SBTC
Small Business Technology Council

SBTC Concerns with the House-Passed SBIR Reauthorization Bill (H.R. 5819)

√ SBTC companies are happy to see the House take action to reauthorize the Small Business Innovation Research (SBIR) Program. This important program has just been praised by the National Academy of Sciences in a landmark study.

√ Some of the changes in the program that the House bill would create are useful and appropriate, such as creating Advisory Committees and giving the SBIR outreach effort, through "FAST" and "Rural Outreach" more of a focus.

√ **But many changes in the House bill are troubling**. They would:

- Eliminate safeguards against abuse in the program.
- Undercut features of the program that the National Academy of Sciences has said are its basic scientific strengths.
- Dramatically shrink the number of companies in the program and the number of innovations funded.
- Shift SBIR away from meeting federal agency R&D needs and toward funding private investor technology priorities.

√ All in all, these changes would transform SBIR. Gone would be its successful history of providing a large and diverse portfolio of early-stage funding for small, technology-based companies addressing high-priority federal R&D needs.

√ Instead, SBIR would move dramatically toward a few big bets on later stage funding for projects that look highly profitable to private sector investors. Here's how:

AWARD SIZES

➢ H.R. 5819 **triples award sizes *without increasing funding for the Program***.

  - "Proof of concept" awards would shoot up from $100,000 to $300,000. Development awards would rocket from $750,000 to $2.2 million.
  - **The number of awards that agencies make will therefore inexorably drop**. This will force out many companies currently receiving SBIR awards or positioned to do so under current program practices. ***Under the new size of awards, there would be approximately 60%fewer awards and 60% fewer companies winning SBIR awards.***

- **I**n the past, when Congress increased SBIR award sizes, the overall size of the SBIR Program was increased by a like amount, to prevent the wholesale destruction of SBIR companies. H.R. 5819 does not take this step.

- At a time of intense global competition, this change would reduce the number of technologies that SBIR can deliver to the nation.

- This shrinkage of awardees runs directly contrary to the broader outreach that the bill seeks.

- **The taxpayer risk would sharply increase** because the portfolio risk would sharply increase. Rather than modestly funding many projects, SBIR would lavishly fund a few projects. R&D is inherently risky. The inevitable result of this shift toward "big bets" in the SBIR Program will be far more R&D dollars wasted and far fewer innovations ultimately developed.

- The shrinkage of Phase I "proof of concept" SBIR awards would be particularly damaging to the long-term health of the program, because it shrinks the pool of technologies eligible for development under Phase II. At present, only about 1 out of 16 Phase I's makes it to Phase II in many agencies. In time, the loss of Phase I's would grievously damage the entire SBIR Program.

➢ The award-size problem is worsened by another provision in the House bill that would let agencies ***exceed even the triple-size award caps***, more or less at will. This raises the prospect of even much larger awards, which could further decimate the number of awards and companies in the SBIR Program.

BYPASSING "PROOF OF CONCEPT"

➢ The House bill also would allow companies to ***bypass the key Phase I "proof of concept" safeguard*** and go directly to Phase II development awards. Companies would simply "persuade" agencies that they had "proven" their technology concepts. This provision is also very troubling.

- The principle of transparent, juried competitions for SBIR awards***, the scientific foundation of the Program*** for 25 years, would be ***eliminated***.

- ***Also eliminated*** would be the ***requirement to demonstrate "proof of concept"*** in a competitive environment, perhaps the single most important safeguard against waste, fraud and abuse in the SBIR Program.

- Thus, the risks of spending millions of SBIR dollars on ultimately unworkable technologies would be greatly increased.

- The process for acquiring Phase II development awards would be ***effectively reduced to "salesmanship" and lobbying***. Companies with Washington lobbyists and deep pockets would gain a huge advantage. Thus companies could win multi-million dollar SBIR awards based on having the best and most expensive lobbyists and "PR" rather than the best science.

- With the far higher Phase II awards that the bill would create, the incentives for such lobbying and public relations would increase enormously.

- Smaller companies will not succeed in this environment. Companies with access to deep pockets and political influence will. Ominously, other parts of H.R. 5819 bring more such companies into the SBIR Program.

LETTING COMPANIES INTO SBIR THAT ARE NOT SMALL BUSINESSES

➢ Despite much discussion on the issue over the past five years, H.R. 5819 still fails to respect the long-standing American legal standard for what constitutes a small business – that a company must be "independently owned and operated."

  - The bill would eliminate SBA's "affiliation rule" – a core principle of small business jurisprudence for over half a century. For the first time, companies that are in fact affiliates of other companies would be treated as though they were independent.

  - The bill would allow syndicates or consortia of venture capital companies to own a majority of an SBIR company, <u>even if the VC's themselves were large businesses or were ultimately owned by large businesses</u>.

  - VC's that are large businesses would be allowed to directly control 20% of SBIR companies. In many cases, this would be enough for the large VC's to gain ownership of the SBIR companies by gaining control of the consortias and syndicates through which VC's frequently operate.

  - **Ultimate ownership of SBIR companies also would become much harder to trace under the bill**. SBA has a long-standing requirement that a firm which owns a small business must itself be <u>owned by individuals</u>, or the acquired business will lose its designation as "small." <u>This requirement was created because of abuses in government contracting</u>. Companies claiming to be small turned out to be in fact owned by large businesses, through various ruses like shell companies and holding companies. The House bill's changes would re-introduce this danger by eliminating the key safeguard designed to prevent it.

  - **Put together the various pieces, and the "new" SBIR picture is not beautiful. (1) Large VC's with deep pockets, their true owners uncertain, are in it for the first time. (2) "Proof of concept" is no longer required. (3) Award sizes are virtually unlimited. Together these changes will transform SBIR. The program will move <u>away</u> from focusing on national R&D needs that would otherwise go unaddressed, and away from small Phase I start-ups. Instead, it will move <u>toward</u> bigger companies, and toward technologies that promise large, rapid payouts. In effect, SBIR will become a system of public subsidies for large VC's -- paying for innovations that the private sector would probably have funded anyway.**

FOREIGN-CONTROLLED COMPANIES

➢ The House bill also would allow valuable, taxpayer-funded SBIR technology to end up abroad. SBIR companies would have to be incorporated and domiciled in the U.S., but could be owned by foreign interests**.**

A Better Way

√ SBTC and its member companies stand ready to work with the Senate Small Business and Entrepreneurship Committee to craft an SBIR reauthorization bill that incorporates the recommendations of the NAS study and meets the needs of our country for broad and rapid technological innovation.

- We urge that the Senate maintain the award caps stipulated in S. 3778, the reauthorization bill that the Committee approved in the last Congress. These are: $150,000 for Phase I and $1.25 million for Phase II.

- We ask that the Senate keep the SBIR Program at roughly its same size, in terms of the number of participating companies. When award caps were last raised in 1992, Congress increasied the SBIR set-aside by a commensurate amount. We recommend that the set-aside be increased by ½ of 1% in 2009, to 3% -- a figure that both the House Small Business Committee and the House Science and Technology Committee agreed to -- and that in subsequent years the set-aside be raised by ½ of 1% annually until it reaches 5%.

  - At this level, SBIR would lose relatively few companies and technologies.

  - And at this level, the largest single pool of America's scientists and engineers – those working for small businesses – could be better tapped. **At present, small business accounts for only 4.1% of federal extramural R&D. More than 90% is awarded to large businesses, universities, and federal labs, each of which employs fewer scientists and engineers.**

- Such a change in the SBIR set-aside would not equate to a "cut" in any agency's R&D spending. The agencies' overall R&D budgets would be unchanged. Each agency would still determine its own research priorities, select its own topics for public solicitations, and make its own decisions about which R&D projects to fund. Not one dime would be "cut."

- SBTC also recommends that the Senate **maintain the integrity of the SBIR Program** by requiring:

  √ transparent and juried Phase I competitions prior to any Phase II awards,

  √ a reaffirmation of the "independently owned and operated" definition of a small business, and a reaffirmation of the requirement that SBIR companies be small under SBA standards – including all affiliates, subsidiaries, and ownership groups, and

  √ a continuation of the requirement that a firm owning an SBIR company must itself be owned by individuals.

SBTC, www.sbtc.org, the nation's largest association of small, technology-based companies in diverse fields, is proud to serve as the council organization of the National Small Business Association on technology issues. NSBA is the nation's oldest nonprofit advocacy organization for small business, serving more than 150,000 smaller companies throughout the United States. 21/05/08