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# Tank Industrial Base in a Fight for Survival

# Making the Case for Irrational Behavior

INDUSTRY PERSPECTIVE

**BY JIM THOMPSON AND KRISTIN WHITE**

As U.S. defense spending decreases from a gush to a trickle, contractors are desperately competing for market share. Programs are being canceled, curtailed and restructured.

Many companies coming off all-time highs over the last decade now find themselves in a declining market. Some are fighting for shareholder confidence, while others are just fighting for survival.

Meanwhile, customers facing an unchanging list of requirements are under pressure to fulfill them with fewer resources. The result is aggressive action on the part of some contractors, which unsuccessful bidders sometimes deem "irrational" behavior.

But is it irrational?

History is riddled with examples in which uninformed and aggressive bid decisions have led contractors down a risky path that ultimately resulted in failure. However, capture managers and executive leadership are now recognizing that aggressive strategies can be very effective, and therefore appropriate and rational, when driven by the right intelligence. An asymmetric strategy requires a detailed understanding of competitors and customers in order to manage risk. In an environment where everyone is trying to gain an edge, there are some contractors who have successfully played to win.

Sometimes, companies will choose to bid a price that is so much lower than the competition that the customer can't help but award the contract to them. This often results in the company executing the program at a loss for a period of time, but it is typically "made well" at a later date via engineering change orders or operations and sustainment work.

The perception within the capture community is that companies tend to buy in only when there is extreme incentive to win, or no other options for survival. This overlooks recent history, which indicates that the rationale for buying in can be quite compelling from an overall business case perspective.

Take the Air Force's aerial refueling tanker competition. While the Northrop Grumman-EADS team offered a technically superior aircraft at a reasonable price, The Boeing Co. recognized that the production contract was an entry point to a larger and more lucrative role as the sole provider for all services associated with the platform. Boeing used this rationale to bid well below EADS. In this case, Boeing took a calculated risk, which it likely justified with a strong business case based on historical customer behavior. This is a decision that is quite rational.

A less extreme, but more frequently employed strategy is for companies to cut fees aggressively. Bidding the contract realistically, but with razor thin margins, can seem a noble gesture in the eyes of the customer. This is particularly effective when the customer is dissatisfied with incumbent pricing. Competitors may pursue this approach when they have a high incentive to win, can pair it with high margin work, or can make up profit through cost optimization. This strategy can save a franchise program, or steal one from an incumbent.

Oshkosh's takeover of the Army's family of medium tactical vehicles contract from incumbent BAE Systems is an example of this approach. Oshkosh understood that BAE's financial motives and reliance on historical pricing were disconnected from customer cost expectations. Paired with a higher-margin business and strong cost-control methodologies, Oshkosh's low-margin bid helped them to grow their footprint in a military tactical vehicle market, where one franchise program is not enough to guarantee survival.

It doesn't always pay to be a prime contractor. Winning large prime contracts is a key component to many Pentagon contractors' growth strategies. Not only do prime wins represent a significant and predictable revenue stream, but they also attract a lot of attention and signify which companies are "in the lead" with a given customer.

But companies sometimes recognize that the procurement environment is not well aligned for a prime bid.

Lockheed Martin's bid for the Navy's Next Generation Enterprise Network is a relevant case in point. Initially entering the competition as a prime, Lockheed changed course and joined the incumbent team led by Hewlett-Packard as a subcontractor. Presumably, Lockheed realized that the proposal evaluation structure was not well suited to their preferred bid approach. Rather than continue to pursue the contract as a prime and expend the resources that go along with it, Lockheed made a choice to team with the incumbent — a move that saved the company money and ultimately resulted in a win.

Capture managers, business development executives and corporate leadership need to make informed bid strategy decisions that anticipate unexpected competitor bid behaviors, which are often perceived as irrational due to a lack of information. The critical success factors in the above cases were a firm understanding of customer cost expectations, competitor bid psychology, program life cycle business case and internal risk tolerance. The rationality of any bid approach is validated through the overall financial success of the winner and the program, not price differential at submission.

In the end, the only truly irrational bid behavior is to lose every bid, and ultimately risk financial insolvency, in order to avoid the risk that comes with winning. **ND**

**Jim Thompson and Kristin White** are senior associates at Avascent, a strategy and management consulting firm that advises government contractors.

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