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– Charles Koch



**A reprint of articles in a series on Charles Koch and Koch Industries,
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The Wichita Eagle

Koch and his empire grew together

Editor's note: Charles Koch is the richest man in Kansas and one of the most private. This series looks at Koch and the company he built.

By Guy Boulton
The Wichita Eagle

As a teenager, Charles Koch spent a summer living in a bunkhouse, miles from electricity and running water, on the Beaverhead Ranch in southwestern Montana.

The log bunkhouse, dug into the side of a hill, was in the Centennial Valley, a summer range 7,000 feet above sea level.

Koch and the seven or eight other ranch hands — including "Bitterroot Bob," a cowboy fond of lying in his bunk at night with his pistol and shooting at flies on the ceiling — scattered bulls among the herd, culled sick cattle and rode fences.

"He was on a horse every damn day," says Sterling Varner, who also worked that summer at the ranch — albeit at its base 35 miles away.

At the end of the summer, Varner took Koch to a restaurant in Dillon, then home of 19 bars and five brothels, before putting him on a train to prep school.

Koch looked around the restaurant and said, "It sure is clean here."

The experience was far removed from the country clubs of Koch's prep school classmates. But Varner says, "His old man, I can guarantee you, would never let him think he's a rich man's son."

Charles Koch, chairman and chief executive of Koch Industries, is now one of the world's richest men, a billionaire, perhaps several times over.

Yet his lifestyle, some four decades later, resembles that of the very rich as much as that ranch bunkhouse resembled a country club.

You don't expect a billionaire to sit down to dinner every weekday night with his wife of 21 years and their two teenage children. You don't expect a billionaire to spend his evenings reading scholarly books on economics, history, philosophy and psychology. And you don't expect a billionaire to make his home in a place like Wichita, Kan.

"His family and his company, that's his focus," says Varner, the former president of Koch Industries.

Charles and Liz Koch live well. They have a beautiful home, drive expensive cars, charter company planes for trips. But their lifestyle is a meager reflection of their wealth.

They do not own a home in Palm Beach or an apartment in Paris. They will not be found on the pages of magazines such as *Town & Country* that cater to the upper crust. They socialize with friends in Wichita, not with Donald Trump and other glitterati.

Instead of jetting off to parties in Los Angeles or New York, Charles and Liz Koch try

to take in a good movie — "Schindler's List," say, or "Shadowlands" — once a week with friends they have known for nearly 30 years.

"He just wants to live his life well and enjoy the things he enjoys and not try to impress anyone," says Joseph Galichia, a friend and a Wichita physician.

Koch has lived in Wichita since his mid-20s, the only one of the four Koch brothers to make his home in a decidedly unglamorous city. And despite being sent to prep school when he was 11 and going to college back East, Koch remains a Midwesterner — someone who begins sentences with "Gosh."

When other cities have offered Koch Industries incentives to relocate its headquarters, Koch has said, "No. This is my home."

Over the past 27 years, Koch, 58, has transformed a midsized energy company, operating on the fringes of the world's largest industry, into one of the most successful companies in the country.

In 1966, the company had revenues of \$177 million. Last year, it had revenues of nearly \$24 billion.

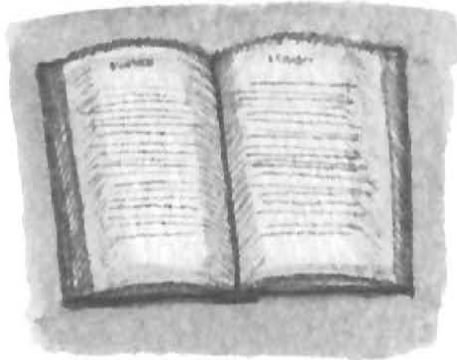
If Cessna Aircraft Co. had grown at the same rate, its sales today would be more than \$27 billion instead of slightly less than \$1 billion.

Koch Industries has interests in oil refineries, petrochemicals, crude oil transportation and trading, natural gas liquids, oil and natural gas production, chemical and refining technology, natural gas pipelines, asphalt, financial services, fertilizer pipelines and plants, ranching, feedlots and grain elevators.

Despite Koch Industries' success, little is known about Koch. He keeps a low profile in Wichita, socializing within a small circle of friends.

"I just think Charles is very

Charles Koch can be a name dropper — not the names of CEO's, politicians or celebrities, but those of philosophers, economists and other intellectuals whose work he reads.





Mike Hutmacher/The Wichita Eagle

“That was one of the first things that I noticed about him, that this guy’s a fighter. No status quo present here. And it added a charm and mystique to him that was immediately attractive and interesting.”

— Liz Koch

careful about where he reveals his personal side,” says an acquaintance.

Koch is not reclusive, but he is private. A 6-foot brick wall surrounds the family’s stone-and-glass house on 80 acres near the Wichita Country Club — an unincorporated island within the city.

Until recently, even the Kochs’ philanthropy has been low-key. Koch Industries and various foundations controlled by Charles and Liz Koch have given an average of \$2 million a year to Kansas charities for the past five years, according to the company. Most Kansans, though, are unaware of that.

Earlier this month, that changed somewhat when Charles

and Liz Koch donated \$1 million and Koch Industries donated another \$1 million to the Salvation Army — an organization that Liz Koch has been actively involved in since 1987.

Still, Liz Koch says that her husband “is not comfortable being a public figure — not at all.”

Charles Koch has shown no interest in publicity, granting interviews rarely and reluctantly. Koch Industries has been renowned for its secrecy. And despite Koch’s success in building a premier company, he may be best known for the longstanding dispute with his brother Bill Koch.

When Charles Koch’s name has appeared in the national media, it is usually with the description “secretive, right-wing oil billionaire.” Asked about that characterization of her husband, Liz Koch winces and hits her heart with her fist.

The misconceptions have prompted Koch and Koch Industries to become more open. Both he and the company have reluctantly accepted that, given the company’s size, they will be in the news.

A heavy and heady reader

The Oxford English Dictionary — 20 volumes that trace the ori-

gin and history of nearly every word in the English language — lines a stretch of shelves in Koch’s office at Koch Industries.

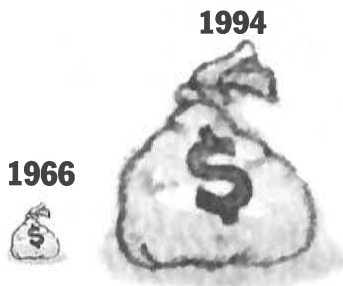
The built-in wooden bookshelves in Koch’s office are filled otherwise with books on economics, political philosophy, psychology and history — not the standard bestsellers on business. Some are worn paperbacks, the kind you would expect to find in a college professor’s office.

Many of the ideas in those books have become an integral part of the way Koch Industries operates.

“I like to use the quotation, ‘True knowledge results in effective action,’ ” Koch says. “When you look at knowledge and learning in that sense, it’s not just getting an inspiration or having a new idea. It’s how to apply that.”

He has always had “some internal requirement” to integrate what he’s read and learned in all aspects of his life, Koch says. When he reads something, he asks how it would apply to society, to his company, to his family life, to his behavior.

“He can read any article and use that information to tackle a problem,” says Richard Fink, a former economics professor who oversees the company’s govern-



In 1966, the company had revenues of \$177 million. Last year, it had revenues of nearly \$24 billion.

mental and public affairs.

Koch is a tall man — 6 feet 3 inches — with a trim and athletic build. His demeanor is a mix of reflective seriousness and easy-going grace. He is businesslike, but the lines around his eyes and mouth are those of someone quick to laugh or smile. A quip — usually self-deprecating — will be followed by his boyish grin.

He can be a shameless name dropper — not the names of CEOs, politicians or celebrities, but those of philosophers, economists and other intellectuals.

Koch has read works by Thomas Jefferson, Immanuel Kant, Stoic and Epicurean philosophers, Aristotle, Arthur Schopenhauer, Herbert Spencer, Jean-Jacques Rousseau, Karl Popper and Thomas Aquinas.

“There’s hardly anything he doesn’t want to learn about,” says Galichia, the Wichita physician. Interested in some new development in medicine, Koch will tell him, “Educate me about that.”

A few years ago, Koch read the Old Testament — not out of religious fervor, but out of intellectual curiosity.

“The Bible has had such a powerful influence, and Charles wanted to see what this hold was over the years,” says David Koch, his brother.

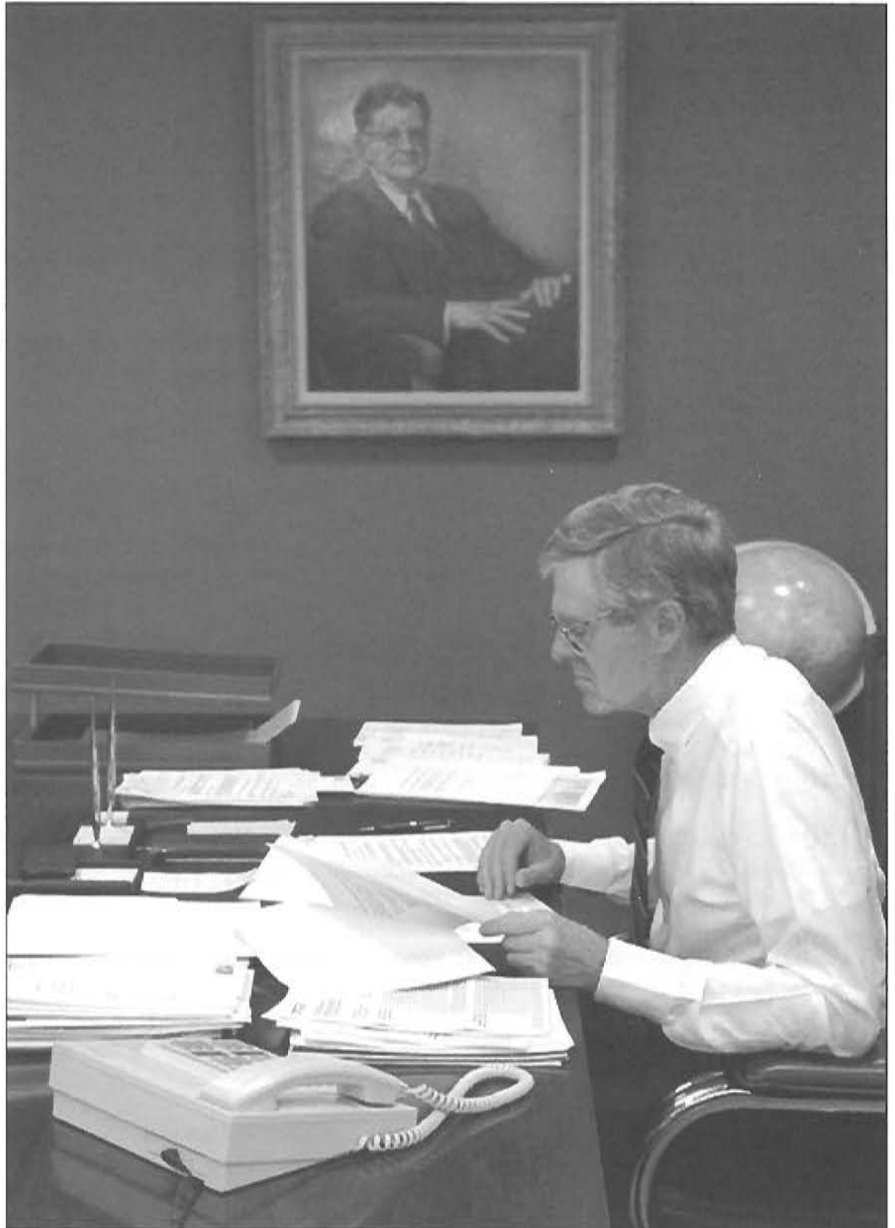
Koch wasn’t always so studious. As a young man, he was more interested in parties or playing rugby — “anything other than read some serious book,” he says, laughing.

But when he went to work for Koch Industries in the early 1960s, he started reading in the evenings and on weekends.

“I guess you’d say I did that for pleasure,” says Koch, sitting back in a chair, occasionally gesturing, legs crossed. “Sometimes it wasn’t pleasure. But it was satisfying enough that I had the incentive to do it.”

He reads at least two hours a day, and only the occasional novel by Tom Clancy could be considered light reading.

Lying in bed at night, Koch will sometimes read a passage to his wife, talk about it, get her interested in the book. “And



Dave Williams/The Wichita Eagle

A painting of his father hangs near Charles Koch's desk. “He was a tremendous role model,” Koch says, “To me, he had character, judgment, loyalty, commitment, humility.”

when I read it, I find it was the only good part of the book,” Liz Koch says.

Intensity at work and play

In another part of Koch’s office, near a cluster of family photos — including a shot of his son as a child, wearing a cowboy hat and sprawling alongside a bale of hay in the

back of a pickup — are neat rows of books-on-tape.

The tapes, which he plays in his car, include such books as Eric Foner’s “Reconstruction,” Jose Ortega y Gasset’s “The Revolt of the Masses” and Thomas Sowell’s “Ethnic America.”

Koch lives 15 minutes or less from work.

“Explain it to me, if you can.

TIMELINE

1940 — Fred C. Koch and two partners form Wood River Oil & Refining Co. to build a small refinery in Wood River, Ill., for an initial investment of \$2 million. Fred C. Koch has a 23 percent interest in the company.



Fred C. Koch

1946 — Company buys the Rock Island Oil & Refining Co., which owned a small refinery in Duncan, Okla., and a crude oil gathering system.

1950 — Wood River refinery is sold to Sinclair Oil. The company buys the Beaverhead Ranch near Dillon, Mont.

1951 — Rock Island refinery is transferred to Sunray DX, a predecessor of Sun Co.

1952 — Company buys the Matador Ranch near Matador, Texas.

1959 — Company's name changed to Rock Island Oil & Refining Co. Company buys a 35 percent interest in the Great Northern Oil Co., which owns a refinery near Rosemount, Minn.

1961 — Charles Koch goes to work for Koch Engineering Co., which makes equipment for the refining and chemical industries.

1963 — Charles Koch promoted to president of Koch Engineering.

1966 — Charles Koch named president of Rock Island Oil. Company has annual revenues of \$177 million.

1967 — Fred C. Koch dies and Charles Koch becomes chairman and chief executive officer. Companies' main holdings are a crude oil gathering system in Oklahoma, ranches, Koch Engineering and a 38 percent interest in Great Northern Oil.

1968 — Company name changed to Koch Industries. Corporate office building on 37th Street North is completed.

1969 — Company buys controlling interest in Great Northern Oil in a stock transaction and enters natural gas liquids business.

1974 — Sterling Varner promoted to president of Koch Industries.



Varner

1970s — Company increases its oil and gas exploration, expands its natural gas liquids business, begins marketing petroleum coke — a refining by-product mixed with coal and sold as fuel, buys coal mines, expands its Minnesota refinery, enters the asphalt business and adds to its gathering systems. By 1979, revenues are estimated at \$6 billion.

1981 — Company buys a refinery and petrochemicals plants in Corpus Christi, Texas, and a south Texas crude oil gathering system from Sun Oil Co. for \$265 million.

1983 — Company buys out Bill Koch, Fred R. Koch and a group of smaller stockholders for \$1.1 billion.

1987 — Bill Hanna promoted to president, and Varner becomes vice chairman of Koch Industries.



Hanna

Sources: Koch Industries and The Wichita Eagle.

It drives me nuts," Liz Koch says in an interview in the company's cafeteria.

The two have come to an understanding. "When I am in the car, we listen to Italian opera, which he likes," she says. "When he is in the car alone, he listens to his books-on-tape."

The short commute and the trips around town add up: Koch estimates he listens to a dozen books a year.

"I've never seen a guy in my life who is so intense in living every minute," Fink says. And he warns, "The one thing that you don't want to do is waste Charles' time."

Edward Crane recalls a three-week tour of the Orient in 1983 that Koch planned. Every moment was filled except for a two-hour period in Hong Kong near the end of the trip. Exhausted, Crane and the others looked forward to relaxing by the hotel pool. Not Koch. He tried to persuade them to go sightseeing. When they balked, Koch went by himself — and talked about the excursion throughout dinner.

"He cannot pass up an opportunity to learn new things, experience new things, analyze new things," says Crane, who was co-founder with Koch of the Cato Institute, a think tank based in Washington.

Koch acknowledges that he doesn't relax much on vacations. When the family went to the Summer Olympics in Spain, he says, he drove his kids crazy because he wanted to see four or five events a day. "They kept swearing that it's the last trip they will go on," he says.

Koch brings the same intensity even to a pastime like Sunday afternoon television.

"While he's watching the football game, his briefcase is in his lap, there are papers everywhere and he's doing both at the same time," Liz Koch says. "And that's how he relaxes."

Sam Wood, a close friend and former tennis partner, recalls how Koch would play for hours in the hot sun without stopping. When Wood wanted

to take a break, Koch would say, "Continuous play."

Wood once nicknamed Koch "Charlie Choke" — an irresistible misnomer. He has never seen his friend truly angry, but he has seen him upset when playing sports.

Over the years, Koch has enjoyed rugby, white-water kayaking, tennis and golf.

Gerald O'Shaughnessy, a Wichita oilman and friend, recalls taking lessons with Koch from a golf pro who had broken the swing down to 175 components — an approach that fascinated the engineer in Koch.

"It was just perfect for Charles," O'Shaughnessy says. "Later on, we realized it was disastrous for our golf game."

He long ago gave up rugby and white-water kayaking. Arthritis in his knees ended tennis. But despite his knee trouble, he still skis.

The family, which had a condo in Vail, recently bought a house in Aspen next to that of Charles' brother David.

Other than the Aspen home, the only interest that betrays Koch's wealth is fine wine.

"That's the only thing he wants to spend money on," Wood says. "He loves great wine. He couldn't care less about clothes."

Liz Koch, in fact, helps pick out his clothes.

An enjoyable evening for Koch consists of good conversation, with people of diverse interests and backgrounds, and good wine. He avoids big parties and has little interest in small talk or gossip. It's a trait inherited from his father.

"If he went to a party, he wanted to be the first one there and the first one to leave," David Koch says. "Mother wanted to stay all night."

Fred C. Koch, the son of a frontier newspaperman in West Texas, was a strong-willed, independent man who loved the outdoors. Mary Koch, the daughter of a Kansas City surgeon, was a cultured, outgoing woman who loved the arts and was an accomplished silversmith.

She was a good balance to

her laconic husband. But she also was an excellent athlete who loved to hunt and fish.

David Koch, a bachelor active in New York society, takes after his mother. His New Year's Eve party in Aspen drew 800 people last year and was listed by Newsweek magazine as one of the best parties in the country to crash.

At Christmas Eve dinner last year in Aspen, Charles Koch made a moving toast to his brother. At the end of the speech, David said, "Does this mean you will let your daughter Liz go to my New Year's Eve party?"

"Hell, no," Charles said.

Charles Koch does go to the party — but you sense reluctantly. And though David Koch won't name names, he says his brother is not one to fawn over celebrities.

"It does not turn his motor at all," Liz Koch says.

Taking reins from 'Papa'

To the right of Charles Koch's desk hangs an oil painting of Fred C. Koch. And Charles Koch clearly retains a deep love and respect for his father.

"He was a tremendous role model," Koch says. "To me, he had character, judgment, loyalty, commitment, humility. And he was constantly studying and trying to learn. He was a student all his life."

In the 1920s, Fred C. Koch, who studied engineering at Rice University and the Massachusetts Institute of Technology, and another inventor developed a process for making gasoline out of heavy crude oil.

The major oil companies, which licensed competing technologies, promptly sued the Winkler-Koch Engineering Co. for patent infringement. Some 40 lawsuits were eventually filed. Fred C. Koch won all of them.

The lawsuits, however, locked the company out of the U.S. market. Fred C. Koch took the process overseas and helped the Soviet Union upgrade 15 refineries during Stalin's historic modernization drive.

Several of Fred C. Koch's business associates were killed during Stalin's purges, and he would become fervently anti-communist, a member of the advisory council of the conservative John Birch Society and the author of a pamphlet titled "A Businessman Looks at Communism."

In 1940, Fred C. Koch and two partners built a small refinery in Wood River, Ill. Their initial investment was \$2 million. Koch had a 23 percent interest in the refinery. The company, Wood River Oil & Refining Co., was the precursor of Koch Industries.

Stories about Fred C. Koch depict a larger-than-life character. Was it difficult being his son? Not at all, Koch says.

"I would attribute whatever I've been able to accomplish to his inspiration."

Nonetheless, Koch was a rebellious and somewhat wild teenager, David Koch says, and he liked being sent to Culver Academy, a military school in Indiana, "about as much as being put in jail."

He was, however, an excellent student with broad interests.

At various times, Koch considered becoming a mathematician, a scientist, a teacher or an economist. He instead chose his father's profession: engineering.

Skilled in math, Koch earned an undergraduate degree in general science in 1957 and graduate degrees in nuclear and chemical engineering in 1958 and 1959 from MIT — all before age 24.

He struck out on his own after graduation, going to work for Arthur D. Little & Co., a prestigious consulting company based in Cambridge, Mass.

David Koch recalls sitting at the breakfast table at the family's home in Wichita when his father told Charles that he wanted him to join the company.

Charles, enjoying life in Cambridge, wanted to stay and get a master's degree in business from Harvard University. In that case, his father said, he

planned to sell the company.

"Papa laid it on the line that if he wanted to take over the company, he had to come now," David Koch says. "And Charles said, 'Well, OK, if that's the way you want it.'"

In 1961, at 26, he returned to Wichita and went to work for Koch Engineering Co., a subsidiary of what was then called Rock Island Oil & Refining Co.

Two years later, he took over Koch Engineering, turning the struggling subsidiary into a business that made several million dollars a year.

He was promoted to president of Rock Island in 1966 and became chairman and chief executive after his father's death in 1967.

At the time, Rock Island consisted of a small crude-oil gathering system in Oklahoma, an engineering company, several ranches and a 38 percent interest in a Minnesota refinery.

The company had a book value of \$30 million. If Rock Island's market value was 1.5 times its book value — a reasonable estimate, given its low-margin businesses — Koch's 20.6 percent stake in the company was worth about \$9.3 million in 1967, the equivalent of \$40 million in 1993 dollars.

Koch's fortune was estimated last year at \$1.5 billion by Forbes magazine and at \$2.3 billion by Fortune magazine.

Learning valuable lessons

Koch could have opted for a life of idle pleasure. Instead, a 32-year-old chief executive, he renamed the company in honor of his father and immediately set to work.

In 1969, Koch Industries bought controlling interest in a Minnesota refinery, the Great Northern Oil Co. Other acquisitions and investments quickly followed. Some were profitable, others were not, but the pace never slowed.

"He gave his heart and soul to make it go," says Varner, the company's former president.

Koch recruited executives from larger companies and

gave them an unusual degree of freedom and responsibility.

When Bill Hanna, now president of Koch Industries, started the company's natural gas liquids business in the late 1960s, for instance, he was basically told to take some money and earn a decent return on it.

It was a heady time. The company stepped up its oil exploration and production, bought pipeline systems and added to others, expanded the Minnesota refinery and entered the petroleum coke, asphalt and coal businesses.

Koch, though, still had lessons to learn.

A foray into the shipping business in the early 1970s nearly proved disastrous. Koch Industries owned five tankers and had others on charter when the shipping market collapsed after the Arab oil embargo. The company was able to buy out the charters and scrapped the tankers.

"It was a big lesson to Charles," Hanna says.

Koch also had lessons to learn as a manager. As a young man, he tended to approach management problems as an engineer — solve the equation and you have solved the problem, Varner says. He had to learn the importance of people — a lesson that Koch credits Varner with teaching him.

Another shortcoming was that Koch often forgot that anything mattered other than building Koch Industries. Executives still recall his calling a meeting in August 1968 at 4 p.m. on a Sunday. The meeting ran until midnight.

"Before he married," Varner says, "he darn near killed us."

Executives would often work a full day and part of the night on Saturday. Koch was no different. Part of the company's folklore is his proposing to Liz Koch over the phone.

"I could hear him flipping through his calendar trying to find a free day," she said in an interview several years ago.



Dave Williams/The Wichita Eagle

Charles and Liz Koch and their two children may live on 80 acres behind a brick wall, but eating dinner together every night, without the help of servants, is a "fact of life," Liz Koch says.

Honest, fair, tough-minded

Koch was a demanding boss but not a tyrant given to outbursts, according to former employees. He was always polite, always fair.

"You could never have anything but respect for him," one former employee says.

Others describe a man with a sharp, analytical mind and a knack for asking the key question. It's a managerial style that

one describes as "hands-on, hands-off."

"He always seemed to be very at ease with himself," another former employee says. "Very honest. Very straightforward."

Koch expects employees to be the same way.

"If he catches you lying, that's the mortal sin," Varner says.

Even small lies disturb Koch.

Fink, the company's vice president of governmental affairs and public relations, recalls receiving a phone call while in a meeting with Koch. Fink told his secretary to say he was not in — only to have Koch go on for 15 minutes on why he should say he's in a meeting or can't take the call but not lie.

"I got a lecture like I was an 8-year-old child, and I deserved it," Fink says. "It was just a concern of his on how we conduct our business."

Does Koch consider himself a tough boss?

"I certainly try not to be nasty — although I probably am from time to time — or insensitive — and I probably am from time to time," Koch says.

Such behavior is inappropriate, he says, but any executive must be tough-minded.

"That is, that you require that you and your people face reality as it is, not as you want it to be — that you evaluate businesses, activities and people based on real performance, rather than ego, image, impressions, whatever other ways people are evaluated," Koch says.

Koch seems to approach business with the skepticism of a scientist and the pragmatism of an engineer. It befits his training. When talking about business, he doesn't refer to the latest management fad, he refers to the English philosopher Popper's scientific theory of proof.

"If you have a proposition or thesis or theory, you're obligated to search just as hard for facts that disprove it as you do for facts that support it," Koch says.

Koch often sits silent at meetings, letting others air

ideas, says Hanna, the company's president. Some people don't like it; they have no idea where he stands. "You are the business leader," Koch will say. "You make the decision."

One of the frustrations of his job, Koch acknowledges, is the way people interact with their boss.

"I try to be just as direct and forthright as I possibly can," he says. "But the tendency for many people is to take what I say and say, 'OK, now what did he really mean? What was the message?'"

"Gosh, if I had another message, I would have told you. You get what you see. But it's hard for people to accept that."

Koch doesn't want people to be intimidated, says Jim Imbler, who oversees Koch Industries' management center. And he works hard to make people feel comfortable. He worries about remembering their names. He gets up in meetings to bring them coffee.

Many CEOs' egos get bigger with each passing year. The reverse seems to have happened with Koch. He seems awkward, almost irritated, when complimented. And he admits to having misgivings daily.

"I think as you grow older, you probably have more self-doubts than when you are young," he says. "You are too ignorant when you are young to know all the pitfalls out there."

Wealth and preconceptions

Koch has a reputation for being rigid and controlling — a reputation that several employees and friends contend is undeserved. It's a "vast mischaracterization," says O'Shaughnessy, Koch's friend.

"His way is to try to avoid being dogmatic about anything," says O'Shaughnessy.

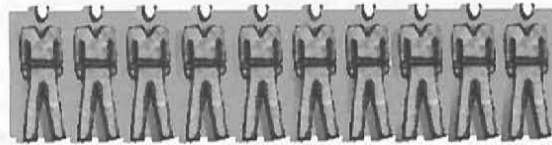
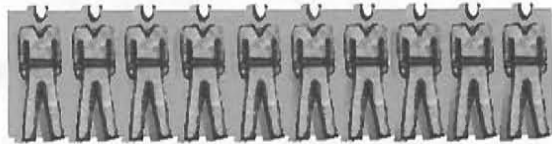
People often have preconceptions about people of power and wealth, assuming that there must be some "evil secret," says O'Shaughnessy, who served on the board of Wichita Collegiate School with Koch.

A rumpus at the private school

1967
650 employees



1994
more than 13,000 employees



Since 1967, Koch's work force has increased from approximately 650 to more than 13,000 — an average of nearly nine new employees a week for 27 years. And Koch Industries now has 2,000 employees at its headquarters on the northeastern edge of Wichita — 600 more than 10 years ago.

last year showed how such conceptions can come into play. Parents were enraged when the headmaster, Nyle Kardatzke, resigned after a dispute with the board. Two board members who supported the headmaster also resigned.

The dispute centered on whether the board would have a say in the selection of the head of the high school. But a tangential issue was the board's effort to use aspects of Koch Industries' management philosophy in running the school.

Koch had resigned from the board the previous month. But when Fink and another Koch Industries executive were chosen as temporary replacements for Kardatzke, parents suspected that Koch had played a role in forcing out the headmaster.

"Even if Charles didn't orchestrate it, it sure looked like it," one parent says.

O'Shaughnessy says such suspicions are "an insult to the intelligence of the board."

Koch's experience at Collegiate, though, may partly explain why he is uncomfortable in the limelight.

"When you are in the position he's in, it's not normal," O'Shaughnessy says. "He's aware of that. And he tries to deal with it in a normal way."

Liz and Charles' courtship

As influences on his life, Koch mentions his father, Varner and his wife.

"I am so goal-oriented that I can get withdrawn from relationships, and Liz really taught me how to have a close, loving relationship," he says.

The tone of his voice changes slightly with emotion, but it recovers when he quijs, "When I got married, everyone here commented, they were more grateful to her than anyone they've ever met."

Elizabeth Buzzi, a Wichita native, met her future husband when she was 23 years old.

Koch was living in a high-rise apartment building at 13th and Woodlawn and driving a 3- or 4-year-old Buick Riviera. An old picture shows a spartan apartment cluttered with books.

The year was 1967, the Summer of Love. And Liz Koch acknowledges that Koch, interested in economics and conservative politics, was out of sync with the times.

"That was one of the first things that I noticed about him, that this guy's a fighter. No status quo present here," she says.

"And it added a charm and mystique to him that was immediately attractive and interesting."

They were married in 1972 after a five-year courtship.

Liz Koch will accept credit for her husband's becoming more demonstrably affectionate and loving. But she adds, "You don't have enough paper there to put down all he taught me."

Liz Koch is chairwoman of the local board of the National Foundation for Teaching Entrepreneurship, an organization that teaches disadvantaged children basic business skills. She also is chairwoman of the Salvation Army Advisory Board and a member of the board of Wesley Medical Center, and she works with the Kansas Cultural Trust, which provides grants to promising artists in the performing and visual arts.

The Kochs' charitable foundations and Koch Industries are supporters of the entrepreneurship foundation, the Kansas Cultural Trust as well as more than a dozen Kansas organizations and charities.

Friends describe Liz Koch as charming, outgoing, dynamic. David Koch's description seems the most apt: "Gracious and outspoken."

Wood, who contends he fixed his friend up with every woman but the one he married, says, "He was probably too strong for anyone but Liz."

Seeking the normal life

Every weekday night, Charles and Liz Koch sit down to dinner with their two teenage children, Elizabeth and Chase. There are no servants. And dinner is mandatory.

"It's a fact of life. Nobody questions it," Liz Koch says. "I'm amazed more people don't do it. I always had to have dinner every night with my parents, and so do our kids."

Elizabeth, their oldest child, is a talented artist who also is interested in poetry and literature. She recently was accepted to Princeton University, which offers a program in art and literature.

Chase is a good student, a tennis player and athlete, who,

not unlike his father, has been put to work.

"It's over for him now," Liz Koch says. "From now on, he will work."

Charles Koch, though, got to spend a summer in Montana. Chase Koch spent last summer working in a feedlot in Syracuse.

In the past, Charles Koch has said Koch Industries has become too big for the top job to become a birthright. Does he worry that his children will always be in his shadow?

"We've always emphasized that the measure of a person is, in a large part, how well they do

Saturday evening, Chase Koch, driving a Ford Explorer, missed a red light and killed a 12-year-old pedestrian named Zachary Seibert.

The Kochs did not hide behind high-priced lawyers. And there apparently was never any question on how to react. "You can't walk away from something and pretend it didn't happen," Liz Koch says.

Liz Koch went to the hospital, where there was an emotional and painful encounter with the Seiberts. And the next day, Charles and Liz Koch visited the family at the Seibert home. They and their son also went to the funeral.

"It was emotionally wrenching to watch them at the funeral," a friend of the Seiberts says. "It took a lot of courage to walk in that group of people. And every eye in that church was on them."

The Kochs wanted their son to accept responsibility for the accident, says Jene' Seibert, Zachary's mother.

"It meant a lot to me how much they reached out and how much emotion and caring they showed," she says.

Chase Koch subsequently pleaded guilty to a misdemeanor charge of vehicular homicide and was placed on probation. He also was ordered to perform 100 hours of community service.

The Kochs have not forgotten the tragedy.

"There's not a day I don't think about it," Liz Koch says.

Trouble among the brothers

Enormous wealth, of course, does not insulate anyone from tragedy. And it brings tragedies of its own.

Charles Koch's accomplishments have been marred by a painful dispute that has set brother against brother. The riving of a family is painful in itself. It's worse when it appears in The New York Times Magazine, in Fortune magazine and on the front page of The Wall Street Journal.

In 1980, Bill Koch tried to oust Charles Koch, his brother,

Koch Industries operates 37,000 miles of pipeline — enough to circle the globe at the equator more than one and a half times.



with what they have and their unique capabilities," Koch says.

What worries him more is that his children have two ways to use the advantage that they have in their lives.

"One is to never push yourself. And the other is to use that advantage to . . . accomplish even more and work even harder," Koch says. "And if they don't do that, they will never know the joy of really creating and producing and contributing."

Liz and Charles Koch have been fiercely private about their children. Last summer, a tragedy forced them to become less so.

On Sept. 18, at 7:45 on a

as chairman and chief executive. The attempt failed and Bill Koch was fired. He has been battling Koch Industries ever since.

The dispute stemmed in part from Bill Koch's opposition to the company's policy of reinvesting 90 percent of its profits and paying relatively small dividends.

"I had all this wealth that was on paper and I couldn't get any cash," Bill Koch says.

His salary his last year at Koch Industries was around \$1 million. He also probably received several million dollars in dividends.

In 1983, Koch Industries bought for \$1.1 billion the stock owned by Bill Koch, Fred Koch — the oldest of the four brothers — and a group of smaller stockholders. The buyout increased Charles and David Koch's interest in the company to 81 percent at the time.

In June 1985, Bill and Fred Koch and the other minority stockholders filed a lawsuit in federal court alleging that Charles and David Koch and three company executives fraudulently concealed the company's true value. Bill Koch and the other plaintiffs are seeking about \$1 billion in the lawsuit, which is expected to go to trial next year.

Bill Koch, who has a doctorate in chemical engineering from MIT, is best known for winning the America's Cup yacht race in 1992. He is a rebel with half a billion dollars, as flamboyant and colorful as Charles Koch is reserved and staid.

He spent an estimated \$50 million of his own money on the America's Cup race, has one of the largest wine collections — some 26,000 bottles — in the country, owns an extensive art collection and has homes in Palm Beach, Cape Cod, Boston and New York City.

He does not shun publicity — he seems to revel in it. And he has become somewhat of a national figure, profiled in such magazines as *Architectural Digest*, *Sports Illustrated* and, most recently, *Vanity Fair*.

In recent years, Bill Koch has become active in Kansas — from sponsoring a show of his art collection at the Wichita Art Museum to contributing to a boathouse on the Arkansas River to financing a study on crime. He plans to buy a ranch in the Flint Hills and acknowledges that he may be interested in running for political office in Kansas in 1996.

Fred Koch, the oldest of the four brothers, had a strained relationship with his father and left Kansas as a young man. He studied English at Harvard University and earned a master's degree in drama from Yale University.

His lifestyle, too, is much different from that of his brother in Wichita. A resident of Monaco who has homes in New York, Pennsylvania, England and Austria, Fred Koch is an arts patron who paid a reported \$13 million for J. Paul Getty's former mansion, Sutton Place near London, and plans to turn it into a public museum for part of his art collection.

Although Fred Koch has joined his brother in the law-

"To me, you've got to have a consistent set of values," Charles Koch says, "or else you are going to be torn apart." Those values are, in many ways, Midwestern ones: hard work, honesty, humility.

suit, no one questions who has been the driving force behind the dispute. Bill Koch has pursued it with the same intensity as his pursuit of America's Cup.

Values — and valuing work

Bill Koch — who seldom passes up a chance to criticize Charles Koch — contends that his brother has "a vicious and vindictive streak" and criticizes his brother's ethics.

Bill Koch's view of his brother contrasts sharply with that of David Koch, Bill's twin.

David Koch, who stays at Charles Koch's home when in Wichita on business and who spends most holidays with his family, describes his older brother as "a man of enormous character and integrity" and as someone who "just can't misrepresent himself."

The dispute must be painful for a man who says he tries to integrate the same values, the same principles, into every aspect of his life.

"To me, you've got to have a consistent set of values," Charles Koch says, "or else you are going to be torn apart."

Those values are, in many ways, Midwestern ones: hard work, honesty, humility.

They are basic values.

And George Pearson, a former Koch Industries executive who has known Koch for nearly 30 years, talks about the unusual balance between the ordinary and the extraordinary in Koch's life: He is a man of extraordinary accomplishments who lives an ordinary life.

"When you refer to a guy's being a billionaire," Pearson says, "it does not reflect a balanced life."

A billionaire.

It may be the description that least aptly characterizes Charles Koch.

"He still works as hard as he ever did. A lot of guys would get to this point and slack off," says Varner, the company's former president.

Why he keeps working, Koch acknowledges, is a common question. It's a question that probably became tiresome years ago. And yet his answer helps define him.

He talks of making full use of your abilities, of trying to lead a moral and productive life, of trying to do something of substance.

At one point, he pulls a worn paperback off his shelf containing "Eupsychian Management" and "Toward a Psychology of Being," two books by Abraham Maslow, and talks about the importance of self-respect and

the role of work in people's lives.

"You cannot have self-respect based on phony baloney," Koch says. "True self-respect only comes from real accomplishment, because you can't kid yourself for very long."

Work "is one of the defining factors in who a person is," he adds, "and how a person thinks about himself."

This may be why Koch's drive shows no signs of waning. It may be why Koch Industries' growth has accelerated. And it

may be why the next 10 years could be the most exciting in the company's history, for Charles Koch hopes to build on Koch Industries' success.

"To build something," he says, "is exciting."

Politics that can't be pigeonholed

From all across the spectrum, Koch has taken shots for views

By Guy Boulton
The Wichita Eagle

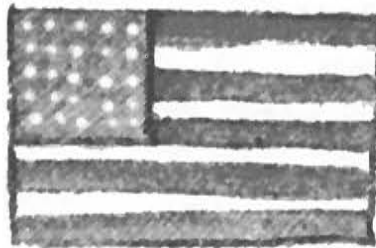
House Speaker Thomas Foley has called Charles Koch a right-winger "way off the charts." Conservatives have accused him of being soft on communism. Libertarians contend that he has sold out and refer to the "Kochtopus."

No part of Koch's life has created more misperceptions than his political views.

"Most of the people who label him don't have any idea of him," says Richard Fink, a Koch Industries executive.

Koch, who doesn't consider himself an ideologue, rejects any label. His interest in politics, though, has been an integral part of his life — one rooted in his fascination with economics and philosophy. And Koch admits to having "driven my family nuts, driven everybody in every aspect of my life nuts, with these concepts for 30 years."

For want of a better label, Koch has been described as a "classical liberal" — someone who believes in a maximum of civil liberties and economic freedom provided you don't harm someone else. The label encompasses a political spectrum that runs from the left to



Koch would never say that what is good for General Motors is good for America. What he would say is that a company producing better products at a lower cost is good for America.

the right, from limited military spending to choice in schools.

But Gerald O'Shaughnessy says of his friend, "The thing that distinguishes Charles is he's careful not to fall into an ideology."

Koch's philanthropy reflects his interest in politics, an interest shared by his brother David Koch.

The two have contributed millions to dozens of academic institutions and public policy organizations that study and advocate what some consider classical liberal ideas. And Charles Koch has helped support the education and research of hundreds of students.

In 1992, for instance, foundations associated with Charles or David Koch gave \$5.2 million to more than two dozen academic or policy organizations — ranging from \$1.3 million for the Citizens for a Sound

Economy Foundation to \$2,000 for the Institute for Political Economy.

The year before, they gave nearly \$5.4 million.

"In terms of the market-liberal movement, I think Charles is recognized as the most generous philanthropist," said Edward Crane, president of the Cato Institute, a respected think tank in Washington founded by Crane and Koch.

Koch has been called "the effective ruler of the bulk of the Libertarian Movement for the past two decades." Whether it is a movement — much less whether it has a leader — is a question.

Further, Koch doesn't consider himself a Libertarian — certainly not with a big "L." He's a registered Republican, and he says he hasn't been a member of the Libertarian Party for well over a decade.

When not labeled a libertarian, Koch has been called a member of the far right, as in "secretive, right-wing oil billionaire." Yet some of his political views contrast sharply with those of the far right.

Koch's opposition to the Reagan military buildup and to the United States' intervention in Central America in the 1980s prompted some conservatives to contend he was "soft on communism." And his views on many social issues, such as opposing mandatory school prayer, are more in line with the American Civil Liberties Union than the Christian right.

But, without question, Koch has a faith in free markets and a skepticism about government.

KOCH CHARITABLE FOUNDATIONS

DAVID H. KOCH CHARITABLE FOUNDATION

A tax-exempt private foundation that had assets of \$8.8 million as of Dec. 31, 1992, and that distributed \$6.2 million in 1992. The main beneficiaries were:

- **Citizens for a Sound Economy Foundation** — \$1 million
- **Deerfield Academy** — \$1 million
- **New York Hospital** — \$1 million
- **Institute of Human Origins** — \$537,625
- **Ballet Theater Foundation (New York)** — \$400,000
- **Cato Institute** — \$352,919
- **House Ear Institute** — \$250,000
- **Institute for Justice** — \$250,000
- **Institute for Humane Studies** — \$250,000
- **Center for Independent Thought** — \$200,000
- **Reason Foundation** — \$177,400
- **Humane Studies Foundation** — \$100,000
- **Memorial Sloan-Kettering Cancer Center** — \$100,000
- **Metropolitan Museum of Art** — \$100,000
- **WGBH** — Boston — \$100,000



David H. Koch

CHARLES G. KOCH CHARITABLE FOUNDATION

A tax-exempt private foundation that had assets of \$12.4 million as of Dec. 31, 1992, and that distributed \$1.5 million in 1992. The main beneficiaries were:

- **Wichita Collegiate School** — \$500,000
- **National Foundation for Teaching Entrepreneurship** — \$450,000
- **Center for Study of Market Processes** — \$271,000
- **Kansas Cultural Trust** — \$85,000
- **Humane Studies Foundation** — \$50,000



Charles G. Koch

FRED C. & MARY R. KOCH FOUNDATION

A tax-exempt private foundation that had assets of \$16 million as of Dec. 31, 1992, and that distributed \$526,072 in 1992. The main beneficiaries were:

- **Wichita Center for the Arts** — \$319,967 matching grant and \$100,000 general contribution
- **Friends University** — \$25,000 for ballet program and \$10,000 for scholarships
- **Institute of Logopedics** (now Heartspring) — \$10,000
- **Rainbows United** — \$10,000
- **Wichita State University** — \$10,000 for scholarships



Claude R. Lambe

CLAUDE R. LAMBE CHARITABLE FOUNDATION

A tax-exempt private foundation established from the estate of Claude Lambe, a Wichita real estate developer and oilman who was a close friend of Charles and Liz Koch and the late Fred C. Koch. Charles Koch was executor of Lambe's estate and is trustee of the foundation. The foundation funds the Claude R. Lambe Fellowships for promising graduate students interested in classical liberalism. It had assets of \$25.1 million as of Dec. 31, 1992, and distributed \$2.5 million in 1992. The main beneficiaries were:

- **Cato Institute** — \$800,000
- **Institute for Justice** — \$450,000
- **Institute for Humane Studies** — \$443,074
- **Citizens for a Sound Economy Foundation** — \$300,000
- **Allen-Lambe House Foundation** — \$60,000
- **Kansas Cultural Trust** — \$54,750
- **George Mason University Foundation** — \$42,660



Fred C. Koch



Mary R. Koch

Source: Koch Industries, Internal Revenue Service

The Wichita Eagle

He's a student of the works of Ludwig von Mises and Friedrich Hayek, who both contended that a central government's knowledge is too limited to solve complex problems. And his political views are based on years of study.

Friends and associates describe Koch as a scholar — someone "who can speak to academics in their own terms," says Bill Beach, president of the Institute of Humane Studies in Fairfax, Va.

Koch's interest in politics dates to the 1960s. He was no conformist. While his contem-

poraries were reading Jack Kerouac's "On the Road," Koch was reading Hayek's "Road to Serfdom."

He was introduced to conservative politics by his father, a member of the advisory council of the fiercely anti-communist John Birch Society. And Koch, at his father's request, briefly joined the group.

Koch and Robert Love, president and chairman of Love Box Co., split with the group after they ran ads in newspapers around the country opposing the Vietnam War.

"It was quite a statement for

those men to make at the time," Beach says. "It enraged many people in the Wichita business community."

Around that time, while searching for out-of-print books, Koch met F.A. "Baldy" Harper, a former economics professor who had founded the Institute for Humane Studies, which worked with scholars interested in classical liberalism. The two became close friends.

"Dr. Harper was one of the most intellectually honest and humble people I've ever known," Koch says. "He was a truly civilized person."

WHO GETS THE MONEY

A sampling of academic and policy organizations supported by the foundations and the money they received during the three-year period from 1990 through 1992.



Cato Institute — A public policy research foundation, based in Washington, that advocated limited government and individual liberty. Its positions have included replacing the Social Security system with a private retirement program; opposing import quotas, farm credits and federal deposit insurance; abolishing the minimum wage; supporting gay rights; and legalizing marijuana. It also supports a non-interventionist foreign policy and supports cutting military spending. Contributors:

- Charles G. Koch Charitable Foundation — \$200,000
- Claude R. Lambe Charitable Foundation — \$2,900,000
- David H. Koch Charitable Foundation — \$2,442,354

TOTAL (1990-92): \$5,542,354



Citizens for a Sound Economy Foundation

— A non-partisan research and advocacy group, based in Washington, that supports freezing federal spending, privatizing certain public services, regulatory reform and free trade. Contributors:

- Claude R. Lambe Charitable Foundation — \$825,000
- David H. Koch Charitable Foundation — \$2,100,000

TOTAL (1990-92): \$2,925,000



Institute for Humane Studies

— An academic organization, affiliated with George Mason University in Fairfax, Va., that administers the Claude R. Lambe Fellowships, sponsors seminars and provides research grants to promising scholars. Contributors:

- Charles G. Koch Charitable Foundation — \$10,000
- Claude R. Lambe Charitable Foundation — \$946,074
- David H. Koch Charitable Foundation — \$750,000

TOTAL (1990-92): \$1,706,074



Institute for Justice

— A public interest law firm that has challenged licensing requirements for entry-level jobs; supported school choice, particularly for low-income parents and children; and support-

ed private property rights.

- Contributors:
- Claude R. Lambe Charitable Foundation — \$600,000
 - David H. Koch Charitable Foundation — \$500,000

TOTAL (1990-92): \$1,100,000

Center for Study of Market Processes

— A non-profit research and education organization affiliated with George Mason University in Fairfax, Va. Contributors:

- Charles G. Koch Charitable Foundation — \$313,400
- Claude R. Lambe Charitable Foundation — \$125,800
- David H. Koch Charitable Foundation — \$150,000

TOTAL (1990-92): \$589,200

Source: Koch Industries, Internal Revenue Service

The Wichita Eagle

In late 1972, Harper visited Koch in Wichita and told him that he wanted the institute to continue after his death. Koch promised that it would. Harper died the following year. Koch gave the eulogy at his funeral. And he remains chairman of the Institute for Humane Studies.

In the mid-1970s, Charles and David Koch began taking a more active role in promoting what would be considered libertarian ideas.

They also began looking at the Libertarian Party as a possible vehicle to promote those ideas. Their interest culminated in David Koch's running for vice president on the Libertarian ticket in 1980, a campaign on which he spent more than \$1 million.

But one former associate speculates that Charles Koch never felt at ease with the cross section of people — from anarchists who opposed any government to hippies who supported legalizing all drugs — drawn to the Libertarian Party.

"He just didn't feel there were a lot of button-down

Kiwanis types there," the former associate says.

Around that time, Koch started contributing to policy organizations such as Business Leaders Against Subsidies and Tariffs, or BLAST, which later became the Council for a Competitive Economy. That was followed by Citizens for a Sound Economy, a group founded in 1984 by Fink with \$500,000 in seed money from Charles and David Koch and the late Jay Humphreys.

Citizens for a Sound Economy has supported the privatization of Conrail, expansion of Individual Retirement Accounts, a flat income tax and free trade.

Last year, the organization actively opposed the proposed energy tax, reportedly spending \$250,000 on radio ads aimed at 100 freshman Democrats and lawmakers from energy and farm states.

The charitable foundations could not legally contribute to the campaign against the energy tax. But Koch Industries could and did. The company — like other energy companies and numerous special interest

groups — also actively opposed the so-called Btu tax.

"Our belief is that the tax, over time, may have destroyed our business," Fink says.

Employees were encouraged — some say strongly — to write to Congress on company time.

"That's the only time at Koch that I've heard anyone talk openly about politics," says a former employee, who worked for the company for almost five years.

The campaign against the tax drew attention to Charles and David Koch. But it was nothing like the response to their backing term-limit initiatives.

In 1991, two of the foundations they control gave \$300,000 to the Citizens for Congressional Reform Foundation, an organization that would later back term-limit initiatives in Michigan and Washington.

It was his support of term limits that earned Charles Koch the obloquy of Foley.

"I don't think he (Koch) ever anticipated the fire storm it would create," Fink says.

Despite Koch's support for

policy organizations, his main interest has been supporting young scholars interested in classical liberal ideas. It may be the area in which Koch has had the biggest influence.

He has always thought that supporting young scholars can have a broader impact than simply supporting political causes, says Crane of the Cato Institute.

When Fink taught at George Mason University in Fairfax, Va., 25 of his graduate students were on scholarships financed by Koch foundations.

In the early 1980s, Koch set up the Claude R. Lambe Fellowships — loosely modeled after the Fulbright, Truman and Marshall fellowships — for promising graduate students interested in classical liberalism.

The fellowships are funded by the Claude R. Lambe Charitable Foundation, which was established from the estate of a Wichita real estate developer and oilman, a close friend of Charles and Liz Koch and the late Fred C. Koch. Charles Koch was executor of Lambe's estate and is trustee of the foundation.

Since 1982, the program, administered by the Institute for Humane Studies, has awarded scholarships totaling about \$2.3 million to 377 students.

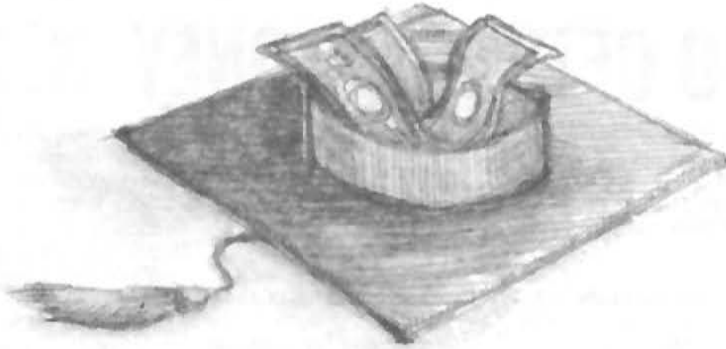
"One of the beliefs we have is a free society is really based on knowledge and learning," Fink says. "The second part of it is that ideas have consequences."

One of the constants in Koch's life is his belief in the power of the market to solve problems.

In a 1970 article in *Nation's Business* magazine, Koch said, "Virtually every function or desire of human beings can be supplied by the marketplace on a voluntary basis."

Koch's political views, though, have become more complicated and sophisticated over time. That trait has earned Koch the reproach of hard-core libertarians.

"Some call it maturing. Some



Koch has always thought that supporting young academics and intellectuals can have a broader impact than simply supporting political causes, said Edward Crane, president of the Cato Institute, a think tank in Washington, D.C., founded by Crane and Koch.

ideologues call it selling out," says George Resch, who is on the board of the Center for Libertarian Studies in Burlingame, Calif.

Some libertarians also resent what they see as Charles Koch's drive to control organizations that he helps fund, Resch says.

Critics refer to the "Kochtopus" and contend, "If he runs it, he funds it." And Koch has enemies.

Early this year, the Rothbard-Rockwell Report, a newsletter published by the Center for Libertarian Studies, ran a harsh attack on Koch, titled "The Wizard of Wichita."

The author, Joe Melton, took particular exception to Koch's statement that "rigid ideologies — even rigid versions of conservatism, liberalism or libertarianism — not only limit learning, but lead away from a free society and social progress."

For certain, Koch is not a billionaire businessman who opposes all taxes or all laws that protect the public or the environment. He often refers to what the political philosopher Hayek called "rules of just conduct." And Koch says that it is wrong for a company to spew pollution on a neighbor's land, capturing the profits while escaping the costs.

Instead of detailed regulations on pollution, though, Koch advocates laws that protect the environment but allow the market to find the best way to meet the standards.

To Koch, the free market is the best system for satisfying needs and creating wealth.

When he talks about profits, Koch means "better satisfying customer needs with the use of less resources." And he always makes clear that he is not referring to what he calls "political profits" — those derived from government subsidies or laws that limit competition.

Koch would never say that what is good for General Motors is good for America. He would say that a company producing better products at a lower cost is good for America.

His politics do not fit within the confines of the Republican or Democratic parties. And Koch can't provide an easy label for his political views.

Koch says he simply thinks "a free society contributes to the well-being of mankind better than a command society."

"So, if you have a label that fits that, I will accept it," he says. "But I don't know of one that does."

Straight-shooting to the top

Varner quietly, kindly helped Koch prosper

By Guy Boulton
The Wichita Eagle

From a rise overlooking the expanse of the Flint Hills, Sterling Varner points out the boundaries of his Shadow Valley ranch.

The view — treeless crests stretching from horizon to horizon — is exhilarating. And Varner's pride in the ranch is palpable.

The 9,940 acres of rolling grassland makes plain the success of this man who was born in a tent in the oil fields of Texas, who never finished college and who stuttered badly when young.

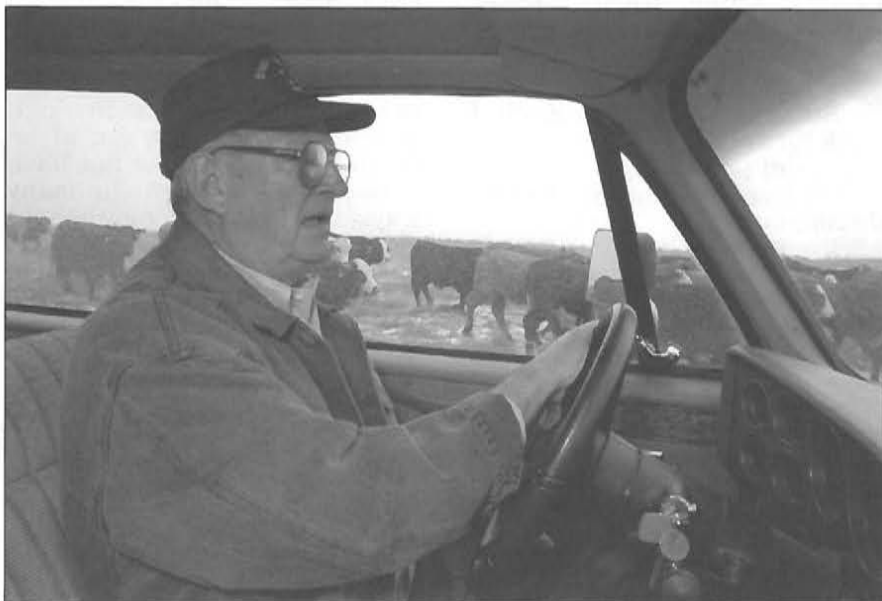
Varner was Koch Industries' president and chief operating officer from 1974 through 1986 and its vice chairman from 1987 through 1989. During that time, annual sales increased from less than \$1 billion to an estimated \$18 billion.

Except for Charles Koch, the company's chief executive and chairman, perhaps no one else deserves as much credit for Koch Industries' success.

At 74, Varner, sometimes called Koch's "alter ego," remains a key adviser to the company as a consultant, director and stockholder. And though he is relatively unknown elsewhere in Wichita, he is revered at Koch Industries.

Company executives describe a man of uncommon charm and sincerity, who treats everyone — from senior vice presidents to office clerks — the same.

"I've never come away from a conversation with Sterling in which I didn't feel better about myself," says David Koch, the company's executive vice president of chemical technology



Dave Williams/The Wichita Eagle

Sterling Varner, a former Koch Industries president, is known as a people person. He humbly downplays the trait: "You take someone like me who is not smart, who is not gifted, and you learn damn quick that you have to rely on other people."

and Charles Koch's brother.

Varner's manner is usually described as "country boy." And Varner does seem untouched by wealth or success.

"We lived in one house for 20 years, and a man who lived in the next house up the street did not know that Sterling was president of Koch," says Paula Varner, his wife of 49 years. "I think that pretty well describes him."

Opportunity, though, came relatively late in Varner's life.

The Varners moved to Wichita in 1948, two years after Wood River Oil & Refining Co. bought the company Varner worked for, Rock Island Refining & Crude Gathering Co. in Duncan, Okla. They lived in a one-bedroom apartment for five years — the last year with a baby. Paula Varner taught home economics at East High School.

When they built their first house in 1953, Varner did much of the work himself. "You'd be surprised how much unskilled

labor goes into a house," he says.

At one point, Varner thought of leaving the company. He was in his early 30s and making \$2,400 a year, a wage equal to less than \$15,000 a year today. The small company seemed to hold little promise.

Varner told Fred C. Koch, the company's president, that he had little to do and that he planned to look for another job.

"Oh, hell," Koch said. "We'll find something for you to do."

They did. But if Varner had a career path, it wasn't the fast track. Part of his job was to handle various chores for Fred C. Koch.

In the early 1950s, Varner was asked to drive Koch's car to the company's ranch near Dillon, Mont. Koch suggested that Varner take his wife and visit Yellowstone National Park along the way. They spent the summer at the ranch while Varner oversaw the drilling of water wells.

Fall came and Paula Varner returned to Wichita to teach school. Several months passed. Shortly before Thanksgiving, Varner called Koch. Varner still remembers the conversation.

"Who?" Koch asked.

"Sterling Varner, Mr. Koch. I work for you."

A brief pause.

"Oh yes, Sterling. What can I do for you?"

"I've been up here in Montana drilling water wells, and I was wondering if I could come home for Thanksgiving."

"Yes," Koch said. "By all means."

"Well, hell," Varner recalls, "he had forgotten about me."

But Koch — a strong-willed, laconic, independent man — would take an interest in Varner.

Paula Varner remembers sitting next to Koch at a meeting and his telling her, "Sterling is a fine young man, and probably his great asset is his ability with people."

When she got home, she asked her husband if that was true. He said he didn't know. She pressed him. "When you stutter," he said, "you observe a lot."

Varner was eventually given a job in the crude-oil purchasing department. The company was buying pipelines from larger companies, and Varner began learning the business. Before long, Koch asked him to oversee the company's ranches.

Other jobs followed. He worked in refining, helped start the natural gas liquids business and, eventually, became president of Koch Oil Co., a subsidiary of Koch Industries.

The summer that the Verners spent in Montana, Charles Koch, then a teenager, worked at the ranch. It was, in some ways, the beginning of a lasting bond. More than 20 years later, Charles Koch

would promote Varner to president and chief operating officer.

"He's family, as far as I'm concerned," Koch says.

The two men come from disparate backgrounds. Koch, the scion of a wealthy family, holds two master's degrees in engineering; Varner, the son of an oil-field worker, does not have a bachelor's degree. In many ways, the two men complement each other.

"Sterling was always a people person," says Bill Houglund, a retired Koch Industries executive and close friend. "And it

was known for stopping people in the halls, talking for a few minutes, saying a few encouraging words, moving on. He is a big man, yet not intimidating. A few years ago, Paula Varner noticed that whenever her husband shakes hands, his other arm reaches out and touches the person's shoulder.

"And I don't even think he is aware of that," she says.

Varner was skilled at building relationships with customers and competitors — often they were one and the same — when the oil industry was a true old-boy network.

When those companies wanted to sell assets, they often called Varner first.

He handled the negotiations for most large acquisitions. "He knew how far to go and not lose the deal — and that's an instinct," Houglund says.

Koch Industries executives still tell stories about Varner's ability to condense a meeting to just one sentence, often in his own "Okie style."

At one meeting, a data-processing manager was making a presentation on the company's computer system. Varner asked why the company owned a Burroughs system as opposed to the industry standard, IBM.

The manager went on about the speed and cost, the advantages and disadvantages, of the two systems. After a while, Varner leaned forward and said, "Let's cut through the fluff. What you are really telling me is we own a Nash."

The Nash, an American Motors car, was a product well outside the mainstream.

Despite his lack of formal education, Varner became president of a company filled with engineers. "If he wasn't good at something, he didn't look at it as a sign of weakness," Koch says.

Paula Varner talks about her



"We lived in one house for 20 years, and a man who lived in the next house up the street did not know that Sterling was president of Koch," says Paula Varner, his wife of nearly 49 years.

"I think that pretty well describes him."

was not something Charles was good at when he came to the company."

Koch, who considers Varner one of the significant influences on his life, acknowledges that. "He really taught me a lot about the importance of people . . . and being people-oriented."

Varner, though, downplays his people skills.

"You take someone like me who is not smart, who is not gifted, and you learn damn quick that you have to rely on other people," he says.

But Bill Hanna, the company's president, says he cannot recall a formal meeting in which Varner did not compliment someone for something he or she said or did.

If you had done something particularly well, Varner would drag you into Charles Koch's office and prod you to tell the chief executive about it.

"He wanted you to get credit for it," Houglund says.

At Koch Industries, Varner



Dave Williams/The Wichita Eagle

Varner, who once supervised company ranches, spends three or four days a week at his 9,940-acre spread near Cassoday. "This is strictly a business — a business I love, but it's a business."

husband's unassuming manner, kindness, thoughtfulness, friendliness and sense of humor.

"But, with all that, he is as stout as goat's milk," she says.

The most successful person Varner knew when growing up in Oklahoma was the "farm boss," a foreman in the oil fields. So was he ever intimidated by corporate counterparts? "I couldn't afford to be intimidated," Varner says.

There was, though, the occasional reminder of his roots.

Varner had to cancel his first business trip to Europe because, not having a birth certificate, he couldn't get a passport in time. Babies born in tents in the oil fields of north-central Texas, where Varner's father was working as a mule contractor, were not issued birth certificates.

His humble roots, though, probably influenced his approach to business.

When his children were growing up, Varner was always turning off lights and turning down the heat.

A few years ago, a Father's Day card from his daughter — a woman voted Outstanding Young Lawyer of Texas by the State Bar of Texas in 1985-1986 — read, "Dear Dad, I'm sitting here in the dark, freezing, thinking of you."

At Koch Industries, he was known for keeping a sharp eye on costs. Varner initially opposed, for instance, the decision to build the eight-story office building completed in 1992.

Although less expensive than adding another building in a few years, the building had

more room than was needed at the time. Varner argued that the empty floors would tempt the company to hire more people than it should.

"You think that you're still a little, struggling company, and that's the way you should think," Varner says.

But he knows that his value to the company stems in part from his willingness to be frank. "I'm the only one who is negative," he says.

Varner now spends three or four days a month at Koch Industries. The bulk of his time — three or four days a week — is devoted to his ranch near Cassoday.

"This is strictly a business — a business I love, but it's a business," he said during a trip to the ranch in December.

"I'll admit," he added, "it's a damn poor investment."

The ranch, which runs 2,000 head of cattle in the winter and 3,000 in the summer, returns no more than what could be earned — with a lot less work — on an investment-grade bond. But Varner says, "It's hard for me to make a career out of recreation."

Paula Varner recalls how, when they were selling cattle last July, her husband would get up at 4:30 to be at the ranch, about an hour from Wichita, by sunrise. He would come home in the evening carrying his lunch bucket, covered with dirt and happy.

His son Richard, who played football for the University of Nebraska and has a master's degree in business from the University of Kansas, and his grandson came from California to join him for the roundup.

As he drives through the pastures in his Suburban truck, Varner points out the thickness of the grass and talks about the deer, coyotes and other wildlife

on the ranch. He is on the local board of the Nature Conservancy, from which he rents 1,840 acres, and is careful not to overgraze the land. He also has released quail and turkey.

"I've always loved the land," he says. "I've always loved the outdoors."

The ranch's name, Shadow Valley, comes from the terrain.

"If you look at the valleys, you see the shadows," says Varner.

But the brand — S.V. — also is Varner's initials.

Varner, who previously owned two farms, looked at 50 ranches before buying this one three years ago. It had qualities he wanted: no houses, barns, roads or fence lines.

And you sense that owning and running a 9,940-acre ranch, set in the beauty of the Flint Hills, is a fitting conclusion to a remarkable career.

In 1945, after the Varners' wedding, Paula continued teaching school in Norman, Okla., and Sterling worked in

Duncan. Housing was in short supply, and Varner lived in a room off the kitchen of a boardinghouse. It was called "The Blue Room."

On her first visit, a noise woke Paula Varner at 4 in the morning. In the dark, she could make out the silhouettes of two women, washing vegetables for the noon meal.

That humble start — that bedroom the two newlyweds unknowingly shared with the kitchen help — has become a nostalgic memory. Whenever something nice happens in their lives, the Varners make the toast, "Here's to The Blue Room."

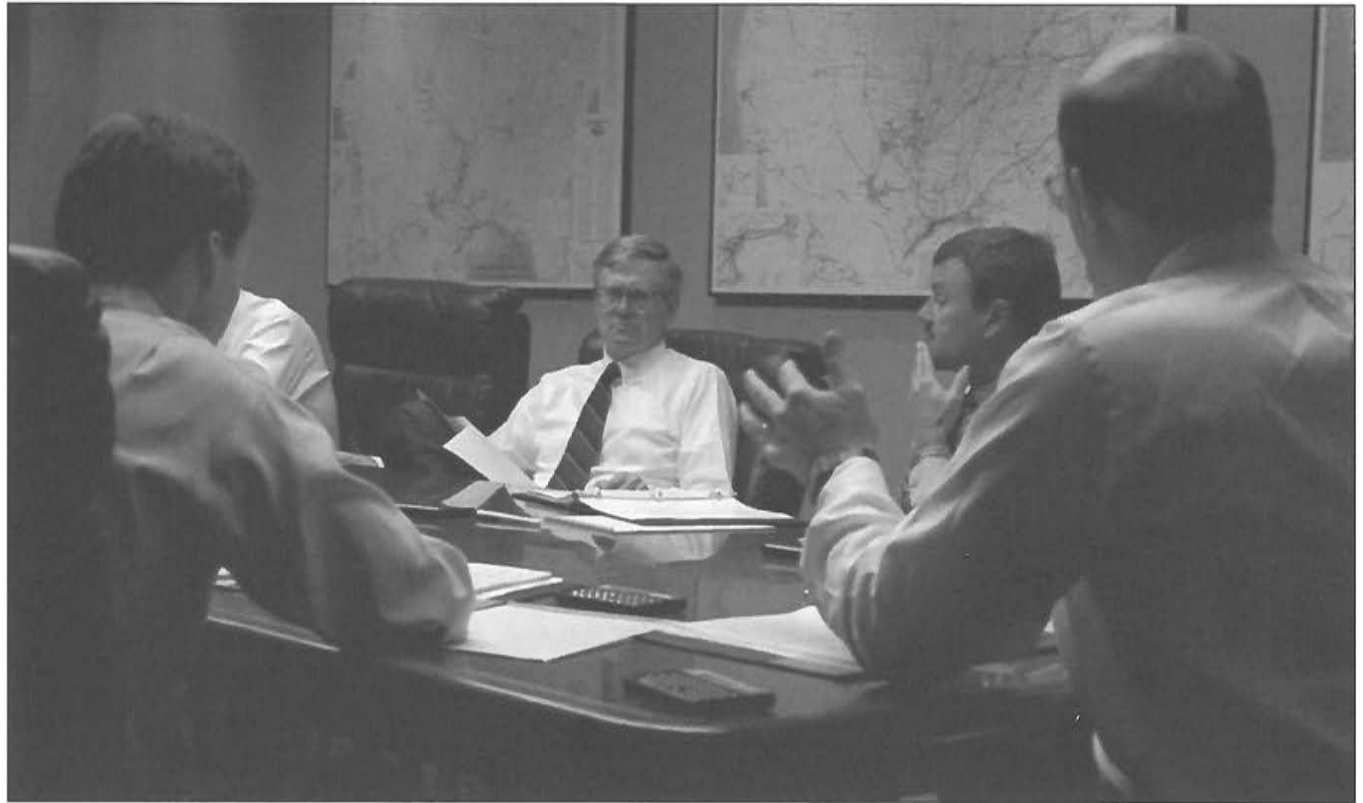
It's a toast they've had many chances to make over the years. But Varner, one of the most successful businessmen in Kansas, remains modest about his success.

"In all this, you are just as lucky as hell," he says. "You are in the right place at the right time."

About this series

Eagle reporter Guy Boulton, who covers the oil and gas industry, interviewed more than 50 people and spent nearly 30 hours talking to Charles Koch and others at Koch Industries over the past year and a half for this look at Koch and his company.

Illustrations in this package were done by Brent Castillo, staff artist.



Dave Williams/The Wichita Eagle

Charles Koch listens at a meeting of the Carbon Group. The company tries to give its divisions a good deal of autonomy.

Lean, patient, ready to pounce

More growth likely as company moves into new businesses, expands old ones

Second of a two-part series

By Guy Boulton

The Wichita Eagle

When Cy Nobles joined Koch Industries in 1979, he soon realized that it was not a typical corporation.

Proposals did not have to move through level after tortuous level of review. There were no orchestrated presentations. Projects were approved with surprising speed.

The emphasis — from Charles Koch, the company's chairman and chief executive, on down — was on growth.

“Charles’ philosophy was, ‘Guys, if this is a good investment and it’s obvious, what are we waiting on?’” Nobles recalls. “‘If it is obviously a good investment — and you guys running the business know it is — isn’t it better to have it in service quicker?’”

The emphasis on speed, on seizing opportunities, partly explains why Koch Industries’ revenues grew from \$177 million in 1966 to nearly \$24 billion last year.

Yet its growth overshadows another remarkable character-

istic: Koch Industries has grown patiently, prudently, even cautiously. Koch and the company’s executives make their bets, but they are not crapshooters.

The company has shown uncommon discipline through the years, consistently using its expertise in one business to expand into other businesses — sometimes starting from scratch, more often starting with small acquisitions and building from there.

That hasn’t changed. But as the company has grown, the pace has quickened. In the past seven years, revenues have increased by an estimated \$8 billion. And in that time, Koch Industries has invested more than \$4 billion in its existing business or on acquisitions — an amount larger than the state of Kansas’ general budget.



Ken Mantyla/The Wichita Eagle

Koch Industries has room for 1,500 more employees in its headquarters on 37th Street North, a sign of faith that the company will continue to get bigger.

“Although the future is uncertain, we have faith that we are going to continue to be successful and grow,” Charles Koch says. “As a matter of fact, I am more excited about the future of Koch Industries than I’ve ever been.”

The company’s new office building, completed two years ago at its headquarters on the northeastern edge of Wichita, reflects the optimism.

Koch Industries now has more than 2,000 employees in Wichita. The eight-story office building — the largest in the state — was designed for an additional 1,500 people. Clearly, the company expects its growth to continue.

“I don’t think that Koch Industries becoming a \$50 billion, \$60 billion corporation in the next 10 years is unrealistic,” says a former longtime employee.

Turning on the spotlight

For years, Koch Industries has been as opaque as the dark, reflective windows of its

headquarters. And the company, renowned for its secrecy, remains a mystery to most Kansans.

Beginning early last year, Koch and other company executives granted nearly 30 hours of interviews on Koch Industries’ management philosophy and its operations. From those interviews — the most extensive access the company has ever granted a reporter — emerges the first in-depth picture of a company best known for its low profile.

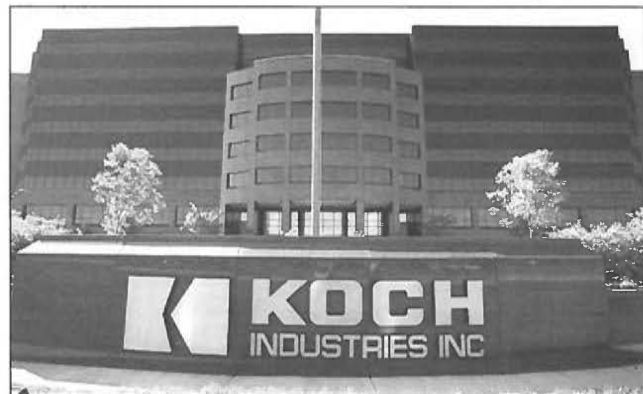
The picture reveals a company that:

■ **Seizes opportunities** with a speed and flexibility rare for a large company. It does not need lengthy studies before investing tens of millions of dollars in a project. The company stunned competitors by building a large

pipeline in 18 months, less time than many companies take to make a decision.

■ **Reinvests 90 percent** of its profits, shuns debt and focuses on long-term profits. The company often uses the inevitable downturns in its cyclical businesses to buy assets at bargain prices.

■ **Sticks to businesses** that it knows, entering new businesses slowly at first and then steadily expanding. The company has used its expertise in trading and transporting crude oil to expand into natural gas



liquids, ammonia, grain and natural gas.

■Shows a strong Midwestern work ethic. The company recruits heavily from Kansas schools, seeks lifelong employees and gives its most-promising executives an unusual amount of responsibility and freedom at a young age.

■Works hard to check the bureaucracy that can overtake a large company. Executives at other companies are often dismayed that Koch Industries did away with annual budgets years ago.

Koch Industries shares many of those traits with other successful companies.

In some ways, Koch Industries simply does what companies are supposed to do. It invests. It manages for the long term. It creates jobs. It gives employees the freedom to do their jobs.

Koch Industries will never become a household name, will never be as well known as Pizza Hut or the Coleman Co. Yet its products and services are an integral part of everyday life.

The gasoline you put in your car this morning may have come from one of Koch Industries' refineries. It may have been made from crude oil transported by one of the company's pipelines. It may have been refined with equipment made by the company or transported over one of the company's products pipelines.

The polyester seats may have been made with a chemical building block made by the company. The road you drive may have been paved with asphalt from one of the company's plants.

The soda bottle in your refrigerator may have been made from chemicals transport-



Dave Williams/The Wichita Eagle

The favored executive dress at Koch Industries is like that of Charles Koch, left, and President Bill Hanna: white shirts and ties, no jackets. The company recruits heavily at Midwest universities, preferring engineers who can become businessmen.

ed by the company's pipelines. The steak in your freezer may have come from one of the company's ranches or feedlots.

And the bread on your counter may have been made from wheat stored at one of the company's grain elevators or grown with fertilizer that the company produced or transported.

That is just a sample. Koch Industries operates dozens of diverse businesses — businesses, often overlooked, that are the underpinnings of an industrial society.

The fact that most of those are tied to the energy business makes the company's success all the more remarkable. Since the oil bust of the mid-1980s, energy companies have shed tens of thousands of employees. Since 1985, Koch Industries' work force has doubled, to 13,000 people.

Koch Industries' revenues last year were more than \$60 million a day. It's an impressive figure. But focusing on revenues can be misleading.

A barrel of oil bought and sold by Koch Industries, for instance, now adds about \$17 to

revenues. Yet the company may earn only a few pennies' profit on the transaction. In other words, many companies with less revenue make more money.

Moreover, the price of oil, natural gas liquids and other commodities fluctuates. A \$5 drop in the price of oil may lower revenues by several billion dollars yet have only a minimal impact on profits.

For that reason, Koch Industries prefers not to talk about revenues. The company does confirm that it has revenues of more than \$20 billion a year. A source close to the company said that revenues last year were nearly \$24 billion.

Revenues could fall this year because of lower oil prices. Nonetheless, revenues have increased by an estimated \$10 billion since 1982 while oil prices have fallen by more than \$10 a barrel.

Squeezing the low margins

Koch Industries has prospered in high-volume, low-margin businesses — the cyclical, capital-intensive businesses

that most companies shun. Profit margins can be pennies on the dollar and, at times, non-existent.

"In our businesses, the typical competitor is losing money or breaking even," Koch says. "So the only profit we are going to have is to the extent we can carry out these activities better than our competitors."

Cyclical businesses play to one of the company's strengths. As a privately held company, Koch Industries does not have to appease Wall Street by posting higher earnings every quarter. It can be patient.

Charles and David Koch own about 81 percent of the company. The Marshall family of Houston — led by J. Howard Marshall II, a business partner of the late Fred C. Koch — owns about 16 percent. The rest is owned by key executives, foundations and relatives.

Someday, Koch Industries may be forced to go public to pay estate taxes. But Koch says, "We prefer being private."

The advantages of being privately held are a refrain among executives of Koch Industries. The stockholders are long-term investors who put 90 percent of the profits back into the business. And the company often capitalizes on downturns in its cyclical business, buying assets at fire-sale prices.

"They are very shrewd in the assets they pick up, and they typically buy at the low end of the market," says Ray Ory, a senior associate with Vector

Associates, a consulting firm based in Houston.

Yet Koch doesn't see himself as a contrarian. "It's using history and economics to understand the structure of a business," he says.

That perspective, though, provides a check against the herd mentality, if not downright madness, that can overtake an industry.

Koch Industries was one of the few companies, for instance, to escape the speculative frenzy of the oil boom in the late 1970s and early 1980s. As a student of history and economics, Koch knew that rising oil prices would increase supply and decrease demand. He never based his decisions on the expectation of \$100-a-barrel oil.

"We swim upstream a good bit, because the common consensus is often wrong," Nobles says. "When everybody's buying, we'd rather be selling."

Looking for middle America

The atmosphere at Koch Industries' Wichita headquarters is neither freewheeling nor button-down. Executives tend to wear white shirts and ties, but no jackets — Koch's standard garb. They can be serious and reserved, but they also crack jokes at meetings and laugh frequently. Most are Midwesterners.

The company recruits extensively from Kansas universities and from the Midwest. It seeks out people with the traditional

values of small towns, people "who appreciate the opportunities, instead of thinking they deserve it," says Bill Hanna, the company's president.

MBAs from elite schools on the East Coast are rare.

"Think of Wichita, Kansas, and that's what they are looking for," says Carol Freedenthal, a principal in Jofree Corp., a Houston company that follows the natural gas industry.

Candidates go through extensive interviews. The company likes to hire engineers who can become businessmen. And several professors at Kansas universities say Koch Industries consistently hires their best students.

Thirty minutes into Jim Imbler's first interview at the company, he was told that he had already done the job he was applying for. The interviewer made some phone calls, set up a new schedule and proceeded to interview Imbler for a different job.

"Basically, they wanted to know what I wanted to do," recalls Imbler, who now oversees the company's management center. "So I told them, and they let me do it."

Cynthia Lengnick-Hall, a management professor at Wichita State University, says, "They seem to be hiring people for the organization, not the job."

The pay for entry level jobs is slightly below the market, according to former employees. But that is changing — and top performers are quite well paid.

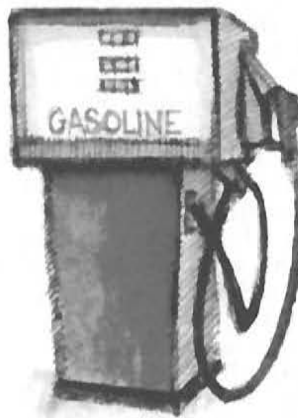
"They made a lot of very rich people," a former employee says. And Nestor Weigand, a Wichita Realtor, says the company has executives making \$300,000 to \$500,000 "whose names you've never heard."

The company tries to avoid layoffs.

"We don't always do a good job of that," Koch says. "But that's our objective. Now, there are certain cases when you can't avoid it."

The company, for instance, has eliminated jobs or fired people after buying a troubled company. And approximately

The gasoline you put in your car this morning may have come from one of Koch Industries' refineries. The road you drive down may have been paved with asphalt from one of the company's plants.



MAJOR ACQUISITIONS AT KOCH INDUSTRIES OVER THE PAST SEVEN YEARS

Koch Industries has steadily grown at a time other energy companies have downsized — and the pace has quickened in recent years. In the past years, the Wichita company has invested more than \$4 billion in its existing businesses and in acquisitions. Below are some of the company's major investments in recent years.

1994 • Completes expansion and environmental projects at refinery in Corpus Christi, Texas. Since 1987, the company has invested \$1.1 billion in the refinery.

1993 • Completes environmental projects at refinery near Rosemount, Minn. Since 1987, the company has invested \$850 million in the refinery.

• Buys 6.46 percent interest in Colonial Pipeline Co., operator of a 5,300-mile petroleum products pipeline that runs from Houston to New York, from British Petroleum Co.

• Buys 645-mile natural gas gathering system from Trident NGL. Purchase includes a fractionator capable of processing 43,000 barrels of natural gas liquids a day and an underground storage site in Hutchinson.

• Expands Sterling Gas Liquids pipeline that runs from Conway, Kan., to Houston.

• Buys Elf Asphalt, which owns 40 asphalt emulsion plants and six asphalt cement terminals in 16 states, from Elf Aquitaine, a subsidiary of Societe Nationale Elf Aquitaine, a French oil company. Elf Asphalt reportedly has 4.5 percent of the U.S. market and sales of \$169 million in 1992.

1992 • Buys United Gas Pipe Line Co. for about \$400 million — the largest acquisition in the company's history. United Gas owned a 9,600-mile interstate natural gas pipeline in the Gulf Coast region and had annual sales of about \$370 million. Koch Industries announces plan to invest \$100 million in the company, renamed Koch Gateway Pipeline Co., over three years.

• Buys a substantial portion of the municipal leasing portfolio of Chrysler Capital Public Finance Corp. An executive for Chrysler Capital says the purchase price was slightly less than \$100 million.

• Buys an ammonia production facility in Sterlington, La., capable of producing 1.1 million tons a year, from IMC Fertilizer for \$81.1 million.

• Buys assets of IT-McGill Pollution Control Systems, a Tulsa company with annual sales of about \$50 million, from International Technology Corp. The price reportedly is \$30 million.

1991 • Buys Unifin International, a maker of heat exchangers based in Ontario.

• Buys Evans Grain & Elevator Co., which processes grain, feed and oilseed and owns 19 plants in five Western states.

• Begins construction of a 583-mile natural gas liquids pipeline, capable of moving 100,000 barrels a day, from Medford, Okla., to Mont Belvieu, Texas. The cost is estimated at more than \$50 million. The company also announces plans to convert an existing pipeline, capable of moving 40,000 barrels a day, to a crude oil gathering pipeline.

• Buys marine terminal in Corpus Christi and a crude oil gathering system and pipeline in south Texas from Scurlock Permian Corp., a subsidiary of Ashland Oil.

• Buys the assets of Evans Grain Co., a grain storage company based in Salina, and several entities owned by Evans Grain Co. The purchase includes 60 elevators in north central Kansas, western Kansas, southern Nebraska and other states.

• Buys cattle breeding operations from George Wilson in western Kansas and Texas.

1990 • John Zink Co., a subsidiary of Koch Engineering Co., begins construction on a 350,000-square-foot headquarters and manufacturing complex near Tulsa International Airport.

• Begins construction on 525,000-square-foot office building estimated to cost \$33 million. The eight-story building — what will be the largest office building in Kansas — can accommodate an additional 1,500 employees and will double the company's office space in Wichita.

• Expands specialty chemicals plant at Corpus Christi refinery.

1989 • Buys John Zink Co. from Lone Star Technologies for \$47.4 million. The Tulsa company, which has about 750 employees, makes burners, vapor control

systems and pollution control systems for the petrochemical and petroleum industries.

1988 • Begins construction of 465-mile products pipeline from Corpus Christi to Dallas-Fort Worth International Airport for an estimated cost of more than \$70 million.

• Buys nearly 3,000 miles of pipelines from Santa Fe Southern Pacific Corp. for \$196.5 million. The acquisition includes a 1,943-mile pipeline that moves anhydrous ammonia fertilizer from the Gulf Coast to the Midwest and an 811-mile pipeline that moves natural gas liquids from eastern New Mexico and West Texas to Houston.

Source: Koch Industries and The Wichita Eagle.



Koch Industries

Koch has invested \$1.1 billion in its refinery in Corpus Christi, Texas, since 1987.



Koch Industries

John Zink Co. makes equipment for the petroleum and petrochemical industries.

100 of its people lost their jobs in Wichita last year because of changes in the accounting, computer and other departments.

But Koch criticizes what he calls "indiscriminate layoffs" — the massive layoffs that have become commonplace in corporate America.

"It's like saying, . . . 'I want to lose weight, so I am going to cut off my leg,'" Koch says. "Well, all of a sudden, you can't run anymore."

Most of the company's executives are white men. The company has few women among its top managers. But a former employee says that is changing. And Kim Carraway, a company spokeswoman, says Koch Industries has a number of women in managerial and supervisory positions.

"During the past 10 to 15 years, there have been more and more opportunities for all employees, and women have participated in those," Carraway says.

Former employees also contend that the company has few minorities — in part, one says, because of the schools from which it recruits. Carraway, herself part American Indian, contends that this, too, is not true. And Koch says the company wants people from diverse backgrounds.

"The more different we are, the more we have to gain (from) working with each other, because the more we can learn from each other," he says.

But several former employees say that, as the company has grown, its executives have become more uniform — more like their counterparts at other big corporations.

"It ought to scare everybody out there," one says. "They want clones."

Taking, giving responsibility

The company is known for giving people responsibility at an early age and for promoting from within. To advance, an employee does not have to wait for his or her boss to be promoted or to retire. Rapid growth provides plentiful opportunities.



Dave Williams/The Wichita Eagle

Pipelines that ship petroleum products and chemicals are one of Koch Industries specialties. From a dimly lighted room at company headquarters, Scott Fleck monitors pipelines.

"There are very few gray-haired people out there," says one employee.

Nobles, who now oversees the refining and petrochemical business, soon realized that.

In November 1981, Nobles was up all night completing the negotiations to buy a refinery and petrochemical plant in Corpus Christi, Texas, from Sun Oil Co.

"Mr. Koch called me in and said, 'By the way, we are going to name you the head of the chemical company we just purchased,'" Nobles recalls.

"I was tired. I hadn't had any sleep. I said, 'No, sir, you are not. You've just spent \$265 million, and it deserves someone a lot better than me to administer that investment.' And I went home and got some sleep."

The next day he accepted the job. He was 32 years old and president of what was then Koch Chemical Co.

Koch Industries has since invested hundreds of millions of dollars in its petrochemical plant.

"Koch (Industries) has as modern a facility as exists in the world," says Mark Fisler, a vice president at CMAI, a con-

sulting company based in Houston.

The business has tripled in size and now has revenues of more than \$500 million a year. The company, which produces 3 billion pounds of chemicals a year, is one of the world's largest producers of paraxylene, a building block of polyester.

Turning things around

The Corpus Christi plant is typical of Koch Industries' acquisitions. Sun Oil had neglected the complex for years. Had it not been sold to Koch Industries, it probably would have been shut down.

Instead, its capacity has nearly quadrupled to 200,000 barrels a day.

"Sun's philosophy and Charles Koch's philosophy are like day and dark," says Chester Pakebusch, a foreman who has worked at the refinery for nearly 30 years.

The company also has steadily expanded and modernized its Pine Bend refinery near Rosemount, Minn.

When Koch Industries bought controlling interest in the Great

Northern Oil Co. in 1969, the refinery could handle 80,000 barrels of crude oil a day. It was expanded to 132,000 barrels by 1976. Other expansions in the past 10 years have increased its capacity to 230,00 barrels.

The Rosemount refinery can refine heavy Canadian crude oil, which sells at a discount. It also supplies a remote market where profit margins are higher.

"They have a nice niche position in upper Minnesota," says Ory of Vector Associates.

Together, the Rosemount and Corpus Christi refineries produce more than \$5 million a day worth of gasoline, jet fuel, diesel fuel and other products. The products are sold primarily to wholesalers; Koch Industries has not owned retail outlets since selling a chain of 300 convenience stores and gas stations in the 1980s. Koch Industries' two refineries nonetheless produce one out of every 50 gallons of gasoline used in the United States.

Spending to be competitive

Since 1987, Koch Industries has invested nearly \$2 billion in its refineries: \$1.1 billion in Corpus Christi and \$850 million in Rosemount.

The investment — about \$800 for every man, woman and child in Kansas — is more than three times the Coleman Co.'s annual sales.

Koch Industries, though, will spend heavily to gain an edge. It's one of its hallmarks. "Our belief is you have to have a competitive advantage to be a long-term player," says Imbler, the executive who oversees the management center.

The refineries, among the most efficient in the United States, can produce a wide mix of products from different types of crude oil. The flexibility can mean the difference between a profit and a loss when prices fall.

There are times in its cyclical businesses when everyone makes money, Imbler says. Koch Industries wants to make money even in the bad times.

The company also has invested tens of millions of dollars on products pipelines to enter new markets.

In 1990, for instance, it completed a 465-mile pipeline from Corpus Christi to the Dallas-Fort Worth International Airport — a move that caught competitors by surprise.

"The speed Koch (Industries) did that in was just phenomenal," says a former employee who worked on the initial studies.

Before the pipeline was built, the Corpus Christi refinery had faced a bottleneck when moving products. The challenge was finding a niche in the market. The company found one: supplying jet fuel to the Dallas-Fort Worth airport.

"We started looking at the numbers, and it got better and better," the former employee says.

The studies began in late 1988; construction began the next year.

Were it not for the pipeline, the company probably could not have expanded the refinery.

"When they see an opportunity, they take advantage of it," says an industry consultant. "They make their decision and go."

Learning, then investing

Steadily investing to gain a competitive advantage — it's a pattern that Koch Industries has repeated in business after business.

The two refineries — the company's single largest assets — were among its two most important acquisitions. But Koch Industries has made dozens of acquisitions over three decades. In the past five years alone, the company has made about 15 acquisitions — from product terminals to an interstate pipeline.

Given the company's size, most of its acquisitions have been small. All of them have been in familiar businesses. "When we get into trouble is when we get into businesses we don't know anything about,"

says Sterling Varner, a director of the company and its former president and vice chairman.

Koch Industries has shown uncommon prudence. "They just don't buy things to have them," says a former employee who spent more than 20 years with the company. "The economics absolutely have to be there."

The company prefers to buy assets, not entire companies. With assets, you know what you are buying. With companies, Varner says, "It takes several years to know what the hell you have."

Although the company tends to enter new businesses gingerly, the size of its investments increases as it learns a business. Its asphalt business, for instance, was built through small acquisitions and new plants. But last year, the company bought Elf Asphalt, which owned 40 plants and proprietary technology for high-performance asphalt.

Koch Industries, the largest buyer and reseller of asphalt in the country, now has 110 asphalt plants in the United States and Canada.

Willing to cut its losses

Koch Industries' record is not flawless.

"Sometimes we make mistakes and lick our wounds and go home," says Hanna, the company's president.

In the early 1970s, the company faced enormous losses in the shipping business after the Arab oil embargo. The company escaped disaster. But executives still recall the venture.

In the mid-1970s, Koch Industries made drilling rigs — a mistake that Varner says was mostly his. The company got out of the business in the early 1980s.

More recently, Koch Industries' entry into the specialty chemical business was unsuccessful. It took several years to find a buyer for its plant in Pittsburg. And some of its existing businesses have not been without problems.

KOCH INDUSTRIES

Koch Industries, the second-largest privately held company in the country, has 2,000 employees at its headquarters and manufacturing plant in Wichita. Most of the company's 13,000 employees and operations are outside Kansas.

Supply, Trading and Transportation Group

- Buys crude oil, intermediate feedstocks such as naphtha, natural gas, natural gas liquids, refined products and chemical plants, terminals and natural gas plants.
- Markets bulk crude oil, refined products, ammonia, chemicals, natural gas, natural gas liquids, coal and petroleum coke produced by the company.
- Trades crude oil, natural gas, natural gas liquids, refined products, chemicals and other commodities. Trading operations are based in Wichita, with offices in Houston; Long Beach, Calif.; London; Calgary, Alberta; and Singapore.
- Crude oil gathering: gathers, transports and sells more than 1 million barrels of oil a day over a network of 15,000 miles of gathering pipelines and several major pipelines, such as the 567-mile Wood River Pipeline, in the United States. The company also owns 700 trucks and five barge tows. In Canada, the company owns more than 2,000 miles of gathering and truck pipelines and 50 percent of a 356-mile trunk line.
- Production: oil exploration and production in 15 states and Canada.
- Petroleum coke: markets more than 5.5 million tons of petroleum coke a year.
- Financial services: manages investments in domestic and international financial instruments, foreign exchange trading, municipal leasing and real estate.

Refining and Chemical Group

- Refining: a refinery near Rosemount, Minn., capable of processing 230,000 barrels of crude oil a day and a refinery in Corpus Christi, Texas, capable of processing 200,000 barrels of crude oil a day.

- Petrochemicals: produces about 3 billion pounds of commodity and specialty chemicals a year at its Corpus Christi plant.
- Products pipelines and terminals: six products pipeline systems with a combined capacity of 250,000 barrels a day and 27 products terminals.

- Sulfur: produces, transports and markets sulfur and sulfur-based chemicals extracted from crude oil and natural gas during refining and processing.

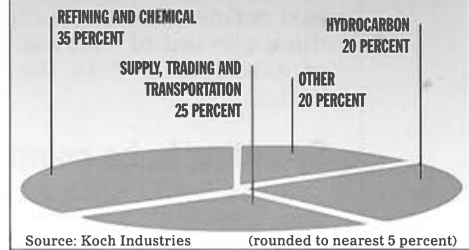
Hydrocarbon Group

- Natural gas and natural gas liquids pipelines and processing: produces, buys, gathers, processes or transports more than 360,000 barrels of natural gas liquids a day. The company's hub is its fractionator at Medford, Okla., which can process 180,000 barrels of natural gas liquids a day. The company also owns a fractionator that can process 43,000 barrels a day at Hutchinson. The group operates six natural gas plants and 6,000 miles of pipelines that transport natural gas liquids. These include the 780-mile Chaparral Pipeline, which transports natural gas liquids from west Texas to the Texas Gulf Coast, and the 583-mile Sterling Pipeline from Medford, Okla., to Mont Belvieu, Texas.

- Interstate natural gas pipeline: Koch Gateway Pipeline Co., a 10,000-mile pipeline in the Gulf Coast region.
- Nitrogen products: makes, transports and sells anhydrous ammonia — an industrial chemical and agricultural fertilizer. Operations include a plant at Sterling, La., capable of producing 1.1 million tons a year, a 2,000-mile pipeline that runs from New Orleans to the Midwest, and 17 terminals.

KOCH INDUSTRIES REVENUES

Koch Industries does not disclose its exact revenues, but confirms that its revenues last year were more than \$20 billion. A source close to the company says revenues last year were nearly \$24 billion. Revenues, however, will fluctuate with the price of crude oil, natural gas liquids and other commodities.



The slag business, for instance, has been disappointing. The company thought that the business was similar to petroleum coke, a refining by-product mixed with coal and sold as fuel. It was wrong.

“What it costs to produce it, what the market price might be, how much of it you can sell — in effect, we missed all of

them,” Hanna says.

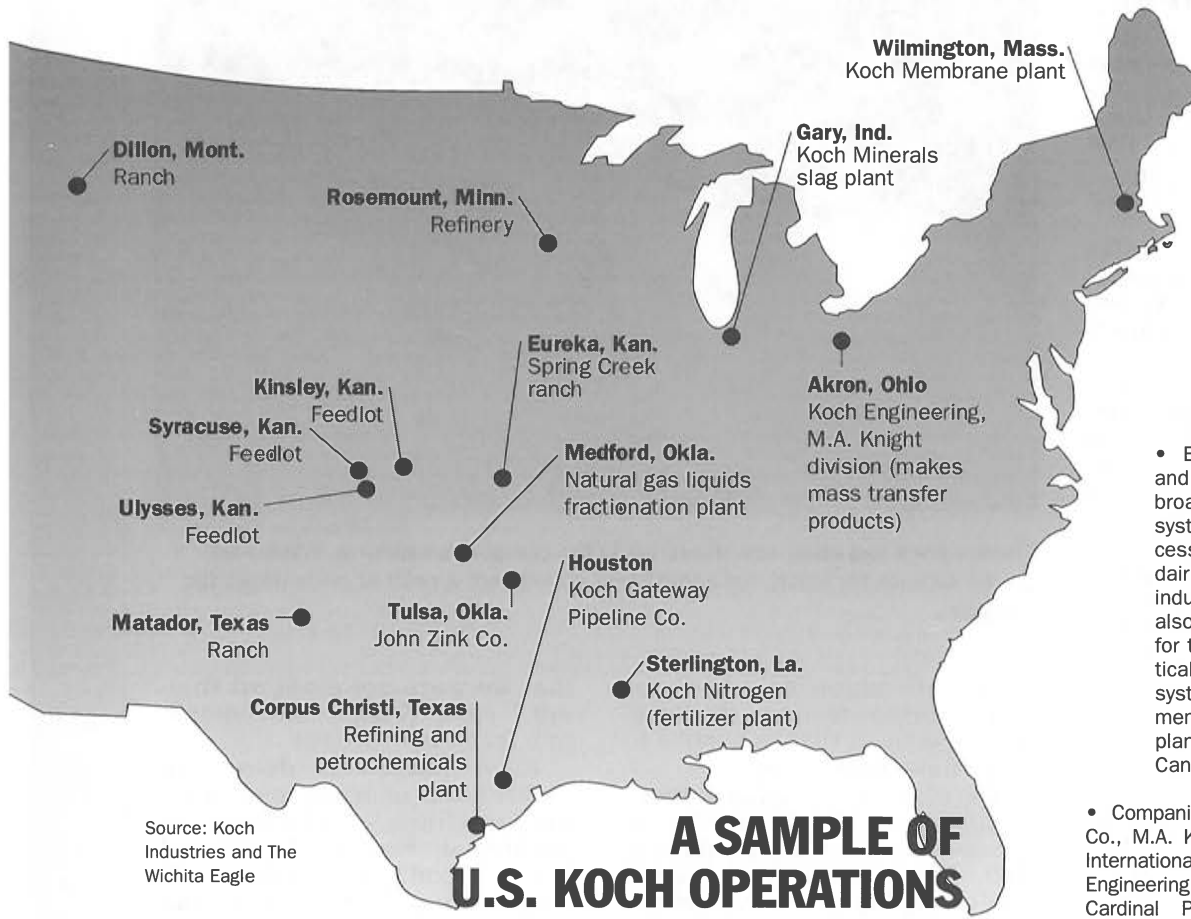
Other businesses also have been disappointing. But Hanna says, “I think we are as good as any (at) saying, ‘This was a mistake.’”

The company's discipline stems in part from its wariness of debt and in part from its stockholders' running the company.

“This is Charles' money,” a former employee says.

When Koch Industries borrows money, it generally uses a mix of bank loans and notes privately sold to institutions. It has been able to finance much of its growth, however, without borrowing huge sums.

“That's one of the biggest assets they have — their ability



Source: Koch Industries and The Wichita Eagle

A SAMPLE OF U.S. KOCH OPERATIONS

- Marketing: sells fertilizer and agricultural chemicals in Kansas, Nebraska, Iowa, Illinois and Missouri.
- Grain elevators and oilseed and feed processing: operates 43 elevators and processing plants in Kansas and six other Midwestern and Western states.

Chemical Technology Group

- Equipment for the chemical and refining industries: makes a broad range of equipment and systems for the chemical processing, oil refining, food and dairy, electric utility and other industrial markets. The group also makes specialty coatings for the chemical and pharmaceutical industries and ultrafiltration systems using semipermeable membranes. The group has 15 plants in the United States, Canada and Europe.

- Companies include Koch Engineering Co., M.A. Knight, Tru Tec Division, Koch International SPA, John Zink Co., Koch Engineering Co. Ltd., Unifin International, Cardinal Pump & Exchanger, Brown Fintube Co., Koch Corrosion Control Co. and Koch Membrane Systems.

Materials Group

- Asphalt: operated 110 asphalt plants in the United States and Canada. The group's four businesses include paving asphalt, industrial asphalt, recreational surfaces and waterproofing products.

Agriculture Group

- Cattle ranches: 450,000 acres in Kansas, Texas and Montana. The company is one of the 10 largest calf producers in the United States.
- Feedlots: three in Kansas and two in Texas. The company is one of the 15 largest feeding operations in the United States.

Minerals Group

- Makes, processes and sells slag cement, slag aggregate and lime at operations in the Great Lakes region, in the eastern United States and Canada.

Koch Equities

- Equity investments in companies, many of them private. These include investments in Colonial Pipeline Co., Catalytica, an insurance company, a foundry and a start-up pharmaceutical company.

to finance things internally," a former employee says.

Koch Industries' net worth is not publicly known. Fortune magazine estimates it as \$5.9 billion, while Forbes magazine estimates \$3.7 billion. The \$2.2 billion difference indicates the shortcomings of the estimates.

Nor are profits publicly known.

In December, Forbes estimated that operating profits — profits before interest expense and taxes — were \$2.8 billion. That estimate may be high given the company's low-margin businesses.

Profits, though, may be almost as meaningless as revenues. The privately held company has an incentive to plow

money back into the business to avoid income taxes. In addition, its depreciation expense — a bookkeeping entry for wear and tear or obsolescence — is enormous given its capital-intensive business.

The best measurement may be cash flow. And all one employee will say is, "It's quite good."

A strong sense of reality

Koch Industries is clearly big enough to play the merger game. But it is unlikely to succumb to the allure of large acquisitions. Koch knows that most prove disappointing — that the much-touted “synergies” prove elusive.

When asked why, he talks about the company’s own experience: “We let our wishes overcome our desire to understand reality.”

He points to a quote — somewhat enigmatic, certainly not pithy — from 1885 by Richard Whately, an English economist. The quote, in a simple wood frame, sits alone on a shelf by the window near his desk.

“It is one thing to wish to have the truth on our side,” it says, “and another to wish sincerely to be on the side of truth.”

“That,” Koch says, “is the major source of bad acquisitions and of poor decisions in the company.”

Executives ignore anything negative. They do studies. They crunch numbers. But their analysis is based on faulty assumptions.

“You have to keep in mind the difference between growth and swelling, and it’s easy to forget this,” Koch says.

If you buy another company, you’ve grown; if you lose money, you’ve swollen.

“And enough swelling and it’s terminal,” he says.

That approach to growth — as opposed to swelling — can be seen clearly in the company’s network of pipelines.

Koch Industries now owns more than 37,000 miles of pipelines — enough to circle the globe at the equator more than 11½ times.

The major pipelines are controlled from a dimly lighted room at the company’s headquarters. The room, filled with glowing screens showing the pipeline network, looks like something you would expect to find in the Pentagon.

Pipelines and distribution are the company’s two main



Dave Williams/The Wichita Eagle

Charles Koch and other executives eat in the company’s cafeteria. Employees get 45 minutes for lunch, but short lunch periods are a point of pride within the company.

areas of expertise. And for nearly three decades the company has used that expertise to enter new businesses.

The company moved from transporting crude oil, for instance, to transporting natural gas liquids in 1969. Characteristically, it started small — building a gathering system in Oklahoma — and steadily expanded. Koch Industries now moves 360,000 barrels of natural gas liquids a day through its 6,000-mile system.

Koch Industries “totally dominates the NGL industry in the mid-continent,” an industry observer says.

The company has since expanded into transporting petroleum products, ammonia and natural gas. In just the past decade, it has built or bought more than 20,000 miles of pipelines.

Oil, gas and the future

Koch is often called an “oil-man.” It’s one of the many misperceptions that surround him.

Koch Industries is not an integrated oil company. Comparisons to Exxon or Mobil do not hold. The company’s exploration and production are limited and have been cut back in recent years.

“We learned a long time ago

that we were not great oil finders,” says Varner, the company’s former president.

Koch Industries does own 15,000 miles of crude oil gathering pipelines — primarily in Oklahoma, Kansas, Texas and North Dakota. It also owns 700 trucks, five barge tows and trunk pipelines in the United States and Canada. The company is the largest buyer of crude oil in Kansas and Oklahoma.

It’s a low-margin business. But the pipelines secure a source of crude oil for its refineries. “If you are a refinery, a crude oil gathering system gives you control over the crude you need,” says John Doshier of Pace Consultants in Houston. “Therefore, it is a very positive strategic asset.”

It’s a business not without long-term risks. Each year, oil production in the United States declines. Koch Industries has an enormous investment in its crude-oil pipelines. As oil production declines, so will the value of that investment.

Natural gas — the so-called fuel of the future — is a different story. And it is one of the businesses that Koch Industries hopes to build.

In November 1992, the company completed the largest

acquisition in its history, paying about \$400 million for United Gas Pipe Line Co., which owned a 9,600-mile interstate pipeline in the Gulf Coast region and had annual sales of \$370 million.

"We think that United Gas will be a key for us," Koch says.

It's a new business for Koch Industries, but not a foreign one. Koch Industries reportedly spent two years looking for a suitable target. United Gas was a classic Koch Industries acquisition — a money-losing company in need of capital.

At the time, Koch Industries announced that it planned to invest \$100 million over the next three years in the company, since renamed Koch Gateway Pipeline Co. And it has since added lines and increased capacity.

"The improvements our people have made there have been just fabulous, way beyond what we projected," Koch says.

In addition, the pipeline is well positioned to benefit from increasing natural gas production in Mobile Bay off the Alabama coast. "We anticipated it would increase, but it has increased more than we estimated," Koch says.

The Mobile Bay production gives the pipeline an eastern source of supply, helping to balance the system and increasing flexibility. And Koch Industries is already looking at other acquisitions that would bring Koch Gateway Pipeline closer to East Coast markets.

"My guess is their buying United is just the start," says Freedenthal, the natural gas consultant.

If you see a chance, take it

Koch Industries' culture has long been one of "constructive discontent" — an entrenched belief that companies must always look for new opportunities, that they must constantly push for the small, incremental improvements that provide a competitive advantage.

Varner puts it succinctly:

Employees must think about how they can make more money for the company every day.

"They are very good at identifying opportunities," a former employee says. And he adds, "Once they identify those opportunities, they move very quickly."

Koch Industries' lack of

The soda bottle in your refrigerator may have been made from chemicals transported by Koch's pipelines. The steak in your freezer may have come from one of the company's ranches or feedlots. And the



bread on your counter may have been made from wheat stored at one of the company's grain elevators or grown with fertilizer that the company produced or transported.

bureaucracy — its speed and flexibility — is one of its defining traits. Executives, for instance, relish telling their counterparts at other companies that Koch Industries doesn't have budgets.

"They think we are nuts," says Paul Brooks, who oversees corporate and management development.

Koch Industries used to set guidelines for the next year's budgets each July, and executives would dutifully project revenues, operating expenses,

capital expenditures and profits.

"What we found is, no matter how hard we worked, no matter what kind of precision we aimed for, it was always wrong," Brooks says.

Three or four years ago, the company ended the annual ritual. The operating companies now just use the past year's figures.

It's a minor example of why Koch Industries has often prospered in mature businesses marked by neither growing markets nor new products. There are, of course, other factors. And even something as intangible as the company's Midwestern work ethic has probably played a role.

"You just can't do this on a 40-hour week," Varner says.

When he started at the company, employees worked a full day on Saturdays. Later it was a half-day. Then they had Saturdays off — but were expected to come in anyway.

Many employees still work on Saturday and sometimes on Sunday. Cars can be found in the company's parking lot at 6 a.m. "Their jobs appear to be their whole lives," says an employee.

Until late last year, lunch was limited to half an hour. Employees can now take 45 minutes. But the short lunch periods are a point of pride within the company.

"The people in Koch Agriculture brag that they only take 20 minutes," says Jerry Ellig, an economics professor at George Mason University in Fairfax, Va., who spent a year at the company's management center.

The subsidized cafeteria — run by Latour Management — resembles a food court in a shopping mall. The offerings range from a Pizza Hut Cafe to Chinese food to a salad bar to sandwiches and entrees.

The elaborate cafeteria exists partly because there were once no restaurants near Koch Industries headquarters. But you suspect that it also exists to keep lunches short.

There is no executive dining room. Koch and other top executives eat in the cafeteria.

Opportunities for growth

Not all that long ago, when Varner told people that he worked for "Koch," they thought he meant Coca-Cola.

Those days are long gone. Koch Industries is now one of the largest employers in Wichita. Given its record, it will probably become an even bigger employer.

Koch, for one, is plainly excited about the company's future. Asked what businesses are particularly promising, he cites nearly half a dozen — Koch Gateway Pipeline, the company's nitrogen business, agriculture, trading and financial services.

He thinks that the company has made a series of wise acquisitions in its agriculture business — though it paid too much for one company that he declined to identify. But he says that the agricultural industry, particularly such tradition-bound businesses as ranching, is well-suited for innovation.

He also says that the company now has a better idea of how its nitrogen business — it paid \$81.1 million for a fertilizer plant in Sterlington, La., in 1992 — fits with its agriculture and other businesses.

Commodity trading also holds promise. Koch Industries is not a speculative trader that makes big bets on the direction of prices. But it does view trading as a profit center. And it is starting to offer a range of financial products — such as price protection and risk management — to customers. Here, too, it doesn't take speculative positions.

"What we are just doing is bringing the parties together," says Corliss Nelson, who oversees the financial services group.

The company may arrange a loan with a fixed interest rate for a customer with a variable-rate loan. Or it may sell a prod-

uct that protects a customer against changes in a foreign exchange rate.

Koch Industries has done that for years, but it hopes to grow the business. "We are at the very early stages of this," Nelson says.

Municipal leasing is one of the financial services added in recent years. In 1992, the company bought most of the assets of Chrysler Capital Public Finance Corp., which leased police cars, fire trucks, computers and buildings to cities and other government entities. The purchase price was not disclosed, but an executive for Chrysler Capital says it was close to \$100 million.

Yet another new business group is Koch Equities, which has invested in a number of companies, many of them private. The investments include a products pipeline, an insurance company, a foundry and a start-up pharmaceutical company.

Will it be hard to find promising investments?

"No," Koch says. "As we are doing a better job using the knowledge of our people, we are finding more opportunities. We've got so many more windows out there on the world and people who have a better understanding of what we are looking for."

Growth could accelerate

Twenty-four years ago, Koch said: "We don't like to jump into a new area, even if it is related to what we are doing. We like to feel our way in, so we can make our mistakes while they're not too costly."

That approach, explained in an interview with Nation's Business, hasn't changed. What has changed is the company's size. What would have been "too costly" in 1970 is now a small investment. The company, after all, has invested more than \$4 billion in the past seven years.

For that reason, Koch Industries' rate of growth could quicken in the coming years.

Still, the company's caution is unlikely to change.

It will continue to enter new businesses — in all likelihood starting relatively small and steadily building. And in all likelihood it will continue to reinvest 90 percent of its profits, pouring billions of dollars into existing and new businesses.

Those and other traits seem permanent. Koch Industries has shown a steadfastness rare in American business — a fundamental approach to business that has increased the company's net worth by more than a hundredfold in the past 27 years.

Koch, clearly proud of the company's record, is optimistic about its future. But he also notes that many other companies have been more successful than Koch Industries.

"We are not the worst," Koch says. "We are not the best, either."

A company tries to manage future

Market-based philosophy has goals but no easy explanation

By Guy Boulton
The Wichita Eagle

One Saturday morning last month, Carl Marhaver was reading the logbook at Koch Industries' refinery in Rosemount, Minn., when he noticed another small improvement.

The operators of a unit that makes gasoline had found a way to tinker with the limits on its capacity. By working with the refinery's engineers, the operators increased the capacity by 500 barrels a day, to 35,500 barrels.

Such sharing of information is a small example of the changes taking place at Koch Industries.

"This potential has always been there, and now we have a management system to capture it," says Marhaver, the refinery's manager.

The management system is called market-based management. And, step by step, it is changing the way Koch Industries' 13,000 employees do their jobs — from refinery workers producing gasoline to accountants preparing reports to vice presidents running large businesses.

Koch Industries wants to make the best use of employees' knowledge and skills, it wants employees to understand how they help the company make money, and it wants employees to focus on tasks that make the most money.

It sounds basic, and it is.

Koch Industries wants every employee to understand that the company makes money by using resources — whether capital, labor or raw materials — more efficiently than its competitors.

"That, after all, is the purpose of all this — to best satisfy the needs of people in society using the least amount of resources," says Charles Koch, the chairman and chief executive. "That's what raises the standard of living and creates wealth."

No simple 'sound bites'

Market-based management is an outgrowth of a 10-year effort to analyze the way Koch Industries does business and the reasons for its success. The company — which has revenues of more than \$60 million a day — is not in a desperate search for quick solutions. Last year was close to the most profitable in its history, continuing nearly three decades of extraordinary growth.

As much as anything, Koch is trying to ensure that the company's size does not undermine its growth.

"One of the greatest indices of future failure," he often says, "is past success."

Koch's ideas on management do not lend themselves to short and simplistic explanations. As he says, he is "not very good at sound bites." He refers to Friedrich Hayek, Thomas Sowell, Karl Popper and Abraham Maslow, and he sometimes sounds more like a professor than a chief executive.

"What I've done in market-based management is drawn from a lifetime, or at least the last 30 years, of studying economics, history, philosophy, psychology, management, and trying to apply it," he says.

Koch once recommended that executives read "Human Action" — a 700-page tome by the Austrian economist Ludwig

von Mises. Several at least gave it a stab.

"What Charles is trying to do is based on a lot of high-octane concepts," says Jerry Ellig, an economics professor at George Mason University in Fairfax, Va., who spent a year at Koch Industries' management center. "This is the type of stuff that Ph.D. students read."

Koch likens the traditional corporation — in which information moves up and orders move down — to a command economy in a socialist country. It's a telling comparison. More than a few CEOs proclaim the virtues of the free-enterprise system yet run their companies like dictators.

Market-based management, in contrast, maintains that a few key executives cannot know everything needed to run a complex corporation — any more than a government bureaucracy can run an economy.

It's a lesson — what Hayek called the "Fatal Conceit" — that companies such as IBM and General Motors Corp., renowned for their bureaucracy, have only recently learned.

What Koch has done is draw lessons from the way free markets work — from the way they allocate scarce resources and create wealth. His goal is to create a company that in some ways mimics the creativity and flexibility of a free market.

He thinks that when people have the incentive and freedom to use their own knowledge, society as a whole benefits. The same applies to companies. He is convinced that companies gain a competitive advantage when employees are free to question how they do their jobs and are given the incentive to make the small, steady improvements that can save millions of dollars.

"It really centers on tapping the individual knowledge of our employees," says Cy Nobles,



Dave Williams/The Wichita Eagle

Cy Nobles, who oversees Koch Industries' refining and petrochemicals, says market-based management lets employees use the knowledge that they already have.

who oversees refining and petrochemicals. "And in order to tap that, you've got to let them use it."

Every worker has a stake

Several years ago, employees — from office clerks to division presidents — spent hours in meetings hammering out mission statements.

The purpose wasn't to craft the uplifting platitudes that hang in the lobbies of corporate headquarters. It was to carry out the kind of planning in which, according to Ellig, the George Mason professor, "you analyze the hell out of your business."

The goal was for each of the company's businesses to figure out what it does better than competitors, what generates the most profits, what influences prices, why the business is profitable or unprofitable.

Such an approach to mission statements shows Koch

Industries' fundamental focus.

The company realizes that people are often so caught up in their day-to-day jobs — sitting through meetings, fielding phone calls, wading through their "in" baskets — that they lose sight of how they help the company make a buck.

"It's not just a day's work for a day's pay. We've got to add value," says Jim Elmore, who oversees the company's natural gas liquids operation in Medford, Okla.

The emphasis on profits and on adding value is the glue that holds market-based management together.

Company executives rarely talk for long without some reference to profits, as in a "profitable person" or "profitable endeavor." And they want employees to realize that profit is not a dirty word.

"Profit is simply a scorecard of how well we satisfy the customer's needs by using fewer resources than the competi-

tion," says Nobles. "Profit is really telling you how well you are doing your job."

Not everyone is sold on idea

Koch Industries' attempt to spread the word on market-based management has had mixed success. The philosophy has caused turmoil and has hurt morale.

"They are all talking the philosophy," one employee said last year. "But when it comes down to implementing, it just doesn't work."

Several former employees also contend that the company's middle managers are unhappy and scared for their jobs. Employees in some departments were supposedly asked to prove that they were "productive." And some employees suspect that the company is trying to weed out older managers.

"Everybody's after everybody else's throat," a former employee says.

Some current and former employees also contend that many of the company's managers are far from open. Most people, says one former employee, do not feel free to challenge their bosses.

"The reality is that it's a privately held company, and Charles Koch runs it," he says. "And most of the people are good soldiers."

Koch knows that employees are often hesitant to challenge their bosses — and that bosses often don't want to be challenged. And he acknowledges that the company has gone through a difficult transition.

"The way I like to think of it is, before you can climb the mountain, you have to go down in the valley," he says. But he adds, "I've seen more progress from market-based management in the last year than from the previous three — and it's accelerating."

The company's crude-oil-gathering operations — a web of more than 17,500 miles of pipelines and 700 trucks scattered throughout the Midwest and western Canada — are one example of the progress. In the past, the business focused on volume, not profit. Yet it might cost 80 cents a barrel to gather oil from one lease, and 5 cents from another.

"Some of the barrels we made money on. Some of the barrels we lost money on. And we couldn't track that," says Bill Caffey, vice president for transportation and operation services.

That's changed.

In pricing its services, the company now considers such things as the costs of picking up small quantities of oil, wear and tear on its trucks and mailing checks to the owners of the well.

Koch Industries gathers an estimated 1 million barrels of oil a day. It is the largest buyer of crude oil in Kansas and Oklahoma. And Koch says the estimated savings from market-based management — in just that one business — have run into the tens of millions of dollars.

Trying to foster initiative

Koch refers to market-based management as "a framework, a philosophy, a methodology."

One of the goals, for instance, is to manage by "rules" instead of "commands." It's a lesson drawn from Hayek, a political philosopher who won the Nobel Memorial Prize for economics. In the marketplace, rules fill in the gaps left by commands and make use of knowledge that nobody possesses as a whole.

The same holds true for large companies.

In the past, a refinery operator would be told to run a unit at its specified capacity. Now, he or she is told to run it at maximum capacity. The operator determines what that is. It is often higher than the company realized.

"We got huge increases in capacity — way above known capacity," says Paul Brooks, who oversees corporate development and management development.

Hayek is just one of the economists and political philosophers whose ideas have influenced market-based management. If executives are to understand the philosophy, they must understand the underlying concepts. And Koch Industries may have the most unusual management seminars in corporate America.

Consider the reading:

■ Excerpts from "Human Action" by von Mises and "The Fatal Conceit: The Errors of Socialism" by Hayek.

■ "Economics in One Lesson" by Henry Hazlitt.

■ "The Law," a 76-page book by Frederic Bastiat, an economist who wrote around the time of the French Revolution.

"It's not something you pick up while watching TV," says Elmore, the executive with the company's natural gas liquids business.

Yet market-based management isn't all esoteric economic and political theory. A good chunk of the philosophy is based on fundamentals, partic-

ularly economic ones.

A seminar, for instance, will include lectures on such economic fundamentals as subjective value, opportunity cost, marginal utility and comparative advantage.

"If you do not understand economics, how do you make money?" asks Jim Imbler, who oversees Koch Industries' management center.

The management center even has its own resident professor.

Koch Industries' academic bent also can be seen in its ties to universities and research institutes.

The company, in developing market-based management, has worked closely with George Mason and with the Center for the Study of Market Processes, an affiliated research institute started with funds from a Koch foundation.

Koch Industries also has begun building ties to the University of Kansas. In 1990, what is now the Fred C. and Mary R. Koch Foundation gave more than \$1.5 million to endow a chair in law and economics at KU. And in March, Koch Industries pledged \$500,000 to set up a Law and Economics Center at the business and law schools.

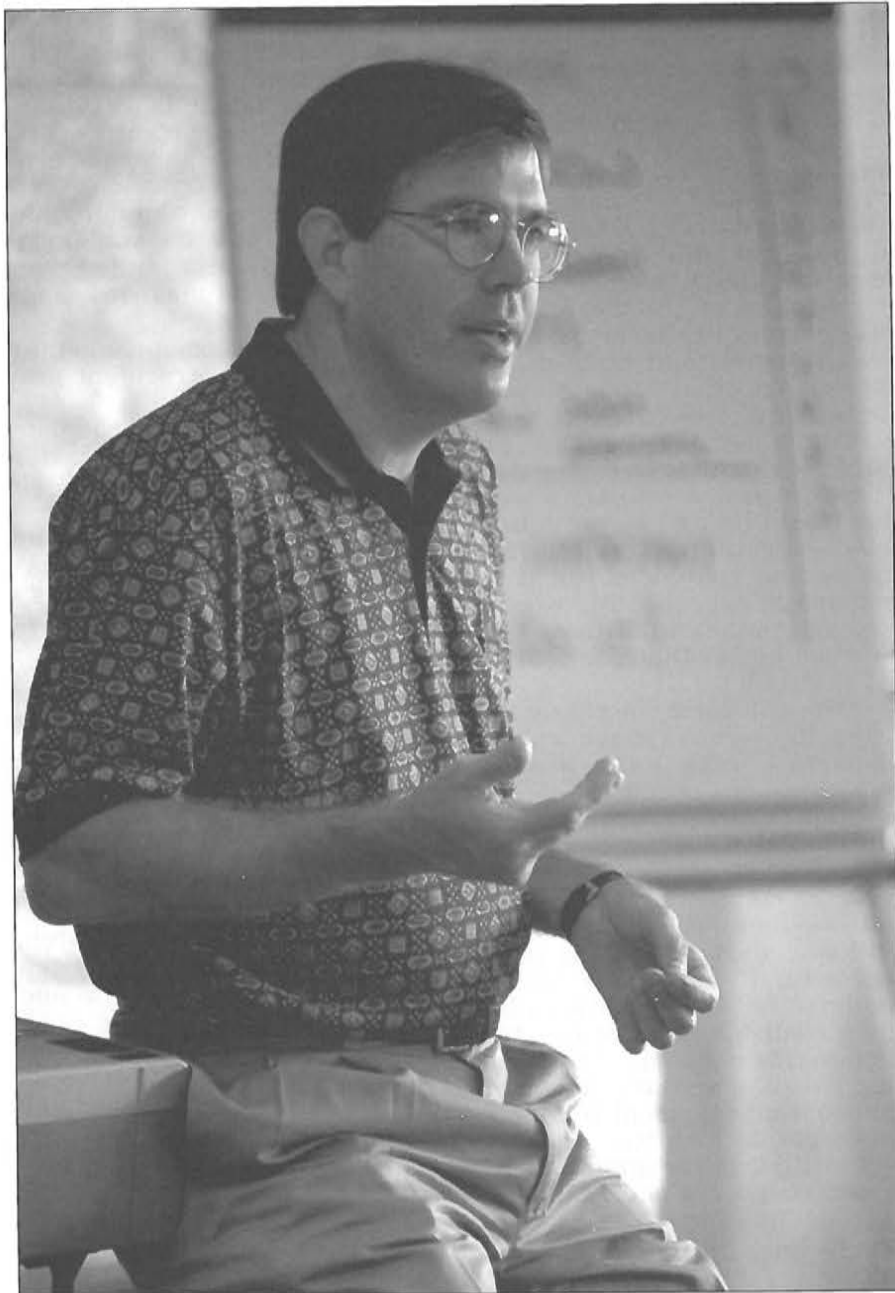
George Mason's expertise is in economic theory. The hope is that KU's business school can help Koch Industries apply the theory. That, after all, is the ultimate purpose.

Incentives for improvement

How, exactly, has Koch Industries used lessons from economics to improve its operations?

Company executives often talk about "roles and responsibilities" — the corporate equivalent of property rights in a free market. By clearly assigning tasks, the company hopes to limit turf wars. "Good fences make good neighbors," Koch says.

The Rosemount refinery, for instance, has hundreds and hundreds of pumps, but no one



Dave Williams/The Wichita Eagle

Jim Imbler, who heads Koch Industries' management center, says that, initially, market-based management was too theoretical and didn't tell workers how it could affect their jobs.

had clear responsibility for maintaining specific pumps. Repair people went to the unit where there was trouble, did their job, and returned to their department.

"The operators blamed the repair people for not fixing it right," says Marhaver, the refinery's manager. "And the

repair people blamed the operators for not running it right."

About nine months ago, the repair people were assigned to the six profit centers, which run the different refining units. They were given responsibility for specific pumps. The operators and craftsmen now work together to increase reliability,

preventing costly down time.

At one profit center, reliability has doubled and maintenance costs have been reduced by 40 percent, Marhaver says. And every profit center has seen improvements.

Executives talk about "incentives" almost as much as "roles and responsibilities." They mean more than pay and bonuses. "Incentives are all the things that factor into a person's decision," Brooks says.

Not all incentives are desirable.

Are managers striving solely for a certain title? Are they interested in only short-term profits? Are they trying to increase revenues instead of profits?

"If you've got perverse incentives, you are going to get perverse results," says Richard Fink, who oversees governmental and public affairs.

One of the strongest incentives, of course, is pay.

Koch Industries wants employees to think of themselves as small-business owners. Ideally, every employee would receive a profit-and-loss statement.

"If you could do that economically, that's where you'd like to be," Brooks says.

Market-based management tries to link employees' pay to their contributions to profits — not to job titles or how many people they supervise.

The former president of an operating company, for instance, is now heading a team to study purchasing. In a typical company, it would look like a demotion. Not at Koch Industries.

Ellig, the George Mason professor, says that it's often difficult to figure out just who outranks whom at the company. Compensation can vary widely from executive to executive. And the amount of money executives can spend is no longer based on titles.

Some employees have even volunteered to eliminate their own jobs.

"They were confident that good people who add value

have a place in Koch," Fink says. "They knew there would be another job for them."

Co-workers as customers

The focus on adding value can be seen plainly in Koch Industries' system of "internal markets." Other companies use the same system. Still, it is one of the most tangible changes brought by market-based management.

In a large corporation, there is often no precise way to allocate the cost of administrative functions, such as accounting or data processing. The operating companies therefore have no incentive to use those services sparingly.

They flood the accounting department, for instance, with requests for report after report. Each year, the department points to the demand for its services and asks for a larger budget. It's one of the ways that large corporations become bloated and inefficient.

"We had some reports that were done in the marketing groups that were costing a tremendous amount of money — that were really valuable until you knew how much they cost," says Imbler, who oversees the management center. "Then it was clear that, gee, it's not worth 'X' dollars a month for that information."

Under the system of "internal markets," administrative departments, such as the accounting, computer and legal departments, are required to bill for their services — much like a private accounting or law firm or an outside consultant.

The system has brought more than a few changes.

An employee says his department regularly asked for specialized computer programs — programs that were nice to have but not essential.

"Once we started getting bills," he says, "a lot of that dried up fast."

The change sounds simple. It wasn't. "If there was a way to screw up, we did it," Imbler says.

Initially, departments focused on costs — and started billing for everything. The result was chaos. The management center started billing for pamphlets, for instance, even though sending out bills cost more than the pamphlets.

The goal was for the administrative departments to focus not only on costs but also on what services are the most useful to the operating companies

Koch Industries wants to make the best use of employees' knowledge and skills, it wants employees to understand how they help the company make money and it wants employees to focus on tasks that make the most money.

— their customers.

That's beginning to happen. The management center stopped providing some services and added others. Other departments are doing the same.

"And that is powerful, because it is changing the function of groups," Imbler says.

The concept of internal markets is taking hold in other parts of the company as well.

The cost of producing steam at the company's Minnesota refinery used to be spread among the different units. Now, each unit is billed for the steam it actually uses. Suddenly, the units have an incentive to conserve steam.

"We think we have saved \$1.3 million a year," says Nobles, who oversees the refineries. "It's a huge item."

Striving for the concrete

Koch Industries has spent the past three years or so trying to spread the word on market-based management throughout the company. The company has developed courses. It has printed pamphlets. And Koch has

given hundreds of talks to employees.

The ideas, at times, have been slow to take hold.

"We are a long way from where we'd like to be," Koch says.

One problem is inescapable: Market-based management is complicated. Koch is given to abstract and complex ideas. And much of market-based management does seem theoretical.

Company executives talk about the company's "philosophy and principles" and "roles and responsibilities" and "incentives" — what one employee calls "Kochspeak." But they sometimes have trouble giving tangible examples of how it works.

"Quite frankly, a lot of the early ways we tried to explain market-based management were not very effective," Imbler says. "A lot of it was too theoretical and not enough on 'How does this affect my job?'"

Most management philosophies are oriented toward tasks: Do this and such-and-such will happen. They are easily grasped. Market-based management, in contrast, has no preconceived ideas on how to improve operations and profits.

"It causes people to think about everything they do," Imbler says. That's a problem. "People like road maps. People like answers."

Market-based management offers no simple answers or catchy slogans.

"They are not trying to memorize rules," says Ellig, the George Mason professor.

Still, Koch worries that market-based management will become just a mix of buzzwords that employees dutifully memorize and recite. And he knows that implementing the philosophy throughout the entire company will take years.

"This is something you do one person at a time," Koch says.

Editorial—July 1, 1994

Natural resource

Koch shows his allegiance

There are lot of impressive things about Charles Koch beyond his billions. Here are three:

His allegiance to Wichita. His determination to make his fortune here. His straightforward, what-you-see-is-what-you-get sense of values.

In a remarkable series of stories earlier this week, Eagle business reporter Guy Boulton chronicled the rise of Koch Industries under Mr. Koch's leadership. In 1966, the company had revenues of \$177 million. Last year, it had revenues of almost \$24 billion. Those numbers speak for themselves, but they certainly don't tell the whole story of Charles Koch.

Despite the international

character of the company, Koch Industries executives don't spend a lot of time grousing about airline service or threatening to move their business to some larger, more glamorous city. They spend their time building their company and this community.

In recent years Koch Industries has completed an unprecedented expansion of its international headquarters out on 37th Street North, including the construction of a 525,000-square-foot office building, the state's largest.

That project is typical of Mr. Koch's disciplined but aggressive approach to his business and his life. It helped Koch's local employment grow past the 2,000

mark. And there's also room for another 1,500 new employees. Mr. Koch is convinced his business is going to continue to grow rapidly, and he's ready.

The presence of Mr. Koch and his wife, Liz, is seen all around the Wichita community. The various Koch Foundations contribute millions of dollars a year to local causes. Most recently, Charles and Liz Koch donated \$1 million to the Salvation Army expansion drive, with Koch Industries adding another \$1 million.

No doubt about it. When you talk about Wichita's natural resources, Charles Koch has to be high on the list.