DALLAS CAPITAL

SUCCESSSTORIES

INTERTHINX

Data validation/fraud prevention company
serving the mortgage industry

Bill Dallas' candid case study
of a company transformed
by Dallas Capital

OVERVIEW

The origination of a home loan fundamentally changed as savings and loans, commercial banks and independent mortgage bankers began to outsource the expensive and highly regulated relationship with the consumer to a cadre of mortgage brokers. By the mid-1990s, independent mortgage originators were taking approximately 70% of all applications.

The rise in broker business brought a rise in fraud, so several mortgage-savvy entrepreneurs started a business called Affinity Corporation (Asset Protection Through Information and Technology) with IndyMac. The purpose of the company was to begin to build a relational data base of bad loan participants—mortgage brokers, realtors, builders, processors, escrow officers, title insurance agents, borrowers—and compare it to current loans preventing the funding of fraudulent loans from mortgage originators.

As with many early startups the idea was good but the execution was poor. A private equity firm funded by Friedman Billings & Ramsey (FBR) purchased the assets of the company from IndyMac, but they too were having limited success with the company.

I was asked to join the company and figure it out. I was immediately interested due to my experiences at First Franklin regarding mortgage fraud. To help reputable mortgage brokers establish and uphold the highest possible ethical standards, I had founded the California Association of Mortgage Brokers in 1990 with Chris Salazar, who would join me as an early investor in this new venture.

OPPORTUNITY…AN IDEA JUST AHEAD OF ITS TIME

In his landmark book, The Innovator's Dilemma, Dr. Clayton Christensen talks about the danger of listening to your customers. That sounds like business blasphemy but he relates the concept to his theme of disruptive technology, which could be described as developing a product that the market "didn't know it needed." This concept relates to Henry Ford's legendary quote: "If I had asked people what they wanted, they would have said faster horses."

Our mortgage company customers weren't clamoring for Affinity's offering at first (see upcoming "Challenges" section.), but we knew the value of what we had envisioned. And right around the corner, economic and regulatory forces would shift monumentally in our favor. You can go broke with an idea ahead of its time unless it's just ahead of its time.

CHALLENGES

The primary challenge was the industry. Delinquencies were low, home prices were rapidly rising, and most companies and their compliance folks weren't focused on the bottom part of the beach ball (fraud and defaults). The atmosphere was completely different from the zero-defect world we live in today. We found another challenge in each company's compliance department. It seems that folks won't purchase products that potentially could put them out of a job. Imagine that!

Finally, we knew we needed access to capital and resources to continue to build out the relational database platform. This was a big idea and need a big data partner with deep pockets to grow the business.

WHAT WORKED...AND DIDN'T

Worked: Aggressive growth through merger and acquisition
Along with our competitors, we were creating a market given the newness of our products and the evolving needs of customers. The best way to grow in such an early market was through merger and acquisition. We applied this concept when we merged with Appntell, instantly becoming a major player in this new space. Another company applied the concept to us when ISO (Insurance Services of New Jersey, today Verisk Analytics Company) bought our company. The aggregate organization rebranded as Interthinx and became the market powerhouse.

Worked: Smart mix of new and current talent
The founders of the original company were dedicated and visionary, but they couldn't take the concept to the next level. The company still needed them but in an appropriate capacity. At the same time, we needed new talent to seize the sizable opportunities ahead. I hired Kevin Coop, a senior executive at Homestore.com and changed the name of our company to Sysdome. Hiring a top-notch sales director from Homestore.com was the right move but a big risk. The SEC and FBI were investigating Homestore.com for a host of issues that ultimately landed several high-level executives in prison. Per our due diligence, Kevin brought no baggage, only plenty of talent to take our company ahead.

Didn't: Lack of product scalability
In the company's early stages, product development was long on complexity and short on flexibility. This occurs when startups focus on the "breakthrough" aspects of their technology instead of its marketability. For example, a veritable "Mr. Wizard" created our original technology; however, he wrote the source code in his native language of Farsi.

At the onset, our technology was not serving customers in the real world. The relational data base was one-dimensional and created lots of false positives in our fraud alerts. Our broker approval product didn't work. We needed to simplify our technology while diversifying and improving it. With this, we took the technology “out of the lab” and into prime time. It required time, money, and a salesperson mindset to satisfy customers without excuses.

Didn’t: Conventional management techniques
The founders of Affinity had never operated a startup business. Like most first-timers, their problem was the allure of a good plan, a solid product strategy, and thorough market research—a seeming contradiction. In the old days, these things were indicators of likely success. The overwhelming temptation is to apply these to startups too, but this doesn’t work. As a startup, Affinity did not yet know who their customer was or what their product could or should be.

The old management methods are not up to the task. Planning, forecasting, and cash flow models are only accurate when based on a long, stable operating history and a relatively static environment. Affinity had neither.

BIGGEST LESSON(S) LEARNED
Entrepreneurship is a different kind of management. No, you didn’t get that wrong— entrepreneurship and management in the same sentence! Despite the volumes written on management, the key attributes of business leaders, and the ways to identify the next big thing, innovators still struggle to bring their ideas to life. Turning around a startup requires a new kind of management specifically geared to its context of extreme uncertainty. “Entrepreneur” should be considered a job title in all companies that depend on innovation for their future growth.

WRAP-UP
I convinced key stakeholders and founders to stay and our primary investor to add more capital. We kept the passion, energy and vision the founders brought to the venture and mixed it with proven entrepreneurial management.

Our selling price to ISO was almost 40 times our earnings, a miracle for our investor group and an extraordinary business for our purchaser. Today, Interthinx is a $200MM revenue business with continued high margins and earnings. It is one of the premier data validation, fraud prevention, and loss mitigation businesses in the United States.