MARKETING STRATEGIES FOR RAW COTTON

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Market Overview

Macquarie Agribusiness report on the market for Australian raw cotton includes an overview of the Australian and world cotton industry. Some key points are:-

* Australia's cotton industry has grown rapidly since its first significant production in the 1960's. Originally supplying only the Australian spinning industry, its focus has since become increasingly export oriented. Now over 90% of Australia's raw cotton is exported.

* Australia was the fourth largest exporter in 1990/91 after the USA, CIS and Pakistan, accounting for 7% of total world exports. However, Australia accounts for a much higher proportion of the world exports in better quality, medium staple types.

* The Australian domestic market is largely unchanged in volume terms. Rationalisation of the local spinning industry has ensured the viability of those companies which have modernised their plant and lifted productivity. However, further reductions in industry assistance for the TCF sector is a threat to the domestic market for cotton.

* The major raw cotton exporter is the USA. It has the size and scope to increase its supply, lower prices or increase its exports. Of total world production, approximately one quarter is traded. The USA accounts for one third of world exports at present and this share is projected to increase to 40% by the year 2000.

* World prices for cotton are volatile and will continue to be difficult to predict. Whilst demand is relatively stable and growing, supply can vary sharply. World prices tend to reflect, inversely, world stocks. Returns to Australian growers are also affected by the AUD/US$ exchange rate and the "basis".

World Market

The world market has the following features:

* Cotton is the world's most important non-food crop, and is an extremely important commodity in economic, political and social terms.
World cotton consumption has increased substantially in the past three decades, and is currently increasing at 2.8% per year.

Most of the world's mill use of cotton occurs in the developing countries (66%), with the developed countries (22%) and CIS / Eastern Europe (12%) accounting for much smaller shares.

Most of the growth in world raw cotton consumption is occurring in developing countries, and this is expected to continue.

World raw cotton imports have also been increasing. In recent years, developing country imports have increased substantially, whilst developed country imports have changed little.

The major growth in raw cotton imports in recent years has been in South East Asia, and this is expected to continue to be the case in future.

Cotton's share of the world fibre market declined from 1960 to the mid 1970's. Since then, it has fluctuated at around 50% or slightly below.

As Australia has increased raw cotton production over the past two decades, a steadily increasing proportion of production has been exported and exports now account for around 90% of production. With no significant growth in the local market expected, exports will comprise an even larger share of production as the crop expands further in future.

The great majority of Australia's raw cotton exports have been shipped to Asia, with relatively small and spasmodic supplies going to Europe.

The major growth areas for Australian exports are expected to be in South East Asia, especially Indonesia and Thailand. There is potential for new export markets in Indo China, especially, as well as other areas, such as Burma and South Asia.

**Australian Cotton Marketing**

The Australian marketing system is characterised as follows:

The profile of Australian cotton growers varies between small farmers, large corporate farmers, farmer / processors, and farmer / processor / marketers. Australian cotton is primarily marketed by the processors. A small group of merchants, mostly with international affiliations, also play a role in the market by offering to buy on an opportunity basis and offering cash.
Australian growers use financial risk management techniques including cotton futures on the New York Cotton Exchange, and currency hedging. Many growers rely on pool arrangements to spread their risk, as they do not want to invest time in the more sophisticated techniques available.

The Australian cotton marketing system operates successfully in clearing the crop, and in providing details on world price and exchange rate information to sellers.

Australian cotton marketers (and growers) accommodate substantial price and exchange rate volatility by using financial risk management techniques, including futures and currency hedging. Some marketers also offer pooling arrangements to growers for averaging returns.

**Classification**

Turning to cotton classification:

* The Australian crop is properly classed, graded and paid for under the long standing traditional classification system. However, HVI objective measurement testing and payments to growers on this basis, will allow the market to pay growers for the true spinnability performance of their cotton, including use of a more sophisticated approach to premiums and discounts. We recommend that the Australian industry strive to be at the forefront in adopting these testing practices.

* From 1992, virtually all USA cotton will be HVI tested by the USDA. HVI testing will be used to provide a series of measurements by which growers, processors, sellers and buyers can agree on a range of specific qualities. Purchasing countries are introducing HVI facilities to enable them to cross-check the USA results.

* Australia already has a number of HVI lines in operation by cotton processors. About half the Australian cotton is now tested by this equipment. But growers are not yet paid on the basis of HVI results.

* To compete successfully on the world market in future, a market in which the buyers seek objective measurement and HVI testing, and in which the dominant exporter is using HVI testing, it is obvious that Australia will have to market its crop using HVI testing as well.
Conclusions

Macquarie Agriculture’s report concludes that our cotton industry’s:

* Production has been increased by the new varieties developed. Australian yields are amongst the highest in the world, due to the large proportion of cotton grown by irrigation and the new high yielding varieties.

* Clearly, Australian raw cotton, overall, is well regarded by overseas and Australian spinners. To enhance its existing good reputation for being a quality product, it needs to be a little finer (whilst maintaining strength) and a little longer, and to have less short fibre content.

* In terms of competition, Australian cotton will need to continue to compete for a viable share of the international trade in raw cotton, although there is no suggestion it will have trouble selling its current potential crop volume.

* Before formulating future marketing strategies, it is necessary to consider not only the current situation and trends, but also the strengths and weaknesses of the Australian situation and opportunities and threats that may develop and alter the situation.

Marketing Strategies

* The suppliers of raw cotton have a real interest in the survival of a viable Australian spinning industry. Despite the dominance of export sales over local sales, which is an increasing trend, the local market provides a secure sales base, no currency exposure, and provides feedback on spinning needs.

* It is in the national interest, also, to encourage efficient local processing of raw materials.

* The industry has developed promotional material for domestic use through the Australian Cotton Foundation (ACF). The ACF’s functions could be expanded to provide a generic promotion role for use in world markets by the industry’s marketers, and to provide an industry information and analysis service.

* Our cotton marketers have been very successful in gaining market share in the Asian markets and in distributing the Australian crop. The challenge for marketers is to obtain better margins for Australian cotton, based on qualities predicted by HVI testing data.
Recommended Action Plan:

**Cotton Classification and Measurement**

The trend to HVI based objective measurement of cotton is irreversible and accelerating. Benefits from HVI testing will accrue to the industry as a whole, including growers.

Australian raw cotton processors should take steps, which some have already done, to install HVI facilities. The goal should be to have all Australian cotton HVI tested by the 1994 crop. Every bale of cotton should be individually tested by objective measurement. Initially, objective measurement will need to be supplemented with subjective manual assessment.

**Recommendation 1:** All Australian raw cotton should be objectively measured, using HVI testing of every individual bale.

**Action:** Processors and Australian Spinners Committee.
**Method:** CRDC and ACF to discuss and encourage acceptance.
**Timing:** Start now with the aim of having 100% testing by 1994.

Cotton growers should be paid on the basis of HVI objective measurement of their cotton, to ensure they are fully rewarded for the qualities of the cotton they supply. Naturally, there is a threat of discount where the qualities are not present. On balance, the reputation of Australian cotton will be enhanced and growers rewarded for supplying premium quality. Marketers and merchants, should monitor the USA cotton industry’s moves in this direction and develop marketing around the benefits to spinners of having HVI tested cotton.

**Recommendation 2:** The Australian cotton industry should adopt the system of paying growers on the basis of HVI objective measurement of their cotton.

**Action:** (a) Processors / Marketers and Merchants to implement.
(b) ACF to monitor HVI based marketing in the United States.
**Method:** CRDC to discuss.
**Timing:** By 1994.

The industry has divided views on how testing should be carried out. In the United States it is done by the USDA. In our Asian markets industry associations are providing the facility to members. Most Australian processors and shippers already have HVI lines. The Australian wool industry has a private company (AWTA Ltd) which carries out the work.
To achieve testing economies of scale, it may be an advantage to have a separate industry company to be responsible for conducting the HVI testing, or, at the very least, a single entity should be given responsibility for co-ordinating all cotton testing. The former would achieve uniformity of testing between shippers and facilitate liaison with overseas testing authorities to ensure testing methods and results are consistent with those of customers and with international standards.

**Recommendation 3:** Responsibility for co-ordinating Australian HVI objective measurement standards should be given to a single entity, preferably the ACF.

**Action:** ACF and Processors.
**Method:** ACF and RCMAC to discuss.
**Timing:** Immediate.

There are only two HVI machinery manufacturers in the world and both are working to capacity. Orders for new HVI lines should be placed as soon as possible.

**Recommendation 4:** Australian processors and marketers/merchants should plan their requirements for new HVI lines, as soon as possible, bearing in mind that spinners and researchers may also wish to purchase additional equipment.

**Action:** Processors, and other HVI line buyers.
**Method:** A co-ordinated approach may achieve a better purchase price.
**Timing:** Start now.

Important research into objective measurement of cotton is continuing in various countries, including Australia. For example, newer faster tests have been developed by overseas test equipment suppliers for honeydew contamination and maturity.

**Recommendation 5:** The Australian industry should not await overseas developments in HVI testing but should increase its participation in the development of new HVI testing methods and machinery.

**Action:** CRDC and Fibre Research Institutions.
**Method:** (a) ACF and CRDC to discuss.
(b) Australia should be represented on the ITMF’s International Committee on Cotton Testing Methods (steps are being taken in this direction).
**Timing:** Ongoing.
**Costs and Benefits of 100% HVI testing:**

**Costs:** Additional cost to Australian cotton growers: 0.5% to 1.0% of bale value.

**Benefits:** Price premiums of 2% of bale values reflecting:
- Spinning efficiencies
- Ginning efficiencies.
- Improved market share in key export markets.

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**Cotton Industry Organisations**

The free market system for marketing Australian cotton operates effectively in terms of buyers' and sellers' knowledge of prices, choice of who to deal with and options on how, when and to whom to sell. The industry should retain this system. It does not need a statutory marketing authority.

The role of major industry organisations was analysed and proposal made to reallocate functions.

Marketing Australia's raw cotton comprises a number of roles which the key organisations are involved in to varying degrees. The actual selling and distribution is carried out by the processor/marketers and several international merchant firms.

Issues of product promotion, advertising, market research and product development of Australian raw cotton is primarily carried out by these firms in respect of their own product. They consider no generic, industry wide marketing organisation (such as Cotton Inc. in the USA), is necessary. Success to date in developing overseas markets tends to support this claim.

The spinning industry in Australia and overseas has commented that it has little contact with growers in respect of communicating market trends and requirements. Spinners Industry Associations in key market areas reported very little or no contact with Australian suppliers. Australian marketers deal directly with customers and not with the industry body. Australia's reputation as a supplier is improving steadily and could be enhanced by industry level contacts.

However, there is scope for expanding the role of ACF to include additional functions. This includes two functions which are currently conducted by RCMAC (industry-government information exchange and cotton sale standards). It would also include providing industry wide or generic information and analysis on industry matters and markets, to complement the plentiful supply of market information available from commercial source.
Reco, ,u, ,endation 6: Consideration be given to expanding the role of ACF to include the additional functions:

- Industry-government information exchange.
- Cotton sale standards.
- Objective measurement coordination and responsibility.
- Industry and market information and analysis.

**Action:** ACF and RCMAC.

**Method:** CRDC to discuss.

**Timing:** As soon as possible.

The future role of RCMAC needs to be examined now (see Section 7.3). Our preference is that RCMAC cease, but if it continues, its charter should alter.

**Recommendation 7:** Consideration be given to abolishing RCMAC (or at least amending its charter if it is to continue).

**Action:** RCMAC and ACF.

**Method:** CRDC to discuss.

**Timing:** As soon as possible.

**Future Export Markets**

East Asia will continue to account for the majority of Australia's raw cotton exports for the longer term. However, markets within East Asia are dynamic and some countries will account for a declining percentage share of our cotton exports, whilst others (such as Indonesia and Thailand, and in future Vietnam) will account for an increasing share. Although it may be trite to say so, marketers will need to continue to monitor market trends in future and alter their targeted marketing efforts accordingly.

**Recommendation 8:** Marketers to continue to monitor constantly the underlying and changing demand factors in current and potential export markets.

**Action:** Processor/Marketers and Merchant

**Method:** Normal commercial market intelligence sources and the industry wide service recommended to be, provided by ACF covering industry and market information and analysis.

**Timing:** Ongoing.
Domestic Market

The concern over the likely decline in the domestic market for raw cotton following the decision to accelerate the reduction in protection for Australia's textile and clothing industries should concern cotton growers. Whilst the size of this market is shrinking in relative terms it is still a significant market, and has benefits beyond the quantity purchased.

Recommendation 9: Cotton growers and processors should consider supporting a more gradual restructuring process to allow domestic manufacturers the chance to rationalise and survive as long term cotton buyers. They should actively support any investigation of other significant means of establishing cotton based industries. CRDC should consider increasing its level of support for research into textile manufacturing and new product development.

Action: (a) ACF and Australian Spinners Committee.
(b) CRDC
Method: CRDC to discuss.
Timing: Immediate, ongoing.

Industry Promotion

The industry promotion role should continue to be carried out by ACF. However, there is scope for ACF to expand its promotional activities.

Recommendation 10: ACF continue and expand its industry promotional role.

Action: ACF.

Method: CRDC to discuss.

Timing: Ongoing.
Costs and Benefits of Promotion:
Costs: Increase ACF levy by 30c/bale
Benefits: Enhanced reputation and opportunities for Australian cotton providing premiums in long term of an extra 1%.

Monitoring and Evaluation:
The additional funds to be raised for market promotion and development by the ACF should be managed by the ACF Board. An independent survey of the results achieved should be undertaken annually to determine the level of market development funding for the following year.

Brand Promotion

The industry should retain varietal names and use them heavily in promoting Australian cotton. The corollary of this is varietal names should be promoted on an ongoing basis in the market place, rather than changed each time an improvement to a variety is bred and released. This will serve to strengthen product differentiation of Australian cotton in international markets.

Recommendation 11: Varietal brand names should be retained and used to differentiate Australian cotton in the market place.

Action: (a) Processors/Marketers and Merchants
(b) Plant Breeders

Method: ACF to discuss and encourage

Timing: Ongoing

Export Market Promotion

We noted that Austrade offices in key customer countries had not had any involvement with promoting Australia’s raw cotton exports. This is in sharp contrast to market research, introductions, promotions, and literature supplied for other Australian agricultural commodities. Cotton markets have operated successfully without this assistance. However, it seems cotton’s profile would be lifted if promotional material were available at relevant overseas Austrade offices and Austrade marketing people were at least a listening post in overseas markets for Australian cotton.

Recommendation 12: ACF send promotional material to key Austrade offices in major cotton buying centres. Consideration be given to any role Austrade could play, at minimal cost to Australian shippers.

Action: ACF.
Method: CRDC to raise issue at the 1992 Cotton Conference.
Timing: Next 3 months and ongoing.

Bale Covers
Spinners have expressed a clear preference for having cotton bale covers made of cotton, to reduce environmental disposal problems (by avoiding having to dispose of non-biodegradable covers) and to lower contamination of lint. Provided the spinners are prepared to pay for any extra cost of cotton bale covers, this is a justifiable request.

**Recommendation 13:** Consideration be given to using cotton bale covers for all Australia's raw cotton, and to use this as a marketing edge.

**Action:** Processors/Marketers and Merchants.

**Method:** ACF and Australian Spinners Committee to discuss.

**Timing:** As soon as possible.

**Contract Marketing Arrangements**

It is common in various grain, meat, fruit and vegetable processing industries for processors (e.g. Uncle Toby's, Edgells, Goodman Fielder) and consumer outlets (e.g. McDonalds) to enter into direct contracts with farmers to supply their specific needs. Typical constraints specify seed used and product quality and size.

Cotton users state they often receive cotton which is not as good or is "too good", for their specific needs. Custom (or contract) ginning is now being revived in the USA. Custom ginning and contract growing may provide price premiums for growers and cost savings for ginners in specific cases.

**Recommendation 14:** Ginners and growers should develop a dialogue with spinners to investigate prospects for custom ginning and, in some cases, contract growing.

**Action:** ACF and Australian Spinners Committee.

**Method:** Spinners to provide details of requirements and likely payment terms to growers.

**Timing:** As soon as possible.

**Plant Breeding**

It takes plant breeders about 10 years to develop a new commercial variety. To date, successful results have concentrated on:

- Higher yields
- Greater strength, fineness and length
- Pest resistance
Yield will continue to be the prime interest for growers. However, the adoption of payments to growers based on HVI tests will ensure new price structures develop which will reflect qualities now not included, or only partially reflected, in the price.

**Recommendation 15:** Australian researchers in plant breeding should be kept fully informed of these developments in a formal structure by marketers.

**Action:** ACF, Cotton Shippers Association, CSIRO and State Agriculture Departments.

**Method:** Periodic meetings for this purpose to be arranged by the above organisations.

**Timing:** Ongoing.

**Research Continuity**

Varietal improvements by Australia's plant breeders have had a significant impact on lifting the reputation of Australia's cotton quality in recent years. It is of great importance that Australia's expertise in the plant breeding areas is not allowed to diminish.

**Recommendation 16:** CSIRO and relevant State Agriculture Departments should have succession plans in place to guarantee this advantage is not lost as key staff retire or move to other areas.

**Action:** CSIRO and State Agriculture Departments.

**Methods:** CRDC to raise the issue with relevant research organisations on a periodic basis.

**Timing:** Ongoing.

**State Agriculture Departmental Advice**

Cotton growing in Australia has shown steady growth and, considering the volatility of Australian agriculture generally, has had a relatively stable history. The recent problems in the wool and wheat industries have led to a rise in dryland cotton growing. In 1991, the severe drought and falling cotton prices slowed this move from other sectors to dryland cotton. There are concerns that excessive expansion in future could cause strains in the market and on research and development resources.

Improved prospects for grain prices in 1992, coupled with the lower cotton price outlook, should slow this trend.
Recommendation 17: The cotton industry should request greater inputs of staff time by New South Wales Agriculture and the Queensland Department of Primary Industries to ensure primary producers who are considering growing cotton are well briefed on the commercial and agricultural risks before committing themselves.

Action: NSW and Qld Agriculture Departments and ACF.
Timing: Ongoing.