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MANAGEMENT CONTROLS IN INDUSTRY

28 January 1957

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ADMIRAL DEUTERMANN: Good morning. This morning we are going into Management Controls in Industry. You have the biography of our speaker, so I need not dwell on it. I would like to call your attention to the fact that there is integration and unification in industry too. Mr. Davis was with Cadillac in General Motors for 21 years and then he shifted over to Ford. He hasn't any scars or anything on him. He had a few years in the process at Avco Corporation, but industry had no bad reaction on him.

I am happy that he is with Ford. I bought five shares of Ford. It might sound piddling, but it is very serious to me. In 1929, when I was an ensign, I bought \$20 worth of Detroit Aircraft and two days later the market evaporated. I wrote several inquiries over the years, and the Post Office always came back and said, "No addressee here," or something of that kind. After 30 years had elapsed I thought I would go back into the market. The Kremlin is still calling me a capitalist, so I went and bought five shares of Ford. They have been very loyal and faithful. I get a \$3 check every 3 months.

I was trying to probe the speaker this morning about how the prospects are this year, because it takes part of my national planning in. The

Industrial College has been a great one for cementing relations with industry, and I have been cementing them so hard with five shares here and there that my bank told me I have run out of cement now. This is our speaker's first visit to the College. Coming as he does as the Vice President for Manufacturing at Ford Motor Company, we are indeed fortunate to have Mr. Davis here. He will talk on Management Controls in Industry. Mr. Davis.

MR. DAVIS: Thank you, Admiral. I could have gotten you some American Motors stock yesterday at a bargain price. The guy that took me through the Capitol Building wanted to sell me 1,000 shares with three months to share off. I didn't buy any.

Good morning, gentlemen.

MANAGEMENT CONTROLS IN INDUSTRY

Salutation

I am pleased that you have invited me here today for two reasons. First, I consider it an honor to have this opportunity to contribute to a program so vital to our nation's security. Second, as a member of my Company's management team, I always welcome the chance to tell a little of the Ford Story.

Purpose and Scope of Management Controls

I have been asked to discuss the subject of "Management Controls in Industry". This is a broad subject, but at the risk of oversimplification I will say that control of a business is basically an administrative function, although many specialized versions, such as cost control, have evolved.

The purpose of a good control system is to give direction to the business by clearly establishing its goals, to develop means by which it can reach those goals, and to measure progress toward those goals. Of course, when I talk about setting goals and showing how to reach them, I'm talking about the leadership that Management must give to the people who really make up a business enterprise -- its employees.

Today, good management control is more important than ever due to the present trend toward more decentralization, diversification of product, and expansion.

Many new systems are being tried out. Some companies have set up staff groups which report directly to the board chairman, while the president manages the daily business of line operations.

Management by committee is becoming popular. In one case, all executive office heads serve on several interlocking committees, which report to a top executive committee. Through their committee work, executives learn more about each other's activities. Major decisions are made by various groups rather than by individual officers. The information on which decisions are based becomes group information which is more quickly disseminated through the company.

A new kind of management man -- the organizational planner -- is working to build better control through reorganization of the structure of the business itself.

Another approach to better top-level control is to set up a super staff group which has control as its principal function. This group helps to develop goals, and the kind of reporting system needed to measure progress. The group also receives top-level control reports, analyzes them, and makes periodic recommendations to the president.

All of these systems have a common denominator. In each case, the chief executive has only a few people reporting to him, and those people are reporting only important, dependable, up-to-date information compiled by good control systems.

At Ford, we feel that management control is just as important in the planning phases of the business as in daily operations. For that reason it permeates all major areas of our industrial activities. I want to spend a few minutes in each of these control areas -- organization, planning, scheduling, inventory, quality, cost, and manpower.

Management Control Through Organization

Good organization is the basis for orderly business operation. Planning such an organization means identifying and grouping the activities of a business and then assigning their functions. The three goals of organization planning are:

1. To determine what activities are necessary.
2. To determine the particular kinds of decisions which must be made, and which executives should make them.
3. To establish the proper responsibilities and interrelationships among components in the organization.

The organization of the Ford Motor Company is divided into three principal segments:

- First - Committees, to consider long-range objectives and policies, to determine products, schedules, utilization of facilities, new plants, and other associated matters, and to make appropriate recommendations to the Board of Directors.
- Second - Central Office Staffs, to administer and supervise the execution of plans, programs, and policies, and to provide necessary staff services to all the operating divisions of the Company.

Third - Operating Divisions, to manufacture, assemble, and market all Company products.

Information on the organization structure of the Company and the functions of all components is disseminated through the medium of an organization manual. The organization manual is used continually as a reference source for clarifying intra-company relationships. In this way it functions as an important tool of Management.

Another important medium of control in the area of organization is the policy letter, which is issued by the Chairman of the Board or the President only when necessary to clarify the Company's position. Perhaps the most fundamental of these at Ford is Policy Letter No. 8, which spells out the relationships between division and staff organizations. For example, this letter points out that some staff offices -- General Counsel, Public Relations, and Tax Affairs -- perform direct centralized functions for the Company as a whole. Others -- Engineering, Finance, Industrial Relations, and Manufacturing -- perform certain direct services for the entire Company, but act primarily as agencies responsible for maintaining "functional supervision" over divisional operations within particular fields of activity. It is in this area of functional supervision that the most important relationships exist between the central office staffs and the divisions.

The extent of functional supervision exercised by the central office staffs is that which is required to assure effective and coordinated operations throughout the Company. The divisions are directly responsible, however, for managing their own affairs within the scope of established Company policies and procedures.

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As you might expect, several of our policy letters deal with governmental relationships. Since several separate divisions of the Company may hold their own contracts with federal agencies or departments, it is imperative from the control standpoint that basic policies and definite procedures be spelled out, followed, and coordinated with those activities to whom company-wide responsibility for governmental relationships has been assigned. For example, settlements of terminated defense contracts are negotiated by the Finance Staff, the Office of the General Counsel, and the Mobilization Planning and Defense Sales Department.

Another medium for control of company-wide activities is the operating guide or manual.

For example, the Controller's Manual spells out Company policies and procedures in the controller's area of responsibilities. Each division and operating activity is responsible through its own controller for following instructions contained in the manual.

Similar tools exist for other major activities of the Company such as a Purchasing Manual, manuals for manufacturing procedures and standards, and for industrial relations.

Product and Manufacturing Planning

Nowhere in general business operation is management control more vitally important than in the development and execution of a new model program. Quite often the financial success or failure of a company depends upon the coordination of such a program.

At Ford, forward planning of Company products is initiated by those divisions responsible for the assembling and marketing of those products -- the vehicle divisions.

The primary responsibility for reviewing new model program proposals is a function of the Administration Committee. A smaller group, the Product Planning Committee, meets more frequently and works closely with the vehicle divisions in considering product plans and proposals between presentations to the Administration Committee.

Each vehicle division is responsible for presenting forward product proposals and other related data to higher management before actual styling development and design of major components is authorized. The Administration Committee reviews and the Executive Committee passes upon proposals for basic product lines and merchandising and financial objectives. These objectives include such matters as estimated production volume, general package specifications, major chassis and mechanical features, performance, interchangeability, body types, timing, design cost, tooling cost, manufacturing facilities investment, and the all-important thing that keeps us in business, the return on assets employed.

Following approval of the basic program objectives by the Administration and Executive Committees, the Product Planning Committee maintains current and frequent review of product planning as it is developed by the vehicle divisions.

The vehicle divisions coordinate proposed product plans sufficiently in advance of scheduled Administration Committee meetings to allow adequate time for study by the Engineering, Manufacturing, and Finance Staffs, and any other staff offices and divisions concerned. The chairman of the Product Planning Committee reviews presentations in advance of scheduled meetings and determines that product planning has been coordinated before they are presented to the Administration Committee.

Throughout the product planning phase of a new model program, close coordination and control is exercised through the operation of Engineering Liaison Committees. These committees are composed of both staff and operating division personnel in the engineering and manufacturing areas. These groups control the program at the "grass roots" level, while the Product Planning, Administration, and Executive Committees exercise higher management control.

Manufacturing planning is carried on almost concurrently with product planning. However before manufacturing planning can proceed, Management determines whether to make or buy each part or assembly. In making this decision, the availability of Company facilities and of reputable vendors, as well as comparative prices, are taken into account. Under the intra-Company pricing policy, prices are negotiated between divisions on the same basis as with outside suppliers. This assures competitive make and buy price levels.

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For those items which are to be made by Ford, detailed manufacturing planning includes determination of the sequence of operations to be performed, the type of machines required, the volume of units to be produced, the production tooling necessary for each operation, and the associated process equipment required, as well as material handling, plant layout, and utilization of manpower. This planning takes into account presently available machines, equipment, and tooling, and considers new or more productive machines if warranted.

Appropriation requests covering all facilities and tooling requirements and other items of cost necessary to the manufacturing program are initiated by the vehicle and manufacturing divisions. These requests are submitted first to staff for review and recommendations, and then to the Administration Committee for approval and to the Executive Committee or Board of Directors for authorization of funds.

A vital part of any new model program is planning for purchasing of those items which have been earmarked for supply by outside firms. Here again top management's goals have been spelled out for better control at the operating level.

Production Scheduling and Inventory Control

When product and manufacturing plans for the new model program have been approved, it becomes necessary to establish an Official Production Program for the Company.

This program is the primary responsibility of a Scheduling Committee, which reviews the proposed production programs of the vehicle divisions giving consideration to such factors as market demand, sales forecasts, production rates, retail deliveries, dealers' stocks, physical inventories, material availability and commitments, and the relationship of proposed programs to the general financial and operating plans of the Company.

Upon approval by the Scheduling Committee, the production program becomes the basis for issuance of fabricating and shipping instructions.

Primary staff responsibility for keeping the production program "on the track" belongs to the Production Programming and Control Office, whose Director reports directly to the Executive Vice President - Basic Manufacturing Divisions.

Relationships between ordering and supplying divisions generally conform to the normal relationships between customer and supplier. Each ordering division keeps its supplying divisions advised on future production requirements. In return, each supplying division as a vendor furnishes advice on manufacturing capabilities.

Each division is responsible for taking action within the limits of its authority to assure that production schedules are met without excess material and manpower costs. This includes action required to provide parts and materials in accordance with approved schedules, the prompt adjustment of schedules when in the Company's interest, and a cooperative exchange of any data that will promote sound production planning and performance.

The Ford Motor Company system of production scheduling involves three basic principles. The first is that the schedule operates as though the entire product were moving along a single assembly line. The various operations may actually be located in many different plants under different ownerships, but the entire process is treated as though all operations were under one management and in one plant, and as though the carriers, such as freight trains, trucks, and boats were simply conveyor systems within the plant.

The second basic principle is that all material, both raw and in-process, is presumed to be in-process material for scheduling purposes.

The third basic principle is that we always work toward an accumulative total of vehicles to be delivered from the end of the final assembly line through a certain period.

Our ship and fabricate orders are prepared on an accumulative basis with schedules advanced to cover system, operational reserve, and transit time.

These time advances are what we call floats. Floats may extend through many operations and many plants but, due to the accumulative method of scheduling, they do not change the authorized total quantity requirement. Float quantities are divided into time compartments for ordering, scheduling, and movement. There is really no difference between scheduling production within a plant and scheduling shipments to the plant, since the supplier's shipping dock becomes in effect the first operation in the plant preparing the schedule.

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Shipping and cycling problems are provided for in the operational reserve. The size of this reserve is primarily determined by the frequency of shipment to be scheduled from the supplier or the frequency of the manufacturing cycle within a particular plant. Obviously, if a particular item is to be received or manufactured once a week, one week's supply must be received or manufactured at one time. This in turn requires an operating reserve of one week. A small amount of protection time is also added to the operating reserve for machine breakdowns, carrier delays, and other contingencies. This protection reserve, however, is kept to an absolute minimum. It has to be kept to a minimum because we maintain a turn-over rate of about twenty-four times a year.

Inventory control as a separate function does not exist in the automotive industry except in the warehousing of service parts, because the finished goods inventory is negligible. Service parts are controlled by standard merchandising methods utilizing sales forecasts, maximum and minimum inventory levels, and re-order points. The inventory of raw materials and work-in-process is controlled through the schedule rather than by separate inventory controls.

In production of defense items, "spares" called for in contracts are scheduled in the same manner as "service parts" for commercial production. No change in the basic production scheduling system is necessary.

This system of scheduling used at Ford serves to control inventory at the desired levels. If components are moving through and out of each plant at the scheduled rate, and are being received into the plants at the scheduled rate, then inventory will always be at the desired level throughout the entire system.

Quality Control

Each of the complete products offered to the public by the Ford Motor Company has been styled, engineered, and exhaustively tested prior to release for production. Quality Control, as well as other Manufacturing activities, reviews each individual part, sub-assembly, and final product to make certain all plans pertinent to quality requirements are fully met.

The Quality Control Office, which is part of the Manufacturing Staff, exercises functional control over the fifteen divisional quality control departments. Each division quality control department in turn coordinates and maintains supervision over the quality control departments in the individual plants making up the division.

Quality control starts early in the planning stage, with an effective relationship between manufacturing and product engineering groups.

Following approval and release of a product design, part prints are analyzed with manufacturing engineers to determine the critical dimensions and locating points. Unless control of dimensional requirements is planned at this stage, the required quality level cannot be achieved in production.

During the manufacturing planning period, process, plant layout, material handling, and work standards engineers work with production, maintenance, and quality control people to assure that the most practical approach will be followed in planning for production. For example, before new machines and equipment are shipped to Company plants, they are tried out whenever possible on the builder's floor. Machines must demonstrate that they can consistently meet part blueprint specifications at required production rates.

Basically, planning for quality requires thorough consideration of each part, each operation, each machine, each tool, and each work place. The importance of control in the planning stage is obvious when it is realized that production quality can be no better than planned quality.

In the production stage, quality control really starts with an attitude rather than a method. We have a saying that quality control means defect prevention, not defect detection. Quality cannot be inspected into the product.

Receiving inspection departments are provided in every manufacturing plant. Complete records are maintained on each supplier as to the number of shipments, parts, and quality. These vendor performance records are also periodically furnished to the respective purchasing departments, resulting in the eventual elimination of consistently poor quality sources. In all cases, we work with the vendors when discrepancies are involved, and immediate correction is made.

In-process controls involve scheduled sampling and other control techniques, or 100 percent inspection at various machining and assembly stages, if required. This is accomplished by the operators themselves, by quality control analysts, or by automatic gages built right into the manufacturing process. Many different types of gages are used, including mechanical, air, electronic, sonic, and radioactive.

Final inspection on parts, sub-assemblies, and complete end items is accomplished through various means, including visual inspection, gages, and dynamometer performance tests.

Component parts such as front wheel spindles and steering gears not only must qualify to all the dimensional and metallurgical requirements, but each finished item is again checked by means of magnetic particle inspection as an added precaution. No expense or effort is spared to make certain that items grouped in the "safety" category receive every possible advantage known to industry.

Field analysis involves following products into the field and through two years of customer usage. Details of troubles are recorded and furnished from the field on a monthly basis for each vehicle sold. This information is run through I. B. M. equipment and evaluated. Troublesome areas are quickly noted and corrective action is taken immediately.

Quality control is a "must" in any successful operation. It must be planned and included in the overall process -- not "hung on" as an afterthought. Good quality control has many virtues, including improved sales, profits, and repeat customers. At the Ford Motor Company, we feel that the most economical way to build a product is to build it right the first time.

Financial Planning and Cost Control

No area of overall management control is more important than that which deals with profits and costs, since the profit motive is the basic reason for the existence of any private business enterprise.

The four essentials for an effective financial control system are:

1. Leadership and active participation of Top Management.
2. Establishment of profit centers if the business is large and complex.
3. Use of business projections as a management tool.
4. Employment of a highly competent Controller and Staff.

At Ford, the manager of each profit center has the responsibility and necessary authority to operate his division as a separate business, subject only to general guidance from broad Company policies, and to critical review by top management. Each division and plant has a controller who is directly responsible to the division or plant manager for financial planning and cost control.

In the highly centralized type of business organization, financial responsibility is often vested in only a few top executives of the Company. Under the decentralized profit center system, the men who are in the best position to know and control costs -- the operating managers -- are charged directly with the responsibility for making a profit. Thus more executives share in the financial management of the business.

Functional responsibility for financial planning and control rests with the Controller's Office of the Central Finance Staff, whose chief executive is a Vice-President reporting to the President.

Financial planning and control relates to both the long-range and short-range considerations of the business. In the long-range cycle, the controller's efforts are directed to volume, facility, and cash planning, and to the establishment of profit objectives.

In the short-range cycle, the controller is concerned with the preparation of expense and profit budgets, and the development of prices for Company products. After budgets have been approved they are used to measure performance in all operations of the Company.

Several factors operate to control long-range planning. For example, volume planning is based on the competitive nature of the automobile industry and on long-range market research. Consequently, the standard volume forecast and model year mix are based on demand in the market. Volume estimates provide the base upon which all further financial planning and analysis is accomplished.

Facilities expansion and construction plans are controlled through certain Management procedures. Such plans are formalized as Project Appropriation Requests. The development of these requests is the responsibility of the individual profit center management.

The controller plays a prominent part in the consideration of requests for facilities appropriations. Several yardsticks are applied. For example: How will the return on the amount to be invested compare with the average return on Company invested funds: Another yardstick is the so-called pay-out period.

Finally, the controller considers the alternatives to each project appropriation proposal. Some of these alternatives are to lease rather than buy, to buy rather than make, or to repair rather than replace. The controller, together with the manufacturing and plant engineer, ascertains that cost estimates for the facilities are realistic and accurate. They also determine that the needs and interests of other activities have been considered. Finally, they recommend the source of action to management.

Once project appropriation approval has been given, the controller keeps Management informed of project status through final completion of the project.

Along with long-range volume and facilities planning, the controller is concerned with product planning. During the product planning stage, the probable sales volume and sales price of each model are agreed upon. These factors determine the overall cost objectives which Company product engineers must work toward. The product must provide the customer with value comparable to or better than other vehicles in its price class. Yet the product design must stay within the limits of the cost objective set for that model.

Since design changes can substantially alter production costs and profits, the control of design costs becomes an essential part of the system.

in the long-range financial program, volume, facility, and product planning cannot be executed without some consideration of where the money will come from.

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Therefore, another phase of this long-range program is cash planning and budgeting, the purpose of which is to project sources of cash income and disbursement and determine the composite effect of planned operations on the Company's cash position.

Now that we have considered long-range planning and control, let's take a few minutes to consider the kind of short-run planning and day-to-day control that Management must exercise. This includes product pricing, budgeting, intra-company pricing, and financial reporting and analysis.

Since prices for Company products may change for each model year, pricing is regarded as a short-range problem. Adequate prices for products are a prerequisite for successful divisional and Company-wide performance. In our selling price we hope to recover all material and manufacturing cost, and all selling and administrative expense, as well as a satisfactory profit.

The principal basis for setting prices in the automobile industry is the competitive market. Another tool used for pricing purposes is the annual price study, which is a collection of cost data from each profit center producing a component of the car. These figures are consolidated by the Central Controller's Office to provide Company-wide cost and profit information for specific vehicles and components. This information guides the Executive Committee in evaluating selling price proposals.

Along with product pricing, another major short-term planning factor is budgeting. At Ford, we like to think of budgets as financial tools which provide convenient yardsticks for measuring actual performance against plans. We use two types -- expense budgets and profit budgets.

All Company components develop expense budgets. The manufacturing and assembly activities of the Company operate under direct labor and manufacturing overhead budgets. Engineering expenses are controlled by the Product Engineering budget. The expenses of all other areas are controlled by administrative and commercial expense budgets.

In addition to preparing an expense budget, each profit center prepares and operates under a profit budget. Each profit center has its own facilities, determines its own make or buy pattern and has the right to negotiate the sale of its own products. Divisional profit objectives are established by top management. Actual profitability is measured by "return on assets employed".

At each level of management, the controller prepares budgets and reports cost performance against budgets to his management.

Short-run financial control includes intra-company pricing. These prices are negotiated each model year between buying and supplying divisions. Prices should approximate competitive levels in order that profits may be a measure of performance.

Day-to-day cost control is carried out by the controller's group in both the division and plant operating organizations. Generally speaking, accounting personnel gather data for cost control purposes. The financial analysts study and interpret these reports and make recommendations to Management.

In summary, the Ford system of financial planning and control is designed to be effective from the day our engineers and stylists first begin work on a model until production of that model has been completed. It is designed to control revenues, costs, and assets. It is designed to hold each level of Management responsible for operating within approved budget limits and for earning a satisfactory profit. This system of control thereby effectively regulates the Company's spending pattern.

The measuring stick of our performance -- both corporate and for individual profit centers -- is the percentage of return on assets employed.

Manpower

Of all the major areas of responsibility in the direction of a business, the most difficult seems to be the management of employees. Perhaps this is because this task can never be refined into an exact science due to the infinite complexity of human nature.

Many firms today are beginning to realize that the success of the business probably depends more on its people than on any other single factor. In the Ford Motor Company, responsibility for the development and administration of an efficient team of employees is assigned to the Industrial Relations Staff.

The general functions of the Industrial Relations Staff are to formulate and set forth Company policies, procedures, and standards relating to employees. This responsibility includes representing the Company in negotiations with labor organizations and acting for the Company in the discharge of its obligations under Federal and State legislation.

The Industrial Relations Staff has developed various manuals which are effective tools in the administration and control of personnel programs.

In the salaried supervisor's manual, policies and procedures are set forth for such matters as employment, transfer, termination, salary and position classification structures, employee benefits, and general personnel administration. Supervisors of hourly rated employees have similar personnel responsibilities. Policies and procedures pertaining to these duties are spelled out in the foreman's manual, along with responsibility for production, quality, cost, effective use of staff services, and Company improvement.

All salaried jobs are analyzed and evaluated so that they can be fitted into a salary grade structure, which is composed of several levels. Position specification manuals based on the job evaluation program are developed for each major component of the Company, and are used in the assignment of classifications to new personnel. Salaried classifications are audited throughout the Company at periodic intervals.

Salary ranges are provided for all classifications. These allow for salary adjustments as an employee progresses from his start on the job as a trainee into the highest quarter of the range by the time he becomes promotable to a higher classification.

Primary responsibility for the effective administration of the Company's salaried personnel program rests with the individual supervisor. Since the Ford personnel program includes consideration for the morale and motivation of its employees, the individual supervisor must personally review the performance of each individual in his group at least once a year.

Control of employee turnover is a vital function of any personnel program. At Ford, a measure of control is applied in this area through the medium of a system of employee benefits comparable with any in industry.

An extensive training program offers the opportunity to ambitious employees to improve themselves and their positions. This encourages capable people to stay with the Company.

In the administration of its hourly employee program, the Company works within the framework of its contractual agreements with the various unions representing employees. In these agreements, the Company recognizes the unions as the collective bargaining representatives relative to wages and conditions of employment for the employees in the contract units. Wage rates at Ford are comparable to those prevailing throughout the industry.

Hourly employees may work toward journeyman status in the industrial trades or may take other technical training as part of the Company training program.

A major element in effective management of personnel is a good communication system for keeping people informed. At Ford, our plant newspapers are distributed to all employees. We also send monthly news letters to salaried employees all over the country and a management information booklet to all supervisors and other management personnel. Within the organizational framework, communication both up and down the line is encouraged.

It is the objective of the Ford personnel program to retain capable employees by offering them fair and equitable salaries and wage structures, good supervisory relations, and opportunity for self-improvement and advancement through extensive training programs in the professional, trade, and technical fields.

The success of this program depends, of course, upon the efficiency with which it is administered and controlled.

Conclusion

Now, I realize that it is difficult to completely describe in so short a period the complex system which the management of a large industrial corporation uses to control its business.

However, I have given you a general picture of the Ford Motor Company's conception of the management control function, and the systems it uses to apply this function.

In concluding, I would like to leave with you the thought that the basic foundation for management controls in industry is sound, thorough, detailed, long-range planning in all areas of the business.

Efficient industrial management will also have a sound organization with definite functions and responsibilities.

It will develop basic policies, and will consistently follow them.

It will develop an enthusiastic, working, management team.

It will have realistic budgeting and financing programs.

It will carry out effective analysis and resolution of employee problems.

It will establish efficient methods and procedures to handle detail, and

It will set up controls to measure accomplishment.

Any business which can list these elements among its management assets is bound to meet its objectives, and will be a successful business enterprise.