The Journal of
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Strategies and Techniques for Venture Investing

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Last issue we spoke of the stock market as similar to the weather: everyone talks about it, but no one does anything about it. For those of us in private equity, the stock markets, tempestuous as they may be, remain a very important gate through which we often pass, whether via the initial public offering of a start-up company, the strategic sale of a more mature business, or the purchase and taking private of a business formerly part of a public entity. The public stock markets are a central player in all we do. In this issue we tackle three topics that are center stage this year: Determinants of stock market performance, how to work on the income statement and balance sheet aspects of a turnaround, and the role of corporate venturing.

Our first piece requires a bit of extra explanation, as in it, Dichev and Janes find startling evidence that lunar cycles have significant effects on stock market returns. We are not an academic finance journal, so we do not present this article as the final word on the important topic of extraneous effects to stock market prices. However, the authors find a nearly doubling of returns in the 15 days around the new moon versus the 15 days around the full moon, and they find this for all major U.S. stock indices for the last 100 years and in almost all major stock indices in 24 other countries over the last 30 years. At the very least, these data are food for thought as we all construct our own model of the influences on stock market behavior.

On a bit smaller, but no less important level, our next article looks at a selection of IPOs and evaluates the effect of the strategy of the firm, the background of the founders, and the reputation of the underwriters. Galbraith, De Noble, Stiles, and Merrill take a sample of 39 business-to-consumer Internet businesses and 25 business-to-business internet offerings and track them through the IPO and first year's performance. Their conclusions are that strategy does seem to matter, and that at least for this sample, the reputation of the firm's underwriter had little effect.

Sticking with stock market measures of success, Teal and Hofer have complied data on 126 companies from *Inc.* magazine's listing of America's fastest growing companies. These companies are rated on three axes: the strategy of the venture, the industry structure and the make-up of the founding venture team. Does it matter if your product sells at a higher price than average? How strong is the industry effect for these "fastest growing" companies?

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How important are in-depth levels of prior entrepreneurial experience? This article reviews these and other measures and adds further data to previous important research on these topics.

Who among us isn't thinking and working with turnarounds these days? And what is the standard response, in almost any case? A new CEO. David Auchterlonie writes about the idea of replacing the CEO with something different, a turnaround management firm instead. Before you dismiss this as little more than a marketing piece for turnaround firms, reflect for a minute on Margarethe Wiersema's paper, published in the *Harvard Business Review,* entitled: "Holes at the Top: Why CEO Firings Backfire" (December 2002). Auchterlonie takes us through some early warning signs to watch out for when thinking about changing CEOs or engaging a professional turnaround firm.

There is of course another side to turnarounds, and that is the equity side, the need to raise additional capital. Peter Susko comments on the messiness and unhappiness that generally accompanies the dilution meted existing investors and the preferences demanded by fresh money. Ever wonder how much of a liquidation preference the new investors can demand? Or what will happen to the residual ownership if a liquidation is required? On a happier note, what about the terms of conversion of preferred stock to common in case of an IPO? Or dividends, or pay to play provisions? These are are ably handled by Peter in this piece.

Xerox, Thermo Electron, and 3M are among the most high-profile innovators in American industry. But how do these companies develop innovations? How do their innovation systems compare, and how are they different? Altman and Zacharakis investigate the issues of how strategy, culture, and viability interplay with each other in these three firms. What can we in private equity learn from those in corporate venturing?

Our final piece continues with the topic of corporate venturing, but in this case, as applied to the pharmaceutical industry. Andrew Reaume examines Pfizer, Johnson & Johnson, Merck, Lilly, Bristol-Myers Squibb, and GlaxoSmithKline with an eye toward their processes of drug discovery and development. Which companies do the best job? Which are best positioned for the future? What is the role of private venture capital? Reaume looks at these questions and reviews the idea of corporate venture capital activities as similar to financial options, with finite downside and significant upside. We think it will provide thought-provoking reading.

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