**Dear Charmain Meuser and Members of the Subcommittee:**

Ben Franklin Technology Partners of Northeastern Pennsylvania (BFTP NEP) is pleased to submit the following testimony about the impact of the Small Business Investment Company (SBIC) Program and the Small Business Innovation Research (SBIR) Program (including the strongly related Small Business Technology Transfer or STTR program).

BFTP NEP has been investing in and supporting early-stage, technology-focused startups and innovative manufacturers for more than 40 years. As a member of the statewide Ben Franklin Technology Partners (BFTP), we have helped support SBIC funds, invested in and supported successful SBIR/STTR companies, raised and invested in venture funds, and helped to create and support a fertile ecosystem for startup and small business activity in Pennsylvania.

The SBIR/STTR programs are often collectively referred to as "America's Seed Fund." They are a valuable source of capital to help small businesses commercialize research into useful products and services and launch those products and in the marketplace. BFTP NEP has supported these companies through investment, mentoring, and technical assistance in their pursuit of SBIR/STTR grants through both internal programs and through a statewide collaborative program called the Innovation Partnership (IPart). Pennsylvania companies have been successful in leveraging the SBIR/STTR programs with Pennsylvania ranking 7th among states receiving the highest amount of SBIR/STTR funding. Pennsylvania's IPart assists primarily first-time SBIR/STTR applicants and, over its years of operation, has a 28% submittal to award, success rate.

Our experience and relationship with the SBIC program has been largely in partnership with licensed SBIC funds. We have invested in SBICs, evaluated SBIC licenses and leverage for separate for-profit funds we have managed/raised, and, in limited cases worked with SBICs to provide follow-on funding to our small business portfolio or co-invest alongside SBICs. Several structural program regulations have limited the use of the SBIC program for early-stage and startup investments, which we will comment on in this testimony.

Ben Franklin Technology PArtners
Northeastern Pennsylvania

Both the SBIR/STTR and the SBIC programs are valuable resources to support small businesses in Pennsylvania. Our mission to grow the Pennsylvania economy and create family-sustaining jobs for Pennsylvania citizens is strongly aligned with the missions and goals of both the SBIR/STTR and the SBIC programs. Congress should continue to evaluate each program's impact and its implementation to consider additional reforms or tweaks such as H.R. 5333 – Investing in All of America Act of 2023 that will continue to expand and improve the reach of one or more of these important small business support programs.

**About the Ben Franklin Technology Partners**

The Ben Franklin Technology Partners (Ben Franklin or BFTP) are a network of four independent non-profit organizations that collectively cover all 67 Pennsylvania counties to support technology-based startups, innovative manufacturers, and the entrepreneurial ecosystem. Founded more than 40 years ago, the network and program remain one of the most widely emulated state technology-based economic development programs in the nation.

The four Ben Franklin Technology Partners collectively invest in approximately 120-140 unique early-stage companies per year and help client companies create and retain thousands of jobs, generate billions of dollars of revenue and secure millions of dollars of follow-on funding. Independent third-party analysis shows that Ben Franklin has boosted the Pennsylvania economy by more than $30 billion since inception, helping clients generate 58,000 jobs, plus an additional 101,000 spinoff jobs for a total of 159,000 jobs that otherwise would not have existed. The same independent analysis shows that BTFP returns $4 in additional state taxes to Pennsylvania for every $1 the state invests in the program.

Nationally, Ben Franklin works closely with similar Venture Development Organizations (VDOs) and a national association, State Science and Technology Institute (SSTI), to create economic development through investments in research and development, turning research into commercial products and services, creation of startups and growth of technology and innovation led early-stage companies and manufacturers.

***SBIC Program – Impact and Suggestions***

## History of the Small Business Investment Companies Program

The Small Business Investment Companies (SBIC) Program was created by Congress as part of the Small Business Investment Act of 1958 to stimulate investments in U.S. small businesses. The Small Business Administration (SBA) manages the program.

SBIC's are typically structured as a for-profit venture capital or private equity fund. Funds are typically managed by a General Partner that structures each SBIC fund a unique for-profit legal entity and then raises capital commitments from Limited Partners to use to make investments in small businesses. The SBA licenses SBICs using a rigorous analysis of managers' backgrounds and investing experience, and an evaluation of the proposed fund's investment thesis, strategy and structure.

The application process to secure an SBIC license can be lengthy, difficult and time consuming, however, the license delivers several benefits. Investors in a licensed SBIC fund may count those investments toward their Community Reinvestment Act (CRA) requirements, which makes SBIC funds an attractive investment opportunity for banks, insurance companies and other financial institutions that are subject to CRA requirements. Licensed SBICs are also permitted, though not required, to access leverage through the program's debenture program. The program's leverage can significantly expand a fund's available capital under management and potentially increase the fund's returns to its limited partners.

Historically, the SBA has used a debenture as the primary instrument to provide leverage capital to SBICs. These debentures require semi-annual payments of interest and fees, and repayment of principal under certain qualifying events or when certain distributions are made to the fund's limited partners. The requirement to make current semi-annual payments of interest and fees has made the debenture program challenging for SBIC funds to make investments in early-stage businesses and/or with investment instruments that do not provide consistent current cash flow back to the fund. SBIC funds have typically favored debt or mezzanine type investments in more established companies that have available cash flow to meet these current pay requirements.

Under the debenture program, the SBA's earnings from SBIC funds are capped at the total of interest and fees earned on the debentures. Over the history of the SBIC program, the SBA has utilized other capital structures, most notably the Participating Securities program authorized by Congress in 1992 that ran through 2004. Under the Participating Securities program, the SBA participated in SBIC funds like other limited partners. This exposed the SBA to the potential for increased earnings if the SBIC fund generated significant returns and much greater losses if a fund was unable to return invested capital or significantly underperformed. The Participating Securities program was suspended in 2004 as the SBA suffered some substantial losses, particularly due to the tech bubble and related recession in the early 2000's.

**Impact and Analysis of the SBIC Program in Pennsylvania**

The Small Business Investor Alliance (SBIA) which serves as an industry association and advocate for SBIC funds and the SBIC program lists 22 SBIC funds managed by twelve general partners in Pennsylvania over the past 15 years. Eleven of the 22 funds are currently active. None of the 22 funds indicate that they invest in early-stage companies with most funds investing in mezzanine, debt, private equity or other types of later stage capital in more established funds.

According to Pitchbook, a venture capital industry data service and deal tracking platform, Pennsylvania SBIC's invested in 84 Pennsylvania companies in the last 15 years. Only one of the twelve SBIC fund managers did any venture capital investments, and that manager only did 4 venture capital deals (with only 3 of the investments considered early-stage venture) out of the 84 companies funded. Every other SBIC investment was in mezzanine, debt, private equity or other later stage capital. These fund managers should not be faulted for their decision to structure their investments as debt or other later stage capital instruments. The structural and administrative hurdles native to the SBIC program make these types of investments the logical choice for SBIC funds and their managing general partners.

## Challenges of the SBIC Program and Suggested Improvements

Ben Franklin's interests, mission, and goals are closely aligned with the stated mission and purpose of the SBIC Program. Similar to the SBIC program, Ben Franklin seeks to help small businesses, primarily startups, secure the capital they need to grow and thrive in all regions of Pennsylvania. BFTP has 40 years of experience investing in early-stage companies in every region of the commonwealth and has developed strong connections with various private capital sources that provide follow-on funding to both our portfolio companies and other small businesses including commercial banks, angel investors and groups, venture capital funds, private equity funds, SBIC funds, as well as other public and private lenders and investors.

Ben Franklin has experience with various aspects of the SBIC program, from working with SBIC funds that invest in our portfolio companies to serving on the investment committee of a New Markets Venture Capital Fund. Innovation Works (the Ben Franklin Technology Partner for Southwestern PA) also considered applying for a leveraged SBIC license when they raised a separate, for-profit venture fund (Riverfront Ventures) in 2013. Innovation Works eventually decided not to pursue an SBIC license due to several hurdles including the requirement to pay current interest & fees to SBA, the subordination of private limited partner interests to the SBA leverage, and the lengthy approval and underwriting process to secure a license.

In late 2023, SBA overhauled several aspects of the SBIC regulations including the addition of accrual debenture and reinvestment licenses and the ability to secure leverage through an accrual debenture. The addition of the accrual debenture license and leverage are positive improvements to the SBIC program and may make both the license and the leverage significantly more attractive to VDOs and other private investors looking to invest in earlier stage companies. A primary advantage of the new accrual debenture license and leverage is that the SBIC repays the SBA at the end of the 10-year term or when making non-tax distributions to other limited partners. This deferred repayment structure better aligns the loan payments to SBA with the unpredictable nature of early-stage equity investments.

SBA also made several positive revisions to the review and approval process for new SBIC applicants.  Some of the more notable revisions include:

- SBA has indicated that it will give greater consideration to a fund's management team experience in related areas of capital activity. This is a welcome improvement to a historically limiting hurdle to SBIC licensing. As an example, 1855 Capital, a fund that Ben Franklin has invested in and works with closely, was denied an SBIC license because the two managing partners had not invested together previously. The two managers had significant venture investing experience (90+ investments) and had raised venture capital as executives for two semiconductor companies.
- SBA has indicated they are open to SBIC eligibility for small funds. This is also a welcome improvement. While SBA regulations technically allow funds with as little as $5 million in leverageable capital (or as low as $3 million in limited cases) to be approved for an SBIC, the agency has historically has not approved funds will less than $20 million. This artificial minimum capital limit put funds in the $5-20 million range in a tough position – technically allowable under the regulations but unlikely to be successful given the agency's historical approval process.
- SBA has lowered its fees and streamlined part of its committee review steps for newer program applicants. The agency has also implemented a new process for considering SBIC applications on a quarterly basis, prioritizing in order: all applications from the previous quarter, then applications from under-licenses states, follow-up funds and underserved markets, then all other applications. This streamlined review process, and lower fees is a welcome improvement to a historically challenging process that was expensive and sometimes uncertain.

The positive changes and reforms SBA has suggested and begun implementing are significant improvements to the SBIC program and make the program much more attractive to VDOs considering the development of a for-profit fund to enhance private investment in early-stage technology or other small businesses. In light of the new changes, streamlined approach and the new accrual debenture program, the statewide Ben Franklin Technology Partners are considering an accrual debenture SBIC license and leverage for the Global Opportunity Pennsylvania Fund II, LP which launched in late 2023 and recently made its first investment in an early-stage company. Time will tell whether the SBA's new licensing approach proves easier and more accessible to VDO organizations and whether the new accrual debenture license and leverage provide the necessarily flexibility to weather the lumpy cash flow cycles of early stage investing.

Ben Franklin is happy to see the SBA making positive changes and implementing additional funding structures that can make the SBIC leverage more accessible and supply additional capital for early stage investing, however several hurdles remain that make the program cumbersome or significantly throttle the ability of prospective qualified managers from pursuing either an SBIC license or leverage.

- SBICs are required to be for-profit entities. The for-profit requirement is not necessarily an insurmountable challenge in and of itself. Ben Franklin and other VDOs often create for-profit venture funds as part of their mission to support early-stage firms for economic development. The challenge, however, is that SBA frowns upon non-profit ownership and/or control of the for-profit venture fund when considering and applicant for SBIC approval. The non-profit mission of the VDO and/or the unique approach to handle fund carry incentives can cause challenges with the SBA review process or disqualify the fund from and SBIC even though the fund is formed to achieve market-based returns and governed in a similar way as other for-profit SBICs.
- Fund size can still be an issue. SBA has indicated a willingness to consider smaller entities and funds for SBIC approval. In practice, however, this willingness remains untested. Allowing smaller funds to seek SBIC licenses and leverage would encourage further investment in early-stage small businesses. Funds seeking to make seed and Series A investments, particularly in currently underserved markets, often find it challenging to raise the de facto $20 million in private leverageable capital SBA requires. Furthermore, larger fund sizes could be challenging to deploy in markets where seed and early-stage investments are in the hundreds of thousands of dollars versus several million.
- The limitation and definition of leverageable capital could be broadened and made clearer. Venture Development Organizations, like Ben Franklin, frequently receive a significant portion of their funding from public sources such as a state government, public authority or bond, or a federal program such as the State Small Business

Credit Initiative. These public funds are then used to make investments in small businesses. Ben Franklin, like other VDOs, receives returns on these investments that are retained and reinvested in additional small businesses for additional returns, creating a virtuous cycle. SBA has very specific requirements regarding the types and sources of capital that may be counted and used for SBIC leverage requirements. We believe that funds that have been returns to us from previous investments and that are retained and reinvested at our discretion should be counted as a private match for SBIC leverage.

- The Accrual Debenture is still a loan. The accrual debenture proposed by SBA will increase an SBICs flexibility to repay the loan and should allow for the lumpy cash flow cycles of early stage investing better than the traditional debenture program. Because the debenture is still a loan, however, the SBA still retains a senior position to the limited partners in an SBIC fund. This senior position can create challenges with raising funds from other qualified limited partners, particularly limited partners who are not familiar with an SBIC or may be newer venture capital investing, such as high net-worth individuals or family offices. Smaller and/or first-time funds often raise significant portions of their capital from these types of limited partners and the SBA's requirements may be too arduous a hurdle for these funds.

***SBIR/STTR Program – Impact and Suggestions***

**History and Structure of the SBIR/STTR Program**

The Small Business Innovation Research Program (SBIR); and the Small Business Technology Transfer Program (STTR) were established by Congress in 1982 to provide research and development (R&D) grant funding to technologically innovative project solutions, moving them closer to commercialization. These initiatives, the SBIR and STTR programs, are sometimes called the Nation's largest source of early stage/high-risk funding for start-ups and small business. Venture capital funds (including in limited cases SBIC funds) highly value companies that have received one or more awards through the SBIR/STTR programs for several reasons: SBIR/STTR grants are highly competitive, the proposal development and submission process is intentionally rigorous, successful applicants are typically aligned with key federal agency research interests, and the awards provide non-dilutive risk capital that allows a small business to advance and derisk their technology(ies) before raising dilutive outside capital.

To be eligible, a small business must be American owned, organized as a for-profit entity, and have less than 500 employees. Eleven (11) Federal Agencies participate annually in the SBIR/STTR programs. Six (6) agencies provide BOTH SBIR/STTR funding opportunities: Department of Energy (DOE), Department of Defense (DOD), National Institutes of Health (NIH), National Science Foundation (NSF), National Aeronautics and Space Administration (NASA), and the U.S. Department of Agriculture (USDA). The Department of Commerce (DOC), Department of Transportation (DOT), Department of Education (DptEdu), Environmental Protection Agency (EPA), and the Department of Homeland Security (DHS) offer only SBIR funding opportunities. The size of the Agency's Extramural R&D budget is the determining factor for SBIR/STTR program offerings.

Throughout the course of a year's cycle, these Federal Agencies designate R&D topics of interest and/or priority via the issuance of Funding Opportunity Announcements (FOAs) or Solicitations, and accept proposals from qualifying, small businesses. SBIR/STTR awards fund innovative research that will meet the objectives of the offering Agency and address their designated topics with proposed, innovative solutions. SBIR/STTR grant awards can range from $80 thousand for a Phase I R&D project, up to over $2 million for a Phase II project, moving the technology closer to commercialization. Award amounts and duration of project can vary, depending upon the offering agency.

**Impact and Analysis of the SBIR/STTR Program in Pennsylvania**

Pennsylvania currently ranks 7$^{th}$ in the amount of SBIR/STTR award dollars annually. From 2018 to 2023, more than 1200 companies received an SBIR/STTR Phase I or Phase II award totally nearly $850 million in SBIR/STTR funding to Pennsylvania companies during those five years. The statewide BFTP network invested in nearly 25% of those companies and IPart assisted 27 of those companies with their submissions. The DOD provided the most awards to Pennsylvania companies, followed by NIH, NASA, DOE and NSF.

**Challenges of the SBIR/STTR Programs and Suggested Improvements**

While there is much merit to having SBIR/STTR awards predicated on a rigorous proposal preparation process, agency-specific, mandated registrations and submission portals, there may still be room for improving these programs across all offering federal agencies. Understanding that the SBA is the SBIR/STTR administrator for all agency programs, they have the ability to recommend program-enhancing changes across all agency SBIR/STTR programs. Section 9 of the Small Business Act (the Act), 15 United States Code (U.S.C.) 638(j) and (p), requires that the Small Business Administration (SBA) issue a policy directive setting forth guidance to the Participating Agencies. The SBIR/STTR Policy Directive outlines how agencies must generally conduct their programs. Each Participating Agency, however, may tailor its program to meet the needs of the individual Agency, as long as the general principles of the program set forth in the Act and directive are followed. Therefore, when incorporating SBIR/STTR policy into agency-specific regulations and procedures, Participating Agencies may develop and apply processes needed to implement the policy effectively; however, no Participating Agency may develop and apply policies, directives, or clauses that contradict, weaken, or conflict with the policy as stated in the Policy Directive.

Using their role as administrator, SBA recommended SBIR/STTR policy changes related to foreign investments in SBIR/STTR companies, as well as certain aspects of awardee reporting, which became effective on May 1, 2023. Congress should encourage SBA to continuously evaluate the efficiency and effectiveness of various agency SBIR/STTR programs and to make ongoing recommendations to improve their performance as needed.

With more than 20 years assisting Pennsylvania small businesses seeking SBIR/STTR awards, IPart has developed several insights that could improve small business access to the program, increase the quality of proposals, provide better customer service to program applicants and improve the effectiveness of consultants and professionals assisting prospective SBIR/STTR applicants with their proposal preparation and submissions.

IPart engages many clients submitting SBIR/STTR proposals to fund the development of and further exploration into the commercialization of technologically innovative solutions for sector-specific problems. Several SBIR/STTR agencies offer preliminary services to help both the company and the agency determine whether the effort to prepare and submit and full SBIR/STTR proposal will be worthwhile. Examples of these preliminary services include:

- The NSF Project Pitch is a preliminary, Go/No-Go review of a planned project. The Project Pitch after being reviewed by topic-appropriate NSF Program Manager(s), results either in an invitation to the client to submit a full proposal, or a decline of invitation to submit a full proposal. The NSF Project Pitch has specific prompts, word-count limitations, and quick turn-around time, which are all highly beneficial and efficient for both SBIR/STTR applicants and supporting counselors.
- The DOE requires applicants to submit a Letter of Intent to confirm the agency's interest in a proposed project and that the project aligns with the DOE SBIR/STTR program before a company commits to a formal proposal.
- The DOD directs potential applicants to submit preliminary 'white papers' or 'quad charts' to verify appropriate alignment with DOD program goals and interests.

All SBIR/STTR-offering agencies should require a similar preliminary Phase I, pre-submission, project-focused document for agency-specific vetting. These preliminary submissions should be standardized as much as possible across all agencies with similar prompts and defined response times that allow for timely feedback and re-evaluation by both the agency and the prospective company. Mandating a preliminary SBIR/STTR project vetting by agency personnel is beneficial for the following reasons:

- For SBIR/STTR clients who do not have a planned project aligned well with the agency's mission/focus/topics, a decline in submission offer saves the client time, effort, and money, as this rejection occurs well before the bulk of proposal development and preparation occurs. This affords timely ability for clients to pursue other forms of funding that may be more productive and/or forces them to reevaluate their planned project. It greatly benefits local SBIR/STTR client assistance professionals by affording them insights into better understanding what the agencies are looking for in a competitive SBIR/STTR proposed project, as well as helping them better manage their resources for assisting SBIR/STTR-worthy clients.
- Preliminary vetting of planned SBIR/STTR projects by agency managers saves their time too. NSF typically sends their Project Pitch response to clients within a few days of its submission. This timely review/feedback of a preliminary instrument, also results in more than half of the proposers being eliminated from submitting a

full proposal, thereby, providing the agency with the ability to have a more calculated idea of how many actual proposal submissions they can expect, while also being able to assemble appropriate review panels well in advance of actual proposal review.

Navigating the myriad technical aspects to prepare an SBIR/STTR submission is unnecessarily complicated. In addition, each agency mandates their own unique registration process, could have multiple extraneous proposal requirements, uses several websites and often fails to provide timely feedback to clients. SBA can and should use their administrative oversight role to work on standardizing as much of the SBIR/STTR proposal process across agencies as possible. Furthermore, SBA should coordinate solicitations, registration requirements and timing of feedback through a single website or information channel. This would significantly enhance the experience of companies seeking awards, increase the number of companies seeking SBIR/STTR awards and likely improve the quality of those submissions.

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