Medicare Fee Cuts Are Coming: Smart Steps Labs Can Take to Anticipate Lost Revenue, Protect Market Share, and Sustain Physician Satisfaction

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Kathy Murphy, PhD, Senior Advisor
Jeff Myers, Vice President, Consulting
Business Lesson #101
“Pigs Get Fat, Hogs Get Slaughtered”!
Medicare Benefit Payments: $540 billion (15% of Federal Budget).¹

Lab payments totaled $7.0 billion in 2015 (3% of total Part B payments).

The Protecting Access to Medicare Act (PAMA) of 2014 requires reform of the payment system for clinical laboratory (lab) tests—the first such reform in 3 decades.

Current Lab Test Payment Rate

- Based on 1984 cost data, adjusted annually for inflation.
- 57 regional fee schedules.

*Base rates have not been updated since 1984 to reflect changes in test methods.*

¹Source: Congressional Budget Office, Updated Budget Projections: 2016-2026 (March 2016).
Price Reform: What Factors Drove PAMA?

- 2010 and 2013 OIG study showed that Medicare paid between 18 and 30 percent more than other insurers for 20 high-volume and/or high-expenditure lab tests.

  - What has price data intelligence shown at this point?

<table>
<thead>
<tr>
<th>Commercial Laboratories:</th>
<th>80% of Medicare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospital Laboratories:</td>
<td>126% of Medicare</td>
</tr>
</tbody>
</table>

- Final Legislation: The current payment rates will be replaced with recent rates paid by private payers.

  What drove deep discounted private payer rates?
  1. Aggressive contracting by commercial laboratories.
  2. Health plan leverage.

  CMS estimates the new payment system will save Medicare $3.9 billion over 10 years.¹

## Comparison of Medicare Payment Systems for Lab Tests

<table>
<thead>
<tr>
<th>Description</th>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year Implemented</td>
<td>1984</td>
<td>2018</td>
</tr>
<tr>
<td><strong>Basis of Payment Rates</strong></td>
<td>Lab charges in 1984-1985; adjusted annually to account for inflation</td>
<td>Private payer rate data; updated every 3 years using then-current data</td>
</tr>
<tr>
<td>Number of Fee Schedules</td>
<td>57 regional fee schedules</td>
<td>Single national fee schedule</td>
</tr>
</tbody>
</table>
Clinical Laboratory Spend Facts

2015 Actual – $7.0 billion

- 474 million lab tests performed
  - $14.77 per test average
- Top 25 lab tests comprised $4.1 billion in 2015
  - 61,040 labs received Medicare payments
  - 14% or $1.0 billion of Part B spend goes to top 3 labs

2014 – CMS bundled lab payments: $2.7 billion decrease in spend under the CLFS

### Top 25 Lab Tests Based on Medicare Part B Payments in 2015

<table>
<thead>
<tr>
<th>Test Description</th>
<th>CPT Code</th>
<th>Medicare Allowable</th>
<th>Total Medicare Payment (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blood Test, Thyroid-stimulating Hormone (TSH)</td>
<td>84443</td>
<td>$22.87</td>
<td>$475</td>
</tr>
<tr>
<td>Comprehensive Metabolic Panel</td>
<td>80053</td>
<td>$14.97</td>
<td>$458</td>
</tr>
<tr>
<td>Complete Blood Cell Count</td>
<td>85025</td>
<td>$10.58</td>
<td>$428</td>
</tr>
<tr>
<td>Lipid Panel</td>
<td>80061</td>
<td>$18.22</td>
<td>$379</td>
</tr>
<tr>
<td>Vitamin D-3 level</td>
<td>82306</td>
<td>$40.29</td>
<td>$337</td>
</tr>
<tr>
<td>Hemoglobin A1C level</td>
<td>83036</td>
<td>$13.21</td>
<td>$241</td>
</tr>
<tr>
<td>Opiates (Drug Measurement)</td>
<td>G6056</td>
<td>$26.48</td>
<td>$208</td>
</tr>
<tr>
<td>Drug Screen</td>
<td>G0431</td>
<td>$98.96</td>
<td>$208</td>
</tr>
<tr>
<td>Basic Metabolic Panel</td>
<td>80048</td>
<td>$11.51</td>
<td>$134</td>
</tr>
<tr>
<td>Blood Clotting Time</td>
<td>85610</td>
<td>$5.35</td>
<td>$117</td>
</tr>
<tr>
<td>All Other</td>
<td></td>
<td></td>
<td>$1,155</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>$4,140</strong></td>
</tr>
<tr>
<td><strong>Percent of Medicare Spending on CLFS</strong></td>
<td></td>
<td></td>
<td>59%</td>
</tr>
</tbody>
</table>

CMS calculates weighted median private payer rate for each test

- Hospital-based laboratories are excluded unless they have a separate NPI.
- CMS estimates that 56 percent of independent laboratories and 95 percent of physician laboratories will not meet definition.

1. Weighted median of private payer rates/test volume.
2. Updated every 3 years.

Phase-in of large reductions for each test:
(10%) 2018-2020
(15%) Year 2021-2023
What to report:

- Associated volume of the tests that correspond to each private payer rate.
- Specific CPT code associated with each test for the six-month period January 2016-June 2016.
- Out-of-network, non-contracted work for private insurers is included.
- Include patient deductibles and coinsurance in the private payer rate.

Reporting Period Due Date – March 31, 2017
Delayed until May 30, 2017

CLFS Payment Rates still go into effect January 1, 2018

What not to report:

- Capitated payments.
- Partial payments.
- Denied claims.
- Claim level payments.
## Limited Sample of Market Pricing: Clinical Laboratories

Potential Impact on PAMA Price Analysis: -19.6%

<table>
<thead>
<tr>
<th>Procedure Code</th>
<th>Test Code</th>
<th>Private Payer Weighted Average Rate Source¹</th>
<th>Medicare National Limit²</th>
<th>Variance</th>
<th>Percentage Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>80048</td>
<td>Metabolic panel total ca</td>
<td>$11.26</td>
<td>$11.52</td>
<td>-$0.26</td>
<td>-2.2%</td>
</tr>
<tr>
<td>80053</td>
<td>CMP</td>
<td>$11.40</td>
<td>$14.39</td>
<td>-$2.99</td>
<td>-20.8%</td>
</tr>
<tr>
<td>80061</td>
<td>Lipid Panel</td>
<td>$16.37</td>
<td>$17.73</td>
<td>-$1.36</td>
<td>-7.7%</td>
</tr>
<tr>
<td>82306</td>
<td>Vit D</td>
<td>$28.45</td>
<td>$40.33</td>
<td>-$11.88</td>
<td>-29.5%</td>
</tr>
<tr>
<td>82542</td>
<td>Chromatography quant</td>
<td>$17.80</td>
<td>$24.60</td>
<td>-$6.80</td>
<td>-27.7%</td>
</tr>
<tr>
<td>82607</td>
<td>B12</td>
<td>$15.09</td>
<td>$20.54</td>
<td>-$5.45</td>
<td>-26.5%</td>
</tr>
<tr>
<td>82728</td>
<td>Ferritin</td>
<td>$13.61</td>
<td>$18.57</td>
<td>-$4.96</td>
<td>-26.7%</td>
</tr>
<tr>
<td>82746</td>
<td>Folic acid serum</td>
<td>$14.81</td>
<td>$20.03</td>
<td>-$5.22</td>
<td>-26.1%</td>
</tr>
<tr>
<td>83036</td>
<td>Glycosylated hemoglobin</td>
<td>$11.16</td>
<td>$13.22</td>
<td>-$2.06</td>
<td>-15.6%</td>
</tr>
<tr>
<td>83880</td>
<td>Natriuretic peptide</td>
<td>$38.41</td>
<td>$46.24</td>
<td>-$7.83</td>
<td>-16.9%</td>
</tr>
<tr>
<td>83970</td>
<td>Parathormone</td>
<td>$44.59</td>
<td>$56.23</td>
<td>-$11.64</td>
<td>-20.7%</td>
</tr>
<tr>
<td>84153</td>
<td>PSA</td>
<td>$19.35</td>
<td>$25.06</td>
<td>-$5.71</td>
<td>-22.8%</td>
</tr>
<tr>
<td>84439</td>
<td>Thyroxine</td>
<td>$9.54</td>
<td>$12.28</td>
<td>-$2.74</td>
<td>-22.3%</td>
</tr>
<tr>
<td>84443</td>
<td>TSH</td>
<td>$8.44</td>
<td>$22.89</td>
<td>-$14.45</td>
<td>-64.0%</td>
</tr>
<tr>
<td>85025</td>
<td>Complete CBC w/auto diff wbc</td>
<td>$8.11</td>
<td>$10.59</td>
<td>-$2.48</td>
<td>-23.5%</td>
</tr>
<tr>
<td>85027</td>
<td>Complete CBC automated</td>
<td>$7.28</td>
<td>$8.81</td>
<td>-$1.53</td>
<td>-17.3%</td>
</tr>
<tr>
<td>85610</td>
<td>Prothrombin time</td>
<td>$4.37</td>
<td>$5.36</td>
<td>-$0.99</td>
<td>-18.4%</td>
</tr>
<tr>
<td>87086</td>
<td>Urine culture/colony count</td>
<td>$8.27</td>
<td>$11.00</td>
<td>-$2.73</td>
<td>-24.8%</td>
</tr>
<tr>
<td>88175</td>
<td>Cytopathology, Auto</td>
<td>$38.17</td>
<td>$47.80</td>
<td>-$9.63</td>
<td>-20.1%</td>
</tr>
<tr>
<td>87491</td>
<td>Chlamydia, Amp. Probe</td>
<td>$36.39</td>
<td>$36.09</td>
<td>$0.30</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

¹Medicare Clinical Lab Fee Schedule (CLFS).
## Sample of Hospital Lab Pricing

### Limited Sample of Market Pricing: Hospital Laboratories with NPI Numbers

**Potential Impact on PAMA Price Analysis: +25.6%**

<table>
<thead>
<tr>
<th>Procedure Code</th>
<th>Test Code</th>
<th>Private Payer Weighted Average Rate Source&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Medicare National Limit&lt;sup&gt;2&lt;/sup&gt;</th>
<th>Variance</th>
<th>Percentage Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>80048</td>
<td>Metabolic panel total ca</td>
<td>$12.36</td>
<td>$11.52</td>
<td>$0.84</td>
<td>7.3%</td>
</tr>
<tr>
<td>80053</td>
<td>CMP</td>
<td>$18.83</td>
<td>$14.39</td>
<td>$4.44</td>
<td>30.8%</td>
</tr>
<tr>
<td>80061</td>
<td>Lipid Panel</td>
<td>$22.30</td>
<td>$17.73</td>
<td>$4.57</td>
<td>25.8%</td>
</tr>
<tr>
<td>82306</td>
<td>Vit D</td>
<td>$51.29</td>
<td>$40.33</td>
<td>$10.96</td>
<td>27.2%</td>
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<tr>
<td>82542</td>
<td>Chromatography quant</td>
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<td>$24.60</td>
<td>$4.81</td>
<td>19.6%</td>
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</tr>
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<td>$53.97</td>
<td>$46.24</td>
<td>$7.73</td>
<td>16.7%</td>
</tr>
<tr>
<td>83970</td>
<td>Parathormone</td>
<td>$68.37</td>
<td>$56.23</td>
<td>$12.14</td>
<td>21.6%</td>
</tr>
<tr>
<td>84153</td>
<td>PSA</td>
<td>$32.14</td>
<td>$25.06</td>
<td>$7.08</td>
<td>28.3%</td>
</tr>
<tr>
<td>84439</td>
<td>Thyroxine</td>
<td>$16.84</td>
<td>$12.28</td>
<td>$4.56</td>
<td>37.2%</td>
</tr>
<tr>
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<td>$28.38</td>
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<tr>
<td>85025</td>
<td>Complete CBC w/auto diff wbc</td>
<td>$13.67</td>
<td>$10.59</td>
<td>$3.08</td>
<td>29.1%</td>
</tr>
<tr>
<td>85027</td>
<td>Complete CBC automated</td>
<td>$10.39</td>
<td>$8.81</td>
<td>$1.58</td>
<td>17.9%</td>
</tr>
<tr>
<td>85610</td>
<td>Prothrombin time</td>
<td>$6.57</td>
<td>$5.36</td>
<td>$1.21</td>
<td>22.5%</td>
</tr>
<tr>
<td>87086</td>
<td>Urine culture/colony count</td>
<td>$14.41</td>
<td>$11.00</td>
<td>$3.41</td>
<td>31.0%</td>
</tr>
<tr>
<td>88175</td>
<td>Cytopathology, Auto</td>
<td>$46.33</td>
<td>$47.80</td>
<td>-$1.47</td>
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</tr>
<tr>
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<td>$36.09</td>
<td>$10.94</td>
<td>30.3%</td>
</tr>
</tbody>
</table>

<sup>1</sup> Medicare Clinical Lab Fee Schedule (CLFS)

### CMS Estimated Impact of PAMA Reductions on Medicare Spending for Clinical Lab Services ($ in 000’s)

<table>
<thead>
<tr>
<th>Description</th>
<th>2018</th>
<th>2018-2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>CLFS Reductions</td>
<td>($520,000)</td>
<td>($3,860,000)</td>
</tr>
<tr>
<td>% Reduction</td>
<td>(7.4%)</td>
<td>(11.0%)</td>
</tr>
</tbody>
</table>

**5-Year Reduction Summary¹:**

<table>
<thead>
<tr>
<th>Year</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>($520,000)</td>
</tr>
<tr>
<td>Year 2</td>
<td>($930,000)</td>
</tr>
<tr>
<td>Year 3</td>
<td>($820,000)</td>
</tr>
<tr>
<td>Year 4</td>
<td>($760,000)</td>
</tr>
<tr>
<td>Year 5</td>
<td>($830,000)</td>
</tr>
</tbody>
</table>

**Total over 5 Years = 11.0% or $3,860,000**

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¹Calculated from Table 14 of the Federal Register Final Rule June 2016, excluding Premium Offset.

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**Final Rule:** Private payer rates updated every 3 years. **Opinion:** Private payer rates will stabilize after the initial reporting period.
### Estimated Impact of Applicable Reporting

Group Private Payer Data ($ in 000’s)

<table>
<thead>
<tr>
<th>Description</th>
<th>Commercial</th>
<th>Hospital NPI</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price as Percent of Medicare</td>
<td>(19.6%)</td>
<td>25.6%</td>
<td></td>
</tr>
<tr>
<td>Number of Labs</td>
<td>1,198</td>
<td>200</td>
<td>1,398</td>
</tr>
<tr>
<td>Percentage Weight</td>
<td>86%</td>
<td>14%</td>
<td>100%</td>
</tr>
<tr>
<td>Net Reduction over 5 Years</td>
<td></td>
<td>(11.9%)</td>
<td></td>
</tr>
<tr>
<td>Total Reimbursement Reduction over 5 Years</td>
<td></td>
<td></td>
<td>($4,148,000)</td>
</tr>
</tbody>
</table>

*Basing private payer rates on a small subset of labs (5%) and excluding most hospital-based labs will skew the data.*

Estimated Impact of PAMA Reductions on Medicare Spending for Clinical Lab Services ($ in 000’s) – What If All Hospital Labs Were Included?

<table>
<thead>
<tr>
<th>Description</th>
<th>Commercial</th>
<th>Hospital</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price as Percent of Medicare</td>
<td>(19.6%)</td>
<td>25.6%</td>
<td></td>
</tr>
<tr>
<td>Percentage Weight (Based on Revenue)</td>
<td>70%</td>
<td>30%</td>
<td>100%</td>
</tr>
<tr>
<td>Net Reduction over 5 Years</td>
<td></td>
<td>(5.3%)</td>
<td></td>
</tr>
<tr>
<td>Total Reimbursement Reduction over 5 Years</td>
<td></td>
<td>($1,875,000)</td>
<td></td>
</tr>
</tbody>
</table>

Including all hospital-based laboratories in the reporting group would decrease the impact by ~55%.

Estimated Impact of PAMA Reductions on Medicare Spending for Clinical Lab Services ($ in 000’s) – Based on Actual Payment Data

<table>
<thead>
<tr>
<th>Description</th>
<th>2018</th>
<th>2018-2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit</td>
<td>($584,000)</td>
<td>($4,148,000)</td>
</tr>
<tr>
<td>Payment Reduction</td>
<td>(8.3%)</td>
<td>(11.9%)</td>
</tr>
</tbody>
</table>

5-Year Reduction Summary:
- Year 1: (8.3%)
- Year 2: (2.1%)
- Year 3: (0.8%)
- Year 4: (0.4%)
- Year 5: (0.3%)

Total over 5 Years = 11.9%

## Estimated Impact of PAMA Reductions on Providers

<table>
<thead>
<tr>
<th>Description</th>
<th>2015 Clinical Laboratory Spend¹</th>
<th>Projected Reductions Over 5 Years²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospital-based Laboratories</td>
<td>$1.7 billion</td>
<td>($1.0 billion)</td>
</tr>
<tr>
<td>Independent and Physician Office Laboratories</td>
<td>$5.3 billion</td>
<td>($3.1 billion)</td>
</tr>
<tr>
<td>Total</td>
<td>$7.0 billion</td>
<td>($4.1 billion)</td>
</tr>
</tbody>
</table>


²Source: Calculated using data from Table 14, Federal Register “Final Rule,” June 23, 2016.
### Outreach Case Study 1

<table>
<thead>
<tr>
<th></th>
<th>Current Base Business</th>
<th>2022 Run Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Revenue</strong></td>
<td>$13,900,000</td>
<td>$11,340,000</td>
</tr>
<tr>
<td><strong>Revenue Per Test</strong></td>
<td>$11.48</td>
<td>$11.06</td>
</tr>
<tr>
<td><strong>Medicare Payer Mix</strong></td>
<td>34%</td>
<td>34%</td>
</tr>
<tr>
<td><strong>Operating Margin</strong></td>
<td>22%</td>
<td>18%</td>
</tr>
<tr>
<td><strong>2018-2022 Reimbursement Impact Over 5 Years</strong></td>
<td>($2,526,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Revenue per Test Decrease Over 5 Years</strong></td>
<td>(3.6%)</td>
<td></td>
</tr>
</tbody>
</table>

### Key Findings:
- Hospital has a high Medicare payer mix at 34%.
- Revenue per test is lower than most hospital outreach-based programs due to efforts to control patient pricing.
- Cost allocation to outreach program is a fully loaded cost, which unfairly penalizes a hospital outreach program.
- Impact is material as operating margin decreases below 20% and will require alternative strategies or the program could be “at risk.”

### Strategies Being Considered:
- Continued efforts for market share growth.
- Expense improvement (supply chain).
- Cost allocation change to incremental cost only.
Outreach Case Study 2

<table>
<thead>
<tr>
<th></th>
<th>Current Base Business</th>
<th>2022 Run Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenue</td>
<td>$16,674,000</td>
<td>$16,219,000</td>
</tr>
<tr>
<td>Revenue Per Test</td>
<td>$23.94</td>
<td>$23.35</td>
</tr>
<tr>
<td>Medicare Payer Mix</td>
<td>23%</td>
<td>23%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>42%</td>
<td>40%</td>
</tr>
<tr>
<td>2018-2022 Reimbursement Impact</td>
<td></td>
<td>($2,050,000)</td>
</tr>
<tr>
<td>Revenue per Test Decrease</td>
<td></td>
<td>(2.5%)</td>
</tr>
</tbody>
</table>

Key Findings:
- Hospital has an average size outreach program that utilizes a premium pricing and reimbursement revenue strategy.
- Revenue per test impact is minimized due to large revenue base and a low Medicare payer mix.
- Incremental cost allocation for outreach services.

Strategies Being Considered:
- Continued efforts for market share growth.
- Serve as a reference laboratory for rural hospitals and they manage hospital laboratory.
## Small Community-Based Program

<table>
<thead>
<tr>
<th></th>
<th>Current Base Business</th>
<th>2022 Run Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenue</td>
<td>$6,000,000</td>
<td>$5,538,000</td>
</tr>
<tr>
<td>Revenue Per Test</td>
<td>$12.00</td>
<td>$11.16</td>
</tr>
<tr>
<td>Medicare Payer Mix</td>
<td>65%</td>
<td>65%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>6%</td>
<td>(1%)</td>
</tr>
<tr>
<td>2018-2022 Reimbursement Impact</td>
<td>(2,085,000)</td>
<td></td>
</tr>
<tr>
<td>Revenue per Test Decrease</td>
<td>(6.9%)</td>
<td></td>
</tr>
</tbody>
</table>

Small community-based laboratories with a high Medicare population are at risk for bankruptcy as a result of payment reform.
What is the Impact on Your Hospital-Based Laboratory?

Analysis 1: Obtain estimated annual Medicare Lab Outpatient/Outreach Reimbursement

- Apply estimated reduction percentages as defined
- Assume $10 million in annual Medicare lab outpatient reimbursement
- 2018: (8.3%) \times $20M = \text{loss of ($0.83M)}
- 2019: (2.1%) \times $20M = \text{additional loss of ($0.21M)}
- 2020: (0.8%) \times $20M = \text{additional loss of ($0.08M)}
- 2021: (0.4%) \times $20M = \text{additional loss of ($0.04M)}
- 2022: (0.3%) \times $20M = \text{additional loss of ($0.03M)}

**Year 5 Run Rate:** $8.8 million (loss of $1.2 million)

**Cumulative reimbursement reductions over 5 years of ($5.3 million)**
Recap – PAMA

- Most disruptive change to the payment system for laboratory tests since inception of payment rates in 1984.

- Estimated Benefit to CMS (based on pricing data):
  - 2018: $584 million or -8.3%.
  - Over 5 years (2018-2022) = $4.1 billion or -11.9%.

- Payment reform unfairly excludes hospitals without unique NPI numbers from reporting group – impact of exclusion will carry the weight of the reduction.
## Strategic Options

<table>
<thead>
<tr>
<th>Option 1: Denial</th>
<th>Option 2: Focus on Smaller, More Profitable “Inreach”</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Do nothing</td>
<td>▪ Limited geography</td>
</tr>
<tr>
<td>▪ Wait for the axe to fall</td>
<td>▪ Affiliated and employed physicians only</td>
</tr>
<tr>
<td></td>
<td>▪ Service model</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Option 3: All In</th>
<th>Option 4: Exit</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Separate company</td>
<td>▪ Growth is stagnant</td>
</tr>
<tr>
<td>▪ Independent lab pricing</td>
<td>▪ Lack of support</td>
</tr>
<tr>
<td>▪ Mean, lean business machine – aggressive growth at lowest cost</td>
<td>▪ Monetize at peak revenue</td>
</tr>
</tbody>
</table>
Impact Disproportionate to Attention

Don’t Overreact

- Context of 10.4% reduction in reimbursement for 25% of the business
- 2.5% reduction to bottom line
# What to Do?

<table>
<thead>
<tr>
<th>Common Approach</th>
<th>Uncommon Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Immaterial pricing changes</td>
<td>1. Pricing</td>
</tr>
<tr>
<td>2. Almost competitive service</td>
<td>2. Service</td>
</tr>
<tr>
<td>3. “Homegrown” sales staff</td>
<td>3. Aggressive sales with professional staff</td>
</tr>
<tr>
<td>4. Hospital billing</td>
<td>4. Outsourced billing</td>
</tr>
<tr>
<td>5. No view to profitability – seen as cost center</td>
<td>5. Aggressive cost reductions</td>
</tr>
<tr>
<td>6. No comparison to external top performers</td>
<td>6. Be proactive; act like a for-profit with structure and autonomy to run as a serious business</td>
</tr>
<tr>
<td>7. “We’ve already done that” approach to lowering cost</td>
<td></td>
</tr>
<tr>
<td>8. Victim mentality</td>
<td></td>
</tr>
<tr>
<td>9. Reactivity</td>
<td></td>
</tr>
</tbody>
</table>
Other Ideas

- Discontinue business with all nursing homes except those with strategic value.
- “Fire” bad (high maintenance, late pay, etc.) clients.
- Don’t pick up clients fired by other labs.
- Develop tools to manage the business.
- Assume you can still reduce costs by 20% or more.
No Magic Bullets for Cost Reductions

To achieve best-in-class performance—you have to do a lot of things right. This is the 80/20 list for cost reductions:

1. Standardize equipment and reagents
2. Maximize synergies from consolidation
3. Grow your outreach program
4. Manage reference lab and blood costs
5. Apply lean practices

ONGOING PRACTICE
6. Participate in a benchmarking service
Cost Reductions: Two Types of Opportunities

Known – Common practice ideas your lab is aware of but has not implemented.

Unknown – New, best practice ideas from outside your organization.

The vast majority of cost savings are in the first category!
“Most people prefer a problem they can’t solve to a solution they don’t like.”

-Lee Thayer
Why Things Stay the Same

It’s too difficult.

Can’t get to it—we have other priorities.

We don’t have the resources.

We don’t want to do it (solution is unpopular, disruptive, etc.).

Don’t agree.
The Cost Challenge

- All the easy stuff has been done already.
- Just like football, success most often comes not from the “Hail Mary” passes but from the basic blocking and tackling.
- Excellence is a moving target.
  - As other organizations make improvements, the standards for others are raised.
  - By definition, there is always a range of 0-100<sup>th</sup> percentile performance in benchmarking.
  - There are always 50% above average and 50% below average.
What the Future Holds...

- Fewer outreach programs over time (down from current participation rate of 80%).
  - Larger in size.
  - Broader geography for those in pure “outreach” model (market at large).
- Migration to one fee schedule for all.
- Offset future declines in reimbursement with improvements to revenue and cost.
How do I know if I should stay in the business?
### Does the Business Make Money?
- Range of $16-20 million in new operating margin over five years for new startups; ROI is 52-71 percent.
- Three factors that have the largest influence on range:
  - Number of employed/affiliated physicians not currently using hospital lab.
  - Spare capacity in staff and equipment.
  - Existing, competitive IT connectivity system.

### Do We Understand Risks and Rewards and Have an Exit Strategy?
- **Rewards**: New operating margin/ROI as indicated above.
- **Risk**: Low. If business environment or organizational priorities change, business can be easily monetized.
- **Exit Strategy**: Current multiples of 1.0-1.5 times revenue (can be higher for specialty labs). There are always willing buyers—both Quest and LabCorp have grown mostly by acquisition over the last few years.

### Do You Have a Better Plan?
- What other plan do you have that will make more money with less risk? If nothing comes to mind, you owe it to your organization to evaluate outreach with a fresh, objective perspective.
Q&A

CONTACT INFORMATION

Kathy Murphy, PhD
Senior Advisor
Chi Solutions, Inc., an Accumen Company
(734) 662-6363, ext. 439
Dr.Kathy.Murphy@chisolutionsinc.com

Jeff Myers
Vice President, Consulting
Chi Solutions, Inc., an Accumen Company
(734) 662-6363, ext. 506
jmyers@chisolutionsinc.com