HEALTHCARE SUPPLY CHAIN ASSOCIATION
Innovators In Evidence-Based Sourcing

A PRIMER ON GROUP PURCHASING ORGANIZATIONS
Questions and Answers

What is a GPO?
A GPO is an entity that helps health care providers (such as hospitals, ambulatory care facilities, nursing homes and home health agencies) realize savings and efficiencies by aggregating purchasing volume and using that leverage to negotiate discounts with manufacturers, distributors and other vendors.

How does a GPO "work"?
GPOs do not purchase or buy any products. They negotiate contracts that hospitals can use when making their own purchases. With input from members and clients, GPOs work to negotiate contracts with healthcare manufacturers, distributors and other suppliers. After a group purchasing contract is created, it is still up to the hospital to decide which product is most appropriate in each circumstance and make the most appropriate purchase. Most health care providers make purchasing selections in a committee setting, usually comprised of healthcare professionals, such as doctors, nurses and other clinicians. These committees help determine which medical supplies are most appropriate from a clinical standpoint. Hospitals and other health care providers remain free to make non-GPO contracted purchases and often do.

What type of services do GPOs provide?
Hospitals and other health care providers are increasingly relying on GPOs to help manage the complex system of purchasing. Many GPOs offer hospitals e-commerce solutions to help manage their purchasing. The GPO community are leaders in the effort to reduce medical errors by helping to standardize some of the product use in hospitals, educating clinicians on best practices, and leading the drive to institute bar coding for medical products. GPOs provide a unique mechanism for a group of hospitals to coordinate not only purchasing power, but also brain power. By drawing upon their broad-based memberships or client base, GPOs give doctors, nurses, pharmacists and other clinical experts a pathway to evaluate new products and assess their impact on the quality of care. GPOs take the old adage that two minds are better than one, and apply it to health care decision-making.

What is the history of GPOs?
GPOs date back to 1909, when the Hospital Superintendents of New York first considered establishing a purchasing agent for laundry services. In 1910, the first GPO was created, the Hospital Bureau of New York. During the last quarter of the 20th century, the importance of GPOs grew as hospitals were faced with rising expenditures due to phenomenal advances in care and an aging population, as well as falling reimbursements from both the government and private sector payers. For many decades, healthcare GPOs grew slowly in number, to only 10 in 1962. Medicare and Medicaid stimulated growth in the number of GPOs to 40 in 1974. That number tripled between 1974 and 1977. With healthcare costs rising sharply in the early 1980s, the federal government revised Medicare from a system of fee-for-service (FFS) payments to Prospective Payment System (PPS), under which hospitals receive a fixed amount for each patient with a given diagnosis. In 1983, the institution of the PPS focused greater scrutiny on costs and fostered further rapid GPO expansion. By 2007, there were hundreds of healthcare GPOs, affiliates and cooperatives in the United States. Ninety six percent of all acute-care hospitals and 98 percent of all community hospitals held

at least one GPO membership. Importantly, 97 percent of all not-for-profit, non-governmental hospitals participated in some form of group purchasing.

Are there different types of GPOs?
If you've seen one GPO, you've really only seen one GPO, as they vary greatly in size, type of ownership and the services they offer their members and clients. Some GPOs are owned by hospitals, while others do not have a link to the facilities they serve. Some GPOs only serve not-for-profit hospitals, while others serve just proprietary facilities, and some serve a mix of the two. Some GPOs offer hospitals the ability to purchase nearly every conceivable type of product, while others focus on specific product categories. In addition, some GPOs specialize in certain types of health care, such as long-term care.

Are GPOs used solely in health care?
No, outside of the health care arena, the concept of group purchasing is seen throughout the economy. Indeed, GPOs provide hospitals and other health care providers the ability to use fundamental economic principles to reduce the cost of purchasing products and improve the quality of care. In addition to healthcare, the federal government, namely the General Services Administration, Department of Defense, and Department of Veterans Affairs, use many of the same techniques for purchasing products as GPOs.

How many GPOs are there in the United States?
There are more than 600 organizations in the United States that participate in some form of group purchasing. About 30 of the 600 are very large GPOs that negotiate sizeable contracts for their members. The remaining organizations may offer their members access to larger groups' contracts and negotiate agreements with regional vendors for some services.

Why are GPOs used/important in the health care industry?
Hospitals and other health care providers use group purchasing to obtain the right products at the very best price. On average, about 72% of purchases that hospitals make are done using GPO contracts.

What type of health care entities use GPOs?
All types of health care organizations use group purchasing. Nearly every hospital in the U.S. (approximately 96% to 98%) chooses to utilize GPO contracts for their purchasing functions. Additionally, estimates are that hospitals across the United States use, on average, two to four GPOs per facility. A growing portion of the long-term care, ambulatory care, home care, and physician practice markets are using group purchasing to help lower costs and improve efficiency. Further, the federal government also provides group purchasing services to various executive branch agencies.

How do GPOs finance their operations?
GPOs rely, in part, on administrative fees paid by vendors to finance the services the GPOs offer health care providers. These administrative fees are generally based upon the purchase price that the health care provider pays for a product purchased through a GPO contract. The administrative fee is paid when a GPO's member or client utilizes a GPO contract.

What are administrative fees?

The contracting services that GPOs provide to hospitals, other health care providers and product and/or service vendors are financed in part by administrative fees paid to GPOs by vendors. These fees are generally based on the purchase price the health care provider pays for a product purchased through a GPO contract. The fee is paid only when a GPO's healthcare provider, or member, utilizes a GPO contract for that vendor's product(s) or service(s), and not before. In general, administrative fees are used to support a portion of GPO operating expenses and in many instances return an efficiency dividend to member hospitals. GPOs are required to report all administrative fees to their customers; these customers must then report to the Medicare program as part of the cost report.

Why are administrative fees an essential part of the GPO business model? What is the value in allowing GPOs to earn administrative fees from vendors?
The value in GPOs earning administrative fees is that it allows hospitals and health care providers to dedicate more financial resources to the direct provision of patient care, such as employing additional doctors or nurses, purchasing the most advanced products, or a host of other goals. Administrative fees provide strong incentives for vendors (e.g., product and commodity manufacturers) to provide deeper discounts and for hospital members to concentrate purchasing volume to obtain better prices. In 2003, when the Government Accountability Office studied how GPOs operate, it found that in addition to using these fees to cover their operating expenses, GPOs often distribute surplus fees to member hospitals. They may also use administrative fees to finance new ventures, such as electronic commerce, that are outside their core business. Without the ability to earn administrative fees, hospitals would be in a terrible situation. They would have to choose between diverting financial resources from the direct administration of patient care to fund the operations of GPOs or they would have to stop using GPOs altogether, thereby losing the volume discounts and raising the cost of healthcare.

Why did Congress grant GPOs "Safe Harbor" from federal statutes?
The purpose of GPO "Safe Harbor" regulations is to reduce costs and assist hospitals in their purchasing needs. In 1991, HHS promulgated safe harbor regulations, reflecting Congress' intent to permit contract administration fees. "Safe Harbor" regulations describe how health care providers should structure their financial transactions so they can comply with federal law and charge vendors' administrative fees.
The "Safe Harbor Provision" in the Medicare and Medicaid Patient Protection Act of 1987 states: "GPOs may be allowed to provide goods or services to a hospital or health care provider as long as both of the following two standards are met – (1) The GPO must have a written agreement with each hospital or healthcare provider, that provides for either of the following agreements: (a) The vendor from which the hospital or health care provider will purchase goods or services will pay a fee to the GPO of 3 percent or less of the purchase price of the goods or services provided by that vendor, and (b) In the event the fee paid to the GPO is not fixed at 3 percent or less of the purchase price of the goods or services, the agreement specifies the exact percentage or amount of the fee. (2) The GPO must disclose in writing to the hospital or health care provider at least annually, the amount received from each vendor with respect to purchases made by or on behalf of the hospital or health care provider." Congress should leave this Safe Harbor provision the way it is because the system is designed to ensure hospitals get the best deal possible. GPOs do not get paid their administrative fee from suppliers until a hospital buys something off the contract. GPOs also adhere to an industry Code of Conduct that ensures protection against conflicts of interest, opportunities for small manufacturers to obtain GPO contracts, and compliance with anti-kickback

and anti-trust laws. This self-regulation requires transparency of GPO-vendor relationships and allows GPOs to respond most effectively to the needs of the health care marketplace.

Do GPOs limit vendor competition? Or limit new innovative technologies and related firms from entering the health care market?

No. In 2008, Lawton Burns, professor at the Wharton School, University of Pennsylvania, conducted a national survey of health care provider materials management executives and found, among other things, that there was no merit to the accusation that GPOs limit innovation or inhibit competition in the marketplace. The study was funded by the National Science Foundation. When asked this question, Professor Burns replied, “There was no great feeling among the survey respondents that the GPOs were blocking access to newer innovative technologies. That whole claim has basically been brought by a handful of small start-up companies…“I’ve been studying that issue for some time. I believe that’s a bunch of bunk. One of the other criticisms that’s been leveled at the GPOs has to do with the sole source contracts and dual source contracts and how those allegedly exclude new companies, as well as the issue of multi-product, multi-vendor bundling. Those practices are always at the center of those disputes. Critics of the GPOs complain these are anti-competitive practices. I don’t believe that either. The study shows that materials managers actually find those practices that the GPOs utilize to be very helpful.” (Source: *The Journal of Healthcare Contracting*, November/December 2008).

What is HSCA?

The Healthcare Supply Chain Association (HSCA) www.supplychainassociation.org is a broad-based trade association that represents 16 group purchasing organizations, including not-for-profit and for-profit corporations, purchasing groups, associations, multi-hospital systems and health care provider alliances. HSCA's mission is to advocate on behalf of health care group purchasing associations, to provide educational opportunities designed to improve efficiencies in the purchase, sale and utilization of all goods and services within the health industry and to promote meaningful dialogue between GPOs.