

WOOL SELLING SYSTEMS REVIEW (WSSR)

REVIEW PANEL DISCUSSION PAPER – JULY 2015

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INTRODUCTION

PURPOSE OF THE WSSR

The Wool Selling Systems Review (WSSR) has been commissioned by Australian Wool Innovation Limited (AWI). Established in 2001, AWI is a not-for-profit company, owned by more than 25,000 Australian wool levy payers, that invests in R&D and marketing to increase the long-term profitability of Australian woolgrowers.

The objectives of the WSSR are to improve the returns that woolgrowers receive for their wool through:

- evaluating whether greater efficiencies and cost savings in the exchange of ownership between the seller and first buyer are attainable
- understanding the potential for increased competitive tension throughout the wool selling process and how it can be achieved; and
- 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.

ACTIVITIES OF THE WSSR

The WSSR commenced in October 2014. The AWI Board selected an Independent Review Panel to drive the WSSR and provide direction and leadership.

REVIEW PANEL

James Lillie	Fox & Lillie Pty Ltd	Managing Director
Graeme Samuel AC	Monash University	Monash Business School
Bernard Wonder PSM	Consultant	Director
William Wilson	Aust. Investor Relation Services	Director

WOOLGROWER EXPERT RESOURCES

Colin Bell	Bell Financial Group	Executive Chairman
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EXECUTIVE OFFICER/SECRETARIAT

John Roberts	Eubindal Pty Ltd	Director
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The Panel released an **Issues Paper** on 10 December 2014 to assist individuals and organisations to prepare submissions to the WSSR. The Issues Paper was made available on the AWI website at wool.com/wssr with submissions due by 27 February 2015.

The Issues Paper contained the scope of the WSSR, matters about which the Panel was seeking comment and information, and information about how you can get involved in the WSSR.

68 written submissions were received in response to the Issues Paper – which are available on wool.com/wssr. The Panel also held discussions with commercial and industry interests in all stages of the value chain from sheep production through to offshore wool processors.

The Panel is issuing this **Discussion Paper** to generate further critical discussion about the wool selling systems by presenting the Panel's preliminary views on potential options to improve the efficiency of the wool selling systems and, in turn, woolgrower profitability.

As well as calling for submissions, the Panel will hold a **workshop** with invited individuals and organisations on 21 July in Melbourne to progress discussion of its preliminary views – see Appendix 1.

The Panel intends to submit its **final report** to AWI in the latter part of 2015.

EXECUTIVE SUMMARY

Following the receipt of 68 written submissions and multiple discussions with commercial and industry interests along the wool value chain, the Panel has identified a number of opportunities that might deliver operational efficiencies and reduce costs in the process of selling wool. These opportunities include but are not limited to: deeper investigation of the centralisation of selling centres, the development of on-farm wool testing options, greater transparency of broker charges and a further investigation of commission buying and its effect on sale room competition.

The Panel's view is that there are no institutional obstacles preventing these opportunities from being progressed. However dealing with these issues on a piecemeal basis is unlikely to provide meaningful and ongoing benefits to Australian woolgrowers. The Panel therefore proposes a more all-encompassing solution that not only addresses the existing identified issues within the wool supply chain, but also creates a platform to provide for ongoing industry developments as well as advancements in technology.

The Panel questions the dominance of the 'open cry' auction system and whether it delivers the greatest efficiencies and subsequent outcomes for all wool categories. The Panel's view is that the Australian wool selling systems are in need of modernisation. Electronic selling systems should at least be investigated, as they can open up markets to new participants, lower participation costs and provide for easier and faster dissemination of market information creating the potential for greater transparency.

Both woolgrowers and buyers/processors are seeking greater (product and market) information. Channels that improve the flow of information need to be opened up.

Wool is a heterogeneous product that has many different characteristics and uses. For this reason, it is the Panel's view that any advancement in wool selling systems must look beyond a 'one size fits all approach'. There are a number of different selling opportunities that should be more readily available to woolgrowers (and buyers). Whilst there are currently a number of opportunities/avenues available for woolgrowers to sell their wool, these are neither well promoted nor fully understood leading them to be underutilised.

The Panel has considered a number of different solutions that might overcome impediments to greater operational and pricing efficiencies. In doing so, the Panel proposes the establishment of an online Wool Exchange Portal (WEP) to effectively address a multitude of issues and future opportunities. In principle such a portal would provide woolgrowers with an online tool to assist them in making informed and suitable decisions with regard to their wool. The WEP would include:

- An extensive information database of selling options available to woolgrowers
- An online meeting point where both woolgrowers and buyers could detail wool on offer and sought respectively
- A ready-reckoner to assist woolgrowers to assess the financial outcomes of selling alternatives including the current dominant 'open cry' avenue
- A 'smart router' that would promote the best outcomes for woolgrowers based on pre-set selling parameters
- Delivery of different testing and appraisal options
- A 'find a broker' and 'find an exporter' function.

The WEP would not replace any of the existing selling channels or alternatives; rather it would work in tandem with them.

The Panel recognises the difficulties involved in driving industry level change in an unregulated market. It has observed that a number of important wool industry institutions all with very different corporate structures and constitutions sometimes appear to be working towards different industry objectives. Wool industry organisations – in particular AWI, AWEX and AWTA – play a critical role in getting Australian wool to market. Any proposal to adopt new selling systems will need the involvement and cooperation of all organisations working in tandem if they are to succeed.

This Discussion Paper presents the Panel's preliminary views on potential options to improve the efficiency of the wool selling systems, and thereby woolgrower profitability. In doing so the Panel has identified the following as 'priority areas', which will be expanded upon in this paper.

- **Operational efficiency in selling Australian wool** – the logistics and costs of transporting, storing, testing, auctioning or use of other selling methods, and delivery to the ship's rail for export.
- **Pricing efficiency of selling Australian wool** – ensuring that price realisation – the price in the market – reflects the underlying demand for, and supply of, Australian wool.
- **Consolidating and improving the choices on offer to woolgrowers and buyers using available technology** – this will facilitate the growth of alternative trading pathways not used intensively to date, and at a reduced cost.

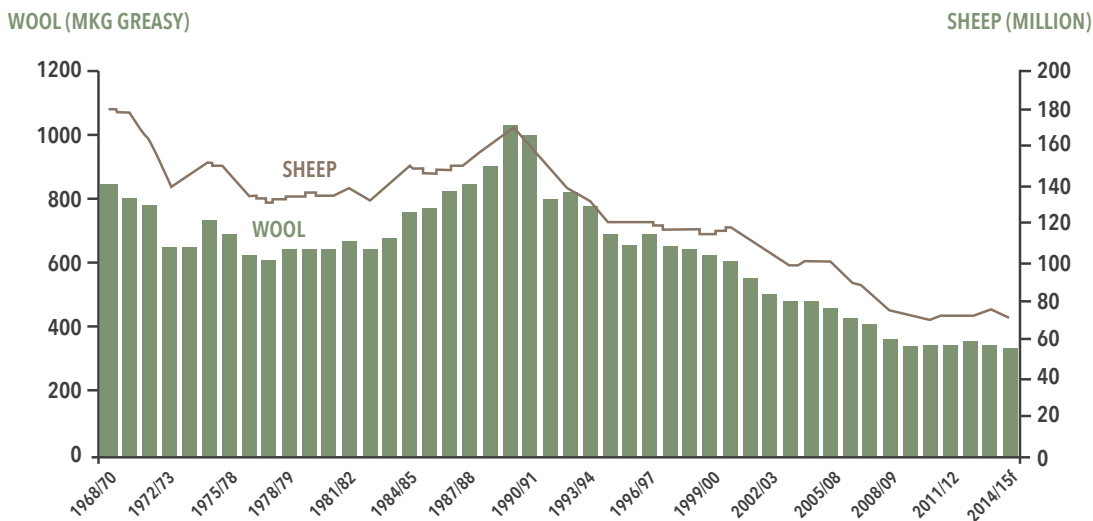
CONTEXT OF THE WSSR

DECLINE IN WOOL PRODUCTION

All activities along the Australian wool selling or value chain are facing adjustment issues in response to production and structural changes in Australian wool-growing.

Australian sheep numbers and wool production has fallen. Whilst production has fallen across all wool-growing states and regions, the decline has been greatest in Queensland. NSW has become a relatively more important source of supply.

FIGURE 1. AUSTRALIAN SHEEP NUMBERS AND WOOL PRODUCTION



However, while the total volume of wool produced has fallen, some segments have increased in supply (fine wool – less than 19 micron) and others decreased substantially (broader wools).

The principal driver of the decline in production has been lower relative farm profitability from wool production (especially Merino wool production). Over the past seven years it has been on average less profitable to produce wool than other sheep enterprises and cropping, although the variation around the average is less for the sheep and cattle enterprises than cropping.

The near term outlook is for a continuation of the lower wool production levels of the past five years.

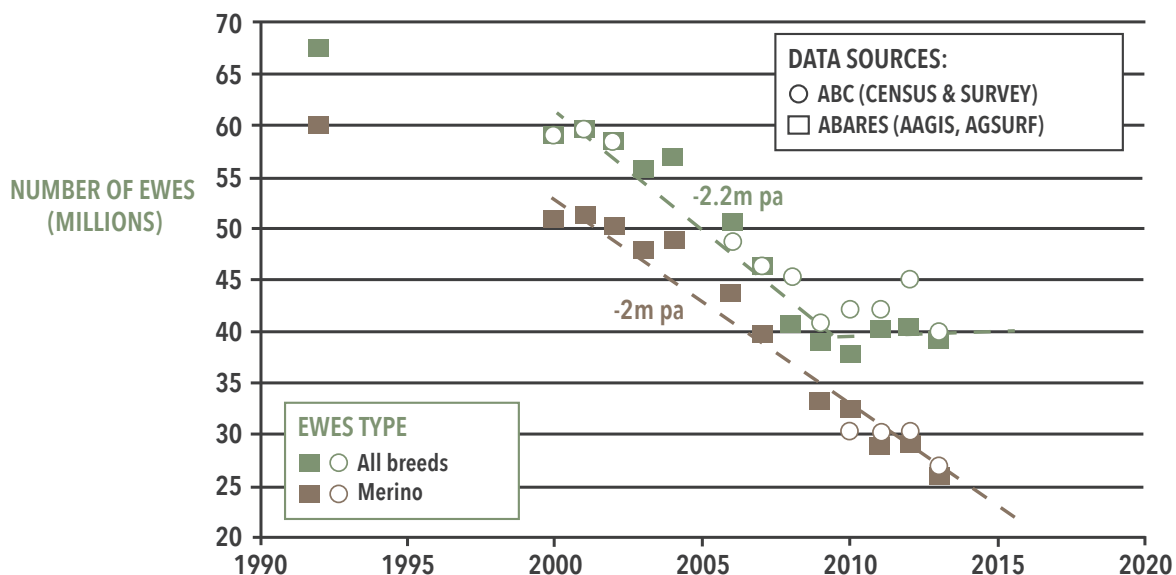
“The Australian Wool Production Forecasting Committee forecasts shorn wool production for 2014/15 at 341 mkg, the same as the 2013/14 level. This reflects a small drop in shorn sheep numbers offset by higher average fleece weights. The Committee’s first projection for 2015/16 has been set at 332 mkg, down by 2.7% from 2014/15, a result of lower sheep numbers arising from the high sheep and lamb turn-off rates this season.”¹

On a more positive note, there are recognised opportunities for productivity improvement on farm (such as through the further application of Lifetime Ewe Management to lift Merino weaning rates) which will help improve the relative returns from sheep production (both wool and sheepmeat).²

However, the underlying structure of the ewe flock suggests that the decline in Merino wool production is likely to continue, at least near term.

“If present trends continue, the Merino ewe will decline to around 50% of joined ewes by 2017/18, with less than 30% of ewe lambs born that year being pure Merino”³

FIGURE 2. EWE FLOCK BREED DEMOGRAPHICS



Until 2008/09, 85% of all breeding ewes were Merino. Since then, Merino share has declined rapidly, and may be -50% by 2017/18

Source: AWI analysis

1. Australian Wool Production Forecasting Committee, Australian Wool Production Forecast Report, April 2015.
2. Lifetime wool. “In Victoria, LTEM participants improved the number of lambs weaned per hectare by 30%. This was achieved through a 15% increase in ewe stocking rate, a 50% reduction ewe mortality and a 15% increase in weaning rates”. www.lifetimewool.com.au/LTEM.aspx
3. Dr. P. Swan, Australian sheep flock demographic trends, Presentation to AWTA Board Meeting, April 2015.

These production changes have had significant implications for the businesses in the wool selling system.

- The demand for specific services such as AWTA Ltd testing has been affected. AWTA Ltd fixed costs are a significant proportion of total average costs, and a volume decline impacts on average costs, and the cost plus price of testing services. The increase in the relative share of crossbred wools has also seen a decline in the demand for additional testing (length and strength).
- There are implications of lower throughput by brokers and buyers including on the commercial future of their respective businesses. Coupled with the ‘fallout’ from the 2008 Global Financial Crisis, global buyer access to credit has been more difficult with implications for the cost of finance. Adjustment to date has been significant. The number of wool exporters is said to have fallen dramatically over the past 20 years. In the past five years the industry has witnessed the exit of the last four ‘corporate’ or publically listed exporters. Private companies now dominate wool buying and exporting.
- As well as fewer buyers, the smaller volume of greasy wool has led to a greater concentration of buyers. The AWEX national buyers list for 2014-15 shows that 58 buyers operated at Australian wool auctions. Of these, the top ten buyers (on bales) purchased around 70% of the bales sold. This high proportion of purchases by the top 10 buyers suggests that wool buying is a reasonably concentrated activity, but not a concentration level that, for example, the ACCC would ordinarily be concerned.

TABLE 1. NATIONAL BUYERS LIST: SUMMARY 2014-15

		BALES	% OF TOTAL	CUMULATIVE %
1	TECHWOOL TRADING	248,371	13.80%	13.80%
2	FOX AND LILLIE	173,816	9.65%	23.45%
3	CHINATEX	167,211	9.30%	32.75%
4	AUSTRALIAN MERINO EXPORTS	122,220	6.80%	39.55%
5	LEMPRIERE AUSTRALIA	117,172	6.50%	46.05%
6	TIANYU	113,797	6.30%	52.35%
7	P J MORRIS	96,998	5.40%	57.75%
8	MODIANO	84,256	4.65%	62.40%
9	KATHAYTEX (VIC)	74,875	4.15%	66.55%
10	G SCHNEIDER	64,436	3.60%	70.15%
	OTHERS	537,397	29.85%	100%
	TOTAL SOLD	1,800,549	100%	

Source: AWEX, National Buyers List by Region, Week 52, 25 June 2015.

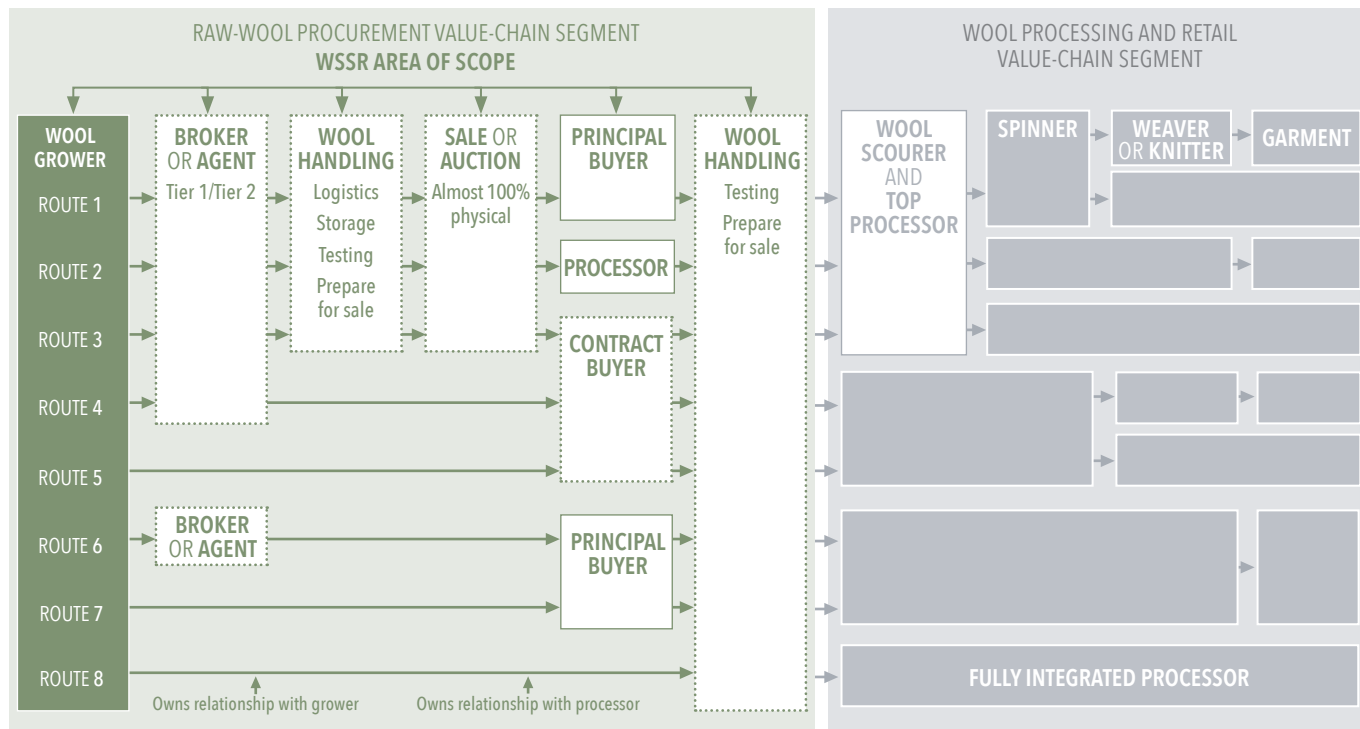
These are aggregate purchases of Australian wool sold at auction — some buyers operate predominantly in specific categories (for example Merino fleece, XB fleece, oddments) and not in others, or in some regions (Northern, Southern or Western) and not others. On top of that, the number of buyers operating on specific lots within wool categories varies (for example, some buying businesses focus on fine wools, others medium wools). Also, buyer interest will vary across the year depending upon the orders they have or the market positions they have taken.

- The Global Financial Crisis was a key driver in the shift in greasy wool demand from Western Europe to China. An important implication, given the differing preferences between Italian and Chinese processors for style and other more subjective attributes in finer wools, is the reduced contemporary relevance of sample appraisal prior to sale versus full sale by description for some wools.

WOOL VALUE CHAIN COSTS

The wool value chain extends from wool on the sheep's back on Australian farms through to finished garments on shelves in retail outlets globally. There are a number of processes and interests that exist within this segment that are the subject of the WSSR (Figure 3).

FIGURE 3. WOOL SUPPLY CHAIN FROM AUSTRALIAN GROWERS TO OVERSEAS PROCESSOR



Sheep's back to mill door costs

The costs of getting wool off the sheep's back through to the mill door total (2013-14) around \$2.87/kg greasy. Since 2009-10 this cost has risen by around \$0.31/kg greasy or 12%.

The major costs between the sheep's back to mill or processor door are those inside the shearing shed. These costs represent 63.8% of the total sheep's back to mill door cost. A key factor influencing the shearing shed costs per kg is the wool cut per head shorn, given the fixed costs of shearing (per head) and classing and shed labour (per day).

While this Review is primarily concerned with the wool selling systems and by implication issues after the shearing shed door, the selling systems (as well as feedback from further down the value chain) raise issues for wool preparation and handling inside the shearing shed.

Selling costs

In 2013-14, selling costs for wool – from the shearing shed to ship's rail at the Australian wharf (given that most wool is exported) – total around \$0.95/kg greasy or \$167.00 per bale.

With the wool levy excluded (on the basis that it does not, of itself, reflect a selling activity rather a levy to fund broad industry R&D and marketing) the average selling cost is estimated at \$0.82/kg greasy or \$144.64 per bale.

The selling costs (excluding the wool levy) measured against the total cost to the mill door (grower shed door price plus the selling costs) represent 28.6% of the total.

TABLE 2. INTERIM INDUSTRY AVERAGE COSTS: SHEARING SHED TO SHIP'S RAIL (CENTS/KG GREASY) 2013-14

	CENTS/KG GREASY		% OF TOTAL
DIRECT COST TO WOOLGROWER (EX SHED)			
TRANSPORT TO BROKERS' STORE COST			
Transport to store	8.75	8.75	9.17%
AWTA TEST CHARGES			
Core test and certification	4.43	6.87	4.65%
Length & strength testing and certification	2.44		2.56%
BROKERS' HANDLING AND SELLING CHARGES			
Warehousing	12.92*	27.57	13.55%
Insurance-to store transport and in store	1.72*		1.80%
Interlotting service charge	0.13*		0.14%
Re-handling & bulk classing charge	1.95*		2.04%
Grower storage	0.08*		0.08%
Brokers' selling commission	8.93*		9.37%
Sale show floor sample value	1.84		1.93%
INDUSTRY FEES AND LEVIES			
AWEX revenue/fees	0.88*	13.74	0.92%
Wool R&D and marketing levy	12.86		13.48%
DIRECT COST TO MILL - BUYER			
PURCHASING COST			
Buying costs	6.85	27.90	7.18%
Post-sale charges (PSC)	14.53		15.23%
Buyer finance costs	5.36		5.62%
Buyer storage costs	1.16		1.22%
SHIPPING/EXPORT COSTS (TO SHIP'S RAIL OR FOB)			
Shipment preparation	10.55	10.55	11.06%
TOTAL	95.38	95.38	100%

Please note:

* These are interim figures only and to be used as a guide only. Accuracy will be increased with more trade data input into the final SBTM document.

Source: Derived from Interim AWI analysis Sheeps Back to Mill

A key feature of the selling costs is that they can (and do) differ significantly between woolgrowers (and indeed between sale lots offered by the same woolgrower) and between buyers.

For the most part, woolgrowers can readily assess their selling costs from the account sale which accompanies payment from the broker/private treaty wool buyer.

For woolgrowers, the differences reflect factors such as:

- How wool is prepared in the shed and scale of operation (lot size, bale weights)
- Distance from property to regional wool store
- How wool is sold (for example, auction as against private treaty) as some costs are selling system specific (for example sampling and AWTA Ltd testing for auction wools but generally not wool sold as private treaty)
- Nature of broker charges: many brokers operate on a commission basis (% of wool sale value) whereas others operate on a flat rate per bale
- The value of their wool where brokers' commission is typically a % of value, and other costs are a % of value, such as insurance and also that the wool levy is 2% of the gross sale value (ex-woolgrower)
- Whether forward cover is undertaken (which is reflected as a cost but impacts on price certainty)
- Wool categories – additional measurement is undertaken for most Merino fleece wool and not for other wool (cardings and XB)
- Woolgrowers might use the auction to sell the majority of their clip but with a proportion sold as private treaty.

However, there are other costs associated with selling wool which impact on net returns to woolgrowers but are not shown in the account sale. In particular the Post-Sale Charge (PSC) paid by buyers to brokers for handling and delivery of wool after the fall of the hammer is passed back to some degree to woolgrowers as lower bid prices at auction.

Many of these cost differences are within a woolgrower's control – such as scale of operation, wool production system (including micron and other factors influencing value), transport to regional or city wool store, lot size, choice of broker and their associated basis of charging.

Similarly, for wool buyers, some costs are similar between wool buyers while other costs differ. For example:

- The PSC rate differs between brokers and locations: distance from wool store (often regional) to dump/export loading
- The PSC is a per bale rate, but bale weights and the value of wool differ
- Storage costs – higher value of wool means higher interest costs and insurance
- Time from purchase to mill: from auction to loading for export.

OTHER WOOL MARKETS

There is a wide range of wool selling systems that operate in offshore markets globally. The nature of these varying selling methods depends heavily on the type of wool produced and the relative importance of the wool clip to the farmer based on wool value versus cost of production.

In the case of the South African wool clip, where a high percentage of the clip is Merino wool, the industry is structured in much the same way as its Australian counterpart. Analogous industry institutions operate and deliver services to woolgrowers in getting wool to market and, like Australia, South African wools are mainly sold via traditional open cry auction with a small percentage sold by private treaty.

Auctions have been centralised in Port Elizabeth, though centrally auctioned wools are warehoused in 3 of the 4 ports: Port Elizabeth, Cape Town and Durban.

Prices paid for South African wools are determined by free market supply and demand forces and are closely linked to the international price for apparel wool, which is determined by the Australian market. Most of the clip is marketed overseas through members of SAWAMBA (the association of South African wool buyers). Only registered members of that organisation are allowed to bid at auctions held under the auspices of the South African Wool Exchange.

In New Zealand, the half bred (or crossbred) and carpet wools which account for the majority of their wool clip also predominantly sell by traditional auction in three main selling centres. One noticeable difference is that in New Zealand, in the absence of any centralised market reporting body, the industry relies on individual companies (exporters and brokers) to generate their own market reporting.

Whilst New Zealand Merino wools also sell by traditional auction (often in Australia), there exists a number of high-end Merino producers who elect to market their wool through to finished garments via The New Zealand Merino Company Limited (NZM), an organisation that focuses on developing and managing relationships between woolgrowers and high-end local and global apparel brands. The NZM selling option is substantially more expensive, but they argue woolgrowers traditionally receive better returns for their wool over the long run. Woolgrowers 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.

In other wool producing markets, such as South America and China, private buying and mill/merchant direct activities dominate. Sampling and testing are not always conducted in order to realise a price between a buyer and a seller. In many cases, only a guidance test for micron will be used. Certainly in the case of China (whose wool is predominantly used for insulation and carpet), wool is generally a by-product of their meat production. Prompt payment and minimal selling charges appear to be a priority over marketing.

In the United Kingdom, the British Wool Marketing Board (BWMB) collects, grades, sells and promotes wool. It is a farmer run, not-for-profit organisation focused on returning to woolgrowers the market price for their wool. Buyers purchase wool via the BWMB computerised auction system using test results and industry approved appraisals provided by the BWMB. Quality is guaranteed by BWMB.

In generating the final WSSR report, the panel will continue to investigate selling systems that operate in off shore markets to determine whether such systems or parts thereof could benefit Australian woolgrowers.

AN UNCHANGED SELLING SYSTEM

In the context of the past two decades of change in the wool industry, the actual 'line items' in the selling costs for wool have remained unchanged. The cost items, for example, in 1990 are more or less the same as they are today, ie over the past 25 years the same cost items face growers and face buyers. Further, the real selling cost/kg is the same in real terms and the relative proportions of the costs much the same, while aggregate wool production and total export value has more or less halved, and the average price of wool continued to increase.

The continued dominance of the wool auction system is in stark contrast to, for example, livestock sales or marketing of grain direct. On farm assessment of livestock and grain prior to sale has also increased, and livestock sales have become more centralised (and computerised to some degree).

The question that arises is whether the wool selling system is somehow held back by complacency and inertia, and whether opportunities for change are being either ignored or even discouraged.

Despite advances in technology (computer systems, telecommunications and the internet, measurement and photography) and greater competition in transport and broking, the marketing system and the associated marketing margin has not changed to any significant extent.

That is not to say that there have not been changes and attempts at change. There have been significant on the ground changes, such as centralisation of selling centres, encouragement to woolgrowers to review selling strategies. Further, other changes have been attempted or experimented with; for example, additional on-farm testing, direct sales to mills, value adding by woolgrowers, and electronic selling. The 1999 Wool Industry Future Directions Task Force report chaired by Ian McLachlan implied that significant if not indeed wholesale change might be on its way.

An alternative view is that the system as it stands is indeed robust and has stood the test of time. It is evidently able to meet the needs of woolgrowers who supply a very heterogeneous product (wool of different characteristics, lot sizes, across the continent, and at different times of the year) with some 300,000 lots sold at auction each year. Similarly, it could be argued that the system meets the needs of buyers who seek and/or are able to accommodate the heterogeneity for the orders they hold.

Most of the service activities along the marketing chain are competitive and contestable – there are no overwhelmingly dominating businesses that benefit from scale or regulations which might exclude new entrants whether it is in technology, transport, broking, storage or buying (the one exception is the company tax exemption of AWTA Ltd). Further, there is no evidence of a high concentration of ownership in broking or buying having substantially lessened the competition in supplying selling services or in achieving greasy wool prices that reflect underlying supply and demand.

All of that said, there are issues that have been identified in submissions, discussions and the Panel's analysis which warrant specific attention.

- AWTA Ltd's apparent monopoly of wool testing is potentially precluding other testing service providers, other testing technologies (given advances in measurement technology generally) or other testing services (such as on-farm).
- Whether the PSC is distorting woolgrower choices in choosing selling options, recognising that, while paid by buyers in the first instance, buyers adjust their bidding limits to account for the PSC and thus the PSC affects the greasy wool price received by woolgrowers at auction.
- Whether woolgrowers are as well informed and able to evaluate wool selling strategies and alternative selling systems as is often presumed.
- Whether users of wool – processors in the first instance but more generally textile businesses – are aware of all the available or potential wool purchasing options.
- Whether 21st century technology provides for improved opportunities for effective sale by description for some wool types, a wider range of 'offer boards' to enable principals (of buyers and top makers) to participate directly in sales transactions and/or hasten the sale process.
- Whether Talman, the dominant inventory management software system within the industry, offers the most efficient and cost effective option for buyers and brokers in the near to medium term.
- Whether there is scope for improved returns to woolgrowers through further centralisation of selling centres. There has been significant centralisation of selling centres over the past 25 years. Research has shown there to be gains from further centralisation (lower costs for buyers) and there is the possibility of improving competition at sales – both issues of contemporary importance given current and prospective lower wool sale volumes.
- Whether commission buying is restricting competition on the auction floor, resulting in a substantial lessening in competition.
- Whether there are opportunities to modernise the auction system, through incorporating improved electronic selling methods.
- More generally whether a more easily accessible approach to the selling system highlights opportunities to significantly reduce selling costs (without a consequent greater loss in revenue).

The Panel's preliminary assessments of these issues are set out in the following sections.

OPERATIONAL EFFICIENCY

APPROACH

Improved operational efficiency is where transactional costs are reduced for no loss of benefit to woolgrowers or processors, for example lower transport, storage or selling costs; or from the buyers' perspective, lower purchase costs through larger orders or sale lot sizes.

Businesses operating within a competitive wool selling system are especially well motivated in seeking to increase operational efficiency. Although their goal may be higher profits, often the benefits of improved operations accrue to wool buyers/users in the form of lower prices, or to woolgrowers as higher offer prices.

Marketing margins or price spread analysis measures the differences between what processors of greasy wool pay and what woolgrowers receive – the total of the value adding services between the woolgrower and processor. However, these are absolute measures of transactional costs and imply little about the efficiency of the wool selling system. The key issue is whether selling costs individually reflect added value.

The Panel's assessment is that in broad terms the selling system is competitive – the selling system services are contestable. Apart from the issues of commercial sustainability, there is little if any constraint to new technologies being applied to the selling system, and new businesses operating in the selling system or avoiding costs all together. Nonetheless, the Panel has reviewed in some detail several specific issues.

AWTA

AWTA Ltd is currently the sole supplier of sampling, weighing and testing for wool destined for auction. Historically other agencies (SGS/Melton) have sought to enter the field but were unable to secure sufficient market share for a continuing viable business. As well as having a well-established commercial position including operating scale, AWTA Ltd operates with an advantage over new entrants. AWTA Ltd's 'not for profit' status and thus its company income tax exemption (as an education institution) give it a competitive advantage over any new rival. The wool testing market place is thus not competitively neutral.

Woolgrowers have taken the view that the favoured position of AWTA Ltd has benefited them through resulting lower testing costs. With the AWTA Ltd objectives explicitly focused on ensuring minimised testing costs for woolgrowers (and the AWTA Ltd Board comprising independent directors as well as nominees of buyers, brokers, woolgrowers and AWI), it is understandable that woolgrowers take the view that they are well served by AWTA Ltd as it currently operates.

BOX 1: AWTA LTD OBJECTIVES

AWTA Ltd commenced operations on 1st July 1982, when it took over all the previous functions of AWTA Ltd.

The objectives for which the Company was established were and are still enshrined in its Memorandum.

They include the following:

1. To promote sales of Australian wool by encouraging the growth and utilisation of objective measurement of wool, particularly by presale testing;
2. To test wool and other fibres, whether natural or otherwise, and wool products and similar products made wholly or partly from other fibres;
3. To provide an accurate and impartial testing service based upon internationally recognised testing standards as an aid to efficient wool marketing;
4. To conduct wool, fibre and textile research and/or to carry out tests on other materials and products where such activities assist or promote the development of the pastoral, agricultural, manufacturing or industrial resources of Australia;
5. To maximise the net income of the Australian wool industry by encouraging the optimum application of objective measurement of wool by woolgrowers, brokers, buyers and both local and overseas processors;
6. To optimise wool industry productivity through research and the implementation of new systems and technology;
7. To establish, equip and maintain laboratories, workshops and other places suitable for testing and research activities;
8. To provide and encourage the provision of data processing services aimed at the more efficient marketing of wool;
9. Generally to promote and foster the more efficient testing of wool as required by the wool and textile industry at a minimum cost; and
10. To provide certificates and make reports in respect of test and research carried out by the Authority.

AWTA Ltd lists its industry good objectives. These include:

- Whilst having to operate in a commercial environment, AWTA Ltd is committed to its industry good purpose underpinned by its not-for-profit status.
- Since its inception, the Company's key goal has been to keep the fees it charges for wool testing to a minimum and predominantly under the rate of inflation. The Company's major business strategies continue to be developed around this goal.

Source: AWTA Ltd , Annual Review 2013-14

AWTA Ltd, for its part, notes that it has been able to hold its fee rate increases at below the rate of inflation, at least until recent years. However, the key issue is not whether fees have fallen or risen in real terms, rather it is whether the fees are fully cost reflective. Whilst lower fees (as a result of preferential income tax status) might be to woolgrowers' immediate benefit, they are likely to have limited competition in testing services and constrain further testing technology development.

It is probable that AWTA Ltd fees will rise in the near term. This is due to the importance of fixed costs in its cost structure (for example, testing facilities), the smaller national clip, changes in the structure of the national clip (less Merino wool and more XB wool meaning less additional measurement) and competition from other selling systems that have less need for AWTA Ltd testing.

A question is whether, in the absence of competitive pressures, AWTA Ltd has been sufficiently focused on: improving its range of services to woolgrowers, the appropriateness of existing/additional tests to meet contemporary buyer and woolgrower requirements, and developments in measurement technology generally (in Australia and overseas). In the Panel's view there is a case for supporting R&D to scope the technical and commercial developments in measurement, testing and associated logistics and their applicability to wool.

A related issue is whether the opportunity for woolgrowers to undertake more sampling on-farm could enable a wider choice of selling options, for example sale by tender, private treaty sales, value adding downstream, electronic offer board as well as the auction. Also, it may permit in-shed storage and subsequent direct transport to the dump. Currently AWTA Ltd provides guidance testing at woolgrower request and it notes that it is available to undertake on-farm testing (fees applying).

On-farm product assessment has been pursued in other Australian farm value chains and thus understandably woolgrowers question whether it has application for them. A case in point is livestock assessment on-farm by accredited assessors for subsequently selling electronically. Another example is supplementary livestock feeds (grain and hay) where feed can be objectively tested (crude protein, energy) and independently visually assessed, and offered for sale directly by woolgrowers, through agents or on offer boards.

Issues to be addressed for wool would include assurances for the sampling and weighing procedures (by 'accredited agencies' which could include woolgrowers), suitable technology (particularly grab sampling), logistics of in-shed handling subsequent to shearing, and assurances of wool storage security post sampling and weighing. Many of these issues have been addressed previously.

It is unrealistic to assume that all woolgrowers could undertake sampling and weighing to agreed protocols, even if the appropriate sampling and weighing equipment were available. Buyers need to have confidence in the process and reliability of in-shed testing. Over time, woolgrowers committed to meeting agreed standards, and audited against those standards, should be able to avoid any price penalties.

The issue of transport direct to the dump would depend upon the availability of storage at the dump, since it is most likely that some lots would need to be held until the buyer required them. However, unlike many other farm products, 'identity preservation' to the retail level or even to processing is not as important for wool. In most cases, woolgrowers' individual lines of wool are aggregated with other wool to meet required mill specifications, including cost parameters. Even so, transport direct to the dump could obviate the need for some double handling, thus reducing costs. Alternatively, wool could be delivered to, and held in, regional storage centres and then delivered to the dump at buyers' request - much the same as happens with brokers' warehouses at the present time.

In the Panel's view the opportunities for in-shed testing should not be dismissed. A feature of technology development is both the capacity for testing and also security. The issues could be addressed within the R&D proposed above.

POST-SALE CHARGE (PSC)

What is the PSC

The Post-Sale Charge or PSC is a charge levied by the wool broker on the buyer of wool following the fall of the hammer at auction.

It is not to be confused with the Broker Service Charge or BSC (Brokerage), which is levied directly on the woolgrower and is detailed on the woolgrowers' invoice/statement.

There is a general understanding within the industry that the quantum of the PSC will be deducted from the price a buyer will pay for a particular lot of wool at auction. In this way, the PSC has a direct impact on the price a woolgrower will receive for his/her wool. In short, it is a charge paid by the wool buyer but indirectly borne by the woolgrower. It is not detailed on the woolgrowers' invoice/statement, nor its constituent well understood.

The Impact of the PSC

Most industry participants generally understand the impact of the PSC on the price paid for wool at auction. Whilst it may be less than transparent to woolgrowers, it is detailed in AWI's analysis of costs in the value chain.

In the (interim) 2013-14 *Sheep's Back to Mill* document, it is noted that:

"The post-sale service charge (PSC) predominantly covers the delivery component of the bales to the dump for shipment preparation. Buyers factor the individual broker's charges for PSC into their pricing structure when buying locally and selling to overseas users, and returns to growers can vary somewhat between sellers. It is important for grower sellers to know the PSC charged by their broker to buyers, as there is an effect on the final price received."

The PSC is about 15.23% of the costs between the woolshed door and ship's rail, making it the single largest component of the total selling costs. A number of submissions noted that the PSC had increased substantially in the past 20 years. This is in stark contrast to the broker commission/selling charge that has remained relatively stable over the same term.

Buyers adjust bidding limits to account for the PSC and thus the PSC affects the greasy wool price received by woolgrowers at auction. Since the PSC will vary from one broker to another, the effect on buyers' price limits and greasy wool prices will vary. In addition, the further the distance that wool is stored (relative to the export dump), generally the higher the PSC, resulting in a corresponding lower sale price at auction.

The key issues for the WSSR with regard to the PSC are:

- Is the PSC excessive (higher than a cost reflective charge)?
- Does it distort woolgrowers' choices (between selling options and between brokers)?
- Does it affect the accuracy of price and therefore market reporting?

Is the PSC excessive?

After allowing for transport differences, the 'base PSC' averages 'around \$25/bale' for wool already in Melbourne store. Freight from regional warehouses to Melbourne/Sydney dumps adds around \$10/bale maximum. This suggests that most of the PSC reflects: the services associated with in-store post-sale handling, storage to enable timely loading to meet buyer instructions, assembly of lots as per buyer instructions, loading for delivery to the dump, transport to the dump, and the associated record keeping.

To a degree, the handling and associated documentation post-sale is somewhat analogous to the handling and documentation pre-sale, that is, on delivery by woolgrowers to the brokers' store. Yet the pre-auction sale process involves significant additional activities and associated costs. In particular, the additional pre-sale activities include:

- Visits to and discussions with woolgrowers on farm
- Assisting sampling and testing
- Cataloguing for sale
- Typing for valuation
- Valuation (which may be undertaken several times depending upon whether wool is re-offered)
- Conducting the auction and any follow up with buyers (including auction room hire and support services).

The broker commission/costs (based on the AWI Interim 2013-14 *Sheep's Back to Mill* analysis) shows the commission/costs directly charged to woolgrowers is about 60% of the value of the PSC. Given the additional broker services pre-sale, the PSC seems 'excessive'.

A reduction in the PSC (say of 25%) of the current average Melbourne PSC would deliver buyers a cost saving of around \$6.25/bale. Spread across the total sale volume of 1.625 million bales (AWEX, 2013-14) this would represent a buyer cost saving of \$10.1 million. To the extent that this saving, if realisable, was then to be fully reflected in higher buyer limits and prices to woolgrowers, it would represent a rise in average prices of \$0.04/kg greasy.

Does the PSC distort the selling options available to woolgrowers?

When looking at operational efficiencies, we need to focus on the level of competition applied to the PSC by wool brokers. The Panel must consider whether there is a degree of price following by brokers. In addition, the Panel would like to investigate the possibility of cross subsidisation between broker pre-sale and post-sale services.

- As the PSC is levied following the fall of the hammer at auction, the buyer is already committed to a particular broker and the conditions of that broker's purchasing contract (including the PSC). It is difficult to change brokers following the fall of the hammer given the purchased wool is in that broker's store. Over time, brokers charging excessive PSCs (relative to other brokers) will be avoided by buyers, but more likely the wool offered by that broker would attract a lower price.
- Price signalling by wool brokers might occur where the disclosed PSC of one broker leads to price following by others. This would be especially relevant where services were dominated by one, or a few providers and where the resulting charges were relatively easily passed on in the form of lower bids at auction. Individually, brokers advise (in advance) all buyers of the PSCs applicable from their stores. The ACWEP distributes to its members a schedule of the respective PSCs of brokers. The NCWSBA does not 'publish' or have any role in advising buyers or woolgrowers, of the respective PSCs. There is no evidence that price signalling is substantially lessening competition between brokers. Wool broking is a contestable industry with many players and low barriers to entry.
- It is possible that PSC reflects cross subsidisation with the BSC or 'brokerage' charge to woolgrowers. Brokers have an incentive to charge a lower BSC to woolgrowers in order to attract their wool/business - noting that it is woolgrowers who decide which broker to use. The indirect nature of the payment of the PSC could enable a degree of overcharging of the post-sale services and under charging of the pre-sale services.

Significantly, private treaty buyers do not incur the PSC as charged by brokers; this is because they manage the PSC services themselves. To the extent that woolgrowers are focused on the PSC as a significant charge, it would be expected that private treaty buying would be increasing. However, it is understood that private treaty sales as a proportion of total sales have been contracting.

In principle, woolgrowers should have the ability to readily examine the net returns they receive for their wool after taking into account both pre-sale charges (BSC) as well as post-sale costs (PSC) allowing them to make more informed commercial decisions.

Price reporting

Market reports are provided by AWEX (and individual brokers) on the basis of prices paid at auction. If the PSC is used to cross subsidise pre-sale broker activities, auction prices would be lower and not fully reflect underlying supply and demand for greasy wool. While the effect of this cross subsidisation on net returns of woolgrowers selling at auction is small, it may well be important for woolgrowers selling outside of the auction. Woolgrowers using private treaty sales, direct to mill or other selling systems that use the auction price as a benchmark would be receiving lower prices than would otherwise be the case (without the cross subsidisation).⁴ The issue is whether AWEX reports should take into account the post-sale costs. An option might be to report prices on a delivered dump basis (auction price plus the PSC), in much the same way that grain export prices are reported 'free in store (FIS)' or 'track at port (track)'.

PSC assessment

In summary, it is difficult to ascertain whether the PSC is excessive, or whether it supports cross subsidisation of brokers' pre-sale services. This is because there is limited transparency as to the quantum and composition of the PSC.

As much as anything, woolgrowers are encouraged to discuss the issues with their broker. A voluntary or even mandatory woolgrowers' account sale (pro-forma invoice) which outlined the PSC and other post-sale charges (as well as pre-sale charges) may provide greater transparency and the potential for greater competition. This seems like a heavy-handed approach that would also be difficult to implement for an issue that could be more easily remedied by industry. Brokers with lower overall charges (both pre-sale and post-sale) have every incentive to promote themselves to woolgrowers to win their business.

The Panel recommends greater discussion between woolgrowers and brokers with regard to the costs they incur along the wool selling chain, both direct and indirect.

Prices at auction are understandably lower as a result of post-sale charges and costs incurred by buyers after purchase at auction. This impact is not always recognised by woolgrowers. As with pre-sale costs, post-sale costs should reflect the cost of the service provided. Any cross subsidisation between post-sale charges and pre-sale charge could distort the choices of woolgrowers. On this basis, the Panel supports greater transparency of post-sale costs that allow woolgrowers to base decisions on total broker charges (pre-sale, plus post-sale).

As well, a publicised analysis of the selling costs, and the implications of post-sale charges on prices bid by buyers at auction, is to be encouraged. However, the Panel does not see a need to go further, for example, through mandatory account sale statements detailing all post-sale costs.

4. AWEX reports prices received at auction. Its price reports do not cover private treaty sales, AuctionsPlus auctions or sales through WoolTrade.

SALE BY DESCRIPTION

The issue of sale only by description was raised in many submissions and a range of views presented, with conviction, in support and against. What was abundantly clear is that there is no support for across the board sale only by description. Woolgrowers, brokers and buyers all recognised that there are some categories of wool which could be sold by description and others which could not, and this may change from time to time. Fine woolgrowers and processors were particularly adamant that the choice of selling only by description or not should remain totally with woolgrowers.

For their part, buyers/exporters were equally supportive of a 'market outcome'. Buyers carry the claims risk, and if assessing a sample helps them to better manage risks then there is no reason to preclude the opportunity of sample inspection. Certainly woolgrowers meet the cost of sampling. But at the margin, given the value of a sale lot and the risk of a buyer not bidding or bidding at a discount, woolgrowers have a strong incentive to support sample inspection.

The Panel, for its part, is strongly supportive of a competitive selling system that enables choice around cost-reflective pricing of selling services, and that is very much the current system.

However, sale only by description does offer the opportunity to remove an entire line item from wool selling costs for relevant categories of wool. That is, possibly avoid grab sampling (but that would, at the present time, not enable length and strength testing), grab sampling handling and testing costs, shipment and display of grab samples at auction, and sale of grab samples. Moreover, sale by description offers the opportunity to much more easily sell wool via offer boards and electronic selling.

Sale only by description raises two main issues.

- Are there constraints to sale only by description for some wool categories and if so can they be addressed?
- Are there developing/new technologies which could extend the opportunities for sale only by description?

There are no regulatory constraints to selling only by description. Further, it is quite probable that some lines of wool are in effect sold only on description. Certainly sample boxes (grab samples) and the associated additional measurement data are part of the sale process, but anecdotal evidence suggests that buyers pay minimal attention to these for some lines of wool. Under the current online selling options in the market place, buyers have the option to inspect the sample but the offer is not taken up in many cases.

The second area concerns technology and technology development. Significant advances have been made in measurement technology across the economy. New technologies are being developed and applied, particularly in respect of the composition of natural products. The Panel suspects that many of these technologies have application to measuring the characteristics of greasy/clean wool that enable wool to be better described objectively.

One example of relevance is digital photography, which is low cost and the images are easily distributed. For some categories of wool, such as crossbreds, a characteristic of interest to processors is colour.

At least one broker has been using video imaging to objectively describe wool on offer at auction and for private treaty sales.⁵

As outlined in respect of ATWA Ltd and future measurement technologies, the Panel suggests that there may be technologies available/in the pipeline that have application to better describing wool characteristics. Significantly these may not be novel technologies that 'the wool industry' has to fund but rather technologies that could be applied to wool. The Panel considers further development of sale by description has the potential to reduce costs and/or open up new wool selling systems. There do not appear to be technical or regulatory constraints but the Panel notes, as above, that further technology development to help support sale by description may be warranted.

5. Bryton wool, see www.weeklytimesnow.com.au/business/sheep/videos-used-to-sell-wool-online-through-auctionsplus-wooltrade/story-fnker8up-1227295345108.

AWARENESS OF ALTERNATIVE SELLING OPTIONS

Woolgrowers' awareness of selling alternatives

Although the open cry auction is the main wool selling option used by woolgrowers (85% of wool production and probably a higher proportion of woolgrowers) there is a range of wool selling alternatives available and used by woolgrowers. AWI/MLA's *Making More from Sheep* has identified and summarised the options available (see Box 2). These point to a number of strategies which woolgrowers can employ to manage valuation, selling and price volatility.

BOX 2: OPTIONS FOR SELLING WOOL

- **Open-cry 'progressive' auction** – The preferred method of sale and ownership transfer for about 85% of wool producers. This system is facilitated and managed by wool brokers, guarantees payment, and allows maximum exposure and competition for wool at sale time, with all major buyers of Australian wool present in the auction rooms.
- **Private treaty** – Prices are negotiated privately with buyers at or about the time of shearing. Wool may be sold either tested or untested, however, untested wools will not be paid the same as tested wools.
- **Forward sales** – A contract is made before shearing to deliver wool to an agreed specification and to an agreed price schedule. Payment is made against the actual test results. Remember that once contracted, your wool must meet specifications.
- **Direct to topmaker/exporter** – Similar to forward contract, but a spot sale through an exporter for delivery direct to a topmaker. Negotiation of the final price in Australian currency must be managed carefully to eliminate fluctuations in currency exchange rates.
- **Internet selling** – Electronic offer board where wool is available for sale to buyers 24 hours a day, 7 days a week. A reserve price is 'posted' (presented for sale on computer screen) and can be simultaneously seen by all registered buyers. Submission of bids and final sale is facilitated via the offer board, and not directly with the seller. The most significant advantage of an electronic offer board comes in a rising market, when it allows buyers to purchase wool lots outside the scheduled auctions.
- **Grower marketing groups** – Grower based marketing groups established to sell direct to processors and manufacturers. Grower marketing groups need a structure, training and a sound business case to succeed and be profitable over time.
- **Wool Pools** – A contract is made to deliver a volume of a shearing or yearly production to the pool up to 12 months prior to shearing. By participating in the pool you are assigning the risk management of your wool portfolio to a third party. The aim is to reduce exposure to price volatility. An upfront payment occurs after delivery based on a percentage of the current market. At the close of the pool a final payment is made based on the performance of the pool against the physical market. This option also includes traceability, downstream education and opportunities for contact with end use customers.
- **Grid Sales** Similar to selling livestock "over the hooks", prices are offered from a set grid of prices for wool delivered to store. Prices are generated from all stages of the demand chain as the various businesses feed direct orders from the pipeline. Most wool selling brokers will offer some form of grid sales or a price at door pricing system for their clients.
- **Partnership Processing – retained ownership** Some processors offer an option to growers allowing the grower to retain ownership of the wool beyond the greasy form. By using downstream manufacturers infrastructure, a grower can participate in the value add of wool from top to yarn to garment. This partnership results in a sharing of the profit as wool is transformed into retail products.
- **Chain pipeline sales – Wool4** The Wool4 program is an example of a commercial value chain pipeline to provide an ethical and sustainable product to the global textile market. The aim is to give growers a means of differentiating their wool based on complying with set production standards.
- **Mill Direct** Marketing wool through Mill Direct enables an offer of growers wool directly to a network of international processors at your own set price. It provides the opportunity to receive valuable feedback on your product and build strong relationships for future orders.

In addition, AWI has published **A Marketing Guide for Wool Growers**: a manual that outlines the various methods and operations involved in selling wool.

Source: AWI/MLA *Making More from Sheep*. www.makingmorefromsheep.com.au/market-focussed-wool-production/procedure_2.3.htm

As well as this type of information, many brokers promote services to help woolgrowers select between options and implement them.

An issue is whether woolgrowers could be better informed via the use of a website hub or tools to provide more market related information to woolgrowers.

Such a wool marketing hub could be maintained by commercial interests and industry organisations (for example AWEX and AWTA). Alternatively, involvement by AWI may be perceived by woolgrowers as more 'neutral' with respect to information. For the most part, such a website would involve description and links to providers and advisory services.

A related issue is the extent to which some selling options, offer boards and electronic selling in general, have been promoted. This is an important issue and is addressed by the Panel in modernising the selling options (Section 3 of Pricing efficiency)

The Panel has concluded that a directly accessible website portal focussed on outlining wool selling options would be valuable to woolgrowers. Additional links would be provided by interested groups such as brokers, buyers and other industry participants.

Users' awareness of purchasing options

Typically when new users of wool – whether processors in the first instance but more generally textile businesses – are seeking to access greasy wool, they are referred to the list of buyers operating in the auction market. A similar situation arises when existing users are looking to expand their purchases or looking to develop upstream relationships with woolgrowers. Existing users of wool (processors and their downstream clients) are well acquainted with the current selling system and the relevant costs.

This issue of accessing greasy wool supply has been of growing importance with the rapid decline in supply over the past decade. This has coincided with the dominance of China as the largest buyer of Australian wool and a shift in their purchasing decisions away from state purchasing authorities to individual processors/users. During the Panel's discussions with Chinese processors, it was evident that there was growing concern over access to greasy wool going forward, highlighting a need for them to forge closer connections to Australian supply and have greater awareness of buying alternatives. While some take the view that users seeking to develop trading relationships with woolgrowers directly is code for 'a cheaper source of supply', the trends in other farm product markets for value adding (through for example, the provenance of supply or the history of a woolgrower) suggests that a broader perspective is required. The situation may not apply equally across the industry.

The Panel considers that the proposed website portal would also benefit wool buyers and users by providing direct access to a multitude of procurement options from a wide range of woolgrowers with varying selling needs.

TALMAN SOFTWARE

The Talman software is central to recording and managing most buyers' lot building and ordering out from brokers.

As Talman outlines on its website:

*"More than 75% of the wool industry in Australia and New Zealand uses Talman software solutions. These wool-management solutions span public and private auctions, private sales, delivery, dumping and local or overseas processing."*⁶

The Panel understands from both consultations as well as submissions that while users were generally satisfied that the Talman Solutions' product met their current requirements, the software is broadly regarded as "somewhat dated" (with no new releases/updates since 2009). In addition, some submissions implied that the annual subscription fee was excessive.

The Panel is of the view that the wool industry's heavy reliance on a single and (seemingly) disengaged provider of this crucial piece of infrastructure leaves the industry vulnerable:

- Vulnerable to a lack of ongoing investment in the service
- Vulnerable to marked increases in annual subscriptions, and
- Vulnerable to an unexpected withdrawal of the service.

The Panel would make the following points:

Given there are low barriers to entry for a new provider of this service, the Panel is surprised that industry has allowed this situation to develop.

Industry should endeavour to engage with the providers of the Talman software and find out their medium-term intentions for this product.

Given Talman's importance to both wool exporters and wool brokers, industry should investigate the development of an alternative offering.

An online Wool Exchange Portal (WEP) might usefully provide connectivity options to other crucial industry software products such as the Talman service.

The Panel takes the view that industry remains vulnerable due to its heavy reliance on the Talman product.

Efforts need to be made to secure industry confidence that there will be ongoing investment in the product and that subscription prices will be held at reasonable levels.

6. Talman Solutions, website, www.talmansolutions.com.au

PRICING EFFICIENCY

APPROACH

Pricing efficiency is concerned with the ability of the wool selling system to 'discover the prices' which reflect underlying supply and demand for greasy wool.

If markets are operating efficiently then prices for greasy wool will be related 'over space and time, and between forms'. Prices (for greasy wool with the same characteristics, available at the same time) should only differ between regional areas by transportation costs from one point to another.

The Panel considers that the Australian wool selling system is broadly efficient.

- Wool exporters and processors have competing alternatives for sourcing wool (auction, private treaty, mill direct) and textile interests have available to them alternative fibres such as cotton and acrylics.
- The prices of these alternatives adequately reflect the costs of providing them (no subsidies).
- For the most part, organisations are free to enter or leave the transport, measuring, storing and selling 'markets'.
- There is competition between those in the marketplace. There is no evidence of cartel-like behaviour.

However, several aspects are of concern.

- Whilst there has been considerable centralisation of selling centres over the years, research has shown that there might be further gains from further centralisation (lower costs for buyers) and there is the possibility of improving competition at sales – both issues are of contemporary importance given the lower wool sale volumes.
- Whether commission buying is having an impact on competition on the auction floor.
- Whether there are opportunities to modernise the auction system, through further application of electronic selling.

FURTHER CENTRALISATION

Context

There has been significant centralisation of auction sales in recent years. The ACWEP submission outlined that from a historical perspective, there were significant cost savings from earlier centralisation efforts. Specifically:

- the adoption of Pre-sale testing and Sale-by-Sample
- the ability to move samples at a relatively low cost to central areas for valuing and sale by separation, meaning buyers (and brokers) no longer have to travel to regional centres to value the wool samples; and
- wool bales could be stored in cheaper regional locations until called for delivery.

This led to progressive centralisation of wool selling centres from thirteen to the current three, in Sydney, Melbourne and Fremantle.

The ACWEP submission also noted that "Centralisation is the issue on which there is the greatest variation among buyers' views" and that the 2009 Australian Farm Institute analysis⁷ found that "the distribution of support for greater centralisation was strongly bimodal, with most responses either strongly for or strongly against. Relatively few responses were neutral".

7. Australian Farm Institute, *The Costs and Benefits of Alternative Selling Arrangements for Australian Wool*, 2009.

Further the ACWEP submission reported “the principal outcomes of the concluding meeting of interested parties in 2010 in Sydney were that there should be no industry led move towards further centralisation. Rather, any such move should be initiated by commercial operators”.

Value of cost savings

The Australian Farm Institute review of further centralisation estimated the cost savings (2009 dollars, based on 2007-08 sale volumes) as follows.

- \$2.4 million for the 3-centre model (from the then 5-centre model to the now (2015) 3-centre model), \$6.1 million for the 2-centre model, and \$7.2 million for the 1-centre model (suggesting a saving of \$4.8 million in moving from the current 3-centre model to a 1-centre model).
- Transitional (one-off) costs were also identified for alternative wool selling models.
- Over ten years, the net present value was estimated to be \$15.5 million (3-centre model), \$37.4 million (2-centre model) and \$43.0 million (1-centre model); suggesting a saving of \$28.5 million in moving from the current 3-centre model to a 1-centre model).

In 2015 terms (that is, adjusted for inflation using the CPI) the savings in moving to a 1-centre model would be around \$5.4 million per annum or \$32 million over 10 years.

The annual savings would represent an average cost saving of \$0.02 per kg of wool sold (2014-15 estimated auction sales of 336 million kg).

Significantly, the AFI analysis focussed on only the cost savings from centralisation. However, in the Foreword, it noted that:

“The Australian wool selling industry is complex, and composed of many different organisations that both co-operate and compete with each other, which generally means that consensus is required before substantial industry change can occur.

The profit and investment-killing inertia this imposes on the wool industry is never more evident than at the present time, when there is widespread industry recognition of a need for change, but little agreement on the nature of that change.

Some argue that changes to wool selling arrangements are unnecessary, because in total the costs of the wool selling system represent only a relatively minor component of the total value of the industry. This argument ignores the crucial role the wool selling system plays in transferring information between buyers and sellers, and the catalyzing impact of the requirements of the wool selling system on long-term investment decisions by wool producers, and the international wool processing, textile and garment manufacturing businesses which play such an important role in transforming wool and placing it into the hands of consumers”.

Since 2007-08, industry developments relevant to the centralisation issue include the following:

- There has been a continuing fall in wool production since 2007-08 (400mkg to 336mkg in 2014-15), suggesting that the gains (from cost savings) would be greater today than in 2007-08.
- Of the total 1.64 million bales sold in east coast auctions in 2013-14, 36% were sold in Sydney and 64% in Melbourne. On a lots sold basis, the distribution was 41% and 59% respectively.
- Support from woolgrowers associations, in particular the WA Farmers Federation, for further centralisation.

In its submission, the WA Farmers Federation concluded that given the declining national clip and the number of lots being offered through Fremantle:

“it makes practical sense to centralize and amalgamate the existing selling centres into a sale by separation at one primary selling centre to be based in Melbourne” (Submission 66 ... pg. 2)

However, as was the case when further centralisation was proposed on the East Coast, there has been significant opposition to the proposal, particularly from regional brokers in WA, since the WA Farmers Federation submission to this Review. The WA Farmers Federation has said its position was intended to encourage discussion of the issue.⁸

Gains in pricing efficiency

As well as the potential lower transaction costs (cost savings to buyers) from further centralisation, there are probable gains in pricing efficiency through bringing supply and demand information to one market at the same time – rather than different markets at the same time. Although modern communications enables much faster transmission of developments in one market to other markets there are still delays, suggesting gains from further market centralisation.

Also, further centralisation may assist in addressing some of the concerns regarding commission buying.

Summary

The Panel takes the view that the centralisation debate has primarily focussed on the net costs savings to buyers and consequential price gains to woolgrowers. There has been little discussion of potential price improvements to woolgrowers through increased competition at individual selling centres and the enhanced capacity of buyers to aggregate lots to meet orders. Commercial interests (including woolgrower organisations and representatives), individually and as organisations, are able to pursue greater centralisation. Further, apart from proposing additional analysis (contemporary analysis of cost savings for example) and facilitating discussions there is little more that organisations such as AWI can (or should) do.

COMMISSION BUYING

Role of commission buying

Commission buyers are a feature of a range of Australian rural product markets, including the wool market. Commission buyers can be described as individuals or businesses bidding on behalf of one or more principals at the same time. They might purchase through auctions or private (direct from producer) transactions.

The concern of wool producers is that commission buying may lessen the competitive tension at auctions since there are fewer buyers operating in the auction room and more specifically potentially fewer buyers operating on individual sale lots.

In addition, commission buying may have an impact on individual exporters' commercial decisions. For example, where one exporter contracts commission buying from another competing exporter, the knowledge of that buying activity may prompt the exporter providing the service to defer buying where possible to reduce competition on wools of similar quality that they are also chasing.

However, the claimed significance of commission buying for wool price determination is likely overrated. Most wool buying businesses, at least the larger businesses, operate on both indent orders and as traders.

Why commission buying?

Commission buyers operate because of the transaction costs for principals (eg wool processors, sheep/cattle producers purchasing stock, meat processors) attending an auction are too high or the knowledge required to participate is too high for the principal of a business to participate themselves. Hence the principal uses traders or commission buyers.

8. See Jenne Brammer, *Wool sale shift concern*, The West Australian, April 29 2015, <https://au.news.yahoo.com/thewest/countryman/a/27451593/wool-sale-shift-concern/>

Aspects of the market (auctions in particular) where commission buyers are likely to operate include the following:

- Auctions are held at some physical site where it costs a principal time and expenses to participate.
- The sale items (some or all) are not able to be fully described hence some degree of visual inspection is required.
- The requirements of individual principals are sufficiently different to enable a commission buyer to adequately represent the cross section of interests and thus avoid clashing.

Role of AWEX

AWEX is responsible for establishing the auction procedures, although individual brokers are responsible for the conduct of their individual auctions (AWEX notes that “Auction sales are conducted under the terms of sale of each seller (broker)”).

With respect to commission buying specifically, AWEX noted:

“AWEX is aware of expressed concerns over potential conflicts of interests with buyers holding multiple buying limits. This issue has been raised by broker members with AWEX on several occasions. However, AWEX has no evidence to suggest that is reducing prices of wool” (AWEX Submission)

The NCWSBA noted that

“it and its member companies considered that there is strong competition between buyers in each auction room. ...

Nevertheless NCWSBA has some concerns about individual buyers holding orders for too many processors clients” (NCWSBA Submission, pg 17)

Commission buying of wool has likely increased in line with indent orders

The number of buyers operating at Australian wool auctions has declined substantially in the past 25 years. This reflects the contraction in the demand and supply of Australia wool, coupled with the concentration of buying to a smaller number of processing interests. Significantly wool processing and the textile industries more generally are highly concentrated in China and Chinese businesses now purchase nearly 80% of Australian supply. That said, processors typically split their indent and trading purchases between several buyers/exporters.

Conclusions and implications

There are sound economic reasons for commission buying, namely the higher transaction costs of direct participation of downstream principals (processors). Those reasons are unlikely to change.

It is difficult to empirically assess whether and to what extent commission buying might adversely impact upon competition and wool prices. Commission buying of itself does not reduce the demand for wool and it is underlying supply and demand which determines wool prices.

AWEX, individual brokers and individual woolgrowers have the option to not offer wool if they believe that commission buying is limiting competition. Unlike most other farm products, wool is easily storable, albeit at the cost of storage and deferred income. Further, woolgrowers can look to other selling options besides auctions if they take the view that commission buying is limiting the potential for realising the best price for their product at that time.

Competition policy, under the ACCC Act, is unlikely to have application and it is unclear what policy steps could be taken to address the situation. Actions to limit buying to principals only would increase buyer operating costs and likely drive buyers away or lead them to other (presumably higher cost) options.

The Panel notes that, irrespective of whether commission buying or the concentration of buyers is adversely impacting upon competition or prices to woolgrowers, there are actions which can be taken to help maximise competition and reduce future concerns.

- Further reducing participation costs through further centralisation, and the development of centralised electronic selling systems.
- Supporting improved wool description, including sale only by description, thereby enabling electronic selling (which in turn can enable direct participation by principals from their respective business locations).
- Continuing to ensure that wool buying remains a contestable activity in both open cry auctions as well as other selling options, such as private treaty selling and vertical trading relationships.
- Growers directing their wool to sales where commission buying is likely to be less evident – including larger sales of similar wool offerings. Livestock producers are well versed in this strategy and hence the decline in smaller local saleyards.

MODERNISATION OF THE SELLING SYSTEM

The “open cry” auction system, the dominant selling system for Australian wool, is in need of modernisation. Electronic selling systems (that dominate the trading of everything from shares through to grains) should at least be investigated. Current and prospective technologies (such as high speed internet) offer the opportunity to significantly improve the sequential open cry (physical) auction platform.

Electronic selling options can open up markets to new (registered) participants, lower participation costs and provide for easier and faster dissemination of market information creating the potential for greater transparency.

- Further centralisation of existing auction sales (Sydney, Melbourne and Fremantle), thus enhancing competitive tension on the day – that said, electronic and other communications undoubtedly mean that developments in any one market or the three markets overall are fully reflected in prices.
- ‘Remote’ buyer access to the auction floor to enable real time bidding, thus absolving the need for all buyers to physically attend the auction. A screen ‘in the auctioneer’s hands’ (visible or not to all buyers) would enable principals to bid directly at auction and wool buyers to operate from offsite facilities. There would be a reduced need for commission buyers, for example.
- Simultaneous auctions, for example the AuctionsPlus system as it currently operates (predefined open market, followed by market subject to continuing bidding). This could be extended to cover open bidding against a fixed start time and against a scheduled end time. As auctions systems such as ebay and graysonline have demonstrated, electronic bidding is well able to handle diverse sale lots, segmented sales (groups of products), and many bidders at different locations.
- Other electronic trading platforms, such as those adopted for trading shares (Box 3) should be considered. These screen-based platforms typically stream live market prices on which users can trade. Some platforms have been specifically designed to allow individuals to gain access to (for example financial) markets that could formerly only be accessed by specialist trading firms. They may also be designed to automatically trade specific strategies.

However, the adopted forms of ‘electronic selling’ in the wool industry, have not gained as much market share as might have been expected, especially given the growth in electronic selling methods in other farm product and non-farm product markets. A question is whether the ownership structure of these companies means that strategically these selling options are not being promoted to any great degree as they could cannibalise the owners’ traditional broking businesses.

Currently wool transacted online in Australia accounts for less than 5% of the market. It has been especially attractive for buyers seeking wool outside of auction times and in a rising market.

BOX 3: ELECTRONIC TRADING SYSTEMS

The adoption of electronic trading systems has transformed the economic landscape of trading venues around the world. Share markets are perhaps the best known and the most widely studied examples of electronic trading. The migration of global Open-cry equity trading floors to screen based electronic systems gathered pace from the mid 1990's through to 2005. The few existing open cry equity exchanges (all of which employ some forms of automation) remain more as form of theatre than as a model of efficient trading practices.

In equity markets the argument has followed the following lines:

Innovation such as the introduction of electronic trading can offer expanded possibilities in Market Architecture, which will have an effect on Market Quality and ultimately lead to 'broader market welfare benefits'.

Electronic Trading has generally had the effect of widening access over a number of dimensions both physical and geographical. Physical limitations that once limited access to traditional venues no longer exist. This means additional users can participate at minimal marginal cost. Remote linkages can also remove geographic limitations on the pool potential market participants.

It is important to note here that the greater access possibilities of electronic markets have brought into question the role of intermediaries.

One of the obvious benefits of electronic trading is that it can facilitate greater pre and post trade transparency. This is achieved by the possibility of direct linkages between the trading platform and market information providers and their end-users.

Electronic systems provide for lower set up costs than trading floors, especially when looking to expand an existing system for a new product or service. Perhaps more importantly by replacing labour intensive processes they can greatly reduce operating costs. An additional potential for cost reductions under an electronic trading regime is the possibility of Straight Through Processing for financing and delivery options.

Electronic trading systems may encourage users to standardize their offerings (which can concentrate liquidity). Interestingly this has been the case in more heterogeneous financial securities such as fixed income. As we know liquidity begets greater liquidity and there is some suggestion that electronic trading systems can advertise liquidity more widely thereby attracting potential liquidity more readily than traditional platforms.

- Allen, Hawkins and Seto, 2005

Looking at the experience of the world's largest equity markets, the migration to electronic trading systems has provided both advantages as well as some highly publicised problems (the issues surrounding High Frequency Trading or HFT) to market participants and end users. There is however no doubt the fast pace in growth of both volumes and market developments have not been hampered by automation.

Implications

The dominance of the open cry auction in Australian wool selling is seen by some as an anachronism since wool has been sold that way for more than a century. Technology has moved on, the structure of the wool-growing industry has changed and so too have the wool using businesses. Yet, it could be argued the auction system has stood the test of time: it has had many alternatives thrown at it in the way of technologies to facilitate direct sale from farm, sale by description, vertical integration along the value chain, electronic selling in its various forms, auctions in Australia and in China, integration with the forward market, and centralisation of auction centres (now down to three). More generally, developments in technology, which have lowered transaction costs, have seen auctions (notably electronic auctions) expand into other areas of the economy.

There is substantial differentiation between brokers in the services offered and in the structure of their charges. There is a wide range of services available in the 'broker market', ranging from simply testing and sale at auction, assisting with selling system evaluation through to 'one stop shops'. Woolgrowers can and do change brokers; brokers know it and are forced to promote their capabilities and compete to maintain their market share, especially in the contracting wool market of the past decade.

The dominance of the open cry auction system is curious in a world where trading markets are generally electronic. Indeed it is hard to identify the constraints to new alternatives developing. Certainly there are development and financing costs; it takes time to build relationships, and to achieve sufficient critical mass to deliver viability. But these are issues for any business development. It may be just a case of industry inertia and a view that "if it ain't broke, it don't need fixing".

Steeped in tradition, many woolgrowers stick with what they have always done; some just like their parents before them. Yet there is diversity in what woolgrowers do in selling their wool. Certainly the auction is used for most wool, but in the process woolgrowers have prepared their wool in different ways (most to the AWEX Code of Practice "COP", some not), some with a classer in the shed but not to the COP, some with a buyer relationship in place and using the auction to establish the price, some using forward markets to manage price risk, some using the auction as a benchmark for private treaty or other sales. Also, there is diversity in the range of services offered by brokers and demonstrated capacity for woolgrowers to shift between brokers.

Overall the (dominant) Australian wool selling system is viewed as efficient. It is competitive and there do not appear to be regulatory impediments or restrictive practices that limit new ideas from being tested, technologies applied or commercial interests entering the supply of services along the value chain.

The Panel recognises the need for continuing development and 'modernisation' of selling options. Competition between auction systems and with other selling systems is to be encouraged. There do not appear to be constraints to further development, but the Panel questions whether woolgrowers are sufficiently well informed to make choices between selling alternatives. The Panel proposes the development of a Wool Exchange Portal to address this situation.

WOOL EXCHANGE PORTAL (WEP)

CONTEXT

The Panel's review of the operational and pricing efficiency issues in the current wool selling systems has highlighted four areas of particular continuing concern.

- Limited woolgrower awareness of and easy access to wool selling systems other than the open cry auction – despite AWI and numerous brokers providing information, and promotion of other systems (in particular, private treaty and existing electronic selling methods).
- Few mechanisms for buyers/processors/top makers further along the wool value chain to directly signal to woolgrowers their specific future requirements. Woolgrowers continue to rely on feedback after their wool is tested and/or sold. Auction results (for example, AWEX's weekly Offering Analysis), AWI market intelligence reports, broker reports and views, and other third party analysis appear to be the main sources of market intelligence.
- Limited access to offer boards for woolgrowers and buyers. The one board that does exist is not well promoted and is utilised essentially only when auctions are not being held – it is more or less treated as a niche system. Offer boards and more generally online selling systems have expanded across all areas of economic activity nationally and internationally. The lack of application in wool selling appears to reflect a demand problem (grower and processor understanding) and a supply problem (ownership issues of current electronic forms of selling/offering).
- It is questionable whether woolgrowers understand adequately the range of alternative selling systems.

To address these concerns the Panel proposes the establishment of a Wool Exchange Portal (WEP) that would include:

- A significantly improved database of selling options for woolgrowers. At a minimum this would mean a website hub delineating the options and links to any wool selling interests (including brokers, AWEX, AWTA Ltd) as well as buyers and downstream interests which sought such connectivity. AWI and others would be encouraged to promote the website hub.
- A ready reckoner to help woolgrowers assess the financial outcome from selling alternatives. This could be an extension of the existing AWI Woolcheque tool and draw upon AWI's recent analysis of wool selling costs from the sheep's back. It would bring enhanced transparency of the individual and total selling costs for woolgrowers' wool.
- A 'smart router' to assess 'best wool selling strategies' for woolgrowers.
- An online meeting point where both woolgrowers and buyers/processors could detail wool on offer and wool sought, respectively. Such a platform would enable woolgrowers to have their wool listed at any time (most likely after it was tested), for pricing.
- A more general portal where woolgrowers nominate their sale option with the respective interests then take the process forward. For example, selecting the auction route through the portal would mean the woolgrower's wool goes to auction using the woolgrower's preferred broker – much as now but using the WEP the woolgrower would have selected this option after (most likely) having listed the wool on the portal and choosing the auction after explicitly evaluating the other options available on the WEP.
- The WEP could be extended to include additional operational features. For example, operating as the sale intermediary after listing on the portal, and price reporting across all sale options (whereas AWEX reports only AWEX auctions).

In proposing the WEP, the Panel is particularly mindful of the risks of crowding out existing 'WEP like options' or new endeavours. Rather it would look to promote new and existing selling initiatives and avoid duplication. However without a more concerted effort coupled with commercial and industry level investment, the Panel doubts that the potential benefits to woolgrowers offered by a WEP type system will be realised.

CONCEPTUAL SCOPE OF THE WEP

The WEP is an online portal that allows for the aggregation of selling opportunities available to Australian woolgrowers. It is a connectivity hub designed to promptly make available both woolgrowers' wool for sale as well as buying interest from wool exporters and processors.

The portal would provide access to a multitude of selling and buying opportunities put forward by industry participants and be designed to cater for the highly heterogeneous nature of wool and its end uses. It would also provide for an evaluation of the opportunities based on a woolgrower's specific selling parameters or a buyer's sourcing requirements.

The WEP would operate in conjunction with the existing auction system and provide both sellers and buyers of wool with additional supply channels for both spot and forward markets. The costs associated with these alternative supply channels will vary to that of an auction depending on the number of steps and processors associated with each channel.

It is anticipated that the WEP would be owned by industry and designed to expose woolgrowers' production, when selling their wool, to every commercial opportunity available in the market place. On the buying side it will allow wool exporters and processors to list their buying requirements and search out wools that best fit their specifications in relation to test results, type, delivery time, reserve price etc.

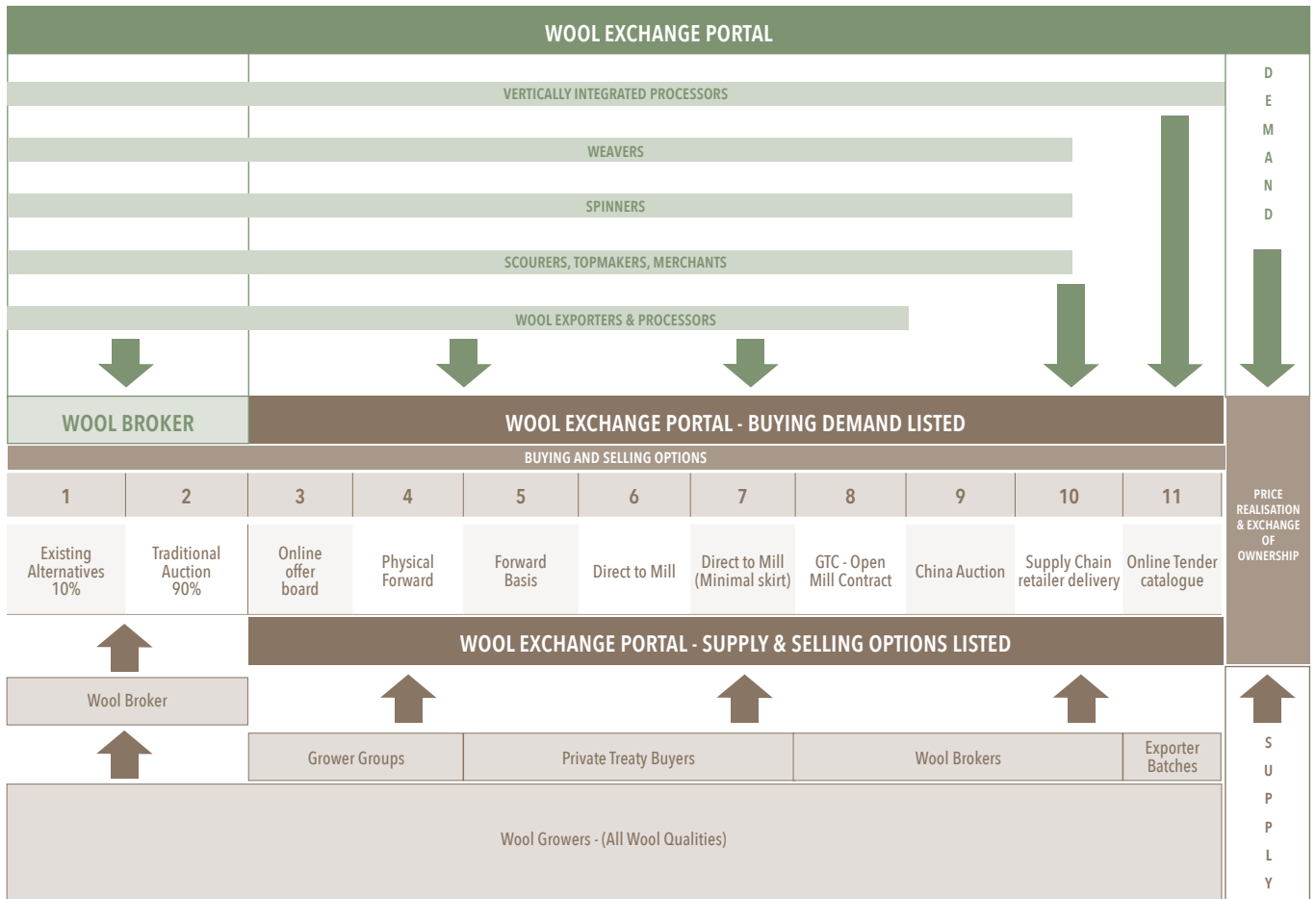
WHAT WOULD THE WEP PROVIDE?

Multiple transaction pathways

WEP matches greasy wool supply with global wool demand via numerous selling alternatives including the existing auction system. It provides woolgrowers with an evaluation of the selling options currently available to them (including the auction), taking into consideration first price, selling and buying costs, payment terms and net returns. Such transparency will allow woolgrowers to make the most informed commercial decision about their wool-growing enterprise. This analysis is generated through the use of IT based technology such as a "smart order router". The same technology can be used to assist exporters and processors in sourcing their buying requirements.

Figure 4 illustrates a number of selling suggestions from which to buy and sell wool. Options will not be limited to those in Figure 4 and the WEP will remain a flexible platform that will continuously look at ways to best respond to market demand for new selling and buying alternatives.

FIGURE 4. WOOL EXCHANGE PORTAL



Education, innovation and marketing

In addition to providing connectivity to multiple selling pathways, the WEP is an information hub to enhance the businesses of woolgrowers and wool users in the following ways:

- Educational content on the use of the various selling and buying alternatives including a breakdown of all selling and buying costs associated with each option.
- Up to date market intelligence including current and forward market levels, selection reports etc.
- Effective, self-tailored search engines for wool exporters and processors.
- Educational search engines that generate cost effective greasy wool blends for global processors looking to source greasy wools that best fit their downstream requirements.
- Meaningful quality feedback between processors and woolgrowers in the instance of direct to mill.

PARTICIPATION ON THE WEP

It is anticipated that existing industry participants and new entrants would be encouraged to participate on the WEP and put forward their selling or buying alternatives for maximum exposure.

Sellers

Selling entities wishing to put up selling avenues and list wool on the WEP would likely include the following:

- Wool brokers – listing wool in a multitude of ways according to their woolgrower client requirements.
- Private treaty wool brokers – listing their own tender catalogues.
- Individual woolgrowers – wanting to control and execute solely the sale of their wool.
- Woolgrower groups – looking to list wool directly for sale.
- Exporters – wishing to trade wool parcels and stock lots for spot and forward sale.

Buyers

Buying enterprises wishing to list buying interest are likely to include the following:

- Wool exporters and processors – either buying for prompt delivery from listed wools on offer, or listing forward buying interest through physical forwards and open mill contracts.
- Buyers could list their buying interests anonymously if desired.
- Off shore processors – listing their demands in form of fabric of finished garments and using the educational search engine to advise the most appropriate and effective greasy wool for input. Orders could then be directly to exporters via a link.

A participation (or listing) fee is likely to exist to buyers and/or sellers to cover the running costs of the WEP and grow reserves for further innovation.

BUYING AND SELLING OPTIONS

Figure 4 outlines a number of potential selling alternatives that could exist within the WEP. These could be provided through online links to existing industry service providers such as wool brokers or online selling platforms. Additionally, new entrants offering innovative selling alternatives could also cooperate with the WEP.

1. Existing alternatives & 2. Traditional auction

The WEP would not look to add additional costs to the existing auction system or selling alternatives. It is proposed that those avenues continue to operate in their current form with their existing cost structures.

It is expected that the auction system would work in conjunction with the WEP and the current market price would be one option available to woolgrowers and wool buyers on the portal.

3. Online offer boards

- Wool lots sit on the offer board in the absence of a woolgrower choosing to allocate their wool to any other selling options on the WEP.
- Wool is available for sale 24 hours a day, 7 days a week.
- 7 day prompt payment applies, unless stated otherwise.
- Buyers set up parameter filters in order to refine their search for wools to fit their buying requirements.

4. Physical forward contract & 5. Forward basis contract

- These two forward options (and new hedging initiatives) could be viewed and traded on the same WEP platform as the spot market (ie. the online offer boards on the WEP).
- Industry-agreed wool category groupings would apply and be listed on screen for spot and forward months.
- Physical wools being applied to physical forward contracts would be subject to pre-agreed premium and discount schedules to determine the final prices applied to the delivered wool.

6. Direct to mill & 7. Direct to mill (minimal skirt)

- Allows a large wool producer or regional producer group to aggregate saleable parcels of wools (usually minimum size is 100 to 112 bales to fit into a 20 ft export container) and list them on the WEP either directly or via a broker for buying consideration of exporters and processors.
- Final purchase price is negotiated and agreed between the buyer and the woolgrower (often via a broker).
- Opportunity exists for woolgrowers to offer variations on standard types including minimal skirting types and speciality consignments etc.
- Payment would be on 7 day prompt in most cases.
- Provides the opportunity for targeted supply chain marketing including wool-growing regions, single properties, and bloodlines.
- Opportunity exists for development of woolgrower relationships with exporters/processors and direct quality feedback on woolgrowers' wool.

8. GTC open mill contracts

- Good 'Til Cancelled (GTC) open mill contracts are orders placed on the WEP by exporters and processors that woolgrowers can accept and deliver wool against.
- Orders are for prompt or forward delivery.
- Prices received by the woolgrower would be determined by a premium and discount schedule stipulated by the buyer.
- The exporter or processor would have the ability to withdraw the order at any point regardless of whether the volume is filled or not.
- Producers wishing to take the price on offer commit a said volume. Buyer can stipulate maximum parcel size per woolgrower allocation to manage volume.
- 7 day payment prompt period applies from the day the test data is transmitted and allocated to the GTC order.

9. China auction

- The Zhangjiagang Free Trade Zone Textile Resources Market (TRM) is a textile market trading platform based in China's textile hub city of Zhangjiagang.
- Operating out of the Zhangjiagang Free Trade Zone, the TRM focuses on the domestic storage, distribution and transacting of global cotton and wool.
- TRM trading platform and facilities are available for Australian woolgrowers interested in storing and selling their wool directly in China.
- The WEP would assist woolgrowers wishing to pursue this selling avenue by providing direct links to TRM and third party shipping and logistics providers, as well as participating Australian domestic facilitators (brokers, transit companies etc).

10. Supply chain retail delivery

- Woolgrowers and retailers looking to develop traceable supply chain managed marketing channels can list their interests on this screen of the WEP. It can include regional supply chain stories, or bloodlines.
- Relationships between woolgrowers and retailers are initiated and the WEP assists in the facilitation of commissioned logistics and processing.
- Deferred payments are expected in return for longer-term direct trade relationships.

11. Online tender catalogues

- Private buying entities and brokers can list online catalogues for progressive online tender sales whereby wool is on sale for a given period on screen with the highest bidder at the end of the sale being the successful buyer.
- Quality is guaranteed by the seller.
- In most cases the principal owner of the wool will be the selling broker

12. Exporter parcels

- In addition to listing buying interest, exporters and processors may also wish to list stock lots for offer on the WEP for prompt delivery.
- There is also the ability to list exporter parcels for forward delivery.
- Parcels could be deliverable and/or cash settle.

DISAGGREGATION AND TAILORING OF BUYING AND SELLING CHARGES

The traditional auction system presents the following stages and relevant costs.

FIGURE 5: EXISTING AUCTION SUPPLY CHAIN

RAW-WOOL PROCUREMENT VALUE-CHAIN SEGMENT WSSR AREA OF SCOPE														
PHASE 1 WOOL PREPARATION			PHASE 2 DELIVERY AND TESTING			PHASE 3 WOOL APPRAISAL			PHASE 4 PRICE REALISATION		PHASE 5 INVOICING AND PAYMENT		PHASE 6 EXPORT PROCESS	
STEP 1	STEP 2	STEP 3	STEP 4	STEP 5	STEP 6	STEP 7	STEP 8	STEP 9	STEP 10	STEP 11	STEP 12	STEP 13	STEP 14	
WOOL SELLING PROCESS	Broker canvassing call	Shearing and wool preparation	Broker shearing visit	Delivery to broker store	Core and grab sample - AWTA testing	Wool presented on show floor	Wool inspected by AWEX and broker	Wool inspected by exporter	Wool auctioned	Exporter pays for wool within 7 days	Broker pays grower within 7 days	Wool dumped/ containerised	Wool railed to wharf	Wool shipped
RELEVANT COSTS	Travel cost	Shearing and classing	Travel cost	Wool transport costs	Wool sampling and storage fees	Show floor rental	Show floor staff and wool valuer costs	Wool buyer costs	AWEX & industry costs, broker man hours, Broker Service Charge, Post Sale Charge	7 days from fall of hammer	7 days prompt date	Per bale fee	Per bale fee	Exporters cost

Whilst the costs described in Figure 5 are not in all cases levied directly to the woolgrower, they ultimately have a direct impact on the final price received for the wool.

In an effort to generate greater transparency for woolgrowers and buyers on the WEP, participating brokers would be encouraged to tailor their charging to reflect the level of services required by the buyer and the seller under the chosen transaction avenue. Only individual service costs that apply to the elected sale channel would be applied and charged directly to the woolgrower. This will require an unbundling of the services and charges incorporated in the existing auction broker service charge (BSC) charged to the woolgrower, and the post-sale charge (PSC) charged to the exporter.

Figure 6 provides an example of potential variations to processes and costs under a WEP selling avenue (in this case an offer board).

FIGURE 6: EXAMPLE OF WEP SELLING ALTERNATIVE SUPPLY CHAIN (ONLINE OFFER BOARD)

	Broker canvassing call	Shearing & wool preparations	Broker shearing visit	Delivery to broker store	Core and Grab sample - AWTA testing	Wool Presented on Showfloor	Wool inspected by AWEX and broker	Wool inspected by exporter	Wool auctioned	Exporter pays broker	Broker pays grower & invoices BSC	Wool trucked to dump. Wool dumped/ containerized	Wool railed to wharf	Wool Shipped	STAGES
Traditional Auction															14
WEP online platform	NA	Shearing & wool preparation	NA	Delivery to wool store	Core and Grab sample + appraisal testing	NA	NA	NA	Buy & sell price matched online - wool sold	Exporter pays vendor	Grower receives payment less costs - testing, cartage, listing fee, and reduced BSC	Wool trucked to dump. Wool dumped / containerized	Wool railed to wharf	Wool shipped	9
		Shearing and classing		Wool transport costs	Wool sampling and storage fees + visual appraisal costs				AWEX & industry costs, reduced pre & post sale charges	7 days from sale	7 days prompt date	Per bale fee.	Exporters cost	Exporters cost	

WEP - ELECTRONIC SELLING AND SALE BY DESCRIPTION

It is anticipated that in a number of cases the selling and buying alternatives available on the WEP would not necessarily involve inspection of physical grower lot samples on a centralised show floor. In this case, it is likely that wools listed on the WEP would be independently appraised at the point where grab samples are drawn for testing. This would be either in a regional centre or at a centralised facility in Sydney, Melbourne or Fremantle. An industry approved and accredited wool appraiser could inspect the drawn grab sample and apply an appraisal on each lot when test samples are taken and before they are sent to the testing laboratory. The inspection process could also be filmed and recorded for future reference if required.

Test laboratory results would then be combined with the wool appraisal and put up on the WEP. At this point the wool would effectively be on sale (subject to woolgrowers' final approval and application of a reserve) within five days of leaving the property. After listing the wool, the woolgrower could determine which selling options on WEP are currently available to them and which deliver the best financial outcomes (including traditional auction).

FIGURE 7: WEP TESTING PROCEDURE AND DATA FLOW

DAY 1 & 2		DAY 3	DAY 4	DAY 5 & 6	DAY 7
PHYSICAL WOOL BALES LEAVE FARM	TRUCKED TO REGIONAL BROKERS STORE & OFFLOADED	CORE AND GRAB SAMPLES DRAWN & SENT TO AWTA	TESTING PERFORMED	CORETEST RESULTS TRANSMITTED TO BROKE	TEST RESULTS & APPRAISAL TYPE LISTED ON WEP FOR SALE
ON FARM GUIDANCE PERFORMED (OPTIONAL)		WOOL APPRIASED AND TYPED (FILMED)		LENGTH & STRENGTH RESULTS TRANSMITTED	KEEPER SAMPLE RETAINED (1 YEAR)

In the event that a buyer did require a physical wool appraisal, samples would be drawn and made available. In the same way, the sample could also be drawn and put up for inspection if they eventually elected to take their wool to auction.

WEP would cater for multiple variations to the testing and sampling procedure. For example woolgrowers could elect to list and sell their wool using an on-farm guidance sample. Data from wools tested under this sampling regime would be listed accordingly on a separate screen. Market forces would determine relevant discounts for wools offered in such a way.

In all cases samples would be retained by the test house for an agreed period and called upon in the event of a quality dispute. Recorded footage of the appraisal would also be available.

QUALITY CONTROL AND ACCOUNTABILITY

In the case of a sales channel that constitutes sale by description, exporters and processors will rely on the test results and independent appraisal when pricing and buying a woolgrower's wool.

Before making wool available for sale via the WEP, the vendors of that selling avenue will need to clearly articulate which party is responsible for the quality of the wool on offer and who would be accountable in the event of a quality dispute.

Should a quality dispute arise, samples can be called upon for inspection and verification. The filmed appraisal footage can also be referred to.

It is envisaged that if a woolgrower's wool is found to be at fault or not consistent with the quality of the appraisal and/or the sample, the WEP would facilitate the negotiation with the broker and/or woolgrower and payment of the agreed level of compensation to the buyer of the wool.

One option could be that there would be a quality assurance component within the WEP listing fee to participants (sellers and/or buyers). These funds would be held in reserve and applied in the settlement of quality disputes.

PARTICIPATION OF EXISTING INDUSTRY STAKEHOLDERS

Wool brokers

Most or all of the services provided by wool brokers under the traditional auction system would remain relevant when using the various selling avenues on the WEP.

The selling option elected by the woolgrower will determine what services are required to facilitate the successful exchange of ownership and subsequent logistical chain.

Brokers wishing to partner with the WEP would look to tailor services in the following areas to best fit the selling avenue chosen.

- wool cartage (into regional store and delivery to wool dump)
- wool storage (pre and post-sale)
- in-store insurance
- in-store sampling
- wool handling
- show-floor and cataloguing of wool requiring physical appraisal
- post sale services.

AWTA Ltd

The existing AWTA Ltd sampling and testing regimes that exist in the current wool supply chain would remain just as relevant as they do in the current wool supply chain (if not more so).

Under the WEP, the 35 regional AWTA Ltd sampling centres that currently operate in broker warehouses Australia-wide would be engaged to cooperate in the services of drawing samples and facilitation of visual inspection by independent accredited appraisers where required.

The WEP would be open to new entrants wishing to provide these services.

AWEX

Classing and typing standards as well as market reporting and buyer registration would be critical to the functionality of the WEP.

The WEP would look to cooperate with AWEX in the development of industry agreed typing descriptions for buyers and market reporting standards that incorporate both wools sold via traditional auction and also on the WEP.

Wool exporters and processors

Exporters and processors would most likely access the WEP via a login and ID system.

Buyers would have unlimited access to wools available on the WEP 24/7 and can place bids on spot and forward wools including individual lots and aggregated parcels of woolgrowers' wool.

Buyers would be encouraged to list their buying interest for both prompt and forward delivery (bids could be listed anonymously if desired).

Payment terms will mirror that of traditional auction (7 days prompt) unless stated otherwise.

Woolgrowers

All woolgrowers would be invited to list wool on the WEP, either directly or via their broker.

A woolgrower wishing to have their wool available on the WEP would deliver their wool lots to their nominated wool receival point that has accredited sampling and appraisal facilities (in most cases an existing broker who participates with the WEP).

Test results and appraisal are transmitted to the WEP (usually via their broker) and wool is then visible on the WEP. The woolgrower can then apply their own reserve (directly or via a broker) on the screen and in doing so place the wool 'on sale'.

ADVANTAGES OF THE WEP

- Woolgrowers receive unrivalled knowledge and access to all the selling options that are available to them within the entire market place.
- Exporters and processors get increased awareness and access to a wider range of buying options.
- Newcomers to the wool industry are educated on what wools to buy that best fit their downstream needs.
- Technology (smart order router) helps producers evaluate and select the best selling strategy.
- Online offer boards provide a broader exposure to woolgrowers' wool 24/7.
- Woolgrowers are provided with greater transparency of supply chain costs by de-bundling the BSC and PSC and only applying the costs that apply to the chosen transaction avenue.
- Woolgrowers have the ability to have their wool visible and for sale very promptly. After leaving the shearing shed a woolgrower's wool with full test results and appraisal can be on the WEP and available for sale within a 6 to 7 day turnaround period.
- Forward and spot markets can be traded within the same portal and viewed on the same screen, leading to a more tangible forward market.
- 'Find a broker' and 'Find an exporter' tabs on the WEP will provide greater connectivity to industry participants looking for services offered by brokers and exporters.

HOW DOES THE INDUSTRY TAKE THE WEP FORWARD?

Should the wool industry see meaningful benefits in the establishment of a wool connectivity portal such as the proposed WEP, a number of key questions arise about the extent of its service offering and the ownership structure. In order to progress the development of the WEP concept, industry stakeholders must have input into the development and ultimate structure to ensure it serves the greater interests of the Australian wool industry. In doing so it must not only provide direct and tangible benefits to Australian woolgrowers, but also to their customers including exporters, processors, service providers as well as downstream processors and potential new entrants looking to source wool for the first time.

Key steps in progressing the WEP

- Seek stakeholder input into the operation and extent of services offered by the WEP.
- Agree on how stakeholders would interact with the WEP (brokers, woolgrowers, exporters, AWTA Ltd, AWEX, AWI).
- Gauge level of support for the WEP from industry stakeholders and incorporate input where provided.

Key questions for industry on WEP

- Who will develop the portal? Items such as R&D funding, software, resourcing must be addressed.
- Who would own the WEP? And who would run it? Would there be an industry stakeholder board structure (similar to AWTA Ltd or AWEX)?
- Where would the WEP's services start and finish? Would it provide offer boards and forward selling platforms or provide linkages to third party providers?
- How would the WEP generate income? Would it be a "not for profit" organisation?
- What role would industry bodies AWEX, AWTA Ltd and AWI have in the establishment and running of the WEP?

In its review of issues and options in wool selling, the Panel endorses a market led approach – businesses and organisation in the industry are best placed to decide which activities deliver value to woolgrowers and others down the value chain and to invest in those activities. However, there are situations where the market may not call forth appropriate levels of investment given the overall industry benefits. Typically these are situations where individual businesses or groups of businesses (such as voluntary industry organisations) cannot capture enough of the prospective benefits to justify making the investment.

These items will be the subject of the WSSR stakeholder workshop to be held in Melbourne on 21 July 2015. The outcomes reached at the workshop and through subsequent submissions and further industry consultation by the WSSR Panel will contribute to the ultimate outcomes and recommendations in the final report at the end of 2015.

APPENDIX 1: WSSR SUBMISSIONS AND WORKSHOP

GUIDE TO PROVIDING WRITTEN SUBMISSIONS

The Review Panel invites submissions in response to its preliminary views expressed in this Discussion Paper and following discussions at the stakeholder workshop on 21 July 2015.

Written submissions to inform the review need not repeat information already provided in response to the Issues Paper. To facilitate the Panel's consideration of your submission, you are invited to provide a concise Executive Summary. Submissions should be sent to the Review Panel's Executive Officer, John Roberts:

Email wssr@wool.com
Fax 02 8295 4143
Post Wool Selling Systems Review
Australian Wool Innovation
GPO Box 4177
Sydney NSW 2001

Submissions will be received up until Friday 4 September 2015.

All information (including name and address details) contained in submissions will be detailed on the AWI website unless you indicate that you would like all or part of your submission to remain in confidence. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. The WSSR Panel reserve the right to not make public any submissions that it deemed to be inappropriate or not constructive.

FUTURE CONSULTATIONS

The Review Panel will be conducting a targeted workshop in Melbourne on Tuesday 21 July 2015. The written submissions on the Issues Paper and the Review Panel's own analysis and research, particularly this Discussion Paper, will form the platform for the workshop.

The targeted workshop will focus on the following themes:

- Improving operational efficiency
- Improving pricing efficiency - price realisation
- Opportunities to improve the selling options available to woolgrowers - the WEP.

The workshop will include a combination of presentations and facilitated breakout sessions. Invited participants will have an opportunity to express their views to the Review Panel. Further information about the workshop and the Panel's consultation process will be made available on the AWI website at www.wool.com/wssr

FINAL REPORT

The Panel's Final Report will be a culmination of the issues explored through the Issues Paper, Discussion Paper and workshop and will make recommendations based on the Panel's findings. The Panel's Final Report is due to be provided to the AWI Board later in 2015.

CONTACT

For administrative matters and Inquiry content see the Australian Wool Innovation website at

www.wool.com/WSSR

or

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