White Paper

Business Strategy for Pathology Practices and Independent Laboratories

What is Your Plan for the Next Five Years?

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Recently, I was asked to speak at the G2 PathForward Symposium about business strategies for pathology practices and independent laboratories, including issues such as mergers and acquisitions, the ACO movement, revenue, and managed care changes. My goal was to look at strategies over the next one to five years and offer some action steps that conference attendees could use to prepare for the future.

**History Lessons**

In preparation for this presentation, I reviewed some of my predictions from 2008. I have been working in the pathology revenue arena for the past 19 years, working with more than 250 groups, labs and hospitals in 48 states.

In 2008 I predicted that urology and gastroenterology work would be insourced; we have seen this business grow and now we are watching it recede.

I predicted that independent labs would see managed care pricing fall to less than 50 percent of the CMS Physician Fee Schedule. Unfortunately this has come true.

I foresaw the consolidation of medical billing companies. The number of billing firms in the Healthcare Billing and Management Association (HBMA) has dropped significantly; subsequently the industry is experiencing the worst billing I have ever seen.

Finally, I predicted some practices would fail the CMS Physician Quality Reporting System (PQRS) mandate, costing them money. Many billers have failed grossly at this task, and many groups received notification that they will lose an extra 1.5 percent on their CMS payments.

**Weathering the Mergers and Acquisitions Storm**

As there are still health systems consolidating and merging, this has caused some pathology practices to merge together. Although there are several large pathology practices with regional presence, we have not yet seen them dominate the marketplace.

Another factor in mergers and acquisitions is the development of pathology management companies. These large companies will farm Part A contracts and place salaried pathologists into these acquired locations. We have seen several groups erased and replaced by these management companies. This trend was quite successful in the 1990s in the emergency physician market.

The world of mergers and acquisitions for independent laboratories has turned upside down. What was once the darling of Wall Street is now a dead horse. No longer are the big venture capital firms foaming at the mouth for these labs. The technical cut in anatomic pathology (AP) has basically stopped this business in its tracks. Labs are laying off staff and retreating. Recently I saw an article about “funding for your lab.” I thought, “What are they funding? Operation expenses?”
When this cut took place I predicted that Quest and Labcorp would show a decrease in their AP profits in the third quarter of that same year. When the results came in, both companies posted a 15-16 percent loss on their AP business. It was not pretty.

My prediction for this business is simple: The big labs are going to see who can weather this storm, and in time they will buy some of the remaining labs to bolster their regional presence in areas of weakness.

**Accountable Care Organizations May Not Be Sustainable**

Most hospitals have developed an Accountable Care Organization (ACO), but this does not mean they are actually using them, nor do they have covered lives, etc. They want in the ACO game but are not sure how it is played.

Many of our hospital-based pathology practices have been approached by their health systems about joining an ACO; in most cases the payment clauses are vague and the terms somewhat incongruent. So far none of our groups have made a single charge, payment, or received a bundled payment. We have one client whose hospital was an early adopter of this format and promised the group great rewards. As of this time, the hospital owes the group hundreds of thousands of dollars with no payment in sight.

There is a reason only 60 percent of the original CMS ACO test models are open: this model does not make money. There has been some clamor about CMS being more generous on these payment models, but at this point there is no great benefit.

Independent labs are also in the pinch when it comes to the ACO market. Of course they want to be the lab provider for the area ACO, but at what cost? Remember they are competing against the big national labs for these contracts. If they can make a margin at 50 percent of the CMS fee schedule, then maybe they will have a stake in the matter; if not, they will be shut out.

Right now, joining an ACO may not be a good play. Do you want to be an early adopter of a losing process?

**Multiple Factors Point to a Downward Trend in Revenue**

Some practices may see a difference in revenue due to changes in Immunohistochemistry (IHC) and the prostate code. There are “new” CPT codes as well, but these will not drive new revenue. Instead, these changes will lead to some confusion, resulting in claim denials.

The 2 percent sequester cut is still in effect, and I doubt it will be repealed any time soon. Of bigger concern is the Medicare Sustainable Growth Rate (SGR) coming to an end. If we reach this point, we will see a 21 percent cut in Medicare reimbursements. My prediction, should this happen, is that many groups will have to withdraw from all their managed care plans. You may be able to survive a cut to the CMS rates, but not across the board. If this comes to pass, physicians will be scrambling to become employed, and negotiating salaries will become a big issue.
If the SGR goes on via the current process, I predict most hospital-based groups will see maybe a 1-3 percent increase or decrease in their revenue, depending on their contracted rates. Many of our groups have 3 percent cost of living allowances (COLA) built into their contracts. This keeps them strong going forward.

The biggest issues on the revenue side are the Health Exchange Programs. These contracts for low-income people are punitive on both sides.

From the patient point of view, many think that just because they are insured, they will have no out-of-pocket expense. We have heard of many calls from patients who are surprised to receive a bill.

From a provider point of view, there are several issues. First and foremost is that many of these plans are not clearly defined on the benefit side; most health systems are just now getting their insurance master files updated. Bad demographic information is a big issue. Also of note, is that these plans pay less than state Medicaid programs, meaning less money for the pathology and lab groups. Many are struggling to get payment from these basically “Self-No-Pay” plans.

**Different Managed Care Environments for Practices and Labs**

We have seen the managed care market condense and now it is getting even tighter. These companies all must make 5 percent per year to keep their shareholders happy, and this means either charging higher premiums or paying less to providers. We have seen 20 percent increases year-over-year for premiums; now we are seeing draconian measures to lower providers’ payments.

Most pathology practices are fairly secure in the current managed care environment. Many of our groups have strong contracts which pay a set rate for a set year of Medicare. For example, some of our practices get 150 percent of the 2013 CMS physician fee schedule.

There will be some issues with payers offering lower rates, but having a strong Part A contract and hospital relationship will insulate them.

The managed care world for independent labs is a much darker picture. Most insurance plans are working feverishly to keep all the work “in-network.” If it goes out-of-network, then the payer must pay more. For example, an out-of-network (OON) lab may get paid 100 percent of CMS but the check is sent to the patient and the collection process is harder. Yet an in-network lab may get paid 50 percent of CMS. It’s easy to see where the managed care plans have tightened down their business model.

If the payers had their choice, they would have one lab for all their work and pay them the lowest possible rate. Unfortunately, we have not seen quality indicators for labs as part of the pricing negotiations.

Most independent labs are being forced into these lower rates; it is well known that Aetna cancelled contracts with many labs over the past few years. Others have publicly stated they are not looking to add more independent labs to their networks. Basically this is a closed market.
The lower-rate contracts being forced on these groups include a 52 percent CMS cut to the technical component for CPT code 88305. On the clinical side, the Clinical Lab Fee Schedule (CLFS) has decreased 5 percent over the past five years.

Such changes have drastically cut the margins in this business. Independent labs are getting paid lower rates than they were several years ago, and they must find a way to make a margin.

**The Game Plan for Pathology Practices**

Pathology practices that have strong relationships with their health systems will not be seen as a commodity. These practices will be much less likely to be replaced by a management company or made salaried. Furthermore, they will have better leverage to negotiate managed care contacts.

To keep their revenue strong, these groups should have strong managed care contracts set to specific CMS fee schedules by specific years with a set COLA built into the contract.

Pathology groups should also have strong payment models built for a Relative Value Unit (RVU), episode of care, and bundled payment methodologies. Having these in place and having set margins per case or per CPT set will help them be strong.

**Action Steps:**

1. Build a strong relationship with your administration. They are your business partner.
2. Build strong managed care contracts with good COLA increases.
3. Look for pod lab work to return; work with these groups and the administration to get this work back in-house.
4. Get on the board of the ACO, defend your position, and get a solid understanding of these plans and how they will affect your income.
5. Be proactive; get various payment models built and prepared. Understand your margin.
6. Be a good businessperson; stay on top of your billing, your coding, and the CPT changes. Be a good steward of your business.

**The Game Plan for Independent Laboratories**

Independent laboratories will face struggles over the next five years. The labs with strong regional ties and strong managed care plans will survive. These labs must learn to practice with much smaller margins than five years ago. Also, some labs will survive by building unique revenue streams and relationships. Complete automation, low-wage workers, and very tight business models will survive until the next round of acquisitions.
Action Steps:

1. Know your margin per case and your pricing benchmarks.
2. Work on relationships with large payers; gaining exclusivity in an area of low provider coverage may be favorable.
3. Pay attention to your managed care contracts. Remember the 51% Rule (if 51 percent of your payments are contracted at a rate less than CMS, then you must offer CMS the same discount).
4. Try to develop relationships with ACOs if the nearby health system does not have a strong lab.
5. Negotiate good payments with Ambulatory Surgery Centers (ASCs) and hospitals for any T-cell work being performed.
6. Be a good businessperson; pay attention to the details in billing and costs. We bleed by nickels and dimes.
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