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From the Desk of R. Lewis Dark...

THE **RD** DARK **REPORT**

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

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R. Lewis Dark

Founder & Publisher



Visualize Your Laboratory's Future

Many of you who read this will be in attendance at the second annual *Executive War College on Medical Laboratory Networking* in New Orleans. The case studies of laboratory consolidation and regional laboratory networks that you'll hear provide compelling evidence that laboratories must change if they are to survive and thrive.

This issue of THE DARK REPORT describes and defines the types of innovative laboratory ventures which represent the cutting edge of change in our industry. It is devoted to the subject of regional laboratory systems. Our editor strongly believes that the dual trends of laboratory consolidation and regional laboratory networks are going to evolve into a single form: the hybrid regional laboratory system.

In fact, those of you at the *Executive War College* will hear a case study about the most advanced "hybrid regional laboratory system" we know about. It is **Calgary Laboratory Services (CLS)** of Alberta. When the province took almost 40% of laboratory funding out of the healthcare budget, every laboratory in Alberta was forced to explore any creative idea that promised survival. The CLS case study is another chapter in the story we brought to you in the January 6, 1997 issue of THE DARK REPORT.

In Alberta, draconian cuts to laboratory funding required laboratory managers to consolidate, integrate, rationalize and restructure every laboratory asset, regardless of who owned it. The goal was to survive, while still providing high quality laboratory testing. When Dr. Roman Szumski, CEO of CLS, presents his case study, you will gain an inside peek at how laboratories will be regionalized in the future.

Stories on pages 5 through 15 describe, for the first time in print, the four different types of laboratory players who aggressively court hospital laboratories to join their vision of a regional laboratory system. You will learn about the first operational models of their laboratory business concepts. I wish we could tell you whether they are succeeding or failing, but some of these "regional laboratory systems" have only been operating for a few months. Any judgment as to their success would be premature.

However, you should recognize that every time someone shows up at your laboratory and wants to enlist you into a joint venture, alliance, consolidation or network, that is our prediction of a regional laboratory system becoming reality. It is proof to you that market forces are causing laboratories to respond. It signals that the time draws closer when your laboratory must change.

Ex-NHL Executives Buy American Medical Labs

Surprise development expected to transform AML into an aggressive laboratory competitor

CEO SUMMARY: *American Medical Laboratories' sale to new owners is a major event. Not only does the new management team have a reputation for top performance in selling clinical laboratory services, but they also arrive with an ample war chest. When the revamped AML hits the competitive laboratory marketplace, they are sure to shake things up.*

SALE OF **American Medical Laboratories (AML)** to an investment consortium which included former executives from **National Health Laboratories** surprised the laboratory world.

When the actual sale of AML was concluded last Monday, May 5, it marked the arrival of a high-powered executive team to the Virginia-based laboratory. New purchasers include Timothy Brodnik, Jack Bergstrom, Jerry Glick and the Chicago-based investment firm of **Golder, Thoma, Cressey, Rauner, Inc.**

Two other investors in the transaction were AML co-founders Ira Goodwin, M.D. and C. Barrie Cook. Both individuals will continue to participate in the management of AML. Dr. Goodwin is expected to retain his responsibility as Director of Labora-

tories. Goodwin and Cook's support of the new owners indicates that no major change of direction is planned for American Medical Laboratories.

The sale of AML is important for several reasons. First, at almost \$85 million in annual revenues, AML is the largest laboratory to be acquired in the last three years. THE DARK REPORT believes AML's sale will trigger a new wave of commercial laboratory acquisitions.

Second, the fact that knowledgeable industry executives were willing to invest tens of millions of dollars to acquire an independent commercial laboratory confirms the market dichotomy which exists today. Independent regional laboratories are making money even as most public laboratories post losses.

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Third, if the new owners of AML live up to their past reputation, AML may become a supercharged laboratory competitor. Were this to occur, expect AML to have increasing clout, particularly in the field of hospital reference testing.

During the next 12 months, AML becomes a perfect management case study. The company's business strategy is straightforward. It already participates in two market segments, clinical testing and reference testing.

The primary market segment is clinical laboratory testing. "This is the majority of our revenue base," stated Robert Collier, Vice President of Marketing and Major Accounts at AML. "We offer clinical and anatomic testing in the Southeast, Mid-Atlantic, Northeast and Southwest."

Service Upgrades

"From what I understand, the new owners intend to upgrade our service infrastructure," he continued. "This includes our laboratory information system and other key components. They will use these infrastructure upgrades to enhance our testing services and add new capabilities.

"Even as this occurs, I believe that the sales and marketing program here will be intensified," Collier predicted. "I think our new owners intend to develop a high-powered sales program that matches our consistent level of customer service. This new sales program will stress bringing on new accounts. The profitability of individual accounts will be monitored, because the goal will be to acquire only profitable business."

Collier's observations coincide with THE DARK REPORT's conclusions. Knowledgeable laboratory managers will recall that Tim Brodnik's reputation was made at **National Health Laboratories**,

where he was the Executive Vice President of Sales and Marketing.

In this position, Brodnik achieved something unmatched by any large commercial laboratory during that era. He developed a sales and marketing team that generated annual growth in revenues and profits of 10% to 15% per year from new client sales. His laboratory competitors achieved growth only through acquisition, not through new sales.

"Everyone at AML is excited about the fact that our new owners are full of innovative ideas and have capital for expansion."
-Bob Collier

For precisely this reason THE DARK REPORT predicts that the "new" AML will become a supercharged competitor within 12 months. Brodnik possesses a knowledge of sales and sales management unmatched by any current laboratory industry executive.

Next Moves

It is the opinion of THE DARK REPORT that the sale of American Medical Laboratories represents the first example of a new business strategy affecting commercial laboratories. Clients and regular readers know that independent regional laboratories do not share the poor financial performance of publicly traded commercial laboratories in recent years.

It would be reasonable to assume the AML's new owners realized that independent commercial laboratories in the United States are not "going broke." To the contrary, even in California's managed care disaster zone, some independent laboratories still earn reasonable profits.

The new owners of AML apparently spotted this business opportunity. They believe that the future of clinical laboratory services is rooted in locally-based laboratories which provide testing and support services tailored to the specific requirements of that community.

They also contribute something very tangible to AML's future. Their "value added" contribution will be to bring a higher level of management execution to AML. They believe that AML's strong service base, combined with new management concepts, will permit AML to increase revenues and operating profits.

Should AML's new owner's make this strategy work, then THE DARK REPORT predicts that a number of acquisitions will take place among the remaining regional independent laboratories. It will be ownership generation of the 1980s selling their laboratories to a new generation of executives schooled in the quality management techniques of the 1990s.

Strong Performance

AML's current level of operating profits did play a part in the sale of the laboratory to its new owners. According to Collier, AML's profit performance during the previous two years was a key factor in the deal. "Financial performance during the last two years was good," he noted. "In particular, we had a strong year during 1996."

AML's revenue performance would be in keeping with other reference testing labs such as **ARUP Laboratories** and **Specialty Laboratories**. Growth in specimen volume and revenue at both companies has been excellent in recent years.

Such revenue growth by independent laboratories may be what encouraged Golder, Thoma, Cressey, Rauner, Inc. to provide capital and

American Med Labs At-A-Glance

- *Laboratories in Chantilly, VA (250,000 sq. ft.); Orlando, FL (20,000 sq. ft.), and Richmond, VA.*
- *33 Primary phlebotomy sites.*
- *7 Stat laboratories.*
- *1,100 Employees; 810 FTEs.*
- *SAMSA certified for toxicology testing.*
- *American Medical Laboratories offers clinical laboratory services in Maryland, Virginia, District of Columbia, North Carolina, South Carolina and Florida.*
- *AML offers hospital laboratory reference testing as far west as Texas.*
- *Company is private and new owners are Timothy Brodnik, Jack Bergstrom, Jerry Glick, Ira Goodwin, M.D., C. Barrie Cook, M.D. and Golder, Thoma, Cressey, Rauner, Inc.*

financing for AML's buyers. It is also relevant that Golder, Thoma was the company which helped **Dynacare** of Canada buy its public stock and return to private status.

Golder, Thoma has a reputation for consolidating companies within the industry sectors it has targeted. For that reason, THE DARK REPORT expects that Golder, Thoma will probably continue funding future laboratory acquisitions.

It would be reasonable to assume that Golder, Thoma would fund additional laboratory acquisitions for its existing clients. That means if both Dynacare and American Medical Laboratories wanted to buy more independent laboratories, Golder, Thoma would logically participate in the financing. Were other laboratory acquisitions to occur, then important shifts would take place in the balance of power among commercial laboratories. **TDR** (For further information, contact Bob Collier at 703-802-6900.)

Regional Lab Systems Beginning To Emerge

Managed care's influence spurs development of various types of lab & pathology networks

CEO SUMMARY: Regionalization of laboratory services is about to become a dominant industry trend. Four groups of players will drive this process and each needs to recruit hospital laboratories to participate in their regional model. This is the first generation of attempts to create financially viable laboratory systems with regional capability.

REGIONALIZATION OF LABORATORY and pathology services is rapidly becoming a reality in the United States. An irreversible transformation of both pathology and the clinical laboratory industry is now under way.

For the first time in the history of the clinical laboratory industry, there are multiple examples of regional laboratory provider systems. The trend is identical within pathology, with the first regional pathology systems now emerging in several states.

Four segments of the lab industry seek to regionalize laboratory services. Each segment has different motives for creating a regional laboratory system.

Four Segments

The first segment consists of the three national laboratories, **Quest Diagnostics Inc.**, **Laboratory Corp. of America** and **SmithKline Beecham Clinical Laboratories**. These three companies want to leverage the existing infrastructure of regional hub laboratories which they operate in different cities around the United States.

The second industry segment consists of smaller independent commer-

cial laboratories, still found in almost every city and rural area of the United States. These laboratories are closely bonded with the healthcare community they serve. They are well positioned to become part of any regional laboratory system which develops in their market.

Examples of laboratories in this segment are **Pathology Associates Medical Laboratories** in Spokane, Washington; **Pathology Medical Laboratories** in San Diego, California; and **Medical Arts Laboratories** in Oklahoma City, Oklahoma.

The third segment is made up of consolidated hospital laboratories which operate successful outreach programs. Like the national laboratories, these organizations are aggressively approaching individual hospitals. Their growth strategy is to expand their market service area by recruiting additional hospitals.

Three examples of such consolidated hospital laboratory organizations are **MDS-Hudson Valley Laboratories** in Poughkeepsie, New York; **Presbyterian Laboratory Services** in Charlotte, North Carolina; and **Centrex Clinical Laboratories** in Syracuse, New York.

Individual hospital laboratories comprise the fourth segment. Their strategy is to form regional laboratory networks for the purpose of test sharing (to lower costs) and acquiring managed care contracts (to protect market share). Outreach sales and marketing is generally not a primary objective for these networks.

Network Movement

Pioneers in the laboratory network movement were **Joint Venture Hospital Laboratories** in Detroit (1993), **Bay Area Hospital Laboratory Network** in San Francisco (1995) and **Reference Laboratory Alliance** in Pittsburgh (1995—ceased operations January 31, 1997). For many reasons, hospital laboratories find networks the most appealing strategy. As a result, numerous other regional laboratory networks are springing up throughout the United States.

Earlier issues of THE DARK REPORT chronicled the compelling economic and cultural factors now forcing laboratories to form regional systems. (*See TDR, June 10, 1996.*) The first marketplace experiments in response to these forces are now in operation.

Recruiting efforts by these four industry segments will pressure hospital laboratories to affiliate with a regional laboratory system. Hospital laboratory administrators face the dilemma of choosing the right regional model for their laboratory.

For many laboratory administrators, the choices are not appealing. Marriage with one of the three national laboratories is frequently not a preferred option. Teaming up with a strong independent laboratory in the area requires overcoming a history of competition by the parties involved.

At this early stage in the regionalization process, most hospital laboratories opt for the “safest” regional laboratory model—the regional laboratory network. However, it is the prediction

Lab Regionalization Centers Around Four Sets of Players

Four groups actively want to create regional laboratory service organizations. Competition will intensify as these players romance hospital laboratories to join their particular model of a regional laboratory system.

● National Laboratories:

Their proposition: “Outsource or joint venture with us.” Their drawback: Hospital administrators resent the fact that these labs still suck the outreach business from the hospital’s medical campus and are unwilling to put those revenues into the proposed joint venture.

● Independent Regional Laboratories:

Their proposal: Strength in numbers. “Join us and we can dominate the market.” Positive aspect: Independent laboratories generally have good quality, high service levels and solid client relationships.

● Consolidated Hospital Laboratories:

Their proposal: “We know your needs as a hospital and we can keep testing local at our core lab.” Another benefit: The best of these consolidated laboratories are very good at outreach sales and marketing.

● Regional Hospital Laboratory Networks:

Their attraction: “Join us, share testing to lower costs and there is no restructuring of your existing laboratory.” Drawbacks: Historical mistrust, political infighting and lack of executive leadership cause most networks to endlessly debate simple business issues.

of THE DARK REPORT that hospital laboratories will find regional laboratory networks to be economically ineffective over the long haul.

Greatest Benefit

The greatest benefit of such networks will come from teaching rival hospital laboratory administrators that they can work together to mutual benefit. As they develop good working relationships over time, THE DARK REPORT believes that clusters of hospital laboratories within the network will begin partnering consolidation projects among themselves. It is this laboratory consolidation phase which will bring the most significant economic benefits. It will also strengthen the market position of the network.

These four models of regional laboratory systems are marketplace solutions to managed care's insatiable demand for continuously decreasing costs. Clinical laboratories will be required to deliver diagnostic tests at the lowest possible cost while maintaining high quality services to the clinicians. The existing infrastructure of commercial and hospital laboratories is unable to meet those requirements.

Proof of Inadequacy

Proof of this inadequacy is found in the published financial performance of commercial laboratories since 1994. It is mirrored by the economic problems now becoming obvious in the hospital world. The well-publicized fiscal difficulties of hospitals in New York perfectly illustrate the problem of hospitals throughout the country. Neither commercial labs nor hospitals have demonstrated a viable solution to such financial challenges.

These facts are indisputable. They are evidence to hospital laboratory administrators that change must come to their individual laboratories. THE

DARK REPORT predicts that during the next 24 months a substantial number of hospital laboratories will find themselves involved in some type of regional laboratory system.

It will be hard for hospital administrators to deny this reality, for they are the prime targets of the four groups of regional organizers mentioned earlier in this story. During the previous three years, hospital laboratory managers were visited regularly by sales representatives of the three national laboratories wanting to "do a deal." Despite this intense marketing effort, few hospital/commercial laboratory deals were consummated during this period.

Similarly, hospital laboratory administrators were pressured by peers to join regional laboratory networks. All four groups of regional laboratory system organizers require the specimen volume of individual hospital laboratories to make their particular project viable. That is why hospital laboratory administrators will find themselves courted by an increasing variety of local players.

Emerging Regional Systems

In the story which follows, the earliest emerging regional laboratory systems are identified and evaluated. Each of these organizations is in its infancy, so any success stories would be premature.

This makes it important to realize that every regional laboratory system now emerging must be considered experimental. Success depends on a good market strategy, outstanding management and good execution of the business plan. Laboratory administrators who possess these skills will be in high demand in the years to come.

TDR

(For further information, contact THE DARK REPORT at 800-560-6363.)

Consolidation And Regionalization Are Different Market Strategies

REGIONALIZATION IS DIFFERENT from laboratory consolidation. It is important to understand the difference. Consolidation usually involves the dismantling of individual laboratories for the purpose of feeding more specimens to a centralized laboratory site.

With an increased flow of specimens through the central laboratory, two things occur. The average cost per test declines at the central laboratory, improving its competitive position. Second, because of the larger volume of tests flowing through the central laboratory, more assays can be done internally, minimizing send-out work.

Regionalization differs from laboratory consolidation. The objective of regionalization is to develop a laboratory system capable of providing services to an extended geographical area. This permits the regional laboratory system to provide services to managed care plans. It also permits the regional lab system to make best use of existing laboratory assets in a given marketplace.

Compare an actual example of consolidation with laboratory regionalization. When Quest (as **MetPath**) acquired the Texas laboratories of **Damon Clinical Laboratories** and **Nichols Institute** in 1994, it made the decision that Dallas would be the central laboratory to serve the state.

Thus, it closed the major laboratories operated by Damon and Nichols in cities such as Houston, El Paso and San Antonio. Those specimens were consolidated into the main laboratory in Dallas. Consolidation of testing caused Quest to downsize or close satellite laboratories throughout the state.

Laboratory regionalization has the goal of establishing laboratory service resources throughout a geographical

area, *without building new laboratories*. MDS-Hudson Valley Laboratories (MDS-HVL) represents one approach to regionalization. Based in Poughkeepsie, New York, MDS-HVL is the dominant outreach laboratory provider in the Mid-Hudson marketplace. It is owned by two hospitals and a commercial laboratory.

MDS-HVL's off-site core laboratory provides testing to both outreach clients and its four hospitals. MDS-HVL's growth strategy relies on recruiting hospitals within a 90-mile radius to join the consolidated laboratory operation.

New hospitals benefit from lower testing costs and an expanded menu of locally performed tests. The sales and marketing team from MDS-HVL will also assist in opening new outreach accounts.

MDS-HVL benefits from the lower average cost per test generated by the increased specimens from the newly recruited hospital. More importantly, MDS-HVL can now market its outreach testing to physicians located in the medical campus around the hospital. Because of physicians' loyalty to their local hospital, this is a winning strategy for both the hospital and MDS-HVL.

One way to view the difference between consolidation and regionalization is to consider that laboratory consolidation is more of an *internal strategy*. The primary benefits accrue from centralizing specimens at the main laboratory.

In contrast, laboratory regionalization is more of an *external strategy*. The goal is to extend the service reach of the organization throughout a target market area. It is to integrate lab services and align them with the needs of the healthcare community within the service area covered by managed care plans in the region.

New Hybrid Lab Systems Provide Peek At Future

Here's an assessment of the earliest variations of regional laboratory systems now operating

CEO SUMMARY: *As the first generation of regional laboratory systems begin operation, the marketplace is about to separate winners from losers. Stakes are high for hospital laboratory administrators. If they choose to affiliate with the wrong model, the consequences can cause extended disruption to both their laboratory and the hospital it serves.*

FOUR COMPETING CONCEPTS of regional laboratory systems confront hospital laboratory administrators. Each concept offers potential benefits, but only one of the four concepts has demonstrated sustained success in the marketplace.

Here is an overview of the most relevant regional models to come into existence during the last two years. They represent a first look at innovative and pioneering efforts to establish regional laboratory systems.

Two caveats are in order. First, getting accurate information about these pioneering organizations is difficult because few laboratory managers will talk publicly about setbacks and problems. Second, many players in the regional laboratory system arena are economically motivated to represent their success as something greater than it was. That is why laboratory executives should perform extensive due diligence before committing their laboratory to join a proposed regional system.

Of the four types of groups attempting to organize regional laboratory systems, the national laboratories are probably the most ubiquitous.

A significant number of hospital laboratories find themselves in regular conversations with sales representatives of the three national laboratories. A fourth company, **Dynacare Healthgroup** of Canada, is just as aggressive as **Quest Diagnostics, Laboratory Corporation of America** and **SmithKline Beecham Clinical Laboratories**. Dynacare should also be included in this segment.

Of the four groups attempting to organize regional laboratory systems, the national laboratories are probably the most ubiquitous.

Most business proposals extended by these laboratories do not represent a true regional laboratory system. In the case of the three national laboratories, they seek to generate more volume for their regional testing laboratories. For that reason, their proposals tend to involve outsourcing, contract management of the laboratory and similar arrangements.

Probably the only true regional laboratory system initiated by a national laboratory partner during the last two years is found in Louisville, Kentucky. In December 1995, **Columbia/HCA** and **LabCorp** announced an agreement that **LabCorp** would manage three hospital laboratories in Louisville, representing over 900 beds.

Simple Concept

The concept was both simple and obvious. **LabCorp** operates a large regional laboratory in Louisville. If **Columbia** and **LabCorp** were to consolidate and integrate the three hospital laboratories with the regional core, significant savings would accrue to both companies.

During 1996, laboratories at **Columbia's Audubon Hospital, Southwest Hospital** and **Suburban Hospital** were integrated with the **LabCorp** site. Although not problem-free, the transition was considered successful by both companies. The first public presentation on this regional model will be made at the upcoming *Executive War College* on May 20-21 in New Orleans.

Considerable cost savings were expected by both companies in this commercial lab/hospital lab consolidation. **Columbia** considered this to be an experiment. If successful, **Columbia** intends to develop similar consolidation laboratory ventures in other cities where the national labs have large regional laboratories.

Columbia is also developing another regional model, this time in Atlanta, Georgia. Canadian-based **MDS Healthcare** is the partner. Both companies are jointly building a core reference laboratory in Atlanta. It will incorporate automated laboratory systems from **MDS's Autolab** subsidiary. Testing from **Columbia's** 18 Georgia hospitals will be performed at the laboratory.

The joint venture also intends to compete for outreach business in the

state. Although this regional laboratory system is not yet in operation, it demonstrates the type of regional market solutions **Columbia** is investigating.

Another commercial lab-hospital lab model which has regional implications is **Dynacare's** Houston operation. **Dynacare** and **Hermann Hospital** entered into a joint venture almost two years ago. Although the partnership had a rocky start, executives in the joint venture indicate that outreach revenues are increasing steadily. Encouraged by the flow of new outreach business, the joint venture is now soliciting outreach accounts in cities outside the Houston metropolitan area.

Because **Dynacare** is aggressively courting other hospitals in Texas, should the venture with **Hermann Hospital** demonstrate sustained profits, it would be reasonable to expect additional hospitals in Houston or east Texas to join the partnership.

Second Group

The second group of regional laboratory system developers are the independent commercial laboratories. They remain numerous. **Dun & Bradstreet** estimates reveal that there are 1,000 of these laboratories which generate at least \$2-3 million per year in revenue.

Several intriguing regional laboratory models are emerging from this market segment. In Spokane, Washington, **Pathology Associates Medical Laboratories (PAML)** formed a statewide alliance with two Catholic hospital systems. Nine hospitals in the **Providence** and **Franciscan Health Systems** are partnering with **PAML** in a network called **PacLab Network Laboratories**. The consortium became operational late last year.

This regional laboratory system is organized to acquire and service managed care contracts. The hospitals can also take advantage of **PAML's** low average cost per test and management

Hybrid Regional Lab Systems Sprouting Throughout The US

Here is where the earliest models of hybrid regional laboratory systems can be found. Most of these regional systems have been organized in the past 24-36 months.



1 PacLab Network Laboratories:

Commercial lab joins with 8 hospital labs to provide statewide laboratory services.

2 Bay Area Hospital Laboratory Network:

18 hospital laboratories in a regional laboratory network. Serving the extended metropolitan area.

3 Physicians Medical Laboratories-Scripps Healthcare:

Independent laboratory in partnering arrangement with healthcare system operating multiple hospitals.

4 Dynacare-Hermann Hospital:

Joint venture between commercial laboratory and hospital involves consolidation of testing and aggressive outreach marketing efforts.

5 LabCorp-Columbia/HCA:

Testing at three Louisville Hospitals integrated and consolidated with LabCorp's regional site.

6 Joint Venture Hospital Labs:

Regional laboratory network of seven hospital systems (representing 24 hospital labs). Now in fourth year of operation.

7 Centrex Clinical Labs:

Consolidated laboratory company serving six hospitals and offering extensive outreach testing.

8 MDS-Hudson Valley Labs:

Consolidated laboratory company serving four hospitals. Consistent sales effort makes it dominant outreach laboratory provider in its market area.

9 Presbyterian Lab Services:

Consolidated laboratory company within integrated healthcare system. Serves system and offers outreach testing.

resources. Another interesting aspect of this venture is that PAML's professionally managed sales and marketing team will be selling PacLab's testing services to the physicians who practice at each of the nine hospitals.

PacLab seems well-designed to meet the needs of all participants. Besides offering testing services throughout Washington state, PAML's executive leadership team is available to bring additional management skills to the network. Early successes by the network will validate PacLab's strategic plan.

PML followed a disciplined strategy of providing high service levels, maintaining strategic relationships and refusing unprofitable managed care contracts.

Another venture between an independent laboratory and a hospital system is **Physicians Medical Laboratories (PML)** in La Jolla, California. Its partner is the **ScrippsHealth System**. There is extensive consolidation of testing between the four ScrippsHealth hospitals and PML's core laboratory. The service region is San Diego County.

Despite the fact that laboratory reimbursement in California has declined precipitously, PML followed a disciplined strategy of providing high service levels, maintaining strategic relationships and refusing unprofitable managed care contracts. With its regional partner, PML seems to enjoy financial stability unknown to other laboratory competitors in the San Diego area, such as **Unilab** and **Quest**.

Hospital Laboratories

Consolidated hospital laboratory companies comprise the third group with a regional laboratory system concept. Three such laboratories were

mentioned in the preceding story: **MDS-Hudson Valley Laboratories** in Poughkeepsie, New York; **Presbyterian Laboratory Services** in Charlotte, North Carolina; and **Centrex Clinical Laboratories** in Syracuse, New York.

All three developed identical strategies. First, hospital testing is consolidated at an off-site core laboratory. Second, they aggressively market their outreach services to physicians practicing around the hospital campuses.

All three companies recognized the importance of a professionally designed, well-executed sales program. Good sales combined with consistent service has earned each laboratory the dominant market share in their specific service areas. The steadily increasing volume of outreach specimens is a key reason why each laboratory achieves a declining average cost per test year after year.

Successful Formula

This successful formula can be replicated, but it requires the consolidated laboratory organization to recruit hospitals within a 60-90 mile radius to join their consolidated laboratory. As those hospitals sign up, hospital testing is consolidated and outreach marketing begins in the new hospitals' medical office complex. When properly executed, the financial results are impressive.

Benefits to the hospital owners are significant. Besides the operating profits earned by the consolidated laboratory for its owners, all three laboratories provide participating hospitals with continually lower testing prices. Service levels to both the participating hospitals and the outreach clients exceed that of competing laboratories. As a regional strategy, this model has established a track

record not yet matched by any of the other three regional concepts.

The fourth regional concept is that of regional laboratory networks. This concept is the most popular among hospital laboratory administrators for several reasons.

First, the administrator retains total control over his laboratory. Second, participation in the regional laboratory network does not require any downsizing, consolidation or restructuring of the member laboratories. Third, participating in a network requires a relatively small commitment of time, money and resources when compared to the other regional laboratory models.

Pioneering Networks

Two pioneering networks received significant publicity in the laboratory trade press. In 1996, **Bay Area Hospital Laboratory Network** (BAHLN-San Francisco) and **Reference Laboratory Alliance** (RLA-Pittsburgh) were the talk of the industry.

A flurry of speeches and trade press articles inspired the creation of regional laboratory networks in almost every corner of the United States. Today there are probably 30-40 laboratory networks at some stage of planning or operation. As many as 10% to 15% of the nation's hospital laboratories may already be participating in a network.

Despite this activity and support, it is still an unproven business concept. Pittsburgh's RLA ceased operations only 13 months after operational launch. San Francisco's BAHLN struggles to maintain a critical mass of participation, shared testing and managed care contracts.

The two most interesting networks to watch are Detroit's **Joint Venture Hospital Laboratories** (JVHL) and Nashville's **Middle Tennessee Healthcare Network** (MTHN).

JVHL is probably the true godfather of the network movement. It was organized in 1993 and began servicing its first managed care contract on January 1, 1994. Currently, seven hospital systems are equity owners, representing 24 hospital laboratories. The network services managed care contracts representing 400,000 lives.

The fourth regional concept is that of regional laboratory networks. This concept is the most popular among hospital laboratory administrators for several reasons.

JVHL's developers built the network as if it was a private, "for profit" business. The network generates a consistent flow of income which is used to pay for an executive director and fund services such as couriers, billing, reporting and similar functions. It is now in its fourth year of operations.

With its established market clout, JVHL is in serious negotiations with a commercial laboratory to assume that laboratory's outreach testing volumes as it exits the Detroit market. If that happens, JVHL would move one step closer to becoming an integrated regional laboratory system.

In contrast to JVHL, the Middle Tennessee Healthcare Network is a newborn. It began formal operations earlier this year. It is a consortium of 13 healthcare systems representing 22 hospital laboratories. What makes MTHN worth watching is the comprehensive strategic business plan which its organizers carefully developed.

MTHN President and CEO Roy Wright helped the development team craft a detailed, professional business plan. They anticipated capital needs and developed an ongoing revenue

source to provide the necessary cash flow to fund continuing operations without regular capital calls to the equity owners.

Should MTHN execute its business plan with skill and sophistication, it may provide an excellent template for

regional laboratory networks in other areas of the country to copy.

THE DARK REPORT predicts that regional laboratory systems will evolve around the four basic models described above. Because each healthcare market is unique, no single concept will emerge

EXECUTIVE WAR COLLEGE To Provide Personal Networking Opportunities

OF THE REGIONAL LABORATORY SYSTEM MODELS mentioned in this story, the following representatives will be at the **EXECUTIVE WAR COLLEGE**, either as speakers or attendees (list complete as of press time). Here is an opportunity to get first-hand information about their regional models.

Columbia/HCA-LabCorp Louisville Joint Venture: Patrick Hess, Ph.D., Ron Wagener, Ph.D, Jeffery Whitesell, Columbia Audubon Hospital.

Dynacare-Hermann Hospital: Bill Pesci.

PacLab Network Laboratories: Thomas Tiffany, Ph.D., Noel Maring, Terri Montano, Pathology Associates Medical Laboratories.

MDS Hudson Valley Labs: Glen Fine.

Presbyterian Lab Services: Bob Hamon.

Centrex Clinical Laboraries: Jack Finn.

Reference Laboratory Alliance: Louis Durigon, Darrell Triulzi, M.D., Institute For Transfusion Medicine.

Bay Area Hospital Laboratory Network: Kathy Romano, Sequoia Hospital.

Joint Venture Hospital Laboratories: Jack Shaw, JVHL; Joe Skrisson, Beaumont Reference Laboratories; Barbara Goch, Oakwood Healthcare System.

Middle Tennessee Healthcare Network: Roy Wright, JoAnne Schroeder, Kim Charlton, R. Whitehead.

MDS-Columbia/HCA: Teri Brown, Autolab.

HERE ARE INDIVIDUALS SCHEDULED to attend the **EXECUTIVE WAR COLLEGE** whose laboratory organizations are involved in innovative and progressive projects.

Health Network Laboratories: (Allentown, PA), Beth Rokus: A consolidated laboratory organization which is developing a lab network among health system members and working to expand the number of hospitals participating in the consolidated laboratory company.

Midwest Lab Link: (Mansfield, OH), Fred Crowgey: Five hospital laboratories operating a regional network in Ohio.

Northeast Community Laboratory Alliance: (Burlington, VT), Geoffry Tolzmann: Thirteen hospital laboratories operating a network with coverage in Vermont, New Hampshire and NE New York.

Neponset Valley Health System: (Norwood, MA), James Nolan, M.D.: An outreach laboratory which was one of the first to use laboratory computer links with physicians offices as a pathway to access patient's hospital records.

NOTE: This is not a complete list and is limited by those laboratory organizations for which **THE DARK REPORT** has direct knowledge. Attendees with progressive, innovative and successful regional laboratory projects are encouraged to bring them to the attention of our editor, Robert Michel. Contact him personally at the **EXECUTIVE WAR COLLEGE**. He can also be reached at 503 699-0616.

as a universal answer. Quite the contrary, expect to see many unique versions of the four basic concepts.

At this stage in healthcare's evolution, the consolidated laboratory model utilized by MDS-Hudson Valley, Centrex and Presbyterian Laboratory Services represents the most successful vehicle for meeting the needs of managed healthcare.

Superior Profits

The operational and profit performance of these three laboratories is clearly superior to the industry average. Each enjoys consistent growth of specimen volume through effective outreach sales programs. Each laboratory provides a yearly reduction in the average cost per test for hospitals serviced by the core lab. Most importantly, each laboratory earns healthy operating profits which are used to expand service capabilities and regional coverage.

There is another overlooked benefit to these consolidated laboratory companies. They have considerable asset value as a stand-alone business. The hospital owners could sell their equity in these ventures for a significant market price. This is one compelling financial reason that motivates CEOs from competing hospitals to jointly own and operate a consolidated laboratory.

Financial Performance

At this point, neither commercial lab/hospital lab joint ventures nor regional laboratory networks can match the financial performance and effectiveness of these consolidated laboratories. For that reason, THE DARK REPORT recommends that this model be given serious consideration by any hospital laboratory which decides it needs to affiliate with a regional laboratory system. **TDR**

(For further information, contact Robert Michel, Editor, at 800-560-6363.)

"Centers of Excellence" As

Regional Laboratory Model

In the past twenty years, two cities saw the emergence of highly successful consolidated laboratory companies. In both cases, founders built the laboratory around a "centers of excellence" model.

*In Lincoln, Nebraska, it was **Clinical Laboratories of Lincoln (CLL)**. In the 1970s, pathologists and laboratory administrators in Lincoln decided that the duplication of instruments and laboratory testing resources among the city's hospitals was unnecessary. They recognized that big savings would result if they created a single integrated laboratory system to serve the entire healthcare community in Lincoln.*

A core lab acted as the anchor site and each hospital specialized in certain tests. A successful outreach program was developed. Within a few years, CLL became the dominant clinical laboratory in Lincoln. Their market position is so strong that no competing laboratory can afford to come into Lincoln and match CLL's full menu of diagnostic services.

***Nichols Institute** purchased CLL in the 1980s and it became part of Quest (then **MetPath**) at the time of the Nichols acquisition in 1994. Within Quest, CLL is one of the more profitable laboratory divisions.*

***Terre Haute Medical Laboratory** of Terre Haute, Indiana has a similar story. It is also a consolidated laboratory which was developed through integration of the various hospital laboratories in Terre Haute. It runs a successful outreach program.*

Like CLL, Terre Haute Medical Laboratory is the dominant clinical laboratory in that market. In fact, management made a conscious decision in the mid-1980s to develop a service mentality that competing laboratories could not match. As a result, they perform testing for a substantial majority of physicians in the region.

Partial List of Regional Laboratory Networks

Here is a representative list of regional laboratory networks which are operating or under development. New networks are started monthly somewhere in the United States.

CALIFORNIA

Bay Area Hospital Lab Network (BAHLN)

San Francisco: 18 hospital laboratories. Operational as of 1994.

Preferred Laboratory Access Network (PLAN)

Statewide: 18 independent commercial laboratories. Operational as of 1997.

Central Coast Regional Laboratory Network (CCRLN)

Monterey/Salinas: 18 hospital laboratories. Planning stage as of 1997.

CONNECTICUT

Connecticut Hospital Laboratory Network, LLC (CHLN)

Statewide: 30 hospital laboratories. Operational as of 1997.

Hospital Lab Alliance of Connecticut (HLAC)

Derby: 6 hospital laboratories. Operational as of 1997.

FLORIDA

Florida Reference Laboratory Network (FRLN)

Tampa/Jacksonville: Six hospital laboratories. Planning stage as of 1997.

INDIANA

Midwest Laboratory Provider Network (MLPN)

Statewide: Four regional laboratories. Operational as of 1997.

KENTUCKY

Consortium of Independent Laboratories of Kentucky (CILK)

Statewide: 40 commercial

laboratories. Operational Status unknown.

MAINE

Network activity taking place among hospital laboratories, but status unknown.

MICHIGAN

M Labs Network (MLN)

Ann Arbor: 4 hospital laboratories. Operational as of 1997.

West Michigan Medical Laboratory Network (WMMLN)

Grand Rapids: 17 hospital laboratories. Operational as of 1994.

Joint Venture Hospital Laboratory Network (JVHL)

Detroit: seven hospital systems representing 24 hospital laboratories. Operational in 1993.

Great Lakes Laboratory Network (GLLN)

Statewide: 25 hospital laboratories have firm commitments to participate. Affiliation agreements have been signed by 50 hospital laboratories. Operational status unknown.

MISSOURI

Regional Laboratory Alliance (RLA)

Kansas City: 10 hospital laboratories, one commercial laboratory. Operational as of 1995.

NEW YORK

Labnet, Inc. of New York

Statewide: 40 commercial and hospital laboratories. Operational in 1997.

NORTH CAROLINA

North Carolina Laboratory Network (NCLN)

Raleigh: six hospital laboratories. Operational status unknown.

OHIO

Labnet of Ohio

Statewide: 18 hospital laboratories. Operational as of 1997.

Midwest Lablink Inc.

Central Ohio: 5 hospital laboratories. Operational in 1997.

PENNSYLVANIA

Reference Laboratory Alliance (RLA)

Pittsburgh: 40 hospital laboratories. Ceased operations in January 1997.

SOUTH CAROLINA

Pathology Service Associates LLC (PSA)

Statewide: 14 pathology practices. Operational in 1996.

TENNESSEE

Middle Tennessee Healthcare Network (MTHN)

Nashville: 13 member associations, representing 22 hospital laboratories. Operational in 1997.

Dallas Hospital Laboratory Network (DHLN)

Dallas: seven hospital laboratories. Operational in 1996.

VERMONT

Northeast Community Laboratory Alliance (NCLA)

Vermont, New Hampshire, NE New York. 13 hospital laboratories. Operational in 1996.

WASHINGTON

PacLab Network Laboratories (PNL)

Statewide: nine hospital laboratories and one regional laboratory. Operational in 1997.

WEST VIRGINIA

West Virginia Labnet

Statewide: 35 hospital laboratories. Operational status unknown.

Editor's Insights

Public Laboratories Struggling To Maintain Competitive Ability

By Robert L. Michel

WITH regional laboratory systems as the theme of this issue, it is appropriate to look at the three national laboratories. What does 1997 and 1998 hold in store for them?

For the last three years, news was uniformly bad for virtually every public laboratory. Problems at **Corning Clinical Laboratories** (now **Quest**) and **Laboratory Corp. of America** got big headlines during 1996.

Because the three national labs still struggle, opportunities exist for independent regional laboratories and hospital labs with outreach sales programs to gain market share at the expense of the three national laboratories. Quest, LabCorp and **SmithKline Beecham Clinical Laboratories** (SBCL) continue to concentrate on internal problems. This makes them less effective with their sales and marketing.

Further, as they cut costs by closing satellite labs, draw stations and reducing medical technologist staffing levels, it only becomes more difficult for them to provide exceptional service for their clients. This opens a door of opportunity for nimble local competitors who operate professional sales programs.

I have several predictions for 1997-98 involving the three national laboratories. For LabCorp, a major reorganization, possibly even a chapter 11 filing, may be in the cards. They must service almost \$1 billion in debt, deal with unhappy lenders and they need to write down a significant portion of their \$891 million of intangibles. Only a huge infusion of capital could elimi-

nate the need to restructure. It remains to be seen as to whether LabCorp's parent, **Roche**, will continue to regularly bail them out by providing additional working capital.

At SmithKline, the laboratory division underperforms other corporate divisions. Although SBCL is modestly profitable, its growth prospects are poor compared to its corporate brothers. Prediction: no major change, but meager corporate support as resources go to the fast-growing pharmaceutical and consumer products divisions.

Probably the best performance of the three national laboratories will come from Quest during 1997-98. This laboratory had the opportunity to clean up its balance sheet and finances when **Corning Inc.** spun it off January 1, 1997. CEO Ken Freeman is also pursuing management strategies common outside healthcare, but ignored by laboratory industry executives.

I predict that Quest will enjoy modest earnings during the next 24 months. However, revenue and profit growth of 10% to 15% per year will prove unattainable. This is the Wall Street benchmark which Quest must meet for its share price to increase.

What does this mean for laboratory competitors? Expect the three national labs to continue to squeeze costs, thus diminishing services. They will also begin raising prices. This provides the opportunity for competitors to enlarge market share, particularly if they will selectively target quality physician accounts.

INTELLIGENCE

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



Beth Israel Medical Center

in New York City is throwing a coming out party for their automated laboratory. Beth Israel is producing a two-day seminar on May 18-19 to demonstrate all aspects of their "totally automated core facility." It was Carl Teplitz, M.D. who championed the automation project. He is Chairman of the Department of Diagnostic Pathology and Laboratory Medicine at Beth Israel.

MORE ON... BETH ISRAEL

The two-day seminar includes a presentation titled "Cost-Benefits and Outcome Analysis." If it is a candid and detailed summary of the real costs incurred to automate compared with the actual cost savings and productivity gains which were realized, then it would probably be the first honest look at the economics of laboratory automation. That would be invaluable for the laboratory industry because such numbers have not been readily available.

LABORATORY BUYERS

Apparently some ex-clinical laboratory executives joined Chicago-based **Physicians Laboratory Management Company** (Phylab) with the goal of acquiring physician office laboratories. That seems like a strange strategy at a time when lab reimbursement is declining and the regulatory burden on labs is about to become onerous.



Good news for those who believe Medical Savings Accounts (MSAs) may be the the way to restore consumer choice to health-care. According to the *Wall Street Journal*, MSAs "are off to a roaring start in the private insurance market." Estimates are that 100,000 policies may have already been written since Congress authorized the program last summer. Demand is so strong that large insurers such as **American Community Insurance**, **Time Insurance of Milwaukee** and even some **Blue Cross/Blue Shield** companies are rushing MSA products to the market.

On April 22, **Physicians Clinical Laboratories** (PCL) in Sacramento issued a press release reporting that their Chapter 11 bankruptcy reorganization was approved by the court. Although this may be a positive step for the executive team, **THE DARK REPORT** believes that lenders such as **Oak Tree Financial** will insist that PCL be tightly managed. If PCL were to encounter further setbacks, the lenders may insist on radical changes to management.

ADD TO... OAK TREE

Oak Tree Financial may become the key player in California's commercial laboratory marketplace. Not only does Oak Tree hold a significant chunk of PCL's debt, but during the second half of 1996 it purchased a sizeable portion of **Unilab's** debt. If Unilab were to violate debt covenants, Oak Tree would be in a position to restructure Unilab. Many observers feel that Oak Tree's ultimate goal is to wait for that event, then cause a merger of Unilab and PCL. Were that to happen, it would drastically change the way laboratories compete in California.

***That's all the insider intelligence for this report.
Look for the next briefing on Monday, June 2, 1997***

THE **LABORATORY** REPORT

UPCOMING...

- ***Commercial Laboratory Makes INC. MAGAZINE'S "Fastest Growing 500 List"... Yet Is Unknown To The Laboratory Industry.***
- ***Winning Managed Care Strategies: Lessons From Labs Doing It Right.***
- ***Laboratory Downsizing Techniques Which Generate More Savings Than Staff Layoffs.***
- ***Coming Hammerblows Of Federal Regulators On Hospital Laboratories.***