

# Maintaining balance



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**N**ine years ago this month, my predecessor, Joe Moeller, sent an important e-mail to all Koch company employees. It was a “Call to Action” that talked about the urgent need to get our affairs in order at a time when many of our businesses were suffering.

Back then, we had created many of our own problems. Too many of our businesses were overstaffed or unconcerned about costs. We were funding experiments as if they were proven winners instead of pure speculation.

Today, the primary source of our problems is external rather than internal, as in 2000. We now face a global economic crisis that is affecting all of our businesses.

## Ripple effects

Koch Fertilizer was our most-improved business last year, turning in record results. It was a shining star throughout most of 2008.

But what happened toward the end of the year? Fertilizer prices dropped by 85 percent in less than a month. Demand

disappeared, in some cases, pushing market prices below the cost of production.

Of all Koch companies, it’s fair to say that Georgia-Pacific has been forced to deal with lower demand longer than any other.

As GP employees know all too well, housing construction began declining two years ago and recovery for that market is still nowhere in sight. Consequently, demand for GP’s building products is down by double digits.

Over at INVISTA, demand for certain nylon products dropped by more than half in 2008.

With auto, clothing and housing sales down, is it any wonder that demand for the fiber used to make airbags, apparel and carpeting has plummeted?

Flint Hills Resources endured a year of dwindling refining margins in 2008 and has already announced plans to shut down a chemical plant this year.

Even Koch Chemical Technology Group, which had a record 2008, is seeing fewer new orders and some cancellations of existing orders.

To be clear, Koch Industries is still a profitable and healthy company. But there can be no doubt that the challenges of today’s struggling economy are affecting all of us.

## Who knew?

One year ago, who knew that U.S. retail gasoline prices would hit \$4 per gallon and then drop to less than \$1.50 per gallon in just five months?

How about global crude prices dropping from more than \$145 per barrel in July to less than \$34 before Christmas?

Who knew that some of the world’s biggest banks and insurance companies would implode, or that a single scam artist could cause losses that exceed those of Enron or MCI?

As Charles Koch has often reminded us, the future is unknown and unknowable. The only constant is change.

So, how do we deal with

such traumatic and unexpected change?

Perhaps the simplest answer is to do many of the same things at work that you’re already doing at home.

## Home and work

At home, you’re probably spending less and saving more. These are two of the most common, and prudent, responses to our challenging times.

That may mean eating out less often or less expensively, downscaling or postponing vacation plans, avoiding new debt or waiting a little bit longer before making any expensive new purchases.

It’s important to note you’re not giving up any necessities, such as food, clothing and shelter. But you’re probably a lot more careful about what you spend and how you spend it.

At work, the same is true across all Koch companies. We are avoiding unnecessary expenses, postponing major projects and trying to keep our inventories and workforce in line with customer demand.

This is not a pleasant or easy process, but it is an essential one.

Speaking of essentials, we refuse to cut corners on safety or compliance. But we’re more than willing to cut capital spending for optional projects – especially those with questionable prospects.

## All of a sudden, living within your means has become fashionable.

I know from experience that it doesn’t take many plant closings, idling announcements or headcount reductions before everyone seems to be asking the same questions: Is my job at risk? Will my role change? What is the future for my company?

I cannot predict the future, but I can share some specifics about how we’re applying our market-based framework to deal with these challenging times.

### Specifics

First, it's important that we all maintain a balanced view of our circumstances. Tough times do not have to mean total gloom and doom.

However, because the external economy is so bad, our internal discipline has to be sharper than ever. The severity of what we do internally is driven by the severity of external markets.

For example, in today's economic environment, re-investing in assets to improve their reliability doesn't make as much sense as it used to make.

When the demand and margins for a product are high, we want our plants making that product to run as close to capacity as is safely possible, because we don't want to miss any sales.

But, if demand or margins drop, it's no longer as important to run at 98 percent capacity 24/7. We may choose to run at 90 percent or less, or even incur some additional down time.

### Working capital

Similarly, because liquidity has become such an issue, we have to think differently about how or when to spend. In today's markets, we need to conserve capital, so we're rethinking our entire approach to inventory levels.

In the past, we may have carried extra inventory so we could always say "yes" when a customer asked for immediate delivery. Today, we cannot afford to carry excess inventory in the hopes that someone might order it soon.

Most customers would love to be given extended payment terms. When you're short on cash, it's always more appealing to pay in 60 or 90 days rather than 30.

But we can't make those kinds of changes unless we are compensated for them. In fact, we may need stricter payment terms for some customers.

Since we are customers ourselves, we also need to be

aware of the financial health of our vendors and suppliers. If we are relying on just one vendor to supply a critical product, what happens if that vendor goes under?

Today's challenge is to be better than ever at evaluating risks – internally and externally – in light of today's turbulent economy. We must also scrutinize every cost and be better than ever at relentlessly eliminating waste wherever possible.

### Changes

By taking this approach, we are likely to travel less often, hire fewer people and acquire fewer assets. Salaries and wages are now much less likely to rise.

As a private company, we have always focused on creating real, long-term value. We don't have to play the game of trying to meet analysts' quarterly expectations.

Even so, we are adjusting our time preference during these tough times. This means we must focus on driving benefits and profits sooner rather than later.

Because of the lack of liquidity in the marketplace, we're postponing projects that require several years to achieve a payout.

We are not giving up on innovation or the need for new product development, but we are giving priority to those innovations and investments that will provide a quicker payback.

### Expectations

As an employee, you need to be intellectually honest in assessing your activities. Make sure what you're doing really contributes to our current priorities.

If you are part of a team that was built to support a growth strategy for a particular product, and there is no longer much of a market for that product, you need to be thinking about other ways to contribute.

If you are an administrative



assistant or hourly line worker, don't be afraid to challenge your boss by asking: What can I do more of? What else needs to be done?

If you're a leader, you must know your customers, stay connected with your suppliers and develop even better market knowledge. Creative destruction pretty much guarantees that you've got to be constantly rethinking what your team is doing and how it is done.

A note of caution about making adjustments to account for the times...

When margins are squeezed and plants are facing overcapacity, compliance becomes more important than ever. Far too many companies succumb to stress by trying to cut corners or colluding with others during tough times.

For us, such actions are absolutely unacceptable. Principles one and two, integrity and compliance, cannot be compromised, ever, for any reason.

### Until then

Perhaps the most important thing I can share with you today is my firm belief that the opportunities of a lifetime await us at the end of these tough times.

When we emerge from this struggle, I suspect bargain prices for assets will abound. We will have chances to expand like never before.

By making difficult but necessary decisions today, we will be ahead of the curve in capturing the opportunities of tomorrow. ■

