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Before

THE HOUSE SMALL BUSINESS COMMITTEE

On

Reform of the Small Business Innovation Research Program

**Washington, D.C.
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Madame Chairwoman Velazquez, Mr. Graves and Members of the Committee, it is with great pleasure that I appear before you today to offer Lynntech's views on the proposed legislation to reform the Small Business Innovation Research Program (SBIR). Lynntech, headquartered in College Station, Texas, is the largest SBIR contractor in the State and one of the largest in the country.

Let me take a moment to thank you, Madame Chairwoman, for your leadership on this issue. It is certainly not easy to create consensus on an important program like this when so much of the debate has been formed out of emotion, rather than from clear and rational debate. You are to be congratulated for persevering in the face of negativity.

The proposed legislation is also the product of hard work and thought generated by your staff. Contrary to the comments of the opposition, this legislation has not been rushed through a process of dictatorial powers, but rather from the input of all parties to ensure that change is accomplished in a thoughtful way.

Lynntech would also like to announce its intention of forming a new coalition of SBIR companies that agree with our view that reform requires access to all capital sources and that technology transition should be the centerpiece of the program. This new coalition will be known as The Council on Small Business Innovation and Research (CSBIR) and is intended to provide SBIR firms an opportunity to present an alternative viewpoint to the Congress on the issues of the day. This action, which has been undertaken within the past few days, we believe will lead to an organization of sufficient size to lend credence to its views.

For the moment, Lynntech will articulate its views on behalf of that coalition of interests. As noted earlier, Lynntech is one of the largest SBIR firms in the country and has a wide diversity of research projects and patents that it currently holds. While two-thirds of Lynntech's research dollars are sourced out of the Defense Department, we have performed research for nearly all of the agencies that control SBIR dollars. Lynntech was founded in 1989 by two former faculty members of Texas A&M University. Lynntech's primary objective is to intensify its efforts to transition the many technologies the company has developed into the marketplace. These technologies are concentrated in the areas of electrochemical synthesis, energy storage and conversion, chemical/biological defense systems, and environmental remediation.

As a result, Lynntech's interest in the debate regarding the SBIR Reform legislation is quite high as our efforts to transition technologies will be driven by the framework of future reforms.

As we have stated many times, we believe that, with all due respect, that last year's debate did not focus on the right set of issues. SBIR firms need the opportunity to access all sources of capital to be successful in the one principal that should guide the SBIR program and that is the success of moving technology into the

marketplace. Ownership of SBIR companies by venture capital firms should not be guiding our discussion regarding reform of the program. In fact, venture capital firms and other private capital resources should be available to SBIR firms to grow their technology development efforts. The only ground rule should be that large corporations should not directly benefit from a small business program. The issue that the debate should be focused on, in Lynntech's opinion, is that of technology transition.

The VC Issue

The proposed legislation does, in fact, begin to address the issue of capital sourcing by allowing SBIR companies majority-owned by venture capital firms the opportunity to compete for SBIR contracts. Let me underline the word, compete. Madame Chairwoman, your critics frequently state that your objective is to attain 100% control of the SBIR market by majority VC-owned firms. The proposed legislation does not say that; what it does do is to allow for the competitive marketplace to be opened to those small businesses, that would otherwise qualify, where their majority ownership lies in the hands of venture capital firms.

Also, contrary to your critics, you do not allow unfettered access to this market for large VC firms. Large VC firms can comprise no more than 20% of the SBIR company. No SBIR firm would be opposed to a major company such as Pfizer, Lockheed, or Boeing taking a stake in their company if there existed the possibility of eventually transitioning technology to the marketplace.

In fact, Lynntech is concerned that its ability to raise capital in the private markets could be damaged by the continued prohibition on majority ownership by VC firms. If Lynntech had had a capital infusion that would have transferred majority control to a VC firm, it would no longer be eligible for SBIR and the country would be effectively denied the achievement of new systems and technologies that improve the safety and well-being of the country.

Therefore, the proposed legislation makes it clear that in all other respects the SBIR firm must continue to meet the size standards of the SBIR program with the one caveat that it can have up to 20% of its capital provided by large corporate entities.

Again, as long as the program is not opened up to participation by large corporate entities, Lynntech believes that ownership should not be the central issue of the reform effort.

Technology Transition

Lynntech is pleased that Title II of the proposed legislation clearly indicates that the policy of the Congress is that the SBIR program should focus on the development of projects that have potential for transitioning to the market.

Lynntech applauds this objective and believe it is key to the efforts undertaken for SBIR reform. The proposed legislation further establishes a reporting mechanism for Federal agencies to report on the success of their commercialization efforts. This last provision is especially key as much of the reform debate has been hampered by inadequate data.

The proposed legislation also establishes a process whereby technology transition efforts would be supported by Phase III funding. The definition of what constitutes Phase III is clearly outlined and the agencies are given a number of tools to use in the achievement of Phase III objectives.

Lynntech supports the authorization of funds for this Phase III effort, although we would argue that additional resources will be needed and believe that a \$100 million authorization would go a long way for supporting continued development. The proposed legislation also permits the creation of a funding vehicle that will help defray the cost of managing the SBIR program. This will help offset the complaint often heard that SBIR is simply a “tax” on appropriated dollars.

The proposed legislation also fosters increased contacts between local economic development organizations, prime contractors, and venture capital companies. All of these efforts are intended to increase the knowledge base of the technologies and innovations that have been developed by SBIR firms and are vitally needed in order for those firms to eventually commercialize their work.

In order to ensure that the program objectives of attainment of maximum technology transition, Lynntech believes that standards must be set as to how many contract awards are made without successful transition to Phase II or Phase III efforts. The proposed legislation does, in fact, seek to address this issue.

Finally, Lynntech has long argued that the SBIR program should be part of a broader Federal Government program to support research and development. The proposed legislation would direct the establishment of an interagency policy committee that would set policy for the SBIR/STTR program, collect data, and analyze the impact of this legislation.

Programmatics

Lynntech also supports the retention of Phase I, but agrees with the objective of allowing some privately funded research to compete for Phase II awards. The proposed legislation allows for this step to be undertaken.

Award caps are increased to \$250,000 for Phase I and \$2 million for Phase II contracts in the Committee proposal. This is also long overdue as Lynntech has observed the frustration of both the Government technical monitors and our own researchers at the small size of the awards. Not enough research can be conducted within the present award sizes.

Concerns

There are a couple of shortcomings with the proposed legislation as is presently configured.

First, the allocation of extramural R&D funds has not been increased for the SBIR program. The current level of 2.5% is no longer adequate to underwrite the myriad of worthwhile projects that the SBIR community can undertake. Lynntech believes that an increase of the allocation to 3.75% would make some sense.

Second, the SBIR program would only be extended for two years. Lynntech believes that this would be a mistake as it normally takes two years for the dollars to be allocated and contracts awarded. A five year authorization would allow for sufficient data collection and analysis to allow the Committee to fully see the impact of their proposed changes. Therefore, Lynntech would support a five year re-authorization.

Summary

Despite a couple of concerns, Lynntech believes that, in general, the proposed legislation goes a long way to achieving the SBIR reforms that are so desperately needed. The twin objectives of achievement of multiple sources of capital and accelerating the technology transition process have been addressed in the proposed legislation. Lynntech is also confident that a middle ground on the allocation increase and the extension of the authorization can be achieved.

We thank you for the opportunity to present our views.