

SOMETHING VENTURED: Uncle Sam Is Staking Start-Ups

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When it came time for David Jevans, the chief executive of IronKey Inc., to raise funding to develop his start-up's USB flash storage and authentication product, he turned to an unconventional choice in Silicon Valley: Uncle Sam.

Jevans received a \$1.4 million grant in 2005 to develop the product through the Homeland Security Advanced Research Projects Agency, a division of the Department of Homeland Security that is tasked with advancing technology designed to protect the U.S.

The benefit of such funding is that it delayed him having to get venture funding for about 18 months, significantly minimizing his dilution, Jevans said.

"You can do a seed and [government funding] and that could double your runway," he said.

Jevans was one of a number of entrepreneurs and venture investors attending the second annual IT Security Entrepreneurs Forum at Stanford University on Tuesday. The event was organized by officials from several government agencies seeking to find new start-ups and inform Silicon Valley entrepreneurs on how to navigate Washington.

Los Altos, Calif.-based IronKey later raised a \$6 million Series A from Leapfrog Ventures and individual investors in December 2006, as well as \$500,000 debt financing in March 2007 from Western Technology Investment.

Government funding is especially useful for IT security companies that are looking for inroads to sell their products to government agencies, because those agencies are more likely to buy from companies that have already been vetted by another agency, Jevans said. It is no secret that while such government contracts are often difficult to obtain, they can be very large. IronKey now has a number of government clients, which he declined to name, in addition to private sector sales.

"You can get an inside track on an early customer," Jevans said. "The other thing is if you do get funding from the government to build a product they can help you when it's time to sell to other agencies."

Many entrepreneurs and venture investors in Silicon Valley do not understand how the funding system works in Washington, just as officials in Washington do not have a good understanding of how Silicon Valley works, said Douglas Maughan, program manager at the Department of Homeland Security who directs the Cyber Security Research and Development within HSARPA, the agency that funded IronKey.

Maughan, whose agency provides funding between \$750,000 and \$2 million, said small start-ups often partner with larger companies who know how to handle government contracts to make the process easier.

The funding that Jevans received - through a process known as a "broad agency announcement" that has specific funding criteria for each

particular agency - is not an equity investment; it is a research grant with required deliverables. Besides Homeland Security, other agencies such as the Department of Defense's Defense Advanced Research Projects Agency also provide such funding. Maughan declined to discuss how many companies or how much funding is involved, but the Homeland Security's Web site lists more than 40 such solicitations over the past three years on topics from "low-cost bio-aerosol detector systems" to "cyber security research and development." Many have multiple accepted proposals. The vast majority of such projects offer total funding at least in the millions of dollars.

In addition, agencies with a research budget above a particular budget figure - including the Departments of Defense and Homeland Security, Army, Navy and the National Science Foundation - are required by law to provide grants known as Small Business Innovation Research to new companies.

The SBIR grants are normally for \$750,000, though they can be increased to \$1 million if the company receives \$500,000 from another source, such as another government agency, private investor or another company.

IronKey obtained its funding alone, but Jevans said that while obtaining the funding is not extremely difficult, the management of the paperwork for the contract can be "onerous." The contract required estimating how many hours certain milestones in the project were expected to take, detailed documentation of certain milestones and things like timesheets that are usually unheard of in Silicon Valley's culture of long hours in exchange for future payoffs.

Such roadblocks, which also include simpler ways for large government agencies to make purchases from smaller start-ups, are items that government officials are aware of and trying to fix, said Pascal Levensohn, managing partner at Levensohn Venture Partners and the honorary chairman of the conference Tuesday.

"It remains difficult," Levensohn said. "The good news is that multiple high level conversations are going on about how to make it less difficult."

According to Levensohn, which has invested in three security related start-ups, there is much untapped opportunity in the public sector for start-ups who are developing IT security for the private sector.

"The private sector and public sector are facing very similar threats, but the public sector is disadvantaged because they don't have leading edge solutions," Levensohn said.

Federal funding is lacking in attempts to keep up with the threats of cybersecurity, according to an October National Research Council report. But with the current presidential election year bringing a new face to the White House, entrepreneurs and investors could see more funding towards security companies from this often overlooked source.

For his part, Jevans says the Department of Homeland Security funding was a great benefit to his company and to maintaining his equity, despite the many hours he spent learning the rules on contracting and

documentation. As start-ups look for more creative ways to bootstrap their companies, such funding could be a fresh option.