

# AUSTRALIAN SUPERFINE WOOL GROWERS' ASSOCIATION INC

ABN: 41 338 467 905      REG. No. A0019005S  
UNIT 9 / 42 - 46 VELLA DRIVE, SUNSHINE WEST VIC 3020, AUSTRALIA  
T: 03 9311 0271      E: aswga@woolindustries.org      F: 03 9311 0138  
www.aswga.com



17 March 2015

ASWGA-15-051

Mr John Roberts  
Executive Officer  
AWI Wool Selling Systems Review Panel

## **ASWGA Wool Selling System Review Submission 2015**

Dear John,

ASWGA appreciates the extension time to complete our submission and the opportunity to add to the discussion. The following submission is a compilation of members' views and we trust the panel will find them beneficial. Additionally there are three attachments that are relevant to your review.

Please do not hesitate to be in touch with any queries you may have on information contained or questions that may arise.

Kind regards,

John Taylor  
President

---

***Thank you to our ASWGA Sponsors in 2014***



What can really make a difference to increase the potential return to woolgrowers is to review what are the price makers that are currently in the system and what additional price makers do we need to include in the system.

We thank you for the opportunity to submit our member's views on the Review Panel Issues Paper. ASWGA is more than happy to answer any queries you may have on information contained or questions that may arise.

ASWGA's priority setting for the WSSR three key objectives are:

- a. evaluate whether greater efficiencies and cost savings within the exchange of ownership between the seller and the first buyer are attainable – *Efficient and cost effective systems are always important however this is a lower priority than (b).*
- b. understanding the potential for increased competitive tension throughout the wool selling process and how it can be achieved, and – ***This is the highest priority for ASWGA as competitive tension is all but absent in the current wool market.***
- c. determining whether there is sufficient transparency within the exchange of ownership to allow woolgrowers to make the most informed commercial decisions about their wool growing enterprise. – *The greater balanced and accurate knowledge held by the woolgrower, the better our decision making process will be.*

## **PHASE 1: WOOL PREPARATION**

### **Extra Costs of Production specific to Superfine Wool**

It is worth noting that while the Australian clip average Lot size is 5 bales; in high crimping SF fleece wool 18.5 – 15.6 the average Lot size is 3.4 and in UF fleece wool <15.5 the average Lot size is 2.6. If this included high crimping oddment wool in these categories the average would fall.

Depending on the enterprise ASWGA members' wool preparation can include any or all of the following points raised by members.

- Production and preparation of superfine wool has been a specialised activity for many years. This involves extra shed staff at shearing when the fleeces are being skirted and more attention is paid to detail by the SF & UF Wool Classer. In SF & UF wool preparation using 3 shearers would require a minimum of 2 rousabouts 2 wool rollers a Classer and a presser.
  - To produce the best 1PP superfine bales, sheep are coated and these coats will need replacing as the wool grows, fleeces are often double skirted, backs are taken out and only the very best sections of any fleece are included.
  - In a stud operation shearers are paid 1.25 times for stud sheep and double the award rate to shear rams. Rams also have to be sedated.
  - Increasing occupational health and safety regulations are payable by all growers depending on the length of the shearing process. SF & UF shearing is a longer process on a per head basis therefore this cost is greater per sheep on specialty wool enterprises.
  - The rams head logo along with Growers membership number used on bales of ASWGA members wool serves as a QA indicator designating the extra care in the preparation of these wools.
  - Additional classing prior to shearing is often carried out with full OFDA testing being incorporated to fine tune Lot contents.
  - Wool harvesting now represents 1/3 of woolgrowers costs. (New methods of shearing still need to be seriously considered).
-

*Is the wool broker able to provide woolgrowers and/or classers with recommendations to meet with customer requirements?*

- The AWEX Classing Code and the AWEX Appraisal Guidelines both establish good independent classing standards and description codes across Australia, however these do not replace the role of our Regional Broker. The Regional broker support is still valuable as current customer requirement information is very important when preparing specialty SF & UF wool lines.

Most growers are expert on their own enterprises however few meet with the processors and manufacturers to gain insights on those customer needs and problems. Brokers see buyers on a regular basis and processors from time to time, keeping up to date with industry intelligence. The Broker is our initial liaison between grower and buyer.

#### AWEX Code of Practice & the AWEX Appraisal Guidelines

- AWEX worked collaboratively with ASWGA and others to establish the current AWEX Code of Practice, and in recent years AWEX and ASWGA workshopped the guidelines to update the AS Appraisal Guidelines.
- ASWGA definitely endorses the AWEX Classing Code and the AWEX Appraisal Guidelines as both establish good independent classing standards and description codes across Australia.
- ASWGA Superfine Classers ensure the strictest classing standards. Specialty SF & UF Merino classing aims to present the best quality and differentiate AS Type attributes to attract a premium price, ensuring our customers that the Merino wool purchased is fit-for-purpose.
- The wide spread practice of not classing wool and/or bulk pressing is not an option for specialty SF & UF woolgrowers. It is a one-size-fits-all commodity approach aimed at the cheapest outcome and underpins a no-premium price system.
- Chinese buyers only buy using micron, other wool characteristics needed for the production of fine quality cloth are often ignored. Therefore China taking around 80% of the Australian clip, consumes all wool into a commodity bracket with no allowance for end use. They either do not know or choose to ignore, in favour of low cost, the better product and marketing edge that can be gained through differentiating attributes throughout the Australian clip.
- The important attribute of curvature does not feature in the orders on raw wool, as micron, length, & strength make up the hauteur measurement and further dissemination.
- Streamlining the division of Lots and clip preparation for SF & UF Merion would depend on the identification of wool Type and curvature. This concept is not suitable for all wool Types.
- The commodity-based approach has been to the detriment of traditional finer crimping SF & UF Merino woolgrowers.

#### **PHASE 2: DELIVERY & TESTING**

*After wool is sold at auction, who retains the box sample?*

Keeping in mind this is a very small quantity of wool; most growers would be unaware what happens to the box sample after wool is sold at auction.

---

*Would there be any commercial benefits to the woolgrower knowing their final test results prior to delivering their wool to a broker's store?*

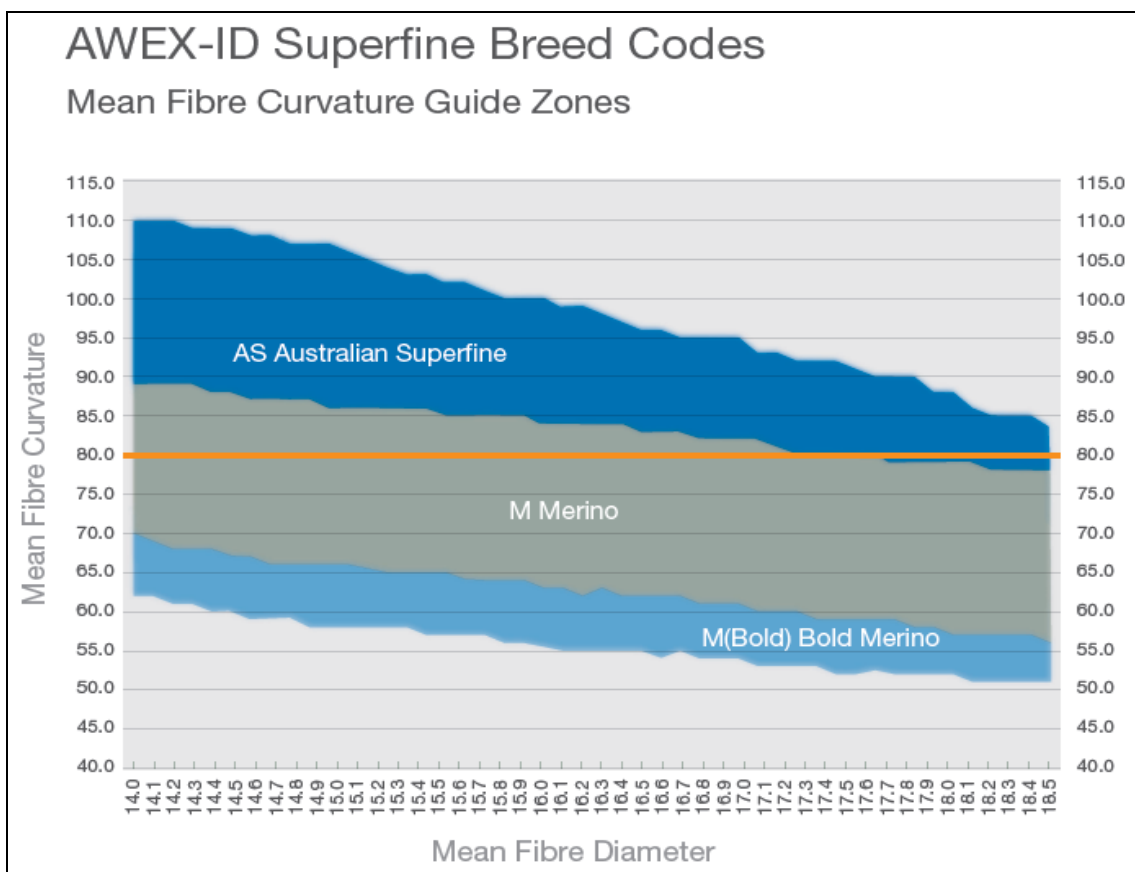
- There are a number of methods used to establish on farm measurement data. Pre shearing or during shearing some growers have in shed testing using either laser scan or OFDA. This requires employment of extra staff and unless the grower owns the equipment a grower is charged per fleece. The cost benefit ratio has meant that some growers collect data yearly others less frequently.
- Knowing the results before sending to store gives the option to store on farm. Many SF & UF growers do test all sheep and micron tag them therefore there is greater certainty on what is included in each Lot and certain markets can be targeted when classing their clip. However for final sale Lot lines or individual bales would still need to be tested. Some superfine growers identify their bales on micron with their own branding code.

*Are there additional characteristics that AWTa should test for to enhance the objective description process and possibly open up alternative processes for the sale of wool?*

- Curvature affects the processing performance of SF & UF Merino. AWTa currently test for curvature however the test is not as reliable as other tests conducted by AWTa. Yet the survival of the high crimping wool fibre, preferred by the Italians and suiting industry in general depends on being able to identify curvature and report on it accurately.

If curvature testing were reliable more buyers would be referencing curvature in their assessment of Lots to bid on. The SF & UF industry needs a reliable and agreed test for curvature (OFDA or laser scan) to maximise competition.

- SF & UF Merino must always have the opportunity to identify attributes that attract a premium to enable continued production of a fibre used and preferred in the high-end fashion industry, despite the pull by the bulk of the wool industry to target commodity-based practices.



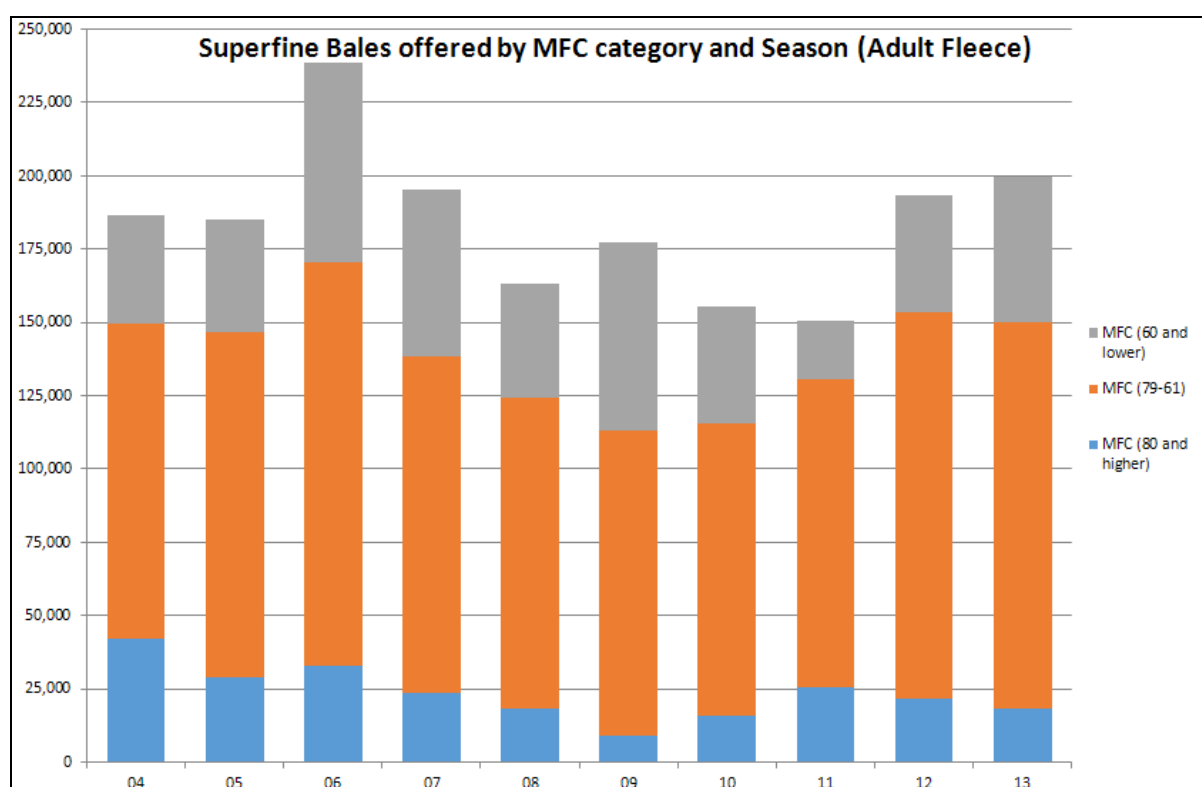
## Notes about Mean Fibre Curvature (MFC) and use in AWEX-ID Breed Group Appraisal

- Precision of MFC is not high. It is typically around +/- 7 degrees/mm. Due to its relatively low precision MFC is used as a guidance measure only. Each appraiser/auditor can apply the AWEX-ID breed they feel best suits the visual presentation of wool.
- Wool that has indistinct crimp characteristic can also record high readings (e.g. Comebacks, Downs).
- However, within the Superfine fleece sector the MFC can be used as a tool to assist the appraiser identifying AS and M - Bold types. (The balance are typed as Merino which may display influences of both Saxon or Bold breeding or neither).
- Why use MFC? Appraisers historically have under appraised the presence of AS bred wool. Using MFC it provokes the appraiser/auditor to make a decision.
- Not all appraisers have measured results when appraising the wool.
- The above MFD/MFC profile is indicative of the general bands of each AWEX-ID breed group. In practice the boundaries between each group is more blurred than illustrated on this chart.

### Superfine Fleece wool (18.5 and finer) by appraised Breed Group 2013/14 ytd

AS 8.1% M 74.7% M (BOLD) 17.2%

### Indicative volumes of Superfine Fleece wool since 2004 using MFC as a proxy for Breed Group.



### PHASE 3: WOOL APPRAISALS

*Can any efficiencies or cost savings be gained through appraisal inspection consolidation?*

All three inspections/appraisals are driven by a different purpose; these three purposes cannot be consumed into one common driver.

Additionally the Brokers, AWEX Appraisers or Buyers already transpose AWTA Test Certificate Results to create the base data for their reports, the work is not done a second time.

As the selling agent, the Brokers appraisal provides an assessment on the potential sale price for the grower to decide how and when they will sell their wool.

The AWEX Appraiser establishes an independent assessment of each Lot based on the uniform standard across all Australian wool, this in turn establishes international product confidence that consistent quality will be supplied regardless of what wool Type is being purchased.

The Buyer will always appraise their prospective purchase to ensure it meets the specific needs of their client and thus protecting their reputation and business.

*Can a combination of AWTA results and a singular industry accepted valuation standard provide an online platform for wool to be appraised and valued?*

- The Australian wool clip comprises many breeds of sheep and wool varieties fit for different end purposes, “a singular industry accepted valuation standard” would be a particularly complex matrix if it were to accurately reward quality. We already have a very good appraisal guideline accepted by industry in the AWEX Appraisal Guidelines.
- If all required attributes could be successfully tested it would be worthwhile doing a trial on the concept HOWEVER, in the case of SF & UF wools a main differentiator is crimp frequency and there is no agreed test to measure crimp frequency/curvature. Additionally whiteness and other tests, currently too expensive for growers to embrace, would need to be included to differentiate quality SF & UF Merino wool categories.
- Even within the current AWEX Type code, initially some appraisers were reluctant to put genuine SF wool into the ASF category because of style factors such as dust and VM.

*To what extent is the physical inspection a necessary element of appraisal and valuation?*

*Would the woolgrower be disadvantaged by relying solely on appraisal and not displaying the physical wool?*

SF & UF would be extremely disadvantaged by an appraisal only system, as at the finer end of the market and in the specialty lines within that market differentiation through crimp frequency, bloom and whiteness, just to name three, are all price makers. The physical inspection of buyers is the only time we realise any premium for these quality aspects.

A selling system void of inspection would be hard pressed to accurately portray differences in wools that experienced buyer's notice and are willing to pay for.

*Could woolgrowers exercise more discretion in the type of tests performed on their wool in order to save costs?*

---

Buyers bid on wools that have the test results they want therefore in SF & UF wools, buyers determine the base set of tests we must have. Limiting the number of tests and therefore the number of buyers interested in bidding on your wool to save a few dollars is a false economy.

*Does the information provided on the showfloor meet buyers needs?*

- ASWGA has not received any feedback on additional or preferred information required by Buyers.
- ASWGA does canvas Brokers to identify, with an ASWGA logo card on the Lot, ASWGA members wool on the showfloor as ASWGA members practice the strictest classing standards in their clip preparation and no ASWGA branded wool co-resides with any exotic sheep ensuring no D&MF, thus differentiating ASWGA wool from the majority of the Australian clip.

#### **PHASE 4: PRICE REALISATION**

*What other selling alternatives exist for woolgrowers in the market place today and how do the selling costs to the woolgrower compare to the traditional auction method? What other methods are worthy of investigation?*

- SF & UF Merino is sold through other methods however other selling alternatives for woolgrowers are limited.
- Some growers have ongoing supply contracts with a particular Brand/company; the financial arrangements of these contracts are not public knowledge. AWI has assisted such contracts in the past so perhaps this information is available via the AWI office.
- In the past forward contracts and futures have provided mixed results. Returns are impacted by wild fluctuations in the auction price, our currency or world events and this in turn effect confidence. Futures are not currently available.
- Many growers have struggled to meet contract specifications because of drought or extreme weather events impacting on the ability to meet specifications.
- Acquisition of portions of the clip may still be a possibility incorporating a central marketing body similar to the strategy of merino New Zealand.

*Do or could other selling alternatives generate a comparable or greater level of competitive tension at the point of price realization relative to traditional auction?*

- Online selling has been successful for some members however anecdotal evidence is that this has occurred after wool has been passed in at a physical auction or when the Brand is already known to the Buyer. So the Buyer in some cases has already inspected the Lot prior to the original auction exposure or there already exists a purchasing history.
- Currently there are so few buyers at the auctions, the auction system actually reduces price discovery. It is difficult to create alternate marketing contracts when buyers can walk into the auction and pay next to nothing for quality UF & SF Merino.
- Would a single desk system work for our type of wool, where price is negotiated – similar to NZMerino?

*Is there further potential to shorten the supply chain and involve downstream interests earlier in the ownership of wool with a view to removing or reducing costs?*

- Special direct sales by a grower or a group of buyers are rarely sustainable for any length of time. Mostly none of these particular alternatives have enough scale or longevity to solve the problems of the whole industry.
  - There is potential for more ownership of wool closer to retail by some entities.
-



- Today there are few vertically integrated global operations or companies in the trade. Most of those that remain are relatively small. Most early stage processing is still done in China.
- Attempts to set up chain marketing ventures have been undertaken by ASWGA under a separate commercial entity but have not been successful.

*If the auction system delivers the highest level of competition for growers wool are there more cost and time effective methods that would ultimately benefit the wool grower and would these savings be passed to the grower?*

- Online selling could provide cost savings, but it is doubtful that savings would be passed on to the grower.
- Inevitably the bulk of the clip will eventually be sold by description.
- Other systems may still be needed to market and sell speciality wool.

The present auction system is dominated by exporters purchasing wool on behalf of their clients. Is there potential to shorten the supply chain and involve downstream interests earlier in the ownership of wool with a view to removing or reducing costs?

Recently big operators have purchased wool properties in Australia possibly to safe guard their supply and to get the benefits of value adding their own product.

*A number of commission buyers hold multiple buying limits from a number of exporters .....*

- The biggest impediment to improve prices particularly for superfine wool is the lack of competition. Commission buyers operating on behalf of a number of companies allow them to have a big influence on the market price. Commission buyers are not going to bid one of their orders against another, while this may not technically be collusion it is destroying the fair competition ethic in the open cry auction system and undermining the financial return to the Australian woolgrower.
- Chinese monetary policy reducing the availability of credit to all but a few select and powerful shrewd operators has had a huge impact on prices paid to growers.

*Are all costs incurred by the woolgrower sufficiently transparent?*

- Immediate costs are all clearly listed on account sales information following the sale of the wool. Brokers charge for different items and have different charging scales. The level of detail seems satisfactory. Offering a tiered wool broker service/price offering has no advantage to specialty woolgrowers, as all costs need to be known.
- Knowledge on the full break up of all costs and who pays, from the farm gate to the first stage of processing could be helpful, as well as also understanding the full processing costs thereafter.

*Auction system and information communications.*

- Designated AS superfine sales have had some success in the past but in the current climate there is little opportunity to leverage price. Superfine growers have a current request to AWEX re holding AS sales in Melbourne as well as Sydney.
- The availability of market information particularly to the Chinese does give our dominant buyer a huge advantage.
- Recently AWEX has canvassed buyer masking to protect the confidentiality of buyers.

## **PHASE 5: INVOICING & PAYMENT**

---

- It would seem that the broker service charge BSC, is inevitably passed back to the woolgrower in the price that buyers pay at auction.
- Similarly when wool is stored in outlying regions the extra freight and shipping costs would be factored into the price paid.
- An industry standard invoice appears to be a positive for easy comparison of charges.

*Could there be any material benefit to woolgrowers by extending the exporter payment period for wool from the existing 7 days prompt payment period?*

The benefit would have to be substantive to offset any delay of funds back to the grower for wool where all production costs have already been outlaid by the grower over the previous twelve months or longer if the wool has been in store.

## **PHASE 6: EXPORT PROCESS**

- ASWGA did have enquiry from a major international processor re Australian wool being scoured in Australia before being exported. The company posed the hypothetical concept that the current wool levy of 2% be charged on all wool exported raw and scoured wool would not attract a levy. As the average yield in the Australian clip is around 70% there would be a 30% saving on dumping and shipping.
- Exporters have to wait too long for payment
- Some companies renege on contracts.
- Only well-established exporters can survive in the current climate.

### ***Wool Industry Institutions***

Talman Solutions could be a vehicle to list growers' wool lots prior to auction. This is currently being explored by ASWGA through an upgraded website.

### ***AWEX & AWTA:***

- AWEX & AWTA both perform different tasks and at different times in the wool selling pipeline. Both are dealing with woolgrower data. One is involved in a testing role and one in a monitoring role.
- ASWGA has always received willing assistance and valuable information on enquiries pertinent to their fields, from both companies.
- Whether there are efficiencies to be gained and whether that amalgamation would or would not create savings could only be answered by both companies.

### ***AWEX Market Reporting:***

- Fee for service seems reasonable however some information should possibly be kept confidential to benefit the Australian sector of the industry.
- More AWEX information should be available to woolgrowers.
- Overseas wool processors do have an advantage when negotiating with Australian exporters because of the availability of local wool market intelligence. eg. Certain companies may have filled their order book.

### ***Centralisation:***

- ASWGA members value the opportunity to liaise with buyers, to attend sales and importantly see how their wool clip presents on the show floor. While this opportunity has been
-

dramatically reduced for many with the closure of several smaller selling centres, it would be completely lost for the majority if there were a centralised centre.

- Centralisation will also mean bigger freight costs for outlying regions.
- For the commodity-based bulk wool it could allow for more wool to be accumulated of similar type and more opportunity for alternate processes for selling those wool types.

### ***Digitalisation:***

The bulk of the Australian clip could be sold on line without the need of box samples.

### ***Transparency:***

Greater transparency is always helpful and it is through knowledge that confidence is created to change an existing practice.

### ***Selling alternatives:***

Industry has limited knowledge, time and capital to access alternate selling methods.

### ***Forward selling & risk management:***

Could lack of forward selling & risk management uptake be connected to the poor digital skill currently in the wool industry and lack of technology uptake, both of which are now changing.

## **IN CONCLUSION:**

ASWGA is very aware that the current system does need alteration to restore good competition into the market place however this does not necessarily align with cost cutting. Industry does need to focus on the long-term success of the selling system across all sectors of the wool industry and not aim for short term gratification.

In addition to the information above ASWGA includes three attachments that do contribute to the discussion.

- 1) The Superfine Wool Industry Strategic Review by John Powell, January 2013, does provide information on appraisal and selling systems for SF & UF Merino wools.
- 2) A member's letter that contains interesting observations.
- 3) Stanford University School of Business review of NZ Merino

For a little light relief:

One member wrote in that - the ultimate system would be using Bio-clip and letting the wool fall off in the paddock, collecting it with the hay baler and tipping it straight into the container for shipping..... and maybe one day that may happen!

---



# STANFORD

---

## GRADUATE SCHOOL OF BUSINESS

CASE: M-338  
DATE: 02/15/11

## NEW ZEALAND MERINO: PURSUING ACCELERATION THROUGH COLLABORATION

### INTRODUCTION

In 2010, the New Zealand Merino Company Limited (NZM) secured a combination of government and private funding to help it further advance its efforts to revolutionize the country's sheep industry. Specifically, the company's top priorities were to expand the international market for New Zealand Merino wool, grow New Zealand's fine wool supply base, and drive greater wealth to the country's sheep farmers by extending the NZM model to their other sheep-based products, such as meat, leather, and lanolin.

To address the priority of expanding the international market for the country's fine Merino wool, NZM decided to convene a meeting of its key brand partners to get their input, seek new ideas, and attempt to engage them in working together toward this mutually beneficial goal. Even though they were competitors to varying degrees, they had all invested heavily (or were planning to do so) in products made from the wool procured through NZM, and they all had a direct interest in seeing demand for these products increase. NZM hoped that they would be willing to think collectively and consider collaborating for the benefit of all players in the category. However, NZM was unsure how the brand partners would feel about joining forces and the extent to which they could agree on specific messages and activities that would help accelerate the growth of the New Zealand Merino wool category.

### THE COUNTRY

New Zealand is the world's youngest country, meaning that it was the last major land mass to be settled just over 1,000 years ago. The first inhabitants were the Maori, who migrated from Polynesia. European migration began with missionaries and whalers in the late 1700s, but accelerated rapidly after New Zealand became a British colony in 1840. In 1853, the British

---

Lyn Denend and Professor Baba Shiv prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. An expanded version of the case, which includes photographs and videos, is available online at <http://www.zque.co.nz/casestudy/>.

*Copyright © 2011 by the Board of Trustees of the Leland Stanford Junior University. All rights reserved. To order copies or request permission to reproduce materials, e-mail the Case Writing Office at: [cwo@gsb.stanford.edu](mailto:cwo@gsb.stanford.edu) or write: Case Writing Office, Stanford Graduate School of Business, 655 Knight Way, Stanford University, Stanford, CA 94305-5015. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means — electronic, mechanical, photocopying, recording, or otherwise — without the permission of the Stanford Graduate School of Business. Every effort has been made to respect copyright and to contact copyright holders as appropriate. If you are a copyright holder and have concerns about any material appearing in this case study, please contact the Case Writing Office at [cwo@gsb.stanford.edu](mailto:cwo@gsb.stanford.edu).*

government granted the settlers the right of self-governance. In 1907, New Zealand became an independent dominion. Formal independence was achieved 40 years later, in 1947.<sup>1</sup>

New Zealand is located in the South Pacific Ocean, about 2,000 km (1,200 miles) to the southeast of Australia (see **Figure 1** for more information about the country and **Exhibit 1** for a map). The country is made up of two main islands, along with a number of other smaller islands. As a whole, New Zealand is smaller than Italy, but larger than the United Kingdom. The country's South Island has a mountainous ridge running along its center called the Southern Alps, with Mount Cook (the tallest mountain) climbing more than 12,000 feet above sea level. The North Island is somewhat flatter and characterized by volcanic terrain in some areas.

**Figure 1**  
**New Zealand at a Glance**

<p><b>Population:</b> 4.2 million</p> <p><b>Total Land:</b> 267,000 square km</p> <p><b>Capital:</b> Wellington</p> <p><b>Climate:</b> Temperate with extreme regional variations</p> <p><b>Official Language:</b> English</p> <p><b>GDP at Purchasing Power Parity:</b> \$115.3 billion (2009 estimate)</p> <p><b>Per Capita GDP:</b> \$27,400 (2009 estimate)</p> <p><b>GDP Growth:</b> -1.6% (2009 estimate)</p>
---

Source: "New Zealand," CIA World Factbook.

Traditionally, New Zealand's economy was based on agriculture, including the production of wool, meat, and dairy products. Today, agriculture is still the country's primary export industry. However, it now accounts for 4.6 percent of GDP, compared to industry at 23.7 percent (food processing, wood and paper products, textiles, machinery, transportation equipment, tourism) and services at 71.7 percent (financial services, infrastructure, transportation).<sup>2</sup> Tourism, in particular, is playing an increasingly important role in the economy. In 2010, it was estimated to account for approximately 9.1 percent of New Zealand's GDP.<sup>3</sup>

In 1984, the New Zealand government launched a major restructuring of its economy to boost the country's financial health and improve its global competitiveness. Key structural reforms involved the liberalization of import regulations, tariff reductions, the elimination of controls on wages, prices, and interest rates, and the dismantling of agricultural subsidies. As a result, New

<sup>1</sup> "Country Review: New Zealand," Country Watch, 2010, [http://www.countrywatch.com/country\\_profile.aspx?vcountry=125](http://www.countrywatch.com/country_profile.aspx?vcountry=125) (November 1, 2010).

<sup>2</sup> "New Zealand," CIA World Factbook, <https://www.cia.gov/library/publications/the-world-factbook/geos/nz.html> (September 21, 2010).

<sup>3</sup> "New Zealand," Wikipedia.org, [http://en.wikipedia.org/wiki/New\\_Zealand](http://en.wikipedia.org/wiki/New_Zealand) (September 21, 2010).

Zealand experienced more than a decade of economic expansion until just before the global financial crisis, which began in 2008.<sup>4</sup>

Given its relatively small domestic population, the country remains highly dependent on exports to countries such as Australia, the United States, Japan, and the U.K.<sup>5</sup> This position leaves the economy vulnerable to financial downturns that affect its trading partners, as well as fluctuations in the prices of its commodity exports.

On a positive note, the country as a whole enjoys a positive reputation. In January 2009, New Zealand Trade & Enterprise (NTZE) commissioned a U.S. consumer research and consulting firm, The Hartman Group, to examine North American consumer perceptions of New Zealand (and more generally of sustainability). Through a series of ethnographic focus groups and retail buyer interviews, researchers determined that most consumers have relatively limited knowledge about New Zealand. However, the vague information they possess is overwhelmingly positive. Overall, they believe that products from New Zealand perform well against factors such as environmental regulation, resource consumption, biodiversity, and animal welfare. These attributes are linked to the perception of more sustainable, higher quality products, which creates an advantage for New Zealand companies in positioning their exports in the North American market.<sup>6</sup>

## THE ANIMAL

The Merino is a type of sheep known for having some of the finest and softest wool of any breed. Physically, Merinos can be recognized by their crimped fleece and distinctive facial features, along with the large, curled horns that are characteristic of many of the males. Even though most Merinos appear deceptively grey, their fleece is bright white just beneath the surface.

Merino sheep, which are one of the oldest breeds in the world, have historically been raised for the desirability of their fine wool. Wool fiber thickness is measured in microns. Merino fibers typically range from 13-24 microns and break down as follows (note that an average human hair is approximately 60 microns):

- Medium Merino – 21-26 microns
- Fine Merino – 17.5-21 microns
- Superfine Merino – 15.5-17.5 microns

---

<sup>4</sup> “Background Note: New Zealand,” U.S. Department of State, <http://www.state.gov/r/pa/ei/bgn/35852.htm#econ> (September 21, 2010).

<sup>5</sup> “Economy of New Zealand,” Wikipedia.org, [http://en.wikipedia.org/wiki/Economy\\_of\\_New\\_Zealand](http://en.wikipedia.org/wiki/Economy_of_New_Zealand) (September 21, 2010).

<sup>6</sup> “Highlights from North American Consumers: Key Drivers, Sustainability and Perceptions of New Zealand,” The Hartman Group, 2009, <http://www.nzte.govt.nz/explore-export-markets/Export-Markets-Resources/Documents/North-American-Consumers-NZ-sustainability-2.pdf> (September 21, 2010).

By comparison, wool fibers used for carpets tend to be 35-45 microns.<sup>7</sup> The finer and whiter the fiber, the softer, smoother, and more versatile the wool. As a result, Merino has a variety of uses, but is most often made into apparel with the finest fibers rivaling the luxury of cashmere.

Although traditional Merinos are sometimes slower growing than those sheep bred for meat, their coats are nearly three times as dense. A typical Merino ewe yields approximately 3-6 kg (6.6-13.2 pounds) of wool each year.<sup>8</sup> (See **Exhibit 2** for a primer on sheep terminology.)

Merino wool fibers are typically long and strong. However, as with all wool, the fibers can be weakened if the sheep is stressed while growing its fleece. Stress, which is caused by inhumane treatment or unusually harsh environmental conditions (e.g., drought), results in thin spots in the fiber where it is likely to break during processing.

Merino sheep are an especially resilient breed, which means they can be raised in geographies that are too extreme for other domesticated breeds without becoming stressed. For example, Merinos thrive in New Zealand's South Island high country. The natural characteristics of their wool keep them cool in the summer when temperatures climb to 35 degrees Celsius (95 degrees Fahrenheit) and warm in the winter when they drop to -15 degrees Celsius (5 degrees Fahrenheit).<sup>9</sup>

Merinos require year-round attention, with the farm year punctuated by certain seasonal milestones:<sup>10</sup>

- **Spring** – Sheep are brought to lower country for shearing to relieve them of their heavy winter coats. The ewes are shorn first (before their lambs are born), followed by the hoggets, and wethers. Lambing begins.
- **Summer** – Lambs are weaned from their mothers and drenched (given an oral medication to reduce infection by worms or other parasites). Ewes and wethers are moved to higher country.
- **Autumn** – Ewes are brought back down to lower country for flushing (providing them with a rich diet prior to mating to positively affect their fertility). Mating occurs.
- **Winter** – All sheep are brought to the most temperate locations at lower altitudes where feed supplements can be provided and they can be moved quickly when major storms are predicted.

Each spring, this cycle begins again with shearing. After a Merino is shorn, the wool goes to a classer, who sorts the fiber based on a visual inspection of its attributes and intended uses. It is

---

<sup>7</sup> "Wool," Wikipedia.org, <http://en.wikipedia.org/wiki/Wool> (September 20, 2010).

<sup>8</sup> "Sheep Farming," Sheep World, <http://www.sheepworld.co.nz/SheepFarming.htm> (September 20, 2010).

<sup>9</sup> "FAQs," Merino Inc., [www.merinoinc.co.nz/Factsheets/Merino\\_FAQ.pdf](http://www.merinoinc.co.nz/Factsheets/Merino_FAQ.pdf) (September 20, 2010).

<sup>10</sup> "A Year on a Merino Property," Merino Inc., [http://www.merinoinc.co.nz/Factsheets/Merino\\_Farm\\_Year.pdf](http://www.merinoinc.co.nz/Factsheets/Merino_Farm_Year.pdf) (September 20, 2010).

"Basic Information About Sheep," Sheep101.info, <http://www.sheep101.info/sheepbasics.html> (September 20, 2010).

then pressed into bales that include the wool of 30-60 sheep.<sup>11</sup> The bales are moved to broker stores where fibers from each bale are tested for quality (primarily length, strength, micron, and yield). Yield is calculated after taking into account wool grease and natural contaminants such as dirt vegetable matter. The wool is then sold through traditional commodity auctions or branded forward contracts (see the section called **The Company** for more information about contracts). Before the fiber can be used to create a finished product, it must first be scoured (cleaned), carded (blended), and combed to prepare it for spinning into yarn. Then it can be knitted or woven into finished fabrics, which are then made into finished goods.

## THE WOOL INDUSTRY

Although fine Merino wool makes up only a small portion of all wool produced, it is useful to understand the overall wool category. Each year, the global wool industry produces approximately 1.3 million metric tons of wool. Approximately 25 percent of that comes from Australia, 18 percent from China, 11 percent from New Zealand, 3 percent from Argentina, and 1 percent from South Africa. A handful of other countries produce small amounts of the world's total. Approximately 60 percent of the wool produced globally is used to make apparel each year.<sup>12</sup>

Historically, wool has been sold as a commodity (in fact, by some accounts, it was the first commodity to be traded internationally).<sup>13</sup> Commodities are products used in the production of other goods that are sold by many different companies with little perceived variation in the quality of those products across suppliers—for example, gold, wheat, and oil. In general, the price of a commodity is determined by the market as a whole (i.e., supply, demand, and events in the external environment that affect these factors). For instance, in a recent industry publication Rabobank, a leading international bank specializing in food and agriculture, noted that wool was one of the agricultural commodities that was hardest-hit by the global credit crisis. According to the report, the discretionary nature of demand for woollen products means that wool consumption (and its price) remains closely aligned with global economic activity.<sup>14</sup> Another key factor affecting demand for wool has been the introduction and widespread adoption of synthetic fibers as a substitute.

As the demand for wool has declined, so too has its production. A dramatic decline in the price of wool also played a role in driving farmers from the industry. In late 1966, the commodity price of wool dropped a startling 40 percent.<sup>15</sup> Since then, the price has generally continued to trend downward. As farmers found it increasingly difficult to profitably produce and sell their wool, they began switching to other agricultural pursuits, such as raising sheep for meat.<sup>16</sup> In the

---

<sup>11</sup> “How Does Merino Fiber Get from the Sheep’s Back to Mine?” Merino Inc., [http://www.merinoinc.co.nz/Factsheets/Merino\\_Broker\\_Process.pdf](http://www.merinoinc.co.nz/Factsheets/Merino_Broker_Process.pdf) (September 21, 2010).

<sup>12</sup> “Wool,” op. cit.

<sup>13</sup> “Meat, Milk, or Wool,” Sheep 201, <http://www.sheep101.info/201/meatwoolmilk.html> (September 22, 2010).

<sup>14</sup> “Wool Demand Up as Global Economic Recovery Gathers Pace,” Rabobank press release, January 25, 2010, <http://www.rabobank.com.au/News-and-Events/Media-Releases/2010-News-Archive/Pages/media-release-20100125.aspx> (September 22, 2010).

<sup>15</sup> “Wool,” op. cit.

<sup>16</sup> “Merino Wool Fiber Definition,” Apparel Search, [http://www.apparelsearch.com/definitions/fiber/Merino\\_Wool\\_Definition.htm](http://www.apparelsearch.com/definitions/fiber/Merino_Wool_Definition.htm) (September 22, 2010).



early 1900s, selling wool was the most profitable way for a farmer to make a living from a sheep operation. Today, many farmers are finding meat and dairy operations to be substantially more lucrative.

Some farmers who continue to grow wool have been able to improve their financial position by shifting into the production of finer wool, which can be used to create softer, lighter-weight, premium products. For instance, the wool from Merino sheep can be sold for up to 10 times more than the wool from other breeds of coarse-fiber sheep.<sup>17</sup> In Australia, the world's largest producer of Merino wool, this breed comprises more than 85 percent of the country's flocks.<sup>18</sup> In turn, the country produces approximately 80 percent of the world's Merino supply,<sup>19</sup> which is worth well over US\$1 billion. South Africa is the second largest producer of Merino, even though it only generates 1 percent of the world's total wool output. New Zealand is the third largest global Merino supplier. While the country has an estimated 40 million sheep, only about 3 million are Merinos.<sup>20</sup> New Zealand's Merino wool market is currently valued at approximately US\$100 million. (See **Exhibit 3**.)

For decades, the majority of wool has been sold via commodity auctions. At auction, the price for strong wool (wool used to make carpets) might be less than US\$1 per pound. In the New Zealand Merino industry, forward contracts are becoming increasingly common as a more sustainable alternative to wool auctions (see the section called **The Company** for more information about such contracts). Yet, approximately 85 percent of Australian wool is still sold via the auction model.<sup>21</sup> In contrast, less than half of all New Zealand Merino wool now changes hands this way.

## THE NZM COMPANY

The New Zealand Merino Company Limited (NZM) is an integrated sales, marketing, and innovation company focused on transforming the country's Merino sheep industry.<sup>22</sup>

NZM is headquartered in Christchurch in New Zealand's South Island. The organization was started in 1995 by Merino growers who wanted to lift New Zealand's Merino wool out of the commodity basket through marketing and differentiation. As demand and prices for coarse wool declined, many farmers transitioned to raising Merinos for their finer, more valuable fiber. However, New Zealand's Merino farmers were still struggling due to the fluctuating prices that are characteristic of any commodity market. In total, the country produced 8,000 metric tons of clean Merino per year—just 2.7 percent of the world's 290,000 clean-ton Merino supply. Against this backdrop, the New Zealand clip had no identity of its own and was often blended with fiber from other countries. Moreover, the growers had only a limited understanding of the

---

<sup>17</sup> "Merino Wool," Woolpower, [http://www.woolpower.se/en/asp/material\\_2.asp](http://www.woolpower.se/en/asp/material_2.asp) (September 22, 2010).

<sup>18</sup> Ben Lyons, "Australian Merino Wool," Proceedings of the Symposium on Natural Fiber, Australian Wool Foundation, <ftp://ftp.fao.org/docrep/fao/011/i0709e/i0709e11.pdf> (September 22, 2010).

<sup>19</sup> "Merino Wool Fiber Definition," op. cit.

<sup>20</sup> "FAQs," op. cit.

<sup>21</sup> "Wool," op. cit.

<sup>22</sup> Background information drawn from "New Zealand Merino Company Brief," The New Zealand Merino Company Limited, as well as other information provided by NZM.

market for Merino fiber, and little ability to influence it. As a result, they faced unsustainable prices, an increasing cost of production, and diminishing returns.

As John Brakenridge, NZM's CEO, recalled around the time the organization got started, "Fine wool in Australia was measured as the single most volatile commodity, behind sugar. So you're talking about a very, very volatile commodity."<sup>23</sup> NZM needed to find a way to minimize that volatility and make Merino wool a more stable, profitable enterprise in New Zealand. This would involve defining a model that would directly shatter a series of prevalent industry myths:

1. There will only be one price for wool—the commodity price
2. The contract prices will only ever equal the average commodity price
3. The market will not honor contracts when the commodity market fluctuates in their favor
4. Fiber ingredients cannot be differentiated
5. Any value added will be captured by others further through the supply chain
6. Growers get little or no value from investments in marketing

The first step toward this end was to develop a strategy for differentiating New Zealand Merino wool from other types of Merino available in the marketplace. The route NZM chose to accomplish this was to identify leading brands in its targeted market segments and then match the needs of these companies to the attributes of its wool. Specifically, NZM had to define those benefits that would distinguish New Zealand's offering from Australian and South African Merino and make the product highly desirable to buyers. "No matter what we do to try to increase demand, it's not going to have an effect on our price unless we can differentiate and brand our fiber," Brakenridge said.

Through extensive market research, along with grower involvement, NZM was able to define a unique identity for its offering (see the section called **Product and Partners** for more details). It also crafted a marketing story that would support a price premium at retail that could be shared among players in the supply chain. NZM would further support this price premium by investing heavily in research and development (R&D) and market development activities that would help retailers and brands boost demand for products made with New Zealand Merino wool.

To capture and share the additional value associated with price premiums, NZM developed a new business model for the industry. According to Brakenridge, "Prior to 1997, auction was the only method for the sale of Merino fiber in New Zealand." Farmers paid a traditional broker roughly 4 percent of their gross income to represent and sell their wool through this mechanism. NZM's business concept is to transition a significant percentage of New Zealand's Merino wool into sales executed via forward contracts. Once retailers are convinced of the superior attributes of the NZM offering and its other associated benefits, they are willing to enter into and honor long-term contracts to ensure their supply. These contracts are not priced directly in relation to historic and forecast commodity prices. Rather the price-points are negotiated between NZM and its brand partners at a level that allows growers to receive a fair, equitable, and sustainable return for their fiber and manufacturers to be successful over the long term. The premium nature of the product gives NZM the leverage it needs to make this model work.

---

<sup>23</sup> All quotations are from interviews conducted by the authors and/or meetings with representatives from NZM, unless otherwise cited.

Growers under contract supply wool to one or more brand partners according to clear specifications at a fixed price—generally, one to three years in advance. These contracts are based on the farmers’ historical production to help ensure that they can meet the specifications from the wool produced on their property. However, given the biological nature of wool production, there is a risk that growers will not always be able to meet their contractual obligations. In these cases, NZM sources wool on the commodity auction market to fulfill the requirements. If the commodity price of the wool is less than the contract price, the growers are paid the difference. If it is higher, then the growers compensate NZM accordingly.

To build its business model, NZM had to align the somewhat adversarial members of the supply chain. “What we wanted to do was a complete contradiction to the traditional way commodities make their way through a supply chain. The whole essence of a commodity supply chain is about short-term transactions, where somebody’s trying to ride a commodity market, bring volatility, and not let anybody else know what’s going on further up or down the chain,” explained Brakenridge. Farmers generally worked in isolation from wool buyers (and vice versa), and this same lack of visibility characterized all of the other relationships between players in the ecosystem (shearers, processors, designers, and manufacturers, among others). NZM had to persuade them that there was more to be gained by openly sharing information and working together to benefit the industry overall. “This required a huge mindset and cultural shift,” recalled Brakenridge. In the end, NZM was able to stimulate increased cooperation among key external players. The organization also drove some consolidation in the industry. “Historically, you’d have government-funded or levy-collected R&D, marketing, and traders all working separately,” he said. “Now we’ve got marketing, creative services, R&D, and administration all working together as cogs. We’ve brought them all in-house.”

NZM also had to convince growers to pay for its services. To cover its costs, which included marketing New Zealand Merino wool as a premium product, developing relationships with prospective buyers, negotiating long-term supply contracts, and performing R&D to help its retail and brand partners succeed, NZM would have to charge nearly twice as much as traditional brokers. “So if you sell your wool through us, in round terms, it costs you about eight percent of your gross income,” noted Brakenridge, “whereas, if you sell it through our competitor, it costs you about 4 percent. It was up to us to justify that differential by persuading growers that, over time, we would generate a lot more revenue for them.”

NZM executed its first direct supply contract in 1997, which brought together New Zealand Merino growers and John Smedley Limited, one of the world’s premier knitwear manufacturers (see **Products and Partners** for more information about NZM’s brand partners). With the contract in place, NZM marshaled its resources to making John Smedley and its Merino products more successful. Brakenridge explained his philosophy: “When we walk into work each day, we ask ourselves, ‘How do we add value to the retail brand?’ because this is the only way that we can get more money back through the entire supply chain to the growers.”

More than a decade after its founding, NZM transacts approximately 85 percent of all Merino wool grown in New Zealand with turnover of more than US\$85 million. More than 50 percent of this volume changes hands through direct supply contracts, some of which extend up to 5

years in the future. As a result, NZM growers have greater price stability that allows them to more effectively manage their farms and make important capital investment decisions. In exchange, NZM's brand partners receive sustainable pricing, guaranteed supply, consistency of supply, traceability, and fit-for-purpose processing consignments.

In 2010, based on NZM's success to date, the New Zealand government committed more than US\$10 million to help the organization continue revolutionizing the country's sheep industry. NZM and its supply chain partners contributed another US\$15 million to the five-year initiative. The program, referred to as NZSTX (The New Zealand Sheep Industry Transformation), has multiple objectives. However, its top priorities are to expand the international market for Merino wool, grow New Zealand's fine wool supply base, and drive greater wealth to the country's sheep farmers by extending the NZM model to their other sheep-based products, such as meat, leather, and lanolin.<sup>24</sup>

### NZM PRODUCT AND PARTNERS

As noted, one of the initial aspects to making the organization's new business model work was defining an identity for New Zealand Merino wool that was clearly differentiated from other sources and could command a premium price. NZM initiated this exercise by researching the inherent benefits of the Merino fiber itself and by branding the fiber in a way that would encapsulate these attributes and protect New Zealand Merino from competitive or substitute offerings.

While traditional wool is widely perceived as being scratchy, hot, heavy, and smelly, New Zealand Merino wool has numerous natural advantages:

- **Moisture management** – The complex natural structure of Merino fibers gives them the unique ability to both absorb and repel moisture. When it comes to shower/rain resistance, a Merino garment can hold up to 30 percent of its own weight in water without feeling damp. It can also absorb vapor from the skin during activity, increasing the time before sweat condenses to a liquid form and makes a garment uncomfortable.
- **Softness/comfort** – Coarse wool fibers push into the skin and irritate nerves close to the surface; fine Merino fibers bend against the skin and do not aggravate the nerves.
- **Thermal control** – Merino provides natural temperature control by absorbing and releasing moisture. For example, in cool, wet conditions, the Merino fibers generate a small but perceptible amount of heat as water vapor interacts with their chemical structure. This heat prevents the wearer from becoming chilled.
- **Insulation** – The natural crimp (wave) and resilience of Merino fibers make Merino garments warm and comfortable to wear by trapping air next to the skin.
- **Fire safety** – Unlike synthetics, wool is naturally flame retardant.
- **Odor control** – In contrast to synthetics, Merino wool has a unique ability to minimize the build-up of body odor during activity.
- **Easy care** – Merino is naturally resistant to shrinkage and wrinkles.

---

<sup>24</sup> "\$36 Million Revolution for the NZ Sheep Industry," Scoop Business, May 27, 2010, <http://www.scoop.co.nz/stories/BU1005/S00856.htm> (September 23, 2010).

The NZM team further evaluated what distinguished New Zealand Merino from fine Australian and South African wool. What they found was that New Zealand Merino is superior when tested for its whiteness and brightness. This attribute increases the potential color choices when dyeing the wool. It also improves the product's ability to retain color without fading. New Zealand fibers are also long and strong, which increases their durability, enhances their ability to stay smooth and soft, and decreases the likelihood of pilling. Finally, NZM validated that the country's Merino sheep are raised in a more responsible and sustainable manner than Merinos in other countries.

Based on this information, NZM developed an "ingredient brand" called Zque. Wool that meets Zque standards is the highest quality natural Merino fiber available in New Zealand. The label is also meant to give buyers confidence that they are procuring materials that give their products *substance* in the following areas:

- **Environmental integrity** – Any Merino carrying the Zque badge must be compliant with New Zealand's Resource Management Act, Biosecurity Act, and Conservation Act. During Zque grower audits, farmers are also asked questions regarding any other on-farm environmental initiatives they may be undertaking.
- **Animal welfare** – Sheep, dogs, and other farm animals must be cared for according to the standards outlined in New Zealand's Animal Welfare Act and the codes that set forth standards for the welfare of sheep. Farmers must also record and produce (on request) records of all animal health treatments. The practice of mulesing is not permitted on Zque accredited farms. During farm audits, sheep are inspected to ensure their condition indicates adherence to these requirements. (See **Exhibit 4** for information about mulesing.)
- **Social responsibility** – All farmers must be in compliance with New Zealand's Occupational Safety and Health and Employment Relations Act. Compliance with these standards is audited during farm inspections.
- **Economic sustainability** – Zque fiber is only available via contract, which means that its price is set between NZM, the brand (buyer), and the grower. The price provides all parties with certainty and stability on which they can base their business plans and forecasts.
- **Traceability** – Zque fiber is traceable from the grower, through the supply chain, to the buyer, and back. This two-way visibility is unique in New Zealand agriculture and has resulted in long-term relationships, direct lines of communication, and a shared sense of pride between growers, brand partners, and their end markets.

NZM works with the third-party accreditation provider, AsureQuality New Zealand Limited to perform the on-farm inspections referenced above, so as to ensure credibility and robustness to the on-farm platforms underpinning Zque.

By positively addressing these factors in a certifiable manner, Zque appeals to the IQ/Minds (intelligence quotient) and EQ/Hearts (emotional intelligence quotient) of brands and consumers alike. As Brakenridge pointed out, "A lot of retail brands are very superficial now. There's nothing underneath them." The Zque badge provides brands with a compelling story they can

share with consumers about the substance of their products to help engender increased brand loyalty.

In terms of who would be most likely to respond favorably to Zque, NZM's research indicated that it should focus on brands operating in the growing "lifestyles of health and sustainability" or LOHAS market. These consumers were characterized as being active, involved, passionate, influential, principled, responsible, self-confident, discerning, sophisticated, and having a relatively high discretionary income. In the United States alone, this market was estimated to be more than US\$200 billion in size. Brands targeting LOHAS consumers fell into several different categories:

- **Active outdoors** – Knitted garments for the active outdoors market (note that many brands and garments in this segment are increasingly seen as being fashionable as well as functional).
- **High-end hosiery** – Knitted garments, particularly socks.
- **Luxury suiting** – Woven garments, primarily men's and women's suits.
- **Knitted fashion** – Fashion garments such as knitted jumpers and dresses.
- **Baby wear** – Knitted garments and bedding for infants.
- **School uniforms** – Woven garments for use by private schools for student's uniforms (particularly in Japan).
- **Bedding** – Mainly knitted blankets or wool-filled pillows and duvets.
- **Interior textiles** – Woolen throws, rugs, and upholstery.

To pursue the brands that fell into these categories, Brakenridge described NZM's approach: "We looked at the segmented market, we took the attributes that we had learned about the fiber, and we lined them up so that it became more like an a la carte menu. And we customized our message for each market segment. Then we tried to identify the leader in each category, or if there wasn't a leader we had to define one. Next we did some international market research in a qualitative manner for these companies and came up with prototypes that we could take to them. When we went to visit people, we went there with prototypes and said, 'Look, here's your product. If you differentiate it with the Zque and/or the New Zealand Merino label, here's some market research that validates what that would do for your brand.'"

Over time, this approach allowed NZM to build a portfolio of leading brand partners that included Designer Textiles International, Ibex, Icebreaker, Johnstons, John Smedley, Loro Piana, Reda, and SmartWool (see **Exhibits 5** through **12** for brand partner profiles).

## THE BRAND PARTNER SUMMIT

After NZM was successful in gaining its NZSTX funding, the team needed to plot a course forward toward achieving the program's goals. To address the priority of expanding the international market for Zque wool, the company decided to convene a meeting of its key brand partners to get their input, seek new ideas, and attempt to engage them in working together toward this mutually beneficial goal.

Even though they were competitors to varying degrees, they had all invested heavily (or were planning to do so) in products made from Zque wool, and they all had a direct interest in seeing demand for these products increase. NZM hoped that they would be willing to think collectively and consider collaborating for the benefit of all players in the category.

NZM would call the brand partner meeting a “Thinkering Summit,” which referred to the intersection of creative thinking and discovery through doing (tinkering). Brakenridge’s hope was that the group would come together to “build and think,” (a form of strategizing through the use of prototypes).

The theme for the meeting would be “Acceleration through Collaboration: Designing a Zque Blueprint that Accelerates Brand Partner Growth in the U.S.” The NZM team chose to focus on expanding New Zealand Merino sales in the U.S. market as a first step for a couple of reasons. First, all of NZM’s brand partners had a significant presence in U.S. markets or had aspirations to establish one. Second, the U.S. had a large population of LOHAS consumers, as confirmed by market research recently commissioned by New Zealand Trade and Enterprise (NZTE). (See **NZM Products and Partners** for more information.)

Eight core team members from NZM would participate in and help orchestrate the summit. The invitees would include representatives from a number of the organization’s brand partners, New Zealand’s Ministry of Agriculture and Forestry (MAF), NZTE, and Stanford University. After the invitations were issued, everyone confirmed that they were very enthusiastic about participating (see **Exhibit 13** for a list of attendees). All were sending at least one representative with the exception of NZM’s two Italian partners (Loro Piana and Reda). These two companies would be unable to attend due to commitments at key tradeshows, but both would send a personal letter of support.

The NZM team convened the summit in Palo Alto, CA due its proximity to a number of thought leading organizations such as Apple, Facebook, Google, and IDEO. In this setting, the team would also be able to involve the thought leaders in marketing from the Stanford GSB, including Professor Baba Shiv, with whom it had been working on an informal basis over the past year. For a venue, the team rented a vacant retail store (along with the space adjacent to it) at the “Town and Country” shopping center near Stanford’s campus. One idea that the NZM team had brainstormed was to develop temporary retail stores in targeted “micromarkets” where NZM’s brand partners could collectively display and sell their products. Consistent with the thinkering philosophy, NZM decided to prototype one of these stores and use it as a ‘set’ for the meeting - to provide a hands-on experience and inspire attendees to expand the “realm of the possible.” The retail space next door would be used as a reception area.

The first morning of the event started with a breakfast. To evoke people’s positive perceptions of New Zealand as a beautiful, natural environment, the team covered the floor of the reception area in real grass that led to a sand beach, and everyone was encouraged to leave their shoes at the door. The walls were lined with bamboo and images of picturesque New Zealand landscapes. To showcase the warm, friendly hospitality for which the country was known, the NZM team brought two of its local caterers to Palo Alto. Their role was to provide the participants with fresh New Zealand delicacies throughout the summit. As breakfast was coming to a close, the

guests were surprised with a performance by three traditional Maori dancers. Afterwards, the dancers welcomed each participant with a customary Maori greeting called *hongi*, which requires the two people to press their noses together.

At this point, the group moved next door where the floor was covered in a luxurious, white shag-pile carpet made from New Zealand Merino wool. Most of the participants took seats on the inviting carpet or in chairs that had been placed throughout the space. However, the leaders of the five primary brands (Ibex, Icebreaker, John Smedley, Johnstons, and SmartWool), along with Brakenridge, were given elevated, makeshift “thrones” at the head of the room as the leaders of their collective future.

After showing a video on the New Zealand experience to keep participants grounded in the country’s allure, Brakenridge led a discussion about why they were all together and what effective collaboration could mean to the participants in the room. The group offered the following early ideas:

- Broader acceptance for New Zealand Merino wool.
- Capturing U.S. market share from consumers currently buying synthetics.
- Sharing best practices in the industry through “coopetition” or “cooperating to compete.”

The group agreed that there was a time to compete and a time to come together, and that in some instances there was room for multiple brands in the stores that they sell through. Primarily though, they needed help to get consumers to understand the benefits of wool. Then it would be up to the brand partners to carve a unique identity for their own products.

One brand partner commented that New Zealand Merino was a great product that elicited an emotional response from customers. Consumers, he noted, become passionate in a unique way once they experience the product. For this reason, the key question that the group needed to answer together was:

How do the brand partners take that experience to the next level?

NZM referred to the concept of taking the consumers (and the industry) to the next level as “Crossing the Chasm.” It was agreed that those who touched and, even more importantly, *experienced* Zque products did not just convert to customers—they became passionate advocates for the product, singing the praises of New Zealand Merino wool and encouraging their friends to try it. As NZM had learned, individuals in the initial target market of early adopters became intellectually interested when the benefits of Zque were explained to them. Once they touched a Zque product, they began to get excited. In situations where they actually had the opportunity to use the product, then they become passionate. Now was the time to mobilize these early adopters to convert their non-user peers.

The challenge was that the devoted group of “converts” in the U.S. was currently small relative to the total addressable market. Not only did relatively few people understand the benefits of New Zealand Merino wool, synthetic substitutes were significantly less expensive—for example,



a basic synthetic short-sleeve base layer might cost \$19-25, while a similar shirt made from New Zealand Merino might cost approximately \$60.

The group came back to the fact that they had all been spending substantial time, energy, and money promoting the benefits of wool versus synthetic fibers, as well as positioning New Zealand Merino as a premium wool fiber. Participants concurred that their messaging around the fiber story was similar and, as a result, their efforts were duplicative. It would benefit all brand partners if NZM would market the fiber and the benefits of wool so that the brand partners could focus on promoting their own brands rather than the attributes of Zque.

As the brand partners talked about their own goals for the next three to five years, two important goals emerged at the category level. The subsequent discussion focused on two key points:

1. The basics of Merino need to be known and acknowledged by the general consumer base. To achieve this goal, two hurdles would need to be overcome. First, few people knew about Merino wool and its benefits. Second, even if they did, they needed to better understand why they should pay more for one type of Merino over another.
2. In order to support the brand partners' planned company growth, there needed to be a consistent, guaranteed wool supply at the specifications they required. This meant that NZM would have to make more high-quality New Zealand Merino wool available.

One of the first tactical issues the group discussed the fundamental messaging it might use to reach U.S. consumers. For NZM and the brand partners to grow the category for Zque wool, it was imperative that the messaging was perfected and told consistently across the category. There were four potential aspects to the fiber story:

- **Wool** – Breaking traditional stereotypes associated with wool and differentiating it as a better, natural alternative to synthetic fibers.
- **Merino** – Explaining that Merino is a type of wool, and that it is preferable to all other wool fibers.
- **New Zealand** – Positioning New Zealand Merino as superior to all other types of Merino and capitalizing on the “goodwill” associated with products from New Zealand.
- **Zque** – Promoting Zque as the highest quality New Zealand Merino available to consumers and explaining its advantages when it comes to performance and sustainability.

The challenge was that explaining all four aspects to consumers was difficult to accomplish in a concise, easy-to-understand message. The brand partners would have to decide which factors were most important in the messaging hierarchy, and which could be reserved for more detailed, second-level communications.

Many companies sold products made from Merino wool. For example, \$40 Merino sweaters were routinely available at the Gap and Banana Republic. The thing that differentiated all of the brand partners from these other companies was their use of Zque Merino from New Zealand. This branding would ensure that value was captured by the group, rather than generic Merino (or

even generic New Zealand Merino) offerings, and that the group would be protected from any detrimental actions of competitors in the Merino sector (e.g., producing garments from lower-quality Merino that resulted in a negative customer experience).

The primary focus of Zque marketing to date had been around its sustainability attributes, but increasingly this attribute was becoming a “must-have,” rather than a true differentiator in the brand partners’ market segments. NZTE’s recent market research in the U.S. confirmed that consumers were more concerned with quality than sustainability (although sustainable products were often considered of higher quality). The Zque story needed to be widened to include other quality and performance characteristics that resonated with consumers such as not sweating or not smelling, and the emotional connection that occurred when the customer experienced the feel of the garment.

Brakenridge asked participants what they thought about including New Zealand as part of the core message. Everyone seemed to believe that associating New Zealand with the product would be a positive from the customer’s perspective. However, some members of the group expressed concerns that this term could be too limiting if the demand for high-quality Merino surpassed the country’s available supply. NZM was actively recruiting more New Zealand growers to join its supply-base, but the possibility remained that NZM would potentially need to expand its model outside New Zealand to keep pace with demand, or as a means of insurance in case the country was ever struck by a disaster that dramatically affected the entire Merino wool supply (e.g., drought or disease).

Another topic that generated a great deal of dialogue during the summit was which particular tactics to use to get a shared message out to consumers and turn them into converts. Given the tactile nature of the product, and the propensity of potential consumers to be converted once that had touched the products (or reached their “delta” point), everyone agreed that they needed to create more opportunities for consumers to touch and feel Zque wool (if not experience the product for themselves). They also agreed that they should consider a combination of traditional and novel channels that included physical, virtual, and event elements.

Another key feature of the model was entering micromarkets—specific cities with a high population of target qualified customers—where the brand partners could work together to significantly raise awareness of their collective and individual offerings. Participants suggested a range of cities across the U.S.

The team defined certain filtering criteria to help decide which cities would make the best micromarket locations. These included:

- **Per capita virality** – The speed and extent to which information and ideas spread virally throughout a population.
- **Brand partner activity in the city** – Do interested consumers have local options for buying brand partner products?
- **Presence of early adopter** – Is there a strong base of forward-thinking risk takers who are likely to try new things?
- **Affluence** – Ability of the population to understand, appreciate, and afford the product.

In terms of having a physical presence in a micro market, the group's initial reaction to NZM's temporary "pop-up" retail store concept was that it was an interesting idea. However, while everyone loved the way the prototype store looked (and was impressed by what the NZM team had accomplished!), they considered that perhaps, even in a high-traffic location, a fixed retail space might not reach enough potential customers.

Building on the concept, another idea was to create a mobile store—in a bus or the trailer of an 18-wheel truck—that could move from one high traffic area to another. Like the temporary retail space idea, the mobile solution would be designed to feature multiple tactile experiences, interactive consumer education materials, and the opportunity to make purchases (or be directed to participating retailers that carried the products of the brand partner).

Another potential concept was to approach established retailers that carried active outdoor products as well as luxury knitwear about setting up in-store areas where consumers could become better acquainted with (and buy) Merino products from all the brand partners.

From a virtual perspective, there was a lot of interest in figuring out how to start a viral movement around the Zque offering. The group was energized by examples of what had been accomplished by organizations and companies alike (e.g., Coca-Cola and its Coke Happiness Machine video). Over the years, the brand partners had all collected testimonials and stories from existing customers praising their products and had used them to help spread the word, but none of them had successfully catalyzed any large-scale viral activity.

In terms of events, participants had numerous suggestions, particularly in the active outdoors segment (e.g., marathons, bike races, and other sporting activities). Physically, the collective could bring its mobile store to an event or set up a booth. They also agreed that they should strive to incorporate a virtual element into each event and find ways to reward consumers who participated in virally amplifying their message.

At the conclusion of the summit, just before the participants adjourned to relax with drinks and a friendly game of cricket, Brakenridge and team recapped what had been discussed and outlined an action plan for moving forward. The brand partners were encouraged and invigorated by the progress that had been made, and looked forward to implementing the action plan. To NZM's delight, the final question was not if there should be another summit; but rather when and where would the next summit be?

**CLASS PREPARATION**

If you have carefully reviewed the materials in the case, you should be able to describe:

1. The basic attributes of Merino wool and what differentiates it from other wool fibers.
2. The basic Merino wool supply chain.
3. Factors that make New Zealand economically vulnerable as a country.
4. The key challenges facing the New Zealand wool industry.
5. How the NZM model has helped address these challenges to date.
6. NZM's goals as outlined as part of the NZSTX program.
7. What Zque is.
8. The target market segments and customer characteristics of those most likely to respond to Zque.
9. Basic similarities and differences among NZM's major brand partners.
10. Basic U.S. consumer perceptions of New Zealand and its products.

In addition, please come to class prepared to discuss the following questions:

1. What specific goal do you think NZM's brand partners can/should agree on?
2. What messages should the group emphasize in its collaborative communication?
3. What specific tactics should they try for getting these messages out?
4. Based on the issues and opportunities discussed at the brand partner summit, what path forward would you recommend to NZM?

### Exhibit 1 Map of New Zealand



Source: "Background Note: New Zealand," U.S. Department of State,  
<http://www.state.gov/r/pa/ei/bgn/35852.htm#econ> (November 1, 2010).

## **Exhibit 2**

### **Understanding Sheep: It's All in the Teeth!**

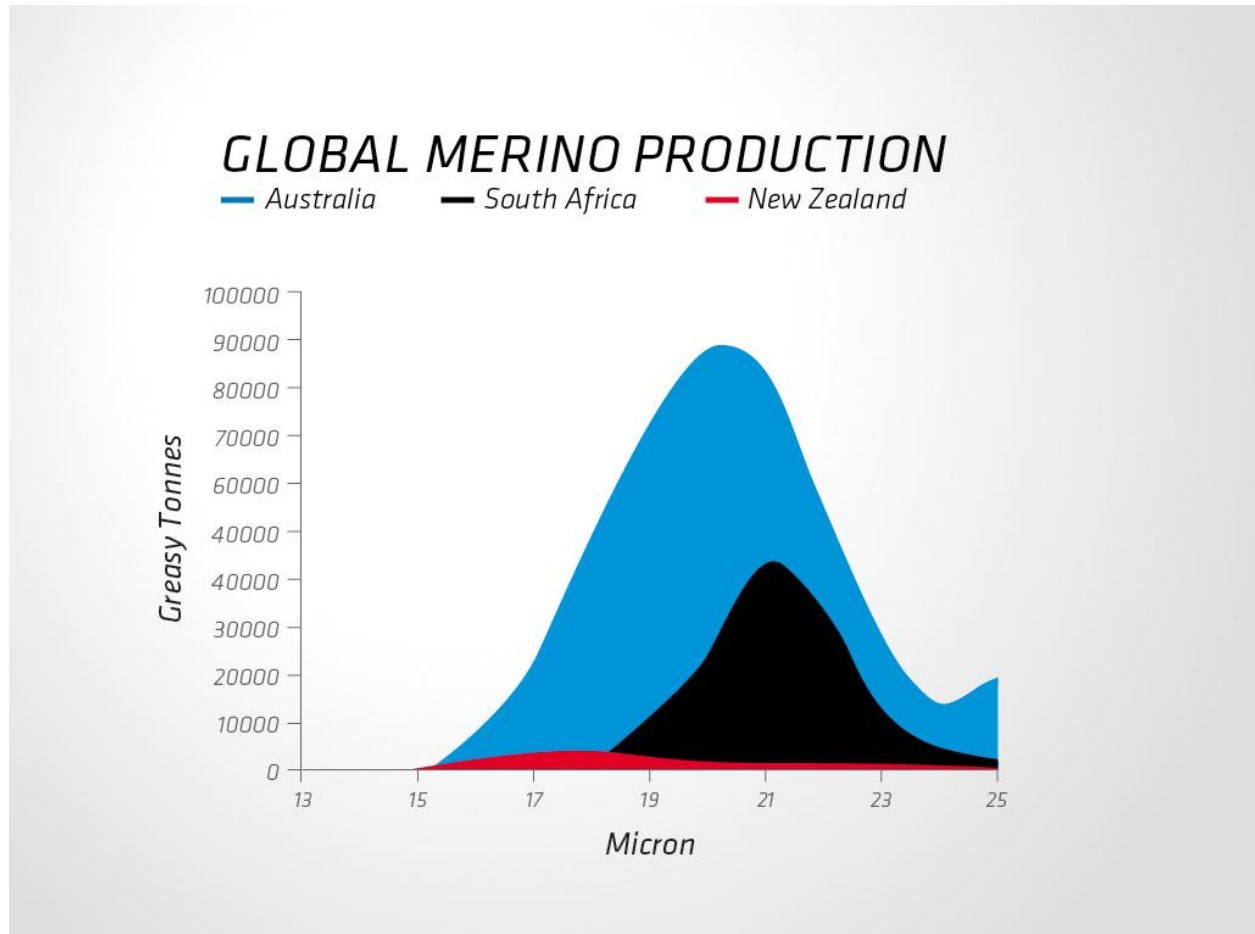
The terms used to refer to sheep at different stages of their lifecycle are based on their teeth rather than their age.

- **Lamb** – Refers to newborn male or female sheep before they cut their first two permanent teeth (typically between 10 and 18 months of age). Lamb also refers to the flesh of young sheep when it is sold as meat. Currently, as soon as a lamb cuts its first two teeth, its meat is downgraded to mutton.
- **Hogget** – A young sheep with two teeth that has not yet been shorn.
- **Ewe** – A female sheep with four or more teeth.
- **Ram** – A male sheep with four or more teeth that has not been castrated and is used for breeding.
- **Wether** - A male sheep with four or more teeth that has been castrated.

The productivity of sheep is also linked to their teeth. Sheep tend to be most productive between three and six years of age. Productivity tends to decline around year seven when their teeth begin to break and wear down, which makes it difficult for them to maintain their body condition. The general life expectancy of a domesticated sheep ranges from roughly 6 to 12 years; Merinos typically live for 7 to 9 years.

Source: Information provided by New Zealand Merino.

### Exhibit 3 Global Merino Production



Source: Information provided by New Zealand Merino.

#### **Exhibit 4**

#### **A Note on Mulesing**

Mulesing is a controversial procedure that involves the removal of skin around the buttock of the Merino to help reduce the incidence of flystrike (a parasitic disease that can be deadly). The practice is generally accepted as an effective way to prevent flystrike. However, because the procedure is performed without anesthesia, animal rights groups have recently deemed it inhumane and unnecessary. In Australia, organizations such as PETA (People for the Ethical Treatment of Animals) have mounted opposition in the form of protests and boycotts. The industry association known as the Australian Wool Innovation (AWI) initially pledged to phase out mulesing by 2010 but then rescinded its commitment in mid-2009, which exacerbated the conflict. In New Zealand, many Merino growers took a different approach and voluntarily adopted alternatives to mulesing in an effort to distance themselves from the controversy. The majority of NZM growers have ceased to use the practice, and it is strictly prohibited on Zque-certified farms. This approach has further differentiated New Zealand Merino from Australian Merino. Another benefit is that the animals no longer experience the stress associated with mulesing, which helps keep their wool strong and undamaged.

Source: "Mulesing," Wikipedia.org, <http://en.wikipedia.org/wiki/Mulesing> (September 30, 2010).



## Exhibit 5

### Design Textiles International Profile

Designer Textiles International (DTI) is a New Zealand-based Merino fabric and garment manufacturing company. It provides a wide range of services to its retail and wholesale brand partners, from fabric, design, and production coordination to fully labeled and packaged garments. As of 2010, the company operated manufacturing facilities in New Zealand and Sri Lanka.

DTI is privately held and does not disclose detailed financial information. However, Malcolm Walkinshaw, the company's CEO advised its annual turnover to be approximately US\$31 million. DTI specializes in producing fabrics and garments made from New Zealand Merino wool. Merino products account for approximately 75 percent of its yearly sales (the remainder comes from other non-Merino fashion fabrics and garments). Its largest market is the U.S. (30 percent of sales), followed by New Zealand (25 percent), Europe (25 percent), and Australia (20 percent).

The company's primary focus is on the active outdoor market segment, serving customers such as Ibex and SmartWool. More recently, it has also begun targeting the fashion market with a wide variety of innovative new Merino-based fabrics. According to a company profile, DTI differentiates itself through fabric innovation. "We actively work to develop innovative Merino fabrics that assist to position our customers differently from their competitors," noted Walkinshaw. The company also prides itself on providing its customers with complete supply chain solutions, from the contracts it forges with Merino growers through NZM to its strong relationships with contract apparel-making facilities.

Although DTI does not sell its fabrics and garments directly to the end consumer, it markets the fabric under the MAPP ingredient brand (MAPP stands for Merino Advanced Performance Programme). "[MAPP] tells the Merino story and adds credibility to the fabric source," Walkinshaw explained. This brand was developed to provide DTI customers and their end consumers with confidence that only premium New Zealand MAPP Merino fabrics are used in their garments. The company's relationship with NZM adds value to the MAPP brand "by providing us with a compelling New Zealand Merino story that focuses on the holistic eco positioning of the product, including its sustainability and animal welfare concerns," said Walkinshaw.

#### Sources:

"About the Company," Outdoor Retailer Summer Market, <http://ors.goexpsoftware.com/2010/goExpo/exhibitor/viewExhibitorProfile.php?id=494> (October 19, 2010).

#### Designer Textiles International at a Glance

**Market Segment:** Active outdoors

**Products:** Premier knitted Merino fabrics and garments

**Percent made from Merino wool:** 75 percent

**Annual sales:** ~US\$35 million

**Go-to-market strategy:** Through retailers and wholesale brand partners

**Employees:** 125

**Location:** Based in Auckland, New Zealand

**Founded:** 1965

**Ownership status:** Privately owned and operated

“Function and Performance Meet Fashion,” LA Textile Show, June 2006,  
[http://www.fabriclink.com/news/Assets/LA\\_textile\\_show2.pdf](http://www.fabriclink.com/news/Assets/LA_textile_show2.pdf) (October 19, 2010).

Information provided via email by Malcolm Walkinshaw, CEO of Pod Ltd. which includes Designer Textiles (October 19, 2010).

“MAPP Story,” <http://www.mapp.co.nz/story/dti.php> (October 19, 2010).

## Exhibit 6 Ibex Profile

Peter Helmetag and John Fernsell founded Ibex in 1997. For years, Helmetag had worn garments made from wool when he went mountain climbing because he knew they would keep him warm and dry (he was introduced to the fiber's benefits by his grandfather, who owned a wool mill). Fernsell, an avid backcountry skier, was always on the lookout for an alternative to synthetic fabrics that would perform better in changeable outdoor conditions. When the two men came together, they defined a vision for a company that would bring "new" wool garments—made from finer, softer, high-performance wool—to other climbers and backcountry skiers. By 2010, their vision had become a reality. Ibex had grown to nearly 50 employees with annual sales between US\$10-\$20 million.

The Ibex product range includes men's and women's apparel, jackets, accessories (hats, scarves, gloves), and underwear. In terms of its primary customers, "We have a strong lifestyle component to the business, but we really design for outdoor enthusiasts," said Fernsell. Approximately 70 percent of the company's offerings are made using New Zealand Merino wool.

In terms of Ibex's go-to-market strategy, Fernsell noted, "We're unique from [the other NZM brand partners] in that about half of our revenues come from direct-to-consumer sales." Ibex is aggressively expanding its direct channels because, he continued, "We feel that the closer we are to the consumer, the better off we are." In 2009, Ibex's online business grew by 47 percent, despite the economic downturn. In 2010, the company opened its first dedicated retail store in Boston, Massachusetts.

Another 40 percent of Ibex's business comes from sales through retail partners; the remainder is from small, miscellaneous channels. Ibex's customer base is strongest in the U.S., which accounts for 90-95 percent of annual turnover, but the company has begun focusing on international markets.

When asked what makes Ibex unique from its competitors in the active outdoor market segment, "Customer service and products are our two key strengths," Fernsell said. Ibex is passionate about providing the best customers service possible. "We treat the customer like gold," he stated. When it comes to products, "Our offering is much broader than our competitors. We knit and do more fabrics than all of them combined.... And our focus from day one has always been on products. We get up in each morning thinking about what cool new things we can make today and how can we lead the market. We're all about products."

### Ibex at a Glance

**Market Segment:** Active outdoors

**Products:** Apparel, jackets, accessories, underwear

**Percent made from NZ Merino wool:** ~ 70 percent

**Annual sales:** US\$10-\$20 million

**Go-to-market strategy:** 50 percent direct-to-consumer sales; 40 percent through retail partners

**Employees:** 50

**Location:** Based in White River Junction, Vermont

**Founded:** 1997

**Ownership status:** Privately owned and operated

The company started working with NZM about nine years ago. Fernsell and his colleagues were introduced to the NZM team by Designer Textiles International after Ibex moved some of its knitting to New Zealand. “Today, probably 60 percent of our fabric is made in New Zealand,” Fernsell commented. The relationship the company has established with NZM is important to Ibex because it provides Ibex with the highest quality fiber available in the market. “I’m always looking for points of differentiation,” he said. “If we’re competing on price alone, we’re in trouble because we’re never going to be the low-cost producer. We want to make a high quality product. We want to make a beautiful product. We want to be differentiated. Zque and New Zealand Merino give us another point of differentiation that’s important.”

Sources:

Information provided by Ibex president, John Fernsell, via a phone interview (September 30, 2010).

“Our History,” Ibex, July 7, 2007, [http://www.ibexwear.com/ibex\\_buzz/2007/07/in-the-beginning-our-histo.html](http://www.ibexwear.com/ibex_buzz/2007/07/in-the-beginning-our-histo.html) (September 30, 2010).

## Exhibit 7 Icebreaker Profile

Icebreaker was the first company to develop a merino fiber layering system for the outdoors. The company was formally founded in 1994, but got off to an illustrious start when Sir Peter Blake, a legendary New Zealand yachtsman, wore prototypes of its early Merino wool garments when he set a world's record circumnavigating the globe in 1993. After his voyage, Blake reported that, "Icebreaker is superior in every way to anything I've ever worn. I wore it for 40 days and 40 nights and it didn't itch or get whiffy."

This high-profile testimonial, along with his own experience with the garments convinced Jeremy Moon to join forces with the Merino farmers making the original Icebreaker apparel. As the company's managing director, Moon helped launch the company across New Zealand and Australia. By 2010, Icebreaker had expanded to 37 countries across Europe, Asia, Australia, and North America. According to an article in TIME, its annual sales were more than US\$100 million.

Icebreaker targets its products at active-minded people who enjoy the outdoors, and its brand has evolved to represent an exploration of "our relationship to nature, and to each other." As stated in the Icebreaker corporate profile, "This phrase is at the heart of our company." To meet the needs of its consumers, Icebreaker has engineered more than 25 distinct Merino fabrics, which it uses to create high-performance, "edgy" underwear, mid-layer, and outerwear products that combine "nature's work with human technology and design," said Rosanne Palmisano, the company's global vice president of marketing.

In terms of its sales channels, "Our primary focus is wholesales sales to retailers," noted Palmisano. This channel currently accounts for approximately 80 percent of sales, with the company's products carried in over 2,000 retail stores around the world. However, Icebreaker also owns six of its own retail outlets in target outdoor markets such as Auckland, New Zealand, Portland, Oregon, and Montreal, Canada. It plans to open another store in New York City's SoHo neighborhood in November 2010, and several others are in the planning stage. Icebreaker also makes its products available via online sales, but so far only in the U.S. "We expect to expand [our online presence] to other markets in the near future," Palmisano added. In combination, the company's own retail stores and its online business accounts for 20 percent of sales. According to 2009 year-end sales, 37 percent of Icebreaker's business comes from New Zealand and Australia; the U.S. is its second largest market at 30 percent.

### Icebreaker at a Glance

**Market Segment:** Active outdoors

**Products:** Apparel, underwear, coats, accessories, socks.

**Percent made from NZ Merino wool:** 100 percent

**Annual sales:** US\$100 million

**Go-to-market strategy:** 80 percent through retail partners; 20 percent direct to consumer

**Employees:** 250

**Location:** Based in Wellington, New Zealand

**Founded:** 1994

**Ownership status:** Privately owned and operated, with wholly owned subsidiaries in the U.S., Canada, Australia, Germany, Switzerland, France, and Eastern Europe

One way that Icebreaker differentiates itself from its competitors in the active outdoor market is as a first-mover and innovator in the segment. “We talk about how we pioneered the outdoor Merino category, and the innovation we have brought to Merino—from the lightest-weight performance fiber on the market to the all-over print on Merino (Bodyfit+),” said Palmisano. The company also emphasizes its focus on quality. “We’re 100 percent focused on Merino. It’s all we do, so we know the fiber inside and out,” she noted. “We buy our wool directly from the sheep’s back and control quality every step of the way.” Palmisano mentioned that the company even works with farmers to directly influence how sheep are mated and cared for to help improve the strength and caliber wool. Finally, she stated, “We share our commitment to having a transparent, sustainable supply chain through our Icebreaker Baacode traceability system.”

Icebreaker was among the first companies to begin offering multiyear contracts to New Zealand’s Merino farmers. According to one article, the commodity purchasing process “almost broke Icebreaker in the late 1990s when its products began to unravel because of inconsistent fiber quality.” So, Moon saw the value of offering price premiums to growers who could produce fiber that uniformly met the company’s stringent requirements. Today, NZM facilitates wool contracts with the growers in partnership with Icebreaker. This includes price and volume negotiations, testing of Merino against preset standards, management of batching, and monitoring of on-farm ethics. “The [NZM] philosophy of nurturing long term relationships is completely aligned with the Icebreaker set of values,” said Palmisano. “They have worked with us closely in the past 15 years to create a healthy co-dependent relationship with our growers.”

Sources:

“Athlete Reviews: Peter Blake KBE,” Icebreaker, [http://www.icebreaker.com/site/aboutus/reviews\\_peter.html](http://www.icebreaker.com/site/aboutus/reviews_peter.html) (October 5, 2010).

Bill Saporita, “Icebreaker Is a Natural,” *TIME*, March 22, 2010, <http://www.time.com/time/magazine/article/0,9171,1971425,00.html> (October 6, 2010).

“Company Profile,” Icebreaker, <http://media.icebreaker.com/index.php?s=18> (October 5, 2010).

“Icebreaker (Clothing),” Wikipedia.org, [http://en.wikipedia.org/wiki/Icebreaker\\_\(clothing\)#cite\\_note-5](http://en.wikipedia.org/wiki/Icebreaker_(clothing)#cite_note-5) (October 6, 2010).

Information provided by Icebreaker’s Global Vice President of Marketing, Rosanne Palmisano, via a phone interview (October 14, 2010).

Joseph B. Lassiter, III and Dan Heath, “Icebreaker” The U.S. Entry Decision,” Harvard Business School, July 17, 2005, [http://hbr.org/product/a/an/806006-PDF-ENG?cm\\_sp=doi--case--806006-PDF-ENG&referral=00103](http://hbr.org/product/a/an/806006-PDF-ENG?cm_sp=doi--case--806006-PDF-ENG&referral=00103) (October 5, 2010).

## Exhibit 8 Johnstons Profile

Throughout its long history, the Johnstons motto has been “only the best is good enough.” The company was founded in 1797 in Elgin, Scotland in the midst of the industrial revolution. Initially, Johnstons focused on producing linen, flax, and tobacco, but in the early 1800s it entered the wool industry. In 1851, its mills were the first to weave cashmere in Scotland and the company has remained dedicated to processing luxury fibers since then. Johnstons produces the majority of its products in the United Kingdom as a way of ensuring that they are consistently of the highest quality.

Today, Johnstons offers a broad range of men’s and women’s knitted clothing, accessories (hats, gloves, scarves, bags), home furnishings (blankets, throws), and fine fabrics. It dedicates approximately 70 percent of its business to manufacturing these products for exclusive private label customers, such as Burberry, Hermes, and Chanel. The remaining 30 percent of the business is focused on selling products under the Johnstons brand through major retail partners, its own retail stores, and a small, but growing online presence. Johnstons three retail stores in Scotland (which are located in Elgin, St. Andrews, and the Northumberland market town of Corbridge) account for roughly 10 percent Johnstons’ branded product sales.

Johnstons estimates that its annual sales are US\$66-\$71 million. Exports represent approximately 30 percent of this total. The company’s largest international markets are Europe (48 percent) and the U.S. (30 percent).

Across its channels, and in all of its geographic markets, Johnstons primarily targets customers in the premium leisure apparel sector. When describing what makes the company’s offering unique, James Dracup, group managing director, referred to “honest luxury” that appeals to its customers because the products are “authentic, ethical, and sustainable.” Johnstons further differentiates itself from competitors in this market segment through the superior quality and performance of the fiber it uses.

As of summer 2010, Johnstons did not have any significant products in its range made from New Zealand Merino wool. However, it was in discussions with NZM to begin procuring Merino through the company. Dracup had learned about Zque and was attracted to the fiber. He also welcomed a partnership with NZM due to the “authentic, ethical, high-quality supply” it offered, along with its “ethos of community and partnership, not just purely selfish gain.”

### Johnstons at a Glance

**Market Segment:** Luxury knitwear

**Products:** Cashmere, Merino, and woolen knitwear, cloth, and accessories

**Percent made from NZ Merino wool:** TBD

**Annual sales:** US\$66-\$71 million

**Go-to-market strategy:** 70 percent private label manufacturing; 30 percent sales of Johnstons brand through retail partners, the company’s own retail stores, and an online presence

**Employees:** 800

**Location:** Based in Elgin, Scotland

**Founded:** 1797

**Ownership status:** Privately owned and operated

Sources:

“Chronology,” Johnstons, <http://www.johnstonscashmere.com/index.php/about-us/chronology> (September 28, 2010).

“History,” Johnstons, <http://www.johnstonscashmere.com/index.php/about-us/history> (September 28, 2010).

Information provided by Johnstons group managing director, James Dracup, via email (September 28, 2010).



## Exhibit 9

### John Smedley Profile

The company John Smedley was founded in 1784 in Derbyshire, England by Peter Nightingale and his associate, the first John Smedley. Initially, the two men started a spinning mill that produced muslin and spinning cotton that could be used on hand frame looms. When the second John Smedley took over the company in 1825, he launched a vision for bringing spinning, knitting, and manufacturing under one roof. In doing so, he significantly expanded the company's operations, installed leading-edge technology, implemented positive working conditions considered unusual for the time, and established the company's reputation for using only the highest-quality raw materials and production processes.

From a product perspective, John Smedley specialized in hosiery and underwear for generations. In the 1930s, the company expanded into nightwear, swimwear, and outerwear. By the 1960s, its main focus shifted to outerwear with the launch of its signature sweater collection. At this point, the company also began selling its product overseas. As of 2010, more than 70 percent of all John Smedley products are exported to more than 35 countries across the globe. However, 98 percent of its entire line is still produced in England.

In 1995, John Smedley began making products with New Zealand Merino wool. To ensure the highest quality fiber from traceable sources, the company was among the first to begin entering into forward contracts with Merino growers, with the assistance of NZM. John Smedley actively promotes the quality and sustainability of its Merino to its customers. For instance, on its website the company boasts, "We... have Zque accreditation which guarantees that we have fair and ethical practices in the way we work with our suppliers and the way they treat their sheep, as well as the quality of our wool."

John Smedley differentiates itself from other companies in the luxury knitwear segment through its focus on quality—from using the finest materials to finishing every garment by hand. It also emphasizes the unique styling of its garments, which provide "a modern take on timeless designs." Finally, the company continually innovates and adapts to expand its range in an effort to bring customers the ultimate in luxury. For instance, in 2009, John Smedley launched an exclusive line of garments using 13.5 micron New Zealand Merino fiber, which is finer than cashmere. According to the company, this yarn is so rare that it is only produced by 0.0013 percent of the world's sheep population.

#### John Smedley at a Glance

**Market Segment:** Luxury knitwear

**Products:** Sweaters, shirts, and other outerwear, underwear, and accessories made from New Zealand Merino wool and Sea Island cotton

**Percent made from NZ Merino wool:** Not available

**Annual sales:** Not available

**Go-to-market strategy:** Through retail partners and direct to consumer activities

**Employees:** Not available

**Location:** Based in Derbyshire, England

**Founded:** 1784

**Ownership status:** Privately owned and operated

In terms of sales and distribution, the company opened its flagship John Smedley retail store on Brook Street in London's West End in 2000. John Smedley also makes its products available through high-end retailers, such as Barneys, Bergdorf Goodman, Harrods, and Selfridges, as well as via an online store. Over the coming months, John Smedley intends to increase its direct-to-consumer sales by growing its online presence and opening more of its own retail stores. It also hopes to further expand into "emerging luxury markets" (China, India, Russia, and Brazil).

Sources:

"Contemporary Design," John Smedley, <http://www.johnsmedley.com/contemporary-design/> (October 25, 2010). Information provided by Andrew Caughey, managing director of John Smedley, at the NZM brand partner summit (September 8, 2010).

Sean O'Grady, "Minor British Institutions: John Smedley," *The Independent*, October 17, 2009, <http://www.independent.co.uk/news/uk/this-britain/minor-british-institutions-john-smedley-1803199.html> (October 20, 2010).

"The John Smedley Story," John Smedley, <http://www.johnsmedley.com/the-john-smedley-story> (October 20, 2010).

"Who Is John Smedley?" John Smedley, <http://www.johnsmedley.com/who-is-john-smedley> (October 20, 2010).

## Exhibit 10

### Loro Piana Profile

Although the Loro Piana family began selling wool fabrics in the 1800s, the current company was founded by Pietro Loro Piana in 1924. The business made a name for itself in the 1940s supplying fine fabrics to the burgeoning post-war haute couture industry. Around this time, Loro Piana also began expanding across Europe and into North America and Japan as an exporter of fine wool and other premium fabrics. In the 1980s, the company began producing its own finished goods, which it distributed through premium retailers. It was not until 1993 that Loro Piana opened its first directly operated retail store in New York. Stores quickly followed in Venice and Milan. In 2010, Loro Piana operates 136 of its own boutiques

According to the company's website, Loro Piana "has carved out a position as the world's foremost cashmere manufacturer and the largest single buyer of the finest wools," which it supplies to the "most discerning and demanding of clients." The company's Luxury Goods division produces clothing for men, women, and children, along with accessories, home furnishings, and gifts. It also boasts one of the most complete made-to-measure services in the world. Its Textile division supplies the company's Luxury Goods division, and also sells fine clothing fabrics, fabrics for interior design, and yarns to other top manufacturers and other customers. Between the two divisions, it operates six manufacturing facilities in Italy, as well three in the United States, and one in Outer Mongolia.

In terms of the end consumers who purchase Loro Piana goods, the company describes them as "high-profile men and women who appreciate genuine quality and are not easily influenced by fashions and trends but instead seek discreetly elegant clothing." Accordingly, the company is committed to carefully controlling quality "from the search for the noblest of raw materials to the distribution of the finished goods through the company's own retail network or in collaboration with its highly selected partners." Loro Piana works with NZM to procure the finest available Merino wool directly from New Zealand growers.

#### Sources:

- "Company Outline," Loro Piana, <http://www.loropiana.com/eng/company/intro.php> (October 25, 2010).
- "Group Structure," Loro Piana, <http://www.loropiana.com/eng/company/struttura.php> (October 25, 2010).
- "History," Loro Piana, <http://www.loropiana.com/eng/company/storia.php> (October 25, 2010).
- "Products: Introduction," Loro Piana, <http://www.loropiana.com/eng/company/intro.php> (October 25, 2010).

#### Loro Piana at a Glance

**Market Segment:** Luxury knitwear

**Products:** Sportswear, leisurewear, home furnishings, accessories, gifts; clothing fabrics, interior fabrics, and yarns

**Percent made from NZ Merino wool:** Not available

**Annual sales:** Not available

**Go-to-market strategy:** 136 Loro Piana boutiques, plus a network of retail partners

**Employees:** Not available

**Location:** Based in Quarona, Italy

**Founded:** 1924

**Ownership status:** Privately owned and operated

## Exhibit 11 Reda Profile

In 1865, Carlos Reda opened a wool mill in Italy's Valle Mosso. Over time, the business expanded into a complete wool factory. When the facility was destroyed by a flood in 1968, Reda rebuilt its operations with state-of-the-art technology and has remained committed to continually experimenting with innovative new equipment and processes to produce fine quality woolen fabrics for men's suiting in the "affordable luxury" category. As the company describes on its website, "Reda represents an example of Italian mastery, joining artisan tradition with technical innovation to obtain even better results."

Reda sells its fabrics to international men's fashion designers. Approximately 30 percent of its sales are in Italy, with the remainder coming from markets around the world. While it is well-established in Europe, Japan, and North America, Reda has discovered important new growth opportunities in Russia, China, and South America. The company presents new collections twice a year, with each collection including as many as 2,500 different fabric variations. These fabrics are "poised between tradition and innovation," says Reda, and they have become known for their "quality, luxury, and taste."

In 2006, Reda began purchasing New Zealand Merino wool through NZM. In 2009, the company decided to purchase only Zque certified Merino and now buys more than half of all the wool accredited through NZM's Zque program. In an article, Reda's owner, Francesco Botto Poala, described the benefits the company receives through its relationship with NZM: "Since 1865, all our fabrics have been produced exclusively in Italy. Quality has always been the key at every step, from the fleece to the finished fabric. But today, consumers are increasingly concerned about sustainability and traceability of products and the Zque Merino fiber delivers all these. By using New Zealand's Zque qualifying fiber we are ensuring the ongoing success of the retail markets. We are convinced genuine products that have heritage, integrity, creativity, and craftsmanship from Italy and New Zealand are a winning combination." Reda's managing director, Ercole Botto Poala, commented in another article: "Even if wools coming from New Zealand satisfy only about 20 percent of our needs, we strongly trust this project. The growers are doing an excellent job, and improve year after year. While a fabric's quality doesn't just come from the fineness of the fiber, the excellence of the wools coming from New Zealand continue to increase, and that's why Reda will grow its purchases from there."

In addition to the sustainability of its products, Reda believed that its Made in Italy label was a key differentiator for the company. It also asserted that its central position in the Billese textile cluster was a major advantage. "Around a 100 kilometer area, Ercole Botto Poala explained,

### Reda at a Glance

**Market Segment:** Luxury suiting

**Products:** Fine woolen fabrics for men's suits

**Percent made from NZ Merino wool:** ~ 20 percent

**Annual sales:** US\$70 million

**Go-to-market strategy:** Wholesale sales to international men's fashion designers

**Employees:** 370

**Location:** Based in Valle Mosso, Biella, Italy

**Founded:** 1865

**Ownership status:** Privately owned and operated

“there is everything: from the combing process to the fashion designer and clothing manufacturer. That means a continuous and fast exchange of ideas, a 360-degree research and innovation operation. The delocalization of certain production phases doesn’t work. The ‘think tanks’ have to be close to production—that’s the reality.

Sources:

- “Ercole Botto Poala: The Twist Interview,” *Twist*, May 2010,  
[http://www.iwto.org/news/wool%20in%20media/2010/twist-05-2010\\_ercle-botto-poala.pdf](http://www.iwto.org/news/wool%20in%20media/2010/twist-05-2010_ercle-botto-poala.pdf) (October 25, 2010).  
“Reda World: Company,” Reda, <http://www.reda.it/sito/main.html> (October 25, 2010).  
“Reda World: History,” Reda, <http://www.reda.it/sito/main.html> (October 25, 2010).  
“Reda World: Quality,” Reda, <http://www.reda.it/sito/main.html> (October 25, 2010).  
“Reda World: Production,” Reda, <http://www.reda.it/sito/main.html> (October 25, 2010).  
“World Class Merino Wool Draws Italian Journalist,” *Scoop Independent News*, October 8, 2009,  
<http://www.scoop.co.nz/stories/BU0910/S00187/world-class-merino-wool-draws-italian-journalist.htm> (October 25, 2010).

## Exhibit 12

### SmartWool Profile

SmartWool was founded in 1994 by two ski instructors who were looking for ways to keep their feet warm and comfortable on the slopes. Through a process of experimentation, they rediscovered the classic benefits of wool and then committed themselves to developing a product that was soft and wouldn't shrink. But, as the story goes, people were hesitant to buy their socks because they thought they would be itchy. Finally, SmartWool challenged target customers to try them, which proved to be just the catalyst that was needed. According to the company, "The instant people tried them they were awestruck with SmartWool's soft luxurious feel. They were even more surprised that their feet stayed comfortable for extended periods of time in mixed weather conditions. Instead of getting clammy, the SmartWool socks stayed dry, soft, and comfortable. The founders then realized that they had to get their socks on as many people as possible to let them speak for themselves."

More than 15 years later, SmartWool is a leader in the active outdoor market, having expanded beyond socks into apparel, accessories (hats, gloves, etc.), and slippers. Based on its success, the company was acquired by Timberland in 2005 for \$82 million. As a subsidiary of Timberland, SmartWool is not able to disclose its annual sales. However, Mark Satkiewicz, the company's president and general manager, placed its yearly revenue in the range of US\$50-\$150 million and indicated that SmartWool was the biggest brand among New Zealand Merino's partners.

"As a company," Satkiewicz noted, "we're active, passionate, responsible, easy to do business with, and fun. All of those things really resonate with our employee-base and with who we are." These characteristics also help SmartWool differentiate itself from competitors who also target outdoor enthusiasts as their primary customers. Satkiewicz explained: "When we do brand affinity work, the number one brand attribute that always comes back from the people we talk to is *comfort*. That's the number one word associated with SmartWool. So we key on that in a pretty significant way. The other things that stand out are related to design attributes—stripes, colors, fun, active designs. All of those things really apply to SmartWool, and if you look at our product range and our catalog you'll see it that way. We're not too serious about ourselves. Even though we make a fantastic product that can perform in any conditions, we like to have some fun with it as well."

In terms of its go-to-market strategy, SmartWool relies heavily on selling through established retailers. More than 90 percent of the company's sales come from department stores (e.g., Nordstrom), sporting goods stores (e.g., Sports Authority), and outdoor retailers (e.g., REI).

#### SmartWool at a Glance

**Market Segment:** Active outdoors

**Products:** Socks, apparel, accessories, slippers

**Percent made from NZ Merino wool:** ~ 99 percent

**Annual sales:** US\$50-\$150 million

**Go-to-market strategy:** > 90 percent through retail partners

**Employees:** 85

**Location:** Based in Steamboat Springs, Colorado

**Founded:** 1994

**Ownership status:** Wholly-owned subsidiary of Timberland (acquired in late 2005)

SmartWool has an online presence that accounts for most of its other sales, but it has not yet begun to explore other channels such as opening its own retail stores. “I think that brands sometimes get ahead of themselves before they’ve actually accomplished everything they should in any one channel,” Satkiewicz commented.

SmartWool began procuring Merino wool through NZM in 2001. As of 2010, approximately 99 percent of its products are made with fibers purchased via NZM contracts. “We do source a very, very small amount of wool from Australia for a couple of sweaters that we make,” Satkiewicz explained. “It’s still traceable, certified, non-mulsed wool; it’s just not from New Zealand.” In terms of the benefits of working with NZM, Satkiewicz said, “It provides price stability for us and price stability to the grower. It also allows us to influence certain quality attributes, along with animal husbandry and all of the ethical things that New Zealand Merino stands for.”

Sources:

“About Us: History,” SmartWool, <https://www.smartwool.com/default.cfm#/About/History/> (September 27, 2010). Information provided by SmartWool president and general manager, Mark Satkiewicz, via a phone interview (September 27, 2010).

“Timberland Buys SmartWool for \$82 Million,” *Sporting Good Business*, November 8, 2005, <http://www.allbusiness.com/retail-trade/miscellaneous-retail-miscellaneous/4462770-1.html> (September 27, 2010).

**Exhibit 13**  
**Attendees at the Thinkering Summit**

***Designer Textiles International***

Malcolm Walkinshaw – CEO

***Ibex***

John Fernsell – President

***Icebreaker***

Rosanne Palmisano – VP Global Marketing

***John Smedley***

Andrew Caughey – Managing Director

***Johnstons***

James Dracup – Group Managing Director

***SmartWool***

Mark Satkiewicz – President

Carol Davidson – Director of Marketing

Ann Wiper – VP and General Merchandising Manager

***Ministry of Agriculture and Forestry (MAF)***

Iain Cossar – Sector Performance Director

***New Zealand Trade and Enterprise (NZTE)***

Jon Mayson – Chairman

Tanya Shuster – Senior Business Development Manager

***NZM***

John Nichol – Chairman

John Brakenridge – Chief Executive Officer

Peter Floris – Chief Financial Officer

Nick Aubrey – Business Development Manager

Gretchen Kane – International Marketing Manager

Steve Williamson – Creative Manager

Jonny Simpson – Art Director

Ryan Hughes – Social Technology Manager

Source: Information provided by New Zealand Merino.



# **SUPERFINE WOOL INDUSTRY STRATEGIC REVIEW**

by

John Powell

**Optimal** ICM

for

Australian Wool Innovation Limited

and

Australian Superfine Wool Growers' Association Inc.

30 January 2013

## About the author



John Powell has been a superfine wool grower for 25 years at his property 'Woodvale' near Yass in southern New South Wales. John is currently Secretary of Goulburn-Yass Branch of ASWGA, and is an Owner-Classifier. He has a BSc in Applied Science (Major in Natural Resources Management, sub-major in Economics). John has had a 30-year professional career (the last 12 years as an independent consultant) managing landcare programs and sustainable landscapes Research Development and Extension.

## Contents

Executive Summary	3
1. Background	
1.1 Origins of this Review	7
1.2 Working Group	8
1.3 Intended audience	8
2. Australian Superfine Wool	
2.1 Organisations representing superfine merino wool	9
2.2 Business strategies	9
2.3 Classing and appraisal	10
2.4 Does appraisal add value?	11
3. Current situation	
3.1 Superfine merino wool production	12
3.2 Superfine wool sales (all breeds)	13
3.3 Production costs	14
3.4 Prices received	15
3.5 Selling systems	16
3.6 Marketing programs	16
3.7 Research and Development – off farm	17
4. Future operating environment	
4.1 Improving global economics, demographics and markets	18
4.2 Global production trends	18
4.3 Australian production environment	19
5. Learning from the past, tips from the present	
5.1 The past	21
5.2 The present	22
6. Current problem statement	23
7. The way forward	
7.1 Confirm the key underlying issue	24
7.2 Acknowledge constraints to productivity increases	25
7.3 Focus on achieving wool price increases	26
7.4 Take advantage of favourable global economic developments	27
7.5 Describe what success would look like	28
7.6 Set out core strategies to achieve success	29

7.7 List researchable questions giving effect to the strategies	30
<b>8. Conclusions and recommendations</b>	
8.1 Conclusions	31
8.2 Recommendations	32
 References	 32
<b>Attachment 1</b> People consulted during the review	34
<b>Attachment 2</b> Possible actions for discussion	35

### **Acknowledgements**

The author gratefully acknowledges financial support provided by AWI, and guidance and input received from the project Working Group, particularly Helen Cathles, President of ASWGA. The time and effort that participants in the Cost of Production work put into contributing detailed financial information is greatly appreciated.

# SUPERFINE WOOL INDUSTRY STRATEGIC REVIEW

## Executive Summary

This review arose from concerns within the membership of the Australian Superfine Wool Growers' Association Inc. (ASWGA) that because their wools are undervalued and market prices are unviable, there is little incentive for them to continue working in a complex, high-risk, and costly business.

Many growers, including those who had generations of passion, skill and experience in producing the world's highest quality superfine merino wool, have left the industry. Following representations from ASWGA, Australian Wool Innovation Limited (AWI) funded this Review to examine the current situation facing the industry and develop strategies to secure a viable future.

In totality, the Australian superfine wool industry comprises all wool 18.5 microns and finer, from well-bred and well-classed merino clips, from poorly-bred and poorly classed merino clips, and from other breeds similar to merinos including South African Meat Merinos (SAMMs) and Dohnes.

However, consistent with its origins, **this Review focuses on securing a viable future for high quality and well-classed superfine merino wool (including ultrafine merino).**

This review: describes superfine merino wool growing business strategies; defines the types and styles of wool they produce; analyses their current situation and operating environment; examines findings from past initiatives aimed at improving viability; synthesises issues into a clear problem statement; confirms the underlying issue causing the problem; articulates goals for industry sectors and stakeholders; spells out core strategies, researchable questions and possible actions for further discussion; draws conclusions and recommends that funding support be provided for printing of this report and wider consultation.

## *Superfine merino wool*

The superfine merino wool industry is characterised by growers adopting three main business strategies. **Ultrafine Merino** businesses produce 15.5 micron and finer wools, visually 80's count and up, all true-to-type Saxon. **Traditional Superfine Merino** businesses produce 15.6 to 18.5 micron wools, visually 74's count and up, mostly true-to-type Saxon. **Bold Superfine Merino** businesses produce 15.6 to 18.5 micron wools, mostly visually 70's count and below.

Following testing and prior to sale, wools from these businesses are typed by appraisers as **AS** (Traditional), **M** (Merino) and **M** (Bold) (Bold crimping merino). **The three merino wool types do not correlate directly with the three main business strategies.** For example a Traditional Superfine Merino business could be producing lines of both AS and M types.

Wools typed as AS must be true-to-type Saxon. Wools typed as M are, in the main, slightly bolder than true-to-type Saxon. Wools typed as M (Bold) have a distinctively bold crimp and a significantly lower quality count than expected for their micron. Except for Dohnes, wools from non-merino breeds cannot be typed as M or M (Bold).

Taking account of other attributes, appraisers also give wools offered for sale a style number, ranging from 1 (Choice) to 6 (average topmaker). **M** and **M**(Bold) wools can be given only styles 3 (spinners) to 6 (average topmaker).

## *Current situation*

Almost 100% of superfine merino wool growing businesses are family owned and managed. Very few superfine merino wool growing properties are running over 20,000 sheep, with the majority of properties running less than 10,000.

At a volume of almost 88 Mkg, production of superfine wool (all breeds) peaked in 2006 in the middle of Australia's record 10-year drought. A large proportion of this wool was probably poor quality 'hunger fine' wool from genetically fine wool sheep, not high quality wool from genetically superfine sheep. Although more favourable wool growing conditions have prevailed from 2009-10

to 2011-12, many superfine merino growers were still rebuilding their flocks and renovating pastures. They may also be 'catching up' on post-drought investment in farm infrastructure.

In 2011-12, total superfine wool production was almost 70 Mkg. This is double the 34 Mkg produced a decade ago. Superfine wool now comprises about 20% of the total Australian wool clip. Data that separates production of superfine merino wool from production of superfine wool from SAMMS, Dohnes etc is not available.

### ***Production costs***

Indicative production costs suggest that with the wool prices and favourable seasonal conditions that prevailed in 2011-12; Ultrafine Merino businesses based on shedded wethers or paddock-run self-replacing flocks **do not break even on production costs**, let alone achieve commercial viability; Traditional Superfine Merino and Bold Superfine Merino businesses operating self-replacing flocks **may break even on production costs but are not commercially viable**; Bold Superfine Merino wether businesses **may break even on production costs, and have the potential to generate a surplus over production costs, but the surplus is probably insufficient** to achieve commercial viability.

### ***Product marketing and promotion***

AWI is currently undertaking marketing programs to increase awareness amongst brands, designers and consumers about the desirable qualities of fine and superfine wool (all breeds). These include: *Merino: No Finer Feeling*; *Campaign for Wool*; *China Luxury Market*; and *Mothers and Babies*. AWI also supports the following off-farm research programs to inform supply chains about the attributes of superfine merino wool: *The Wool Lab*; and *Superfine Merino Knits*. AWI also produces a monthly Market Intelligence report that includes superfine wool coverage.

These initiatives appear to have rekindled interest in superfine wool apparel as a whole. However, identifying the actual impact that they may have had on demand and prices for high quality superfine merino wool, or what would have happened to demand and prices without them, has been beyond resources available for this Review.

### ***Learning from the past and tips from the present***

Several recurring themes emerged from an analysis of reports and initiatives over the last 30 years concerning the superfine wool industry, including: lack of viability; growers leaving the industry or changing enterprises; challenges in describing and measuring the special characteristics of superfine merino wool; educating supply chains about the characteristics; and demonstrating the value of the characteristics to supply chains.

These themes indicate among other things that: the superfine/ultrafine merino industry will continue to be a difficult business; demand can be improved by strategic product innovation and targeted product marketing; selecting countries in which to conduct pilot programs and product marketing campaigns is important; and targeted marketing must incorporate an easy way (such as certification for next-to-skin comfort) for consumers to differentiate between superior and inferior superfine wool products.

A recent overseas visit by ASWGA representatives drew the following suggestion from overseas processing interests: *'We [currently] have a measurement chart to sell greasy wool [to processors] that articulates the attributes of raw wool based on scientific analysis. **We need [to develop] an attributes chart, established through scientific trial and drawn from the consumers' language, that articulates the attributes for each [of the three] wool types. Thus establishing the value at the only place willing to reward [special] attributes – the retail consumer.'***

## ***Problem statement***

The problem statement can be described as a **downward spiral** in which higher meat prices and low wool prices result in superfine wool growing businesses increasing emphasis on growth rates and carcase weights at the expense of wool quality; clip preparation standards fall; other businesses turn to more viable enterprises; our major customer appears to buy predominantly on measurements, with supply chains for it and other customers not valuing wool attributes currently assessable only by visual inspection; there is no simple mechanism whereby consumers can recognise quality and to relay their preferences back through supply chains; the price setting mechanism has changed from a market that pays higher premiums as quality rises to a market that applies bigger discounts for increasing variation down from perfection; premiums for choice, superior and spinners styles over best topmakers and good topmakers decline; global demand in general remains weak; more growers lose heart and leave the industry; and in succession planning, potential new entrants pursue more rewarding pursuits.

The key underlying issue causing the problem for high quality superfine merino wool is that there is **limited consumer appreciation of the benefits for them of products made from high quality superfine merino wool, which leads to a lack of consumer desire for products made from it, and hence lack of consumer willingness to pay higher prices for those products.** In the case of ultrafine merino wool produced from shedded sheep, the market was underpinned by limited competition, and when some of the buyers left the industry, the price collapsed.

These issues are not new. Low prices, lack of supply chain appreciation for and valuing of superfine merino's special characteristics, and growers leaving the industry have been recurring themes for several decades.

## ***Future operating environment***

In examining the future operating environment, presentations made by AWI representatives during Wool Poll 2012 suggest that **global economics, demographics and markets are becoming more favourable for wool.**

Supply of superfine wool (all breeds) is expected to remain tight, but superfine wool represents only a small fraction of apparel fibre. A watching brief must be maintained on global production of superfine wool and similar prestige fibres and the implications for Australian growers. It is unlikely that the superior position of cashmere over ultrafine merino will change without a separate targeted marketing campaign for ultrafine wool.

The emergence of China and other BRIC countries (Brazil, Russia, and India) as affluent consumer markets will underpin 40-70% growth in clothing expenditure. In Australia's traditional wool markets, especially the UK, France, Germany, Italy and Japan, over 50 year olds will dominate and this cohort will have more than 50% of their countries disposable income. New product categories will be critical, for example infants/maternity, urban, and below the waist casual for men and women.

In the future production environment in Australia, **climatic constraints and native vegetation protection legislation in some States will limit the extent to which growers can reach viability by increasing productivity.** Growers are also facing calls from domestic and overseas consumers of wool and sheep meat products that the products be produced only in accordance with consumer expectations of acceptable animal welfare practices. Costs associated with meeting consumer expectations, as well as the usual production costs, will continue to increase.

## ***The way forward***

The way forward is to: confirm the key underlying issue; acknowledge constraints to productivity increases; focus on achieving wool price increases; take advantage of favourable global economic developments; describe what success would look like; set out **core strategies** to achieve success; and list researchable questions to generate the knowledge to implement the strategies.

**Core strategies** are to:

- Implement a ***Campaign for Superfine Merino***, including re-branding and re-launching ultrafine merino. The Campaign should rebuild the prestige and markets surrounding **1PP** and **AS** types – the ‘flagships’ of the ultrafine/superfine merino industry
- Ensure the *Campaign’s* product innovation and product marketing activities focus on assisting consumers to differentiate between products made from high and low quality ultrafine and superfine merino wools, encouraging them to lift their desire and demand for the former and to relay their preferences back through supply chains to wool buyers
- Monitor and evaluate the *Campaign* to ensure that it is delivering increased prices to growers of Australian ultrafine and superfine merino wool. Re-direct and adapt the *Campaign* accordingly
- Improve the way we technically specify and describe the attributes of ultrafine and superfine wools throughout supply chains (from the *Code of Practice* at shearing to swing tags in retail stores) – curvature R&D and reliable tests have an important role
- Ensure technical specifications clearly differentiate between **AS**, **M** and **M (Bold)** superfine merino wools, the differences between 1PP and Styles 1-6 of these wools, as well as the differences between these merino wools and wools from SAMMs and Dohnes
- Understand how these technically different wools process, identify what the processing advantages are for each, and how they can be made into new and innovative products
- Use this understanding of technical and processing differences to add value and engage each stage of supply chains to get uptake
- Ensure wool testing and market reporting arrangements provide detailed information on the profile of the Australian superfine wool clip, particularly for microns, volumes and prices for the main types and styles.

In parallel with the above strategies, AWI and ASWGA should work together on a collaborative and collegiate basis to:

- Enhance grower and processor knowledge of and commitment to high quality superfine merino wool through effective communication and engagement during implementation of the core strategies
- Ensure that AWI programs are more effective in increasing demand and prices for superfine and ultrafine wool, and that there is transparent attribution of the program’s results
- Improve availability of independent market intelligence to growers, including predictions of global trends in demand and likely prices, and the factors affecting those trends, within and across selling seasons
- Enhance growers’ business management skills to ensure they can access necessary financial arrangements.

## **Conclusions and recommendation**

Despite a favourable global outlook, the superfine wool industry should expect similar challenges as in the past, viz volatile global economic conditions, markets that don't sufficiently recognise and value the special characteristics of high quality superfine/ultrafine wools, and competition from alternative fibres, including poorer quality superfine wools.

There is scope for improvement in Australia's investment in product innovation and targeted product marketing and promotion in relation to superfine wool. There should be **enhanced focus on assisting consumers to differentiate between products made from high and low quality superfine wools, encouraging them to lift their desire and demand for the former, and to relay their preferences back through supply chains to superfine wool buyers.** This focus is especially applicable to high-income consumers who are likely to be price inelastic (they buy what they desire irrespective of price), and hence largely unaffected by the strong \$A.

**It is essential to monitor the extent to which improved product innovation and marketing does result in improved prices to growers, and to re-direct and adapt the programs accordingly.** It is also critically important to maintain continuity in not only promoting and marketing high quality superfine merino wools as the world's best fibres, but also in researching methods and techniques to prove that they are, and in doing so, demonstrate their value at each step in supply chains.

Improved market intelligence, coupled with responsive, well-funded and well-targeted product promotion, marketing and research, may deliver an increasing price trend over time. In addition, growers could achieve greater increases in prices received over time (ie beat the trend) by selling during price highs and holding during price lows. To do this, they need access to accurate market intelligence that includes predictions of global market trends affecting demand and prices within and across selling seasons. They also need access to training to learn the necessary business skills and build or source the financial capacity to hold wool for long periods if necessary.

**The emphasis of strategies and actions arising from this Review must be on increasing prices received and improving growers' business management skills.**

Finally, this Review recommends that AWI should provide funding for and ASWGA should provide support for printing and wider circulation of this report, and consultation with industry stakeholders identified in the Attachments. **Should that consultation endorse the core strategies listed in this report, or variations of them, it is recommended that AWI provide funding to reconfigure them as a Strategic Plan, and to implement that Plan.**

---

## **1. Background**

### **1.1 Origins of this Review**

This review arose from concerns within the membership of the Australian Superfine Wool Growers' Association Inc. (ASWGA) that because their wools are undervalued and market prices are unviable, there is little incentive for them to continue working in a complex, high-risk, and costly business.

Many growers, including those who had generations of passion, skill and experience in producing the world's highest quality superfine merino wool, have left the industry. The big superfine merino wool clips that used to come from Tasmania are now gone. At the elite ultrafine end, only a handful of growers are left.

ASWGA is concerned that as a whole, the high quality end of the superfine merino wool industry is contracting and trending towards a lesser quality product, produced down to a price. This situation is damaging Australia's reputation as the world's largest supplier of high quality superfine merino



wool, and is exposing our superfine merino wool industry to further substitution from other fibres and increased competition from other superfine merino wool growing countries.

As the peak body representing growers and processors of superfine merino wool, ASWGA is determined to secure a viable future for growers and processors of quality superfine merino wool, by developing and implementing a strategic plan.

Following representations to Australian Wool Innovation Limited (AWI), AWI agreed to provide funding for a small consultancy to review the current situation and the future operating environment facing the superfine merino wool industry, and develop strategies to secure a viable industry future.

## 1.2 Working Group

This report has been authored by John Powell, **Optimal ICM**, under direction from an expert Working Group comprising:

- Dr Paul Swan, Group Manager, Market Intelligence and Reporting, Australian Wool Innovation Limited
- Helen Cathles, President, Australian Superfine Wool Growers' Association Inc
- Trevor Mibus, Vice President, Australian Superfine Wool Growers' Association Inc
- Andrew Blanch, Managing Director, New England Wools
- Philip Attard, 'Gostwyck', New England

Other people consulted during this Review are listed in Attachment 1.

This Review:

- Describes superfine merino wool growing businesses and the wool types they produce
- Analyses their current situation and future operating environment
- Examines findings from past and present initiatives aimed at increasing the viability of superfine merino wool growers
- Synthesises current issues into a clear problem statement
- Confirms the underlying issue causing the problem
- Articulates goals for industry sectors and stakeholders
- Spells out core strategies, researchable questions, and possible actions that could be discussed further with industry stakeholders
- Draws conclusions and recommends that funding support be provided for wider consultation.

## 1.3 Intended audience

The immediate audience for this Review report is ASWGA Council and AWI. These organisations will determine the extent to which the report may be more widely circulated.

# 2. Australian Superfine Merino Wool

In totality, the Australian **superfine wool industry** comprises all wool 18.5 microns and finer, from sheep breeds including Merino, South African Meat Merinos (SAMMs), Dohnes etc. However, consistent with its origins, this review concentrates on **high quality and well-classed superfine merino wool (including ultrafine merino)** 18.5 microns and finer.

## 2.1 Organisations representing superfine merino wool

There are two industry organisations representing Australian superfine merino wool growers.

ASWGA was founded 42 years ago to represent the superfine merino industry to the wool industry generally and to governments, and to foster good working relationships with overseas mills processing superfine merino wool. ASWGA has 18 mill members throughout Italy who were inaugural members 40 years ago. Mills in Turkey, United Kingdom, China and Japan are also members. ASWGA has peak body status with the Australian Government.

ASWGA grower membership is divided into seven regions, with grower members in all States. Growers applying to join ASWGA are assessed and if accepted as members, they must use high quality breeding, classing and clip preparation techniques. Members can use the ASWGA 'Rams Head' brand on bales and in sales documentation as a symbol assuring wool quality, animal welfare and environmentally sustainable production. ASWGA's constituency comprises growers producing **AS**, **M** and **M** (Bold) superfine merino wools (see section 2.3 below) in accordance with ASWGA's standards.

AUSFINE<sup>(TM)</sup> was established 10 years ago to provide a readily identifiable market brand for the traditional 'Saxon type' superfine wool industry and to provide a base for education programs specifically designed for superfine wool growers, classers and shed staff. AUSFINE<sup>(TM)</sup> members undertake to supply mills with traditional 'Saxon type' (**AS**) wools that have implied quality guarantees. The unique AUSFINE<sup>(TM)</sup> bale branding and description system applies across all superfine wool growing districts on similar wool types to give mills and buyers extra confidence with the consistent quality of delivery (Anon 2002).

Some growers of high quality superfine merino wool are members of both ASWGA and AUSFINE<sup>(TM)</sup>.

## 2.2 Business strategies

In response to higher sheep meat prices and lower wool prices, superfine wool growers have shifted their genetics away from traditional 'Saxon' type merinos producing fine crimping 'true to type' ultrafine and superfine wool, towards larger-bodied, heavier-cutting merinos producing 'bold crimp for micron' superfine wool.

As a result, there is now considerable variation in the crimp frequency and staple length of superfine merino fleece wools of the same micron with the same 12 month's growth. For example, at one end of the continuum, 16.5 micron fleece wools can be 100's visually, with 75mm staple length, while at the other end of the continuum, 16.5 micron fleece wools can be 66's visually, with a 140 mm staple length.

The extremes in crimp frequencies and staple lengths, and the range of frequencies and lengths in between, reflect the different **business strategies** adopted by growers in an attempt to maintain viability. For the purposes of this report, and in particular to assist analysis of production costs, the business strategies have been grouped as follows:

- **Ultrafine Merino** 15.5 and finer, visually 80's and up, **all** true to type Saxon. A very high cost business strategy characterised by all or most of the following: shed construction, sheep coats, wether sheep purchases, substantial feed costs, high labour costs, very substantial clip preparation costs (to ultrafine wool classing standard, eg sides only in top lines)

- **Traditional Superfine Merino** 15.6 to 18.5, visually 74s and up, **mostly** true-to type Saxon. A high cost business strategy characterised by all or most of the following: sheep coats, high cost genetics, routine supplementary feeding, routine fertiliser spreading, high labour costs, high clip preparation costs (classed to the AWEX premium classing standard, eg segmenting within pieces and bellies as well as within fleece (backs, necks out)
- **Bold Superfine Merino** 15.6 to 18.5, **mostly** visually 70s and below. A relatively high cost business strategy characterised by all or most of the following: similar cost categories as above for Traditional Superfine Merino, but usually lower costs within those categories, and can be classed according to either the AWEX premium classing standard or the AWEX Merino classing standard.

## 2.3 Classing and appraisal

Table 1 below shows AWEX *Code of Practice 2013-15* style descriptions for superfine merino, to guide wool classers as they prepare lines of wool during shearing. The descriptions of premium quality superfine merino wools (particularly styles 1-3), also inform growers of standards their clip needs to meet to achieve excellence in superfine wool production.

### Styles

In the table, style is a collective term used to describe a range of characteristics. The descriptions are general in nature with different weighting applied to each characteristic. Wool buyers and their processors will use their own style recipes (AWEX 2012<sup>(a)</sup>).

Style	Name	Description
1	Choice	High yielding, dense, high staple strength (relative to micron), low mid breaks, high uniformity in length and strength, excellent crimp uniformity, character and definition, excellent colour (very white), true to type, no faults, well skirted and classed, vegetable matter content must not exceed 1.5%. <b>Note:</b> less than 0.1% of all Superfine/Ultrafine wool falls into this style grade.
2	Best spinners	High yielding, dense, high staple strength, low mid breaks, high uniformity in length and strength, excellent crimp uniformity, character and definition, excellent colour (very white), true to type, well skirted and classed, vegetable matter content must not exceed 1.5%
3	Spinners	High yielding, high staple strength though some part tender acceptable provided not high in mid breaks, uniform length, uniform crimp, very good colour, must be skirted and classed.
4	Best	Generally high yielding, lower staple strengths accepted, higher mid break readings accepted, less regular in length, less regular in crimp presentation, good/fair colour
5, 6	Good (5) Average (6)	Generally good to average yielding, all staple strengths and mid break readings accepted, less regular in length, less regular in crimp presentation, good/fair colour.

AWEX also produces Appraisal Guidelines and an **AS** Style Guide Table to provide additional guidance for brokers, appraisers and auditors in making appraisal decisions after wool has been classed and tested and prior to sale. The Style Guide Table is a general guide to style definition. One characteristic in isolation will not define the applied style. An appraiser/auditor may elect to overrule one or more specifications due to placing higher priority on other characteristics (AWEX 2012<sup>(b)</sup>)

## Types

From the beginning of 2013, fleece wools produced by the three business strategies, with the exception of 1PP wools <sup>(a)</sup>, are appraised prior to sale as one of the following **types** (AWEX 2012<sup>(a)</sup>), along with an assessment of style.

- **AS** - Traditional true to type, Saxon style, 74s count or higher, styles 1-6
- **M** - Merino 18.5 micron and finer not displaying true-to-type Saxon style appearance, slightly bolder. May show the influence of visually broader crimp, styles 3-6
- **M (Bold)** – Bold crimping merino 18.5 micron and finer displaying a distinctively bold (prominent) and significantly lower quality count (ie stronger) than the expected mean fibre diameter, styles 3-6.

Except for Dohnes, wools from non-merino breeds cannot be typed as M or M (Bold). The three merino wool types do not correlate directly with the three main business strategies described in section 2.2. For example, a Traditional Superfine Merino business could be producing lines of both AS and M types.

*<sup>(a)</sup> 1PP (Perfect Plus) wools must be of AST style 1 (Choice), 16.9 micron and finer, 90s/100s count visually, and containing 1% vegetable matter or less, at least 70mm in length unless wool is significantly finer (eg 15.0 micron), where a slightly shorter length will be accepted. These wools must exhibit superlative quality, style and soundness and be prepared in the best possible manner (AWEX 2012<sup>(c)</sup>). Quality being defined as fit for purpose.*

## 2.4 Does appraisal add value?

Appraisal of sale lots in accordance with AWEX Appraisal Guidelines and the **AS** Style Guide Table is the first opportunity in the sale process for a qualified professional to certify the extent to which wools on offer meet the standards that distinguish premium superfine merino wools from lesser quality merino wools of similar micron.

In the past, in traditional markets, there was an effective feedback loop concerning product quality from consumers back through supply chains to buyers. This meant that buyers' limits were raised for wools from well-grown and well-classed clips that were appraised accordingly. Buyers recognised this value to supply chains and prices to growers were maximised.

Today, the information from classing, testing and appraisal that accompanies superfine merino wool throughout supply chains to consumers is largely limited to micron measurement. The high quality styles that passionate growers and classers strive to achieve, and the appraisal that confirms the high standards have been achieved, are lost.

**The price setting mechanism has changed from a market paying higher premiums as quality rises to a market that applies bigger discounts for increasing variation down from perfection.** For a natural product produced in a highly variable climate like Australian superfine merino wool, perfection is never achievable.

The end result is that premiums for style have declined to such an extent that there is now virtually no premium for 1PP wools, with these selling for as low as 1300 cents/kg greasy in 2012 (Cathles Pers. Comm.).

### 3. Current situation

#### 3.1 Superfine merino wool production

Almost 100% of superfine merino wool growing businesses are family owned and managed. Very few businesses are running over 20,000 sheep, with the majority running less than 10,000 (Cathles Pers. Comm.).

At a volume of almost 88 Mkg, production of superfine wool (all breeds) peaked in 2006 in the middle of Australia's record 10-year drought. A large proportion of this wool was probably poor quality 'hunger fine' wool from genetically fine-wool sheep, not high quality wool from genetically superfine sheep.

The record drought had (and continues to have) serious impacts on most superfine merino wool growers. Growers reduced stocking rates significantly. Supplementary feed costs increased, while superfine merino fleece wool prices halved, down from 1,600 c/kg greasy in 2002 to 800 c/kg greasy in 2004 (Powell, 2011).

Although more favourable wool growing conditions have prevailed from 2009-10 to 2011-12, many superfine merino growers were still rebuilding their flock and renovating their pastures in early 2013. They may also be 'catching up' on post-drought investment in farm infrastructure. Hence their current production costs (see section 3.3 below) may still reflect the legacy of the drought.

Investment in drought recovery is expensive and is limited by income received by growers post-drought or from off-farm investments or employment. Recovery can take many years and can be further delayed if drought returns after only a short respite.

Individual growers can be seriously impacted financially and emotionally by multiple events. For example, bushfires destroyed thousands of high quality superfine merinos and burnt almost 14,000 ha of pasture near Yass in southern New South Wales in early 2013. Floods and disease outbreaks are additional risks faced by superfine wool growers.

In 2011-12, total superfine wool production was almost 70 Mkg. This is double the 34 Mkg produced a decade ago. Superfine wool now comprises about 20% of the total Australian wool clip.

Data that separates production of superfine merino wool from production of superfine wool from SAMMS, Dohnes etc is not available. Nor is data on the volume of sales of the three main types of superfine merino wool, viz AS, M and M (Bold).

**The absence of relevant production data is an impediment to understanding the clip profile of the superfine merino industry, how the various wool types are used throughout supply chains to make different products, and how targeted product marketing programs can be developed that showcase merits of the different types and hence improve type-specific demand and prices.**

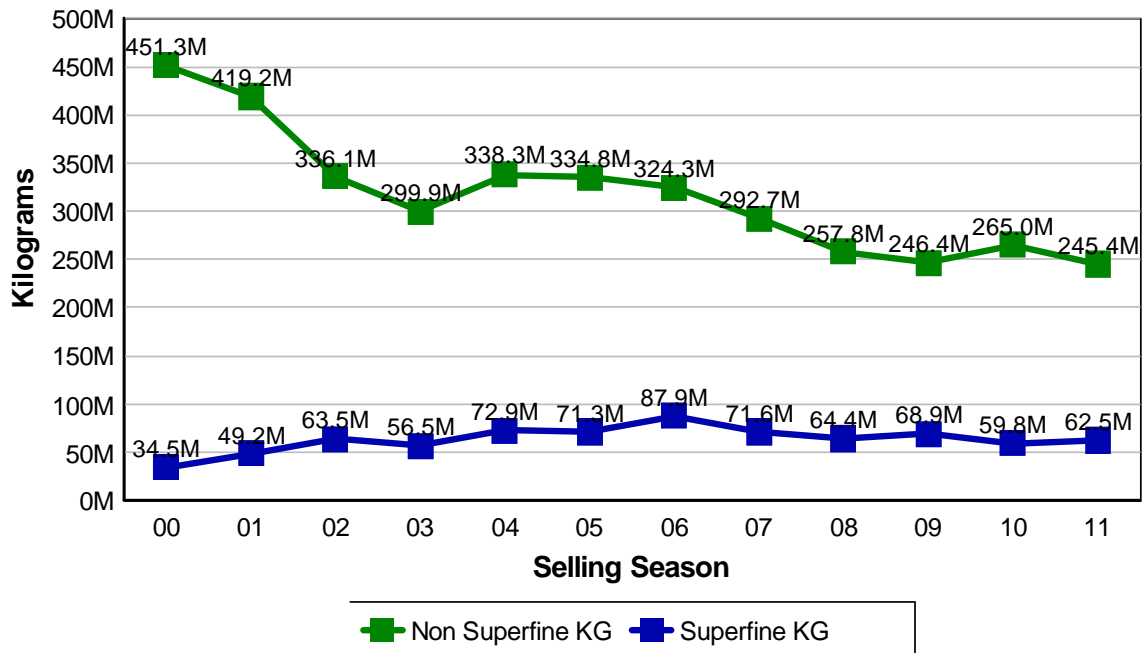
**In establishing procedures to collect and analyse production data for superfine merino wool, it is important for accuracy and international supply perception that weights are used and not percentages.**

## 3.2 Superfine wool sales (all breeds)

The graphs below show sales data for superfine wool from all breeds from 2001 to 2011 (Cother, Pers. Comm.).

### Profile of Weight offered at Australian auctions

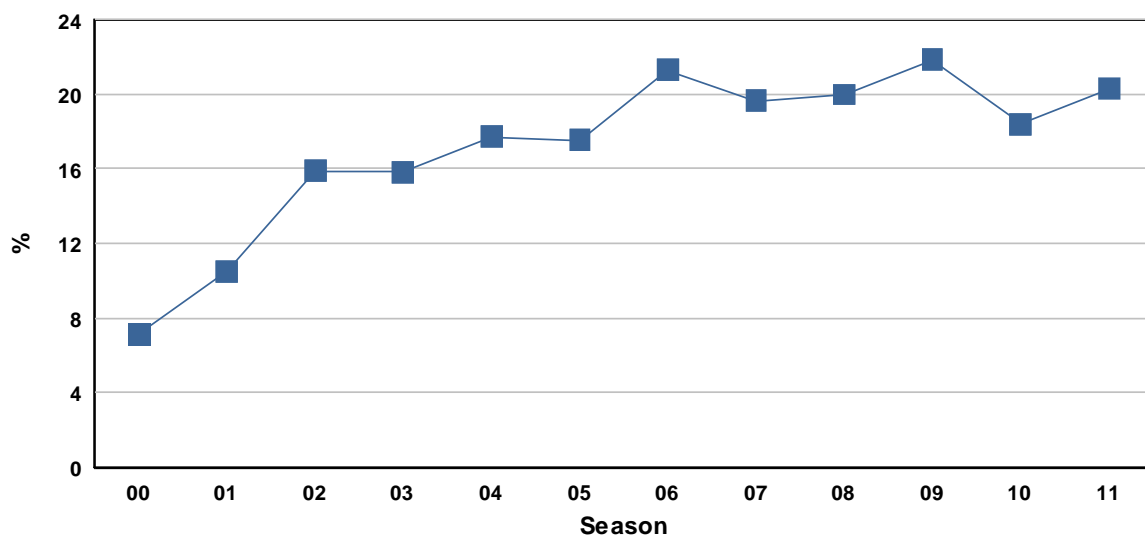
First Hand offered Greasy Kilograms



All wool

### % of Australian Auctions

Superfine (18.5 micron and finer)



## Wool offered at Australian Auction by Selling Season (greasy kilograms)

Australian Wool Exchange Ltd

<u>Season</u>	<u>KG Total</u>	<u>KG Non Superfine</u>	<u>KG Superfine</u>	<u>% Superfine</u>
00	485.7 mkg	451.3 mkg	34.5 mkg	7.1 %
01	468.3 mkg	419.2 mkg	49.2 mkg	10.5 %
02	399.6 mkg	336.1 mkg	63.5 mkg	15.9 %
03	356.4 mkg	299.9 mkg	56.5 mkg	15.8 %
04	411.2 mkg	338.3 mkg	72.9 mkg	17.7 %
05	406.1 mkg	334.8 mkg	71.3 mkg	17.6 %
06	412.1 mkg	324.3 mkg	87.9 mkg	21.3 %
07	364.2 mkg	292.7 mkg	71.6 mkg	19.7 %
08	322.2 mkg	257.8 mkg	64.4 mkg	20.0 %
09	315.3 mkg	246.4 mkg	68.9 mkg	21.9 %
10	324.8 mkg	265.0 mkg	59.8 mkg	18.4 %
11	307.9 mkg	245.4 mkg	62.5 mkg	20.3 %

### 3.3 Production costs

A small sample of ASWGA members was contacted as part of this Review, to participate in an exercise estimating the cost of production per greasy kg (total wool clip including oddments) for the each of the three business strategies described in section 2.2 above.

Participants completed Excel spreadsheets with cells covering income, variable costs including owner-operator labour, and overhead costs attributable to their ultrafine and superfine wool businesses.

**The figures provide only an indicative estimate of the cost of production per greasy kilogram for each business strategy. They do NOT provide the price per greasy kilogram required for commercial viability.**

Commercially viable wool prices would need to cover not only production costs, but in conjunction with any increase in business asset value, would need to generate a surplus over production costs equivalent to or better than returns available from alternative investments.

Participants' individual spreadsheets were analysed by the author of this Review report and will remain confidential. Indicative estimates are:

- Ultrafine Merino shedded wethers > \$120/greasy kg
- Ultrafine Merino self-replacing flock > \$30/greasy kg <sup>(a)</sup>
- Traditional Superfine Merino self-replacing flock \$10-15/greasy kg
- Bold Superfine Merino wethers \$ 9-16/greasy kg

*(a) Author's estimate, due to non-availability of actual data*

The above figures have been based on data from 2010 to 2012. In these years, seasonal conditions for wool growing were about **'as good as it gets'** across much of southern Australia. **Wool cuts per head and per hectare were good to excellent**, and supplementary feeding was minimal. In the author's opinion, the figures suggest that with seasonal conditions and prices prevailing in those years:

- Ultrafine Merino businesses based on shedded wethers or paddock-run self-replacing flocks do not break even on production costs, let alone achieve commercial viability
- Traditional Superfine Merino and Bold Superfine Merino businesses operating self-replacing flocks may break even on production costs but are not commercially viable

- Bold Superfine Merino wether businesses may break even on production costs, and have the potential to generate a surplus over production costs, but the surplus is probably insufficient to achieve commercial viability
- Most superfine merino growers and their families are paying a high price for the passion and emotional commitment which they and their families employ in producing the highest quality raw fibre
- Producing high quality ultrafine and superfine merino wool is weighted more towards a lifestyle choice than a business.

### 3.4 Prices received

Currently prices received are based mainly on micron and the Hauteur measurement. In the 2011-12 selling season, superfine wool prices fell significantly. For example, the 18.0 micron price guide dropped 34% from 1,997 c/kg on 6 July 2011 to 1,309 c/kg on 14 June 2012. The 17.0 micron price guide dropped 41% from 2,364 c/kg on 6 July 2011 to 1,390 c/kg on 14 June 2012 (Anon, 2012<sup>(b)</sup>).

These prices reflected a slowdown in demand, especially from China, and extreme volatility caused by economic concerns in Europe. Superfine wool prices were hit hardest, with the impact of lower demand exacerbated by the increase in wool supply (Wilcox 2012). Information on China's domestic wool consumption during late 2012 and into 2013 was unavailable at the time this report was being completed.

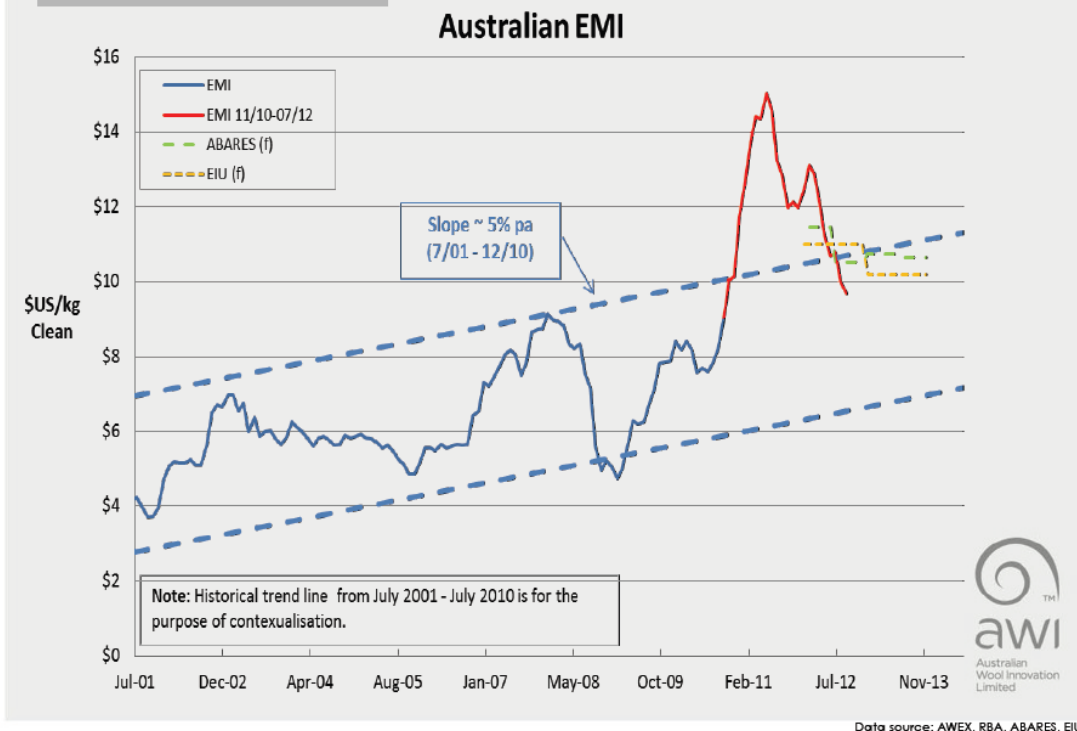
While the Chinese domestic market's desire for western-style apparel continues to grow, the European slowdown is affecting China's wool export industry as follows:

- China's wool top exports have dropped 24% in value and 32% in volume respectively year on year (2010-11 to 2011-12)
- Exports to Europe, which account for 40% of China's wool top exports, are down 37% year on year
- Exports of knitwear are down 8% year on year overall, with exports to Europe down 29%
- Exports of wovens are down 21% year on year (Swan 2012).

The chart below illustrates trends in the Eastern Market Indicator (EMI) since 2001. Roughly speaking, price peaks occur every 2-4 years, suggesting that to maximise profit over time, wool growers need to forward contract and/or be prepared to hold wool until their cost of production is met or exceeded.



## Sustainable?



### 3.5 Selling systems

Alternative selling systems to auction that were briefly examined by this Review include:

- Wool pooling through The Merino Company (including organic wool and carbon neutral wool)
- Direct marketing through branding (eg Australian Extrafine Merino, Zque (New Zealand Merino destined for Reda's Rewoolution collection among others), Saxxon (Escorial), eWool/New Merino (Vandeleur)
- Electronic selling through Wooltrade (which includes only **AS** types under superfine, and does not incorporate unmeasured information).

Alternatives to auction have not attracted high levels of superfine wool grower participation, with the auction system remaining growers' preferred selling method. Selling, broking and exporting wool are all specialised fields. Few growers have the expertise or the capacity to undertake these roles. Other impediments to grower participation include large discounts for supply variations, and unpredictable weather impacts on growers' wool clips.

Furthermore, growers see the auction system as flexible and low risk. At relatively short notice they can schedule sales of their clip or lines of their clip for sale to take advantage of price spikes, secure in the knowledge that they will receive their funds within two weeks of sale.

### 3.6 Marketing programs

AWI is currently undertaking marketing programs aimed at increasing awareness amongst brands, designers and consumers about the desirable qualities of fine and superfine wool (all breeds).

Progress with these initiatives is briefly described below. More detail is available in the *AWI Annual Report 2011-12* (Anon, 2012<sup>(c)</sup>).

The **Merino. No finer feeling** campaign has included endorsement by brands such as Armani, Zegna and Loro Piana. It informs a new generation of consumers about the attributes and benefits of merino wool. It positions Merino wool as the premium luxury fibre of choice. In 2011-12 the campaign focussed on touch, showing that Merino wool is fine enough to be worn next to skin, and can be made into lightweight fabrics suitable for trans-seasonal use.

The **Campaign for Wool**, whose Patron is HRH The Prince of Wales, is a global campaign that encourages manufacturers, retailers and designers to choose wool and, in turn, educate consumers about wool's environmental benefits. A highlight of 2012 was the Wool Modern exhibition in London, opened by their Royal Highnesses the Prince of Wales and The Duchess of Cornwall. This exhibition showcases the aesthetic, environmental and technical benefits of wool with stunning fashion pieces, installations and products.

The **China Luxury Market** campaign launched in December 2011 aims to reinforce Merino wool's premium credentials and build market share for wool in the rapidly-expanding Chinese women's wear segment. It uses multi-media to drive the message of merino wool to Chinese women through television, radio, print, online, social media and in-store promotion. This program is entering its third year. Previous years focused on the rising business elite, mainly men. The second focused on influential women. ASWGA has assisted AWI with this program.

AWI's **Mothers and Babies** program drives demand for merino wool in the baby and infant wear market. It funds scientific research into merino's health benefits, innovative product development, and creating awareness of the fibre's benefits. AWI and famed photographer Anne Geddes joined forces to launch the program.

These programs appear to have rekindled interest in superfine wool apparel as a whole. However, identifying the actual impact that these initiatives may have had on demand and prices for high quality superfine merino wool, or what would have happened to demand and prices without them, has been beyond resources available for this Review.

### 3.7 Research and development – off farm

AWI R&D programs with a focus on fine and superfine merino wool are briefly summarised below. AWI also produces a monthly electronic Market Intelligence report that includes superfine wool coverage. Further detail is available in the *AWI Annual Report 2011-12*.

**The Wool Lab** is a seasonal guide to the best wool fabrics and yarns in the world, across all microns, to inspire textile companies to use wool in their apparel collections. The fabrics and yarns have been selected by AWI from the collections of the world's leading textile companies. All the fabrics and yarns are commercially available to retailers and designers and feature merino wool products from partner mills and spinners such as Zegna Baruffa and Botto Poala. AWI presents *The Wool Lab* at the most important textile and fashion trade shows in the world.

AWI is supporting research into the use of **Superfine Merino Knits** to alleviate symptoms of chronic skin conditions. Early results indicate that, far from being a skin irritant (as is still widely perceived in China), Superfine Merino Knitwear can substantially reduce symptoms for sufferers of chronic skin conditions, through its moisture and temperature management properties.

Identifying the impact that these initiatives have had on demand and prices for high quality superfine merino wool, or what would have happened to demand and prices in the absence of the initiatives, has been beyond resources available for this Review.

AWI has invested in the Sheep CRC's **ComfortMeter** project which will enable the production and marketing of wool garments that need to meet critical next to skin performance criteria for consumers in the key emergent wool apparel markets. It is close to commercialisation. AWI is also investing in the Sheep CRC's **HandleMeter** project, which will be used to measure a fabric's handle – the way it feels.

If successfully commercialised, both the *ComfortMeter* and the *HandleMeter* could be expected to add value to high quality fabrics made from superfine merino wool by objectively measuring attributes that at present can only be assessed subjectively.

## 4. Future operating environment

### 4.1 Improving global economics, demographics and markets

The following points, which suggest that global economics, demographics and markets are becoming more favourable for wool, were made by AWI representatives in Wool Poll presentations in late 2012:

- On average, the wool Eastern Market Indicator (EMI) has increased 5% per annum from July 2001 to July 2012
- Demand growth for wool is driven by global Gross Domestic Product (GDP) growth. China's share of global GDP growth is rising from 5% in 2006 to a forecast 15% in 2017, while the Asia-Pacific share is rising from 23% in 2006 to 34% in 2017
- Consumer spending growth in China is forecast to grow at 8-9% per annum between 2010 to 2017, while Japan and the US are forecast to resume growth
- Over the next 10 years, per capita clothing expenditure growth in the BRIC countries (Brazil, Russia, India and China) is forecast to increase at 40%-70%, and in the Eurozone and US is forecast to increase from -10% to +20% (the latter mainly in Germany and Japan). Much of this share of expenditure growth will be by wealthy people
- For Australia's key traditional wool markets: over 50 year olds will dominate by 2016, especially in the UK, France, Germany, Italy and Japan and this cohort of people will have more than 50% of their countries' disposable income; there will be fewer suit wearers, declining birth rates, and hence new product categories will be critical, eg infants/maternity, urban, below-the-waist casual
- Key drivers in growth markets will be affluent ageing and 'little emperors' (doted on babies and toddlers)
- In addition to Russia and China, other emerging markets will be important eg Turkey and Belarus, and AWI is now providing technical assistance in Vietnam
- Consumer attitudes to wool can improve, for example between 2007 and 2011 in China, consumers developed more positive perceptions for wool in the following areas: is a symbol of status; is expensive; is worth paying extra for; is a classic fabric; and is natural (Swan, 2012).

### 4.2 Global production trends

AWI Wool Poll presentations indicate that at present Australia produces more than 90% of the world's fine apparel wool, and that there will be little or no change in the proportion of apparel wool produced by the main supplying countries. Supply will remain tight. However there is anecdotal concern that countries such as Kazakhstan (a neighbour to China) are rapidly increasing their supply of superfine merino wool and are exporting this wool to important Australian markets such as China (Ive, 2012).

One report (Schoenian, 2009) accessed by this Review that suggests much of the fine-wool grown in South Kazakhstan lacks the quality to compete in international markets, and that the first step towards finding acceptance in the world market will be to have the wool core-tested. Like wool in the United States, it is necessary to know the fibre diameter, length and yield of a wool clip in order to find a suitable buyer and negotiate a fair price. In addition, Schoenian comments that it will be necessary for Kazakh sheep farmers to make improvements in sheep breeding and management and wool handling in order to bring their wool up to international standards.

A watching brief must be maintained and reliable data obtained on global production of superfine wool and other prestige fibres, the quality and standard of preparation, and the implications for Australian growers.

## 4.3 Australian production environment

### ***Productivity constraints***

Many public sector agricultural research and extension programs focus on increasing productivity as the key to increasing viability. Over past decades as the cost-price squeeze intensified, this has been an appropriate strategy for extensive cropping industries and livestock industries on better land in more favourable environments.

Increasing productivity has helped some superfine wool growing families to remain in business. In terms of productivity per hectare, Cost of Production participants in this Review indicated that their figures for greasy wool produced per grazed hectare ranged from 7 kg/ha to almost 22 kg/ha.

It could be expected that the higher figure would have come from better than average land that received above average rainfall. In fact, the latter figure was achieved by a Bold Superfine Merino business running wethers on typical non-arable superfine wool growing land, receiving similar rainfall to other properties participating in the Cost of Production exercise.

Hence at first glance there appears to be scope for other superfine wool growers to further improve productivity as the key to remaining viable.

However, native vegetation protection legislation now prevents superfine wool growers, a majority of whom depend on native pastures (ASWGA 2011), from productivity-increasing activities pursued in previous decades by the Bold Superfine Merino business (for example sowing legumes, applying fertiliser, and intensifying grazing).

Woolgrowers are also required to comply with increasingly complex taxation and occupational health and safety laws that involve increased costs and heavy penalties for non-compliance.

### ***Climate Change***

In the future, if climate change predictions are correct, it may not be feasible for wool growers to achieve large increases in productivity, even on exotic pastures on deeper soils. The *Southern*

*Livestock Adaptation 2030* project funded by AWI, Meat and Livestock Australia (MLA) and the Department of Agriculture, Fisheries and Forestry (DAFF) has found that:

- The majority of future climate scenarios suggest that much of southern Australia will potentially have higher temperatures and less rainfall, with higher growth rates in winter and early spring, but the spring growing season will contract, with an earlier onset of the dry summer period – these factors will require lower stocking rates to maintain ground cover
- Sustainable stocking rates are set to decline due to lower and more variable pasture growth and longer periods of pasture decay over summer. The lower stocking rates may be partly countered by increases in production per head due to higher pasture legume content and lower lamb mortality
- For some areas, eg parts of Tasmania and mainland higher rainfall/colder regions, the outcomes could be positive
- Increasing soil fertility is the most effective and persistent adaptation for wool growers (Anon, 2012<sup>(d)</sup>).

**Large productivity increases on an industry-wide basis for superfine merino wool are unlikely to be achievable in the future due to legislative and climatic constraints. Hence the focus for action to improve viability must be on increasing wool prices.**

### ***Community expectations***

Woolgrowers are facing increased calls from domestic and overseas consumers of woollen products and sheep meat that the products be produced only in accordance with consumer expectations of acceptable animal welfare. Their concerns extend not only to mulesing, but also to live sheep exports, which in 2012 were adversely portrayed in the media by animal rights activists. Greenhouse gas emissions from sheep are also a concern.

In this challenging environment, ASWGA should continue to drive close contact between its grower and processor members, and assure brokers, buyers, exporters, processors, retailers and consumers that members' clips are grown and prepared using best practice for fibre purity and quality, animal husbandry and welfare, and ecologically sustainable production.

Costs in meeting consumer expectations, as well as production costs, will continue to increase.

## **5. Learning from the past, tips from the present**

A number of previous reports on the wool industry and superfine merino wool growing in particular were examined during this Review. Several recurring themes emerged, including:

- Lack of viability
- Superfine merino wool growers leaving the industry or changing enterprises
- Special characteristics of superfine merino wool that are not duplicated in other fibres
- Challenges in describing and measuring the characteristics
- Challenges in educating supply chains about the characteristics
- Difficulty in demonstrating value of the characteristics to supply chains
- The impact of a high Australian dollar
- The importance of global economic growth.

These themes can be recognised throughout the report extracts presented below.

## 5.1 The past

### **1978 ASWGA policy paper by Merv Mibus**

*There have been a lot of casualties from the ranks of superfine breeders and growers – a lot of growers have been lost to the industry, are phasing out, or have introduced stronger woollen rams. .... Why have these people changed? Quite simply because compared to medium and strong wools, the superfines are not a financial proposition.*

*...our Saxon superfines have other characteristics, characteristics which over the years have made them a prestige fibre, characteristics which given due recognition put us in that exclusive category – superior – clearly in front. Our Saxon superfines have these characteristics which have never been accurately measured by instrument, but assessed by the expert skills of the hands and the eyes for their character, style, bloom, texture and handle. ....If our industry is to survive it will only do so as an exclusive, superior, top quality product; it will not survive if we turn it into a bulk commodity! (Mibus, 1978)*

### **Diversity and Innovation for Australian Wool: Report of the Wool Industry Future Directions Task Force, 1999**

*‘For many woolgrowers, prices have been too low to keep them profitable or in business.’*

*‘product marketing ... is vital, especially at the designer/garment maker level where fibre choice decisions are made.’*

*‘Woolgrowers need to examine clinically all facets of their cost structures.... the best 20 percent of woolgrowers earn net returns three times the average.’ (Anon, 1999)*

### **Fine wool prospects, Elders/Australian Wool Services, 2005**

*‘It was a tough year for luxury items during 2003/04 as a tepid global economic recovery, the SARS outbreak in China and the war in Iraq all placed downward pressure on consumer confidence and thus spending.’*

*‘the emerging middle class in China, with 100 million middle income households, are looking for higher quality products which should help sustain demand for wool garments, particularly finer wool.’*

*‘Improving demand trends and a forecast production decline are positive for fine and superfine wool prices for 2004/05, but the strong Australian dollar, high oil prices and a potential slowdown in economic growth within major wool purchasing countries in 2005 may constrain upward price movements.’ (Anon, 2005<sup>(a)</sup>)*

### **ASWGA/Australian Extrafine Merino (AEM) Pilot Supply Chain 2004/05**

*‘... the programme is assessed to have made a positive impact on the promotion of the top end market for men’s suits made from Australian superfine wool.’*

*The AEM – Ram’s Head branding is expected to justify the price to consumers and increase the volume of sales, rather than pushing their unit prices up ..... [because ] the Brands ..are already positioned at the very top end of the price scale for custom made suits or made to measure suits.’*

*‘Reports show a difficult position for textile retail in Japan during the period [and] overall there was a decline of 9.5% in the volume of men’s suits sold during the period.’ (Anon, 2005<sup>(b)</sup>)*

### **Test Marketing Project USA 2006**

*‘...at the very least in the US market, the words ‘merino’ and ‘wool’ had to be used in conjunction with ‘new wool’ and ‘wool evolved’ to distance this wool from other poor quality wool to change perceptions. This was to get American women away from their ‘itchy/scratchy’ perceptions of wool and take them to a new mindset.*

*Focus groups and research showed that the fastest way to get their heads around ‘new wool’ was to liken it with fine wine – that it is special, and like the finer things in life, it is worth paying a premium for. Highlighting*

*the special qualities of Fine and Extra Fine Merino Wool was important to clearly position it as superior to other wool US consumers may have tried and rejected.'*

*'As we remind consumers of the things they need to watch out for, their response is always the same: Well, tell me how to tell the difference? I need some kind of easy differentiator; a word, an icon, a story, some kind of a wake-up call in the marketplace to shift perceptions and make it clear for me that I should be on the lookout for these specific benefits.'*

*'One of the 'sweet spots' is staff training – with sales associates educating themselves to better educate consumers'*

*'...innovation is essential to keep product new and fresh. And it is particularly important to show retail buyers how to develop new innovative product with wool...'*

*'...the 'Wool Story' is everything and must be told as close to the point-of-sale and shop floor as possible.'*  
(Anon, 2007)

### **Lessons from the past**

The following conclusions can be drawn from the above points, and the more detailed content of the past reports:

- The superfine merino industry is a difficult business – global economic conditions have been volatile for many years, and will continue to be a major influence on consumer demand for high quality products made from superfine merino
- Demand can be improved by strategic product innovation and targeted product marketing initiatives. However, to-date marketing initiatives have only increased volumes sold, not prices received by growers. Global economic conditions are the dominant influence on prices to growers through the auction system.
- Selecting countries in which to conduct pilot programs and product marketing campaigns is important. Potential return on investment can be adversely-affected by country-specific economic issues, for example the Global Financial Crisis originated in the USA shortly after the completion of the Test Marketing Project.
- Targeted product marketing to shift consumer perceptions must incorporate an easy differentiator – the fine wool /fine wine story has achieved this to-date in differentiating fine wools from medium wools. Certification for next-to-skin comfort may be an option.
- With increasing volumes of poorer quality superfine merino and non-merino superfine wool coming onto the market, there is a new challenge for high quality superfine merino growers – how to differentiate and extract more value from the performance of their fibres compared with other fibres

## **5.2 The present**

A visit by ASWGA representatives to members' mills and other organisations throughout Europe in late 2012, where samples of AS, M, and M (Bold) wools of similar micron were displayed and discussed, yielded the following comments from the overseas interests (Cathles Pers. Comm.):

*'Raw material attributes are very interesting if there is something unique. Provenance is the greatest value, not the wool! We do need to differentiate why our product should be bought over another (otherwise it is price!).'*

*'We do need to do trials that compare the attributes between AS, M, and M (Bold) wools, in worsted and woollen, through to cloth and knitted. We also need to do trials of worsted into knitted.'*

*'We then need to identify differences between AS, M and M (Bold) and articulate the value of those differences. For example, why is AS different? We need to be able to recognise special values in AS to pay more. We also need current data on quantities of the three types, their characteristics, and prices for the previous 12 months.'*

*'R&D is crucial, but persuading purchasers about wool attributes is the biggest education needed. Trials of AS, M and M (Bold) would be worthwhile, to deliver important measurements in fabric.'*

*'We [currently] have a measurement chart to sell greasy wool [to processors] that articulates the attributes of raw wool based on scientific analysis. **We need [to develop] an attributes chart, established through scientific trial and drawn from the consumers' language, that articulates the attributes for each [of the three] wool types. Thus establishing the value at the only place willing to reward [special] attributes – the retail consumer.'***

## 6. Current problem statement

Elements of the current problem affecting all three superfine merino wool business strategies described above in section 2.2 are not dissimilar to the recurring themes identified in the past. However, there are three key differences today.

Firstly, we have one dominant market that is relatively new in recognising and appreciating the special characteristics and the value of those characteristics in producing high quality superfine merino wool products. Secondly, there is almost sole reliance by wool buyers on measurements, resulting in a significant decline in premiums for high quality, well-prepared clips that possess currently un-measurable attributes. Thirdly, there is increasing availability of poor quality superfine merino wool and non-merino superfine wool (for example, from Dohnes and SAMMs).

The current problems can be described as a 'downward spiral' thus:

1. Higher meat prices and lower wool prices have resulted in breeders increasing emphasis on growth rates and carcase weights at the expense of traditional superfine merino wools
2. Increased shearing and wool handling costs, coupled with low returns for wool, have lowered clip preparation standards
3. Of the total superfine clip, there is an increasing proportion of poorly-bred wools and poorly-prepared clips, which produce measurements similar to high quality wools, eg for micron, yield, staple length and strength, coefficient of variation of length, and position of break.  
**The increasing supply of inferior merino wools and non-merino superfine wools, and the fact that micron is the only measurement that continues through to retail, compound the effect of lack of demand on wool prices**
4. Our major customer appears to buy predominantly on micron and hauteur, and **supply chains for it and other customers do not identify the value of intrinsic qualities in high quality wools which are currently assessable only by visual inspection. In addition, there is no simple mechanism whereby consumers can recognise quality and to relay their preferences back through supply chains.** The *ComfortMeter* and *HandleMeter* may assist in partly overcoming this issue if processors see value in tracing fabric back to raw product
5. Prices received at auction continue to be volatile. Price rises and falls in excess of 30% during one selling season are common, with even higher rises and falls (>100%) occurring over two to four year periods. Timing the sale of a wool clip to achieve a price that meets or exceeds the cost of production can have a major bearing on growers' viability, but in reality such timing is difficult for most growers to achieve



6. Premiums for style, compared with Style 5 [good topmaker], have declined in both cents/kg and percentage terms since 2004-05. This decline is particularly evident for Style 1 [choice] and Style 2 [superior] (Nolan, 2012). The decline is the result of a major change in the way wools are valued by buyers. **The price setting mechanism has changed from a market that pays higher premiums as quality rises to a market that applies bigger discounts for increasing variation down from perfection**
7. Notwithstanding the AWI marketing initiatives mentioned above, global demand for premium quality superfine merino products remains weak. Buyers for European customers who do recognise and have in the past paid a premium for high-quality wools do not compete strongly with buyers for Chinese customers, hence the price to growers is lower than it would be otherwise
8. More growers of well-bred superfine merino wools become disheartened and decide to increase their emphasis on growth rates and carcase weights at the expense of high quality wool production, and/or pursue other enterprises. Succession planning sees the next generation of potential superfine merino wool growers deciding to enter more rewarding occupations and businesses.

### Key points

Recurring themes within changing contexts over three decades demonstrate the critical importance of **continuity in targeted product marketing** for high quality superfine merino wools as the world's preferred prestige fibres.

It is also critically important to **innovate methods and techniques to prove that quality superfine merino wools do have special attributes**, and in doing so, provide the means to demonstrate their potential value in supply chains.

**There is still no effective way for consumers to differentiate between high quality and poor quality superfine wool products, and to relay their preferences** back through supply chains.

**Attempts to use superfine merino wool mystique and provenance as differentiators have been ineffective to-date** – there remains a dis-connect between consumers and wool buyers, with wool buying decisions based almost solely on measurements.

**Good market intelligence is also essential**, including predictions of global trends affecting demand and prices within and across selling seasons. To maximise long-term profit in growing high quality superfine wool, producers need access to this intelligence and financial mechanisms to hold wool for long periods if necessary.

## 7. The way forward

### 7.1 Confirm the key underlying issue

The key underlying issue causing the problem for high quality superfine merino wool is that **there is limited consumer appreciation of the benefits for them of products made from high quality superfine merino wool, which leads to a lack of consumer desire for products made from it, and hence lack of consumer willingness to pay high prices for those products**. This situation, coupled with the absence of a mechanism to relay consumer preferences back down through supply chains to wool buyers, means there are few to nil signals encouraging buyers to purchase high quality superfine merino wools for production of premium products.

In the case of ultrafine merino wool produced from shedded sheep, the market was underpinned by limited competition, and when some of the buyers left the industry, the price collapsed. It is unlikely that the superior position of cashmere over ultrafine merino will change without a targeted marketing campaign for ultrafine wool.

This lack of consumer appreciation and demand translates to a lack of competition between our major customers, China, India, Italy, and others, for our premium wools. We need to also enhance demand from additional potential buying countries, such as Russia.

To understand this lack of demand and the resulting lack of competition, we need to start with the retail consumer and work back.

### Key points

The underlying issue – a lack of appreciation for quality superfine wool and hence lack of sustained high demand and prices – is similar to that expressed in 1978 by Merv Mibus.

However, it appears we face greater challenges today. The \$A is at or near parity with the \$US, and the global apparel industry is more cost-competitive than ever. Price premiums for elite ultrafine wool, which used to have an upward influence on prices for high quality superfine merino wool, have disappeared. Superfine wool has become a generic commodity, which more growers are producing down to a price. The superfine wool clip comprises increasing volumes of inferior merino wools and non-merino wools.

In essence, **there needs to be significant improvement in investment in ultrafine/superfine product innovation and targeted product marketing**, focussing on assisting consumers to differentiate between products made from high and low quality superfine wools, encouraging them to lift their demand for the former, and to relay their preferences back through supply chains to wool buyers.

This focus is especially applicable to wealthy consumers who are price inelastic (price is a minor or irrelevant issue for them when choosing luxury apparel), and whose buying decisions are likely to be unaffected by a strong \$A.

## 7.2 Acknowledge constraints to productivity increases

Over the last 20 years, ultrafine and superfine wool growers have stayed in business by either increasing productivity, reducing costs, holding wool to sell during market spikes, or by subsidising their wool growing businesses using income from other agricultural enterprises or from off-farm investments or employment.

In future, further important productivity increases may come from improvements in sheep genetics, improved technologies (for example in predator, parasite and flystrike control), and improved pasture management including more effective fertiliser use.

The rate of adoption of these technologies and practices will be governed by the prevailing legislative and climatic circumstances, the knowledge, attitudes, skills and aspirations of wool growers, the extent to which the technologies and practices offer growers comparative advantage over existing technologies, and the ease with which they can be trialled and put into practice on larger scales.

However, even if all these advances do eventuate, it is difficult to envisage the superfine merino industry as a whole achieving the three-fold increases in productivity that some growers have achieved in the past. Climatic and legislative conditions, and to a lesser extent community expectations, will prevent this.

### 7.3 Focus on achieving wool price increases

**Limits to productivity improvements mean that wool price increases must be the primary focus of strategies and actions aimed at increasing superfine wool growers' viability.**

The best way to achieve a sustained increase in prices and minimise the dramatic price swings referred to in the **Current problem statement** is to ensure targeted product promotion, research and education activities correctly anticipate global developments and that they are targeted to the right countries, and the right supply chains within those countries, in a timely way. An appropriate level of investment is also critical.

However, notwithstanding effective promotion, research and education, there will always be some unforeseen developments affecting markets, and growers need a 'Plan B' to manage the remaining price volatility to their advantage.

Growers already have options to smooth out price volatility (forward contracting, holding wool in-store etc), but there is low uptake of these options (Hedley, 2012). The key reason for the low rate of forward contracting is that forward prices are usually below most growers' cost of production and growers are naturally reluctant to lock in a loss. Forward contracting is also considered high risk as it is difficult to predict climatic conditions and their effect on the clip 12 months or more out from the time of negotiating a forward contract.

In addition, truly independent market intelligence (especially future developments in major wool buying and consuming countries) is scarce, and growers' decisions about selling are often made largely in an information vacuum.

To their detriment, growers frequently sell at low points in the market, 'because they need the cash flow'. Yet for every seller there is a buyer, and in these circumstances the higher profit usually goes to informed people in the trade who understand reasons for the low point, the factors that lead to market rises, and who have the financial capacity to ride out the low periods.

As an example, in recent years the prices of several Australian commodities (eg wool, cotton, lamb, and iron ore) have largely reflected expectations about China's growth. Between February-April 2011 when prices of these commodities peaked due to positive sentiment about China, and July 2012 when concerns about a hard landing in China were extreme, the wool EMI fell 50%, cotton fell 63%, lamb fell 40%, and iron ore fell 44%.

By mid-January 2013, following dissipation of more extreme concerns about China, and more positive news from the US and Europe, the 17 micron wool indicator had risen more than 15% and the iron ore price had risen more than 50%. Interests who bought these commodities at July-August 2012 prices may have made good profits in just five months.

### Key points

An opportunity exists to improve the availability of **independent market intelligence** to growers, including predictions of global trends in demand and likely prices, and the factors affecting those trends, within and across selling seasons.

As it may be in growers' best interests to hold wool so they can time selling it to their advantage, there is also an opportunity to enhance growers' business management skills to ensure they can access the necessary financial arrangements.

How do we ensure growers have the necessary business and financial skills to **hold wool until the price at least meets their cost of production**, or better still, generates a surplus?

One caveat about focussing on wool price increases is that it is difficult to see short to medium term prices for shedded ultrafine Saxon wool returning to viable levels, because:

- There is global underuse of these wools
- Current held stocks are very high in relation to current demand
- Although the quantity of ultrafine merino wool is only about 2% of world cashmere production, it is no longer perceived as rare, therefore it does not offer processors and brands the high value competitive edge that it did in the past
- Improved processing techniques can now superficially give fabrics from superfine wools the attributes that could previously only be delivered by ultrafines
- Grain prices are likely to remain high with increasing global food demand.

Some premium products are still made from shedded ultrafine merino wools, but they are used by leading global brands such as Ermenegildo Zegna and Loro Piana as flagship products to promote the prestige of their brands. The products are not volume sellers. In the past there was higher demand for raw ultrafine merino wool from shedded operations as mills bought small volumes to prove that they could process them. However many were unable to find markets for their products as demand fell away (Cathles Pers. Comm.).

## 7.4 Take advantage of favourable global developments

AWI has indicated that out to 2017 the global wool market will be favourable, characterised by:

- Tight supply, with Australia's dominance of fine apparel wool and the ability to supply unchanged
- The emergence of China and other BRIC countries as affluent consumer markets underpinning growth in clothing expenditure
- Elsewhere, market drivers implying a need to focus on affluent consumers, and creating new categories such as infants/maternity
- Improving consumer attitudes to wool.

## 7.5 Describe what success would look like

A sustainable increase in prices for high quality ultrafine and superfine merino wool, along with enhanced grower viability, will be delivered when a series of industry-wide goals are achieved.

### ***Production and reporting***

- Quality superfine merino wools will be better recognised, specified and differentiated from other superfine wool, from shearing to retail
- Superfine wool testing, specification and selling systems will maximise the use of new technologies to enhance operation of the auction system and assist further development of alternatives to auction
- Wool testing, appraisal and sale reporting will be enhanced to provide reliable information on the profile of the Australian superfine wool clip, particularly for microns, volumes and prices for the main types of superfine merino wool (eg **1PP**, **AS**, **M**, and **M (Bold)**) and their styles (eg Choice down to Average Topmaker), and volumes and prices for of other superfine wools (eg SAMMs and Dohne)
- AWI will enhance its market intelligence systems that monitor global markets for superfine wool and other prestige fibres, and enhance monitoring of trends in other countries' production of fibres that can potentially compete with Australia in global markets

### ***Supply chains, innovation, marketing, consumers***

- There will be increased awareness within supply chains of the attributes of high quality superfine merino wools, their added value to processing and manufacturing at each stage of supply chains, and their added value to consumers
- AWI will continue to develop new and innovative products made from superfine merino wool, and will enhance its targeted product marketing and promotion for superfine merino wool, especially in the Asia-Pacific and emerging economies
- AWI's initiatives in partnership with leading brands and retailers will stimulate increased consumer demand and advocacy for high quality superfine merino wool products. This will translate to increased competition amongst Australia's customer countries for quality superfine wool, and hence increased prices for growers
- AWI, ASWGA, and supply chains will design and implement mechanisms and language to articulate consumer preferences concerning superfine merino wool from retail back to wool buyers

### ***AWI and ASWGA working together***

- AWI and ASWGA will work on a cooperative and collegiate basis to improve program adaptation, monitoring and evaluation, attribution of the programs' effects on demand and prices for superfine and ultrafine wool, and communication with the superfine wool industry
- ASWGA will attract the majority of high quality superfine merino wool clips into its network, by developing an effective value proposition for new members, including improved market intelligence and business management skill upgrading
- ASWGA will strengthen recognition that rams head branded superfine wools have more valuable attributes than other superfine wools
- ASWGA and AUSFINE <sup>TM</sup> will continue to collaborate for the mutual benefit of their members

## Growers

- The number of new entrants to the superfine wool industry will increase as they access improved genetics, improved farm management practices, and improved business management skills to make superfine wool growing more viable
- Superfine wool growers generally will improve the way in which they grow and prepare superfine wool
- Growers will have access to improved market intelligence including predictions concerning global demand and prices, access to business management training and access to financial arrangements to hold wool for long periods.

### 7.6 Set out core strategies to achieve success

There exists a significant opportunity to improve wool buyer to retail consumer appreciation of the attributes of premium superfine merino and their advantages, and in particular, our major customers' understanding of the premium products that can be produced from different types of superfine wools.

To make the most of this opportunity, Australia needs to continue to foster working partnerships with Chinese, Indian, Italian, United Kingdom and other important superfine wool buying countries to:

- Implement a ***Campaign for Superfine Merino***, including re-branding and re-launching ultrafine merino. The Campaign should rebuild the prestige and markets surrounding **1PP** and **AS** types – the 'flagships' of the ultrafine/superfine merino industry
- Ensure the *Campaign's* product innovation and product marketing activities focus on assisting consumers to differentiate between products made from high and low quality ultrafine and superfine wools, encouraging them to lift their desire and demand for the former, and to relay their preferences back through supply chains to wool buyers
- Monitor and evaluate the *Campaign* to ensure that it is delivering increased prices to Australian growers of ultrafine and superfine merino wool. Re-direct and adapt the Campaign accordingly
- Improve the way we technically specify and describe the attributes of ultrafine/superfine wools throughout supply chains (from the *Code of Practice* at shearing to swing tags in retail stores) – curvature R&D and reliable tests have an important role
- Ensure technical specifications clearly differentiate between **AS**, **M** and **M** (Bold) superfine merino wools, the differences between 1PP and Styles 1-6 of these wools, as well as the differences between these merino wools and wools from SAMMs and Dohnes
- Understand how these technically different wools process, identify what the processing advantages are for each, and how they can be made into new and innovative products
- Use this understanding of technical and processing differences to add value and engage each stage of supply chains to get uptake
- Ensure wool testing and market reporting arrangements provide detailed information on the profile of the Australian superfine wool clip, particularly for microns, volumes and prices for the main types and styles.

In parallel with the above strategies, AWI and ASWGA should work together on a collaborative and collegiate basis to:

- Enhance grower and processor knowledge and commitment to high quality superfine merino wool through effective communication and engagement during implementation of the strategies
- Ensure that AWI programs are more effective in increasing demand and prices for superfine and ultrafine wool, and that there is transparent attribution of the program's results
- Improve availability of independent market intelligence to growers, including predictions of global trends in demand and likely prices, and the factors affecting those trends, within and across selling seasons
- Enhance growers' business management skills to ensure they can access necessary financial arrangements.

## 7.7 List researchable questions giving effect to the strategies

1. Can various ultrafine and superfine merino wools be differentiated in terms of their characteristics that affect end product type and quality. For example, how do you describe high quality ultrafine/superfine merino, lower quality ultrafine/superfine merino, various non-merino superfine?
2. What are the key characteristics that influence ultrafine/superfine merino end product type and quality? Can the characteristics (eg curvature, elasticity, drape, comfort etc) be measured objectively with a view to certification and extracting value along supply chains? How do we get uptake by supply chains of any extra value?
3. If the characteristics can't be measured objectively at present, is there a business case to invest in developing the necessary tests and tools to aid quantification? Would investment in qualitative education using existing measurements and 'hands on' assessments be better?
4. What are the various types and qualities of products that can be made from these wools (and their blends?)
5. What proportion of ultrafine/superfine wools produced globally are high quality, poor quality, and non-merino? What are the standards of preparation of superfine wools from supplier countries that compete with Australia? What are trends in volumes and prices for each of these?
6. How do we establish wool testing and sale reporting arrangements that provide more detailed information on volumes and prices for all wool types and styles in the Australian superfine wool clip?
7. Could a business case be developed for a ***Campaign for Superfine Merino, including re-branding and re-launching ultrafine merino***, that in addition to stimulating demand from high-end consumers, would answer these questions in partnership with processors, brands, designers etc?
8. Could AWI provide funding support to ASWGA in return for assistance in making AWI programs more effective in increasing viability of the superfine wool industry?
9. How can independent market intelligence be gathered and communicated to growers?
10. How can growers access improved business and financial management skills including the capacity to hold wool for long periods?

## 8. Conclusions and recommendations

### 8.1 Conclusions

This Review builds on other investigations into the superfine merino wool industry over recent decades. It is a timely reassessment of the where the industry is at, and its challenges and opportunities. It has drawn the conclusions outlined below.

#### ***Favourable global outlook, but expect similar challenges as in the past***

Notwithstanding a favourable global outlook for wool generally in terms of economic growth, demographics and markets, the superfine/ultrafine merino industry will remain a difficult business – key challenges in the future will be similar to those over the last 30 years, viz volatile global economic conditions, markets that don't sufficiently recognise and value the attributes of high quality superfine/ultrafine wools and products made from those wools, and competition from alternative fibres. A contemporary difference to the past is that the main competing fibres today are poorer quality superfine merino wools, and non-merino superfine wools.

#### ***Opportunity to improve market intelligence, promotion, marketing, and research. Continuity of investment is important***

Ongoing price volatility and inconsistent demand indicate that promotion, product marketing, and research have not kept pace with the changing profile of the Australian superfine wool clip and dynamic changes in global markets, especially the rapid emergence of China as the dominant market, financial issues affecting markets in the European Union, and the economic rise of some former Eastern Bloc countries.

**There needs to be significant improvement in product innovation and marketing in relation to superfine merino wool. Consideration should be given to developing a *Campaign for Superfine Merino*, including re-branding and re-launching ultrafine merino.** The campaign should focus on assisting consumers to differentiate between products made from high and low quality superfine wools, encouraging them to lift their desire and demand for the former, and to relay their preferences back through supply chains to superfine wool buyers. This focus is especially applicable to high-income consumers who are price inelastic (they buy what they desire irrespective of price), and hence largely unaffected by the strong \$A.

**It is essential to monitor the extent to which improved product innovation and marketing and any new campaigns do result in improved prices to superfine merino wool growers, and to re-direct and adapt the programs accordingly.**

In addition to further improvements in market intelligence and timeliness of responses, it is critical to ensure **continuity** in not only promoting and marketing high quality superfine merino wools as the world's prestige fibres, but also in researching methods to prove that they are, and in doing so, demonstrating their potential value at each step in supply chains.

#### ***Opportunity to increase grower viability through improved access to and use of market intelligence and financial arrangements***

Legislative and climatic constraints mean that superfine wool growers will not achieve viability by relying mainly on productivity improvements. **Hence the emphasis of strategies and actions arising from this Review must be on increasing wool prices received.** Improved market intelligence, coupled with responsive, well-funded and well-targeted promotion, product marketing and research, may deliver an increasing price trend over time.



However, due to inevitable price volatility, growers could achieve greater increases in average price received over time (ie beat the trend) by selling only when their cost of production is exceeded, and preferably only when they can generate a surplus. To do this, **growers need access to accurate market intelligence** which includes predictions of global trends affecting demand and prices within and across selling seasons. They **also need access to the necessary business skills** and the financial capacity to hold wool for long periods if necessary.

***Cost of production figures indicate Bold Superfine Merino wethers is the only business strategy that may generate a surplus over production costs***

Cost of production figures drawn from a small sample of ASWGA members suggest that even with the prices and favourable seasonal and paddock conditions that prevailed during 2011-12:

- Ultrafine Merino businesses based on shedded wethers or paddock-run self-replacing flocks **do not break even on production costs**, let alone achieve commercial viability
- Traditional Superfine Merino and Bold Superfine Merino businesses operating self-replacing flocks **may break even on production costs but are not commercially viable**
- Bold Superfine Merino wether businesses **may break even on production costs, and have the potential to generate a surplus over production costs, but the surplus is probably insufficient** to achieve commercial viability.

***Shedded Ultrafine Merino unlikely to return to viability***

Due to large capital and operating expenditures, it is difficult to see ultrafine prices in the short to medium term being sufficiently high for production of shedded Ultrafine Merino wool to return to viability. There is global oversupply and under use of these wools, and their special attributes are not recognised and valued. They no longer offer processors and brands a competitive edge, grain prices are likely to remain high, and improved processing techniques can now give fabrics from superfine wools the attributes that could previously only be delivered by ultrafines.

## 8.2 Recommendations

This Review has been a brief study involving limited consultation amongst the broader superfine merino wool industry, particularly with ASWGA regions. Hence **it is recommended that AWI provide funding for printing and wider circulation of this Review report, and consultation with the industry stakeholders** listed in the Attachments. Should that consultation endorse the core strategies and researchable questions listed in this report or variations of them, **it is recommended that AWI provide funding to reconfigure them as a Strategic Plan, and implement the Plan.**

In addition to seeking the stakeholders' views on core strategies listed at section 7.6 and researchable questions listed at section 7.7, Attachment 2 puts forward possible actions that stakeholders may consider undertaking, consistent with the strategies and questions.

-----

## References

Anon (1999) *Diversity and Innovation for Australian Wool. Report of the Wool Industry Future Directions Task Force*. Unpublished.

Anon (2002) *Invitation to join as a member of Ausfine Wool Company Pty Ltd*. Unpublished.

Anon (2005) <sup>(a)</sup> *Fine Wool Prospects 2005*. Elders Limited, Australian Wool Services. Unpublished.

Anon (2005)<sup>(b)</sup> *Australian Extrafine Merino. Review of Pilot Marketing Programme April 2005.* Unpublished.

Anon (2007) *Test Marketing Project USA 2006. Extra Fine Merino Wool.* Australian Wool Innovation Limited, IWTO, Woolmark. Unpublished.

Anon (2012)<sup>(a)</sup> Australian Wool Testing Authority Ltd. *The Australian Superfine Wool Growers' Association Inc Annual 2012-13*, 57

Anon (2012)<sup>(b)</sup> AWEX. *The Australian Superfine Wool Growers' Association Annual 2012-13*, 55

Anon (2012)<sup>(c)</sup> *Australian Wool Innovation Limited. Annual Report 2011/12.* Australian Wool Innovation Limited. Sydney.

Anon (2012)<sup>(d)</sup> Adapting to climate variability. *Beyond the Bale* **52**, 29-30

AWEX (2012)<sup>(a)</sup> *Code of Practice 2013-2015* IN PRESS.

AWEX (2012)<sup>(b)</sup> *Australian Superfine (AS) Fleece Style Table – Guide Only* IN PRESS.

AWEX (2012)<sup>(c)</sup> <http://www.awex.com.au/standards/1pp-certification.html>

Cathles, H (Pers,. Comm.)

Coother, D (Pers.Comm.)

Hedley, M (2012) Australian Wool Network. Pers. Comm.

Ive, J (2012) Pers. Comm.

Mibus, M (1978) Extract from an address to ASWGA Annual General Meeting, July 1978. *The Australian Superfine Wool Growers' Association Inc Annual 2012-13*, 45

Nolan, E (2012) *The economic value of fleece wool attributes. Report prepared for Australian Wool Innovation Limited.* The University of Sydney. Unpublished.

Powell, J (2011) Managing through the drought – our story. *Celebrating Forty Years. The Australian Superfine Wool Growers' Association Inc 1971-2011* 41-43

Schoenian, S (2009) <http://www.sheepandgoat.com/articles/kazakh.html>

Swan, P (2012) *Wool market outlook.* Presentation for Woolpoll Roadshow. Unpublished.

Wilcox, C (2012) Superfine wool prices hit by higher supply and economic uncertainty in 2011/12. *The Australian Superfine Wool Growers' Association Inc Annual 2012-13*, 58-59

## People consulted during the Review

(in addition to the Working Group members)

Dott. Paolo Zegna, Chairman, Ermenegildo Zegna

Don Belgre, Managing Director, Giovanni Schneider Australia

Kevin Dunn, ASWGA member, immediate past President ASWGA

Barry Walker OAM, ASWGA and AUSFINE member, Co-principal 'Ledgerton' Stud, The Mullion

Paul Vallely, 'Cladymore' Fullerton, New South Wales

John Ive, ASWGA member, 'Talaheni', Murrumbateman, New South Wales

Kevin Rattigan, ASWGA member, past Treasurer, Goulburn-Yass ASWGA

Andrew and Cassandra Ledger, ASWGA and AUSFINE members, 'Mullion Hill', The Mullion

Presentations by the author to ASWGA Council and Goulburn-Yass Branch ASWGA

Alan Phillips, ASWGA member, 'Glen Stuart' Tasmania

Geoff Fysh, ASWGA member, 'Ronneby Park', Western Australia

Danny Picker, ASWGA member, AUSFINE member, 'Hillcreston Park', Bigga

Jock McRae, 'Eileen Donan', Victoria

Cost of Production participants (anonymous)

## Mills visited (by Helen Cathles, President ASWGA)

*Full report can be obtained from ASWGA*

**Turkey** – Altinyildz

**Italy** – Zegna, Vitale Barberis Canonico, Zegna Baruffa, Schneiders, Tallia Di Delfino, Cerutti

**UK** – Bulmer & Lumb, Johnstons of Elgin, Holland and Sherry, Moxons, Anderson & Shephard, Modiano, Dormeuil, Retail Connect, WT Johnstons, John Foster, Minova, Jaegar

**China** – Ruyi, Redsun, Thrive, Sudwolle, Schneiders

## Possible actions for discussion

### Brands/retailers

- Enhance product promotion focusing on the low volume/high value/luxury/classy end of the superfine wool apparel price spectrum
- Educate floor staff about the attributes of quality superfine wool apparel that are likely to appeal to their consumers within their cultural context, and the advantages of buying quality superfine wool products over other superfine wool products
- Provide consumer feedback to designers and the supply chain and support the supply chain to adapt to changes in consumer preferences
- Work with designers, wholesalers and processors to ensure the provenance of Australian superfine wool, and in particular ASWGA-branded wool, is verifiable to the consumer

### Processors

- Working with AWI, AWEX and ASWGA, develop improved specifications for the different types and styles of superfine wools, and continue to develop innovative products made from those wools
- Enhance initiatives aimed at improving knowledge and skills in processing and marketing superfine wools, especially in developing and recovering economies
- Continue to promote quality superfine wool as an elite fibre, sought after by luxury brands for its unique qualities
- Work with stakeholders up and down the supply chain to ensure the provenance of Australian superfine wool, and in particular ASWGA-branded wool, is verifiable

### AWI

- Consider investing in the research questions listed in section 7.7 of this Review report and actioning agreed responses
- Enhance superfine wool product innovation and marketing, especially in the Asia-Pacific as these economies come to dominate world GDP
- Work with overseas processors and designers to educate their consumers about luxury apparel and assist them to develop indigenous interpretations of that apparel
- Continue targeted R&D to produce products consistent with consumer and market opportunities
- Ensure market intelligence monitors global production and sales of fibres that compete with ultrafine and superfine merino wool
- Enhance liaison to improve grower feedback concerning AWI priorities and grower uptake of AWI's research and marketing results

### Brokers/exporters

- Working with AWEX, participate in new wool testing and sale reporting arrangements that provide more detail on the profile of the Australian superfine wool clip, particularly volumes and prices for the main superfine wool types and styles
- Provide frank feedback to growers concerning breeding and clip preparation
- Improve two-way feedback between growers and buyers on attributes valued by supply chains
- Identify barriers to alternative selling options and develop new options that deliver more stable prices and improved trace back

- Suggest credible sources of information and assistance to growers

## Growers

- Improve breeding and clip preparation
- ASWGA members operate to codes of practice giving effect to rams head brand values
- ASWGA members maximise net income per hectare within the limitations of their environment

## ASWGA

- If invited, and with funding support from AWI, work more closely with AWI to make AWI programs more effective in increasing viability for the superfine merino wool industry
- Work with its members to develop codes of practice giving effect to *Rams Head* brand values and differentiating members' clips from other superfine wools
- Attract the majority of the quality superfine wool clip to its member network by developing an effective value proposition for new members

-----