

Review of Charles Koch's recently released book:
“The Science of Success: How Market-Based Management Built the World's Largest Private Company”

Forty years ago, Charles Koch returned home to Wichita, Kansas to take the reins of the oil and gas company that his father had established and was threatening to sell.

Today, Koch is chairman and CEO of the largest privately-held company in the world, with 80,000 employees in 60 countries and annual revenues greater than Microsoft. It is still in the oil business, but has added pipelines, refineries, jet fuel, and asphalt to its capabilities...along with fertilizer, chemical technology, commodities trading, municipal finance, ranching, carpet, spandex, and toilet paper.

How did Koch achieve such phenomenal success—multiplying its book value 2,000-fold in the course of 45 years, outpacing even the S&P 500 index by orders of magnitude—with what seems to be an irrational hodge-podge of businesses? He took the analytical mindset he developed as an engineer, dedicated himself to intense study of some of history's greatest free-market economists, crafted his own system of Market-Based Management, and set out to drill that philosophy into all of his employees.

Koch has now made his system available to the masses through his new book, “The Science of Success: How Market-Based Management Built the World's Largest Private Company.”

“As an engineer, I understood the natural world operated according to fixed laws,” Koch writes in the introduction. “Through my studies, I came to realize that there were, likewise, laws that govern human well-being. I learned that prosperity is only possible in a system where property rights are clearly and properly defined and protected, people are free to speak, exchange and contract, and prices are free to guide beneficial action. Allowing people the freedom to pursue their own interests, within beneficial rules of just conduct, is the best and only sustainable way to promote societal progress.”

If that sounds familiar to students of the Austrian School of economics, it should. Koch's business philosophy (and personal philanthropy) is influenced heavily by the writings of Ludwig von Mises, F.A. Harper, and other leaders of that movement.

Koch's Market-Based Management system is based on five dimensions: vision, virtue and talents, knowledge processes, decision rights, and incentives.

Vision is about “determining when and how your organization can create the greatest long-term value.” One of the key concepts that Koch embraced from the Austrian School was Joseph Schumpeter's creative destruction—that the destruction of existing structures was necessary to

promote innovation and economic growth. “We must continually drive constructive change in every aspect of our company or we will fail,” Koch says. “We believe it is essential to drive creative destruction internally, otherwise creative destruction will drive us out of business.” That begins to explain how Koch Industries has bought 37 businesses and exited from pizza dough and 41 others over the years.

Virtues and talents relate to “helping ensure that people with the right values, skills, and capabilities are hired, retained, and developed.” Here, Koch embraces Friedrich Hayek’s rules of just conduct, which include both the rule of law and norms of behavior. One of the guiding principles of MBM is 10,000% compliance—100% of employees complying 100% of the time.

Knowledge processes involve “creating, acquiring, sharing, and applying relevant knowledge, and measuring and tracking profitability.” In one case, a failing Koch company discovered that 60 percent of the volume of one product sold to a few large customers generated only 20 percent of the profit. With this knowledge, the sales force switched its focus away from these large customers to the smaller, more profitable customers.

Decision rights “ensur[e] the right people are in the right roles with the right authorities to make decisions and holding them accountable.” Koch makes a compelling case for private property rights, pointing out that when people own a resource, they both realize the benefits and reap the costs of consuming it. Where there is no ownership (e.g., the oceans), the consumers realize the short-term benefit without paying the cost, and thus the resource is often depleted.

Finally, incentives “reward people according to the value they create for the organization.” Koch stresses the importance of aligning each employee’s individual interests with the overall interests of the company. He also labels conventional compensation systems—with their automatic raises and pay classification scales—as “destructive.” At Koch, employees are compensated based on the value they add to the company.

“The Science of Success” figures to become a must-read for business students and aspiring entrepreneurs, as well it should be. But those in government and politics will also benefit from reading Koch’s work. At a minimum, Koch’s quotes and footnotes can form a reading list on some of the most important influences on modern free-market theory. But beyond that, Koch’s illustrations can point out the inherent flaws in government bureaucracies—particularly how they view their missions, evaluate their performance, and compensate their employees—and how government policies can have unintended consequences on private-sector behavior.

Charles Koch has made a huge impact through his leadership of Koch Industries and his stalwart support of free-market institutions. Through “The Science of Success,” Koch adds eight chapters to that legacy.

David Guenthner, Director of Media and Government Relations for the Texas Public Policy Foundation, was born and raised 15 minutes from Koch Industries, Inc.’s world headquarters.