

Austrian Lessons for a Vibrant Economy

Charles Koch credits the principles of Austrian School of Economics as the catalyst for his Market-Based Management® business philosophy, which is the foundation of Koch companies' business practices. In September 2005, Mr. Koch accepted an invitation from the Friends of Austrian School of Economics Foundation to speak to an audience that included members of the Austrian Parliament, as well as industry and academic leaders. The presentation focused on two themes. First, how he applied the principles from the Austrian School of Economics to build Koch Industries, Inc., and second, how these same principles can be applied in society to create prosperity and economic growth. The following is a summary of that presentation.

I am honored and humbled to be here where some of the pioneers of the Austrian School of Economics once served your government. They established the foundation for economic thought that has been a guiding force in societies around the world.

I owe a huge debt of gratitude to the giants who created the Austrian School. They developed principles that have enabled me to gain an understanding of how the world works.

This understanding, combined with an experimental laboratory in the form of our company, enabled us to develop tools from these principles that produced amazing results.

In this way, economists from Austria have helped me succeed beyond my wildest dreams.

"I believe I owe a good part of what success I've had to concepts developed by Austrians."

By the book

After joining Rock Island Oil & Refining Company, my father's company, I developed two great passions. One was to help build a great company. Another was to understand the principles that lead to prosperity and economic growth. What initially inspired me was Ludwig von Mises' great book, "Human Action." It convinced me that it was possible to understand and improve the social world, just as it was the physical world.

I immersed myself in such books for a number of years, studying economics, history, philosophy, science and psychology. In economics, the Austrian School has proved by far the most useful.

As I pursued my studies, I became convinced that a free society is the form of social organization that best provides prosperity and economic growth.

Building blocks

I didn't realize at the time how valuable my studies would be – that the same principles that enable a market economy to prosper, could also work when applied in a company.

Over the years, we've learned through trial and error, and many missteps, how to apply these principles in our businesses to get results.

One concept we've used to great benefit is that a market economy is an experimental discovery process for finding and delivering what people value.

Joseph Schumpeter (a student of two Austrian School pioneers), called it a process of creative destruction in which less effective firms, products, and methods are constantly being eliminated.

Very few companies have been able to match the creative destruction of the marketplace. Since 1960, the U.S. stock market has grown about 100-fold (assuming reinvestment of dividends). Using the same assumption, Koch Industries has grown almost 1600-fold, or more than 15 times the market.


How did we do it? By applying a philosophy and methods largely based on the Austrian School of Economics.

Our approach to creating value and bringing about creative destruction is to identify the key factors in a market economy that drive value creation and bring them into Koch Industries.

We call this Market-Based Management®, which we apply through five dimensions largely based on Austrian School insights.


Here is a brief overview of the five dimensions of MBM®

- 1) Vision:** Our approach to vision is based on concepts drawn from the Austrian School of Economics such as uncertainty, experimental discovery, creative destruction, comparative advantage, and real value creation. Therefore, we constantly seek opportunities for which our capabilities will create the greatest value, and exit those that don't.
- 2) Virtue & Talents:** Virtue and talents covers what Koch companies seek and expect from employees. We have found that virtue is at least as important as talent. Accordingly, we believe long-term business success requires embracing certain core values.



Our core values, what the Austrian economist and Nobel laureate Friedrich von Hayek called rules of just conduct, are articulated in our Guiding Principles. Many companies have something similar, but they too often remain paper principles. What makes us different, if not unique, is that we take the difficult steps to ensure that these principles reach the hearts and minds and change the habits of every employee.

We ensure that they affect every aspect of an employee's career – whether the person is hired and retained and how the employee is rewarded. We also evaluate all policies to ensure that they lead to a culture of initiative and responsibility, rather than one of entitlement and unaccountability.

- 3) Knowledge Processes:** This dimension is rooted in the concept that market economies are highly effective at anticipating and communicating what people value and how best to satisfy those values. Similarly, we strive to help our people better anticipate and deliver what our customers value. We do this, first, by ensuring employees know how the Koch companies create value. Then, we ensure that our financial statements reflect economic reality. We measure profitability wherever practical. We encourage a strong challenge culture to provide discipline and stimulate thinking. We also give our people tools to help them create value. Having widespread economic thinking skills is vital to our long-term success, so we teach the application of economic thinking throughout Koch companies.
 - 4) Decision Rights:** Decision rights can be thought of as property rights within the firm. This dimension is based on the fact that, in a market economy, control of property (property rights) is constantly earned by people who make decisions that create value and lost by them when they no longer do so and incur losses. In Koch companies, decision-making authority is set, not automatically by hierarchy, but more by proven knowledge and comparative advantage. Employees develop a written statement of their roles, responsibilities, and expectations so they know what they are responsible for and can be held accountable.
 - 5) Incentives:** Finally, we attempt to replicate the way incentives work in the marketplace, in which entrepreneurs are rewarded by getting to keep a portion of the value they create in society. Likewise, our philosophy is to pay our people a portion of the value they create for the Koch company. Our emphasis is on long-term value. The key is a system in which employees can only promote their individual interest by promoting the general interest.
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Science of Liberty

Just as Koch Industries has prospered by applying methodology developed from the principles of Austrian economics, countries have prospered to the extent they have likewise applied them.

Of course, the many conflicting interests in a society make applying these ideas in a country much more difficult than in a company.

Even so, countries that clearly define and protect individual private property rights stimulate investment and grow.

Those that threaten and confiscate property lose capital and decline. They also lose the capability and efforts of the individuals who would be the greatest contributors to prosperity.

Real prosperity

Applying these principles has never been more important, given the increasingly global marketplace. The application of free-market principles leads to prosperity globally, across national boundaries, just as it does within specific companies and countries.

Free trade and open competition are the hallmarks of a global free market, and they are vital to global prosperity.

The only way to increase real income is to increase real productivity. Real productivity increases with improvements in labor skill, management and capital.

Free trade brings these improvements from the developed to the underdeveloped world. That is why globalization fosters the best conditions for the world's poor to move out of poverty into prosperity.

To the extent the world embraces Austrian free-market ideas, it will prosper. ■



Charles G. Koch

is chairman and CEO of Koch Industries, Inc., a position he has held since 1967. Under his leadership, Koch Industries has been transformed into a dynamic and diverse group of companies.

Much of Koch Industries' success can be traced to Mr. Koch's interest in and commitment to scientific and social progress, which led to the development and implementation of the Market-Based Management® business philosophy.

The concepts and practice of MBM® are described in Mr. Koch's book, "The Science of Success: How Market-Based Management Built the World's Largest Private Company," published in February 2007.