Apogee Consulting, Inc. has worked with government contractors in all industries, from the largest defense conglomerates to small not-for-profits, and pretty much everything in between. At one point a few years ago we visited a small-to-middlin' subsidiary of a large defense contractor, located somewhere in the Midwest. We were tasked with evaluating the management team's effectiveness and identifying opportunities for improving program performance.

(Yes, we do more than harp on FAR and CAS and DCAA audit issues. Sometimes we even get out of the back office!)

We identified a number of fairly minor issues, but we also noted that the subsidiary had only two experienced system engineers, both of whom were retirement eligible. The program management team was similarly small in number and senior in age. And there were no plans in place to deal with the impact of the inevitable retirements that were going to take place in the near future. Programs were (in the main) currently executing well; but tomorrow (metaphorically speaking) program execution was going to be a completely different story. The management team was simply oblivious to upcoming challenge of executing programs without seasoned program managers and experienced system engineers.

I'll never forget what that General Manager said when we brought these issues to his attention: He said, "*Well, in my 30 years of doing this, I have never seen any problems couldn't be fixed by enough new orders."*

Meaning, of course, that business development and booking new orders were his priorities, and that anything that distracted him from that mission was a waste of his time. And to be fair, it's very possible that his management metrics and incentive comp plan were focused on the winning of new business to the exclusion of other matters. It may well be that he was following his management's wishes. But we came away convinced that his operation had a huge downstream risk that, if not addressed right then and now, was going to severely impact the execution of all those new orders he was focused on winning.

I was reminded of that story by a recent story about Oshkosh's Family of Medium Tactical Vehicles (FMTV) program, reported in **Defense Industry Daily** .

In 2010, Oshkosh was awarded the follow-on FMTV production contract, reportedly worth up to $3 Billion. **As we reported** at the time, Oshkosh was the surprise winner, beating-out incumbent Stewart & Stevenson (now a subsidiary of BAE Systems). We **also reported** the views of Dr. Loren Thompson, who pointed to the Army's FMTV award as being a poster child for the notion that a low bid price (however unrealistic) gets a better rating by the source selection authority than a more realistic, higher price. At the time, Dr. Thompson asserted that Oshkosh’s bid was “30% below what the incumbent is currently charging for identical trucks,” and that Oshkosh’s profit projection was based on receipt of “financial aid from state and local governments.”

The DID story that got us thinking about business development versus program execution stated—

… reports indicate that for this re-buy program, BAE Systems submitted a bid 20% lower than the current FMTV price, despite a supply chain for FMTV that is 60% directed source (i.e. sub-contractors and parts specified by the government). Oshkosh’s bid was reportedly 33% below the current FMTV price

The DID story also noted that Oshkosh faces challenges in executing its FMTV program. The BAE Systems team in Sealy, Texas, saw FMTV production more than triple in 2009, from 2,400 vehicles per year to more than 8,000 per year. Oshkosh faces a similar high-volume production environment. But that’s not their only challenge.

The DID story tipped us to the machinations of **Carl Icahn** , billionaire investor. Some of you may remember Mr. Icahn from his role in the attempted hostile takeover of the Phillips 66 oil company in the mid-1980’s, financed by the firm Drexel Burnham Lambert and its “junk bond king,” Michael Miliken. DID reported that, by December 2011, Mr. Icahn had amassed a 9.51% ownership stake in Oshkosh. What’s perhaps more interesting is that Mr. Icahn had also accumulated a 10% ownership stake in **Navistar** — maker of MRAPs (Mine-Resistant Ambush-Protected vehicles) such as the MaxxPro. In fact, Navistar may the single largest provider of MRAP vehicles to the US Army.

So when Mr. Icahn opined that the two companies should be merged, that got everybody’s attention. The two companies’ Boards of Directors were—shall we say?—alarmed at the prospect of a shotgun marriage, and reportedly took defensive measures in order to try to abort the plan.

Mr. Icahn listed several reasons for his proposed merger of the two companies. Reportedly, he was critical of Oshkosh management and “expressed concern” about the upcoming FMTV rebid. According to Mr. Icahn, Oshkosh management has been distracted by the rebid strategy, as well as by a recent acquisition.

When the BODs proved reluctant to move forward with his plan, Mr. Icahn launched a proxy battle in January 2012, writing in an SEC filing, he said—

We believe that the FMTV represents the single largest problem with the future of this company…. We believe this unprofitable contract represents management's unrealistic attitude and poor planning, as well as the board's lack of oversight on a product that represents over half of segment revenue.

Regardless of the merits of Mr. Icahn's hostile maneuvering, it did surface financial problems with Oshkosh's FMTV program. DID reported—

The facts of the matter do make it appear that the Army played its FMTV hand well, and Oshkosh chose a strategy that failed at every point. As BAE surmised at the time, given the value of Army-specified sub-contracts, Oshkosh's bid could not be profitable, and has not been. Worse, the Army chose not to be interested in enhancements, which would have restored some profit for Oshkosh; they also front-loaded FMTV purchases, before price-escalation clauses in the contract could kick in.

Dr. Thompson, of The Lexington Institute, **also opined** on Oshkosh's current predicament. He wrote—

The company finds itself in this predicament because it made some ill-timed acquisitions at the top of the sub-prime real estate boom (most notable lift-maker JLG), and then sought to compensate for its error by bidding very aggressively on Army truck contracts. It won the contracts and by most accounts is performing well, but profitability has been hard to sustain. Oshkosh executives apparently thought they could win more favorable terms on the Army work by proposing design enhancements, but the customer insisted on sticking with the original contract terms.

Dr. Thompson also sounded a cautionary note for the US Army. Assume Mr. Icahn gets his way and Navistar and Oshkosh merge into "a $20 billion behemoth that can dominate the domestic truck-building industry." What does that mean for future acquisitions of Army vehicles?

Dr. Thompson cautioned—

When you are by far the biggest source of demand for a company's products, then you can pretty much dictate the terms of the relationship. When you are only one of many customers, you have less influence over how managers and investors choose to deploy their capital. In the case of Mr. Icahn, he doesn't much care what the long-term consequences of combining Oshkosh and Navistar might be for the price and performance of Army vehicles, because he is motivated by near-term financial results. The fact that submerging Oshkosh into the Navistar culture will give the Army fewer competitive options in the future is fine with him; that's how you get pricing power. So even before the Army's strategy of relying more on commercial sources for its vehicles has fully coalesced, the marketplace is sending a signal that there may be consequences service officials hadn't considered.

DID also noted a related issue. BAE Systems is no longer in the FMTV production business, with predictable results for its staff. If Navistar and Oshkosh merge, and BAE Systems is no longer a serious player—then where's the competition. DID wrote—

Though [the Army's] acquisition approach drove down short-term costs, in the long term, it could actually backfire on the Army by destroying 2 key suppliers. With BAE's Sealy, TX truck plant largely emptied of work and staff … [and the Lexington Institute's prediction of problems from the proposed merger] [one] wonders if [the Army's] procurement victory will prove as pyrrhic as Oshkosh's.

So you see, sometimes all the new orders in the world won't solve your management problems. Sometimes those new orders are just the beginning of a whole new host of management problems that you never even considered. Sometimes, you can be the victim of your success, as Oshkosh appears to have been.