SBIR Proposal Writing Basics: What Does the SBIR/STTR Reauthorization Mean for Your Company?

Gail & Jim Greenwood, Greenwood Consulting Group, Inc.

You probably have heard by now that the SBIR and STTR programs have been reauthorized. It occurred in late December, and was tucked inside of the National Defense Authorization Act, but at least it happened. It gives us the SBIR/STTR programs through 2017. Kudos go to Senator Mary Landrieu of Louisiana who really lead the effort, as well as to Jere Glover of the Small Business Technology Council (SBTC, www.sbtc.org) and Rick Shindell of the SBIR Gateway (www.zyn.com/sbir) who worked tirelessly to move the reauthorization forward and keep us all informed of the progress (and at times, the lack thereof).

So after we all heave a sigh of relief that we have "secure" SBIR/STTR programs for the next six years, the question becomes how the reauthorization will impact our firms and how (or even if) we should compete in these programs for grants and contracts to move our innovations forward. We have plowed through the 100+ pages of the reauthorization legislation (you are encouraged to do likewise; you can find it at www.zyn.com/sbir/insider/SBIR_Pages_from-HR1540conf.pdf), and we want to offer our initial impressions and conclusions about how the reauthorization is going to impact the SBIR/STTR programs. We apologize for the length of this discussion but, as you will see, there are a lot of changes in store for SBIR/STTR.

1. There are changes in the level of funding for the SBIR/STTR programs. For SBIR, the reauthorization calls for annual increases of 0.1% from the current level of 2.5% of the agencies' extramural R&D budgets that must be set aside for SBIR. Therefore, the set aside is 2.6% in Federal fiscal year (FY) 2012, 2.7% in 2013, and so forth—although oddly there is a 0.2% increase from 3.0 to 3.2% between FY2016 and FY2017. But the agencies are now allowed to keep up to 3% of their SBIR budgets for administrative purposes, and a fraction of the SBIR funds are now available to previously-ineligible applicants who are majority owned by multiple venture capitalists, hedge funds and private equity funds (VC/HF/PEFs). And of course there's the impact of the inevitable ebb and flow of each agency's extramural R&D budget, especially in such turbulent economic times.

So what is the net increase or decrease in SBIR funding? Here's our assessment: we assume a steady state in each agency's extramural R&D budget. We add the annual 0.1% increase in the SBIR set aside amounts while subtracting the 3% that the agencies can now keep for administrative purposes. This yields, by FY2017, a 24% net increase in SBIR funding, compared to FY2011. That overall increase will then be impacted by the fraction of each agency's SBIR budget that can now be awarded to previously-ineligible firms (those that are majority owned by multiple VC/HF/PEFs). Who knows at this point how many proposals from such entities will be submitted and funded, but if we assume the average agency awards 15% of its SBIR funds to them (the reauthorization permits a maximum of 25% at NIH, NSF and DoE, and 15% at the other agencies), then there will be a 5% net increase between FY2011 and FY2017 in SBIR funds available to small firms that are not majority owned by multiple VC/HF/PEFs.

That's the SBIR situation. What about STTR? We think STTR comes out far better. The reauthorization legislation calls for 0.05% increases in each fiscal year between 2012 and 2016. Doesn't sound like much, but 0.05% as a fraction of the current STTR set aside of 0.3% is actually quite a bit—we estimate that, by FY2017, there will be a 50% increase in STTR funding, compared to FY2011 amounts. What's the bad news relative to the STTR funding? THERE ISN'T ANY. STTR is not subject to the 3% administrative tax being imposed on SBIR, and firms majority owned by multiple VC/HF/PEFs are still ineligible for STTR.

Our conclusion is that STTR may look more attractive to you as a candidate for your Phase 1 proposal. Yes, there is far less money in STTR than SBIR, and not all agencies have STTR programs, but a 17% increase in STTR funds this first year (especially when some of your competitors don't know that STTR is getting that kind of increase), and a 50% overall increase by FY2017 could create opportunities for you. Further, you do not have to compete with firms that are majority owned by multiple VC/HF/PEFs that may have deep pockets to fund their SBIR proposal preparation efforts.

2. STTR is far more prominent in this reauthorization compared to past ones. Ever since STTR was created in the 1992 Reauthorization, it has been treated with less respect (and with lower expectations) compared to SBIR. But in this reauthorization, most of the provisions and expectations put on SBIR are also placed on STTR (notable exceptions being the 3% admin tax and VC/HF/PEF siphoning discussed above). Particularly notable is the expectation that STTR should generate the same sort of Phase 3 commercialization successes as those coming from SBIR.

Again, our interpretation is that this is good news for you if your project is a candidate for STTR. STTR recipients can now qualify, for example, for the DoD's popular commercialization pilot program and the opportunity for expansion of that program into the other 10 agencies (see more on this below).

3. Some of us have supported the 3% administrative tax that is available to the agencies because we thought it would give them funds to do a better job of managing their SBIR/STTR programs, give more beneficial debriefings, and more quickly get awards in place. Unfortunately, the reauthorization puts many new administrative requirements and expectations on the agencies, which will undoubtedly take some of that 3% admin money.

4. Several parts of the reauthorization legislation convey a very unfortunate, if not alarming, attitude that SBIR/STTR companies cannot be trusted and are not being truthful, honest, and sincere in their dealings with the Federal government, and that those sins must be sought out, prosecuted, and eliminated. See, for example, subparagraphs E through G on page 1123 of the above referenced PDF file, which talk about how the 3% admin tax can be spent: "activities relating to…waste, fraud, and abuse prevention…targeted reviews of…recipients...at high risk for fraud, waste, or abuse to ensure compliance… verification of reports and invoices and cost reviews." The tone towards small businesses participating in SBIR/STTR is not positive, in our opinion, in a number of sections of the reauthorization. There have been some bad apples among the thousands of small companies that have received SBIR/STTR funds over the years, and they should be weeded out, but a more common problem in our experience has been a lack of knowledge about the rules and regulations and/or a lack of appreciation for the seriousness of things that an entrepreneur may think is "no big deal." Unfortunately, the tone appears to be one of "seek out and destroy" rather than to heighten the awareness of SBIR/STTR applicants on the seriousness of major waste, fraud and abuse issues, and educating them on what is permitted and what is not.

5. The reauthorization legislation not only places many requirements on the awarding agencies, but also on the Small Business Administration (SBA). SBA has always had a role in developing SBIR/STTR related policy and gaining compliance by the awarding agencies. At times it has done this job well, and not so well during other times. But the reauthorization requires SBA develop and implement policy and guidance for a large number of new provisions and, unlike the SBIR/STTR awarding agencies which get their 3% admin tax, the SBA does not appear to get any additional resources under the reauthorization. We are concerned about SBA's ability to meet its obligations under the reauthorization, with no new resources to do so. This may manifest itself with delayed implementation of some provisions of the reauthorization, or worse.

We'll finish up now with some additional interesting provisions in the SBIR/STTR reauthorization:

- Agencies are no longer allowed to use an "invitation only" process for selecting Phase 2 applicants. While several agencies do this currently, Dept of Defense is the most prominent.
- The 3% admin tax given to the agencies is only authorized for 3 fiscal years, and is referred to as a "pilot" provision. It is not clear what happens after this pilot program expires.
- Agencies are not to exceed the $150k Phase 1 and $1 million Phase 2 "guidelines" by more than 50%. Therefore, Phase 1 awards are really capped at $225k and Phase 2 awards at $1.5 million (with annual provisions for increases in the cost of living). This will certainly impact NIH

grant and PA/RFA programs, under which much larger awards have been made. There is a provision for SBA waivers on specific topics

- Phase 1 SBIR winners can receive Phase 2 funding through the STTR program, and Phase 1 STTR winners can get SBIR Phase 2 awards. This gives you greater flexibility if you want to switch from one program to the other between phases.
- A pilot program will allow NIH, DoD and DoEd to make Phase 2 awards for a particular project to firms that have not received a Phase 1 award for the same project. Critics of this approach have argued that it will reduce the level of innovation funded by SBIR, and increase the funding of "sure bets." There is no limit on the fraction of SBIR funds that can be channeled into this pilot.
- Up to 25% of SBIR funding at NIH, NSF and DoE can go to small businesses which are majority owned by multiple VC/HF/PEFs. All other agencies can give awards equaling 15% or less of their SBIR budgets to such entities. There is no minimum dollar amount that must be awarded to such entities, but there are penalties for agencies that exceed the stated percentages.
- The legislation clarifies that the VC/HF/PEFs cannot be majority owned or controlled by large or foreign firms. This allays some fears that large firms could set up venture capital companies and compete for SBIR awards.
- It also states that the agencies "…may not use investment of venture capital…as a criterion for the award of" SBIR/STTR projects. Presumably this was inserted to prevent agencies from discriminating against VC/HF/PEFs, but it also oddly seems to prohibit them from giving any preference for these firms. This also will impact agencies that have used funding commitments from third parties as a measure of an SBIR/STTR project's commercial potential.
- Firms are given greater freedom to subcontract to Federal laboratories. This replaces an unfortunate waiver process that has hindered use of Federal labs on SBIRs. Federal labs also can't require advance payments for more than 30 days worth of work as a subcontractor on an SBIR or STTR award.
- The DoD's popular Commercialization Pilot Program (CPP) becomes permanent under the name Commercialization Readiness Program. The legislation also invites the other 10 agencies to create a Commercialization Readiness Pilot Program (CRPP) modeled after the DOD's CPP using not more than 10% of their SBIR/STTR funds. We expect several of the agencies that are more aggressive on Phase 3 commercialization to take advantage of this opportunity.
- Final funding decisions must be made on SBIR and STTR proposals within 90 days of the deadline for their submission, except at NIH and NSF where such decisions must be made within 1 year. This suggests to us that agencies may seek ways to quickly narrow in on a relatively small number of proposals that will be given serious consideration. It also seems to give an incentive to agencies to reduce the number of awards given

(perhaps by increasing the dollar value of each, or putting significant portions of their SBIR/STTR budgets into CRPP or other set asides).

- NIH can spend up to $5 million of its STTR funds for a Phase 0 Proof of Concept Partnership Pilot Program in which it give up to $1 million per year for up to 3 years to a university "or other research institution that participants in the [NIH] STTR Program" to "accelerate the creation of small businesses and the commercialization of research innovations" from within the institution. NIH's FY09 STTR obligation was about $72 million, so this pilot could absorb about 7% of NIH's STTR funding.
- There does not appear to be any provision for continuing the Federal and State Technology Partnership Program (FAST) that has sporadically provided funding to state SBIR/STTR outreach efforts. This is unfortunate, because those outreach efforts are crucial to help ensure that SBIR/STTR applicants do not unknowingly or unintentionally engage in the "waste, fraud and abuse" issues that permeate the reauthorization.

We recommend you stay in touch with the reauthorization implementation efforts, through www.sbtc.org and www.zyn.com/sbir, to know what SBA and the awarding agencies are doing, and take advantage of any public comment opportunities to voice your questions, concerns and complements. Put another way, we can't sit back and rest now that we finally have the reauthorization, but instead we must remain diligent as changes in the SBIR/STTR programs required under the reauthorization are implemented by SBA and the awarding agencies.