

### ***A capital idea***

What role for government in the financial marketplace? A question that is now academic, as the role of government is great in many swaths of the economy, in areas such as health, transportation and aerospace and defense. In normal times, the companies that participate in government business – either through direct procurements or via subcontracts, would be viewed as less exciting, slower growth investment opportunities. Now, with private-sector demand in turmoil, the capital markets morose and with trillion-dollar government stimulus packages being actively bandied about, companies that participate in the government market are looking more and more attractive. In these times of government largesse looming larger than private sector largesse, we ought to consider the implications on business development and on financing of competitors in this field.

For smaller companies, participating in the market for government contracts can be a difficult experience. Onerous reporting requirements and an often obtuse bureaucracy can turn off small entrepreneurial companies that would just as well do without the headache of working with the government. Although modern government practices have tended to specifically favor certain types of small business in contracting, too often they are still going up against against huge, well-connected, competitors. Even for those better suited to the government contract and procurement process, there too can be peril. Relatively “easy” money, in the form of contract set-asides, favorable bidding status for procurements or special research or technology-transfer grants for small companies, can be a booster for initial growth but can also have negative effects. By orienting itself to the specifics of government demand and the perils of bureaucracy, a small company can neglect greater opportunities in the private sector and stunt its own growth.

There ought to be a better way. If we must have the long arm and the fat wallet of government spending, then there ought to be a way for it to support the activities of the most dynamic and entrepreneurial companies without stunting their development. Although many solutions have been proposed to address this problem, we would like to highlight one experiment which stands out in the unique way it bridges government interests with the needs of entrepreneurial firms - an outfit known as In-Q-Tel.

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Launched in 1999 by none other than the Central Intelligence Agency, In-Q-Tel is a private, independent, not-for-profit organization, which acts as a venture capital arm of the CIA. In this arrangement, the CIA provides government funds plus its copious technical resources, while In-Q-Tel identifies and executes equity investments in companies that show promise in developing technologies that benefit both their potential for growth and the CIA's activities. While the government aspect is a unique element, this arrangement is not too different from the strategic venture capital funds set up by the likes of Motorola, Sony or Intel. At its most basic level, the concept combines the government's advantage of deep pockets and access to resources with the agility and independence of a venture capital firm.

The results of this experiment in government backed VCs have thus far been fairly encouraging. Over the course of its short history, In-Q-Tel has produced engagements with over a hundred companies, many of whom had never transacted business with the US government before. On the government side of the ledger, In-Q-Tel claims to have delivered more than 140 technology solutions for the benefit of the US Intelligence Community. One particular standout engagement was its investment in Keyhole, a Mountain View, California developer of digital mapping solutions. Not long after the investment, Keyhole was sold to Google – and today its central product is known much more famously as Google Earth. From both a financial and strategic perspectives, this was a nice return on investment.

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If a government-sponsored venture capital fund can work for intelligence gathering and analysis, whither the more capital intensive areas of government, such as aerospace and defense? There is OnPoint Technologies, the VC backed by the US Army, which has made a number of investments in energy technologies. If this model is good for the CIA and the Army, what then our space agency, NASA? As one of the most voracious consumers of advanced technology, surely it should be looking at innovative ways to find it in the private sector.

Earlier this decade – with a new mission and vision for exploration, with In-Q-Tel and the idea around it gaining its own traction, and above all else, with NASA's own Administrator, Dr. Michael Griffin, having previously served as President of In-Q-Tel, it seemed that the stars were aligned for such a fund. In 2006 plans were drawn

up for the creation of what would be known as 'Red Planet Capital', funded by NASA (to the tune of about \$11 million) and administered by experienced investment professionals. Just as with In-Q-Tel, investments would seek technologies and companies that would enable NASA's ambitious exploration plans. Press releases were written and a new era of public-private collaboration at NASA was hailed. Unfortunately, as months following the announcements went by, the plans ran aground and then quietly scrapped.

Although what little explanation exists publicly about the fate of Red Planet Capital mentions budgetary pressures and shifting priorities, reliable inside sources indicated another reason. Officials had apparently objected to the idea that government would participate in the equity market by taking stakes in portfolio companies. Although there is merit in this line of thought, given recent events in the financial world and what has effectively been the partial nationalization of the financial system, this argument seem a bit quaint.

We believe the idea merits reconsideration. As they serve NASA and the CIA's unique needs, government-backed funds are less likely to compete with private VCs for the same deal flow. Moreover, in the troubled economic times in which we now live, competition for deal flow is hardly the issue. Most VCs are conserving their scarce cash to service their existing portfolio companies while entrepreneurs are left in the lurch with limited access to capital. New sources of funds making new investments, particularly in an environment in which the sources of business may be shifting from the private to the public sector, may be just what the economic doctor ordered. Lastly, consider the alternative – money from government VCs would otherwise be spent on funding more of the traditional forms of government spending. Is that necessarily a better allocation of resources?

With a new administration in the wings and change in the air, no doubt many new initiatives will be unveiled or revived from previous lives, and we believe that Red Planet Capital should be one of these. But why stop at NASA? Certainly other government agencies and departments could pursue new technologies and innovative companies through their own venture capital arms. How about a VC for the Department of Health and Human Services to develop new medical tests and therapies? Or how about a VC for the Department of Energy to support clean energy technology or

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efficient transportation? For that, we could even call it 'Green Planet Capital'.

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In the Federalist Papers, James Madison wrote that "No government, any more than an individual, will long be respected without being truly respectable." If government is to keep its new-found role in the financial markets, or even its more traditional role in executing large, difficult national projects, then it must constantly seek and find new ways to be more innovative and to use the public purse wisely. New initiatives and new visions will only get us so far - what we need are new ways of doing business. With smarter practices and new ideas resulting in more efficient uses of funds, shouldn't we get not only the government we have but the government we need and deserve? Now that would be a capital idea.

By Ian Fichtenbaum  
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