



# What government can learn from venture capital

How government venturing can “spin in”  
commercial innovation

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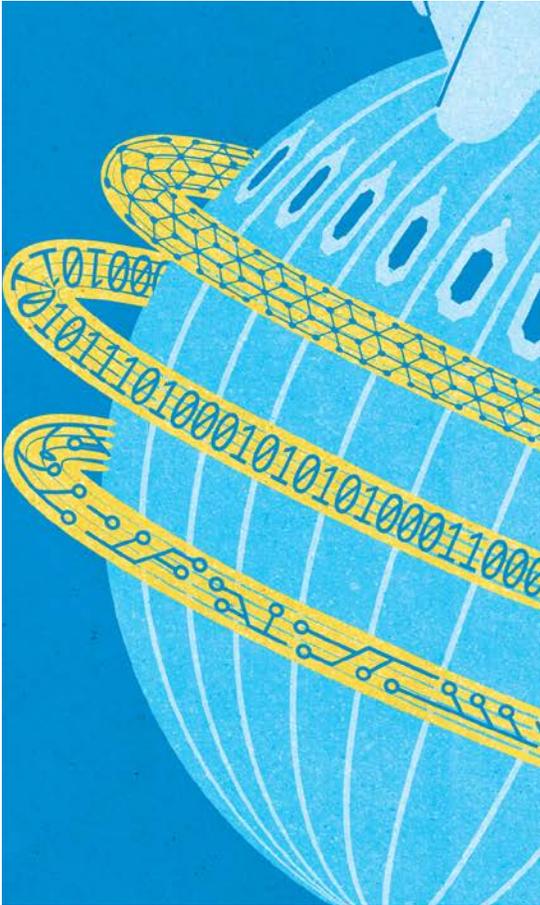
# Introduction

More and more, government access to cutting-edge technology, skills, and business models involves tapping into the advances being made by outside players—essentially engineering a “reverse tech transfer.” Historically, government has fostered technological leaps, from space flight to GPS to vaccines, and the tech-transfer process then helped commercialize these new capabilities. Now, leading capabilities are often already commercial: Consumer facial recognition technology may prove valuable for law enforcement,<sup>1</sup> commercial mapping tools have become part of the arsenal used by military special forces,<sup>2</sup> and commercial genetic testing could offer public health data and insights beyond what research studies are likely able to recruit.<sup>3</sup>

INSTEAD OF SPINNING off government innovations into commercial products, government now needs ways to “spin in” technology to speed innovation and improve mission delivery. As Erika Wagner, payload sales director of space startup Blue Origin, recently said at a conference: “We always talk about space being a place where spin-offs happen, where we would go spend a lot of money on Apollo and, in exchange, we get Teflon and cordless drills,” she said. “Now we’re in a different part of the cycle.”<sup>4</sup>

Spinning in is not easy to do. Unlike commercial entities that have access to legal and financial structures such as joint ventures, mergers, and acquisitions, governments have to find more creative ways to capture external innovation. Many

government organizations are developing strategies to do so—evidenced by a growing number of units, procurement vehicles, and programs dedicated to commercial and early-stage venture engagement. However, they often fail to attract the new (and new types of) players at the forefront of innovation, possibly due to lack of interest from these companies: A December 2018 Government Accountability Office (GAO) report found, for example, that Small Business Innovation Research (SBIR) grants awarded less than 3 percent of funds to companies “majority-owned by venture capital companies, hedge funds, or private equity firms.”<sup>5</sup> And it is not necessarily easier to attract “big tech” companies, where high-profile employee protests have cut short several promising projects.



So how can government bring in and better harness external innovation? Strategies to spin-in innovation should reimagine two critical aspects:

(1) investment **structures** and partnership models to engage new and more diverse types of partners, moving beyond the traditional “make or buy” mindset; and (2) dedicated **functions** within government that have the capabilities to connect new ideas to mission delivery.

Corporate venture capital offers a blueprint. To keep pace with startups’ agility and speed, many large corporations have created functions and investment strategies to engage external innovators—with more than 750 corporations making venture investments in 2018.<sup>6</sup> The primary motivation for many of these investments is less financial than strategic, gaining insight into new products, the competitive environment, and partnership opportunities.<sup>7</sup> (See the sidebar “What’s driving spin-ins?”)

Government can adapt this model to realize similar benefit—an approach the CIA pioneered in 1999 when it established its not-for-profit venture arm, In-Q-Tel, to invest in ventures with strategic relevance to the defense and intelligence communities.

This study explores four models of partnerships that governments can use to spin in technology—in other words, four “investment strategies”—and then outlines the core capabilities organizations need as part of a government venturing model.

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## WHAT'S DRIVING SPIN-INS?

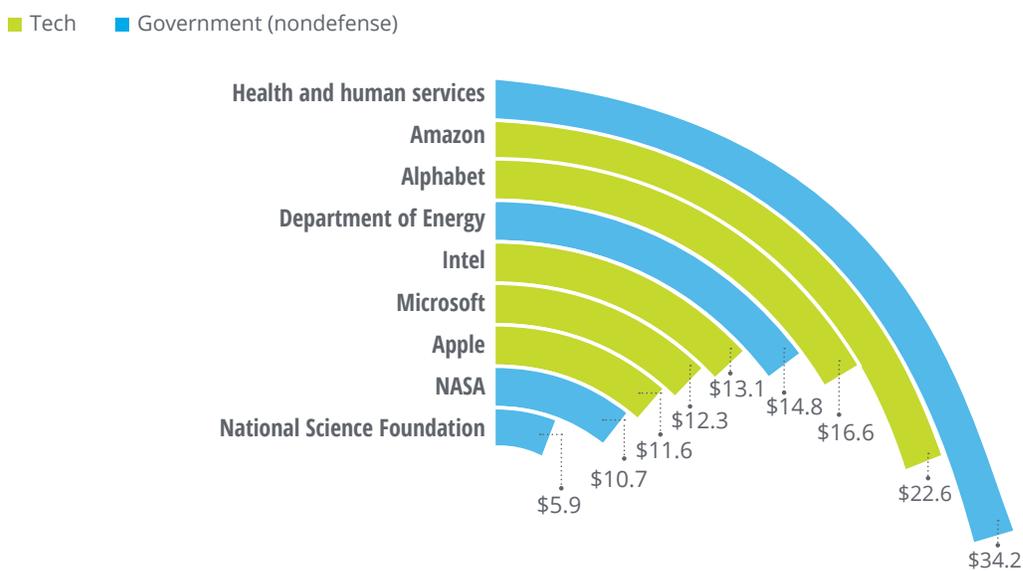
Digital technologies and business models are redefining industry structure and dynamics. As commercial companies race to respond and create competitive advantage, three dynamics make it both particularly hard for organizations to simply invent or copy what they need—and particularly important to bring external capabilities in.

- **Greater investment in innovation.** Investing in technology earlier in the commercial cycle offers companies enduring advantage—and speeding the “lab-to-street” part of the cycle. Companies are placing bets further upstream to capitalize on intellectual property, notes economist Mariana Mazzucato.<sup>8</sup> This trend is also reflected in the growing R&D spend of leading companies: the top five “big tech” firms now *each* spend as much on R&D as NASA or the Department of Energy<sup>9</sup> (see figure 1).
- **Greater distribution of innovation.** The startup economy creates a greater number of smaller players and products that may be relevant to an organization. These new entrants can often take bigger, riskier bets, which attracts capital looking for outsized returns—with 2018 proving a record year for the global VC market.<sup>10</sup> In response, the supply of new ideas and founders continues to proliferate.
- **Broader sources of innovation.** At the same time, innovation is becoming more multidisciplinary. The diversity of innovation in fields from internet security to genetic editing offers greater opportunity to engineer breakthrough solutions from the convergence of multiple domains—in fact, research suggests that the most-cited papers are increasingly those with interdisciplinary collaboration.<sup>11</sup>

Many organizations are not designed for this operating context: Traditional R&D does not do a good job surfacing threats, often neglecting disruptive advances outside the company.<sup>12</sup> Emerging and evolving solutions also create high levels of change over the traditional R&D life cycle, which drives up total cost. To stay at market speed, R&D models involving painful gestation periods are beginning to yield to models designed to keep pace with rapid external developments in science and technology.

FIGURE 1

### Big tech firms now spend as much as government organizations on R&D



Note: All dollar amounts are in US\$ (billions); taken from FY2017 data sets.  
Sources: FactSet; graphic adapted from ReCode; government data from Congressional Research Service (CRS).

# Four strategies for spinning in

IN MANY WAYS, the government venturing model represents an evolution in public-private partnerships. PPPs traditionally focused on private provision of public goods, asking, “Who can distribute this most efficiently?” The next wave—which one of us termed “the solution revolution” in a Harvard Business Review Press book—focuses on outcomes, asking, “Who else is already working to address this societal challenge, and how does my initiative fit into the ecosystem and accelerate existing efforts?”<sup>13</sup>

By contrast, a government venturing model asks: “Are there others *not* focused on my problems who have assets or capabilities that could accelerate or help? And how do I engage them?”

To do so, public sector organizations should develop investment strategies that attract players with relevant assets or capabilities by creating

mutual advantage. In some cases, government may look to “hard” assets such as financing that traditionally underpin PPPs, but it should also tap into “soft” assets such as access to complex environments for early-stage testing, relief from existing regulations, and credibility and brand signaling that can

attract additional investors.

Attracting players to these opportunities, however, likely depends more on how the partnership is set up—and government should tailor the investment based on two features that make these players different: the *nature* of the capability they offer (whether more a product or a platform<sup>14</sup>), and maturity of the capability (how developed or new it is).

The interplay of these factors points to four models government can use to spin in key capabilities: **industrial base**, **accelerator**, **strategic partner**, and **open architecture** (figure 2).

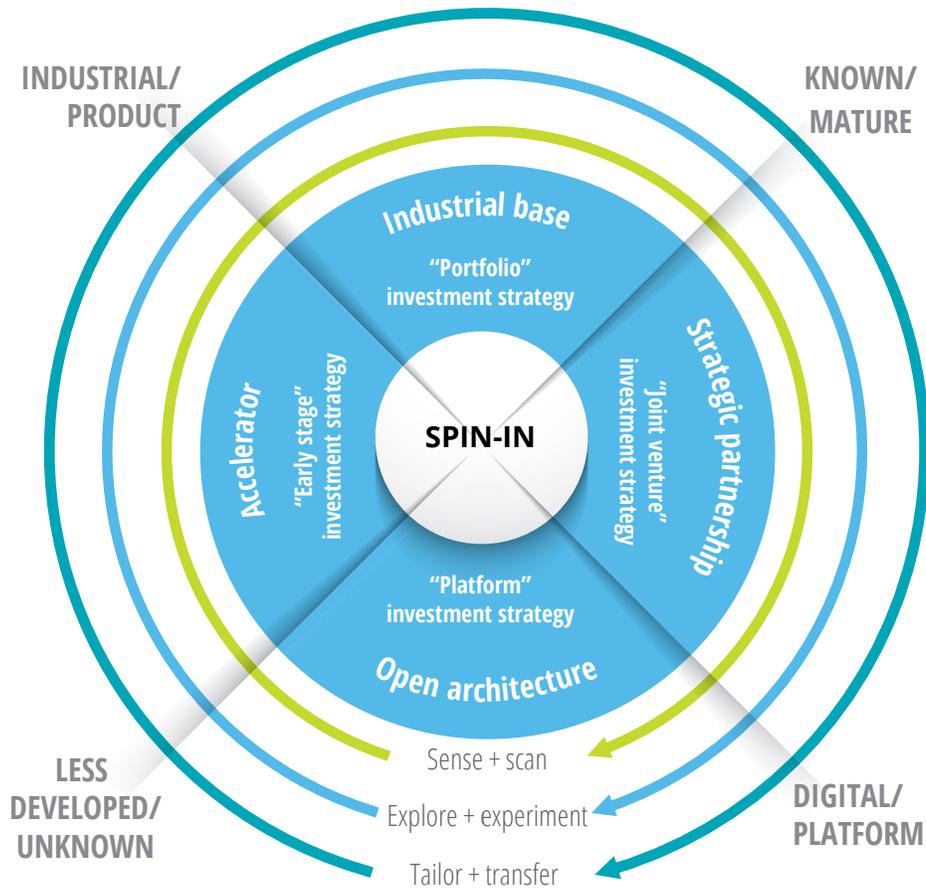
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FIGURE 2

**Government can use four spin-in models for external innovation**

Spinning in asks organizations to adapt partnership models *and* develop dedicated functions to sense and scan, explore and experiment, or tailor and transfer



Source: Deloitte analysis.

**Industrial base: “Portfolio” investment strategy**

As soldiers met evolving threats in Iraq and Afghanistan, the Joint Improvised-Threat Defeat Organization (JIDO) needed a way to tap into a trusted group with ready solutions to counter new

types of improvised explosive devices (IEDs)—and to do it quickly and often.<sup>15</sup> By continuously scanning for the latest commercial capabilities, JIDO finds partners to help stay ahead of adversaries<sup>16</sup>—creating new technologies to counter threats from armed drones, for example<sup>17</sup>—and uses rapid acquisition authorities to get them to the frontline soon.

**Building a diverse set of suppliers like JIDO’s commercial partners is an example of an “industrial base” partnership—one variant of a broader “portfolio” investment strategy, which can be used to source products whose usage is well understood.** Commercially described as a “direct” investment strategy—designed to advance the strategy and operation of the current business<sup>18</sup>—it engages external partners as a way to diversify

production risk and gain outside perspective to reduce “disruption risk.” A commercial example is Pfizer shifting funding from its neuroscience R&D to its venture group—gaining valuable insight into new therapies and diversifying its pipeline in a fast-moving and uncertain field.<sup>19</sup>

The US Department of Defense has long relied on a large industrial base to efficiently supply military equipment—what’s important today is to broaden the base to include nontraditional players and startups to accelerate innovation. “The companies that serve the armed forces cannot produce innovations fast enough, and the often-smaller companies that excel at innovation are not focused on defense,” says Steve Blank and Pete Newell, creators of Hacking for Defense.<sup>20</sup>

To sustain the portfolio, government can use two mechanisms: innovative acquisition approaches and venture funding arms.

**Innovative acquisitions.** While new vehicles alone will likely not attract new players (as the aforementioned GAO report suggests), tailoring procurement mechanisms to companies’ growth trajectory could make government a more sought-after partner. The ability to solidify a short-term revenue pipeline can allow startups to focus on product build-out, for example, rather than having to spend as much time on sales. The US Air Force tested this hypothesis in what might be the most rapid contracting process to date, awarding pilot contracts within a day. Using a process that looked

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more like that of startup investors, the Air Force team vetted solutions based on 15-minute pitches, and as a result, attracted a novel company profile: over half of awardees had not worked with the US government before.<sup>21</sup>

NASA has also been an early leader in using innovative procurement strategies to seed the commercial space industry—and scale and sustain companies that help the agency deliver supplies to the International Space Station or to support craft that operate in low Earth orbit. By offering SBIR grants to small companies that are rich in new ideas but short on resources, the initiative has helped to create a commercial space economy predicted to grow to more than US\$1 trillion in value over the next two decades.<sup>22</sup>

**Venture funding.** In other cases, a solution may not yet be ready to deploy or test in a specific mission area; here, governments can use traditional venture funding to maintain access to strategically valuable technology until they can find a foothold in the market. This scenario is the classic value proposition for In-Q-Tel: The organization provides startups capital and access to frontline users in return for equity and technology. More recently, the US Department of Health and Human Services Biomedical Advanced Research and Development Authority launched the Division of Innovation, Research, and Ventures to identify promising health security solutions, and then invest in these companies as part of a PPP.<sup>23</sup>

## Accelerators: “Early-stage” investment strategy

Historically, food aid as a category has been particularly vulnerable to corruption. Humanitarian agencies need to ensure that aid reaches the hands of those who need it the most—this is particularly difficult in conflict situations.<sup>24</sup>

**The World Food Programme is not out to invent new technologies. We are out to adapt things that we see going on elsewhere for the benefit of the people that we serve.**

—Robert Opp, director of innovation

So when WFP sought a more secure way to track aid distribution, it turned to a nontraditional source: its in-house Innovation Accelerator, which uses new technologies to improve food security. “The World Food Programme is not out to invent new technologies. We are out to adapt things that we see going on elsewhere for the benefit of the people that we serve,” says Director of Innovation Robert Opp.<sup>25</sup> The model is based on startup accelerator Y-Combinator, which invests US\$150,000 in each startup selected (alumni include Airbnb, Dropbox, and Stripe) and then spends three months working with the startup to refine its product and attract additional investors. Similarly, WFP awards up to US\$100,000 to build out proofs-of-concept for promising ideas—what Opp refers to as “scale-ups”—to a point where they can qualify for outside funding.<sup>26</sup>

To improve cash transfers to refugees, the accelerator prototyped a blockchain-powered transfer system in Pakistan’s Sindh province—and is now testing an updated version that includes retinal scanning at refugee camps in Jordan.<sup>27</sup>

**Accelerators offer an early-stage investment strategy, providing resources to startups with less mature products to further develop a promising capability.** They speed up innovation by offering access to customer insights, sector or category expertise, and real-world environments or assets. Like WFP’s Accelerator, these short-stint programs can help to position the startup for later funding rounds by providing the resources, experience, and mentoring to help commercialize the technology.

And by providing these assets, government gets hands-on experience with cutting-edge technologies for a fraction of the cost

of acquisition. WFP originally built the accelerator in response to former executive director Ertharin Cousin’s concern that they were not taking advantage of emerging technologies and platforms—as Opp recalls, “She would travel around the world and see AI and blockchain and IoT, and come back to headquarters and say, ‘okay, what are we doing about this?’”<sup>28</sup> Now, the Accelerator is experimenting with digital market places for smallholder farmers, hydroponic farming in refugee camps, and AI-based image recognition to diagnose malnutrition.<sup>29</sup>

**Partnering with existing accelerators.** Government can also get many of these benefits by partnering with existing accelerators. In fact, such partnering may not only allow government to use this strategy sooner but also more quickly attract startup interest; it can be tough to recruit startups initially, since they usually shy away from programs that lack an extensive commercial network.<sup>30</sup> ENGAGE in Atlanta offers a corporate analog, where corporations fund and work with the accelerator in a “shared services” model, giving startups a range of use cases to test as they consider possible paths to profit.<sup>31</sup>

The US Department of Defense (DoD) has pioneered several similar accelerator partnerships: the Air Force Research Laboratory’s (AFRL’s) partnership with ABQid in Albuquerque, Army Futures Command’s partnership with Capital Factory in Austin, or the MD5 and AFWerx collaboration with TechStars. “Traditional technology transfer is about getting ideas out of the AFRL and into the marketplace, but this is the other way around,” says ABQid executive T.J. Cook. “We want to build AFRL awareness about new, privately built technologies that the Air Force could benefit from.”<sup>32</sup>

And it goes beyond defense: The US Department of Agriculture’s (USDA’s) National Institute of Food and Agriculture funds AgLaunch, an external accelerator for high-tech, precision agriculture startups. It offers a ready base of farms where agtech startups can test their product and get feedback from producers—helping to speed the maturity of agriculture technology.<sup>33</sup>

**Sandboxes.** One specific variant of accelerators is “sandboxes”—controlled environments to test new technologies or business models, often relaxing current regulations. In the fintech arena alone, Deloitte has identified more than three dozen regulatory sandboxes globally.<sup>34</sup>

Autonomous transportation has also spawned several testbeds, such as Michigan’s MCity,<sup>35</sup> in situations where large-scale deployment would be dangerous but controlled experiments can yield useful insights for both companies and regulators. The Federal Aviation Administration, for example, granted temporary waivers to release 10 sites from drone flight restrictions such as flying at night or beyond line of sight of operators, allowing companies to test applications including medical equipment delivery, monitoring oil pipelines, and scanning the perimeter of an airport.<sup>36</sup>

## Strategic partnerships: “Joint venture” investment strategy

To provide humanitarian aid in underbanked regions, the United Nations (UN) has to set up

infrastructure for tracking and management—at significant cost and effort. To tackle this problem, the UN teamed up with an unlikely partner: Mastercard.

It turns out that credit card companies have core capabilities that are helpful in aid disbursement: fraud detection, electronic tracking, digital infrastructure, and even marketing. Mastercard’s collaboration with the UN helps it to monitor distribution of welfare grants using a smart card processed by a card reader that can be tethered to an Android device—replacing the manual processes used by local merchants to reconcile transactions.<sup>37</sup> What is in it for Mastercard? An increase in brand equity, a chance to prototype new technologies, and an opportunity to expand into developing countries—potentially reaching 500 million new customers.<sup>38</sup>

**When commercial assets are mature platforms—making them harder to simply procure—strategic partnerships create the public equivalent of a “joint venture,” capitalizing on areas where business and social incentives align.** “When we talk about startup-driven innovation, we think of it as large organizations adopting practices that make startups successful. One of the practices is significant partnering—knowing who to partner with and how to develop these partnerships efficiently,” observes venture capitalist Evangelos Simoudis.<sup>39</sup>

And as in the case of Mastercard and the UN, these partnerships focus on solutions that benefit from consumer access or data. Domestically, several US cities have partnered with navigation app Waze to better understand traffic patterns, identify areas of congestion, and analyze modifications such as lane reductions or signal changes—all based on consumer-provided data, instead of sending out crews with traffic-counting equipment. Traffic engineers in one of these cities, Louisville, use the data to test whether the modifications work in real time.<sup>40</sup>

Similarly, producer data from the Farmers Business Network (FBN) might reduce the cost of studies for USDA researchers, and provide more recent and frequent data on US agricultural production for pol-

icymakers. Or a government agency could team up with one of the companies that specialize in genome testing: With millions of customers, these companies have a large amount of data on human genetics. With appropriate privacy controls, the data sets could be instrumental in facilitating medical research and advances—particularly for diseases with small populations or for which it has been hard to design studies.<sup>41</sup>

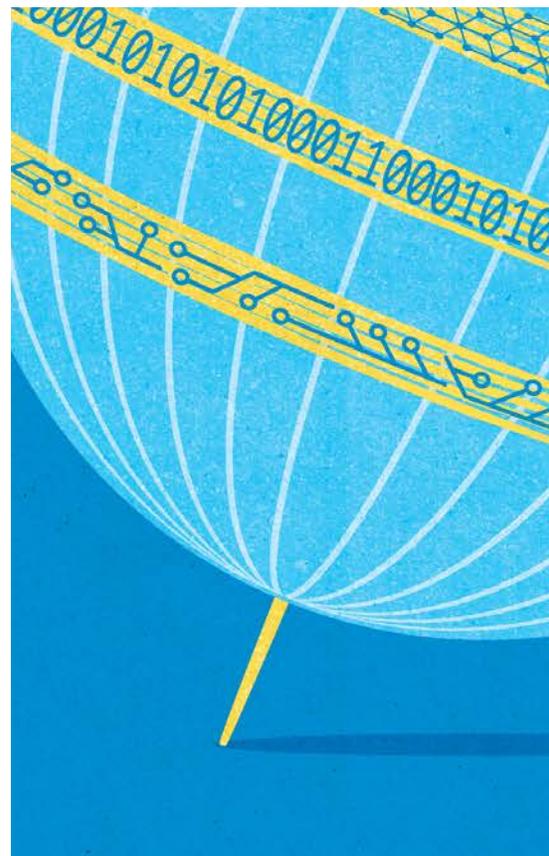
The Federal Bureau of Investigation (FBI), meanwhile, has been exploring the use of Amazon’s facial recognition software, whose machine learning algorithms improve based on access to a broad set of consumer training data. After a mass shooting, for example, the FBI pieces together the last weeks or months of the shooter’s movements from scores of camera footage. The FBI said that after the Las Vegas shooting in 2017, analyzing a petabyte of video footage of the days leading up to the event took three weeks, running “24/7, eight people per shift”—but it takes facial recognition software only 24 hours.<sup>42</sup>

## Open architecture: “Platform” investment strategy

The health sector is a data-rich landscape, with inputs as diverse as genomic data, electronic health records, clinical trial data, and patient-generated data from wearables or mobile apps. Much of this data, however, exists in silos due to privacy concerns, competitive fears, or interoperability challenges. To break these silos, the US National Institute of Health (NIH) launched the NIH Data Commons, a

cloud-based platform where investigators can store, share, access, and experiment with digital objects generated from biomedical research—thereby speeding hypothesis generation and validation. The Data Commons initiative is now in a pilot phase, using three high-value data sets as test cases for the principles, policies, processes, and architectures to be developed.<sup>43</sup>

Similarly, the US Food and Drug Administration (FDA) is beginning to integrate “real-world evidence” into its evaluations—not just data from



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a controlled FDA trial but also ongoing evidence about the effectiveness of treatments. For example, the next generation of the National Evaluation System for Health Technology, which regulates medical devices, will include data from clinical registries, electronic health records, and medical billing claims.<sup>44</sup>

Collectively part of a movement toward “open science,” **these initiatives illustrate the fourth investment strategy governments can use to spin in new capabilities: a “platform” investment strategy.** In the commercial space, Slack Fund offers one such example of a corporate venture fund’s effort, creating an US\$80 million fund to seed development of services on the Slack platform, which attract and retain users (from which Slack gains additional value).<sup>45</sup> Similarly, a public sector platform strategy makes investments in structures that increase the underlying value of the broader system—what the United Kingdom’s Nesta Innovation Foundation describes as “government as impresario,” enabling data-sharing and innovation in more nascent areas.<sup>46</sup>

“It’s hard to collaborate or innovate without common platforms, and government has a role in creating the context and ability to innovate,” says Brookings Metropolitan Policy Fellow Adie Tomer.<sup>47</sup>

Indeed, data about user satisfaction, technical performance, and interactions allows tech companies to thrive; what if cities, which have an enormous user base but fewer ways to check their pulse, had a platform for the same kinds of data?

Cities can help orchestrate the platforms that use IoT data to make smart cities a reality. Mobility-as-a-service creates this kind of integration in smart transportation systems—such as the one in Cascais, Portugal, which brings in data from telecom companies, other municipalities, and multiple modes of transit.<sup>48</sup> The system is expanding to include a single-payment platform, to ease operability between these services.

Aggregating this data will involve partnerships with both private app providers as well as public data sources. But it will also create the context for greater private sector innovation—making it easier for new players to surface insights about civic needs, and then facilitate the integration of these solutions within the broader system.

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# Organizational capabilities: Adopting the venture capital playbook

**T**O REALIZE THE full value of spin-in strategies, organizations also require specialized capabilities—a new “playbook.” Government agencies today are largely set up to efficiently manage known problems, and they should consider what new behaviors and functions it will take to adapt to new opportunities.<sup>49</sup>

Government “needs to train program managers and leaders on how to work with industry—fundamentally it boils down to the organizational behavior, the culture, and methods by which government people are taught to engage with ‘outsiders,’” says Jackie Space, founder of BMNT, an organization that specializes in “hardwiring organizations to rapidly solve problems.”<sup>50</sup>

So what capabilities are needed for a government function dedicated to external innovation? The core competencies of a venture capitalist can offer

a blueprint.<sup>51</sup> Venture capitalists define an “investment thesis,” identify where solutions can create value (“product-market fit”), and provide support to help the company scale (“market penetration”). A corresponding spin-in strategy for the public sector should build out three basic capabilities (see figure 3):

1. Sense + scan;
2. Explore + experiment;
3. Tailor + transfer<sup>52</sup>

Singapore’s National Security Coordination Secretariat, for example, has built its Risk Assessment and Horizon Scanning office around these core activities, through the RAHS Think Centre, RAHS Experimentation Centre, and RAHS Solutions Centre.<sup>53</sup>

FIGURE 3

## A public sector spin-in strategy comprises three core capabilities



Source: Deloitte analysis.

## Sense + scan: Investment thesis

To harness external innovation, leaders first need a pulse on what trends and technologies may reshape the future operating environment, in turn shaping their intuition and hypotheses. A general trend analysis is not enough—the research should focus on government operations and public services.

While new technologies may not be at full capacity, early applications can point to how the “core business” could evolve—and where spin-ins may help it do so. Organizations can generate such insights by developing disciplined mechanisms to *engage the ecosystem and track market maturity*.

**Engage the innovation ecosystem.** Leaders across government are increasingly recognizing and embracing the reality that the future is uncertain; in response, many government organizations already engage industry and gain context—most commonly through specific offices or programs, requests for information, or “industry days.” Some agencies have created offices of private sector engagement or strategic partnerships, have advisory boards such as the Defense Innovation Board, or host one-off summits on emerging topics. Others cross-pollinate by sending employees out and establishing talent-sharing arrangements such as industry tours.

However, fewer organizations have invested in capabilities for strategic foresight, horizon scanning, and technology scouting. Some model themselves on In-Q-Tel, which split the organization between offices in Washington, DC, focused on mission needs, and offices in the Bay Area focused on scouting and surfacing new solutions; examples include the National Geospatial Agency’s Silicon Valley outpost, or the recently launched Army Futures Command in Austin. “You almost need to be smashing into innovation ... you get into these wars of ideas, and you get better outcomes because it sharpens the rigor and helps garner better perspective,” says Army undersecretary Ryan McCarthy.<sup>54</sup>

**Monitor market signals and maturity.** To create discipline in identifying and responding to opportunities, government can mimic how asset

management firms track market insights. These firms create hypotheses about market conditions that signal when to engage, then monitor these metrics. Likewise, governments can define thresholds of pre-identified trend maturity and track signals to prompt action and experimentation.

The Department of Homeland Security’s Science and Technology (DHS S&T) group has adapted this investment-driven approach. Its mission areas are as diverse as cybersecurity, chemical defense, and disaster recovery. This diversity of applications makes it difficult to create best-in-class internal R&D for all mission areas—which prompted Congress to encourage greater engagement with small business and startup ventures with niche capabilities.<sup>55</sup> DHS S&T developed an office to track relevant news, research, patents, and companies—which has produced over 800 relevant alerts since 2017.

A dedicated sensing and scanning function can help government leaders identify the most relevant and ready technologies. Venture capitalist Evangelos Simoudis compares it to earthquake early-warning systems, where “presence gives a signal—and then you can decide on the right response.”<sup>56</sup> And as a result, a formal, ongoing capability such as the United Kingdom’s Horizon Scanning Programme<sup>57</sup> can shape a more informed research agenda or procurement strategy.

## Explore + experiment: Product-market fit

Once organizations identify a promising technology that has reached maturity, how do they apply it to their own mission?

**Define the use case.** Government agencies should explore and experiment with how they might use a new solution or technology—and build a disciplined process to do so. They can iteratively increase maturity by defining what is possible, what is practical, and then what is valuable. “You need to demonstrate what you’re trying to accomplish,” continues Simoudis in his overview of the playbook for externally driven corporate innovation. “Just

because you have a venture fund and just because you're willing to spend some money doesn't mean you become a value-add partner for a startup or group of startups." Starting with a technology or solution (what we've written about as push innovation) and then pinpointing a specific mission area—likely one that is underperforming or in need of step-function change—creates the context to define a clear use case, test case, and business case before adopting it more broadly across the enterprise.<sup>58</sup>

Inviting outside partners into the discovery process makes it easier to “codevelop” solutions that are both desirable for the user and practical to provide—and which break existing orthodoxies. Working with outside partners is a critical part of any spin-in strategy. NASA embeds personnel within engineering departments of companies such as Boeing and Space X to better understand their processes and what their equipment is capable of. “Working in close proximity with the private sector has caused a culture change at NASA,” says Phillip McAlister, director of commercial spaceflight development at NASA headquarters. “Collaboration has expanded the scope of ideas NASA is willing to consider; the agency now has a better appreciation for different possibilities.”<sup>59</sup>

For example, the DoD's technology accelerator program MD5 wanted to mitigate one impact of emerging technologies: adversaries in the Middle East buying commercial off-the-shelf drones and strapping grenades on them. They hosted a 48-hour workshop with “about 150 engineers, drone pilots, academics, entrepreneurs” and were able to develop 12 potential solutions.<sup>60</sup> The workshop is part of MD5's broader “collaboration” offering (see figure 4), designed to connect skilled innovators with the troops who would use the solutions—in other words, *explore*.

**Codevelop solution.** MD5 also offers the ability to mature and translate these capabilities through its “acceleration” portfolio, in which it partners with TechStars to experiment with ideas and turn prototypes into viable ventures.

Cities and local governments have embraced similar collaboration and discovery processes. San Francisco's Startup in Residence (STIR) program (part of the San Francisco Office of Civic Innovation), for example, selects and embeds small teams of tech entrepreneurs within government to help solve a specific challenge. The city benefits from outside solutions applied to its own issues, while

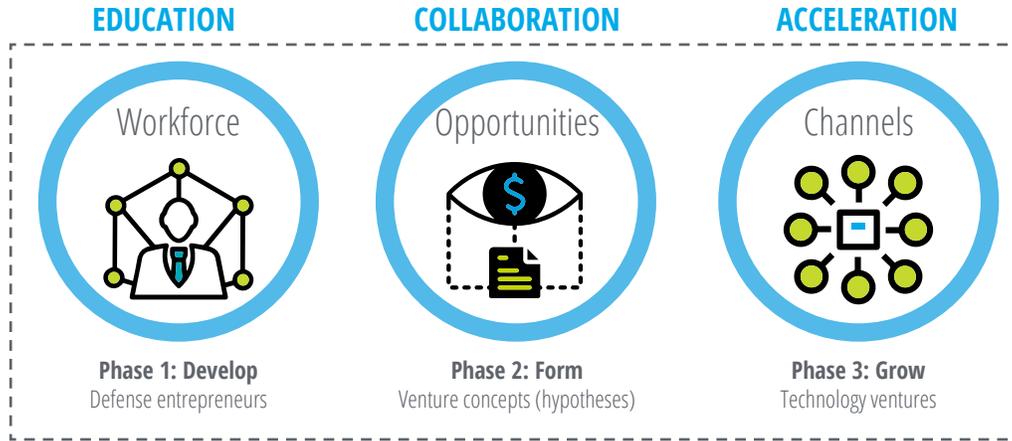
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the entrepreneurs get exposure to the public sector and a path toward a contract with an otherwise-complex government entity. Through STIR, the San Francisco International Airport got a navigation system for the blind, and the city's Human Services Agency was able to develop software for foster applications that helped reduce approval time by 50 percent and increase applications by 300 percent.<sup>61</sup>

New York City's Office of Technology and Innovation focuses specifically on offering testing environments, or “Co-Labs,” for startups looking to experiment. Co-Labs offer an opportunity to test new tools and technologies that address real-world challenges—working directly with community residents in neighborhoods such as Brownsville, a largely underserved community in Brooklyn. The program awards up to US\$25,000 to startups with winning proposals, but more importantly, it provides startups the opportunity to prove their solutions in a unique and tough environment.<sup>62</sup>

FIGURE 4

**MD5’s innovation model explores collaboration opportunities with external innovators**



Source: Deloitte analysis.

**Tailor + transfer:  
Market penetration**

Identifying promising solutions and testing them for mission advantage, however, only creates value if the solution can grow and scale in the enterprise. Just as venture capitalists draw on their experience as investors and operators to help new products realize the market potential (market penetration), government organizations should consider how they can help these new ideas get to the heart of the organization.

**Define the standard to match mission requirements.** Sometimes, this means creating the initial market for a new product and sharing some of the risk inherent in beta testing. After several rounds of testing and iteration, the company Made in Space made two gravity-neutral 3D printers, thanks to funding from a NASA SBIR grant. The company uses one commercially, and NASA uses the other.<sup>63</sup> Similarly, a mobile phone manufacturer partnered with the DoD to test a new, more secure identity authentication hardware for its devices. While the Pentagon already has super-secure devices, they’ve been too costly (upward of US\$4,500 per unit) to deploy beyond a handful of top officials. The new identification technology is

intended for the commercial market, but trials of early products are often risky. The phone company tested the behavioral biometrics system on 50 phones at the DoD for the initial deployment, giving them a government-funded beta test and giving the Pentagon cheaper secure phones.<sup>64</sup>

“Government users have some of the most sophisticated and intensive use cases in the world, and any startup’s product development process would benefit from lessons learned when deploying under such conditions,” says entrepreneur Joel Meyer, vice president of machine learning startup Predata.<sup>65</sup>

**Identifying promising solutions and testing them for mission advantage only creates value if the solution can grow and scale in the enterprise.**

**Find (and fund) a foothold.** Public sector organizations can also help tailor the product for more effective use through additional enhancement, testing, and hardening. Where commercial companies may sometimes acquire a startup at this point and more formally integrate it with the company, government organizations have to be more creative and strategic.

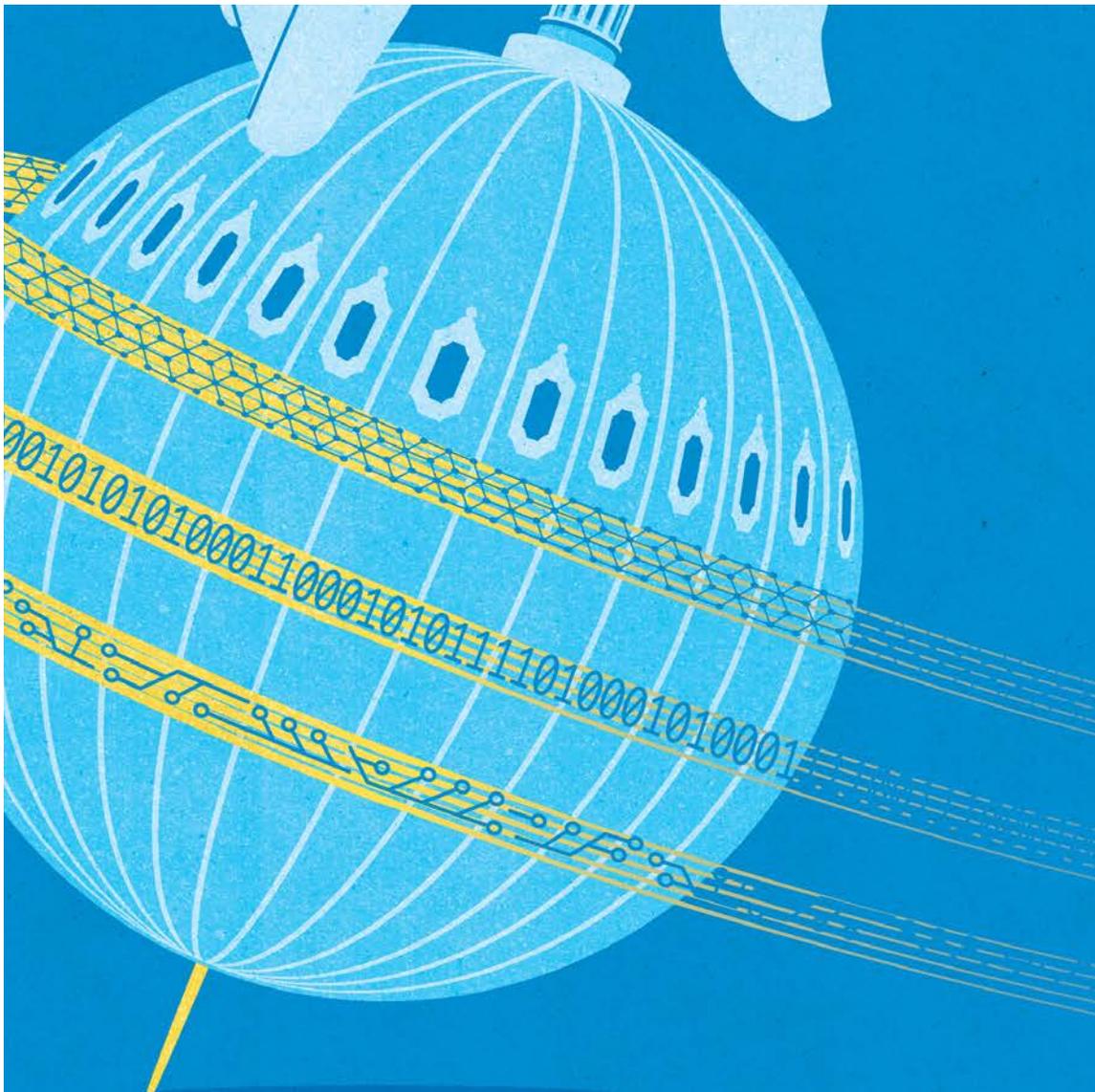
Sometimes this function can sit external to government, much like DCODE accelerator does for govtech startups, or the Government Effectiveness and Advanced Research Center that the US Office of Management and Budget has proposed to help

incubate startups to improve management. In other cases, it can be an explicit function—much like the DoD’s Defense Innovation Unit (DIU) within the defense innovation ecosystem. If MD5 is focused on collaboration and generating ideas for military use cases, DIU provides a vehicle to pilot more mature solutions with frontline users. Established in 2015, the DIU model has provided more than US\$226 million of nondilutive capital in the form of pilot contracts for relevant startups, offering a path for the companies to tailor their products and ramp up operations to meet the demand of traditional contracts.<sup>66</sup>

# Spinning in, speeding up

**I**N A RAPIDLY evolving operating environment being redefined by technology, government must keep pace—or risk mission-critical consequences. The diversity of innovation necessarily demands diversifying R&D—spreading across more suppliers, taking a wider range of bets, and infusing new capa-

bilities mid-stream. Public sector organizations can learn from venture capital to diversity and evolve investment strategies to “spin in” these new capabilities, and then creating dedicated mechanisms to scan, adapt, and scale these investments.



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## Acknowledgments

Several colleagues helped to shape this report through their review and research support. In particular, the authors would first and foremost like to thank **Neha Malik** from the Deloitte Center for Government Insights, the chief researcher of the study. We would also like to thank **Jesse Goldhammer, Mike Isman, Mark White, Alan Holden**, all of Deloitte Consulting LLP, and **Joe Mariani** of Deloitte Services LP for their thoughtful input and perspectives. The authors would also like to recognize the research contributions of **Ryan Gatti, Gabi D’Agosto**, and **Dave Geyer** of Deloitte Consulting LLP.

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