

Cost Saving by Cutting the CEO's Salary : A Case Study of Narmada Techno Crafts Ltd.

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Abstract

Narmada Techno Crafts Ltd. is a company in Pithampur (M.P., India) which produces machines, which are exported. The company was suffering because of the lockdown caused due to the COVID-19 pandemic. During the lockdown, the factory was closed and the production was also shut down ; hence, the company was unable to complete the export orders. The board of directors was seriously thinking about the same issue. The way of thinking was towards cost cutting. One of the directors had an objection on the high salary of the Chief Executive Officer of the company. He advised a cut down in the CEO's salary package. The Managing Director, Mr. Shantanu Kapadia was not in favour of the same. As per his opinion, the CEO, Mr. Murlidhar Agarwal was an asset for the company who contributed towards a lion's share in the progress of the company. He presented a four pillared plan to save costs in the future after lockdown as well as tried to prove that the salary of the CEO was not excessive.

Keywords : COVID-19 pandemic, lockdown, salary package

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Narmada Techno Crafts Ltd. is a machine manufacturing company, and it is a 100% export oriented unit (EOU). It has a plant in the special economic zone in Pithampur, Madhya Pradesh where the Central government has given them a plot on a lease of 30 years. The plot size is of 10,000 square meters. The company has invested into a fixed infrastructure on the plot. There is a staff of 210 employees in the factory which include the marketing, finance, production, human resource, and stores departments. The company's Managing Director, Mr. Shantanu Kapadiya is very much worried about the present situation of the company in the lockdown of few months, which pushed the company back in terms of performance. The production was totally stopped during the lockdown. The company lost few orders of export because they had to supply the machinery up to April 15, 2020.

Mr. Kapadiya was worried about the export orders and the delay in the manufacturing ; so, he called a meeting of the Board of Directors.

Mr. Talreja, a director said :

I already raised the issue of slow speed of manufacturing in the plant since last December, but

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nobody gave attention. We should have purchased the new machine from Japan earlier for our cutting division, and our order delivery in March and April would have been completed before time.

The MD, Mr. Kapadiya replied,

Sir, that machine was very costly and we were facing the problem in getting a long term loan from our banker. Finance is just like blood in the business, right now we are facing a working capital crisis, we must think about how to fight with the current situation. We cannot ignore the routine expenditure like salary, energy bills, as well as dues to suppliers. Kindly give me your views regarding the cost control. This is the requirement of the time. There will be an adverse situation for the exports of the country in the next few months, we should rely on the package announced by the Central and State governments in the form of subsidies, but I think it is very important for us to focus on saving and cost cutting. I have planned for a strategy in our company, which will lead towards cost control. It is an effective tool of financial management to regulate the working of a manufacturing concern. In the global business approach, mere planning is not enough, efforts are constantly required to scrutinize the results of the working. In such a tough situation, future threats are also to be recognized and the action plan should be prepared. With the help of cost control, the organization can limit the costs in a planned manner. I have a four pillar model for cost control, let me present that :

↳ **Cutting the Expenses :** We have to look how we can cut the excessive expenses. In the last quarter, if we see the consumption of raw material before the lockdown, it was 1.5 times than the previous quarter, but the production was the same. This indicates that the wastage of raw material was there in a huge quantity, which is to be controlled. Secondly, we have staff working in overtime and earning double rated wages. This should be prevented, and the production process should be regularized in a proper shift of 8 hours. Similarly, extra power and fuel expenditure must be controlled to the maximum extent. Extra staff should be removed from all the departments.

↳ **Training the Staff :** Staff is required to be trained professionally. New qualified engineering consultants are required to be hired for skill enhancement and professional training of the employees in all the divisions.

↳ **Debt Recovery :** The recovery from the debtors is very much important. During the lockdown, the international transactions were also in problem ; so, the recovery of dues is very important. A follow up program is required.

↳ **Streamlining the Machinery :** There are so many bulky machines in our factory which have slow speed and high requirement of electricity power. We have to remove these type of old and heavy machines and purchase a new set up from abroad. This will save our cost in the future.

Mr. Kothari, a senior Director said,

Right now, we must take up immediate actions to go for cost management. We have to fight this situation and we must start with immediate effect. I would like to suggest that we can work on the cost cutting model by removing the burden of highly salaried employees. I am always in the favor not to appoint the Chief Executive Officer on a very high package. We need to remove

him from the job or cut his salary as this might be an effective step towards cost management.

The other directors did not fully agree with Mr. Kothari. The CEO, Mr. Murlidhar Agarwal was appointed by the board of directors 2 years ago. He had 20 years of experience in the export of machinery in which Narmada Techno Crafts Ltd. was dealing. Mr. Agarwal was a dynamic person and the company observed a remarkable boost in the turnover in the past 2 years. He used to work for 10 hours minimum in the company's office and was a very sincere person. The workers were very happy with his behavior, and he had a perfect coordination with all the staff in the hierarchy of the organization. In these 2 years, the company raised its turnover from INR 100 crores to INR 125 crores and the revenue of the company also increased with near about 25%. Mr. Murlidhar had a very good command on the international business and he was very proficient with the ups and downs ; supply and demand ; logistics, other factors, and laws which affect the international market. He had a sound knowledge of the machinery in the plant, and he always had been very keen on the maintenance of the same. The salary given to him was ₹ 11.5 lacs per annum as the revenue (net) of the company was ₹ 25 crores and ₹ 31 crores in the last 2 years. Mr. Kothari was always against appointing him on such a huge salary package.

Mr. Shantanu Kapadiya was very unhappy with his attitude. He said :

Mr. Kothari, most of the members of the Board do not think so. We all believe that in the recent progress of the company, the CEO has a major share. I have brought the details of the salaries which our competitors are paying to their CEOs. We had a net revenue of ₹ 31 crores in the last year, and in comparison to this, we pay a reasonable salary to Mr. Agarwal. We do not think it is an excessive burden of expenses. Sir, most of us are present in today's meeting, and we should make clear what will be our strategy.

Most of the board members agreed that it is not a good step to remove the CEO or cut his salary. Mr. Kapadiya presented a table showing the annual salaries of CEOs and revenues (net) of seven competitor companies (refer to Table 1).

Table 1. Annual Salaries of CEOs and Revenues (Net) of Competitor Companies

S. No.	Name of Competitor Company	Annual Salary of CEO (in Lakhs ₹)	Annual Revenue (Net) of the Company (in Crores ₹)
1	Alpha Engineering Ltd.	11	15
2	Bajrang Manufacturers Ltd.	14	27
3	Himani Agro Ltd.	14	27
4	Karishma Exporters Ltd.	17	30
5	Amazon Machineries Ltd.	17	34
6	Excellent Tools Ltd.	21	38
7	Ishwar International Ltd.	25	46

Questions

(1) Make a SWOT analysis of the case.

(2) If you are the Managing Director of Narmada Techno Crafts Ltd., what decision will you take about the CEO's salary cut ? Justify your answer.

Teaching Notes

Synopsis

This is a case of a company named Narmada Techno Crafts Ltd., which is a 100% export oriented unit (EOU). It manufactures machines and exports them. The company has its plant at SEZ Pithampur and is suffering from problems in the lockdown. It lost some orders of export machinery and the Managing Director, Mr. Shantanu Kapadiya was worried about the future of the company after lockdown. He called upon a meeting of the board of directors and wanted to discuss how to save the costs after and during the lockdown. Mr. Kothari, a senior Director, was in favour of removing or cutting the salary of the CEO, Mr. Murlidhar Agarwal. However, the other directors and Mr. Kapadiya did not agree with him. They appreciated the qualities and experience of the CEO. Mr. Shantanu Kapadiya wanted to convince all the directors that the CEO is paid reasonably and not excessively in comparison to other competitor companies.

Learning Objectives

The following are the main objectives of this case study :

- (i) To make the students aware about the problems faced by Indian industries due to the lockdown due to COVID -19.
- (ii) To explain the situations where a company has to implement cost cutting measures.
- (iii) To discuss that hardworking employees are always an asset for every organization.
- (iv) To develop an understanding about regression analysis.

Potential Audience

The target audiences for this case study are the students of BBA and MBA and working professionals of corporate and government sectors. It may also include the faculty members teaching subjects like Business Statistics, Research Methodology, Fundamentals of Management, and other streams like commerce, economics, engineering, and research scholars.

Teaching Approach and Strategy

The teaching approach and strategy adopted was that the students were given the case study a day before to read. Similarly, they were also advised to revise the topic of regression analysis and impact of COVID - 19 over the Indian industry as well as economy. This may be done before discussion of the case study in the class. The concepts like cost cutting, lockdown, selection, and promotion are to be discussed with the students in depth.

Teaching Plan

This case study was discussed in the class of BBA IIIrd year online. It was discussed after a thorough study of the impact of COVID -19 on the Indian industry and economy. Previously, the case was mailed to the students and then it was discussed in the virtual class.

(Q.1) Make a SWOT Analysis of the Case (20 minutes).

The Indian as well as the global economy is facing a slow down which is expected to remain up to some months in the future. When there was a reduction in the revenues, as in this case, the company lost the export orders and was very doubtful about the future of exports, and the management looks forward to cut the costs. It considers various options for cost savings.

Strengths of the Case :

- ✍ Mr. Shantanu Kapadiya is a responsible person working as the Managing Director of the company. He has a four pillared cost cutting strategy.
- ✍ The board of directors is willing to continue the business in the future.
- ✍ The CEO of the company, Mr. Murlidhar Agarwal is a well qualified and experienced person.
- ✍ The company is established in a special economic zone.
- ✍ The company is 100% EOU, with a bright record of increments in revenue.

Weaknesses :

- ✍ The pandemic situation of COVID - 19 lockdown has impacted the export business quite negatively.
- ✍ There is a loss of export orders.
- ✍ The board of directors has difference of opinion.

Opportunities :

- ✍ After lockdown, the company may recover its business.
- ✍ There will be an increase in demand for machines in the global market in the near future.
- ✍ Cost cutting might help the company to survive in this difficult situation.

Threats :

- ✍ If the lockdown continues, it will result in reduction in production.
- ✍ If the four pillared cost cutting strategy is not implemented, there will be a huge loss.
- ✍ The CEO may resign if his salary is reduced.
- ✍ In future, there will be a possibility of shut down.

(Q.2) If you are the Managing Director of Narmada Techno Crafts Ltd., what decision will you take about the CEO's salary cut ? Justify your answer (40 minutes).

If I am in the position of the Managing Director, I will go for other options of cost saving. Cutting the salary of the CEO is not appropriate in this difficult time. If Narmada Techno Crafts Ltd. was able to increase its revenue, it was due to the devotion of its CEO, Mr. Agarwal. However, there was an objection raised by Mr. Kothari, a senior Director, that the salary paid to Mr. Murlidhar Agarwal was an extra expenditure, which needs to be cut down. He

ignored that the CEO used to work for 10 hours minimum in the company's office and was a very sincere person. The workers were very happy with his behavior, and he had a perfect coordination with all the staff in the hierarchy of the organization. In the past 2 years, the company raised its turnover from INR 100 crores to INR 125 crores and the revenue of the company also increased with near about 25%. Mr. Murlidhar had a very good command on international business, had a sound knowledge of the machinery in the plant, and he always was very keen on the maintenance of the same. The salary given to him was ₹ 11.5 lacs per annum as the revenue (net) of the company was ₹ 25 crores and ₹ 31 crores in the last 2 years. The company needed his expert leadership to sail through this toughest time. If we compare the salary earned by the CEOs of the competitors in the market, the salary given by Narmada Techno Crafts Ltd. to Mr. Agrawal is quite reasonable and as the revenue increased, the salary deserves to be increased. The organization can decide not to give any increment to Mr. Agarwal this year due to the pandemic situation, but it is not feasible to cut down his salary.

We will apply regression test on the data of CEO's salary and revenue given in the case (Table 1). Here, revenue is independent and salary is dependent variable.

⇒ **H0**: There is no significant dependency of salary of CEOs on the revenue of the companies.

⇒ **H1**: There is a significant dependency of salary of CEOs on the revenue of the companies.

Table 2. Regression Statistics

Multiple R	0.96802
R Square	0.937063
Adjusted R Square	0.924476
Standard Error	1.298735
Observations	7

Table 3. ANOVA

	<i>Df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	125.5664	125.5664	74.44444	0.000345
Residual	5	8.433566	1.686713		
Total	6	134			

Table 4. Coefficients

	Coefficients	Standard Error	t-Stat
Intercept	2.475524	1.753498	1.411763
Revenue	0.468531	0.054303	8.628119

Table 3 (ANOVA) reveals that the *F* - value of 74.44 is significant at the 1% level. Degree of freedom is 1/5, which means that the null hypothesis H0 is rejected and H1 is accepted. Further, it can be described that salaries of CEOs significantly depend on the revenue of the companies. It can be further highlighted that if companies' revenue will increase, the salary of CEOs will also increase or vice versa.

R-square value (Table 2) of 0.93 reveals that 93% variation in dependent variable is explained by the independent variable. It means that 93% variation in salary, which is the dependent variable in this case, is explained by revenue of the company.

Table 4 indicates the following regression equation for future prediction purposes :

$$y = 2.48 + 0.47 * x$$

or

$$\text{Salary of CEO} = 2.48 + 0.47 * \text{Revenue of the company}$$

If regression coefficient for exogenous variable, revenue of company, indicates a positive relationship with the dependent variable, salary of CEO, it implies that if the revenue of a company increases by 1 point, the salary of CEO will increase by 0.47 points.

Conclusion

From the analysis, it can be concluded that there is a significant dependency of the salary of CEOs on the revenue of the companies. The salary paid to Mr. Murlidhar Agarwal, CEO, Narmada Techno Crafts Ltd. is dependent on the revenue of the company, which has been increasing year by year. When the revenue was increasing in previous years, it was not said that the high salaried CEO was drawing an excessive salary. So, in this difficult situation of lockdown, it will not be a good decision to cut down the salary of the CEO as a cost saving measure.

Managerial Implications

The most significant implication of the case is that during difficult situations, the management can think about cost savings, but they should not focus on the employees who are on the key posts in the organization. If the salaries are reasonable and not excessive, then the first step of the management to save the costs should be controlling it by saving other extra and unnecessary expenditure.

Suggested Readings

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Disclaimer

This case was prepared by the authors for the sole purpose of aiding class room discussion. Cases are not intended to serve as endorsements, or sources of data, or illustrations of effective or ineffective management. This case is based on a hypothetical strategic problem the industry is facing right now due to lockdown.

Authors' Contribution

Dr. Manish Khargonkar conceived the idea and developed qualitative and quantitative design to undertake the case study. Dr. Sachin Mittal verified the analytical methods and supervised the study. The numerical

computations were done by Dr. Manish Khargonkar and Dr. Sachin Mittal in Excel. Dr. Manish Khargonkar wrote the case study in consultation with Dr. Sachin Mittal.

Conflict of Interest

The authors certify that they have no affiliations with or involvement in any organization or entity with any financial interest, or non-financial interest in the subject matter, or materials discussed in this manuscript.

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