Consolidation and Integration: Industry Trends

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Consolidation and integration have been subjects of interest in recent Chi Solutions, Inc. (Chi) webinars and research projects, as well as ongoing topics of discussion at national industry meetings and seminars. While some use the terms “consolidation” and “integration” interchangeably, they do have different meanings and strategies. Consolidation is about bringing as much testing as possible to a common testing location, and integration focuses on creating the centralized management and infrastructure necessary to optimize the benefits of consolidation. Both assume a strategy employed when there is more than one testing or service location.

This article will include discussion of current industry trends related to consolidation and integration, including:

- The benefits derived from consolidation/integration via value creation.
- Consolidation/integration models in use in the industry today.
- Critical elements of success related to consolidation/integration.

Readers will be able to review industry trends and then determine how their own laboratory organizations compare as well as find helpful suggestions they can apply to their own operations.

Value Creation from Consolidation and Integration

The benefits of consolidation and integration can be characterized via a balanced scorecard (BSC) approach. As shown in Figure 1, the four elements include attributes related to:

- Clinical quality and internal business.
- Customer service.
- Work culture.
- Financial performance.

Value is created by improving or enhancing the attributes associated with each of the BSC quadrants. In addition, this is an interactive strategy in that improvement (or change) in any one of the quadrants tends to impact the other three quadrants. For example, any improvement in customer service results in higher client satisfaction due to quality/business process improvements, employees are more satisfied because the reputation of the laboratory is improved, and ultimately the financial performance of the operation can improve due to higher customer and employee retention.
Figure 1: The Balanced Scorecard (BSC) Approach

Let’s examine how value is created via consolidation/integration by discussing examples for each quadrant. While some of the metrics one can use to measure change or improvement associated with value improvement are within the laboratory, many metrics are health system metrics (i.e., many of the improvements inside the laboratory have concurrent impact that can only be measured outside the laboratory).

**Clinical Quality and Internal Business**

Value is created when:

- Standardization of policies, procedures, processes, equipment, and supplies leads to reduction in variation, higher quality, and reduced risk. These are clear quality enhancements as well as risk management strategies. Standardization also leads to lower unit costs and higher staff satisfaction.

- Laboratory information system (LIS)/information technology (IT) standardization and connectivity supports continuity of the medical record and access to laboratory data and information for all providers and patients. This is an essential element of success for the future, and most regional or health system consolidated laboratories have this capability.

- Consolidating volume leads to supporting the acquisition of new technology that reduces length-of-stay (LOS) and improves outcomes. I will discuss the MALDI-TOF example in the Financial Performance section, although there is a clear quality enhancement produced via this and similar strategies.

- The laboratory helps to create a health system-wide approach to utilization of laboratory testing, including onsite-performed and referred tests. This will become a much more important management task in the future, and laboratory leadership, in concert with health system and medical staff leaders, must develop a dialogue and processes focused on laboratory test utilization.

**Customer Service**

Value is created when:

- You create a better service delivery operation via consolidation/integration and are able to better service the needs of the entire population (e.g., inpatient, outpatient, inreach, and outreach market segments). A better service delivery operation means you have enhanced the consistency of service delivery from a medical, technical, and administrative perspective.
- You create a standardized infrastructure that allows you to better service patients and clients. The logistics, specimen collection, call center, and sales/marketing processes are the same regardless of the patient or client location.
- You create standardized solutions for connecting to providers and the flow of laboratory data and information. This relates to the continuous medical record and demonstrates how IT is both a business process/quality and customer service attribute.
- You capture sufficient volume to justify a larger local test menu resulting in more rapid turnaround time (TAT), greater client satisfaction, and the potential for cost reduction.

**Work Culture**

Value is created when:

- You leverage the knowledge and skills of your staff by sharing that expertise across a larger laboratory operation. Since people resources (medical, technical, and support staff) are shrinking in the current environment, sharing becomes an important strategy and also can lead to improvement in employee satisfaction.
- Standardization of equipment, procedures, and policies allows motivated people to work in multiple locations, as needed. Not all employees desire to work in various locations, but those who do become a valued resource to the operation.
- Standardization of human resource (HR) policies and procedures, including salary/wage/benefits (SWB), results in the equal treatment of staff across the organization. Some health systems create a consolidated laboratory operation, but since the health system has not yet integrated HR as a single system, different salary structures or benefit offerings lead to dissatisfaction among laboratory staff.
- Improved productivity via consolidation ultimately reduces the need for laboratory staff and allows existing people resources to be better utilized.
- You create a consolidated integrated laboratory that is successful in its mission, laboratory staff has greater opportunity, and the work challenges can provide a higher level of satisfaction for them.

**Financial Performance**

Value is created via:

- Improved purchasing power due to higher volumes, which results in lower unit cost. It is important for laboratory leadership to take an active role in negotiation of laboratory-related contracts so that a strong argument is made related to the increased volume. Procurement personnel do not always understand or appreciate how consolidation has brought increased volume to bear in purchasing contracts.
- Leveraging the underutilized investment in laboratory facilities and equipment, which ultimately provides financial benefit to the health system. Most hospital-based laboratories have significant spare capacity from a space, people, and equipment perspective. Consolidation and integration, in concert with inreach/outreach growth, provide the opportunity to better utilize those resources.
- Volume growth via consolidation/integration and external market penetration leads to additional revenue, cost reduction, and enhanced margins. This will be important as the market moves toward risk-based reimbursement.
Investing in certain new technology, even if laboratory cost is increased, can lead to the ability to diagnose and treat patients more rapidly, resulting in reduced LOS and improved outcomes. An example is the use of MALDI-TOF methodology for the rapid identification of bacteria (which has been shown to deliver millions of dollars of benefit to the health system).\(^1\) Consolidated laboratory operations are better able to justify the use of such technology, providing they can identify the hospital cost savings resulting from the benefits discussed already.

The attributes and examples discussed in this section are not intended to represent the entire value opportunity available via consolidation and integration. While single-site laboratory operations may pursue many of these strategies, the creation of a consolidated and integrated operation involving multiple laboratory testing and service sites provides for greater value opportunity.

**Consolidation Models**

In the laboratory industry, there are several legal or organizational models employed to achieve varying levels of consolidation and integration. The preferred model chosen by a given health system is directly related to the following health system attributes:

- **The business culture** of the health system and/or proposed consolidation/integration partners will affect consolidation and integration efforts. There are three key business culture attributes that apply. First, whether the health system is willing to embrace change will impact the decision to adopt a consolidation/integration strategy. Those that embrace the safety of “status quo” tend to not be risk takers and will not pursue consolidation/integration completely because of the changes required. Health systems in which a higher strategy supports consolidation/integration will not allow the requirement of change to interfere with adopting the strategy. Second, how serious leadership is about integration will impact the chosen model. There are health systems that came together several years ago that have not yet fully integrated each of the hospitals or the overall infrastructure into a common health system model. They continue to operate as independent but related units. In this case, consolidation/integration will not be as serious an endeavor as it will in health systems that have a clear mandate or strategy to fully integrate all aspects of health system operations. Third, whether the health system is strategy-driven or consensus-driven will impact the chosen model. Those that are consensus-driven in their philosophy may move toward the “least change” models and will always be slower in making progress than those health systems that are strategy-driven. The strategy-driven health systems will have a leadership team that is fully supportive and understands the need to pursue consolidation/integration via the model that delivers the best chance for achievement of the strategic goals of the health system.

- **The financial position** of the parties involved will have an impact on the chosen model. The historical financial performance is directly related to the availability of capital to support future strategies. Health systems that have capital tend to be the ones that will pursue a consolidation/integration model that is more complex in nature and may require some capital investment. Health systems that lack capital may consider bringing in a capital partner to help fund a consolidation/integration strategy. In those cases, the capital partner tends to take a controlling management position.

Leadership influence will have both a short- and long-term impact. This applies to the influence of both laboratory leadership as well as health system administrative leadership. Whether there is a “strategic” laboratory leader (laboratory administrator or pathologist) who can bring his or her influence to bear on the model decision can have a significant impact on the chosen model. It is also important to have a key “champion” within health system administration. I have experienced scenarios where a strategic laboratory leader is stifled because health system leadership is not supportive of a model that will ensure the best opportunity for success. I have also seen instances where a health system champion is dealing with a laboratory leader who is focused on the technical operation vs. the strategic opportunities. In both scenarios, the laboratory leader usually leaves the position.

All consolidation models assume the scenario involves more than one testing and service location. The model options range from the least change, status quo, risk-averse models to the more complex organizational and legal models. Also, the presence of a partner can significantly influence the model chosen. Models in existence in the industry today are discussed below.

Federation Model
This is the chosen model in those health systems that have not yet fully embraced integration across the health system. Each hospital laboratory operates independently and reports to local hospital operations; there is no centralized management with authority. (Sometimes there is a person in a system-wide coordinating position, but the individual has no real authority to direct change or strategy. It is more of a “gatekeeper” position.) Any changes made or standardization strategies adopted are done so via consensus and tend to be opportunistic (low-hanging fruit). Some value is created in these scenarios, but it tends to be limited and achieved slowly. Also, if outreach is pursued, there tend to be multiple programs that operate independently, are billed by each hospital separately, and compete against each other. Consolidated laboratory operating and financial metrics may or may not exist in this model.

Business Unit Model
This model is chosen in health systems that want some serious level of value creation via consolidation/integration but are not willing to adopt a legal structure for various reasons. The business unit is treated as a separate company within the health system but is not a formal legal structure. Consolidated operating and financial statistics exist. The laboratories report to one individual but also continue to report to local hospital administration and pathology. The employees remain employed by the hospital and may or may not have similar SWB practices. A formal relationship is created between the system laboratory administrator and the pathologists so that common medical direction can be achieved where possible. If outreach exists, it is under common direction of the system laboratory administrator but may still be billed separately by each hospital. In some cases, a hospital administrative council is created to provide the communication necessary to achieve optimal standardization with concurrence from each hospital. A business unit model can be successful in achieving some level of consolidation and integration and delivering value to the health system. This model does find it difficult to compete in the outreach market since there is no ability to bill centrally and be competitive in pricing strategy. This model is usually competing for IT resources from the health system and is not always able to implement needed IT strategy for outreach success.
Legal Entity Model

Legal entities are created for a number of reasons:

- The health system is serious about optimizing the value opportunity through consolidation/integration and also has adopted an aggressive inreach/outreach strategy.
- The health system has a business unit model and has achieved some success but realizes there is additional opportunity if the laboratory can operate competitively like a regional or national laboratory.
- The health system wants to legally separate the unrelated business income (UBI) aspects of operating an outreach program from the not-for-profit operations of the health system.
- The health system wants the ability to position the laboratory operation for potential “monetization” of the outreach program.
- There is a potential partnering opportunity now or in the future, and a legal entity is necessary to create that partnership.

There are a few legal models in use today in the industry. The primary benefits of creating a legal model are centralized management, all employees are employed by the entity and have common SWB practices, management is responsible for the fiscal health and the financing of resources, billing is conducted by the entity using outreach-savvy billing methods, and IT is under the control of the laboratory entity. The following summarizes the model options but does not go into detail about the legal intricacies.

The most common model is creation of a limited liability company (LLC). There are several examples of this today. An LLC has the benefits of corporate liability protection and is taxed based on the member tax status.

Shared service 501(e) cooperative is in use in some health systems. It is used where the focus of the organization is to provide consolidated/integrated laboratory services to not-for-profit hospitals or health systems. If an outreach program also exists, it would be structured differently and not included in the co-op.

Partnership models do exist in limited scenarios. They may include the acquisition of or partnership with pathologists for a laboratory previously owned by pathologists.

I have not mentioned C corporation or co-tenancy models in this section. They may exist but are not the most common models adopted in today’s environment.

Using one of the legal models, there are subsets of model types that include:

- Joint ventures between hospitals/health systems, hospitals/health systems and regional independent laboratories, health systems and national laboratories, and health systems and payers.
- Outsourced management includes models in which management is outsourced to a regional independent laboratory, national laboratory, or laboratory management company.

As stated previously, the model chosen is based on varied factors. The LLC model provides the greatest current and future flexibility while allowing for optimal value delivery for the health system.
Critical Success Factors for Consolidation and Integration

There are certain attributes necessary for successful consolidation/integration. The following list of critical success factors is derived from my personal experience as well as Chi’s experience over the past 30 years.

*Pathologist involvement* is not only a success factor for implementation of consolidation/integration strategy but is considered a **critical path** to success. Many times, laboratory and hospital administration will develop a consolidation/integration strategy and business plan but not include representatives from the pathology groups (seldom is there a single group serving a health system) in the discussions. As a result, the strategy ceases when medical staff support for the pathologists becomes apparent, or the strategy is slowed significantly while the pathologists are brought up to speed. Remember that regulations require the active involvement of pathologists and define the role they play. They must be involved and can be important champions within the medical staff to gain the support for the strategy.

*Information technology* capability and expertise is an important success factor that is also considered a **critical path** for achieving success. Depending on the model chosen, IT resources may or may not be under the control of the laboratory. Where they are not, there is always a challenge related to the priorities given the laboratory. While the laboratory generates approximately 60 percent of the content of any health system EMR, because it is only five to seven percent of the cost base it does not receive the priority needed to support a consolidation/integration strategy. That is one reason why the separate legal entity model, with internal IT resources for laboratory, can be more successful than a model in which the laboratory competes within the health system for resources. The product of the laboratory is data and information, and no laboratory can be successful in effectively delivering the product to clients and patients without the proper IT resource.

*Centralized management* is essential for optimizing the value delivery via consolidation and integration. No organization runs efficiently when it reports to multiple leaders with competing priorities. Centralized management of a health system laboratory delivers a common message to employees and customers and is also responsible for being the steward of the resources and obligations of a mission-critical health care service. Common infrastructure and consolidated operational and financial reporting are essential to effectively manage such an operation.

*Executive support*, as mentioned earlier in the BSC discussion, is critical to the creation and ongoing operation of a health system laboratory. This includes executives within the laboratory operation as well as executives within the health system who are champions of the chosen strategy and model. Very few consolidations move forward without a strong champion in health system administration. Related to this success factor is the need for succession planning. I have seen successful health system laboratories struggle when either the laboratory executive or the health system champion leaves to pursue a new position or retires.

*Testing attributes* are also success factors. This refers to the ability of organizations to standardize testing across the system and make appropriate decisions related to the site of testing (e.g., is the testing being performed at the right site in an optimal manner). Centralized management that includes medical, technical, and administrative representatives is required to
address this operational aspect. How quickly an organization can move to enhance testing attributes will impact the ultimate success in delivery value.

*Infrastructure* capability and standardization are also success factors. Integration of laboratory operations cannot be achieved without adding some level of infrastructure that did not exist previously. This will add expense, but it must not exceed the cost reduction opportunities that result from consolidation. Development of an internally-managed infrastructure is critical for all health system laboratories. While some of the infrastructure may be contracted from the health system, it is important that laboratory management have the authority to make that decision.

*Financial performance* is certainly a critical success factor and tends to receive more attention than any of the others. In many organizations, the financial aspect takes on a life of its own and becomes a separate focus from the other factors mentioned above. In the end, failure to achieve the financial goals will certainly doom the operation, as will failure in any one of the factors also mentioned in this section. In fact, failure in the other areas will have a financial impact as discussed in the BSC section.

**How to Judge Your Consolidation/Integration Status**

Using the critical success factors mentioned above, on a subjective basis, you can create an assessment tool to help monitor your current status as well as progress toward reaching your consolidation/integration goals. Once you have defined the attributes necessary for success in each critical success factor category, you can subjectively assign a score from five to zero, with five indicating that all of the attributes within a given category have been met. Once that is done, you can create a spider chart to demonstrate current status (Figure 2). If you would like help assessing your status, please contact Chi.

*Figure 2: Current Status Spider Chart*
Consolidation/Integration Remains a Viable Strategy

Many wonder whether consolidation/integration remains an active and viable strategy. In a 2015 Chi webinar on this topic, 81 percent of the 71 participating sites across the U.S. indicated they were pursuing consolidation activity at that time, either via original consolidation/integration within a health system or by adding additional sites to an already consolidated/integrated operation. This represents a continuing trend directly related to current health system approaches. It makes sense in light of the strategy of bringing more hospitals together into a single organization to better compete, the ongoing activity of health systems to employ more physicians including physician practices that may already have laboratory operations, or the activity of growing outreach programs via the acquisition of physician or regional laboratories. Expertise in this area is still needed, and ongoing education in the industry continues from the sharing of experiences of those successfully consolidated and integrated operations.

If you would like to learn more about Chi’s 30 plus years of consolidation and integration experience, please contact Mike Kachure at mkachure@chisolutionsinc.com.