Wool Innovation (AWI) for instigating the Wool Selling Systems Review (WSSR). As AWI is aware, NSW Farmers has been had a long term interest in various aspects of wool sales.

NSW Farmers is Australia's largest state farming organisation representing the interests of the majority of commercial farm operations throughout the farming community in NSW.

As noted in the NSW Government's recent report on the future of the wool industry, NSW has the largest sheep population and is the largest wool-producing Australian state. If it were a country, it would be the world's fourth-largest supplier.<sup>1</sup>

NSW Farmers made a preliminary submission to this review process (in March) and outlined our support of moves to make wool preparation simpler and cheaper while still meeting processor requirements.

### **1.2 NSW Farmers' Policy**

In our preliminary submission, we underlined the need for growers to be more responsive to market forces and suggested that "better education of growers to the already extant alternatives, via extension or market forces, may be – in the end – more efficient than making radical changes to the existing system".

In this respect, we welcome the proposal for a Wool Exchange Portal (see below, Section 4), because it meets this essential requirement of education and, hopefully, meets it with market forces. However, recommending the Wool Exchange Portal is only one part of the responsibility of the panel – NSW Farmers feels that the review needs to identify other opportunities for improvement. This is particularly important in the context of the market failure in the selling space, *i.e.* failure to drive and promote innovative selling mechanisms.

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<sup>1</sup> Pattinson *et al.*, 2015 *NSW Wool Industry & Future Opportunities*, A report to the NSW Department of Primary Industries from Miracle Dog, Poimena Analysis, Scott Williams Consulting and DAFWA, p. 24

## **2. Operational Efficiency**

### **2.1 Australian Wool Testing Authority Ltd (AWTA) and Wool Testing**

NSW Farmers notes the panel's observation that the wool testing market is not competitively neutral" in that AWTA operates with an advantage over new entrants. NSW Farmers shares the view of wool growers, as outlined in the July discussion paper, that growers have been "well served by AWTA Ltd as it currently operates."

NSW Farmers has been consistent in expecting a clear and transparent service from bodies as they provide feedback to growers on wool clip testing.

We note that one of AWTA's objectives is to 'encourage to provision of data processing services aimed at the more efficient marketing of wool'. The panel suggests that there is a case for supporting R&D to scope further technical and commercial developments. In particular the panel highlighted 'in shed testing'<sup>2</sup> and NSW Farmers is 100% in support of of further work to support this.

### **2.2 Post-Sale Charge (PSC)**

NSW Farmers notes the difficulty the panel encountered when trying to ascertain whether the PSC is excessive, or whether it supports cross subsidisation of brokers' pre-sale services, "due to the lack of transparency as to the quantum and the composition of the PSC." NSW Farmers has always been of the view that greater transparency is required and supports the panel's recommendation that there should be greater discussion between woolgrowers and brokers.

### **2.3 Sale by Description**

NSW Farmers agrees that further technological development to support sale by description may be warranted. The Association supports the establishment of sale by description, electronic sale and direct marketing between growers and processors.

### **2.4 Awareness of Alternative Selling Options**

As we noted above, NSW Farmers recognises the need for growers to be more responsive to market forces and in our preliminary submission we suggested that "better education of growers to the already extant alternatives, via extension or market forces, may be – in the end – more efficient than making radical changes to the existing system".

In this respect, NSW Farmers supports the development of the proposed Wool Exchange Portal (WEP). However, we feel there is more work to do in articulating the value of the WEP and, specifically, how it will drive interest and liquidity in the forward markets for wool (see below).

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<sup>2</sup> As almost all samples taken on farm are tested elsewhere, there is basically no 'on farm testing'. Although wool testers such as AWTA can issue 'guidance test' results from the farm samples that they are sent, it might be better to refer to 'on farm sampling' rather than 'in shed testing'.

### **3. Pricing Efficiency**

#### **3.1 Further Centralisation**

The Association notes the projected savings of \$32 million over ten years of moving to a one-centre model, but also notes that this is based on an analysis of wool sales over five years ago (notwithstanding the analysis provided in the discussion paper). NSW Farmers sees a role for commercial interests to advocate to growers how centralisation would result in greater prices at the farm gate.

In the end, market forces will determine whether centralisation in wool selling centres occurs but the growth of online selling and/or advances in electronic trading are more likely to break down the stranglehold of the auction system. It may be that the distance travelled to the processor and how that cost is apportioned to the grower in a 'direct to buyer' scenario vs the costs of transport to the auction centre which will, inevitably, drive choices.

#### **3.2 Commission Buying**

The Association notes the panel's observation that increased support of wool sale by description would enable greater electronic selling and decrease the anti-competitive effect of commission buyers. We also acknowledge that the current practice of combining small lots does make it more challenging to ensure a clean, efficient product to overseas markets.

We further note that the panel is advocating that growers 'go around' commission buyers by using other, alternate selling methods (private treaty, vertical trading *etc.*) including greater use of online selling. The panel notes that this is more common in livestock trading than in the wool market, resulting in the decline in smaller local saleyards. It is worth pointing out that in the livestock sector, growers continue to cite difficulties at the hands of commission buyers at saleyards and NSW Farmers advocates a stronger code-of-practice for buyers. Our wool committee's policy is consistent with this view. However, we further note, that now that the average flock size is 2,000 head, there needs to be more options available.<sup>3</sup>

#### **3.3 Modernisation of the Selling System**

NSW Farmers agrees with the panel's observation that electronic trading holds considerable promise to increase 'remote' buyer access. However, as the panel notes, the dominant impediment is the lack of take up by growers (when online transactions make up only 5% of wool sales).

History tells us that enlightened action by industry service providers, or an individual service provider, can have a pivotal impact on the nature and operation of industry services *e.g.* when innovative wool broker Economic Wool Producers (EWP) introduced sale by sample and description enough of its win/win merits were readily assimilated by

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<sup>3</sup> Pattinson *et al. op. cit.*, p. 35

its competitors and it quickly replaced the relevant parts of traditional handling procedures.

However, over a decade later in 1984, when the fully computerised and commercially proven sealed bid/sale by tender process also established by EWP, in accordance with its favourable endorsement in the 1972 AOMP Report, was acquired by Dalgetys the relative merits of this concept were clearly not recognised and it was terminated without further consideration in favour of returning to the traditional auction process. It is within this context the NSW Farmers' Association recommends the consideration of the concept described as "A Better Way of Selling Wool" as is contained in Professor David Cottle's R&D proposal already submitted to AWI.

We emphasise that any new proposals need to bring brokers, exporters, and early stage processors along (*i.e.* effective consultation) as it is they that will be the ones that will need to embrace any new 'systems'. The Panel must articulate how new ideas will be delivered.

Part of the challenge lies not just in identifying innovation but on establishing extension/education programs that have the capability to build farmer confidence, and competence amongst industry service providers so that the industry can become more efficient. We understand that the panel proposes that this need would be met by the WEP, but the WEP itself will need to be marketed to growers. Unless new offerings are well targeted, and appropriately coordinated with all levels of the supply chain, mainstream application of new mechanisms are likely to remain tantalisingly out of reach.

## **4. Wool Exchange Portal (WEP)**

### **4.1 Scope and provision of the WEP**

The power of the WEP will depend entirely on the strength of its offerings. Industry tradition has perhaps stifled advances made available to growers by service providers within the existing supply chain, resulting in unnecessary costs. The panel has suggested that the WEP will provide 'access to opportunities'. NSW Farmers underlines that the power of the WEP will be directly related to the real time information provided and the actual ability for farmers to access multiple selling platforms via the WEP.

### **4.2 Participation on the WEP**

We note the 27% decline in wool production in NSW & Queensland in the ten years to 2013/14. In addition, the offering volumes in Sydney in 2013/14 were about 44% lower than in 2003/04.<sup>4</sup> We estimate that the average clip size is now approx. 45 bales. The issue is then how will the WEP or anything else provide opportunities/incentive for a large number of relatively small producers – there is a need to engage those growers in any system. The dominant theme of wool industry is lack of interest in innovation and technology – growers may need data to support a change of behaviour.

### **4.3 Buying and Selling Options**

We question whether the WEP will facilitate forms of selling other than the auction system. To date other systems have been slower than, and not as transparent as, the auction system, perhaps because of the lack of critical mass. Any new innovation, including the WEP itself, requires significant buy-in from growers to be effective and compelling. By extension, all of industry will have to see a benefit in it for successful implementation.

We note that there are many different ways to sell wool now if growers choose to do so: direct to mill, electronic sale (e.g. on Auctions Plus) either in a live auction or on the offer board, fibre direct, etc. are all available now if growers would like. However, the sequential open cry auction process remains both the central yardstick in discovering price but also something of a millstone around the neck of the industry. This is not only due to its limitation on the number of bidders able to access the process but also on the instability of its process of price discovery.

In addition, the WEP should play a role in identifying and facilitating products that can be developed for the market that may improve finance options for exporters, allowing growers to be paid promptly and for the exporter to have access to cheaper/more capital and hence liquidity in the market/forward market for wool.

It is the broker/manufacture that will drive 'take up' of the WEP so growers will need them to take it forward but also to engage with major overseas buyers. Currently, the Chinese seem to want the exporter to take control of the supply chain and these market realities must be taken into account.

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<sup>4</sup> *ibid.*, p. 45



#### **4.4 Key Questions for Industry**

1) Who will develop?

The success of the WEP is dependent upon it having enough buy-in from growers and therefore it must be commercially viable. In view of this, it would make sense for private enterprise to drive the development of the WEP, with input from industry.

2) Who will own?

Industry should 'own' the WEP, while commercial interests may draw profits from it in order to provide for ongoing upgrades to ensure a sustainable product.

3) Where would it start and finish?

Its interests should extend at least from sheep's back to monitoring quality in wool tops.

4) How would it generate income?

See above, question 1.

5) What roles would industry bodies AWEX, AWTA and AWI have in the establishment and running of WEP?

The independence and integrity of AWTA and AWEX seem to provide confidence to early stage processors. The integrity provided by this must be matched by new methods of selling wool if they are to have a chance of engaging with these important parts of the trade.

## **Conclusion**

In its recent review of the NSW Wool Industry, the Department of Primary Industries concluded:

The wool industry is perceived by many as unattractive, for reasons (true or otherwise) that include low profitability and productivity, technological backwardness and a lack of vision.<sup>5</sup>

With its proposal of the WEP, AWI has an opportunity to actually drive a new vision for the industry. NSW Farmers is completely supportive of this but urges the panel to specify how they think that their ideas will be implemented.

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<sup>5</sup> *ibid.*, p. 18