

From the Desk of R. Lewis Dark...

THE **RD** DARK REPORT

RELIABLE INTELLIGENCE, EXCLUSIVELY
FOR MEDICAL LAB CEOs / COOs / CFOs

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Commentary & Opinion by...

R. Lewis Dark

Founder & Publisher



It Can't Happen Here

Here is another issue of THE DARK REPORT with stories about radical changes to laboratory organizations. When Canada's Alberta Province whacked almost 40% out of the healthcare budget over two years, laboratories were left with no option but to engineer radical change. (See pages 8-13.)

How would laboratories in the United States respond if they were told by Medicare, Medicaid and private carriers that current reimbursement levels would be reduced 40% over the coming two years? I'll bet that most laboratory executives would expend more effort to encourage legislative intervention by Congress than to reengineer their laboratories.

In Alberta, laboratory executives were not given that option. In order to survive, they were forced to take action. The only viable solution was massive cooperation between hospital laboratory administrators and independent commercial laboratory executives. Two years later, there are still laboratories in Alberta, but laboratory overcapacity has shrunk closer to actual demand. The numbers of employed pathologists and medical technologists are severely diminished compared to original levels.

I consider the Alberta experience to be a wake-up call to laboratory executives in the United States. For those who say "it can't happen here," I have a surprising answer. It already has! When the laboratory industry began bidding managed care contracts for laboratory services using marginal costs, they effectively slashed laboratory reimbursement by as much as 80% from existing fee-for-service levels!

Of course, no one could see that at the time. Managed care was less than 5% of any single regional market. But now that managed healthcare is achieving market share of 40% to 50% in some regions, laboratories in those areas are feeling the full economic impact. With capitated reimbursement levels below the amount needed to recover testing costs, laboratories are bleeding. The experience of California's publicly traded labs is a precursor to what will soon happen to laboratories in other parts of the country.

When matching the Alberta experience against established trends in the United States, I predict that laboratory executives will get no relief from government-funded health plans nor private insurers. Rather, laboratory reimbursement levels will continue downward. In consequence, I believe we will see the creation of regional laboratory "authorities," or "networks," not dissimilar to those in Alberta. Whether under government or private ownership, their structure and function will closely mirror what exists in Alberta.

1997's Most Interesting Laboratory Innovators

Our pick of the eight individuals demonstrating uncommon leadership, initiative and vision

By Robert Michel

CEO SUMMARY: *During the next year, the clinical laboratory industry faces some of its toughest business challenges in history. Here are eight individuals who possess a unique combination of spirit and grit and seek to transform their laboratory organizations into winners.*

EXCEPTIONAL PEOPLE are to be found within the clinical laboratory industry. However, because of the variety of laboratory organizations, it is difficult to know exactly where to find them.

The eight laboratory executives introduced in this issue of THE DARK REPORT share uncommon qualities of innovation and initiative. I define them as 1997's "Most Interesting Laboratory Innovators."

At a time when clinical laboratories throughout North America are under extraordinary pressure to cut costs, improve service and introduce new technology, these individuals possess a forward-looking vision. They have an uncanny ability to get people to change and move toward the unknown.

Whether in an academic or clinical setting, our eight "innovators" use

sophisticated leadership and management skills to nurture change and create common purpose.

I predict that such leadership will be the essential success factor separating laboratory winners from laboratory losers. Leadership is what made the presidential administrations of Franklin Delano Roosevelt and Ronald Reagan vastly more influential than those of Jimmy Carter and Gerald Ford. It was leadership that made **Apple Computers** (Steven Jobs) and **Microsoft Corporation** (Bill Gates) into dominant firms during the evolution of the personal computer industry.

The clinical laboratory industry is no different. Those laboratories which did well in 1996 have a higher caliber of executive leadership than their competitors. As the growth of managed healthcare places a premium on busi-

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R. Lewis Dark, Founder & Publisher. Robert L. Michel, Editor.

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ness and management skills, laboratories with sophisticated management leadership will be better positioned to succeed and prosper.

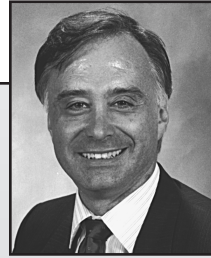
In choosing these eight people as 1997's "Most Interesting Laboratory Innovators," the goal was to identify individuals whose established track record indicates they will continue guiding their respective laboratory organizations toward progressive new ways of providing medical testing.

Making such choices was not easy. To ease the process, the list was restricted in two ways. First, it was limited to executives who directly work in either an academic or clinical laboratory environment. Second, it excluded executives employed by laboratory vendors, such as instrument manufacturers and LIS companies. In these cases, the quality of the product is often integral to the success of the executive.

Several of these eight laboratory innovators come from struggling laboratories. This should be expected. Not only does necessity stimulate creativity and innovation, but financial problems actually encourage implementation of innovative management ideas.

These eight individuals share several common traits. They are passionate about their vision. They communicate that vision effectively to coworkers and others. They go outside the laboratory industry to find solutions to their problems. They use sophisticated management tools to implement necessary changes in their laboratory organizations. Undoubtedly there are others who deserve to be recognized as laboratory "innovators." THE DARK REPORT encourages clients and readers to contact us with information about such individuals.

During the course of 1997, expect to hear more about these eight people and their laboratory organizations. As their innovations hit the marketplace, both the successes and failures of these ideas will provide invaluable knowledge for the entire clinical laboratory industry.



Richard Beckwith, Ph.D.

Clinical Director

Health Network Laboratories
Allentown, Pennsylvania

CONSOLIDATION of hospital laboratories is the most widespread trend now evident in the laboratory industry. Richard Beckwith, Ph.D. quarterbacked an unusually smooth consolidation at **Lehigh Valley Hospital's Health Network Laboratories** in Allentown, Pennsylvania.

Beckwith did his homework, studied good models of management and leadership, then facilitated the players involved in the laboratory consolidation project, which included construction of a core laboratory.

As with all good leaders, Beckwith's vision did not end with the completion of the laboratory consolidation project. That was only step one. Beckwith is actively working to expand the regional access of his laboratory system.

Lehigh Valley Hospital is part of **PennCARE**, an integrated delivery system consisting of eight hospitals in eastern Pennsylvania. Planning is under way to further integrate the laboratories within the system. Anticipating the arrival of managed care in his market, Beckwith is also initiating a variety of projects to counter that threat.

With a strong management team in place, Health Network Laboratories should prove to be a tough competitor.



Richard Brooks

Chief Financial Officer
Physicians Clinical Laboratories
Sacramento, California

WHAT COULD an executive from **AMFAC Foods** teach a clinical laboratory? Apparently a great deal, given what has transpired at **Physicians Clinical Laboratories (PCL)** in Sacramento, California since the arrival of Richard Brooks in January 1995.

Brooks, Chief Financial Officer of the publicly traded laboratory, came to PCL during a time of financial crises. As CFO, he has done more than juggle the demands for money at the financially strapped laboratory. He has brought a variety of proven management techniques into PCL and made it possible for the laboratory to “survive on a shoestring.”

Although PCL filed a Chapter 11 Bankruptcy action in November 1996, outsiders had predicted such a step would come much earlier than it did. Brooks played a key role in delaying that action.

It is PCL’s financial difficulties which puts Richard Brooks on THE DARK REPORT’s list of innovators to watch during 1997. Adversity means that a company becomes willing to try new things. PCL is actually a living “management laboratory” that provides Brooks with the opportunity to apply his management experience from outside the clinical lab industry to laboratory problems.



Robin Felder, Ph.D.

Professor of Pathology & Director
Medical Automation Research Center
University of Virginia Hospital
Charlottesville, Virginia

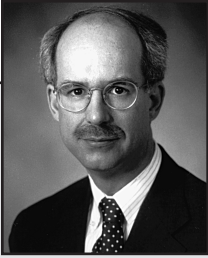
ALTHOUGH WORKING in an academic setting, Robin Felder’s passion for laboratory automation is transforming the industry.

He was instrumental in launching an annual seminar which now is considered the “must-attend” event for those interested in laboratory automation. *LabAutomation ‘97* will convene in San Diego on January 18-22, 1997. Attendees will travel from around the world to participate.

As a founder of the **Association For Laboratory Automation (ALA)**, Felder provided the vehicle to rapidly disseminate information about technology and business applications of laboratory automation and robotics.

Of equal interest is his activities at the University of Virginia in Charlottesville. Felder established a center for the study of laboratory automation and robotics which is growing in recognition and influence. At the center, Felder evaluates a wide variety of technology and laboratory automation solutions in a working environment.

Felder’s activities in laboratory automation and robotics put him squarely in the middle of some of the industry’s most controversial issues. Expect Felder to be one of the first to have opinions and facts about developments in lab automation.



Ken Freeman

Chief Executive Officer

Quest Diagnostics Incorporated
Teterboro, New Jersey

NO ONE in the clinical laboratory industry may face a greater challenge than Ken Freeman, Chairman and CEO of **Quest Diagnostics Incorporated**.

As of January 1, 1997, Quest (formerly **Corning Clinical Laboratories**) began life as an independent company. The \$1.7 billion laboratory must address a variety of significant operational and marketplace problems.

Freeman has the skills and experience to succeed in this task. Because of his experience with Corning Incorporated's manufacturing and high tech divisions, Freeman brings a decidedly un-laboratory management perspective to the table.

Expect him to address basic issues with a management approach seldom found in the clinical laboratory industry. It is a philosophy deeply rooted in Quality Management principles, such as those of W. Edwards Deming and Joseph Juran. These lessons were absorbed during his time with **Corning Incorporated**.

Although the rapid transition to managed healthcare may erode Quest's revenue base faster than Freeman can respond, Freeman's management initiatives are worth watching. Those that are properly implemented will provide invaluable knowledge for the perceptive observer.



Bruce Friedman, M.D.

Director

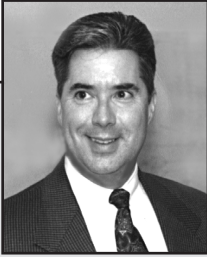
Pathology/Ancillary Data Systems
University of Michigan
Ann Arbor, Michigan

MANAGED CARE's hunger for patient data is relentless. Bruce Friedman, M.D. is the clinical laboratory industry's point man to keep it in the game.

Friedman organized an annual seminar on laboratory information systems which has become the premier event of its kind. On May 28-30, 1997, hundreds of specialists and lab executives will gather in Ann Arbor at the 15th annual *Symposium on Automated Information Management in Clinical Pathology* to explore how the latest technology affects laboratory information systems and laboratory medicine.

Friedman's consuming interest is in preserving laboratory medicine's essential contribution to clinical practice. He wants to prevent managed care companies from co-opting the essential role that pathology and laboratory medicine has played within the healthcare system.

Although more a scientist than a businessman, Friedman's organizational skills and enthusiasm regularly bring together the leading minds in laboratory information systems. He continues to be a catalyst for pushing the boundaries of existing technology to the benefit of laboratory medicine. In this role, he stimulates innovation.



Robert Hamon

Director of Laboratory Services
 Presbyterian Laboratory Services
 Charlotte, North Carolina

WOULD MANY laboratory managers seek out **Federal Express** and **United Parcel Service** to teach their laboratories about sophisticated package pick-up and delivery techniques?

Robert Hamon did. After visiting both Federal Express and UPS to learn their secrets, he hired a UPS manager to operate the courier and logistics system at **Presbyterian Laboratory Services (PLS)**.

Hamon is the Director of Laboratory Services at a consolidated laboratory organization which services five hospitals and over 30 community clinical laboratory sites. He is a regular visitor at laboratories throughout the United States. He recently toured Japan to learn about their laboratory philosophy and study laboratory automation.

As a management innovator, Hamon is getting the perfect opportunity to demonstrate his ideas. PLS is constructing a new off-site core laboratory, giving him the chance to implement innovations.

On a parallel front, PLS is negotiating with a number of hospital labs in the region to affiliate with the consolidated laboratory. As a result, Hamon is simultaneously consolidating and regionalizing. That is twice the challenge most laboratory managers must deal with.



James Neeley, MD

Consultant
 Meris Laboratories
 San Jose, California

OFT-PREDICTED to be on its financial deathbed, **Meris Laboratories** has so far outlasted its naysayers. Much of the credit should go to James Neeley, M.D.

Until recently, Neeley was President of Meris and responsible for operations. In that role, he revamped the entire laboratory system over a three-year period. His vision permitted Meris to operate with a low cost per test and a relatively high service level within its strongest market areas.

Neeley's genius, born of necessity, was to approach laboratory operations from a systems perspective. He tinkered with each process, from collection and transport to test reporting.

Guided by the twin forces of economic pressure and customer expectations, Neeley refined the Meris operation on an incremental basis. In the manufacturing world, the word is *kaizen*, which is Japanese for "continuous improvement." Neeley continuously improved each process in the lab by implementing many small changes.

Over the course of three years, Neeley directed each department at Meris to change its philosophy and its operational procedures. That required persistence and leadership skills which set Neeley apart from the typical laboratory manager.



Louis D. Wright, Jr., M.D.

Chairman

Pathology Service Associates
Florence, South Carolina

DURING THE LAST TWO YEARS, Louis D. Wright, Jr., M.D. quietly labored in Florence, South Carolina to design and bring into operation the first pathology network to provide statewide services. **Pathology Service Associates (PSA)** now actively services statewide managed care contracts.

But Wright's true objective is to create the means for pathology to be provided at the point of care, while meeting the needs of a managed care plan for a single contract provider offering regional coverage. Wright is single-mindedly promoting his concepts to pathologists throughout the United States. He is actively helping pathologists in neighboring states create pathology networks which interlink with PSA. In the process, he is demonstrating that the network concept can succeed, given the right executive leadership and cooperation among the participants. Performance of PSA so far validates that the concept works. That success, combined with Wright's untiring salesmanship, will encourage the further spread of PSA's pathology network model.

During 1997, PSA will have to demonstrate that the network concept is effective over time. It is much easier to dream up a business idea than it is to actually make it run day-by-day. This will be Dr. Wright's challenge.

Searching For Lab Innovators

INNOVATION WITHIN THE LABORATORY INDUSTRY has been limited mostly to introducing new technology. Less attention was directed to developing radical new ways to organize laboratories and deliver testing.

THE DARK REPORT's list of 1997's "Most Interesting Laboratory Innovators" spotlights executives who understand management techniques and use these techniques to implement new ideas into their laboratory organization. This makes them different from most of their laboratory peers.

Yet these eight individuals are not alone in this effort. Other lab executives and other laboratory organizations are doing progressive things as well. Here is a short list of organizations that should receive acknowledgement as innovators. They are presented in alphabetical order:

- **ARUP Laboratories**
Salt Lake City, Utah: rapid growth, customer-responsive.
- **American Medical Laboratories**
Chantilly, Virginia: constant market presence, sustained earnings despite revenue erosion.
- **Centrex Clinical Laboratories**
New Hartford, New York: consolidated laboratory with expanding regional affiliations.
- **Dallas Regional Laboratory Network**
Dallas, Texas: alliance of several unlikely hospital laboratory participants creates community resource.
- **New York State Clinical Laboratory Association**
New York, New York: proactive in organizing commercial lab network, responsive to changing marketplace/legislative forces.
- **Pathology Consultants & Associates**
Cambridge, Massachusetts: non-hospital-based pathology company which is developing into a regional pathology resource.

Lab Services In Canada Undergo Radical Changes

Alberta's healthcare cost reduction program creates regional laboratory provider systems

CEO SUMMARY: *Canada's single-payer healthcare system is undergoing transformation. Rising costs now compel individual provinces to reengineer their existing healthcare arrangements. In Alberta, commercial laboratories were forced to merge and cooperate with hospital-based laboratories.*

U PHEAVALS WITHIN CANADA'S HEALTHCARE SYSTEM are radically transforming laboratories. This is particularly true of Alberta, where the province brought both hospital and commercial laboratories into a common operating framework.

The result is a province-wide regional laboratory system, comparable in many ways to the emerging laboratory networks found in the United States. But unlike the United States, laboratories in Alberta were given no choice, no time and no money to implement the regionalization program.

Laboratory regionalization in Alberta meant that laboratories in academic centers, hospital-based laboratories and private commercial laboratories were literally forced to combine themselves into a more efficient laboratory system.

"It would be difficult to accurately describe how revolutionary these changes were to laboratories in the province," stated David Dawson, M.D. "A large portion of the laboratory workforce has been displaced. For

example, the laboratory sector lost about one-third of its pathologists and technologists during the last two years."

Dawson, a pathologist, is the Laboratory Director of the **David Thompson Regional Health Authority** in Red Deer, Alberta. This is one of 17 regional health authority boards created by the province during a 1995 restructuring of the healthcare system in Alberta.

"Alberta's provincial government wanted radical change to the healthcare system and wanted it to happen quickly."

—David Dawson, M.D.

"All of this began because the province faced a large operating deficit," said Dr. Dawson. "Healthcare was about one quarter of the province's total expenditures. Our provincial government decided they were going to control healthcare costs. They stated their intention to achieve major reductions."

“Alberta reduced costs by doing several things,” explained Dr. Dawson. “First, they announced that they would cut provincial funding for healthcare by 20%, effective July 1, 1995. A further reduction in funding for laboratory services would occur on April 1, 1996. Second, they created 17 regional health authorities in the province and appointed boards.

“These replaced the existing elected hospital boards,” he continued. “The regional health boards were then given a global budget and global responsibilities to meet the healthcare needs of their specific region.

“These budget cuts are not the whole story,” noted Dr. Dawson. “Provincial population growth between 1992 and 2000 is expected to be about 20%. Inflation over this same period will be 13%. Per capita provincial healthcare spending in the year 2000 is expected to be two-thirds of its value in 1992. Thus, further efficiencies will be required if these spending targets are to be met.”

Severe Action

It is the severity of Alberta’s action which triggered how laboratories responded. “Originally there were four laboratory components in Alberta’s system. Two of these, the **Provincial Health Laboratories** and the **Red Cross Blood Transfusion Services**, are expected to undergo major changes in the future,” said Dr. Dawson.

“Hospital labs and private (commercial) labs comprised the other two components,” he continued. “Under previous budgets, hospital labs got \$100 million per year for reimbursement. Private labs, which served physician offices, got \$110 million per year. These funds were combined and reduced at the source by an average of about 30% during the past two years.”

All hospitals in Alberta were publicly funded through global budgets.

But commercial laboratories in Alberta were paid differently. Like clinicians, they were paid on a fee-for-service basis. They billed the provincial government for reimbursement.

“Effective July 1, 1995, the provincial government abolished the schedule of benefits for commercial laboratories,” Dr. Dawson said. “They no longer accepted bills from the commercial laboratories. They took the monies which had been paid to commercial labs, less the 20% each for year one and year two, and gave those monies to the regional health authorities.”

This placed responsibility on the regional authorities to determine how laboratory services would be organized and reimbursed for their particular region. “These changes proved brutal for commercial laboratory operators,” stated Dr. Dawson, “But in the region where I work they were responsible companies and working relations were good. The choice was clear. Either the commercial labs would compete against the hospital laboratories, or both groups would meet together to develop win-win opportunities.”

Cooperation Resulted

“In this region, cooperation was the result. Given the magnitude of the challenges, the laboratory service has coped remarkably well with the massive change,” he explained. “When problems arose, there was enough goodwill between stakeholders to resolve them. It hasn’t always been easy, but for the most part it worked.

“Also, because there are seventeen regional health authority boards, each board developed a slightly different plan for laboratory services in that region. However, such differences were not major. The need to cut tremendous costs out of laboratory services simplified decision making.”

What resulted were regional laboratory systems similar to those pre-

Dawson Sees Changes In Pathology Activity

"As Laboratory Director of the David Thompson Regional Health Authority, I must coordinate services across a primarily rural area," stated David Dawson, M.D. "My primary activity has changed from looking through a microscope to communicating with others.

"Clinicians are now more interested in effective use of laboratory testing. Many physicians realize that if the laboratory is not able to keep its expenditures down, funding will need to be diverted from other services which they do not wish to see downsized.

"All of this must be accomplished with less staff," noted Dr. Dawson. "Formerly we had six pathologists and three Ph.D.s in clinical pathology at my hospital. Now there are five pathologists and one Ph.D. Yet we have more work because we cover more locations."

dicted by THE DARK REPORT based on lessons learned from the regional network case studies at the *Executive War College on Medical Laboratory Networking* in Pittsburgh last May. (See TDR, June 10, 1996.)

Our prediction is that hybrid regional laboratory systems will emerge in metropolitan areas. These systems will be a combination of consolidated hospital laboratories, local commercial laboratories and academic or teaching hospital laboratories.

"That is virtually identical to the larger regional laboratory systems in Alberta," noted Dr. Dawson. "In order to function with the available budget, each region squeezed out duplicate

instruments and excess medical technologists. Consolidation of testing was achieved wherever it made sense, regardless of whether a commercial lab, an academic center or a hospital lab was to get the specimens."

Traumatic Changes

Traumatic changes were endured by almost all laboratories in Alberta. But the most radical change occurred to commercial laboratories. "In Edmonton, there were two large commercial labs and three smaller private labs. A combination of buyouts and mergers created one private laboratory. It is now called **Dynacare Kasper Medical Laboratories**.

"Also in Edmonton, most of the hospital laboratories were converted into stat labs. As much testing as possible was centralized," Dr. Dawson said. "Within the Edmonton region, there is collaboration between hospitals, the academic center laboratory and the commercial laboratory."

Eliminate Duplication

"Also, the two large commercial laboratory competitors in Alberta agreed to eliminate duplicate facilities, and concentrate on specific regions of the province," added Dr. Dawson. "Dynacare Kasper has focused on Edmonton and the northern part of the province. **Calgary Laboratory Services** is focusing on Calgary and the south."

Huge costs were wrung out of the system as a result of this consolidation and rationalization. "A good example of how cost savings were achieved involves collection stations," noted Dr. Dawson. "Edmonton and Calgary each have about 700,000 people. There were approximately 120 collection sites in each city. Most collection stations were operated by the commercial labs. These have been reduced to about 20 collection sites in each city."

Health Services In Quebec Province Undergoing Similar Restructuring

QUEBEC IS RESTRUCTURING ITS PROVINCIAL HEALTHCARE SYSTEM for the same reasons as Alberta. "Rapid increases in the cost of healthcare now force Quebec to look for ways to save money," said Jean-Pierre Emond, Ph.D. "Because the government funds the healthcare plan, they have direct influence over hospitals and physicians in the province."

Emond is Supervisor of the Automation and Protein Laboratories at **Notre Dame Hospital** in Montreal, Quebec, Canada. He recently hosted the Editor of THE DARK REPORT during a site visit to the laboratory. "Most people know that Quebec has a strong socialist slant to the government. Yet the need to control costs has caused the government to negotiate with unions to reduce the number of jobs in healthcare."

Emond explained that two hospital systems are being organized in Montreal as part of a cost-saving initiative and to reduce the number of beds. "Six hospitals will affiliate with **McGill University Hospital**," he explained. "Two other hospitals will affiliate with Notre Dame Hospital to form University of Montreal Hospital (CHUM). In both systems, certain hospital facilities will be converted over to rehabilitation services.

"Here at Notre Dame, we received staffing reduction targets for the laboratory. We will achieve those reductions through attrition and by an early retirement program. Also, laboratory testing from the three hospitals will be consolidated within the CHUM system. So we will be doing more work with fewer people."

Unlike Alberta's "slash and burn" approach to cutting healthcare costs, Quebec seems to be cautious in its efforts to save money. However, just the fact that the government is willing to publicly negotiate employment cutbacks with the unions bears powerful testimony to the financial squeeze that rising healthcare costs are creating upon Quebec's provincial budget.

"A similar reduction took place in rural areas. Commercial laboratories operated collection sites in the rural towns. Those sites were closed. Collections are now done primarily at the local hospital."

In Alberta, this regionalization activity was not limited to laboratories. "Because of the huge cutbacks in the global healthcare budget given to each regional authority, hospitals and other providers underwent restructuring as well," explained Dr. Dawson. "Major acute care hospitals were closed in both Edmonton and Calgary. Hundreds of acute care beds were either closed or converted to long term care. More emphasis has been placed on community-based services and ambulatory services."

"In my community, the **Red Deer Regional Hospital's** acute care beds were reduced from 343 to 261. Small acute care rural hospitals were converted to other uses. These budget cuts caused a significant realignment of healthcare services in every part of Alberta."

Major Changes

"In view of the turmoil surrounding major changes to both hospital and laboratory systems since 1995, patient services have been remarkably well maintained," observed Dr. Dawson. "Everyone worked hard to preserve adequate levels of service and quality during the transition.

"What is also remarkable is the reduction in the number of people affiliated with laboratories in

Alberta. As I mentioned earlier, there are one-third fewer pathologists now practicing in the province than before. I couldn't tell you where they have all gone. I know some found positions overseas, in places like Saudi Arabia. Some went to other provinces or the United States."

Reduction in Training

"One other important change has been the reduction in training programs for medical technologists," noted Dr. Dawson. "Prior to the cutbacks, Alberta was training about 120 medical technologists each year. It now graduates about 40 per year. Some neighboring provinces have suspended their training programs."

One positive change seen by Dr. Dawson is increased interest in practice guidelines involving medical testing. "Clinicians now pay more attention to recommendations from the laboratory on how its services can be best utilized. Most clinicians now realize that the laboratory is a limited resource and they must use it carefully.

"Everyone is using the same medical commons. If it is not used wisely, then there is not enough to meet basic needs," said Dr. Dawson. "Most clinicians have adapted to this remarkably well. Anecdotal evidence indicates that compliance with practice guidelines has increased.

"Much of my time is spent working with clinicians to insure that laboratory services are as effective and relevant as possible. In this regard, changes from the regionalization effort have brought about more informed use of laboratory testing by clinicians."

Alberta provides a number of interesting lessons concerning consolidation and regionalization of laboratory services. There are also several parallels to similar activity under way in the United States.

Facts About Canada's Single-Payer System

Canada does not have a true national healthcare system like Medicare in the United States. Instead, each province designs its own healthcare system.

"Healthcare is actually a responsibility of each province," explained David Dawson, M.D. "The bulk of the money to pay for the program comes from the province itself. The federal government legislated national standards which must be met by the provinces if they are to receive federal transfer payments."

As each province seeks a solution to control healthcare costs, clinical laboratories are affected in different ways. In Alberta, laboratories were regionalized by the 17 regional health authorities. Quebec is reducing hospital beds and consolidating laboratory functions. Ontario chose to outsource laboratory testing from the hospitals to commercial laboratories.

First, rising healthcare costs are motivating the payer to take radical steps to control expenses. Laboratory funding was reduced by 30%-40% over two years. In the United States, employers are turning to managed care plans as a way of controlling healthcare costs.

Second, under the pressure of severe reimbursement cutbacks, laboratories in Alberta were forced to become cooperative. This meant that both commercial laboratories and hospital laboratories quickly found a common self-interest. From that point

forward, putting together a regionalization plan for clinical laboratories became feasible.”

Control Utilization

“The change in incentives makes this possible,” added Dr. Dawson. “Laboratories reimbursed by fee-for-service were not compelled to control utilization. When this method of payment changed, utilization control became imperative for all laboratories. Incentives changed 180 degrees as of midnight on June 30, 1995.”

With both private commercial labs and government-owned hospital labs sharing a common economic interest, the third lesson from Alberta’s experience is how sizeable the cost savings can be if laboratories are forced to rationalize their services.

“Things which you would have thought impossible became immediately doable once people understood the consequences of inaction.”

—David Dawson, M.D.

The cost savings from consolidation were significant. In Edmonton, five private laboratories were consolidated into one organization. Also in Edmonton, the hospital laboratories were downsized into stat labs and testing was centralized to the commercial lab and the academic hospital laboratory. This meant that duplicate instruments and services were eliminated. Excess testing capacity was taken off line and dismantled.

The reduction in collection facilities was astounding. Both Calgary and Edmonton saw a reduction of 85% in collection sites. Each city dropped from 120 sites to about 20. With hos-

pital laboratories consolidating into regional clusters, the number of pathologists and medical technologists declined by one-third.

Related Story:

Management Analysis of Alberta’s project by Mark Smythe. See Page 14.

Fourth, the experience in Alberta indicates that a rational plan to regionalize laboratory resources can be made to work. This should not discount the difficult negotiations and emotional impact of such serious restructuring. Historic patterns of competition and political turf battles had to be set aside before a workable plan could emerge.

Fifth, with a constrained healthcare budget placed upon all healthcare providers in the system, clinicians gain a greater appreciation for the value of laboratory testing. They realize that better use of testing can improve healthcare outcomes while reducing the cost per episode of care.

Five Lessons

These five lessons bear evidence that a similar form of laboratory regionalization will eventually occur within the United States. The pressure to reduce laboratory costs will finally cause competing laboratories in a metropolitan area to combine forces in a rational way. In the process, excess capacity and duplication of lab resources will be eliminated. This process is under way now in California.

There will be more to learn from the experience of laboratories in Alberta, particularly as continued evolution of healthcare in that province requires more sophisticated solutions from the regional laboratory system. **TDR**

(For further information, contact David Dawson, M.D. at 403-343-4712.)

Management Wisdom

Alberta Lab Regionalization Teaches Four Important Lessons

By Mark Smythe

CEO SUMMARY: *When the Province of Alberta sliced more than 30% from the healthcare budget in less than two years, it was borrowing a trick from high performance turnaround experts. Laboratory executives in the United States can use these same management principles in their own laboratory.*

REMARKABLE ACCOMPLISHMENTS result from setting ambitious goals. In a two-year period, Alberta's provincial government slashed healthcare costs by over 30%. (See pages 8-13.)

When healthcare providers in Alberta reacted to these cutbacks, clinical laboratories underwent a radical transformation. As a management coach who strives for extraordinary results, I am impressed with how Alberta's government used two secrets of high performance management to achieve its objectives.

Secret number one is to establish the goal first. Regardless of whether or not the team understands how they will achieve the goal, it is the goal itself which triggers innovative solutions.

Budget Reductions

In the case of Alberta, the provincial government told the healthcare system that the budget would be reduced by 20% effective in 1995. They also declared that further budget cutbacks would follow in subsequent years.

Armed with this knowledge, healthcare providers had no option but to consider any and all ideas that would lower costs while maintaining quality and preserving universal access.

Secret number two is to strive for radical departure from existing methods. It is a fundamental premise of Value Analysis that "the greater the change, the greater the improvement." Human nature tends to reject change and when given the choice, makes only minor adjustments to their lives and environment. Turnaround experts know that drastic situations require drastic measures... and they take them.

Difficult Goal

Alberta established a difficult goal in cutting 20% from the healthcare budget in one year. However, it was this stimulus which triggered the radical restructuring among healthcare providers to achieve the goal. Radical departures from the status quo brought about radically different results.

Of course, none of this took place without a significant amount of turmoil. As Dr. Dawson noted in the preceding story, over the two years since reduced healthcare budgets were implemented, the number of pathologists and medical technologists has declined by one-third in the province. Comparable staff reductions took place among hospital employees and other providers.

Key Management Lessons For Labs

1. Establish the goal first.
2. Strive for radical departure from existing methods.
3. Quality can always be maintained and even improved.
4. Great benefits accrue with cooperation as opposed to competition.

All of us understand that extensive restructuring such as this is invariably accompanied by pain. However, it is a rule of management that the longer you postpone making changes which you know need to be made, the greater the negative impact upon people and organizations.

In other words, change is inevitable. Perceptive managers know that embracing change permits them maximum flexibility to cushion its negative effects.

Alberta's Experience

The experience of Alberta reinforces this point. As a government-directed healthcare system, evolutionary changes to the system were deferred until a budget deficit of crises proportions could no longer be ignored. The negative impact of these necessary changes was greater than it had to be.

For laboratory executives, the Alberta experience teaches us four lessons. One, set the goal first. When people know what the goal is, they become extraordinarily creative in making it happen. Dr. Dawson's quote illustrates this perfectly: "Things which you would have thought impossible become immediately doable once people understood the consequences of inaction."

Two, strive for a radical departure from established practice. The more extensive the change, the greater the benefits from the change.

Three, during this process, quality can always be sustained, and generally improved. There is no mention of any significant decline in quality during this process in Alberta.

Four, there are great benefits in cooperation versus competition. As excess laboratory capacity was dismantled and laboratory competitors arranged to use regional laboratory resources in new ways, huge savings resulted.

Smart Management

Alberta also did something that was smart management. As part of the process of cutting back funds, Alberta created a new group of decisionmakers: the 17 regional health authorities. These new players were given a global budget, then allowed to take whatever steps were necessary to maintain required services with the allotted budget. The establishment of new decisionmaking authority defused existing vested interests. It made the process of innovation easier.

There is no reason that Alberta's cost-cutting success could not be duplicated by laboratories in the United States. The management principles necessary to accomplish the task are proven and simple to learn. Further, the speed with which these changes occurred provides a management lesson. Alberta demonstrates how rapidly major restructuring can be implemented.

Value Analysis Techniques

What I find fascinating is how Alberta's provincial government used techniques integral to Value Analysis in their efforts to cut costs. Value Analysis has been used by manufacturers for almost 50 years to improve quality and cut costs. It is a controlled way to get results on an accelerated basis. That certainly squares with Alberta's cost-cutting success in the healthcare and laboratory sector.

TDR

(For further information, contact Mark Smythe at 503-694-2473.)

The Dark Index

Three National Laboratories Begin 1997 With Challenges

CEO SUMMARY: *Expect a number of surprises during 1997. The three national laboratories face unique challenges and must operate with unequal resources. By year's end, the marketplace for commercial laboratory services will be quite different. However, picking the winners will not be easy.*

FOURTH QUARTER EARNINGS will not be announced for some time. However, Wall Street and the financial community are closely watching the performance of all public laboratory companies.

Corning Clinical Laboratories gets to start 1997 with a clean slate. Effective January 1, 1997, the company was spun-off from **Corning Incorporated**. Renamed **Quest Diagnostics Incorporated**, it now trades on the New York Stock Exchange. Its ticker symbol is DGX.

"Quest is benefiting from the opportunity to 'clean house,'" stated one bond analyst. "Quest used the spin-off to aggressively clean up its balance sheet and position itself to maximum advantage. Their \$150 million bond offering was strongly subscribed. Their stock opened trading at \$15 per share. Both facts indicate that Wall Street is comfortable with Quest's business prospects."

In contrast to the optimism at Quest, **Laboratory Corp. of America** still struggles to solve its financial dilemma. "Investors were hoping that Lab Corp.'s parent, **Roche**, would invest equity into Lab Corp." said this same analyst. "When Roche only lent money to Lab Corp., this was widely interpreted to

mean that Roche will not readily provide capital to help Lab Corp. through its cash crunch."

"Virtually all of Lab Corp.'s debt is held by banks," stated another financial analyst. "If the company's management fails to develop an effective plan to raise capital and refinance this debt, I would speculate that the banks will become more assertive in seeking a solution."

"Laboratory Corporation of America would love to raise capital and pay down some of their debt. However, as a three dollar stock, they would have to issue a lot of shares to raise significant capital."

—Wall Street Stock Analyst

In contrast to the major events underway at Quest and Lab Corp., things are relatively quiet at **SmithKline Beecham Clinical Laboratories**. The long-awaited \$300 million settlement with the federal government on Medicare billing claims has not been announced yet, surprising many observers. Observers say that much internal reorganization

is taking place, but that management is maintaining a low profile concerning these changes.

“Financial prospects for the laboratory industry in 1997 are mixed,” stated the bond trader. “From what I understand about the companies I track, any positive prospects continue to be mitigated by reimbursement declines resulting from managed care plans. These revenue declines will only partially be offset by revenue growth.”

Focus on Corporate Issues

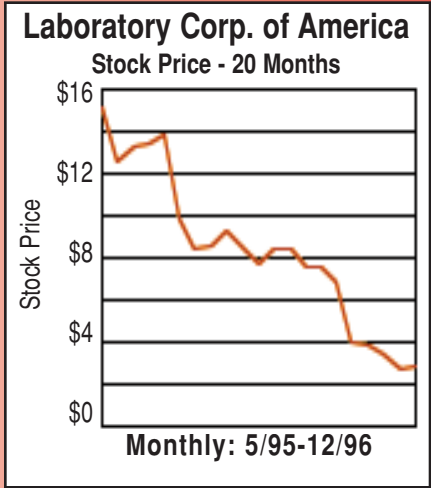
“I would love to see consolidation take place among the major laboratories,” he continued. “This would allow these companies to solidify their market share in regions where they are dominant, and reduce costs in regions where they have less presence.”

As reported throughout 1996 in THE DARK REPORT, marketplace fundamentals continue to move against the financial health of clinical laboratories. The most striking effects of these trends can be seen in California. In that state, bankruptcies and lab downsizing dominated the news last year.

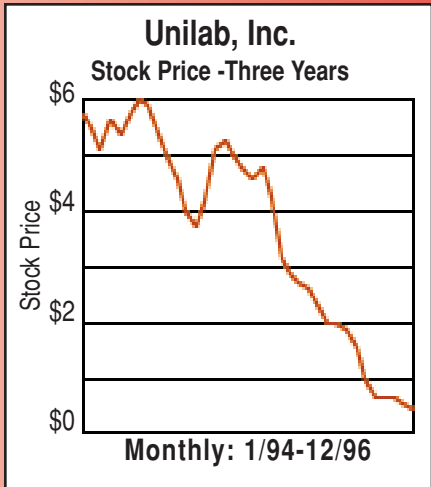
For laboratory executives who compete against the national laboratories, 1997 will provide opportunities to expand market share. Lab Corp., Quest and SmithKline will all be preoccupied with internal issues. Within California, **Unilab** is still concentrating on downsizing and consolidation. **Physicians Clinical Laboratories** is struggling to maintain positive cash flow.

There is anecdotal evidence that strong regional laboratory competitors are benefiting from the distractions of the national labs. As the major laboratories concentrate on internal management priorities, their more nimble regional competitors are quietly acquiring new business. 1997 may be the year that regional laboratories regain dominance in many markets.

DECLINING STOCK PRICES



Stock prices for Laboratory Corp. of America and Unilab, Inc. illustrate the rapid decline in profitability for the clinical laboratory industry. Lab Corp. shares currently trade at \$3.00. Unilab shares are at 50¢.



INTELLIGENCE

LATE & LATENT
 Items too late to print,
 too early to report



Interesting bedfellows have come together in Pittsburgh. The **University of Pittsburgh Medical Center (UPMC)** and **Quest Diagnostics Incorporated** (formerly **Corning Clinical Laboratories**) announced an agreement to “explore joint ventures in laboratory testing, medical informatics and molecular diagnostics research.” This is early evidence that Quest seeks to diversify away from routine testing services.

Wayne Patterson, Ph.D. will join the Board of Directors for **OncorMed, Inc.** of Gaithersberg, Maryland. Patterson, currently President of **Green Mountain Associates** in Parker, Colorado, was President of **Nichols Institute Reference Laboratories** from 1984 to 1989, and President of **Nichols Institute Laboratories** from 1989 to 1991. OncorMed specializes in genetic testing and cancer detection services.

Laboratory Corporation of America had to turn to **Roche Holding Ltd** for assistance in its cash crunch. A subsidiary of Roche will lend \$187 million to Lab Corp. The funds will be used to pay off the money owed to the federal government as a result of the Medicare billing practices settlement announced in November.

MORE ON: QUEST

DIAGNOSTICS INCORPORATED...

Quest operates a sizeable regional laboratory in Pittsburgh. With the recent demise of **Reference Laboratory Alliance (RLA)**, the 40 hospital laboratory network, Quest’s partnership with the University of Pittsburgh Medical Center must also be viewed as a strategic marketing move. UPMC’s growing hospital network represents a significant volume of lab tests that Quest would like to access.

SUNQUEST ACQUIRES ANTRIM

Knowledgeable observers are speculating about the impact of the merger between **Sunquest Information Systems, Inc.** and **Antrim Corporation**. Antrim is a major player in providing commercial laboratories with laboratory information systems. Sunquest is strong in hospital laboratory information systems. Sunquest sees Antrim’s products as complementary with their existing software.



Northern Diagnostic Laboratories

in Portland, Maine starts 1997 with a new President. Stan Schofield will begin duties there in January. Schofield is a Past President of the **Clinical Laboratory Management Association** and was most recently Executive Vice President and Chief Operating Officer of **Cedars-Sinai Laboratory Services**, a joint venture in Los Angeles between Cedars-Sinai and **Dynacare**.

*That’s all the insider intelligence for this report.
 Look for the next briefing on Monday, January 27, 1997*

THE **LABORATORY** REPORT

UPCOMING...

- ***A Veteran Industrial Engineer Points Out The Pitfalls Of Laboratory Automation.***
- ***Managed Care Contracting Strategies For Laboratory Services Undergo Evolution.***
- ***Pap Smear Wars: Report On The Marketing Success Of New Cytology Technology.***
- ***Consolidated Hospital Laboratories: Off-Site Core Laboratories On The Increase.***