After a long number of years working for different employers, of different sizes, in different industries, one gets a certain amount of perspective. This company did that thing well; that company did this thing well. Those companies didn't do much of anything very well and ended-up in financial trouble; whereas those other companies did quite a bit well and were successful: they were admired by their competitors as well as their customers.

If we know one truth from all that diverse employment and consulting history, it is this: ***You get the behavior that you incentivize***
.

If you tell executives that their incentive comp will be based on their individual performance, they will make self-serving decisions, regardless of the outcome to the company at large. But if you tell executives that their incentive comp is a formula that starts with overall company performance, then they will cooperate with each other.

If you tell employees that their raises depend on keeping the boss happy, then they will do whatever it takes to keep the boss happy—perhaps to the exclusion of good corporate citizenship. But if you tell employees that their raises are tied to the company's performance, then they will start thinking about what's good for the company.

You get the behavior you incentivize.

If you tell the sales team that their bonuses are tied to sales, then they will deliver the sales; but you may not like the pricing. You may find that your deals are losers, but you didn't tell them that the sales had to be profitable.

You get the behavior you incentivize.

Similarly, if you are a government contractor, a multi-billion dollar defense contractor, if you establish the wrong incentives you may find yourself with the wrong employee behaviors, and somebody with a conscience may decide to “blow the whistle” on those wrong behaviors. You may find yourself dealing with a full-blown criminal investigation, and resulting litigation under the False Claims Act. You may find yourself agreeing to a multi-million dollar settlement.

Sort of like Huntington Ingalls Industries (HII) **did** .

You get the behavior you incentivize, and sometimes the incentives are wrong and the resulting behavior is wrong. In the defense contracting world that situation tends to erode shareholder profit.

HII settled its FCA suit, initiated by a whistleblower, for $9.2 million. Not all that much, in the scheme of things.

The verbiage of the Department of Justice press release is dry and details are sparse. From the press release—

The civil settlement resolves alleged labor mischarging on various U.S. Navy and Coast Guard contracts dating back to 2003. HII allegedly mischarged labor incurred on particular contracts to other contracts, even though the costs were not actually incurred by those contracts. The settlement also resolves claims disclosed by HII that it had billed the Navy and Coast Guard for dive operations to support ship hull construction that did not actually occur as claimed.

Mischarged costs. Doesn’t sound too bad. It can happen to anybody.

But if you go looking for more details you can learn that there was a systemic problem, and (in our opinion) it started with employee financial incentives. For example, let’s look at **an article** written by Anita Lee for the Sun Herald; it relates some of the relator’s allegations that led to the settlement. According to the article, Byron Faulkner (the relator) alleged that the shipyard was subject to organized corruption. The article reported—

The whistleblower lawsuit outlines fraud at Ingalls by more than 20 directors, supervisors and foremen involved with filling out time sheets for contract work on Navy and Coast Guard vessels.

Completing tasks ahead of schedule or on time entitled Ingalls and company supervisors to incentive pay under the military contracts. Ingalls, the lawsuit says, ‘organized and allocated its supervisory and other personnel based on Ingalls’ corporate purpose of receiving maximum dollars in periodic incentive payments.’ Faulkner said he learned firsthand about the fraud after being named a foreman at Ingalls in August 2012.

In our view, the key sentence in the above quote has to do with the allegation that on-time schedule completion entitled the front-line supervisors to receive incentive pay. Unsurprisingly, their decision-making focused on completing tasks on-time—or on creating documents that showed tasks were completed on time regardless of the reality of the situation.

The article reported that “Daily time reports showed hours worked on specific projects, but if too many hours had accumulated on a project to qualify for incentive pay, Ingalls supervisors simply billed the time to a project that would qualify, even though the work was not being performed on that project.”

The whistleblower reported the situation to HII’s internal auditors, who investigated and corroborated at least some of his allegations. The article reported that “The company wound up firing at least 20 managers in the shipfitter and welding departments in 2013.” Two HII supervisors later pled guilty in December, 2015, for their roles in filing the false time reports. However, the FCA lawsuit alleged that the company’s anti-corruption efforts didn’t go far enough or reach all the affected organizations.

Finally, the article reports that HII released a statement that included the following:

The company informed the government of alleged misconduct by certain employees and fully cooperated with the government in investigating and reaching a resolution of the matter. The company has strengthened its compliance program to help ensure that no similar issues arise in the future.

There was no discussion as to whether HII had changed its incentive program to better align incentives with compliant behaviors.