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Dissecting the Kochtopus

A fascinating peek inside a successful and idiosyncratic private company

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KOCH INDUSTRIES, an oil, gas and commodities conglomerate based in Wichita, Kansas, is one of the great success stories of American business, with more than 100,000 employees worldwide and annual turnover of around \$115 billion. It is also one of its most unusual, in everything from its management techniques to its enthusiasm for political activism to the intensity of the family feuds which have threatened, at times, to tear it apart. Far more is written about the Kochs' political activism—often somewhat hysterically—than about their business. But a new book, Daniel Schulman's "Sons of Wichita", offers a fuller picture.

Koch, pronounced "coke", is America's biggest private company after Cargill, another commodities titan. Charles Koch, the second son of the late founder, Fred Koch, is the undoubted boss of the firm. (Insiders joke that Koch stands for "Keep old Charlie happy".) A younger brother, David, acts as a loyal lieutenant. Two other brothers, Fred junior (the oldest) and Bill (David's twin), have a more complex relationship with the company that has helped to make them two of America's richest men.

Charles believes that staying private brings many advantages. Spared the requirements for disclosure and corporate governance imposed on listed firms, Koch can avoid tipping its hand to rivals, and think long-term while acting quickly when it sees a bargain. Above all, it frees the group to focus relentlessly on growth. Mr Schulman quotes an executive saying that growth is: "Our religion...to make things grow...to push, push, push." Charles says that it will go public "literally over my dead body."

Charles runs Koch according to the principles of something he calls market-based management. Employees are expected to read his 2007 manifesto, "The Science of Success", and attend a two-day seminar on the theory at an in-house academy. Its aim is to bring the efficiency of markets into the company's internal workings. Competition between different business units and employees is encouraged, and all workers are given broad permission to make decisions without referring upwards.

The system is highly democratic. Koch has an unusually "flat" organisational structure for a company its size. Workers can earn more than their bosses. High-school-educated farm boys from Kansas can rise

faster than Ivy League MBAs and end up running multibillion-dollar divisions. It is also ruthlessly Darwinian. For those who succeed, bonuses running into six or seven figures are the reward; for those who fail, there is no hiding-place.

The Kochs are also at the heart of one of America's most powerful political machines. Most businesspeople take a strategic approach to politics: they lobby for special privileges and contribute to both sides of the political aisle. The Koch brothers have ideology in their DNA. Fred senior was a leading light in the anti-communist John Birch Society. David ran as the Libertarian Party's vice-presidential candidate in 1980, and Charles and David helped to raise an estimated \$400m for efforts to defeat Barack Obama's re-election bid in 2012. Critics fret about the "Kochtopus"—the Kochs and the network of institutions that they finance, ranging from the Cato Institute, an august think-tank in Washington, DC, to Tea Party organisations like Americans for Prosperity.

For all the successes of Koch and its founding family, their idiosyncrasies have brought costs. The firm has been racked by family feuds that, in the words of one of the protagonists, made "Dallas" and "Dynasty" look like playpens. Bill has brought a series of lawsuits against "Prince Charles", accusing him, among other things, of wasting money on political causes, paying too little in dividends and keeping the family wealth locked up in illiquid form. In the 1990s it suffered a barrage of cases from the federal government accusing it of violating safety and pollution laws: the book suggests that Charles's market-based, growth-focused management may have tempted it to overlook such issues. Charles's enthusiasm for political activism has led the public to view the company through an ideological rather than a business lens. For those on the left, Koch Industries stands for everything that is wrong with capitalism, from billionaires trying to buy elections to oil barons despoiling the environment.

Nevertheless, the company's business record has been extraordinary: it does not publish its profits but it is a safe bet that the family can well afford the odd billion in political donations and legal fees. Although Fred senior and his first business partner started out trying to perfect the refining of crude oil, Koch Industries has grasped that its core competence nowadays is not so much the research side of the business as its understanding of how to process and transport commodities efficiently. This encouraged it to move further beyond its original oil-and-gas business to make, in 2005, an audacious \$21 billion bid for Georgia-Pacific, a larger public company that sells Brawny paper towels, Dixie cups and Angel Soft toilet paper. This almost trebled the firm's workforce and provided fuel for further growth.

The power of regeneration

Koch Industries has also demonstrated a striking ability to reform itself. Prodded by the spate of legal suits in the late 1990s, the firm introduced a big safety programme. Charles's corporate mantra was "10,000% compliance with all laws and regulations", by which he meant 100% compliance from 100% of employees. The company sold the bulk of its pipeline operations and refocused on the far less regulated area of trading commodities and energy. It also hired a small army of former federal-government prosecutors and regulators to help guard the hen house. After wasting millions of dollars trying to defeat Mr Obama in 2012, Charles and David are now applying their re-engineering skills to their gigantic political operation. What does not kill the Kochtopus only makes it stronger.