

From the Desk of R. Lewis Dark...

THE DARK REPORT

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

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Commentary & Opinion by...

R. Lewis Dark

Founder & Publisher



Lab Industry Easing Back to Financial Stability

IT MAY NOT BE JUBILATION, BUT THERE'S CERTAINLY LESS DESPERATION among laboratories around the United States. In travels around the country, both commercial laboratories and hospital laboratories tell THE DARK REPORT that the 2000 was unusually free of crises. It was also a more productive financial year than those of the 1990s.

Of course, most lab executives and pathologists know the stock prices of public lab companies made a strong showing during 2000, reflecting improved financial performance during the year. (*See pages 9-14.*) Share prices for both **Laboratory Corporation of America** and **Quest Diagnostics Incorporated** broke above \$100 for the first time. Late in 2000, both **Specialty Laboratories, Inc.** and **Dynacare, Inc.** successfully closed initial public offerings (IPO). These were the first IPOs for clinical lab companies in many years.

But what is less known is that a large number of the remaining independent commercial labs consider 2000 to be one of their strongest financial years ever. Excepted from this group would be some lab companies located in unique managed care markets like Los Angeles and San Francisco and those smaller independent labs lacking a critical mass of specimen volume.

The most aggressively-managed hospital labs report similar good news, particularly those with professional sales outreach programs. Budget reduction pressures eased last year and it became easier to attract new client accounts among physicians' offices. The decline in the number of hospital mergers and acquisitions during 2000 also contributed to a calmer working environment for hospital laboratory administrators.

Certainly there are still obstacles and industry-wide problems which elude solutions. The shortage of trained med techs is now having a growing impact in laboratories across the country. Onerous regulatory and compliance requirements—backed by the threat of aggressive enforcement action—still place ongoing pressure on lab administrators. And don't forget declining lab reimbursement! There is no clear evidence that widespread downward pressures on pricing for lab testing have ceased.

The relative peacefulness of the current marketplace for laboratory testing services shouldn't be mistaken for a general turnaround in lab industry finances. But it is certainly unmistakable proof that the worst of these problems may be past for the clinical laboratory industry.

TDAR

LabNet of Ohio Profits From Network Projects

Efforts at shared testing and group buying pay big dividends for urban and rural labs

CEO SUMMARY: *Since its inception seven years ago, this regional lab network has worked diligently to create the service infrastructure necessary to pursue managed care contracts. Along the way, LabNet of Ohio has found gold in such business initiatives as shared testing and group purchasing. Now it wants to supplement its good coverage in Southern Ohio with lab members from the northern half of the state.*

LIKE MANY OTHER regional laboratory networks, managed care was the threat that launched LabNet of Ohio, Inc. back in 1994.

But financial success for this 20-member network has come from shared testing, group purchasing, and a couple of other unexpected business opportunities. In particular, the shared testing initiative has proved significantly rewarding.

"1994 was a time when, as Larry Garner, an organizer and early champion of LabNet, used to say 'our hospital labs were getting carved out of managed care contracts left and right,'" recalled Michael McGowan, Laboratory Director at Marietta Memorial Hospital and a member of LabNet's executive board. "That loss of busi-

ness was painful and we wanted to do something to stop it.

"Since 1994, however, the managed care threat never materialized as expected," said McGowan. "Instead, our network has generated considerable economic benefits through shared testing and group purchasing."

The most notable accomplishment is a shared testing arrangement that was organized with the goal of directing send-out testing to LabNet members. "We have 75% participation in our shared testing program," stated McGowan. "Three member labs are the testing centers. They are Children's Hospital in Columbus, Ohio State University Medical Center in Columbus, and TriHealth Laboratories in Cincinnati.

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"Referring members direct the majority of their send-out testing to our three 'reference labs,'" explained McGowan. "Whatever they can't test in-house is directed to a national reference lab. LabNet's primary relationship is with **ARUP Laboratories, Inc.**"

"We've been able to maintain adequate access and pricing without [managed care] contracts..."

The referral testing arrangement was launched in 1996, when LabNet of Ohio was incorporated as a limited liability corporation (LLC). Laboratory information services at that time were totally manual.

"Our member hospitals provided working capital in 1996 so that we could begin the process of creating CPU-CPU connections between our member labs," McGowan said. "All three of our testing centers were using **Sunquest LIS**, so that became the foundation for our system. Additional hardware was installed at Children's Hospital and each sending lab got a PC workstation in its send-out area.

"Currently we test in one direction, from sending labs to the testing center labs," added McGowan. "Our goal is to have CPU-CPU links among all member labs. Two years ago that would have cost us about \$1 million. With new technologies and the Internet, the price of this capability is falling rapidly and will soon be within our reach."

Original Strategic Vision

LabNet's ability to rapidly develop this shared testing arrangement is a direct result of its original strategic vision from 1994. "We are building a laboratory service infrastructure to serve that individual patient who holds a LabNet testing card for his health

plan," noted McGowan. "Our regional laboratory network is organized to provide managed care contracting services under the 'messenger model'."

"As this patient is logged in by a hospital lab for testing, that lab decides which tests it will perform, based on the network's contract price for that test," he continued. "Any tests that it doesn't want to do are then referred to the network's testing center labs.

"Regardless of how many labs do tests for this patient, LabNet will then generate a single report to the physician and send a single bill to the payer. This arrangement allows all the testing to remain in Ohio and that's our dream," stated McGowan.

Managed Care Contracts

So how many managed care contracts does LabNet hold today? "None!" declared McGowan. "We've been able to maintain adequate access and pricing without contracts because of our unique combination of rural and urban hospitals, along with the unexpected 'demise' of managed care in Ohio.

"Specifically, managed care never pushed into rural areas as expected," noted McGowan. "That's allowed rural hospitals to keep lab services as part of their full service capabilities with different HMO contracts. In the urban areas, the power of managed care is declining in favor of PPOs and discounted fee-for-service lab agreements.

"The upshot of this is, over the last five years, LabNet has been able to say 'no' to unprofitable managed care contracts, keep a strong hold on its existing fee-for-service work, and develop the shared testing and shared lab information system capability that will push us to a higher level of service for physicians and health insurers," McGowan said.

LabNet of Ohio has a self-sustaining cash flow and currently employs

Continued on page 5

LabNet of Ohio, Inc.

At-A-Glance

Headquarters: Columbus, OH

Organized: 1994

Incorporated: April 1996 as a limited liability corporation (LLC)

Equity lab members: 13

Participating lab members: 20

Phlebotomy sites: 40+

Employees:

FT operations manager, FT LIS analyst,
1 FT/1 PT CSR, FT marketing rep



LabNet of Ohio offers good coverage across the southern half of the state. The red circles indicate laboratories.

Business strategy: organized as a lab test broker; supports group purchasing program; enables single test reporting to physician and single source billing to managed care companies.

Information systems: Sunquest LIS platform, linked through PCs at referring labs' send-out desks.



Hospital	City	# Beds	Lab Director
A. Adena Regional Medical Center	Chillicothe	262	Phil Nelson
B. Barnesville Hospital*	Barnesville	60	Janet Childers
C. Children's Hospital [†]	Columbus	300	Charles Dudley
D. Clinton Memorial Hospital	Wilmington	90	Elaine Ewald
E. Fairfield Medical Center*	Lancaster	266	Larry Rosier
F. Genesis Health Care Systems	Zanesville	725	Tammy Bruner
G. Greenfield Area Medical Center	Greenfield	40	Phil Nelson
H. Highland District Hospital	Hillsboro	60	Rochelle Wagoner-Combs
I. Henry County Hospital*	Napoleon	57	Alan Rizzo
J. Holzer Clinic*	Gallipolis	0	Susan Davis
K. Holzer Medical Center*	Gallipolis	369	Bill Gouckenour
L. Madison County Hospital	London	90	Lucinda Manning
M. Marietta Memorial Hospital	Marietta	220	Michael McGowan
N. Mary Rutan Hospital*	Bellefontaine	102	Andy Burton
O. McCullough Hyde Memorial Hospital	Oxford	60	Joe Hornfeck
P. Memorial Hosp of Union County	Marysville	70	Alice Liggett
Q. Southeastern Ohio Rgnl Med Center	Cambridge	215	Tim Sinfield
R. The Ohio State Univ Med Center [†]	Columbus	846	Mary Grose
S. TriHealth Laboratories [†]	Cincinnati	1,103	Diane Cundiff
T. Wayne Hospital	Greenville	104	Lee Stone

[†]LabNet testing center laboratory. *Participating laboratory, all others are equity members of network.

on a full-time basis an operations manager, an LIS analyst, a marketing rep and a customer service rep, supplemented by a part-time customer service rep. LabNet uses a contract service to handle its courier needs.

Borrowed From RLA

"Remember the **Regional Laboratory Alliance (RLA)** in Pittsburgh?" asked McGowan. "We borrowed liberally from its business plan. That lab network did several shrewd things. For example, like RLA, LabNet is actually a broker for testing. It gets a discount from its testing centers. Referring labs pay the 'gross price' per test to LabNet, and LabNet refers the 'net discounted price' forward to the testing center lab. The difference pays LabNet's salaries and operating expenses. Everybody's happy because the overall cost of lab testing within the network has declined significantly."

This financing mechanism means CFOs of the hospital member are also happy with the network. "I'd estimate that each participating hospital originally invested about \$65,000 to get LabNet up and running," said McGowan. "Since start-up, all operating costs for our network have been recouped from ongoing shared testing arrangements."

Group Purchasing Benefit

Another area of substantial benefit is group purchasing. "We fell into this somewhat unintentionally," said McGowan. "Back in 1996, one vendor's sales rep noticed that several of our members used his company's instruments. He offered a discounted package for the network that allowed our smaller members to pick up some worthwhile savings."

"Inspired by that, we began to develop a more sophisticated buying program," he continued. "Now we have a quite an impressive book of

contracts. At my 200-bed hospital, we've saved \$70,000 just on chemistry slides during the past two years. In fact, our purchasing program has been so effective that we plan to develop a GPO (group purchasing organization) among the LabNet members."

LabNet wants to expand, and is running into the typical "chicken and egg" dilemma. McGowan explains the situation: "To expand our geography, we've approached hospitals in other parts of Ohio. Using our sending lab/testing lab formula, the urban hospitals ask 'who will send to us?' while the rural (sending) hospitals say 'who is close and will do our testing?' To date, neither group of labs has been willing to sign up first."

"However, we believe the demonstrated financial benefits cannot be ignored by these prospective lab members," he added. "We remain optimistic about developing a truly state-wide testing capability. That will make us very attractive to the larger health plans."

Impressive Track Record

LabNet of Ohio's impressive track record during the past six years demonstrates there is still vitality in the regional laboratory network business concept. It also illustrates that collaboration between urban hospital labs and rural hospital labs can be mutually beneficial. Above all, it is strong evidence that regionalization of laboratory services is ongoing. **TDR**

Contact M. McGowan at 740-374-1439.

McGowan Scheduled to Speak at the EXECUTIVE WAR COLLEGE

Michael McGowan will give an in-depth presentation on the business strategies and financial performance of LabNet of Ohio at the upcoming EXECUTIVE WAR COLLEGE, scheduled for Tues-Wed, May 8-9, 2001 at the Hyatt Regency Hotel in Cincinnati. Call 800-560-6363 for information or to register.

Knoxville Path Group Reports Tests Via Web

System now live after local pathologists made commitment to "cutting edge" services

CEO SUMMARY: *Pathologists at Knoxville Pathology Group are adding to their reputation for progressive business thinking. In addition to a regionalization strategy—which includes participation in Pathology Service Associates—in January they became one of the first local pathology practices to offer physician-clients access to pathology test results via the Internet.*

UNTIL RECENTLY, LEADERS in the move to offer Web-accessed services to referring physicians were primarily public lab and pathology companies.

That changed just eight weeks ago, when **Knoxville Pathology Group** began offering Web-accessed pathology test reporting to its physician-clients. Based in Knoxville, Tennessee, the seven-pathologist practice went live with its system after two years of development work.

Capital And Hard Work

"Don't let anybody tell you that this is an easy thing to pull off," said Paul Johnson, DBA (Doctor of Business Administration), who is Chief Operating Officer for the group. "It took persistence, capital and a lot of hard work to get to the point where we can offer the service of accessing pathology reports via the Internet.

"It was early this January when we began to introduce this service to our office-based physician-clients and their staffs," he added. "So far the

reception has been positive. We have 12 clients now using this feature. Moreover, our customer service staff and sales people have good success at converting offices where they demonstrate this new service."

Knoxville Pathology Group (KPG) is using an ASP (application service provider) software product developed by **Dynamic Healthcare Technologies, Inc.** (DHT). The host computer for the ASP is maintained by KPG and is located in their office.

"We were an alpha and beta development site for DHT's 'CoMed for Results™,'" stated David Jones, who manages information systems and human resources at KPG. "We worked with DHT for almost one year before this product was ready to launch into the marketplace."

Promising Early Feedback

Although it's still premature to accurately gauge the impact of Web-accessed lab test reporting on both KPG's client physicians and staffs, early feedback is positive. "Doctors and their staffs like it

Details of Web Reporting At Knoxville Path Group

- **Software:** KPG was an alpha and beta development site for DHT's "CoMed for Results." KPG is the host and maintains the server for the ASP on-site.
- **Internet Connectivity:** KPG's server connects to the Internet by a T-1 line.
- **Physician Office Connectivity:** Any broadband access or dial-up modem can connect to KPG's ASP server.
- **Test Result Availability:** Almost real time—within five minutes of pathologist sign-out, case results are available for access via Web inquiry, including photo images.
- **No Additional Fees:** KPG offers this service to physician clients at no additional charge. KPG also leaves existing reporting arrangements in place.

because it's both simple and fast to use," noted Jones. "They get a speedy connection and a straightforward inquiry that allows them to get what they want without fuss or complication."

So far, Web-accessed pathology results reporting hasn't caused major changes in the daily habits of physicians and their staffs. KPG never expected that it would. "We've always viewed this as an important part of our information management strategy," said Johnson.

"To remain competitive, pathology groups both big and small must become more sophisticated in how they create clinical information, share it, and convert it into added-value knowledge for clinicians," he noted. "KPG's information management is both internal and external.

"Internally, our investments are boosting the productivity and effectiveness of our pathologists," Johnson observed. "Externally, our information management capabilities position us to be an added-value asset to our health-

care community, including health systems, hospitals, physicians' offices, payers, and patients.

"In the short term, Web-accessed results reporting probably costs us more than we can directly recover, but in the long run Knoxville Pathology Group has set a competitive benchmark that competing groups must match," declared Johnson.

Ready To Connect

"More importantly," he added, "hospitals and health systems in the Knoxville region are actively building new information-management systems to link with their physicians, payers, and patients. Knoxville Pathology Group intends to be ready to connect into these systems and add value."

THE DARK REPORT believes that KPG has correctly recognized a trend which has gone unaddressed by many pathology groups. Hospitals and integrated health networks (IHN) are actively developing sophisticated intranets and information management systems. Their goal is to improve the flow of clinical and operational information.

Despite the fact that anatomic pathology information plays a key role in hospital and IHN activities, few pathology group practices have addressed the way these new information systems will shift the balance of power within their local healthcare community.

Competitive Advantage

Dr. Johnson believes that it will be another 12 to 24 months before the larger health systems in Knoxville successfully roll out such enhanced information management systems. When these hospitals do, Knoxville Pathology Group intends to be ready to connect in ways that give its pathologists leverage and competitive advantage.

TDR

Contact both Dr. Paul Johnson and David Jones at 865-522-7591.

Knoxville Pathology Group Offers Some Dos and Don'ts

AS AN "EARLY ADOPTER" IN WEB-ACCESSED PATHOLOGY RESULTS REPORTING, Knoxville Pathology Group has learned some valuable management lessons. THE DARK REPORT asked Chief Operating Officer Paul Johnson, DBA, and Information Systems/Human Resource Manager David Jones to share some basic "do's and don'ts." Their answers were revealing.

Do know what you're getting into before you start. Paul Johnson: "Do your homework before you commit money and people. Understand exactly what it will take to make your project successful. Learn what the pitfalls are and have contingency plans ready. For example, do you want to control the host for your ASP on site? Even if you decide to have a remote-host ASP, you'll still need someone in your operation who is Web-literate and can 'mind the store' to keep you operational."

Don't ignore the difficulties of the marketplace. David Jones: "My background is in computers and information management. But even I was surprised at the challenges of: a) getting Knoxville Pathology Group wired into the Internet; and b) dealing with the general lack of sophistication about the Internet within physicians' offices. These are considerable obstacles, but they can be overcome with good planning and execution."

Do give priority to security and privacy. David Jones: "Security and privacy are paramount concerns. Emphasize solutions which keep you in control, keep you in full compliance with laws and regulations, and give clients confidence and trust in your pathology group."

Do invest in connectivity to the Internet. Paul Johnson: "If your pathology group is moving to Web-based services, take care to invest in a reliable broadband connection to the Internet. There are many options, including T-1, DSL, ADSL, and others. After considerable study, we opted to use T-1 lines to connect our pathology group to the Internet."

Don't skimp on expertise. David Jones: "It's important to put knowledgeable experts on your implementation team. Hire the best. For smaller pathology groups that can't afford a full-time information manager, select a qualified consultant to help with implementation and engage them to return on a regular basis to perform updates and upgrades"

Do use customer service and sales reps to introduce your service. Paul Johnson: "You can build the better mousetrap, but if no one knows it's out there, you won't sell many. Web-accessed pathology test results reporting is a beneficial feature and physicians like it. Use service reps and sales people to introduce your new service to both clients and non-clients. Your pathology group should generate increased case referrals because of this sales and marketing."



Market Changes Lead LabCorp To Follow New Strategic Direction

"LabCorp must change and serve its customers in profoundly different ways than was common for labs in the 1990s."

—Bradford T. Smith



LabCorp is building expertise in genomic and esoteric testing to differentiate itself in the market

GEO SUMMARY: When formed in 1995, Laboratory Corporation of America faced a financially-hostile marketplace for lab testing services. However, strategic planning retreats in 1997 and 1999 were pivotal in redirecting this billion-dollar lab behemoth toward financial stability. During 2000, its share price soared as LabCorp posted strong gains in revenue and profit. Here's a look at the strategic business changes which fueled the rebirth of the nation's second largest laboratory testing company, as well as a peek at how LabCorp expects to differentiate itself from competitors.

EDITOR'S NOTE: The following is an interview conducted recently in New York City by Editor-In-Chief Robert L. Michel with LabCorp Executive Vice President Bradford T. (Brad) Smith.

EDITOR: I'm curious about the management strategies unfolding at Laboratory Corporation of America. Brad, what makes LabCorp a different company in 2001 than, say 1995? How does LabCorp differentiate itself today from competing laboratories?

SMITH: Those two questions strike at the heart of the progress we've made since the mid-1990s. In hindsight, it seems like healthcare trends that emerged in the early 1990s hit the lab industry hardest in 1996 and 1997. At LabCorp, the timing was doubly tough, because 1996-97 were the years immediately following the merger of the two lab companies which created LabCorp. We were in the midst of integrating the distinct corporate cultures and business systems.

EDITOR: Was the LabCorp we see today shaped by those challenges?

SMITH: Yes. Groundwork for the current financial resurgence of LabCorp was laid in Orlando, Florida at a corporate strategic retreat in the fall of 1997. It was a time when both LabCorp and the general lab industry were facing daunting financial challenges. After considering different ways we could redirect our company, we decided to focus on the role of diagnostic lab testing within the American healthcare system.

EDITOR: So LabCorp's strategic focus at this retreat was to reassess how the healthcare system used lab testing and find opportunities for LabCorp to serve those needs?

SMITH: That's generally correct. From a business perspective, we believed LabCorp's future success would be directly linked to how well we served the needs of each segment of the healthcare community. To be

successful, we realized LabCorp must change and learn to serve its customers in profoundly different ways than was common for laboratories during the 1980s and 1990s.

EDITOR: Could it be said, then, that the vision at LabCorp was to focus on delivering "added-value" to lab test users? How did the strategic business plan evolve from this vision?

SMITH: Not easily. I can simplify the intense discussions and debates that occurred at Orlando with this business metaphor. We were searching for effective ways to respond to the widespread decline in prices for lab tests. We framed that problem by asking this question: What is the relationship between the "real value" of a test to the end user, the level of reimbursement for that test, and the cost for the lab to produce that test?

EDITOR: Basically, you wanted to know if the end user of the test would be willing to pay more for a quality lab test result. If so, would that amount be more than the lab's cost to perform the test?

SMITH: Correct. At the Orlando retreat, we used this example. In 1997, many female patients would pay, say \$10 for a Pap smear every two years, but would then go out and spend \$30 for a haircut every few months. It was our conclusion that once consumers were educated about the 'real value' of the lab test, consumers would generally be willing to pay more for a lab test.

EDITOR: That's a reasonable assumption. But how did this assumption shape the new business strategy for LabCorp?

SMITH: In 1997, we assumed that pricing for lab tests was unrealistically low and would have to begin increasing during 1998, 1999, and beyond. This would be very positive for LabCorp. The arithmetic is compelling. LabCorp accessions more than 64 million patients per year. Increase the average revenue per requisition by \$1 and LabCorp generates an additional \$64 million annually! That's money we can use to invest in new technology and better services.

EDITOR: Interesting. Your sense that prices for lab testing would begin increasing in 1998-99 gave you confidence that sufficient capital would be available to fund LabCorp's new strategic business plan.

SMITH: In simplest terms, this was the specific insight which guided us. In Orlando, we agreed on three primary business strategies for LabCorp. First, we would become more sophisticated in our application of management tools. This would lead to improvements in both productivity and quality.

EDITOR: That also means a program of educating the staff at LabCorp on how to use unfamiliar management tools and concepts.

SMITH: True. Second, we agreed to measure a variety of business variables which directly impacted our customers and our business. For example, we now regularly measure cash collections, days sales outstanding (DSO), and the quality of several service functions, including courier, customer service, billing, and specific aspects of laboratory testing.

EDITOR: This strategic initiative gave you the ability to accurately monitor progress toward your goals. And the third strategic initiative?

SMITH: Third, customer satisfaction became a key strategic priority for LabCorp. We viewed this as a departure from the prevailing standard within the lab industry, where active and regular measurement of physician client, patient, and payer satisfaction about the lab's performance is not done in a regular and rigorous manner.

EDITOR: This is consistent with the requirements of management systems such as ISO-9000, which require a company to regularly measure the satisfaction of its customers, then implement corrective action to fix deficiencies.

SMITH: That's right. At LabCorp, we now measure customer satisfaction regularly. It helps us to identify work processes that need to be improved, but it also helps us learn about new ways we could serve our customers.

EDITOR: Interesting. In 1997, all three of those strategic business priorities would have not only immediate, but lasting impact on the operational performance of LabCorp.

SMITH: Very true, because in 1997 LabCorp was still working to unify different systems and cultures. The Orlando strategic retreat helped our management team line up behind a common vision for the company. With the three strategies of better management, better measurement, and better evaluation of customer satisfaction, managers and staff throughout LabCorp could work toward common purpose.

EDITOR: What was the next milestone in LabCorp's road back to financial stability?

SMITH: That would be in fall of 1999, when we held our second strategic business retreat in Pinehurst, North Carolina.

EDITOR: What was different at this strategic retreat?

SMITH: Two years had passed since the gathering in Orlando. During that time, the financial situation at LabCorp had improved steadily.

EDITOR: Among other things, your assumption that a variety of factors would lead to improved pricing for lab tests had indeed come true in 1998 and 1999.

SMITH: Yes, and the positive impact of improved lab test pricing was amplified by significant gains in operational improvements. LabCorp was better at all the business functions needed to acquire specimens, perform tests, report the results, and bill payers. At the Pinehurst retreat in 1999, we wanted to use these operational improvements as the foundation for the next cycle of change within the company.

EDITOR: What important decisions were made at the 1999 strategic planning retreat?

SMITH: Not surprisingly, one easy decision was to maintain our basic strategic plan established in 1997. We would continue using sophisticated management tools, accurately measure performance against goals, and be guided by customer satisfaction.

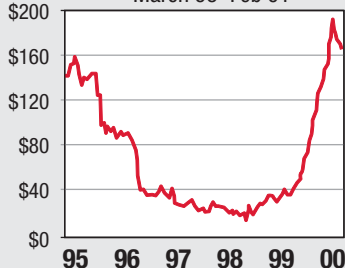
EDITOR: What were the new elements to LabCorp's business strategy?

SMITH: There was plenty of debate about what should be LabCorp's next strategic priority. Over time, an interesting consensus emerged. Given all the potential business models, we decided that LabCorp should be a national laboratory company. It should offer lab testing services that leverage our unique capabilities in genomic and esoteric testing to specifically support this business model.

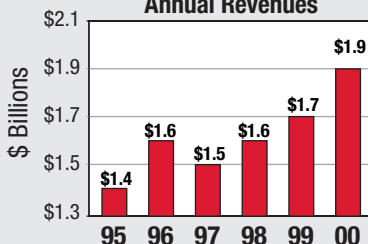
LabCorp's New Business Strategies Deliver Growth

This financial data shows how, beginning in 1998, year-to-year price increases in average revenues per requisition helped LabCorp achieve improved financial performance. This is demonstrated by increases in net earnings and the steep gains in its share price during 2000.

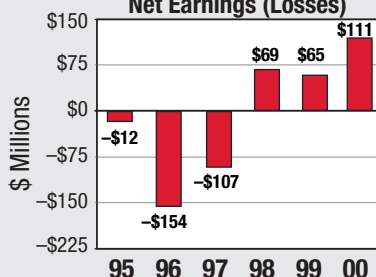
Monthly Stock Price
March 95–Feb 01



Annual Revenues



Net Earnings (Losses)



	(In Billions) Revenue	(In Millions) Net Earnings	Increase % Volume	Increase % Price	Increase Total %
1995	\$1,432	\$-12.3	NA	NA	NA
1996	\$1,607	\$-153.5	NA	NA	12.2%
1997	\$1,519	\$-106.9	-6.5%	1.0%	-5.5%
1998	\$1,612	\$68.8	-1.2%	3.2%	2.0%
1999	\$1,698	\$65.4	2.2%	3.1%	5.3%
2000	\$1,919	\$112.1	9.0%	4.0%	13.0%

EDITOR: Help me understand better what this business model means, given other options.

SMITH: Sure. One of the debates which dominated the retreat at Pinehurst was that classic laboratory question: Are we a laboratory or are we an information company? We decided to define ourselves as a laboratory, for an interesting reason—somebody actually has to perform the laboratory test to create the information used within the healthcare system.

EDITOR: That's a recognition that LabCorp expects the healthcare system will continue to reward the lab which performs the bench test necessary to create diagnostic test information.

SMITH: Certainly, but it doesn't mean that LabCorp is ignoring the value which information can bring to the company. To the contrary, we see LabCorp as a laboratory [creating lab test results] that supports improved patient care through better use of information. This is reinforced by our

leadership in genomic and esoteric testing.

EDITOR: These are interesting insights. Effectively, your business strategy is to leverage your size to pursue business opportunities unavailable to smaller lab organizations, and emphasize your laboratory roots.

SMITH: Yes, so long as this strategy incorporates two things true about LabCorp today. One, we define ourselves as a lab with expertise in genomic and esoteric testing. Second, we have an existing delivery channel to physicians' offices. These resources support two main business strategies that LabCorp is pursuing. One involves clinical trials and what we might define as "cutting edge diagnostic technology." The other involves helping doctors manage their diagnostic activities in more sophisticated ways. Let me explain both of these.

EDITOR: Please continue.

SMITH: LabCorp sees the clinical trials business as an integral part of our business strategy to be a leader in genomics and esoteric testing. This is because much diagnostic technology is actually developed to support new therapies. Our participation in clinical trials often leads to follow-on business that can be substantial.

EDITOR: Do you have an example?

SMITH: Yes. LabCorp did clinical trials with **Genentech Inc.** in support of the drug Herceptin. Within days following FDA approval to market Herceptin, related diagnostic tests developed by DAKO, with the help of LabCorp, were also approved for clinical use.

EDITOR: Do clinical trials take LabCorp outside the United States?

SMITH: Certainly. Clinical trials is an international business. You may be aware that LabCorp opened a lab in Belgium. This allows us to unify both test proto-

cols and the information management required to support clinical trials.

EDITOR: LabCorp recently acquired an esoteric laboratory in Los Angeles—**National Genetics Institute**—does this relate to your clinical trials and esoteric strategies?

SMITH: It actually supports both. National Genetics Institute was intimately involved in the major clinical trials and studies done on Hepatitis C. Dr. Andrew Conrad at NGI is actively doing studies on breast cancer and melanoma for pharmaceutical companies.

EDITOR: Are the relationships with **Virco Group, NV** and **ViroLogic, Inc.** related to your goals in esoteric and genetic testing?



“One, we define ourselves as a lab with expertise in genomic and esoteric testing. Second, we have an existing delivery channel to physicians' offices.”

SMITH: Definitely. You probably know that LabCorp was an early leader in HIV genotyping and phenotyping. Our work with Virco is directed toward using diagnostics to match the right therapeutic solutions for the patient as early as possible. The relationship with ViroLogic involves work in phenotyping.

EDITOR: Genomic and esoteric testing have been a fast growing segment within LabCorp in recent years, correct?

SMITH: Yes. One of the fastest. If you look at the revenues, LabCorp is probably earning more dollars in genomic and resistance testing than any other clinical company.

EDITOR: Moving forward in genomics and esoterics, what clinical areas are a priority for LabCorp?

SMITH: We are active in infectious and genetic diseases and oncology. I'm sure clients of THE DARK REPORT understand the opportunities that exist in these fields. Such laboratory tests improve diagnosis, therapy, and patient monitoring. In the area of oncology, population demographics will fuel a demand for lab tests supporting easier detection and monitoring for various types of cancer.

EDITOR: Would you discuss LabCorp's plans for helping physicians manage their diagnostic activities?

SMITH: This is the other business strategy which we are emphasizing and draws heavily upon information management technology. It is the logical extension of performing the test, then adding value to the physician from the lab test data.

EDITOR: Explain how LabCorp intends to accomplish this, please.

SMITH: As you know, the demands upon a physician's time are increasing. At the same time, there's a steady flow of new diagnostic information entering the marketplace. Physicians need help in managing the way they order lab tests, evaluate the results, and act upon that knowledge. LabCorp sees an opportunity to help physicians get more value from the lab tests they order for their patients.

EDITOR: More specifically, what are ways that LabCorp could generate added-value for these doctors?

SMITH: We see several potential services. One of the most exciting is the ability to give physicians a way to look at their patients' test results and compare it to how other physicians have treated patients with similar test results.

EDITOR: That sounds like a "best practices" arrangement...

SMITH: ...yes. We've seen the value of this type of service in HIV geno- and

phenotyping as well as viral load testing. During recent years we've worked closely with many of our referring physicians and developed some very productive "data sets" that measurably improve healthcare outcomes. This pioneering work tells us that LabCorp is certainly positioned to do more with helping physicians match lab test results and outcomes data.

EDITOR: Brad, you mentioned oncology as an area of emphasis for LabCorp. Given the nationwide network of anatomic pathology resources that LabCorp has assembled, how will LabCorp structure its anatomic pathology offerings?

SMITH: We are a full-service oncology laboratory. We provide oncology services in routine testing, such as tumor markers, genetic testing, and anatomic pathology. We believe that closer collaboration between clinical testing and anatomic pathology is the future.

EDITOR: Does that mean LabCorp will emphasize anatomic pathology services?

SMITH: Yes, but in a focused way. We want to match the needs of our referring physicians with the right pathology solution. In some cases that may mean using our in-house pathologists. In other cases we may draw upon outside expertise. It is also important to remember that anatomic pathology cases generally represent a more serious health condition for the patient. These cases are accompanied by more acute health concerns, a wider variety of testing needs, and other similar issues. That is why LabCorp intends to maintain a balance between in-house and external anatomic pathology expertise.

EDITOR: Brad, your comments about the management strategies at LabCorp are certainly appreciated by clients and readers of THE DARK REPORT. Thanks for your time today!

TDR

Contact Brad Smith at 336-584-5171.

Lab Industry Trends

Controversial Montana Ruling Pits Nurses Against Labs

MONTANA IS IN THE MIDST of an interesting feud over the scope of practice between nurses and certified laboratory professionals.

On December 11, 2000, the **Montana Board of Nursing** issued a declaratory ruling stating that the scope of practice for nurses included performing unwaived laboratory tests. This ruling appears to ignore the Laboratory Licensure Act, a long-standing statute passed by the Montana state legislature which establishes a higher standard for licensure than CLIA.

In response, the **Montana Society of Clinical Laboratory Scientists** (MTSCLS) filed a court action to obtain a preliminary injunction to stay this declaratory ruling. On February 21, a local judge refused to grant the injunction, but scheduled an expedited hearing on the full matter for March 21.

"The nursing board's ruling erodes the very integrity of laboratory medicine," said Carrie Biskupiak, President of the MTSCLS. "The scope of practice for nurses clearly falls short of the necessary knowledge level needed to ensure the highest degree of standards for a patient's protection."

Efforts To Present Evidence

Montana's clinical lab community has made repeated efforts to present evidence on the public record that unwaived laboratory testing requires a comprehensive range of training, knowledge, skills and certification to ensure consistent results. So far, official hearings have not been receptive to that message.

"The original discussions involved the scope of practice for nursing," noted Biskupiak. "However, emphasis then shifted to the lack of availability of trained lab professionals in rural hospitals, and claims that nurses could perform unwaived lab tests in an acceptable manner. Testimony was presented stating that nurses already do unwaived testing in some settings and there was no public record of problems resulting from this practice."

Pharmacists' "Lab-Grab"

The action by the Montana Nursing Board is another demonstration of the thin line that exists between a rational regulatory scheme and the power of vested interests to shape regulations to their particular needs. In recent years, pharmacists have lobbied in several states to gain the legal right to provide and perform clinical laboratory tests.

Laboratorians in Montana say they have yet to get an objective and thorough hearing on the documented evidence that non-professionals fail to properly address many of the required steps to insure a quality lab test result that can be trusted by the clinician. They hope the court hearing scheduled for March 21 will give them that opportunity.

Collectively, the events in Montana, combined with efforts by pharmacists to gain legal authorization to perform lab tests, demonstrate that other segments of the healthcare market see value in lab testing. As testing disperses from the core lab, expect to see similar battles in other states.

Lab Industry Briefs

FEDERAL ATTORNEY SERVES SUBPOENA ON DIANON SYSTEMS

NEWS BROKE LAST WEEK that **DIANON Systems, Inc.** had received a subpoena from the **U.S. Attorney's Office** in Connecticut for documents relating to laboratory billing.

Apparently "LabScam" is still alive and well within the Department of Justice. LabScam is the OIG's code word for its extensive investigations into claims of laboratory billing fraud and abuse throughout the 1990s.

DIANON disclosed the federal subpoena in its annual report, filed last Wednesday. The company said it was under subpoena to provide "a variety of documents, with a particular focus on documents relating to billing for tumor biomarkers, DNA testing and screening tests."

This disclosure comes only four weeks after UroCor, Inc. announced it had signed an agreement with the **Department of Justice** to settle charges of improper billing for laboratory tests. UroCor will refund about \$8.5 million to various government health programs, including Medicare. The agreement covers alleged violations which occurred during the years 1992 and 1998.

There is an obvious link between the government's interest in UroCor and DIANON. Both companies compete aggressively in the urology sector for lab tests and biopsies. At least one Wall Street analyst compared DIANON's potential billing problems with those of UroCor.

Based on the government's past pattern of laboratory investigations, the timing of DIANON's disclosure may not be coincidental. If allegations against DIA-

NON include similar billing practices covered under UroCor's \$8.5 million settlement with the federal government, then it would be reasonable to assume that the Department of Justice believes it can use the UroCor refund agreement as a template to pursue allegations of illegal billing practices by other labs for the same types of lab tests.

If this proves true, and federal prosecutors eventually prevail in their claims against DIANON Systems, then other laboratories doing extensive volumes of urology-based lab tests and biopsies could also find themselves under investigation for similar allegations of Medicare billing fraud and abuse.

MEDICARE ANNOUNCES NATIONAL FEE OF \$28 FOR THINPREP® PAP TEST

IT'S A MILESTONE ACCOMPLISHMENT for **Cytec Corporation**. Last Thursday, the company announced it had learned that HCFA "has established a national fee of \$28 for the CPT codes describing the ThinPrep® Pap Test."

Compared to a conventional Pap smear, HCFA will now pay almost double for a ThinPrep Pap test. This decision will certainly influence many managed care plans which have been slow to accept the ThinPrep Pap test, or have chosen to reimburse for ThinPrep at a significantly lower rate than what Medicare will now pay.

For Cytec, this culminates a carefully-crafted marketing plan. When ThinPrep was rolled out to the clinical marketplace five years ago, payer acceptance of the test and adequate reimbursement for labs performing ThinPrep testing were critical factors. Without either, the product could not succeed.

In contrast to Cytyc's strong marketing push to payers, **NeoPath, Inc.** (original developer of the AutoPap® automated QC/QA and screening system), devoted considerably less resources to marketing its products and technology to payers. Five years later, market penetration and clinical usage of AutoPap is significantly lower than ThinPrep.

The lessons of the Cytyc and NeoPath marketing strategies will not be lost upon diagnostic vendors. Cytyc's successful campaign to introduce ThinPrep will be studied and duplicated for years to come.

In fact, its major elements are already being copied by **Digene, Inc.**, maker of the Hybrid Capture® 2 HVP DNA test. Borrowing a page from the Cytyc marketing playbook, Digene issued a press release on March 14 to trumpet the fact that health plans insuring more than 200 million members now provide coverage for its HPV test.

In the United States, Digene's test is used as an adjunct test to the Pap smear for cervical cancer screening. However, in several other countries, Digene is marketing its HPV test as a primary cervical cancer screen, as well as an adjunct test to the pap smear.

ABATON.COM CAUGHT IN ONGOING MAELSTROM AT MCKESSON HBOC

SINCE THEIR COMPANY WAS ACQUIRED by **McKesson HBOC, Inc.** in 1999, it's been a rocky ride for Minneapolis-based **Abaton.com**, developer of a viable system for Web-accessed lab test ordering and results reporting.

McKesson HBOC paid \$103 million to purchase Abaton.com in November 1999. A change of ownership is always difficult, but just seven months later, in June 2000, McKesson threw Abaton.com into a new business unit—dubbed **iMcKesson**.

iMcKesson was intended to be the “e-health” flagship for McKesson HBOC. Along with Abaton.com, another five operating divisions were folded into iMcKesson. This new company got started with \$300 million in revenues and 2,000 employees.

But iMcKesson proved to be a short-lived concept. Born of the investor fever for anything “dot-com,” it faded as investors abandoned Internet stocks. On February 26, 2000, just eight months after its creation, McKesson HBOC is disbanding iMcKesson and folding its business units back into the parent company.

This means another wrenching corporate change for Abaton.com. At one time, prior to its acquisition by McKesson HBC, Abaton.com was poised to capture a good share of the market for Web-accessed lab test ordering and results reporting. However, during the past 18 months, the need to accommodate McKesson's shifting management goals has hindered the roll-out of Abaton.com's key products to the laboratory industry.

REVENUES IN 2000 CLIMB AT ABBOTT LABS— SO DOES CEO'S PAY!

LOTS OF LAB EXECUTIVES and pathologists were more than aggravated when the FDA forced **Abbott Laboratories, Inc.** to cease selling more than 100 of its diagnostic tests early in 2000.

So how did the year 2000 end for Abbott Labs? Worldwide sales, mainly pharmaceuticals, were up 4.3%, to \$13.2 billion. But worldwide diagnostic sales declined by 2.9%, totaling \$2.9 billion.

But the interesting number is the compensation paid to Abbott CEO Miles White. Following Abbott's diagnostics debacle with the FDA, total 2000 compensation to White is reported to be \$29.6 million, mostly from the value of stock options issued to him. **TDR**

INTELLIGENCE

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



It's one more market sign of the continuing turmoil still transforming the traditional healthcare marketplace. New numbers reveal another decline in the membership of the **American Medical Association (AMA)**. During 2000, the AMA lost 3,000 physician members. Only 290,357 physicians, or 32%, of the nation's 901,147 physicians retain AMA membership. More significantly, at least 82,000 of the AMA members are medical school students or residents paying deeply discounted fees.

ADD TO: AMA'S DECLINE

As most laboratorians know, the AMA's struggles to refocus on the new needs of its physician members are similar to struggles occurring among the lab industry's professional associations. CLMA, AACC, CAP, ASCP and others have experienced changes in revenues and member interests. Some of these associations are doing serious soul searching and considering radical changes to their programs and services.

MANAGED CARE LOSING CLOUT OVER PROVIDERS

Is the balance of power shifting in the managed care wars? "Yes!" says a new report by the **Center for Studying Health System Change** in Washington, DC. After studying 12 nationally representative communities, the Center says that consolidation of hospitals and physician groups is increasing the leverage providers have against managed care companies. But the Center also predicts dramatic changes in coming years, attributable to a replay of the medical "arms race" of the 1980s involving hospitals and specialty physicians.

EXPECT STIFF RISE IN HEALTH PREMIUMS

There's been plenty written about impending increases in health premiums for 2002. But proof is in the pudding. The **California Public Employees' Retirement System** (Calpers) recently opened HMO's bids for 2002 premiums. Prospective premium rate increases varied from 5.5% to 41%! Calpers officials characterized these bids as "so out of sight" that they were obliged to "throw

them out" and request new, lower bids. Reportedly, **Kaiser Permanente**, a major Calpers insurer, tendered a premium bid that was 30% higher than for 2001.

HOMETOWN HOSPITALS EARN "TOP 100" HONORS

Here's a little local boosterism. The **Providence Portland Medical Center** and **Providence St. Vincent Medical Center** earned a spot on *Modern Healthcare* annual "100 Top Hospitals" list. Both hospitals are located in Portland, Oregon, home to THE DARK REPORT.

ADD TO: "TOP HOSPITALS"

Lab executives would find the "100 Top Hospitals" list to be interesting reading, since well-managed hospitals tend to have well-managed laboratories. The study was done for *Modern Healthcare* by **Solucient** (formerly **HCIA-Sachs**), consultants in Evanston, Illinois. In aggregate, if all American hospitals operated like the Top 100, overall expenses would fall by \$12 billion annually and deaths would decline by as much as 87,000.

***That's all the insider intelligence for this report.
Look for the next briefing on Monday, April 9, 2001.***

PREVIEW #3

EXECUTIVE WAR COLLEGE

May 8-9, 2001 • Hyatt Regency Hotel • Cincinnati

Topic: Secrets of the Win-Win Part A Pathology Contract Between Hospital System and Docs

Both hospital administrators and pathologists struggle with the question about how to properly compensate pathologists for services provided under the Medicare Part A program. Learn how Sentara Health System addressed these challenges, and crafted a first-ever agreement to pay for Part A services with its pathologists and master useful techniques for Part A contracts.

Full program details available—call:
800.560.6363 or visit darkreport.com

UPCOMING...

- ***THE DARK REPORT Picks This Year's Laboratory Industry "Movers & Shakers."***
- ***Dissecting the Business Strategies of the Newest Public Labs: What's Up at Dynacare and Specialty Labs.***
- ***Making Money From Laboratory Test Data: How Labs Are Leveraging Information With Payers.***
- ***Looking at Pathology's Leaders: Surprising New Crop of Innovators is About to Emerge.***