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A boost for biotech

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The U.S. House gave the biotechnology industry a long-awaited victory when it passed legislation that allows small companies majority-owned by venture capital firms to be eligible for federal small-business programs.

The legislation, part of a bill that expands the **Small Business Administration's** investment programs, passed the House by a 375-72 vote Sept. 27. Similar legislation is pending in the U.S. Senate.

The bill's supporters contend the legislation is necessary because current SBA rules make many small biotech companies ineligible for Small Business Innovation Research awards, a critical source of funding for early-stage development of new drugs.

Biotech companies often don't generate revenue "for a decade or more," said Dr. Scott Koenig, CEO of **MacroGenics**, a Rockville-based company that is developing monoclonal antibodies to treat patients with cancer or other diseases.

As a result, many biotech firms depend on venture capital. Often, Koenig said, venture capital firms end up owning more than 50 percent of a company. Under the SBA's current rules, these companies are no longer considered to be independently owned and operated, and therefore aren't eligible for SBIR awards.

The new legislation would change that. Under the bill, venture capital funding wouldn't change a small company's size status as long as one VC firm doesn't own 50 percent or more of it.

"Private investment in small business is a good thing and should be encouraged, not discouraged," said Rep. Sam Graves, R-Mo., the bill's co-sponsor.

At least one Baltimore-area biotech could benefit from a change.

Despite being backed by about \$40 million in venture capital, **Alba Therapeutics** was unable to convince its investors to fund a "risky" development related to its treatment of healthy cells in patients with diabetes, said Dr. Blake Paterson, CEO of Baltimore-based Alba. And because the firm is backed largely by venture funds, Alba was unable to apply for a federal small-business grant of \$1 million to \$2 million for the project.



Nicholas Griner | Staff

Dr. Blake Paterson of Alba Therapeutics says his firm would go after federal funds if permitted.

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The lack of funding forced Alba to put the research on the back burner.

"It closed the door to an important funding mechanism to the best biotech companies in the industry," said Paterson of the rule that didn't allow venture capital-backed companies to apply.

Before turning to venture capitalists for funds, Alba Therapeutics received about \$200,000 from a SBIR grant to develop a treatment that protects healthy cells from being destroyed in patients with diabetes. If the legislation passes, Paterson said the company plans to apply for more federal money to support the tabled research.

"This represents a return to a state of rationale and normalcy for the industry," Paterson added.

Question of control

But the SBA and many small-business groups contend ownership equals control when it comes to business.

Small businesses can receive venture capital and still be eligible for SBIR awards under current rules -- as long as majority ownership stays in small businesses' hands. In fact, 17 percent of the SBIR grants awarded by the **National Institutes of Health** in 2004 went to venture-backed small businesses, according to the **Government Accountability Office**.

The House legislation would allow large corporations to establish venture capital subsidiaries, invest in small firms and get advantages designed for small businesses -- not just SBIR awards, but other federal deals, too, critics contend.

"A VC firm could create a conglomerate controlling 1,000 small companies, employing 100,000 people, and generating billions in revenue, and the SBA and other federal agencies would be forced to treat each company in the conglomerate as a small business as long as it had fewer than 500 employees," said Todd McCracken, president of the **National Small Business Association**.

Rep. Steve Chabot, R-Ohio, said he thinks this concern was addressed by his amendment to the bill, which specifies that a company wouldn't be considered a small business if a single VC firm owned a majority stake in it.

But large businesses could sidestep this obstacle by establishing two or more VC firms, which together could acquire a controlling interest in a small business, critics contend.

"It's so easy to get around it," said Jere Glover, executive director of the NSBA-affiliated Small Business Technology Council and head of the SBA's Office of Advocacy during the Clinton administration.

Chabot's amendment is "a Band-Aid on a gaping wound," he said.

The bill also would, for the first time, allow universities, which already receive more than half of the federal government's research dollars, to access SBIR grants through investments by VC

subsidiaries, said Rep. Don Manzullo, R-Ill., former chairman of the House Small Business Committee.

"This provision will further decrease federal R&D dollars going to independently owned and operated small high-technology firms," Manzullo said.

And the change could make the competition for federal funds more fierce, said Stephen Auvil, director of the **Office of Technology Development** at the **University of Maryland**, Baltimore County's business incubator. Companies still developing technology that aren't getting venture capital will now have to compete with more mature companies, some of which are backed by venture capital, for the same federal funding.

"It will make it more challenging for [startup companies] to get to the next level," Auvil said. "But some argue that if they can't compete then maybe they don't deserve to get the funding."

VCs don't fund basic R&D

The argument that large companies would try to abuse the legislation to get small-business contracts doesn't make sense to some venture capitalists.

Some corporations have venture capital arms, but they mostly invest in later-stage companies prior to acquiring them outright, said Mark Heesen, president of the **National Venture Capital Association**. **A Johnson & Johnson** is not going to try to "figure out how to penetrate a three-person biotech company," he said. "It's not in their strategic, long-term interest."

For a huge company, an SBIR award "is not going to impact your bottom line at all," he said.

But SBIR awards are vital to small biotech companies, he said.

"These young companies require government support to keep the pipeline of innovation moving and the venture capital community to bring those innovations to market," he said. "Venture capitalists do not fund basic research and development. Without government support, these innovations will never get to the point where a venture capitalist can take it further."