SECTION A

Corporate Governance: Executive Leadership

CASE 1

The Recalcitrant Director at Byte Products, Inc.

CORPORATE LEGALITY VERSUS CORPORATE RESPONSIBILITY

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BYTE PRODUCTS, INC., IS PRIMARILY INVOLVED IN THE PRODUCTION OF ELECTRONIC components that are used in personal computers. Although such components might be found in a few computers in home use, Byte products are found most frequently in computers used for sophisticated business and engineering applications. Annual sales of these products have been steadily increasing over the past several years; Byte Products, Inc., currently has total sales of approximately $265 million.

Over the past six years, increases in yearly revenues have consistently reached 12%. Byte Products, Inc., headquartered in the midwestern United States, is regarded as one of the largest-volume suppliers of specialized components and is easily the industry leader, with some 32% market share. Unfortunately for Byte, many new firms—domestic and foreign—have entered the industry. A dramatic surge in demand, high profitability, and the relative ease of a new firm's entry into the industry explain in part the increased number of competing firms.

Although Byte management—and presumably shareholders as well—is very pleased about the growth of its markets, it faces a major problem: Byte simply cannot meet the demand for these components. The company currently operates three manufacturing facilities in various locations throughout the United States. Each of these plants operates three production shifts (24 hours per day), seven days a week. This activity constitutes virtually all of the company's production capacity. Without an additional manufacturing plant, Byte simply cannot increase its output of components.

This case was prepared by Professors Dan R. Dalton and Richard A. Cosier of the Graduate School of Business at Indiana University and Cathy A. Enz of Cornell University. The names of the organization, individual, location, and/or financial information have been disguised to preserve the organization's desire for anonymity. This case was edited for the *SMBP*–9th, 10th, 11th, 12th, 13th and 14th Editions. Reprint permission is solely granted to the publisher, Prentice Hall, for the book, *Strategic Management and Business Policy – 14th Edition* by copyright holders Dan R. Dalton, Richard A. Cosier, and Cathy A. Enz. Any other publication of this case (translation, any form of electronic or other media), or sale (any form of partnership) to another publisher will be in violation of copyright laws, unless the copyright holders have granted an additional written reprint permission.

James M. Elliott, Chief Executive Officer and Chairman of the Board, recognizes the gravity of the problem. If Byte Products cannot continue to manufacture components in sufficient numbers to meet the demand, buyers will go elsewhere. Worse yet is the possibility that any continued lack of supply will encourage others to enter the market. As a long-term solution to this problem, the board of directors unanimously authorized the construction of a new, state-of-the-art manufacturing facility in the southwestern United States. When the planned capacity of this plant is added to that of the three current plants, Byte should be able to meet demand for many years to come. Unfortunately, an estimated three years will be required to complete the plant and bring it online.

Jim Elliott believes very strongly that this three-year period is far too long and has insisted that there also be a shorter-range, stopgap solution while the plant is under construction. The instability of the market and the pressure to maintain leader status are two factors contributing to Elliott's insistence on a more immediate solution. Without such a move, Byte management believes it will lose market share and, again, attract competitors into the market.

Several Solutions

A number of suggestions for such a temporary measure were offered by various staff specialists but rejected by Elliott. For example, licensing Byte's product and process technology to other manufacturers in the short run to meet immediate demand was possible. This licensing authorization would be short term, or just until the new plant could come online. Top management, as well as the board, was uncomfortable with this solution for several reasons. They thought it unlikely that any manufacturer would shoulder the fixed costs of producing appropriate components for such a short term. Any manufacturer that would do so would charge a premium to recover its costs. This suggestion, obviously, would make Byte's own products available to its customers at an unacceptable price. Nor did passing any price increase to its customers seem sensible, for this too would almost certainly reduce Byte's market share as well as encourage further competition.

Overseas facilities and licensing also were considered but rejected. Before it became a publicly traded company, Byte's founders had decided that its manufacturing facilities would be domestic. Top management strongly felt that this strategy had served Byte well; moreover, Byte's majority stockholders (initial owners of the then privately held Byte) were not likely to endorse such a move. Beyond that, however, top management was reluctant to foreign license their goods—or make available by any means the technologies for others to produce Byte products—as they could not then properly control patents. Top management feared that foreign licensing would essentially give away costly proprietary information regarding the company's highly efficient means of product development. There also was the potential for initial low product quality—whether produced domestically or otherwise—especially for such a short-run operation. Any reduction in quality, however brief, would threaten Byte's share of this sensitive market.

The Solution!

One recommendation that has come to the attention of the Chief Executive Officer could help solve Byte's problem in the short run. Certain members of his staff have notified him that an abandoned plant currently is available in Plainville, a small town in the northeastern United States. Before its closing eight years earlier, this plant was used primarily for the manufacture of electronic components. As is, it could not possibly be used to produce Byte products, but it could be inexpensively refitted to do so in as few as three months. Moreover, this plant is available at a very attractive price. In fact, discreet inquiries by Elliott's staff indicate that this plant could probably be leased immediately from its present owners because the building has been vacant for some eight years.

All the news about this temporary plant proposal, however, is not nearly so positive. Elliott's staff concedes that this plant will never be efficient and its profitability will be low. In addition, the Plainville location is a poor one in terms of high labor costs (the area is highly unionized), warehousing expenses, and inadequate transportation links to Byte's major markets and suppliers. Plainville is simply not a candidate for a long-term solution. Still, in the short run, a temporary plant could help meet the demand and might forestall additional competition.

The staff is persuasive and notes that this option has several advantages: (1) there is no need for any licensing, foreign or domestic, (2) quality control remains firmly in the company's hands, and (3) an increase in the product price will be unnecessary. The temporary plant, then, would be used for three years or so until the new plant could be built. Then the temporary plant would be immediately closed.

CEO Elliott is convinced.

Taking the Plan to the Board

The quarterly meeting of the board of directors is set to commence at 2:00 P.M. Jim Elliott has been reviewing his notes and agenda for the meeting most of the morning. The issue of the temporary plant is clearly the most important agenda item. Reviewing his detailed presentation of this matter, including the associated financial analyses, has occupied much of his time for several days. All the available information underscores his contention that the temporary plant in Plainville is the only responsible solution to the demand problems. No other option offers the same low level of risk and ensures Byte's status as industry leader.

At the meeting, after the board has dispensed with a number of routine matters, Jim Elliott turns his attention to the temporary plant. In short order, he advises the 11-member board (himself, 3 additional inside members, and 7 outside members) of his proposal to obtain and refit the existing plant to ameliorate demand problems in the short run, authorizes the construction of the new plant (the completion of which is estimated to take some three years), and plans to switch capacity from the temporary plant to the new one when it is operational. He also briefly reviews additional details concerning the costs involved, advantages of this proposal versus domestic or foreign licensing, and so on.

All the board members except one are in favor of the proposal. In fact, they are most enthusiastic; the overwhelming majority agree that the temporary plant is an excellent—even inspired—stopgap measure. Ten of the eleven board members seem relieved because the board was most reluctant to endorse any of the other alternatives that had been mentioned.

The single dissenter—T. Kevin Williams, an outside director—is, however, steadfast in his objections. He will not, under any circumstances, endorse the notion of the temporary plant and states rather strongly that "I will not be party to this nonsense, not now, not ever."

T. Kevin Williams, the senior executive of a major nonprofit organization, is normally a reserved and really quite agreeable person. This sudden, uncharacteristic burst of emotion clearly startles the remaining board members into silence. The following excerpt captures the ensuing, essentially one-on-one conversation between Williams and Elliott:

Williams: How many workers do your people estimate will be employed in the temporary plant?

Elliott: Roughly 1200, possibly a few more.