

Clinical Laboratory: The High Cost of a Bad Decision

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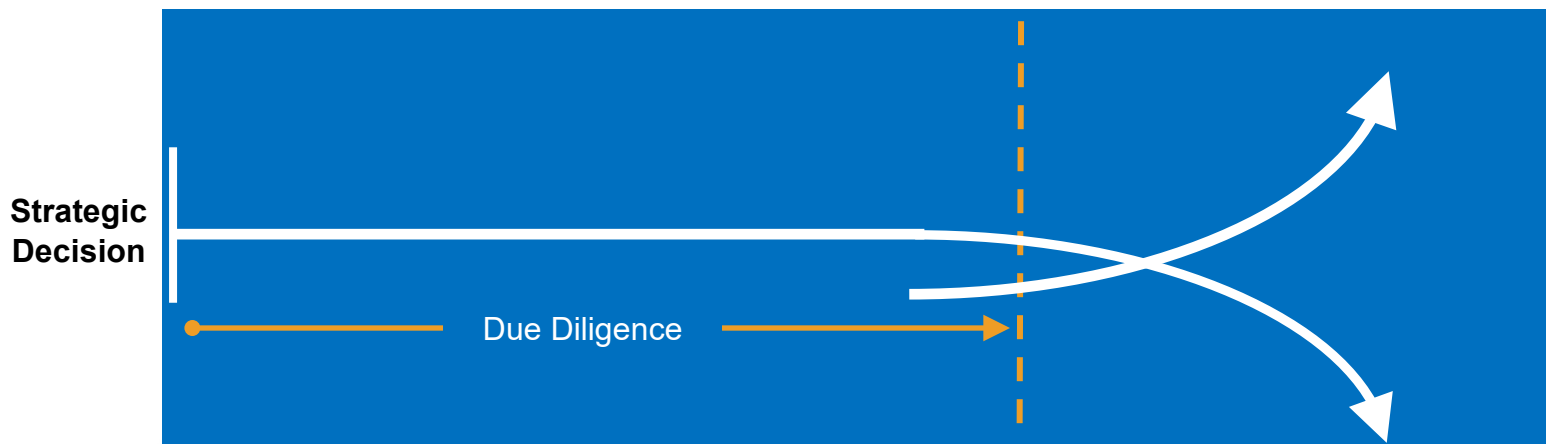
In the Clinical Laboratory, hundreds of decisions are made every day. Many of these decisions are technical, patient care related, or driven by regulations. However, health systems in the U.S. often find themselves at an inflection point regarding its clinical laboratories, often requiring a major strategic decision. Should we consolidate lab services across our multi-hospital laboratories? Should we enter into a managed services agreement with a national lab to manage our clinical laboratories? Should we sell our outreach lab program? Should we invest and grow the outreach program? How does my lab need to grow to support my growing hospital system? These are just a few of the critical decisions health system executives must make regarding clinical laboratory services over the next decade.

These strategic decisions impact not only the laboratory, but every clinical service area that the laboratory supports in the health system. A wrong decision can cost a health system not only valuable operating margin and cash flow, but also impacts the quality of care for its patients. Gartner Research estimates that “Bad Strategic Decisions Cost Organizations an estimated 3 Percent of Profits”. The origin of a bad strategic decision is often traced back to insufficient and/or inaccurate evidence gathered in the due diligence phase(s) of the strategic initiative decision cycle. Figure 1 below shows the cycle of how a bad strategic initiative decision can affect a health system.

Reliable Due Diligence = Right Strategic Decision

- Economic and Operational Value Improved
- Patient and Physician Satisfaction Increased

Figure 1: The High Cost of a Bad Decision



Insufficient Due Diligence = Wrong Strategic Decision

- Loss of Economic and Operational Value
- Decline in Patient and Physician Satisfaction

So how can organizations make better strategic decisions?

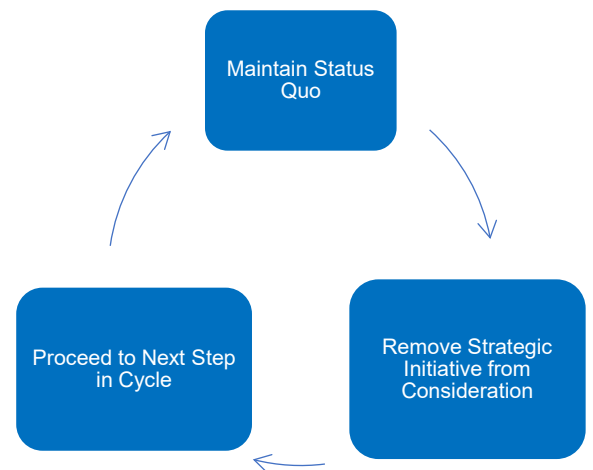
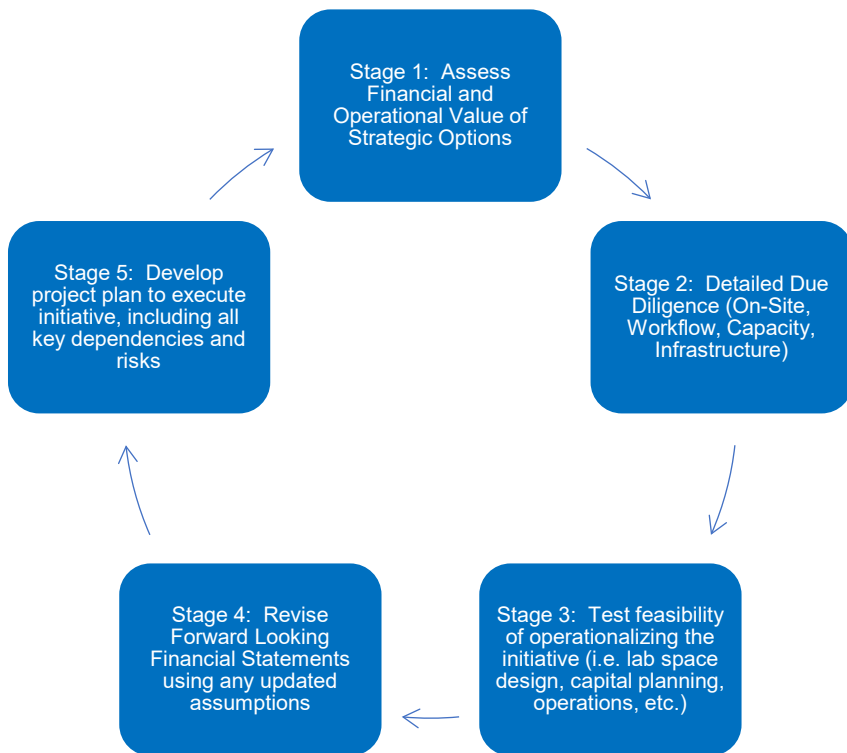
At Accumen, our Strategic Advisory Services division has been entrusted by health systems across the U.S. to assist them in making better strategic decisions. We have found that the most effective way to make the right strategic decision(s) is to approach the decision in phases and/or stages, that we call, the Strategic Initiative Decision Cycle, visualized in the figure below.



All steps in strategic initiative decision cycle require decision points at the end of each stage

Figure 2: Strategic Initiative Decision Cycle

Figure 3: Decision Points at Each Stage



Stage 1: Assess Initial Financial and Operational Value

In this step, decision makers must identify the strategic options. For this article, we will follow the Strategic Initiative Decision Cycle process for an imaginary health system (ABC Health), a large, growing health system with multiple, full-service hospital laboratories (ABC Laboratories) across several states. ABC Health is at an inflection point and is seeking to determine if it should build an Off-Site Central Laboratory to consolidate and support increased laboratory testing needs across the health system or consolidate testing to one of its existing hospital labs. ABC Health is in Stage 1 of the Strategic Initiative Decision Cycle and must identify its strategic options. Leadership for ABC Health has determined that they have 3 options:

- 1) Status Quo – make no changes to the current laboratory structure, with each hospital lab location continuing to perform testing with no changes to its current test menu;
- 2) Consolidate non-essential laboratory testing to the largest hospital laboratory and restructure test menus at other hospital lab locations to an essential services lab (ESL) test menu only;
- 3) Build an offsite Central Laboratory to consolidate non-essential laboratory testing and restructure test menus at other hospital lab locations to an ESL test menu.

Once the options available to the lab have been identified, an initial operational and financial assessment of the system laboratory is conducted. This first stage assessment should use a combination of supporting financial data (lab expenses, volumes, productivity, etc.) operational data (workflow, floorplans, possible site visits, etc.) and industry assumptions around market trends to determine an initial estimate of the value of each strategic option and begin to narrow down the choices.

A critical decision is required at the conclusion of Stage 1. Assuming that there is evidence that economic value is available and operational risks are minimal or can be mitigated, then an organization would move on to Stage 2, Detailed Due Diligence, which would include developing more detailed estimates for capital costs (renovation, equipment, etc.) that support the current strategic decision.

Conversely, if the initial estimate of economic value is not favorable or of the operational risk is considered too significant, then the project would be placed on hold indefinitely or removed from strategic consideration.

Stage 2: Detailed Due Diligence

Once an initial decision and or direction has been determined, the most crucial stage in the entire Strategic Initiative Decision Cycle is the Detailed Due Diligence stage. It is at this stage that many strategic decisions fail, where critical assumptions must be further validated and confirmed before action is taken. This includes additional Financial Analysis Due Diligence, where a high level of evidence is used to confirm all prior financial assumptions (renovation costs, labor and other cost savings, etc.) , Operational Due Diligence, where Site Visits and interviews confirm laboratory capability and workflow assumptions, and a Risk Assessment that begins to delineate and quantify, where possible, the risks associated with the Strategic Initiative.

Stage 3: Lab Space Design Plans and Associated Capital Planning

Once Detailed Due Diligence has been completed, any space and capital assumptions must be validated. This Stage may or may not be required, depending on the Strategic Initiatives being considered. If any renovation or new construction is required for the initiative, then a better understanding of the space requirements is needed prior to further planning. Capital purchase considerations also need to be clearly understood. This may include capital equipment, furniture, and/or construction.

Stage 4: Revise Forward-Looking Financial Statements using Validated Assumptions

Using the outcomes from Stage 2 and Stage 3, our initial forward-looking financial statements and value analysis must be revised. The revised financial analysis should be reviewed to determine if any changes are significant enough to change our strategic direction. If information was revealed in stages 2 or 3 that significantly alter the financial impact of the decision or identify significant risk, then the organization may need to return to Stage 1 to identify the next best option and repeat Stages 2 and 3. If the organization remains confident in its initial decision, it is now time to invest in detailed project planning and risk identification in order to successfully execute the selected Strategic initiative.

Stage 5: Develop project plan to execute initiative

In Stage 5, detailed project planning begins. A detailed project plan identifies all actions required to successfully execute the initiative. Even the best decisions can fail if poorly executed. Not only should all activities be identified in this stage, but all risks should be identified as well. Any risks identified should have a Risk Mitigation plan in place and included in the budget.

Final decisions should not be made until all five (5) stages are complete and all risks have been adequately identified. The right decision is not always a purely financial decision. The option with the best Return on Investment may require too much clinical risk.

Table 1: Case Study Examples

Client	Strategic Question	Stage of Strategic Decision Cycle Completed	Decision	\$ Magnitude of Decision
# 1	Should we build an off-site core lab to capture new ambulatory lab revenue?	Stage 5	Expansion supported by economic and operational value, execute initiative	\$25 million
# 2	Should we sell our outreach asset and outsource lab testing to a 3rd party?	Stage 2	Economic and operational value of selling outreach asset and outsourcing lab testing outweighs current lab position, proceed to next step in cycle	\$120 million
# 3	Should we expand into Molecular and Genetic Testing and build an offsite Center of Excellence?	Stage 2	Scale and clinical expertise support moving forward with initiative, proceed to next step in cycle	\$89 million
# 4	Should we recapture employed physician lab referrals that current go to unrelated labs?	Stage 2	Expansion supported by economic and operational value, proceed to next step in cycle	\$30 million
# 5	Should the Health System make a multi-million investment in a local independent lab?	Stage 2	Economic and operational value of lab to be acquired does not support acquisition, remove strategic initiative from consideration	\$125 million
# 6	Should we build an off-site core lab to capture new ambulatory lab revenue?	Stage 2	Expansion provides minimal economic value and significant risk of initiative failure, remove strategic initiative from consideration/maintain status quo	\$300 million
# 7	Should we insource lab testing that is current managed by a 3rd Party Lab?	Stage 5	Initiative supported by economic and operational value, execute initiative	\$131 million