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Lab Consolidations Seen as Driver of Savings When Hospitals Merge

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NEW YORK (360Dx) – In recent years, the number of hospital mergers has skyrocketed as health systems try to create economies of scale and trim costs while dealing with a challenging reimbursement landscape.

When hospitals merge, laboratories can be among the first ancillary functions to be consolidated in an effort to find cost savings, industry consultants say.

"It's because the laboratory is a high fixed cost, low variable cost business, and typically there is tremendous excess capacity in hospital laboratories, especially when one looks toward second and third shift capacity," said David Nichols, president and founder of Nichols Management Group.

When St. Paul, Minnesota-based HealthEast health system and Minneapolis-based Fairview announced plans to merge in 2017, laboratory directors of the two systems came up with a list of about 75 issues the two organizations needed to address to truly operate as a unified laboratory system, Deb Rodahl, who was at the time system director of laboratory services at HealthEast, said during a presentation at The American Society for Clinical Laboratory Science annual conference in Chicago earlier this month. In the short term, the labs were tasked with finding efficiencies that could translate into cost savings.

"Our charge was to come up with some quick wins. There were a lot of things we could do that would spend [money], but we needed to come up with a few that would save," she said.

As a result, HealthEast identified certain tests that it has sent to Mayo Medical Laboratories for reference testing that could be performed by labs of the University of Minnesota Medical Center, which was part of the Fairview system.

"We realized we needed to start insourcing and looking at things we had sent out that could now be performed in the combined organization," she said.

Other quick savings included moving HealthEast's HPV testing to Fairview. HealthEast's HPV testing platform was nearing the end of its life cycle and needed to be replaced, and Fairview had the capacity to accommodate the HealthEast testing, Rodahl said.

The two labs also reviewed their reference lab contracts and ended up negotiating a new reference lab contract for the combined organization with ARUP, which had been Fairview's reference lab provider.

"It was a nice win because not only was it a savings for the HealthEast side, but we got an improved contract for the combined organization because now we were bringing in higher test volumes," Rodahl said.

The challenges of finding savings from hospital mergers is something many hospital laboratorians experience as high numbers of hospital systems have merged in recent years. In 2017, a record 115 hospital and health system merger and acquisition transactions were announced, according to management consulting firm Kaufman Hall. The strong pace appears to be continuing in 2018, with 30 transactions announced in the first quarter, according to the firm.

While some quick savings can be found in the laboratory when hospitals merge, full integration can be a lengthy and complex process, according to Rodahl. A daunting challenge for HealthEast and Fairview is that the hospital systems are on different technology platforms. HealthEast's laboratory information system is Epic Beaker, while Fairview uses Sunquest Information Systems. In addition, Fairview has customized features in its LIS, and the two hospitals also have different intranet systems. The customization, in particular, makes converting to a common platform challenging. The health systems also have differing financial platforms, she said.

PCL Alverno Labs, a laboratory joint venture between Presence Health and Franciscan Alliance, has found savings through standardization, but the years-long effort has required careful coordination, Marty Lampman, regional director with Alverno said during a presentation at the Clinical Laboratory Management Association KnowledgeLab meeting in Long Beach, California in May. Presence Health became part of Ascension's AMITA Health in February.

"Think about designing that entire [laboratory] system. That is quite complex when the individual parts of the system are not equal, when they vary in size and in scope," Lampman said.

Standardization within Alverno has reduced costs by enabling the laboratory organization to achieve economies of scale from a fixed set of needed supplies, Lampman said. It has also reduced variation, which has helped promote best practices and meet accreditation requirements uniformly, she noted.

The PCL Alverno Laboratories standardized with Beckman Coulter Diagnostics' systems for chemistry, immunoassay, hematology, and urinalysis in 2014. PCL Alverno has also standardized with IL Werfen for coagulation, Immucor for blood banking, and Alcor for sedimentation rate testing. In addition, in problem solving situations, such as a recall, the company has developed a standardized protocol for uniformly managing the recall throughout the organization, she said. Yet there are still other areas where standardization work continues, she noted, such as standardizing critical values.

Accounting for cost savings

Despite the efforts to find savings through consolidation and standardization, demonstrating those savings can be tricky, Nichols noted.

"You have to make sure that there is a good cost accounting mechanism so one hospital that may refer work to another facility isn't penalized on the top line," Nichols said. "You want to make sure that the acquired hospital is made whole. In other words, if they have a margin in their current laboratory of 20 percent, and now that hospital is acquired by a health system, the administrator of the acquired hospital is used to having that margin from the lab business."

Depending on how the laboratory is managed by the hospital, accounting for changes like insourcing and other efficiencies can be a challenge, noted Lale White, executive chairman and CEO of health information firm Xifin. In some cases, payor contracts are negotiated by the hospital rather than the lab, and there can

be a disconnect between the laboratory teams tasked with finding efficiencies and the business teams overseeing accounts receivable management systems.

"The outreach, or the laboratories in general, usually are managed mostly by technical people rather than business people. Usually they don't have a CFO," White said.

The largest hospital systems, however, are not only looking to reap efficiency savings from lab consolidation, but are looking to a large standardized lab operation as a way to drive savings elsewhere in the health system through population health approaches to value-based care, she noted.

"What we are seeing with some of the major health systems is as they merge, they are immediately understanding that they have to get synergies because they have a cost structure that they have to preserve," White said. "At the same time, I think a lot of the health systems have recognized that diagnostics in general may be one of the easiest ways for them to gain control over the rest of the hospital cost if they use it strategically and if they are very analytical about the data they are producing in the hospital."

By analyzing testing data, hospitals can optimize what testing is being ordered, when it is being ordered, and how it is being used to guide treatment, which has the potential to drive larger savings that simply streamlining laboratory operations, she noted.

Reshaping the industry

Hospital systems that successfully integrate their laboratories may have the potential to reshape the laboratory competitive landscape. Nichols suggested that health system mergers have likely motivated large independent lab companies to solidify relationships with hospitals through laboratory joint ventures or acquisitions of hospital outreach businesses.

"It's a change throughout the industry. It's a change to Quest and LabCorp because they have fewer hospitals to call on," he said. "Also as these hospital systems get larger, they have a tendency to send out less work because they can expand their test menu and they are going to be more successful at outreach and inreach."

Hospital mergers are also likely to put pressure on independent regional laboratories that may have trouble competing for lab business with large health systems, White noted.

"In rural areas, your costs are high and the reimbursement is low. We might see a lot of that business shifting to hospitals who can actually bear the cost a little bit better because their private payor rates are so much higher that they have better margins to work with," White said. "I think what we will see is except for the major national labs, independent regional labs may shift to more specialty testing, esoteric testing, or may begin specializing in disease types, while the hospital labs might absorb some of the regional commodity testing into their menu as part of their outreach services because they are better able to afford it."

The largest health systems, however, are beginning to reach a size where even advanced specialty testing is no longer off limits, said Kyle Fetter, Xifin's executive vice president and general manager of diagnostic services.

"Something we are seeing in relation to the consolidation of hospitals and health systems is that where health systems may have had two or three patients a month that would have been indicated for more complex esoteric testing, now, within that broader system they may have 50, 100, 200, 300, or 400 patients that are indicated for complex testing like next-generation sequencing for cancer patients," Fetter said.

"They actually have the capacity and the patient volume to run more esoteric but expensive tests on their own."

Xifin has seen interest from large hospitals looking at revenue cycle solutions to manage the prior authorizations and reimbursements for complex testing that they are beginning to offer, Fetter said. Eventually, he noted, the large health systems exploring esoteric testing aim to begin offering it outside not only within their health system but beyond, he noted.

"They all see themselves ultimately offering it as a reference service to outside communities as well," he said.

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