

Oyster Communications (A)

In June, 1995, Financial Education Publishers (FEP) began selling its first product, *The Colorado Guide to Financial Sources for the Entrepreneur and Small Business Owner*. Within eleven months, 4000 copies had been sold. By June, 1996, FEP founder Margot Langstaff had begun to get solicitations from companies such as USWest Communications and American Express to put her financial resource information on their internet web pages.

In February, 1996, C.J. Juleff, Vice President of the Colorado Banking Association, suggested that she, Margot and Kenton Kuhn, owner of an internet software design company, form a new company which would design, develop and sell information pages for the World Wide Web. Margot knew that this new venture would need a central location where designers and software engineers could work together with the customer support and marketing representatives to respond to quick changes that on-line development required. If she decided to join this new company, she would have to change the focus of her company from marketing and data compilation to coordination and product design. New roles and responsibilities would probably preclude her working out of her home.

Margot thought carefully about the impact of giving up her home office. She was not as concerned about a change in her daily schedule as she was about the loss of flexibility and the rush-hour commute.

Her daughters, a toddler and an infant, were cared for by a full-time nanny. But when the nanny left, or if she needed help, Margot was there. Margot needed to think carefully about the strategic direction she and her company should take.

The Beginning

Margot Adam grew up in Connecticut and spent much of her life in New York City. In 1973 she graduated from high school and went to Utah to ski before starting college. When her father died in 1975, Margot joined the army and spent three years as a medic. She attended night school and worked in medical and surgical intensive care units at Ft. Devens, Massachusetts, and ended up overseeing a large military outpatient clinic. In 1979, she left the army and was recruited to help set up an operating/recovery room and outpatient clinic in Haiti. At the same time, she enrolled in the University of Connecticut's nursing program. When she finished her degree in 1982, she joined Yale-New Haven Hospital's surgical intensive care unit, working her way up to supervisor for the night shift. "I thought that there had to be an easier way in life than dealing with the dregs of society--every pimp, prostitute, and drug dealer getting shot in the middle of the night" for \$22,000 a year. So, after two years as a nursing supervisor, she went to work as a drug salesperson in Manhattan for Schering Pharmaceuticals.

Within a year of taking the job at Schering, she received a call from a headhunter about a sales manager job with W.L. Gore. Gore's medical division made artificial arteries out of the same fabric used in Gore-tex waterproof sportswear. A few years later, a call from Medtronic, Inc., the largest manufacturer of pacemakers, prompted another job change.

At Medtronic, Margot assisted in starting a new medical devices division. Her responsibilities involved three acquisitions, internal product research and development, FDA product testing and approval

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regulations, product launch, and the formation of a salesforce. “It was a tremendous opportunity for me to learn how the pieces of a corporate puzzle fall into place. That was my executive training.” A glance at the company's annual report showed her that, unless she changed course, there were no promotion opportunities in her current position. Margot applied to Harvard Business School and enrolled in their MBA program in 1989.

In 1991, Margot finished her MBA, married Samuel Langstaff, and moved to Denver where Sam had grown up. “Harvard was the best of times and the worst of times,” she commented. “But I learned about how businesses work and I learned how to get information.” Her move to Denver was not quite what she had expected, however, when, after several months she did not have a job. So she started doing independent consulting. Working by herself was quite a change from the corporate world to which she had grown accustomed. However, she was able to secure contracts with Somatogen, RPI, and Synergen to provide R&D consultation and market research. “Mostly I was doing market research, but I repeatedly got requests for financial information. I had never been involved in financing, but I had no qualms about getting on the phone and I was able to assist them in securing some financing.”

In 1994, Margot became involved with the Denver Chamber of Commerce and was put on a task force to study small business financing. The Denver Chamber of Commerce task force wanted to put together a pamphlet outlining small business needs. However, they soon realized that this was a bigger project than they were able to deliver. Margot's discussions with members of this task force convinced her that there was a need for a publication that contained financial information for small business owners. Margot's involvement in community activities put her in touch with lenders and policy makers, and she became increasingly aware of the issues that small business owners faced in obtaining financing. Through an appointment by Colorado Governor Roy Romer, she became involved in the Colorado Women's Economic Development Council and, in 1995, she was elected as a delegate representing Colorado at the White House Conference on Small Business.

Financial Education Publishers

Having set up an office in her home for her consulting work, Margot started doing a market analysis to determine the need and set the specifications for a book on small business financial resources. Working out of her home, Margot contacted business organizations, banks, and accounting firms to find out what information was needed and what was available. At any given time Margot was managing up to 18 contract employees from her home office.

Her first child was born in October, 1994, and by January she had put together a team to put out *The Colorado Guide to Financial Sources*, a directory of sources and types of financing options for small businesses.

I took out an SBA loan--the whole works--in January, and we came off press on June 15. At any given time I had anywhere from 5 to 18 contract employees putting together this book: the writers, the editors, the graphic design firm, PR, marketing, etc. All of the pieces were in place

and it was not difficult to do that since I had put together teams before to design, manufacture, and get through FDA medical devices. It's the same, whether it's a medical device or a book, it's really the same components that you have to put together. I was very happy that I didn't have to deal with the FDA though!

Part of her market research efforts had been spent exploring different avenues of promotion and distribution. It soon became clear that the easiest way to distribute her book was through large associations that dealt with small business owners. Margot was successful in arranging alliances “which brought down my marketing costs tremendously, and those [contacts] continued to keep going.”

“My clients really designed the book,” she explained. “I went to lending institutions and trade associations and asked them what they had and what they needed. Not only were they eager to have their information made available, they were also interested in providing this type of information to their clients. I had a large number of books sold before we went to press.” And the ads from banks, associations, and CPA firms practically paid for printing the first 5000 copies. Within a year she had paid back most of the SBA loan [see Financial Statements, Exhibit 1].

The book got attention from USWest Communications Division of Association Management and American Express (AMEX), both of whom inquired about information for other states. USWest was in the process of setting up an internet Website for its business customers--targeted for January 1997--and was interested in Margot's book as the content for their financial section. Margot began getting requests for seminars on funding opportunities and financial planning.

In January, 1996, shortly after the birth of her second child, Margot met with C.J. Juleff, Vice President of the Colorado Banking Association (CBA). CBA was interested in distributing the book to their bankers. CBA had an on-line service for their bankers which listed the products and services that CBA provided. C.J. suggested that Margot meet with Kenton Kuhn, CEO of Intellinet, the provider of the on-line service, to get her book displayed on CBA's internet web site.

Oyster Communications

Intellinet was a designer of internet web pages. Kenton and his partner Greg Stander had a staff of about 20-25 people, mainly software engineers, and operated out of a 6,000-square-foot office in downtown Denver. Their specialty was designing on-line services for organizations such as the CBA and the Colorado Association of Commerce and Industry. Kenton showed Margot the on-line services that he had designed, some of which had icons and links for business and finance information but without the detail that Margot had included in the *Colorado Guide*.

C.J. was interested in providing on-line financial information to municipalities and trade associations. Kenton knew that he and Greg could provide graphics and solicit on-line advertising. But he also saw the larger possibilities in linking potential business clients directly with the financial institutions that Margot had listed in her book. C.J. and Kenton proposed setting up a partnership with Margot to provide on-line financial information and referral.

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“The world is our oyster,” C.J. prodded. Margot knew that this technology was so new, they could almost do whatever they wanted. Kenton and Greg had the programming skills, C.J. had association contacts, and Margot understood the content and knew how to sell any products they might design.

Oyster Communications could function as a marketing and distribution company, with Intellinet providing the technical support. The *Colorado Guide to Financial Sources* would be a subsidiary or division of Oyster Communications. Oyster would license Margot's book, and brand it with the licensee's name and logo, e.g. *The American Express Guide to Financial Sources*. The book design would be tailored to each licensee and would contain information from all 50 states.

Contract employees and a home-office base would not be sufficient to roll out the kind of company Margot, C.J. and Kenton envisioned. And though Margot was confident that she and Kenton had the skills and experience to build a new company, she was not sure that she was ready to move out of her home. She was enjoying the flexibility and independence of running her own company and she knew that her book, and the potential of licensing its contents, would provide adequate returns without compromising her present lifestyle.

Oyster Communications (B)

“The future is in technology,” Margot Adam Langstaff observed, “and I’m going to help lead the way.” Margot’s book, *The Colorado Guide to Financial Sources for the Entrepreneur and Small Business Owner*, had sold over 4000 copies in its first year of publication. In June, 1996, Margot began to get solicitations from companies such as USWest Communications and American Express to supply the content for their internet web pages. With financial information and bill paying services on the internet gaining acceptance, Margot’s sights began to change from print to on-line delivery. She was also exploring the possibility entering into a partnership to launch a new company that would use the internet not only as a provider of financial information, but as a direct lending resource.

Originally developed for military intelligence in 1968, the internet was becoming increasingly used for marketing, information dissemination, and personal and business communication in the 1990s. As the World Wide Web of graphical presentation technology became easily accessible through web browser programs and search engines, interactive communication between customers and suppliers launched the internet as a powerful advertising and distribution medium. As Electronic Data Interchange and Electronic Funds Transfer became more commonplace, financial institutions saw interactive information sites for their customers as not only a powerful marketing tool, but a low-cost means of providing transaction information and services.

By 1996, hundreds of banks had created websites to advertise their services on the internet. In October, 1995, First Security Bank was the first to launch Security First Network Bank, a remote-access on-line banking service which allowed customers to set up accounts, transfer funds, and pay bills electronically. Bank of America had set up an information web-site which allowed customers to complete credit-card and home-loan applications. Intuit had joined with America Online to provide checking-account statements, fund transfers and bill payment services to AOL subscribers. Microsoft was preparing to launch a personal financial management program through its Microsoft Network. Canada’s Bayshore Trust Company had begun accepting “cyberapplications” for consumer loans, with approval of loans up to \$15,000 within two minutes.

As Margot and her partners prepared for the launch of the venture, they faced a number of questions regarding strategy, structure, and sources of financing. Furthermore, Margot realized that at some point her venture would need a formal business plan. The remainder of this case describes the decisions and events that occurred during the early stages of Margot’s efforts to make Oyster Communications a viable business organization.

The Partners

C.J. Juleff, Vice President of the Colorado Banking Association (CBA), had developed an on-line bulletin board system for the financial services industry in 1993, with the help of Kenton Kuhn, owner of Intellinet, a designer and provider of internet services. C. J. recalled,

Margot contacted me in the hopes that I would endorse her book. I couldn’t think of anything more boring than spending some time with a woman who had written a financial catalog.

About ten minutes into the conversation, I knew this was a hot idea, but I also knew that it needed to be on-line so I called Kenton and arranged a meeting.

Kenton, like C.J., was intrigued with the possibilities that Margot's information resources represented. Kenton's company, Intellinet, had been the first to establish an online legislative database and the first private vendor to operate the Central Filing Lien Program authorized by Congress in 1985. Intellinet designed and operated the Colorado Central Indexing Program for the Colorado Department of Motor Vehicles, a Tax Locator Index, and an on-line mortgage information service for home buyers and realtors. Kenton's partner, Greg Stander, was responsible for Intellinet's software design and programming, having developed software for Hewlett-Packard for six years before helping Kenton launch Intellinet in 1989.

Kenton had the infrastructure, the people, the computers, the phone lines. This was the growth opportunity that he was looking for. "This company is based on the infrastructure that we [Intellinet] already have. We could just charge for our design services up front--we'd get paid and they'd get financing--but we made the decision that we'd rather be an owner and share in the long-term. There's not much risk."

The Oyster Concept

In August, 1996, Margot, C.J., and Kenton met with an attorney, and Oyster Communications was born. C.J. quit her job with CBA and she and Margot began to contact lending institutions and associations in the hopes of having a contract in hand to help direct their first efforts. One fruitful contact was Women Inc., a California association involved with financing businesses owned by women. C.J. and Margot offered to design their web site, laying out sketches and talking about the types of financing options that could be included for their membership.

In addition to listing sources for financing in an on-line searchable format, Margot and C.J. envisioned an automated system for actually matching a potential client with the appropriate source of capital, using an on-line screening process. There were twelve categories of financing sources, with thousands of players in each category, that served different levels of client needs and risks: commercial banks, investment banks, SBA lenders, business and finance brokers, commercial finance companies, venture capitalists, angel capital networks, micro-loan companies, factors, leasing, state and federal programs.

Margot and C.J.'s goal was to develop an internet product which could locate the appropriate sources of capital for a small business. C.J. knew that this product would be extremely useful for banks and business associations. Margot would provide the exclusive license to Financial Education Publishers and subsequent financial information, which would need to be continually updated. Kenton, in addition to his web-design expertise, would provide office space, telephone lines, and \$60,000 to sustain operations until revenues from contracts started coming in. Greg, with his expertise in software engineering, understood the technical aspects of accessing and translating information and linking customers and providers.

Software for credit scoring was already being used by the largest U.S. banks. The technology on the encryption of business loans to ensure security was being perfected. But despite the growing acceptance of the internet as a source of information, and credit card and “smart card” technology advancing quickly, a referral network for financial services and information was not yet available.

C.J. described Oyster as

...a business resource, a complement to the financial services industry. On-line loan approvals allow the small business person to avoid the humiliation that comes with going to a financial institution and begging for money. Or being turned down because your credit isn't good enough or your business plan isn't put together well enough. We also see an opportunity to assist banks in their loan process by automating systems for them that currently are prohibitive cost-wise. A lot of this is public information, but we're putting it in a format that's usable and accessible.

C.J. understood the process of working with financial institutions and business associations. “It always takes a lot longer than you ever anticipate to get people to the table and actually go through all of the corporate committees that need to be involved with these big companies.” Margot and C.J. started making contacts and designing promotional literature, and outlining the design of the website.

Kenton was convinced of the financial potential of linking business owners with a fast, accurate picture of their credit options. “We offer the bank anonymity--because the bank doesn't want the person to know who's turned him down--and we're doing the [bank's] screening for them. Eventually we'll go beyond that and offer a list of venture capitalists and factoring companies. This has unlimited potential.” Kenton continued,

Henry Ford didn't invent the automobile; he just put the pieces together. Credit reports have been around, scoring has been around, lending has been around, but I don't think anybody has put those pieces together in the manner that we want to and deliver it in this new medium. The internet really didn't exist three or four years ago.

False Leads

Margot and C.J. viewed Oyster as an intermediary, linking associations whose members wanted to access financial information and the financial institutions that obtained customers as a result of Oyster's referral service. Kenton suggested that in addition to reaping commissions from loan referrals, Oyster might also set up its own lending arm.

One of C.J.'s early contacts was Stuart Scott, Financial VP of Lending Resources, Inc. Stuart was instrumental in obtaining financing for Security First, the first internet bank established in the United States. When Stuart flew to Colorado to lecture at the CBA's annual meeting, C.J. arranged dinner with him to discuss the possibility of setting up an internet bank. Stuart's contacts in the banking

industry could be instrumental to their getting financial backing for their venture. A deal with Lending Resources could pave the way for Oyster Communications' move into internet banking.

As Margot and C.J. saw it, there were only a few companies with the financial resources and expertise to set up an internet bank. With Stuart Scott's connections, C.J.'s marketing expertise, and Kenton's programming skills, Margot believed that Oyster was in a good position to secure contracts from major financial institutions to provide internet applications services for on-line banking transactions, financing information, and loan approvals.

C.J. also introduced Margot to Phil Tucker, the CEO of First Commercial Bank in Colorado. First Commercial was interested in setting up an electronic virtual bank, but Phil wanted to move quickly so that his bank would be the first bank in Colorado to process SBA loans on-line. Phil Tucker wanted a time-line of deliverables and a contract for Oyster's services within 30 days.

It took more than 30 days for the Oyster partners to realize that the capital requirements and legal hurdles to set up a bank were more than they could handle at this point. A partnership with Stuart was not workable. He was a banker, not an entrepreneur. A contract with First Commercial was premature. They were not ready to commit the resources necessary to add interactive banking to their on-line services. However, the months spent on research led the four partners to a clearer understanding of Oyster's original focus on lending referral.

Refining the Plan

While talking with various banks and lending institutions had taken a lot of time and energy, Margot and C.J. were closer to understanding what Oyster would need to put their loan referral service into place. They refocused their energies on designing a product which would have a user-friendly interface between the credit scoring function and the lending institutions so that the small business owner or small community bank could access and understand the same information that large banks were currently able to do. The internet was a more efficient and less antagonistic lending officer than an individual bank or credit bureau.

Oyster Communication would provide a three-tiered information network. The first level, credit score computing, would enable a business owner (or potential business owner) to submit financial information, bank and credit card numbers--information requested by any lending agency--in a computer-readable format. This information would be collated with credit bureau information and submitted to the credit scoring program. Oyster's second level would translate the credit score and act as a filter to direct the user to appropriate financing options, debt or equity, based on acceptable scores for different loan programs and lending institutions. If one scored well, they would be directed to a debt source and an on-line application. If no financing options were available, the program would divert the user to an educational site containing business plan templates and information for improving credit ratings. "The idea is that nobody should come to the site and leave empty-handed. They'll leave with a loan or a better understanding of how to get a loan next time."

In November, several tele-marketers were contracted to collect, validate and update the financial sources that Margot had compiled for her book. Margot set to work designing the questions that would drive the search engine. After two to three months of frustration, she called C.J. to help. The two of them spent two more months before realizing that they couldn't solve the search problem that the volume and diversity of clients and financing options required. They needed a sophisticated process for screening, and an automated credit scoring program could actually start the process.

Credit scoring was a systematic process for assessing loan risk. The 24 largest banks in the U.S. used an automated scoring program called "Fair Isaac" for commercial loan approvals. This automated scoring process minimized the loan underwriter's task of risk evaluation. Depending upon loan volume, the Fair Isaac Scoring Service could save \$300 to \$1,000 per loan evaluation over manual scoring methods. Fair Isaac's annual licensing fee of \$18,000 put it out of reach of the smaller community banks.

As Margot and C.J. wrestled with flip-charts and search link designs, they realized that they needed a loan screening program like Fair Isaac. Although this was not a perfect fit for the equity capital referrals, it would solve the debt referral issue. At this point, Greg was called in to evaluate the trade-offs between developing their own screening software and purchasing a license from Fair Isaac.

The Breakthrough

While contract negotiations with Fair Isaac, business associations, and large banks were frustrating, at best, they forced the Oyster team to gather the information they needed to put together a formal business plan. As they researched business-lending demand, financing options, internet use, and content providers, they made three important discoveries.

The first concerned the nature of business lending. While there were twelve tiers of capital sources, lenders in each category used similar screening criteria. Differentiating within a category was not feasible, nor was it necessary. The only necessary criterion for differentiation was geographic. If Oyster could screen applicants by location, they could easily direct them to a financing source in their area that fit their credit profile.

Margot realized,

We don't need the telemarketers because where we generate the most money is on origination fees. We don't need all 60,000 banks on our network, because if you're bankable, any bank wants you. But banks are geographically defined. If I meet a bank's lending parameters, I still have to have a bank there to do business with, to validate who I am. We realized that if we went to the top five banks in the US we could cover the whole country: Bank of America is in 11 states, Bank One in six states, Nations Bank is in six states. But only the smallest percent of business owners fits the bank parameters. So we need to group the other lenders into scoring categories. If we can score the loans, we can refer businesses to the right source. Only the lowest scores, those who won't qualify for any loans, will be referred for equity funding.

The second discovery freed them from their dependence on a contract with Fair Isaac. While Fair Isaac was the “trade standard”, other companies were involved in developing similar software for credit scoring. One such company, Affinity Technologies, had gone public in May, 1996, and was looking for strategic alliances. Headquartered in Columbia, South Carolina, Affinity specialized in automating mortgage loans and credit card applications, and operating touch-screen ATM kiosks. Not only did they have the technical expertise to create the software that Oyster needed, they were eager to enter into alliances that boost their name recognition in the banking community.

The third breakthrough occurred just as negotiations with Affinity began. The Annual Conference of the National Black Chamber of Commerce would be held in Denver on July 30, 1997. The Black Chamber of Commerce boasted 163 affiliate chapters and 60,000 members. Margot contacted the Chairman, Herman Malone in hopes of setting up an contract with the Chamber’s membership. She sent him the remaining inventory of her book to distribute to the conference attendees.

On-line lending approval was the perfect leveler for loan approval and access to capital. This had been the appeal for Women, Inc. Similarly, Herman Malone understood the benefits of anonymous loan screening for minority businesses. Margot was sure that if she could get a contract with the Black Chamber, the big banks would follow. “If we have the first channel of distribution for them, what can a bank say to them? They can’t say no.”

As the negotiations with Affinity and the Black Chamber of Commerce began, there was still a lot of work to do. C.J. was working on promotional material. Kenton was working on the internet linkages and web page designs. Greg was scrutinizing Affinity’s business plan and software specifications. Margot was working out the details of Oyster’s formal business plan.

Margot admitted,

What makes it tough is that all of us have been working so hard on [formulating proposals and making contacts] that we’re all under a cash flow crunch right now. If we can enter into a strategic alliance with Affinity, we’ll be in a good position to get exclusive on-line contracts with several big banks. In addition, we’re negotiating with the American Banking Association and the National Black Chamber of Commerce--these are enormous membership associations. This will give us the financial base and the credibility that we need to get this off the ground.

Right now we have no idea what all this will look like in six to eight months. The technology is moving fast and, to be perfectly frank, we don’t have a business plan. But Kenton and I have built companies before so we know what is entailed and the type of infrastructure that’s needed. We don’t have it down on paper but we know the type of staffing and wrap-up that we will need very very fast--as soon as that first contract is written. We are in the process of identifying individuals who are willing to leave their employment and come on board full time.

There were still unsolved problems concerning Oyster Communications's organizational structure, equipment and personnel needs. This new company was different than anything Margot or C.J. had engaged in before. Licensing agreements and commission rates would need to be ironed out. Oyster would need a design team and dedicated core of software engineers who worked closely with clients and with each other to keep abreast of rapid changes in the market. And what would protect them from the increasing competition that was sure to come?