WHAT WOULD YOU DO?

Channel Strategy, Regulatory Risk, and the Cost of Waiting in a PE-Backed Digital Health Company

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Background

You are an independent director on the board of VirtuDerm, a rapidly growing digital health company. The founders — a group of physicians — built a technology-enabled care model designed to expand access to dermatology expertise for patients who lack timely access to in-person care.

How the platform works: A patient notices an irregular skin lesion. Rather than waiting weeks for an in-person dermatology appointment, she uploads photos and completes a structured symptom questionnaire through the company's app. Within 24 hours, a board-certified dermatologist reviews the case, provides a clinical assessment, and either recommends a care pathway or escalates to an urgent in-person evaluation. The interaction is fully asynchronous — no video call or real-time appointment required.

The regulatory workaround: VirtuDerm's physicians are currently licensed in approximately 20 states. The company offers the service nationally by positioning its consultations as an "educational offering" rather than a formal clinical encounter — a framing that, if accepted by regulators, removes the requirement that the reviewing physician be licensed in the patient's state of residence. This interpretation is the foundation of the current business model and the source of its most significant regulatory exposure.

Current go-to-market channels: VirtuDerm sells through two channels. The first is direct-to-consumer (DTC): patients pay out of pocket for a monthly or annual subscription giving them on-demand access to specialist consultations. The second is regional health plans, which offer the platform as a covered benefit to their members. These two channels account for all current revenue.

Two years ago, a private equity firm acquired a 51% majority stake to fund expansion and professionalize operations. The physician founders retained 49% ownership and continue to lead clinical strategy. The PE firm has indicated a target investment horizon of three to five years, with an exit via strategic acquisition or IPO.

The board consists of two physician founders, two PE firm representatives, two independent directors,[1] and the CEO as a non-voting observer.

Early Performance

Since the PE investment, the company has scaled rapidly. Financial performance has been encouraging:

- Projected revenue this year: approximately $30–35 million
- Revenue split: roughly 60% DTC subscriptions, 40% health plan contracts
- Gross margins: approximately 55% and improving
- Break-even projected within 18–24 months

Both the founders and investors believe VirtuDerm is well positioned to become a national leader in digitally enabled dermatology care. The PE firm has privately signaled it expects to pursue an exit within 30–36 months if growth continues on the current trajectory.

The Strategic Opportunity: The Employer Channel

Management has identified a significant untapped opportunity: selling directly to large self-insured employers. This represents a fundamentally different go-to-market motion than either DTC or health plans.

Why it matters: Large self-insured employers — companies with 500 or more employees who bear direct responsibility for their workforce's healthcare costs — are under intense pressure to reduce specialty care spending. Digital health point solutions have become a standard part of the large employer benefits stack. A well-positioned digital specialty care platform can command $5–12 per employee per month in contract value, meaning a single enterprise employer contract can be worth $2–5 million in annual recurring revenue.

The 50-state requirement: Large employers require vendors to demonstrate coverage in all 50 states before signing a contract. A Fortune 500 company with employees across 35 states cannot offer a specialty telehealth benefit that only works in some of them. This is a hard requirement — not a preference — and it is the crux of the decision the board faces.

Management projects that entering the employer channel successfully could add $18–25 million in annual recurring revenue within 24 months and increase the company's exit valuation by $40–60 million. The board agrees this is the single highest-impact growth lever available. The disagreement is not about whether to pursue it — it is about when, and at what risk.

The Regulatory Constraint

The employer channel opportunity is real — but growing regulatory scrutiny has put the current operating model at risk.

As telehealth activity has surged, state regulators have begun challenging business models that rely on interpretations similar to VirtuDerm's "educational offering" framing. Several states have issued guidance questioning whether asynchronous specialty consultations can be structured to avoid physician licensure requirements. Outside regulatory counsel has reviewed VirtuDerm's model and concluded it is "defensible, though not without risk."

The physician founders are comfortable with the current, more limited channel strategy: the existing physician network covers the 20 largest U.S. states, which generate approximately 90% of DTC volume, and aligns well with the regional health plans the company serves. But they are not comfortable expanding that footprint — or making commitments to employers — until the regulatory model has been hardened.

Their concern is twofold: first, that participating physicians could face professional or licensing risk if the model is challenged across a larger geographic footprint; and second, that a regulatory disruption mid-expansion would be far more damaging — commercially and reputationally — than a deliberate delay now.

The impact of a regulatory reboot: Under the founders' preferred approach, VirtuDerm would build a fully licensed physician network covering all 50 states before pursuing employer contracts. Regulatory counsel estimates this process — recruiting, credentialing, and onboarding physicians in 30 additional states — would take 12–18 months and cost $3–5 million. The consequence is that entry into the employer channel would be delayed by at least 18 months.

On physician malpractice exposure: Physicians on the platform carry individual malpractice coverage, but that coverage may not extend to asynchronous encounters across state lines structured as they currently are. The company's separate professional liability policy covers some but not all scenarios. This ambiguity is a legitimate and significant concern for the founders.

The Investment Decision

Management has requested authorization for an investment to support the employer channel expansion. The total amount depends on which path the board chooses:

- $2.0M: Employer-focused product features - HR system integrations, population health reporting, benefits administration APIs *(required under either option)*
- $1.5M: Regulatory compliance infrastructure and outside counsel *(required under either option)*
- $3.0M: Physician network expansion into the 30 remaining states (*Only required under Option 2)*

The PE firm's model projects that entering the employer channel on the accelerated timeline increases exit valuation by $40–60 million compared to an 18-month delay. That delay is also not cost-free: two well-funded competitors are actively building broker relationships and employer-facing products in the same space. Ceding an 18-month head start may prove very difficult to recover.

Differing Board Perspectives

Management and the PE investors believe the regulatory risk is manageable and that waiting 18 months is commercially unacceptable. Outside counsel has called the model defensible; competitors are moving now; and the valuation impact of delay is concrete. The CEO has

proposed proceeding with the employer channel under the current model while simultaneously investing in regulatory hardening — treating the two workstreams as parallel rather than sequential.

The physician founders believe the regulatory restructuring must come first. They are not willing to expand the physician network — and thereby increase the number of clinicians exposed to potential licensing risk — before the model has been hardened. They also note that a regulatory challenge during an employer channel rollout could be significantly more damaging than a challenge to the current, smaller footprint.

As an independent director, you are aware that the other two independent directors are likely to follow your lead. Your vote — and how you frame the issues at the board table — may determine the outcome.

The Decision: Two Options

At tomorrow's board meeting, directors must decide how to proceed.

Option 1: Full Speed Ahead — $3.5M

Authorize the $3.5M investment and proceed with the employer channel expansion under the current operating model. Accept that the regulatory framework may need to evolve during the expansion, with the understanding that physician network buildout (an additional $3M) could be required later. Move now before competitors gain further ground.

Option 2: Regulatory Restructuring First — $6.5M

Require that the physician network be expanded to all 50 states before any employer contracts are signed. This almost doubles the total investment and results in an 18-month delay in employer channel entry, risking ceding ground to competitors and reducing the business upside. Go slow and minimize regulatory exposure before scaling.

Whose side do you land on?

[1] A note on "independent" directors: In this context, "independent" has a precise legal meaning — these directors have no financial or employment relationship with the company. However, both independent directors were sourced through the PE firm's network. They have no formal obligation to the PE investors, but they are aware that their board service, reputation, and future opportunities in the PE ecosystem depend in part on maintaining those relationships. Governance scholars sometimes call these "grey directors" — legally independent, but not fully arms-length.

This case is based on a composite of real situations. Details have been modified for educational purposes.