

All for one, one for all? Laboratory consolidation

Anne Paxton

June 2016—Consolidation among hospitals and laboratories can sometimes seem like too massive a tide for independent and hospital-based laboratories to effectively resist. What are the advantages that large size provides to a hospital system or national lab in a competitive marketplace? And will there be any space left in which smaller laboratories can survive?

Second of two parts. [Last month: Fresh options fuel lab asset reshuffle](#)

In interviews with CAP TODAY, laboratory executives who have been involved in building large hospital labs to fend off competitors or in making the choice to sell to a large national lab suggest that size can bring more than just economies of scale and volume discounts. Among other things, when competition and economic conditions tighten, larger entities have a much easier time shrugging them off, and can be ready to offer a solution for smaller labs that are struggling.



Dr. Lui

Alfred Lui, MD, a co-founder of Pathology Inc., recently bought by Laboratory Corp. of America, has built two successful independent laboratory enterprises and sold off part of one and all of the second. In 1980, Dr. Lui and partner Richard Ellis, MD, started an independent laboratory across the street from the hospital to which they provided pathology services. They expanded it to a clinical and anatomic pathology laboratory and simultaneously founded a pathology group that grew from two to 35 pathologists covering 18 California hospitals, then sold the clinical lab business to LabCorp in 2000.

After the non-compete clauses in that deal expired, Dr. Lui built an anatomic pathology only company that, after recapitalization by a private equity firm, focused on women's health, and restarted a routine clinical lab business that became a head-to-head competitor of LabCorp. But the potential market for Pathology Inc. began to change, making the ongoing sustainability of the laboratory very difficult, Dr. Lui says.

"In our area, there are several large systems, including UCLA Health, Cedars-Sinai Medical Center, and USC Health, buying physician practices, and once they do that, the practice is no longer controlled by individual doctors. Then there were incredible cuts to payment rates, particularly by the Blue Cross affiliate in Southern California. It's very hard to survive competitively in the outpatient market if you're not contracted with major insurance carriers." In addition, Dr. Lui says, it became increasingly hard to compete with noncompliant labs, which he finds to be rife in the region. Where enforcement is lax—as it can be when smaller operations are involved—it becomes a major source of pressure on independent labs trying to survive.

So on the second round, Dr. Lui and partners sold the entire independent lab portions of the business to LabCorp. The associated pathology group with its hospital-based practice remained intact. It was a different corporation and provided services to the independent lab on a contractual basis.

But Pathology Inc. was anything but an early seller. "We were one of the last holdouts. In terms of the pathologist-built, pathologist-owned, and pathologist-operated labs, we were virtually the last one. They are being absorbed by

bigger organizations that have lower overhead and can perform tests, because of immense buying power, for fractions of the costs of little labs."

It's a phenomenon similar to Walmart's or Amazon's takeover of a large segment of the retail business in their segments, Dr. Lui says. But he prefers to analogize the laboratory industry to the food industry. "Despite the big Kroger and Safeway stores with their cost advantages, there's still room in some markets for some specialty stores like butchers or fishmongers. But what's happening in the lab business is that the customers who are able and willing to pay for what they might perceive as quality are becoming fewer and fewer. The people who are shopping are primarily interested in price and the convenience of one-stop shopping."

The trend toward accountable care organizations accentuates these pressures by way of bigger and bigger integrated organizations, Dr. Lui believes.

For hospitals with outreach businesses, it's looking like the time is ripe to monetize that asset. "It gets very tempting for hospital owners to look at their outreach business as potentially a crop of fruit waiting to be harvested at a good price and sell it. It's hard to argue with that logic. Hospitals would rather have that cash now because they can reinvest those funds in other higher priority hospital services or infrastructure." Building a new laboratory will likely fall further down the scale of hospital priorities, Dr. Lui says.

He sees the current wave of mergers and acquisitions as merely the leading edge of a trend that will continue: "The big will get bigger and the smaller will need to consolidate or be acquired."

On the opposite coast, perhaps an exemplar of that predicted pattern is Northwell Health Laboratories, part of newly reorganized Northwell Health (formerly North Shore-LIJ Health System), headquartered in Great Neck, NY. Northwell Health is one of a few large hospital networks that realized they already had the makings of a commercial partner within their organizations, says Robert DeCresce, MD, MBA, director of clinical laboratories at Chicago's Rush University Medical Center and the Harriet B. Borland professor and chair emeritus, Department of Pathology, Rush Medical College.

At Northwell Health Laboratories, at ACL Laboratories (Advocate Health Care) in Chicago, and at PCL Alverno in Hammond, Ind., "they've decided they can do what Quest would do. They don't need a commercial partner because they're becoming commercial labs themselves" by forming one laboratory for all their hospitals, Dr. DeCresce says.



Dr. Crawford

The major trend in the industry right now, says James Crawford, MD, PhD, senior VP and executive director of laboratory services at Northwell, is the large national labs—Quest being the most aggressive—buying up the ambulatory part of lab services from health systems. He cites Barnabas Health in New Jersey and Hartford HealthCare in Connecticut as examples of systems that are going to have Quest run their ambulatory services—and may have Quest run their hospital labs as well.

Northwell Health wants to offer an alternative, nonprofit model to this dynamic, Dr. Crawford says. "We are trying to be a regional, highly integrated lab system serving not just our host health system but also doing outreach for the regional ambulatory market and being a gathering point for partner hospitals that might want to join the network."

The hospital system, which recently created a joint venture cooperative with the New York City Health and Hospitals Corp. network of laboratories, has always been proactive, aggressive, and entrepreneurial, and its central laboratory alone expects to perform 20 million billable tests in the next year, says Robert Stallone, Northwell Health Laboratories vice president of laboratory medicine.

New York is a highly competitive market, Dr. Crawford notes. "Our major hospital competitors are Mount Sinai Health System, New York University Hospitals, and Memorial Sloan Kettering. And in the ambulatory market we have BioReference Laboratories, CBLPath, Quest, LabCorp, and others." Measured by the number of unique patient encounters per year and the percent of the hospital market, Northwell Health is comfortably the largest hospital system, he says.

But the system is trying to go from being "hospital heavy"—in 2009, when Dr. Crawford arrived, two-thirds of system revenues were from inpatient admissions—to providing the preponderance of its care in the community. "We've been building an extensive ambulatory network. Through purchase of physician practices, we've grown from 1,300 physicians to over 2,300 physicians in the last seven years. And the other health systems in our market have been doing the same. This is where the industry is going."

This project has benefited the laboratory, which has grown along with the network. "When physician practices are being acquired by us, then the testing comes to us." But the lab doesn't stop there. "We're bringing information forward, helping the health system manage patients, helping identify patients at risk, and helping them meet the requirements of performance-based managed care contracts. So we in the laboratory are acting as a true asset to the health system, not just a commodity."

Despite the ever more sophisticated services that health care institutions are offering, he notes, "the fundamental information that labs provide is actually based on very inexpensive testing. We do millions of tests per year and most are very inexpensive." So while cheaper lab services are available, Northwell's laboratory has developed extensive infrastructure to manage information, including data analytics, Dr. Crawford says, and that helps show the link between the laboratory's services and better outcomes. "Being an integrated system, we are a better health care provider and we can show that patients do better for having used our lab."

From Dr. Crawford's standpoint, it's particularly fortunate that in 2008 the system's board of trustees voted against selling the laboratory. "It is precisely because you have an internal lab that serves the entirety of care that you should retain it. Your lab could be a substantial benefit to the operation of your health system with regard to efficiencies, favorable outcomes, and the total cost of care, and if you sell your lab, that opportunity is gone because someone else will be obtaining the financial benefit."

Northwell Health has not stinted on resources for the laboratory. With the new joint venture with New York City Health and Hospitals network, Stallone says, "we are expanding the model we created, which was a central lab that both organizations will share, standardization of all equipment at all locations, both their labs and ours, standardization of the laboratory information system throughout, and working through clinical and operational groups and management on the standardization of best practices. We have new buildings to accommodate the new lab space and we went live last month with the first implementation of the Cerner LIS." Between the two networks, the laboratory expects to be performing almost 40 million tests per year.



Stallone

Stallone is optimistic that laboratory information can have an impact on not only the three percent of the cost of

health care that is lab services, but also on the other 97 percent. "We've been making investments in project management teams for informatics here at the lab and we've strategically engaged them for about two years now. We're working on what information we can cull, gather, and deliver that people can use to make a difference in cost." One example, he notes, is monitoring of patients to improve detection of undiagnosed acute kidney injury. Even in the early stages of this project, "we're seeing better financial payback as well as better patient care."

He credits the aggressive growth strategy of Northwell Health as well as its large outreach program with giving the laboratory the resources it needs to demonstrate its value. "If you can show that you are doing the testing longitudinally across the continuum of care, and consolidating that information and delivering it to the providers in a way that makes a difference, you can make a case to payers that even if it's a little bit more expensive, it's still cheaper and a better deal. And that's our strategy."

Turning to the national laboratories as partners is not part of Northwell's game plan. "We've watched carefully as other organizations have gone to Quest and LabCorp and obviously we have concerns. I would have concern about alignment of mission. We think the lab is integral to the care of patients, and it will become rapidly more so with personalized medicine and the ability of information systems to deliver data in ever more powerful ways." But growth has been central to the lab's ability to deliver revenue and provide value, Stallone adds. "If you want to survive, then you're one of the folks who are doing what we're doing. Or you probably have a pretty good chance, at some point in the future, of being commoditized and sold."

Despite the pressure to consolidate, many laboratory executives still believe they can operate the labs in their system more cost-effectively than someone else can, says CAP TODAY publisher Robert McGonnagle. "They believe the lab operation is not like the laundry service, that we depend on having pathologists and others in our lab who are intimately part of patient care and on a first-name basis with our nurses and clinicians, and that these local people working for us will do a much, much better job overall than anyone else."

To those who like things the way they are, McGonnagle agrees with Stallone that the question the laboratory must answer is: "What can you do to add value in your own system's lab operation, to make the argument that it should keep those lab operations going?"

Preparing for decreased revenue has to be done in a preemptive manner, in Stallone's view. He quotes hockey player Wayne Gretzky: "I skate to where the puck is going to be, not where it has been."

"Less revenue and more consumerism is where the future is, so what do you do? If labs want to be where the puck is in the future, they really need to build their strategy around what the patients want," Stallone says. "If we as labs are thinking about how we deliver solutions to our patients, whether it be financial solutions or access or information they're hungry for, then we have an opportunity to be ahead of the commercial labs."

But, he warns, "This doesn't happen just by coming to work tomorrow. You have to have strategies for this. You really have to take a group aside, have regular planning sessions, have everybody involved, and have an understanding of where you're going and why you're going there." In a nod to the inherent advantages of large size, he also suggests that smaller hospitals and smaller hospital systems find a large player, like Northwell, that will partner with them by sharing resources and infrastructure.

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