



**TESTIMONY OF FRED S. PATTERSON  
PRESIDENT AND CEO, THE SBIR COACH  
BEFORE THE SMALL BUSINESS ADMINISTRATION  
DALLAS REGIONAL PUBLIC HEARING ON  
SMALL BUSINESS SIZE STANDARDS - JUNE 22, 2005**

Mr. Chairman and distinguished members of this committee, I am pleased to appear before you to discuss the proposed changes to small business size standards and proposed changes to the eligibility rules for participation in the Small Business Innovation Research (SBIR) Program.

I have been involved with both large and small businesses over my forty years in the business world, from having served as Director of Planning for a Fortune 500 Aerospace company, to having been involved in a founding role with no fewer than six start-up companies over the past 25 years. I have held every C-Level executive position that you can name.

As a result of my experience, I can speak with conviction on the dynamics of small vs. large businesses, and on the relative importance of fair treatment in business matters. The fact is that small businesses are at a distinct disadvantage with regard to access to participation in the commerce of the country. The big players can pay for resources that are beyond the reach of the small player.

Contrast this with the fact that innovation comes primarily from small business. Large businesses are unwilling to bother with taking the risks inherent in fostering innovation. They want to bet on sure things, with predictable returns on invested capital. Small businesses, on the other hand, are inveterate risk takers, and the results can pay huge dividends.

It was in recognition of this that the SBIR Program was created some twenty-three years ago. With a meager percentage of the government's R&D budget set aside for high-risk projects to be undertaken by small businesses, the idea was to foster innovation and give these risk takers a chance to show their stuff, for the betterment of the national interest.

My involvement with the SBIR Program began in 1986, with my involvement as a co-founder (I was CFO) in a start-up company that quickly won repeated successes with obtaining SBIR awards. Eleven years later, I did it again, as a co-founder with both the COO and CFO hats. Together, the two companies secured close to \$50 million in SBIR and STTR related funding in all three phases. The 2<sup>nd</sup> company leveraged its \$12 million in SBIR funding to obtain \$18 million in Series A Venture Capital funding, but we were astute enough to negotiate a valuation position that kept their ownership below 50% so as not to lose our eligibility for continued SBIR participation.

In both cases, the companies were competing for SBIR awards against other companies in the same league, with similar resources. It was a level playing field and a fair competition. We won because of superior presentations of the proposed projects to produce robust technology that met the needs of the customer agencies. Neither we nor our competitors in the competition for awards had deep pockets with virtually unlimited resources. It was, we felt, a fair competition.

If Congress or the SBA changes the eligibility rules to permit majority-ownership by venture capital entities, small businesses owned by large VC organizations with millions of dollars of available capital would compete head to head with small businesses that have no such funding potential. The early stage funding process for qualifying small businesses would be in jeopardy and the entire spirit of the SBIR

program would be subverted to serve large interests. The entrepreneurial spirit so vital to the SBIR program's success would be quashed.

Of the firms who are receiving Venture Capital, the overwhelming majority are in the Bio-technology world, and are targeting the National Institutes of Health (NIH). In actual fact, aside from obvious overstated suggestions of what terrible things would happen if the rules are not changed, the numbers of companies involved are actually quite small. Based on data assembled by the Innovation Data Institute of Swampscott, Massachusetts, of the over 2500 firms which were in receipt of SBIR funding from the NIH between 1998 and 2003, only about 80 were in receipt of Venture Capital. We can document how much money that involves but do not know how the deals were structured and whether the VCs secured a majority interest. However, based on the numbers, estimates have been made that that the proposed rule change perhaps involves fewer than fifty companies - hardly enough to warrant a major shift in how SBIR is managed. Perhaps the problem lies more in how the valuation was arrived at that gave the VCs a majority position. The VCs seem to want ever bigger and bigger pieces of the small business pie.

Far more telling than any position the proponents of this change are taking specific to this issue is the fact that if we do allow this to happen, it will be the thin end of what may be a very thick wedge. What other exception do we allow next?

My current role is that of a consultant doing business as The SBIR Coach, guiding small businesses who have a roadmap to commercialization of their technologies to successful navigation of the SBIR competitive process as a source of seed funding for the risky venture of technology development. My clients are typically at a too early stage and are too risky for venture capital entities to be interested - yet. But, with a couple of successful SBIR projects and some good partnering, that interest will manifest. What I fear, is that if this proposed rule change is put into effect, companies such as I coach will find that the numbers of projects available to them have diminished, with awards going to companies farther along the road, who find the pickings easy. The net result will be fewer companies working on fewer innovative technologies, with a profound reduction of important public-to-private sector technology transfer, and the ultimate loser will be the US economy and our national security.

Please DO NOT make any changes to the eligibility rules. If it's not broke - don't fix it! The rules have worked well for twenty-three years. Let the companies with deeper pockets play in the bigger games, and stay out of the SBIR sandbox. After all the SBIR set-aside is only 2.5% of the money that's being spent by the government for such R&D. Let these well-funded companies compete for the other 97.5% and leave the struggling not-yet-ready-for-the-major-leagues entrepreneur alone!

With regard to the size standard, my belief is that 500 employees is an awfully big small business. Under no circumstances should it be raised. I believe it should be lowered, perhaps to 250, but no lower than 200. I also do not believe that a receipts-based standard should be used for eligibility or qualification matters. As a former CFO, I know all too well that there are too many accounting games that can be played with revenue numbers!

I am grateful for this opportunity to make known my position on this important issue of SBIR eligibility. I do believe that the SBIR Program was the smartest and best thing that Congress has ever done on behalf of small business. I would hate to see anything done that would diminish its value and impact on the small business community. Thank you.

