



SBTC Action Alert - Urgent

1156 15th Street NW
Suite 1100
Washington, DC 20005-1755
202-785-4300
Fax: 202-872-8543
www.sbtc.org

January 2005

The U.S. Small Business Administration is accepting comments on proposed changes in the Small Business Innovation Research (SBIR) program. The changes would open up the SBIR program to broad access by venture capital companies. SBTC believes that these changes would prove detrimental to many SBIR companies, and to the SBIR program as a whole. Small companies need to make their views on this issue known to SBA by the close of the comment period on April 3, 2005.

In recent months, representatives of the venture capital and biotechnology industries have been pressing SBA and Congress to make a behind-the-scenes change in how the SBIR program works. They want venture capital firms that *do not qualify as small businesses* to be able to own SBIR companies – and then to allow the acquired companies to continue accessing SBIR funds.

The venture capital and biotech lobbyists first sought to have Congress make these changes **without any public hearings**. Thus far, Congress has held back – largely in response to the outpouring of opposition from the SBIR community.

In December, the Small Business Administration (SBA) published a notice that it will ***publicly*** consider the changes that the venture capital and biotech lobbyists are seeking¹. Small technology-based companies that participate in the SBIR program, or that plan to, should file their comments with SBA by April 3, 2005. See “How To Comment”, below.

SBA’s questions.

As of now, SBA permits venture capital companies of any size to hold minority positions in SBIR companies. Also, venture capital companies may hold controlling positions in SBIR companies, as long as the combined companies (including all subsidiaries and affiliates) are small by SBA standards – and are owned by individuals rather than larger companies or institutions.

At stake in this SBA public comment period is whether venture capital companies that are **large** by SBA standards, and/or are owned by companies or institutions **also will be allowed** to control SBIR companies.

Specifically, SBA wants to know whether allowing unlimited VC access to SBIR companies would:

¹ See the *Federal Register* of December 3, 2004, page 70197 to 70202, especially pages 70201-2.



- Shift the program toward lower-risk technologies that are closer to the market
- Increase the geographic concentration of the program (in states like California and Massachusetts, where VC's are most active)
- Change the profile of successful and unsuccessful SBIR companies
- Lead to calls for a further change in the SBIR rules -- allowing large institutions like universities to own SBIR companies, and/or
- Shift the SBIR program more toward multiple repeat award winners.

To comment on these questions, or any other aspect of venture capital company participation in the SBIR program, please use the contact information listed at the end of this document, under "How To Comment".

Background on the issue.

SBTC views. SBTC members have strongly voiced the view that allowing large venture capital firms to own early-stage SBIR companies amounts to letting big businesses into the SBIR program through the back door. Corporations like the Bank of America and Intel already operate their own venture capital companies. The changes that the VC and biotech lobbyists are seeking would allow such corporations to own over 50%, or control a majority of the Boards of Directors, of small companies in the SBIR program. Then these large companies could access SBIR contracts.

Once this is allowed, there would be nothing to stop other large corporations, such as IBM, Boeing, Lockheed Martin, Genetech, and large pharmaceutical firms, from forming venture capital companies for this explicit purpose. Soon SBIR companies would be competing with Fortune 500 corporations for the small SBIR share (2½%) of federal R&D dollars.

SBTC believes that this process would likely eliminate many of the companies now in the SBIR program.

It also could destroy the character of SBIR as a small business program. It would surely lead to accusations that the SBIR program was subsidizing Fortune 500 businesses as well as affluent venture capital companies. (Venture firms currently have more than \$84 billion in uninvested funds, according to the September 29, 2003 issue of *Business Week*).

Moreover, it would be likely to further concentrate SBIR awards in California and Massachusetts, where the VC's are most active, while draining awards away from other states.

All of these developments would devastate the political support for SBIR.

Venture capital companies unquestionably play a vital role in the world of small technology companies. They are welcome partners in commercializing innovations under Phase III of the SBIR program. But SBTC believes that they should NOT be

scooping up scarce federal R&D dollars for conceptual and development work. They and other large companies should focus on the other 97½% of federal R&D contracting, not the 2½% set aside for small business.

Although this prospective change would directly or indirectly affect all companies in the SBIR program, an early target of the venture capital and biotech lobbyists has been SBIR funding in the biotech field. That push has led to a difference of opinion within the biotech community. This dispute is instructive. It shows how the venture capital controversy would likely play out in other technology fields.

Views of small biotechnology companies. A number of small biotech companies are critical of the proposal to enlarge the VC role in the SBIR program.

In a comment letter to SBA, a group called the Coalition of Biotechnology Entrepreneurs notes:

“Venture capital investment in biotechnology—particularly over the last five years—has mainly been directed to a small number of companies engaged in relatively low-risk, late stage development of pharmaceuticals that address only the largest markets. Companies focused in fields such as vaccine development, gene therapy, bioinformatics, agbiotech, diagnostics, personalized medicine, biodefense, treatments for orphan diseases, research tools -- as well as high-risk or early stage technology development of any type -- have had virtually no access to institutional venture capital during this period. Clearly advancement of these and other technologies is critical from a public health and national security standpoint. When it does occur, first round biotech investing has concentrated heavily in those regions with a large base of life science oriented venture capitalists, such as the San Francisco and Boston regions. Thus, the SBIR program has and will continue to play an essential role in the survival and growth of early stage biotech companies especially those in markets not being served by the VC community.

Companies that are majority owned by venture capital firms that are controlled by large corporations or pension funds are not small businesses. These companies, though a critical part of the biotech industry, usually do not maintain a small company culture and lack the freedom to pursue technologies and markets that their large company owners do not want pursued. Thus these are not the type of companies that the SBIR program was created to support.”

Alternative views. An alternative view has been expressed by the segment of the biotechnology industry that includes the largest companies, including major pharmaceutical corporations. Representatives of this part of the biotech industry at times seem to be saying that companies without venture capital funding are unworthy of any SBIR support at all. For example, here is what a spokesman recently told the *Washington Business Journal*:

"Any company in the biotech or biomedical industry that is developing real products must access venture capital in order to succeed."

-- Morrie Ruffin, vice president of business development and emerging companies at the Biotechnology Industry Organization (BIO), quoted in *Washington Business Journal*, December 10-16, 2004, p. 28.

The accompanying article described the views of Mr. Ruffin's organization regarding those who oppose large venture capital company access to SBIR. Ruffin said these opponents include companies that have become "dependent" on SBIR "grants" and companies that have been turned down for venture capital funding because their business models aren't viable.

Regarding the whole question of bringing promising innovative research to the marketplace – what the SBIR program calls "commercialization" -- Ruffin stated: "The venture-backed firms are in the best position to do this."

How to comment.

You may submit comments on SBA's questions to the agency in any of the several ways listed below.

All comments should reference rulemaking number RIN 3245-AF22 and refer to "SBIR Size Standards for Venture Capital Companies".

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: restructure.sizestandards@sba.gov. Include RIN 3245-ZA02 in the subject line of the message.
- Fax: (202) 205-6930.
- Mail: Gary M. Jackson, Assistant Administrator for Size Standards, 409 Third Street, SW, Washington, DC 20416.
- Hand Delivery / Courier: Gary M. Jackson, Assistant Administrator for Size Standards, 409 Third Street, SW, Washington, DC 20416.

Upon receipt of a written request under the Freedom of Information Act, SBA will make available all public comments received.

Remember that the comment period closes on April 3, 2005.