

**SBIR REAUTHORIZATION AS PROPOSED BY
THE HOUSE OF REPRESENTATIVES**

**THE THREAT TO THE STATE OF WISCONSIN:
THE OPPORTUNITY AND THE ISSUES**

Updated as of June 19, 2009

THE BILLS: [H.R. 2767](#), [H.R. 2772](#), ; [H.R. 2769](#), and [H.R. 2747](#)

The Threat

- ❖ If we allow proposed changes to the Small Business Innovation Research program (SBIR) to go through, WI firms will receive significantly less R&D funding in the future.
- ❖ This would kill the prospects for many WI early-stage startups and remove continued support for established firms with innovative ideas.
- ❖ These are the companies that create jobs!
- ❖ Over 90% of seed investment in WI comes from SBIR. (See map below)
- ❖ WI is not alone. Small innovative businesses are germinating all over the country.
- ❖ Will we sustain them, or let them fail, like last year's corn crop?

The Opportunity

- ❖ This is an opportunity for true leadership in Washington, DC, to cross party lines and ideologies for the good of America.
- ❖ This is not a partisan issue. Strong bipartisan involvement on both sides of the issue exists in both House and Senate.
- ❖ This is not a fight between venture capital and small businesses.
- ❖ SBIR is not an entitlement or a handout. It is not additional funding, merely a stipulation that some percentage of R&D funds on the books be allocated to small businesses.
- ❖ This is a question of how best to foster innovation in America.
- ❖ This is a matter of how we can lead business forward, creating jobs and creating wealth.
- ❖ This is a chance for America to regain our footing, and once again lead the world in innovation.

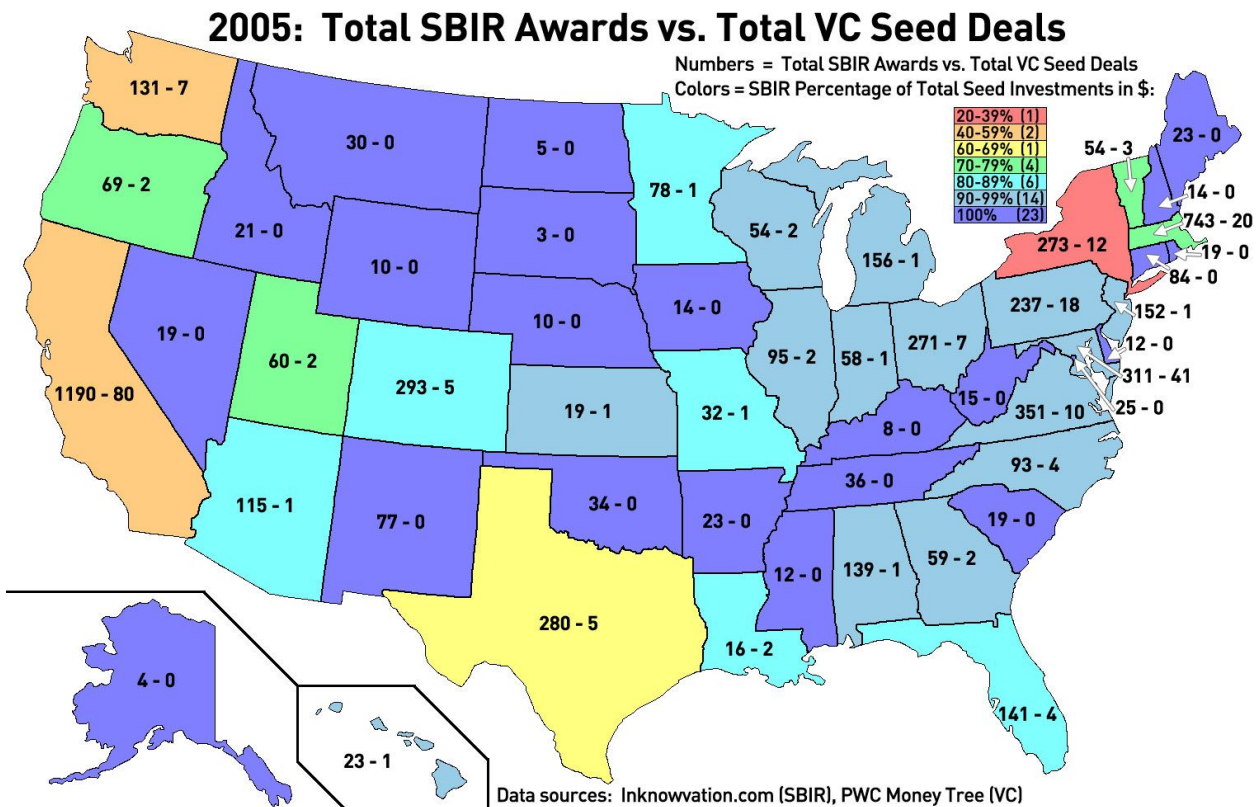
The Issues

- ❖ H.R. 2767 redefines independent ownership "by natural persons" as ownership by "natural persons or venture capital operating companies" (§3.aa.3.A) .
 - ◆ Current rules explicitly state that a qualifying small business will not lose eligibility so long as large VC investment remains below 50%.
 - ◆ We can encourage VC investment AND support innovative small businesses at the same time.
 - ◆ The restriction is only on majority-ownership and control not investment!
 - ◆ In the proposed changes, there are no restrictions on who could own those venture capital operating companies.
 - ◆ In many cases, this means U.S. taxpayer dollars are going to subsidize the profits of foreign parent firms.
 - ◆ The provision that multiple VC firms could own a majority of a qualifying firm (§3.aa.3.B) is an open invitation to abuse, as this hurdle would be easy to surmount.
- ❖ H.R. 2772 contains some fruitful provisions, but the following are major concerns that require remedy:
 - ◆ §11. purporting to encourage fast-track authority for agencies to facilitate moving companies to Phase II without delay, includes the wording to permit Phase II awards "in appropriate cases simultaneously with the issuance of the first phase SBIR award." This would set a dangerous

precedent and undermine the agency's ability to obtain proof of feasibility (Phase I) before committing significantly more funding to a project that may not deliver its stated objective nor prove commercially viable.

- ◆ §12. (a) raises award caps from \$100,000 for Phase I and \$750,000 for Phase II to \$250,000 & \$2,000,000 respectively.
 - ◇ While award caps should be raised to reflect changes in the cost of living since they were last adjusted more than a decade ago, raising the caps this dramatically across the board threatens to overinflate many awards, reducing the number of ideas that may get funded, and setting a one-size-fits-all approach to a great diversity of projects.
 - ◇ The aim of Phase I is to prove feasibility. The cap should be set to obtain and ensure this result.
 - ◇ Phase II is for development of a prototype. The cap for awards should be set to accomplish this goal. There needs be flexibility with oversight.
- ◆ §12. (b) adds 'with a mandatory annual adjustment of such amounts to reflect economic adjustments and programmatic considerations, and with lesser amounts'
 - ◇ An open-ended provision that does not specify a means for future adjustments will do nothing to ensure SBIR funds are used to support innovation. There needs be more specificity to adjustments (as for instance, any of the federal COLA standards), and oversight to ensure that agency's "programmatic considerations" align with the goal of supporting innovation and commercialization by small businesses.
- ◆ §13. proposes "express authority" for multiple sequential Phase II awards.
 - ◇ While at times it may be fruitful to continue funding for SBIR projects after successful completion of a Phase II award to ensure commercialization, the goal of commercialization is absent the language for this section.
 - ◇ It must be explicitly stated that the goal for follow-on funding after successful completion of a Phase II is directed toward facilitating the commercial success of the product, service, or deliverable beyond perpetual funding by the government.
- ◆ §14. contains obscurantist language, which seems to refer to non-existent or non-specific "determinations" regarding the definition of a Phase I.²
 - ◇ It is likely that this section, while pretending to require a Phase I, is rather intended to permit Phase I bypass, through mincing of words.
 - ◇ It is clearly in opposition to the spirit of plain language.
 - ◇ The wording should read something like "No Phase II award under SBIR or STTR shall be offered or funded except where the proposing parties have received and successfully and verifiably completed a Phase I under the SBIR or STTR programs."
 - ❖ The following might be added: "Phase I proposals that have received positive evaluation but were not awarded SBIR funds due to a limitation of funding available under the sponsoring agency may be allowed to continue with outside funding under the SBIR umbrella, and shall only thereby retain eligibility to compete for Phase II and subsequent funding, at the discretion of the sponsoring agency, if completion of their self-funded or privately-funded Phase I is deemed successful."
- ❖ None of the House bills (four in all: H.R. 2767; H.R. 2772; H.R. 2769; H.R. 2747) includes any provisions or proposals to increase SBIR or STTR funding as a percentage of existing and budgeted expenditures toward R&D.

- ◆ This is a significant oversight as any effort to raise award amounts without raising the overall pot of funding will have the effect of reducing the number of awards available to be issued.
- ◆ Since small businesses account for about 80% of all net new jobs in this country, and because job creation will have an undeniably salutary effect on the economy, we should expend taxpayer dollars in a manner most directed toward creating jobs.
- ◆ Increasing support (not as additional expenditures, but merely as a percentage of funds already committed) for truly small businesses to bring innovative ideas and products to market is perhaps the best investment the government could make.
- ❖ Further the suggested expiration date coming a mere two years later in 2011 can serve no one well.
 - ◆ Reauthorization should ideally make SBIR/STTR permanent parts of the federal budget, or at the very least should last for a minimum of 10 years.
- ❖ In light of these deeply flawed versions coming from the House, the Senate's version (S.1233), cosponsored by Sen. Mary Landrieu (D-LA) and Sen. Olympia Snowe (R-ME), while not perfect on all counts, is a refreshing, satisfactory, and practical compromise.
 - ◆ If anything, the House should be reconciled in full with the Senate approach, for the good of the nation, the economy, innovation, and small businesses.



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2005 VC Seed Investment vs SBIR Awards

In 2005 22 States and the District of Columbia received no VC Seed-Stage funding					
In the same year, those states (and DC) received 517 SBIR awards totalling \$151,217,202.					
State	2005 total SBIR awards	2005 total SBIR dollars	2005 VC Seed Deals	2005 VC Seed Dollars	2005 VC Seed w/o NY & CA
Alabama	139	\$33,656,865	1	\$925,000	\$925,000
Alaska	4	\$641,600	0	\$0	\$0
Arizona	115	\$35,536,577	1	\$5,499,900	\$5,499,900
Arkansas	23	\$6,752,151	0	\$0	\$0
California	1190	\$386,785,821	80	\$305,426,400	\$0
Colorado	293	\$78,827,244	5	\$13,236,000	\$13,236,000
Connecticut	84	\$27,555,856	0	\$0	\$0
DC	25	\$6,055,294	0	\$0	\$0
Deleware	12	\$2,966,972	0	\$0	\$0
Florida	141	\$40,402,050	4	\$6,104,000	\$6,104,000
Georgia	59	\$16,757,960	2	\$255,000	\$255,000
Hawaii	23	\$5,861,319	1	\$330,000	\$330,000
Idaho	21	\$5,512,080	0	\$0	\$0
Illinois	95	\$24,449,284	2	\$1,300,000	\$1,300,000
Indiana	58	\$15,439,281	1	\$1,500,000	\$1,500,000
Iowa	14	\$2,622,331	0	\$0	\$0
Kansas	19	\$4,872,494	1	\$250,000	\$250,000
Kentucky	8	\$3,828,023	0	\$0	\$0
Louisiana	16	\$6,978,962	2	\$1,550,000	\$1,550,000
Maine	23	\$4,464,204	0	\$0	\$0
Maryland	311	\$100,888,973	41	\$9,946,000	\$9,946,000
Massachusetts	743	\$241,777,816	20	\$69,914,800	\$69,914,800
Michigan	156	\$46,043,445	1	\$350,000	\$350,000
Minnesota	78	\$28,921,998	1	\$4,000,000	\$4,000,000
Mississippi	12	\$4,621,218	0	\$0	\$0
Missouri	32	\$9,018,790	1	\$1,575,000	\$1,575,000
Montana	30	\$7,519,207	0	\$0	\$0
Nebraska	10	\$2,957,927	0	\$0	\$0
Nevada	19	\$4,770,240	0	\$0	\$0
New Hampshire	54	\$14,815,585	3	\$6,050,000	\$6,050,000
New Jersey	152	\$46,338,055	1	\$4,000,000	\$4,000,000
New Mexico	77	\$20,819,314	0	\$0	\$0
New York	273	\$87,923,764	12	\$339,915,300	\$0
North Carolina	93	\$36,792,628	4	\$3,365,000	\$3,365,000
North Dakota	5	\$2,341,610	0	\$0	\$0
Ohio	271	\$83,158,038	7	\$7,745,000	\$7,745,000
Oklahoma	34	\$9,955,236	0	\$0	\$0
Oregon	69	\$27,044,526	2	\$7,848,000	\$7,848,000
Pennsylvania	237	\$74,860,684	18	\$6,900,000	\$6,900,000
Rhode Island	19	\$6,677,348	0	\$0	\$0
South Carolina	19	\$8,962,857	0	\$0	\$0
South Dakota	3	\$928,968	0	\$0	\$0
Tennessee	36	\$10,303,600	0	\$0	\$0
Texas	280	\$82,435,543	5	\$48,633,000	\$48,633,000
Utah	60	\$17,844,070	2	\$4,920,000	\$4,920,000
Vermont	14	\$4,831,439	0	\$0	\$0
Virginia	351	\$96,100,123	10	\$7,119,900	\$7,119,900
Washington	131	\$46,089,458	7	\$35,199,000	\$35,199,000
West Virginia	15	\$4,144,261	0	\$0	\$0
Wisconsin	54	\$17,699,841	2	\$50,000	\$50,000
Wyoming	10	\$1,985,466	0	\$0	\$0
TOTAL	6010	\$1,858,538,396	237	\$893,907,300.00	\$248,565,600.00

% VC Seed Money vs SBIR Seed Money

0.480973

% CA & NY get of VC Seed Money

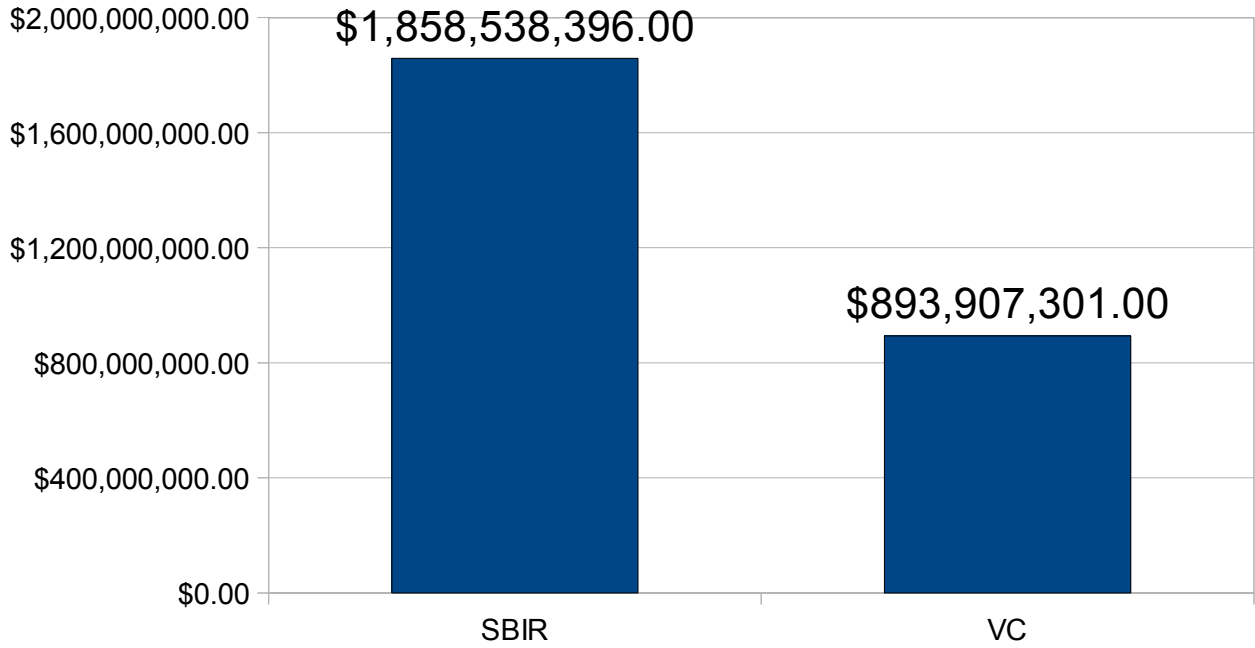
25.5420%

0.133743

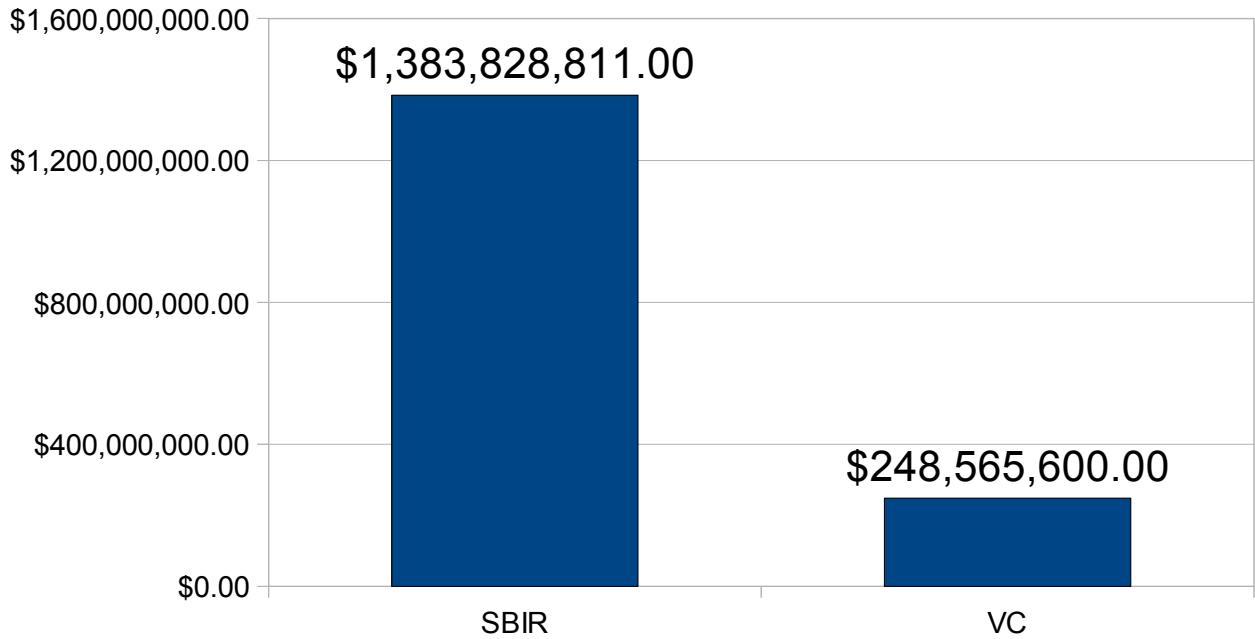
72.1934%

*SBIR data from inknowation.com, VC data from PWC Money Tree

2005 VC Seed Money vs SBIR Awards



2005 VC Seed Money vs SBIR Awards (Minus NY & CA)



Document prepared by Jonathan Pearl, PhD, with support and data provided by InKnowvation.com and members of the SBIR-advocacy Google Group. Jonathan Pearl is President & Founder of Perceptral LLC, a Wisconsin technology venture, founded in Racine May 2008. Perceptral LLC is on target to accomplish job growth in SE Wisconsin on the order of 400-500% between 2008 and 2010.

⌘ The cited "subsection (e) (4) (A)" may refer to that subsection of the Small Business Act (15 U.S.C. 638). The possibly intended sections read:

- ❖ (e) (4) the term "Small Business Innovation Research Program" or "SBIR" means a program under which a portion of a Federal agency's research or research and development effort is reserved for award to small business concerns through a uniform process having—
 - ◆ (A) a first phase for determining, insofar as possible, the scientific and technical merit and feasibility of ideas that appear to have commercial potential, as described in subparagraph (B), submitted pursuant to SBIR program solicitations;
 - ◆ (B) a second phase, to further develop proposals which meet particular program needs, in which awards shall be made based on the scientific and technical merit and feasibility of the proposals, as evidenced by the first phase, considering, among other things, the proposal's commercial potential, as evidenced by— ...etc.
- ❖ Such a reference to a reference reminds one of the wording in the American Reinvestment and Recovery Act (ARRA, H.R. 1-62): "That the funds provided in this Act to the NIH shall not be subject to the provisions of 15 U.S.C. 638(f) (1) and 15 U.S.C. 638(n) (1) "
 - ◆ That bit of obscurantism effectively stole \$229 million away from innovative small businesses!
 - ◆ Let's not let it happen again.