

Submission

Wool Selling Systems Review (WSSR)

To:
Australian Wool Innovation
Review Panel Discussion Paper Two
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WAFarmers Federation

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Agriculture in Western Australia

The Western Australian Farmers Federation Inc. (WAFarmers) is the State's largest and most influential rural advocacy and service organisation. Founded in 1912, WAFarmers boasts a membership of over 3,500 farmers including grain growers, meat and wool producers, horticulturalists, dairy farmers, commercial egg producers and beekeepers. Collectively our members are major contributors to the \$7.2 billion gross value of production that agriculture in its various forms contributes annually to Western Australia's economy. Additionally, through differing forms of land tenure, our members own, control and capably manage many millions of hectares of the State's land mass and as such are responsible for maintaining the productive capacity and environmental wellbeing of that land.

WAFarmers welcomes the opportunity to provide comments to the second discussion paper as part of the wool selling systems review.

Introduction

Whilst WAFarmers welcomed the current wool selling system review, we are concerned the Review Panel has tended to focus its efforts on the development of the Wool Exchange Portal (WEP) whilst brushing over possible logistical changes, which could result in significant cost savings for wool growers.

The concept of the WEP has merit but it doesn't address the issues of excessive cost in a convoluted supply chain, and we question why a new web based portal should be developed at considerable expense, when there are a number of electronic platforms already available.

The Panel must articulate how the WEP will drive future change, benefits and opportunities and what the business model will be to support its development and long term maintenance.

WAFarmers is strongly opposed to AWI using any levy funds to develop or maintain a web based wool exchange portal. If during this process, evidence indicates the majority of wool growers paying the levy are supportive of an independent web based marketing portal we must be assured an alternative funding source will be found to support its development.

It is extremely difficult to develop a policy position on the WEP until the Review Panel provides the industry with details of the proposed business model to support the portal's development and maintenance over time.

We cannot ignore the fact that wool levy contributions will continue to decrease and therefore it is important for AWI as an industry owned RDC, to target its resources on the completion of production based research projects, rather than divert limited funds in to the establishment of WEP with no clear evidence to indicate the portal will be of benefit to wool growers or secondly will be used by the majority of levy payers.

To reinforce this point, we understood from the stakeholder meeting in Melbourne that there is considerable duplication and cross subsidisation of charges within the wool selling system. If the

Review Panel really wants to ascertain a beneficial outcome from this review it could consider a realignment and reduction of the fees charged and look at ways to ensure the long term year on year demand that provides a forward market for wool that would lead to hedging/mill relationships for products. Until this happens it will still be a volatile, high risk market to sell into.

Please find below WAFarmers comments to the three main priority areas.

1. Operational Efficiency

We are not convinced the Review Panel has really addressed the core fundamentals required to establish a long term and orderly selling system for wool to enhance returns for all businesses involved with this unique value chain.

1.1 AWTA and Wool Testing

In terms of wool testing we need to ascertain what tests are absolutely necessary to meet buyer requirements. Wool growers are questioning why they are paying for a plethora of tests which may not be required. For example, we need more research on how we get better objective tests to get better top predictions.

Wool growers need a feedback service from the relevant body that provides clarity and transparency on wool clip tests demanded by the buyer and the fees associated with this testing.

On-Farm Wool Testing:

In-shed wool testing is currently available but there are accuracy issues and additional cost implications. For this reason we don't believe a push for on-farm testing will achieve the desired outcomes.

Wool test validation completed in a bonded store provides the best guarantee to all parties. AWTA does not have the same controls if wool testing is completed in a grower's woolshed and an unintended consequence of on-farm testing is that a wool grower would forfeit a claim against AWTA if a problem about validity occurred. Wool test validations are important if selected wool categories are to be sold sale by description electronically.

Post Sale Charges (PSC)

Clearly, we note the Review Panels difficulty in trying to ascertain clarity around post sale charges and cross subsidisation of Brokers' pre-sale services. For example, growers have questioned whether the PSC is incurred if the wool is not dumped?

WAFarmers believes any hidden charges will distort price transparency and accurate market reporting. We question why wool growers are paying for these post sale charges which may already have been accounted for in pre-sale charges.

Electronic board reporting could help to provide clarity and transparency around the various charges to get the most cost efficient system before and after the change of ownership. A value chain analysis could be used to diagnose and create competitive advantages on both cost and differentiation.

WAFarmers suggests that whilst we acknowledge there are costs to the wool grower, some of these appear to lack transparency and are possibly duplicates. For example,

- The warehousing cost would appear expensive
- Is the Brokers selling commission in-line with other Broker selling commissions in other industries, e.g. real estate, finance, insurance, etc.
- Insurance to store and transport would seem high based on any probability of loss in an accident or in store.
- Buying costs – what are these, is it another Broker fee?

Any review of and reduction of the cost will increase the amount received by the wool producer, even something as small as 3% will add significant dollars to the cheque received by a producer.

Just to use a basic example: A wool grower shears 2000 sheep each cutting 5kg/head greasy wool, to produce a 10,000 kilogram clip, valued at 1200c/kg (21 micron). With current “costs” at 95.38 cents per kilo, a 3% reduction in costs to 92.5 cents per kilo equates to an extra \$288 in the growers pocket. If the cost was reduced by 7% to 88.7 cents per kilo the extra return to the grower would be \$668. If we spread this calculation across Australia and assume there are 1000 wool growers in Australia producing 10,000 kg wool clips, then the saving to the industry becomes \$288,000 at 3% or \$668,000 at 7%.

In an industry where the seller is a “price taker” not a “price maker” every dollar counts. To maintain an industry you need to demonstrate profitability in the industry, to do this, you need to give every dollar possible to the producer. No profit will eventually lead to no industry.

If we want wool growers to stay in wool production, let alone try and encourage new ones into the industry, then everyone in the chain needs to trim their take.

WAFarmers also recognises there is a gap in real commercial knowledge in what some wool growers really should know. However, we question whether a WEP can provide this knowledge because the chances of them using it could be debatable. We do believe the majority of switched on wool growers know their options already. More importantly, it still comes back to not having a long term, year on year contract that provides a forward market for wool categories.

WAFarmers would strongly encourage the Review Panel to further analysis pre and post-sale charges to get a better handle on transparency issues.

2. Pricing Efficiency

Wool growers already have a multitude of selling options, including web based portals like Elders WOOLTRADE or ActionsPlus Wool. In a world of computers and technology there is no reason for not being informed as to what value your commodity, be it grain or wool, is worth on any given day. Spearwood Wool offers a weekly price update for prompt selling out to two years in advance to its clients.

Centralisation

Earlier in the year, WAFarmers suggested an investigation could be had on having one selling centre possibly in Melbourne. However, after a thorough review of the options WAFarmers fully supports the continuation of the wool selling centre in Fremantle.

Western Australian wools are primarily destined for China as commercially good top making wools for this market. There is the potential for WA wools to be discounted if sold in Melbourne because of visual differences compared to wools produced in the high rainfall areas in the east. The visual valuation of wool still plays a large part in the overall purchase of wool and buyers look to match large parcels of wool that look similar.

The fact that WA operates on the same time zone as China has seen many companies trading directly out of WA and also completing post sale operations (batching/shipping, etc.) out of WA ready for start of business in the east the following day. There are significantly less costs and logistical advantages of selling wool in Western Australia and this trade must continue.

Another key factor to consider is wool, or woollen items, do not have a forward market simply because we have not been able to establish year on year demand that the garment makers/weavers/ spinner are able to consistently or confidently predict what type or how much wool they require for the next season or beyond. The 'Ice-breaker' brand from NZ for example, has established long term demand and as such can offer their growers three year contracts.

3.0 Consolidating and Improving Selling Choices

A huge amount of work must be done by the Review Panel to articulate the value of a WEP before the industry will support its development.

Without any detailed information to support the WEP, WAFarmers cannot support its development and certainly does not support any use of wool levy funds for this concept.

We certainly question how the portal will drive interest and liquidity in the forward markets for wool.

To operate a web-based portal proficiently and with the expertise it will require, the Review Panel must provide robust details on the business model options, which may be used to fund the development of the wool exchange portal and its ongoing running costs.

If we look back at history for a minute:

Greasy wool futures were traded by the ASX right up to April 2014 when it was delisted because of volume and contract specification demand issues.

In Australia, exchange traded derivatives are traded through the Australian Securities Exchange (ASX). Australia has one of the largest derivatives markets in the Asia-Pacific region. Derivatives trading via an exchange in Australia commenced in 1960 with the Sydney Greasy Wool Futures Exchange which became the Sydney Futures Exchange, before merging with the ASX. The options market opened in 1976 and the warrants market in 1990.

The wool industry was one of the first to extend the use of computers and electronic technology from traditional financial and accounting functions to assist in improving the efficiency of the business operations within the industry. So, we should not under-estimate the innovativeness of the wool industry.

We need to consider the reasons why the majority of wool is still sold through the open cry auction system and not via electronic platforms. If the latter is to resume, perhaps this should be driven by the market place rather than through a research development corporation like AWI. In the end, market forces will determine whether centralisation in wool selling occurs, but the growth in online selling and/or advances in electronic trading, particularly for cooperative based consolidated wool lots, is more likely to change the preference for the auction system.

Recently, WAFarmers spoke to one of the Directors of an E-bay type wool selling company initiated six years ago. The business partners (including wool growers and brokers) invested \$1.5 million in I-Trade Wool, but after six years they had not been able to convince most producers to sell wool online.

It could be said that having fourteen levels of a supply chain with nine different routes is not the most efficient system operating in today's modern IT based culture given that you can now integrate finance and banking, freight and logistics along with warehousing and trace systems all via the internet.

We are also aware there are platforms in place to sell wool direct to China but there has not been a lot of support to date. The million dollar question is whether the time is right to invest in a web based portal as is being suggested. It is impossible to answer this question until a detailed business plan around the options is explored and presented to levy growers.

WOOLTRADE is the second most used platform system after the auction system. It has a reserve and access for international buyers. However after proper consultation with wool growers, both commercial and stud breeders, the general view on the WEP is to leave it up to the trade to develop it and most felt it wouldn't be a good use of levy income. It was suggested AWI should stick to aligning wools with high profile brands like they are doing, as this a better use of levy funds. Many questioned whether the WEP would provide greater returns at the farm gate and most believed the WEP is a distraction from AWI's core business objectives.

The benefit of a WEP is it consolidates all existing systems in to one place; it could act as an information repository and assimilation of market information.

Smart Order Routing allows hedging of bales of certain quality and suggests best buyer opportunities and helps issues with multiple bids and centralisation. However, wool growers are not interested in hedging wool as they use other commodities to cover the risk on wool. The size and dimension of the wool market doesn't warrant such an investment within the wool portal. We only have small volumes of wool and volume is shrinking whereas the liquidity and volume of other commodities like wheat is increasing.

A significant issue for the wool industry is the need for liquidity assurances to knock down volatility spikes. Long term brand based forward contracts would resolve this. At present, a percentage of

short term forward contracts are offered at below spot market price. How would the portal resolve these issues?

An option that could be considered is the use of an existing platform like Clear Grain Exchange, or one of the Meat and Livestock Australia (MLA) developed web based portals, which levy payers have already contributed to. Why re-invent the wheel. We must not forget that poor liquidity is the biggest issue for the wool trade. Wool is a boutique/niche market product. Using an existing platform could encourage new entrepreneurs into the sheep industry.

At an industry meeting hosted by WAFarmers in Katanning in August, which Paul Swan attended, there was good support for re-introducing sheep into the main cropping areas of WA.

We could also investigate the option of developing a wool selling system smart phone application (app) linked to a crop trading platform to encourage participation in both commodities even on a share farming related basis.

The Review Panel has made reference to the potential of setting up a Cooperative to support the WEP, where wool growers can access markets, services and products. An important consideration for wool growers in joining a cooperative is that their membership gives them equal ownership of the cooperative, providing them with control of its activities and services. As a member of a cooperative small bale lot owners can take advantage of combining lots of the same characteristics to capitalise on values. Members have equal ownership which should motivate participation.

CBH in Western Australia is a grower-owned, highly successful cooperative. Cooperatives are people-centered and are owned, controlled, used and invested in by their members, who have a responsibility to support their cooperative by being an active member. In return, the cooperative must ethically service the needs of its members.

Their democratic nature means that all members are equal decision makers, with one vote per member, enabling members to determine the decisions their cooperative makes. Active membership is mandated by the law, and its nature is determined in the cooperatives rules. Active membership is the 'quid pro quo' for democratic control of the entity.

To conclude we offer some key questions to be answered before the WEP recommendation progresses.

- Smart order routing is mainly a broker tool, how does this help growers?
- Who will have ownership of the portal in the short, medium and long term?
- Will the portal sell services and shelf space advertising on the portal and who will get the financial benefit of this?
- How will the portal integrate with existing selling systems?
- Will buyers have the confidence in the quality assurance/assessor validations?
- What education campaign will support the portal and who will pay for this?
- The portal could open opportunities to younger entrants, entrepreneurs from other sectors.
- We need to ascertain participation rates and liquidity derivatives.

- Consolidation of services generally means decreased product prices to growers – will the portal bring more buyers to the table to increase demand or have the opposite affect?
- Would the formation of wool based cooperatives shorten the logistics chain on page 9 and act on behalf of grower members in the portal? What is the definition of an ‘orderly marketing systems’?
- The wool marketing world is changing and we do need to support different marketing options. The portal may offer a collective system to deal with aggregated lots.
- Will the portal assist price elasticity? The more elastic the price, the more the buyer gets the advantage. We need evidence to say the portal will open up the industry to new buyers as competition pushes prices up to wool growers.

WAFarmers does not believe investing levy income into the development of a web based portal is good use of the levy.