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From the Desk of R. Lewis Dark...

THE DARK REPORT

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

Restricted information, see page 2

Commentary & Opinion by...

R Lewis Dark

Founder & Publisher

Labs Should Leverage Their "Crown Jewels"

ONE NEW FEATURE of our annual *Executive War College* every May is a Lab CEO SUMMIT which takes place on the Thursday after the Tuesday-Wednesday event. It attracts a growing number of senior lab executives and pathologists who come to explore the strategic directions of the lab industry and pathology profession.

This year's Lab CEO SUMMIT was the setting for the presentation of Marc Grodman, M.D., President and CEO of **Bio-Reference Laboratories, Inc.** of Elmwood Park, New Jersey, which is our lead story in this issue of THE DARK REPORT. *(See Pages 2-6.)* Dr. Grodman's presentation is a fine example of the lucid market trend analysis that is occurring in some of the nation's most progressive laboratory organizations. I think you'll find his thoughts provocative and his insights directly applicable to your own laboratory situation, regardless of whether you're part of a commercial lab, a hospital lab, or a pathology group.

Those of you reading this issue of THE DARK REPORT are once again among the first in the lab industry to learn how and why the laboratory's best asset, its network of physician clients, is coming under attack by a host of Internet-based predator companies. This is an early warning about a threat and an opportunity. I concur with Dr. Grodman's assessment that connectivity providers are flooding into the healthcare industry and will transform it in just as radical a fashion as the managed care companies did during the early 1990s. I also concur with his belief that, in this new and evolving health business model, connectivity to a network of physicians is the key to both survival and prosperity. For that reason, I would categorize the physician client base of any clinical laboratory as the "crown jewels." These are worth protecting at any cost.

But winning laboratories will understand that business success relies on more than protecting the crown jewels. Bio-Reference Laboratories is reaching out to its physician network to offer enhanced, added-value services ahead of E-commerce competitors. Laboratories and pathology practices should recognize the true market value of their physician network. In the world of interconnected healthcare E-commerce, every lab's physician network is its best asset to leverage for success, long-term stability, and enhanced profits! **TDR**

BRLI Ready To Leverage Physician Relationship

New Jersey lab prepares E-health services for its physician clients, other clinical labs

CEO SUMMARY: As healthcare E-commerce rapidly approaches, clinical laboratories will find they have a built-in competitive advantage—their existing business relationship and communication links to physician offices. Bio-Reference Laboratories, Inc. is moving rapidly to capitalize on this competitive advantage. It is making sizeable investments to offer physicians more than just laboratory tests.

IN THE COMING WORLD of healthcare E-commerce, clinical laboratories have a built-in advantage over new "dot.com start-ups" that want to enter the healthcare marketplace.

In Elmwood Park, New Jersey, one laboratory company intends to capitalize on this favorable situation. **Bio-Reference Laboratories, Inc.** (BRLI) is moving swiftly to position itself as a major healthcare connectivity portal to physicians in the tri-state area of New Jersey, New York, and Connecticut. From this initial base, BRLI will then help other clinical laboratories sell E-commerce services to their physician clients.

Although Bio-Reference is a public laboratory company, it has kept a low profile within the laboratory industry. It is one of the largest laboratories in the Northeast, and primarily serves physician offices, along with a drugs of abuse testing program. It has a direct sales force of 30 people. Revenues in 1999 were $53.8 million, and BRLI is on track to hit $64 million in 2000.

"Clinical laboratories already possess one of the most valuable assets in the healthcare marketplace," said Bio-Reference President and CEO Marc Grodman, M.D. in a presentation to the *Executive War College's Lab CEO SUMMIT* on May 18 in New Orleans.

"This asset is the network of physician clients served daily by the clinical laboratory," he explained. "The business plans of many healthcare dot.com start-ups require access and distribution to a physician network before rev-

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enues can be generated. Much of their seed capital will be spent to acquire or develop a network of connected physicians to which they can sell products and services.

Valuable Physician Network

"But clinical laboratories already possess this valuable network of physicians," added Dr. Grodman. "Most labs have yet to realize that they are already in the best position to profit from the coming tidal wave of Internet-based health services.

"At Bio-Reference Labs, like all clinical labs, we possess four important business assets. One, our technical skills in laboratory medicine is what we do every day. We are not defined by our instruments and equipment in the lab," he said. "This is complemented by our existing management team.

"Two, we have an enormous amount of clinical data generated by both patients and physicians," continued Dr. Grodman. "It's data which has great importance to the healthcare system, but its potential to generate improved outcomes has yet to be tapped in any significant way.

"Three, we have an experienced and proven marketing and sales staff. In recent years, we did not downsize our sales effort at Bio-Reference Labs," noted Dr. Grodman. "These people are an important link in our ongoing relationship with our physician clients. Sales reps are essential for us to expand and develop new physician clients.

Daily Interaction With Docs

"Four, we have a physician network. Daily we interact with these physicians, their staffs, patients, and payers," he explained. "Also, like other clinical labs, we have an established communications infrastructure with physicians. This includes courier service and direct electronic connections between the laboratory and the doctor's office.

"Collectively, these four assets have great value in the changing healthcare landscape. People want these assets. They are what business people raise money to develop or acquire. In fact, businesses will spend a lot more to buy assets already in place than to develop them."

Laboratory executives and pathologists should pay close heed to Dr. Grodman's statements. His strategic business assessment of clinical laboratory assets is a fundamentally different way to look at the laboratory's value to the healthcare community it serves.

Strategic Drivers

Not only does the management of Bio-Reference Laboratories recognize the change in strategic drivers for added-value laboratory services, but it is acting to capitalize on these changes. It is already pushing several business initiatives into the physicians marketplace.

"During the past year, we acquired several businesses that position us to be more than just a laboratory to our physician network," said Dr. Grodman. *(See TDR, TBFI, 2000.)* "One of these is a nutritional products company. Our sales force offers these to doctors, who, in turn, can sell specialty food items to their patients as part of a total package of medical and nutritional care.

"Our biggest strategic initiative is a web-based product called **CareEvolve.com**. It brings physicians a variety of needed services, of which laboratory test ordering and results reporting is only one."

Like the multitude of competing services, BRLI's CareEvolve.com product connects physicians with the Internet and uses it to bring them a host of services beyond lab tests. These include claims processing,

Healthcare B2B Requires Distribution; Labs Already Have Doctor Access & Distribution

IN THE COMING WORLD OF INTERNET-BASED healthcare services, the name of the game will be interconnectivity. That gives clinical laboratories a competitive advantage, because they already have established service links with their network of physician clients.

"Our strategic business plan makes two assumptions," noted Marc Grodman, M.D., President and CEO of Bio-Reference Laboratories, Inc. in Englewood, New Jersey. "One, no matter how our healthcare system changes, we believe physicians will continue to control the decisions.

"Second, healthcare will continue to be a local business and will consolidate into regional organizations," explained Dr. Grodman. "Doctors are independent. They don't like to be told what to do. Thus, we believe that connectivity and control of the desktop will also be local. If it's not local, physicians will not respond to it.

"Distribution is the key in B2B (business-to-business), which means distribution to the physician (who controls the decisions)," said Dr. Grodman. "Thus, it is imperative to have access to the physician. Clinical laboratories, like BRLI, already have access to the physician. On a daily basis, our lab has ongoing information exchange with the physician.

"If the question is 'who has access to the physician?', the answer is clinical laboratories," he added. "We are already there. At BRLI, we are moving to seize that competitive advantage and use it to generate additional revenues by offering physicians additional value-added services."

Bio-Reference Laboratories is ahead of the clinical lab industry on two counts. First, it recognizes the strategic shift under way to the American healthcare system. This continuing shift creates new profit opportunities for any clinical laboratory perceptive enough to act upon that recognition.

Second, Bio-Reference Laboratories understands that ***Healtheon/WebMD****,* ***CareInsight****, and other healthcare E-commerce companies need access and distribution to the physicians' desktops in order to succeed. Clinical laboratories already have that access, and BRLI does not intend for these competitors to come between it and its physician clients.*

Thus, BRLI's business strategy is both offensive—to generate new revenues from expanded services; and defensive—to protect its existing business relationship with physicians. Other clinical laboratories should heed this early warning and join BRLI in protecting their physician network from outside intrusion.

insurance eligibility, patient referrals, CME credits, immunization tracking, medical supplies, office supplies, and many other medical and administrative services.

"It is important to understand that our CareEvolve.com philosophy is to bring doctors things which provide value, and don't simply make their lives easier," said Dr. Grodman. "CareEvolve.com is organized to bring compelling value to different aspects of the physician's daily practice of medicine."

Two other strategic elements set BRLI's CareEvolve.com apart from competing connectivity vendors that want to solicit the doctor's business. "First, we already have an established relationship with the physician," noted Dr. Grodman. "He knows us well, and we interact daily with him, his staff, his patients, and payers. This is credibility that outside competitors do not have.

"Second, we've positioned CareEvolve.com to be a natural complement to what the physician is already doing in the daily operations of his medical practice," explained Dr. Grodman. "It enhances and adds value to the range of activities which occur in the typical medical practice."

New Profit Opportunities

BRLI's strategic business plan is more sophisticated than those of most clinical laboratories. It points the way to new profit opportunities for labs as the American healthcare system shifts from its cottage industry roots into an interconnected, integrated industry where information—and knowledge extracted from raw data—becomes the prime driver for added-value and enhanced reimbursement to clinical laboratories.

"I want to emphasize two additional key strategic points that lab executives should understand. One, we believe that physicians will continue to control the important decisions in the healthcare system," observed Dr. Grodman. "No matter how managed care changes our healthcare system, it will be doctors who control decisions about patient care, technology, and other aspects of healthcare.

One essential theme underlying every aspect of BRLI's Internet business strategy is to emphasize the value of laboratory test data.

"Two, business-to-business (B2B) Internet activities in healthcare will be huge," he continued. "We believe that both physicians and patients will migrate to Internet-based services. But they cannot be forced to change overnight. We believe physicians and patients will migrate to the Web slowly, safely, and comfortably. Our experience to date confirms this observation.

"BRLI's business strategy accomodates both dynamics," he said. "We've designed CareEvolve.com to sit on top of the physician's existing practice management system and procedures. He doesn't have to discard existing equipment nor retrain or lay off staff.

"Instead, CareEvolve.com provides the physician with an additional resource for his medical practice, without changing anything that is already there," noted Dr. Grodman. "It enhances and brings recognizable value to the physician."

Value Of Lab Test Data

Although CareEvolve.com may deliver a wide range of services and products to the physician's practice, BRLI has not overlooked its opportunity to add value to BRLI's laboratory testing. One essential theme underlying every aspect of BRLI's Internet business strategy is to emphasize the value of laboratory test data.

"The way we introduce our Web-based product is by setting it on top of the physician's existing laboratory arrangements," noted Dr. Grodman. "For example, why go to a physician, who may really like his lab printer or lab computer, and tell him that he must abandon those to get this wonderful, Web-based lab ordering/results reporting system?

"We all know that's a tough sell. Instead, BRLI's approach is to give him both the option and the flexibility to access lab results by the Internet and enable him to go one step beyond the existing capabilities of lab printers and computers," stated. Dr. Grodman. "We give him the ability, after accessing his lab results through a Web browser, of transmitting those results securely to his patient.

"Moreover, our Internet solution gives him the ability to review results and create customized presentations for his office and his patients," he explained. "We believe some physicians spend a lot of time, in person and on the phone, giving normal test results to the patient and explaining them. Our Web-based solution makes this easier for the doctor, even if it is not appropriate for all patients and all types of tests."

Revenue Strategy At BRLI

The revenue aspect of BRLI's Internet strategy goes beyond how most labs currently view the potential of the Internet. CareEvolve.com will cost the physicians about $39.95 per month, including the charge for the ISP (Internet service provider).

"It is important to understand that, with this strategy, we are not competing with any other clinical laboratory," observed Dr. Grodman. "Our competitors are all the E-commerce companies and the traditional healthcare IS vendors who are moving toward thin server/Web browser-based information services.

"We expect that Web-based solutions will reduce the expenses involved in lab test ordering and results reporting," he continued. "But it is more important to realize that the healthcare world is changing in a very different way than in past years.

Connectivity Providers

"Connectivity providers are entering healthcare and affecting our lives in a similar way as managed care did to healthcare during the past decade. Our CareInvolve.com product is a way for clinical laboratories to protect their physician network from other companies who want to connect to doctors."

Dr. Grodman's comment reflects the fact that Bio-Reference Laboratory wants to offer CareInvolve.com to other clinical laboratories as a tool they can use to protect their existing physician network and to generate additional income. "We believe that, by working with CareInvolve, clinical labs can generate revenues, cut expenses, and protect the integrity of their own physician networks," explained Dr. Grodman, "CareEvolve allows them to offer their physicians an extensive menu of added-value services."

BRLI's ambitions for CareEvolve.com and its Internet business strategy demonstrate that clinical laboratories and pathology group practices do have substantial opportunities to enhance services and generate additional revenues and profits.

Its internal business focus—to protect and develop its existing physician network from healthcare E-commerce predators—is a timely wake-up call to all clinical laboratories.

External Business Strategy

BRLI's external business strategy—to offer its CareEvolve.com product to other clinical laboratories—demonstrates that a variety of unexpected, and low cost, business solutions are flowing into the competitive marketplace. Laboratory executives and pathologists will have an increasing number of competitive weapons to use in preserving and enlarging their existing revenue base.

Dr. Grodman's master strategy for BRLI includes more intensive use of laboratory and clinical data. A business unit called **PsiMedica** is developing effective disease management and patient management tools for physicians. THE DARK REPORT will provide more information when this lab-based business initiative moves closer to the marketplace. TDR

Contact Marc Grodman, M.D. at 201-791-2600.

New CEO Takes Charge At Pathology Partners

National pathology company using a unique business plan to generate revenue growth

CEO SUMMARY: Pathology Partners, Inc. got a new President and CEO this month. The company is organized to build and operate independent regional histology and cytology laboratories in support of anatomic pathologists. Its business model is different than competing pathology companies and Pathology Partners believes that it will be well-positioned as integrated clinical care becomes the norm.

IS THERE MONEY TO BE MADE operating regional histology and cytology laboratories in support of anatomic pathologists?

Pathology Partners, Inc. of Dallas, Texas believes the answer to this question is yes. The company, now in its third year of operations since receiving $20 million of venture capital funding, is carefully building an infrastructure of regional histology and cytology laboratories. *(See TDR, April 13, 1998)*.

Pathology Partners was originally organized to be a pathology physician practice management company (PPM). The financial problems of the PPM industry, along with rapid changes to the pathology profession, led the company to shift its strategic focus away from the acquisition and management of pathology practices. Instead, the company is developing regional pathology laboratories.

Earlier this month, Pathology Partners selected Stephen Spotts to be its new President and CEO. Spotts was promoted from his position of Vice President and Chief Development Officer. He replaces Richard D'Antoni, who recently left the company to pursue other interests.

"This is an exciting time for us," stated Spotts. "On May 1, we opened up a new laboratory in Birmingham. We expect to have another new laboratory operational in Dallas by July 1. These lab operations put us into two new regional markets."

Different Business Strategy

Pathology Partners has a different business strategy than other national pathology companies. "Typically, competing pathology firms generate increased test volumes by sending sales reps directly to physicians," explained Spotts.

"This is not our core business," he continued. "Instead, we identify outsourcing opportunities for anatomic pathology work. We want to provide histology and cytology services to hospitals, surgicenters, and large pathology group practices, preferably under a contract outsourcing arrangement."

In simplest terms, the business plan at Pathology Partners is to build and operate pathology laboratories in various cities around the United States. This is a different and unique business model for regionalizing pathology services.

Pathology Partners' first regional pathology lab was constructed in Miami. "During the time when our focus was on pathology practice management," stated Spotts. "we purchased **Histopathology Consultants**, a 12-pathologist group. We then constructed a 12,000 square foot laboratory.

Serves Three Hospitals

"Under outsourcing agreements, our Miami laboratory serves the **Mercy Hospital** (512 beds), **Cedars Medical Center** (575 beds), and **Aventura Hospital and Medical Center** (407 beds)," added Spotts.

"Our second laboratory was built in Conroe, Texas. We purchased two small labs in Houston and consolidated them. Our lab has outsourcing contracts to serve three hospitals. We anticipate a fourth hospital will be added shortly. We will also provide services to ambulatory surgery centers in Houston that are owned by **HEALTHSOUTH Corporation**."

"On May 1, our new laboratory in Birmingham, Alabama became operational," he said. "This laboratory serves two acute care hospitals owned by HEALTHSOUTH, plus seven HEALTHSOUTH ambulatory surgery centers located in Alabama.

Newest Market

"Dallas is our newest market," Spotts added. "On July 1, this lab will begin operations. It will provide services to one HEALTHSOUTH acute care hospital, along with seven HEALTHSOUTH ambulatory surgery centers in the Dallas market."

As a business strategy, Pathology Partners thinks it has an unserved market niche. "There are many smaller hospitals which find it expensive to maintain a pathology laboratory. This is particularly true of rural hospitals." observed Spotts. "These facilities have a difficult time in hiring and retaining histotechs. To control expenses, they often cut back service hours, but this doesn't meet the needs of the hospital's medical staff.

Physician Solutions Firm Evolved Into Path Partners

Many pathologists remember the flurry of recruiting activity that pathology physician practice management (PPM) companies conducted during 1995-1997.

One company that was ever-present at pathology meetings throughout the country was Nashville-based **Physician Solutions** and its President, Harold Roe. When Physician Solutions finally landed its venture capital funding in early 1998, the decision was made to make Dallas the headquarters. Shortly thereafter, Physician Solutions had a new President and CEO, Richard D'Antoni, and a new name, **Pathology Partners.**

"We believe that we can offer better service to such facilities," noted Spotts, "while at the same time helping them control costs. To date, our experience bears this out. Hospitals and surgery centers recognize and appreciate the increased levels of service we provide."

One interesting aspect of the Pathology Partners business model should intrigue pathologists. Unlike existing pathology PPMs, Pathology Partners does not want: 1) to buy or manage pathology practices; nor 2) to compete for specimens. Its regional histology laboratories are company-owned and company-operated facilities that prepare specimens which will be diagnosed by area pathologists.

"We prepare the anatomic pathology specimen in our laboratory. These slides are then sent to the appropriate pathologist for evaluation," explained Spotts. "That means we do not compete with local pathology practices for specimens. The pathologists get the professional component for their work, and in many cases, we actually generate increased specimen volumes for the pathology practices that contract to work with our laboratory."

Another Asset

Pathology Partners' working relationship with HEALTHSOUTH is another asset. "As we looked at the marketplace, we saw that anatomic pathology specimens originating from surgery centers and similar sources were an underserved market," said Spotts. "Generally these sources are not well-served by nearby hospitals because of the difficulty of doing frozen sections.

"We want to serve this unaddressed market segment," he continued. "It allows us to build our anchor laboratory in that city. We then intend to expand that pathology lab into a regional 'super-lab' that offers histology and cytology services beyond the 30-mile radius that is typical of most pathology labs."

This unique business plan of Pathology Partners was a direct response to the changed circumstances of the PPM business when Pathology Partners completed its venture capital funding. During the past 24 months, the company has moved carefully to redirect its business priority toward the construction and operation of histology and cytology laboratories.

"Within our company, the level of enthusiasm is at its highest levels," stated Spotts. "Support from our board and venture capitalists is strong and without reservation. Performance of our first regional laboratories gives us confidence that our business strategy is right on target."

Among the members of Pathology Partner's Board of Directors are venture capitalists and outside directors which include James B. Powell, M.D., President of **TriPath Imaging, Inc.** and formerly President and CEO of **Laboratory Corporation of America**, and Louis Villa, Jr., M.D., President of **Histopathology Associates**.

...Pathology Partners is another example of the evolutionary experiments in the healthcare marketplace that are creating new pathology business models.

In recent years, Pathology Partners has been one of the quieter companies on the national pathology scene. However, that may be changing. If its budding relationship with HEALTHSOUTH continues; and if smaller hospitals find it appealing to outsource histology and cytology, then Pathology Partners might be able to expand into new cities at a fairly swift pace.

Outsourcing Contracts

More importantly, if Pathology Partners demonstrates that outsourcing histology and cytology can be a profitable business, then it will be first to establish a new business model within the anatomic pathology profession.

THE DARK REPORT observes that Pathology Partners is another example of the evolutionary experiments in the healthcare marketplace that are creating new pathology business models. Moreover, the Pathology Partners business model is organized specifically to regionalize this aspect of anatomic pathology services. **TDR**

Contact Stephen Spotts at 972-753-5500, email: sspotts@pathologypartners.com.

War College Identifies Emerging Lab Trends

Case studies by leading laboratories point to Internet, information as key

By Robert L. Michel

CEO SUMMARY: Disruptive technologies and the arrival of healthcare E-commerce were two common themes which emerged from this year's* Executive War College on Laboratory and Pathology Management*. Consensus by faculty and attendees alike was that every lab organization should have an Internet business strategy, along with an accelerated implementation timetable!

DESPITE CONTINUING laboratory consolidation and a shrinking number of senior lab executives, a record crowd of 450 attended this year's *Executive War College*, held May 16-17 in New Orleans.

In itself, the large number of attendees at the *War College* verifies an industry trend. A growing number of laboratory administrators and pathologists recognize they must have answers if they are to prepare their laboratory organizations to meet the challenges of healthcare E-commerce, laboratory regionalization, and continuing pressures to further reduce the cost of laboratory testing.

Reshaping Healthcare

As Editor-in-Chief of THE DARK REPORT, it is my responsibility to set the themes for each *Executive War College*. This year, I used the concepts of macrotrends and microtrends to describe these forces.

Macrotrends are those dynamics which influence the entire healthcare system. I can identify at least four of these. *(See sidebar on page 11.)* Microtrends are specific dynamics exerting maximum influence on the evolution of laboratory management. These key trends were identified and published earlier this year in THE DARK REPORT. *(For clinical laboratory key trends, see TDR, January 3, 2000. For anatomic pathology key trends, see TDR, January 24, 2000.)*

I believe it is important to relate these macro and microtrends to the dilemma facing the laboratory industry. I call this dilemma the "Nike Sports Shoe Paradox." All clinical labs must address this dilemma before they can profit from new opportunities in laboratory medicine and diagnostics.

The **Nike Corporation** business model is built around contract manufacturing. It is contract manufacturers who fabricate the sports shoes that Nike sells under its brand. These manufacturers are located in low-cost economies, where the shoes can be made most cheaply. This allows Nike to pay about $5 per pair to the sports shoe manufacturer. Nike then sells these shoes to the retail public at $120 per pair.

Thus, Nike receives $115 of profit on every pair of shoes to cover the cost of design, engineering, G&A, marketing, sales, and allow a profit. The contract manufacturer gets only $5 for every pair of sports shoes to cover all of its expenses and leave a profit.

Apply the "Nike Sports Shoe Paradox" to clinical laboratory and anatomic pathology management. Labs are paid commodity prices to do high volumes of routine testing. Reimbursement for routine testing is at rock-bottom levels and is barely adequate to cover expenses, let alone generate an adequate profit.

Commodity-Priced Testing

Yet, despite these tenuous profit margins, labs typically spend virtually 98% of their capital, resources, and management time in specimen collection, accessioning, testing, reporting, and billing for tests that generate little or no profit. Only 2% of the lab's resources are invested in products and services which have higher utility to physicians, and come with greater profit margins.

Labs are like the contract manufacturers of Nike sports shoes. They only get $5 of the $120 a consumer pays for a Nike sports shoe. The dilemma facing all laboratories today is how to shift away from manufacturing the sports shoe (routine assays) and shift to the higher profit products that lab data can yield, such as early disease detection, disease state management, test utilization trends, and so forth.

Recognizes Dilemma

The kick-off case study at this year's *Executive War College* recognizes this dilemma. **South Bend Medical Foundation** (SBMF) is Indiana's largest clinical laboratory. It is actively pursuing several simultaneous management priorities to deal with pressures to reduce costs, while positioning itself to offer laboratory services which have higher value to physicians, payers, and patients.

"We have four primary strategic initiatives," stated Bob King, Vice

Four Macrotrends Now Reshaping Healthcare

During the *Executive War College's* opening presentation, Editor-In-Chief Robert L. Michel of THE DARK REPORT identified these four macrotrends as major forces for change to the American healthcare system.

MACROTREND 1
Information Technologies

Lump together all technologies enhancing the collection, analysis and communication of data. This includes computer hardware, software, Internet, Web, wireless, ASP, PDA, and more.

MACROTREND 2
Miniaturization

Since the 1970s, technology continues to shrink and miniaturize the size of the machines which do our work. Size of both diagnostic instruments and required amounts of reagents will continue to shrink.

MACROTREND 3
Management Philosophy

New management philosophy embodied in IS0-9000 and similar quality management systems. Emphasis is on "system of prevention", meeting customer's expectations.

MACROTREND 4
Consumer Empowerment

We are leaving the age where individuals depended on government to meet their needs. (Social security, welfare, unemployment insurance.) Better educated populations are taking greater responsibility for their own lives. (Investing in retirement, healthcare, educating their children.)

President at SBMF. "They include new technology, networking and regionalization, information management capabilities, and direct-to-consumer/ provider advertising.

Positive Results

According to King, the earliest phases of each management priority have generated positive results. Technology applications in the laboratory have lowered costs. Networking has increased the geography that SBMF services while increasing specimen volume and revenues.

It was a similar story at **Sonic Healthcare LTD**, a public lab company based in Sidney, Australia. In his case study presentation, Colin Goldschmidt, M.D., Managing Director, described how Sonic had used acquisitions of local, pathologist-owned laboratories to become the biggest lab company in Australia.

"In 1992, we were a financially-struggling laboratory with revenues of A$12 million," he said. "This year, our revenues will approach A$400 and we have 64 laboratory operations located in most of the key population centers of Australia and New Zealand."

"The Australian healthcare system is experiencing much of the same types of economic pressures as those of the United States and Canada," added Dr. Goldschmidt. "Many of your laboratory solutions have equal application in Australia and New Zealand."

Faster Cycle of Change

Dr. Goldschmidt was one of almost 50 faculty presenters at this year's War College. A careful analysis of the podium comments and audience dialogue during the course of the event revealed that the cycle of change in the lab industry is far faster than anyone realized. Specifically, the rate at which new technology is flowing into laboratory medicine is far swifter than has been publicly recognized.

This was undeniably true during group conversations at the Lab CEO SUMMIT, which is held for senior-level lab executives and pathologists the day after the War College ends. For example, during one discussion about an emerging new lab technology, a Vice President from **Roche Diagnostics, Inc.** told lab CEOs in attendance that approximately 60% of Roche Diagnostics' sales this year comes from products which did not exist 18 months ago!

If the cycle of change to laboratory management and technology is accelerating at this rate, it means that the lab industry is going to separate into new groups of winners and losers at an even faster pace than THE DARK REPORT has predicted.

> ***...the lab industry is going to separate into new groups of winners and losers at an even faster pace than THE DARK REPORT has predicted.***

Another interesting insight emerged from the discussions among CEOs at the Lab CEO SUMMIT. During the session on **CARESIDE, Inc.**'s new point-of-care (POC) chemistry and hematology instrument suite, attendees were learning how and why **SmithKline Beecham Clinical Laboratories** (SBCL) decided to fund the precursor company to CARESIDE in 1993.

I was fascinated to learn that SBCL had explored a possible business scenario where it would use still-to-be-developed POC technology to shift routine chemistry and hematology out its regional labs and back into the physicians' offices.

These POC instruments in the doctors' offices would be electronically connected to SBCL. This arrangement would permit SBCL to have continuing access to lab test data from routine testing. But it would be the physician offices that had responsibility for doing the test and getting paid.

Exit Routine Testing

Remember the laboratory dilemma and the "Nike Sports Shoe Paradox?" This business scenario, once it is enabled by POC technology, would allow commercial labs to exit the manufacturing of sports shoes (routine tests) at $5 per pair, while still retaining access to the test results from routine testing, which represents the value-added that accrues to Nike from the $120 retail sale.

For laboratory executives and pathologists who can think "out of the box," this is an intriguing business model. It retains a lab's access to laboratory test data, but allows the lab to shift resources away from doing routine tests reimbursed under commodity pricing and shift to lab services which have higher profit margins.

There was a single, ever-present theme to almost every *War College* presentation. It was the need for laboratories and pathology groups to respond to the Internet and healthcare E-commerce. Laboratory executives from all types of lab organizations discussed their Internet strategies.

Web-Based Lab Information

Although the heavyweights of the healthcare E-commerce world get all the publicity and attention, the reality in the laboratory marketplace is quite different. It appears that the Internet will indeed be one of the equalizing factors in the delivery of laboratory services.

More specifically, the capital cost to become an Internet-enabled laboratory provider is going to be quite reasonable. Once Internet-enabled, a laboratory can compete very effectively against better-capitalized laboratory organizations.

This is demonstrated by the experience of **Clinical Laboratories, Inc.** (CLI) of Throop, Pennsylvania. On its own, this independent commercial laboratory developed its Web-based lab test ordering/results reporting system two years ago.

Chief Executive Officer Kuo Cheng described to an enthralled audience how his lab "home-brewed" its own Internet solution on a modest capital budget. Earlier this year, CLI allowed its physician clients to use their wireless devices to access and download test data. "We accomplished this wireless capability at no cost to us," declared Cheng. "Our experience is that the Internet allows us to compete against any laboratory, even the nationals. It also permits us to give every physician-client virtually the same high level of service."

Plenty Of Evidence

THE DARK REPORT sees plenty of evidence that Kuo Cheng's experience at CLI can be duplicated by other labs. There are many small, specialty vendors who have viable laboratory information products entering the market.

For the traditional giants of the LIS industry. this means it will probably not be easy, nor automatic, to move their existing lab clients onto ASP-based products for lab test ordering and results reporting. Instead, the lab marketplace may be a little like the Old West, as upstart companies come gunning for the established firms' lab customers.

Add up the collective wisdom of 50 innovative management presentations at this year's *Executive War College* and one thing becomes obvious: the laboratory marketplace is evolving at an ever faster pace! **TDR**

For more information, contact Robert L. Michel at 503-699-0616.

Columbia/HCA's $745 Mil Settlement Announced

Here's more to the story, with lessons for study by the clin laboratory industry

CEO SUMMARY: Although Columbia/HCA will pay the feds $745 million as part of its recent settlement, the facts of "Medicare fraud" are far from convincing. **Wall Street Journal** ***analyst Holman W. Jenkins, Jr. makes a strong argument that the government was able to pick on Columbia/HCA for a variety of reasons, most tied to former CEO Rick Scott's unpopular efforts to consolidate and reform the hospital industry.***

IT WAS LONG-AWAITED NEWS. On May 18, officials from **Columbia/HCA Healthcare Corporation** announced basic details of an agreement to settle, subject to certain conditions, the longstanding civil claims against the company alleging Medicare fraud.

A careful reading of the terms of this agreement indicate that the federal government will not get a whole lot more money than the $745 million specifically mentioned. Many experts had confidently predicted that Columbia/HCA would pay somewhere between $1.5-$2.0 billion to resolve the host of Medicare fraud and abuse claims filed against it.

Unwarranted Persecution

Probably the most cogent analysis of the Columbia/HCA "scandal" was published by the *Wall Street Journal* on May 24, 2000. Opinion page writer Holman W. Jenkins, Jr. characterized the government's case as an unwarranted persecution of a company that played the upcoding game according to the unofficial "rules" of the Medicare system and its administrators. Holman points out that, in the 1980s and up until 1997, Medicare "routinely reduced payment levels to counter hospital upcoding, usually to the tune of 1% per year, or the equivalent of $2 billion in current dollars."

He continues, writing "what this means is that any hospital that doesn't cheat will actually get less money than it should. And thanks to the scare the Columbia crackdown put into hospital administrators, Medicare [per the Medicare Payment Advisory Commission recommendation] is pondering doling out an extra $1 billion a year to compensate [hospitals] for an epidemic of non-cheating."

Holman offers as evidence these facts. During the years when Columbia's alleged "frauds" occurred, Medicare intentionally underpaid hospitals, knowing that hospitals would shift costs onto the bills of private-pay patients. For example, in 1993, Medicare only paid hospitals 89% of the true cost of providing care to Medicare patients. In contrast, during 1998, the most recent year for such numbers, Medicare paid hospitals an average of 102% of the cost of treating Medicare patients. This change in Medicare funding was a direct result of HMOs squeezing dollars out of the hospital industry during the 1990s.

Good Guy/Bad Guy Roles

Another interesting observation of Holman's was the good guy-bad guy roles assumed by Rick Scott and Columbia/HCA's current CEO, Thomas Frist, Jr., M.D. Holman notes that Rick Scott directly challenged the hospital industry to change its business practices and consolidate unnecessary facilities.

Consequently, Scott was branded as the villain by the media, allowing Dr. Frist to wear the white hat and clean up the "scandal." However, Holman observes that one of the key claims against Columbia/HCA, that they kept "two sets of books" for reserve accounting was a business practice not followed at Columbia prior to its acquisition of HCA (then owned by Dr. Frist) in 1994. But it was part of HCA's business operations, and was imported into the post-merger Columbia/HCA after 1994.

Politicized Management

The entire Columbia/HCA mess is an example of politicized management of the government healthcare system. Holman's characterization of how Columbia/HCA responded to this situation is a classic example of the bureaucratic Catch-22. He states "Dr. Frist, in short, has made lemonade out of the lemons. If his company was guilty of overcharging Medicare, it did so when Medicare was deliberately underpaying. Now he's kicking back a modest rebate at a time when Medicare is finally carrying its own weight. This is the Medicare reimbursement equivalent of buying low and selling high."

For the clinical laboratory industry, there are some interesting lessons in the Columbia/HCA experience. First, laboratory reimbursement pricing and guidelines are not established to be fair and reasonable. Quite the contrary, they are created to game the system in favor of the Medicare program. A look at the past 15 years of changes to laboratory reimbursement bears eloquent testimony to this fact.

Second, the clinical laboratory industry and the pathology profession will never attain negotiating strength with HCFA until there is uniformity of action. The disparate interests of commercial labs, hospital labs, specialty labs, and pathologists have failed, during the past two decades, to blunt the effectiveness of HCFA bureaucrats at carving money out of the lab industry's reimbursement schedules.

A Feeding Trough

Third, it is time for laboratory executives and pathologists to set aside their rose-colored glasses and see the government healthcare system for what it really is: a highly-politicized feeding trough for voters and healthcare providers. Since the 1960s, money from Medicare and Medicaid has fueled explosive growth in the American healthcare system. There are vested interests who want to see this money continue.

For these reasons, THE DARK REPORT believes that the *Wall Street Journal's* assessment of the Columbia/HCA "scandal" is on target. It is a timely lesson that the operation of the Medicare program is fraught with its own byzantine politics. For the laboratory industry to get a better financial deal in the 2000s than the 1990s, it will have to become a lot more pragmatic about making its case with Congress. TDR

For more information, contact Robert L. Michel at 503-699-0616.

Lab Industry Briefs

COLUMBIA/HCA GETS NEW NAME; ACQUIRES FOUR LONDON HOSPITALS

NOW THAT IT HAS A SETTLEMENT with the federal government on civil claims of Medicare fraud, expect a rapid cascade of changes at **Columbia/HCA Healthcare Corporation**, the nation's largest for-profit hospital company.

First is a new name. Effective on May 25, Columbia/HCA is now called **HCA-The Healthcare Company** (HCA). Its stock symbol becomes "HCA" on May 30. This is clearly a move to distance the company from many negative perceptions which accrued during the ten years between 1987 and 1997 when former CEO Rick Scott transformed a two-hospital enterprise into a $20 billion healthcare behemoth.

Second, HCA announced on May 19 that it had acquired full ownership of four hospitals in London, England. It did so by purchasing the 50% interest of its joint venture partner for $110 million. Collectively, the four hospitals represent about 600 beds, and are recognized as among the leading private hospitals in England.

THE DARK REPORT has predicted that the larger healthcare corporations will begin to develop international operations. Examples are **Quest Diagnostics Incorporated's Nichols Institute** activities in Brazil and the **University of Pittsburgh Medical Center's** new hospital and transplant center in Italy.

HCA's expansion of its assets in England is one indication that the company believes that private healthcare providers will play a larger role within the British Isles in coming years. In Canada's single payer health system, some provinces are now actively encouraging the development of privately-owned and operated healthcare services. There is growing recognition that the single-payer systems of Great Britain and Canada have specific problems that can best be solved through private healthcare service providers.

Prior to its problems with Medicare Fraud and Abuse issues, HCA was aggressively reshaping the form and structure of its hospital-based laboratories. Now that most Medicare fraud issues are settled, HCA will certainly put more management attention into the way its laboratory services are organized and delivered.

AMERIPATH ANNOUNCES FINANCIAL PERFORMANCE FOR FIRST QUARTER

Strong revenue gains for the first quarter were posted by **AmeriPath, Inc.**, based in Riviera Beach, Florida. AmeriPath is the only public pathology PPM in the United States.

Net revenue totaled $68.2 million for the quarter. This was a 30% increase over Q1-99's net revenue of $52.3 million. Net income increased by 17.3%, from $5.2 million to $6.1 million.

AmeriPath's new laboratory in New York City posted revenues of $4 million during its first nine months of operations. The company also projects that its anatomic pathology Center for Advanced Diagnostics (CAD) will be open by the end of June. This new 10,000 square foot facility is located in Orlando and will be AmeriPath's national center of excellence.

On May 15, AmeriPath also announced the acquisition of **Chap-**

pell-Joyce Pathology Association in Texarkana, Texas. This acquisition complements the company's operations in Dallas. It extends AmeriPath's anatomic pathology capabilities in that regional market.

EPITOPE TO MERGE WITH STC TECHNOLOGIES AND GET A NEW NAME

IT'S A MARRIAGE of emerging diagnostic technology capabilities. **Epitope, Inc.** of Beaverton, Oregon will merge with **STC Technologies, Inc.** of Bethlehem, Pennsylvania.

The combined company will be called **OraSure Technologies, Inc.** and will be headquartered in Bethlehem, Pennsylvania. It will have annual revenues of approximately $26 million. The agreement is subject to shareholder votes and the merger will not take place until this fall.

Epitope developed an oral fluid assay for HIV called OraSure®. It has become the primary HIV screening test for a number of prominent AIDS clinics in the United States.

STC Technologies developed Up-Converting Phosphor Technology™ (UPT). This technology "utilizes submicron phosphor particles that convert infrared light to visible light. When used in conjunction with antibodies or DNA as a probe label, UPT assays produce no background signal, which dramatically improves the sensitivity of the test." UPT also has multiplex bioassay capability.

According to STC, the first application of UPT will be in a point-of-care system used to screen for drugs of abuse in oral fluids. This is slated for a market launch sometime after June 2001.

The newly-merged company intends to combine these two technologies into a test device called OraQuickHIV. This will be a "visually read, oral fluid testing device, which can detect HIV antibodies within 20 minutes." Company officials say this product will be offered internationally by this summer. It will soon be in clinical trials in the United States.

The OraSure oral fluids testing technology was developed and brought to market by Epitope. It's found ready acceptance in the life insurance industry for the medical testing of new life insurance applicants. It is representative of an emerging class of diagnostic assays which are designed to eliminate the need to collect whole blood specimens by needle and syringe.

QUEST DIAGNOSTICS TO BE LISTED IN S&P'S HEALTHCARE GROUP INDEX

IT APPEARS THAT the clinical laboratory industry is gaining favor again with the Wall Street Investment community.

During the past year, a growing number of financial analysts have made favorable recommendations for investments in lab companies such as **Quest Diagnostics Incorporated** and **Laboratory Corporation of America**.

Now **Standard & Poor's** has joined the club. It announced on May 25 that Quest Diagnostics Incorporated would be added to the *S&P Midcap 400 Health Care* (Specialized Services) industry group. S&P uses this index to identify and highlight industry financial trends for bondholders and investors.

Quest Diagnostics also earned more recognition when *eWEEK Magazine* ranked it number one on its FAST-TRACK 100 list of "networking e-business innovators." The list ranks companies that deploy big-bandwidth pipes in the WAN (wide area network) and build in service redundancy, with 99.99% reliability. Quest Diagnostics' network currently handles 3.4 terrabytes of data per month. TDR

INTELLIGENCE LATE & LATENT

Items too late to print, too early to report

Expect an announcement this week that **Pathology Consultants of America, Inc.** (PCA), based in Nashville, Tennessee, has acquired **PathSOURCE, Inc.** of Port Chester, New York. Both are single specialty physician practice management (PPM) companies devoted exclusively to pathology. Each company has substantial venture capital funding. PathSOURCE, organized by dermatopathologists, did not generate the revenue growth hoped for by its founders. This is an example of continuing consolidation in the pathology profession. A full intelligence briefing on this acquisition will be in the next issue of THE DARK REPORT.

ADD TO: PATHOLOGY PPMS

Pathology consolidation is ongoing, but is evolving in some unexpected directions. The number of regional pathology super-practices seem to be increasing, as pathologists recognize the importance of having critical mass in their local market.

PATIENTS BUILD THEIR OWN INTERNET HEALTH RECORDS

THE DARK REPORT has long predicted that patients would use the Internet to create and maintain their own copy of their health records. Entrepreneurs are now offering software programs and instructions to patients that teach them how to gather their health records from doctors and read the charts. A retired neurosurgeon, Ira Denton, M.D. created a product, the *Personal Health Record*, that can be purchased and/or downloaded through CapMed.com. A similar product is *The Savard Health Record*, a book available through **Time-Life Publishing**.

MORE ON: PATIENT RECORD

A number of Internet sites allow patients to upload and store their medical records. However, control over privacy remains an issue of concern to many consumers. This inhibits the growth of such web sites. There is also growing recognition by patients that their health files may be incomplete, inaccurate, or outdated. This motivates patients to collect copies of their medical records and store them on their personal computer. Patients can then print a complete file when they visit doctors or other healthcare providers. Labs should recognize there is an opportunity to build "brand loyalty" by helping patients in their efforts to compile a complete and accurate healthcare record on themselves and their family.

CHANGES AT CLMA'S EXHIBIT HALL

Another large diagnostic vendor will change the way it exhibits at one of the two big summer trade association shows. **Beckman Coulter Corporation** is planning a different exhibit for the **Clinical Laboratory Management Association's** (CLMA) annual convention in Anaheim, California next month. Instead of a large exhibit area packed with the latest in diagnostic instruments, the company plans a small exhibit that emphasizes the actual performance of its technology in working laboratories around North America. THE DARK REPORT believes this is another vendor statement about the redundancy of having two lab industry trade shows literally back-to-back each year.

That's all the insider intelligence for this report. Look for the next briefing on Monday, June 19, 2000.

THE DARK REPORT

UPCOMING...

- Evolving Healthcare Market is Stratifying Clinical Laboratories in New Ways.
- How Clinical Laboratories, Inc. “Home-Brewed” Its Own Web-based Test Ordering and Results Reporting Arrangement.
- More Consolidation in Pathology as PCA Acquires PathSOURCE.
- New Compliance Issues Place Laboratory Administrators at Greater Personal Risk.