

## Business Finance II – 40592 - Spring 2016

### Book Review- GOOD PROFIT

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<b>Book Title</b>	<b><i>GOOD PROFIT</i></b>
<b>Author(s)</b>	<b><i>CHARLES G. KOCH</i></b>
<b>Publisher &amp;Publishing Year</b>	<b><i>CROWN PUBLISHING GROUP, 2015</i></b>

#### Author (s):

Charles G Koch is an American businessman and philanthropist. He is chairman of the board and CEO of Koch industries. He did his bachelors and masters from MIT. In 2007 Koch's book "The science of success was published in which he described his management philosophy which is market based management. According to Forbes, Charles Koch along with his brother David Koch is ranked at 6<sup>th</sup> richest people in the world with worth of \$42.9B each.

#### Synopsis of the book:

This book is in continuation of Charles's last book in which he described his market based management in Koch industries. In this book he defines terms and techniques to apply market based management to other companies and even individuals to make good profits.

The story begins when his father Fred, a chemical engineer developed a better cracking process in 1927 for converting heavy oil into gasoline. Since then Koch industries had a mixed time in making profits but in 1967 Charles joined his father and never looked back.

He described that profits can be characterized as good or bad. Profits earn by mutual respect and benefit are good whereas profits earn by exploitation are bad although in finance/accounting both are just profits. For earning good profit his MBM technique must be followed. MBM emphasizes Principled Entrepreneurship over corporate welfare, virtue over talent, challenge over hierarchy, comparative advantage over job title and rewards for long term value creation over managing to budgets.

MBM has five core dimensions

1. VISION
2. VIRTUE AND TALENT
3. KNOWLEDGE PROCESS
4. DECISION RIGHTS
5. INCENTIVES

## **VISION:**

Koch brothers as the world call them share the broader vision which is:

- Innovate
- Grow
- Reinvest

Vision is to maintain roughly 12% growth rate so that when compounded it will double the earnings every six years. To achieve this growth rate right partners are needed who share the same vision and key for this is a phenomenon known as creative destruction which can be countered through continuous innovation.

Koch's vision value people not the things and chooses long-term value addition for consumers and society as a whole. In this fast changing world the future is unknown and unknowable so any company's vision must be open-ended. Koch's vision was last updated in 2013.

Another important aspect for this kind of vision is the Principled Entrepreneurship which means maximizing the long-term profitability by creating superior value for customers while consuming fewer resources and always acting lawfully and with integrity.

A vital part of this long-term vision is selecting most attractive opportunities which requires best knowledge no matter from where it comes from and also point of view about industries of interest.

Vision is broadly comprised of two parts

- North Star (Fundamental principles that are not changed)
- Strategic Guide (which needs to be updated according to the needs)

## **VIRTUE AND TALENT:**

According to Koch virtue is more important than talent when it comes to achieving goals and earning sustainable good profit. For this Koch emphasizes greatly on its MBM guiding principles which are

1. Integrity
2. Compliance
3. Value creation
4. Principled Entrepreneurship
5. Customer Focus
6. Knowledge
7. Change
8. Humility
9. Respect
10. Fulfillment

Koch emphasizes on designing job roles to best fit the people based on their aptitude and interest rather having rigid career paths. He says that if someone is not good at a particular position then it's a possibility that he can perform much better in any other role. But this kind of career planning requires 360 degree input from everyone while evaluating performance.

**KNOWLEDGE PROCESS:**

Creating, acquiring, sharing and applying relevant knowledge and keeping track of profitability. The purpose of this process is to encourage employees to challenge their supervisors and bosses if they think they have a better answer and everyone is obligated to promote this kind of culture.

**DECISION RIGHTS:**

In big companies like Koch industries decision rights for any kind of decision normally lies with upper management. This is not the case in MBM, as any employee who thinks that he is in a better position to make decision for a product/design or anything MBM enables him to make decision and owns that decision. Just like owners take better care of their property than renters, employees who own decisions are better performers especially when the role is good fit for his skills and abilities.

**INCENTIVES:**

Incentives are linked with value addition especially long-term value addition. In Koch where MBM is followed anyone can earn more than his boss if he creates more value. All employees must be motivated to maximize their contribution regardless of the role.

**Key Learning:**

- In the recent history we have seen many companies making large profits but then faded away. For companies to last long (like Koch) the emphasis must be made to long-term value addition which may cause smaller profits in short term but it will be sustainable.
- For any organization to last long, it must develop a culture in which integrity must prevail and when hiring people don't compromise on the virtue as it can distort your culture.
- For companies to be successful in this fast changing world innovation is the only way to avoid creative destruction and to follow continuous innovation a comprehensive framework of knowledge sharing is required.
- It is not necessary to have rules for everything, there should only be some guiding principles which must be broad and culture must be promoted to allow employees to be bounded to those principles.
- Incentives must be linked with value addition , in this way challenging environment is made and innovation will become routine process.
- Profit is good if it creates value for customers, partners, employees and whole society.

**Application:**

- Pakistan is considered as one of the most legislative country in which almost there is rule for everything including corporate laws but yet it lacks implementation. Instead of having laws for everything (which may be good) a culture of earning good profit must be introduced with only broader guiding principles and rules for guarding those broad principles.
- Many Pakistani companies emerge in the corporate world earning profits but are not able to sustain the growth. MBM can be applies for long-term value addition in the society to sustain the growth and embrace creative destruction by innovation.