

With Public Dollars Flowing, IT Start-Ups Shake Hands With Washington

By Scott Denne
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Landing contracts with federal government agencies is notoriously difficult for start-ups, but with tight budgets in the private sector many companies are turning to the government for a boost.

For information technology companies, selling to the federal government has usually been either a company's sole focus, or something it's steered clear of entirely. But the recession has made many companies in the latter category more willing to explore the sector for possible opportunities.

"With so many private sector purchasers on the sidelines, the federal sector is one of the few that's expanding budgets," said Andrew Bartels, a vice president and principal analyst with research firm Forrester Research.

Selling to the federal government requires a different kind of expertise than what is found at most early-stage technology companies. Bringing on additional sales staff to tackle the federal government, its layers of bureaucracy and its lengthy sales cycle is usually viewed as an unnecessary risk that can distract a company in its early days. But that viewpoint is changing.

Board Embraces Opportunities

One company that sees more pluses than minuses in dealing with the government is OnPath Technologies Inc., which has raised at least \$8.5 million from GKM Ventures, L Capital Partners and Blueprint Ventures. The company, which makes virtual physical layer switches, has its roots in the 1980s, in a company called Telenex Corp., which went through several mergers and acquisitions before ending up at Brocade Communications Inc., where it was spun out as OnPath nearly three years ago.

Telenex had numerous federal government customers for its circuit-based switches, which connect hardware directly, rather than moving data packets around a network. Though most corporations moved away from physical layer switching for other standards, like fiber channel, much of the government didn't, said Brian McCann, chief sales and marketing officer at OnPath.

When federal customers came to OnPath looking for upgrades, additions and servicing for their old Telenex equipment, the company's board fully embraced it since federal and private sector sales "don't tend to be in the same [economic] cycle," McCann said.

Sales to the federal government now make up half of its business, but new accounts don't come easy. McCann estimates that it adds 12 months to its normal sales cycle, which already takes between one and two years, he said.

It also helps OnPath that physical layer switching is more secure than the packet-based standards that dominate most networks today, and having that security component makes it easier to get the government's attention, McCann said.

OnPath is not alone. For many start-ups, the federal government's growing concern with cyber security has helped them capitalize on the spending opportunities.

"Because it's a matter of economic and national security, we're going to see the greatest mobility" for information technology security start-ups, said Pascal Levensohn, a managing partner with Levensohn Venture Partners and a director with the Security Innovation Network, an organization that seeks to increase the collaboration between the federal government and private IT security companies. "The risks are high, therefore [the government is] most likely to change its processes."

For Solera Networks Inc., being discovered by some security evangelists in the federal government was key to growing its business, said Steve Shillingford, its chief executive. The company, which has raised about \$12 million from Allegis Capital and Canopy Ventures, makes appliances that monitor and record activity on a network, similar to a video surveillance system that monitors a bank.

It started a handful of government pilot projects in 2007, but now about two-thirds of its 125 customers are in the federal space, Shillingford said. Over the long-term the company expects to gain more traction in the federal space. "I think we'll always have this as a strong part of the business, but there will be more equilibrium down the road," he said.

Even SaaS Companies Finding Favor

It's not just security companies that are benefiting. Even in software-as-a-service, where the security factor is viewed as more of a liability than an asset, companies are gaining government sales.

"The Obama campaign, and now administration, does seem to be more open to using different types of applications," said Deborah Farrington, a general partner with StarVest Partners, adding that it has as much to do with the growing acceptance of software-as-a-service as with expanded budgets.

Many of those companies are also finding that their sales model helps minimize some of the red tape in the federal sector.

"You don't have to engage their IT people at all. It's no longer a technology purchase, but an HR purchase," said Jai Shekawat, chief executive of Fieldglass Inc., a provider of software-as-a-service for finding and managing contract labor and services that has raised \$39 million from Grotech Capital Group, BlueStream Ventures, StarVest Partners and HLM Venture Partners.

Since software-as-a-service is bought directly by the department using the product, an agency's IT department isn't as involved in the sale. And since there are few upfront costs, there is a shorter period to vet the new service. "When you make an IT purchase, IT has their own things they've purchased" and they take time to figure out if any of those can do the same job before committing to buy something new, he said.

Though many companies have benefited from the government's expanding budget, the opportunity is likely to pass, if it hasn't already.

"Obama's been clear that we have to cut back on our spending and bring budgets under control. We've got a two- or three-year window here," said Forrester's Bartels. "If [you've just started] looking at the federal government, you're probably too late to be a big player."

Aside from a larger budget, there is some reason to hope that selling to the federal sector may get easier in the future, but it won't happen overnight.

"There's a lot of discussion about the federal government trying to modify and streamline its procurement policies," said Bob Ackerman, a managing director of Allegis Capital, an investor in Solera Networks. Government officials, he said, acknowledge that a difficult procurement process "limits your choice as a customer. But overhauling massive bureaucracies takes time."