



TOWARDS
HEROIC CAPITALISM

REMAINING SUCCESSFUL IS A GREATER CHALLENGE THAN BECOMING SUCCESSFUL.

In 1859, the first treatise on “best practices” appeared: *Self-Help, With Illustrations of Character, Conduct, and Perseverance*, by Samuel Smiles. Motivational self-improvement books were not new, but Smiles’s 400-page opus was persuasive. Profusely illustrated with stories of men-made-good in industry, engineering, the arts, and music, *Self-Help* combined age-tested wisdom with knowledge of the industrial present.

Nearly 150 years later, the most recent addition to the self-help literature is *The Science of Success* by Charles G. Koch: businessman, philanthropist, and applied intellectual. Koch’s book has all the earmarks of a classic, but not because it is a tome (the 166-page main text is quite brief for the material covered) or because it is the last word on the subject (it is really just the beginning, despite two monographs published by Koch disciples a decade or more ago). The book’s seminal potential is that it presents what could be the most logical, systematic framework for organizational success articulated to date.

Applying primarily to business but also to nonprofits and government, the book offers the outlines of a tested framework for organizational success. Koch draws upon his forty years of experience in building what *Forbes* calls America’s largest privately held business (80,000 employees, \$90 billion in annual revenue), studying and applying what is called “The Science of Liberty,” and founding and nurturing dozens of libertarian-related nonprofits.

Charles Koch deserves an audience. The family company he took over in the 1960s, which had an enterprise value of perhaps tens of millions of dollars (inflation-adjusted), is worth, again according to *Forbes*, tens of billions. Koch Industries has never suf-

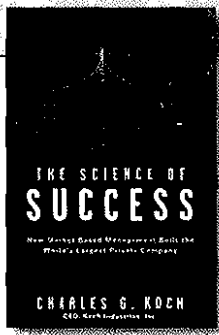
fered a yearly loss. And in relative terms, a dollar invested in Koch in 1967 (the year Charles took over from his father) would be worth \$2,000 today, outdistancing the same investment in the S&P 500 index (\$500 today) or Warren Buffett’s Berkshire Hathaway (\$1,400).

Koch, like Smiles, stresses the timeless personal attributes required for success. The Victorian moralist had carefully made a case for self-respect, cleanliness, chastity, reverence, honesty, thrift, sobriety, politeness, courtesy, generosity, forethought, economy, and (his favorite) *perseverance*. Koch pays homage to “principled behavior” and “a culture of virtue,” consisting of integrity, humility, and respect, as well as “the sense of urgency, discipline, accountability, judgment, initiative, economic and critical thinking skills, and risk-taking mentality necessary to generate the greatest contribution to the company.”

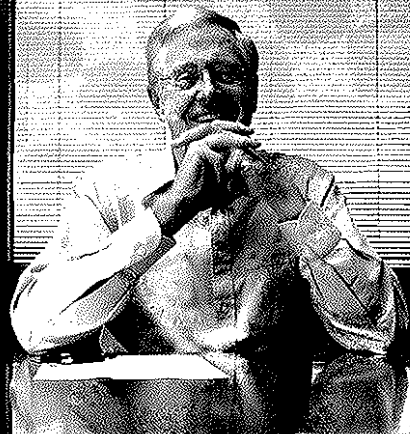
But for Koch these personal traits are only the beginning. For it is one thing to tell an employee what is good, to instruct him to be good, and to urge him to do well—but quite another to have employees creating real wealth for an organization and thus for society. The challenge of “the science of success” is to get from the commonsensical micro to the complex macro, or to achieve what Charles Koch has termed *Principled Entrepreneurship*[™], defined as “maximizing long-term profitability for the business by creating real value in society while always acting lawfully and with integrity.”

Enter Market-Based Management[®], defined as “a philosophy that enables organizations to succeed long-term by applying the principles that allow free societies to prosper.” MBM, Koch’s framework for

Charles G. Koch, *The Science of Success* (New York, John Wiley & Sons, 2007), 194 pages, \$22.95.



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Above: Charles Koch took over the family business on his father's death in 1967. Right: With headquarters in Wichita, Koch Industries is America's largest private company.



the science of success, has five dimensions (reproduced here verbatim):

- *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 efficiently measuring and tracking profitability
- *Decision Rights*—Ensuring the right people are in the right roles with the right authorities to make decisions and holding them accountable
- *Incentives*—Rewarding people according to the value they create for the organization

Five of the book's eight chapters explain these dimensions, one chapter per principle. What is left is an opening chapter on the history of Koch Industries, a second chapter introduc-

ing the science of human action (of which MBM is a part), and a final chapter on lessons.

MBM entails asking the right questions and getting to the right answers about how to continually create economic value while staying within the rules. MBM is about creating a free market in communication and feedback ("free speech") and a meritocracy where property rights ("decision rights") flow to the value creators. Such economic concepts as opportunity cost, sunk cost, transaction cost, comparative advantage, and time preference come alive in the framework, as do the more abstract notions of tacit knowledge and spontaneous order. MBM is a way to learn and apply Austrian-school economics, which is just real-world economics under another name.

Koch repeatedly (eight times by my count) emphasizes that MBM is a *holistic system*, with all five dimensions being interdependent and mutually reinforcing. Just as one can neuter a

diet by breaking the regimen for just minutes of a 24-hour day, one cannot expect to obtain the benefits of MBM by following only some of the dimensions or by following all the dimensions for only part of the time. And not only the organization, but MBM itself, must be subject to continuous improvement and creative destruction for inter-temporal success.

The underlying assumption of MBM is that there is an objective means for identifying success and for becoming successful (thus the *science of success*). The terms "reality" and "truth" (see the sidebar) are taken as self-evident, although there is a warning that correctly interpreting reality takes work and having the right values. For example, profit/loss measurement should not be profit-

maximizing for its own sake ("let's show as much profit as we can to please the bosses and get more reward") but for the sake of value-creation ("let's realistically match period costs and revenues for learning"). Koch explains:

A business can best determine where and how to create value when it is organized into profit centers . . . [But profit/loss] financial statements must reflect economic reality. Remember, anywhere profit and loss is measured, analysis is also needed to understand what drives those results.

Koch does not mention companies other than his own in the book. But, to use a riveting example, Enron was "profitable" during almost the entire time it was destroying enterprise value on a grand scale. By gaming the accounting rulebook, Enron reported paper profits instead of creating real wealth. And so there was little midcourse correction,

almost everyone was surprised, and many were victimized.

The Science of Success also takes aim at the enemies of wealth creation (and thus of applied MBM): “cynicism, form over substance, bureaucracy, command-and-control, or destructive, self-serving behavior.” Other attitudes and behaviors that come in for criticism are “emotion and gut feeling,” “impulsive action,” “entitlement and unaccountability,” and “inaction, abdication or finger-pointing.”

Koch takes particular pains to warn against arrogance and to extol the

replicated amid change, where the good drives out the bad and the better drives out the good.

A section of Koch’s book deals with “Practicing MBM in a Political World.” Here, Koch distinguishes between the *economic means* and the *political means* to success. The first involves voluntary transactions in the marketplace; the latter, the use of government coercion to achieve business ends. Koch advocates the economic means as part of Principled Entrepreneurship™ by which value and wealth are created rather than forcibly obtained (redistributed from

KOCH STRESSES THE TIMELESS PERSONAL ATTRIBUTES REQUIRED FOR SUCCESS.

virtue of *humility*, which might surprise some who are supremely confident about interpreting objective reality. But if business and life are about learning and making mid-course corrections for improvement, then humility—understood contextually—is important indeed. For the business person, humility means being open to changing course, if necessary. Consumers can start and stop valuing something altogether. What works today might fail tomorrow, and, given competition, each business success will inevitably peter out unless changes are made (cost reductions, product improvement or differentiation).

Thus the challenge for any organization is not only to become successful but to *stay* successful. “It is often more difficult to overcome success than adversity,” Koch notes—the implication being that, ironically, it can be easier for an unsuccessful company to become successful than for a successful company to remain that way.

Thus Principled Entrepreneurship™ is a framework for how to deal with the “creative destruction” of the marketplace, how to *stay successful* in the sense of avoiding losses and making real wealth. Such success has to get beyond personalities and products—the stuff of the moment—to an organizational methodology where success can be

others). But given existing regulations and laws—even those that the company opposes on business or intellectual grounds—full compliance is rule number one. Only in that context can reform be effectuated, Koch explains:

Striving to comply with every law does not mean agreeing with every law. But, even when faced with laws we think are counter-productive, we must first comply. Only then, from a credible position, can we enter into a dialogue with regulatory agencies to demonstrate alternatives that are more beneficial. If these efforts fail, we can then join with others in using education and/or political efforts to change the law.

This is a profound, even radical, book. For historians, including the present writer, it explains organizational success in a way that also helps us to understand organizational *failure*, such as the bankruptcy of notable companies. But, to repeat, this book is but an introduction. One can hope for a good deal of follow-up study, analysis, and testing, to see just how far a “science of success” can go—and whether such a science can overcome its *own* success. Stay tuned. **TNI**

Thoughts on Success from Charles Koch

“We must constantly remind ourselves that just because we believe or want a thing to be true does not make it so.” (Page 30)

“[We] pioneered internal markets and greatly expanded the use of scorecards. This helped us more fully appreciate the value of having measures based on economic reality.” (Page 43)

“A company’s reputation is critical to how it will be treated by others and to its long-term success. We must build a positive reputation based on reality, or others will create one for us based on speculation or animus. . . .” (Page 47)

“Our losses . . . were costly examples of the failure to develop a reality-based vision . . .” (Page 70)

“As . . . Richard Whately observed: ‘It is one thing to wish to have truth on our side, and another thing to wish sincerely to be on the side of truth.’” (Page 115)

“Decisions should be made using economic and critical thinking, logic and evidence, rather than emotion or gut feeling. . . [Moreover,] style should never take precedence over substance.” (Page 117)