

Submission to

**Australian Wool Innovation
Wool Selling System Review**

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By

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Introduction

Participants in any market need assurance that the market is transparent and efficient. While any review of a selling system that results in improved transparency and efficiency is welcome, it needs to be balanced with the other critical requirement of a market, certainty. Conducting a review of the Wool selling System in Australia may by its very existence, create an atmosphere of uncertainty which is counterproductive to the best interests of the market.

This “uncertainty” is accentuated by the appalling track record of Australia’s Statutory Wool Institutions in respect to previous aborted market intervention schemes. The historic inclination of these institutions to blame the selling system when their wool promotion endeavours fail is endemic!

The sale of Greasy Wool is probably the only market where the “discovery price point” is established in Australia. Australia’s cavalier performance in protecting the integrity of this market is culpable and without a doubt a significant contributor to the rapid decline of world fine/medium wool production.

It is understandable why the Board and staff of Australian Wool Innovation (AWI) cosily protected as they are by the comfort of a statutory tax on wool grower’s gross incomes, fail to understand the implications of the Reserve Price Scheme’s (RPS) collapse and the ramifications of the shock waves that are still reverberating throughout the industry.

Comments on Review Criteria

The following responses are based on 55 years’ experience as a grower of fine/medium merino wool, a registered owner classer, and five years as a buyer and exporter of speciality greasy wool, tops and yarn from Australia, together with 15 years’ experience in knitwear production in Melbourne and then China for the Australian and New Zealand market.

The Panel is seeking feedback on the farm visitation process conducted by the wool broker and wool preparation and classing practices.

- *Are the direct costs incurred by the wool broker in conducting these visits considered to be part of the broker service charge (BSC) incurred by woolgrowers post auction in the account sale? And, if so is there scope for a “user pays” component should the woolgrower not require this level of service?*

The extensive aggregation of farms that has taken place in Australia over the last 30 years has resulted in fewer but larger farm enterprises. However this has not significantly changed the way wool brokers service the industry. This is in marked contrast to the rest of the livestock industry. To use our farm as an example, which is by no means unique, Sheep are sold directly to meat works in processing lots at an “on farm grid” price with **no agent or broker** involvement, similarly cattle.

Wool is different as virtually no wool producer in Australia has the production capacity to produce consistent mill lots. There are two basic reasons for this. The first is that because of seasonal variability across Australia, buyers need access to a range of wool clips to build mill lots that perform consistently year after year. The other is the mere size of modern combing mills. For example a mill currently being built in China has the capacity annually to process half the Australian Wool Clip.

While grower's needs are different, the basic essential ingredients of the market are:

1. A central location where wool clips are warehoused, core tested, sampled and dumped.
2. A reputable and efficient wool testing house.
3. A central location where authentic wool samples are displayed for each sale lot prior to auction.
4. A transparent, competitive and efficiently conducted wool auction, (either open cry or electronic).
5. A secure system of post- sale delivery and payment.
6. Transparent dispute resolution process.
7. Reputable market reporting and statistical information.

As the wool broking is very competitive, it must be assumed that Brokers are supplying the services and skills the clients require. There is plenty of opportunity in such a competitive market for larger growers who require less services to negotiate a reduced commission.

During the farm visitations is the wool broker able to provide the woolgrowers and/or classer with recommendations on how best to class and prepare the wool to meet with current customer requirements? Or is the classing advice designed to meet with the AWEX "Code of Practice" for classers?

- *To what extent are the wool brokers providing woolgrowers with information they already have? Do wool brokers have an expert understanding of market developments and implications for sheep husbandry and wool production?*

Historically, ram selection, sheep husbandry, market developments have been information sought from Broker representatives. Better education of Managers, their capacity to seek advice and information widely, including IT, means this is a service that many producers may not require. Cross subsidising by Brokers of clients who do need additional assistance at the cost of their larger efficient producers while a risk, in the current competitive market is unlikely to be sustained.

- *Is there scope for the wool broker to provide additional services during the farm visitation?*

There is, and there should always be opportunities for innovation in a competitive market!

- *In the last decade China has become the largest buyer of Australian wool taking nearly 80% of the total wool clip. This dominance has been accompanied by a more commodity based approach to wool usage as a fibre. Does this evolution present*

opportunities to create greater efficiencies at the point of shed preparation (for example larger lot sizes) and should the classing “Code of Practice” be reviewed to better suit this evolving processing consumer base?

While China is the destination for 80% of the clip, much of this goes into yarn, fabric and end garments for Europe, Japan and the US on behalf of European and other manufactures; - China is not just a bulk commodity buyer. In addition the 20% of the clip that goes elsewhere mainly goes to premium buyers in other countries.

From my experience as a buyer I know once the product is “messed up” in the woolshed it is very expensive to unstitch. If Australia wishes wool in the long term to remain a premium fibre, attention to clip preparation is essential. One of the problems confronting our industry at the moment is the rapid decline in the skill level of woolshed staff and the preparation of the Clip. Once an industry becomes deskilled it is a difficult process to reverse. The danger is that this may yet be another nail in the coffin of the Australian Wool Industry.

Larger lot sizes of course must be encouraged but not at the cost of clip preparation.

The panel is seeking input on the process of local cartage, sampling and testing.

- *For a woolgrower to receive a fully certified AWTA test result on their wool they must first have delivered their product to a wool broker’s store that has AWTA certified core and grab sampling facilities. Would there be any commercial benefits to the woolgrower in knowing their final test results prior to delivering their wool to a broker’s store?*

The grower’s wool clip is what it is, so there is little point in pre testing before store. Unless of course there is an opportunity to supply a premium market in which case the service ought to be available on a cost plus basis.

- *Is there a more efficient logistical process for conducting the testing compared to the current core, grab, tuft sampling, and sample movement process?*

The current system has evolved over a period of time in an industry that has and is experiencing severe cost pressures. All operators are certainly looking to eliminate costs, a driver of efficiency. Any change should be driven by the “market” not the result of a tax funded enquiry!

- *After the wool is sold at auction, who retains the box sample? Is there an industry standard procedure for this?*

This is immaterial as long as the respective broker’s policies are transparent.

- *Can AWTA testing be performed on-farm or at another regional location of the woolgrower’s choice if such alternatives are preferred?*

The least number of times a bale is handled from when it leaves the woolshed door until it is placed in a containers the more efficient and the less costly. Therefore the movement from the woolshed to the testing/dumping facility needs to be as close as possible to the

container port of export. Distance of the dump from the port is a cost that the buyer calculates in his margin and so the grower pays. Inefficiency compounds growers cost!

- *AWTA currently tests for a multitude of measurements including micron, vegetable matter (VM), yield, length, strength, CVD, CVH, position of break, wool base etc.- Are there additional characteristics AWTA should test for that would enhance the objective description process and possibly open up alternative processes for the sale of wool?*

Many growers believe that additional measurement has resulted in discounts rather than premiums. In addition many growers believe that additional measurement is Australia's statutory wool institutions on going quests for sale by description, - removing the need to display greasy wool samples. Many buyers believe the same thing! If wool is to remain a quality premium fibre the buyer must have access to samples before auction. Most buyers knowing their clients requirements must have the opportunity to handle the greasy sample to ensure it matches their requirements.

The panel is seeking input on the item of wool appraisal and valuation.

- *Can any efficiencies or cost savings be achieved within the appraisal stage of the wool supply chain through some consolidation of the three forms of inspection? For example, why not just have the AWTA apply an AWEX type rather than have the wool broker and AWEX both complete this task?*

Pre- sale appraisal and valuation has two purposes. The first by the broker is to advise the client of expected auction price, the other is by AWEX for the purpose of market reporting. It is critical that the integrity of market reporting is safeguarded. Broker's valuations are necessary for the purposes of assisting clients set reserves and make selling decisions while some clients may not require this service, the savings from the Broker valuing some lots and not others would be miniscule.

- *Can a combination of AWTA test results and a singular, industry accepted valuation standard provide an on-line platform for wool to be appraised and valued? If so what efficiencies and costs savings (if any) can be achieved?*

AS above!

- *To what extent is physical inspection a necessary element of appraisal and valuation? Would the wool grower be disadvantaged by relying solely on appraisal and not displaying the physical wool sample?*

Accurate market appraisal and reporting is an essential ingredient of a transparent market; nothing should be done in this respect to jeopardise the integrity of the market. Obviously if the buyer cannot inspect the greasy wool samples the grower is disadvantaged. If buyers who create the market are making their valuations on the basis of test results plus physical inspection of samples and if their knowledge of the market is different to what is being reported to the growers and the rest of the trade, (based on AWEX reporting on less information i.e. no samples) then the credibility of the whole market comes under question

and creates a lack of confidence. The cost of lack of confidence, while difficult for AWI to understand, is overwhelmingly the most important aspect of any market.

Information has costs - it is about the benefits and cost of additional information. The marginal value of extra information diminishes, and, the value of information is inversely proportional to the number of people who have it.

- *Should the industry be seeking to achieve a wool selling system based entirely on sale by description? Are multiple systems needed to address diverse buyer needs?*

Sale by description has been the “tiger in the tank” of Australia’s statutory wool institutions now for 50 years. It is a “Furphy” in the guise of efficiency and should be dismissed.

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

Additional measurement now has become so universally accepted that immediately a test is eliminated by the grower/broker, it signals a problem with that characteristic of the greasy wool. The solution is to build bigger lots of well classed wool.

- *Does the information provided on the show floor meet buyer needs? What, if any, additional information would be useful? What information could be dispensed with?*

Buyers will have their own views on this but from my buying experience the most important issues are:

1. The sample is truly representative of the Lot.
2. Test result for:
 - a. micron
 - b. position of break.
 - c. tensile strength.

In that order. Buying decisions were based on test results and the physical wool and its inherent processing characteristics!

The panel is seeking information and evidence on the effectiveness of the current open cry wool auction system as a mechanism for competitive and cost effective price realisation, in particular;

- *What other selling alternatives exist for wool growers 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?*

Growers have a wide range of marketing choices and over the years the auction has proved the most consistent at price discovery and reward. There should be no impediment to other systems being tried in the future as long as they are market driven.

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

Judging from other rural commodity markets the other principle driver of price discovery is Futures (Refer Andrew Woods submission from ICI). As a yarn buyer I believe that topmakers and spinners have over the years developed a buying and selling strategy that has taken a lot of risk out of the price. They have in effect developed their own price stabilisation system, therefore have little interest in a futures market. Without buyers, sellers and punters a futures market cannot operate, as has been previously found with greasy wool futures market. The most important thing for Australia to do is to protect the integrity of the greasy wool auction system, - the World price discovery point greasy wool!

- *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 (for example: on line selling) and would these savings be passed down to the wool grower?*

On our farm, we purchase most of our ewe and cow replacements on “auctions plus”. An attractive electronic buying system. However it is not completely transparent and in our view Australia would be unwise to depart from the current open cry auction for greasy wool until such time as transparency was 100% assured.

** The present auction system is dominated by exporters purchasing wool on behalf of their clients. 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?*

- *The Panel understands that due to a reduction in weekly auction volumes a number of exporters no longer employ a full time wool buyer in each wool selling centre of Australia. This has resulted in a number of commission buyers holding multiple buying limits from a number of exporters. Against this background, is it well known whom a commission buyer is acting for in respect of individual purchases? Do commission buyers confront any conflicts of interest in their purchasing decisions when buying on behalf of clients with similar interests? What effect (if any) do such issues introduce with respect to competition for a woolgrower’s wool? Is there a need to cap the number of clients one commission buyer can buy for?*

There should be no problem with buyers operating for multiple clients. The issue is for the commission buyer to be able to satisfy all their clients’ requirements. If this is not possible then business will be lost. If the client cannot find satisfaction then the decision has to be made whether to put their own buyer back in the auction room. These are completely commercial matters and should be left to the exporter and their client to resolve

- *Are stakeholders able to draw examples of previously attempted selling alternatives and reasons for their lack of adoption to the Review Panel’s attention?*

There have been many different systems tried and failed. The greasy wool auction system is a very efficient way for any buyer anywhere in the world to inspect wool available for sale on any sale day in the wool selling year, and be assured that on that day he is paying no less

or no more than competitors. This underscores the confidence the traders around the world have in the current price discovery point and should not be tinkered with and put at risk.

- *Are auction results communicated in an efficient and timely manner to market participants and thereby enhance the dynamics of the price discovery process? Why is it necessary for AWEX staff to attend auctions to record information for their market reports? Couldn't this information be automatically generated at lower cost?*

Costs could be reduced by collating at the end of the selling day; - try selling that concept to the Australian Stock Exchange, or any other market!

- *Are the auctions basically the same in each of the three major selling centres, or do they differ in some respects? Are there transparent rules governing the conduct of auctions? Do auctions in the different centres generally realise similar outcomes for the sale of specific wool types?*

Buyers in a free, competitive and transparent market will always buy at the cheapest price, (any who don't are fools and won't last very long). The differences in prices between different selling centres in Australia are a reflection of the different costs structures of that market, the freight component and the known processing qualities of wools from those regions. Wools from different parts of Australia have different processing efficiencies based on climate, pasture, genetics and skill levels of growers and shed staff. Western Australia have for example a culture that by and large preferences throwing it all together at the cheapest cost, while New England growers are fastidious in their breeding, husbandry and clip presentation.

- *Are there barriers to entry or other impediments impacting participation at Australian wool auctions? Could those barriers or impediments be reduced by adopting alternative processes? What are the key requirements and/or costs applied in order to participate?*

When our Company applied to become a wool exporter in the mid 1990's our application was speedily processed, and there was no impediment to participation. If there is now, it should be removed.

The Review Panel is seeking information on the post-sale invoicing process and the various charges:

- *In what proportions is the Post Sale Charge (PSC) borne by the various participants in the supply chain? For example, is the cost incurred by the exporter reflected in the price paid by the overseas customer? Or is it taken out of the initial price they bid at auction for the woolgrower's wool?*

Buyers by and large work on incredibly tight margins, naturally they will apportion costs were they can, the most likely outcome is that like all other costs they come off the buyers

limits and therefore paid for indirectly by the grower. I don't see any problems with this but the PSC, should be transparent and published for grower's information by their broker!

Under effective competition between buyers and sellers, additional costs are borne at either end of the chain, by producers or consumers. The way additional costs are shared between producer and consumer depends on the relatively responsiveness (elasticity) of supply and demand, with the side of the market least able to respond bearing the bigger share of any additional cost burden.

- *What services are provided by the wool broker to the wool grower that are covered by the Broker Service Charge (BSC)?*
- *What services are provided by the wool broker to the buyer that are covered by the Post Sale Charge (PSC)?*
- *Are all costs incurred by the woolgrower sufficiently transparent (i.e. are they generally known and publicised prior to the sale of wool?)*
- *Is there potential for a more detailed breakdown of the individual selling and buying costs of wool to be made available to woolgrowers to facilitate more informed commercial decisions regarding the sale of their wool? Is there a need for an industry standard invoice or account sale format?*
- *Given a move to a more transparent invoicing standard, would there be a demand for the broad introduction of a tiered wool broker service/price offering, such as: Premium, Standard and Basic?*
- *Could there be any material benefits to wool growers by extending the exporter's payment period for wool from the existing 7 days prompt period? (i.e. would this free up additional working capital that could be applied to create increased competition at the point of price realisation?)*

Selling Agents and Brokers everywhere, are all trying to extend payment periods. This is extra ordinary when cost of money is historically low. It does however indicate the fragile state of the industry. Extension of payment should be resisted. The focus needs to be on increasing profitability of the entire industry; - that is the only real way to replenish the billions of Dollars of capital lost from the fallout of the collapse of the RPS in the early 1990's

How this could be achieved, ought to be the focus of this enquiry.

First of all it needs to be acknowledged that:

1. the integrity of the Australian greasy wool auction needs to be jealously protected.
2. exporter's margins are very tight, partly to due to lack of volume.
3. by and large the current system has evolved in a market with low profitability that has driven efficiency and there is not a lot to be gained with yet another Selling Review although efficiency and cost cutting should always be a priority.

4. that the Australia's statutory wool institutions 50 year preoccupation with *Sale by Description* is perhaps the most crippling aspect of the entire wool trade because:
 - a. the pretense that wool with the same measurements will process the same.
 - b. pretending that wool is a harmonious generic commodity. Because of the sale by description agenda, these wool institutions have failed to educate downstream manufactures that wool is not a harmonious generic commodity but a fibre with intrinsic values, some of which cannot be easily measured.
 - c. these wool institutions have been duplicitous in this process by allowing exporters to surrender AWTA test certificates for multiple lots purchased at auction and replace with one amalgamated certificate. This hides the ingredients that the exporter has included in the blend, and encourages exporters to blend down to price. The exporter is not to be blamed for this because a few cents can win or lose an order. However not knowing the ingredients the top maker and spinner, thinking wool is wool, continue to concentrate on price rather than extracting the full value of the wool.

For example pilling is the bug bear of the knitwear industry. Consumers hate pilling and it detracts from the reputation of wool as a fibre. This impacts on consumer's preference for woolen garments and consequently the profitability of the industry. Some spinners are investing heavily in trying to develop technology to produce a pill free yarn. One of the contributors to pilling is the short fibres (from greasy then tops and into yarn). Instead of investing in a technological solution, investing in the quality of the ingredients of the greasy wool in the top specification and thus increasing exporters limits, could be a more rewarding exercise, - from the grower of wool to the final garment wearer.

The focus of our entire industry should be to improve profitability. Only profits can repair the damage caused by the last wool debacle. This review is an example of waste emanating from AWI; any money wasted results in less available to rebuild the stock of industry capital.

A good start to a more vibrant profitable industry would be to return the 2% wool tax on growers gross proceeds to the growers, who will surely spend it more wisely than AWI.

Peter Small.

17th February 2015.

