9. Selling Systems

Mark McDonald

Learning objectives

On completion of this topic you should understand:

- the major wool selling methods in Australia
- the key reasons for the relative market share for each method
- likely trends in selling mechanisms in the medium term
- the major players in each selling method
- the wool description system called AWEX-ID.

Key terms and concepts

Transfer of ownership, open cry auctions, private sales, AWEX-ID, electronic sales, forward sales, portfolio sales, marketing chain, wool brokers and buyers, wool lot aggregation

Introduction to the topic

This topic describes the characteristics of the main transfer of ownership methods for wool in Australia.

9.1 Selling systems overview

A wool trader from the late nineteenth century would still be familiar with the main method of exchange of ownership for wool as we commence the 21st century. The open cry auction system is still the major sale mechanism with around four in five bales being purchased this way.

The other major transfer mechanism is also well established in the industry and has been operating since wool trading began in the mid-1800s. This method is referred to by a variety of names but generally under the banner of private treaty or merchants.

In the last decade a number of other methods have been introduced commercially with varying degrees of success. They include a variety of electronic systems, direct sales to processors (a longer running method but more prevalent now) and sales based on different classing standards (e.g. Fibre Direct).

Despite this plethora of options, open cry auctions continue to dominate the transfer systems and still retain their importance in terms of industry price setting and logistics control. We'll briefly discuss the reasons for this ongoing auction dominance as well as the potential changes in the medium to longer term.

A number of electronic sale methods have been introduced in Australia (and in New Zealand) over the last decade. Most of these have failed but a number of these (AWEX, Eclipse, Wool Trade, E-wool) continue to operate as an adjunct to the auction process. Most have some sort of web capability with Wool Trade and a number of smaller systems completely web based. These electronic systems probably account for 2 – 4% of the annual turnover and are treated as useful backups to the auction process by the majority of buyers. In theory their 24/7 accessibility and the capability to buy multiple lots (compared with sequential sales in auctions) should be attractive to potential buyers. However, the existence of several alternatives in this market is probably another factor in limiting the uptake (e.g. auction provides a 'one stop shop' for a large quantity of wool types while electronic sales tend to have less range and quantity and are spread over a number of systems).

There is also a human element to the slow uptake of electronic selling systems. The buyer side of the industry remains wedded to the open cry system and until this sector is convinced to change, electronic sales will remain an adjunct to auction.

The sale method(s) making the most impact on auction throughput in the last five years are variously described as 'direct' methods. These include direct to mill, forward sales and portfolio management. As stated elsewhere there is still some leakage of wool from these methods to the auction system depending on market conditions and quality factors.

The main feature of these selling options is the more direct linkage between the producers and other market chain players. Sometimes these are still brokers (Elders, Landmark (formally Wesfarmers)) or, exporters, but often they are further down the market chain with actual mills or early stage processors. These options have the potential to radically alter the marketing chain from its current long-term structure.

Traditionally the wool marketing chain has operated as a series of aggregation points comprising:

- growers aggregate individual fleeces into bales of similar qualities and types
- brokers aggregate these bales into sale lots for purchase (and pre-sale viewing) by buyers/exporters (e.g. average lot size = 6 – 7 bales)
- buyers aggregate sale lots into order sized shipments usually linked to container capacity (1 container = approximately 100 – 105 bales)
- early stage processors often aggregate various orders into longer mill batches. Often these orders can come from multiple country locations
- weavers will generally aggregate various stops into longer production runs etc.

This structure is similar in shape to a funnel with many producers providing product to a smaller number of intermediaries with a large retail audience as the other side of the funnel. The expansion of selling methods described above will ultimately impact on the broker and buying sectors with a reduction in numbers and expansion in functions likely to occur. This is already occurring within the Australian industry with a number of brokers providing buyer like options to their clients (e.g. direct access to mills). On the buyer side a number of operators are expanding into private treaty and auction brokering services to expand their product range and increase their direct exposure to the production base (e.g. Lempriere, Fox and Lillie).

A number of operators have also expanded their companies to include control of early stage and mills to provide a complete service to clients. Examples include Elders who provide brokering, direct to mill (via GWC) and private treaty and portfolio based services. The declining production base will also increase the pressure on these market chain intermediaries. This will result in the traditional stage by stage aggregation model described above becoming more flexible with stronger direct links between growers and processors.

9.2 Selling systems description

Let's look in more detail at the characteristics of the main selling systems currently in Australia namely:

- open cry auction
- private treaty
- direct to processors
- electronic systems
- others (forward sales/portfolio).

Open cry auction

Currently the well-established open cry auction system for wool sales accounts for between 75 – 85% of each year's production in Australia. These sales are held in five locations around Australia: Fremantle (WA), Melbourne (SA and VIC), Launceston (TAS), Sydney and Newcastle (NSW and QLD). The number of selling centres around Australia has gradually declined over the last 15 years but has been stable with these five centres for over five years.

The auction system has been under various management arrangements over the past century. Presently the system is administered by the Australian Wool Exchange (AWEX). This body is effectively an industry cooperative with membership from all major auction players, i.e. Brokers, buyers, growers, processors and private treaty merchants. Wool sold at the AWEX auctions have to comply to a variety of selling rules which cover quality, logistics and presentation standards. These rules are set by AWEX via its members. A key feature of these rules is that they often form the defacto basis for the other selling systems.

AWEX's role also includes operating the industries Market Reporting and Quality control systems. These obviously require significant sales volume to generate the data sets required to accurately perform their purpose. Unfortunately these services do not currently have access to other sale methods.

A number of reasons account for the continued domination of open cry auctions for selling wool in Australia, these include:

- it is a transparent method that provides ready access to all market participants
- the majority of industry infrastructure is based on the auction facilities (e.g. wool appraisal, market reporting, logistics movements and quality control)
- a belief by producers that competition is maximised by this method compared with other systems
- the relatively low cost for conducting this sale method
- the concentration of a wide variety of heterogenous wool types in one location at one time allows buyers maximum choice for fulfilling orders in a specified time frame
- ongoing support for the major industry players for this method (e.g. brokers, buyers, growers and industry organizations).

A quick analysis of these 'success' factors indicates that many are generic factors that would apply to any potential selling mechanism. Therefore, the key issue for the industry in moving into the future is to ensure that open cry systems retain their dominance based on relevant economic factors.

Pass-in rates at auction average around 10% partially due to the frequency of the sales in the major locations (WA, NSW, VIC). However, a significant quantity of private treaty, direct to mill wool and forward/portfolio wool ends up back in the auction system. This reflects wool types that have been unsuitable for their original purposes and is more pronounced in a rising marketing.

The industry is also undergoing major structural change with its key industry players. The role and functions of wool brokers and buyers is being increasingly blurred with the trend towards vertical integration impacting on the selling methods. A number of brokers offer their clients the full suite of selling method (e.g. auctions, electronic, forward sales or portfolio plans, and direct to mill in the case of Elders and Landmark).

In addition to this several buyers have purchased broker front ends to allow them to compete with the vertically integrated brokers and mills offering direct access (e.g. ITOCHU and TW Green. Australia Wool Network and Belgore). A number of processors also offer direct sales to growers (often this is via intermediary parties like private treaty agents and brokers). The main driver for all of these players is to maintain access to wool supply in a tight supply market. For the brokers it allows them to maintain or enhance their market share by offering their clients a broader range of selling methods.

Unfortunately due to the private nature of the non-auction methods it is difficult to accurately quantify the quantities of wool being sold by these methods particularly via these vertically integrated firms.

Private treaty sales

These sales are characterised by growers selling directly to agents at the farm gate. Sometimes these sales are based on forward prices/production. This method of sale accounts for between 10 – 20% of annual wool sales but varies significantly due to market conditions. In times of good auction prices significant quantities of this wool is 'returned' to the market via auction after being purchased at the farm gate.

Traditionally these types of sales were performed by:

- traders working directly for local processors (e.g. G H Michel, Chargeurs)
- traders sourcing product for a variety of processors/buyers
- traders working directly for wool exporters.

The distinctions between these areas are often quite blurred particularly for the traditional private treaty intermediary (second case above). The characteristics of this system are quite different to the auction system. Sales often involve a full clip as against sequential lots at auction and locations are widely dispersed across the production areas. This form of selling also involves a significant personal element often lacking in the auction. The increased vertical integration by buyers/brokers is putting increased pressure on this form of sale and recent trends indicate a declining importance in the future.

Direct to processors

This selling method has risen steadily in importance over the last decade. This growth has come from a number of sources including processors opening up avenues for direct grower participation or other market intermediaries (brokers and buyers) providing this source to growers via linkages with downstream processors. This source is often marketed on the basis of more information (on processing performance; for growers and the ability to avoid auction costs and sell in a more flexible time frame (independent from rostered auction days in your region).

Most of these sources still rely on the application of existing market chain requirements being undertaken (e.g. pre sale testing, change to industry standards and aggregation by bale lots). However, one system, Fibre Direct (linked to Landmark) provides a novel alternative to this structure. Unclassed fleeces are sent direct to the processor who determines the best processing technique for this wool. This source has attracted significant industry comment since its inception in the 1990's. Unfortunately being a private system throughput figures are unavailable.

Electronic sales

This sale method has attracted the highest degree of industry comment over the last ten years. A number of attempts (starting in the 1980's by Elders Wool bid) have been made by various industry players (Elders, AWTA, AWEX, Landmark, E-wool, individual wool brokers and merchants) since then without significantly increasing the market share of this sale method. Currently AWEX (Eclipse), E-wool, Wool trade (Primores of WA and several other brokers) and a number of smaller web based systems (generally via small industry operators or individuals) are providing electronic services.

The combined market share of these computer-based services is difficult to quantify (most do not provide public sale volume figures) but are estimated at 4
– 5% of annual sales. As with the other non-auction systems, electronic sales have a degree of 'churn' associated with the auction systems. In this case it tends to be post auction with most systems based on variations of either tender or offer board catalogues (tender = sale stops at a set time, offer board = sales are possible at any time).

Generally wool (but also pre-sale or non-auction wool) is placed on these electronic systems after it has been passed in at auction. However, the trend with these systems is towards offering wool lots prior to auction as well as post auction or even independent of auction.

The potential industry benefits for converting to electronic sales are revolutionary. Proponents believe that the current marketing structures could be drastically altered. This includes the move to 24/7 sales without static open cry systems (therefore no buildings, show floors etc). Wool could be sold in larger lot aggregates (e.g. container sizes or mill batches). Sales could be conducted in reverse with the software automatically filling orders based on agreed specifications and using all wool lots available on the electronic system. It would also provide wool traders with more flexible working conditions (e.g office locations and work hours).

Based on past industry experience it is likely to be some time before these changes occur due to resistance from established industry participants. Potentially wool could be sold directly from producers to mills with minimal (logistical support) services required by the existing broker and buyer organisations.

However, as with other systems, a shift in industry sentiment could see a significant increase in electronic sales in the next five years. Eventually the cost benefits from industry rationalisation and improved flexibility and productivity will establish electronic sale methods as the main form of transfer of ownership both within Australia and on the global market because processed wool can be traded just as easily as greasy wool.

Forward sales / portfolio management

Forward sales and portfolio management sales are not in themselves independent sales methods but operate on discrete adjuncts to existing systems. Due to the lack of publicly available sales data it is difficult to quantify the market share of these methods but evidence indicates that throughput is only slowly rising from a very small base (less than 1 – 2%).

Forward sales

This method is often linked with private treaty and direct to mill sales. Producers agree to supply wool (to an agreed specification) at a certain time in the future at a certain price. This method of forward sale may be linked to wool fibres contracts (by either the producer or buyer) but is characterised by the physical delivery of the wool. If the specifications are not reached (e.g. micron is too broad or higher VM%), then an agreed discount will be applied (using a discount schedule that was part of the contract).

The benefit of this sale method is that the producer (and buyer) has managed his risk and has more certainty of supply/sale than with other methods. The transaction costs are usually lower with this method as well. As with other systems a significant percentage of these sales will often end up back in the auction system as agents review their requirements and existing market condition once wool is received.

Portfolio sales

This is really not a sale method but a management process designed to maximise the clips returns. It is similar in nature to portfolio management of share accounts in the equities market. It is offered by Elders and Landmark and to a more limited degree by several other wool merchants. The basis of the process is that a specialised team will 'manage' the clip via considering all available selling options. This may include auction or electronic sales linked with futures contracts, direct to mill or even processing the greasy wool to top stage before sale.

Obviously, the larger brokers can provide a more complete service as they have direct access to all of these methods. The ultimate aim is to maximise the net return in dollars for the clip. This type of service tends only to be offered to larger clients and is often part of an overall client service regime that may include other features like insurance, retail sales and stock sales and husbandry.

The benefit of this system is obvious if it generates the best net return for the producers. However, it is difficult to quantify this result given the multitude of market and external factors that impact on portfolio management system.

9.3 AWEX-ID and pricing

The purpose of this section is to provide an understanding of the AWEX-ID wool description system and its uses within the Australian wool industry. The current AWEX-ID version details are described in Topic 6 – Type and Style.
A frequent characteristic of agricultural trading systems is a publicly and trade accepted common description system for the produce. Examples include ASW for Australian wheat and the various meat industry descriptions. However, in the wool industry a variety of descriptions co-exist depending on the audience and the users. This partially reflects the changing state of the product as it passes through the processing chain and a degree of tribalism amongst certain segments of the marketing chain.

Therefore in the mid 1990's AWEX attempted to create a more widely understood description system that would be useful for all segments of the marketing chain. To date this goal has only been partially successful with grower and broker uptake not matched by significant wool trader/buyer adoption.

AWEX-ID characteristics (see Readings – AWEX-ID 1999.pdf)

The AWEX-ID system is a combination of measured and subjective parameters designed to fully describe greasy wool. The example below demonstrates how a combination is documented.

MF5B.HWW15O11	**M** = merino **F** = fleece **5** = good style **B** = burr as the predominant VM type **H1** = light unscourable colour **100** = estimated fleece length **W1** = part tender wool

In the case of wool with a full set of test results the only additional information that the AWEX-ID needs to provide are for subjective parameters (e.g. MF5B). This description is then combined with the relevant test results for a full product description (e.g. 21.2 micron, 0.6% VM, 36 N/kt, 93mm etc).

AWEX-ID forms the basis of the market reporting systems for both Australia and South Africa. Further development in the future is planned to spread the uptake to New Zealand and South America as well as to increase adoption by the wool processors and buyers.

When used for Market Reporting AWEX-ID and its objective results are converted into a quote type. Similar quote types are combined to calculate average weighted prices for this group. An example of a quote type is described below.

AWEX-ID = MF5S (Merino, fleece, good style, seed predominate VM type) Micron = 21.7 VM = 0.8% Staple length = 87mm Staple strength = 41 N/kt. The lot has no other subjective faults (e.g. colour, cott or dermatitis) therefore the full AWEX-ID description of this lot is **MF5S.21.7, 0.8, 87, 41**

For quoting purposes each of the four major objective variables are converted into a reporting group for market reporting aggregation purposes.

For example: Micron 21.7 - 21.5 (all microns between 21.3 – 21.7)
VM 0.8 - 1.0 (all VM between 0 – 10%)
Length 87mm - 90 (all lengths between 86 – 95mm)
Strength 41N/k t - 40 (all N/kts above 38 N/kt).

Therefore the AWEX-ID quote type becomes **MF5.21.5, 1.0, 90, 40.**

Note that the VM type (S) is also removed from the quote type. On the sale day each quote type of a similar description (often only one for many quote types) is aggregated together and has the clear sale price converted back to these reporting means (e.g. 21.7 micron is converted back to 21.5 micron equivalent). These conversions are controlled by a statistical (regression based) program in the AWEX Market Reporting system.

Currently the AWEX-ID description is applied at various stages within the market chain. Most brokers apply this either at the time of receival or during the lotting/binning stage. This broker description is passed onto AWEX for all auction lots and has to be applied by an accredited wool appraiser. AWEX regional appraisers audit all broker AWEX-ID's for auction sales by reviewing the sale lot bins at each show floor. It is this audited AWEX-ID (if it differs from the broker appraisal) that is used for the auction Market Reports generated by AWEX.

Wool buyers and processors within Australia also have access to these AWEXID results but most are still using their own in house appraisal system. Often they will run a number of these schemes depending on their clientele (e.g. China types for the Chinese market and European types for other markets).

For non-auction sale methods AWEX-ID has also become the standard description method transferred between the buyers/sellers. This includes private treaty, electronic and direct to mill sale methods. However, other description systems also operate for these sale methods depending on the sale originator. The AWEX-ID's supplied for these systems are usually not audited by AWEX regional appraisers.

Summary

The transfer of ownership of greasy wool occupies a major position within the wool infrastructure. Currently this position is dominated by one selling method, open cry auctions, which account for around 80% of all first hand wool sales in Australia. Much of the industry marketing chain is built around the auction sale process in terms of timings, location and logistics control. Open cry auctions benefit from being public, relatively low cost and presently have the best combination of buyers and sellers in the one location.

However a number of other sale methods exist in Australia to support the auction system. In order of activity these are Private Treaty sales, Direct to Mills and Electronic sales. These methods often act as conduits into the auction system with a high degree of 'churn' evident between systems. The main benefit that these systems offer over the auction process is flexibility in terms of timing and location. Electronic sales in theory can operate 24/7 on a global basis.

In the short to medium term it is likely that the current status quo will remain unchanged. However the most likely selling method to emerge as a competitor to open cry auction during this time will be Electronic sales. This will require significant readjustment of existing industry market chain logistics both physical and human.

Glossary of terms

Topmaking	The process of converting greasy wool into wool tops
Value Proposition	The reasons that a company will promote to attract customers (effectively what the company tells its potential customers that it will do for them)
Vertical Integration	The act of being involved at more than one stage in a marketing/processing chain
Wool Tops	Combed slivers of wool with grease, dirt and vegetable matter removed