

# **THE MARKETING OF AUSTRALIAN WOOL: CRITICISMS AND PROPOSALS**

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The price of wool has recently collapsed. Growers claim that prices are now over a dollar a kilogram below costs of production. Many growers face ruin if prices remain depressed. The Wool Council of Australia - the industry's elected body - is lobbying the Federal Government for financial assistance. Some has been granted. At the end of April 1993, the Federal Government set up a new Wool Industry Review Committee to take a comprehensive look at the industry and its problems. Yet on the 1991 recommendations of an earlier Wool Review committee, the Government instituted radical "reforms" to wool marketing, including the scrapping of the reserve price scheme which guaranteed a minimum price to growers above costs of production.

The wool auction system was turned over to the 'invisible hand' of the price system, in the belief the market would clear at an average price of about 500c a kilogram clean. It recently fell to below 400c and later recovered, but is still far too low. The Government intervened in a way that was contrary to the wishes of the industry. Now the industry is in dire straits.

The Wool Industry Review Committee has now submitted its report (the Garnaut report) to the Government, which has accepted its recommendations with only a few minor modifications. The report recommended the disposal of the wool stockpile by releasing fixed quantities onto the market each month (now commencing on July 1, 1992); but the continuance of the present auction system without any attempt to regulate the supply of wool to the auction floor.

The Garnaut report also suggested that trade with less developed low wage countries, particularly Asia, China and Mexico, should be encouraged as this should allow low cost garments to be made and exported to established markets in developing countries: thus, in its opinion, increasing the demand for woollen garments and hence the sale of wool. This ignores the realities of international trade and the protectionist policies, such as the Multi Fibre Arrangements allowed under GATT, which apply in those countries.

Although it made motherhood statements about the need to advertise Australian wool as such and to provide just-in-time inventories alongside overseas manufacturers, the Garnaut report made no firm recommendations in these areas. It envisages that the International Wool Secretariat would initially continue in its present form, but a new body, Wool International, would be formed to manage the sale of the stockpile: this would be privatised in 1997 and take over the remaining marketing organisations. Wool growers would be given the opportunity to become shareholders in a specific way related to their levies for wool taxes and voluntary contributions.

Fundamentally, the Garnaut report fails to recognise the nature of the structure of the global textile, clothing and retail network and what is needed to sell wool - an industrial fibre - to that network. The fundamental problem of the industry will not be solved by adopting the Garnaut approach. Instead, the main effect is to allow the Government to relinquish its financial support of the industry, forcing wool-growers to take financial responsibility in four years time.

This article reviews recent events in the industry and considers what can be done to rectify past mistakes.

## **Recent History.**

The wool textile industry is a global and complex one. Moreover, the recent history of the industry is also very complex. I shall therefore concentrate only on what I believe to be the main issues.

A major cause of the present problems is grounded in the structure of the Wool Marketing Act, 1987. This was designed with the idea of strengthening the wool marketing process. Authority was vested in the then Australian Wool Corporation (AWC) to market the Australian wool clip, and to administer the wool reserve price scheme. This gave the AWC the authority to manage the auction system and the reserve price scheme; and provided a mechanism for wool-growers to set the reserve price. The Act did not empower them to regulate supply.

Wool was still auctioned, but the AWC could enter the auction as a buyer of last resort if the price fell below the reserve. The AWC would buy at the reserve price, and hold the wool in inventory until it was able to sell it. This had worked well in the past. At various times, the AWC had bought wool in the market at the reserve price, stockpiled its purchases and then sold it later, sometimes at a substantial profit. When the Act was proclaimed, stocks held by the AWC were at minimum levels. As the Act did not give the AWC the power to regulate the supply of wool coming on to the market, the AWC had the dubious responsibility of selling all the Australian wool clip at auction sales, regardless of the volume being sent in for sale.

An auction system for selling a product is vulnerable to the actions of any one group of buyers if the number of buyers is limited. If a large buyer, or a group of buyers, withdraws for any length of time, the market can collapse. This happened in 1971/2 when the Japanese stopped buying in anticipation of a fall in the US dollar, which eventually, made wool cheaper in terms of yen. Now, the withdrawal of other major customers, notably command economies<sup>1</sup>, has triggered the present severe fall in price.

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<sup>1</sup> The terms "command economies" and "free enterprise economies" are used to distinguish between those countries and markets without an established retail marketing, advertising and distribution system. It is accepted that the command economies are moving towards free enterprise at varying rates of progress, but the structure of their retail markets is still quite different from the established retail market systems of western economies.

**Table 1: Wool Prices (\$), 1986-1993 (per equivalent clean kg)**

1986	September	5.56
	December	5.87
1987	March	6.75
	June	7.53
	September	8.18
	December	9.15
1988	March	11.58
	June	11.42
	Floor Price Set	8.70
	September	11.07
	December	10.10
	1989	March
1989	June	9.35
	September	9.26
	December	9.20
	1990	March
1990	June	7.63
	Floor Price Set	7.00
	September	7.37
	December	7.40
	1991	Floor Price Abolished (February 11)
1991	March	4.68
	June	5.97
	September	4.74
	December	5.78
1992	March	5.73
	June	5.39
	September	5.34
	December	5.09
1993	January	5.01
	February	4.72
	March	4.34
	April	3.96

Source: "The Australian Wool Corporation", *The Age*, 24 April 1993.

Even if there are many buyers, they all behaved ethically and demand was more or less constant, an auction system is vulnerable to fluctuations in supply. If an increase in supply is not matched by an increase in demand, prices can also collapse. Conversely, if an increase in demand is not matched by an increase in supply, prices can skyrocket, as they did several years ago (Table 1). These elements in combination provide the potential for crisis. That crisis has now occurred.

In the late eighties there was an increase in the demand for wool from both Russia and China. These are two command economies without established retail markets in which wool products can be sold using sophisticated advertising and promotion techniques. The volume of wool purchased could be determined by decree of the central government, regardless of demand. In the past, these governments had a record of unstable buying and uncertain credit ratings. The consequence of the increase in demand from these two unreliable markets without an immediate increase in supply was that the price skyrocketed.

This had two effects. First, it pushed up the price at which wool could be bought by customers in the Western economies. Other fibres, such as cotton and man made fibres which take wool dyes, can be substituted for wool. Rayon and polyester are two such fibres. When prices rise suddenly, manufacturers in the free enterprise countries can substitute these fibres for wool. This reduces wool's market share and can have a serious effect upon the future sales volumes of wool in those markets. There was a reduction in wool's market share, but it is difficult to estimate its extent. In the short term, overall prices rise and growers get windfall profits, which is destabilising for the long term growth of the established markets in free enterprise economies.

Second, in response to the rapid increase in price, farmers with diversified operations can shift some of their activities to growing wool. Coincidentally, other avenues for revenue from sheep, such as the sale of live wethers to the Middle East, had declined. Farmers allocated more resources to wool growing. Wheat farmers bought more sheep. Some dairy farmers sold their cows and switched to wool.

Such newcomers to the industry damage the market for the long term specialist wool-grower, who is often located on lands unsuitable for other forms of production. Moreover, the newcomers generally produce a broader (coarser) fibre in volumes out of proportion to the demand for it.

Other events intensified the industry's problems. The Wool Marketing Act 1987 virtually allowed the growers to set the reserve price by empowering the Wool Council and the AWC to determine it jointly. The Minister had the power to override them if deemed necessary. He also appointed the Board of the AWC which ultimately reported back to him. In response to the increase in market price outlined above, the reserve price was increased from around 500c a kg in 1986/7, to 645c for 1987/8, and then to 870c in June 1988. These were decisions with a lot of ambiguity. Instead of being an insurance against a fall in price if demand declines and supply remains the same, the reserve eventually became a price which growers were forcing customers to accept.

Nevertheless, the higher reserve price was still well below the auction price, and was accepted by the international textile trade. Much the same volume of wool was still being sold in traditional Western markets, even allowing for the substitution effect. The growers judged from this short term success that they had established the natural price at which wool could be sold without affecting demand. The cost of the raw material - wool - is a relatively small proportion of the total retail price of a men's suit, for instance.

The success was short term. There was a sudden surge in supply - mostly of broader wools which were mainly demanded by the command economies - and a bumper season, which both broadened the clip and increased its size. Simultaneously, the biggest command economy customers such as Russia, China, Poland and Czechoslovakia reduced purchases dramatically in the 1989/90 year. There were political upheavals in each of these countries. Their actions had nothing to do with the demand for wool in their economies. An auction market is vulnerable to such conditions, and the auction price collapsed. An increase in production of between 20 and 30 per cent was sent to the AWC for sale (Table 2), just at the time when a number of major customers severely curtailed purchases. In spite of this, the 870c

reserve price was maintained until June 1990, when it was reduced to 700c by the Minister, against the advice of growers who feared customers would be severely damaged financially if the price fell. No effort was made by the Minister to reduce supply. As the auction price fell below the reserve, the AWC had to buy the excess supply of wool and stockpile it. This process subsidised wool growers at high prices for an over production of wool which could not be sold. It was a serious mistake on the Minister's part to have allowed supply to continue at record levels without attempting to restrict it to a volume which could be sold.

**Table 2: Average Auction Prices and Gross Value of Wool Sold.**

	Bales Sold	Average Price c/kg Greasy	Gross Proceeds (\$ billion)
1985/86	3 642 712	342.06	2.115
1986/87	3 756 175	395.47	2.555
1987/88	4 201 971	632.69	5.594
1988/89	4 386 509	647.26	4.910
1989/90	5 713 403	555.27	5.579
1990/91	5 374 583	413.83	3.983
1991/92	4 246 238	358.82	2.758

Source: *Dalgety Farmers Annual Wool Digest* 1991/92 Season (the National Council of Wool Selling Brokers of Australia).

The orthodox response to a situation of this kind - a sudden loss of several large customers from the one particular market segment - is to cut back production. Excess production results in accumulating inventories, has to be financed and ties up capital. The correct strategy is to hold the higher price, once established, in the other segments of the market where demand remains good; and to hold market share at that price. Production must then be reduced to a level that will satisfy market needs of those segments of the market that are still viable. The AWC got the first part right, but unfortunately did not have the power to restrict supply.

If major customers are lost for an indefinite period, production must be restricted until such time as new customers can be obtained to offset the lost ones or until the lost ones return to the fold. To its credit, the AWC realised its predicament and commenced steps to obtain the statutory power to regulate the volume of wool produced. In November 1990, it also commenced a flock reduction programme, which will be discussed below. This approach reflected sound management principles, but there are long time lags involved. In such situations, finance is needed to cover the costs of accumulating inventory until production is reduced to match demand.

Before the AWC's actions could take effect and contrary to the AWC's wishes, the Government, using its final authority under the Act and pending the advice of a special committee it had established to review the industry, suspended the reserve price scheme in February 1991, after the Gulf War. It worked on the theory that if the price was allowed to fall, demand would go up and the price would settle at about 500c a kg. This was considered a price that would just cover growers' production costs. At this level, it was thought, "the market would clear", and the stockpile could be divested. But this policy displayed a complete ignorance of the structure of the global wool textile, clothing and retail network.

The market did not clear. No more wool was sold in the remaining markets in the free enterprise economies. A lot less was sold in the 1990/91 season as buyers predicted a price fall. More was sold in 1991/92 to offset this. But it was evident that there was no significant increase in demand in response to the reduction in price, and certainly not enough to clear the stockpile, as had been predicted (Table 2).

The greatest single factor affecting overall demand was the decline in sales to command economies, not any sudden and unanticipated decline in the demand for Australian wool in the established free enterprise markets. It would have been more prudent to have treated the command economies as a separate market segment, and to have negotiated sales to their governments and related agencies independently of the auction system. This would have resulted in a more stable price to the established and more reliable free enterprise segment of the market.



**Table 2: Greasy Wool Exports (000's kg)**

	1987	1988	1989	1990	1991	1992
Japan *	117 900	112 135	97 764	65 788	68 526	73 528
Asia **	99 292	98 731	84 534	78 608	77 806	118 481
<b>Sub-Total</b>	<b>217 192</b>	<b>210 833</b>	<b>182 298</b>	<b>144 396</b>	<b>146 332</b>	<b>192 009</b>
Europe	207 657	203 076	211 840	241 193	201 001	259 266
USA ***	26 690	27 751	26 755	18 575	26 920	28 034
USSR & Satellites	122 171	126 632	147 716	80 492	24 770	36 951
China	60 802	54 015	24 816	9 633	24 024	68 535
Other	42 797	41 205	36 349	35 090	28 930	37 234
<b>Total</b>	<b>677 309</b>	<b>663 545</b>	<b>629 832</b>	<b>529 379</b>	<b>451 987</b>	<b>622 029</b>
Average Price per kg (cents)	395.47	632.69	647.26	555.27	413.83	358.82

Note: These figures are for greasy wool exports and do not include sales of greasy wool to Australian firms for processing on behalf of overseas customers. Japan has a lot of greasy wool processed in Australia, which is then exported in a clean state. Private sales outside the auction system are also excluded. Many of these sales are made to Japan.

\* Japan has located wool processing plants in Asia to produce for the Japanese market.

\*\* a number of Asian mills would be exporting to both the Japanese and US markets.

\*\*\* some of the US market would be supplied from plants in Asia.

The price of greasy wool is lower than the price of clean wool. The reserve price is always quoted as an equivalent clean wool price, which is higher.

The decline in 1991 was probably due to speculation. The increase in 1992 would offset this.

Source: *Dalgety Farmers Annual Wool Digests, 1987/9*. Compiled from figures provided by the Australian Bureau of Statistics.

The demand for Australian wool in free enterprise markets is relatively price inelastic in the short term. Most of the Australian wool clip is used to make garments for ultimate sale in retail stores. In the final retail price of a garment, the cost of the fibre is not a major item, due to the lengthy processing involved in fabric and clothing manufacturing which use major elements of labour and overhead in proportion to the initial

input of wool, plus the high retail markups on garment manufacturers' selling prices of between 35 and 50 per cent and sometimes more. Rather than producing a significant increase in sales, the fall in price following the scrapping of the reserve price scheme forced customers to write down the value of their stocks. The risk of losses on inventory valuations was one of the main reasons why manufacturers wanted the reserve to remain at 870c and advised against lowering it. From their point of view, this was an acceptable price.

Interest rates had escalated as the Government attempted to arrest the speculative boom which had developed after the stock market crash of 1987, and allowed credit to increase by about 20 per cent in both 1989 and 1990. All sections of the economy, including the wool industry, were made to pay for the excesses of the money boom fostered by financial deregulation. Concerned about the impact of the high interest rates on its contingent liability as guarantor for the financing of the stockpile (owned by the growers), the Government appointed a committee in July 1990 to review the industry. As mentioned above, in February 1991 the Government suspended the reserve price scheme pending a report from that Committee. This was effected by the government refusing to underwrite any further stockpile debt. The AWC could therefore no longer obtain the finance to purchase and stockpile wool which failed to reach the reserve price.

In March 1991, the Wool Review Committee (WRC) recommended that the wool reserve price scheme not be re-introduced, and that future sales of wool be conducted in open auction with no reserve. The stockpile stood at 4.7 million bales with a debt of \$3.1 billion. It was to be frozen under specific conditions (the government appointed a board of liquidators who seized control of the old AWC's assets and transferred them to the new Australian Wool Realisation Commission). All the wool produced in future would be auctioned until the market had established a "market clearing" price. The AWC would not be empowered to restrict supply. The Government accepted these recommendations, with some minor modifications. It is ironic that, while the WRC was sitting, the AWC was preparing legislation to give it the authority to restrict the supply of wool by quota, and had already implemented programmes to reduce the size of the flock.

When prices were so exceptional, wool growers postponed the normal procedure of annually culling old and poor producing sheep. When prices collapsed in 1990, several year's culling was overdue. This was effected mainly by shooting the animals, as the market could not absorb them and they were practically worthless. The WRC's recommendations effectively stopped the flock reduction programmes. The preparation of appropriate legislation was abandoned. There was to be no restriction on the supply of wool. The price was to be allowed to decline under the influence of the free market.

This policy greatly aggrieved customers in the Western world. They again faced huge financial losses from stock write-downs. Most of these losses were borne by processors in the early stages of the pipeline - wool scourers and carbonisers and top-makers, who carry the largest proportion of raw materials stock in the network. Their losses were substantial, as wool is a large proportion of their total costs.

The advice of long term customers was ignored and they sustained severe financial losses. Faced with further losses if they buy on a falling market, customers would be loath to continue buying. By May 1993 the market was still being forced down, a direct outcome of the marketing policy adopted by the Government - hardly one to win customer goodwill and increased sales. Instead of increasing demand, the effect of allowing the market to clear has been to increase speculation, reduce demand in the short term and lower prices further.

The AWC was reorganised, but still has no power to restrict the supply of wool coming onto the market. Supply has certainly fallen, but mainly because of the deferred culling described earlier, and because many growers are now facing bankruptcy. Many of the diversified farmers who moved into wool growing when prices were high have now moved out again. Forcing customers to take severe financial losses and forcing suppliers (farmers) into bankruptcy is a very harsh way of allowing market forces to set a price at which the market will clear. From a business and marketing viewpoint, it is absurd.

The sorry story of the industry's and the Government's behaviour over the last few years is an object lesson in how not to market a product which is a basic input into a complex industrial system. Although there

is some measure of bureaucratic control in most agricultural marketing schemes, in this case the Australian bureaucrats lacked sufficient practical knowledge of the complexities of the market and were influenced too much by neo-classical economic theory. Their interference has now done great harm to what was once a viable and prosperous industry. There is nothing the matter with the product. It is in a world class of its own for quality, with a unique monopoly. But its current selling price is now only about half the price which was being accepted by free enterprise customers before the reserve price was lowered.

Admittedly, the final recommendations to restructure the industry came from the WRC, not from tenured bureaucrats. But the thrust of these recommendations was accepted by the Government, which had already taken action to suspend the reserve price scheme. The turning point of the game came when the Government overruled the growers and reduced the reserve price to 700c without simultaneously restricting supply. The present disaster would have been averted if the Government had supported the 870c reserve price and legislated for the AWC to control supply.

The Chairman of the WRC was Sir William Vines, a past Chairman of the AWC and member of the International Wool Secretariat (IWS). He is also a former Chairman of wool broker Dalgety's and the ANZ Bank, both organisations with a vested interest in maintaining the present auction system. Mr. Fred Millar was also a member of the Committee. He is considered to be an outstanding company director, holding seats on the Boards of TNT (Chairman), Hoechst Australia, ANZ Life Assurance and the Health Insurance Commission. The other member was Jeremy Davis, a University professor of management and Chairman of Alcan Australia.

None of these men had an intimate knowledge of the international network of yarn manufacturing, knitting, fabric manufacture, clothing manufacture and retailing that should have been necessary in a review of the marketing system for Australian wool. Moreover, in the submissions to the inquiry there were a number from Government departments and agencies which would have influenced its opinions. There was only one submission from a retailer, Marks and Spencer of

the UK. There were a number from growers and grower interests, breeders, top-makers, brokers, and from textile manufacturers' associations in the UK, US, India, and Japan. There were no submissions from clothing manufacturers, probably because of their distance in the processing chain from the initial input of raw material.

Due to the virtual disappearance of a once thriving wool textile manufacturing industry in Australia over the last 30 years because of increased imports, there are now few Australians with an expert knowledge of the global wool textile manufacturing and retailing system as a whole.

## **The Flaws in Wool Marketing**

The fundamental flaw in the design of the existing marketing system for Australian wool is that it is producer oriented, instead of being customer oriented. In the design of any new system, the primary focus must be on the customer. In Western economies, the key customer is the retailer. The retailer is the one to whom wool promotion must be primarily directed.

Wool is now sold in an "open cry" auction system to both free enterprise and command economies. Yet they are two separate markets. Command economies should be treated separately and kept out of the auction market. In addition, the problem with the auction system is that both the AWC and the IWS do not know who eventually uses the wool as it is transformed into cloth and garments. Except for some industrial fabrics such as electric-blanketing cloth and car-upholstery fabrics - which are made from carding types (the off-sorts from the fleeces) - virtually the whole of the clip is sold in retail stores as clothing in one form or another. But exactly how much Australian wool is used in these products, by whom and where it is eventually sold, is unknown to the Australian wool marketing bodies.

### **The Wool Processing/Selling Network**

Generally speaking, effective marketing strategy requires assistance to retailers for advertising and promotional costs. This is the strategy adopted by the manufacturers of the fibres that wool competes with. The approaches to retail stores, however, are made by clothing manufacturers. They make up samples of garments which they show to retailers. If retailers like what they see, they place orders with clothing manufacturers for bulk quantities to be delivered at specified times during the winter selling season. Clothing manufacturers, in turn, if they are making tailored garments such as mens' suits and sports trousers, or ladies' outerwear, work in conjunction with weavers and knitters of fabric to develop cloths which they think will sell if made up into garments. Manufacturers make sample lengths of cloth which the clothing manufacturers then make up into sample garments for showing to retailers. If they receive bulk orders from the retailers, they place bulk orders for cloth with the fabric manufacturer.

The fabric manufacturer then orders the required quantities of yarn from a yarn manufacturer. Alternatively the yarn could be made in house if s/he is an integrated manufacturer. But there is a further stage of backward integration. Yarn is made from wool tops. The required specification of top must then be either made, or ordered from a specialist wool top manufacturer. The wool top maker may or may not have his/her own scouring and carbonising plant. If so, the top maker proceeds to clean the required types of wool to make the tops to make the yarn to make the cloth to make the garments. If not, requirements are ordered from a specialised scourer and carboniser. This firm, in turn, has to obtain the specialised types of wool it needs to fulfil orders. All the stages of ordering in this chain depend on the final decision of the retailer to stock the garments shown by the clothing manufacturer.

This process is shortened somewhat for knitwear. Where garments are fashioned completely on machines, the knitter simply orders the yarn from the yarn-maker after receiving orders from the retailer. The knitter does not have to wait for lengths of cloth to be made, as a tailored garment maker does. In some cases, fabric is knitted by the

length and then cut and made into garments. Even in this instance, lead times are much less than for woven cloth.

The process can be speeded up by different forms of standardisation. Most knitters and weavers specialise in cloths made from particular yarn diameters. Their machines are set only to process certain thicknesses of yarn, and the fabrics they make are standardised to this extent. Colours are more or less standardised internationally for each season, to avoid holding large stocks of yarns of many different colours.

Within the work in process pipeline, some stocks can be held as buffers to enable the peak production demands to be met at the height of each season. At all stages in the network, manufacturers strive to obtain level production runs and to even out seasonal fluctuations in demand. To some extent, this can be achieved by splitting products into "stock" and "fashion" lines. Stock lines are those least subject to fashion changes and which can be accumulated in the off season with a minimum risk of lost sales. Fashion lines are those which are more or less made to order each season.

### **Time Lags in the Production/Selling Network**

Ultimately, someone at the start of the pipeline has to carry large stocks of wool, because the retail selling season in the Northern hemisphere - where 95 per cent of Australian wool is sold - is out of phase with the production season for wool in Australia. In Australia, shearing starts in the spring and the major part of the wool clip comes on to the market in the summer and autumn. By the time it is shipped, it is too late to be used in the same calendar year it was purchased. Wool bought in Australia in autumn 1993, for instance, would not appear in overseas retail stores until about September 1994 at the earliest, at the start of the winter retail season.

Thus over 12 months production of Australian wool must be carried in the global pipeline by somebody. With the present marketing system, that somebody is not the Australian wool grower, but the customer in the pipeline. Moreover, customers must also carry the risk of price fluctuations during the period they are holding the stock; the risk of

exchange rate fluctuations; and the costs of carrying such a large inventory. The grower, on the other hand, does not take these risks. Under the present system, after the wool is shorn, the grower sends it in to be sold and receives the proceeds of the sale almost immediately. The grower does not have to carry the costs of holding inventory, but forces the customer to do so.

Many customers refuse, particularly in the USA. Therefore, few garments made from wool are included in the ranges of men's and women's garments shown to US retailers by clothing manufacturers at the start of each selling season, because there are few woollen cloths available for them to sample.

The US market has the potential to be at least as big as Europe, which buys about half the Australian clip. At present, the US buys about 5 per cent directly, although some of the purchases made by customers in Taiwan, Korea and China could be used to fulfil US orders. The potential in the US market is therefore very significant. If properly exploited, the size of the Australian flock could be increased by up to 50 per cent, and annual export sales increased by between \$1 and \$2 billion. But US manufacturers refuse to carry inventory costs and take the risks of price fluctuations. This has been publicly stated by Burlington, one of the biggest US textile manufacturers.

### **Australian Merino Wool**

Selling to the retail trade requires an established brand. A recognised brand provides an insurance in the market against other manufacturers, and differentiates your product. Once established, a brand also provides a degree of continuity of sale from one season to the next. An established brand is essential in the Western economies, where most retailers have sophisticated marketing and promotion systems.

On the other hand, command economies, including at the present time Russia and the Eastern bloc countries, do not have such retailing systems. Manufacturing plants were owned by governments and purchasing was subject to government policy. At present, these countries and China are trying to "privatise" their industries. In Russia,



many large mills are closed and a few are trying to operate under various forms of private ownership. But they lack hard currency to buy their raw materials. China's system is somewhat more advanced, but both countries are inefficient and lack the level of manufacturing know-how taken for granted by private sector management in the West. Wool purchases have fallen significantly (although sales to China have recently increased). As mentioned, these countries should be treated as a separate market segment.

Australian wool is strictly an apparel wool and is finer than wool grown anywhere else in the world, mainly because of the unique soils, grasses and climate in Australia which cannot be reproduced elsewhere. The finest wool in most other countries is broader than anything grown in Australia in volume. This is recognised by retailers world wide, and Australian Merino wool and Geelong Lambswool are known for their quality, fineness and softness. These brands are priceless, and are recognised internationally in much the same way as Scotch whisky. But no Australian wool is sold under these brands by the AWC or the IWS.

The International Wool Secretariat (IWS) is responsible for the promotion of wool internationally, and promotes the Woolmark as its brand. However, the IWS consists of Australia, South Africa, Uruguay and New Zealand. Australia contributes about three quarters of the funding of the IWS, proportionately greater than the volume of wool it produces, which would be over half of the total. But South American and Uruguayan wools are much broader than Australia's. New Zealand produces carpet wool, and little apparel wool.

The original idea of the IWS was to combine the marketing efforts of the major Southern hemisphere wool exporters, who would produce about 90 per cent of all wool exported. They produce only about 25 per cent of all wool grown in the world, but the production of most other countries is sold for local consumption. Woolmark's original proponents seemed unaware of the unique properties of Australian wool, which is distinctly superior to the wool grown by the other IWS members. Indeed, the Woolmark brand, by promoting wool, helps the sale of wool grown by Australia's competitors, including the UK, France, Spain and other European countries, as well as the other

members of the IWS. By hiding Australian Merino and Geelong Lambswool under the Woolmark brand, Australian wool is unable to reap the benefit of its unique quality because it is not branded as such and cannot be differentiated in the market.

In general, the sums spent by Australia on promotion - nearly \$2 billion over the last decade - have been wasted. The volume of wool produced and sold over this period has not increased. Prices have now collapsed. Most of the promotion money has been spent on institutional (or generic) advertising in fashion magazines featuring women's wear. But these products are made from carding types (off-sorts) which are only about 8 per cent of the total clip. While the Woolmark may do some good in keeping wool before the public eye, it never tells the public in which retail stores woollen garments can be bought, nor does it tell them where they can buy Australian wool. If promotion funds were spent instead with retailers, backed by in-store promotions, and directed to the trade where most of the wool is used - men's wear - the public would know where it could buy the goods, while the quality features of Australian wool could still be promoted.

The probable reason for the institutional advertising policy is that under the present auction system, neither the AWC nor the IWS knows which manufacturer is buying the wool, where it will be eventually made up into garments, and which retail stores will sell it. It is usually bought by scourers and carbonisers or top makers, often through Australian-based brokers who service a number of customers. The identity of the final user is unknown.

When confronted with this problem, the IWS and the AWC state that they could not keep track of Australian wool because it is often blended with other wools. This may be true, but the global industry is relatively small, and if an efficient liaison was maintained with customers, this aspect could be managed. In any event, the main object is to see that retailers buy woollen garments made by clothing manufacturers and knitters. These firms can be identified and contacts made through them for promotional purposes right down the processing pipeline. This is an essential feature of successful marketing.

## **The Importance of a Stable Pricing Policy**

As already discussed, the wool auction system is inherently unstable for there are few buyers in relation to sellers, and the supply of wool coming on to the market is not effectively controlled. Manufacturers claim they need a stable price for raw material throughout the season. It is unsatisfactory to have one price at the start of sampling, and to quote a price for a cloth on that basis, only to find that when the raw material is to be ordered in bulk, the price has increased. Retailers buy goods for sale in clearly defined market price groupings. They cannot tolerate price movements above those at which they placed their orders. Any losses from price hikes in raw materials must be borne by those down the pipeline. In contrast, the producers of other fibres with which wool competes, particularly the factory made fibres, usually quote customers a fixed price for the whole of each season. Stocks are also available for immediate delivery, thus minimising customers' inventory carrying costs.

The wool reserve price scheme, while guaranteeing a minimum price to growers, only put a floor under the price. It did not put a ceiling on it. If prices escalate, as they did several years ago, manufacturers are still vulnerable to price declines. What manufacturers want is a stable price, not a fluctuating one, but the reserve price scheme did not deliver this to them. It only protected the growers from a fall in price.

## **The Design of an Ideal Marketing System**

All of the above factors mean that from the point of view of a Northern hemisphere manufacturer, the marketing of Australian wool is obsolete. If some of these faults could be eradicated, the volume of Australian wool sold would grow significantly. However, the system cannot be changed overnight. Plans should be made to design an efficient system, directed at customers, and then steps taken to implement it over a period of years. If the present system continues, the Australian wool growing industry could eventually disappear; and with it the potential for about \$5 billion per annum in export revenue.

An appropriate procedure is to design an ideal system, and then delineate the steps needed to achieve that objective. There would be many practical technical, industrial and financial problems to be resolved, but the task is not insurmountable. Good progress has been made in other rural industries, particularly wheat, dairying and meat; there is no valid reason why the wool industry cannot follow suit.

The major components of an ideal system should be:

- A stable price to customers should be established for the whole of each selling season.
- Stocks of clean wool should be available at sites close to overseas manufacturers.
- Australian wool should be distinctly marketed under the Australian Merino and Geelong Lambswool brands. Blends could be distinguished accordingly.
- Advertising should be channelled through the manufacturers to the retail trade, where in-store promotions should be supported.
- Sales to command economies should be treated as a separate market segment, and consideration given to direct negotiation including barter and counter trade.
- One overall marketing body should be established for Australian wool. To control supply, wool would be grown on contract to this body.
- A firm price should be set for each season with a reasonable profit margin to growers.
- All wool should be cleaned, either in Australia or overseas, before sale.
- Australia should withdraw from the IWS and Woolmark promotion.

## Conclusion

The present state of the Australian wool industry is a situation where a product with a market price of 870c a kg a couple of years ago is now selling for less than 500c a kg to the same customers. These customers have not significantly increased their purchases. Huge financial losses have been imposed on an industry producing a world class export product of the highest quality at internationally competitive prices. The main problem which confronted the industry in recent years was the loss of sales to the command economies, chiefly Russia and its satellites. This exposed serious weaknesses in the current marketing strategy. In response to the loss of major but segmented markets in command economies, the price in entirely different markets in the free enterprise economies was allowed to fall. This latter price should have been held.

Production of those types of wool purchased by the command economies (essentially broader types) should have been reduced. Most of the stockpile represents the reduction in purchases from Russia, its satellites and China. This should be held separately and not offered to free enterprise customers. Special financial arrangements should be made with the command economies - including barter and counter trade - and the stockpile directed solely to those countries, plus other new customers in the US, where clean stocks of wool should be held to provide an immediate stock service at market rates.

While it is difficult to ascertain the volume of wool eventually going to the US market, it is obvious this market is not being exploited to its full potential. It has the potential to be at least as large as that of Europe, because the population and climatic conditions are roughly similar. At present, the Australian wool marketing and distribution system is not acceptable to US manufacturers. An expanded US market could have offset any decline in sales to command economies. Too much of the clip was sold through the auction system to command economies, which are unreliable customers. This strategy had a high degree of risk.

Large sums have been spent on wool promotion but they have been ineffective. Money has been wasted in generic advertising and the Woolmark brand. Australian wool is not differentiated in the market place nor is it supported by in-store retail promotions. These strategies are essential to maintain market share for Australian wool in highly competitive markets.

Moreover, the reserve price scheme was designed without providing the AWC with the power to control the supply of wool. Control of the volume of wool production is essential.

Ian Mitroff (1983) has claimed that in any form of scientific enquiry, the background, personality and experience of the observers of the system influence their perceptions of it. The findings of the Wool Review Committee would seem to have been affected by such constraints. None of the members had in-depth experience of either clothing manufacture or retail selling, nor were there sufficient submissions from clothing manufacturers and retailers, which could have assisted the Committee<sup>2</sup>.

While the size of the stockpile seems large (3.9 million bales in mid 1993), it represents little less than 12 months production. Yet, because of the time lags between Australian production and Northern hemisphere manufacturing requirements, a stockpile of this volume would be necessary to provide customers with a just-in-time stock service. This is an essential feature of an appropriate marketing strategy. Consequently, the costs of financing such a stockpile should be recognised as an inherent part of marketing strategy and should be built into the price at which the wool is sold. Eventually, all wool should be cleaned - either in Australia or overseas - prior to offering it for sale at stable prices on a stock service basis to customers. This would match the service offered by other fibre producers and would give it a competitive edge over other wool producing countries. Stable pricing is also an essential feature of the marketing strategy outlined in this paper.

However, to introduce an efficient wool marketing system, careful and detailed planning over a long time frame would be needed, and with the

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2 The same applies to the Garnaut report.

co-operation of all parties involved. Some parties to the present system, mainly middlemen such as banks, brokers and pastoral houses, may think they would be disadvantaged. But other opportunities for them would emerge as the system evolved.

In the interim, it would be necessary to re-introduce a wool reserve price scheme to ensure that growers remained viable. Provision in the reserve price should be made for any costs of carrying inventory if supply exceeds demand, and these costs should be borne by the grower. Steps should be taken immediately to restrict the production of wool to match demand, while financial assistance in various forms should be provided growers on a repayment basis to tide them over these difficult times.

As the Garnaut report, in my opinion, did not address the above issues adequately, it could be appropriate for the woolgrowers themselves to fund an independent study of wool marketing by a reputable international firm of marketing consultants. The members of the Wool Council whom I know admit they do not understand the complexities of the global textile/clothing/retail industrial system. Until they do, or are advised by professional marketeers rather than government appointed committees whose members are also unfamiliar with the system, the future of the industry looks bleak indeed.

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