GPOs: Helping to Increase Efficiency and Reduce Costs for Healthcare Providers and Suppliers

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Applied Policy, LLC 1700 Diagonal Rd, Alexandria, VA 22314

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Executive Summary

For more than 100 years, healthcare group purchasing organizations (GPOs) have been delivering value to their customers (i.e., "members and/or clients"), such as hospitals and nursing homes. The GPO model is historically rooted in not only pooling the purchases of its customers in order to obtain lower prices, but also taking on the administrative burden of negotiating purchasing contracts on behalf of their customers with manufacturers, suppliers, and distributors of medical supplies, devices, and pharmaceuticals. In an industry where there are thousands of complex and varied medical products, centralizing the product value analysis and competitive bidding process provides significant economies of scale. It is estimated that this work saves healthcare providers more than $2 billion annually in administrative costs.[1]

GPOs have grown beyond these roots into a dynamic industry that offers hospitals, nursing homes and other healthcare providers a variety of services to meet the demands of the ever-evolving healthcare marketplace. The shift away from fee-for-service towards bundled payments and pay-for-performance initiatives, as well as Medicare and Medicaid payment cuts, has incentivized hospitals and other providers to deliver the highest quality healthcare at the most efficient price. In recent years, GPOs have begun to offer value-added services to customers beyond the traditional contracting process. GPOs now assist their customers in optimizing their supply chain, adopting evidence-based best practices through clinical evaluation and standardization services, helping to protect the safety of the patients that they serve, and developing software applications to enable customers to benchmark the value of their contract portfolio and identify savings opportunities. GPOs also offer benefits for suppliers by providing an efficient sales channel, standard contracts, educational and information services on the products and services, and other services that free up resources that suppliers can then redeploy toward research and development of new products. Today, more than 600 GPOs are competing for customers.[2]

The GPO marketplace is voluntary; hospitals and manufacturers are free to negotiate purchasing agreements outside of a GPO, yet almost all hospitals elect to purchase the majority of their products through a GPO contract. Healthcare providers are able to partner with one or more GPOs and choose from competing GPOs that meet the individual needs of their clinical staff and patients. Surveys of hospital materials management staff show high satisfaction with the cost savings offered through GPO contracts and the staff's general satisfaction with GPOs.[3] This serves as a powerful indicator of the value that GPOs provide to the U.S. healthcare system.

Over the past decade, GPOs have made a concerted effort at increasing transparency and accountability throughout the industry. This report serves as a snapshot of the GPO industry as it stands today. In 2013, the U.S. Government Accountability Office (GAO) sent a questionnaire to five large GPOs requesting information on a broad range of issues related to their role in the health care supply chain. Using the

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[1] Schneller, E. S. (2009, April). *The Value of Group Purchasing – 2009: Meeting the Need for Strategic Savings*. Health Care Sector Advances, Inc. Retrieved from https://www.novationco.com/media/industryinfo/value_of_gpo_2009.pdf

[2] U.S. Government Accountability Office (2010, August). *Group Purchasing Organizations: Services Provided to Customers and Initiatives Regarding their Business Practices* (Publication No. GAO-10-738).

[3] Burns, L. R. and J. A. Lee. (2008). Hospital Purchasing Alliances: Utilization, Services, and Performance. *Health Care Manage Rev 33*(3), 203-215.

data reported by those five major GPOs to the GAO, we identified a number of important findings about contracting and business practices.[4]

Key findings from the report include:

- GPO purchasing volume has been growing at a healthy pace, indicating satisfaction among GPO customers. The purchasing patterns also show GPO efforts to expand contracting to new areas, such as food services and construction, in order to better meet the needs of their customers.
- The average administrative fee received by GPOs from suppliers for all medical products is 1.7%.
- Over the past few years, the GPOs participating in this report have shared a majority of fees with customers, on average, and the percentage of fee sharing has grown over the years.
- GPOs have also increased the number of additional services offered to their customers. Each GPO offers their customers a different value proposition through the variety of services offered.

Our conclusion is that the GPO industry is a highly competitive industry that has developed innovative services to meet their customers' needs. The current GPO business model was able to be maintained through an exemption to the federal Anti-Kickback Statute, enacted into law in 1986, and expanded in 1987, to allow for a "safe harbor," that was formally established by the Department of Health and Human Services (HHS) in 1991.[5] Any attempt to undermine this protection has the potential to fundamentally alter today's healthcare supply chain, and endanger the benefits that healthcare providers are now receiving via GPO-negotiated contracts. Because GPOs have been important partners for hospitals and other healthcare facilities for over 100 years, it is unknown how severe the disruption could be, including the overall impact on healthcare prices.

GPOs: Aggregating Hospital and Healthcare Providers' Purchasing Power for More than a Century

Healthcare group purchasing organizations (GPOs) are specialized service providers that negotiate contracts and provide value-added services on behalf of their customers. GPOs negotiate contracts for a wide variety of products, from surgical dressings to implantable cardiac defibrillators, as well as provide numerous related services such as spend analysis, custom contracting and product evaluation.[6] GPO customers include hospitals and other health care providers, like ambulatory care facilities, nursing homes and home health agencies, that are interested in gaining the economies of scale possible when pooling purchases. This arrangement also benefits medical suppliers, pharmaceutical manufacturers, wholesalers, and distributors, as the GPO can deliver a more predictable and higher volume of sales in exchange for lower prices. GPOs also benefit manufacturers by lowering their selling, general and administrative (SG&A) costs and helping them avoid duplicating those costs across thousands of individual providers. These benefits to both healthcare providers and healthcare suppliers help place downward pressure on the overall cost of healthcare for all patients and payers.

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[4] It is important to note that different organizational structures, contracting philosophies, and varying services and capabilities differentiate GPOs from one another, and these differences can make data analysis across the industry difficult. A full discussion of the data limitations may be found at the end of the report.

[5] Medicare and State Health Care Programs: Fraud and Abuse; OIG Anti-Kickback, 56 FR 35952 (July 29, 2991).

[6] Healthcare Supply Chain Association. *A Primer on Group Purchasing Organizations: Questions and Answers.* Retrieved from http://c.ymcdn.com/sites/www.supplychainassociation.org/resource/resmgr/research/gpo_primer.pdf

Group purchasing arrangements date back to at least 1910, when the Hospital Bureau of New York was formed and began to negotiate contracts on behalf of their customers. GPOs experienced moderate growth from that time until the late 20th century. In the early 1980's, Medicare reformed the way in which hospitals and other health care facilities were reimbursed, moving from a cost-plus, fee-for-service model to a prospective payment system. Under this system, which is still in use today, providers receive a fixed payment based on the patient's diagnosis. The payment bundles all items and services that are typically used when treating a patient with a particular diagnosis. This payment reform required hospitals to be even more prudent purchasers of medical products and supplies. Recognizing the value provided by the GPO industry, providers rapidly increased their reliance on the lower prices offered through GPO contracting. Additional reforms, including "pay for performance" programs that link payments to a provider's performance on various quality metrics, and the growth of accountable care organizations (ACOs), as well as Medicare payment cuts have only increased the pressure to reduce costs.[7]

Almost all hospitals (between 96%-98%) are customers of a GPO and use GPO-negotiated contracts for at least some of their purchasing.[8] A 2009 survey of 28 hospital systems representing 429 hospitals estimated that GPO contracts accounted for approximately 73% of their purchases.[9] It is estimated that there are over 600 GPO-like organizations today.[10]

In Recent Years, GPO Purchasing Volume Growth Has Increased Across All Product Categories

Between 2008 and 2012, the weighted average growth rate in purchasing volume for five large GPOs grew across all product categories. For fiscal year 2012, the aggregate purchasing volume of the five participating GPOs equaled approximately $130 billion. The fastest growing area for purchasing is the "other" category, which can include products and services such as food and beverage, construction, and health technology services. The weighted average growth rate in this category was 9.7%. Many of these products and services had not previously been a focus for GPOs; this indicates that the GPO industry has evolved to better meet the needs of its customers. Each GPO self-reported purchasing volume data, and also used their own internal definitions of each category in order to determine the appropriate allocation of purchasing volume. Therefore, the average annual growth rates should be considered an approximation, as different GPOs may have categorized products in different categories.

[7] Ibid.
[8] Ibid.
[9] Schneller, E. S. (2009, April). *The Value of Group Purchasing – 2009: Meeting the Need for Strategic Savings*. Health Care Sector Advances, Inc. Retrieved from https://www.novationco.com/media/industryinfo/value_of_gpo_2009.pdf
[10] Healthcare Supply Chain Association. *A Primer on Group Purchasing Organizations: Questions and Answers.* Retrieved from http://c.ymcdn.com/sites/www.supplychainassociation.org/resource/resmgr/research/gpo_primer.pdf

Offering Customers a Variety of Choices

The historic GPO model provides value by taking on the administrative burden of negotiating purchasing contracts on behalf of their customers with manufacturers and distributors of medical supplies, devices, and pharmaceuticals. One study calculated that this work saves hospitals more than $2 billion annually in administrative costs.[11] A GPO's customers are then able to take advantage of the efficiencies associated with pooling their purchasing power. Most of the largest GPOs use task forces and councils composed of clinicians and hospital experts to help drive their contracting decisions. Similarly, most hospitals use a committee of doctors, nurses and other clinicians to evaluate the products available through GPO-negotiated contracts and decide which products to purchase.

Being a customer of a GPO does not limit the customer's ability to purchase products elsewhere. Each GPO customer has the ability to make an independent decision regarding the purchase of products that best meet the needs of its doctors, nurses, and patients, including the ability to decide to purchase outside of a GPO-negotiated contract.[12] Healthcare providers purchase products directly from manufacturers as well as from distributors. Even in instances where a hospital or provider chooses to negotiate an independent purchasing agreement (in which the provider negotiates directly with the supplier), they can still derive value from their membership in the GPO by using the GPO-negotiated price as a starting point and, in many cases, negotiate an even lower price. The GPO-negotiated contracts help to eliminate some of the information asymmetry that can exist between the supplier and the purchaser.

GPO Administrative Fees are Similar to Fee Structures in Other Industries

GPOs negotiate contracts with vendors (e.g. manufacturers, distributors, wholesalers, suppliers); GPOs do not take ownership of products. Vendors submit contract proposals in response to a public request for proposals (RFP) issued by the GPO. The contracting process, as well as the minimum qualification requirements for contracted suppliers, is transparent and available to all bidders.[13] After reviewing and evaluating the proposals, GPOs will negotiate prices and contract administrative fees with vendors. These fees are based on a percentage of the sales price for a particular product. When a GPO customer makes a purchase through a contract, the vendor pays the associated administrative fee to the GPO.[14] In accordance with federal regulations, all GPOs must disclose in membership agreements the range of administrative fees that have been negotiated between the GPO and vendor. At least annually, GPOs

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[11] Schneller, E. S. (2009, April). *The Value of Group Purchasing – 2009: Meeting the Need for Strategic Savings*. Health Care Sector Advances, Inc. Retrieved from https://www.novationco.com/media/industryinfo/value_of_gpo_2009.pdf

[12] Healthcare Supply Chain Association. *A Primer on Group Purchasing Organizations: Questions and Answers.* Retrieved from http://c.ymcdn.com/sites/www.supplychainassociation.org/resource/resmgr/research/gpo_primer.pdf

[13] See the following Calendar Year 2013 Public Accountability Questionnaires:
Amerinet: http://www.healthcaregpoii.com/images/HGPII-2013-PAQ-Amerinet.pdf;
HealthTrust: http://www.healthcaregpoii.com/images/HGPII-2013-PAQ-HEALTHTRUST.pdf;
MedAssets: http://www.healthcaregpoii.com/images/HGPII-2013-PAQ-MedAssets.pdf;
Novation: http://www.healthcaregpoii.com/images/HGPII-2013-PAQ-Novation.PDF;
Premier: http://www.healthcaregpoii.com/images/HGPII-2013-PAQ-PREMIER.PDF.

[14] U.S. Government Accountability Office (2010, August). *Group Purchasing Organizations: Services Provided to Customers and Initiatives Regarding their Business Practices* (Publication No. GAO-10-738).

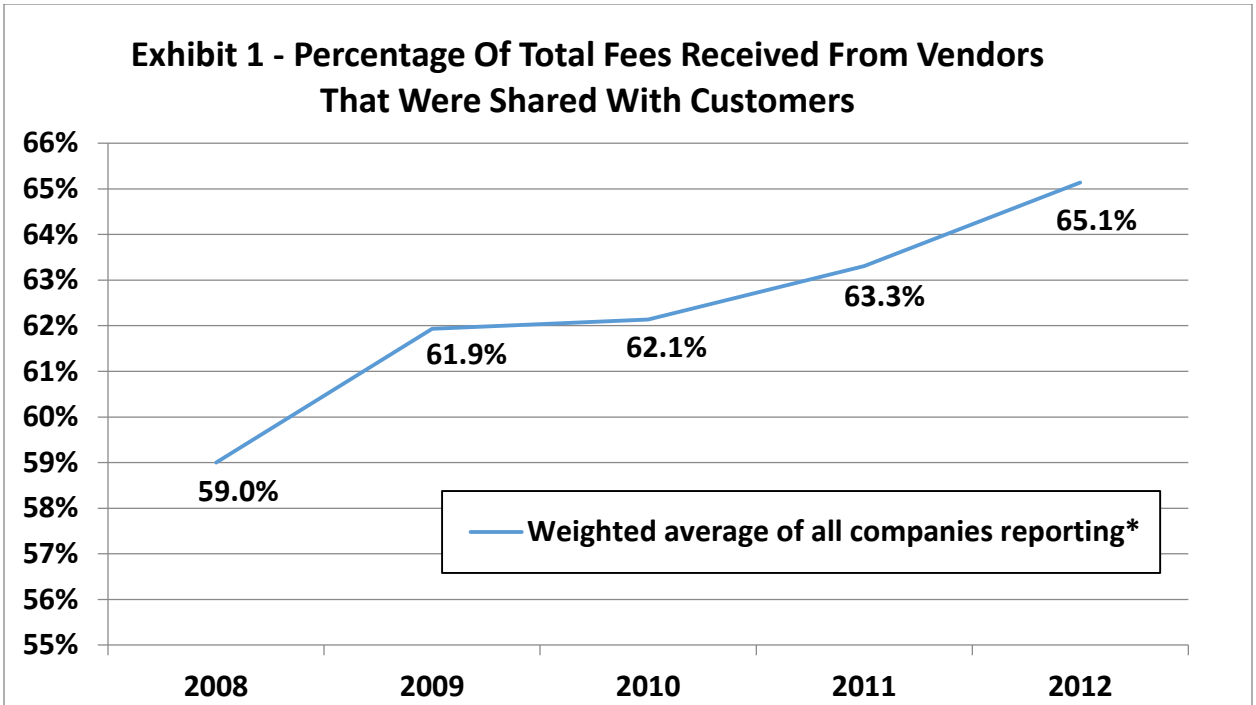
must also disclose to their customers the amount of administrative fees that the GPO received from vendors as a result of purchases made by the customer.[15] In FY 2012, the weighted average administrative fee for all products was 1.7% of the total purchase price. In no category was the average administrative fee higher than 3 percent. In FY 2012, the total amount of administrative fees that were collected by the five GPOs equaled $2.22 billion. The majority of fee revenue (97%) collected by GPOs is made up of administrative fees; the five GPOs reported receiving $2.28 billion in total fees (i.e. administrative fees plus income from other services) in FY 2012. The administrative fee business model is common in other industries, within and outside of health care. The federal government, agriculture industry, financial services industry, real estate transactions, and online marketplaces all employ this type of business model.

Some critics of GPOs maintain that elimination of administrative fees, and even GPOs, from the supply chain would result in a reduction in prices, alleging that manufacturers would pass the administrative fee savings on to hospitals. However, this does not seem to be the case in practical application. This past year, HRSA issued guidance that reduced the number of situations under which a 340B hospital could purchase drugs for outpatient use through GPO contracts.[16] No longer able to purchase certain outpatient drugs through GPO contracts, 340B hospitals now have no choice except to purchase certain drugs directly from wholesalers. Despite no longer paying administrative fees, suppliers have not reduced prices; rather suppliers have chosen to charge hospitals higher prices that have increased by as much as 40% in one year.[17]

Additionally, all GPOs distribute a portion of the administrative fees back to customers based on the business model of the specific GPO. Some GPOs distribute administrative fees based on a customer's share of ownership, or, for non-owners, as a percentage of revenue produced through customer purchases. GPOs that operate under a cooperative agreement will distribute virtually all administrative fees to the cooperative's shareholder-members, who are then responsible for making individual distributions to their respective customers. GPOs that are publicly traded companies will distribute a share of net revenue to shareholders. GPOs may also negotiate agreements with individual customers that describe the amount of administrative fees that will be shared with the customer.

In FY 2012, the five participating GPOs shared approximately $1.58 billion of the $2.28 billion in total fee revenue with customers, including owners. Exhibit 1 shows the weighted average of total fees received from vendors that were shared with customers between FY 2008 and FY 2012. On average, GPOs share a majority of fees (65%) directly with their customers. The weighted average of total fees that were shared with customers has increased each year in which data were available.

[15] Medicare and State Health Care Programs: Fraud and Abuse; OIG Anti-Kickback, 56 FR 35952 (July 29, 1991).
[16] Health Resources and Services Administration (2013, February). *Statutory Prohibition on Group Purchasing Organization Participation* (Release No. 2013-1).
[17] Based on internal company data from one of the five GPOs that participated in the report.



* Each GPO's percentage of total fees received from vendors that were shared with customers is weighted by that company's share of total fees collected across the five firms.

It is the responsibility of healthcare providers to accurately report the amount of administrative fee revenue and other rebates received to the appropriate government agencies, such as the Centers for Medicare and Medicaid Services (CMS). This reporting ensures that the true costs of products are reflected in cost reports and do not artificially inflate costs to Medicare and Medicaid. The Department of Health and Human Services' Office of the Inspector General (HHS OIG) has audited hospital cost reports for accuracy in the past, and has found that the vast majority of hospitals are in compliance with this requirement.[18]

The hospital cost report was initially used to calculate reimbursement in the cost-based reimbursement system of the early 1980's. Hospitals are still required to file a cost report despite the Medicare program moving to a different method of reimbursement related to the cost of goods and services used under the Medicare Inpatient Prospective Payment System (IPPS).[19] CMS conducts an annual rulemaking cycle related to the IPPS system in which payments are increased or decreased based on the Medicare inpatient "market basket." The Medicare inpatient market basket is a complex calculation subject to many factors. The term market basket is generally used to describe a variety of cost categories that

[18] U.S. Department of Health and Human Services Office of the Inspector General (2005, January). *Review of Revenue from Vendors at Three Group Purchasing Organizations and their Customers* (Publication No. A-05-03-00074); and U.S. Department of Health and Human Services Office of the Inspector General (2005, May). *Review of Revenue from Vendors at Three Additional Group Purchasing Organizations and Their Members* (Publication No. A-05-04-00073).

[19] Centers for Medicare and Medicaid Services. *Cost Reports*. Retrieved from http://www.cms.gov/Research-Statistics-Data-and-Systems/Files-for-Order/CostReports/index.html?redirect=/costreports/.

include the items and serviced used by a hospital. It includes price proxies (i.e. data sets that track changes in price over time).[20]

The cost reports are also used to establish the diagnosis-related group (DRG) weights.[21] The weights are based on the typical resources used to treat a Medicare patient within the DRG, and they shift money available in the payment system rather than changing the total amount of available funds.[22] Provider costs are deducted, in relationship to their revenues, on the cost report to determine Medicare reimbursement; these costs include any revenues received from hospital participation in GPO programs.[23] It is worth noting that that amounts attributable to funds flowing from GPOs to hospitals is relatively small in comparison to the overall Medicare program budget. For example, the potential amount of GPO reductions recorded on hospital cost reports is estimated to be approximately $1.6 billion,[24] or roughly 1.1% of total 2013 Medicare inpatient payments.[25] In sum, hospital cost reports do not directly affect whether, or by how much, the market basket increases payments. The information contained in the report could, however, slightly affect the mix of goods and services within the market basket itself.

The Benefits of a Competitive Contracting Process

Contracts - Most contracts negotiated by GPOs are either dual source (in which a customer has the option of two vendors on contract for a given product) or multiple source (in which a customer has the option of more than two vendors on contract for a given product). In the appropriate circumstance, and when it benefits customers, a GPO can negotiate a sole source contract, usually after a competitive bid process. Under these contracts, the GPO decides to contract with only one vendor, in exchange for a much lower price than what could be negotiated under a dual source or multiple source contract. Sole source contracts are generally used for commodity products. Regardless of the number of vendors on a particular contract, all contracts are reviewed and approved by the GPO's senior leadership team and/or the GPO's customers themselves.[26] Hospitals and other health care providers always remain free to negotiate directly with vendors to purchase items "off contract."

Bundled Agreements - In addition to multiple source, dual source, and sole source contracting, GPOs can also maximize value to their customers through coordinating the purchase of multiple products from the

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[20] Centers for Medicare and Medicaid Services. *Market Basket Definitions and General Information*. Retrieved from https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/MedicareProgramRatesStats/downloads/info.pdf.

[21] Medicare Program: Hospital Inpatient Prospective Payment Systems for Acute Care Hospitals and Long Term Care, 78 FR 50504 (August 19, 2013).

[22] Centers for Medicare and Medicaid Services. *Acute Inpatient PPS*. Retrieved from http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/AcuteInpatientPPS/index.html?redirect=/acuteinpatientpps/07_ime.asp.

[23] GAO. (2012, March). *Group Purchasing Organizations: Federal Oversight and Self-Regulation* (Publication No. GAO-12-399R).

[24] This is the approximate amount of administrative fees collected by the five GPOs participating in this report in FY 2012.

[25] Centers for Medicare and Medicaid Services. *2014 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. Retrieved from http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/downloads/tr2014.pdf.

[26] See Calendar Year 2013 Public Accountability Questionnaires.

same manufacturer. These bundling agreements offer a way for a GPO's customers to access even lower prices and standardize their purchases through a single supplier. One example of this type of agreement may include several types of paper products – such as paper towels, facial tissue, napkins, and wipes – from the same manufacturer in one contract. The decision to purchase products via a bundle agreement is at the discretion of the customer. Hospitals are still able to purchase products outside of the bundling agreement. GPOs examine each agreement to ensure that customer choice and flexibility are not compromised, and that it does not create barriers that would prevent innovative technology from reaching hospitals and other health care providers.

Committed Programs - Committed programs are another contracting option that some GPOs offer to customers. These programs provide access to lower prices, up-front savings, and rebates when customers commit to purchase a certain percentage of their annual volume in a given category through the committed contract portfolio. Many hospitals prefer to standardize related purchases as much as possible, or to purchase all quantities of a certain product from a single supplier in order to simplify their internal supply chain and inventory. Committed programs allow customers to capitalize on this natural preference by securing lower prices or other savings opportunities.

Innovative Technology - GPOs are constantly reviewing their contract portfolios to make sure that customers have access to the newest and most innovative technologies. The average contract bidding cycle is three to five years. However, GPOs have simple procedures for renegotiating contracts, or negotiating new contracts outside of a regular contract cycle to account for instances of new, innovative technology.[27] Some GPOs have a separate contracting process for innovative technologies that benefit patient care or increase worker safety, and offer opportunities for customers to experience innovative technologies first-hand.

GPOs Offer Comprehensive Integrated Services to Their Customers

In the constantly evolving health care industry, GPOs also offer additional services for customers. These services aim to go beyond helping customers save money, but also to meet the varying challenges facing hospitals today such as improving quality and patient safety. By outsourcing some of these functions, hospitals today can devote more resources to patient care. These additional services can be financed directly by administrative fees, or through separate fees charged directly for the service. All service-specific fees charged to customers are fully disclosed and transparent.

The cafeteria of additional services is one of the many ways in which GPOs compete for customers. Exhibit 2 below shows the different types of services offered by GPOs, along with the percentage of the five major GPOs that offer those services. With the exception of warehousing (which no GPO offered), all of the other services were offered by at least one GPO. Common programs offered by GPOs are described below:

Examples of Value-added Services

- **Supply chain analysis and services.** Few hospitals could undertake the expense necessary to assume the full range of supply chain functions provided by GPOs. Even large systems with established procurement staff and processes rely on GPOs for the majority of their procurement needs. Supply chain services are intended to maximize the effectiveness of the healthcare

[27] Ibid.

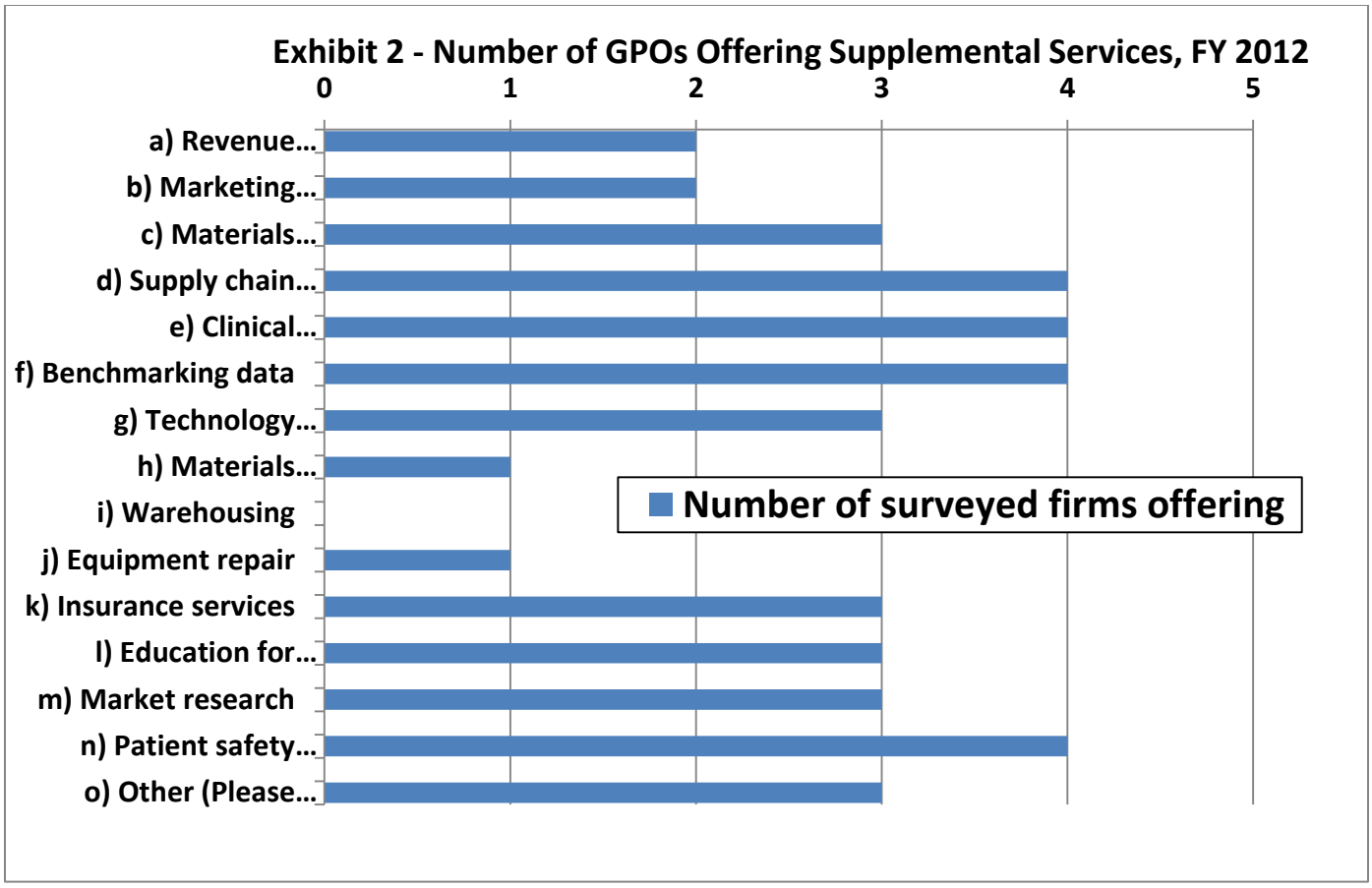
supply chain and procurement functions. Services related to supply chain operations enable GPOs to help customers lower supply costs by incorporating best practices and key performance indicators. Once an analysis of the customer's current spend is conducted, the GPO can better align the purchasing needs of the customer with the GPO's current contract portfolio. GPOs work with customers to standardize contracts across suppliers and manufacturers, or identify committed programs that can lower overall costs for the customers.

- **Clinical evaluation and standardization.** These services help health care providers adapt to the rapidly changing health care payment system. As Medicare, Medicaid, and commercial health insurance plans move away from traditional fee-for-service payment, and toward bundled payments, accountable care organizations, and pay-for-performance metrics, clinical evaluation and standardization services become more important. Using the input of experienced clinicians, GPOs ensure the appropriate products and programs are available to the appropriate staff. Programs can also help providers establish, implement and adhere to clinical process standards, while removing waste, defects and errors. Clinical evaluation teams can also provide research and contracting assistance for the introduction of new and innovative technology, which assists customers in offering the latest in cutting edge clinical care, and manufacturers with finding a market for their products.

- **Benchmarking data.** Benchmarking data analytic services enable customers to compare the contract prices of supplies and services against the constantly fluctuating market. These applications can provide detailed, line-item level data that help health care providers maximize the value of their contract portfolio. Individual GPOs have developed proprietary software applications to meet the needs of their customers. A 2009 report attributed $840 million in both direct and indirect savings on orthopedic implants, out of the $7 billion marketplace, to benchmarking services provided by GPOs.[28]

- **Patient Safety.** Perhaps most importantly, GPOs also help their customers protect the safety of their patients. GPOs help customers address patient safety issues, especially issues that must be addressed at the macro, facility-wide level, such as antibiotic stewardship and infection control. GPOs offer their customers access to quality improvement plans, in which evidence-based best practices are shared. These plans, which can focus on topics ranging from hand hygiene to emergency department care to FDA recalls, improve patient outcomes while reducing costs. GPOs also help customers stay up-to-date on the latest guidelines and recommendations via issue briefs and other educational offerings.

[28] Schneller, E. S. (2009, April). *The Value of Group Purchasing – 2009: Meeting the Need for Strategic Savings*. Health Care Sector Advances, Inc. Retrieved from https://www.novationco.com/media/industryinfo/value_of_gpo_2009.pdf



- **Private Label.** Another way that GPOs provide additional value to their customers is through private label programs. Private label brands are used in many industries, including grocery, drug, and general merchandise stores. These programs, which are not offered by all GPOs, offer customers an opportunity to purchase high quality products at a competitive price. GPOs offering private label programs contract directly with manufacturers to manufacture products that are then sold under the GPO's private label brand name. This direct contracting eliminates the need to spend money on sales or marketing, which enable GPOs to offer lower prices on these products. Manufacturers offering products through the private label must go through the same rigorous, competitive contracting process – including clinical and quality review - as the remainder of the portfolio. GPOs that offer private label programs provide yet another option for customers to reduce their costs while not sacrificing quality.

The GPO Safe Harbor Works to Save Hospitals Money and Does Not Increase Costs for Medicare and Medicaid

In 1972, Congress amended the Social Security Act to make it a crime to "knowingly and willfully offer, pay, solicit, or receive remuneration in order to induce or reward the referral of business reimbursable under any of the Federal health care programs…"[29] This provision, which is known as the Anti-Kickback

[29] Medicare and State Health Care Programs: Fraud and Abuse; Electronic Health Records Safe Harbor Under the Anti-Kickback Statute, 78 FR 79202 (December 27, 2013). The Anti-Kickback Statute is codified in Sec. 1128B(b) of the Social Security Act.

Statute (AKS), was intended to prohibit practices that were considered unethical or unlawful, and which increased costs for federal health care programs. Examples of these types of practices included anything that had the potential to interfere with medical decisions, or increase the risk of overutilization or inappropriate utilization of medical services and supplies or otherwise compromise patient safety or the quality of care delivered.[30]

Because the statutory language is broad in scope, Congress has made several revisions over the years to exempt certain practices. In 1977, Congress enacted the Medicare and Medicaid Anti-Fraud and Abuse Amendments Act (P.L. 95-142). The legislation increased the severity of the penalties for violating the statute, but also established two exceptions to the law, including discounts or price reductions that were "properly disclosed and appropriately reflected in the costs claimed or charges made"[31] and the salaries of employees.[32] The former seemingly exempted GPOs from the AKS, as long as hospitals appropriately accounted for the receipt of fees shared by the GPO.

However, hospital suppliers continued to submit formal inquiries and complaints to the HHS OIG regarding the business practices of GPOs, arguing that the GPOs were violating the AKS. The OIG disagreed with the complaints, noting that hospitals were able to secure lower prices under GPO agreements than they could when purchasing independently. The OIG also determined that the introduction of the prospective payment system for inpatient hospital costs under Medicare mitigated any of the risks that may have been present previously (i.e. that GPO contracting could somehow lead to higher costs for the Medicare and Medicaid programs). In response to these inquiries and complaints, the OIG requested that the Department of Justice (DOJ) issue a "blanket declination" of prosecution under the AKS:

> The use of volume purchasing through group purchasing agents clearly reduces the costs of purchases by hospitals. Therefore, we would encourage use of such arrangements regardless of the reimbursement methodology. In the case of inpatient hospital care under PPS [Prospective Payment System], any savings which result from volume purchasing accrue to the hospital because Medicare will reimburse a predetermined amount based upon a patient's DRG [Diagnosis Related Group]. In the case of services reimbursed on the basis of cost, the savings from volume purchasing will be passed onto the Medicare program.[33]

In response to the letter, the DOJ rejected the OIG's request, suggesting that Congress was the appropriate authority to resolve the issue.[34] Congress included a provision in the 1986 Omnibus Budget Reconciliation Act (P.L. 99-509) that amended the Social Security Act to exempt GPO arrangements from the AKS, as long as those arrangements were established via a written contract and were disclosed to HHS.[35]

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[30] OIG Supplemental Compliance Program Guidance for Hospitals*,* 70 FR 4858 (January 27, 2005).
[31] Sec. 1128B(b)(3)(A) of the Social Security Act.
[32] Sec. 1128B(b)(3)(B) of the Social Security Act.
[33] Letter from Richard P. Kusserow, Inspector General, DHHS, to Stephen S. Trott, Assistant Attorney General, Criminal Division, U.S. Department of Justice, April 17, 1985.
[34] Letter from Stephen S. Trott, Assistant Attorney General, to Richard P. Kusserow, Inspector General, DHHS, October 30, 1985.
[35] Sec. 9321 of P.L. 99-509 amended Sec. 1128B of the Social Security Act by adding Sec. 1128B(b)(3)(C).

In 1987, Congress further broadened HHS' authority to establish "safe harbors" under the AKS. The Medicare and Medicaid Patient and Program Protection Act of 1987 authorized the OIG to use the public rulemaking process to issue "safe harbor regulations" for practices that would not be considered a violation of the AKS.[36] The final regulation implementing this provision was released on July 29, 1991. In this rule, OIG formally established a safe harbor for group purchasing organizations that meet specific requirements set forth in the regulation.[37]

In the years since finalizing this regulation, the OIG completed two audits of GPO agreements and their impact on federal health care programs. The first audit, completed in January 2005, showed that most GPO agreements met the safe harbor requirements and overall, $200 million of the $255 million in net revenue (78 percent) reviewed by the OIG was appropriately reported by the GPO customers (i.e. hospitals) on their Medicare cost reports. Almost all (99 percent) of the $285 million in rebates collected by hospitals from vendors were correctly accounted for on hospital cost reports. [38]

OIG released a second audit in May 2005, examining how large health systems, each representing multiple hospitals, adhered to the GPO safe harbor requirements. The OIG found that 96 percent of net revenue was correctly accounted for in Medicare cost reports. In addition, the seven health systems correctly accounted for 100 percent of the rebates received from vendors on Medicare cost reports.[39]

As a result of their audits, the OIG recommended that CMS clarify to hospitals that they are required to accurately report all net revenue and rebates received under a GPO agreement on Medicare cost reports in order to be in compliance with the safe harbor requirements.[40] In turn, CMS updated the hospital provider manual with clarifying language regarding the hospitals' reporting responsibilities.[41] Because the OIG has not conducted another audit since 2005, it is unknown how much the compliance rate has changed since the provider manual update.

In addition to the OIG, GPO agreements are subject to review by the Federal Trade Commission (FTC). Enforcement authority for GPO agreements lies with the Department of Justice and the FTC, as all antitrust issues fall within those agencies' jurisdictions. The agencies have the authority to begin an investigation as the result of a complaint, or as the result of their own investigation. Both agencies also have jurisdiction over review of proposed mergers between two competitors in the same business market.[42] Since the establishment of the GPO safe harbor exemption, the DOJ has filed one lawsuit in relation to potential antitrust activity by a GPO, which resulted in a settlement agreement.[43] This is the only instance of a lawsuit filed against a GPO by the DOJ, and the GPO named in the lawsuit is not one of

[36] Sec. 1128B(b)(3)(E) of the Social Security Act, as amended by P.L. 100-93.
[37] Medicare and State Health Care Programs: Fraud and Abuse; OIG Anti-Kickback, 56 FR 35952 (July 29, 1991).
[38] U.S. Department of Health and Human Services Office of the Inspector General (2005, January). *Review of Revenue from Vendors at Three Group Purchasing Organizations and their Customers* (Publication No. A-05-03-00074).
[39] U.S. Department of Health and Human Services Office of the Inspector General (2005, May). *Review of Revenue from Vendors at Three Additional Group Purchasing Organizations and Their Members* (Publication No. A-05-04-00073).
[40] Ibid.
[41] GAO. (2012, March). *Group Purchasing Organizations: Federal Oversight and Self-Regulation* (Publication No. GAO-12-399R).
[42] GAO. *Group Purchasing Organizations: Federal Oversight and Self-Regulation* (GAO-12-399R). March 2012.
[43] *U.S. v. Ariz. Hosp. and Healthcare Assn*., CV07-1030-PHX (D. Ariz. filed May 22, 2007).

the five GPOs that participated in this report. While the FTC has acknowledged the receipt and subsequent investigation of complaints regarding the behavior of GPOs, they have not pursued any further actions.[44]

In September 2010, the signing of the agreement of MedAssets to acquire the Broadlane Group required both MedAssets and Broadlane to comply with the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The Act established the federal premerger notification program, which provides the FTC and the DOJ with information about large mergers and acquisitions before they occur. The parties to certain proposed transactions must submit premerger notification to the FTC and DOJ. Premerger notification involves completing a form entitled "Notification and Report Form for Certain Mergers and Acquisitions." The form contains required information that is then reviewed by the FTC's investigative staff who focuses on determining whether the acquisition presents competitive issues that warrant further review.[45] The FTC and DOJ promptly reviewed MedAssets' and Broadlane's filings. Following appropriate and proper review of the filings, the federal government granted the transaction an early termination of the waiting period, thus allowing the acquisition to be completed within 90 days of the initial filing. In approving the merger, the FTC specifically stated that the transaction would increase competition.

GPOs Reduce Health Care Costs

Independent analysts[46] have also examined the economic impact of GPOs, and have concluded that GPOs save their customers money, both in the form of lower prices for products and supplies, and in reduced administrative overhead cost. These conclusions support the idea that GPOs operate in a competitive marketplace, and deliver value to both their customers and vendors.

In 2013, Blair and Durrance performed an analysis of GPO contracting practices and their impact on a competitive health care market place. Specifically, the authors investigated whether GPO contracting practices, such as sole-source contracts and volume-based discounts, were anticompetitive and whether contract administration fees charged to vendors and membership fees charged to customers were conflicts of interest. The authors concluded that sole-source contracts and volume-based discounts are procompetitive. Sole-source contracts generally result in a lower price than what could be secured under a dual-source contract or a multiple-source contract. Additionally, volume-based discounts increase economies of scale for manufacturers, enabling them to offer lower prices. The authors also emphasize the competitiveness of the GPO industry, noting the large number of GPOs (over 600), and the ability of GPO customers to purchase products outside of a GPO's contract. Moreover, the authors warn that attempts to curtail the ability of GPOs to offer a full range of contracting options may lead to higher prices. GPOs use multiple tools to reduce prices. Manufacturers are more willing to negotiate lower prices in exchange for the higher purchasing volume expected through dual-source or sole-source contracts, or contract options that offer volume-based discounts. Eliminating those types of tools, therefore, can have the unintended consequence of increasing prices. On the issue of fees, the authors

[44] GAO. *Group Purchasing Organizations: Federal Oversight and Self-Regulation* (GAO-12-399R). March 2012.
[45] U.S. Federal Trade Commission. *Premerger Notification Program*. Retrieved from http://www.ftc.gov/enforcement/premerger-notification-program.
[46] Analysis in this section was conducted by independent parties and was not funded or supported by organizations that are directly involved with healthcare providers, GPOs, and/or manufacturers.

conclude that regulatory requirements surrounding full disclosures of fees dramatically reduce the potential for conflicts of interest to exist. [47]

Researchers from Purdue University also examined the impact of GPOs on prices and purchasing costs for healthcare providers, as well as manufacturer profits. The authors used a theoretical model to explore these issues. Their model showed that, overall, providers' total purchasing costs are decreased when using GPOs, even though in some instances, the per-unit prices of some products may be higher. This is especially true for small providers.[48] However, the model used in the study assumes a monopoly situation in which there is only one GPO. The authors acknowledge that the findings regarding higher unit prices, therefore, may be a result of this oversimplification of the actual current market (in which there are multiple GPOs competing against one another).[49] The authors also found that contract administration fees charged to manufacturers do not increase costs to providers, nor do fees have an adverse effect on manufacturer profits. While the study did not directly address the issue of the safe harbor provision, it did model a situation in which there were no GPOs (which would conceivably be the situation if the safe harbor exemption were rescinded), and concluded that in such a setting, health care prices would be higher.[50]

In 2008, Burns and Lee conducted a nationwide survey of hospital directors of materials management to gauge their perceptions of their relationships with GPOs. The hospitals surveyed were all customers of the seven largest GPOs at that time (Amerinet, Broadlane,[51] Consorta,[52] HealthTrust, MedAssets, Novation, and Premier) as well as individual customers of the Association of Healthcare Resource and Materials Management, a professional society of materials managers. The majority (85%) of hospitals used one of the national GPOs for over 50% of their commodity item spending, while almost as many (80%) used one of the national GPOs for over 50% of their pharmaceutical spending. The survey used a Likert rating scale method to measure hospitals' perceptions of whether GPOs delivered cost savings and lower prices, and whether they were satisfied with their GPOs. Using a scale of 1 to 5, with 5 representing the highest level of agreement, respondents' mean scores on those questions were 4.5 and 5, respectively. The authors concluded that there is high demand for GPO-type purchasing arrangements based on: 1) the hospitals' heavy reliance on GPO contracting for their purchasing decisions; 2) their overall satisfaction with the relationship and 3) the experience among hospitals surveyed that GPOs delivered value through lower prices and overall cost savings.[53]

In 2002, at the request of the U.S. Senate Subcommittee on Antitrust, Competition, and Business and Consumer Rights, of the Committee on the Judiciary, the GAO completed a pilot study of the role that GPOs play in the marketplace for medical devices purchased by hospitals. The study focused on two

[47] Blair, Roger D. and Christine P. Durrance. (2013). Group Purchasing Organizations, Monopsony, and Antitrust Policy. *Manage. Decis. Econ.*

[48] Hu, Qiaohai (Joice), Leroy B. Schwarz, and Nelson A. Uhan. *The Impact of Group Purchasing Organizations on Healthcare-Product Supply Chains.* Purdue University. May 2011.

[49] Healthcare Supply Chain Organization. *Recent University Research Examines the Impact of GPOs on Healthcare-Product Supply Chains*. Retrieved online http://www.supplychainassociation.org/?page=Studies

[50] Hu, Qiaohai (Joice), Leroy B. Schwarz, and Nelson A. Uhan. *The Impact of Group Purchasing Organizations on Healthcare-Product Supply Chains.* Purdue University. May 2011.

[51] Broadlane was acquired by MedAssets in 2010.

[52] Consorta is now a part of HealthTrust.

[53] Burns, L. R. and J. A. Lee. (2008). Hospital Purchasing Alliances: Utilization, Services, and Performance. *Health Care Manage Rev 33*(3), 203-215.

types of medical devices – cardiac pacemakers and safety needles – that were purchased by 18 hospitals, all located in one metropolitan area. The authors concluded that price savings varied by product, as well as by size of hospitals, with larger hospitals with higher purchasing volume more frequently obtaining lower prices outside of GPO contracts and smaller hospitals with lower purchasing volumes more frequently obtaining more favorable pricing when purchasing via GPO-negotiated contracts.[54] GAO acknowledged that the study had significant limitations in its methodology, however: a limited scope (the study was limited to two medical products, and the providers were all located in the same metropolitan area); a lack of consideration that hospitals purchasing outside of GPO contracts (which was more frequent among large hospitals) use the GPO-negotiated price as a starting point for price negotiations; the unique market for physician preference items such as pacemakers; and a lack of consideration for the savings associated with reduced administrative costs and overhead to hospitals as a result of their membership in a GPO. The GAO later concluded, in response to a 2009 request from Sen. Charles Grassley (R-IA), that the agency was unable to address these limitations and design a more sound methodology, and therefore could not respond to the Senator's request.[55]

Accountability

In 2005, nine of the larger GPOs in the country formed the Healthcare Group Purchasing Industry Initiative (HGPII), a self-regulatory organization intended to establish best practices for the industry. In order to join HGPII, customers must agree to:

- Follow the organization's code of conduct and its set of principles, including adopting a written code of business conduct;
- Deliver high quality health care services and cost effectiveness;
- Encourage open and competitive purchasing processes, sharing best practices with other customers;
- Be accountable to the public.

Each year, all HGPII customers, which now number 10 companies, submit a public accountability questionnaire that is made available to the public. HGPII also established an American Arbitration Association (AAA) review of grievances reported by vendors about GPO contracting practices, as well as the formation of a group of independent experts in business ethics to support HGPII' s efforts to promote compliance throughout the industry. If a vendor exhausts the extensive GPO grievance process, AAA is available to review the grievance.[56]

GPOs and Suppliers: A "Win-Win" Relationship that Drives Innovation

The value GPOs provide to suppliers goes beyond just increased sales volume. The GPO industry's focus on openness, accountability, and ethical business practices has led to a more transparent purchasing

[54] GAO. (2002, April). *Group Purchasing Organizations: Pilot Study Suggests Large Buying Groups Do Not Always Offer Hospitals Lower Prices* (Publication No. GAO-02-690T)
[55] U.S. Senate Finance Committee Minority Staff Report. (2010, September 24). *Empirical Data Lacking to Support Claims of Savings with Group Purchasing Organizations*. Retrieved from http://www.healthlawyers.org/News/Health%20Lawyers%20Weekly/Documents/10%2001%2010/2010-09-24-GPO-Report[1].pdf
[56] GAO. (2012, March). *Group Purchasing Organizations: Federal Oversight and Self-Regulation* (Publication No. GAO-12-399R).

process for all stakeholders in the health care supply chain. By reducing the transaction costs associated with purchasing medical products and supplies, GPOs increase the amount of available funds that hospitals have to spend on the products and supplies themselves. GPOs also help manufacturers and suppliers increase visibility for new products by offering access to a large pool of potential customers through a single negotiation point. With the reduction or elimination of the overhead and administrative costs, GPOs free up resources for the supplier that can be devoted toward research and development of new products.

Increasingly, suppliers are also looking for GPOs to assist with such services as placement of supply contracts on the GPO's online and other catalogs, access to trade fairs, assistance with product conversions, and assistance with managing the distribution of rebates. Further, the medical supply market is rapidly expanding with new entrants presenting supply chain options that compete with the traditional GPO model. The variety of GPO business models and methodologies provide health care organizations with multiple options to effectively manage supply chain costs and provide suppliers with services that help suppliers efficiently and cost-effectively service their customers (i.e. providers).

Competition and Costs

Multiple independent analyses of the GPO market have found that it is highly competitive. It is important to keep in mind that there is no monopoly power in the GPO marketplace. Rather, more than 600 GPOs compete for customers, and hospitals and other health care providers enjoy the flexibility to negotiate directly with manufacturers themselves. The fact that almost all hospitals are customers of at least one GPO demonstrates that hospitals see value in these associations. This is confirmed through surveys of hospital materials management personnel, who report high satisfaction with their GPO relationships.

The HHS OIG's office has examined the role of GPOs in the healthcare system and has found no evidence that GPO agreements have a negative impact on Medicare and Medicaid costs. Almost 30 years ago, the sitting HHS Inspector General, citing his office's conclusion that GPO agreements have led to lower prices for hospitals, and have not increased costs to the taxpayer, requested a blanket declination of prosecution from the DOJ in regards to GPO agreements.[57] Two separate audits from the HHS OIG have confirmed these findings.[58]

Over the past 10 years, as the GPO industry has continued to evolve to meet the needs of today's health care industry. Codes of conduct have resulted in more transparency in the contracting process and administrate fee disclosure. The GPO industry is a successfully self-regulating industry whose services continue to be in demand by their customers as evidenced by the extremely high purchasing rate through GPO contracts.

Conclusion

GPOs have served the U.S. healthcare system for over one hundred years. They provide services that are critical to the effective operation of healthcare organizations and to their ability to provide the highest

[57] Letter from Richard P. Kusserow to Stephen S. Trott, April 17, 1985.

[58] OIG. (2005, January). *Review of Revenue from Vendors at Three Group Purchasing Organizations and their Customers* (Publication No. A-05-03-00074).; and OIG (2005, May). *Review of Revenue from Vendors at Three Additional Group Purchasing Organizations and their Customers* (Publication No. A-05-04-00073).

quality prescription drugs, medical products and other products and services to patients at the lowest cost. In today's healthcare environment, it is more crucial than ever to control supply costs, lower the overall cost of healthcare, and provide the best possible care to patients.

GPOs negotiate the best price possible for the products and services that hospitals need in order to deliver quality patient care. GPOs help the U.S. health system control health care costs and at the same time ensure availability and reliability of those supplies, prescription drugs, and services that enable hospitals to treat patients.

As payment reforms from both public and private payers have migrated away from a more traditional fee-for-service system to a prospective, or bundled payment system, hospitals face increased pressure to reduce costs. GPOs have proven to be valuable partners supporting virtually every hospital across the country. GPOs have helped hospitals save money, and help manufacturers and distributors increase their market shares. The administrative fees that represent the majority of revenue for GPOs are extremely modest relative to the savings they enable. As much as 65% of this revenue is shared back with customers which can have an outsize effect on a Customer's bottom line.

Over the past decade, GPOs have made a concerted effort to address the needs of both their customers and their vendors while at the same time increasing their transparency and public accountability. Codes of conduct, innovative contracting and a suite of value-added services integral to contracting, have strengthened the relationship between hospitals and GPOs. By maximizing the efficiencies from pooled purchases of health care providers, GPOs are playing an important role in reducing the rate of health care spending that is currently plaguing the country. As the healthcare system continues to evolve, it is essential that GPOs remain viable and continue to be important partners for providers and manufacturers.

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Data Limitations

- As a result of the business and operational differences between each GPO, the data reported and used in this study is an approximation. Data reported is based on the individual GPO's fiscal year, which may or may not be in alignment with other GPOs and/or the calendar year.
- Each GPO maintains records and defines categories of supplies and products differently. The survey did not provide definitions for categories of medical products, and left categorization up to each GPO. For example, the same product may be considered a "supply" by one GPO and a "commodity" by another GPO.
- These same data limitations would also necessarily apply to any report or analysis that uses the same data set.

This report was prepared by Applied Policy, LLC, with support from the Healthcare Supply Chain Association (HSCA). HSCA and its members provided editorial guidance and feedback on the report during the preparation process.

GPOs: Helping to Increase Efficiency and Reduce Costs for Healthcare Providers and Suppliers

Submitted by:

APPLIED POLICY®

James G. Scott, J.D.
John S. Voorhees
Melissa Angel, MPP

October, 2014

Submitted to:
Healthcare Supply Chain Association (HSCA).