

From the Desk of R. Lewis Dark...

THE **RD** DARK REPORT

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

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R. Lewis Dark

Founder & Publisher



Are Pathologists The Next “Fish In The Barrel?”

“SHOOTING FISH IN THE BARREL” MAY BE A GOOD METAPHOR TO DESCRIBE what can soon happen to the profession of pathology. This issue of THE DARK REPORT covers several important stories on laboratory management, with direct consequences to pathologists.

First, the ISO 9001 certification of the **Nichols Institute** division of **Quest Diagnostics Incorporated** (see pages 2-8) means that an internationally-accepted business management philosophy is finally taking root in the laboratory industry. Most major diagnostics companies have already become ISO 9000-certified, for competitive reasons. Pathologists who want to survive and thrive in the future of healthcare had better start to understand this new management philosophy, built around very different concepts than the old top-down, hierarchical management style that used to be the norm.

Second, **Premier’s** new initiative to create a breakthrough in how hospital-based laboratories contribute to the healthcare continuum (see pages 9-14) should get equally serious consideration. Premier is the latest among several prominent hospital operators where corporate leadership finally recognizes the value of laboratory diagnostics. Its response is to immediately co-opt leadership of the laboratory and order that integration, consolidation, and regionalization take place... pronto! Isn’t it logical to assume that, once laboratory consolidation is complete, senior hospital administration will insist on pathology consolidation?

Third, **MedPartners’** intention to divest **Team Health**, its \$690 million division which manages hospital-based physicians (see pages 16-17), brings into question the validity of physician practice management (PPM) companies for hospital-based physicians. This happens just as pathologists are about to be besieged by acquisition offers from at least three well-funded pathology PPMs.

My reading of these tea leaves causes me to recommend that hospital-based pathologists create a game plan for survival. The pace of change is accelerating. The degree of change will be radical, even revolutionary. Pathologists should not remain motionless, like deer in the headlights of an approaching car. Rather, pathologists should immediately access business experts and healthcare futurists for the purpose of developing their road map to success. All of these changes will create new classes of winners and losers. Career stability and financial achievement will accrue to those pathologists who heed the warning and help both themselves and their partners identify viable business options for their practice.

Nichols Institute Earns ISO 9001 Certification

Becomes first clinical laboratory in U.S. to comply with international standards

CEO SUMMARY: *Although it's the first ISO 9001-certified clinical laboratory in North America, Quest Diagnostics' Nichols Institute is a late-comer to the party. Most major diagnostics companies already have ISO 9001 certification. This issue of THE DARK REPORT explores why Nichols' ISO certification is an industry milestone. Our prediction is that all larger laboratory organizations will travel the same road within five years.*

FURTHER CHANGE CAME to the clinical laboratory industry when the **Nichols Institute** division of **Quest Diagnostic Incorporated** announced on May 13 that it had passed its final audit and was now ISO 9001-certified.

"The ISO 9000 series of standards was developed to insure management integrity and product quality for certified companies throughout the world," stated George Pounds, Corporate Director of ISO 9001 at Quest Diagnostics. "Companies operating under these standards are recognized as having consistent quality and good management practices."

During the last ten years, ISO 9000 certification has become an essential requirement for manufacturers seeking to do business internationally. In many industries, such as computers, electron-

ics, and automotive, any company lacking ISO 9000 certification is automatically excluded from bidding for business because of contractual requirements established by the buyer.

That is why THE DARK REPORT believes that Nichols' ISO 9001 certification is a clear signal to the clinical laboratory industry. ISO 9000 standards will eventually force fundamental change to the organizational form and management of clinical laboratories. This change will be compatible with recognized trends toward consolidation, regionalization and clinical integration.

In fact, as the entire healthcare industry transforms from small cottage businesses to large corporate management models, the management philosophy inherent in ISO 9000 standards can facilitate a successful transition. To make this transition, laboratory direc-

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History of ISO 9000 Goes Back To 1959

*ISO stands for the **International Organization for Standardization**, based in Geneva, Switzerland. It represents the standardizing committees for 91 countries throughout the world.*

*Early roots of quality standards go back to 1959, when the American **Department of Defense** issued Mil-Q-9858. By the late 1960s, **NATO** had established a set of quality standards. Things picked up in 1979 with the formation of Technical Committee 176 by the ISO. The goal was to harmonize international activity in quality management and quality assurance standards.*

ISO 9000 standards were drafted in 1984, issued in 1987 and adopted by 26 countries. A major revision was completed in 1984. By the end of 1996, more than 90 countries had adopted ISO 9000 as their national standards for quality management.

tors and pathologists will need to acquire knowledge and techniques appropriate for corporate-style management, such as found in ISO 9000 standards. These are designed to complement and enhance the management of businesses and similar organizations such as healthcare providers.

It is market forces which push companies to adopt ISO 9000. The story of how Nichols Institute made the decision to pursue ISO 9001 certification perfectly illustrates this fact.

“At the time **Corning Inc.** owned **Corning Clinical Laboratories** [now **Quest Diagnostics Incorporated**],” said Pounds, “they wanted to imbed quality management systems into all their business divisions. There was a master quality plan, which included ISO 9000. Corning wanted the lab division to begin pilot implementation of this plan by 1997.”

Clients of THE DARK REPORT should recall that Corning Inc. was recognized as one of the best-managed corporations in America through the late 1980s and into the 1990s. It was also one of the first large corporations to embrace quality management principles. Its manufacturing divisions earned Malcolm Baldrige Quality Awards and similar honors.

More importantly, Corning’s growth and profits from such new technology areas as fiber optics were substantial. Quality management techniques, including ISO 9000, were helping the company become a tough competitor throughout the world.

Management Principles

In 1990, Corning’s board of directors became serious about getting the laboratory division to adopt quality management principles. Early efforts to introduce these principles were overwhelmed by declining profits in the laboratory division.

In 1994, the laboratory began bleeding red ink. In 1995, Corning’s board installed a non-laboratorian as Chief Executive Officer of Corning Clinical Laboratories. Ken Freeman arrived at the lab division with a keen understanding of how quality management principles could enhance the working environment, boost quality, and enhance profits.

Lab Division To Adopt

“Because Corning Inc. was so successful with quality management techniques in its manufacturing divisions,” observed Pounds, “it was logical for Corning to want the laboratory division to adopt these same techniques. After Ken Freeman became CEO, he asked if any of the regional managers would volunteer their laboratory to be the first within Quest Diagnostics to implement this management philosophy. Management of the Nichols Institute division stepped forward.”

Nichols Institute, the specialty testing division of Quest Diagnostics

Incorporated, is nationally-known as a development and research center. "It was this fact that made us a natural choice to be the pioneer," noted Pounds. "After all, we were the center of innovation for clinical testing. Further, we perform a high volume of esoteric testing. Compared to routine testing, it is more challenging to sustain high quality results and consistent reproducibility. Yet the end users of esoteric testing recognize the value of consistent quality and reproducibility.

"For these reasons we believed that ISO 9001 certification would definitely add value to the testing and services offered by Nichols Institute," he continued. "This was not an idle exercise. It was firmly rooted in the goals to measurably improve quality and increase profits."

Appreciate The Benefits

"It took us sixteen months to implement the ISO 9001 standards and pass our final audit," said Pounds. "Although it was not easy, the deeper we got into the process, the more our staff appreciated the benefits. A lot of operational problems were resolved with positive consequences. Systems and processes attributed to the ISO 9001 standards definitely enhance people's ability to do high quality work.

"Measuring progress is integral to the ISO 9001 process," Pounds said. "Everyone is surprised and energized by the dramatic improvement across a range of operational areas. Such success motivates everyone to pursue additional improvements."

According to Pounds, the out-of-pocket cost to gain certification was about \$50,000. This included outside training for the staff as well as the cost of registrars and auditors used over the term of the project.

"One measurement of cost savings demonstrates the financial benefits of the ISO certification effort," said Pounds. "While we were pursu-

ISO 9000 Is A Series Of Quality Standards

ISO 9000 represents a series of quality standards for management and quality assurance. Companies and organizations can certify for different levels of compliance.

- **ISO 9001:** most comprehensive, covers design, manufacturing, installation and servicing systems and processes.
- **ISO 9002:** covers production and installation.
- **ISO 9003:** covers only final product inspection and test.

These three models were developed for use in contractual situations between a customer and a supplier. Another designation in the series, ISO 9004, provides quality guidelines for internal use by a producer developing its own quality system to meet business needs and take advantage of opportunities.

ing ISO 9001 certification, the cost per test declined by 5% at Nichols Institute. We know that improvements resulting from implementing ISO 9001 contributed significantly to that achievement.

"Now that we have ISO 9001 certification, the process moves to another level within Nichols Institute," continued Pounds. "We are using these management processes to continually improve the quality of our testing and service, reduce costs and enhance customer satisfaction.

"Also, I believe continued demonstration of the benefits from ISO certification at Nichols Institute will support ISO certification efforts by the other regional laboratories within Quest Diagnostics," added Pounds. **TDR**
(For further information, contact Laura Terrone at 201-393-5777.)

Expect ISO 9000 To Alter Clinical Lab Management

ISO 9000 standards already widespread among international diagnostics companies

CEO SUMMARY: *Perceptive laboratory executives and pathologists should welcome the impending arrival of ISO 9000 into the clinical laboratory industry. It promises to solve many problems of laboratory management. The diagnostics industry, responsible for manufacturing instruments and supplies used by clinical laboratories, has already embraced ISO 9000 with good results.*

MANY LABORATORY EXECUTIVES yawned at the news that **Nichols Institute**, a division of **Quest Diagnostics Incorporated** was now certified as ISO 9001 compliant. After all, what competitive advantage does Nichols Institute gain by this accomplishment? And what is ISO 9000, anyway?

“ISO 9000 is the spearhead for an entirely different way of managing a laboratory,” stated David Nevalainen, Ph.D. and Director of **Abbott Quality Institute**, a part of **Abbott Diagnostics, Inc.** “Consistently, those companies which adopt ISO 9000 and similar formal quality management systems find significant improvement in four key areas: customer satisfaction, error reduction, cost reduction, and profit enhancement.”

Consulting SWAT Team

Nevalainen heads up a consulting SWAT team established by Abbott Diagnostics as a consequence of its own ISO 9000 certification program. “During the last five years, all our manufacturing sites worldwide were certified as ISO 9001-compliant,” he

observed. “The Abbott Quality Institute was formed to help customers and healthcare providers introduce quality management systems like ISO 9000 into their organizations.”

Growing Awareness

According to Nevalainen, there is growing awareness of ISO 9000 by the laboratory community. “One blood bank in San Antonio gained certification last year. We are assisting several quality system efforts by laboratories in Denver, Minneapolis, and Portland, Oregon. We are also helping two different blood banks become ISO 9000-certified.

“Also, NCCLS is currently revamping its laboratory guidelines to incorporate processes and procedures inherent in quality management systems like ISO 9000,” continued Nevalainen. “The reasons behind these changes are well-known to people who understand the principles of quality management.”

Among other things, quality management principles require a business organization to identify and flow-chart all work processes. Outcomes

from each process must also be accurately measured and reported as a defect rate in terms of errors per million. The impact of such activities is revealing. "I am part of the subcommittee at NCCLS which is revising laboratory guidelines," said Nevalainen. "As the study team looked at data from those blood banks and clinical laboratories which are implementing quality systems, they were surprised at the findings, particularly in defect rates.

"When defect rates are converted to errors per million, it becomes startling," explained Nevalainen. "For example, in the airline industry, the error rate for lost bags is 2,500 per million. That is considered so poor that serious business travelers carry their luggage on board rather than check it. Yet, in the laboratory, error rates in excess of 10% on simple processes are not uncommon. For example, at one laboratory, Pap smear labels had an error rate in excess of 10% for missing, incomplete, or inaccurate information. That is 100,000 defects per 1 million labels!"

Accurate Information

"What this demonstrates is that most laboratory managers do not really know how well or poorly their laboratory processes are performing," said Nevalainen. "When managers get accurate information, presented in a defects-per-million format, it allows them to redesign systems and processes in the laboratory to improve performance in a controlled, steady manner."

Nevalainen's work with blood banks and clinical laboratories involved in the ISO 9000 certification process gives him an unmatched perspective on the industry's acceptance of this management tool. "We are on the verge of a major change," he said. "The public announcement that Nichols Institute earned its certification will accelerate many trends already under way in the laboratory industry."

"The reasons for this impending breakthrough are undeniable," continued Nevalainen. "The amount of money wasted by healthcare organizations is startling. Quality management systems like ISO 9000 permit a laboratory or other healthcare provider to generate big cost savings, while at the same time improving the quality of its products and services. That is powerful, particularly at a time when the reimbursement squeeze is taking money off the table."

"We don't have a systematic approach to producing health-care services. Defect rates, when accurately measured, would surprise most consumers. Waste and unnecessary expenses go undetected."

David Nevalainen

Director, Abbott Quality Institute

"Also, what I am about to say is well-understood by those who understand quality management," added Nevalainen. "We don't have a systematic approach to producing healthcare services. Defect rates, when accurately measured, would surprise most consumers. Waste and unnecessary expenses go undetected. These are fundamental problems which effective quality management systems can help resolve.

"As the improved performance of ISO 9000-certified labs like Nichols Institute becomes known," he predicted. "it will stimulate other clinical laboratories to introduce serious quality management programs into their laboratory organizations. As this happens, physicians, patients, and the entire healthcare community will benefit."

THE DARK REPORT concurs. Quality management programs are an over-

looked tool which laboratory executives have hesitated to adopt. Further, this is one vital area of management where laboratory administrators and pathologists have generally failed to lead change. The marketplace now offers many examples of the consequences where lab directors failed to take the initiative in redirecting their laboratory organizations.

Lab Consolidation At Tenet

In southern California, lab directors at many of the **Tenet** hospitals recognized the need to consolidate testing and reengineer their laboratories. However, during the last five years, no two Tenet lab administrators succeeded in getting their hospital CEOs to approve such consolidation proposals.

The result? Tenet's corporate executives stepped in and gave **SmithKline Beecham Clinical Laboratories** the green light to design and implement a streamlined regional laboratory system for the 31 hospitals, most located in Los Angeles and Orange Counties.

Within 60 days of launching the project, the 31 hospital lab directors were reduced to 13 (two core lab directors and 11 directors of rapid response lab clusters). Further, because of the cost-cutting goals of this Tenet project, there will be less ability to reduce laboratory staffing through attrition.

Pathology Next?

If laboratory consolidation proves successful at these 31 Tenet hospitals, can pathology consolidation be far behind? At what point do reductions in reimbursement cause corporate executives at Tenet to finally pursue cost-saving opportunities in pathology?

Will the pathologists at these 31 hospitals wait to see what will happen next? Or, could they exercise more control over the situation by overcoming traditional issues of turf, politics, and control, giving Tenet a well-designed consolidation plan of their own? This is not an idle question. Any objective observer would

tell pathologists to seize the initiative, because radical change will occur, whether or not they initiate it.

The strategic services alliance between **Premier, Inc.** and Quest Diagnostics further illustrates how the marketplace is pushing changes upon hospital-based laboratories. Although participation in the alliance is voluntary for any hospital, lab directors should realize that a number of hospital and system CEOs among Premier's membership are ready to be the first guinea pigs. Here is another example in the marketplace where hospital owners are ready to push radical change down into the laboratory.

New Management Systems

The longer the delay by hospital laboratory administrators and pathologists in introducing these new management systems into their organization, the greater the financial pain will be inflicted upon both the laboratory staff and the hospital served by the laboratory. Administrators and managers have a responsibility to bring positive changes to their laboratory. Economic trends make it imperative to act sooner, not later.

The ISO 9001 certification of Quest's Nichols Institute is a marketplace signal that new management models are finally reaching the clinical laboratory industry. **THE DARK REPORT** recommends that hospital laboratory directors and pathologists give serious study to the new management principles which are about to transform healthcare.

The future of both the clinical laboratory industry and pathology lies in early adoption of quality management systems like ISO 9000. It will be the source of both financial success and employment stability for those laboratories fortunate enough to have perceptive leadership.

TDR

(For further information, contact David Nevalianen, Ph.D. at 847-937-0691.)

Management Revolution Overlooked By American Healthcare Providers

ISO 9000 STANDARDS ARE A DIRECT RESULT of the revolution in management philosophy which swept through the business and industrial world starting in the 1980s.

Even as this management revolution reshaped and transformed business organizations throughout the world, healthcare providers in America tended to remain oblivious. The reason was simple. Hospitals, physicians, and clinical laboratories still enjoyed ample profits from fee-for-service reimbursement, giving them little incentive to change the way they conducted business. That is why, even in 1998, a sizeable majority of provider organizations operate today under old-paradigm management philosophies.

Such was not the case in other segments of the business world. Behemoths of the American economy found themselves going broke as a result of a new type of competitor, invented by Japanese corporations. These corporate giants would only survive if they learned to match this new type of competitor.

Clinical laboratories should understand the parallels between themselves and these industries: **Xerox** and the copy machine business (late 1970s); **General Motors, Ford, and Chrysler** and the auto industry (late 1970s through early 1990s); **Braniff, Pan American, and Eastern Airlines** and the airline industry (1980s).

Faced with competitors who managed their business with a different philosophy and system, each of the above companies was forced into radical change. Xerox survived. General Motors continues to struggle. Ford is doing okay, but Chrysler has merged with **Daimler-Benz**. And the three airlines? Each went bankrupt and ceased operations. Meanwhile, the hot performer in the airline industry is **Southwest Airlines**, organized around the new management philosophy.

The financial struggles of big companies in the copy machine, automotive and airline business were also matched in the laboratory industry. Recent years found the commercial laboratory landscape littered with the debris of failed lab companies. **Physicians Clinical Laboratories** and **Meris Laboratories** both filed Chapter 11 bankruptcy. **Unilab** lost tens of millions of dollars before stabilizing operations. Losses at Nichols Institute forced its sale to **MetPath**, which itself lost hundreds of millions of dollars.

The point should be obvious. Healthcare in the United States led a profitable, but sheltered existence. As the business world around it changed in the 1980s and 1990s, healthcare did not adapt and incorporate much of the new philosophy and techniques which were transforming international business management.

It is time for hospital-based laboratory directors and pathologists to wake up to this new world. Commercial laboratories have already begun the process of management transformation. ISO 9001 certification at Quest's Nichols Institute division is just the first round of far-reaching management initiatives planned for the billion-dollar laboratory company. Similar efforts are under way at **SmithKline Beecham Clinical Laboratories** and **Laboratory Corporation of America**.

At the least, hospital-based lab directors and pathologists should recognize that the ISO 9001 certification at Quest's Nichols Institute sets into play a new series of market forces. Should Quest Diagnostics gain competitive advantage from ISO 9001 certification, it will cause competing laboratories to similarly revamp their management systems. As David Nevalainen points out, once a laboratory adopts quality management principles, it "becomes a way of life."

Unrealized Gains Targeted By Premier's Lab Initiative

CEO SUMMARY: In part one of this exclusive interview, Premier's John Biggers described the reasons why the 1,700 hospital consortium developed a strategic services program for clinical laboratories. In this final installment, Biggers provides insight as to how the program will work and what the objectives will be. Biggers' comments deserve careful reading, particularly by hospital lab directors and pathologists, because it is a real-world demonstration that hospital-based laboratories, as an industry, are on the verge of a radical readjustment in their organization and relationship with both clinicians and hospitals.

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Part Two of Two Parts

THE FOLLOWING CONCLUDES our exclusive interview between Robert Michel, Editor, and John Biggers who was Vice President of Corporate Business Development at Premier. He is now Vice President of Operations for Premier Clinical Laboratory Services.

EDITOR: In the first part of this interview, you and I discussed the reasons why Premier, Inc. decided to emphasize clinical laboratory services as a business initiative. You also shared with us how Premier evaluated its options for establishing such a program and eventually made a decision to create a strategic services alliance with Quest Diagnostics Incorporated as the partner. In this segment of the interview, I would like you to discuss two things. First, what specific outcomes do Premier's member hospitals hope to gain from revamping laboratory services? Second, how will this strategic services program actually be introduced to Premier's 1,700 hospitals?

BIGGERS: Both of your questions are intertwined. The benefits will result from the implementation plan. Premier is convinced that clinical laboratory services can be the vanguard for effective integration of

clinical services within both the hospital and the extended integrated delivery system (IDS). In so doing, the process of laboratory integration will have several effects. One, it will reduce the cost of laboratory testing to the hospitals and IDSs. Two, laboratory integration will expand the actual testing resources available to clinicians even as lab overcapacity is reduced or eliminated. Three, it will initiate changes to clinical practices which enhance the quality of healthcare while reducing the cost of providing it.

EDITOR: John, each of these three goals is precisely what pathologists and laboratory administrators have screamed that they could do for years. They've argued that clinical laboratories have the potential to impact clinical practices in ways which are disproportional to its cost.

BIGGERS: Their message has now been heard. Our internal studies convinced the highest levels of management at Premier, as well as some of the most influential executives of our largest hospital system members, that clinical laboratory services are the best way to anticipate and meet the challenges of managed care.

EDITOR: In a sense, you describe a sleep-

"Laboratory testing is involved in a majority of clinical decisions... and its potential to do more has gone unrealized"

John Biggers, VP, Premier, Inc.



ing giant which is now aroused and ready for action. Power players at the highest levels of Premier and its most influential hospital system members finally recognize the power of the clinical laboratory. They now want immediate action...

BIGGERS: It's true, for this reason. As I stated earlier, every couple of years Premier wants to create a breakthrough. We define a breakthrough as triggering outcomes which were previously considered impossible. Our senior management team, in studying how clinical services are delivered, realized the truth known to most lab administrators and pathologists: laboratory testing is involved in a majority of clinical decisions, yet is relatively inexpensive. And its potential to do more has gone unrealized and untapped by the large majority of hospitals.

EDITOR: A consistent theme that underlies all your comments, John, is that the laboratory should play a bigger role in the healthcare community than it is currently giving.

BIGGERS: Good observation. As our path for the laboratory unfolds into the future, our main objective is to create a national database of clinical information. This database, built around laboratory test data, would be used to optimize healthcare practices and patient outcomes.

EDITOR: Then the real objective of the strategic services alliance is to position laboratories so that they can play an increased role in improving clinical practices.

BIGGERS: Basically yes. But it goes beyond that. CEOs of our member hospitals have a problem that laboratories can solve.

EDITOR: What problem is that?

BIGGERS: Clinical integration.

EDITOR: For example?

BIGGERS: Our hospital CEOs recognize that few, if any, truly integrated healthcare delivery systems exist in the United States today. The CEOs believe clinical laboratory services can be an ideal rallying point for clinical integration. More specifically, a number of our CEOs now think that they can use a well-designed core lab system to break down historical barriers within their healthcare community and encourage rapid integration of clinical services.

EDITOR: Is that the reason why a national data base is one goal for the strategic services alliance?

BIGGERS: Precisely. Such a uniform data base creates the ability to pool patient data from the physicians office with that of the same patient in the hospital. Our strategic services alliance is designed to give our member hospitals that capability without any capital required by the hospital. In fact, the hospital will enjoy significant dollar savings even as its laboratory resources are expanded.

EDITOR: This national data base of laboratory test information would eventually impact test utilization, correct?

BIGGERS: That is one of our long-term goals. As clinicians use this information to improve patient care, over time we expect to see the number of tests ordered reduced by as much as 25%. This will require several years to occur, but it is one additional source of

major cost-savings to the hospital from the strategic services alliance.

EDITOR: What you describe is a grand vision. If the strategic alliance delivers as it is intended, individual hospitals and IDs will realize significant cost savings while getting enhanced laboratory services in the short-term. In the long-term, the strategic services alliances will create a comprehensive national data base of lab test results that clinicians accept and use to improve diagnostic and therapeutic pathways.

BIGGERS: Now you can appreciate why information capability plays a big part in our plans. Quest Diagnostics, our alliance partner, agreed to be the conduit for this information. It should be no surprise to you that, in all our discussions with commercial labs, everybody realizes that added value in lab testing lies not in performing the test, but in how the resulting laboratory data is used. In the future, clinical labs will actively help clinicians use laboratory data for diagnostic and therapeutic decisions.

EDITOR: Assembling a national data base of laboratory information is a worthy goal. But so far, no commercial laboratory has yet to demonstrate a practical system that delivers global information in a useful fashion.

BIGGERS: We recognize the challenge in that area. But that is why, when successful, Premier will create an innovative breakthrough for our member hospitals.

EDITOR: Of course, the path you follow to that objective will also produce more immediate benefits to the hospital's laboratory. Would these benefits be the short-term goals of the strategic services alliance?

BIGGERS: Yes. With 1,700 member hospitals, we believe that we can deliver worthwhile gains to every single one. However, each hospital starts from a different position. We recognize that, for those hospitals where extensive consolidation and reengineering has already

occurred to the clinical laboratory, short-term gains would be modest. But the opposite is also true. There are many hospitals where potential savings from the laboratory range from 10% to as much as 40%. We've established a threshold of 10% in evaluating our first alliance candidates. If strategic services cannot project a minimum of 10% in cost improvement, we don't think it will justify the hospital's efforts.

EDITOR: There is probably a large number of ideal candidates for the strategic services alliance...

BIGGERS: That's correct. CEOs of several hospitals and hospital systems have already asked us if they could be the early innovators with the strategic services alliance.

EDITOR: So you start with a ready pool of willing volunteers?

BIGGERS: Definitely. In fact, a number of these early innovators are prominent institutions. We are pleased to have strong interest from them. Our game plan specifies that we start with a limited number of projects. They will be selected from this pool of motivated volunteers. Before we splash this throughout the country, we want a clear demonstration of how Premier and Quest, working cooperatively with the hospital partner, can deliver worthwhile savings and service enhancements. We want to demonstrate that this occurs without the kind of disruption or organizational pain which lab administrators often fear, needlessly.

EDITOR: Rumors within the laboratories of Premier hospitals imply that this lab initiative would be "mandatory." I hear you describing the opposite. You plan to only work with those hospital members which invite the strategic services alliance to make a proposal.

BIGGERS: This is strictly on a volunteer basis. Rumors can take on a life of their own, regardless of the facts. From the beginning, our intention was that the strate-

gic services alliance be a three-way partnership between each participating hospital, Premier and Quest Diagnostics.

EDITOR: How many projects do you anticipate initiating in the opening months of this alliance?

BIGGERS: Just a handful. I can guarantee you that we want our first one or two or three projects to be extremely successful. You'll probably see a mix of large systems and small hospitals in the first round of projects. Hopefully the results from a couple of these projects will be remarkable enough to startle our members and cause them to say "If that can happen with their laboratory, then anybody can do it."

EDITOR: I like that approach. Take the toughest challenges out there and prove that the partnering concept works. Laboratory administrators are like the folks from Missouri. "Show me" is the fastest way to gain their support for new management concepts in their laboratory.

BIGGERS: That is why we will do a limited number of these partnering arrangements, then talk about them a little bit. We want administration at all levels of prospective hospitals to understand the design of this program, see its effectiveness, and know precisely how it would occur in their own institution.

EDITOR: Would you talk more about the goal of bringing Premier hospitals a laboratory cost per test which is as low as that of the commercial laboratories?

BIGGERS: One way to develop a breakthrough in accepted practices is to establish an outlandish assumption, then figure out how you would make it happen. At one point, we asked a simple question: What would it take for a hospital laboratory organization to get a cost per test as low as, or lower, than that of larger commercial laboratories.

EDITOR: But commercial labs derive their rock-bottom costs from pushing high volumes of specimens through

their regional testing centers. Hospital labs, by definition, generally can't access similar volumes of specimens.

BIGGERS: Robert, that is traditional thinking. Now, work out of the box for a moment. Can you think of a few ways you might restructure a hospital laboratory to get low-cost tests?

EDITOR: Well, two things come to mind, both based on aggregating hospital specimens into central locations. One is to partner or outsource with a commercial laboratory in the region. The other would be to create a regional core lab that would do testing for a number of hospitals in the vicinity. In fact, that is what **Tenet** is doing with its 31 hospitals in Orange and Los Angeles counties in California.

BIGGERS: Those are pretty obvious solutions, aren't they?

EDITOR: Yes. So is your point that lab directors already know ways to radically push down the cost of lab testing?

BIGGERS: Correct. As Premier's Bill Nydam pointed out to you, left to their own, lab administrators take as long as ten years to work through incremental steps of internal reengineering, lab consolidation and maybe regional cooperation with other hospital labs in the nearby area. But hospital CEOs no longer have ten years to wait for the benefits of this.

EDITOR: Even though these laboratory administrators intuitively recognize the need to act, they hesitate to change the status quo...

BIGGERS: ...which is why, for a long time, the hospital laboratory industry rode the horse of excess capacity. The truth is that excess capacity carries a huge price tag. One goal we have is to reduce that excess lab capacity and lower the overall price tag for lab testing.

EDITOR: But there is more to your strategic analysis than a simple reduction of overcapacity.

BIGGERS: Excess capacity, and the extra costs associated with it, must be viewed in tandem with a fundamental shift in the economics of clinical laboratory operations. Generating more specimen volume into the laboratory today can be at counter-purposes to the integrated clinical environment it services.

EDITOR: In what way?

‘For a long time, the hospital industry rode the horse of excess capacity. The truth is that excess capacity carries a huge price tag. One goal is to reduce that excess lab capacity.’

BIGGERS: Ten years ago, if you generated a lab test, you got paid for it. Today, if you generate test volume for the sake of generating volume, it is simply an expense to your health system.

EDITOR: I see two reasons why your analysis is correct. First, if a laboratory is on a prospective, or capitated reimbursement arrangement, then additional testing adds expense without generating offsetting revenue. Second, if the laboratory is part of an integrated delivery system which offers total healthcare against fixed premiums, then unneeded lab tests simply become unnecessary costs for the parent system.

BIGGERS: Yes, laboratory expenses for inpatient testing now represent a cost to the CEO. That is why our goal for the strategic services alliance is three-fold: 1) to reduce the cost per laboratory test to a level approaching that of commercial laboratories; 2) to expedite clinical integration within the IDS; and 3) to position laboratory data so as to improve clinical outcomes while lowering the cost of care. The last two items should also favorably impact utilization.

EDITOR: John, you also believe these goals can be accomplished with little or no capital investment by the hospital partners. Explain that please.

BIGGERS: There is a clear-cut advantage for hospitals to participate in the strategic services alliance. We seek to create the optimal organization at no capital cost to the hospital owners. Their participation should result in direct savings of 10% to 25% in laboratory costs. The alliance will provide information system interfaces to connect the hospital, the laboratory, physician offices, and reference laboratories. These interfaces will build upon the existing information systems. Once this capital infrastructure is operational, it potentially can be used to access other clinical data such as radiology, cardiology, physical therapy, and pharmacology between the hospital and various providers within the IDS.

EDITOR: This created infrastructure is a side-benefit from the laboratory project. It opens up new opportunities for the hospital to interact clinically with the physicians offices.

BIGGERS: Yes. That is another aspect that appeals to our more perceptive hospital owners.

EDITOR: Talk a little bit about how laboratory outreach business will be handled in the alliance.

BIGGERS: As part of the strategic services alliance, Quest Diagnostics will offer to purchase the outreach testing for any hospital partner.

EDITOR: I assume that Quest will be working to increase the market share of outreach testing generated by the alliance from that hospital’s nearby medical campus?

BIGGERS: That is the plan. But there is a more global motivation behind this aspect of the strategic services alliance.

EDITOR: Please explain.

BIGGERS: First, we want to be smart about where testing is done. Remember that lowest cost per test and improved laboratory services are the immediate goals. But other issues must be addressed as well. If several hospitals in

a city are part of the strategic services alliance, inevitably the decision must be made as to how testing will flow from various sites in the regional effort. I know that readers of THE DARK REPORT are familiar with the political issues and turf problems surrounding many attempts to create some form of regional laboratories.

EDITOR: Then having a mechanism to put outreach testing in “neutral hands” while still allowing the alliance to benefit from increasing the outreach specimen volume is part of the strategic design?

BIGGERS: We certainly hope so. We believe that laboratory regionalization requires a “United Nations” solution, a neutral third party who has credibility with all participants. Certainly every lab director knows of discussions between laboratories to create core labs or networks which lasted for two, three, even four years. Yet at the end of that time, there was little agreement and even less tangible action.

EDITOR: So you believe that Premier and Quest Diagnostics, in combination, can help participating hospitals develop effective regionalization plans?

BIGGERS: Yes, for an important reason. Everybody gets to win something if the project can be designed and implemented. Premier has business planning skills and credibility with the hospital CEOs. Quest Diagnostics has hands-on experience operating a multi-site regional lab system, including LIS resources, courier networks, sales, marketing, and managed care relationships.

EDITOR: So your strategic plan has a built-in mechanism for moving past what I will call “parochial interests?”

BIGGERS: We know that most regional laboratory initiatives flounder rather than succeed for reasons of politics, turf, and control, Robert. However, the strategic services alliance brings an

array of business acumen and capability which is frequently lacking from these projects. Plus, most regional laboratory programs are initiated by the lab directors, who must try to sell their CEOs and senior administrators on the concept. Our regional projects will generally have the full support and authority of the hospital CEOs. For that reason, we anticipate that traditional points of conflict will not get in the way of a rapid implementation once all participants agree on the plan.

EDITOR: As we prepare to close, do you have some final comments for clients of THE DARK REPORT?

BIGGERS: Basically, I would like to reaffirm the original motives behind this strategic services alliance. Hospital laboratory administrators and pathologists should recognize that Premier has spent almost two years studying various opportunities to create breakthroughs in healthcare. We recognize that clinical laboratories have untapped potential to help expedite clinical integration, while at the same time providing their parent hospitals with enhanced service at reduced cost. It is confirmation of what laboratorians have preached to us for years. Now we are true believers and ready to pursue and harvest those benefits.

EDITOR: Should Premier succeed with this concept, it will bring definite changes to hospital-based laboratories.

BIGGERS: Yes, but keep in mind that this entire effort will take place one hospital laboratory at a time, over a period of several years. Only a handful of hospitals will participate in our first round of strategic service alliances. **TDR**

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MedPartners To Divest Hospital-Based MD Unit

Team Health is a \$690 million division with 2,240 ER doctors and radiologists

CEO SUMMARY: *Hospital-based pathologists are increasingly the target of buy-out offers by the emerging group of pathology-based physician practice management (PPM) companies. But MedPartners decided that managing hospital-based physicians was something that was not in its best interest. What message should pathologists read into MedPartner's exit from managing hospital-based doctors?*

PATHOLOGISTS MAY WANT TO PAY close attention to what happens with **Team Health**, the hospital-based physician management division of **MedPartners, Inc.**, the \$6.3 billion physician practice management (PPM) company based in Birmingham, Alabama.

MedPartners announced on June 23 that it intended to sell all Team Health operations. Team Health is large, with \$690 million in annual revenues. It manages 2,100 emergency room physicians and 140 radiologists. There are also a few anesthesiologists and intensive care specialists. The company's reach is significant, as it has 268 hospital-based contracts and 58 radiology services contracts in 30 states. That is about 5% of all the hospitals in the United States.

No Pathology Management

According to company officials, Team Health has no management arrangements with pathologists. Business-minded pathologists will probably ask two questions. First, if PPMs really add value to the management of hospital-based physicians, why does Team

Health not have contracts with any pathologists? Second, if the nation's largest PPM, MedPartners, wants to exit the business of managing hospital-based physicians, does that mean PPMs cannot do much to boost the revenues and operating profits for hospital-based physicians?

Relevant Questions

Both questions are highly relevant to the future of pathology. At least three pathology-based PPMs have sizeable amounts of venture capital money and bank credit. They are now in the marketplace seeking to acquire pathology practices. PPMs generally claim that they can manage a doctor's practice better than the doctor by lowering costs, improving operating profit and boosting revenue through sales and marketing.

These concepts have yet to be validated in the pathology world. **AmeriPath, Inc.** went public just nine months ago, in October 1997. It will take several years before the company demonstrates its ability to deliver sustained economic benefits which are attributable to its management of pathology practices. Because dermatopatholo-

gy specimens originating outside the hospital comprise a sizeable portion of AmeriPath's revenue, the company is not a pure play on hospital-based pathology.

Pathology PPMs

Competing pathology PPMs, such as **Pathology Consultants of America, Inc.** and **Pathology Partners, Inc.** (formerly **Physicians Solutions, Inc.**) are just now entering the marketplace. Like AmeriPath, it will take several years before an accurate judgement can be made as to their effectiveness in running pathology practices.

The PPM industry itself is at a crossroads. After many years of increased profitability, several closely-watched PPM companies lost money in 1997. The investment community is watching to see if these losses were one-time hiccups or the first signs of sustained financial problems.

"MedPartners recognized that managing hospital-based physicians and managing multi-specialty clinics are two different businesses," said Tom Dingley, Corporate Communications Director at MedPartners.

Core Competency

"This decision to sell Team Health had nothing to do with the performance of that division," he continued. "It was a decision by MedPartners to emphasize our core competency in the management of multi-specialty clinics. We intend to concentrate our resources on the multi-specialty segment."

Dingley's comments seem to reflect a recognition by MedPartners that the growth and profit potential of multi-specialty clinic management is greater than that of hospital-based physicians. The reason may be the way hospitals contract with hospital-based physicians for services. Cost-cutting by hospitals is widespread and hospital-based physicians find themselves being asked by their hospital to accept less money at each contract renewal.

Another relevant aspect to the Team Health operation is its lack of pathologists. Although Team Health has 2,100 ER physicians, 140 radiologists, some anesthesiologists and a modest number of pediatric and adult intensivists, not one pathologist is represented by the group. Apparently the financial aspects of hospital-based pathology caused Team Health to avoid involvement in that physician specialty.

If an experienced physician practice management company like Team Health, with thousands of doctors and almost \$700 million in revenue, deliberately avoided hospital-based pathology, what is it they have learned which the pathology-based PPMs don't yet know?

Marketplace Signal

As a signal in the marketplace, the Team Health divestiture says two things. First, a major PPM has decided to get out of the business of managing hospital-based physicians. The challenges of succeeding in the hospital environment are tough compared to the family practice and multi-practice environment.

Second, despite doing business with 5% of the nation's hospitals and managing 2,200 hospital-based physicians, Team Health never went so far as to bring pathologists under their management umbrella. Apparently the fundamental economics of hospital-based pathology discouraged them from this step.

Team Health's experience may demonstrate that pathology-based PPMs face a market environment (hospitals) which is unfavorable for achieving sustained, long-term financial success, both for themselves and the pathologists they manage. If true, hospital-based pathologists should carefully consider the reasons for selling their practice to a PPM. **TDR**

(For further information, contact Tom Dingley at 847-937-0691.)

INTELLIGENCE

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



Last week THE DARK REPORT toured the Framingham, Massachusetts laboratory of **Genzyme Genetics**, the diagnostic testing division of **Genzyme Corporation**. It is probably the largest genetics-based diagnostics laboratory organization in the United States. The company's roots are in pregnancy testing for early detection of inherited diseases and similar conditions. Thus, a necessary part of the laboratory's services are counseling services for the ob-gyns and their patients. Genzyme Genetics is also active in cystic fibrosis testing. Developments in this area are so rapid that widespread fetal screening for cystic fibrosis may become clinically viable and desirable within 18 months.

AmeriPath, Inc. announced the acquisition of five pathology practices on June 19. Located in Florida, Texas, and Mississippi, these deals add 14 pathologists and another \$10 million to AmeriPath's annual revenue. To meet declared growth goals and keep stockholders happy, AmeriPath must acquire about \$30 million per year of pathology revenues. For that reason, it will aggressively pursue more deals through the remainder of 1998.

LAB MANAGEMENT CHANGES AT SBCL

Significant changes were recently made to the management team at **Smith-Kline Beecham Clinical Laboratories (SBCL)**. John B. Okkerse, Jr., Ph.D., currently President, has also been named Senior Vice President and Director of Operations for SB's Healthcare Services division. He will be responsible for operations at both divisions and continues as President of SBCL (which is a division of Healthcare Services).

MORE ON...SMITHKLINE:

Another SBCL executive gained new responsibilities. Vijay Aggarwal, Ph.D. is now Vice President and Director of U.S. Reference Laboratories. In recent years he has been involved in SBCL's national managed care efforts for provider relations and managed care contracting. In his new position, Aggarwal oversees the performance of SBCL's regional laboratories.

Here's up-to-the minute data on physician practice acquisitions. During 1997, physicians whose practices, IPAs,

or MSOs changed hands totaled 27,862. That is an increase of 37.3% over 1996 and involves about 5% of all the doctors in the United States. The data, assembled by **Irving Levin Associates** of New Canaan, Connecticut, indicates that 24.1% of the purchasers were physician practice management (PPM) companies. Hospitals, as a segment, were the second leading source of buyers, followed by independent practice associations (IPA), medical groups and others. Clinical laboratories are affected by this continuing acquisition of physician practices because buyers frequently switch to their preferred laboratory provider.

Laboratory executives and pathologists are getting savvier about working the political system. Last month, Representative Neil Abercrombie of Hawaii introduced House Bill HR 4092 in the House of Representatives. The bill would raise the Medicare reimbursement for Pap smears from \$7.15 to \$14.60. Cytopathologists James Navin, M.D. and Jeff Killeen, M.D. of **Clinical Labs of Hawaii** played a role in this effort.

*That's all the insider intelligence for this report.
 Look for the next briefing on Monday, July 27, 1998*

THE DARK REPORT

UPCOMING...

- *Secrets Of Success Used By Nichols Institute To Introduce ISO 9001 Into The Laboratory.*
- *Why Anthem Blue Cross Is Again Adding Local Laboratories To Its Provider Panels.*
- *More Competition Among Pathology PPMs: New Players Prepare For Launch.*
- *New Niche Lab Success Stories: Why Specialty Testing Is Flourishing.*