



Jackson, Etti & Edu

THOUGHT LEADERSHIP

Backward Integration: Strategy in the Manufacturing Sector





INTRODUCTION

Backward integration implies the process by which a company or a manufacturer produces its major inputs requirements. It occurs when a company acquires or internally produces parts of its supply chain. Backward integration is what happens when one company buys a company that supplies the resources or services required for the buying company's production of goods or services.

This means that a food processing company, for instance, must produce or organize the supplies of major agricultural raw materials in a manner to ensure and guarantee the efficiency of input procurement, capacity utilization and overall output.¹

In this article we shall examine the prospects of backward integration in the manufacturing sector of the Nigerian economy.

UNDERSTANDING BACKWARD INTEGRATION

An effective input procurement system that can provide a solid foundation for manufacturing operation must possess some basic characteristics. These are the supply of adequate quantity of raw materials of desirable quality, at the right time and at reasonable cost, within the framework of an efficient organizational structure².

¹ Ismaila, Usman. Mallam (1991) "Backward integration and foreign exchange conservation," Bullion: Vol. 15: No. 1, Article 3. Available at: <https://dc.cbn.gov.ng/bullion/vol15/iss1/3>

² Ismail, Usman Mallam (Supra)

The supply chain process in the line of production generally begins with the sourcing and delivery of raw materials to the manufacturer and ends when the product gets to the final consumer. However, certain complex dynamics of the market such as price and quality of raw materials, stock distribution, may hamper the commercial expectations of the company.

To gain a more controlling stake over the source and supply of raw materials, a business may “move backward” in the supply chain. Thus, a manufacturing company may open its own retail outlets and do for itself that which the company could have otherwise bought on the market.³ A company would often consider backward integration as a cost-saving measure, for optimum revenue, improved efficiency in the production process, or for competitive advantages over rivals.

Backward integration can therefore be leveraged to grow a business, gain firmer control of the supply of raw materials, and the prices and distribution of finished products. Backward integration can be most relevant to a consumer goods manufacturer whose strategy is the sale at lower prices of goods of same quality as its competitors. Such company may sell at low price in the hope that the low profit margins per unit of sale would be offset by large volumes of sales.

Backward integration can be achieved by merging with or acquiring another company involved in the production of raw material or distribution of the goods of the acquirer company. Thus, the acquiring or merging company can maximize its cost-leadership stance via total cost reduction by eliminating the middleman from whom it obtains the raw materials for its finished products or the middleman that distributes its finished products.

BACKWARD INTEGRATION IN NIGERIA’S MANUFACTURING SECTOR

It is backward integration for a company to invest directly in the raw material processes required to produce its goods⁴. For example, FrieslandCampina WAMCO Nigeria that has developed its local raw milk sourcing in Nigeria as against the importation of all the milk required for its production⁵. Also, Dangote Sugar Refinery Plc invested millions of dollars into sugarcane plantations across northern Nigeria to cut the costs of raw sugar imports.⁶

³https://scholarship.law.upenn.edu/faculty_scholarship/1782/#:~:text=Vertical%20integration%20occurs%20when%20a,be%20vertically%20integrated%20into%20distribution.

⁴ Incorporated in 1973, FrieslandCampina WAMCO started local production (manufacturing) in 1975. In 1984, FrieslandCampina WAMCO pioneered its first backward integration in dairy through the establishment of a dairy farm located in Vom, Plateau State. Since then, FrieslandCampina WAMCO has integrated all learnings and progressed into a more sustainable dairy value chain model named Dairy Development Programme which was launched in 2010.

⁵ <https://thewillnigeria.com/news/backward-integration-consumer-goods-profit-holds-prospects-for-small-businesses/>

⁶ <https://businessday.ng/business-economy/article/rising-insecurity-threatens-fmcg-firms-backward-integrationexperts/#:~:text=One%20of%20the%20companies%20actively,has%20over%2030%2C000%20farmers%20who>

Flour Mills of Nigeria Plc (FMN) is yet another company that has through its subsidiary, Golden Sugar Company, commenced growing sugarcane as raw material for its production rather than a strict reliance on sugar imports. FMN is leading the National Sugar Master Plan (NSMP) Agenda⁷ through its Sugar Cane Outgrower Scheme, on an area of 22,000ha on which a 15,000-hectare sugar estate is being developed. More than N73 billion has already been invested to establish the sugar estate of 3,500ha of irrigated sugar cane and a Sugar Factory with a 3,000 tons per day milling capacity.⁸

The manufacturing sector is fiercely competitive, and one strategy that may prove defining for a company in that environment is backward integration. The success of backward integration depends to a large extent on technological evolution that makes greater specialization profitable and allows for a high degree of adaptation of existing plants, machinery, and technical packages for use in domestic production of raw materials and substitutes.

NIGERIA'S BACKWARD INTEGRATION POLICY

One of the Backward Integration Policy of the Federal Government of Nigeria is the establishment of the National Sugar Development Council (NSDC) to drive the National Sugar Master Plan (NSMP). The function of the council is to enhance the local production of sugar by providing guidance on the development of sugar estates and the organisation of the sugar cane out-growers scheme⁹. According to the Council, the industry has attracted over N250 billion worth of investment in seven years of the Backward Integration Initiative. Despite the huge investment, in 2020, Nigeria imported 1.5 metric tonnes of sugar. As of 2019, sugar consumption in Nigeria stood at 1.4 million tonnes. Production was at 38,597 tonnes, while the country imported 1.36 million tonnes during the period to augment local production. This prompted manufacturing companies to increase their investment in local production of sugar.

Flour Mills of Nigeria as part of its contribution to Backward Integration Strategy of the National Sugar Master Plan (NSMP) has expanded its investment in the Backward Integration Plan in the in-country production of sugar with the acquisition of 20,450 hectares of land in Nasarawa State for the local production of sugar which is worth over \$300 million.¹⁰ Similarly, Kia Group Africa have also

⁷ The masterplan is the objective of the Federal Government of Nigeria to raise the local production of sugar to attain self-sufficiency and reduce unbridled sugar importation, etc. See <https://www.nsdcnigeria.org/nsdc-sugar-master-plan/>. See also <https://www.thisdaylive.com/index.php/2021/09/22/sugar-council-tasked-operators-to-comply-with-national-sugar-master-plan/>

⁸ <https://www.thisdaylive.com/index.php/2022/03/31/fmn-drives-the-national-sugar-master-plan-agenda-through-its-outgrower-scheme/>

⁹ See section 3 of the National Sugar Development Council Act, 1993.

¹⁰ Remi Feyisipo "Nigeria's Sugar Backward Integration Policy Attracts N250BN Investments" September 7, 2022 available at Nigeria's sugar backward integration policy attracts N250bn investments - Adedeji - Businessday NG

acquired the defunct Nigeria Sugar Company in Bacita, Kwara State. The Company joins other industry players to drive the Backward Integration Policy of the NSDC with the plan of producing 300,00 metric tonnes of sugar cane.

In 2002, the government adopted and implemented the backward integration policy (BIP), which required cement import licenses to be allocated only to importers who show proof of building factories for local cement manufacturing in Nigeria. Incentives under the policy include waiver of VAT and custom duty for importation of cement production equipment. Following the implementation of the BIP, all the moribund existing government owned cement plants were privatized, while the private sector installed additional production and bagging capacities, which has eliminated the need for cement imports.

The Central Bank of Nigeria is currently focusing on growing and improving the value chain of ten commodities (rice, tomato, palm oil, maize, cassava, groundnut, livestock/poultry, milk/dairy, cocoa, and soya beans). Thus, concerted efforts should be made to embark on large scale production of these commodities and processed into industrial raw materials and finished products.¹¹ This will necessarily entail installing processing plants and manufacturing industries aimed at adding value, and possibly, achieving other by-products. To this end, it will involve setting up research and development units in such manufacturing industries concerned with creating value addition to certain commodities. It is left to be imagined the tremendous economic benefits derivable by processing raw materials into finished products, this is aside from job creation, skill acquisition and other activities down the value-chain such as marketing, packaging etc.



¹¹ Mohammad R, (2020) CBN Update, Vol. 2, No. 2, page 9

BENEFITS OF BACKWARD INTEGRATION

Backward Integration fosters economic growth. By developing local industries and creating backward linkages, Nigeria can boost employment opportunities and generate tax revenues. The establishment of local production facilities leads to increased economic activities, stimulates investment, and fosters technological advancements. Backward integration diversifies the economy by reducing its reliance on a few sectors and creating opportunities in previously untapped industries.

Import substitution through backward integration reduces the need for foreign exchange to finance imports. This conserves foreign reserves, stabilizes the local currency, and mitigates the risks associated with fluctuations in global markets.

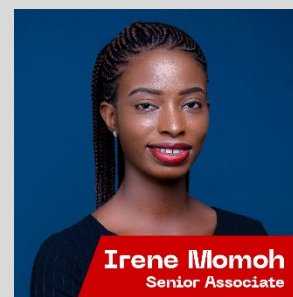
Backward integration promotes the development of a robust domestic value chain. By investing in industries that produce intermediate inputs, Nigeria can create a supportive ecosystem that encourages collaboration, knowledge sharing, and technology transfer.

CONCLUSION

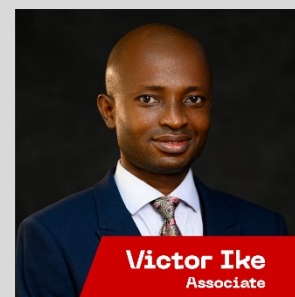
In conclusion, backward integration is a strategic approach that holds significant promise in the manufacturing sector. This strategy involves a company taking control of its supply chain by acquiring or integrating with its suppliers. As we have highlighted above, backward integration offers several benefits, including increased control over quality and costs, enhanced supply chain stability, and the potential for innovation and differentiation.

It is important to note that backward integration is not without its challenges. Companies must carefully evaluate the feasibility of such integration, consider the potential disruption it may cause to existing relationships, and assess the long-term benefits against the initial investment required. Additionally, market dynamics must be considered when deciding to pursue backward integration.

AUTHORS



Irene Momoh
Senior Associate



Victor Ike
Associate

Key Contacts

For further information, kindly reach the key contacts below:



CHINWE OGBAN

Partner, Head, FMCG Sector

E: chinwe.ogban@jee.africa



ITOHAN IROKO

Senior Associate, Co-Deputy
Sector Head, FMCG

E: itohan.iroko@jee.africa



IRENE MOMOH

Senior Associate, Co-Deputy
Sector Head, FMCG

E: irene.momoh@jee.africa

Victoria Island

RCO Court,
3-5 Sinari Daranijo Street,
Victoria Island,
Lagos, Nigeria

Tel

+234 (02) 014626841/3,
+234-(02) 012806989

Email

jee@jee.africa

Abuja

42, Moses Majekodunmi Crescent,
Utako, FCT, Abuja

Ikeja

1st floor, ereke house,
Plot 15, CIPM Avenue
CBD Alausa Ikeja
Lagos Nigeria

Accra

3 Emmause, 2nd Close
Akosombo House
Labone, Accra, Ghana
P.O. Box 14951
Accra, Ghana

Yaoundé

3rd Floor, Viccui Building
Apt. 15-16, Carr Street
New Town, Yaoundé
Cameroon

Harare

38 Clairwood Road,
Alexandra Park,
Harare,
Zimbabwe.