



# The Science of Success: How Market-Based Management Built the World's Largest Private Company

By Charles G. Koch

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### Praise for THE SCIENCE OF SUCCESS

"Evaluating the success of an individual or company is a lot like judging a trapper by his pelts. Charles Koch has a lot of pelts. He has built Koch Industries into the world's largest privately held company, and this book is an insider's guide to how he did it. Koch has studied how markets work for decades, and his commitment to pass that knowledge on will inspire entrepreneurs for generations to come."

—T. Boone Pickens

"A must-read for entrepreneurs and corporate executives that is also applicable to the wider world. MBM is an invaluable tool for engendering excellence for all groups, from families to nonprofit entities. Government leaders could avoid policy failures by heeding the science of human behavior."

—Richard L. Sharp, Chairman, CarMax

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"What accounts for Koch Industries' spectacular success? Charles Koch calls it Market-Based Management: a vision that nurtures personal qualities of humility and integrity that build trust and the confidence to enhance future success through learning from failure, and a culture of thinking in terms of opportunity cost and comparative advantage for all employees."

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"In a very thoughtful, creative, and understandable way, Charles Koch explains how he has used the science of human behavior to create a culture that has produced one of the world's largest and most successful private companies. A must-read for anyone interested in creating value."

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"The same exacting thought, rooted in the realities of human nature, that the framers of the U.S. Constitution put into building a nation of entrepreneurs, Charles Koch has framed to build an enduring company of entrepreneurs—a company larger than Microsoft, Dell, HP, and other giants. Every entrepreneur should study this book."

—Verne Harnish, founder, Young Entrepreneurs' Organization, author of Mastering the Rockefeller Habits, CEO, Gazelles Inc.

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### Editorial Review

#### Review

Before diving into Charles Koch's *The Science of Success*, you must understand two things: Koch is an engineer, born and raised in the Midwest, and he's an autodidact, with a passion for the free market theories of Austrian economist Ludwig von Mises.

Combine the two and you get a management philosophy book long on hard-edged statements where the author professes an almost Marxist faith in the "fixed laws" that "govern human well-being." His "Market Based Management" (the term is trademarked), is "The Science of Human Action."

Since taking over his father's refining business in the early 1960s, this M.I.T.-trained engineer has grown Koch Industries more than 2,000-fold, expanding into petrochemicals, fertilizer, trading and, most recently, the \$21 billion purchase of Georgia-Pacific. Along the way, Koch notes, there have been huge failures, including a foray into shipping and an attempt to build a cattle-feed-to-steaks agribusiness.

Both fit with Koch's libertarian philosophy of allowing people to make decisions and reap the rewards or penalties that result. Employees are given "decision rights" according to their demonstrated ability to make choices that result in lower costs or returns that exceed the company's "opportunity cost," which Koch defines as the returns from investing in the best alternative. "Any employee who is not creating value does not have a real job in the MBM sense of the word," Koch writes, although a worker on the assembly line might consider his weekly paycheck real enough.

Failure isn't necessarily penalized, unless an employee overlooked some necessary detail or put self-interest ahead of the corporation. "Business failures are inevitable, and any attempt to eliminate them only ensures overall failure," Koch writes.

The grandson of a Dutch immigrant who settled in hardscrabble West Texas, Koch can sound like a Calvinist minister at times. He excoriates as "destructive compensation schemes" such common practices as granting cost-of-living adjustments or automatic raises when employees achieve certain levels of education or seniority. Putting his own spin on Marx, he proposes the maxim "from each according to his ability, to each according to his contribution."

*The Science of Success* is short on concrete examples, and Koch acknowledges that implementing his Market Based Management can be difficult because of the hazy connection between, say, property rights and the day-to-day decisions of a midlevel manager in charge of a fertilizer plant. The book is especially obtuse when Koch describes his system for grading employees, a four-box "virtue and talents matrix" that balances "values and beliefs" against the skills needed to run the business.

Sprinkled throughout are miniature case studies from Koch's ascent, however, including his advice to be extremely cautious about entering partnerships and to do so only with an "exit mechanism" in case it doesn't work out. (The book is dedicated in part to the family of the late J. Howard Marshall, whose own marriage to Anna Nicole Smith spawned a bitter legal battle that will probably continue beyond her recent death).

Performance measures like energy costs should be measured against an ideal, not a budget, he says, and when divisions transfer products among themselves they should be at market prices for the entire amount of goods being "sold," not just a portion. Otherwise one division might wind up subsidizing another, denying Koch the chance to invest the money at a higher return elsewhere.

A graphic example of Koch's clear-eyed approach to opportunity cost is the Iowa asphalt plant Koch moved when the land under it proved more valuable, on a present-value basis, than the foreseeable earnings from the asphalt production. "There is now an Ameristar Casino and Hotel where the Council Bluffs asphalt plant once stood," Koch writes proudly.

Readers expecting a recipe book for business success will be disappointed, but those of a more philosophical bent will find Koch's observations fascinating. Not only has he digested the entire Ayn Rand syllabus of free

market theory, but he's had the chance to put it to work from his headquarters on the plains north of Wichita. It's hard to argue with the results. The question is whether anybody but Charles Koch could pull off a similar feat. (*Forbes.com*, February 26, 2007)

"Unlike many management books, which are little more than over-heated and overspun drivel, this one deserves as wide an audience as possible." (*The Business*, Saturday 9th June 2007)

#### From the Inside Flap

Charles Koch may very well be the most successful businessman you've never heard of. Under his leadership, Koch Industries has become a dynamic and diverse enterprise that Forbes called "the world's largest private company."

This groundbreaking book includes the same material used by the leaders and employees of Koch companies to apply Market-Based Management (MBM) to get results. In it, Charles Koch outlines the unique management methodology developed and implemented by Koch Industries. Koch credits MBM for its 2,000-fold growth since 1967, with today having 80,000 employees in 60 countries and with \$90 billion in revenues in 2006. MBM is a scientific approach to management that integrates theory and practice, and provides a framework for dealing with the ongoing challenges of growth and change. There really is a science behind success, and it can be applied to any organization.

MBM is rooted in the Science of Human Action, and is defined by five dimensions:

- Vision—Determining where and how the organization can create the greatest long-term value
- Virtue and Talents—Helping ensure that people with the right values, skills and capabilities are hired, retained and developed
- Knowledge Processes—Creating, acquiring, sharing and applying relevant knowledge, and measuring and tracking profitability
- Decision Rights—Ensuring the right people are in the right roles with the right authority to make decisions and holding them accountable
- Incentives—Rewarding people according to the value they create for the organization

When these dimensions are applied in an integrated, mutually reinforcing manner, they create continuous transformation and positive growth. Any organization—corporation, small business, nonprofit, government agency—can apply these proven principles.

In addition to an in-depth discussion of MBM's five dimensions, this book also draws on Koch's candid examples of his company's successes and failures. Born out of a life-long study of economics, science, philosophy, psychology, political theory and history, MBM is essentially a practical business application of the principles that have led to innovations and the most prosperous, peaceful, robust economies in history. Let this book show you how to apply the same management philosophy that has served Koch Industries so effectively. MBM will benefit you, your company, your customers and your employees. For more information about Market-Based Management, visit [www.mbm-institute.org](http://www.mbm-institute.org).

#### From the Back Cover

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