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**A Strategic Investor:
Federal Equity Investing Approaches to Advance
National Security**

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A Strategic Investor: Federal Equity Investing Approaches to Advance National Security

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Abstract

The U.S. government has begun purchasing equity in private companies as a tool for advancing national security. This approach can be appropriate for a narrowly scoped set of conditions: gaps in the capital markets for investments requiring large volumes of capital, with high levels of risk, for which debt is inappropriate, and the need to govern firms in sensitive industries where existing control mechanisms are insufficiently robust.

This complex and powerful form of industrial policy is unfamiliar to most national security professionals. Yet, if government equity activities continue to expand, the acquisition workforce will increasingly encounter these instruments. This paper argues that although equity investing can advance national security, the risks are also acute, and managing those risks will require a major investment in training, governance, and control mechanisms.

Introduction: The Potential Role of Government Equity Investing

There is growing interest by national security leaders and policy-makers in industrial policy tools that can expand domestic industrial capacity, control supply chain risks, and shape the global economic landscape in strategic sectors such as semiconductors, critical minerals/materials, advanced manufacturing, and defense-unique supply chains. At the same time, there is increasing recognition that America’s strong, deep, and sophisticated capital markets can contribute to national security if appropriately engaged.

Government equity investing—that is, direct ownership stakes in companies by the U.S. federal government—has emerged as one potential tool to help achieve these goals. Recently executed examples of government-involved equity transactions include Intel Corporation (electronics), MP Materials (rare earth minerals and magnets), and U.S. Steel (steel production).

Empirical research suggests the existence of a gap in capital markets for high-risk, capital-intensive scale-up projects, such as “first-of-a-kind” manufacturing centers—even when expected return on investment (ROI) is high (Institute for Security and Technology, 2025). These investments, which can require hundreds of millions or even billions of dollars, are often the logical next step for growing companies after the proof-of-concept or pilot stage, after they have outgrown venture capital or the Small Business Innovation Research (SBIR) program.

One reason for this gap is that debt markets, which commonly invest in capital-intensive industries, typically make lending decisions based on credit risk (default risk), rather than expected value of a positive ROI. Underwriting by expected value has been shown in the academic economics literature to be challenging or even impossible for lenders due to adverse selection effects that emerge when lenders raise rates to compensate for risk (Stiglitz & Weiss, 1981).

The result is an investment “valley of death” for certain projects which are ROI-positive but have a high risk of default. Many strategic projects fall into this category—especially new manufacturing projects. In this setting, government equity may be more effective at providing



the necessary “patient capital” than the private capital markets or government-sponsored loans, loan guarantees, or other debt-based industrial policy mechanisms.

Another advantage of equity is the wide range of governance mechanisms it can provide to shareholders, including voting rights, information rights, and covenants. These mechanisms may be more comprehensive than other control mechanisms like the Committee on Foreign Investment in the United States (CFIUS).

From a federal fiscal health perspective, equity can be balance-sheet neutral for the taxpayer, with a potential ROI when compared with mechanisms like grants and contracts. Especially when financing a major industrial scale-up effort—which may cost billions of dollars—grants and contracts could more rapidly strain the federal budget.

Defining Equity Investing

“Equity” refers to a family of investment securities that have shared features. Among these features is the ability to receive a share of future profits, or upside, from a firm. Common types of equity include preferred stock, convertible notes, warrants, and common stock. Each of these securities constitutes a legal contract between the security owner and the firm and confers a distinct bundle of rights and obligations that can affect a company’s incentives and governance over time. These factors must be negotiated and then enshrined in a set of legally binding documents, typically some combination of an investment agreement, a corporate charter amendment, stockholders agreement, a contingent proxy, and employee rights and confidentiality agreements (Sherman, 2012).

Some of the commonly defined rights and obligations include the following:

- **Economic Rights:** Equity holders typically obtain some form of economic rights, commonly in the form of financial upside from company profitability (i.e., residual claimant rights). Other economic rights include dividend payments from the company, and prioritization or “seniority” in financial payouts (i.e., liquidation preferences).
- **Control Rights:** Equity holders often gain the ability to vote as part of corporate governance. This governance role typically provides either a seat on the board of directors or a vote in board seat elections. Governance rights include veto rights over certain actions defined in the corporate charter (e.g., mergers and acquisitions [M&A] activity) and the ability to amend the corporate charter. Of particular importance to national security, equity holders can obtain veto rights over M&A and intellectual property dispositions, which can help address adversarial capital concerns.
- **Information Rights:** As owners of a firm, equity holders also gain access to critical, often confidential, company information pertaining to financial and operational performance. This information is typically shared to assist shareholders with conducting corporate governance (e.g., voting on key questions).
- **Transfer Restrictions:** Equity agreements often create limitations on who can buy shares or control the company later. Terms such as anti-dilution or “ratchet” clauses can be used to restrict future actions by the company that might reduce a shareholder’s rights to economic upside or other rights.
- **Enforcement Rights:** Clawbacks, step-in rights, and affirmative or negative covenants create ongoing requirements in areas such as compensation, accounting practices, leadership requirements, and many others. Of particular importance to national security, equity holders may hold companies to pre-agreed cybersecurity and other security requirements.



In the private sector, the bundle of rights corresponding to each equity transaction is negotiable. As the Pentagon participates more in equity markets, it will be required to thoughtfully negotiate the terms of each transaction to ensure the rights it obtains are optimal for the specific goals it aims to achieve in each deal.

In practice, equity transactions can be grouped into categories that share similar features:

- **Preferred Stock:** Typically have priority to common stock in payback. Preferred shareowners often have more control rights (e.g., board seats), translating to greater influence over strategic decisions such as M&A and intellectual property (IP) disposition.
- **Common Stock:** Equity with lower priority for payback compared to preferred shareholders. Common stockholders typically have privileges to vote for the board.
- **Warrants:** Securities that provide an option to purchase shares at a set price at a later date. This provides the potential for financial upside without control or information rights.
- **Convertible and Simple Agreement for Future Equity (SAFE) Structures:** Securities that provide options for future economic rights dependent on future conditions.
- **Controlling or Dual-Class Shares:** These unusual structures can be negotiated to include ongoing control and information rights without economic rights. At the extreme, governments can receive so-called “golden shares,” a term for an arrangement that provides complete control of companies by offering an automatic override in any decision put to a board for a vote (Thomson Reuters, 2026).

Current Department of Defense Approach to Equity Investing

The U.S. government has recently been piloting new approaches to acquiring company equity. As of 2026, the federal government has acquired equity in at least eight firms, including Intel, Westinghouse, and xLight (Murphy et al., 2024). The Department of Defense (DoD) specifically has sponsored equity-type transactions with at least five companies (Shivakumar et al., 2026):

- MP Materials
- Korea Zinc
- ReElement Technologies
- Trilogy Metals
- L3Harris

The government has used a range of authorities and funding types to transact equity investments, including Title III dollars and the purchase authority of the Defense Production Act (DPA). Specifically, the DPA’s purchase authority to expand the defense industrial base has been used to authorize purchases of shares (MP Materials, 2025).

In one recent example, the DoD acquired stock in MP Materials, a rare earth mine, refining, and magnet production company (DoD, 2025b). The MP Materials transaction illustrates how the government is combining demand guarantees, debt support, and equity-like instruments to pursue strategic industrial outcomes.



Case Study: MP Materials

In July 2025, MP Materials and the DoD entered into a multipart transaction involving equity to create a domestic rare earth mining and magnet production supply chain (MP Materials, 2025).

One component of this transaction was the provision of strong demand signals, in the form of offtake and price floor agreements, for finished and intermediate product from MP Materials. This near-guaranteed profit arrangement enabled the DoD's Office of Strategic Capital, as well as private investment banks, to syndicate over \$1 billion in debt in support of this transaction.

The DoD also received \$400 million in convertible preferred stock in MP Materials, as well as a warrant to purchase additional shares in the future. As disclosed in an 8K filing, the deal did not include voting rights, board seats, or other direct control mechanisms.

Based on publicly available disclosures, which may be incomplete, the transaction was negotiated to include several rights and obligations of relevance for national security. Covenants include binding requirements to construct or expand facilities involving mining, refining, chemical processing, and magnet manufacturing, at targeted activity levels. Additionally, there are numerous prohibitions against conducting business in prohibited jurisdictions, or with non-U.S. or prohibited persons. Examples of controlled activities include M&A, major asset sales, equity transactions, and magnet sales.

If these covenants are violated, the Department can demand immediate payback of loans, seek damages, or terminate its offtake and purchase agreements.

The MP Materials deal demonstrates how equity-type arrangements can support key national security goals: in this case, domestic rare earth production capabilities. The transaction blended government demand signaling tactics, commercial-style debt and equity investments, as well as tailored control mechanisms. Used in combination, these mechanisms can support one another and shift risks and financial burdens to appropriate stakeholders.

However, transactions of this complexity also introduce risks, some of which are familiar, while others are new. The sections below examine those risks and the governance frameworks needed to manage them in this new setting.

Key Risks

Government purchases of equity-type instruments present a range of risks to the government, taxpayer, and warfighter. The U.S. acquisition workforce is acclimated to managing most of these risks in the course of normal acquisitions. However, because equity-type instruments can be highly complex, powerful, and valuable, many of these risks may manifest in a new or more profound manner. Moreover, the fact that equity investing exposes the government to financial losses, and opportunities to control private company decisions, creates novel challenges.

1. **Soft-Budget Constraints:** When the government becomes a shareholder of a firm, it can be incentivized to keep funding a weak firm to avoid realizing a loss on its invested capital or to avoid national security challenges. The concept of the soft-budget constraint was examined extensively by the Hungarian economist János Kornai, who noted that in communist Hungary, "chronic loss-makers among [government supported firms] were not allowed to fail. They were always bailed out with financial subsidies or other instruments" (Kornai et al., 2003).



Kornai noted that, in many cases, when important firms are outcompeted and begin to make losses, it can lead to “social unrest and political tension.” When the government owns firms, it may encounter scenarios where it is forced to choose among competing priorities, such as eliminating jobs, taking a financial loss, or promoting national security.

2. **Reduced Innovation:** When the government supports a company through equity investing, it may inadvertently suppress innovation among other companies. Through innovation, competing companies may generate alternative, or cheaper, products when compared to the subsidized firm. A subsidized incumbent, however, would be difficult to displace — particularly when soft-budget constraints might allow it to absorb losses that the private competitor could not. If innovative firms are outcompeted by subsidized firms, this would represent a stifling of private sector innovation.
3. **Crowding Out Effects:** The DoD’s equity investments depend on appropriated funds furnished by the U.S. Treasury. Such funds are derived either from taxation or debt issuance. Either of these activities removes capital from the economy that could otherwise be used for private investment. This phenomenon is known as the “crowding out” of private investment activity by the government. As a result, a government equity investment may come at the cost of a potential alternative investment.

A similar effect can occur in the labor market. The U.S. faces a shortage of skilled workers, such as engineers. If engineers are drawn into working for a firm that the DoD has invested in, those workers will be removed from other, potentially more productive opportunities. For example, if skilled engineers are hired to construct a domestic semiconductor fab, those workers become unavailable to work in other strategic industries, such as quantum computing.

4. **Workforce and Education Gaps:** Absent a skilled, expert team, the government risks paying too much, negotiating weak or inappropriate control rights, or failing to enforce conditions. In certain scenarios, the government could overpay for equity or unfairly compete with private investors.

When the DoD conducts equity investments, it must rely on the acquisition community to assemble and execute those deals—a community which is currently not typically trained in these techniques. Engaging with the relevant financial intermediaries, such as investment banks, and negotiating with companies requires a deep understanding of the typical business practices in the financial services industry, types of investment capital, legal aspects of investing, valuation techniques, and commercial accounting practices.

5. **Politicized Decision-Making:** After deals close, government personnel will be responsible for exercising equity rights received, such as information or control rights. If the government takes voting rights or board seats, a key risk is that the government may not be a competent board member, making sound decisions about corporate governance leading to profitability. The DoD generally lacks these skills in its acquisition workforce and faces barriers with hiring or training individuals that do.

Control rights provide the government with mechanisms to monitor and address risky behavior in companies such as adversarial acquisitions or sensitive IP disposal. The same rights can give shareholders significant influence over major corporate actions and, in some cases, indirect leverage over management’s day-to-day choices; this power can easily be abused or mismanaged when the government is a shareholder. As a shareholder, the government could be in a position to harm the business prospects of a company and undermine its purpose for obtaining equity in the first place.



6. **Mandate Creep:** When governments invest directly in firms, the funds can be used for a relatively wide range of activities compared to more constricted grants and contracts. Private investment firms typically develop explicit “fund mandates” that restrict investments to specific industries, firm types, or regions. In a government context, the mandate function may be subject to “mandate creep,” with changing purposes after a change in government (e.g., an election) or a perceived change in market conditions. As a result, it can be difficult to maintain accountability of government equity programs or to judge their success via predetermined metrics or other criteria.
7. **Potential Misappropriation of Public Resources:** Like all industrial interventions, such as grants, procurement, or credit enhancements, equity investments must be awarded through competitive processes and in line with procurement integrity standards. Because of the novelty and complexity of equity investing, as well as the challenges associated with setting clear success metrics and conducting oversight, these programs can be vulnerable to misappropriation.

Globally, there are many examples of abuse involving equity investing. For example, Malaysia’s 1MDB Sovereign Wealth Fund engaged in intensive equity-based industrial policy. A corruption investigation revealed that the program had outsourced significant elements of the investment activities to financial intermediaries, who were then able to misappropriate more than \$3.5 billion in taxpayer funds (Parliament of Malaysia, 2016).

Recommended Best Practices for Using Equity Mechanisms

The risks above create unusual scope for abuse and therefore require careful implementation of mechanisms to control risk. Fortunately, there are numerous well-designed programs, both in the private and public sectors, that can be drawn from. The following recommendations are designed to address one or more of the risks described above. This is not intended to be a comprehensive list of best practices. National security leaders, acquisition professionals, and policy-makers should consider opportunities to implement these tactics to control key risks.

1. **Workforce and Institutional Capability:** To successfully run an equity purchasing program, the government will need to staff its execution offices similarly to commercial investment offices. Key capacity requirements include:
 - a. **Deal underwriting:** conducting financial analysis (e.g., valuations, weighted average cost of capital) and negotiating securities transactions
 - b. **Portfolio monitoring:** reviewing company information, voting in board meetings, enforcing covenants
 - c. **Risk management:** performance tracking, concentration limits, high-risk negotiating (e.g., disposing of sensitive or strategic assets, moving production overseas)

To execute on a similar mission as part of the CHIPS program, the Department of Commerce recruited experienced investment professionals from companies like Goldman Sachs, KKR, and Blackstone (Vorland, 2025).

The Department may find it necessary to structure such a cell within a Federally Funded Research and Development Center or University Affiliated Research Center in order to provide the hiring and compensation structures necessary to access the relevant workforce. Of particular importance will be flexibility on work location, since most investment professionals are concentrated in large investment centers like New York City, instead of Washington, D.C. or other centers of government activity. Work-from-



home options, or physical offices in those financial centers will be essential to recruiting skilled personnel and for the mission.

2. **Minimally Intrusive Control Rights:** Controlling stakes, golden shares, or board seats should be exceptional tools used only with explicit statutory grounding and clear necessity. In many cases, security concerns about foreign influence are better addressed by non-equity tools such as
 - a. CFIUS enforcement and conditions
 - b. Export controls
 - c. Government contract supply chain requirements

When use of control mechanisms is deemed warranted, the DoD should be prepared to negotiate for minimally invasive control rights and remedies. Control rights must be implemented as a mechanism to either prevent or raise awareness when a narrow set of highly consequential activities take place, such as moving IP or production offshore. Rather than provide a blanket veto over company decisions, the DoD equity should instead aim to offer the government some degree of voice and visibility with respect to decisions that could negatively impact national security.

In general, the types of control rights and remedies that are commonly provided to private preferred equity holders may offer an appropriate template. Common control provisions for preferred equity holders include veto rights over M&A and IP dispositions, as well as covenants requiring high standards for security.

The 2025 MP Materials transaction illustrates this approach: the government received non-voting preferred equity and a warrant, with covenants (rather than voting rights) controlling for key risks such as foreign ownership, customer selection, and asset disposition.

These control mechanisms can also be further limited to specific time periods or geographic regions. Board observer seats, or mutually selected independent board members are also common mechanisms for shareholders to exercise influence in a balanced manner.

Since these terms are common in industry, they may also be perceived as less intrusive than other formulations—such as arrangements like golden shares.

3. **Oversight Mechanisms:** Equity investing has generally been carried out under the aegis of the DoD's industrial policy toolkit, such as Title III Fund (Harrell, 2025). The DoD currently collects information about its industrial policy activities via the National Defense Industrial Strategy, which reports on overall progress across several qualitative levels of effort for strengthening the industrial base, such as "onshoring critical production capacity." The DoD also reports in ad hoc briefings on its use of the DPA. The Office of Strategic Capital is required to submit an annual report.

Equity investments are powerful industrial policy actions with the potential to have broad effects on the economy and society. Proper oversight is required to provide accountability to Congress and transparency to the taxpayer. At the same time, Congress is not well-positioned to oversee day-to-day investment decision-making. Considerations that must be balanced include data privacy (including specific deal terms, as well as information provided to the government as part of company board reporting), ethical oversight, investment performance metrics, and other non-pecuniary performance metrics. The oversight mechanism should be designed to allow Congress to assess the financial performance and strategic impact of the DoD's equity



investments in a timely manner and to mandate timely reporting of urgent updates involving risk. Important information to be transmitted should include the following:

- a. **Financial Statements:** A balance sheet and other financial statements reflecting the financial performance of the government's equity positions. Data should include the current fair value of the DoD's equity portfolio and the amount paid for those assets.
- b. **Accounting/Scoring:** An explanation of how and when equity stakes are valued.
- c. **Fund Performance Metrics:** Relevant information on the activities and results of government equity investing activities (National Defense Authorization Act, 2025b). This could include default and recovery rates, private capital mobilized, and ROI.
- d. **Risk Management Considerations:** Portfolio concentration and performance against anticipated results.
- e. **Impact on DIB:** Impacts on small businesses (e.g., financial fragility metrics, supply chain resiliency impact), technology performance milestones, NAICS code, or investment locations.

This information could be provided to Congress across a range of form factors, such as a public annual report, a classified annual report, or in-person briefings. Congress should consider expanding these to include an "investment scorecard" for information on how equity investments are being managed across the DoD.

Ad hoc briefings may also be required if triggered by certain events (e.g., investments above some threshold size). For instance, the U.S. Development Finance Corporation (DFC) provides prenotification to the congressional foreign affairs committees if a deal over \$20 million is intended to be transacted (22 U.S.C. § 9656). Ad hoc briefings may also be helpful in scenarios involving the acquisition of majority ownership of firms, controlling stakes, or major breaches of covenants.

4. **Internal Governance:** Given the compliance and ethics risks outlined above, programs engaging in government equity investing will require thoughtful internal governance systems. Strong governance can protect the taxpayer from abuse and ensure satisfactory transparency about significant industrial policy decisions. Strong internal guardrails will be required to prevent misuse of authority and ensure accountability.

Among private investment firms, a critical governance role for equity investing is often the investment committee (IC). The purpose of this committee, often composed of senior investment professionals, is to ensure each investment is conducted in accordance with an agreed investment policy, such as the investment mandate (Miranda & Corcoran, 2026). For governance purposes, the committee provides a forum for making sound investment decisions, as well as a written record of how investment decisions were made.

In the private sector, a chief compliance officer (CCO) is typically considered a requirement for organizations conducting complex financial transactions. The Department of Justice's Evaluation of Corporate Compliance Programs (ECCP)—the authoritative guidance federal prosecutors use to assess compliance adequacy—calls for a designated CCO with genuine independence (defined partly as maintaining a separate line of reporting) from the deal teams they oversee (Department of Justice, 2024). A DoD equity program should designate a CCO, ombudsperson, or comparable official with a direct reporting line to senior leadership and sufficient resources for



ongoing monitoring. In addition, particularly for complex financial issues, a chief audit executive, which can provide a strong and thorough internal audit function and facilitate independent outside audits, is standard.

Another common approach is inspector general offices, independent oversight officials established across the federal government with authority to conduct audits, investigations, and evaluations of their host agency's programs and operations. The DFC created a dedicated Inspector General that conducts both audits (covering financial statements, cybersecurity, and payment integrity) and discretionary performance audits and reports regularly to Congress, the DFC Board of Directors, and DFC management (International Development Finance Corporation, 2026).

5. **Portfolio Risk Management and Exit Policy:** Among private investment firms, a range of sophisticated risk management tactics are used to prevent negative portfolio outcomes. Leading asset managers employ dedicated quantitative teams, proprietary models, and real-time monitoring systems to manage risks such as outsized losses, illiquidity, and overconcentration. Selected methodologies include
 - a. **Stress testing and scenario analysis:** Asset management firms often use stress testing to evaluate how well portfolios would perform under extreme but plausible scenarios, including financial crises or changing interest rates (Kenton, 2023). In the private sector, such stress testing is often required by law.
 - b. **Liquidity risk management:** Investment firms often use models of portfolio liquidity, such as “time to liquidation” or “market depth” to design portfolios (BlackRock Investment Institute, 2014). This may be relevant for government equity investments, which could concentrate in capital-intensive sectors. If an asset cannot be sold without significant value loss, exiting that asset may be painful for the owner, making continued support more likely.
 - c. **Concentration limits and exposure caps:** Investment firms often maintain “exposure limits” to prevent excessive investment in single companies, sectors, or regions (AssetVantage, 2026). Portfolio rebalancing may be required when exposure limits are reached.

In practice, the application of portfolio risk management mechanisms like these can involve complex mathematical analysis. Applying these methodologies in practice can require expertise as well as experience managing large portfolios of assets in related sectors. Managing the risk of an equity portfolio in accordance with industry best practices will require the development of a tailored risk-management approach by an expert team.

Conclusion

U.S. national security increasingly depends on economic and industrial resiliency. Where traditional acquisition tools struggle—supporting capital-intensive projects in sensitive industries—equity instruments may have a unique role.

However, equity investments also create novel opportunities for abuse by government due to their complexity, power, and challenging incentives. To take advantage of this tool, the DoD will need to invest in its own acquisition and oversight capabilities and implement proven best practices to control risks.



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