

Army Venture Capital Initiative

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On May 7, 2003, the Army announced that OnPoint Technologies of Maitland, FL, would manage an Army Venture Capital Initiative (AVCI) focused on innovative power and energy technologies for the soldier. The announcement marked the introduction of a new Army model for engaging small, entrepreneurial businesses to develop and transition innovative technologies to support the needs of individual soldiers — the centerpiece of Army transformation.

Venture Capital and the Army

The National Venture Capital Association defines venture capital (VC) as “money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors.” Because VC is usually invested in young companies with innovative products, VC investments are inherently risky, but hold the potential for high rates of return on investment. VC is usually provided in exchange for an equity stake in the recipient business, with typically substantial investor involvement in the company’s day-to-day operations. This provides a degree of business focus and expertise that might otherwise be very limited within the company, improving the startup company’s chance of success.

The Army constantly looks for technology innovations that can offer greater performance, lower cost and better ways of accomplishing its

mission. Entrepreneurs in small, young companies often develop such innovations, but generally target larger commercial markets for profit potential. These companies may not consider defense markets because of concerns about the defense contracting environment, intellectual property protection, limited market size and the perceived potential for extensive oversight, largely because of a requirement to protect the public interest.

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An Army-focused and -funded VC company, managing its relationship with the Army through a flexible agreement instrument, can, if properly formulated, mitigate some of these concerns. By offering what the entrepreneurs need most — capital for company and technology development — the VC company can provide a strong incentive for initiating and maintaining close relationships with the Army. An Army-focused VC fund would help entrepreneurs develop products that are potentially useful to both the commercial and government markets. In this dual-use

market, the Army could be the entrepreneur’s influential “first user,” as opposed to being an isolated and limited niche market player.

There is a precedent for this type of approach. The CIA established In-Q-Tel® as a not-for-profit (NFP) VC-like corporation to find and develop technologies for the intelligence community. Though the CIA and In-Q-Tel have only been using VC for a few years, the experience appears to have been positive.

AVCI

In Section 8150 of the *2002 Department of Defense Appropriations Act*, Congress earmarked \$25 million of the Army’s FY02 basic and applied research funds for a “Non-Profit Army Venture Capital Corporation.” As a result of this legislation, the Army moved forward to establish its VCI.

The Army focused the VCI on power and energy technologies for the soldier — a technology area with a clear Army requirement, a parallel commercial market and ability to be influenced by the amount of available funding.

In the fall of 2002, a Broad Agency Announcement was issued for

proposals to establish and manage the Army's \$25 million VCI. Twenty proposals were received. The Army selected Military Commercial Technologies Inc. (MILCOM), a for-profit VC company with an excellent investment track record and experience in collaborating with government organizations. MILCOM proposed an NFP partner, OnPoint Technologies Inc., through which the Army and MILCOM would manage the initiative.

The AVCI was established through an "other transaction" (OT), a legal instrument with significant flexibility. The OT highlights OnPoint's two principal goals:

- Find innovative power and energy technologies, invest in their development and then transfer them to the soldier.
- Reap substantial net returns for the investing organizations from commercial and Army markets.

Because OnPoint is an NFP organization, earnings on its investments are reinvested. If the fund is successful, OnPoint will become an "evergreen" fund (self-financing), using the proceeds from earlier investments to finance each new round of investments in technologies of interest to the Army.

Under the terms of the agreement, MILCOM will manage most of the actual investing activities by identifying potential investments, conducting due diligence to recommend investments and managing most of the administrative burdens associated with the investment process. OnPoint will approve investments recommended by MILCOM, manage relations with the Army and ensure that Army technology goals are

pursued as a main objective of the investment activities. Both entities are responsible for managing the technology road-mapping process used to identify investments that best balance the Army's technology requirements and the venture capitalist's need for a positive return on investment.

For its efforts, MILCOM will be compensated much the same as any other venture capitalist, though with a twist. The typical venture capitalist has only one goal when making investment decisions: to make significant returns on the money invested over a relatively short time period. To encourage moneymaking investments, the typical venture capitalist retains a percentage of any profits (the "carry") earned on the investments made with the monies entrusted to him/her. The AVCI, however, differs in that the goal of realizing a positive return on monies invested must be considered concurrently with the more important goal of developing technologies that transition to the Army. MILCOM will be incentivized with the prospect of additional compensation when technologies from its investments actually transition to the Army. These two primary mechanisms, the carry and the technology transfer incentive, have been carefully structured to encourage investments with the dual likelihood of making money *and* yielding technologies that will be integrated into Army systems over time.

Managing AVCI for Success

The Army has decided to have no decision-making authority in approving or disapproving OnPoint's investments. This will go a long way toward eliminating the perception of extensive oversight that is of concern to companies that the Army seeks to engage through the AVCI. It will also provide OnPoint with the flexibility to shape its strategy and maintain its agility in responding to both commercial and Army interests. However, this does not imply a hands-off approach. The initiative's probability for success will be enhanced by the Army's actions on its market side.

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OnPoint, in partnership with the Army, must identify the issues and requirements associated with the soldier's power and energy needs — teaming with soldiers, with those in the Army responsible for managing the development of soldier equipment and with the entrepreneurial companies doing the development work. The planned Army participation in these teaming activities will help to ensure that On-

Point has the information and knowledge it needs to make investing decisions that correctly align with and produce innovative technologies that transition to the Army.

Through this new approach to doing business, the Army expects to capture

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As the Army transforms, spiral development will bring in technologies from both inside and outside the Army. LTG Benjamin S. Griffin, Deputy Chief of Staff, G-8, works with the Joint Capabilities Integration and Development System, a joint board that looks at common systems among services. To reinforce this cooperation, the “8s” of each Service have been meeting every 2 weeks to lay the groundwork for the Joint Requirements Oversight Council. “Our goal is to cut bureaucracy and get systems approved and fielded quicker,” he said.

One such good news story is the Army’s Stryker Brigade Combat Team. “It took 4 years from concept to IOC (initial operational capability) for the Stryker Brigade,” said Griffin. “And we are upgrading the Strykers with Force XXI

Battle Command Brigade and Below and Blue Force Tracking to improve situational awareness, satellite communications and slat armor for rocket-propelled grenade protection.”

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Another element critical to the Future Force is command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR). “We must fully integrate space and terrestrial communications,” Griffin implored. “The C4ISR technical initia-

tives include Blue Force Tracking, combat identification systems and software blocking.”

LTG John M. Riggs, Director, Objective Force Task Force, explained that DOTML-PF (doctrine, organization, training, materiel, leadership, personnel and facilities) development and fielding is being accelerated and that this is being

driven top-down to the Services. “We’re not just preparing for war,” Riggs said. “We are at war and we must bring technology to the warfront sooner.”

Riggs suggested that, to bring technology to the warfront, the Army must operate in Joint Interagency Multinational teams using common architecture, network, equipment and processes. Title X (the U.S. code that lists the responsibilities to raise an Army) functions will also need to be modified — the civilian workforce will need to assume non-core and nonmilitary-essential missions.

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innovative technologies produced by small entrepreneurial companies that, in the past, hesitated to do business with a government agency. This will widen the Army reach into other innovative and rapidly evolving commercial world segments. The expectation is that this could open up unforeseen technological opportunities to support the needs of future soldiers.

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