Reprinted from the October 2000 Issue of OutsourcingJournal

A Healthy Decision to Take Stock

Start-up companies are typically short of cash. One Internet company found an unusual source of capital: its outsourcing provider.

HEALTHradius is an application service provider (ASP) for health care providers and public health agencies. The company's application decreases the cost of health care data management for health plans and public health departments by managing their databases. For example, federal law requires health plans to submit a report measuring their immunization rates if they want to be reimbursed by Medicaid. "They can get this information from us," says Gene Shook, vice president of operations and development for the Bellevue, Washington ASP.

The application also allows government agencies to assess the health status of their communities. It is helpful to physicians, too, by providing them with accurate aggregated personal health data for their patients. Next year the company plans to make this data available to consumers via their Web browsers.

The company started its corporate heart beating in 1997, launching its service in the spring of 1998. As a start-up, its founders wanted to concentrate solely on market and business development. So, its Rx for success was to outsource some of its fund raising and operational development to Semeron Corporation, a Seattle, Washington outsourcing provider. Shook says the company made the decision to outsource from the very beginning. "We needed someone to help us with strategic planning," he explains.

In addition, the company didn't want to add staff to its payroll. "We are a very lean company and we didn't want to hire professionals for this job," says Shook.

The Need for Speed

Speed to market was another factor in HEALTHradius' decision to outsource. "The job had to be done quickly, so we realized it had to be done by someone else," adds Shook.

HEALTHradius interviewed three consulting companies, diagnosing their strengths and weaknesses. Shook says the company liked the principals at Semeron and the fact the company had worked with Microsoft.

Shook says Semeron "took a unique approach to outsourcing" by taking an equity participation in the company as its fee. "We loved that," says Shook. The founding member of HEALTHradius appreciates the cost savings of not having to pay its outsourcing provider every month. Having an equity stake in the company "means they are committed to our financial success," says Shook.

The executive believes HEALTHradius has received bonuses for its stock swap. "They have been able to do a lot of prospecting for us on their own time. They are committed to our success," says Shook.

Shook says he has worked with other outsourcing providers in the past whose relationship degenerated as the contract progressed. "The results were disastrous because all they were interested in was getting paid," he reports.

Semeron now shares in both the risk as well as the rewards of the growing company. "Instead of receiving fees in the near term, we will be rewarded in the long term," says Jill McPherson, a principal at Semeron. The supplier also benefits from this arrangement because "we gain the trust and support of a client who's willing to serve as a reference for us and help grow our consulting business."

Payments in Stock

If the outsourcing provider reduces the cost of a process, HEALTHradius will share one-third of that savings with Semeron. In addition, the outsourcing provider earns a quarterly bonus if it performs well. Both payments are made in HEALTHradius stock.

Shook says Semeron did “a real good job” at strategic planning, so HEALTHradius added another task to its assignment. It hired the consultant to complete an operational review for the company’s customer care center. “We wanted to know how we are responding to our customers,” says Shook. In addition, HEALTHradius asked Semeron to develop a “soup to nuts” marketing plan for opening new regional data centers. Finally, Semeron has assumed the chief financial officer (CFO) duties at the ASP.

HEALTHradius also uses its outsourcing provider to help its own customers. One customer, for example, had some operational issues. HEALTHradius paid Semeron to visit this customer and show its employees how to use HEALTHradius’ system more effectively.

To date the companies have not formally written any service level agreements (SLA). “Everything has been done on a case by case basis,” reports Shook. The two parties, however, did craft a time line so both parties are clear when specific tasks are supposed to be completed.

Shook says one of the key questions to ask when searching for an outsourcing provider is, “Have you done this before?” He also suggests pouring over their documentation before signing a contract.

Have Clear Expectations About the Scope

Shook says if he had to do something differently, he would have set clearer expectations. For example, Semeron prepared a very detailed operational plan. “Two-thirds of the way through we realized they were going into too much detail. We didn’t have the people to support some of the things they were setting up,” he explains. Shook says the misunderstanding occurred “because we weren’t clear.”

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Lessons from the Outsourcing Primer:

- Fast growing companies can ask their outsourcing providers if they can pay for their services in stock.
- Buyers can offer revenue sharing options to their suppliers and pay them in equity in the company.
- Giving suppliers shares in the company spreads the risk and makes the supplier have a vested interest in the buyer's success.
- Check the supplier's documentation before signing an outsourcing contract.