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Upstream Business Integration Strategy and Profitability of Food Manufacturing Industries in Nigeria

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Abstract
With the increasing population and scare resources due to rising global demand for food, consumer goods manufacturers would increasingly have to pay more for import of raw materials, with resultant decrease in their profit margins. It has therefore become very important for Food Manufacturing Companies that want to stay competitive to take more interest in upstream business integration to sustain their raw materials supply chain at reasonable prices and sustain its profitability. The paper examines Upstream Business Integration Strategy and Profitability of Food Manufacturing Industries in Nigeria. The paper therefore concludes that Nigeria posses great potentials in agriculture. Integrating backward by these industries will unlock the untapped potentials of the agricultural sector. In so doing it will help open new frontiers of business which will reduce cost and deliver dividends to shareholders and allow for overall growth. It is therefore recommended that Food Manufacturing companies should do an analysis of other benefits which can lead to future profit e.g. tax relief, concessions, increased market share etc and Consider creating new innovative products which will create a variety of products that your raw materials can be used to produce as this may help in distributing the fixed cost attributable per unit cost.
Key Words: Upstream Business Integration, Value Chain Analysis, Profitability, and Market Share.

Introduction

We have 160 million people in Nigeria and this is expected to grow as year's rolls bye. That means demand for more sophisticated food, thus putting pressure on food supply. The country would not continue importing food and has to increase domestic production. With the increasing population and scarcer resources due to rising global demand for food, consumer goods manufacturers would increasingly have to pay more for raw materials, with resultant decrease in their profit margins. It has therefore become very important for consumer goods manufacturing companies that want to stay competitive to take more interest in upstream business integration to sustain their raw materials supply chain at reasonable prices. This is important in terms of the balance of payment and to ensure more readily affordable supply for manufacturers' and guarantee higher profit and future growth.

UPSTREAM BUSINESS INTEGRATION

By upstream business integration, we mean the expansion of business activities into processes which feed ones demand for inputs in producing final products. It is the process of integrating firm's production facilities with its input materials production. The terminology 'upstream business integration' is used interchangeably with 'backward integration' as they mean the same thing. Many steps are involved in getting a finished product into the hands of a consumer. First, raw materials must be obtained through mining, drilling, growing crops, raising animals, and soforth. Second, these raw materials must be processed to obtain or extract the desirable and usable material from the bulk of materials available. Third, the usable materials must be fabricated into desired form to serve as basic inputs for manufactured products. Forth, the actual manufacturing of the finished product must take place. And finally, the finished product must be distributed to the ultimate consumer. When a company is involved in more than one of these steps, it is said to be vertically integrated. According to Akinsulire (2003) vertical integration is the combination of two firms which are in the industry but at different stages of in the process of producing and selling of products.

It is a management style that brings large portions of the supply chain not only under a common ownership, but also into one corporation. It is the degree to which a firm owns it's upstream and its downstream buyers. It is typified by one firm engaged in different part of the production process (e.g. growing raw material, manufacturing, transportation, marketing and/or retailing). Vertical integration is categorized into backward integration, forward integration and balanced integration. Whereas forward integration deals with expansion of business activities to include control of the direct distribution of its products, backward integration is a business strategy that involves the acquisition of its suppliers.

Conlin (2008) noted that a company exhibits backward vertical integration when it controls subsidiaries that produce some of the inputs used in the production of its products. In economics, backward integration is the growth of a business enterprise through the acquisition of companies that produce the intermediate goods needed by the business. Business backward integration has been a long standing practice adopted by several companies in different sectors of business environment. Oil companies, both multinationals such as Exxon Mobil, Royal Dutch Shell BP, Slumbger etc often adopt backward integration structure. This means they are active along the chain from locating deposits (exploration), drilling or extracting crude oil. In the telecommunication industries, the companies (MTN, GLO, Etisalat, Starcoms etc have integrated, making their own branded telephones etc.

UPSTREAM BUSINESS INTEGRATION BY FOOD MANUFACTURING INDUSTRIES IN NIGERIA.

Nigeria, a country located in the West-African region of Africa is blessed both in the area of oil deposit, solid minerals and agriculture. Agriculture accounts for about 40 percent of our GDP and over 70 percent of all employment. Moses-Ashike (2012) quoting President Goodluck Jonathan, "we are now treating agriculture as a business, one that can generate wealth and create jobs for millions of our youths". This move by the Federal Government to diversify to agriculture creates huge opportunity which food manufacturing industries and other agro-allied companies can leverage to drive growth in the business. Nigeria is endowed with fertile available farmland which makes it possible for the growing of variety of crops/plants for commercial purposes; Moses-Ashike maintained that "there are many areas of agriculture where you can invest to earn reasonable income. They include crop production to achieve food security and to provide industrial raw materials". The following crops are known to be well cultivated in Nigeria; for cereals we have, maize, rice, sorghum, millet, wheat; the root crops are cassava, yam, ginger, onions, garlic, potato, cocoyam, etc and for legumes such as soya beans, groundnut, cowpeas and beans etc. Most of these like cassava have been proven to be variable input material for bread production likewise other Nigeria cultivated crops.

More so, livestock and fisheries production possess great potentials for development. Grazing lands are in abundance, facilities for animal feed production are plentiful and the in-land rivers, lakes and costal creeks are sufficient to augment ocean fishery resources. One of the cardinal objectives of the local content Act is the emphasis on (progressively) increasing the "Nigerian content" of a company, which is defined as the quantum of composite value added to or created in the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilization of Nigerian human material resources and services. President Goodluck Jonathan in his May 29, 2012 Democracy Day national broadcast said "our agricultural transformation agenda is directed to promoting local production, substituting for imported foods and adding value to our locally produced crops. Government in her bid to encourage investment has made possible a number of tax reliefs and concessions etc, a number of loan facilities through the Bank of Industries and Agricultural Development Banks for companies to source finance. Also the Federal government and most state government have opened their arms through its various agencies for public private partnership and is committed to providing enabling environment that will make investments in agriculture thrive.

The food market have witnessed tremendous development and growth since the early 2000 with the entrant of more companies into the industry giving way for competing varieties of products in the market for consumers to make choice. The market is greatly opening up and more competitive than ever and thus exciting. According to Isakpa (2012) "of recent, the Nigerian food market has been exciting as players adopt different strategies to have a larger chunk of the market and build brand loyalty that cannot happen without a thorough understanding of the consumer and deliberate action to satisfy and exceed the consumer's expectations". They are adopting backward integration in their supply chain. Alawode (2012) quoting Grant Hatch, senior strategist, Accenture said "the global agribusiness industry is going through a significant transformation due to market and environmental pressures. Scarce resources combined with increasing global demand have trigged unique challenges. High performance companies are seizing opportunities and addressing obstacles from the rising demand in global food consumption to the increasing cost of commodities".

Giving the above situation, many companies have adduced reasons for integrating backward; Moses-Ashike (2012) commenting on the need for companies in the food manufacturing industry to integrate backward noted "Agriculturists say that the market for agricultural products in Nigeria is very vast but untapped. Companies need to venture into production of useful crops which serve as their raw materials as this will ensure constant and regular supply, quality input material and provide customers with valuable products, and good income which is the essence of business." In line with the backward integration policy of the Federal government, De United Foods Industries Limited, makers of Indomie Noodles has started talks with some state governments for plantation of palm trees and other crops for its multi-million naira seasoning plant at Ota in Ogun State. Obi (2012) quoting the public relation manager of the company, Tope Ashiwaju said,., the company presently has up to 45 percent locally sourced materials and the expansion .... is part of its objectives towards the full local content production of its noodles in Nigeria. This will save the company huge sum of money in the importation of materials." Also Isakpa (2012) quoting the Managing Director of Vegefresh Company Limited S. J. Samuel "the company has gone a step further in realizing its objectives of achieving a wholly Nigeria produced tomato ... we are poised to unlock the untapped potentials of the agricultural sector, starting with the tomato value chain."

In a bit to increase the company's capacity to 1.5million tons in future, Flourmills of Nigeria Plc has disclosed the take off of a sugar factory building worth over N30million in Lagos. Imhonlele (2010) quoting the company group Managing Director Emmanuel Ukpabi said "The company was aggressively diversifying its operations to deliver dividends to shareholders and sustain a growth path started over 50years ago, and it is strategically important for the flour group to be involved in new sustainable businesses that have synergies with our existing operations, to help the company's future growth." He maintained, the company will cultivate a sugarcane plantation of 15,000 hectares in Sunti, Niger State to feed the mills; we have two functioning sugar refineries in the country for now, and we will not mind exploring the export market once the local consumption is met.

To decide to integrate backward is a good strategy mainly to achieve lower cost. Organizations incur costs due to market transactions with suppliers and with clients. Since the organization is also its own supplier, factories are sited near or within their farms or source of raw materials, so this will lower transport cost, breakeven point is quickly reached and the organization can capture the profit margins that their previous suppliers or client were earning. When a company integrates backwards, the company engages in the work done by previous suppliers or a customer, the company is by so doing introducing or expanding the core competencies of his workers. That way the company can be enriching some of the organization jobs, leading to increasing satisfaction and motivation of workers. This leads to greater work efficiency and minimization of wastages and loss, hence cost is greatly controlled.

Backward integration ensures that there is synergy and effective control of supply chain. For instance, an enterprise has a contract with a supplier for buying a maximum amount of a product, but the context changes and that organization needs more than the fixed amount for a certain period of time. It has to renegotiate with the supplier to buy a higher amount, but it is really up to the supplier to deliver more than agreed previously, and it is possible that he won't do it. Now, if the organization is handling that product by itself, it just has to increase production - it has the control to increase or reduce production at will, so there is more supply chain coordination. If an organization integrate backward, in a way that organization can gain sole access to a scarce resources (product or raw material), that would represent a strong barrier to potential competitors. Backward integration could lead to investment in highly specialized assets, which could represent an advantage over competitors, that your external suppliers or client wouldn't be interested in. this way you can invest and improve your products.

Corporate backward integration offers an organization the opportunity to go even further. With specialized assets and having more control over inputs, it is possible that an organization can differentiate from its competitors and gain competitive advantage. This is a way to increase your share in the market, which can lead to increased profit.

CORPORATE PROFITABILITY

Corporate profit represents a portion of the total earnings in excess of cost of production. It is one of the most closely watched economic indicators. Hodges (2011) explained that "profitability provides a summary measure of corporate financial health and thus serves as an essential indicator of economic performance.

(i) **Profitability Analysis from Management View Point.**

Kuchhal (1993) opine that "the study of increase or decrease in retained earnings, various reserve and surplus will enable the financial manager to see whether the profitability has improved or not. He maintained that an increase is indicator of improvement in profitability, where as a decrease indicates a decline in profitability.

ii) **Profitability Analysis from Shareholder View Point**:

Shareholder is most concern with analyzing the decrease or increasing in net profit which is the bottom line of the company's operations and in addition whether the returning accruing to owners of equity is increasing or decreasing. This analysis is used to determine the continuous stay of their investment in that company.

Rassier (2012) noted that "most businesses report profits on both financial accounting basis and on tax accounting basis. He maintained that both financial accounting and tax accounting calculate profits as the difference between receipts and expenses however they differ in the definitions of some receipts and expenses, in the timing of when the receipts and expenses are recorded and in the purposes for which the information is prepared.

CONCLUSION

In competition, no company could afford to remain complacent as consumer is dynamic and his expectations grow with time. The struggle to retain consumers and have more market share could be exercised by Integrating backward by food manufacturing industries in Nigeria. This will mean unlocking the untapped potential of the agricultural sector, it will save companies huge sum of money on importation, and reduce transaction cost of operation as a result of being one's own supplier. All this put together will open new frontiers for generating more profits which will in turn deliver dividends to shareholders and sustain the growth of the company.

RECOMMENDATIONS

1. Food manufacturing companies in Nigeria should carry out a value chain analysis of the proposed backward integration. This will help to answer the question whether or not it is more cost effective to integrate at all.
2. Food Manufacturing companies should do an analysis of other benefits which can lead to future profit e.g. tax relief, concessions, increased market share etc.
3. Companies should evaluate the short term and long term financing options available and how to sustain current business pending when the investment begins to yield expected returns.
4. Consider partnership with farmers. This may be in the area of expanding their already existing production level and technology as this may reduce the cost of beginning from the scratch.
5. Also consider private public partnership (PPP) with State Governments or even Federal Government agencies as some State Governments are yearning for this as it can be a means of queuing into an organized platform for guaranteed success e.g. Rivers State Songhai farm and sustainable development project.
6. Site factories or production plant close to farms (raw materials sites) as this will help in reducing transportation and other logistic cost.
7. Consider creating new innovative products which will create a variety of products that your raw materials can be used to produce as this may help in distributing the fixed cost attributable per unit cost.
8. Evaluate what good use your waste or bye products can be put into (recycling) to eliminate the disposal costs thereby creating additional revenue.

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