

Actions You Can Take to Have Your Lab Viewed as a Profit Center

Presented by Kathy Murphy, PhD, Senior Advisor
Chi Solutions, Inc., an Accumen Company

April 19, 2017



CardinalHealth

Essential to care™

Logistics
Product
Business
Patient

Learning Objectives



Demonstrate an understanding of today's market and business trends and how they can be used to provide strategic and financial value to your clinical laboratory

Identify actions you can take that can help various medical and laboratory executive stakeholders think differently about your laboratory operations

Apply relevant strategies to position yourself and your lab proactively for change and growth based on changing healthcare dynamics

Overview



- Review of industry trends.
- Five actions to improve profitability.
- Choices are a bit counterintuitive; you already know the obvious.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



Action #1

**UNDERSTAND THE BIG
PICTURE**

Outreach programs can contribute well over 50% of total hospital EBITDA (earnings before interest, taxes, depreciation, and amortization).

Source: Chi Solutions, Inc., an Accumen Company.

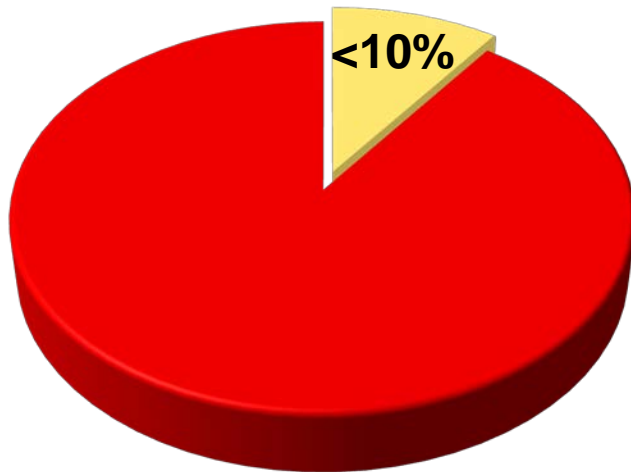
Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

What About Cost?

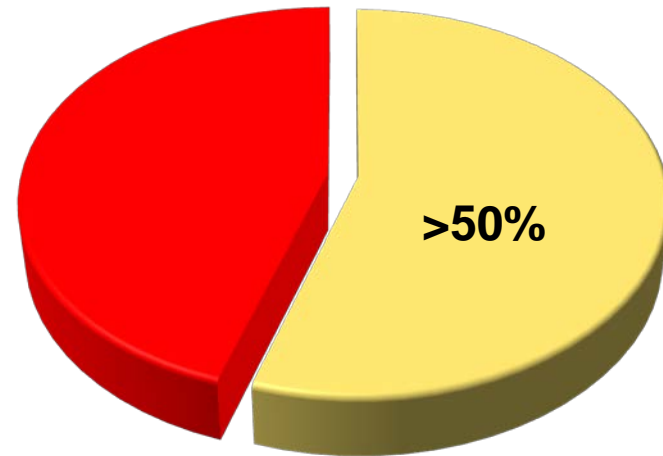
- Lab provides a disproportionate value to the health system:

***Less than 10% of
the cost...***
COST



Typical for a not-for-profit system.

***...can drive over
50% of EBITDA***
EBITDA



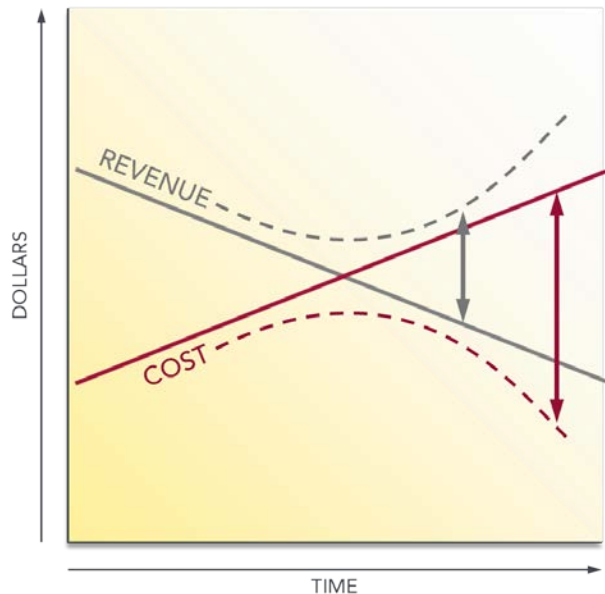
Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Solution to Intersecting Curves

- How are you going to prevent the intersection of the cost and revenue curves?



Outreach helps you bend the cost and revenue curves.

- Lab is one of the best, untapped opportunities for new revenues and margins.
- No other hospital service scales like lab.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



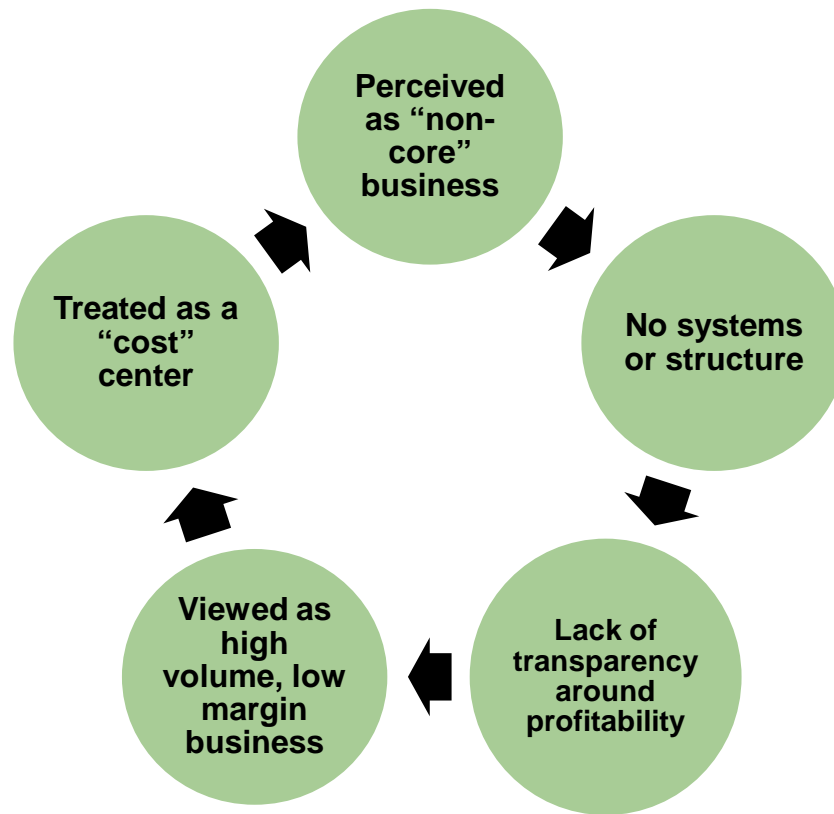
Why is Outreach So Misunderstood?

Why doesn't every hospital own its local market?

Why do commercial labs exist?

Self-Fulfilling Prophecy of Outreach

IT'S DIFFERENT
+
IT'S COMPLICATED
+
IT'S A SMALL PORTION OF THE HOSPITAL BUSINESS
+
IT'S NOT A PRIORITY

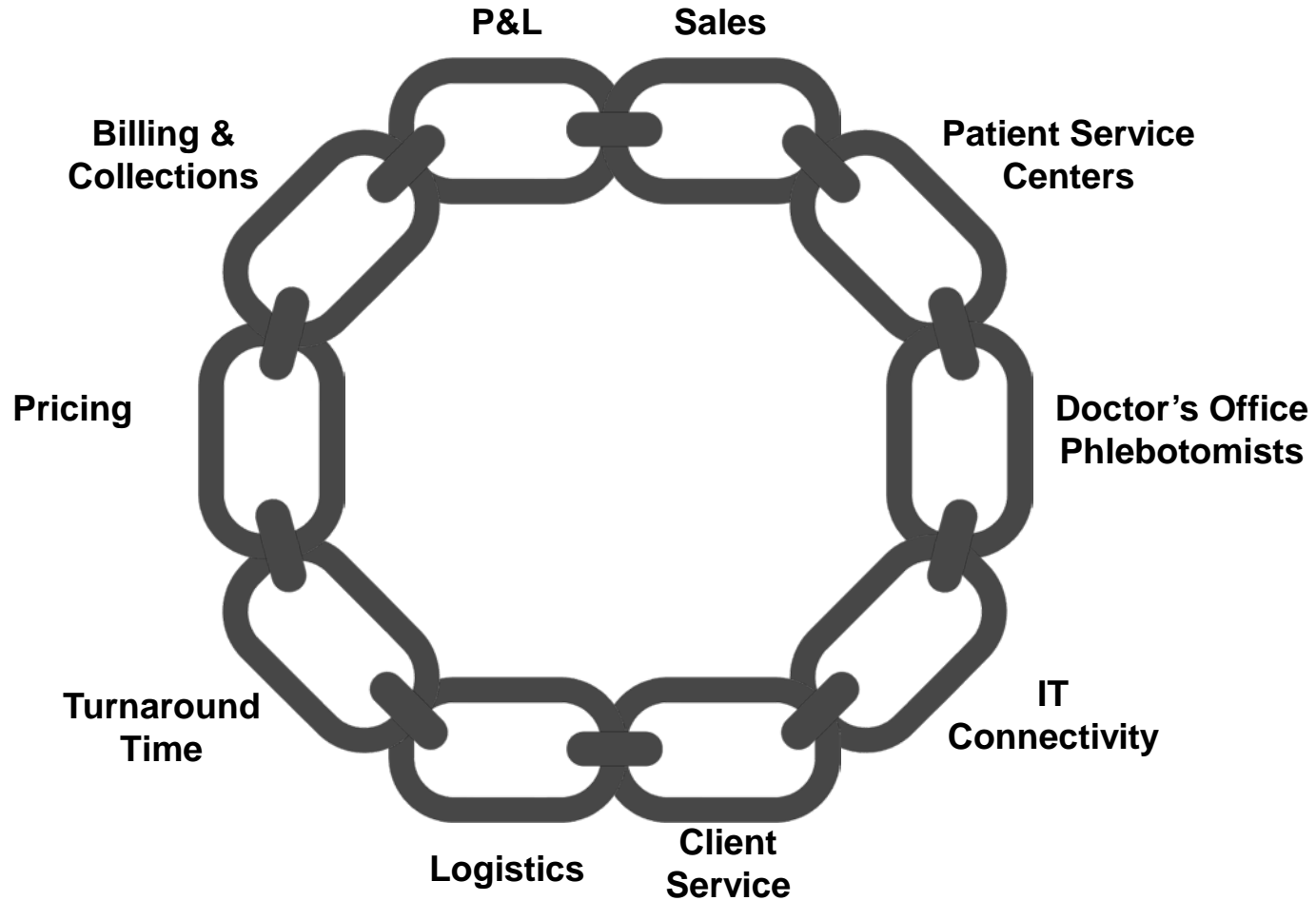


Source: Murphy, Kathleen A, The Profit Machine in the Hospital Basement, Ellsworth Press, 2016.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Complex Business



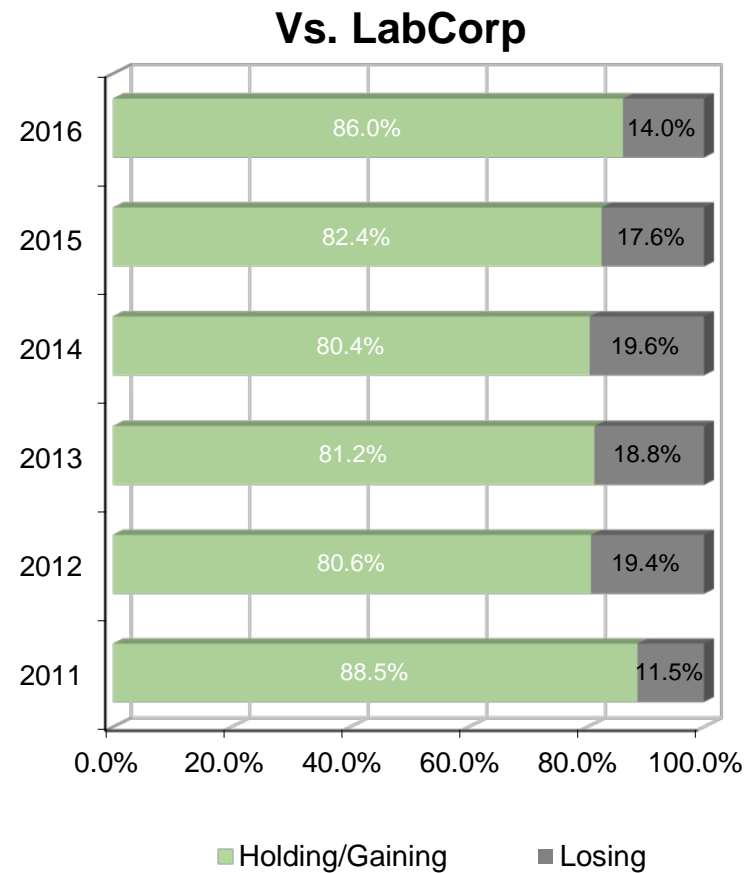
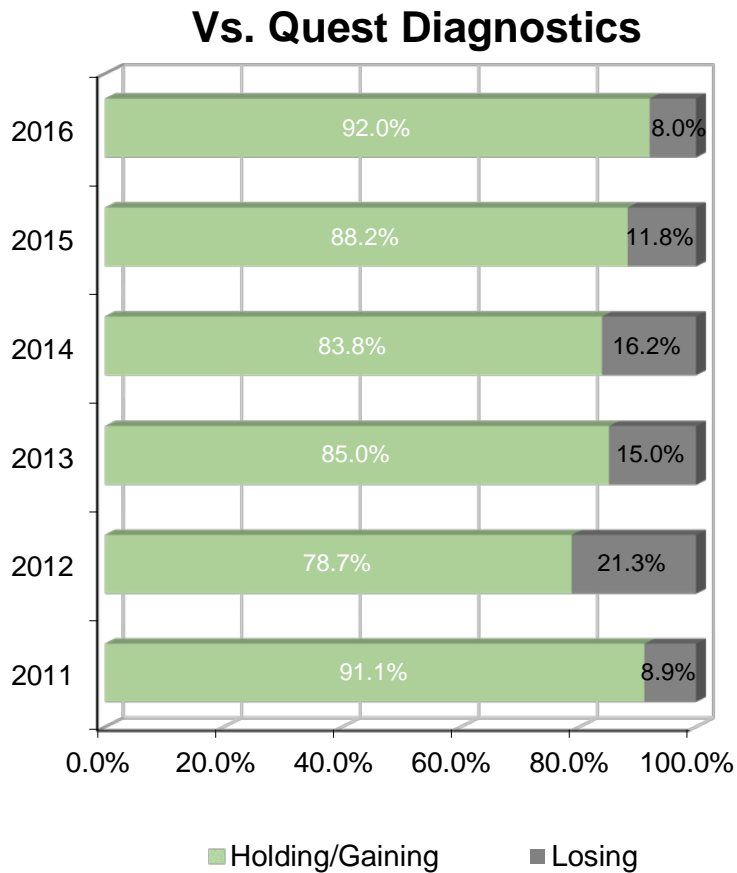
Your lab is only as good as the weakest link in the chain.

Source: Murphy, Kathleen A, The Profit Machine in the Hospital Basement, Ellsworth Press, 2016.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Limiting Beliefs About Competitiveness



The vast majority of respondents are either holding their own or gaining against the national labs.

Source: 2011-2016 Comprehensive National Laboratory Outreach Surveys, Chi Solutions, Inc.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

No View to Profitability

- Outreach revenue intermixed with outpatient revenue.
- Unique outreach costs not separated from rest of lab operation.
- No clear profit and loss (P&L) reports.
- How can a business be evaluated objectively without mechanisms to track profits on an ongoing basis?

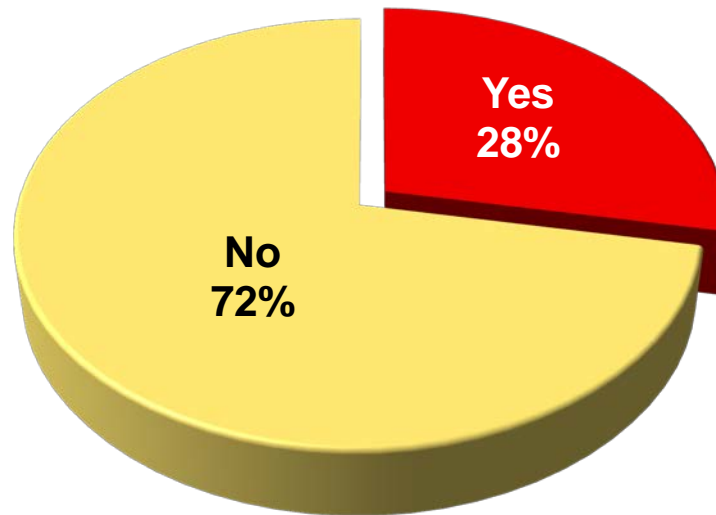
Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Management by Braille

Have Information to Manage Business



Almost three-quarters of outreach programs report that they do not have the information they need. Is that any way to run a business?

Source: Eleventh Comprehensive National Laboratory Outreach Survey, Chi Solutions, Inc., June 2012.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Lack of Autonomy



The vast majority of outreach programs run under the hospital structure without any autonomy to operate as a competitive business.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



Hospitals can compete and win
against the national laboratories.

**The FACTS overwhelmingly
support an outreach strategy.**

Three Trends Favoring Hospital Labs



Financial Performance



Market Share



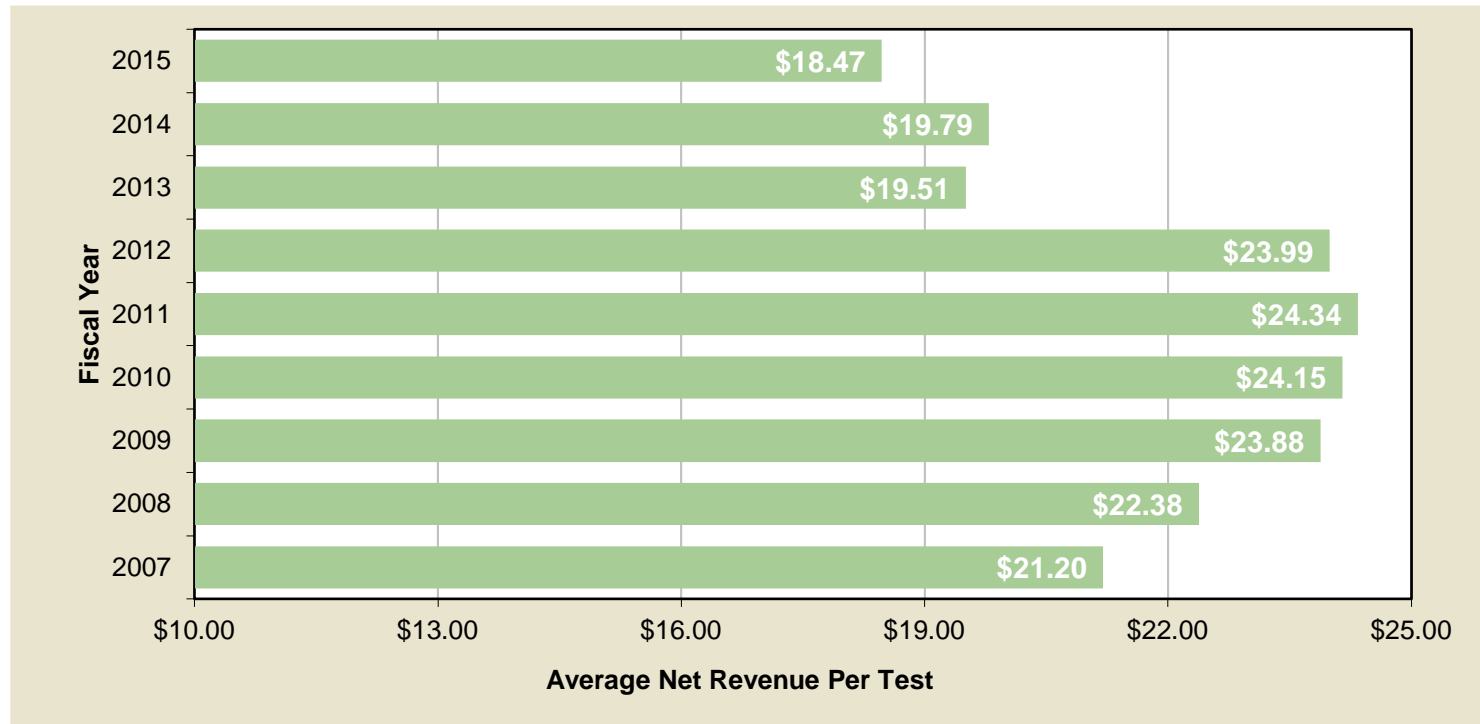
Physician Alignment

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Revenue



Source: Fifteenth Comprehensive National Laboratory Outreach Survey, Chi Solutions, Inc., August 2016.

- **Payment levels increased until 2010-2011 and have diminished since. In 2015, the levels were 13% lower than those experienced in 2007.**
- **Cost inflation of more than 3% compounded per annum in 5 years amounts to an additional 19.4% in cost structure. The double-whammy of revenue reduction and cost increase requires careful analysis and execution of cost reduction opportunities.**

Profitability



Hospital Lab Contribution Margin (Revenue less Dedicated and Incremental Outreach Costs)	2016 Study¹	Net Profit Margin²
Average	26.7%	Quest Diagnostics: 7.5% LabCorp: 8.5%

¹Fifteenth Comprehensive National Laboratory Outreach Survey, Chi Solutions, Inc., August 2016.

²Laboratory Economics, Vol 11, No 3, March 2016.

What About PAMA?

- Five-year impact of 3% reduction in margin.
- Refer to Appendix B for a calculation of the potential impact on hospital laboratory outreach programs.

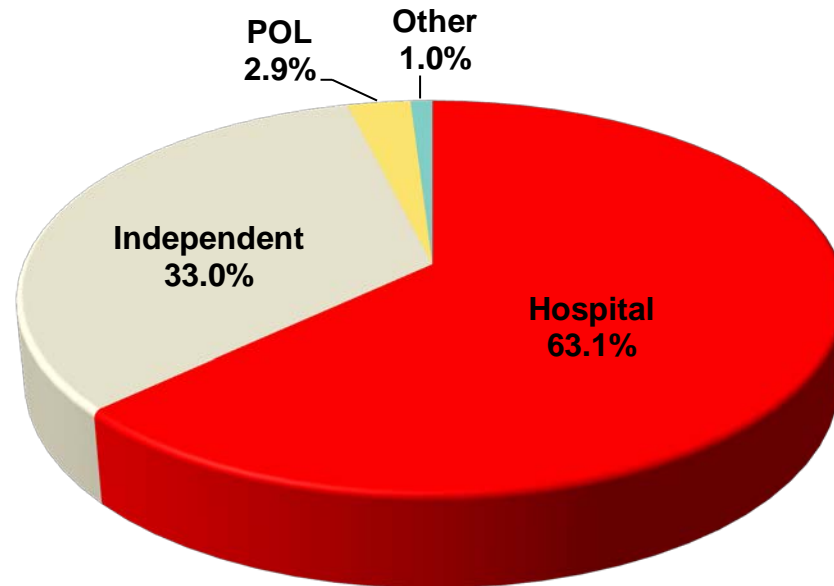
Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

More Market Share

Laboratory Industry Revenue by Facility Type 2012



Hospitals control most of the market.

Source: G2 U.S. Clinical Laboratory and Pathology Testing 2013-2015: Market Analysis, Trends and Forecasts, Figures 1.3 and 1.4; Truven Health Analytics; CMS CLIA Oscar Database.

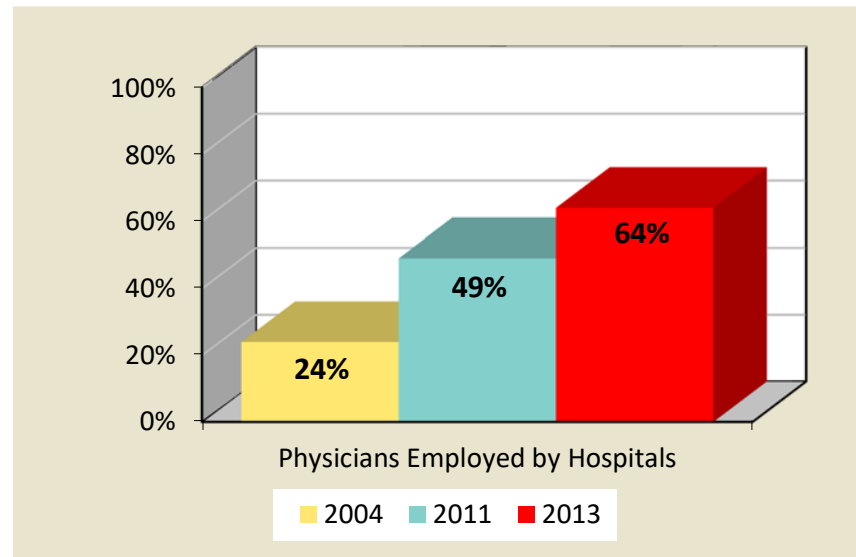
Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Migration of Physicians

- Physician employment by hospitals is expected to continue to increase.
- Hospital employment practice strengthens prior two trends.

Physician Employment by Hospitals¹



¹Sources: Keckley, Paul, 'Go Big or Get Out' No Sure Bet, Pulse Weekly, September 15, 2014; and Becker, Scott and Gamble, Molly, 10 Concerns and Trends Facing Hospitals Right Now, Becker's Hospital Review, July 21, 2014.

Success Stories

Current Performance of Outreach



Average revenue of \$25M



Median revenue of \$13M



Operating margin of 30%

Many Success Stories



Dozens of labs over \$50M



Some well over \$100M

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



Action #2

**GARNER FULL EXECUTIVE
SUPPORT AS ORGANIZATIONAL
PRIORITY**

Executive Support



- Need broad organizational support to succeed:
 - Compliance and HR for competitive compensation programs (lab executives, sales, field service reps).
 - HR for hiring staff quickly with salaries competitive with national labs.
 - Finance – P&L methodology agreed by all parties.
 - Managed Care Contracting – Ensure lab is included in negotiations.
 - Information Technology for timely bidirectional interfaces to physician office EMRs.
 - Decision Support for management reports.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Executive Support



- Only surefire way to accomplish the above is to have outreach designated as an organizational priority.
- Jump to the front of the line!

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

The Case for Outreach



How to talk to your executives...

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Risk vs. Reward – The Venture Capitalist Test



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.

Source: Adapted from Murphy, Kathleen A, The Profit Machine in the Hospital Basement, Ellsworth Press, 2016.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.



Action #3

**INSIST ON BUDGET FOR A
PROFIT CENTER**

Profit Center Budget

- Variable operating budget.
- Pre-approved capital.
- Exclusion from hiring freezes.
- Simplified, fast-track hiring process as long as operating at or above budget.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



Action #4

**DEVELOP P&L AND OTHER
MANAGEMENT REPORTS**

Information to Manage the Business



- Monthly profit and loss statements showing actual to budgeted performance for revenue, cost, and operating margin.
- Days in accounts receivable (AR).
- Bad debt as a percentage of net revenue.
- Key performance indicators for service and quality (see Appendix A).

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.



Action #5

**HAVE YOUR BOSS'S
BACK**

Protect Your Boss

- Health care executives are not selected for entrepreneurial qualities. They are risk adverse and are rewarded for avoiding mistakes rather than taking risks.
- Executive turnover in healthcare becoming more like private sector; many just trying to survive, stay under the radar.
- You have to protect your boss from failure – ALWAYS make your numbers.

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Summary

- 1 Understand the big picture.**
- 2 Garner full executive support as organizational priority.**
- 3 Insist on budget for a profit center.**
- 4 Develop P&L and other management reports.**
- 5 Have your boss's back.**

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Appendix A – Minimum Performance Metrics

Service	Quality
<ul style="list-style-type: none">▪ Turnaround time – routine and stat▪ Customer service metrics such as:<ul style="list-style-type: none">▪ Abandoned call rate▪ Average time to answer▪ Number of internal transfers▪ Compliance with physician alert notification▪ Missed courier pickups	<ul style="list-style-type: none">▪ Corrected reports (percent)▪ Proficiency track record

Source: Chi Solutions, Inc., an Accumen Company.

Proprietary & Confidential © Accumen 2017. Materials may not be copied or distributed.

© Copyright 2017, Cardinal Health. All rights reserved. CARDINAL HEALTH, the Cardinal Health LOGO and ESSENTIAL TO CARE are trademarks or registered trademarks of Cardinal Health.

Appendix B – Assumptions and Calculation of 5-Year Estimate of PAMA Impact

PAMA Impact on CLFS

Time Period	Chi Analysis ¹	Laboratory Economics ²
Year 1	6.4% ³	6.4% ³
Year 2	4.9%	5.0%
Year 3	0.9%	1.0%
Years 4-5	0.0%	0.0%
Totals	12.2%	12.4%

¹Calculated using data from Table 11, Federal Register, October 1, 2015.

²Laboratory Economics, Volume 10, October 2015.

³Arnold & Porter and Xifin, “Private Payor Data Reporting: What Information Must Be Reported, When, and How?” (webinar, July 12, 2016). Webinar stated that CMS projects Medicare benefit savings as 5.6% of the CLFS spending in the first year, but cautioned the estimate is based on very limited information.

- Assumptions and calculation for the impact of PAMA cost reductions on lab outreach revenue:
 - Medicare payments represent about 24% of a typical hospital laboratory outreach program’s collected revenue.¹
 - Average net (collected) revenue per test for laboratory outreach is \$19.79.²
 - Calculation:
 - Step 1: $24\% \times \$19.79 \times 12.3\%$ (average of Chi and *Laboratory Economics* conclusions) = \$0.58, or 3% as an overall reduction in outreach revenue for all sources in the payer mix. This calculation assumes other payer group reimbursement stays constant.
 - Step 2: Assuming a contribution margin for a laboratory outreach program of 25%, this will reduce it to approximately 22%. Many outreach programs have a 30% plus contribution margin, thus making the net margin approximately 27%.

¹Office of Inspector General, September 2015 Data Brief.

²Chi Solutions, Inc., *Fourteenth Comprehensive National Laboratory Outreach Survey*, August 2015, combined with Chi’s January 2015 survey of 20 large laboratory outreach programs.

Questions?

Presented by:
Kathy Murphy, PhD, Senior Advisor
Chi Solutions, Inc., an Accumen Company
Dr.Kathy.Murphy@chisolutionsinc.com
ChiSolutionsInc.com or Accumen.com
HospitalProfitMachine.com

The information in this presentation is provided for educational purposes only and is not legal advice. It is intended to highlight laws you are likely to encounter, but is not a comprehensive review. If you have questions or concerns about a particular instance or whether a law applies, you should consider contacting your attorney.



CardinalHealth
Essential to care™

Logistics
Product
Business
Patient

Thank you



CardinalHealth
Essential to care™

*Logistics
Product
Business
Patient*