

The Honorable David Wu, Chair
Subcommittee on Technology & Innovation
Science & Technology Committee

2321 Rayburn House Office Building
Washington, D.C. 20515
Fax: (202) 225-3895

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Dear Representative Wu:

The undersigned small business leaders wish to lend their voices to the call for reauthorizing the Small Business Innovation Research Program (SBIR) in a manner consistent with the needs of small businesses for whom the program was established. Doing so will best address our collective desire to restore the economic health of our nation, and to create the jobs and technologies that will allow us once again to be leaders around the world. We respectfully request that you do all in your power to ensure SBIR is reauthorized without weakening its greatest strength, namely seeding the high-risk/high-reward/early-stage research that leads to the breakthroughs and innovations most likely to accomplish these goals.

We applaud you for having invited the testimony of Jere Glover on behalf of the Small Business Technology Council. We remain concerned however over the suggestion that weakening the eligibility requirements on ownership might be somehow more palatable if restricted only to programs of the National Institutes of Health (NIH). We understand that there has been an unrelenting effort by some, the National Venture Capital Association (NVCA) and the Biotechnology Industry Organization (BIO) first among them, to reshape SBIR into their own vision, even to the detriment of the program itself if they fail to capture a share of the take.¹

We hope the inclusion of the SBTC in the April 23rd hearing indicates a new willingness to include small businesses themselves in the decision-making process. Because representation of some special interests (in particular the Venture Capital community) have in recent times been heard much more frequently and loudly than those of small businesses, we wish to contribute our comments on behalf of the vast majority of small businesses that are not backed or owned by Venture Capital.²

Despite the arguments from some quarters that most innovations arise from university and government labs,³ there is clear evidence that a larger proportion of economically-viable innovations derive from the labs, offices, spare rooms, and garages of small businesses than from university and government labs combined, more even than from large corporations.⁴ These latter three however take the lion's share of federal R&D dollars, while agencies routinely fail to meet benchmarks for small business procurements.⁵

With the President's stated commitment of 3% of GDP for research & development, a larger pool of funds should be available.⁶ We ask for your assistance in making sure that a fair percentage of these funds are used to support the efforts of our nation's greatest proven and reliable innovators, small businesses.

Fact is, if there were sufficient university and government positions to employ all the worthy researchers, and if those environments reliably supported the sort of out-of-the-box thinking that leads to innovations, there would be less need for the early-stage seed funding that SBIR provides researchers working outside of academia and government labs.⁷ It has become increasingly clear that private-sector backing for such research is in short supply.

The stated preference of venture capital investment is for the growth stage of companies, which better promises a rapid and significant return on investment.⁸ The current market has pushed investors even further away from early-stage development, toward sustaining their existing portfolios.⁹ The last thing we need is to shut off the one remaining opportunity available to outside researchers for early-stage high-risk/high-reward efforts.

If there must be changes to the SBA rules, to accommodate large venture capital majority-owned enterprises (which admittedly have their place in the general scheme of R&D in America, but not as part of small business programs), why not permit them to compete for R01s and R21s rather than R43/44s, matching them more fairly against institutions with similar resources, namely the university and government labs which some in the venture capital community claim provide the bulk of their researchers in any case.

To be clear in our recommendations, we specifically support:

- Preserving across all agencies the **SBIR eligibility rules requiring ownership by individuals**, thus retaining benefits for truly small businesses (about 75% of which employ fewer than 20),¹⁰ who not only most need the support for research that SBIR represents, because it is not elsewhere available through loans or investment, but who have proven themselves time and again as the most productive innovators¹¹ and the most prolific job creators¹² in America;
- Retaining **Phase I for small-scale feasibility studies**, and not allowing by-pass of Phase I;
- Ensuring that **in no case should the number of Phase I awards be reduced**, as for instance would happen if direct-to-Phase II awards were to be supported or if award sizes were raised without concurrently raising overall allocations.
- Requiring that all agencies (including the NIH) be permitted to **exceed established caps only with funds taken from resources supplemental to the SBIR/STTR allocation**;
- Strengthening SBIR by **increasing award sizes to reflect changes in cost of living** since award sizes were last adjusted, but **not weakening it by unnecessarily overinflating awards**. SBTC recommendations are to raise Phase I caps to \$150,000 and Phase II to \$1,000,000. Flexibility may be warranted in setting these caps, but we oppose the awarding of jumbo Phase II amounts in excess of \$2,000,000.
- The **increase of base allocations as a percentage of agencies' budgets** to more fairly reflect the contribution innovative small businesses make to our national economy. 38% of all scientists and engineers are employed by small businesses, outpacing their employment by large companies (27%) and universities (16%).¹³ Some, including administrators at the NIH, have argued that allocated percentages should not be raised, because increases to R&D budgets will necessarily benefit SBIR/STTR equally with other programs. But we have seen already, under the ARRA stimulus act, that these same detractors have forced through exclusions explicitly

targetting only SBIR/STTR elements from increases to agency budgets. Thus putting a lie to such “rising tide lifts all boats” arguments. The fairest and most cost-effective distribution of federal R&D dollars would follow the trail of job creation. Such a tack could justify an allocation of 38% to reflect the employment of scientists and engineers, or even 80% to reflect the contribution of net new jobs that small businesses provide. In that light, the SBTC recommendation of gradually doubling SBIR to 5% and tripling STTR to .9% of relevant agency's budgets is modest;

- **Facilitating the transition of SBIR-developed technologies from prototype to commercialization** through continuing existing programs (like the NSF Phase IIB and NIH continuation awards) and developing new ones, including ones funded from resources supplemental to the SBIR/STTR base allocations for the purpose of navigating the so-called “valley of death,” since the object of the program is not only to conduct research but to produce and deploy the innovations that result;
- Establishing **SBIR as a permanent program** of the federal budget;

We thank you for the time to consider our contributions, and would welcome your invitations to participate further in strengthening and sustaining SBIR now and in the future.

Respectfully,

Jonathan G. Secora Pearl, PhD
President
Perceptral
1436 Monroe Avenue
Racine, WI 53405

Dr. James R. Prudent
CEO
Centrose
802 Deming Way
Madison, WI 53717

Fred Patterson
President
The Commercialization Funding Coach, Inc.
6250 Rosewood Dr, Suite 2501
North Richland Hills, TX 76180

Edward Rapp
President
Flocel Inc.
4415 Euclid Ave. Suite 421
Cleveland, OH 44103

Dr. Douglas N. Arion
Hedberg Distinguished Professor of Entrepreneurial Studies, Carthage College, Kenosha, WI
President, Galileoscope LLC, Kenosha, WI
Senior Program Advisor, Center for Advanced Technology and Innovation, Racine, WI

Michael Sorensen
President
Simatra Modeling Technologies
75 5th St. NW, Ste. 214
Atlanta, GA 30308

Hani Kayyali
President
Cleveland Medical Devices Inc.
4415 Euclid Ave., Suite 400
Cleveland, OH 44103

Thomas M. Crabb (Tom)
President / CFO
Orbital Technologies Corporation
1212 Fourier Drive
Madison, WI 53717

Leslie J. Bowen
President
Materials Systems Inc.
543 Great Road
Littleton, MA 01460

Raman K. Mehra
CEO
Scientific Systems Co., Inc.
500 West Cummings Park, Suite 3000
Woburn, MA 01801

Jeffrey Gilling, CEO
Diamond-Roltran, LLC
Diamond Antenna and Microwave Corporation
59 Porter Road
Littleton, MA 01460

Dr. Alison Brown
President and CEO
NAVSYS Corporation
14960 Woodcarver Rd
Colorado Springs, CO 80921

Abraham Kovoov
Director
Kovogen, LLC
168 Long Wharf Drive
Mystic, CT 06355

Ray Zatorski
VP Engineering
Zatorski Coating Co., Inc.
77 Wopowog Road
East Hampton, CT 06424

Stanley Abkowitz
CEO
Dynamet Technology, Inc.
Eight A Street
Burlington, MA 01803

John Torinus
President
BizStarts Milwaukee
Milwaukee, WI

Kevin Burns
President
Precision Combustion, Inc.
410 Sackett Point Road
North Haven, CT 06473

Tatjana Zikov
President
NeuroWave Systems Inc.
2490 Lee Blvd., Suite 300
Cleveland Heights, OH 44118

David Mead, Ph.D.
CEO
Lucigen Corp.
2120 W Greenview Dr
Middleton WI 53562

James L. Grimsley
President/CEO
Design Intelligence Incorporated, LLC
350 David L Boren Blvd, Suite 1780
Norman, OK 73072

Pat Dillon
Principal
NanoValley Innovations
Eau Claire, WI 54703-1372

Fred Lisy, PhD
President
Orbital Research Inc.
4415 Euclid Ave., Suite 500
Cleveland, OH 44103

Scott Hauge
President
Small Business California
2311 Taraval Street
San Francisco, CA 94116

Lawrence S. Nannis CPA
Shareholder
Levine, Katz, Nannis + Solomon, PC
250 First Avenue, Suite 101
Needham, MA 02494

Arthur Levitan
President
Personnel Protection Technologies LLC
50 Mollbrook Drive
Wilton, CT 06897

Dr. Stuart Farquharson
President & CEO
Real-Time Analyzers, Inc.
362 Industrial Park Rd. (#8)
Middletown, CT 06457

David Model
Executive Vice President
Triton Systems, Inc.
200 Turnpike Road
Chelmsford, MA 01824

David W. Martin
Vice President, Product Development
Windmill International, Inc.
2 Robinson Road
Nashua, NH 03060-5830

Heidi Jacobus
CEO
Cybernet Systems
727 Airport Boulevard
Ann Arbor, MI 48108

Ken Mahmud
Chief Technology Officer
Triton Systems Inc.
200 Turnpike Road
Chelmsford, MA 01824

Joseph M. Kunze, Ph.D.
President and CEO
SI2 Technologies, Inc.
267 Boston Road
North Billerica, MA 01862

Dr. Dan Alspach
Former Chairman, CEO, and President
Orincon Corporation (now Lockheed Martin Orincon)
San Diego, CA

Larry Barstow
President and COO
Headwall Photonics, Inc.
601 River Street
Fitchburg, MA 01420

Leszek Motowidlo
President
SupraMagnetics, Inc.
214 Canal Street
Plantsville, CT 06479

Andrew G. Timmerman
President
Fairfield Crystal Technology, LLC
8 South End Plaza
New Milford, CT 06776

Arturo Pilar
President
Ciencia, Inc.
111 Roberts Street, Suite K
East Hartford, CT 06108

Christopher Tupper
Technical Director
Raven Technology LLC
14 Industrial Parkway
Brunswick, Maine 04011

Dr. Michael A. Serio
President
Advanced Fuel Research, Inc.
87 Church Street
East Hartford, CT 06108

Craig Campbell
CEO
Cepstral LLC
1801 E. Carson St., 2nd Floor
Pittsburgh, PA 15203

Marina R. Pascucci, Ph.D.
President
CeraNova Corporation
85 Hayes Memorial Drive
Marlborough, MA 01752

Simon H. Budman, Ph.D.
President and CEO
Inflexion, Inc.
320 Needham Street
Newton, MA 02464

Mark Seligman
President
Spoken Translation, Inc.
1100 West View Drive
Berkeley, CA 94705

- 1 Mark Heesen, president of the National Venture Capital Association, remarked in testimony last year before the House Small Business Committee: "if the provisions which guarantee a level playing field for venture-backed companies are removed or compromised in any way, NVCA will not support the re-authorization of this program."
[\[http://localtechwire.com/business/local_tech_wire/venture/story/2577803/\]](http://localtechwire.com/business/local_tech_wire/venture/story/2577803/).
The NVCA seems intent on distorting the facts, and pretending that SBA rules prevent small businesses from receiving ANY outside investment, rather than clearly stating that the only restriction is on majority-ownership by entities that do not themselves qualify as small businesses. They seem committed to poisoning the well, rather than finding compromise solutions (as for instance limiting their members' ownership of SBIR-eligible businesses to 49% or less) which many in the small business community would welcome.
- 2 "Kauffman's Paul Kedrosky analyzed the Inc. 500 list of the country's fastest growing companies. Of 800 companies on the list during the past 10 years, 645 were either angel-backed or bootstrapped. Only 155 firms used venture funding." See the article "Have We Oversold the Role of Venture Capital?" on entrepreneurship.org of the Ewing Marion Kaufmann Foundation (<http://entrepreneurship.org/Resources/Detail/Default.aspx?id=20008>).
- 3 In testimony before the House Small Business Committee Subcommittee on Investigations and Oversight on March 26, 2009, P. Sherrill Neff, on behalf of the National Venture Capital Association (NVCA) remarked: "[V]enture capitalists typically look for companies that are innovating in a significant way. ...We often find these innovators in university and government labs," and later "We do not fund basic research but rather search for concepts that have been vetted through the basic research process and show promise for the broader public marketplace. We most often find these opportunities in university and government labs..." His full testimony appears at:
<http://www.house.gov/smbiz/hearings/hearing-3-26-09-expanding-equity-investment/Neff.pdf>.
- 4 Jere Glover's testimony before your subcommittee on April 23, 2009, presented much of this evidence. His full comments and supplements appear at: <http://science.house.gov/publications/Testimony.aspx?TID=15059>.
- 5 The Inspector General of the Small Business Administration issued a report in February 2005, entitled "Large Businesses Receive Small Business Awards". See http://www.sba.gov/idc/groups/public/documents/sba/oig_gcdb_05-15.pdf. To this day, the issues have not been satisfactorily resolved.
- 6 The President's remarks were given at the annual meeting of the National Academy of Sciences, on April 27, 2009. (http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-at-the-National-Academy-of-Sciences-Annual-Meeting/).
- 7 The April 26, 2009 New York Times includes an Op-Ed piece entitled "End the University as We Know It." Its author, Mark C. Taylor writes: "The dirty secret of higher education is that without underpaid graduate students to help in laboratories and with teaching, universities couldn't conduct research ... It is simply cheaper to provide graduate students with modest stipends and adjuncts with as little as \$5,000 a course — with no benefits — than it is to hire full-time professors. In other words, young people enroll in graduate programs, work hard for subsistence pay and assume huge debt burdens, all because of the illusory promise of faculty appointments. But their economical presence, coupled with the intransigence of tenure, ensures that there will always be too many candidates for too few openings." The full article is posted at: <http://www.nytimes.com/2009/04/27/opinion/27taylor.html>.
- 8 See note 3 above. If VCs are not funding "basic research" by innovative small businesses, who is? It seems the answer is fairly clear: SBIR represents one of the few remaining sources for such investment. By opening the SBIR door to full-participation by Venture-Capital *owned* firms (since VC-backed firms have never been excluded so long as they remain small businesses), the likely result will simply be even less investment in crucial early-stage efforts, as more funds will be funneled to the later stage development favored by VCs.
- 9 See the article "Venture investing hits lowest level in over a decade," MarketWatch Online, at:
<http://www.marketwatch.com/news/story/venture-investing-falls-lowest-level/story.aspx?guid=%7B61CF5CCE%2DB974%2D49C8%2D8EF1%2D5DD62CF81AF0%7D>.
- 10 Statistics about Business Size from the U.S. Census Bureau, <http://www.census.gov/epcd/www/smallbus.html>.
- 11 See pp. 6-8 of Jere Glover's testimony cited above in note 4.
- 12 Ibid., pp. 4-5.
- 13 Ibid., p. 6.