

From the Desk of R. Lewis Dark...

THE **RD** DARK REPORT

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

R. Lewis Dark:
Consolidation Within The Diagnostics Industry.....Page 1

Ohio Hospital Laboratory Lawsuit
Tossed Out By The Judge.....Page 2

Laboratory Market Trends
Drive Beckman-Coulter Deal.....Page 4

Diagnostic Companies
About To Undergo Change.....Page 6

Rural Hospital Succeeds
With Laboratory Outreach.....Page 9

Scottsdale Pathology Gathering
Targets Three “Money Tracks”.....Page 15

Nominations Now Open
For Laboratory Innovators.....Page 16

Intelligence: Late-Breaking Lab News.....Page 18

Commentary & Opinion by...

R. Lewis Dark

Founder & Publisher



Consolidation Within The Diagnostics Industry

IN THIS ISSUE WE ARE GIVING COVERAGE to the acquisition of **Coulter Corporation** by **Beckman Instruments, Inc.** for an important reason. I believe this merger is first evidence of impending and significant changes to the diagnostics industry.

During the next 18 to 24 months, a deluge of mergers, acquisitions and joint ventures will be announced. Why? Because consolidation is about to hit the diagnostics industry with the same vengeance as it hit clinical laboratories and hospitals. The Beckman-Coulter deal is a major event. No less a major event was the **Roche-Corange** transaction last May, which gave ownership of **Boehringer Mannheim** to Roche. These are important market signals telling us what is about to happen.

Consolidation will be the overarching theme in the diagnostics industry during the next few years. It is the inevitable consequence to the widespread consolidation that clinical laboratories underwent from 1985 through 1994, as well as the recent tidal wave of hospital mergers, acquisitions and alliances which occurred over the last three years. If customers and users of diagnostics instruments and kits are consolidating, it is inescapable that a fragmented diagnostics industry must respond. Their marketplace has fewer buyers. The buyers who remain are large, if not huge, and want their increased buying clout to bring them lower prices, volume discounts and improved services.

For diagnostics companies, these evolving market dynamics can only be successfully addressed by increasing their own size and resource base. Few existing diagnostics companies have the internal capital necessary to finance such growth. Thus, they will go outside and either acquire or use joint ventures to build the resource base necessary to serve the remaining laboratory and hospital buyers. Either way, consolidation within the diagnostics industry results.

Along with my prediction that consolidation is about to radically transform the diagnostics industry, I would like to add a warning to laboratory executives. For owners of independent commercial laboratories, the time has come to consider "consolidation strategies" which ally your laboratory with strong regional players. For laboratory administrators in hospitals, it would be timely to involve your laboratory in some type of regional laboratory provider system. The day is fast-approaching when size will be just as important as excellent service and long-standing physician relationships.

Ohio Hospital Lab Lawsuit Tossed Out By The Judge

OHA, AHA sought court order to prevent further investigation of lab billing practices

CEO SUMMARY: *Hospitals in Ohio now find themselves at square one again in their efforts to stop federal prosecutors from continuing the statewide investigation of laboratory billing practices. The judge's legal ruling denied jurisdiction to hear the case and did not address any of the arguments for or against the plaintiffs' case.*

STATING THAT HER COURT had no jurisdiction, U.S. District Judge Kathleen O'Malley tossed out the lawsuit jointly filed by The **Ohio Hospital Association (OHA)** and the **American Hospital Association (AHA)**. Her ruling was announced last week.

O'Malley's decision blunted the attempt by the OHA and AHA to seek a court order preventing federal prosecutors from continuing their investigation of hospital Medicare billing practices involving specific laboratory tests.

"Effectively, the judge left us two options," stated plaintiff's attorney Diane Signoracci of **Bricker and Eckler**. "One option is to appeal this decision. The second option, which the judge recommended in her ruling, was to seek relief through legislative action. We are currently considering our next move."

This legal ruling has consequences outside of Ohio. As **THE DARK REPORT** predicted in July, 1996, federal prosecutors began expanding these investigations to other states besides Ohio. (See *TDR*, July 22, 1996.)

In recent months hospitals in at least six states received letters from federal investigators requesting that the hospital initiate a self-audit of how Medicare was billed for certain laboratory tests. Hospitals in Georgia, Maine, Mississippi, Rhode Island, Vermont, Virginia and the District of Columbia have acknowledged getting such letters.

The American Hospital Association was hoping that any favorable legal result in the Ohio lawsuit would enhance the defense of hospitals targeted in these other states.

THIS PRIVATE PUBLICATION contains restricted and confidential information subject to the TERMS OF USAGE on envelope seal, breakage of which signifies the reader's acceptance thereof.

THE DARK REPORT Intelligence Briefings for Laboratory CEOs, COOs, and CFOs are sent 17 times per year by The Dark Group, Inc., 1731 Woodland Terrace Center, Lake Oswego, Oregon 97034, Voice 1.800.560.6363, Fax 503.699.0969.

R. Lewis Dark, Founder & Publisher.

Robert L. Michel, Editor.

SUBSCRIPTION TO THE DARK REPORT INTELLIGENCE SERVICE, which includes THE DARK REPORT plus timely briefings and private teleconferences, is \$10.80 per week in the US, \$11.40 per week in Canada, \$12.45 per week elsewhere (billed semi-annually).

NO PART of this Intelligence Document may be printed without written permission. Intelligence and information contained in this Report are carefully gathered from sources we believe to be reliable, but we cannot guarantee the accuracy of all information.

© The Dark Group, Inc. 1997.

All Rights Reserved.

The Ohio lab billing probe began in 1995. Federal prosecutors targeted 75 of 90 hospitals in the Northern Ohio District for further investigation. A similar percentage of hospitals in the Southern Ohio District underwent the same scrutiny. To date, at least 24 Ohio hospitals have agreed to settle charges and pay fines.

"It is not appropriate for the government to take an adversarial relationship with these hospitals. We believe government prosecutors are abusing the False Claims Act in this matter of how laboratory tests were billed to Medicare."

-Diane Signoracci

The OHA and AHA filed the lawsuit last October in an effort to stop the investigation from proceeding further. It was also a goal of the lawsuit to challenge the use of the False Claims Act. OHA spokesperson Mary Yost explained at that time "We hold that, for certain types of tests which may have been incorrectly billed, if mistakes were made, they were honest mistakes. Thus, it is inappropriate and extreme for the government to use the threat of the False Claims Act to say, not only must you pay back whatever overage you may have received, but you owe us to three times that amount, plus up to \$10,000 per error."

"This is a key point in our position opposing the way the federal investigation is proceeding," added Signoracci. "It is an inappropriate use of the False Claims Act. Prosecutors hold the threat of \$10,000 per incident against hospitals which might choose to fight this in a court action. It is a huge economic deterrent for any hospital weighing the risks of openly contesting federal claims in court."

Even as the judge ruled against the hospitals, she noted several encouraging points. She declared that there were "understandable concerns" to the manner in which the **U.S. Department of Health and Human Services (HHS)** and the **U.S. Department of Justice** proceeded with their investigation.

Judge O'Malley further commented, "despite the very real possibility that the (HHS) Secretary's position regarding the hospitals' billing practices is wrong, the practical barriers of challenging the Secretary leave the hospitals with little choice and no bargaining room. Still, that the Secretary's actions seem heavy-handed does not confer jurisdiction upon this court."

"Although this decision was sympathetic to our case, it was not helpful," said Signoracci. "Our legal team must now decide whether to appeal this to the Sixth Circuit Court. We are also evaluating how to make our case with Congress."

Judge O'Malley's decision illustrates the difficulty in opposing the government at any level as they pursue their claims of Medicare Fraud and Abuse. After almost one year of legal work and time, the Ohio Hospital Association and the American Hospital Association failed to stop government prosecutors from continuing with their investigation.

Practical Insights

Diane Signoracci had some practical insights on how easy it would be to correct the situation. "It is time for Donna Shalala (Secretary of Health and Human Services) to step to the plate and tell Janet Reno (Attorney General) to cease taking an adversarial position against the hospitals. Everyone wants to resolve any inappropriate billing. It is just they would prefer to do it without the heavy hammer of the False Claims Act. **TDR**

(For further information, contact Diane Signoracci at 614-227-2300 and Mary Yost at 614-221-7614.)

Lab Market Trends Drive Beckman-Coulter Deal

Merger of two high-quality diagnostic firms predicted to create a tough new competitor

CEO SUMMARY: *Laboratory executives should pay attention to Beckman's acquisition of Coulter. Together, both companies service a sizeable base of laboratory customers. Any changes to products and services resulting from this merger will affect a large number of clinical laboratories. Observers believe the merger is a strategic plus for both companies.*

FEW WERE SURPRISED when it was announced on September 2 that **Beckman Instruments, Inc.** would acquire **Coulter Corporation**. The combined company represents worldwide sales of \$1.7 billion.

Beckman is paying \$875 million in cash to Coulter's shareholders. Beckman will also assume \$175 million of Coulter's debt. It is expected that the merger will occur before year end.

Trigger Shock Waves

Although it may not seem like major news, **THE DARK REPORT** predicts that the Beckman-Coulter merger will trigger a series of shock waves in the diagnostics industry. Laboratory users of Beckman and Coulter products will see many changes as the two companies combine product lines, consolidate operations and merge the sales and technical services departments.

The biggest shock waves, however, will come from how competitors respond to the Beckman-Coulter merger. The diagnostics marketplace is about to be altered beyond recognition as competing diagnostic firms reshape them-

selves to counter the threat of the Beckman-Coulter combination.

To be called **Beckman Coulter, Inc.**, the combined company will represent a blockbuster competitor in the diagnostics marketplace. "This is the same as assembling two extremely powerful baseball hitters in the same line-up," stated Andrew Schmidt, Principal of **Kellan Corporation**, a consulting company in Alpharetta, Georgia. "Both companies have unequalled reputations for quality throughout the world. Neither company has ever let quality take a back seat to price. Their technology and products have consistently performed to the equal of any competing system."

Merger Impetus

Impetus to this merger may have come from the sale of **Boehringer Mannheim GmbH** to **Roche Holdings, Ltd.** in May. Roche paid \$11 billion to acquire **Corange Ltd.**, parent company of **Boehringer Mannheim**. With this acquisition, Roche eclipsed **Abbott Laboratories Inc.** as the world's largest diagnostics company.

Even before the Roche-Boehringer deal occurred, both Beckman and

Coulter were considered likely takeover candidates. That changes with this merger. "Beckman is taking on a lot of debt to do this acquisition," said Schmidt. "Besides helping Beckman acquire a critical mass of sales and revenue, the addition of the debt makes them a more expensive acquisition target. From this perspective, it was a good strategic move for Beckman to structure the deal in this manner.

"What should not be overlooked in this merger is how the two product lines complement each other," he noted. "Beckman already has a complete offering of instruments for special chemistry, general chemistry and electrophoresis. Coulter has a world-class line of hematology instruments. As a combined company, Beckman Coulter can bundle these products together. They become a sole-source solution."

Offer Better Pricing

"This also permits Beckman Coulter to offer better pricing," Schmidt continued. "A laboratory can buy both chemistry and hematology from a single vendor. What is interesting is that Beckman not only purchased a quality line of hematology instruments, but they also bought the largest share of the hematology marketplace. That strengthens the overall financial position of the combined diagnostics company."

Laboratory clients of Beckman and Coulter should expect obvious changes to occur. "One of the first things which will happen is that the sales force and field service team from each company will undergo restructuring. No longer will a sales rep from each company call on every laboratory. You will see one sales rep, with appropriate technical support in each region."

"What will be most interesting to observe is how Beckman Coulter, Inc. integrates its two sales teams," explained Schmidt. "Because Coulter owns 70%-80% of the hematology

market, they do not have much growth potential. Its strategy has been to retain the hematology base business. Expect Beckman Coulter to make retention of this core hematology business a major priority.

"The chemistry instrument marketplace is different. Because no single vendor has more than 30% of the market, Beckman Coulter will want to aggressively pursue new sales. How it revamps its sales force to accomplish both goals will be interesting to watch."

Continuing Consolidation

The Beckman acquisition of Coulter is another reminder to laboratory executives that consolidation continues to be a dominant trend reshaping healthcare. Beckman Chairman and CEO Louis Rosso said as much. "We are certainly in a consolidating part of the market," he said when asked how hospital and laboratory consolidation was impacting both companies.

Rosso's comment acknowledges the shrinking number of laboratory customers due to consolidation. There is less business volume to support the diagnostics industry. That constrains the growth rate and forces diagnostics companies to look at other ways to expand revenues and operating profits.

Bewildering Changes

"I believe that laboratory administrators who purchase instruments are going to face a bewildering array of changes in coming years," predicted Schmidt. "Look at the various instruments which Beckman Coulter can now bundle under one contract. It makes them a better 'sole-source solution' than before the merger. As competing diagnostics companies respond, lab administrators will find themselves facing totally new options for acquiring equipment and testing technology."

TDIR

(For further information, contact Andrew Schmidt at 770-992-8713.)

Diagnostic Companies About To Undergo Change

Extensive shake-up to diagnostics marketplace expected as consolidation trends continue

CEO SUMMARY: *Diagnostic companies are undergoing the same consolidation wave as commercial laboratories and hospitals. Beckman's acquisition of Coulter provides an early example of how diagnostics companies will use acquisitions to create a comprehensive product line. Other surprising mergers between diagnostic companies are expected.*

CONSOLIDATION ACTIVITY WITHIN the diagnostic industry is about to intensify. As it does, the entire structure of the diagnostics industry will evolve into radically different forms, affecting how laboratories acquire and use diagnostic instruments.

THE DARK REPORT believes that the acquisition of **Boehringer Mannheim** by **Roche Holdings, Ltd.** in May will trigger a cascade of significant diagnostic acquisitions during the next 18 months.

Several market trends make consolidation in the diagnostics industry inevitable. First, continuing consolidation within healthcare is creating a new class of healthcare provider: multi-billion dollar corporations with national reach. These range from for-profit hospital companies like **Columbia/HCA** and **Tenet Healthcare** to **MedPartners**, **PhyCor**, and **HealthSouth**.

Matching the growth of multi-billion dollar corporations are insurance plans such as **Aetna/US Healthcare**, **Cigna** and **Kaiser**. They are developing local healthcare products from a national platform. All of these national firms, with their multi-billion dollar purchasing

clout, want diagnostics suppliers who can service local markets from coast to coast and have the product volume to offer the lowest possible prices.

"Niche players won't survive in the diagnostics industry as the marketplace evolves towards managed care."

—Andrew Schmidt

Second, to survive the consolidation process, the remaining diagnostic companies must have a comprehensive product line to offer their customers. Niche players will fall by the wayside.

Diagnostics customers will increasingly want a single source vendor solution. This is becoming evident to diagnostics vendors. As buying consortiums like **Premier** and **VHA** intensify their efforts to squeeze costs from vendors, diagnostics companies with a broad line of products are more favorably positioned to win the business.

Third, the cost of developing new technology continues to spiral upward. This means that any diagnostics compa-

ny which wants to remain at the front of the technology curve must invest great sums of money in research and development. Only size provides sufficient cash flow to finance such efforts.

“Expect these trends to actively shape and transform the diagnostics industry as we know it today,” stated Andrew Schmidt, Principal of **Kellan Corporation**, a consulting company in Alpharetta, Georgia. “Size and breadth of product offering will rapidly become critical success factors for any surviving diagnostics company.

“Consolidation activity among diagnostic companies will accelerate the

Becton Dickinson Seeks Acquisitions

CLATEO CASTELLINI, CEO of **Becton Dickinson**, perfectly illustrates the coming acquisition wave among diagnostics companies. In an interview with the *Wall Street Journal* last week, Castellini outlined the company's plans to double in size over five years. One source of growth: acquisitions of medical-device and diagnostic companies.

The reporter writes “Most of the companies in the... diagnostic-equipment business are highly innovative, but are small and have a difficult time getting access to the healthcare industry's big buyers, such as **Columbia/HCA Healthcare Corp.** and large hospital buying groups.”

Both Castellini and the reporter recognize that only the larger diagnostics companies will have ready access to healthcare's multi-billion companies. This will fuel consolidation within the diagnostics industry. Beckman's acquisition of Coulter can be understood by the need to achieve size and market clout if any diagnostics supplier is to access large healthcare systems. Becton Dickinson recognizes this market dynamic and is positioning itself to achieve the necessary size and resources to capture market share.

impact of these trends,” he said. “I believe that Beckman's acquisition of Coulter is a response to the Roche acquisition of Boehringer Mannheim only four months ago. Once Roche changed the historical balance between the major diagnostics companies, competitors had to act. We have not seen the last of it. For example, what will Abbott do in response to these acquisitions? Certainly they have the checkbook and the motivation to maintain their sizeable market share.

“Another interesting company to watch will be **Johnson & Johnson Clinical Diagnostics**,” noted Schmidt. “Traditionally this company had a close relationship with Coulter. I am curious as to why Johnson and Johnson did not acquire Coulter, especially since J&J has a history of using acquisitions to build their product line.”

Anticipating Mergers

According to Schmidt, one key aspect to anticipating possible mergers among diagnostics companies is to understand the strengths and weaknesses of each company's product line. “If I were only a chemistry-based diagnostics company, I would be concerned by the Beckman-Coulter merger. I would look to combine in some fashion with a company offering hematology instruments.”

Schmidt believes that single-line diagnostic companies will be at a disadvantage to vendors offering a full menu of products. “Look at how acquisitions have changed hematology in recent years. **Cell-Dyn**, **Technicon** and now Coulter were all purchased. That leaves **Sysmex**. It would be reasonable to assume that Sysmex is even now looking for an appropriate partner.”

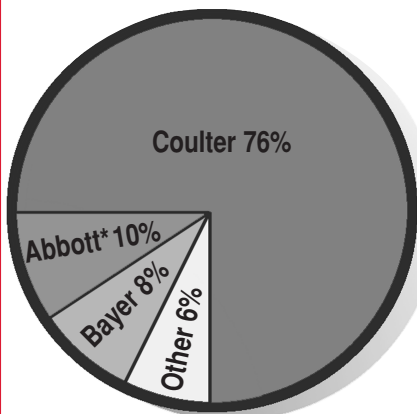
Schmidt believes that larger diagnostics companies will also react to Beckman's acquisition of Coulter. “I see the Beckman-Coulter marriage as affecting Roche and Boehringer Mannheim. They offer only chemistry. In my experi-

Is The Diagnostics Industry Poised For Consolidation?

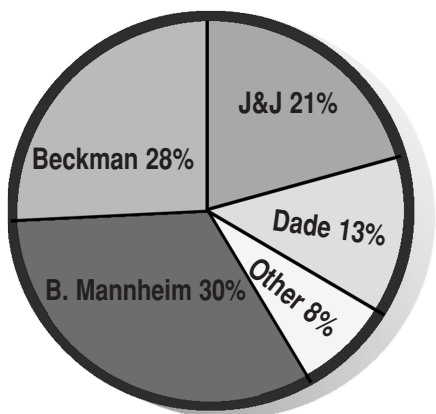
The pie charts below illustrate how Beckman's acquisition of Coulter Corporation creates a powerful new competitor. During the next 18 months, acquisition activity among diagnostic companies will increase significantly as the major players reposition themselves.

Estimated Market Shares Prior To Merger Of Beckman & Coulter

Hematology



General Chemistry



* Abbott purchased Cell-Dyn, 1991

Source: Kellan Corporation, Alpharetta, Georgia

ence, there is a distinct advantage to approaching a prospective customer and offering a bundled solution. I would bet that Roche and Boehringer are looking at ways to accomplish that.”

“If you agree that the market is asking for a fuller range of diagnostic solutions from one vendor, then you can speculate about some interesting combinations,” he went on. “From my perspective, a joint venture between Abbott and J&J Clinical Diagnostics would provide some interesting competitive benefits. It matches Abbott’s strengths in hematology with J&J’s solid line of chemistry products.

“I don’t think that one would sell to the other, but I do think that economic

forces will cause them to explore ways that they can profitably work together,” predicted Schmidt. “Because market forces are transforming healthcare at a rapid pace, you should not be surprised to see some unusual pairings announced during the next year.”

THE DARK REPORT believes that the coming wave of consolidation in diagnostics will actually benefit clinical laboratories. But clinical laboratory executives must be prepared for the short-term turmoil and dislocation such acquisitions frequently force upon their customers.

TDR

(For further information, contact Andrew Schmidt at 770-992-8713.)

Management Initiative Reaps Dividends

Rural Hospital Succeeds With Lab Outreach Service

FEW LABORATORIANS BELIEVE THAT RURAL HOSPITALS can launch and sustain viable laboratory outreach programs. That is why the success of **Olympic Memorial Hospital's** laboratory outreach program should cause laboratorians to rethink the common wisdom on this subject.

Olympic Memorial Hospital is a 120-bed facility located in Port Angeles, on the northernmost coast of Washington's Olympic Peninsula. Port Angeles borders the Olympic National Forest, one of the largest old-growth forests remaining in the continental United States. The geographic isolation of Port Angeles is reinforced by its population of only 17,000 people.

"The reasons we wanted to do a laboratory outreach program are the same reasons why any rural hospital laboratory should want to offer laboratory outreach services," stated Eric Cook, Director of Laboratory Services at Olympic. "One is profitability. It is good to bring more dollars into the hospital.

"Second is our commitment to the community," he continued. "If we can operate a larger laboratory, we can do more testing locally instead of sending it out. We can be a better laboratory for the operating room, the emergency room and our critical care unit. Of course, we are also a better laboratory for the physicians practicing in our community and service area."

CEO SUMMARY: *Laboratory administrators at rural hospitals generally believe there is no point in establishing a laboratory outreach program. Potential clients are few, and distances between small towns are great. But neither of these obstacles prevented Olympic Memorial Hospital from successfully offering laboratory outreach services to its rural market area. Olympic even acquired an independent laboratory to build outreach volume. This second installment of our two-part series tells the story of how Olympic created the outreach effort and what made it both successful and profitable.*

The impetus for Olympic's laboratory outreach efforts came with the advent of a new hospital administrator. "He arrived in the middle of 1994," explained Cook. "I was still addressing laboratory problems and helping the staff to come together and work as a team. Yet he immediately began to hint that we should be pushing harder for outreach business."

Cook is referring to laboratory problems he was fixing after his arrival in early 1993. For six months prior to his hire, the laboratory operated without a department director. As a result, morale was low among the staff and performance was unacceptable. Cook's management strategies to turn this situation around were discussed in the first installment. (*See TDR, September 15, 1997, pages 9-14.*)

"When my administrator asked me to begin building outreach business, I was hesitant," noted Cook. "There was some fear and trepidation that we did not have the laboratory situation corrected. There were also the usual reasons not to do something different, and outreach is certainly different.

"Also, like most hospital laboratories, our staff had an inward focus," he added. "They didn't want to deal with issues originating from outside the four walls of the hospital. That attitude would have to be overcome if our outreach program was to succeed.

"The other source of hesitation was me! I had no prior experience at formulating a business plan," Cook confessed. "This was the first opportunity in my career to create a new

business operation. But with the encouragement of my administrator, we established simple goals for our first year.”

The key objective was to create the operational structure within the lab to acquire and service laboratory outreach accounts. “This alone is not a small goal,” said Cook. “With just 32 FTEs in the lab, it meant that everyone would have to accommodate changes to their duties and job description if we were to service outreach accounts properly.

“There had to be buy-in from the entire laboratory staff for this outreach project to succeed,” he noted. “In our case, we identified a technical leader who would provide continuity of contact with clients. A client service team was organized. We looked for med techs who were real doers at the bench, because they would take primary responsibility for getting in/outpatient and outreach specimens tested.”

Balancing Act

“Keep in mind the balancing act which is under way as we do this,” explained Cook. “We still had to maintain service to all departments of the hospital, and we had to accomplish all the goals with a very small staff of people. Everyone around here has to wear multiple hats if the work is to be done on time and with good quality.”

“One bold move we made was to hire a courier before we had a good job description. That turned out to be a blessing because it forced us to really get out and market our services to keep her busy.”

Not surprisingly, the sales and marketing role was the most difficult part of the organizational realignment to accomplish. “I admit we spent a lot of time passing that potato around. As you know, many laboratorians are introverted people. But we had to identify someone who would go out, contact physicians and ask for the business,” stated Cook. “The person for this job was identified. It was me!

“That was an experience. I found myself out there beating the bushes with our client services person. We were both doing something people at this hospital had never done before. We made appointments, went in and asked what we were doing right and what we were doing wrong. We always ended by asking them to use the laboratory services of the hospital.”

Although serving as a sales rep might have been somewhat intimidating and out of his “comfort zone,” Cook’s experience and sales success should be sobering to all laboratory administrators. “I started making these calls in April. By June our first accounts began to come in. What I found surprising is that about 50% of the offices I called upon gave me some form of increased test volume. You see, a number of physicians used our laboratory for stat testing. I was able to persuade them to send us more of the bread and butter test volume.”

Cook’s call activity was neither daunting nor burdensome. “I averaged about two or three sales calls per week. What I learned about making sales calls is that preparation is essential if the sales call is to go well. The sales call itself may last only about 30-45 minutes. But there is preparation before the call, travel time, debriefing the staff and follow-up with the prospect.”

Hospital Thinking

“It is important to note that none of this activity is complementary with hospital thinking,” mused Cook. “After 15 years in hospitals, it seems they believe you can spend half an hour and you are done with that sales call. End of story. It was an eye-opening experience for me to go out and do what the reference laboratories have been doing for years. The sales process really does require a professional support system and proper resources to succeed.

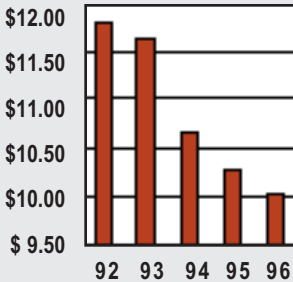
“I believe one reason our sales effort succeeded was because responsibility for

Olympic Memorial Hospital:

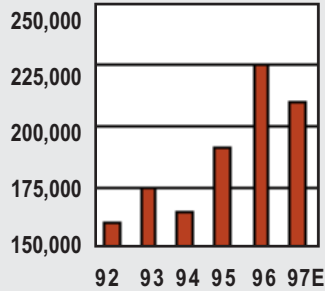
Laboratory Outreach Program Demonstrates Sustained Success

Sustained growth in outreach specimens during the past three years triggers an increase in productivity and lower operating expense per test, even as the lab hired more FTEs to handle the additional work. As these numbers show, increasing specimen volume into the laboratory makes it easier to manage costs and productivity.

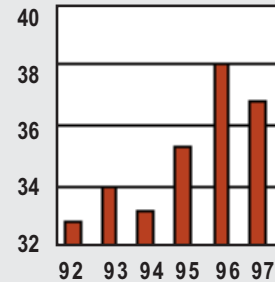
Variable Op Exp Per Procedure



Total Laboratory Procedures



Total Laboratory FTEs



the different functions was vested in me as the laboratory director," he continued. "Marketing, operations, client services, and technical support are all my responsibility. When I went into a doctor's office and they asked for three things before giving us their account, I could make that commitment, then go back to the laboratory and insure those things occurred."

"Another element which helped our outreach program succeed was the consistency of our sales calls," Cook explained. "We averaged two to four calls per week. Admittedly, there were times when I would lose a week or two because of other priorities, but I was diligent about making up the lost calls. As a result, we had a steady volume of new client accounts or increased test referrals from existing clients."

This sales activity was launched in the final months of 1994. It did not take long before the impact was felt in the lab-

oratory. "I was surprised. By the end of the first quarter of 1995, we could see a measurable increase in the number of specimens going through the laboratory," recalled Cook. "It gave the entire team in the laboratory a good feeling to know that they were having a positive impact."

Cook understates the importance of this team perspective. After spending 18 months rebuilding morale and improving service levels, the outreach program had become a unifying project. People in the laboratory had a positive goal, even though increased specimens from the outreach community meant more work inside the laboratory.

"As I think back, that is what occurred," responded Cook. "As more outreach business hit our front door, the med techs began to develop pride in our laboratory. As they got busier, grumbling about issues in the hospital disappeared. The entire staff began to focus

Olympic's Growing Market Share Encourages Lab Network Strategy

WHEN OLYMPIC MEMORIAL HOSPITAL REACHED A POINT of diminishing returns in its laboratory outreach service area, a new business strategy was required to sustain growth in specimens and revenue. This strategy is to network laboratories with neighboring hospitals. The experience at Olympic shows how successful an outreach program can be, even in a sparsely populated rural market. But sustained growth requires all rural hospitals in a region to come together and form a laboratory provider network. This network can offer competitive services throughout the region which are impossible for a single hospital to offer.

"After watching how a steady increase in specimen volume has improved the economics of our laboratory, we now appreciate the value of growth," stated Eric Cook, Laboratory Director at Olympic Memorial Hospital. "Since we have captured much of the market in our natural service area, we want to develop other strategies to sustain growth. The most logical approach is to explore laboratory networking opportunities with other hospitals similar to us." According to Cook, laboratory managers from the hospitals in Forks and Port Townsend are meeting with Olympic to discuss opportunities for working together. "The first initiative which made sense was to combine purchasing. We are developing that. As our meetings continue, I expect that increased trust will foster other, closer alliances involving testing, pathology and who knows what else."

Here is another example of a regional laboratory strategy emerging from the competitive market forces in this rural area. At some point in the market cycle, the only way for laboratory administrators to improve their competitive position, enhance services, lower costs and stabilize employment is to work in a cooperative fashion. This is as true for rural areas as it is for urban areas.

on giving our both our hospital and outreach clients the best service possible."

Increased specimen volume did require staffing changes. "Up front, we felt like the laboratory had excess capacity, both in terms of labor and capital resources. We believed we could handle increased volume without increasing staff," Cook said. "The major adjustment was to inaugurate new evening test schedules.

"The technical leader we had earlier identified was responsible for organiz-

ing the evening operations. The group involved actually did the planning and implementation with little input from me. We used the same number of FTEs, but we scheduled them differently, eliminating an 11:30 a.m. shift and adding a swing shift."

The impact of the outreach program was significant and rapid. During 1995, specimen volume climbed 17.5% over 1994. "As the staff saw more specimens coming in, they pointed out the need for new instruments," stated Cook. "It was

recognized that certain instruments lacked the throughput to handle the additional work and still maintain service to our inpatient population.”

Hospital administration was favorably disposed to acquire the necessary instrumentation, as cash flow from the increased outreach business was available to fund those purchases. Hospital administration also did another unusual and surprising thing.

“We bought a laboratory in our service area,” said Cook. “This laboratory was located in Sequim, about 12 miles east of the hospital. It generated about \$250,000 annually in gross revenue from its location in a medical office building. It was staffed with seven employees. The owner was a local doctor preparing for retirement and looking to sell.”

Support Local Community

According to Cook, the doctor considered selling to a larger commercial laboratory, but his preference for keeping business in the local community led him to sell to Olympic Memorial Regional Hospital. “We had two challenges in this acquisition. One, we had to maintain a profit from the day we purchased it. Two, we had to maintain employment of the existing staff. That was not difficult, since Sequim and Port Angeles are reasonably close and it is feasible for employees to work at either site.”

The positive impact of the acquisition was immediately felt. “With new specimens flowing into our lab, we needed to acquire discrete analyzers to replace our batch analyzers,” recalled Cook. “This also provided us the opportunity to acquire additional assays which we can do in-house. This improves the lab’s service to the clinicians. It is another way the hospital is directly benefiting from the laboratory’s successful outreach program.”

Olympic Memorial Hospital’s experience with laboratory outreach is a great lesson for rural hospitals all

over the United States. Why did Olympic achieve something most rural hospital laboratorians believe is impossible, unfeasible or uneconomical? Because there was a hospital administrator and a laboratory director with the vision to see the opportunity and a willingness to invest time and money to make it real.

As laboratory director, Eric Cook took political and career risks to sell the concept of laboratory outreach, organize the program and bring it into reality. Moreover, it was Cook who made the sales calls and took responsibility for the commitments made to new physician clients of the laboratory. His persistence in maintaining a sales call cycle should also be recognized as a critical success factor.

This is real leadership from within the laboratory and the benefits are obvious. Today Olympic Memorial Hospital boasts a better-equipped laboratory and enhanced laboratory testing services than three years ago. Olympic also gets a cash flow kicker from outreach revenues while enjoying year-to-year declines in its average cost per test.

Stable Lab Employment

Employment is stable within the laboratory even as increased outreach business creates new career opportunities for the technical staff. The laboratory team at Olympic demonstrates high morale because they are achieving uncommon goals. Physicians in the surrounding communities receive a higher level of laboratory services even as their business supports the local healthcare community. At a time when most rural hospital laboratories are scrambling to maintain services and revenues, Olympic serves as an important reminder: positive action creates positive consequences. **TDR**

(For further information, contact Eric Cook at 360-417-7778 or ecook@usa.net.)

Pathologist Income Symposium

Scottsdale Pathology Gathering Targets Three "Money Tracks"

THE DARK REPORT'S Private Pathologist Income Symposium in Scottsdale on November 8, 1997 promises to be a uniquely candid, invaluable source of strategies, techniques and knowledge for preserving and enhancing pathologist income. It is restricted only to pathologists and their business advisors. Symposium leaders represent some of the shrewdest business and financial minds in the pathology profession today. Those interested in details should call 800-560-6363.

CONTRACTS

Jake Dougrey

Pathology Consultants
And Associates

Contracts are the lifeblood of pathology practices. Since pathologists don't see patients, access to specimens is dependent on contracts with hospitals and managed care plans.

Mr. Dougrey offers pathologists a unique window on contracting strategies. He handled ancillary contracts for several large health plans on the east coast. He now sits on the other side of the table, representing one of the largest outreach pathology practices in the New England area.

Learn to counter threats to declining pathology reimbursement. Discover the latest in negotiating strategies for both anatomic and clinical pathology fees.

FINANCES

Mike Rabin, MD

Bayless-Pathmark, Inc.
Diagnostic Path Services

Financial management of money flows into and out of the pathology practice is now a critical success factor. Michael Rabin, M.D., M.B.A., Chief Administrative Officer at Bayless-Pathmark, Inc. in Cleveland, shepherded the consolidation of nine pathology practices into the Bayless practice model.

He initiated a successful sales program to sell Bayless to outreach physicians and is guiding the pathology group towards a shared equity venture with a major hospital system. Dr. Rabin is a wellspring of knowledge about financial strategies and money management techniques which add extra dollars to the profit line of any pathology practice.

LEGAL

Gary Spradling

Duckor, Spradling &
Metzger

Legal issues in the business management of pathology are rising to the forefront. Gary Spradling of Duckor, Spradling & Metzger provides legal counsel to a variety of pathology practices in the managed care hotbed of Southern California.

Mr. Spradling is advising a number of pathology practices on issues ranging from valuation and sale to pathology PPMs such as AmeriPath and American Pathology Resources, to issues of managed care contracting with hospitals and IPAs in California.

His valuable insights will provoke new considerations for structuring the business and financial functions of a pathology practice.

Nominations Now Open For Laboratory Innovators

THE DARK REPORT again seeks nominations recognizing innovative laboratory executives

CEO SUMMARY: Nominations are now open as *THE DARK REPORT* seeks to identify laboratory executives who deserve recognition. Our annual awards program honors the innovators and leaders within the clinical laboratory industry who push the boundaries of management change and show us how to best respond to the challenges of managed healthcare.

WITH 1998 FAST APPROACHING, it is time to gather nominations for *THE DARK REPORT Movers and Shakers Awards*. It is the opportunity to honor 1997's most innovative and far-sighted administrators and pathologists.

Within the laboratory industry, *THE DARK REPORT* is unique in its attempts each year to smoke out the little-known movers and shakers. These are frequently unheralded executives actively advancing the art of laboratory management beyond the curve. These individuals overturn the status quo in their quest to create high-performance laboratories.

"Historically, technical expertise, consistent service and new laboratory technology tended to be the success factors separating exceptional laboratories from their peers," stated Robert Michel, Editor-In-Chief of *THE DARK REPORT*. "That is no longer the case. Increasingly it is management skill and executive leadership which distinguishes the excellent laboratory from its competitors."

Six broad criteria are used to evaluate nominees: leadership, strategic thinking, people skills, innovation, vision,

and the ability to make things happen. "These criteria are what make the awards unique," stated Michel. "We seek to acknowledge that elusive something that is an uncommon confluence of ability, savvy, charisma and energy. These people dare to be different. They may even be iconoclastic when necessary."

"Movers and Shakers are the executives who show us innovative new ways to lead our laboratories into the future."

—Robert L. Michel

Enclosed with this issue of *THE DARK REPORT* is a nomination ballot which can be faxed directly to our offices. (Fax: 503-699-0969.) Nominations will be accepted through November 30, 1997. Award winners will be announced after the New Year.

"Last year's winners perfectly illustrate the type of management innovation and leadership we seek to recognize and honor," noted Michel. "For example, among the three national laboratories, Ken Freeman, CEO of **Quest**

Diagnostics Incorporated was recognized. He is successfully introducing quality management principles into the \$1.7 billion laboratory.

“During 1997, Freeman boldly applied the 80/20 Rule to thousands of unprofitable physician accounts. He restructured his Phoenix laboratory division into a joint venture with **Sonora Laboratory Sciences** and gave Sonora operational leadership. (See *TDR*, June 2, 1997 and August 4, 1997.) Moreover, Quest has been forthcoming and cooperative with **THE DARK REPORT** and other lab industry publications to explain the management strategies behind these activities.

“Contrast Freeman’s management leadership with Dr. Bruce Friedman’s contributions from the academic environment. Friedman, another 1997 award winner, continues to foster innovation and sharing of worthwhile LIS technology through his annual AIMCL conference at the **University of Michigan** every May.

Laboratory Innovation

“Hospital laboratory administrators recognized how 1997 award winner David Beckwith, Ph.D. quietly and competently consolidated two hospital laboratories in the **Lehigh Valley Health Network** in Allentown, Pennsylvania. He then proceeded to develop a cost-effective platform to introduce total laboratory automation into his new off-site core laboratory.

“These examples from last year’s award winners amply illustrate the diverse ways that management innovation can contribute to helping every laboratory become more productive and a better asset to the clinicians it serves.”

Nominations will be accepted through November 30, 1997. Details of the nomination process appear on each ballot enclosed with this issue. The selection panel will review nominations and award winners will be announced in January, 1998.

Broad-Based Criteria Support Award Goals

IN CONSIDERING NOMINATIONS, laboratory executives are encouraged to identify innovation and management success in a variety of settings. Hospital laboratories, national laboratories, regional laboratories and academic laboratories are all sources for new management models.

Six criteria for award selection are used: leadership, strategic thinking, people skills, innovation, vision and the ability to make things happen.

The accomplishments of the nominees should be documented with financial, productivity and client satisfaction measurements which show the performance of the laboratory before and after the management changes were implemented.

“We are adding an important category to this year’s awards process,” stated Michel. “It is recognition of those laboratory industry vendors creating some type of product or service which directly enhances management capabilities within the clinical laboratory. This vendor recognition is not based on the technology itself, but its positive impact on improving the management and administration of the clinical laboratory.

“These awards recognize those individuals who bring innovative management techniques to clinical laboratories. They have usually taken considerable political and career risks to inaugurate change. But in the process, they improve the financial performance of their laboratory, enhance job security for their staff and improve laboratory services to the clinicians in their community.” **TDR**

(For further information, contact Robert Michel at 503-699-0616. Nominating ballots can be obtained by calling the same number.)

INTELLIGENCE

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



Michael J. Bechich, M.D., Ph.D. at the University of Pittsburgh School of Medicine, is hosting his second annual conference in Pittsburgh next week. *Anatomic Pathology Informatics, Imaging and the Internet* is scheduled for October 16-18 at the Pittsburgh Marriott City Center. Dr. Bechich is actively developing the capability of a virtual pathology practice using advanced imaging technology and the Internet. Expect to see some fascinating applications of cutting-edge technology at Dr. Bechich's program.

HEARD ON THE STREET:

In recent months one national laboratory made a major purchase of multiple automated sample-handling systems from a national diagnostics vendor. The system's performance was so disappointing that the laboratory has yet to pay the vendor for the equipment. This may be further evidence that the current state of laboratory automation technology is still too immature for commercial operation.

PRUDENTIAL'S NAT'L LAB CONTRACT

Prudential Insurance Company of America's healthcare unit has yet to award a national contract for laboratory services to any of the national labs. The RFP process extends back almost three years. Knowledgeable sources tell THE DARK REPORT that **SmithKline Beecham Clinical Laboratories** is pitching hard to convince Prudential to award them a sole-source contract to be the national provider of laboratory services. This would be similar to its national exclusive provider contract with **Cigna Healthcare**. Prudential has 4.7 million HMO enrollees, plus another 2 million in indemnity plans, so a huge chunk of laboratory business is on the negotiating table.

ADD TO:... PRUDENTIAL

Financial performance of Prudential's healthcare division is so bad that the parent company has authorized investment bankers to explore options for selling or divesting the business unit. With operations in 40 markets, it would be an

attractive plum for major players such as **Aetna, Inc., Cigna Corp., United Healthcare Corp., Humana Inc.** and **Pacificare Health Systems, Inc.** Don't be surprised to see a sale announced in the near future.

AmeriPath, Inc. continues pushing to become the first public pathology-based physicians practice management company (PPM). AmeriPath's executives are preparing to launch the road show for securities analysts to drum up support for its initial public offering. (See *TDR, September 15, 1997*.) Pathologists interested in seeing AmeriPath's business plan should get a copy of the offering prospectus. It can be obtained by calling **Donaldson, Lufkin & Jenerette's** prospectus department at 212-892-4542.

MORE ON:... PPMs

Speaking of pathology PPMs, two more such firms are sprouting in Nashville. It seems this Tennessee town is to healthcare start-ups what the silicon valley is to computer start-ups.

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



UPCOMING...

- Prudential's Three-Year Struggle For A National Laboratory Contract.***
- High-Performance Hospital Laboratory Becomes Dominant Regional Provider.***
- Third Quarter Earnings At Public Labs Reveal Marketplace Challenges.***
- Columbia/HCA-MDS's Atlanta Laboratory Joint Venture Nears Operational Status.***