New Policy May Boost US Tech 'Seed Fund'

By **Todd Overman** (November 14, 2022)

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The Small Business Innovation Research, or SBIR, and Small Business Technology Transfer, or STTR, programs, collectively touted by the National Science Foundation as America's seed fund, seek to foster a healthy environment for small business startups to innovate and to provide a path for private-sector commercialization of new technologies.

While the programs have enjoyed a fair amount of success with notable companies like QUALCOMM Inc., 23andMe Inc. and Biogen Inc., getting their start as SBIR grant recipients, the programs have also been tested by exploitative SBIR mills; and concerns have grown about the programs' potential facilitation of technology transfer to China.

Both programs were set to expire on September 30 absent congressional intervention. However, on the eve of that expiration date, the U.S. House of Representatives voted overwhelmingly to reauthorize the almost $4 billion program through 2025, with strings attached poised to reshape the program's administration. President Joe Biden signed the reauthorization bill soon thereafter.

SBIR Mills

There is a perception within industry and Congress that a few companies that have no intention to commercialize their innovations — so-called SBIR mills — win many SBIR and SSTR contracts, due partly to sophisticated proposal-writing capabilities and industry know-how.

These companies are seen as a drain on program resources and antithetical to the program's mission.

Others see SBIR mills as a congressional boogeyman that limits the number of awards. These advocates argue that innovation is not a simple concept, rather, it often requires a long horizon, multiple investments and supporting inventions.

Regardless, the recent legislation looks to reign in companies receiving over 40 SBIR and STTR awards by doubling the benchmark requirements.

First, companies that have received more than 50 Phase I awards over the past five years must now show a 50% transition rate to Phase II awards.

Small businesses that received 50 Phase II awards over the last five years must show $250,000 in aggregate sales and investments per Phase II award. Similarly, small businesses receiving 100 Phase II awards must show an average of $450,000 in sales and investments per award.

If it is determined that a small business fails to meet the enhanced benchmarks they are then subject to a 20 award cap on Phase I and Direct to Phase II annual awards for the next 12 months.

In limited circumstances, the agency can apply for an exemption if the award is deemed critical to the mission of the Federal agency or relates to national security.

These increased benchmark requirements become effective April 1, 2023.

Foreign Influence

Recently, Congress has positioned American technological innovation as an increasingly important counterweight to rising Chinese security threats. Some see the programs' reauthorization and its efforts to weed out foreign ties to congressional funding as an extension of overall congressional momentum on the issue.

This comes after an April 2021 U.S. Department of Defense study found that China has been targeting companies receiving SBIR funds.[1] The report documented SBIR participants who dissolved their American corporations to continue working for the People's Liberation Army.

To address the issue, the recent legislation creates several new requirements related to foreign countries of concern, which the legislation currently defines as China, Russia, Iran and North Korea.

All small businesses upon submitting a proposal must now disclose the identity of those affiliated with "any foreign talent recruitment programs of foreign countries of concern," joint ventures or subsidiaries with foreign affiliations, contractual obligations with foreign entities, the percentage of venture capital with a foreign affiliation, and "any technology licensing of intellectual property sales to a foreign country of concern … during the 5-year period preceding submission of the proposal."

The technology licensing disclosure is applied retroactively. Companies in compliance with SBIR and STTR requirements just a month ago will now be subject to these disclosure requirements.

The legislation also calls for establishing a due diligence program, necessary to vet small businesses applying for federal funding for national security risks. The program will evaluate the "cybersecurity practices, patent analysis, employee analysis, and foreign ownership" of small businesses. The Small Business Administration will coordinate with the White House Office of Science and Technology Policy and the Committee on Foreign Investment in the United States to provide further guidance.

National Security-Related Clawback Provisions

The new legislation also added two mechanisms for the government to clawback federal funds. First, upon a material misstatement from an award recipient, the federal agency can force repayment of the appropriated funds if it determines that the misstatement poses a risk to national security. Additionally, if a change in ownership or entity structure, or "other substantial change in circumstances of the small business concern," is determined to threaten national security, the agency can recover the funds.

GAO Oversight

The bill also requires additional oversight of the program going forward. The U.S. Government Accountability Office must submit a study, to be made publicly available within the next 18 months, focused on those small businesses awarded more than 50 Phase II SBIR or STTR awards.

The study will analyze the impact these firms have on the programs, their ability to commercialize inventions and their effect on new entrants. The study will also evaluate the increased minimum-performance standards, other potential award caps, and lifetime program earning caps, and recommend alternative minimum-performance standards.

The legislation requires a second study to review subcontracting's impact on SBIR and STTR programs, its effects on the programs' overall mission, and to ensure awardees comply with the Federal Accountability and Transparency Act.

Potential Impact

The SBIR and STTR programs have been a useful tool in fostering innovation and American technological leadership. These legislative changes will likely further that goal.

First, the enhanced benchmarks will require companies to more actively pursue progress toward Phase II and Phase III awards. While some skeptics believe the new rules will inhibit the prospects for long-shot ideas, the increased benchmarks only apply to companies receiving over 50 Phase I awards — and 50 Phase II awards over the same period.

The legislation specifically targets SBIR mills, which are overly dependent on SBIR and STTR awards and have disappointing performance records.[2] The enhanced benchmarks will ensure funding is provided to those companies intending to field new innovations leading to higher percentages of commercialization.

Second, the new restrictions on foreign influence in SBIR and STTR firms align with the U.S. government's ongoing efforts to use American technological superiority as a tool of geostrategic influence. In addition to new CFIUS guidance and export controls, the reauthorization strengthens guardrails for taxpayer funded awards.

The new curbs restricting funds to certain foreign-owned U.S. businesses and adopting clawback mechanisms may result in a number of newly ineligible firms, but ultimately will better serve the program's original mandate to serve as America's seed fund. The new national security scrutiny will help stop the ceding of American innovation and know-how to foreign countries of concern, and instead enhance domestic industry.

For Small Businesses Going Forward

The changes to the SBIR and STTR programs reflect a growing congressional appetite to counter China through technological leadership while reigning in spending costs and ensuring the program's ultimate mission is realized. The changes place a higher administrative burden on many awardees. Companies readying new applications should gather information on potential foreign investments, intellectual property sales, and technology licensing to prepare for enhanced filing requirements.

Additionally, while the foreign-countries-of-concern designation currently only applies to China, North Korea, Russia and Iran, other countries like Belarus may also be added to the list. Small businesses with ties to other countries associated with national security concerns should consider this when making investment and procurement decisions.

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[1] https://www.wsj.com/articles/pentagons-china-warning-prompts-calls-to-vet-u-s-funding-of-startups-11652014803.

[2] https://benvanroo.substack.com/p/are-a-few-dozen-sbir-mills-sucking.