FORUM

NOTES ON "THE MARKETING OF AUSTRALIAN WOOL"

S. Durbin*

The Australian Wool Corporation’s report The Marketing of Australian Wool, December, 1973, is yet another addition to the continuing debate on wool marketing. It warrants, and has been given, particular attention because it recommends substantial intervention by the Australian Wool Corporation (AWC) in the sale of wool at auction. A stockholding policy has been the conventional form of intervention to be considered, but forward selling and sale by allocation are innovations. In these notes on the AWC report attention is confined almost entirely to post-auction issues. They query whether adequate justification is given for this form of intervention and then seek to determine if the AWC can significantly improve the trading environment for wool.

THE BASIS FOR REFORM

The AWC report locates the lack of competitiveness of wool vis à vis synthetics in two main areas, namely the effect of the unpredictability of wool prices on fibre choice by fabric and garment manufacturers, and the deleterious effects of fluctuations in the price of semi-processed wool products. It is certainly true that the report has touched upon important issues, but it will be argued here that the documentation of these is inadequate. To agree with the hypothesis that the current marketing system is failing the reader will or should be looking for a detailed study of those aspects requiring improvement. Some of these aspects are now considered for the purposes of clarification.

(i) WHO DECIDES FIBRE USAGE

There is a need, in the first instance, to indicate the extent to which manufacturers and retailers can and do modify consumers’ choice of fibres. It is not surprising that manufacturers have a good deal to say about fibre choice, but to devote one paragraph (on p. 50) to saying that the consumer’s contribution is minimal, justifying this with the statement that this is “well documented by market research” is unsatisfactory. The more consumers dictate this choice, the less freedom manufacturers have in choosing the fibre which is to them more suitable, and the less important is their decision. It would be interesting to know whether the distribution of promotional funds by the IWS conforms

* Economist, N.S.W. Department of Agriculture, Sydney.
to the attitude: "It is on the textile machinery of these influential manufacturers that inter fibre competition is resolved." (p. 4.) A more positive comment would be to note that influencing consumers’ preferences by increasing the advertising budget may be superior to introducing price predictability for manufacturers by intervening at auction—at least for equal financial outlays. There is certain to be some sort of trade-off.

A summary of the bargaining process between manufacturers and retailers on the one hand and consumers on the other including advertising costs would be more informative and convincing. The process will be complex as consumer requirements must be predicted well in advance and a short-term lack of choice on the part of consumers (i.e. nothing suitable in the shops) does not imply a long-term lack of choice. Presumably, as processing continues manufacturers and retailers are also increasingly constrained in the range and quantity of products they can make available for sale.

(ii) PREDICTABILITY OF WOOL PRICES

Again the report needs to indicate the time period over which wool prices would need to be known in order to encourage manufacturers to use more wool. The key reason given for the necessity of predictable auction prices over the next 6–8 months is the need for fabric and garment samples to be accompanied by a fixed price (p. 54). That a fixed price should be required 6–8 months before retailers need to make decisions about placing orders seems strange, but is not amplified.

The present author is not particularly conversant with this stage of the textile industry, but it does seem that manufacturers produce both to order and to stock, and the proportion of each also influences the need for price predictability. Where retailers require prompt delivery of purchases—either when samples are shown or 6–8 months later—manufacturers must hold stocks of their final products thereby introducing risks not only of price movements but also of the quantity and type of products required. The price that the retailer pays will presumably include the cost of carrying these risks, and, to the extent that the price component is important, price predictability will improve wool’s competitive position. With production to order and delays in delivery, manufacturers can delay purchases of raw materials thereby reducing or avoiding the price risk.

This argument would apply to each stage of the textile industry. Thus, in the European situation where wool takes over 1 year to process, the current requirement for price predictability in retail orders is that wool products must be ordered by retailers over 12 months in advance of their sale in shops. The more the retailers wish to defer the decision to order and so, amongst other things, allow better forecasts of consumer requirements, the more the textile industry must act in anticipation of their requirements—with a consequent rise in the price risk. Whether the effect of price predictability on fibre content is more important in the initial setting of fashion trends than in subsequent ordering procedures is unknown. It would also seem relevant to stress the retailer’s confidence
in his ability to reorder popular lines at a later date at relatively constant prices. If all three effects are important prices may need to be predicted for well over 12 months—a staggering task for the AWC to undertake.

Even if some level of predictability is possible, the extent to which the increased knowledge of wool prices will contribute to wool usage is still unanswered. And if the risks associated with an evaluation of the quantity and type of products to be purchased by consumers are more important to manufacturers and retailers than price risks, then a market intelligence service at the retail stage would seem to be more desirable than intervention at auction.

(iii) FLUCTUATIONS IN WOOL PRICES

It is also argued that fluctuations in auction prices place wool at a commercial disadvantage. That would not be contested, but it is desirable to give some indication of how costly are the methods currently used for avoiding or carrying the risk that price fluctuations engender. These costs have to be compared with equivalent costs to the AWC, since the AWC wishes to assist in carrying this risk (section (b), p. 8). The statement on page 63 that most short-term factors are random and that attempting to model short-term price formation is unrewarding may be a reflection of the elementary nature of wool marketing research. Otherwise it suggests that the AWC has only a limited ability to control or predict the supply conditions for wool products at retail by intervening at auction because the random factors substantially complicate the relation between the two. In this case any action at the auction end of the marketing chain may be suboptimal.

In the report there seems to be some confusion as to whether the textile industry wants future auction prices to be known or stable, or some combination of both. At retail the emphasis is on predictability. At intermediate stages the argument is less clear although it is claimed that “the main disadvantages of fluctuating wool prices is the uncertainty created in assessing future price movements” (p. 66). If predictability is more important than stability then a policy of collection and dissemination of information is an alternative to direct intervention. The claim on p. 73 or on p. 79 of the report that direct trading will improve information flows may be true in some circumstances, but it is easy to visualize conflict situations where the trade divulges the minimum. It is also possible that indirect forms of intervention may call forth even better information. Indeed, since there is no intention of defying long-term trends, it is difficult to see how the proposed policies can introduce long-term predictability. And yet it is these major upturns and downturns which are the most damaging.

(iv) COMPARISONS OF WOOL WITH SYNTHETICS

These topics introduce another point which requires clarification. If more time and more processes are involved in making wool garments relative to synthetic garments then it is correct that this tends to place
wool at a disadvantage. But it does not follow that the effect is avoidable or that intervention at auction is necessarily desirable. And the comparisons need to be very carefully stated so as not to imply that firms in the wool trade are automatically inefficient. As an example of this we read "... the disadvantages under which wool competes with synthetic fibres become apparent ... but generally improvement can be achieved only by introducing significant changes to the marketing system itself" (p. 76). The additional spatial and temporal separation between the decisions to produce and to consume wool does introduce complications such as having to make forecasts further in advance and having to summarize the effects of other intermediate stages of processing. There is little meaning in regarding these complications as inefficiencies.

LIKELIHOOD OF SUCCESS OF AWC PROPOSALS

Inadequacy of documentation may not be regarded as a particularly damaging criticism of the AWC report. Some may argue that it would be nice to justify more fully the AWC recommendations, but, in the absence of that, a decision for or against intervention still has to be made. Some comments should therefore be made about the likelihood of success of the AWC proposals. If the AWC wishes to implement a short term price stabilization scheme to users rather than a price stabilization scheme to growers then it is in fact implying that, in some sense, the wool trade is inefficient relative to itself. The conclusion that the current system is "failing" (p. 4) relative to some ideal marketing system (in this case that for synthetics) is not a sufficient reason for reform; rather the activities of the wool trade must be compared with those of the Wool Corporation.

The objective of the AWC of intertemporal trading is also an objective of firms in the wool trade. Whether significant differences exist in the rate of discount or in the level of risk aversion is debatable. To be fair, one must decide if the limitation of a large proportion of trading activities in the future to within 8–9 months (which appears in trade in wool and tops) is unnecessary, or whether firms have learned from experience that it does not pay to trade further ahead. The proposition that the wool trade is relatively inefficient may be suggesting that the AWC is better informed in that they know what is the "right" price for a particular time period; this contention is unlikely to be true as published data series are only a small fraction of the material needed to summarize trade activity. It may be possible, of course, for data series to be transferred directly to the AWC but the author has no evidence of this.

The proposition may suggest that the AWC is financially stronger, but with continued horizontal integration in the wool trade this becomes less important. It may be argued that the "right" flow of wool onto the market can be better achieved by the AWC than through the stockholding practices of the trade. If the costs and risks of storage are properly imputed and remembering that warehousing facilities at combing mills are normally used at no extra cost, then given similar objectives the question again becomes one of information.
What seems to be the remaining inference from the hypothesis that the trade is inefficient relative to the AWC is that there is a lack of competition in the textile industry—though there is little comment on this subject in the report despite its crucial importance. Attention is usually drawn to reductions in the number of firms operating. This has important theoretical implications (viz. the invalidation of the perfect competition assumption), but it does not immediately imply that collusion or supernormal profits exist.

Moreover, even if there is a lack of competition it does not automatically follow that inefficiencies can be overcome by intervention at auction. To determine the optimal approach for increasing competition the reasons for the lack of it must be found. It is due to incomplete information then where AWC decision rules add yet another uncertain factor, demand at auction may not be increased: speculation on these rules will be substituted for speculation on wool prices. Intervention at auction also presumes that growers are in a strong bargaining position vis à vis the trade. Given the availability of substitutes in the form of synthetics, this is immediately suspect. There also seems to be little reason why buying at low prices and selling at high prices is the appropriate sequence for discouraging collusive behaviour.

If one assumes that the wool trade is competitive, it can be argued with some degree of certainty that the proposed activities of the AWC in relation to inventory control and forward selling (if insisted on being profitable) will not bring about significant improvements in wool marketing. The caveat "if the trade is competitive" is important since if all the resources used in the wool market are allocated competitively then the least cost environment is attained and no reallocation by firms within the trade or by an organization with monopoly power like the AWC can yield greater overall benefits. If it is more fruitful to think of the wool trade as an imperfectly competitive environment, the comments on the resource endowment of the AWC still apply, but the outcome of AWC intervention is less clear-cut. A quantitative model of the wool marketing chain is required which can include information on the cost and quality of marketing services provided by the AWC together with some description of the nature of their interaction with the trade.

CONCLUSIONS

The implication of these notes is that the AWC report does not provide adequate justification for the implementation of its proposals. The report does however attempt to come to grips with the dynamics of the textile industry. Yet it is the very complexity of the industry which necessitates caution in accepting the conclusions of this introductory investigation.

The present author has also been involved with an introductory study (published as a report to the AWC)—in this case on the more limited question of the contribution of Australian buying and European top-making firms to price formation. While the resulting report does not
confirm the view expressed in the AWC report that the (price?) speculative activities associated with wool merchanting have increased both the instability and the uncertainty of wool prices (p. 78) neither does it refute the contention in an unambiguous way. Lack of data precludes a quantitative analysis. Further, views such as those in the AWC report they may appear plausible at an aggregate level, but give little insight into the activities of firms which give rise to the effects being discussed.

With an absence of both descriptions of the activities of firms within the textile industry and detailed statistical material at various levels of aggregation, the AWC report cannot be expected to satisfactorily answer the questions that it raises. Even if the AWC recommendations are accepted and implemented, the building of a model of the wool marketing chain should be continued so that alternative AWC strategies can be compared in a more rigorous way.