

Bill could open door for venture capital firms

It would let small firms with wealthy backers collect federal grants.

By Cyndia Zwahlen, Special to The Times
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Here we go again.

That's the concern of some small-business owners who worry that a bill scheduled for a House vote today would open a door for billion-dollar companies to benefit from federal small-business programs.

The Small Business Investment Expansion Act, which has been fast-tracked for a House vote with little debate since it popped up about 10 days ago, would allow a small firm that is majority owned by a venture capital firm or other investment company to continue to qualify for federal small-business programs.

Proponents say it's needed to ensure that small biotech and high-tech firms get the backing they need to survive their long product development time frames and produce crucial drugs and devices.

"It's really a necessity," said Steve Mento, president and chief executive of San Diego-based Conatus Pharmaceuticals Inc., which has nine employees and four venture capital investors.

Critics counter that the bill gives an unfair advantage to businesses that should no longer qualify for small-business programs, including the Small Business Innovation Research grants that benefit the biotech industry, because they are backed by a deep-pocketed entity.

"How do you compete?" asked Rick Shindell, chief executive of Zyn Systems, a small technology contractor in Sequim, Wash.

Jere Glover, executive director of the Small Business Technology Council, called it "the worst piece of small-business legislation I've seen in 25 years."

"This provision that allows rich individuals to take advantage of small business preferences, that's just unheard of. This not only opens up the Small Business Innovation Research program, but all the other [Small Business Administration] programs to companies owned by venture capitalists," said Glover, former chief counsel for the SBA's Office of Advocacy.

The bill's protections, such as the requirement that the venture capital company be small, don't offer much reassurance to Shindell and other opponents. Under SBA rules, a company must have fewer than 500 employees to be considered small, and many of the country's biggest and

wealthiest venture capital firms would fall below that benchmark, they say.

The same concern was raised over an amendment offered Wednesday that would restrict venture capital firms to less than a 50% stake in a small firm and a minority representation on its board of directors.

"Donald Trump and his daughter could start a venture capital firm and qualify" for small-business contracts through their portfolio companies, said Lloyd Chapman, president of the American Small Business League and a longtime critic of the SBA.

In fact, the SBA is on his side on this one. The agency strongly opposes the bill, including the proposed change to the definition of small business for the purposes of venture capital investment. It's unfair for small businesses, the SBA said.

"It would be a step backward from our recent progress in addressing the misidentification of large firms as small businesses for federal procurement purposes," the SBA said in an e-mailed statement in response to questions from The Times.

The SBA has been touting its new rules meant to keep the country's largest companies from holding small-business contracts via the acquisition of small federal contractors. The rules, which went into effect June 30, were in response to years of criticism of regulations that allowed the giant companies to benefit from the small-business status of their acquisitions for the life of the contracts, which can be as long as 20 years.

In 2003, the SBA reinterpreted federal regulations regarding small-firm status and venture capital backing. Since then, under the agency's affiliation rules, a small firm's employee count for purposes of determining its federal size classification had to include those at the company as well as employees at its venture capital investors and their portfolio companies.

That move shut down access to Small Business Innovation Research grants for many small firms, including Conatus Pharmaceuticals.

"In an industry where capital is very, very intensively needed, Small Business Innovation Research helps to get products to market," said Alan Eisenberg, executive vice president for emerging companies and business development at the Biotechnology Industry Organization, a trade group.

Other efforts to reinstate access to the research grants for venture-capital-backed firms have been tried since 2003 without success.

HR 3576, introduced Sept. 18 by Rep. Jason Altmire (D-Pa.), a member of the House Small

Business Committee, would allow small firms with venture capital backing to qualify for all federal small-business programs, including procurement contracts, as well as Small Business Innovation Research grants. Cosponsors include the committee chairwoman, Rep. Nydia M. Velazquez (D-N.Y.), who has championed the repair of federal small-business contracting problems.

To some opponents, the bill looks like a possible end run around the new SBA rules, although the bill's backers say the issues are unrelated. They say the bill simply helps close a capital gap for small companies that was opened in 2003.

The bill, which would amend the Small Business Investment Act of 1958, is supported by the National Venture Capital Assn., which says it encourages venture capital firms to invest in small businesses.

In addition to the changes in the venture capital investment standards, the bill would establish an investment program at the SBA that would provide as much as \$2 million for angel investor groups to fund small companies. It also seeks to expand the agency's New Markets venture capital program and improve the SBA's surety bond insurance program.

In addition to voting on the amendment today, the House will vote on two others that would add green technology language to the bill. If approved, the amendments will be added to the bill and the House will then vote on the amended legislation.

If approved, the bill then goes to the Senate, which could consider it or create its own version for a vote in the future.

For Zyn System's Shindell, who also runs a website about Small Business Innovation Research grants, the House bill uses words with definitions so vague, such as control and ownership, that they create loopholes.

"When you allow that large of a question mark," he said, "it opens the doors, more often than not, for the big guy."

cyndia.zwahlen@latimes.com