

The What, How and Tao of Business

– A Conversation Starter –

Prepared for:
Penn State DuBois Students

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The What, How and Tao of Business

I. INTRODUCTION

The purpose of this paper is to begin a conversation with the students of Penn State DuBois as part of the Alumni Fellows program for 2003. This paper contains my personal reflections about business: what it is, how it is done, and the way it is done. Hopefully, when I visit classes at Penn State DuBois, we can discuss some of these observations.

My time spent in business has hardly been a career in the typical sense. Rather, I've had a series of jobs, opportunities or problems, as the case may be. As an assistant professor at Penn State, I realized that I wanted to be a player in the game of real estate; I wanted to be part of the action! I left the academic world in 1979 and have since played many roles in the real estate business.

I have found the real estate business to be fascinating, challenging and intellectually stimulating. It has also been frustrating and bewildering; however, it has always been interesting.

My experiences have been sometimes rewarding and always thought-provoking. I realize that my experiences have taught me more about what I *don't* want to do than what I want to do. It's not that the experiences were negative, but, rather, they effectively defined my "shadow self," the person that I decided not to be. In Appendix A, I have listed various periods in my life and the "lessons" that I have learned from those experiences.

I've organized this paper into three major sections. First, I discuss the What of business: solving problems. Secondly, I discuss the How of business; the problem solving process. Finally, I discuss the Tao (or way) of business: what I as an individual can control; the way I choose to act while finding and solving problems.

II. THE WHAT OF BUSINESS: SOLVING PROBLEMS

In my opinion, business is all about solving problems. The classic economic problem is: how to allocate scarce resources among unlimited wants and desires. Alternatively, business is about meeting unmet needs, hopefully at a profit. Business is about solving the problems of our human existence.

Einstein once said that the amount of knowledge in the world at any time is limited, but the amount of imagination in the world at any given time is unlimited. To paraphrase, I suggest that the number of jobs at any given time is limited, but the amount of problems at any given time is unlimited.

In my mind, business is not about jobs, it's about solving problems. However, governments and government programs are all about jobs (or votes). Likewise, educational programs are all about jobs. In our knowledge-based labor markets, better education leads to better jobs. This is an appealing pitch to education consumers – tuition paying students.

Unfortunately, job-oriented thinking misses the point. How do I find a job, get a job, and keep a job? This thinking focuses on a limited commodity that is provided by others. Conversely, seeking out and looking for problems to solve, focuses the thinking toward unlimited possibilities and opportunities. I don't need to find a job; I need to find a problem to solve.

Problem-oriented thinking leads to the question, "What problems should I personally attempt to solve?" I have three criteria for selecting a problem to solve: it must be

- (1) interesting,
- (2) worthwhile, and
- (3) potentially profitable.

First for me, problems must be interesting, that is, intellectually stimulating. I can't be paid enough to be bored. Psychologists say that "life is a show between our ears," and I want that show to be an exciting and interesting one. Real estate problems are particularly fascinating because of the combination of art and engineering, economics and politics, and the spill-over effects on existing neighbors and future generations. Taken together, these characteristics make for a very complex and interesting set of problems.

Second, a worthwhile problem is one that deserves the investment of my human capital: my energies, my imagination, and my skills. A worthwhile problem should be one whose solution makes a difference to society, to a group or to me. For example, a crossword puzzle can be interesting but hardly worthwhile, at least to me. On the other hand, providing decent housing to every household in America is very worthwhile.

Finally, an interesting and worthwhile problem must be potentially profitable for me to undertake its solution. While the solution to problems may not end up being profitable,

they should at least start out to be potentially profitable. This pragmatic criteria addresses the economic reality of our lives. We all face the challenge of funding of our cash flow enterprises such as our households, our companies, our non-profit organizations, and our political entities and organizations.

Unless we bring in more money than we pay out, these enterprises will cease to exist. Thus we must attempt to solve interesting and worthwhile problems in an efficient manner where income exceeds expenses, at least in the long run. Personally, I decided that problem of providing a decent home to every American was a an interesting and worthwhile problem, but not one that I could solve and make a profit.

Some of the problems that I have chosen to solve are as follows:

- How do I find appropriate real estate investments for my clients?
- How do I provide modern, efficient, office space at competitive prices?
- How do I convert a partially-constructed retirement community in Hilton Head, SC into cash for the liquidation of a bankrupt insurance company?
- How do I build a mixed-use community in the middle of the Washington. D.C. metropolitan area?
- How do I lease 60,000 square feet of warehouse space in DuBois, Pennsylvania?

With our present world situation and with an optimistic, positive and energetic attitude, there are no problems, only opportunities.

III. THE HOW OF BUSINESS: THE PROBLEM-SOLVING PROCESS

If the “What” of business is solving problems, the “How” of business is the problem-solving process. Contrary to many business text books, business is not one solved problem, one sale, one new product, one financial report, or one relationship. Problems are not just solved and decisions are not just made. There are a series of decisions and a series of solutions in the problem-solving process. There is no right answer to a problem, but there are right processes that result in effective problem-solving.

Many of my clients (both institutional and individual) think of real estate investments as a single, distinct event. “I want a good real estate investment,” or “I want a good deal” This limited view, inevitably leads to poor investments, unhappy clients, and personal despair. On the other hand, a systematic approach to the real estate investment process will lead to a reasonably good investment, happy clients, and for me, self-satisfaction. Consequently, I attempt to define the real estate investment process in the following eight steps:

- Step One: Establish Investment Objectives, Policies and Guidelines
- Step Two: Seek Out and Screen Investment Opportunities
- Step Three: Analyze and Evaluate the Real Estate Investment Opportunities
- Step Four: Structure the Real Estate Investment
- Step Five: Complete the Due Diligence
- Step Six: Control, Close, and Fund the Investment
- Step Seven: Manage the Real Estate Investment
- Step Eight: Sell, Refinance and/or Securitize the Investment

My general approach to the problem-solving process is to use the decision-matrix model which I first learned as an undergraduate business major at Penn State. The approach is summarized in Appendix B. Other favorite conceptual models that I use regularly are listed in Appendix C.

Many modern problem-solving processes use optimization strategies in which the best solution, the maximum return, or minimum risks are determined. While optimization is a noble goal, I try to find solutions that have the best chance of meeting or satisfying all of the constraints that are present and constantly changing in the real estate market. I call this the “satisficing” strategy. Recognizing that returns can always be a little bit better or that risks can always be a little bit less, I try to find solutions that will actually work for all of the parties involved even though market conditions and investor expectations are constantly changing.

Also I have developed the “reasonableness” criteria for evaluating strategies or courses of action. It asks the question: “Is this course of action reasonable in the face of the risks and uncertainties of the various future economic and market conditions?” It’s a criteria that is most applicable in very unstable, uncertain, and dynamic environments. It’s a good criteria for making high stakes real estate decisions. The reasonable criteria can be defined in a series of questions:

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- Can I afford to be wrong?
- Can I explain this to my mother, my kids, etc.? (25 words or less).
- How does this decision feel? (Try it on and wear it around.)
- Can this be on the front page of the Wall Street Journal, Washington Post, or New York Times?
- Can I sleep well with this course of action?
- Would a prudent woman do this?

By using reasonableness as a decision criteria, my intention is to use our intuitive decision calculus based on our experience and judgment to balance and enhance the explicit and technical decision processes which are based on mathematical formulas and relationships.

I believe that one of the most important parts of the decision-making process is to look back and review my decisions and the subsequent results or outcomes. This is an important way to reinforce successful and effective problem-solving especially when the wrong outcomes or results occur. Before concluding that I made the right decisions but was unlucky to experience the wrong economic conditions, I need to:

- check my problem definition again,
- check the possible alternative solutions again,
- check my economic and market forecasts again,
- check my calculations (better yet, have someone else check them) again, and
- check the alternative strategies for reasonableness again.

In the late 1980's, I structured numerous complex real state investments that collapsed in the early 1990's. What did I miss? Did I apply the wrong investment structure to the underlying real estate enterprise; did I underestimate the depth of the savings and loan crisis; did I try to make a deal for the adrenalin rush and not for good economic reasons; or did I choose the wrong people with whom to do business? I still wonder.

In summary, after choosing what problems to solve, employing an effective problem-solving process is imperative.

IV. THE TAO OF BUSINESS: THERE IS NO WAY TO HAPPINESS ...

“There is not way to happiness; happiness in the way.” I’ve always loved this saying, and I have always found a certain solace in its message. As a results-oriented person with a type-A personality, it’s hard for me realize that the outcome or the “result” of my strategy or decision is usually outside of my control. It’s hard for me to appreciate that the success of an investment will be determined by people and events that are absolutely outside of my control no matter how hard I try to make it otherwise. I finally realized that the “way” that I do business is really the only thing that I can personally control.

As I define problems, evaluate alternatives, and choose strategies, these decisions are implemented over time usually in a collaborative and dynamic environment. The reality is that I can’t control the future environments, that available alternatives are usually defined and limited by others, and that strategies are usually negotiated with many other participants in the problem-solving process. The reality is that the only person that I can control is me. Therein lies the problem and the opportunity. The way in which I decide to conduct business is my personal responsibility.

To me, honesty is the foundation of business. With free and open markets in which independent companies make voluntary contractual agreements, honesty is a necessary condition for business or commerce to survive. Neither companies nor individuals will choose to do business with other companies or individuals that lie or are dishonest. When firms and individuals are dishonest, they fail. Remember Enron, Penn Square Bank, Richard Nixon?

Honesty is a multi-dimensional and all-pervasive concept. For example, as a market participant, I must be simultaneously honest with my partners and stockholders, suppliers and vendors, customers and clients, as well as and political entities and regulatory bodies.

One of the lessons that I learned from my father in the context of our family business was the importance of “brutal self-honesty” (see Appendix A). The corollary of this is the danger of “self-kiddery.” I can hear him say, “In a small business, you can’t afford to kid or delude yourself. If a person is working out, deal with him; if a product isn’t selling get rid of it; if a line of business isn’t profitable, stop it.” This concept was usually framed as the difference between large bureaucratic organizations with substantial overhead and profit margins and small businesses like ours. (J.A. Kohlhepp Sons, Inc. no longer sells coal, delivers ready-mix concrete, or installs overhead garage doors.)

I had the opportunity to witness first hand the dangers of self-kiddery in the Oklahoma oil and real estate boom in the early 1980’s. Several of my incredibly successful business acquaintances confessed that they viewed themselves as smarter than other competitors and that they were grateful that God had seen fit to

bless them with all of this material success. When the law of business cycles kicked in as it always does, and market conditions began to deteriorate, these associates were faced with a particularly difficult dilemma. Not only were they not as smart as they thought they were, but that it was clear that God was no longer blessing them as they once thought. Unfortunately, during the period of booming market conditions and self-kiddery, they also developed other dishonest habits such as infidelity and drug and alcohol abuse. Consequently, their difficult economic conditions were exacerbated by the loss of personal friends and family support.

Integrity is an extension and application of honesty. Integrity means acting consistently with our values. The first step is to define our hierarchy or system of values, and the second step is to act in concert with them. As I hired a large number of people to be part of my real estate investment advisory business, I quickly realized that a core set of values about the way I wanted to do business needed to be articulated and enforced. These “Guidelines for Business” are as follows:

- “ We are committed to a code of business practices and basic beliefs, which are focused on honesty, integrity and creative problem-solving.
1. Be honest; always tell the truth.
 2. Never be too busy to be nice to people; remember the Golden Rule.
 3. Never lose your sense of humor; keep things in perspective; don’t take yourself too seriously.
 4. Keep an open, flexible mind.
 5. Stay in good physical condition; get enough sleep.
 6. Keep a positive attitude; there are no problems, only opportunities.
 7. Good ideas are simple ideas.
 8. Judge people by their actions; don’t be naïve; get agreements in writing.
 9. Persevere; Illegitimus Noncarborundum (don’t let the rascals grind you down).”

These guidelines became effectively a contract between me and my employees and between our company and our clients.

As a company, we all needed to trust that we would act according to our shared values. In the process of defining our corporate values and basic beliefs, we needed to reexamine these values and actions as seen by our clients, our shareholders, and our business associates. The most important outcome was that we were a company and individuals that kept our word. We said what we were going to do and did what we said.

What happens when I change my mind or make a mistake or misjudgment? The most important thing is to take responsibility and say, “I changed my mind; I made a mistake!” As I make mistakes and struggled to be consistent to these values, I

try not to forget to affirm the individual value of the people with whom I am struggling.

As I work my way through the problem-solving process of business, I realize that Walt Disney had it right, “It’s a small world after all!” To me, there is a finite number of players in the my business world, and they leave tracks of their past dealings. I’ve divided these players into three groups:

1. All-time Good Guys (non-gender specific),
2. Life’s Too Short Guys (non-height specific), and
3. Others (not yet defined in 1 or 2 above)

I look for and seek out opportunities to work with people on the All-time Good Guy list. Conversely, I assiduously avoid opportunities to work with people on the Life’s Too Short list. While I have on occasion violated my resolve not to do business with Life’s Too Short people, I have always regretted it. People don’t change.

The Tao of business also involves building a team with partners (partners in Oklahoma). The fact of the matter is that no one person can do it alone. We must bring other people into our problem-solving process. These must be people who have complimentary skills and shared values. Appendix D is an excerpt from my favorite management consultant Peter Drucker’s book, Management. Drucker summarizes the lesson that I have learned over and over: it really takes at least four different people to run a successful business. While it’s important to learn from the mistakes of others, sometimes it is harder to learn from our own mistakes. It certainly is more painful.

In summary, the Tao of business it to work honestly and ethically with people that you trust and with whom you enjoy working. This is a personal responsibility, and one that is controllable on a personal level.

VI. SUMMARY

To briefly summarize, this paper has outlined my reflections of the How, What and Tao of business. Admittedly, these observations may be a little over the top, but I hope that they will help start a conversation about business with students during my campus visit as part of the Penn State Alumni Fellowship program.

Here are the take-aways:

- look for the right kinds of problem to solve,
- view problem-solving as a process,
- learn from your varied experiences,
- participate in the problem-solving process with personal honesty and integrity, and

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- find good people with whom to work.

One final thought, work hard. I find that working hard makes problem-solving more fun, more rewarding, and more interesting.

Post Script: I included Desiderata as Appendix E because I like to read it.

Appendix A

What I've Learned

My experience has been varied and rich in “lessons taught”

As a Family Business Participant

Always family first, always

The importance of brutal, self-honesty

As an Athlete

Only you can judge yourself

The sun always comes up in the morning

Where to win, where to lose

As a Penn State Student

No problems, only opportunities (Professor R. H. “Sam” Wherry)

Persevere; Illegitimus Noncarborundum (Professor J.D. Hammond)

Things change

As a College Professor

Freedom of independent learning

The importance of partners

Value what the system has to give

As a Developer, Broker and Syndicator

The importance of partners

What makes you successful is mostly outside of your control

As an Investment Advisor

The importance of partners

Mickle’s Monkey Management

The importance of leadership (the vision and the culture)

Articulation

defining the vision and the culture

defining the better process of decision-making

As a Real Estate Consultant

Importance of partners

High correlation between good accounting and good investments

Aging is a philosophical problem

As an Urban, Mixed-use Developer

The Coexistence of multiple realities

Defining the vision in multiple realities

Paradoxes of NIMBY’s and government integrity

Appendix B

Decision Matrix

The Decision Matrix approach is described in most business texts about decision-making, so I will only present my summary of this conceptual model in the following six steps:

- Step One: Define the problem (preferably 25 words or less).
- Step Two: Define the alternative solutions (or courses of action) e.g. investment A, B, or C.
- Step Three: Identify possible future “states of nature” or economic environments, e.g. pessimistic, most-likely, or optimistic.
- Step Four: Estimate the possible outcomes for the various alternative solutions in the various states of nature, e.g. rates of return, net present values, or payback periods.
- Step Five: Estimate probability of each state of nature actually occurring, usually subjective probability estimates.
- Step Six: Determine a decision strategy for evaluating the decision matrix, e.g. minimize maximum loss, maximize maximum gains, or maximize the expected value.

Graphically the decision matrix is shown below:

Problem Definition (25 words or less)

		Possible States of Nature			
Possible Alternative Solutions		State 1	State 2	State 3	Expected Value
	Alternative A	Outcome 1A	Outcome 2A	Outcome 3A	
	Alternative B	Outcome 1B	Outcome 2C	Outcome 3B	
	Alternative C	Outcome 1C	Outcome 2C	Outcome 3C	
	Probability of States	% of State 1	% of State 2	% of State 3	

Appendix C

Favorite Conceptual Models

Break-Even Analysis

Revenues = Expenditure

Sales + Other Income = Operating Expenses + Overhead + Debt Payments + Minimum Profit

Present Value Analysis

Value = Present Worth of Future Benefits

Value = Present Worth of Annual Benefits and Residual Benefits

Value = Present Worth of Annual Income and Residual Income at a Risk Adjusted Rate of Discount

Regression and Correlation Analysis

Formula of a Straight Line ($Y = a + bX$)

Capital Asset Pricing Model

Risk-Return Line

Causation versus correlation

Cross Tabulation

Appendix D

Peter Drucker's Top Management Tasks*

A peculiar characteristic of top-management tasks is that they require diversity of capabilities, and above all, of temperaments. They require the capacity to analyze, to think, to weigh alternatives, and to harmonize dissent. But they also require the capacity for quick and decisive action, for boldness and intuitive courage. They require being at home with abstract ideas, concepts, calculations, and figures. They also require perception of people, a human awareness, and empathy and altogether a lively interest in people to respect them. Some tasks demand that a man work by himself, and alone. Other are takes of representation and ceremonial, outside tasks, that require the politician's enjoyment of crowds and protocol; the ability to represent and to make a good impression by saying nothing.

The top-management tasks require at least four different kinds of human being: the "thought man," "the action man," and the "people man," and the "front man." Yet those four temperaments are almost never found in one person.

Failure to understand these characteristics is a main reason why the top-management task is so often done poorly or not at all.

Because the tasks, while continuing, are not continuous, the top-management job itself is often seen, even by people running sizable businesses, as something that will be done if and when the need arises. But in the meantime, that is, day by day work in manufacturing and marketing, in accounting and engineering, in advertising and quality control. And the top management tasks will not get done at all. There are simply too many of them to be done that way. While each individual task within top-management function may require only a comparatively limited amount of time in the smaller less complicated business, the totality of the top-management function, even in small business, is far too large to be handled on the side and in addition to functional work. Day-by-day operating work always has urgency – an many top-management jobs are for the long pull and look as if they can wait until the "tomorrow" that never comes.

In addition, the top man, even in the large business, tends to see only those parts of the top-management function which are congenial to him. They will constitute for him the top-management job – and it will get done. The top man is right when he assigns to himself those top-management tasks that fit his personality, his temperament, his experience. He is wrong, however, in believing, often without

conscious thought, that this takes care of top-management function. It actually makes the business unbalanced and likely to be out of control.

The first requirement of effective top management, as George Siemens saw a century ago, is to identify objectively all the key activities and key tasks of top management in the business. The old saw that “every chief executive has his own style and decided what top management is” is nonsense. Every chief executive – indeed, ever person – has his own style and is entitled to it. But what decide top management is or should be is an objective decision. It depends no more on individual style than the law of gravity depends on what the physicist had for breakfast.

The fact that the top-management tasks, or at least a good many of them, while continuous tasks, are not continuous work and the fact that top-management tasks demand a diversity of qualifications, skills, and temperaments make it essential that every top-management task be clearly assigned to someone. Otherwise, important tasks will be overlooked. In fact, there should be a *top-management work plan* – especially in the small business – which spells out in considerable detail who is responsible for what; what the objectives and goals are with respect to each task; and what the deadlines are. Precisely because the top-management function differs in basic character from practically every other kind of work within the enterprise, it has to be made specific and has to be clearly assigned.

*Peter F. Drucker, Management: Tasks, Responsibilities, and Practices, Harper & Row Publishers, New York, 1974, pp 616-617.

Appendix E

Desiderata

Go Placidly amid the noise and haste, and remember what peace there may be in silence. As far as possible without surrender, be on good terms with all person.

Speak your truth quietly and clearly; and listen to others, even the dull and ignorant; they too have their story. Avoid loud and aggressive persons; they are vexations to the spirit. If you compare yourself to others, you may become vain and bitter; for always there will be greater and lesser persons than yourself.

Enjoy your achievements as well as your plans. Keep interested in your own career, however humble; it is a real possession in the changing fortunes of time.

Exercise caution in your business affairs; for the world is full of trickery. But let this not blind you to what virtue there is; many persons strive for high ideals; and everywhere life is full of heroism.

Be yourself. Especially, do not feign affection. Neither be cynical about love; for in the face of all aridity and disenchantment, it is as perennial as the grass.

Take kindly to the counsel of the years, gracefully surrendering the things of youth.

Nurture strength of spirit to shield you in sudden misfortune. But do not distress yourself with imaginings. Many fears are born of fatigue and loneliness.

Beyond a wholesome discipline, be gentle with yourself.

You are a child of the universe, no less than the trees and the stars; you have a right to be here. And whether or not it is clear to you, no doubt the universe is unfolding as it should.

Therefore be at peace with God, whatever you conceive Him to be, and whatever your labors and aspirations, in the noisy confusion of life keep peace with your soul. With all its sham, drudgery and broken dreams it is still a beautiful world.

Be cheerful. **Strive To Be Happy**

About the Author



Daniel B. Kohlhepp, Ph.D.

As regional vice president for the Mid-Atlantic Region, Dan Kohlhepp is responsible for the acquisition, development and leasing of commercial real estate in Virginia, Maryland, Pennsylvania and the District of Columbia for Crescent Resources, LLC. He is currently focused on developing Potomac Yard, a 300-acre, mixed-use, urban in-fill project in Northern Virginia.

After serving on the faculties of the University of Oklahoma and Pennsylvania State University where he specialized in real estate investment analysis, Kohlhepp left academia in 1979 to become a developer, broker and appraiser/consultant with R.W. Finley in Oklahoma City. In 1984, Dan moved to Washington, D.C., to enter the real estate investment advisory business, and in 1989 he sold his company, Potomac Realty Advisors, to Baltimore-based USF&G Corporation, where the company was renamed USF&G Realty Advisors. He was responsible for all development activities for a \$1.5 billion portfolio containing office, retail, multifamily, industrial and golf course communities. Kohlhepp left USF&G and started Kohlhepp Realty Advisors in 1992.

Prior to joining Crescent in 2000, Kohlhepp specialized in real estate portfolio valuation and management for institutional and government regulatory clients.

Born and raised in DuBois, Pennsylvania, Dan earned his B.S. and M.B.A. degrees from Pennsylvania State University and earned his Ph.D. with a major in Real Estate and Urban Analysis at the Ohio State University. He has published numerous academic and professional articles in real estate, and continues to teach adult education classes and seminars.

He is a past president of the DuBois Educational Foundation, the advisory board for Pennsylvania State DuBois, and currently serves on the advisory board of the Johns Hopkins University Real Estate Program. He also serves on the board of director of the Alexandria Economic Development Partnership.

A licensed real estate broker, Dan is a member of the Appraisal Institute (MAI) and the Urban Land Institute.

He is married to Donna Sell and they have three daughters: Kaydee (PSU '03), Joanne (PSU'04), and Kimberly (PSU '10 hopefully).

In the DuBois area, Dan operates the Kohlhepp Corporation, a real estate management company, and is on the board of directors of J.A. Kohlhepp Sons, Inc.