

The Journal of **PRIVATE EQUITY**

Strategies and Techniques for Venture Investing

VOLUME 3, NUMBER 2

WINTER/SPRING 2000

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In keeping with our promise to provide thought provoking and useful material not readily available elsewhere, we have a host of articles in this issue touching upon subjects out of the spotlight, each offering lessons with wide application.

The industrial technology sector, especially as it applies to aerospace, is the subject of our first two articles. John F. Lehman, former Secretary of the Navy and member of the National Security Council, along with his associate, Stephen L. Brooks, writes about the changing face of the defense industry over the past decade. This has been an active arena for leveraged buyouts, and many of the issues presented are applicable to a broad range of industries. Where to find these companies? How to operate within a declining industry? How to formulate an exit strategy? These are questions any buyout shop faces. The answers provided are not only interesting, but also useful in confronting similar quandaries about other sectors, even ones such as the Internet that are strikingly different.

Commercial airlines present a topic with a colorful past. How has the move away from regulation affected the way investors think about startup airlines as investments? Airlines and other technology businesses evolve in spurts, as injections of new ideas come on-stream and build market share. Products that deliver lower cost and higher output also deliver magic to investors, and those who bet on changes can reap outsized rewards. Is it possible that the new round of Regional Jets will deliver this type of punch to the airline business? Matthew G. Andersson, Tom Svrcek, and Brian Erskine lead us through the possibilities in an engaging article about a special type of startup airline.

Management buyouts inherently can produce conflicts of interest. Andrew R. Brownstein, Mitchell S. Presser, and David E. Shapiro, of Wachtell, Lipton, Rosen & Katz, examine the use of special committees to protect against possible legal complications. There are three judicial standards that control court review of MBOs: the business judgement rule, enhanced scrutiny, and entire fairness. While we are all familiar with the standards of the business judgement rule, the two higher standards must be carefully understood. Selection of the special committee and how to make it effective are also examined in this article.

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Given the multi-layered complexity of the beast, an overview of healthcare investing is difficult to imagine. But Lewis Lorton tackles each piece of the puzzle and foreshadows potential pitfalls. The single biggest issue to confront is the broad and complex environment of healthcare. How difficult are the legislative and regulatory issues? How fragmented are the medical markets? How powerful are the competitors? How accepted is the technology? This article presents a thoughtful checklist to assist investors considering an investment in this arena.

Our interest in internationally based private equity leads us to an insider view of venture investing in China. While we may read much about China in general, not often do we have a chance to learn first-hand about venture capital activity in this giant and rapidly changing Asian powerhouse. David Ahlstrom, Garry Bruton, and Eunice S. Chan lead us through all the interesting questions: How to source deals? How to manage portfolio investments? How to exit? Some answers may seem natural and obvious to you, but others will surely surprise.

Our final article asks a provocative question: Does the U.S. government's Small Business Innovation Research program do us any good? My own knee-jerk response to this question may be similar to yours. But Josh Lerner, of Harvard University, has tackled this question in a scholarly and insightful manner, and his answers may propel us all to rethink our judgement.

James E. Schragger
Editor