PRODUCTIVITY COMMISSION REVIEW INTO RURAL RESEARCH AND DEVELOPMENT CORPORATIONS

WOOLPRODUCERS AUSTRALIA

JUNE 2010

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1 INTRODUCTION

The following paper is in response to the 2010 review into Rural Research and Development Corporations (RDC's) by the Productivity Commission. The submission is on behalf of WoolProducers Australia (WPA), which is a national body representing the interests of Australian woolgrowers.

The submission has been prepared by WPA on behalf of its members.

While woolgrowers will often pay levies to a number of RDC's due to multiple commodities contributing to their enterprise, most of the specific comments in the submission relate primarily to the wool industry RDC, Australian Wool Innovation (AWI).

AWI is owned by Australian woolgrowers as its shareholders. AWI initiates, commissions and delivers research and development (R&D) to Australian woolgrowers through alliances and contracts and, where possible commercialises R&D outcomes. AWI also provides trade development and marketing services on behalf of Australian woolgrowers.

AWI's main source of income is the wool levy collected by the DAFF Levies Revenue Service. The levy rate is currently two per cent of the sale price received for shorn greasy wool. The Commonwealth Government also contributes funding for eligible R&D projects.

WPA critically assesses the activities and governance of AWI, while also contributing to its programs where appropriate.

WPA has also sought to provide additional information to the Productivity Commission through investment in a submission by the Australian Farm Institute (AFI). The AFI paper has been funded by a number of rural industries, including woolgrowers through WPA.

2 EXECUTIVE SUMMARY

WPA recognises the core funding principle of the rural research and development system – being the collection of a compulsory levy combined with public funding to address areas of market failure – as essential, and should be part of any future model.

We believe this mechanism and the system it is part of serves rural Australia and the broader economy well. WPA does not support a reduction in Commonwealth funding for rural research and development or a return to government ownership of RDC's. However, WPA does not believe that elements of the current model optimise the return on investment that it is capable of.

Industry Owned Corporations (IOC) such as Australian Wool Innovation (AWI) have a mix of governance procedures, rights and responsibilities that come from the corporate, public and political spheres. The concern of WPA is that together these are not interacting in a way that maximises levy payer returns. In the case of AWI, the company has become highly politicised, thus undermining its activities and diverting resources from the company objectives.

RECOMMENDATION

1. *That an external review of AWI structure and governance model be conducted, with the aim of introducing an improved governance regime.*
2. *The introduction of a skills based board within AWI, with an independent recruitment process to select directors that are measured against a set of criteria for each position, to be confirmed (or rejected) by levy payers.*
3. *Limited terms for directors in AWI.*
4. *Term lengths for director in AWI that are in accordance with best practice governance.*

In response to ongoing perceptions of conflicts of interest within the AWI board, WPA supports an independent inquiry to resolve this issue to the satisfaction of investors.

RECOMMENDATION

5. *That an independent inquiry be held into the concerns of conflicts of interest within AWI board and management.*

The politicisation that has occurred in RDC's such as AWI has also occurred because of a lack of clear direction as to what the role of the company is and isn't, and through the opportunity of directors to selectively go beyond the intention of statutory funding agreements by relying on general 'cover-all' clauses.

RECOMMENDATION

6. *The development of a clear definition of agri-political activity for inclusion in statutory funding agreements with the objective of excluding political, policy development or lobbying objectives.*
7. *Implementation of tighter controls in statutory funding agreements and constitutions, to enhance appropriate use of grower funds and minimise the subjective interpretation by boards of general clauses.*

A consistent problem for AWI has been the perception of the company by itself and the industry – a criticism highlighted in successive performance reviews. While the actions of the company and the process for the selection of directors have no doubt contributed, a further problem is the way in which AWI relates to, and consults with, its shareholders.

RECOMMENDATION

8. *That improved reporting and consultation mechanisms are developed for AWI.*

WPA is committed to the continuation of a wool specific, industry levy funded research and development corporation. However, WPA believes that the system could be strengthened and limited resources better utilised through better improved collaboration between rural RDC's.

RECOMMENDATION

9. *The commonwealth investigate how commodity specific levy funded R&D companies can share physical and intellectual resources, including the potential for co-location.*

As institutions such as the CSIRO have been impacted by funding cuts and had priorities diverted to cross-commodity research priorities, the need for the retention of commodity specific research is heightened. With state departments increasingly downsizing their commitments to research and extension, while increasing their role as regulators, WPA contends that efforts should be made to protect key research assets for the future.

RECOMMENDATION

10. *The commonwealth investigate the formation of a National Rural Research Properties Trust to ensure the future all existing research stations.*

The process for setting the levy collected by AWI is expensive, time consuming, and like many other activities within the company has become politicised. There are also significant limitations in the actual degree to which growers can contribute to the process, with successive polls supporting a consistent rate of levy, with the board determining the breakup of funds.

RECOMMENDATION

11. *A review be held on the future of WoolPoll, including, but not limited to:*
    - *Possible alternative means for setting the levy;*
    - *Opportunities for greater determination in the funding split for levy payers; and,*
    - *Role and relevance of 'supplementary' questions.*

The Wool Services Privatisation Act 2000 stipulates that the wool levy is to be collected on all 'shorn wool', and as such it is not collected on any other method of harvesting – which includes fell-mongered wool and biological harvesting – which should be updated to avoid free-riding on R&D outcomes.

RECOMMENDATION

12. *That existing loopholes be closed, so that the R&D levy for wool be collected from all wool regardless of harvesting method.*

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3 ABOUT THE WOOL INDUSTRY

In 2007 the industry celebrated the 200th anniversary of the first shipment of wool from Australia, making it the oldest export industry in our nation's history. Since that time, wool has been an important driver of the nation's economy, for a period being the largest export earner for Australia across all commodities and services.

Today, wool remains an integral part of Australian agriculture, being one of the most widespread and common commodities produced by Australian farms. In excess of 70 million sheep graze over 85 million hectares in Australia, generating exports of $2.3 billion.

Last year the industry produced 363 million kilograms of wool, making Australia the largest producer of wool in the world. Wool accounts for 2% of total world fibre use. Australian wool is primarily utilised in production of knitwear (27% of the nations clip), and men's and women's wovens (60%).

Wool is natural, biodegradable, flame resistant and able to absorb up to one-third of its own weight in water, giving it unique performance attributes for clothing and many other applications. Wool is 50% carbon, which has been captured from the atmosphere via plant material. As a farmed and renewable resource, wool is ideally placed to contribute to a reduced reliance on petroleum based fibres and to decrease the use of fossil fuels utilised in heating.

4 ABOUT WOOLPRODUCERS AUSTRALIA

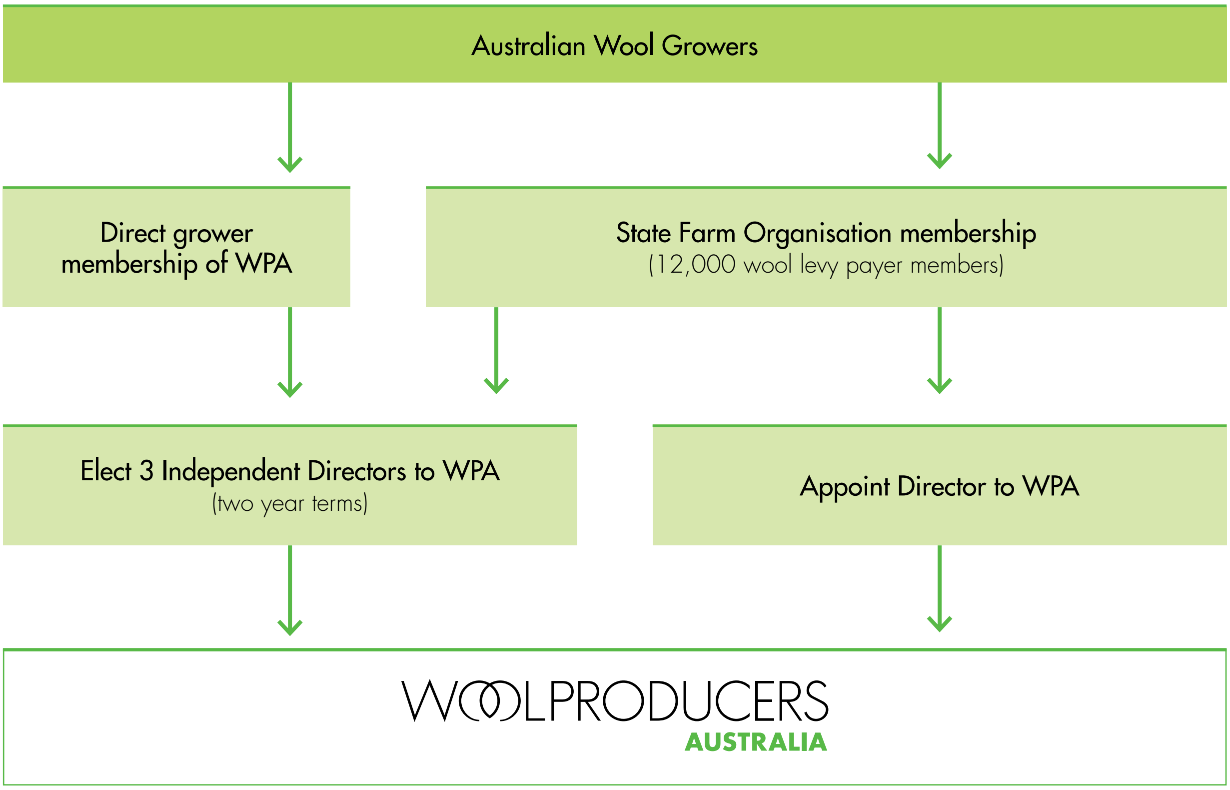
WoolProducers Australia (WPA) is the peak national body for the wool producing industry in Australia, representing farmers whose primary business is growing wool.

WPA is the national voice on behalf of producers, advocating their interests to both the Federal Government and internationally and providing a strong, unified voice that enables woolgrowers to determine policy and drive change in their industry.

WPA is led by a National Executive made up of woolgrowers from around Australia. Each state farmer organisation member is represented on the Executive, while another three members are directly elected by growers Australia-wide. Democratically elected independent members gives anyone involved with wool growing in Australia the opportunity to be a part of the leadership team. This sets WPA apart from other grower groups and gives it the mantle of the true democratic voice of the Australian wool industry.

This structure is also unique amongst other similar livestock representative bodies in Australia, to which membership is often only available through state farmer organisations. WPA is the only national organisation that can speak on behalf of the mainstream wool industry and represent the concerns and hopes of wool growers.

MEMBERSHIP PATHWAYS OF WPA AND GOVERNANCE STRUCTURES



WPA plays a key role in working with the companies that are funded by grower funds – whether they are compulsory levies or fees for service – to develop constructive and profitable outcomes for industry. WPA carries the responsibility of appointing a director to the Australian Wool Exchange and the Australia Wool Testing Authority, promoting good corporate governance and ensuring that the interests of growers are paramount.

WPA maintains a close working relationship with Australian Wool Innovation (AWI) as the voice on behalf of their shareholders. WPA aims to contribute to AWI's programs for the benefit of growers, promoting responsible use of levy funds and ensuring good corporate governance.

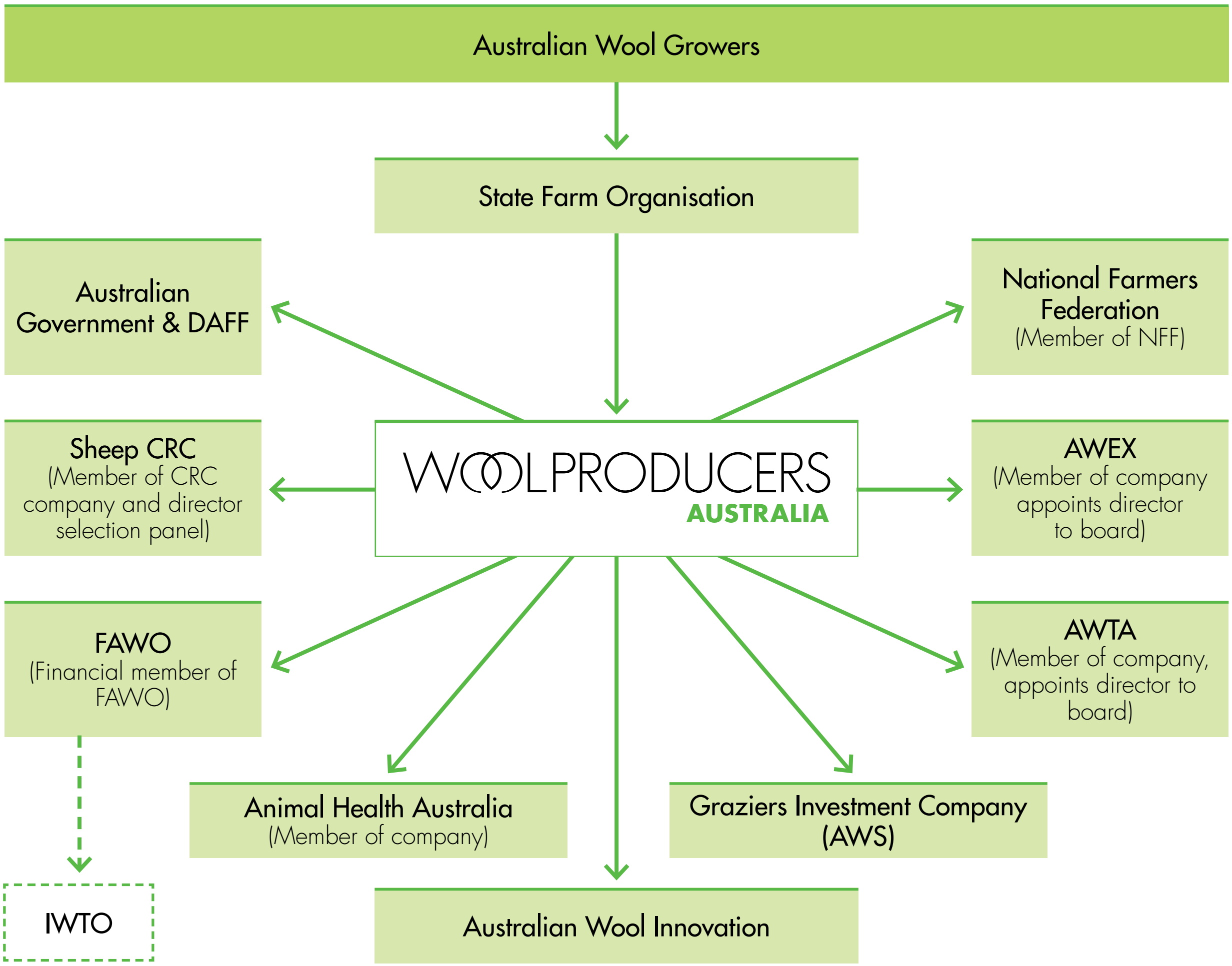
WPA is the sole wool industry member of Animal Health Australia, and as such, carries a significant responsibility for decision making on behalf of the industry in the event of an emergency animal disease outbreak. WPA also provides advice to AHA on behalf of the wool industry on a day to day basis through its representation on national animal health and welfare committees.

WPA also works closely with the Federal Department of Agriculture, Fisheries and Forestry on key issues such as animal health and welfare, emergency animal disease outbreak preparedness and industry development.

As the only woolgrower organisation with membership of the National Farmers' Federation, WPA is responsible for providing key policy advice on behalf of our members to Australia's peak farm body. The policy contribution to the National Farmers' Federation includes environmental laws and regulations, climate change, water, industrial relations, taxation, international trade issues, economics and training.

The following diagrams demonstrate the roles and responsibilities carried by WPA nationally on behalf of growers and linkages to other key stakeholders.

WPA LINKAGES AND RESPONSIBILITIES TO INDUSTRY



5 QUESTIONS POSED BY PRODUCTIVITY COMMISSION

Why should government provide funding support for rural R&D?

WPA is committed to the continuation of a wool specific, industry levy funded research and development corporation. Further, that there be a continuation of the present commonwealth government co-contribution to research and development activities.

As institutions such as the CSIRO have been impacted by funding cuts and had priorities diverted to cross-commodity research priorities, the need for the retention of commodity specific research is heightened. WPA does not support a reduction in commonwealth funding to wool and sheep specific research and development.

In the absence of government support, individual producers will be unlikely to invest in R&D themselves. As will be highlighted further in this submission, the wool industry R&D corporation, Australian Wool Innovation (AWI) has progressively reduced its investment in on-farm R&D. While there are a number of reasons for this, nonetheless the wool industry faces a number of challenges that must be addressed on-farm, yet it is vulnerable in terms of the investment being made in this area.

There is a constant tension within the wool industry between the competing use of levy funds, being R&D versus marketing and promotion. Government contributions to rural R&D ensure that industry retains a core level of investment in R&D.

The original rationale for government funding support for agricultural research and the establishment of the rural RDC's remains valid. RDC's, such as in the wool industry, still continue to address issues of policy failure first considered at the time of their establishment, including:

- the agricultural sector is characterised by many industries with a large number of producers unable to capture sufficient benefits from R&D they would fund as individuals, which potentially leads to underinvestment;
- the collection of compulsory levies avoids free-riding by some on R&D provided by others; and
- the spillover benefits to the wider community that are not captured by the immediate industry. [1]

With the large number of wool growing enterprises which exist – around 29,000 levy payers of AWI – a collective levy overcomes market failures and allows producers to collectively invest in research.

The Australian government plays a role in directing the investment priorities in accordance with national policy objectives and it therefore leverages the activities of the RDC's. Through investing in agricultural research and development, the government is able to achieve environmental, social and economic objectives of national significance that are related to rural Australia.

1 National Farmers Federation, May 2010.

How important is it that government contributes to the cost of maintaining core rural research skills and infrastructure? Without that support, how specifically would the capacity to adapt overseas technologies to meet the particular requirements of Australia's rural sector be compromised? What role do RDC's play in maintaining core rural R&D capacities?

WPA considers that there is a key role for governments in maintaining rural research infrastructure. The maintenance of assets is not a core role for rural RDC's, however, as highlighted further on, WPA believes that innovative and co-operative structures should be considered to protect the future of assets and physical infrastructure.

In terms of skills and intellectual assets, WPA sees an important role for RDC's in developing and maintaining human capital in the rural R&D sector. This is not an area that has necessarily been developed to its potential in some RDC's.

WPA supports the present requirements for a mandated contribution to higher education through the CRC model. We submit that any future structure for research and development corporations should include this as a requirement within their industry roles and responsibilities.

4. IS THE RDC MODEL FUNDAMENTALLY SOUND?

How effective is the current rural R&D and extension framework, and is the role of the RDC's within that framework appropriate and clearly defined?

Extension of rural R&D activities remains a challenge within the wool industry. Encouraging the uptake technologies and practice proves equally difficult in the periods of high or low profitability as growers either lose sight of the need to improve productivity or are unable to source capital to invest respectively.

RDC's currently make a positive contribution within the extension framework, however, a changing environment whereby state governments are providing less resources for extension activities may well require a new and increased role for rural RDC's.

Are there any reasons to argue that the RDC model is no longer fundamentally sound? Or can deficiencies in the model be addressed through more minor modifications to the current requirements?

Although WPA has raised serious concerns at elements of the governance arrangements with RDC's, we do not agree that this is a reflection on the model at its broadest level. On the contrary, wool growers have benefited from a co-operative R&D model and consider that a partnership between government and industry remains the most effective way to achieve returns to both the industry and community.

Key elements such as a compulsory levy with matching public funding to deliver R&D outcomes that include commodity specific, livestock in general and community wide benefits, remains relevant.

That said WPA considers that the review into rural RDC's by the Productivity Commission is timely. There are elements of the model such as governance, measurement and evaluation of the returns of investment for not just R&D but other activities such as promotion, and extension that all need improvement.

Do the current levy payment and governance arrangements for the RDC's lead to an excessive focus on R&D effort within the 'farm gate' and, if so, how might this be addressed?

On the contrary, while the current governance arrangements within AWI have delivered a decision making and strategy setting group that is dominated by growers and early stage processors, the company has moved its focus away from this end of the value chain and placed a high emphasis on consumer marketing.

WPA considers that a balanced portfolio of R&D, demand creation and industry good activities should make up the investment strategy of a successful rural RDC, however WPA, would be concerned if one section was focused on to the detriment of another.

For example, according to a report funded by AWI and Meat and Livestock Australia (MLA), genetic improvement within the wool industry has been slower than competitive farming activities. Swan et al [2] reports that the merino industry is behind terminal breeds in terms of genetic progress, realising only 30% of predicted gains between 2000 and 2005. The authors conclude that while the broader sheep industry has made 'impressive' gains in genetic progress, the merino industry needs to make a similar jump.

Improved productivity and genetic gain, internal and external parasites (including flystrike protection and mulesing), predation from wild dogs, labour costs and availability, and the high cost of wool harvesting all remain significant impediments to profitability in the wool industry. Obviously, each requires a response from within the farm gate.

Is there an appropriate mix between longer-term and broadly applicable R&D and shorter-term adaptive research, and where in this context should the RDC's be focusing their activities?

The strategic move away from on-farm research has led to the cessation of all 'blue-sky' research projects within AWI, which is of concern to many growers. An element to this approach is possibly the need for directors and management to deliver 'wins' to levy payers, given the political nature of governance arrangements within the company.

At a more concerning level is seemingly limited appreciation by some directors of the intrinsic role of R&D in the company, and need to address market failure.

Within RDC's there should be a balance of research projects and priorities that doesn't skew work towards a shorter term, if solely on the basis of appealing to levy payers. This can obviously have consequences in terms of creating a gap in the stream of innovations coming online in the future and undermining the human capital base, through inconsistent and uncertain access to funding.

Is overlap with the work of the CRCs largely complementary, or are changes warranted to either or both programs to reduce that overlap? Will the new guidelines for CRCs make it more difficult to get new rural CRCs approved and, if so, what are the implications for the future role and activities of the RDC's?

WPA supports the current Co-operative Research Centre (CRC) model as a means for producing research outcomes for the wool industry.

However, WPA is concerned that the strategic direction of the CRC program appears to be moving towards new CRC's over the coming decade and away from repeat industries or initiatives. With the sheep CRC into its second term, WPA is concerned that a failure by a potential second rebid would leave a significant gap in the research capacity of the wool and sheep industry.

Recent changes to the CRC program will have a dramatic impact on the composition of the CRC community over the next eight years. Half of the upcoming funding rounds will be predominantly directed towards funding new CRCs, while the remaining rounds will have a focus on funding new from existing CRCs.

The balance is expected to shift from a clear majority of CRCs being second or third term to a large majority being first term. At present 29 of the 46 CRC's are second or third term: by 2015, 10 of these will be gone; by 2017, 22 will be gone: and, by 2019 all will be gone. With the sheep CRC currently being in its second term, this doesn't paint an optimistic picture for wool industry into the future.

In parallel to this, during 2009 the Australian Wool Innovation (AWI) board put a split of 30/70 percent for 'on-farm' activities against 'off-farm' activities respectively to growers at the WoolPoll, signaling the focus from the industry's research and development company has moved very much towards marketing and away from research. In evidence of this changing philosophy, in 2005 AWI spent $35.8 million on wool production. In 2009 this figure had halved to $18 million.

The decrease in spending on R&D by AWI is also due to declining revenue from lower wool prices over recent years and falling flock numbers – but it nonetheless paints an alarming picture for the future of research and development in the merino industry.

2 Genetic Progress in the Australian Sheep Industry', Swan AA, Brown DJ, Banks RG.

If State Governments continue to wind back their role in R&D and extension, should the RDC's be seeking to fill the gap, or are there private players that could effectively fill this role?

The lack of support by state governments in extension activities is lamentable, and discussion concerning the role that RDC's could play in mitigating this problem should not be seen as a validation of state's underinvestment in rural Australia. Or worse, an invitation for it to continue further.

Many growers would consider that state departments still have an ongoing obligation to industry, particularly as practices and technologies change and methods promoted vigorously by states in the past are now undergoing change – mulesing being a prime example. That said, there may be a role for RDC's if this problem cannot be resolved at the government level.

The role of the private sector in extension has proved beneficial, however, it remains limited. It is also worth noting that the use of private sector support such as farm consultants can vary significantly. This suggests a bias for or against this support by regions or across states, which would in itself require cultural change from growers to be more widespread.

5. FUNDING LEVEL ISSUES

What does the fact that some RDC's have built up significant surpluses indicate about the availability of worthwhile projects to invest in?

The maintenance of a surplus in itself is not a problem – in fact, it is arguably necessary for sound management. RDC's must consider a policy for surpluses that takes into account a contingency for reduced income due to seasonal variability's or commodity prices; costs associated with winding up; obligations in respect to disease outbreaks, etc. This can equate to a large surplus in the eyes of levy payers and stakeholders, despite being justified as part of a rational surplus policy.

Unfortunately, the issue of the level of surpluses within the wool industry RDC has at times become the subject of political discussions and director elections. Improved communication with levy payers about the reason for a surplus and government recommendations or guidelines on surpluses could be of benefit in the future.

A major challenge in respect of surpluses is the absence of clear guidelines, or enforcement of existing guidelines, in respect to increases in projected income. AWI will no doubt meet its obligations over the term of a future statutory funding agreement with respect to the broad directions from WoolPoll on the dollars to be spent on R&D. However, the description by the company of an accumulation of what it calls a 'considerable war chest'[3] dedicated to marketing suggests that increased scrutiny on the acquittal of surpluses may be beneficial.

If the focus of most of the RDC's is on industry-specific and adaptive R&D and related extension, does this suggest that the bulk of the benefits accrue to levy payers?

Although benefits may be argued to be captured in the first instance by levy payers, in reality, they are shared by regional Australia as a whole. A profitable farming sector adds to the capital base of rural and regional Australia, providing more employment and growth opportunities.

6. IMPROVING THE RDC MODEL

Where do the main opportunities for enhancing the current governance regime lie?

Industry Owned Corporations (IOC) such as AWI has a mix of governance procedures, rights and responsibilities that come from the corporate, public and political spheres. The concern of WPA is that together these are not interacting in a way that maximises levy payer returns.

In the case of AWI, director elections are political in nature, yet beyond this element the company is not equipped (or entitled) to behave in a political or policy development capacity. The company exists and receives revenue due to statute[4], yet is not subject to administrative review. Its primary source of governance comes from the private sector, but it is protected from many of the disciplining aspects of the corporate environment.

3 'Target EMI of 1,100 or Bust', the Weekly Times, 3 June 2010.

4 Wool Services Privatization Act 2000.

The reasonably unique nature of Australia's RDC's does mean that there will most likely be elements of these different systems influencing their structures, reporting, interaction with stakeholders and governance. However, this submission argues that at present, the balance does not maximise the return that the public and private investors should expect from AWI.

Some of these problems possibly relate to the application of almost exclusively private sector governance mechanisms to companies such as AWI that have retained public privileges and objectives – combined of course with a political process for the selection of directors. Traditional assumptions, principles and the checks and balances that exist in the private sector are thwarted by the quasi-private models in some RDC's such as AWI, which are exemplified by the receipt of a guaranteed income through compulsory levies or non-contestable matching government funding.

As the structure of RDC's has evolved and moved further away from their statutory beginnings to a corporate model, they have found themselves with reduced external controls. AWI owes its existence to public powers which collect compulsory levies from all wool growers. It is the beneficiary of a measure enacted by government, which is not afforded to others in the private sector. However, it is not subject to administrative review as might be the case for a statutory body.

The primary mechanism for government to influence the behaviour of AWI is through the terms of the Statutory Funding Agreement (SFA), which historically has appeared to be an ineffective and blunt instrument. Outside of the period of negotiation of the SFA, AWI and other RDC's are controlled by their respective boards and shareholders. To date, this has been the approach accepted by government – that is, as companies they are generally responsible for their own affairs in accordance with corporation law.

WPA argues that company law on its own is not an effective means to completely fill the void by the lack of administrative review in regard to the activities of RDC's given they are in receipt of public funds and levies from growers. There are a number of reasons for this.

The concept of shareholder democracy implies that there is a capacity of the individual investors that initially pooled their capital, to accordingly act in concert to protect and promote their collective investment. However, in reality the dearth of shareholder activism in Australia suggests that this capability is overstated. Current academic thought on governance [5] suggests it is likely that any improvement in the regulation of behaviour of private sector management directly attributable to shareholders is more likely due to the increased involvement of institutional investors in corporate governance, rather than from individual shareholders. Unlike individual shareholders, institutional investors have both the expertise and understanding to contribute to good governance, as well as a level of investment to warrant the time and effort involved.

In the case of RDC's, however, this powerful mechanism controlling the actions of the board or management is usually non-existent. In 2008 AWI had around 29,000 levy payer shareholders, with a very limited capacity for large shareholders to influence the management of the organisation. In fact, the largest shareholder in AWI holds less than one percent of the voting entitlement, while the tenth largest shareholder holds one quarter of that of the largest.[6] There is the ability of shareholders to act through organised shareholder groups such as farming or breed organisations, however, the 'capture' of the AWI board by any of these political groups is not preferable and the evidence has not shown that governance has generally improved as a result.

In a market economy, the decisions of investors are assumed to be made on an economically rational basis.[7] The inference is that decision-makers, in this case producer shareholders, act in a manner that will maximise their economic benefits and minimise their costs. However, far from being dispassionate investors, farmers are likely to be shareholders not by choice, but by virtue of participation in the industry, with their entitlements linked to production. It is likely that their primary consideration is not the dividends to be earned from shares or future capital growth, but the value that the company can add to the commodity they produce.

In an efficient market made up of rational decision makers, consistent availability of current information and mobile capital are mechanisms to limit and constrain non-profit maximising behaviour by companies. Markets will acquire information about the performance of a company and deliver judgment on the effectiveness of management in pursuing shareholder interests, through the pricing mechanism of the share price. However, a shareholding in AWI is not tradable. While a producer may have the capacity to opt out of their shareholding, statutory levies associated with their commodity will still be remitted to the company making the exercise purely symbolic. In the absence of an opportunity cost of their investment, there is no market mechanism by which the board or shareholders can benchmark the performance of the company.

5 Farrar, Professor John. 'Corporate Governance: Theories, Principles and Practice'. (2008). 3rd Edition, Oxford University Press, Melbourne.

6 Chapman, Chris. AWI Company Secretary: Interview, (2008).

7 Baumol, William J; Blinder, Alan S; Gunther, Alan W; and, Hicks, John RL. 'Economics Principles and Policy'. (1988) Australian Edition, Harcourt Brace Jovanovich, Sydney. Pg 5, 10-11.

While growers also have the opportunity to vote for the rate of levy – including for zero – this occurs every three years. In between times, their capital is not mobile and the company cannot be punished for poor performance through a low share price. Growers may not be happy with the performance of the company between WoolPoll, but many consider a vote for zero to be too harsh a sanction.

This disciplining principle of markets also extends to the capacity of the company to raise debt. This can be expressed through a higher cost of debt or conditions put on the company, relating to governance. However, for obvious reasons these market based mechanisms are largely unhelpful in influencing management of many agricultural service providers.

RECOMMENDATION:

1. *That an external review of AWI structure and governance model be conducted, with the aim of introducing an improved governance regime.*

Does the fact that some RDC's seem to have more satisfied stakeholders than others provide any insights on how to improve governance arrangements, or are such differences mainly due to the nature of the industries concerned?

WPA agrees that the level of discontent and politics associated with some RDC's is a function of the governance arrangements and the perceptions of those organisations by levy payers. That is not to say that a simple transfer of some governance arrangements into other RDC's is the solution – it would seem that many of the RDC's have elements of public, political and business based structures. However, in the cases where the mixture of these elements appears least compatible, WPA believes that dissatisfaction by shareholders is the highest.

We do not accept the proposition that different cultures within different farm sectors are responsible for the variation in the satisfaction rating of RDC's.

In the case of the sheep industry – where the percentage break-up of gross value of production between meat and wool has moved towards meat in recent times – the majority of growers are contributing significantly towards both Meat and Livestock Australia (MLA) and AWI, and consider themselves as having an important stake in MLA. However, the same levy payers appear to have a higher degree of concern about the standard of governance within AWI than MLA, which WPA argues is therefore due to the difference in structures not innate attitudes of a sector.

What is the scope to improve the effectiveness of RDC boards?

WPA believes that the effectiveness of RDC boards can be improved through the implementation of skills based boards where they do not exist, limiting tenures on RDC boards, improving competition for positions on RDC boards and reducing the political character of some RDC boards.

A key concern of WPA about the method of electing directors to AWI is the impact that this current process – and the types of political campaigns that it generates – has on potential candidates for the board. It is the view of WPA that AWI, now and into the future, is being denied potential high quality candidates attempting to be elevated to the board.

The candidates of the kind that industry requires are likely to be less inclined to be prepared to run the gauntlet of the wool industry agri-political process that currently surrounds the elections at AWI, when their talents are sought after elsewhere and dealt with in a more professional manner. This argument is not to suggest that current or previous board members have been unskilled for the roles, however, the competition for these places is limited and arguably a wide enough mix of directors is not being achieved.

TABLE I. CANDIDATES FOR AUSTRALIAN WOOL INNOVATION DIRECTORS ELECTION[8]

Year	Number of directorships contested	Number of existing directors standing	Number of new directors standing
2002	6	5	6
2003	3	3	0
2004	3	3	3
2005	3	3	3
2006	3	3	2
2007	3	3	3
2008*	5	5	5
2009	3	3	0
2010**	0	N/A	N/A

* In 2008 3 directors were appointed in May.

** In 2009 the constitution was amended to conduct director elections every 2 years.

As can be seen from Table I above, the maximum number of new directors seeking election in any one year in the history of AWI has never exceeded the number of positions available.

This compares unfavourably with other RDC's and similar agricultural based service provider organisations, where it may not be uncommon to receive a triple digit number of applications for director positions.

In the case of the recent appointment of a new AWI Chief Executive Officer, the company announced that 93 applications were received – yet for the position of director in 2009, zero new directors expressed interest in employment by the shareholders of AWI.

Is there an appropriate balance on boards between industry expertise and more general skills? If not, is this a result of deficiencies in the processes for electing/appointing boards, or does it reflect other factors?

WPA has concerns at the balance and range on skills on the AWI board and also considers that the current system does not promote a constant renewal of board members. Underpinning these problems is the system for selecting directors and the terms on which they are engaged.

Political Selection of Directors

AWI was corporatised in 2001 and although levy payer shareholders voted for a 'commercial board'[9] in the interests of decreasing the role of government, the preference by many growers to maintain absolute control over the selection of directors has given the impression that it is anything but. The current system is in fact political.

This desire for 'democracy' in the stead of any formal measures for selecting directors or requirements for a specific type of skills or competency, has contributed to the politicisation of annual elections and public splits in the board on issues of industry policy and company direction.

Combined with the shortcomings of market based mechanisms to moderate the behaviour of the company, AWI has a political process for selecting directors which, from the perspective of WPA adds further difficulties to the management of the company.

Consistent with the democratic system that is in place, there is no defined set of skills for directors on the AWI board to dictate a minimum standard of qualification for the role, and to ensure a diverse and appropriate range of skills.

A danger is that such a system encourages prospective directors to differentiate themselves from the incumbents. Developing a high profile within rural Australia, which is usually accompanied by making claims about the company's performance – whether correct or not – is often the norm. Or worse, working in a manner that is destabilising to the company.

8 Australian Wool Innovation Ltd, annual reports.

9 Australian Wool Innovation. http://www.woolinnovation.com.au/About_AWI/Shareholder_information/page__2138.aspx.

This is combined with candidates stating a manifesto outlining what they intend to achieve if elected. As directors are seeking election, it is not uncommon to see references made to important industry issues and what that prospective director will seek to achieve, rather than the focus being on the skills they bring to a specific position. The price of wool or the size of the sheep flock is a common example, with the implication being that the company has a direct capacity to influence these measures under the 'right' leadership.

For example, the majority of the current board were elected on a 'platform' of continuing the practice of mulesing, however, as time progresses evidence suggests that there is little that can be done by the board to influence the outcome of this debate.

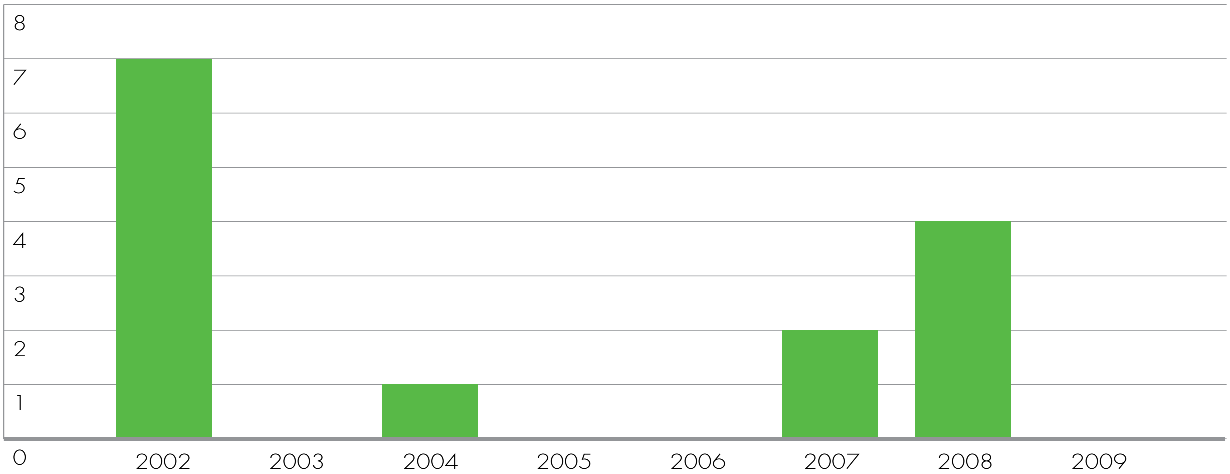
When the reality materialises that these expectations of growers cannot be met, there is disillusionment with the company and the political cycle recommences.

The other major drawback of the current system is that once successful, through the process of election, directors are encouraged to believe that they have a mandate for certain actions, often considering shareholders as 'constituents' rather than the owners of the company. Unfortunately, many shareholders accept and adopt this position.

Over time, this leads to blurred understanding of the roles, responsibilities and capacity of AWI.

An illustration of this problem is the way in which the directors of AWI have been replaced since inception of the company. Graph I charts the turnover of directors, [10] against each annual meeting of AWI.

GRAPH I: TURNOVER OF DIRECTORS (AWI)



* Note: in 2008 3 directors were appointed during May.

Rather than demonstrating a gradual turnover of individuals to replenish the board and bring new energy and ideas to the company while maintaining corporate knowledge, the chart shows periods of significant upheaval on the board. This has the opposite effect of what would otherwise be seen as one of the possible advantages of a corporate structure. Instead, there have been periods of no new members coming onto the board, intersected by wholesale change of directors and company direction.

Over the past decade of AWI's existence, the board can be described in three distinct periods, where a group of shareholders have purged the board of the majority of directors. In each case it is under acrimonious circumstances and with the aim of radically changing the direction of the company. These are: the period of inception until 2002 under the chairmanship of Ms McCaskill; 2002 to 2008 under chairs McLachlan and van Rooyen; and, the current period of Mr Merriman.

10 Australian Wool Innovation Ltd, annual reports.

The instability created by these upheavals has been reflected in the management of the company, with AWI recently appointing in 2010 its fourth Chief Executive Officer in five years.

In 2009 the AWI board appointed ARCHE Consulting to conduct the triennial Review of Performance (ROP) of the company, which also supported the claims of WPA that the company needs structural reform.

In identifying systemic problems within AWI, the authors of the ROP have recommended that AWI implement a skills based board. The ROP states:

> *"It is recommended that AWI, in collaboration with shareholders and industry stakeholders, conduct a review of the architecture for the appointment of directors in the Constitution, to ensure the election of a skills based Board."*

The underlying principle should be that potential directors are assessed against a set of criteria for the position, where they are considered on two levels, being the:

- General skill level and qualification (formal or informal) to undertake the role of director; and,
- Specific skill of the individual against the pre-determined criteria for the director position they are applying for (for example legal, wool production, marketing, financial, commercialisation of R&D etc).

A further important principle for WPA is that levy payers have an opportunity to contribute to the process (through either its development or ongoing involvement) to ensure that growers feel a continuing sense of engagement with the company.

Tenure on RDC boards

WPA has concerns at both the length of terms of directors and the overall length of tenure. At present, the AWI constitution does not limit the number of terms that a director can re-offer themselves for election and directors can serve terms of up to six years.

The Australian Institute for Company Directors (AICD) policy on terms of directors states that:

> *"Australian Institute of Company Directors acknowledges that directors of publicly listed companies are usually elected for a term of 3 years."*

Prior to the 2009 AWI annual meeting, the maximum term for directors was three years. However, in 2009 the board succeeded in amending the constitution to hold director elections every two years – effectively doubling the maximum possible term from three to six years – by arguing that the change would save costs and reduce industry infighting.

The AICD policy position on terms also reflects the long held policy of WPA, which calls for a limit on the terms on directors at AWI:

> *"The trend of companies to combine performance reviews and/or maximum terms for directors is viewed as a positive development"*

WPA considers that instituting the changes proposed will drastically increase the effectiveness of the company.

RECOMMENDATION:

2. *The introduction of a skills based board within AWI, with an independent recruitment process to select directors that are measured against a set of criteria for each position, to be confirmed (or rejected) by levy payers.*
3. *Limited terms for directors in AWI.*
4. *Term lengths for director in AWI that are in accordance with best practice governance.*

How has the Ministerial approval process for appointments to the boards of the statutory corporations affected outcomes? How might any negative impacts of the removal of government nominees from the boards of the statutory corporations be ameliorated? For example, has the attendance of a departmental representative at the board meetings of some of these corporations been helpful? What lessons can be learned from differences in the procedures for appointments to individual IOC boards?

The way in which government services have been delivered over recent decades has fundamentally changed, as both state and federal governments seek to improve the use of resources to gain maximum value for the public. This value is expressed in terms of the efficiency with which resources are used and services delivered and also the effectiveness of the governance of the expenditure of these funds.

This has been brought about as a result of governments reassessing their role in service delivery, which transforms the way in which government does business – the broad trend being towards commercialisation.

Possible reasons for the shift from public to private sector ownership include commercialisation being driven by ideological views of the role of government and what is seen as the effectiveness of private sector governance processes. Governments may also be inclined to pursue commercialisation as a way of reducing the impact of the state on the lives of individuals, in line with their own view of the world and politically, it may also be seen as a means of potentially avoiding public accountability.

Most importantly to this debate, in respect to governance it is sometimes considered that private sector systems and rules are superior to the public sector, something that Uhrig [11] and successive governments have tended to accept.

However, others have expressed concern at the effectiveness of adopting private sector practices to the exclusion of all other oversight, suggesting that it is driven as much by a perceived need to 'legitimise' government practices and gain acceptance of the business community, as improve efficiency and performance. [12] As stated, WPA has its own concerns at the mix of political, private and public within AWI and does not believe that the current environment enhances efficiency or performance.

Clearly, the lesson to be learned is that the previous way of thinking, which involved the abrogation of a certain level of responsibility by government in respect of their investment in IOC's, has not been altogether successful in some cases.

That said, WPA believes that it is essential that growers retain a sense of ownership of their respective RDC and would be wary of a return to the types of models that have been rejected in the past – the continued support by growers of levies and the willingness to embrace R&D are two obvious reasons for this. An improved balance must be found.

Are there any significant conflict of interest issues that need to be addressed in regard to the appointment and membership of boards, the relationships between RDC's and industry representative bodies etc?

There have been numerous reports about conflicts of interest within the AWI board and these have been aired within the media and forums such as Senate Estimates, [13] hence it is not necessary for WPA to delve into the specifics of these issues within this report. However, WPA does habour ongoing concerns about how well conflicts are being managed by the company as a whole.

There is general knowledge within the industry of most of the private interests of AWI directors and the company has stated that these issues are closely controlled when board deliberations occur on related subjects. What is important for stakeholders to understand – yet in our view is at present not completely clear – is how well the company is managing the engagement with external stakeholders by directors outside the boardroom. Specifically, in situations where there is the possibility for the perception of a conflict to arise.

The political nature of AWI director selection processes over time may have also led to ingrained cultural problems within the board environment, which have possibly limited the capacity of the directors to question decisions being made by the company or other board members. Through the election of boards made up of likeminded directors on a single agripolitical ticket, regardless of their individual skills they may be constrained in their objective decision making through membership of that group.

11 J. Uhrig, Review of the corporate governance of statutory authorities and office holders, June 2003.
12 Bowrey, Graham. 'Keeping Up Appearances' (2005). University of Wollongong. At 3.
13 Senate estimates, Rural and Regional Affairs and Transport 25 May 2010.

This negative aspect of collective decision-making can occur in strong groups and be reflected in group blindness and peer pressure.[14] The types of factors that may contribute include: a sense of belonging to a group; similar backgrounds and beliefs to other members; loyalty to a leader; insular practices; and, a history of success.

WPA argues that creating boards with a wide cross section of directors with diverse backgrounds and skills, would complement directors that are focused more particularly on issues from the grower perspective.

In the view of WPA, a broader source of conflict within successive boards of AWI that has arguably held the organisation back is when it comes to meaningful reform of the governance of AWI. All the time that a particular group has had perceived control of the AWI board, there has been no motivation to support reform of the company – particularly where it relates to the process for selecting directors. While the political pendulum is in the favour of the incumbents on the board, there is no support for change, as it is seen as weakening their own hold on power.

The existence of this problem was reflected by comments the Minister for Agriculture, Fisheries and Forestry to the National Press Club in 2009.[15] Mr Burke noted that it was only the groups that were not 'in power' that perceived a problem within the company.

WPA argues that given such a change is unlikely, the only way that genuine reform will occur in respect to the governance of AWI is through outside influence.

RECOMMENDATION:

5. That an independent inquiry be held into the concerns of conflicts of interest within AWI board and management.

Are there aspects of the governance arrangements applying only to the statutory corporations, or only to the IOCs, that should apply across the board?

As noted, WPA has serious reservations about governance arrangements within AWI. WPA considers that the application of a skills based board is one measure that should be applied across the board as a matter of good governance.

An example of the successful application of this measure can be seen with the Co-operative Research Centre community. WPA considers the Sheep CRC to be an effective model for both the delivery of research outcomes and the governance of industry and public funds. Its governance arrangements are an example of how an agricultural public and private partnership can be managed and provide adequate ownership by the stakeholders without adverse politicisation.

In the case of the current Sheep CRC (CRC II), a requirement of refunding from the previous CRC was the transition from a representative board to a skills-based board. WPA considers that this should be a minimum standard across RDC's.

How useful are the Statutory Funding Agreements, including as a means to ensure that the IOCs meet the core requirements in the PIERD Act? Would greater standardisation of these agreements across the IOCs be desirable?

The Statutory Funding Agreement (SFA) has clearly not proved a satisfactory means to ensure that AWI meet its core requirements. The SFA has proved to be a 'blunt instrument', in that outside of the period of re-negotiation there is little scope to influence the company. At present the agreement does not limit agri-political activity sufficiently, as well as giving scope for the company to conduct activities outside the intent of the agreement.

WPA has concerns about the lack of clear demarcation of the roles or RDC's, particularly as they relate to agripolitical activity, and does not believe that the SFA effectively deals with these issues.

14 Hall, Kath. 'The Psychology of Corporate Dishonesty'. (2006). Australian Journal of Corporate Law, vol 19.
15 'Food: Making it and moving it', Hon Tony Burke MP, Minister for Agriculture, Fisheries and Forestry, National Press Club 2 December 2009.

Increasingly over the past five years, AWI engaged in activities that encroach on the political, with seemingly little resistance. The company has been able to achieve this through the actual meaning of agripolitical activity being unclear or unenforced.

For example, in 2009, AWI attempted to circumvent the collective decision by the wool industry to phase out the husbandry practice of mulesing, by announcing that the industry was turning its back on the agreement. This political action was arguably well beyond the scope of the company, which should end at conducting R&D to support the industry decision.

Likewise, over the past 12 months AWI has, in the view of WPA, inappropriately engaged in the process of the development of animal welfare standards and guidelines through lobbying farmer groups, government and other stakeholders.

WPA believes that there should be detailed investigation into the scope of activities of rural RDC's, to ensure that decisions on strategy and funding are made within a defined set of parameters. These should be to the exclusion of political, policy or lobbying objectives.

RECOMMENDATION:

6. *The development of a clear definition of agri-political activity for inclusion in statutory funding agreements with the objective of excluding political, policy development or lobbying objectives.*

Although its activities may seemingly be contrary to other sections of the SFA or the AWI constitution, it has relied on its interpretation of clauses that allow it to engage in activities in the interests of the Australian wool industry, thus circumventing legitimate restrictions on its activities.

WPA cites two examples where significant undertakings were made over the past decade by AWI, which involved large expenditure of grower funds, with no prior consultation with industry and were questionable within the expected scope of the company's role. These are the legal case against PETA in 2004 and the support of the International Wool Textile Organisation (IWTO) Test Marketing Project TMP in 2006.

The legal action was for a time, part of a campaign to combat the activities of animal activists and protect international markets for wool. It was not only a large investment, but also a landmark case in terms of potential legal ramifications and in the context of the activities of Australian RDC's. Aggressive legal action against an international animal activist group broke new ground, was embarked on without reference to growers and was questionable in the context of the SFA and AWI's constitution.

Likewise, the TMP that was announced at the IWTO Congress in May 2005 saw a commitment by the board of AWI of up to US five million dollars of grower funds. Again, this was taken without any prior consultation with growers, yet it pushed the boundaries of the SFA – this time in relation to marketing, which at that stage was not part of the company's charter. This concern about the relationship between the TMP and the SFA was in fact raised in the 2006 Review of Performance (ROP) of AWI. [16]

In more recent times, AWI has arguably breached its own constitution through engagement in political bodies. The AWI Constitution states that AWI must not make 'grants, or otherwise provide financial assistance, to a body that represents woolgrowers' (Section 2(c)) – other than for the purchase of goods and services.

In 2009 AWI joined the Federation of Australian Wool Organisations (FAWO) as a full voting member. However, the FAWO constitution states in its Objects that the role of FAWO includes:

(a) To maintain a permanent connection between the organisations representing wool production and the wool textile trade and industry in member-countries;

(b) To represent wool production and the wool textile trade and industry in all branches of economic activity;

(c) To promote, support or oppose measures affecting wool production and the wool textile trade and industry;

16 'AWI Review of Performance 2003 to 2006', ACIL Tasman, 2006.

These objects seem to be inconsistent with the AWI constitution, just as the PETA legal case and the TMP before would appear inconsistent with the core purposes of a rural RDC. The justification that AWI boards have used in the past to defend such actions is the objects of the company allow it to engage in activities for the benefit of growers. The relevant section reads as follows:

> *2. Objects*
> *(a) The objects for which the Company is established are to:*
>
> *(ix) engage in any other activities in the interests of the Australian wool industry, in each case for the benefit of Australian woolgrowers.*

Although Objects (i) to (viii) appear to give fairly specific direction as to the purpose of the company, Object (ix) has been construed by successive Chairs to give scope for activities that were probably never intended for an RDC.

It should also be considered that the use of a general clause to override a specific limitation could be viewed as an incorrect legal interpretation of its constitution.

RECOMMENDATION:

7. *Implementation of tighter controls in statutory funding agreements and constitutions, to enhance appropriate use of grower funds and minimise the subjective interpretation by boards of general clauses.*

How effective are current industry consultation protocols? Are all of the key stakeholders routinely consulted, or at least provided with adequate opportunity to make their views known? Should the legislative requirement for some RDC's to consult with particular peak industry groups be scrapped and replaced by a more generic requirement simply requiring consultation with an appropriate range of stakeholders?

The 2009 Review of Performance (ROP) of Australian Wool Innovation (AWI) highlighted the ineffectiveness of industry consultation protocols within the wool industry over a long period of time.

It was recognised that consultation was historically dominated by the selection of like-minded groups or individuals and was usually after the event, once the critical decisions had already been made by the AWI board.

WPA does not support the proposition that replacing 'peak industry groups' with a general and generic requirement would be a positive initiative, in fact, it considers that where this arrangement is not in place there is a higher likelihood that industry politics will be manifested in the RDC in question. However, WPA does not consider that such arrangements should be at the exclusion of levy payers that chose to exercise their right to not belong to an organised group.

The development of factions within the AWI system has resulted in inadequate measures for consulting with shareholders – a concern that was highlighted by the ARCHE ROP. In the absence of a transparent and agreed process, successive boards within the company have tended to select what they consider to be 'like-minded' sections of the industry, who then dominate in consultation with the company.

WPA has consistently argued the case to the successive relevant Ministers that the lack of formalised mechanisms for AWI to consult with growers has been a shortcoming of the company. This has in turn exacerbated the politicisation of AWI that has been caused by a poor governance model.

In response to the ARCHE recommendations, the AWI board stated the importance that it placed in 'democracy' when relating why it rejects the notion of a skill based board. The term democracy is defined as a political system in which the supreme power lies in a body of citizens who can elect people to represent them. [17] In reality, the idea that AWI reflects a system with power to represent a body politic is completely at odds with the purpose of the company.

The perpetuation of this belief by AWI and some levy payers that it is a democratic institution is not only a result of the outdated system for electing directors, but also from the way in which it relates to growers. The absence of formalised structures for consultation sends the signal to growers that the board and its associated activities – such as WoolPoll or directors elections – constitute the 'parliament' for the industry and are the arena for debate on industry policy.

17 Princeton University Wordnet database www.wordnet.princeton.edu

Where systems for consultation with a particular group are recognised by government, there is a clear message that a divide exists between the organised political activity of levy payers and the legitimate work of an RDC – in particular the governance of the company. The model of structured consultation has proved successful, and WPA contends that this is evidenced by lack of politicisation within the similar RDC's that have such mechanisms.

In 2005, WPA worked in co-operation with the Department of Agriculture, Fisheries and Forestry (DAFF) in completing the Industry Partnerships Program *Taking Stock and Setting Directions* project. The project was a success, bringing a broad range of key industry players together to review where the industry was at the time, and consider ways in which it move ahead for the benefit of woolgrowers.

In November that year, a final report was released by Hassall & Associates, who assisted in the project. Action item 6 from *Taking Stock and Setting Directions* recognised this issue, and recommended that the key to removing the politics from AWI is empowering growers with alternative means to influence the direction of the expenditure of their levy funds than director elections.

The action reads as follows –

> *"… the politics associated with AWI board elections were thought to also add a disruptive element to industry operations… it (politics) may be lessened if other channels for industry dialogue existed. We recommend that the industry consider additional mechanisms for industry influence into AWI's investments".*

As outlined in an earlier section, WPA has multiple pathways to membership (either directly or through state based organisations), transparent governance arrangements and long established policy development processes that go back to grass roots growers. These arguably earn WPA or like bodies (and their members), an expectation of a primary role in consultation with industry owned corporations.

However, the vulnerability of the AWI board to be capture by splinter groups can lead to the undesirable outcome where groups are 'rewarded' with influence over strategic outcomes in an RDC, for their capacity to support political campaigns rather than their ability to foster a strong membership base or invest in good internal governance and sound policy development.

While RDC's should not limit engagement or consult exclusively, WPA contends that recent history has demonstrated the need for a higher level of discretion by RDC's in selecting partners for formal consultation environments, which place expectations of transparency and a representative base.

RECOMMENDATION:

8. *That improved reporting and consultation mechanisms are developed for AWI.*

What are the benefits and costs of the combination within the IOCs of R&D responsibilities and other industry services? To what extent have synergies between the two been a factor which has motivated the transformation of some statutory corporations into IOCs? What have been the other drivers and what have been the downsides experienced during and after such moves?

WPA does not see benefit in a combination of other industry services with IOC's.

Previous periods of decentralisation have placed services such as wool testing into separate companies, and it would be unlikely that this process could be reversed even if it were seen as preferable.

Using the example of the Australian Wool Testing Authority (AWTA), it has been able to reduce overheads specifically applied to wool testing, through diversifying its business and spreading this cost base across business units that are not related directly to wool.

It is also unlikely that the broader industry would accept such a proposition. Organisations such as AWEX and AWTA have added value to the industry, in part due to their make-up which harnesses a broad cross section of the value chain. It is quite probable that these other stakeholders would not see benefit in transferring activities related to the change in ownership of wool or wool testing to a body that has a primary responsibility to one sector.

There are certain 'industry good' activities, such as production forecasting, that should quite rightly be part of the AWI portfolio of investments. However, given the need for an objective approach to such projects and current possibility that AWI can be captured by special interests, means that the enshrining of new responsibilities within the company should only occur as part of a far broader restructure.

What are the particular benefits and costs of combining R&D and industry representation responsibilities within a single entity?

One option canvassed by WPA in a recent internal review of structures in the industry, was the creation of a national wool body that manages all aspects of the industry from research and marketing through to industry policy. Members of WPA rejected this approach, primarily on the basis of concerns at a further politicisation of the industry RDC.

In the case of AWI, numerous examples have already been given at the problems caused by politics with R&D and industry services. The aim of any future restructure should, as an underlying principle, be to further shield industry services such as R&D and marketing from industry politics.

What scope is there to reduce the costs of administering the RDC model without diminishing the outcomes it delivers? Are there too many RDC's and, if so, how might this number be reduced? How big are the potential downsides of amalgamations, such as loss of focus and the increased challenges of dealing with a more diverse, and possibly hostile, range of industry stakeholders? Would wider application of the RIRDC approach be a means to reduce total administrative overheads, while still allowing individual industries to retain their 'research identity'?

WPA is committed to the continuation of a wool specific, industry levy funded research and development corporation. However, WPA believes that the system could be strengthened and limited resources better utilised through considering how levy funded organisations in other jurisdictions are managed.

A major review into levy funded bodies in the United Kingdom (UK) in 2005,[18] concluded that delivery of services efficiently and effectively could be enhanced by better collaboration between different levy funded bodies – in particular 'back office' functions.

In the case of Australian RDC's, it is a reasonable for investors to question the appropriateness of locating RDC's in the CBD of capital cities such as Sydney. When considering a list of key stakeholders – government, individual growers and research providers – none are based in the state capital cities. Further, in terms of wool, around 99% of the product is exported, requiring that staff is situated abroad to service customers.

This means that the industry is funding staff and office costs commensurate with a major city when there is little evidence to suggest why this is essential. In the UK example, levy funded bodies are responding to this situation through regional relocation (in close proximity to farmer organisations and other agricultural service providers) and improved sharing of resources.

Such a model can potentially improve interaction between staff, break down silos within each RDC and focus the activities of the organisation on its core role.

RECOMMENDATION

9. *The commonwealth investigate how commodity specific levy funded R&D companies can share physical and intellectual resources, including the potential for co-location.*

Are there significant opportunities for additional collaborative research effort across the RDC's which would have significant payoffs? If so, where specifically do these unrealised opportunities lie and why do they still exist? For example, are some of the RDC's unnecessarily siloed and reluctant to work with others on value adding areas of common interest? Or is it simply that these collaborative projects are expected to provide a lesser return than other project options within each silo?

An ongoing concern that is raised by members of WPA is the future of the state contribution to rural research and extension. Central to the role of state agricultural investments is the network of agricultural research stations.

WPA views the continuation of regional and climate specific research stations as essential to the nation's ongoing rural research and development efforts. However, members in all states point to continuing cuts to funding and staff and the concern of farmers that more research stations will be closed without adequate reference to the needs and views of industry.

18 'Review of Agricultural and Horticultural Levy Bodies', Rosemary Radcliffe CBE, 2005.

One option that should be considered to protect the future of research stations is for governments, research institutions and universities to consider a collaborative approach from all levels. The suggestion is that consideration is given to research stations being vested to a national rural research properties trust.

The proposal by WPA is that the Trust would be administrated by a board made up of government, industry and research appointments with financial contributions from industry, state and commonwealth governments. It would be hoped that efficiencies could be gained through scale, priorities and projects could benefit from improved co-ordination and the risk of governments, industry organisations or institutions realising these assets to satisfy short term financial goals would be eliminated.

A further benefit of this approach is the opportunity for improved integration and collaboration, and cost savings between the various RDC's.

RECOMMENDATION:

10. The Commonwealth investigate the formation of the National Rural Research Properties Trust to ensure the future all existing research stations.

Are the processes for amending levy rates unduly cumbersome? Are there options for streamlining these processes that would maintain appropriate protections against unduly frequent and potentially disruptive or costly attempts to change levy rates?

WPA supports further examination of the current system of determining the levy rate collected from wool growers. At present, the system is expensive, does not reflect the operating cycle of the current RDC, does not give growers a meaningful opportunity to determine the course of the RDC and the process has been unduly politicised.

The process for setting the levy collected by AWI is expensive, time consuming, and like many other activities within the company has become politicised. Following the 2009 WoolPoll, the AWI board attempted to portray the result of 2% levy vote as an affirmation of the board and decisions by the company, [19] yet in reality, the votes over time in WoolPoll have seen little variation.

In 2006 the percentage of votes cast and votes for 2% or above was 51.6% and 69.5% respectively, while in 2009 it was 53.7% and 73.1% respectively. [20]

There are also significant limitations in the actual degree to which growers can contribute to the process, with successive polls supporting a consistent rate of levy, with the board determining the breakup of funds.

While growers are able to vote on the percentage rate of the levy, the board of AWI sets the manner in which it will be spent. Many growers have expressed the view that they would consider the exercise more meaningful if they were able to be given choice on the split of funding – specifically between marketing and R&D.

Over recent WoolPolls, along with the vote for the rate of levy, supplementary questions have been put to growers. There is a degree of confusion amongst some growers both as to what the criteria for a question being included are and what the general purpose of the question is.

In the case of the 2006 WoolPoll, growers responded overwhelmingly in the affirmative to a question as to whether wool sold from all types of harvesting methods should attract the levy. Despite the outcome, this change has never been implemented leading growers to question the benefit of the process.

19 'WoolPoll Results In', Farmonline.com.au 11/11/2009.
20 WoolPoll 2006 Results and Analysis, Link Market Services 7 November 2006.

RECOMMENDATION:

11. A review be held as the future of WoolPoll, including, but not limited to:

- *Possible alternative means for setting the levy;*
- *Opportunities for greater determination in the funding split by levy payers; and,*
- *Role and relevance of 'supplementary' questions.*

Should processors generally pay a levy for R&D? If they were required to do so, what is the likelihood that they would simply pass the cost back down the line to the primary producer? Does this happen in those industries where processors currently pay a levy?

Wool processing is historically a major Australian industry, both value adding and creating employment, particularly in regional areas. But, like other manufacturing industries, it has declined in recent years, in particular because of the impact of China and other low labour cost countries.

The change has seen Australia move from the pre-eminent early stage processor in the world ten years ago to the stage where it now produces less wool tops than Uruguay, a country whose wool production is a little more than 10% of Australia's. Therefore the issue of an R&D levy on processing wool is perhaps less relevant than other commodities.

However, WPA has identified a major loophole in the collection of wool levies that is related to the processing of wool known as 'fell-mongering'. Fell-mongering is the chemical removal of wool from sheep skins *post mortem*.

At present, the Wool Services Privatisation Act 2000 stipulates that the wool levy is to be collected on all 'shorn wool'. As such, the levy is not collected on any other method of harvesting, which includes examples such as biological harvesting, dead and plucked wool and fell-mongered wool – the latter of which is the most significant leakage of the levy. In all non-shearing methods of harvesting wool, the same benefit from R&D investments made by the industry has accrued.

To treat wool that has the same end use differently in respect to the levy on the basis of the method of harvesting and processing, costs the industry significantly in lost revenue each year – which AWI have previous estimated to be in the millions of dollars.

As noted previously, the 2006 WoolPoll overwhelmingly endorsed the principle that all wool, regardless of method of harvesting, be subject to the levy to eliminate 'free-riders'.

RECOMMENDATION:

12. That existing loopholes be closed, so that the R&D levy for wool be collected from all wool regardless of harvesting method.

Is there any evidence of a significant mismatch between the regional distribution of levy payments and the regional distribution of the benefits from the ensuing R&D, for particular RDC's or across the program as a whole? Would an explicit effort to more closely align the two materially reduce the overall return to the community from the RDC program?

As a federated structure, WPA has members from across Australia. A question that has been raised in the past amongst members has been that of the distribution of the R&D dollars via institutions and the ensuing benefits of the work. However, WPA has yet to find any evidence of a mismatch between distribution of levy payments and distribution of benefits from R&D.