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Success and the state

By Richard W. Rahn

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What is the world's largest private company and how did it get that way? The company is Koch Industries. Its revenues in 2006 were about \$90 billion, up from only \$70 million in 1960. Charles Koch, who, along with his brother, David, built this massive and very successful enterprise -- which includes petroleum refining, chemicals, fibers and carpets, fertilizers, building materials, paper products and financial services, etc. -- has just written a gem of a little book, "The Science of Success." The book describes how Mr. Koch, through trial and error, and applying the insights of great economists, such as Ludwig von Mises, Friedrich Hayek and others, was able to develop what he calls "market-based management" (MBM).

Successful businesses that grow rapidly in part because of a unique invention or technology are relatively easy to understand. But it is more difficult to understand the success of businesses like Koch Industries which, as part of their business model, acquire businesses from other large companies and then just plain manage them much better. As an economist and former graduate business school professor and businessman, I am familiar with many of the thinkers Mr. Koch refers to in developing his own success model. But as I thought more about his management model, I realized he is also proving, once again, why well-managed companies will always do a more cost-effective and customer-satisfying job than government.

We know some government operations are managed reasonably well, but most are not. Unlike government, which has a perpetual monopoly no matter how poorly managed, badly run businesses eventually die or are taken over by better managed ones. Rudy Giuliani greatly improved the management and delivery of services in New York when he was mayor and made life better for most residents. But as good as Mr. Giuliani was, the political constraints under which he operated ensured New Yorkers were still paying way too much for what they were getting, versus what well-managed companies, such as Koch Industries, can accomplish.

One of the five dimensions in Mr. Koch's MBM system is "vision" -- whereby management attempts to determine where the organization can create the greatest long-term value. This works well in business and, particularly, in privately held companies that do not have to worry about what the stock market analysts will say each quarter. Few government leaders really have the luxury of being able to present and execute a long-term vision, because of the shortness of the political cycle and the inherent conflict over visions among the voters.

Ronald Reagan was successful in laying out a vision and getting a majority of the electorate behind much of it (as long as he was in office), but immediately upon his departure his successors began to undo what he was starting to put in place -- e.g., tax and expenditure reduction.

Like many really good business people, Mr. Koch understands long-term success depends on finding the right person for the right position and making sure that person is well motivated and adequately rewarded for the "value" he or she adds to the organization. Contrast this with government. Public school teachers, as a result of union contracts and customary practice, are normally paid according to length of service and the number of "teaching degrees" and certificates they have. Studies have shown these "measures" have almost nothing to do with student performance; hence, we have a high-cost public school bureaucracy that does a lousy job of educating our children.

Many activities now done by government can be fully or, at least, partly privatized. I have no doubt that if parents were given vouchers for the same amount the public schools now get on a per pupil basis, private companies using Mr. Koch's MBM system could deliver a far superior education to the children, while providing teachers higher incomes and much greater job satisfaction.

Charles Koch, more than almost all others, has proven he knows how to manage, motivate, and reward. Anyone who is in management or aspires to manage people in the private, public or nonprofit sector, and is willing to spend two or three hours with Mr. Koch's book and think about its lessons, will benefit from and enjoy it.

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