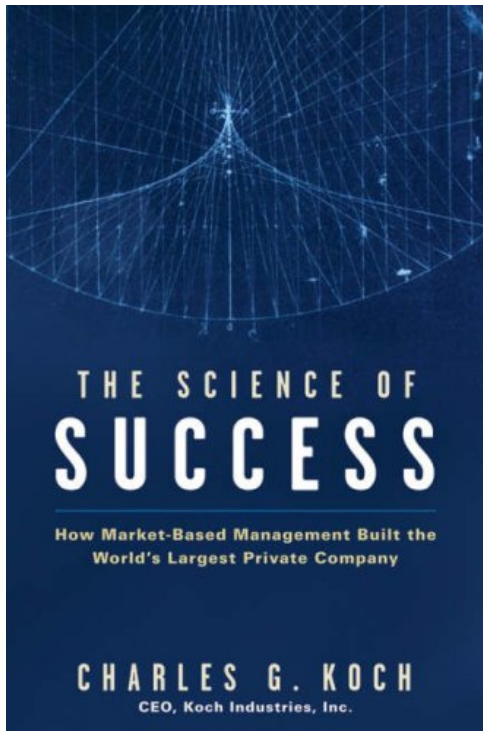


The Science of Success - Charles G. Koch

"I hope your first deal is a loser, otherwise you will think you're a lot smarter than you are."

—advice Charles got from his father, [Fred Koch](#)

Summary: curious how billionaire Charles G. Koch built [Koch Industries](#) into one of the largest private companies in the US with \$125 billion in revenue and 120,000 employees in 2022? Read on. This book has one central theme: **Market-Based Management (MBM)** which many consider to be Koch's legacy. **The key points within MBM are:**



1. **Vision:** Recognize the potential of MBM to ensure the success and viability of organizations.
2. **Virtue and Talents:** Recruit, retain, and reward people who create value. It's essential to have employees with the right values, skills, and knowledge.
3. **Knowledge Processes:** Create, acquire, share, and apply relevant knowledge, and measure and track profitability.
4. **Decision Rights:** Ensure that the right people are in the right roles with the right authority to make decisions and hold them accountable. (read: decision rights are NOT based on title)
5. **Incentives:** Reward employees based on the value they create for the organization. Align incentives with value creation.
6. **Price System:** Use internal prices to set priorities and allocate resources effectively.
7. **Change:** Always strive for continuous improvement and change in response to market feedback.

A life-long learner, his influences include: [Friedrich Hayek](#), [Ludwig von Mises](#), [Adam Smith](#), [F. A. Harper](#), and [Joseph Schumpeter](#) among many.



Charles G. Koch

Author bio: Charles G. Koch, born on Nov. 1, 1935, in Wichita, Kansas, is an influential American businessman, philanthropist, and political donor.

As the chairman and CEO of Koch Industries since 1967, he expanded the firm from a mid-sized oil refining company into a **diverse conglomerate** with interests in chemicals, consumer products, energy, raw materials, and ranching. He owns 42% of Koch Industries and is worth \$62 billion.

Charles is renowned for his philanthropy. Through the [Charles Koch Foundation](#) he's donated millions to educational, cultural, and research institutions. Passionate about criminal justice reform and educational opportunities, he's supported various initiatives to advance these causes. Along with his late brother David, Charles also influenced American politics, advocating for **economic freedom and limited government** policies.

Koch holds a two master's degree in nuclear and chemical engineering from MIT. Koch has been married to his wife Liz since 1972. He has two children, Chase and Elizabeth. They have homes in Wichita, Kansas (primary), Indian Wells and Aspen. In his free time he enjoys reading, sports and relaxing at his ranch.

2-5-10-20: a distillation exercise aimed to increase clarity via constraint.

- **This book in 2 words:** Value creation.
- **This book in 5 words:** Principled entrepreneurship drives value creation.
- **This book in 10 words:** Principled entrepreneurship harnesses knowledge, drives innovation, and creates transformative organizational value.
- **This book in 20 words:** Using principled entrepreneurship, Koch outlines harnessing knowledge, driving innovation, valuing employees, and creating organizational value through visionary, sustainable business practices.

Koch Brothers: before we dive in, most people think there are two Koch brothers. There are four, all brilliant and noteworthy in their own way. Since they are largely estranged (long story), it is hard to find an adult picture of all four brothers together, so Bloomberg made this:



We continue to *The Science of Success*.



My #1 highest-value takeaway from this book: What struck me more than any brilliant business framework, was how a quiet young man in Kansas devoured books, applied concepts, learned, and iterated his way to such a thoughtful, intentional and comprehensive personal philosophy.

That is the meta-learning here: the **tremendous power** of developing—actually writing out—a personal philosophy. Make it a goal: **I will develop my own personal philosophy by the end of 2023.**

Introduction

In *The Science of Success* Charles G. Koch, the Chairman and CEO of Koch Industries, Inc., articulates a management philosophy called Market-Based Management (MBM). Drawing inspiration from his years of leadership and the growth of Koch Industries from a modest company to one of the largest private businesses in the U.S., Koch distills his insights into how free-market principles can be applied within the enterprise—and beyond.

Philosophical Underpinnings

- Koch emphasizes long-term success in business requires dedication to **real value creation** in society.
- The principles of MBM are rooted in **property rights, free-market capitalism, and rule of law.**
- Human progress is **driven by innovation**, which is best fostered in a system that's both **free** and **just**.

Foundation

- **Vision:** At the core of MBM is the importance of having a clear vision. For Koch, it's about creating real, sustainable value for all of the organization's constituencies.
- **Culture and Values:** A company must foster a culture that rewards principled entrepreneurship. For Koch, integrity, compliance, value creation, humility, and knowledge are pivotal.

Economic Principles Within MBM

- **Value Creation:** At the heart of MBM is an emphasis on creating value. It's not just about profits, but about producing goods and services that improve people's lives. This principle mirrors the larger economic principle where transactions in free markets occur because they provide mutual benefit.
- **Rights and Responsibilities:** Koch believes that employees should have the decision rights for their roles and be held accountable. This mirrors property rights in free-market systems where individuals utilize their property in ways they believe will maximize its value.

- **Incentives:** MBM heavily emphasizes the importance of aligning incentives for all stakeholders. Just as in an open market where individuals act in ways that they believe will enhance their personal value, employees will be most motivated and productive when their incentives align with the organization's objectives.
- **Knowledge Processes:** In any organization, as in economies, knowledge is dispersed. MBM stresses the need to develop processes to harness this distributed knowledge efficiently, akin to how prices in free markets convey information about supply and demand.
- **Change:** The only constant is change. MBM sees change as an opportunity rather than a threat, paralleling the evolutionary nature of free markets.



Picture of Koch house in Southern California

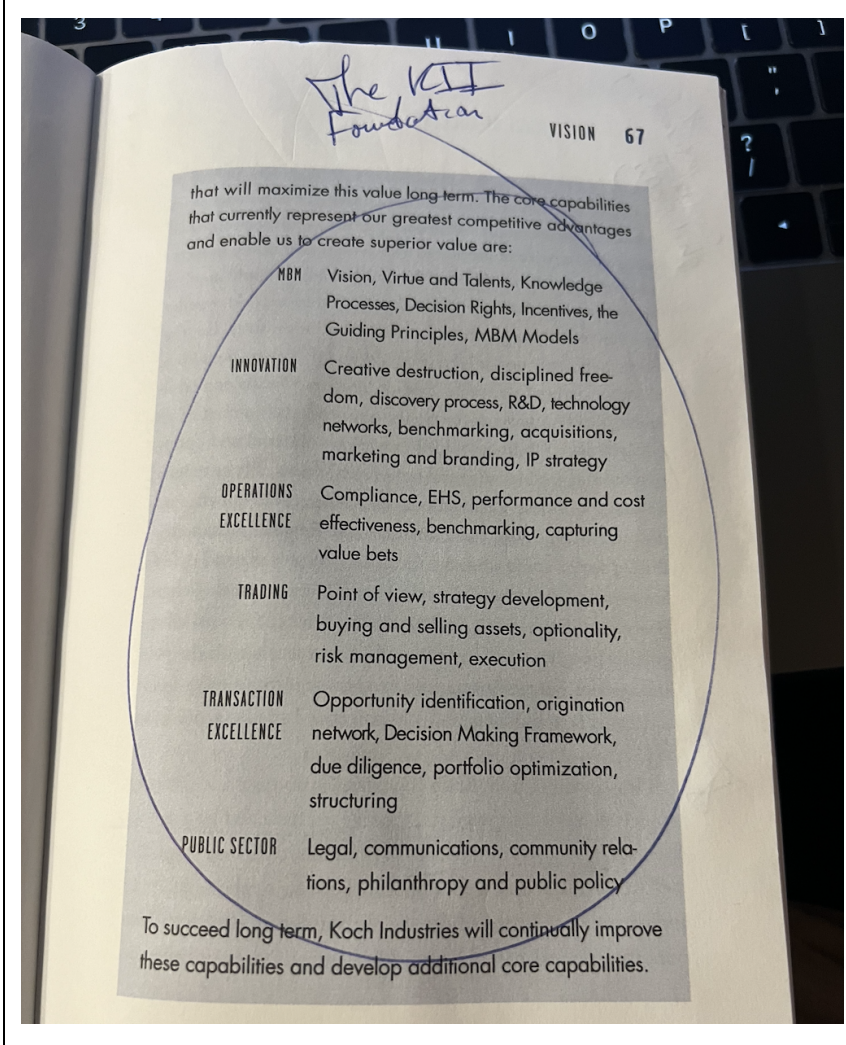
Additional, more canonical economic principles/metrics

- **Sunk Costs:** This refers to the costs that have already been incurred and cannot be recovered. In decision-making, these costs should be ignored because they're irrelevant to future decisions. One shouldn't be influenced by the amount already spent but should focus on the potential future costs and benefits.
- **Marginal Costs:** The additional cost of producing one more unit of a product. This concept is crucial in determining pricing and production levels. If the price at which the product can be sold exceeds its marginal cost, it's profitable to continue production.
- **Comparative Advantage:** This is the ability of an entity to produce a particular good at a lower opportunity cost than another entity. It's a foundational concept in trade theory. For organizations, understanding their comparative advantage can guide decisions about which markets to enter and which products to produce.
- **CPV (Capabilities, Passion, Value) Triangle:** While not a traditional economic concept, this

framework suggests that for an individual or organization to be successful, they should work in areas that align their capabilities, passions, and where they can create the most value. This overlap leads to the highest productivity and satisfaction.

- **Opportunity Cost:** Refers to the potential benefit that's given up when one choice is made over another. In a business context, it's the profit a company misses out on when choosing one alternative over another. It emphasizes the idea that resources (time, money) are scarce and decisions must take into account not just the obvious costs but also the benefits of foregone alternatives.

Koch Industries Vision & Core Capabilities



Behold the enviable list of Koch Industries' **core capabilities** which, Koch asserts, form their competitive advantage, i.e. how they win.

So from this C-level altitude, the entire MBM philosophy is consigned to just one of several **core capabilities** within their company **vision**.

It is here we get a glimpse of **the vastness**, the largesse, of the Koch empire.

This stuff might read dry at times, but at Koch scale, the clarity and intentionality of how they communicate their own company identity is **culturally critical**.

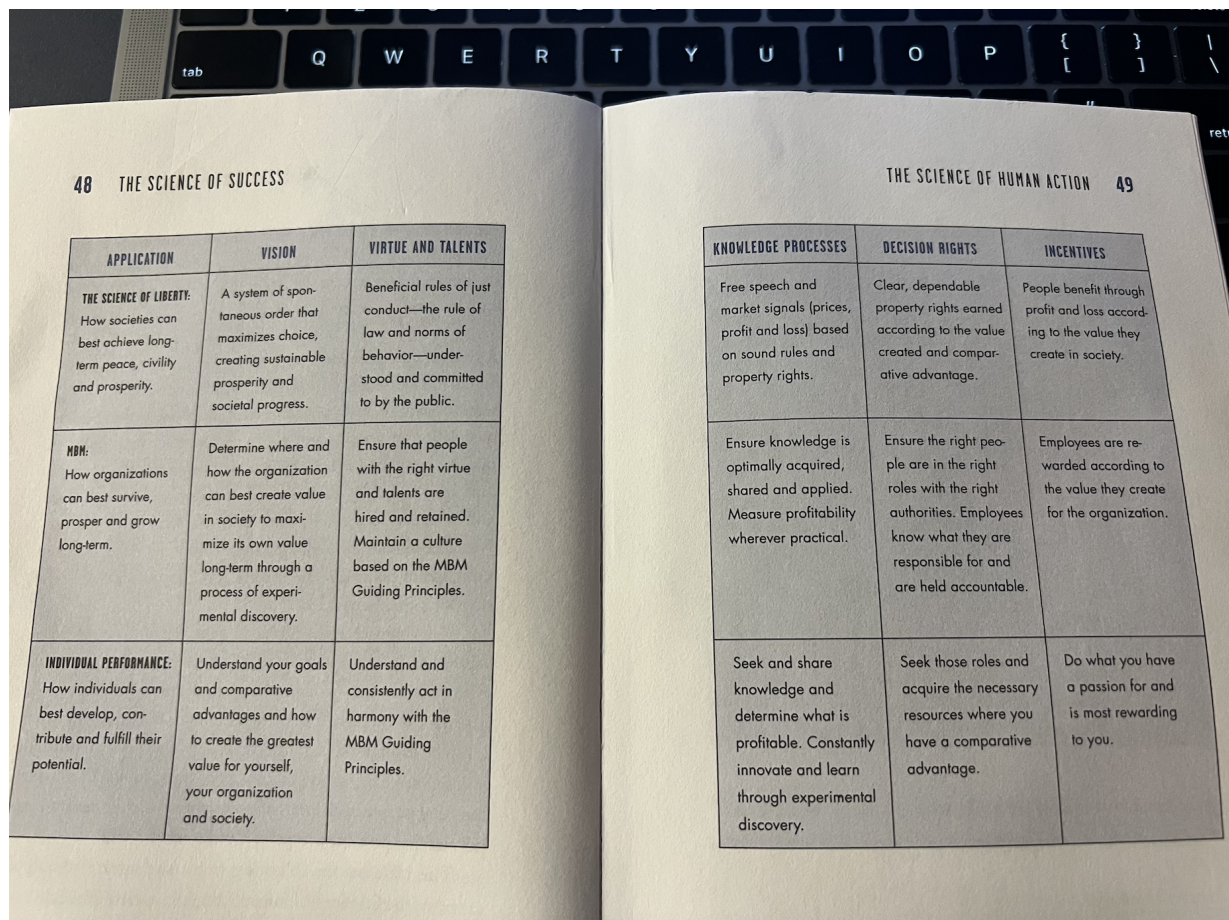
Well articulated, expressing key company virtues can answer a question in the minds of 120,000 employees..

Powerful. So I suppose there are two takeaways for founders:

- 1) **build for the long-term**: think bigger, broader!
- 2) be **uncomfortably proactive and intentional** with the type of company you want to build. . . to win.

The "Public Sector" item (bottom of list) is an example of a new core capability Koch built after a [series of regulatory and environmental mistakes](#) between 1999-2003.

Applications of Science of Human Action: *this is going to get a bit weird*, but here we go. I don't quite understand what Koch is trying to do here, but he appears to be applying his world view to: **society, companies, and individuals.**



I suspect Koch may have felt constrained by the boxes. For example, surely **Individual Virtue and Talents** is more than “Understand and consistently act in harmony with the MBM Guiding Principles.” If I may offer a passing criticism, this example sweats of recursive “The rules of Fight Club” logic.

MBM in Practice

Koch Industries is evidence of MBM's effectiveness. The company's remarkable growth in diverse sectors like oil refining, chemicals, ranching, and commodities trading is attributed to its consistent application of MBM principles. Yes, Koch Industries has made [regulatory and environmental mistakes](#)—for which they've paid some \$400m in fines—but there's no denying the growth and success of their fundamental business.

One example of MBM in action is the **incentive structures at Koch**. Employees are not just given bonuses based on short-term profits, but on the **sustainable value they create**. This has driven innovation and long-term thinking.

Another illustration is how Koch Industries encourages **entrepreneurial thinking**. Rather than top-down directives, employees are empowered to own their projects, fostering innovation and autonomy.

Furthermore, **decision-making rights are granted based on performance, not necessarily job title**. This encourages “bottoms up,” decentralized decision-making regardless of seniority. Speed.

Thinking more broadly to MBM and free-market principles applied to countries:



On Ireland: “Among other things, corporate tax rates were reduced from 50% to 12.5%, much lower than today’s European average of 30%.

The results exceeded even the most optimistic expectations. Ireland’s economy grew by 83% during the 1990s. . . Unemployment rate fell from 18% in the late 1980s to less than 5% in 2005. GDP per capita grew from \$12k in 1990 to \$36k in 2002, making it the second-most prosperous country in Europe.

My favorite quotes from this book

- *“When Southwest airlines sought ways to decrease the time it took to refuel, disembark and board passengers, and unload and load baggage, it did not study other airlines. It studied NASCAR pit crews and drivers.” —Charles Koch*
- *“In truth, there is no such thing as a growth industry. There are only companies organized and operated to create and capitalize on growth opportunities. Industries that assume themselves to be riding some automatic growth escalator invariably descend into stagnation.” —Theodore Levitt*
- *“I spent virtually all my spare time studying history and the humane sciences. As I learned concepts that seemed relevant to business, I started to apply them.” —Charles Koch*
- *“The solution of the economic problem is a voyage of exploration into the unknown, an attempt to discover new ways of doing things better.” —F.A. Hayek.*
- *“There is a natural aristocracy among men. The grounds of this are virtue and talents.” —Thomas Jefferson*
- *“Laws control the lesser man. Right conduct controls the greater one.” —Chinese proverb*
- *“Decisions should be made using economic and critical thinking, logic and evidence, rather than emotion or gut feeling. We should be explicit in the mental models we are applying and communicate them clearly.” —Charles Koch*
- *“The greatest virtues are those which are most useful to other persons.” —Aristotle*
- *“The greatest obstacle to discovery is not ignorance but the illusion of knowledge.” —Daniel*

Boorstin

- *“To be praised for what one does not deserve or to have one’s accomplishment unduly exaggerated can actually be guilt-producing.” —Abraham Maslow*
- *“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.” —Richard Whately*
- *“The only combination of rewards and feedback that seems to improve motivation is rewards that depend not only on doing the task, but upon how well it is done plus informational feedback.” —Charles Murray*
- *“Decisions should be made using economic and critical thinking, logic and evidence, rather than emotion or gut feeling. We should be explicit in the mental models we are applying and communicate them clearly.” —Charles Koch*
- *“Years of experience, credentials or titles have not proven to be reliable predictors of good decision-making ability. Only demonstrated success in decision-making reveals an individual’s decision-making ability, and then, only for that type of decision.” —Charles Koch*
- *“Both the person making the decision and the person delegating are held accountable. This ensures that a culture of ownership, accountability and appropriate delegation is developed to avoid inaction, abdication or finger pointing.” —Charles Koch*
- *On the role of leaders: “Leaders must be role models, exemplifying the values while guiding, measuring, and holding everyone accountable.”*
- *On change: “We must embrace change as an inevitable and beneficial aspect of improvement.”*
- *“The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it.” —Thomas Sowell*
- *“It takes considerable knowledge just to realize the extent of your own ignorance.” —Thomas Sowell*
- *“The essence of strategy is choosing what not to do.” —Michael Porter*
- *“Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.” —Michael Porter*
- *“I hold it that a little rebellion now and then is a good thing, and as necessary in the political world as storms in the physical.” —Thomas Jefferson*
- *“The market is not a place, a thing, or a collective entity. The market is a process, actuated by the interplay of the actions of the various individuals cooperating under the division of labor.” —Ludwig von Mises*
- *“What is necessary to change a person is to change his awareness of himself.” —Maslow*



The Koch household in Wichita, Kansas.

Relevant Stories and Anecdotes

- In the book, Koch shares a story from the 1960s when the company faced severe challenges and was on the **brink of financial collapse**. Instead of panicking, the company leaned into MBM principles. They cut unnecessary costs, focused on value creation to achieve future growth.
- Another narrative revolves around the **acquisition of a failing company**. Where others saw no potential, Koch Industries, applying MBM insights, recognized the company's intrinsic value, turned it around, and integrated it successfully. I'm fairly confident the company being acquired [was Invista](#) (part of DuPont).

Conclusion

The Science of Success is more than just a business book. It's a manifesto on how **free-market principles can drive success** in an organizational context. Koch's insights, borne from years of experience and tested in the crucible of real-world business challenges, provide valuable lessons for any leader or manager. **The core message: create value, trust in the capabilities of your people, and leverage the power of market principles within your organization.**