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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

Hardball and Lowball in the Lab Industry

CLIENTS OF THE DARK REPORT and attendees at our annual *Executive War College* know that we are advocates for tough competition, excellence in management, and integrity in service.

After all, isn't it true that the companies many Americans annually recognize as the most respected are known for these three qualities? Certainly the recent examples of **Nordstrom's Department Stores**, **General Electric Corporation** and **Home Depot** illustrate that employees and customers alike innately prefer forthright companies which offer quality products and stand behind what they sell. On the other hand, **Microsoft Corporation** wouldn't make that list. Nor would most of the nation's largest HMOs. These are companies which the public doesn't trust, for a host of reasons. I offer these contrasting examples to make a point.

Within the laboratory industry, we have our own spectrum of companies with differing reputations for quality and integrity. Despite the protestations of many former employees of **National Health Laboratories**, this was a company that never earned the respect of its industry peers. On the other hand, there were, and still are, many private laboratory operations that have intensely loyal doctors and patients—because of that lab's quality of service and integrity of management.

So, I for one, look with disappointment upon **Cytyc Corporation**'s recent decision to sue **AutoCyte, Inc.** for patent infringement. *(See page 7.)* Timing of the lawsuit is interesting, coming within 12 weeks of AutoCyte's recent FDA approval for its own monolayer Pap smear prep system.

Call me old-fashioned, but I like to compete in the traditional way. I want to beat my competitors with better products and better service. So I tend to view patent infringement suits as a backdoor way to handcuff competing companies. I call that the difference between hardball and lowball.

Hardball is in that time-honored American tradition of play tough and pursue every advantage, but always keep within the bounds of the game. Lowball has that connotation of riverboat gamblers and carny booths on the midway, where all is never as it appears to be.

Certainly, if AutoCyte has egregiously infringed Cytyc's 1993 patent, then Cytyc is entitled to compensation. But, assuming that's not the case, I think the lab industry would be much better served if these two firms compete on product and service in the marketplace, rather than duking it out in federal court. TDR

Bi-Coastal Powerhouse Formed by Lab Merger

Respected Las Vegas laboratory company joins with American Medical Laboratories

CEO SUMMARY: Changes to healthcare continue to stimulate responses from independent commercial laboratories. This time it's a merger of Las Vegas-based Associated Pathologists Laboratories with American Medical Laboratories of Chantilly, Virginia. This combination creates the third-largest commercial laboratory organization in the United States and shows that size is still important.

CONSOLIDATION OPPORTUNITIES continue to fuel mergers and acquisitions among commercial laboratories.

It was announced today that **Associated Pathologists Laboratories** (APL) of Las Vegas will merge with **American Medical Laboratories** (AML) of Chantilly, Virginia. The merger is expected to occur in October.

This merger creates the third largest commercial laboratory organization in the United States. THE DARK REPORT estimates that the two labs' combined revenues total about $250 million per year.

The business implications of this merger are several. First, it gives AML an operational base west of the Rocky Mountains. This supports AML's goals of developing a national business in reference and esoteric testing. *(See TDR, April 5, 1999.)*

Second, the combined resources of the two laboratory organizations should improve their competitive position in offering routine testing to physician offices in their service areas of Las Vegas and the Washington, D.C. metropolitan area. Both labs are tough competitors in their home markets.

Third, although company executives emphasize that a primary reason for this merger is to position the lab company to better serve hospital labs with reference and esoteric testing, it does put the company in an excellent air hub (Las Vegas) to enter new markets for physician office testing, such as Phoenix, Los Angeles, and Sacramento.

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

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"The owners of these two laboratories have had close relationships for many years," stated Bob Collier, Vice President of Marketing and National Accounts at AML. "They are both long-time members of TIPII [**The Independent Pathology Institute, Inc.**] and have explored this kind of merger more than once in past years.

"Also, this past year, AML has provided reference laboratory testing for APL," added Collier. "This has given both labs increased familiarity with each other's operations and staff members."

Combined Lab Enterprise

According to Collier, a holding company called AML/APL, Inc. will be formed to operate the combined laboratory enterprise. "The plan is for each laboratory to continue business operations under its current name and operational structure."

Clients and readers of THE DARK REPORT should not be surprised that AML and APL decided to join forces. Discussions about how to combine the two labs have occurred as long as five years ago. In fact, there was one period, around 1995-1996, when both lab's Boards of Directors engaged financial consultants to value each laboratory and identify the issues involved in forming a single laboratory company from the two firms. For many reasons, no action was taken at that time.

Tough New Competitor

THE DARK REPORT expects this merger to create a tough new competitor. Since new owners took control of AML in 1997, it has enjoyed rapid growth. AML's primary goal is to develop into a national provider of reference and esoteric testing to hospital labs.

APL is an equally hard-nosed business operation. Within Nevada, APL has achieved a virtual lock on the laboratory business. It has accomplished this by always bringing sophisticated laboratory services to its customer base ahead of laboratory competitors.

APL also benefited from the fact that, since the early 1970s, Las Vegas has consistently topped any list of the fastest-growing urban areas in the United States. In this market, population growth has fueled a steady increase in the volume of laboratory testing that needs to be performed.

Given the individual successes of these two commercial laboratory companies, a merged AML/APL should be expected to have significant impact on the laboratory industry. There are several reasons why this would be true.

The merger does combine two strong leadership teams. At AML, Tim Brodnik and Jack Bergstrom have energized both the sales and operations of a long-established and respected regional laboratory.

Delivering New Business

At APL, President John Schwartz has similarly developed a tight operational capability. Under the direction of Craig Shanklin, Vice President, Marketing, APL's sales force has a reputation for delivering new business. It's also created a thriving, national drugs of abuse testing business, supported by a patented hair testing assay. *(See TDR, July 19, 1999.)*

It should be expected that the blending of these two proven management teams will work to the favor of combined laboratory company.

Next, APL's location in the well-served air hub of Las Vegas provides AML with an important operations base for developing its reference and esoteric business in the Western United States. Indications are that reference and esoteric testing will continue to be done at AML's main lab in Chantilly, Virginia. But the operations and logistics support offered by the Las Vegas location will help AML

AML and APL are Successful Labs Because of Top-Flight Client Service

One canny observer believes that customer service will definitely be a success factor in this merger between Associated Pathologists Laboratories (APL) and American Medical Laboratories (APL).

"Both of these laboratories know how to treat customers," observed Stephen J. Brase, Executive Director of The Independent Pathology Institute, Inc. (TIPII). "What a good regional laboratory knows how to do best is to take care of their physician clients and patients. Historically, this has not been the strong suit of national laboratory organizations.

"For example, within regional labs like AML and APL, there is a strong interest by personnel to go above and beyond in serving clients. This is reinforced and supported by management," continued Brase. "That doesn't happen in many other laboratory settings."

Played An Active Role

Brase is a long-time lab industry executive with senior management experience in both private regional laboratories and public commercial lab companies. As Executive Director of TIPII since 1995, he actively supports its membership, comprised of independent laboratories located throughout the United States.

"I believe the merger of APL and AML demonstrates that continuing changes to healthcare still make it important for labs to find ways to work together," said Brase. "This will be expressed by other mergers and joint ventures among independent labs in coming months and years.

"I also believe that many of these regional efforts will succeed because of their emphasis on the need to serve customers," explained Brase. "As long as national labs concentrate on cost management, the customer focus of regional labs will give them a competitive advantage."

Customer Service Focus

Brase describes an unusual reason why some labs lose their focus on customer service. "Although most big lab companies have a CEO with extensive lab industry experience, frequently the CFOs and COOs come from outside the lab field.

"These individuals tend to reduce laboratory testing to a commodity product because they consider low price to be the competitive advantage," he noted. "This attitude moves that laboratory further from the customer. But people working in regional laboratories tend to personalize their work. They understand that each specimen tube represents someone's father, mother or child.

"That is why regional labs tend to support 'unnecessary' costs that add service value to patients and physicians," said Brase. "They are in close contact with their customers and see the difference it makes.

"As long as national labs emphasize cost over individual service, I believe that regional laboratories will continue to service and thrive within the markets they serve," concluded Brase. "Top service is their big competitive advantage!"

serve new clients from that region.

Finally, the AML/APL combination continues to enjoy the financing and support of **Golder, Thoma, Cressy, Rauner, Inc.** (GTCR) of Chicago. This investment firm stands ready to provide the capital necessary to expansion, as well as the financial resources to do future acquisitions.

Laboratory owners should recognize that GTCR's involvement in AML/APL will not stop with this deal. They want to actively build this laboratory organization. Thus, further laboratory acquisitions should be expected, probably during the first half of next year.

Reshape The Lab Industry

The combination of Associated Path Labs and American Medical Labs has the potential to reshape several aspects of the laboratory industry as it exists today. THE DARK REPORT has already written about how AML's ambition to become a national provider of reference and esoteric testing will alter the send-out marketplace. *(See TDR, August 30, 1999.)*

For routine testing, it is unclear what business strategy AML/APL will follow. Its central laboratories in Chantilly and Las Vegas are well-positioned to support a higher volume of specimens from physician offices.

Increase Routine Testing

APL/AML can increase the amount of routine testing volumes in either of two ways. One, by direct sales and marketing to doctors' offices. Two, by acquiring other regional independent laboratories.

It is the belief of THE DARK REPORT that AML/APL follow a different path for expanding routine testing than what was used earlier this decade by national laboratories. Any laboratories acquired by AML/APL in the future will be financially strong and dominant in their regional service area.

STRUCTURE OF THE DEAL BETWEEN AML AND APL

None of the principals to the merger of AML and APL will comment on the financial structure of the deal nor the price paid for APL.

THE DARK REPORT believes that APL was purchased under a similar formula used to acquire AML. *(See TDR, May 12, 1997.)* If so, then all owners of APL, primarily five pathologists, were paid for their stock. They were then given the opportunity to buy an interest in the "new" company.

This was how AML's founder's, Ira Godwin, M.D. and C. Barrie Cook, sold their company, yet remained with the new group as executives with an equity interest. Thus, it should be understood that the APL transaction is not just a merger, it is an acquisition. Once the deal is closed, APL will operate under its own identity, using the same executive team and staff as before the acquisition.

After acquisition, THE DARK REPORT predicts that AML/APL will not consolidate and standardize the acquired labs, but will instead allow that regional laboratory to continue operating under its old name, guided by its key executive team. AML/APL will provide corporate services, set ambitious goals, and offer the necessary capital to achieve these goals.

Assuming this to be an accurate prediction, then Associated Pathology Laboratories can be expected to continue operating the way it always has.

The most noticeable difference will be an increased focus on growth and profitability at APL, so long as customer service remains at high levels. If this business strategy works at APL, then other laboratory acquisitions are sure to follow. **TDR**

For further information, contact Bob Collier at 703-802-6900, X2301.

Finally: Respect for Cytyc As Aetna OKs ThinPrep®

Nation's largest health insurer to pay for monolayer Pap smear preparation

CEO SUMMARY: Here's an important development in the battle to get the healthcare community to accept new technology for the preparation of Pap smears. Aetna/U.S. Healthcare announced that it would cover the monolayer preparation tests offered by Cytyc and AutoCyte. Aetna's decision makes it more difficult for other insurers to refuse reimbursement for this test. Aetna will also cover NeoPath's AutoPap® test.

IF RODNEY DANGERFIELD WERE to pick a laboratory company that "don't get no respect," he might well choose **Cytyc Corporation** of Boxborough, Massachusetts.

Over the last five years, Cytyc has battled red ink, obstreperous HMOs, and skeptical pathologists as it struggled to bring its ThinPrep® monolayer Pap smear preparation technology to market.

However, that long-awaited respect may finally have arrived with the September 2 announcement that the nation's largest health insurer, **Aetna/U.S. Healthcare,** is now providing coverage for Cytyc's ThinPrep test and **AutoCyte, Inc.**'s PREP™ test.

Banner Achievement

Aetna/U.S Healthcare will also cover **NeoPath, Inc.**'s AutoPap® Primary Screening Test. Given Aetna's acceptance of these three Pap smear technologies, it was a banner achievement for the entire spectrum of companies offering enhanced Pap smear technologies.

For Cytyc, Aetna's acceptance of its ThinPrep test is a major boost. The company has worked diligently to introduce ThinPrep technology to clinical laboratories throughout the country. At the same time, it has relentlessly pressed managed care companies to provide reimbursement for these tests.

Can Turn A Profit

Aetna's decision to reimburse the ThinPrep test will make it easier for Cytyc to become profitable. During the past 24 months, the company's sales volume has increased steadily. Cytyc's revenues are now reaching the point where some financial analysts believe it can turn a profit. When that occurs, Cytyc will be the first of the four pioneering cytology companies to attain black ink.

It has been a difficult struggle. In recent years, these four firms have chewed through a quarter billion dollars of investor money. One company, **Neuromedical Systems, Inc.**, maker of the PapNet system, went bankrupt earlier this year. *(See TDR, April 5, 1999.)* NeoPath and AutoCyte are merging in order to eliminate redundancies and

combine their technologies.

The significance of Aetna's decision is that it brings credibility to the entire range of enhanced cytology technologies. Since 1995, THE DARK REPORT has declared that new Pap smear technology faced an uphill battle for clinical and market acceptance.

Tangible Clinical Benefits

Unlike fee-for-service medicine, today's managed care companies do not want to spend money on any clinical procedure which costs more than an alternative method without delivering tangible clinical benefits.

Critics regularly attacked monolayer Pap smear products and NeoPath's AutoPap system as not being cost-effective when compared to traditional Pap smear methods. These criticisms might have had lots of validity back in 1995, when the FDA began to allow these products to enter the marketplace.

But the products sold today are much improved over their 1995 versions. This process of steady improvement will continue into the near future. For that reason, pathologists and lab executives will see a different cost-performance equation each time they inspect the next generation of Pap smear technology.

Aetna Not Endorsing

Aetna's public comments on the subject of new Pap smear technology make it clear that it is not endorsing any one product. Rather, it is allowing the clinician to choose whatever method of Pap smear testing he/she prefers.

"While we recognize that there is still considerable controversy over the proper role for these new technologies...we feel it best to have the treating physician make the decision about whether the patient is best served by one of these new approaches, knowing that coverage is not an issue," declared Arthur Leibowitz, M.D., Aetna's Chief Medical Officer.

THE DARK REPORT believes that Aetna's decision to reimburse for new Pap smear technology ends the first market cycle of this infant industry. New Pap smear products have established a permanent place within the clinical laboratory industry.

Although the battle for sufficient reimbursement will continue, Aetna's decision means that most managed care plans will probably fall into line. Now the attention of Cytyc, and its main competitor, AutoCyte/NeoPath, will shift to clinicians and pathologists. It is these doctors who actually order Pap smears, perform the tests, and act upon the results. **TDR**

For further information, contact Jeff Keane of Cytyc Corp. at 800-442-9892.

Cytyc Sues AutoCyte For Patent Infringement

It didn't take long for Cytyc Corporation to begin attacking its newest competitor. Last Monday it filed a lawsuit against AutoCyte, Inc. of Burlington, North Carolina. This action may be the opening salvo of a particularly rancorous battle in the Pap smear marketplace.

AutoCyte recently gained FDA authorization to bring its PREP™ automated monolayer Pap smear preparation system to market. **(See TDR, June 28, 1999.)** ***This brings it squarely into competition with Cytyc's ThinPrep® monolayer product.***

Cytyc's lawsuit, filed in a Delaware federal court, claims that AutoCyte infringed Cytyc's patent covering its proprietary preservative solution, called PreservCyt®. It seeks a preliminary injunction to keep AutoCyte from "making, using, offering for sale, or selling AutoCyte's CytoRich Preservative Fluid in the United States."

Managed Care Update

Capitated Contracts Losing Favor Within the Hospital Industry

As more hospitals reject capitated contracts, insurers expect to see further earnings erosion.

IT APPEARS THAT AN INCREASING number of hospitals in mature managed care markets like California and Colorado are rejecting capitated managed care contracts.

If future events verify this trend, the experience of hospitals may demonstrate a way for clinical laboratories to reject capitated arrangements for laboratory testing in favor of other types of agreements.

California is the bellwether state for managed care trends. Hospitals there are already in widespread rebellion against capitated contracts. "We got sold a bill of goods," said Richard Warren, CEO of **El Camino Hospital** in Mountain View, California. "I don't know anybody who's making money on it."

They Don't Make Sense

Columbia/HCA Healthcare Corp. is in the process of renegotiating or exiting capitated contracts covering its California hospitals. Columbia Public Information Officer Jeff Prescott confirmed that the company had changed its policy toward capitated agreements, saying, "in most cases they don't make sense for us."

Like clinical laboratories, hospitals find capitated contracts to be unprofitable, difficult to administer, and nearly impossible to acquire the data needed to properly evaluate utilization and risk. "The all-encompassing global contracts have been financial disasters, and so have the hospital-only capitation agreements," said Larry Foust, attorney with **Jenkens & Gilchrist** in Houston.

Widespread Resistance

Hospitals, with plenty of economic clout, have more power to reject capitation than clinical laboratories. Also, capitation remains widespread among primary care physicians and some specialist categories. But THE DARK REPORT predicts that the day fast approaches when physicians mount their own widespread resistance to capitated arrangements.

It should also be noted that any growing shift by providers away from capitation will have a financial impact on many HMOs. For example, **PacifiCare Health Systems, Inc.** is organized almost totally upon capitated, shared-risk arrangements. **Moody's Investor's Service**, recognizing hospitals' growing rejection of capitation, recently downgraded PacifiCare's rating for precisely this reason.

Lab executives and pathologists should begin tracking this new trend. It is likely that hospitals will participate in developing another reimbursement mechanism to replace capitation. Their solution may help clinical laboratories improve the risk-reward combination from managed care contracting. TDR

CEO SUMMARY: We offer our second installment about the ten management myths which led the clinical laboratory industry astray during the 1980s and 1990s. Regretfully, clients responding to part one of this series tell us that these management myths remain alive and well—and continue to steer many well-intended but misguided laboratory managers in the wrong direction!

PART TWO OF OUR THREE-PART SERIES

Ten Management Myths Misled Clinical Laboratory Executives

IT SEEMS THAT OUR FIRST INSTALLMENT in this series about laboratory management myths stirred up controversy in some quarters of the clinical laboratory industry.

This is a healthy development. It is time for concerned lab administrators and managers to seriously question the current state of laboratory management and organization. Outmoded thinking and outdated management practices should be identified and discarded.

The ever-hastening pace of change within the world economy is mirrored by the equally swift restructuring of the American healthcare system. In order to survive these radical changes, management leaders within the clinical lab industry must constantly reassess the manner in which they organize and deliver laboratory testing services.

Failure to do so will mean continued turmoil in our industry. The unnecessary lay-offs of loyal, hardworking lab employees will continue even as counterproductive consolidation measures remove existing lab services infrastructure from the very neighborhoods that rely on them.

It is for this reason that we offer our "ten myths of lab management which led the lab industry astray." It is time to move the debate about effective laboratory management to a higher level. As of yet, few of the lab industry's trade associations have been willing to tackle this subject with candor, vigor, and even bluntness.

THE DARK REPORT is venturing into this leadership vacuum. In this second installment of our series, we offer the next four management myths of the lab industry.

MANAGEMENT MYTH #4

Laboratory automation is an automatic way to access cost savings.

LABORATORY AUTOMATION IS ONE of the most fascinating topics in clinical laboratory management. Since it first appeared on the lab industry's radar screen some ten years ago, most lab executives came to believe it was inevitable that every clinical laboratory, including their own, would have to automate in order to remain competitive and cost effective.

This uniform belief in the potential of lab automation was so strong that there was really only one question that the typical lab manager asked about automation—*when* must I automate my laboratory?

It is the opinion of THE DARK REPORT that the management myth of laboratory automation was rooted in the lab industry's universal acceptance of this basic assumption: an automated lab would have lower costs and higher quality than a non-automated laboratory.

For most of the 1990s, many lab managers considered it an unquestioned truth that any competitive laboratory would have to fully automate its lab if it was to remain viable and match the services of its competitors. This competitive spiral would begin once the earliest labs to automate became operational and gained competitive advantage.

But a funny thing happened on the way to the automation party. Those pioneering laboratories which were first to automate *did not* gain an immediate competitive advantage! To the contrary, a number of the earliest TLA (total laboratory automation) sites failed to yield enough cost savings and service enhancements to justify their acquisition and installation. *(See TDR, January 11, 1999.)*

More importantly, the inflexible design of these early systems locked these labs into a work flow arrangement that prevented them from efficiently incorporating other management philosophies and emerging lab technologies.

THE DARK REPORT believes that validation of this management myth comes from one fact: since the earliest TLA sites became operational in 1995 and 1997, there has not been a rush by the lab industry's highest volume laboratories to

adopt TLA into their own operations.

When other lab executives studied the actual performance of those pioneering TLA laboratories, they quickly realized that the expenses of TLA were prohibitive when compared to the modest benefits they delivered in cost savings and productivity improvement.

Most laboratory executives have ceased to grant unquestioning acceptance of the premise that lab automation must occur, and with it comes automatic competitive advantage. Rather, a more skeptical attitude has emerged.

Now laboratory administrators and managers are looking at lab automation solutions which address specific areas of lab operations. Under the various monikers of automated workcells, modular automated systems, and the like, a new generation of automated laboratory equipment is entering the marketplace.

It is this "component" approach to laboratory automation which will first achieve the necessary balance of acquisition cost, return on investment, and operational benefits. Moreover, as component automation proceeds, there will be a natural evolution in technology and lab processes that will eventually yield a cost-effective TLA solution.

MANAGEMENT MYTH #5

The best way to cut costs in the laboratory is to cut people.

WHAT SINGLE MANAGEMENT strategy was used by more clinical laboratories than any other during the 1990s? THE DARK REPORT believes the answer is indisputable: staff layoffs.

It was the loyal, long-serving med techs and support employees who bore the brunt of deficient management leadership during the 1990s. Whenever costs needed to be squeezed, the easiest solution for the brass upstairs was to terminate employees and downsize the staff.

It is a tragedy that the lab industry placed such profound reliance on staffing cutbacks as the way to deal with the need to reduce costs. Had many commercial and hospital lab managers studied the long-proven effective management techniques of manufacturers, distributors, and service companies outside the healthcare industry, they would have discovered a wide range of other techniques for reducing costs and improving quality.

Addicted To Layoffs

Staff downsizing was just as prevalent among hospital laboratories as it was in the commercial lab sector. High-performance management experts who've studied the clinical laboratory industry say that lab managers were addicted to staff layoffs as the swiftest, easiest way to reduce costs.

They observe that a great number of laboratory administrators and managers never got training in sophisticated management techniques such as deliberate methods change, quality management, value analysis, ISO-9000, reengineering, and others.

Thus, a significant number of the commercial lab and hospital lab industry's management leaders were unfamiliar with the other effective management techniques available to them. Utilization of these methods could reduce laboratory costs without widespread, repetitive layoffs of lab employees.

Industrial engineer Mark H. Smythe, a frequent contributor to these pages, has noted that in a well-executed consolidation of manufacturing facilities, it is typical to get cost savings from operational changes which equal those of reducing staff.

To apply this to the clinical laboratory, anytime that a laboratory consolidated operations and cut costs by 25% through employee layoffs, it could

have saved *an additional 25%* from operational savings, using value analysis, deliberate methods change, and other proven management cost reduction methods.

This means that a rigorous consolidation of multiple hospital labs had the potential to yield up to a 50% reduction in total costs! But since lab managers generally were untrained in these more sophisticated cost management principles used by industry, it was common to see an absolute reduction of not more than 15% to 25% of costs, with the majority of these savings directly attributable to cutbacks in the number of lab employees.

Myth Will Curse The Industry

Unfortunately, this management myth will curse the laboratory industry for years to come. Unless some lab trade association steps up and develops a "lab management university," most laboratory administrators will have no other tool for swift and deep cost-cutting but employee staff reductions.

MANAGEMENT MYTH #6

It takes a long time to implement plans for lab restructuring or reorgnization.

FOR ACTION-ORIENTED LAB MANAGERS, this myth is the most frustrating. There seems to be a built-in expectation that any significant change to laboratory operations or organization must take months, if not years, to prepare and implement.

This myth is particularly prevalent among hospital lab administrators. It is understandable, given the historic problems of gaining buy-in from hospital administration, physician staff, nurses, and other vested interests in the hospital.

Premier, Inc.'s Vice President, Bill Nydam, succinctly described the situation among hospital labs last year. "...our hospital owners were frustrated with the lack of speedy responsiveness that seemed to be common from many laboratories," he told THE DARK REPORT. "Although they were focused on cost reduction, we found that it was happening in little steps...it was taking as long as 10 years for labs, on their own intiative, to work through these incremental steps [cost-cutting, consolidating testing among several hospitals, organizing a regional lab network]." *(See TDR, June 15, 1998 and July 6, 1998.)*

Nydam's GPO represents 1,700 hospitals. His observations about lab management should be a wake-up call to administrators and executives genuinely concerned about maintaining a viable laboratory organization while

Laboratory Industry's Ten Biggest Myths

Here's the first seven on our list. The final installment will complete the list of ten management myths:

1. **Lowest cost per test gives a laboratory an unbeatable competitive advantage.**
2. **Bidding for additional specimens using marginal cost pricing is a viable business strategy.**
3. **Getting a managed care contract guarantees that pull-through business will follow.**
4. **Lab automation is an automatic way to access cost savings.**
5. **The best way to cut costs in the laboratory is to cut people.**
6. **It takes a long time to implement plans for lab restructuring or reorganization.**
7. **Only other laboratorians can offer useful management or business advice to lab managers.**

Myths 8-10: To be featured in final installment.

providing employment stability to their employees.

This myth will disappear once a sizable number of laboratory managers acquire the mindset, along with the ability, to effect change on a rapid timeline. Individual laboratories no longer have ten years to adapt and transform themselves to the needs of today's healthcare system.

MANAGEMENT MYTH #7

Only other laboratorians can provide useful management or business advice to lab managers.

THIS MYTH ALSO REPRESENTS our pet peeve about the clinical laboratory industry. Entering the 1990s, it was an ingrained trait of both commercial and hospital-based lab managers to reject the business advice offered by professionals who had no lab experience.

Although management within the clinical laboratory industry was inbred, it was generating immense profits during the 1980s and early 1990s. Such confidence encouraged managers to look within the lab industry for management wisdom.

It was common to hear statements such as: "how can someone who's never worked in a laboratory understand what kind of business expertise we need?"

This mindset caused lab managers to look at other laboratories for inspiration and innovation. Seldom would they go outside the clinical lab industry to find business and management models that could benefit their particular laboratory.

Clients of THE DARK REPORT remember how unique it was that the Bob Hamon, then Laboratory Director of **Presbyterian Laboratory Services** (PLS), in Charlotte, NC, had ridden in a semi-truck on its LTL (less than a load) delivery route to understand how it scheduled stops. *(See TDR, October 21, 1997.)*

This same individual went to **Federal Express** in Memphis to watch its system of picking up and delivering packages. When it came time to hire a new manager to run the PLS courier system, he hired a former **United Parcel Service** (UPS) manager.

Why? Because a lab courier system is almost identical to Federal Express, UPS, **Airborne Express** and other commercial delivery systems. Their business wisdom learned from delivering and tracking packages had value and relevance to that part of the Presbyterian laboratory operation.

There is still an innate resistance by clinical laboratory managers to learn the techniques, methods, and philosophies of other industries. Evidence of this is the fact that few laboratory programs will feature successful executives from outside the healthcare industry on the podium.

Someday the clinical laboratory industry may realize that much of the management wisdom it needs for survival can be found by studying the experience of other industries.

Difficult To Collaborate

As these four laboratory management myths demonstrate, much of the clinical lab industry continues to operate with inappropriate or outmoded management philosophies. That is why it remains difficult, if not impossible, to develop collaborative laboratory projects such as core lab joint ventures, regional laboratory networks, and shared facilities arrangements.

The final three lab industry management myths will further demonstrate why "honest-wrong" thinking continues to lead the lab industry down unproductive paths. **TDR**

For further information, contact Robert Michel at 503-699.0616 or email: labletter@aol.com.

Upcoming: Final Myths!

Look for the final three management myths of the laboratory industry in an upcoming issue of THE DARK REPORT.

New Trend Threatens Pay For Path Part A Services

Growing cadre of hospital administrators want to avoid paying for Part A services.

CEO SUMMARY: Each year, more hospitals adopt an aggressive stance and attempt to eliminate or greatly reduce the compensation paid to their pathology groups for Medicare Part A technical services. There is a surprising reason why an increasing number of hospital administrators suddenly have the confidence to tackle the Part A compensation issue in such a forthright manner.

ASK THE MAJORITY of pathologists about who's winning the battle over Medicare Part A technical compensation and you'll invariably get one answer—hospitals!

Although the trend for hospitals to shrink Part A compensation has been around for a number of years, it has intensified during the last 24 months.

Recently THE DARK REPORT surveyed pathology practices around the country. This informal survey uncovered a surprising reason why hospital administrators are increasingly willing to demand substantial reductions or outright elimination of Medicare Part A compensation to pathologists.

In a growing number of situations, those hospital administrators agitating for change are ex-employees of **Columbia/HCA Healthcare Corporation**. Now working in not-for-profit hospitals, they believe they have justification for the types of compensation arrangements, or lack thereof, that they want to offer pathologists serving these hospitals.

This is a disturbing trend for the pathology profession. Columbia/HCA took extremely aggressive positions against compensation to pathologists for Medicare Part A technical services during the Rick Scott regime, which ended in July 1997.

Pathologists Will Attest

As many pathologists working at Columbia/HCA hospitals during this time period will attest, Columbia's senior executives pushed their regional vice presidents to encourage the reduction or elimination of compensation for Medicare Part A technical services to pathologists and certain other hospital-based physicians.

Columbia/HCA's corporate policy was to allow the individual hospital CEO to handle this sensitive issue as appropriate to the needs of his/her facility. But Columbia was not shy about emphasizing the lack of compliance interest by either HCFA or the OIG on this issue.

Hospital administrators working for Columbia/HCA learned this mind set. Rightly or wrongly, the information they use to justify severe reduc-

tions or total elimination of pathology Part A technical compensation continues to drive their thinking today.

Effectively, Columbia/HCA trained a sizeable number of the hospital industry's senior administrators and CEOs to think aggressively about pathology Part A compensation. The numbers tell the tale.

Flooding Into Not-For-Profits

At its peak, Columbia/HCA owned more than 320 of the nation's 5,000 non-government, acute care hospitals. Since the summer of 1997, ex-Columbia hospital administrators have flooded into the not-for-profit hospital segment in two ways.

First, normal turnover of hospital CEOs and senior administrators within these 400+ facilities has been significant. Second, Columbia/HCA sold almost 100 hospitals to other operators during the past year. Administrators of these ex-Columbia facilities are now owned by different hospital systems.

So it should not surprise pathologists that this flood of Columbia/HCA-indoctrinated hospital administrators increasingly wants to hit on pathology Part A agreements. The "Rick Scott philosophy" taught them to do this.

Fundamental Threat

THE DARK REPORT believes this flood of ex-Columbia hospital CEOs and administrators will trigger a fundamental threat to the long-established principle that pathologists who provide technical services to the hospital are entitled to fair compensation.

If, in coming years, a sizeable number of the nation's 5,000 hospitals enact onerous Part A agreements with pathologists, it will create the very justification that HCFA regulators might use to subsequently "ratify the decision of the marketplace" and undermine existing Medicare guidelines for compensating pathology Part A services.

Even as this trend intensifies and expands across the country, it seems that both the pathology community and its professional associations have failed to fully respond to the dangerous impact this will shortly have upon pathologist-hospital relationships.

In the absence of concerted action by the pathology profession, THE DARK REPORT sees the marketplace now establishing new parameters for pathology Part A technical compensation. Once 1,000 or 2,000 hospitals successfully negotiate to totally eliminate Medicare Part A technical compensation with pathologists, the pathology profession will have lost much of its ability to argue from a position of strength.

After all, if it reaches a point were a majority of hospitals already pay little or no compensation to pathologists for these services; and pathologists participated in the negotiations to reduce this compensation, then pathologists may be judged to have already ceded this battle, one hospital and one pathology practice at a time.

Bright Spot In The Battle?

Is there a bright spot in this battle? THE DARK REPORT believes so. In its survey of pathology practices, it located a small number of enthusiastic pathology practices which are developing win-win Part A agreements with their hospitals.

Successes by these pathology practices prove there is an effective way to productively respond to the hospitals' demands and needs concerning Medicare Part A pathology services.

In future issues of THE DARK REPORT, and at the upcoming private *Pathologist Income Symposium* in Scottsdale on November 12-13, 1999, some of these pathology groups will present case studies and success stories about their Part A arrangements. TDR

For further information, contact Robert Michel at 503-699-0616 or email: labletter@aol.com.

Lab Industry Briefs

PATHOLOGIST INCOME SYMPOSIUM DATES ARE NOVEMBER 12-13, 1999

SCOTTSDALE IS AGAIN SLATED TO HOST the upcoming private *Pathologist Income Symposium*, scheduled for November 12-13, 1999.

This year's symposium tackles the toughest of all topics: increasing the compensation paid by hospitals for pathology Medicare Part A technical services. Compelling case study presenters will offer effective techniques for protecting and enhancing Part A compensation.

"We believe that this year's *Pathologist Income Symposium* will be the first meeting to report positive developments in the effort by pathologists to establish fair Part A compensation arrangements with hospitals," stated Robert Michel, Editor-In-Chief of THE DARK REPORT and producer of the symposium. "Several pathology practices will share their successes and demonstrate how specific negotiating strategies were used to develop win-win Part A agreements with their hospitals."

The symposium will include the full range of business, financial, and marketing topics needed by pathologists to preserve and increase group revenues and income. Of particular interest will be the analysis of three recently constructed off-site pathology labs, in Connecticut, Tennessee, and Alabama. All three laboratories are generating black ink and helping their affiliated pathologists to increase specimen volume and the revenues associated with those specimens.

"Faculty for this year's symposium represent some of pathology's most effective organizations," noted Michel. "These are growing, dynamic groups who are willing to share the details and secrets about their successes and their defeats. This is timely information, based on practical experience."

To obtain details about the private *Pathologist Income Symposium* in advance of the regular mailing, call 800-560-6363.

HEALTHEON SELECTED BY LABCORP TO PROVIDE LAB ORDERING/REPORTING

HERE'S A SIGNIFICANT LAB INDUSTRY story which is still unfolding. **Laboratory Corporation of America** announced the selection of **Healtheon Corporation** to provide a web-browser solution for lab test ordering and results reporting.

With this contract, Healtheon is now provider to two of the three national laboratory systems. As reported earlier in THE DARK REPORT, Healtheon was selected by **SmithKline Beecham Clinical Laboratories** (SBCL) to similarly move its test ordering/test reporting functions away from line printers and onto a web-based system.

By contracting to serve the LabCorp and SBCL systems, Healtheon has effectively positioned itself as a provider of choice for laboratories seeking to upgrade their information links to physician offices.

THE DARK REPORT believes that the laboratory industry is about to undergo a rapid transition onto web-based lab test ordering and lab results reporting. This information service upgrade will occur more rapidly than the movement, in the first half of the 1990s, to convert physician offices away from paper requisitions and onto computer-generated requisitions.

Healtheon is moving rapidly to become the preferred pipeline for healthcare transactions. Its impending acquisition of **WebMD** makes it a dominant player in the emerging field of web-based healthcare informatics. *(See TDR, July 19, 1999.)*

BIOGENETICS SHOWS THAT PHARMACOGENOMICS IS CAPABLE OF SPURRING REVOLUTIONARY CHANGE

PHARMACOGENOMICS WILL PROBABLY SPUR more change to clinical laboratories than any other area of science. *(See TDR, September 8, 1998.)*

Not only will these changes be revolutionary, but they will trigger a new class of winners and losers among laboratories and pathology practices. For that reason, laboratory executives and pathologists will find the impact of biogenetics to be an excellent precursor to how pharmacogenomics can change things.

Monsanto was first to trigger widespread changes in agriculture. The company figured out a way to genetically engineer seed to be resistant to its popular herbicide, Roundup. This meant that Roundup would kill all the weeds and plants, except the farmer's transgenic crop.

Introduced in 1996, farmers are now buying enough modified seed to plant 35 million acres of soybeans, about half of American production. Since that date, while sales of Roundup soar, sales of herbicides at **Cynamid**, a Monsanto competitor, have dropped by 50% since 1996. Prices for its flagship product, Pursuit, have declined by 32% in just the last 12 months.

A similar thing is happening among pesticide manufacturers. Biogenetics companies have developed transgenic seeds which are resistant to certain insect pests, thus reducing or eliminating the need for farmers to apply pesticides. For example, there is now a cotton seed with the Bt gene, which instructs the cotton plant to make a protein poisonous to the tobacco budworm.

Conclusion? Biogenetic science is disrupting long-established business relationships between farmers and billion-dollar suppliers. The benefits of the scientifically-altered agriproducts are too compelling for farmers to ignore. Thus, market leaders find themselves pushed out of their markets in the space of only three or four years.

The message for the clinical laboratory industry should be clear. Pharmacogenomics promises to revolutionize diagnostics and therapeutics in the same radical way that biogenetics is now transforming certain aspects of agriculture.

When these changes happen, there will be little time for lab executives to wait and see what happens. By the time they know the answer, a competitor will have captured their business!

HEALTHWORKS ALLIANCE CHUGS ALONG WITH ITS COMPLIANCE PRODUCTS

ALTHOUGH **Healthworks Alliance, Inc.** never scored the home run it sought with its lab clearinghouse product, it's still active in the marketplace. *(See TDR, August 25, 1997.)*

It's laboratory compliance program, called Compliance Checker™, has become a bread and butter product for this application software company.

Healthworks Alliance recently announced two contracts involving this software product. **Shared Medical Systems, Inc.** (SMS) will offer the Compliance Checker as part of its software suite of LIS options. The **North Carolina Hospital Association** (NCHA) also signed an agreement to make Compliance Checker available to its member hospitals. TDR

INTELLIGENCE

LATE & LATENT

Items too late to print, too early to report

Here's an interesting company to keep an eye on. **Abaton.com**, based in Minneapolis, is one of the early entrants in the race to offer web-based clinical network solutions at the point of care. **Centrex Clinical Laboratories, Inc.** of Utica, New York is purchasing Abaton.com's product for lab test ordering and reporting. Called ClinLabs.com, the product uses the Internet to connect the doctor's office with the laboratory. Centrex's President, Jack Finn, expects a rapid implementation and enhanced informatics services to his laboratory's customers.

MDS-Hudson Valley Laboratories of Poughkeepsie, New York will raid **Health Network Laboratories, Inc.** (HNL) in Allentown, Pennsylvania for its new CEO. Reports are that Charles Fenstermaker will leave HNL to become the CEO of MDS-Hudson Valley. Fenstermaker was responsible for HNL's sales and marketing program. He replaces Glen Fine, who was recently promoted to the Nashville office of **MDS Laboratory Services**. *(See TDR, April 26, 1999.)*

15-MINUTE URINE TEST FOR PNEUMONIA HITS THE MARKET

New assays continue to change diagnostic procedures. The FDA recently approved **Binax, Inc.'s** urine-based test for *Streptococcus pneumoniae*, the bacteria responsible for pneumonia. A swab is dipped in the urine, then placed on the test device, where results become available within 15 minutes. This allows doctors to make a faster diagnosis and start treatment more quickly. Current assays, based on blood or sputum, take at least two days to yield results.

ADD TO...NEW ASSAYS

Aetna/U.S. Healthcare's decision to reimburse for new Pap smear tests *(see pages 5-6)* may generate a pull-through benefit for **Digene Corporation**. Digene makes a Human Papillomavirus (HPV) test which can use a liquid prep Pap smear as the specimen. It will be interesting to see if physicians ordering liquid prep Pap smears also begin requesting the HPV test for that segment of their patient population where such tests are indicated. This is another example of how changing diagnostics technology creates new clinical opportunities.

Many laboratories know that the number of laws and regulations to improve safety conditions in the healthcare industry are increasing. As more states enact laws to protect health care workers, at least one diagnostics company stands to benefit. The latest example is the enactment, last July 1, of a law in California which requires hospitals to use appropriate safety products in all cases where a healthcare worker uses a device that comes in contact with a bodily fluid, such as blood. For **Becton Dickinson & Co.** (BD), this includes a wide range of the company's products. BD executives believe that currently only about 20% of the nation's market has converted to health safety products. It predicts that, within three years, it will be 85% converted. For laboratories, this trend will generate increased costs. Such products, like needles and syringes with safety features, cost more than those without.

That's all the insider intelligence for this report.
Look for the next briefing on Monday, October 11, 1999

UPCOMING...

- ***Next Installment about UPMC's Progress at Repacking Anatomic Pathology Into an Information Therapy Resource.***
- ***Inside Look at How Healtheon/Web MD Will Transform Clin Lab Informatics Next Year.***
- ***Regional Laboratory Network Takes Direct Approach to Build Statewide Laboratory Capabilities.***