

# Wool Selling Systems Review

## Submission to Review Panel AWI

February 2015

Document prepared on behalf of:

Australian Merino Exports Pty Ltd and United Wool Company Pty Ltd



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# 1. EXECUTIVE SUMMARY

## Background

In late 2014 a Review Panel was appointed by the Australian Wool Innovation Ltd (AWI) to undertake a Wool Selling Systems Review (WSSR). The Review Panel having released an Issues Paper in December 2014 have sought submissions from key stakeholders in response to this paper. This submission is in response to that request.

This submission has been made on behalf of two businesses that operate as Wool Exporters. These businesses are: Australian Merino Exports Pty Ltd and United Wool Company Pty Ltd and has been written from the perspective of a Wool Exporter.

## Issues & Findings

The key overriding context that this report should be read is that the Wool Exporter is both customer and ally to the Woolgrower and the Wool industry in its entirety, providing the bridge between farm gate and ultimate user. The Wool Exporter provides an essential specialist service to all Woolgrowers. To bypass any of these services will simply result in the need to create another exporting business or commission someone to perform the same role.

The reduction of services and volume of wool sales in the past 15 years has led to market efficiencies with only the most competitive surviving as either a Woolgrower or Wool Exporter. However it appears that the domestic brokerage fraternity do not appear to have implemented any rational consolidation to match the current market capacity of today's wool industry.

The centralisation of storage and selling centres is seen as a key to resolving many of the role duplication and uncommercial cost issues within the selling process.

No buyer wishing to stay in business will ever make that ultimate decision without a visual review of the sample box to confirm that the wool they are buying on behalf of their clients meets their required specifications to complete an order. The reason for this is that buyers will place a different value on each sample box based on the needs of their clients. They will be looking for different characteristics that testing data will not provide. All buyers undertake a commercial appraisal of the wool being sold. To do this they requires "eyes over the sample box".

The resolution to the lack of transparency and uncommercial charges applied by the Wool Brokers under the cover of Post Sale Charges is seen as a key desired outcome of this review.

## Recommendations

### **Recommendation 1: Tiered Approach to Broking Services.**

Introduce a tiered approach to broker services that would enable the Woolgrower to determine the level of service it receives from the Wool Broker rather than a service based on history and quaint traditions.

### **Recommendation 2: Lot Sizes**

Only increase the average lot sizes by the removal of excessively small lot sizes (i.e. less than 3 bales and excluding speciality wools.)

### **Recommendation 3: Wool - A Specialist Fibre**

Resist the tendency to refer to wool as a commodity and reinforce the specialist nature of our product.

### **Recommendation 4: Market Diversification**

Diversify our marketing focus to seek alternatives rather than rely on a buyer whose demand seems to have peaked.

**Recommendation 5: South Africa Wool Preparation**

Consider changes undertaken by the South African wool industry in its wool preparation processes and consider implementing appropriate changes to the preparation processes within the local wool industry.

**Recommendation 6: Testing Requirements**

Consider options that may reduce the requirement to test all characteristics of the wool bale, especially those of poor quality, and avoid the temptation to measure just because we can.

**Recommendation 7: Centralisation**

In the short term commit to a consolidation of storage and testing centres with the centralisation of all selling centres to one key centre with the ultimate goal of having all storage and selling centres being totally centralised.

**Recommendation 8: Sale by Description**

Resist the temptation to treat wool as a commodity and avoid the introduction of sale by description.

**Recommendation 9: Testing Options**

Greater transparency is required in the communication of the testing options available to Woolgrowers.

**Recommendation 10: Selling Alternatives**

Communicate the relative merits of selling alternatives to all Woolgrowers ensuring they appreciate the commercial value in their use.

**Recommendation 11: Appointment of One Independent Person/Body – Auction Day**

Nominate one independent person or body to be responsible for the management, recording and reconciliation of sales on auction day.

**Recommendation 12: Role of Broker at Auction**

Remove the repetitive, costly and unnecessary role played by the Wool Broker on auction day.

**Recommendation 13: Buyer Accreditation**

Consider implementing a more rigorous accreditation process for buyers in line with processes in the South African wool industry.

**Recommendation 14: Post Sale Charges - Transparency**

Review the services provided under PSC and whether these need to be made transparent to the market including the Woolgrower.

**Recommendation 15: Post Sale Charges - Indexation**

Place a control over the increase in PSC and considering linking it to an appropriate index.

**Recommendation 16: Storage Charges – Wool Broker to Wool Exporter**

Ensure the Wool Broker charges a commercial rate for storage to the Wool Exporter. A practical application of this recommendation would be to include 14 days free storage as part of the current PSC.

**Recommendation 17: Countermarking**

Review the practice of charging uncommercial rates for countermarking and incorporate this charge in the PSC.

**Recommendation 18: Standard Invoicing**

Introduce a more detailed breakdown of the individual selling and buying costs of wool to be made available to Woolgrowers via the introduction of standard invoicing.

**Recommendation 19: Prompt Date Charges**

All Wool Broker costs, such as storage, should only start after the prompt date.

**Recommendation 20: AWEX Pricing**

Convert AWEX pricing to a centrally based price.

**Recommendation 21: Subscriber Access**

Better limitation to access the AWEX quotes to subscribers only.

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## 2. BACKGROUND

In late 2014 a Review Panel was appointed by the Australian Wool Innovation Ltd (AWI) to undertake a Wool Selling Systems Review (WSSR). The Review Panel having released an Issues Paper in December 2014 have sought submissions from key stakeholders in response to this paper. This paper is in response to that request.

This submission has been made on behalf of two businesses that operate as Wool Exporters. These businesses are: Australian Merino Exports Pty Ltd and United Wool Company Pty Ltd.

One of the Directors of Australian Merino Exports Pty Ltd (AME), Chris Kelly, is also President of the Australian Council of Wool Exporters & Processors (ACWEP) and a Director of the Australian Wool Testing Association (AWTA). This submission is made only in his role at AME.

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## 3. Introduction

### 3.1 This Report

This report has been written from the perspective of a Wool Exporter. Wherever possible sources of information have been quoted. In some cases only anecdotal assertions are made but it was felt necessary to do so in order to provide a complete picture of the Wool Exporters needs and recommendations that they hope will come from this review.

The report provides background information regarding where the industry has come from in the past 20 - 30 years, the competitive forces that have changed in that time and how the role of Woolgrower, Wool Broker and Wool Exporter has evolved and changed to the ever-changing market forces. It was also felt important that the Review Panel have a very clear understanding of the role of the Wool Exporter and this role and value has been clearly articulated.

Each phase of the Wool Selling System detailed in the Review Panel Issues Paper has been commented upon under *Section 4: Issues & Findings* with recommendations incorporated under each phase where appropriate.

### 3.2 Definitions

<b>ACWEP:</b>	Australian Council of Wool Exporters & Processors
<b>AME:</b>	Australian Merino Exports Pty Ltd
<b>AWI:</b>	Australian Wool Innovation Ltd
<b>AWEX:</b>	Australian Wool Exchange
<b>AWH:</b>	Australian Wool Handlers
<b>AWIS:</b>	Australian Wool Industries Secretariat Inc.
<b>AWTA:</b>	Australian Wool Testing Association
<b>BSC:</b>	Broker Service Charge
<b>PSC:</b>	Post Sale Charge
<b>UWC:</b>	United Wool Company Pty Ltd
<b>WSSR:</b>	Wool Selling Systems Review

### 3.3 The Relationship between Woolgrower and Wool Exporter

The key overriding context that this report should be read is that “the Wool Exporter is both client and ally to the Woolgrower, providing the bridge between farm gate and ultimate user. No body, no system, no laws protect this position. If they do not provide a service of real value, both to the Woolgrower and to the ultimate user, they fail<sup>1</sup>”. “Wool Exporters see their own fortunes and those of Woolgrowers as intrinsically linked and have a vested interest in the prosperity of producers<sup>2</sup>.”

The growth and sustainability of the wool Industry within this country will rely heavily upon the ongoing and continuance of the dialogue between Woolgrowers and Wool Exporters. The Wool Exporter understands that in doing their business in discovering prices it is in their best interests to benefit the Woolgrowers and keep them profitable and in business.

### 3.4 The Role and Value of Wool Exporters.

*The following is an edited version of an article written by Michael Lempriere<sup>1</sup>, Wool Industry Leader, (dec. 2008)*

“When discussions on the efficiencies of the wool industry occur many Woolgrowers focus on the need to “shorten the pipeline”. They are tempted by the idea of marketing their own wool directly to an “end client”. Many have found that this is not without some pitfalls, that they have needed some professional assistance, and inevitably have been hit financially in an unsuccessful bid to increase the return from their wool clip. To avoid these pitfalls the Wool Exporter provides an essential specialist service to all Woolgrowers. To bypass any of these services will simply result in the need to create another exporting business or commission someone to perform the same role.

The key role of the Wool Exporter is to:

- Deploy an international sales team to communicate daily with every wool user around the world to find willing buyers at fair market prices for every category of wool, from superfine fleece to crossbred crutchings. This is supported by regular personal visits to precisely monitor the customer’s requirements and to establish and maintain his confidence in the supplier;
- Negotiate and conclude a firm and enforceable contract of sale which would include conditions particular to that customer’s requirements and wishes. These conditions often require first hand review of each clip to satisfy particular specifications that cannot be gained by current testing procedures. This includes: breed, bloodline, crimp definition, style, relevant commercial combing length
- Negotiate forward foreign currency exchange at competitive rates;
- Accept and manage full market risk between negotiation and the physical covering of the sale;
- Provide funding at or close to Bank’s “cost of funds” rates often for up to 6 months or more from date of purchase;
- Underwrite the customer’s financial and fiduciary performance thus allowing the grower to be guaranteed to receive their money in full, within seven days of sale;
- Undertake the selection, competitive purchase and assembly of appropriate shipping parcels to fulfil customer’s particular specifications and requirements;
- Negotiate and organise and fund the most competitive and effective processing of the wool to deliver a predetermined outcome both in all parameters of quality and in price;
- Undertake the administration of the shipping parcel, to dump and to load at competitive rates;
- Determine and negotiate the most cost effective shipping opportunities;
- Prepare the necessary shipping, banking and export documentation;

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<sup>1</sup> : “What Does a Wool Exporter Do?” – An article by Michael Lempriere.

<sup>2</sup>: Letter to the Editor – Peter Brice (AME) – *The Land*, December 2014

- Negotiate the documents through the banking system;
- Organise customs clearance at destination and cartage to final destination;
- Undertake long term stockholding in greasy, processed or top, accepting the full market risk, in order to satisfy modern customers' "just in time" buying needs;
- Continually work on refining ways in which Australian wool is marketed to the world; and
- Accept full liability for any claims resulting from any shortfall in processing outcome, unforeseen faults or whatever reason including market claims."

Any changes made to the wool selling processes or systems need to be made with the current key and often under valued role of the Wool Exporter in mind.

### 3.5 Market Competition Affecting Woolgrowers and Wool Exporters

Australian annual wool production has reduced from its peak of 1.0 billion kg 15 years ago to just over 340 million kg today. This is a reduction of 66%. The composition of the wool clip has also been compromised via an increased focus on alternative, dual purpose and even single purpose meat sheep. Woolgrowers have been required to consolidate their position and have found the lack of demand for their product in many cases financially draining and debilitating.

For many this period has also meant that many Wool Exporters have gone out of business. "In 1979 there were almost 300 members of the Australian Council of Wool Buyers. Today the membership of its successor, The Australian Council of Wool Exporters (ACWEP), number only 30. Those that have survived have done so because they have been able to do it better than their competitors and have made numerous changes to their business to maximise efficiencies within their processes.

Among the casualties in the auction room in the past 20 years have been several corporate entities that, it is assumed, found the returns and margins too slim within the wool exporting business. Today's Wool Exporters are in many cases private firms, family companies or small independent operators who survive and grow through their knowledge, dedication, expertise and passion for the business. As in wool growing even the most efficient are finding managing their business in a cost efficient way extremely difficult. Profits are becoming illusory and returns on capital and risk somewhere between negligible and negative. A gross margin (before any overhead costs) of between 2% and 3.5% is the normal calculation in exporter's costings and when squeezed business is usually concluded at even lower margins.

With even the largest players enjoying little over 10% to 12% market share, this remains an extremely competitive industry, with a high level of competitive tension throughout the wool selling process. Nobody is in a position to use their market advantage to extract favourable margins or to minimise returns to the Woolgrowers. There can always be process and efficiency improvements however as costs and services being sharply honed by the rigours of fierce competition the wool industry enjoys an extremely tight and efficient distribution system.<sup>3</sup>

"Australian wool auctions operate in the spotlight of strict regulation which ensures auction competition is open honest and transparent. Any short-sighted move to offshore this control will effectively remove the safety net Woolgrowers currently have."<sup>4</sup>

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<sup>3</sup> "What Does a Wool Exporter Do?" – An article by Michael Lempriere.

<sup>4</sup> Letter to the Editor – Peter Brice (AME) – *The Land*, December 2014

### 3.6 Market Competition Affecting Wool Brokers

The reduction of services and volume of sales in the past 15 years has led to market efficiencies with only the most competitive surviving as either a Woolgrower or Wool Exporter. However it appears that the domestic Brokerage fraternity do not appear to have implemented any rational consolidation to match the current market capacity of today's wool industry. There appear to be the same amount of brokers supporting an industry that has reduced in production volume by two-thirds. Every other sector in the industry has rationalised but it appears the brokerage fraternity has maintained a similar if not more diverse infrastructure.

In order to service the ever-increasing range and number of brokers there has been a multiplication of infrastructure and resources, some centralised, some satellite. The cost of this increase to service provision is expected to be absorbed through the sales transaction. When considering ways to effectively reduce costs and make the transaction between Woolgrower and Wool Exporter more efficient we surely have to look closely at areas that have failed to consolidate over this period. It seems from the Wool Exporters' perspective that the Wool Brokers have engineered a simplistic way to shift cost recovery to a charge structure, which is not subject to competitive forces. If greater transparency and competition were introduced to these costs then consolidation would happen rapidly.

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## 4. Issues & Findings

### 4.1 Wool Supply Chain Review

#### 4.1.1 PHASE 1 WOOL PREPERATION

Although commentary on the service provided by the Wool Broker to the Woolgrower during the Wool Preparation phase would be best made by those involved in the supplying and the receiving of such a service it was felt the following comments were relevant to this review.

#### *Is there scope for a user pays component should the woolgrower not require this level of service?*

Farm visitations seem to be a timely, costly and in many cases an unnecessary way to maintain a relationship with one's suppliers. The continuation of this traditional way of maintaining a relationship between the Wool Broker and Woolgrower appears to occur due to no alternative being offered or requested. It appears to only serve the purpose of making the breaking of this broker/grower relationship a lot harder due to this apparent "personal" approach. We doubt whether this approach is required and only serves to add to the costs charged to the Woolgrower as brokerage or via the non-transparent method of Post Sale Charges (PSC). The dropping off of wool packs and setting the lines can only be viewed by those new to the industry as a quaint visit to how things once were. The Wool Broker providing such a service must surely be able to find more productive tasks in making the wool supply chain more efficient.

Improved technology would enable contact to be made that would minimise or in fact completely remove the need for ongoing face-to-face meetings or visits. If the Woolgrower seeks this level of service then a premium price could be determined. If this service is not required then a discount should be offered. (More comments and support of a tiered Wool Broker service is covered in section 4.1.5 *Invoicing and Payment.*)

#### **Recommendation 1: Tiered Approach to Broking Services**

Introduce a tiered approach to broker services that would enable the Woolgrower to determine the level of service it receives from the Wool Broker rather than a service based on history and quaint traditions.

#### *To what extent are the Wool Brokers providing woolgrowers with information they already have?*

The information provided by Wool Brokers in their farm visitations can only be imagined to be reciting information that is easily accessible by Woolgrowers online, if appropriately educated, or if their systems are set up to have this information readily available. This would include the online provision of industry papers, AWEX information, AWI newsletters or industry information provided by their own broking business.

#### *Does the evolution of China's demand for wool (80% of total wool clip) and a more commodity based approach to wool usage as a fibre present opportunities to create greater efficiencies at the point of shed preparation?*

China's demand peaked at 80% of the wool clip and has since reduced to 74%.<sup>5</sup> Let us be wary of making any decisions based on a demand that has appeared to have peaked. We should also be wary about setting precedence for any new and emerging markets that remain untapped or unidentified.

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<sup>5</sup> : Prepared by AWIS from source data supplied by Australian Bureau of Statistics July 2014 – December 2014.

We would be supportive of an increase in average lot sizes if they were the result of the removal of excessively small lot sizes (i.e. less than 3 bales). This would need to take into consideration some speciality wools that would be excluded from this removal.

An across the board increase in lot sizes and a commodity-based approach will only succeed in the quality of Australia's wool product reducing and therefore lower prices may eventuate. It is then very hard to repair such a hit to our brand and price if our current largest buyer has accepted these suggested changes in practice. It is unlikely that our ability to market quality premium fibres due to the acceptance of larger lot sizes be enhanced by this change. The extension of that would be that Woolgrowers would then unlikely to be rewarded for their focus on continually improving their wool quality. To remove any risk of impacting the brand, quality and demand of the Australian wool product we would suggest avoiding the introduction of practices that incorporates larger lot sizes.

### **Recommendation 2: Lot Sizes**

Only increase the average lot sizes by the removal of excessively small lot sizes (i.e. less than 3 bales and excluding speciality wools.)

By increasing lot sizes you accept the notion that wool is a commodity. A commodity is a word used to describe a class of goods for which there is demand, but which is supplied without qualitative differentiation across a market. Petroleum and wheat are examples of such commodities, their supply and demand being a part of one universal market. One of the characteristics of a commodity good is that its price is determined as a function of its market as a whole. Items such as wool, on the other hand, has many aspects of product differentiation and price variability based on such variables as: the breed, region grown, vegetable matter, yield, the perceived quality etc. The demand for one bale of wool may be much larger than demand for another depending on the needs of the end buyer and the scarcity of such product.

Comparing wool with cotton or manmade fibres is ineffective or even counterproductive in terms of creating a comparable sales model or developing "sale by description" or an electronic selling system dependant on generic wool types. Buyer risk & confidence would reduce and more than likely de-value wool while attempting to save a minimal amount in selling costs.

Globally, wool is a tiny part of the global textile fibre industry: 1.4% and falling. Since Australian wool makes up approximately 25% of all global supply, Australia's clip represents around 0.3% of textile fibre supply, and wool < 19.5 um, about 0.15%.<sup>6</sup> The nearest volume competitors to Australian fine Merino wool are silk or cashmere. We cannot afford to treat wool like a commodity. It is a niche/specialist fibre and we need to treat its sale and processing as such.

### **Recommendation 3: Wool - A Specialist Fibre**

Resist the tendency to refer to wool as a commodity and reinforce the specialist nature of our product

### **Other Comments**

We should be concerned at the apparent lack of diversification on the market with an over reliance on the Chinese market to sell our wool. Diversification requires spreading your investment of time and capital across different markets to reduce your overall risk. Diversification in our market focus, such as investing time and energy and marketing spend in countries other than China e.g. India or Vietnam, future proofs our industry. So, by diversifying our marketing focus and practices rather than concentrating our approach on one market we can achieve smoother, more consistent returns over the medium to longer term.

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<sup>6</sup> : Data source - Australian Wool Innovation (2014)

**Recommendation 4: Market Diversification**

Diversify our marketing focus to seek alternatives rather than rely on a buyer whose demand seems to have peaked.

South Africa used to have a very poor reputation for wool preparation but now they have a much improved process. Many would argue they have now surpassed the Australian standard and the price for South African wool is showing that improvement. In previous years its wool used to be charged at a 20% - 30% discount now it is selling at a 10% - 20% premium.

**Recommendation 5: South Africa Wool Preparation.**

Consider changes undertaken by the South African wool industry in its wool preparation processes and consider implementing appropriate changes to the preparation processes within the local wool industry.

#### 4.1.2 PHASE 2 DELIVERY AND TESTING

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

Without undertaking a detailed financial analysis the commercial benefits of decentralisation the testing process is hard to determine. However on the face of it any benefits gained by undertaking testing on-farm or at another regional location of the Woolgrower's choice would unlikely be related to financial benefits. Decentralizing the testing process would only add to the costs of the testing process due to requiring additional resources both in equipment and trained testers.

In addition it would raise the issue of lack of security over the testing process and would also raise doubts over the accuracy of the testing.

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

Technology enables us to do wonderful things. It can provide us with a vast array of data and information that previous generations could only dream about. Testing on wool can be done faster, cheaper and more accurately than ever before. We can measure almost everything. The question really being asked is: does the buyer need any additional data? From the Wool Exporter's perspective the answer is no. Just because it can be measured or tested doesn't mean it should be measured or tested.

If anything Wool Exporter's would be recommending that the Review Panel look at ways of reducing the amount of testing, or at worst maintain the current levels of testing but look at ways of improving its consistency. Any moves to introduce new testing will not help the buyers with their decision making process. The Wool Exporter will always seek to have more "eyes over the sample box" than rely on testing data provided.

#### **Recommendation 6: Testing Requirements**

Consider options that may reduce the requirement to test all characteristics of the bale, especially those of poor quality and avoid the temptation to measure just because we can.

### 4.1.3 PHASE 3 WOOL APPRAISAL

#### ***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?***

A consolidation of the appraisal process between the Wool Broker and AWEX with a generic type being applied would be applauded. It doesn't matter who does it but the duplication should be removed. However the underlying need from the perspective of the Wool Exporter is that we will always need to inspect/appraise the wool prior to auction. Prior to purchase a “commercial type” needs to be ascertained i.e. is the wool I am about to buy on behalf of my client meeting the commercial needs I require?

One way of achieving the reduction within the appraisal stage is to fully support the concept of centralisation. Rather than keeping the wool in the original broker warehouse, **all wool** should be transported immediately after shearing to a centralised storage facility within each region. On arrival one process for testing/appraising could be completed. Not only would this remove one of the appraisal stages but it would provide the added advantages of: removing post sale cartage costs; increase the speed of order finalisation; and reduce the duplication of storage facilities throughout the country. If we were to take this recommendation to the extreme then the establishment of one national storage centre could be a long term target e.g. Melbourne, then all wool being auctioned could be stored in this storage centre with maximum saving due to the achievement of peak economies of scale.

#### **Recommendation 7: Centralisation**

In the short term commit to a consolidation of storage and testing centres with the centralisation of all selling centres to one key centre with the ultimate goal of having all storage and selling centres being totally centralised.

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

All Wool Exporters and Wool Classers will concur that although wool samples may look the same on paper, based on the AWTA testing results and AWEX value, in reality they are different. This difference may at times be minor but even minor differences could lead to an overseas client rejecting the wool and a claim being lodged. Therefore “sale by description” is a concept that would not be supported by the wool exporting industry.

#### ***To what extent is 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 sample?***

Throughout this submission you will see that Wool Exporters, armed with certain amount of information, already provided by AWTA testing, are able to determine the focus of purchase. However few buyers wishing to stay in business are likely to make that ultimate decision without a visual review of the sample box to confirm that the wool they are buying on behalf of their clients meets their required specifications to complete an order. The reason for this is that buyers will place a different value on each sample box based on the needs of their clients. They will be looking for different characteristics that testing data will not provide e.g. breed, bloodline, crimp definition, style, relevant commercial combing length, and a more comprehensive summary of vegetable matter types. All buyers undertake a commercial appraisal of the wool being sold. To do this they requires “eyes over the sample box”.

### ***Should the industry be seeking to achieve a wool selling system based entirely on sale by description?***

The question that needs to be answered is: If sale by description is introduced based on the acceptance that, at times, errors will occur, who is ultimately responsible for that error? The buyer, the broker, AWEX, AWTA or the Woolgrower? Currently, as established in *Section 3.4 The Role and Value of Wool Exporters*, the Wool Exporter currently accepts full liability for any claims resulting from any shortfall in processing outcome, unforeseen faults or whatever reason including market claims. Under “sale by description” that acceptance would not continue. There has been industry talk about such occurrences being insured against by the establishment of a claim fund. We would expect that this would add to the costs of the industry not reduce it, as any overseas client may see this fund as an easy way to make a claim for lost earnings etc. Therefore any fund established would need an independent assessor and be robust and large enough to cope with any claims through tough times. This all comes at an additional cost.

Not only would the concept of sale by description need to cope with the increased claims and associated financial settlements but the impact on goodwill would also need to be addressed. The potential loss of goodwill will not only impact the Wool Exporters’ business but the entire Australian wool industry could be hurt as overseas parties become dispirited with the inconsistencies of wool quality coming out of Australia.

#### **Recommendation 8: Sale by Description**

Resist the temptation to treat wool as a commodity and introduce sale by description.

### ***Are multiple systems needed to address diverse buyer needs?***

The fact is, as outlined by the Review Panel Issues Paper, multiple systems are already available. In addition to the popular auction system wool can be sold by tender, using electronic platforms, Woolgrowers can go direct to the mill, or any other variation. These platforms are there and they should be encouraged more to meet diverse needs.

The buying and selling of wool is an extremely mature industry and it already has multiple systems. The ones that have been proven to work and to meet the needs of both the Woolgrower and the Wool buyer with the most accepted process (via auction) involved in the sale of 80% of all wool sales.

Electronic selling auctions have been tried before but they ended up being much slower than the current auction house system.

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

Woolgrowers currently have the capacity to opt out on certain tests. Do they know they have this option or are they convinced by the Wool Brokers that this is a key value service provided by the broker?

#### **Recommendation 9: Testing Options**

Greater transparency is required in the communication of the testing options available to Woolgrowers.

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

No additional information is required. Any efforts to streamline and if possible reduce the amount of information would be supported.

#### 4.1.4 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? 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? 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 woolgrower (for example: online selling) and would these savings be passed down to the woolgrower?*

The selling alternatives are clearly identified on page 6 of the Review Panel Issues Paper which do give the Woolgrower many options. Private auctions are currently held and forward contracts are available offering fixed price contracts. Therefore it seems clear that the market appears to be happy with the auction system due to 80% being sold via the auction process currently held by AWEX.

Anecdotally many exporters believe that the competitive tension already available produces the highest price for wool at auction. In many cases cheaper wool can be obtained through private sale when the Woolgrower or dealer is happy to accept a lower, yet fixed price.

The auction system works and allows the buyers to progressively pull together orders that meet their clients' needs. They are able to construct their orders quickly and easily due to the volume the auction process provides.

Exporters have enough responsibilities already and do not have the time or resources to go to each individual grower when they need to complete an order. Other methods are there but are only used if both the Woolgrower and Wool Exporter see the commercial value in using them.

#### **Recommendation 10: Selling Alternatives**

Communicate the relative merits of selling alternatives to all Woolgrowers ensuring they appreciate the commercial value in their use.

*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?*

Due to the complexity and the variation in the quality of wool the processors e.g. top processor, spinner, scourer, and the ultimate manufacturer and seller of woollen products e.g. weaver, knitter, retailer, should not reasonably be expected to be able to also appraise, purchase and ship the greasy wool. That is a key role of the Wool Exporter. (See Section 3.4 The Role and Value of the Wool Exporter)

The key role the Wool Exporter plays should never be scorned or dismissed. They should be seen as the client, a person that is a catalyst for growing the Australian wool market throughout the world. Someone, who through their negotiations with providers along the chain, is actually effective in reducing the overall costs to the ultimate purchase of woollen garments.

*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 is no doubt that due to the number of centres and concurrent auctions being conducted throughout Australia at any one time it is necessary to nominate a person or a commission buyer to purchase wool on behalf of several overseas clients or to act on behalf of an exporters request. This can at times be seen to be a conflict and may have the effect of lowering the competitive tension.

Rather than put bureaucratic impediments in place the concept of true centralisation would go a long way to fixing this issue. Centralising would mean bringing the three current centres all into one location. Consideration should be given to not only bringing the sample but the entire wool bales as well. Having three large dumps in one centre. Not only would savings associated with economies of scale be met but also increased competition amongst providers to the industry would be required to reduce costs to compete.

Another advantage of the centralisation of the auction process would remove a current blockage in the auction process. Some Wool Exporters currently choose not to make purchases of wool stored in WA or stored in small regional centres e.g. Portland, due to the possible need to wait an extended length of time until the wool arrives to complete their entire order. If all the wool is in one place this weakness in the system is removed.

#### **See Recommendation 7: Centralisation**

*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?*

There is a definite need to have an independent person present that ensures appropriate processes are in place and the appropriate reconciliation of sales is undertaken. This needs to be an independent person but not necessarily a person from AWEX. For example a representative from AWH could complete this role.

The role of the broker during the actual auction process would seem to be repetitive, costly and unnecessary. It is a replication of infrastructure that can easily be removed. Why do up to four representatives from each Wool Broker attend these auctions? Why does each Wool Broker provide an auctioneer? What value-add do they provide by their presence? By wearing matching ties do they believe the price paid by the Wool Exporter magically increase? The role of the Wool Broker should stop at the arrival of the wool at the centralised wool centre unless a premium service is being provided.

#### **Recommendation 11: Appointment of One Independent Person/Body – Auction Day**

Nominate one independent person or body to be responsible for the management, recording and reconciliation of sales on auction day.

#### **Recommendation 12: Role of Broker at Auction**

Remove the repetitive, costly and unnecessary role played by the Wool Broker on auction day.

*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?*

The auctions undertaken in each major selling centre are basically the same with similar rules governing the conduct of the auction. There may at times be slight variances in prices from one centre to another but only by slim amounts and would not vary on a consistent basis. Again any inconsistency of this type would be removed with the introductions of one centralised selling centre.

#### **See Recommendation 7: Centralisation**



***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?***

Currently entry to the market could be argued to be too easy and in fact more hurdles should be put in place to protect the integrity of our market. Currently anyone interested in buying wool only needs to obtain a buyers code from AWEX. No financial information is required nor proven business credentials before purchasing unlimited amounts of wool. The wool purchased is certainly not released so no immediate financial impact to the Woolgrower would occur however introducing some accreditation process on the suitability of the potential buyer should protect the integrity of the market.

South Africa have established a much more rigorous process for would-be buyers and should be reviewed for application in the Australian market.

**Recommendation 13: Buyer Accreditation**

Consider implementing a more rigorous accreditation process for buyers in line with processes in the South African wool industry.

***Other Comments***

Some may argue that the current auction process is somewhat old school and that greater use of technology and systems could be introduced to reduce costs and speed up transactions. Previous experiences with online systems have shown them to be slower than auction rooms - at best half the speed.

The advantage of the current auction room is that market tension is maximised by those competing for the sale being able to "eyeball" each other. The sale price can often be elevated due to the competitive nature of an auction, which can cause people to bid higher than they originally wanted to spend. This can result in larger profits for the Woolgrower. Many buyers will say that if you are not present in the selling centre during the auctions you miss out on the market feel and the sentiment of the room. During the auction Wool Exporters will progressively make up an order, averaging, make out the margins as they go and they see this as a key feature ensuring ultimate overseas client satisfaction.

#### 4.1.5 PHASE 5 INVOICING AND PAYMENT

*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?*

It is taken out of the initial price that is bid at auction for the Woolgrower's wool.

*What services are provided by the wool broker to the woolgrower that are covered by the Broker Service Charge (BSC)?*

The Woolgrower pays for delivery from farm to transport company and pays for testing and is charged for warehousing by the brokers. Therefore the BSC is really a commission to cover the Brokers overhead. The BSC however over the past 15 years has remained at a relatively stable level. The current system has required that brokers charge structures be amended to show competitive commissions charges to growers. This have remained relatively stable over the past 15 years at between \$25- \$35 a bale. This is in stark contrast to rise in the PSC, which has risen by 261% since 1994.

*What services are provided by the wool broker to the buyer that are covered by the Post Sale Charge (PSC)?*

The Post Sale Charge, and what it represents, have kept Wool Exporters awake at night for many years as it represents over one-fifth of all grower selling costs from the time the wool leaves the growers shed to being delivered to an overseas buyer. All other associated costs are itemised when the broker charges the Wool Exporter.

This can best be shown in Figure 1 below which clearly outlines the indicative and relative costs associated with selling and buying 100 bales of wool that is delivered to Shanghai, China. The BSC plus the PSC makes up over one-third of all costs. These charges can only be seen as Commission to be received by the Wool Broker. None of these Post Sale Charges and other costs is evident to the Woolgrower.

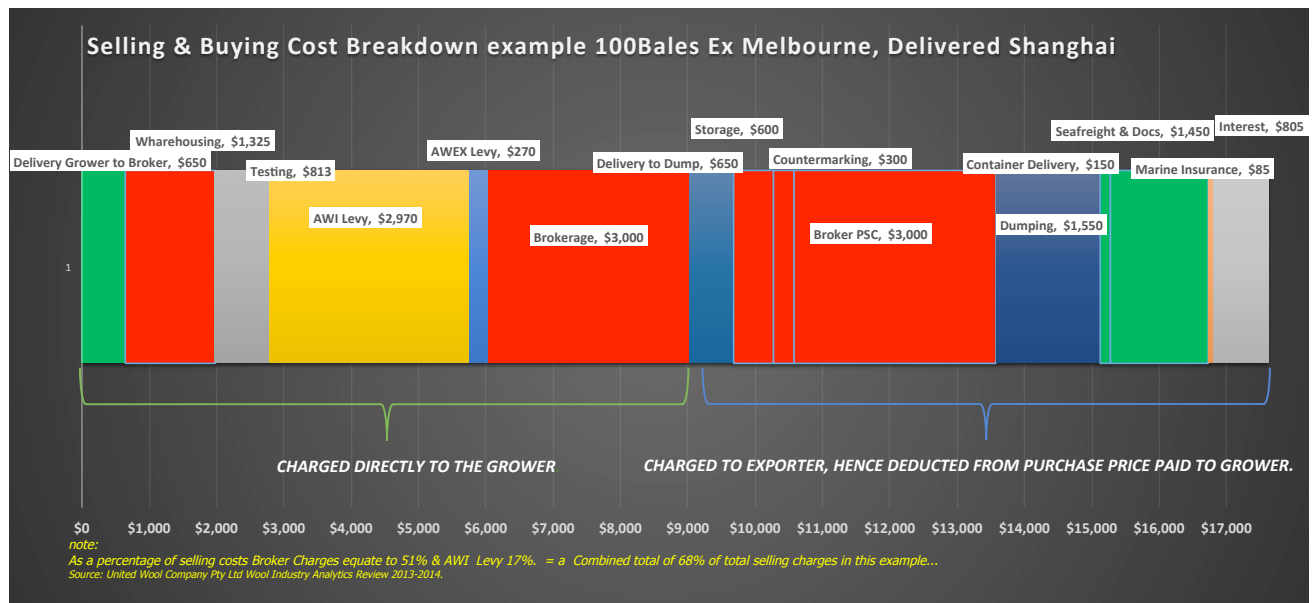
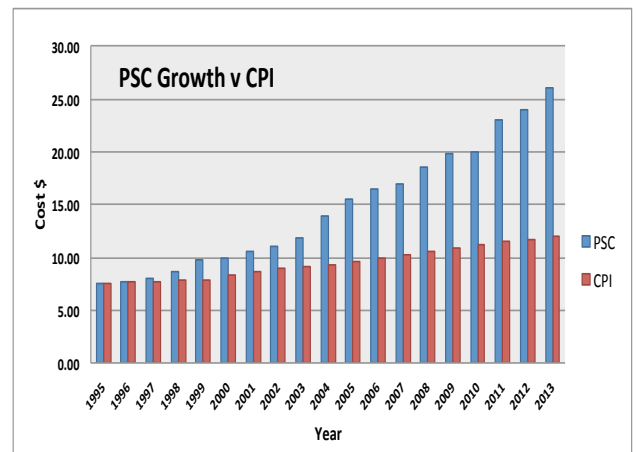


Figure 1: Selling & Buying Cost Breakdown

The unsubstantiated rise in PSC over the past twenty years is clearly evident in the data shown below. The PSC has grown by 261% since 1994 with CPI in the same period rising by only 67%. Wool Brokers would find it extremely difficult to justify this significant and unexplained rise and therefore the current level of the PSC is grossly overstated.

Year	Post Sale Charges per bale (PSC)	Consumer Price Index <sup>7</sup> (CPI)	Post Sale Charges Applying CPI
	\$	%	\$
1994	7.20		7.20
1995	7.50	4.7	7.54
1996	7.75	2.6	7.73
1997	8.00	0.3	7.76
1998	8.65	0.7	7.81
1999	9.70	1.5	7.93
2000	10.00	4.5	8.29
2001	10.50	4.3	8.65
2002	11.00	3.1	8.92
2003	11.90	2.7	9.16
2004	14.00	2.3	9.37
2005	15.50	2.7	9.62
2006	16.50	3.5	9.96
2007	17.00	2.3	10.19
2008	18.50	4.4	10.64
2009	19.80	1.7	10.83
2010	20.00	2.9	11.14
2011	23.00	3.3	11.51
2012	24.00	1.7	11.71
2013	26.00	2.5	12.00

**Table 1: Post Sale Charges applying the CPI (1994 -2013)**



**Figure 2: Post Sale Charges v Consumer Price Index (1994 – 2013)**

<sup>7</sup> Source: Australian Bureau of Statistics

In addition to the rise in PSC over the past twenty years two uncommercial charges that the Wool Broker impose upon the Wool Exporter include storage costs and countermarking.

The Woolgrower is charged a certain amount by the Wool Broker to store its wool prior to auction. Immediately upon sale the Wool Exporter is responsible for this storage cost. Why is it that although the wool has not moved the wool storage charge increases from 11 cents per bale per day, which is charged to the Woolgrower, to 22 cents per bale per day, which is charged to the Wool Exporter – an increase of 100%. Surely a commercial storage rate needs to be charged, not over inflated rates.

Countermarking is an obvious requirement to ensure each bale is appropriately identified. This can be done by various means including automatic markings or manually applied using stencil and markers. The cost per bale to undertake this simple task can range between \$2 and \$3. To put this into context it costs \$650 for a 40-foot container containing 125 bales to be sent from Melbourne to Shanghai. It costs the Wool Exporter and ultimately the Woolgrower \$375 for someone to put 5 letters on the bottom of each of these 125 bales. Why is this an additional cost? Why is this not absorbed by the PSC?

As detailed in *Section 3.6 Market Competition Affecting Wool Brokers* the brokerage fraternity has not consolidated. Their infrastructure is no leaner taking into consideration the reduction in wool sale volumes by two thirds in the past twenty years.

#### **Recommendation 14: Post Sale Charges - Transparency**

Review the services provided under PSC and whether these need to be made transparent to the market including the Woolgrower.

#### **Recommendation 15: Post Sale Charges - Indexation**

Place a control over the increase in PSC and considering linking it to an appropriate index.

#### **Recommendation 16: Storage Charges – Wool Broker to Wool Exporter**

Ensure the Wool Broker charges a commercial rate for storage to the Wool Exporter. A practical application of this recommendation would be to include 14 days free storage as part of the current PSC.

#### **Recommendation 17: Countermarking**

Review the practice of charging uncommercial rates for countermarking and incorporate this charge in the 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?*

The introduction of a standard invoice, if it achieved greater transparency of costs associated with the buying and selling of wool, would be a welcome introduction. The Woolgrower is currently kept in the dark in relation to costs charged by the Wool Broker to the Wool Exporter and any changes to Post Sale Charges need to be made know to the Woolgrower. In the end these costs are hurting them and the entire wool industry.

#### **Recommendation 18: Standard Invoicing**

Introduce a more detailed breakdown of the individual selling and buying costs of wool to be made available to woolgrowers via the introduction of standard invoicing.

*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?*

We believe the introduction of a tiered approach Wool Broker service will assist in lifting the transparency of the cost structure currently in place and will make the Wool Broker more accountable for his/her services.

**See Recommendation 1: Tiered Approach to Broking Services**

*Could there be any material benefits to woolgrowers 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?)*

Clearly the larger players in the market are better equipped to cope with the 7-day prompt payment. The bigger you get the more able you are to cope with this. Therefore to extend this period may enable more people into the market.

The more confusing issue in relation to the "prompt date" (the day the wool was due for payment) is the inconsistent manner in which Wool Brokers begin charging the Wool Exporter for storage immediately on the fall of the hammer.

**Recommendation 19:**

All Wool Broker costs, such as storage, should only start after the prompt date.

#### 4.1.6 PHASE 6 EXPORT PROCESS

***Is there scope for the exporter and processor sector of the industry to leverage its combined scale to negotiate more competitive freight rates from shipping companies and freight forwarders?***

This is not a necessity as freight rates aren't the major expense (less than 4% of the overall costs) and there are competitors everywhere ensuring that commercial rates are always applied.

Due to the competitive nature of the industry and in combination with the production reduction, in order to remain in business Wool Exporters over the past 15 years have been constantly reviewing how to operate in a much more cost efficient way. It is very clear that even undertaking these efficiency reviews the exit of Wool Exporters in that period has been severe. While there have been some additions these new entities are of a much smaller scale when compared to the corporate style entities who have left the industry.

***Can the exporter sector of the industry leverage its combined scale to negotiate more competitive rates from wool dumps and whether there is scope for an industry owned and/or managed facility?***

Dumping is a large cost however it is understood that it is a highly capital intensive business with a lot of maintenance required and is not a license to print money. As the entire industry negotiates its rate at least twice a year this is seen as an accepted cost however with only one wool dump in WA and only two in NSW there may not be enough business competing to provide truly best practice prices.

If the concept of true centralisation was undertaken then the ensuing increased volume may create a greater competitive market and greater efficiencies.

**See Recommendation 7: Centralisation**

***What ability does the exporter's have to achieve consistent and competitive funding lines from banking institutions, particularly considering a high percentage of wool is shipped prior to receiving payment for the goods?***

There are many stories of those qualified and prepared to enter the market that have been knocked back by the banking institutions. It is still very difficult to garner banking support in this industry. We are not sure how this could be changed without an overarching body providing short-term guarantees to those that require support. We cannot see any current group being prepared to provide such guarantees.

#### 4.1.7 PHASE GENERAL

##### *Wool industry institutions*

Many of the issues/questions raised in this Phase have been commented upon already in this submission. As a general statement however any efforts undertaken to pool current resources or to reduce the current multiplication of infrastructure would be supported.

##### *AWEX market reporting*

The quoting/valuing system is not seen as commercial as they do not include the variable post sale charges which may vary by up to 100%. An example of this is that they do not include the actual transport costs from Tasmania that are higher than mainland wool. Therefore in the early part of the auction the quotes are wrong, which gradually corrects itself over the day.

Daily reports are deemed to be unnecessary and in many cases not used due to the perception of their inaccuracy. Some Wool Exporters provide their clients with their own market reports to ensure the information being provided to their clients accurately reflects the market.

People, both locally and overseas are accessing the AWEX reports who are not subscribers to the data. We do not know how this can be restricted but somehow this must be better managed.

##### **Recommendation 20: AWEX Pricing**

Convert AWEX pricing to a centrally based price.

##### **Recommendation 21: Subscriber Access**

Better limitation to access the AWEX quotes to subscribers only.

##### *AWI Levy*

It is understood that the WSSR specifically excluded the wool levy as part of this review. As the levy makes up 17% of the overall selling costs (see Figure 1) it seems that its exclusion means that a major component of the cost to Woolgrowers is not being reviewed.

Is it possible that greater communication and greater transparency be provided to all within the wool buying and selling industry that enables greater insight into the key purpose of the levy and the alignment of the AWI's activities with this purpose?

##### *Forward selling and risk management*

As previously stated in this submission wool should not be treated as a commodity and should not be compared to full grain. Forward selling and creating a derivatives market can only work if your product is a commodity. Derivatives markets with wool have been tried before and failed dismally.

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## 5. CONCLUSION

The matters contained in this submission serves as an important part of the feedback process requested by the Review Panel. This however is only a summarised version of what we see as our position and key needs as Wool Exporters.

We would seek additional opportunities to meet with and present to the Review Panel if it sought clarification as to our position or required additional information from us.

We look forward to maintaining the dialogue between ourselves and the Review Panel and the changes that will emanate from this review.

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