Is Today's Business Model for Clinical Labs & Pathology Soon To End?

(If So, What Comes Next?)

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1 May 2012

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Why Ask the Question?

- Clinical labs and pathology groups face major changes to healthcare system.

- This *Executive War College* is an important milestone in lab test industry.

- Failure to anticipate and respond to unfolding changes can spell financial disaster.

- Equally true, the right strategies can ensure clinical and financial success for a laboratory organization.
Shift in Clinical Emphasis

- Away from reactive/acute care and toward proactive care. (early detection/active intervention.)

- Different demographics:
  - Growing incidence of chronic disease.
  - Increase in proportion of older folks.

- Personalized Medicine and Genetic Medicine
ObamaCare’s Influence

- Accountable Care Act (ACA) of 2010 enacts specific mandates each year through 2020.

- Law designed to bring health coverage to 30 million Americans by 2016.

- Both government and private health programs are introducing “value-based reimbursement.”

- Fee-for-service predicted to decline.
New Health Delivery Models

**Medicare:**
- Accountable Care Organizations (ACO).
- Value-Based Reimbursement.
- Bundled Reimbursement.
- Pay incentive for provider use of electronic health record (EHR) systems.
- Pre-authorization of expensive molecular and genetic tests.
- ICD-10 conversion looming.
New Health Delivery Models

- Private health insurance firms:
  - Medical Homes
  - Accountable Care Organizations (ACO).
  - Acquiring and operating medical groups.
  - Value-Based Reimbursement.
  - Consumer incentives to stay in network.
  - Pre-authorization of expensive molecular and genetic tests.
Lab Medicine’s Vital Role

- Concepts of personalized medicine and genetic medicine require doctors to utilize laboratory tests.
- Flood of new diagnostic technologies enables more clinically-useful lab tests.
- More accurate and earlier disease detection.
- Capabilities to help physicians select therapies that are most appropriate.
Premise: Lab Test Business Is at a Crossroads

1. Healthcare in the United States is earliest stage of major reform.

2. Changes in delivery and payment for clinical care will directly alter how lab tests are ordered and reimbursed.

3. Powerful demographics assert influence in different ways.

- These are three primary forces for change.
Existing Independent Lab Company Business Model

- Dominant business model reaching back to 1970s.
- Must understand economics of this business model.
- Healthcare fundamentals that supported this lab test business model across five decades are undergoing swift transformation.
- This model not likely to survive...
Lab Business Model Traits, or… Fastest Way to **Big Profits**!

- Reimbursement is fee-for-service (FFS).
- Thus, each additional test adds to lab revenue.
- Economies of scale are key—the more specimens tested in a lab facility, the lower the average cost-per-test.
- Lower cost-per-test increases the profit from the fee-for-service reimbursement.

*P.S.-These same dynamics drive hospital laboratory outreach programs!*
How to Maximize Profits?

Question:
Since the early 1980s, what was the fastest way for a public lab company to increase specimen volume—thus maximizing profits?
Maximizing Lab Profits...

**Answer:**
Buy another lab company, and...

- Gain its client list;
- Close its lab facility, lay off those med techs, consolidate all lab tests in existing lab facilities; and,
- Close duplicate patient service centers, courier routes, and stat labs to further cut costs.
Lab Consolidation Explained
Remember these public labs of the 1980s?

- Damon Clinical Laboratories
- Dynacare Laboratories
- International Clinical Labs
- Meris Laboratories
- MetPath
- MetWest (Unilab)
- National Health Laboratories
- Nichols Institute
- Physicians Clinical Laboratories
- Roche Biomedical Labs
- SmithKline Beecham Clinical Labs
- Universal Standard Med Labs

Are they gone?
Yes and No!

Ultimate lab industry consolidators and winners were Quest Diagnostics and Lab Corp!
Consolidation Not an Answer

Exhibit 4. System-level Changes Can Bend The Cost Curve

Consolidation only provides unit cost improvements and temporary relief

Consolidation plus system-level changes offer potential to alter volume trajectory

Consolidation savings disappear after ~5-6 years

Trajectory change pushes lab cost in-line with GDP growth

Note: Post-2010 numbers assume 6% growth per year without system-level changes; 2% per year (estimated real GDP growth) with system-level changes
Source: Washington G-2 reports, BCG analysis
Public Labs’ 1st Problem...

- Few lab acquisition and consolidation opportunities remain.
- Labs available for acquisition are small in size.
- Moving forward, public lab companies need a strategy to replace acquisition and consolidation.
- Then, there’s the 2nd problem.
Lab Industry’s 2\textsuperscript{nd} Problem...

- **Question:**
  Since the 1970s, what was the dominant type of customer for independent laboratory companies?

  - **Hint:** this category of customer/client was consistently the source of 80% or more of an independent lab company’s specimens and revenue.
Lab Industry’s 2nd Problem...

- **Answer**: Office-based physicians practicing as partners or in a professional corporation (PC).
  - These doctors owned their medical practice.
  - They were free to choose their clinical lab.
  - As owners, they were typically motivated to select labs based on service, price, and clinical relationships.
Era of Private Practice Medicine is Ending

- Large numbers of office-based physicians sold/are selling their medical practice.
- Doctors are no longer owners, but employees.
- Buyers of these medical practices are hospitals and managed care companies.
- Employers are opening corporate clinics.
- New owners of medical groups now decide their choice of a laboratory company to provide testing.
Remember This Number

691,000 physicians practice in the United States.

Source: 2010, U.S. Department of Labor
73% in solo or office-based settings (504,430 MDs)
Source: Center for Studying Health System Change (HSC)
Medical Practice Ownership in the USA

Trend in Hospital Ownership of Medical Practices is Compelling……..

Source: MGMA Physician Compensation and Production Survey

These numbers date from 2008!
Percentages of Active U.S. Primary Care Physicians (PCPs) and Specialist Physicians Employed by Hospitals, 2000–2012.

Core Question for Strategy

- If the dominant business model of office-based physicians is no longer that of private practice/partnerships....

- ...how do independent lab companies serve the business model that replaces medical partnerships and professional corporations?
Challenge to Entire Lab Industry

- Don’t forget!
- Today, office-based physicians are the single largest source of lab test specimens and revenue for:
  - Most national and regional lab companies
  - Hospital/health system lab outreach programs.
  - Community-hospital based pathology groups.
- All lab organizations require strategy to address the change in ownership structure of office-based physicians.
Important Take-Away

- My view—Single most important insight presented today and tomorrow:

“Business model of the office-based physician is migrating from doctors as partners/owners to one of doctors as employees.”
Labs Need New Strategy

- If the office-based physician no longer has full control of choosing his/her lab test provider, who will?

- Answer that question correctly, and your lab organization is poised to prosper.

- Sessions here at *Executive War College* designed to help you craft that strategy.
Change Gears...

- More disruptive elements that require a response:
  - Managed care companies prepared to attack the high lab test prices charged by hospital/health system labs.
  - Two Blood Brothers are investing heavily to reshape the competitive marketplace in their favor.
  - Example of LabCorp’s BeaconLBS product to create a panel of network labs on one side and a panel of payer contracts on the other side—managed by BeaconLBS.
“Our Four Core Competencies”:

- Physician Decision Support (PDS)
- Lab Networks – Efficient and High Quality
- Pricing and Editing Support.
- Risk Management
Capitation for Molecular Tests?

What BeaconLBS says in its Marketing Presentation

- “Risk Management. BeaconLBS is prepared to accept full financial responsibility for all outpatient laboratory expenditures upon adoption of the BeaconLBS model.

- “By managing laboratory economics through a capititated model, we have created a simple solution to complex laboratory trends.”
Potential Disrupters

- ACOs and medical homes will mean bundled reimbursement.
- How will labs be paid in these models?
- More payers educating and incentivizing consumers to stay in network.
- What value can labs offer these consumers?
Then There’s Congress!

- Recall last *Executive War College*—the government’s money pot is empty.
- Lab test utilization is increasing at double-digit rates, but Medicare cannot sustain funding for this growth.
- Labs can expect to be paid less, with deep cuts still to come.
- Small independent labs, with margins of 4% to 8%, may face extinction if no solution is found.
Candid Observation

- Lab insiders tell *The Dark Report* that Senators and Representatives in Congress increasingly have troubling opinions about the profit margins earned by national lab companies.

- All clinical labs and pathology groups will deal with the consequences of these opinions—whether they are accurate or inaccurate.

- Sessions today and tomorrow about the good, bad, and ugly unfolding in Washington, D.C.
Healthcare Is Transforming

- Understand that the shift in ownership of office-based physician groups is, itself, a strategic response to other disruptive changes in healthcare.

- Next speakers will address these transformational forces.

- Common theme is integration of clinical care and the drive to achieve the universal electronic patient health record (integrated health informatics.)
Coming this Morning

- Strategic look at healthcare’s transformation;  
  *by Paul Mango of McKinsey & Company.*

- Insights about the gathering battle to preserve lab access to payer contracts and competition;  
  *by Marc Grodman, MD, of Bio-Reference Laboratories.*
This Morning and Afternoon

- Addressing the wider issues of the coming crises in lab staffing, reimbursement and technology;
  by Leslie Burnet, PhD, of PALMs in Sydney, Australia.

- Our afternoon panel tackles the issues unfolding in Washington, DC, from many lab perspectives-itslef a lab industry first:
  featuring panelists from AAB, ACLA, ADVMedDx, and CAP.
Yes, It’s a Time of Change!

- Healthcare’s coming transformation will unfold at a pace unseen by this country since World War II.

- For 17 years, the *Executive War College* has been an important source for strategic insights and practical lab management knowledge.

- Next cycle of change in healthcare is poised to fundamentally reshape the lab testing industry.
“Change Means Opportunity”

Disruption of status quo in lab marketplace creates the opportunity for nimble lab organizations to prosper in new ways!
Final Thoughts on Change…

“In a chronically leaking boat, energy devoted to changing vessels is more productive than energy devoted to patching leaks.”
—Warren Buffett

“You miss 100% of the shots you never take!”
—Wayne Gretzky