

White Paper: The Role of GPOs in the Supply Chain

Overview

Group Purchasing Organizations (GPOs) have existed in the U.S. for more than 100 years, but their reasons for being have evolved, and in the last decade their importance has come under increased scrutiny. About 96% of all acute-care hospitals in the U.S. use GPO services, and roughly 72% of all hospital purchases are made through GPO contracts.¹ But some in hospital leadership are asking if they have the right GPOs or even need them at all. Using independent data, hospitals should be able to determine how or how often to engage GPOs and, once engaged, if they continue to deliver value. Continuous data-driven due diligence is the best practice way to engage GPOs.

Why a GPO at all?

The GPO serves as a buying cooperative to purchase goods and services at lower prices or with more favorable conditions. The net savings result on a number of levels:

- Reduced cost per unit due to larger quantities procured (on average 10.4% of annual supply costs²)
- More advantageous contract terms (such as payment periods) with larger quantities
- Negotiation expertise due to deep and practiced knowledge (better and faster deals)
- Elimination of internal specialist and administrative staff (average of \$198,000 annually³)
- Establishment of benchmarks from which the hospital can negotiate further.

GPOs generally serve end healthcare providers, usually hospitals or hospital systems. The largest GPO, Novation, controls access to over one-third of all hospitals in the U.S.⁴ and influences sales in the revenue order of a Fortune 100 company. A listing of the largest GPOs in the U.S. appears in Appendix 1.

There are two common types of GPO:

- Integrated Healthcare Network (IHN)
 - normally defined by geographic area, with functions formally combined
- Voluntary (“alliance” or “traditional”) GPO
 - shared goals only; retain independent functions.

¹ Bloch p5

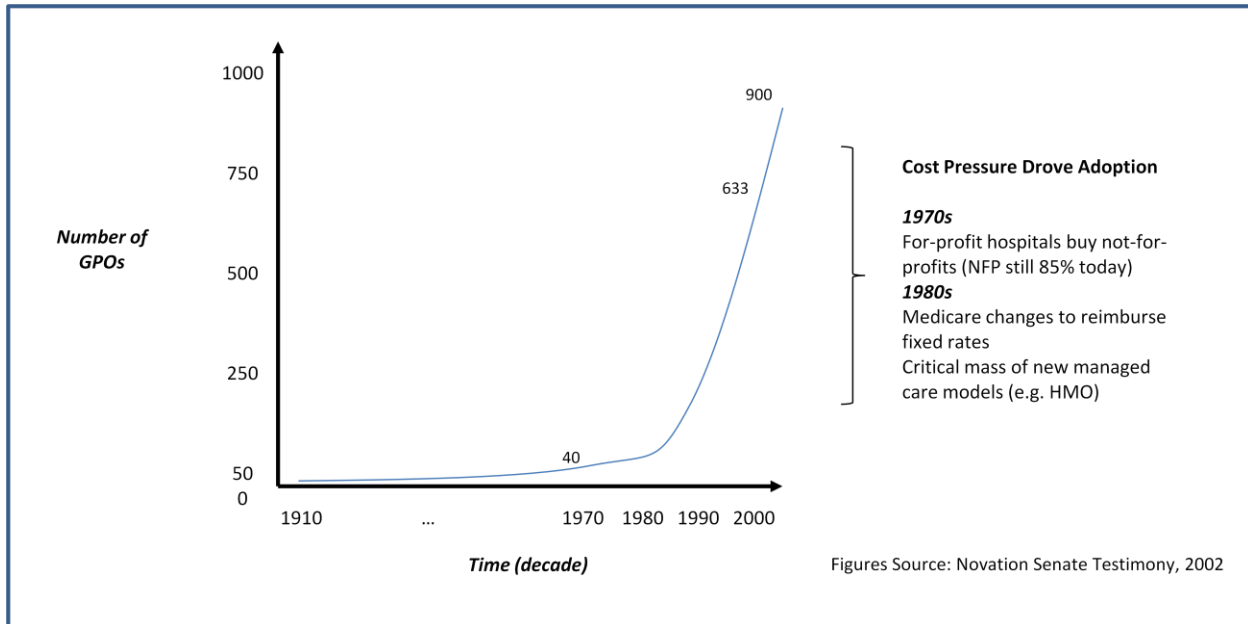
² HIGPA (2003)

³ Ibid.

⁴ *Fort Worth Weekly* (2005)

Everything about GPOs you didn't know and were afraid to ask

Though they have a long history in the U.S., GPOs have grown markedly in popularity since the 1970s, driven by evolving cost pressures as illustrated below.⁵



Prior to the 1990s, GPOs were largely regional affiliations of hospitals organized to pool purchasing volume. During that decade, healthcare costs escalated at a rate much faster than at any previous time.

In response to skyrocketing costs, GPOs needed to employ new strategies to maintain their relevance. Some steps included:

- Coupling vendor discounts with very strict compliance from hospitals
- Offering additional “competition enhancing” programs such as benchmarking, networking, and educational quality improvement
- Growth of for-profit models (GPOs collecting vendor fees under “safe harbor” provisions)
- Consolidation (of the more than 900 named GPOs, an estimated 200 contract directly with suppliers regionally and 26 at a national level).⁶

Some of these efforts were seen to violate anticompetitive law around sole source contracts, as bundling and discounts effectively excluded certain smaller vendors. Starting in 2002, these practices resulted in hearings by the FTC, the U.S. Dept. of Justice (Antitrust Division), the U.S. General Accounting Office, and, most famously, the U.S. Senate. Some of those studies showed that GPOs do not always achieve the lowest price and that hospitals can do better by contracting on their own.⁷

⁵ Novation Senate Testimony (2002)

⁶ Bloch p4

⁷ Simmons fn5

The GPO industry pre-empted legislative response in 2005 by adopting a voluntary Code of Conduct incorporating nine principles:⁸

1. Compliance with Applicable Laws
2. Conflict of Interest Policies (officers, equity interests)
3. Member Relations, Product Evaluations & Vendor Grievance (process)
4. Use of Contracting Tools (common elements in all arrangements)
5. Compliance, Certification and Implementation (with the principles)
6. Reporting and Education (share information on industry innovation)
7. Disclosure of Vendor Payments
8. Safety, Cost-Reduction & Clinical Comparability (information disclosure)
9. Diversity.

The spirit of this code is overall transparency of process. It has resulted in an increasing diversity of mission in GPOs and improved flexibility in responding to hospital needs. New offerings include revenue recovery, benchmarking, value analysis assistance, and information management. New activities include involvement in the clinical review process of new technologies.

Senate-driven legislation has not yet been proposed, though it is a topic that arises from time to time.⁹ Meanwhile, periodic reports question the value of GPOs at an operational level—for example, the allegations detailed by the *New York Times* in Appendix 2.

Thus it is essential for hospitals to have a plan for engaging a GPO, monitoring it, and changing it when circumstances require. Industry leaders have often “...wondered if their purchasing partners [GPOs] were the best possible purchasing partners. Several even questioned the need of having such partners.”¹⁰

Ideally, a hospital will use a GPO when its benefits or services add to the hospital's mission, provided that its usage:

- is justified by data (typically value analysis)
- is selective depending on the parameters of the situation
- is subject to periodic reevaluation to ensure the value equation stays optimal.

Experts contend that progressive hospitals engage in collaboration, using both GPOs and internal supply chain resources in a strategic way.

⁸ HIGPA (2002-2009) GPO Code of Conduct Principles: http://www.chca.com/mm/pdf/higpa_code_of_conduct.pdf

⁹ *New York Times* (2009)

¹⁰ Schneller & Smeltzer (2006)

How should you really use GPOs?

GPOs can be categorized in many different ways according to the services they offer:

- **Alliance:** group purchasing plus a menu of procurement and revenue-related services (analytics, benchmarking, etc.) (VHA, Novation, Premier)
- **For Profit GPO:** group purchasing services plus a menu of procurement and revenue-related services (analytics, benchmarking, etc.) (Med Assets)
- **Low Cost GPO**
- **Vendor Selection GPO** (Amerinet)

So how do you choose (if at all) and move between GPOs or GPO types? Ask the following questions, using data to support a strategy over time.

Selecting a GPO type:

- What is your procurement strategy (in-house, competitive bid, outsourced)?
- Will the primary use of the GPO be to baseline or to deliver the procurement function?
- What is the priority of your procurement objectives among cost, quality, timeliness?
- What is the risk profile for your organization?
- Do you vary your sourcing strategy on a risk vs. cost (TCO) basis?
- Can you identify what value-added services benefit your organization and their fair cost?

Deciding how and when to engage:

- What are your negotiation goals?
- What is the cost of leaving a GPO mid-contract?

Maintaining a fair return on GPO services

Once you have selected and engaged a GPO, you must ensure that you continue to receive fair value from its services. Through a combination of agreed up-front contractual provisions and detailed reporting by the GPO, the following metrics should be available to help you run your business better.

Order management:

- Consistent pricing
- Collection of all contractual rebates and chargebacks
- Vendor evaluation charges
- Custom shipping/delivery charges
- Price protection for price increases (ability to buy at old prices)
- Admin fees on a transparent pass-through (thus a portion of back-end rebates are being captured)
- Promotional allowances (dollars or bonus goods)
- Clear definition of tier-level rebates, possibly allowing a combination of GPO and local supply contracts
- Visibility of inventory levels throughout entire supply chain, including satellite storage
- Formulary control—what saves margin and has high margin

Customer service:

- Survey results/practitioner satisfaction

- Simple periodic auto-replenishment or point of use
- Easy requisition of the items you need.

How we can help

Organon Professional Services provides diagnostic engagements whereby we facilitate a business strategy for using GPOs supported by sound data architecture. This arrangement leads to data-driven decisions that can be reevaluated over time. Our technical expertise bridges the gap among multiple disparate systems without disrupting the daily flow of operations. Your result is insight in executing your strategy.

About Organon Professional Services

For the past 12 years, Organon has focused on building custom Decision Support, Business Intelligence, and Supply Chain Optimization solutions that have not only resulted in exceptional returns for our customers but have also improved our customers' competitive and strategic positions within the healthcare marketplace. We bring to our projects a diverse set of skills that include industrial engineering, financial analysis, and statistical analysis. Organon is a small and nimble organization, working collaboratively with our clients to deliver real ROI in short and contained engagements.

Why Organon?

Our heritage is in distribution, which encompasses many of the complexities within the supply chain. The healthcare industry can borrow from other industries for savings and improvement strategies. Pharmaceutical distribution was the first to recognize this area of opportunity, driven by massive volumes and constant structural changes to the market. Organon has worked with some of the largest pharmaceutical companies to streamline their supply chains. We are well positioned to carry our expertise to the hospital community and achieve exceptional results.

APPENDIX 1

Largest GPOs by number of hospitals and beds (Source: Verispan LLC, 2007)

GPO	Hospital Members	Staffed Beds
Novation	2541	480,224
Amerinet	1817	213,823
MedAssets Supply Chain Systems (PB)	1717	246,330
Premier Purchasing Partners	1586	245,879
MAGNET	874	186,308
HealthTrust Purchasing Group	859	98,199
Broadlane	793	107,253
Managed Healthcare Associates, Inc.	459	87,769
Consorta Catholic Resources Partners	277	39,489
Department of Veterans Affairs	225	34,977

APPENDIX 2

Alleging Value Lost With GPOs: A Pending Lawsuit

“A whistle-blower lawsuit offers an example of how this might happen. The plaintiff, Cynthia Fitzgerald, is a former employee of Novation. In her complaint, she says that she sought money from companies that were competing for a contract for intravenous catheters, then awarded the contract to the one that gave her a check for \$100,000, Becton Dickinson.

“Ms. Fitzgerald said that she never told the companies they could win the contract by making a big payment — the message was implicit. She said Novation was collecting donations then to finance an internal communication system for its hospitals, but it channeled many other cash and in-kind payments to the hospitals for other purposes.

“In her lawsuit, she argues that the hospitals would not be able to accurately account for these payments when reporting their supply costs to the government. That meant they would claim bigger reimbursements from Medicare than they were entitled to.

“Novation and Becton Dickinson are both fighting the lawsuit, filed in United States District Court for the northern district of Texas, in Dallas. Becton Dickinson calls Ms. Fitzgerald’s accusations “attenuated and speculative.” Novation, which fired Ms. Fitzgerald after she questioned its practices, says she did not work there long enough to understand how its business worked, much less build a credible case of Medicare fraud.” —*New York Times* (2009)⁹

Sources

Footnoted:

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- ⁴ P. Lastra, "Hijacking at the Hospital," *Fort Worth Weekly*, Nov. 23, 2005.
- ⁵ M. McKenna, President, Novation LLC, "Testimony Before US Senate Committee on the Judiciary," Apr. 2, 2002.
- ⁷ R. Simmons, "An Enhancement of Anticompetitive Activity through Group Purchasing Organizations: A Case Study," 17 [Antitrust Healthcare Chronicle](#) 1, Spring 2003
- ⁹ M. Williams Walsh, "Senators to Investigate Hospital Purchasing," *New York Times*, Aug. 14, 2009
- ¹⁰ E. Schneller, L. Smeltzer, [Strategic Management of the Health Care Supply Chain](#), Wiley & Sons, (2006)

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