



NEWS RELEASE

PRESS OFFICE

Release Date: October 18, 2007

Release Number: 07-69

Contact: Tiffani Clements (202) 401-0035

Internet Address: www.sba.gov/news/

Frequently Asked Questions on SBA's Small Business Innovation Research Program and Venture Capital Investment

Q: Has the SBA recently changed its interpretation of eligibility requirements for SBIR applicants with venture capital investment?

A: No. However, in 2005, the SBA amended its regulations to *broaden* the eligibility requirements for SBIR applicants. To receive an SBIR award, the applicant must:

1. Be organized as a for-profit concern;
2. Have no more than 500 employees, including its affiliates, and;
3. Be at least 51% owned and controlled by one or more individuals who are U.S. citizens or permanent resident aliens, or it must be at least 51% owned and controlled by another for-profit concern that is at least 51% owned and controlled by one or more individuals who are U.S. citizens or permanent resident aliens.

13 C.F.R. § 121.702

Q: Is venture capital investment in SBIR projects allowed?

A: Yes. Under current regulations, venture capital investment and partial ownership in a Small Business Concern receiving an SBIR award is allowed. Ownership interests by venture capital companies is generally limited to 49% or less, depending on the facts of each case. However, if a venture capital company is for-profit and owned at least 51% by one or more individuals who are U.S. citizens or permanent resident aliens, it may own more than 49% of the SBIR applicant so long as the SBIR applicant, together with its affiliates (including the venture capital company and its affiliates), have no more than 500 employees.

The SBIR program provides funds for innovative research in the early stages (known as Phases I and II), before the technology has been fully developed or proven. Studies show that most SBIR awardees are unable to raise funds for their research from private risk capital, such as venture capital, at this early stage.

SBIR and other SBA programs actively encourage and facilitate venture capital and angel investment in SBIR projects in the later phases of the work. For example, by working with state-level organizations, SBA has provided business assistance and investor matchmaking services to small businesses participating in, or interested in, the SBIR and STTR programs.

Q: Why did the SBA amend the SBIR eligibility criteria in 2005?

A: Cases were brought to SBA's attention where small businesses formed research and development subsidiaries to pursue innovative research with SBIR funding. However the subsidiaries were unable to receive the funds directly because they were more than 49% owned and controlled by another firm.

In 2005, the SBA amended its regulations to make it possible for such subsidiaries to receive SBIR awards by extending eligibility to for-profit business concerns that are at least 51% owned and controlled by a single other for-profit business concern that is itself at least 51% owned and controlled by one or more individuals who are U.S. citizens or permanent resident aliens provided that the subsidiary, together with the parent firm and its affiliates, employ no more than 500 people.

Q: What are the implications of the 2005 rule change for venture capital investment in SBIR projects?

A: The implication of the rule change for venture capital involvement is the same as for any other type of firm: it allows venture capital and other for-profit companies to own at least 51% of an SBIR applicant if a the venture capital or other for-profit company is at least 51% owned and controlled by one or more individuals who are citizens of, or permanent resident aliens in, the United States, and the SBIR applicant has, together with all of its affiliates, no more than 500 employees. Prior to the rule change, a venture capital or other company could not own more than 51% of the SBIR applicant. In addition, one or more venture capital companies can own less than 49% of or invest in the SBIR applicant, as long as the venture capital company or companies do not control the SBIR applicant.

Q: What does SBA think of the proposed legislative changes to small business definitions as it relates to the SBIR Program and SBA's other programs?

A: SBA does not believe the proposed legislation is necessary. Currently, venture capital companies may invest any amount of money into the SBIR applicant, as long as they do not control the SBIR applicant.

SBA is currently clarifying its existing policies, as well as internally examining whether the SBIR program should be changed to reflect the concerns of the biotechnology and venture capital industries. SBA is consulting with the National Institute of Health, the agency most affected by the venture capital restrictions, to determine any effects on their SBIR applicants. We do note that only 2.5% of an SBIR participating agency's extramural research dollars are set aside for small businesses under the SBIR program. That leaves 97.5% - approximately \$80 billion – available to companies with majority venture capital ownership.

In addition, any changes to SBA's size standards will impact our lending and other government contracts programs.

###