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From the Desk of R. Lewis Dark...

THE DARK REPORT

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

Commentary & Opinion by...

R. Lewis Dark

Founder & Publisher

Hitting Financial Bottom

During the last three years, financial news from the clinical laboratory industry has generally been bad. Two things attracted the media's attention. Multi-million dollar Medicare fraud settlements involving laboratories got widespread notoriety. Financial losses at public laboratories attracted less public attention, but were big news among Wall Street analysts and investors.

After such a sustained diet of bad news stories, I take pleasure in writing what I believe is good news. I believe that 1997 is the year when the clinical laboratory industry hits financial bottom. The financial performance of public laboratories in 1997 is much improved over the years 1994 through 1996.

Does that mean I believe the turnaround has started? *No*! The laboratory industry is still subject to declining utilization, falling reimbursement and increased regulatory scrutiny. There is still excess capacity in both hospital laboratories and commercial laboratories which the marketplace will continue to squeeze out. It will be difficult for the majority of laboratories to show strong operating profits. Sustained growth of 15% to 20% per year with fat operating profits was true in the 1980s and early 1990s. It will not be true during the next five years.

Stronger financial performance during the first nine months of 1997 is not the only reason I believe our industry is hitting bottom this year. I see evidence that an increasing number of lab executives are finally willing to make radical changes to their laboratories in order to survive. The easy-going management environment of the fee-for-service healthcare world is being replaced by the frenetic, ever-changing intensity of managed care. A growing number of laboratory administrators are recognizing this and beginning to introduce new strategic paradigms and management techniques into their laboratories.

The most tangible evidence of this is in the earnings of the publicly traded laboratories. So far this year, the three blood brothers report stable revenues and earnings. This is in stark contrast to 1995 and 1996. Meanwhile, since the three national laboratories are underperformers compared to the best of the independent regional laboratories which still operate, I predict that our industry will see most of its management innovation spring from these independent laboratory companies. This includes consolidated hospital laboratory organizations which operate aggressive outreach programs. TDR

Tenet, SBCL Discussing 33 Hospital Lab Contract

Proposed service agreement would involve all Tenet's Southern California hospital labs

CEO SUMMARY: Tenet Healthcare's decision to entertain proposals for improving laboratory operations in its Southern California division triggered a year-long discussion with national laboratories. If a deal results, it would represent one of the largest "reengineering" projects between a hospital company and a national laboratory.

GRAPEVINE BUZZ in Southern California says that **SmithKline Beecham Clinical Laboratories** (SBCL) inked a deal to manage the clinical laboratories in 33 **Tenet Healthcare** hospitals. But Tenet officials state that no definitive agreement exists between the two companies.

"As of today, we are still negotiating with SmithKline," stated Bob McDaniel, Corporate Director of Laboratory & Respiratory Services at Tenet. "We've only signed a letter of intent to discuss the project and define the scope of the conversations."

According to McDaniel, SmithKline has been invited to study the existing laboratory operations at the Tenet hospitals and provide a range of suggestions for service improvements and cost savings. Because the proposed project involves at least 30 of Tenet's Southern California hospitals, it represents a sizable business opportunity.

Tenet launched this process several months ago with an RFP process. "We entertained proposals from several large laboratory companies," said McDaniel. "As this process unfolded, SmithKline gradually emerged as a potential partner. With so much detail to evaluate for this project, it is time-consuming to develop a precise plan of action. That is why it is taking so long."

According to McDaniel, Tenet's original goal for this vast project was to go beyond direct purchasing to identify potential reductions in laboratory operating expenses. "SmithKline already has our national reference lab contract," observed McDaniel. "What we wanted to do with this proposal process is to explore other opportunities for reducing operating expenses in our labs.

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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).

"When we looked at our 33 hospitals in Southern California, we recognized that our 'laboratory system' had specific elements in common with a commercial laboratory," he said. "We do the same tests in many locations. Does it make sense to centralize some testing? How do specimens get transported between facilities? What about integrating data systems between sites?

"The national laboratories have lots of experience in precisely these areas. That is why we asked them to look at our existing laboratory infrastructure and help us identify ways to operate more efficiently while improving service."

Interestingly enough, Tenet did not look to laboratory consultants for this input. "The commercial laboratories not only understand this business, but they have the capability to teach us what we don't know and help us implement the improvements," said McDaniel. "It seemed logical to partner with a laboratory which can bring all these resources to the table."

> ***"The national laboratories have lots of experience in precisely these areas. That is why we asked them to look at our existing laboratory infrastructure and help us identify ways to operate more efficiently..."***

The enormity of the task facing Tenet and its final laboratory partner should not be underestimated. The number of hospital laboratories involved, as well as the extensive geography to be covered, make this an unprecedented project in both size and scope. Hospital and laboratory executives throughout the United States will closely watch how Tenet proceeds.

The huge scope of this project is one reason the development process has taken months. During the spring, word on the street was that **Quest Diagnostics Incorporated** looked to be the favored partner with Tenet. Given that the former **Nichols Institute** laboratory in San Juan Capistrano was favorably sited to serve Tenet's hospitals, there seemed to be some natural strategic strengths to a Quest-Tenet arrangement. No Tenet officials would comment on that situation, nor why SmithKline emerged as the leading candidate at this stage of the negotiations.

Lab Joint Ventures

Unlike **Columbia/HCA,** which has done a number of laboratory joint ventures, Tenet has historically focused attention on the direct purchasing side of the laboratory business. The proposed laboratory project in Southern California will be Tenet's first non-traditional laboratory partnering arrangement.

According to McDaniel, Tenet is not actively soliciting similar arrangements in other parts of the country. "This Southern California project is complex. We want to gain more experience with this project before we look for others."

The main initiative within Tenet's hospital laboratory division is standardization, including a reduction in the number of "SKUs" within supply categories. "Beyond simply negotiating lower prices for common supplies, we want to concentrate on reducing the unnecessary variety of items used in our laboratories," explained McDaniel.

"On the lab side, these efforts have been worthwhile," he continued. "We obtain excellent compliance and utilization with our contracts. In fact, our initiatives are less about procurement and more about utilization."

With the proposed Southern California laboratory project still under development, much is still unknown about how Tenet and its laboratory partner will proceed. But there is another aspect to this potential relationship which should not be overlooked.

Tenet's Southern California Hospital Line-Up

Facility	*Location*	*Beds*
Alvarado Hospital Medical Center	San Diego	231
Brotman Medical Center	Culver City	438
Centinela Hospital Medical Center	Inglewood	400
Chapman Medical Center	Orange	135
Coastal Communities Hospital	Santa Ana	177
Community Hosp of Huntington Park	Huntington Park	81
Encino-Tarzana Rgl Medical Center	Encino	151
Encino-Tarzana Rgl Medical Center	Tarzana	233
Fountain Valley Rgl Medical Center	Fountain Valley	395
Garden Grove Hosp and Medical Center	Garden Grove	167
Garlfield Medical Center	Monterey Park	211
Greater El Monte Community Hospital	South El Monte	113
Irvine Medical Center	Irvine	176
John F. Kennedy Memorial Hospital	Indio	130
Lakewood Regional Medical Center	Lakewood	161
Los Alamitos Medical Center	Los Alamitos	173
Mission Hospital of Huntington Park	Huntington Park	109
Monterey Park Hospital	Monterey Park	102
North Hollywood Medical Center	North Hollywood	160
Placentia Linda Hospital	Placentia	114
Santa Ana Hospital Medical Center	Santa Ana	90
St. Luke Medical Center	Pasadena	165
South Bay Medical Center	Redondo Beach	201
Suburban Medical Center	Paramount	182
USC University Hospital	Los Angeles	285
Western Medical Center	Santa Ana	296
Western Medical Center-Anaheim	Anaheim	193
Western Medical Center-Bartlett	Santa Ana	202
Whittier Hospital Medical Center	Whittier	159

Total Beds Involved In Proposed Laboratory Project: 5,630

Tenet and **MedPartners** have a major agreement which links MedPartners' 4,000 affiliated physicians with Tenet's 33 hospitals. As part of this agreement, MedPartners' 1.4 million patients will have access to Tenet's hospitals.

Assuming that Tenet chooses a laboratory partner like SmithKline and intertwines its laboratory operations with that partner, it would create an opportunity for the commercial laboratory to do an exclusive deal with MedPartners' physicians.

Were this to come about, the result would be a fascinating linkage between the commercial lab, Tenet's hospital labs and MedPartners' physician offices. It would represent a unique laboratory services business model adapted to California's managed care marketplace.

Before that can occur, Tenet must chose a laboratory partner and successfully integrate that partner into its multi-hospital system. The challenges facing Tenet and its partner in these first steps are complex. It will require adept management skills to effectively make any eventual partnership succeed. TDR

(For further information, contact Bob McDaniel at 972-789-2598.)

Pathology As A Business: Experts Highlight Issues

DARK REPORT's Pathologist Income Symposium triggers dialogue on profession's dilemma

CEO SUMMARY: A select group of business-minded pathologists broke new ground last week in Scottsdale, Arizona. Candid discussion about the profession's most sensitive issues provoked a variety of strategies. Among the topics were declining reimbursement, arbitrary contract pricing for AP services, and the increasing vulnerability of small practices.

SOLUTIONS, NOT PROBLEMS, was the focus of an unusual pathology symposium held last week at the exclusive **Sunburst Resort** in Scottsdale, Arizona.

Pathologists from 24 states, representing a variety of practice settings, including academic, rural, suburban and metropolitan, convened in Scottsdale with one goal: to identify effective strategies for preserving and enhancing pathologist income.

"Healthcare is undergoing revolutionary change, with the most radical developments yet to occur," said keynote speaker, Robert Michel, Editor of THE DARK REPORT. "For pathologists, the roller-coaster ride has not yet begun. Radical changes soon to hit the marketplace will totally transform the practice of pathology as we know it today.

"Unfortunately, pathologists are ill-prepared to meet this onslaught of change," he continued. "Historically, pathologists tended to practice medicine in solo or 2-3 man practice settings. This historical fact now makes it more difficult for pathologists to band together to combat the challenges of declining reimbursement and managed care."

"Contracting strategies will be a critical success factor in the healthcare system of the future," said Jake Dougrey, M.B.A., who is an executive with **Pathology Consultants and Associates,** "It is essential for pathologists to do two things. First, they should bring somebody onto their business team who is skilled at contract negotiations. Second, they should develop an understanding of the structure and design of managed care contracts.

"For pathologists, the roller-coaster ride has not yet begun. Radical changes soon to hit the marketplace will totally transform the practice of pathology as we know it today."

"It is difficult for pathologists to sit at the managed care table and attempt to negotiate a win-win contract if they are unaware of how that managed care contract is designed to reward payers, hospitals and providers," Dougrey explained.

To illustrate his point, Dougrey dissected a typical **Secure Horizons** Medicare HMO contract. Pathologists at the symposium were surprised to discover how profitable such a contract could be for hospitals and providers. But the profits don't come from the capitation payments. Rather, it is risk-pool sharing on the back-end which generates substantial bonuses if utilization stays below projected rates.

"The secret is to know where the dollars flow," stated Dougrey. "If the pathologists are unaware of all the different ways that a provider can be compensated from a managed care contract, then they may accept only the capitation rate and miss out on income from the risk-sharing pools. This is just one example. The variety of contract twists is infinite."

Financial Management

Financial management of money flowing through the pathology practice was another subject addressed by the symposium. Michael Rabin, M.D., M.B.A. and Chief Administrative Officer of **Bayless-Pathmark Pathology, Inc.**, laid out a number of money management strategies.

One example was particularly compelling. "As we consolidated seven pathology practices into Bayless-Pathmark," said Dr. Rabin, "we found that careful attention to billing gained us major dollars. One pathology practice was collecting $250,000 per month in revenue. When it joined Bayless-Pathmark, we took over its billing from the hospital. Our billing department, by careful tracking of 'lost' procedures and thorough billing practices, raised monthly collections to $350,000!"

For this pathology practice, having its existing work billed by individuals who understood anatomic pathology increased its revenues by 30%, without any change in the volume of specimens it was handling.

"These types of financial management techniques are critical if pathology practices are to protect and enhance their income," declared Dr. Rabin. "As our use of these techniques became more sophisticated at Bayless-Pathmark, we saw commensurate improvement in our cash flow and operating profits."

Legal Issues In Pathology

"Rapid changes in the structure of healthcare have complicated the legal issues confronting a pathology practice," stated Gary Spradling, Partner at **Dukor, Spradling and Metzger** in San Diego, California. "Many of our clients are required to contract with a variety of new business entities offering healthcare services. Unlike the traditional roles in fee-for-service, physicians and pathologists are required to assume different roles. These roles convey new legal liability, but physicians often don't understand the consequences until it is too late."

Spradling also offered some practical "street-wise" techniques for changing the balance of power in contract negotiations. However, the sensitivity of the material and the confidential nature of the symposium make it inappropriate to present here.

Key Symposium Lessons

Probably the key lesson of the symposium came from the strategic assessments done by pathologists in attendance. Almost unanimously, they recognized that strategic alliances and critical mass among pathology practices in a region was essential to maintain a relevant seat at the negotiating table.

"It is interesting that, in a profession known for its independence, pathologists here in Scottsdale universally recognized that if they tried to negotiate independently, they were relatively powerless," concluded Michel. "But teaming up with other pathologists is a necessity to conduct viable negotiations." TDR

(For further information, contact Robert Michel at 503-699-0616.)

STORY UPDATE

Regional Tox Laboratory Shows Sustained Growth

Laboratory Specialists of America implements acquisition game plan with consistent success

CEO SUMMARY: Over a three-year period, this regional substance abuse laboratory has shown dramatic growth in revenue and operating profits. Strong leadership combined with good implementation skills fuel this lab's success.

HERE'S ANOTHER QUIET SUCCESS story about a regional laboratory. At a time when most clinical laboratories are struggling to maintain a flat revenue base, **Laboratory Specialists of America, Inc.** (LSA) has nearly doubled in size in only 24 months.

When THE DARK REPORT first wrote about LSA in December, 1995, the company was announcing its first acquisition. Since that date, LSA closed three deals and has one pending. *(See TDR, December 4, 1995.)*

LSA's strategy is to acquire a geographically-concentrated base of substance abuse testing clients. For example, the 1995 acquisition of **National Psychopharmacology Laboratory** in Knoxville involved toxicology accounts primarily located in Tennessee and Georgia.

After completing an acquisition, LSA will integrate client services, sales reps, and marketing staff from the acquired company. The goal is to maintain and improve customer service levels. LSA's success in that effort is demonstrated by its low rate of client turnover.

In October, the brokerage house of **Barber & Bronson, Inc.** recommended LSA's shares as both a good short-term and long-term investment. This stock recommendation is based on LSA's consistent financial performance during the last three years.

> ***"Since 1983, the number of Fortune 500 companies that test their employees for drug use increased from 3% to 98%."***
> ***—Jeffrey Hasse***

It is THE DARK REPORT's opinion that substance abuse testing is an overlooked profit engine for regional laboratories. To support this opinion, the performance of LSA should be matched against two other publicly traded substance abuse companies: **PharmChem, Inc.** and **MedTox Scientific, Inc.**

At PharmChem, annual sales in 1992 were $27.3 million, increasing to $41.2 million in 1996. Medtox's growth rates parallel those of Laboratory Specialists of America. Annual revenue at Medtox climbed from $6.2 million in 1994 to $26.5 million in 1996.

Another laboratory doing well with its drugs of abuse testing program is **Lab*One*, Inc.** in Lenexa, Kansas. As described on pages 16-17 of this issue, Lab*One*'s substance abuse testing volumes in the third quarter increased by 106% over the same period last year.

Clearly this market segment is growing at a rapid pace. Jeffrey Hasse, Analyst at Barber & Bronson, believes that demand for substance abuse testing will climb by 15% per year. Hasse also believes that revenues at Laboratory Specialists of America will increase by 30% per year, double the industry growth rate.

$700 Million Market

Substance abuse testing is estimated to be a $700 million market annually. Testing is dominated by the three blood brothers. **Laboratory Corporation of America**, **Quest Diagnostics Incorporated** and **SmithKline Beecham Clinical Laboratories** perform about half of the substance abuse testing in the United States.

The majority of the remaining business is done by SAMSA certified laboratories. Hasse notes that most of these labs generate annual revenues of less than $5 million. It is this market dispersion which provides LSA the opportunity to consolidate testing through acquisition and to use the acquired client base as a platform for further sales and marketing.

LSA's latest acquisition tender illustrates this management strategy. It signed an agreement on September 30, 1997 to acquire the drugs of abuse operations of **Accu-Path Laboratory, Inc.** This involves an estimated $500,000 per year in testing.

After LSA assimilates the Accu-Path toxicology business, LSA will concentrate sales and marketing efforts into that area to expand revenues. LSA uses the acquired revenue base as a beachhead to pursue untapped potential in that market area.

From a strategic market perspective, substance abuse testing has several appealing aspects. First, as Hasse of Barber & Bronson points out, the market for substance abuse testing has grown rapidly in recent years. It is expected to continue growing at rates of 15% per year. If true, then this market will double in size, from $700 million to $1.4 billion during the next five years. This is certainly contrary to the shrinking volumes of clinical diagnostic testing.

Second, prices for substance abuse testing are not declining like those of clinical diagnostics. By marketing carefully to select categories of employers, a regional laboratory can generate adequate pricing to protect operating profit margins.

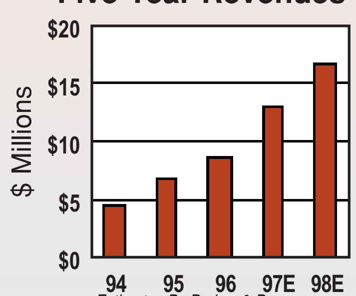
Laboratory Specialists of America's sustained success over three years demonstrates that this market segment strategy has been a viable way to maintain a dynamic and profitable laboratory. **TDR**

(For further information, contact THE DARK REPORT at 503-699-0616.)

LSA Revenue Growth Is On The Fast-Track

WITH A WINNING BUSINESS STRATEGY, Laboratory Specialists of America is growing rapidly. Its acquisitions boost specimen volume, while creating a sales and marketing platform. LSA uses this platform to increase market share in the target market area.

Five Year Revenues



Estimates By Barber & Bronson

Regional Growth Strategy Guides Presbyterian Labs Services

Last of a special two-part series.

CEO SUMMARY: Here's a consolidated laboratory organization serving six hospitals and an extensive outreach program. As described in the first installment of this two-part series, Presbyterian Laboratory Services actively reshaped itself into a well-run asset for its parent healthcare system. Consistent growth and strong management execution gives Presbyterian Laboratory Services the potential to become the anchor for a potent regional laboratory system that could serve the Carolinas.

SUSTAINED SUCCESS at **Presbyterian Laboratory Services** in Charlotte, North Carolina is a direct result of careful strategic thinking, combined with effective implementation.

As documented in the first installment of this two-part series, Presbyterian Laboratory Services (PLS) decided as early as 1988 to simultaneously pursue consolidation of laboratory operations among existing sites and increased outreach testing. *(See TDR, October 27, 1997.)*

In subsequent years, a total of six hospital laboratories were consolidated into the laboratory system. During the period 1988-1997, annual outreach revenues climbed from $1 million to $22 million!

Today, Presbyterian Laboratory Services is a diversified laboratory organization with 330 employees and a sizable market share of outreach testing in Charlotte. Testing from six hospitals and more than 300 physician office clients flows into a core laboratory at the Presbyterian campus. PLS manages 34 physician office labs in the Charlotte area.

Future Investment

Because it is profitable, PLS is capable of investing in the future to meet the challenges of managed care. But what has PLS done differently than other hospital laboratories to expand at a time when most laboratories are shrinking?

According to Bob Hamon, Administrative Director of PLS, part of the answer lies in its application of the Darwin Theory. "This means we evolve in response to changes in the healthcare world," he said. "More specifically, 'Darwin Theory' management means that we roll with the punches. Instead of dogmatically adhering to a fixed business plan, whenever healthcare changes become apparent, we try to understand and adapt to those changes."

Hamon is describing a management system rooted in two principles: 1) know your market and customers; and 2) respond to marketplace changes by quickly introducing solutions.

"We are best described as opportunists," added Hamon. "We don't try to second guess the market. Rather, we carefully watch our customers, competitors and healthcare providers. We believe that changes to the existing healthcare arrangements in town create opportunity for us.

"Anytime payers and providers change historical relationships, they create the opening for us to introduce ourselves, bid for the testing and acquire new business," noted Hamon. "We view changes to healthcare within our community as opportunities to expand our business relationships.

"Obviously, embracing change brings us new business," he continued. "But there is another benefit. Our entire laboratory staff now realizes that changes to healthcare are not a threat to their job stability. Because of our opportunistic pursuit of new business, the laboratory staff now appreciates the connection between growth, employment stability and additional career opportunities within the laboratory."

By encouraging the PLS laboratory staff to embrace change, Hamon unleashed a powerful asset commonly overlooked by hospital laboratory administrators: the human potential of a talented group of laboratorians willing to support change and innovation.

This is also consistent with how PLS maintains flexibility to redirect energy away from planned projects toward new market opportunities whenever justified by circumstances. "Although we are flexible and frequently deviate from our plan," explained Hamon, "our actions are always consistent with the strategic vision for PLS. The strategy remains constant, even if we decide to change our planned tactics."

Operational Design

Within the **Presbyterian Healthcare System,** PLS operates as a stand-alone division. The operational design of PLS gives it the flexibility to pursue opportunities which other hospital-based laboratories cannot. Despite the fact that PLS is not structured as an independent division, corporation, LLC or other business form, PLS operates "autonomously."

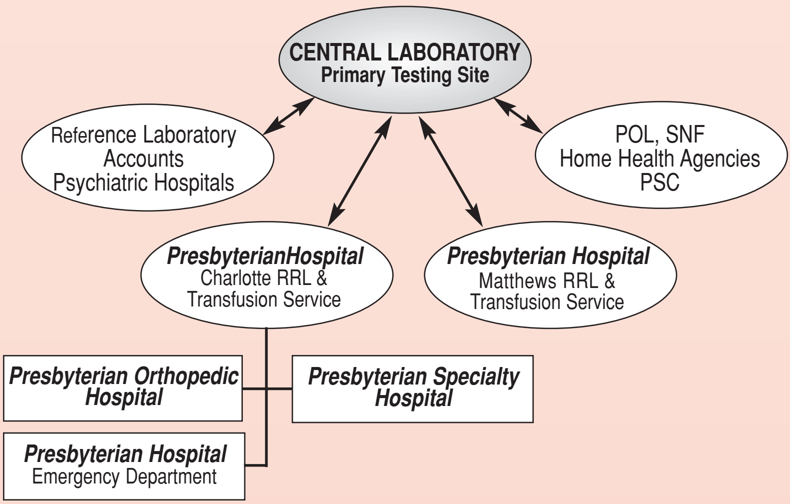
Budgets and cost accounting arrangements treat PLS as a separate entity within the Presbyterian System. "It is important to understand that our cost accounting is rigorous," Hamon noted. "It is handled as if we were a separate company. Each service that our parent system provides us is costed

How PLS Delivers Lab Services

Currently the offsite core laboratory for Presbyterian Laboratory Services is located on the campus of Presbyterian Hospital. Rapid response laboratories and transfusion service units operate within the Presbyterian Hospitals in Charlotte and Matthews.

As PLS consolidated laboratory testing from the different sites, the objective was to funnel all reference testing into the central (off site core) laboratory. This effort was largely successful. However, a large number of patients are still served by the rapid response labs. For example, Presbyterian Hospital's emergency department sees more than 85,000 patients per year.

Process Map For Lab System-1997



as if we were contracting with outside vendors. We believe this makes our financial numbers and productivity measurements much more accurate than those of other hospital laboratories."

PLS also has its own human resource person. This arrangement permits the laboratory to quickly redesign job descriptions, fill open positions and deal with human issues resulting from ongoing restructuring and reengineering of the various laboratory sites.

Another fascinating aspect to PLS is the way it is reimbursed by the hospitals for the in- and outpatient testing it provides. "As new hospitals were acquired, we wanted to consolidate their laboratories," recalled Hamon. "Most frequently this met with resistance from the new hospital CEO and staff. After all, it requires trust and confidence to give up in-house testing to an off-site core laboratory.

"In order to put the relationship on a win-win basis, we agreed to accept reimbursement from the hospitals on a per-test basis. This accomplished two things. First, it took the expense of the laboratory off the hospital CEO's monthly budget. Second, it converted laboratory services from a fixed cost to a variable cost.

"Now his laboratory expense varies in direct proportion with his occupancy," continued Hamon. "The hospital only pays for laboratory services as incurred by the patient. Hospital CEOs like this, because it permits laboratory costs to rise and fall proportionally with occupancy levels."

The obvious question is: What happens to the laboratory when hospital occupancy rates are down, and the laboratory is receiving proportionately less money? How does the laboratory pay its bills?

"It is our large volume of outreach testing which makes this arrangement work for the hospital and the laboratory," answered Hamon. "We have a diversified source of revenue outside the hospitals. Thus, declines in hospital bed occupancy and the resulting decline in lab testing reimbursement is offset by the steady flow of outreach testing and revenues."

PLS also knows what business it is in. "We are organized to provide five distinct product lines: 1) hospital contracts, which cover in- and outpatient testing; 2) physician office laboratories managed under contract; 3) skilled nursing facilities; 4) traditional reference and physician outreach accounts; and 5) patient service centers," he noted.

Strategic Plan

"This feeds our strategic plan," Hamon said. "We've identified six core competencies at PLS. We are lumpers, not splitters. Thus we tend to lump things into categories. We determined that our business involves six core competencies.

"Because we want to encourage people to think outside of their traditional boxes, we created six core competency teams. These are headed by either a director or a manager. Each team is structured to include the following: a facilitator, a pathologist, an executive owner, a working owner and six staff employees."

Problems and management issues are fed into these cross-disciplinary teams. "Each team is responsible for its area of lab operations across the entire system," explained Hamon. "This cross-discipline approach requires people to think outside the box on a regular basis.

"Also, every month we meet off-site as a team for one full day," he said. "We work on strategic planning and address operational issues. This allows us to regularly update our strategic plan. Our teamwork consultant emphasized to us that we cannot be a team if we do not practice. So we use this one day per month as our practice day."

Constant Site Visits

Hamon addressed another strategic factor in PLS's success. "We constantly do site visits of laboratories and business operations throughout the United States which we perceive as being ahead of us. We want to borrow the things they have done well and bring them back to implement them in Charlotte."

This creative borrowing inspires the management team at PLS. For example, to solve logistics and courier problems, Hamon spent the day riding in a **Roadways** diesel truck looking at how they picked up and delivered packages. He visited **Federal Express** in Memphis.

When PLS looked at ways to improve courier service, they invested in a hand-held package registration system. "This technology is similar to that used by Federal Express and **UPS**," said Hamon. "In each doctor's office, our courier wands the specimen with a bar code reader. This information goes into the hand-held unit. When the courier returns to the lab, he downloads this information into the computer. We now have accession number, patient, office pick-up time and laboratory arrival time in our computer database."

Clients of the laboratory love this feature, since PLS now can account for the specimen at pick-up, and every step which follows. Plus, there has been a direct improvement in service. "Once these tracking units were in place, we saw mistakes and errors involved in specimen pick-up and delivery fall by as much as 75%," said Guanah Davis, logistics manager at PLS. "We got a double benefit. Our customers noticed the new technology and improved service. Meanwhile, we saw a direct reduction in errors with a corresponding reduction in costs."

One obvious secret to PLS's sustained success is its recognition that costs in the laboratory could only be controlled by increasing specimen volume. Two strategies bring additional specimens into a laboratory. One is consolidation, the other is increasing outreach.

"Frankly, a turning point was when we looked at our cost performance in 1993," observed Hamon. "As we defined our average cost per test, it had increased from $10.60 in 1988 to $16.50 in 1993. We understood that, if we didn't do things differently, our average cost per test would probably top $21.00 in five more years.

"This was the point in time when we appreciated how important increased outreach testing would be if we were to provide our parent healthcare system lower average testing costs over a multi-year period," continued Hamon.

"We manage our laboratory as a business, not as the old paradigm of a clinical provider. Thus, our emphasis is on meeting and exceeding the expectations of our customers. Since our clients expect clinical accuracy and quality, our business strategy delivers that. But, unlike laboratories still caught in the old paradigm, we are prepared to respond to their other needs and expectations for service, cost and testing. Those other features become our competitive advantage in the marketplace."

PLS, Hamon Honored As Lab Innovators

Sustained excellence at Presbyterian Laboratory Services (PLS) has not escaped the notice of others. In recent years both PLS and Bob Hamon earned recognition as innovators within the laboratory industry.

In 1995, ***SunHealth Alliance, Inc.*** *gave PLS its* 1995 Laboratory Innovator Award. *PLS was selected through a peer review process comprised, in part, of members from the 300 hospital buying alliance.*

In 1997, Bob Hamon, Administrative Director at PLS, was picked by THE DARK REPORT as one of only eight Laboratory Innovators To Watch In 1997.

In both cases, outside experts recognized that the multi-year performance of Presbyterian Laboratory Services was exceptional, particularly during a period when the clinical laboratory industry is under financial pressure from managed care.

Business Differentiation

"We accomplish this by a strategy of business differentiation," explained Hamon. "We differentiate ourselves on three points: quality, cost effectiveness, and customer satisfaction. We benchmark our effectiveness by watching client turnover, which is negligible from year to year."

Apparently the marketplace recognizes PLS's success in differentiating itself in these three business areas. The outreach geography served by PLS has increased in four steps. Beginning in 1988, PLS defined its service area as a one mile radius around the hospital laboratory. By 1992, this had expanded to a ten mile radius.

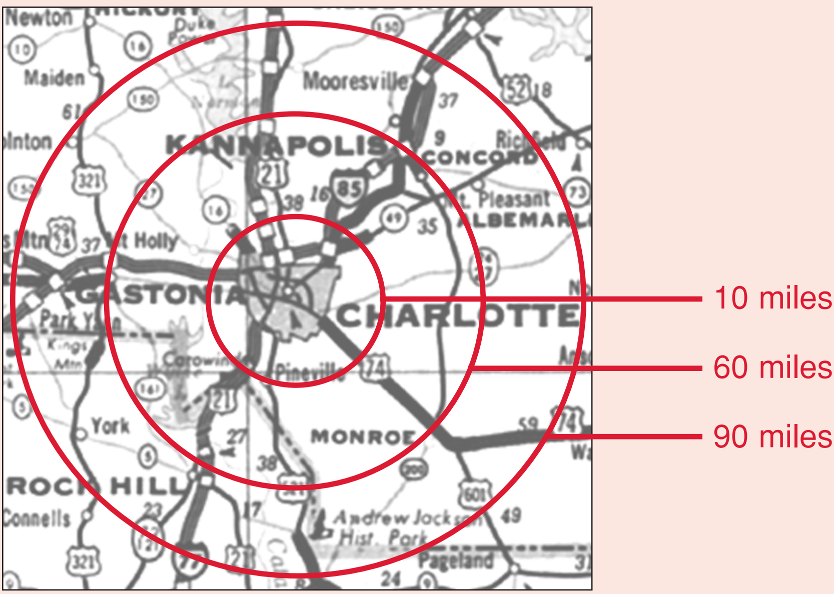
In 1994, PLS opened the radius to 60 miles around the core lab and began to approach other hospitals to see if they were interested in joining the consolidated laboratory organization.

As outreach specimen volume increased, PLS found it necessary to build a bigger core laboratory. Currently, upfitting of a new 54,000 square foot facility is under way. As part of this strategic expansion, PLS expanded its service area to a 90-mile radius.

"We believe that the next step in the revolution of healthcare in Charlotte is regionalization," explained Hamon. "Our healthcare system is merging with another and we must be prepared to

PLS Evolves From Hospital Into Regional Lab Resource

When Presbyterian Laboratory Services first launched its outreach program in 1988, the "circle of service" was one mile. In 1992, that was expanded to ten miles, using the off-site core laboratory as ground zero. By 1994, the circle of service was 60 miles, later increased to 90 miles in 1997. PLS concentrated service within these designated areas as a specific management strategy. The goal was to provide an exceptional level of service to PLS clients while maximizing the utilization of necessary infrastructure, such as courier routes, logistics, patient service centers, and rapid response labs. As market share was acquired within the circle of service, PLS would then expand outwards.



serve a much larger geography than before. Although we are excited about building a new core laboratory, we are also wary about making such a major commitment at a time when managed care is threatening the financial structure of clinical laboratories."

Despite Hamon's concerns, his group is on target with its assessment that the marketplace is undergoing regionalization. Assuming the PLS continues its tradition of strong service and, competitive pricing, it has as good a chance as any of the national laboratories to become the dominant regional laboratory provider in that area.

During The DARK REPORT's recent site visit to Presbyterian Laboratory Services, many of the management strategies described by Hamon can be seen in action. There are five key drivers which are applicable to any hospital-based laboratory seeking to increase revenues and expand services.

First, PLS is based upon proactive management. Instead of waiting for fundamental market changes to become obvious, it constantly tinkers on the margin in response to perceived changes. For relatively small investments in time and money, it develops products and services wanted by the market. This is a competitive edge.

Second, administration of both the parent healthcare system and the laboratory fully agree upon the importance of expanding specimen volume through internal consolidation and external marketing. The resulting predictable increase in specimen volume provides PLS management with an entirely different set of strategic options than if the laboratory was static or shrinking.

Third, innovation and experimentation with new lab services permits PLS to offer clients and prospects a menu of laboratory services unlike its competitors. This makes PLS the laboratory partner of choice with physicians and managed care plans in the Charlotte market.

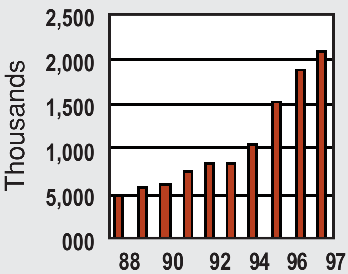
Fourth, concentrating on a limited service area is a simple and obvious strategy. Because PLS was careful and disciplined in executing that strategy, its service infrastructure is closely-tailored to customers' needs and the territorial concentration permits management to make a difference when acquiring and servicing new clients.

Fifth, leadership does make a difference. At PLS, there are three levels of enlightened leadership supporting the laboratory's success: hospital/system administrators, pathologists/medical directors, and laboratory administration. These three groups understand the laboratory's mission and have made it possible to develop, then execute, a successful strategic business plan. **TDR**

(For further information, contact Bob Hamon at 704-384-5116)

Presbyterian Laboratory Services

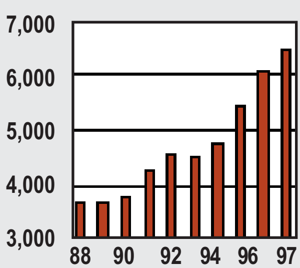
Total Laboratory Procedures



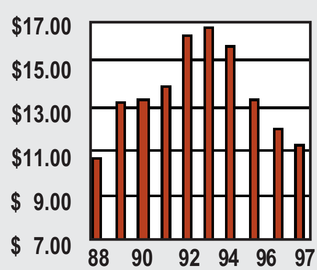
Consolidation Strategies Combined With Outreach Bring Sustained Improvement

Regular growth in specimen volume permits Presbyterian Laboratory Service to lower the average cost per test on a yearly basis while improving productivity and increasing operating profits returned to the parent healthcare system.

Billable Tests Per FTE



Average Cost Per Test



The Dark Index

Niche Markets Boost Earnings For Both DIANON And Lab*One*

THIRD QUARTER EARNINGS at **DIANON Systems** and **Lab*One*, Inc.** demonstrate that niche market strategies can be growth engines for clinical laboratories, even in the face of declining reimbursement.

As the crunch in clinical testing hit the laboratory industry in recent years, both companies reassessed their market position. New strategies to expand revenues were developed and implemented.

In the case of DIANON Systems, revenues for third quarter were $14.5 million, up 5% from the same quarter last year. Net income was $820,000, an increase of 25%. For the full nine months of 1997, performance is even better. Revenues are up 16% and earnings grew by 11%.

According to Kevin Johnson, CEO of DIANON Systems, the company's sales growth during the quarter was hindered by declining reimbursement for clinical and esoteric testing. To offset such declines, DIANON launched a market segment strategy in 1995.

Pleased At Results

"We are particularly pleased at the results from our efforts in full-service anatomic pathology," he said. "AP services accounted for less than $1 million in revenues during 1995. In 1997, AP services will generate more than $15 million. Further, we believe that anatomic pathology revenues should continue to grow at rates approaching 20% per year."

DIANON's niche market strategy continues with the announcement that the company licensed rights to **Meretek's** Meretech UBT Breath Test for H. Pylori. It is believed that H. Pylori infects the stomach of up to 35% of American adults and contributes to peptic ulcers. It may also contribute to gastric cancer. Because it is a non-invasive test, if DIANON successfully markets this assay to gastroenterologists, the test could become another profitable niche.

Increased Revenue

At Lab*One*, third quarter revenues and earnings were $19.7 million and $1.5 million, respectively. Revenue growth was 34% and earnings growth was 88%.

Lab*One* is a great example of niche strategies. Its primary service is diagnostic testing for life insurance companies. It is a dominant player in that market segment.

When demand for life insurance policies collapsed in 1990-91, Lab*One* saw its revenues decline precipitously. Lab*One* responded by developing three diagnostic testing niches.

First, they began offering clinical testing to physician offices in the Kansas City area, where the central laboratory is located. Second, Lab*One* began a toxicology testing program. Third, Lab*One* developed a laboratory benefits program called Lab Card™. This laboratory benefits program is a particularly clever strategy and was profiled in an earlier story in THE DARK REPORT. *(See TDR, March 18, 1996.)*

According to Lab*One*'s financials, all three market niches grew during third quarter. Clinical testing at Lab*One* increased 81%, to $1.8 million for the quarter. Substance abuse testing climbed by 106%, to $2.7 million.

The Lab Card program is showing strong growth. "We continued to add lives in this program," said W. Thomas Grant, Chairman, President and CEO of the company. "Currently 1.4 million lives are enrolled, plus another 400,000 lives are awaiting implementation. In this segment of our business, we saw revenues increase 15% from Lab Card accounts active more than one year."

The substance abuse and Lab Card testing niches allow Lab*One* to utilize its primary strength: an efficient, high-volume laboratory located in the Kansas City area. Toxicology and Lab Card specimens are picked up from any location in the United States and transported to Lab*One* by **Airborne Express**, just like the life insurance testing specimens.

Two Product Lines

Thus, Lab*One* has developed two clinical testing product lines which can originate specimens anywhere in the United States and feed them into the core laboratory. Growth in specimen volumes has been substantial enough that Lab*One* decided to expand its facilities.

Last month the company announced the plans to construct a 280,000 square foot facility on a 54-acre parcel that was recently purchased. The objective is to consolidate all laboratory testing and corporate operations into this one facility. Currently Lab*One*'s operations are split between three buildings, occupying 150,000 square feet.

According to analyst Jerry Duggan, President of **Duggan Investment Advisors,** Lab*One*'s proposed new laboratory is an optimistic bet on the future. "From my perspective, Lab*One* is well-positioned to see strong growth in specimen volumes in all three market segments: life insurance testing, clinical testing and toxicology testing. Construction of a new facility allows them to do two critical things. First, they bring all corporate activities into one site, improving productivity. Second, the proposed new laboratory anticipates the growth curve and will permit them to accommodate increased specimen volume without bumping into diseconomies now surfacing at the existing laboratory facility."

Repricing Testing Services

Duggan also shared with THE DARK REPORT that Lab*One* studied the economics of its toxicology program during the last year. Lab*One* learned that its pricing policies did not allow it to fully recover the cost of testing from certain accounts. "Lab*One* aggressively repriced toxicology services to better reflect the true cost of the service," stated Duggan. "It is my understanding that virtually all of the affected clients chose to stay with Lab*One*."

If Duggan's knowledge of this process is correct, then Lab*One* is another example of THE DARK REPORT's opinion that laboratories can reprice testing services to reflect costs. Clients will accept such repricing if it is reasonable, introduced in a professional manner, and the laboratory offers acceptable service. **Quest Diagnostics Incorporated** repriced small volume accounts earlier this year, with considerable acceptance and success. *(See TDR, June 2, 1997.)*

The DARK REPORT strongly believes that niche testing is a valid growth strategy for regional independent laboratories and hospital-based laboratories involved in outreach testing. The revenue gains seen at DIANON Systems and Lab*One* during the last two years demonstrate that effective marketing of clinical services to segments of the marketplace can be profitable. **TDR**

(For further information, contact Jerry Duggan at 913-385-2920.)

INTELLIGENCE

LATE & LATENT

Items too late to print, too early to report

Neuromedical Systems' PapNet® procedure is included in the new CPT codes covering automated cytology. The CPT codes take effect on January 1, 1998. Expect to see a flurry of announcements that selected managed care plans will reimburse for automated cytology procedures.

MORE ON:... NEUROMEDICAL SYSTEMS

On November 5, it was announced that Paul Sohmer, M.D., would be the new President and Chief Executive Officer at Neuromedical Systems. Dr. Sohmer was formerly President of **Genetrix, Inc.** prior to its acquisition by **Genzyme Corporation**. He was also a Corporate Vice President at **Nichols Institute** and was President and CEO of the **Pathology Institute** in Berkeley, California.

Columbia/HCA Healthcare is reported to be weighing a proposal to spin off as many as one-third of its 340 hospitals. According to the *Wall Street Journal,* the spin off could take the form of a publicly traded company.

BECKMAN NOW OWNS COULTER

On November 4, **Beckman Instruments, Inc.** formally completed its acquisition of **Coulter Corporation**. The combined firm will now be known as **Beckman Coulter**. As reported earlier in THE DARK REPORT, this merger creates a powerhouse company in chemistry and hematology. Expect to see other mergers as the diagnostics industry undergoes its own consolidation wave. *(See TDR, October 6, 1997.)*

For-profit hospitals are losing favor with the public. According to a recent **Kaiser Foundation** study, 47% of Americans polled in October said "the conversion of non-profit hospitals and insurance companies to for-profit institutions was a 'bad thing.' Just 15% said the trend was good."

ADD TO: NONPROFIT CONVERSIONS

Consider this study as part of the ongoing political lobbying between the non-profit and for-profit segments of the hospital industry. With Columbia/HCA under siege, nonprofits would like to see legislative constraints placed on the ability of for-profit hospitals to buy and convert nonprofit hospitals.

U.S. Labor Department Bureau of Labor Statistics published data showing that the monthly producer price index (PPI) for acute care hospitals increased only 0.1% in September. For the previous 12 months, the PPI increased 1.1%. Experts predict that this index will begin increasing at a faster rate during 1998 and 1999.

That's all the insider intelligence for this report.
Look for the next briefing on Monday, December 8, 1997

THE DARK REPORT

UPCOMING...

- State Of The Laboratory Industry: Surprises Ahead For 1998.
- Academic Hospital Finds Significant Success With Outreach Lab Program.
- Overlooked Liability Issues Involving Pap Smear Testing.
- Regional Laboratory Networks: Marketplace Dinosaurs Or Emerging Powerhouses?