

# LABORATORY ECONOMICS

*Competitive Market Analysis For Laboratory Management Decision Makers*

## Think Twice Before Selling Your Hospital Outreach Lab, Advises Laughman

**K**eith Laughman has more than 30 years' experience in the lab business, including a 15-year term as President of Mayo Medical Labs. Following Mayo, Laughman became President of AmeriPath Reference Services and Specialty Reference Laboratories. He later helped to create and served as President and CEO of the reference lab startup Med Fusion (Dallas/Fort Worth). Both AmeriPath and Med Fusion were later sold to Quest Diagnostics. Most recently, Laughman has been the Managing Partner at CareTinum Consulting Partners (Scottsdale, AZ). Below we summarize his views on the hospital outreach laboratory market.



*Keith Laughman*

### **Are hospital outreach lab businesses still viable given the Medicare CLFS rate reductions from 2018-2020 and the potential for further rate cuts?**

Absolutely. Outreach lab services leverage existing hospital infrastructure with excess capacity to achieve a low variable cost per test. As a result, attractive contribution margins have remained even after lowered fee schedules.

In addition, as healthcare systems transition to value-based reimbursement models, the value of the clinical lab's outreach program supporting the care of patients across the community's continuum of care will become even more attractive.

### **So why do some health systems choose to sell their outreach labs?**

It is often because leadership is attracted to the one-time cash payment and because they view their outreach activity as a diversification strategy that can be sold without negatively impacting the healthcare system. Both reasons miss the bigger picture.

The attraction to the one-time payment ignores the annuity that lab outreach can provide well into the future. This annuity will increase going forward under value-based care and at-risk reimbursement.

In addition, there seems to be a lack of understanding that by selling the outreach volume, currently performed in the health system's existing labs, they are setting the stage for increased unit costs for their inpatient testing.

It will likely also put pressure on the current hospital length-of-stay (LOS) because certain tests that previously could be performed in an affordable manner in-house, courtesy of the additional outreach volume, may now need to be sent to a reference lab, likely delaying inpatient care and increasing inpatient LOS.

### **If a health system feels compelled to sell its outreach lab business, what are some of the quality or turnaround time goals that should be included in the sales contract?**

Service levels and quality metrics that were in place before the outsourcing must remain unchanged for two key reasons.

Test turnaround time is key because delayed test results delay care and are a key factor in a patient's dissatisfaction with their physician office visits.

In addition, specimen quality metrics are essential because as samples leave the community, there is an increased chance that they will be lost or damaged. In addition, transport to a distant commercial lab (often out-of-state) can put specimen integrity at risk, leading to the need for a second sample collection. This can cause additional delays, canceled tests, and provider and patient frustration.

**Don't third-party payers benefit from lower fee schedules after a national lab acquires a hospital outreach lab business?**

Yes and no. Although insurers are likely to get lower test prices, the aggregate cost of care, which is also a payer's responsibility, can be expected to increase due to the previously identified delays and lack of alignment between testing protocols and local patient care pathways. So, while payers may benefit from lower test prices, these savings will be far outweighed by increased costs for the non-lab aspects of care due to delayed results, medical errors, increased hospital readmissions, etc.

It is important to remember that lab costs only represent 3% of healthcare expense in the U.S. while generating approximately 70% of the objective data in a patient's medical record and influencing the majority of their healthcare costs.

**Some health system/commercial lab joint ventures (e.g., Sonora Quest) have been long-lasting and successful. What makes these arrangements successful?**

These programs differ from most current outsourcing/acquisition arrangements because they are true joint ventures. Health systems, in these scenarios, often maintain a majority stake in the venture allowing for enhanced organizational alignment, improved visibility regarding service and quality, and a strong voice at the table.

**Some health systems have chosen to bring their lab outreach services back in-house. What are the challenges they face in transitioning lab services back to the hospital?**

Based on what I have heard and my experience when I have been asked to make recommendations, reestablishing a previously outsourced lab to a level capable of supporting inpatient and the local community's testing needs is a true lab service restart for the health system.

This restart effort is due to a reduction in the hospital lab's equipment and staff attrition that occurred through layoffs and voluntary departures, and low morale and trust issues among the remaining staff that occurred after the outsourcing arrangement. As a result, considerable investment and management effort are needed to reestablish a high-quality lab operation and service culture.

In my opinion, it is well worth this effort when the health system value generated by a high-functioning, integrated, and aligned laboratory is fully recognized. This is especially true when its role in reducing patient care costs outside of the lab are fully considered. We saw this clearly play out with many community labs' innovative responses to the challenges posed by the pandemic.

**What's the most common misconception hospital CEOs and CFOs have about hospital outreach labs?**

Some health system CEOs and CFOs tend to view their lab outreach activity as a diversification strategy that can be sold without negatively impacting the healthcare system.

From my perspective, the lab, including its outreach program, should be viewed as a core competency.

The level of lab service required for any healthcare system that intends to thrive in value-based care, including keeping pace with new advanced diagnostics, can only be provided in a cost-effective manner by having access to the needed resources at an optimized unit cost. As we know, unit cost optimization in the lab can only occur through growth. Health systems benefit from their outreach growth by receiving profitable incremental net revenue and reduced healthcare delivery costs.

In addition, lab outreach programs are becoming vital to maintaining an integrated patient-centric medical record as more patient care migrates into the ambulatory setting.