



Exhibit C

Exhibit D

Q.—Assuming the same conditions; if instead of the economies in Fixed Cost the Variable Cost is reduced to \$.70 on each dollar of sales, how much business will it be necessary to do to break even?

A.—If the Variable Cost is reduced to \$.70 on each dollar of sales, then we have \$.30 on each dollar of sales applicable to Fixed Cost. Accordingly we divide \$.30 into \$120,000. The answer is \$400,000 per month.

$$\begin{array}{r} .30) \$120,000 \\ \underline{\$400,000} \end{array}$$

Q.—Assuming the same conditions, how much would our loss be if we should do \$500,000 business per month?

A.—Since we get a contribution to Fixed Cost and Profit of \$.20 on each dollar of sales, we would have a total contribution of \$100,000, and since our Fixed Cost is \$120,000 we would lose \$20,000 per month.

| | | |
|--------------|-----------|--------------------|
| \$500,000 | \$120,000 | Fixed Cost |
| .20 | 100,000 | Total Contribution |
| \$100,000.00 | \$20,000 | Loss per month |

Q.—Assuming the same conditions, how much would our profit be if we should do \$1,000,000 business per month?

A.—Following the same procedure as in the foregoing question, we would make \$80,000 per month.

| | | |
|--------------|-----------|--------------------|
| \$1,000,000 | \$200,000 | Total Contribution |
| .20 | 120,000 | Fixed Cost |
| \$200,000.00 | \$80,000 | Profit per month |

To emphasize the full significance of this subdivision of costs, the next exhibit shows how four businesses, each doing the same volume of business—\$30,000,000 per annum—and making the same profit—10 per cent or \$3,000,000 per annum—might have very different potentialities.

Exhibit B—The Best Business

The fact that an enterprise has earned 10 per cent on a business of \$30,000,000 is not in itself sufficient to warrant an opinion concerning what that enterprise can do on any other volume of business.

To say that an enterprise has a Variable Cost of 70 per cent and a Fixed Cost of \$6,000,000 means not only that it will make 10 per cent on \$30,000,000 of business, but also that it will break even on \$20,000,000 and will make different percentages of profit according to the amount of business done from \$20,000,000 up to its capacity.

On \$25,000,000 it would make \$1,500,000 = 6 per cent.
 On \$30,000,000 it would make 3,000,000 = 10 per cent.
 On \$35,000,000 it would make 4,500,000 = 13 per cent.

If I were given a choice of the four businesses shown on Exhibit B, assuming that the smallest volume of business which there was reasonable probability of doing was \$20,000,000 and that the practical capacity of the plant was \$35,000,000, I would select business B. If, however, there was probability of the business falling to as little as \$15,000,000, I would select business A; or if, on the other hand, there were little danger of its going below \$25,000,000, I would select business C or even D.

As is stated at the bottom of the exhibit; *The best business is the business with the lowest Variable Cost consistent with a breaking point below the smallest volume of business which there is reasonable probability of doing.*

For the present I shall drop this subject and take up certain features of organization which must go hand in hand with it for either to be fully effective.

2. UNIFICATION OF RECORDS WITH REFERENCE TO RESPONSIBILITY

Exhibit C—Organization Chart

This is a simple organization chart, but the principle it illustrates is applicable to any enterprise regardless of its limitations or ramifications.

First, consider what an organization chart is. No two or more men can function together effectively without an agreement and understanding concerning their respective responsibilities and duties. An organization chart is nothing more nor less than a conventional means of recording and making clear the responsibilities and duties of the persons constituting the organization.

If the organization chart represents the units of responsibilities and duties upon which the success or failure of the enterprise depends, then obviously it represents the units in which all costs and records should be kept if the chief executive is to exercise an effective control over the situation. If responsibilities and duties are assigned on one basis and records kept on another, one might as well try to check with a bushel basket something bought by the pound. That is what is unconsciously being done in many of the best organizations.

In making a report on a very large and successful organization, we recently recommended that the classification of operating accounts be changed to conform