



With a little help from Hayek, Mises, and Maslow, the CEO of America's largest private company, **Charles Koch**, spreads the gospel of 'market-based management.'

PHOTOGRAPH BY NICK VEDROS

CHARLES KOCH (pronounced "coke") is CEO of Koch Industries, the largest privately owned company, by revenues (\$90 billion), in the United States. The company's sectors include forest products, energy, plastics, ranching, and finance, with such well-known brands as Dixie Cups and Lycra. If it

were a public company, Koch would rank about 16th on the Fortune 500, ahead of such behemoths as Procter & Gamble and Boeing. Since Charles, now 71, joined the business, the value of Koch Industries has risen 2,000-fold, compared with 110-fold for the average S&P 500 firm. He earned

Charles Koch, photographed at Koch Industries headquarters, Wichita, Kansas, May 10, 2007.

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three degrees in engineering from MIT, is ranked among the 20 richest Americans by Forbes, and is author of the new book, *The Science of Success* (Wiley).

**THE AMERICAN: Charles, why have you never gone public?**

It is very difficult to do what we do as a public company. By being private, we can focus almost solely on maximizing long-term value and applying our philosophy of principled entrepreneurship.

A public company has to cope with the extreme focus of the analysts and the equities market on quarterly earnings. Somebody misses quarterly earnings projections by a penny, and their stock goes down 10 percent.

Another concern of a public company is to have a high price-to-earnings ratio. This causes all sorts of weird behavior. For example, you cannot be in certain businesses that are considered cyclical or out of favor with Wall Street. You have to handle your business in just the right way with steadily increasing quarterly earnings. Also, the public wants vision that can be grasped in sound bites, and not all companies work that way.

**More companies are going private. Is increased regulation driving the trend?**

Yes, plus litigiousness. We had class-action lawsuits against us in our acquisition of Georgia-Pacific, claiming that we did not disclose enough or misled investors. We put everything in the documents. They were like a doctoral thesis, but still, we were hit with strike suits to see if lawyers could extract something from us.

Investment bankers told us, “Gosh, you only got two suits. Usually, we have four or five, and we pay them all off.” Well, we did not pay any of it because we would be paying blackmail. It feeds on itself.

**In your book, you list more than 40 businesses from which you have exited. How important is it to cut your losses?**

It is absolutely critical. If you do not, then the tendency is to focus on the problems. And with creative destruction and the nature of the experimental discovery process in the marketplace, you have to nurture your winners constantly—whether the winners are the people, the processes, the products, the businesses.

You have got to be anticipating what the customer is going to value in the future and how the competitors are improving. It is all-consuming just to keep a business in a leadership position. But if you have these problems and these losers, you get distracted and your winners start to slip.

**Are there lessons here for government?**

Absolutely. One of the big problems with government activities is that if something does not work, rather than applying analysis to see why and eliminating it or changing it, the answer's always, “Well, the reason it did not work is we did not put enough money into it.” That is crazy. It would be like having an experiment that failed and then building a full-scale plan.

**You often say that experimentation and discovery are important to your business. What do you mean by that?**

It was a concept of Hayek's<sup>1</sup> that the marketplace is an experimental discovery process for finding and delivering what people value. The future is unknown and unknowable, and master 20-year plans are prescriptions for disaster. So our philosophy is to start by understanding what our capabilities are and then finding the best opportunities.

For example, we decided that forest products was an industry to which our capabilities could add value, so we looked for opportunities to try that sector as an experiment, a modest-size investment. We approached Georgia-Pacific. We knew they were interested in selling one part of their pulp business, and we bought two mills. The purchase was successful.

We develop a point of view, articulate how we're going to improve the business, and what value

<sup>1</sup> Friedrich von Hayek (1899-1992), Nobel Prize-winning philosopher and economist.

we will create. So we started looking for larger opportunities, and that led us to the acquisition of Georgia-Pacific as a whole.

**And if it hadn't worked out, you would have just said, "Well, we tried, and we are just going to close that business down or sell it."**

Or if we had understood what it was that caused it not to work and believed we could correct it, then we would have done another experiment. But if our attempts were fundamentally fatal, we would have done what you suggest.

**How does that fit in with what you call "market-based management"?**

More broadly, market-based management draws on lessons from history and from all the humane sciences, what Mises<sup>2</sup> called "the science of human action"—on economics, psychology, anthropology, the philosophy of science.

For example, we look at neurology—how people learn, form mental models that guide how they think and act, and what it takes to modify them. When we make an acquisition, we are trying to get the people to think and act differently, so we have to understand that process to be effective.

Take Maslow.<sup>3</sup> He was not a free-market thinker, but he addressed how you motivate people. One way is you have to give them work that is just challenging enough so they are stimulated and not bored, but not so challenging that they are overwhelmed.

**These are sophisticated ideas, yet you believe in communicating them to all your employees.**

Oh yes. That was the initial and primary purpose of [my] book. After it was written, there was outside interest, so we decided to publish it to help businesses see that principled entrepreneurship is the way to be successful—and to have businesses practice better and be held in higher regard by the public so we can preserve a market economy.

**Do you feel business leaders have been involved enough in public policy in promoting free-market principles, or any principles at all?**

Just a relatively small minority. Today, various government programs get started, and then businesses learn how to profit from them and build constituencies that make it impossible to get rid of them, whether it is protectionism or subsidies, or regulations.

**Some people think we may be seeing this phenomenon now with the reaction of business leaders to global warming.**

And I know a bunch of these people. They don't really believe what they're saying, but they feel they've got to say it to ensure that the regulations are such that they will be profitable rather than unprofitable for them. It's really disturbing and very dangerous for the future of this country.

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**You live in Wichita. Why?**

This is a good place because of the culture here, the work ethic, integrity and humility, dedication to value creation. And then, the ease of living here makes it easier for people to be productive. The main disadvantage is that it's not the easiest place for travel. But we're all over the world.

**Give us your impression of the U.S. economy right now.**

We are in better shape than Europe. There, the culture and institutions encourage entitlement rather than value creation. I see the opposite in Asia. I see the United States moving away from the conditions for prosperity, and in many places in Asia, those conditions are getting better. What we see in the trends is a direct correlation, as you have pointed out in your magazine, between economic freedom and prosperity. ■

<sup>2</sup> Ludwig von Mises (1881–1973), dean of the Austrian School of classical liberal economics. Author of *Human Action* and, like Hayek, a staunch advocate of market, rather than government, decision-making.

<sup>3</sup> Abraham Maslow (1908–1970), American psychologist, known for his "hierarchy of needs," in the shape of a pyramid. Higher-level needs, what he called "self-actualization," like creativity, only can be addressed once lower-level needs like safety and food have been secured.