IDNs and GPOs Past, Present and Future — Collaborations to Achieve a Better Model and Outcome

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Overview

• GPOs and IDNs
• History
• Purpose
• Antitrust Issues
• Reimbursement
• Large IDNs
• Changing Environment
• Future
History of GPOs

- The first group purchasing organization was established in 1910
- GPOs created to leverage the purchasing power of group of businesses to obtain discounts from vendors
- GPOs are not unique to healthcare and are used in many markets outside of healthcare
History of GPOs

- There are all types of GPOs:
  - Some are large others are small
  - Some are owned by health entities where others have no link to purchaser
  - Some serve niche markets whereas others have a wide variety of products
  - Some are national and some are regional
History of GPOs

• Prior to introduction of Medicare DRGs in 1983, the healthcare reimbursement system was cost plus and inefficient providers were profitable

• Medicare and Medicaid caused growth in GPOs especially Medicare’s movement from fee for service (FFS) to Prospective Payment System (PPS)

• Hospitals received fixed amount for patient with a specific diagnosis. (DRGs)

• Movement from a costs plus system to a system where controlling costs became important

• This gave health providers the incentive to cut costs and led to a market for GPOs in healthcare
History of GPOs

• GPOs came to prominence during last quarter of the 20th century as they steadily aggregated the purchasing of hospitals and IDNs

• In 1991 GPOs granted safe harbors by Congress

• Over 95% of hospitals in nation belong to at least one GPO

• Approximately 72% of hospital purchases are through GPOs
IDNs

- The changes to Medicare in 1983 also led to the expansion of Integrated Delivery Networks (IDNs).
- Oosdyke states that, “An IDN is an organization of healthcare providers, which, through ownership or formal agreements, aligns local healthcare facilities and manages them with one governing board.”
- Just like GPOs, IDNs are very diverse.
- Often stated if you have seen one IDN you have seen one IDN.
IDNs

- Each IDN is unique but they have one thing in common that is to minimize costs of operations
- IDNs have 3 performance categories: access, high-value of standardized coordinated care, keeping people in-network
- Efficiencies became more important for IDNs under pressure from PPS and MCOs
- Thus, controlling costs became a high priority for IDNs
- A major portion of these costs is through the supply chain
IDNs and GPOs

- GPOs can decrease costs for IDNs by
  1. Aggregating purchasing power: lower input prices
  2. Reduction in personnel needed to negotiate input prices: lower labor costs
  3. Fees paid by vendors: No out of pocket costs (these fees may be passed onto IDN in form of higher prices)
  4. Voluntary so if not working can leave certain GPO and go to another one or bypass GPOs entirely by negotiating directly with supplier
  5. Use GPO negotiated price as price ceiling for direct purchases

- GPOs may not get lowest possible price but achieve lower prices and are especially helpful to smaller IDNs
The purpose of GPO is to negotiate lower prices for healthcare providers’ inputs through bulk buying and decreasing the costs of staff to negotiate contracts.

GPO helps healthcare providers achieve savings and efficiencies by aggregating purchases and using that leverage to negotiate discounts with vendors.

GPOs do not purchase products, only negotiate price and IDNs have option to purchase at that price or if large IDNS can use it as price ceiling.

GPOs are generally paid a fee of 1 to 3 percent of purchase price of IDNs by supplier.

GPOs are in many industries and they can perform a valuable function.
Purpose of GPOs is to Decrease Costs

- GPOs allow hospitals and IDNs to dedicate more resources to the provision of healthcare
- As more physicians become employees they lose autonomy and IDN can decide what medical devices to use so have homogeneity within IDNs
- IDNs represent the majority of healthcare spend and this percent of spend will continue to grow even though number of IDNs may decrease in future due to mergers
- Savings from use of GPOs go directly to the bottom line of IDNs
- IDNs will use GPOs when they create value
Purpose of GPOs is to Decrease Costs

- Burns reports that GPOs services can include, clinical review process, e-commerce solutions and technology assessment
- GPOs can decrease transactions costs for both buyer and seller
- For any given product there is one negotiation instead of many individual ones between the various buyers and sellers
- Instead of negotiating with about 5000 hospitals, negotiate with far fewer and transaction costs can be cut for hospitals as well since there would be less need for backroom employees
- According to Schneller hospitals also save money by spending on average approximately $600,000 to $800,000 less on contracting staff and operations
Purpose of GPOs is to Decrease Costs

• This is also possible for IDNs

• Henson states that “Most IDNs don’t have the staff to negotiate with thousands of vendors. They will negotiate large spend areas, capital or minor equipment contracts on their own or in conjunction with their GPO.”

• Thus, GPOs create value by decreasing transaction costs and possible input prices

• Larger IDNs can negotiate lower prices on their own while smaller IDNs get GPO negotiated prices

• So GPO lead to lower prices since have benchmark and IDNs would need to add staffing to compensate for the functions provided by GPOs
Purpose of GPOs is to Decrease Costs

- Most IDNs use GPOs but larger ones purchase a smaller percentage because they have more negotiating power.
- So small IDNs see greater savings from using GPOs.
- GPOs saved money on product prices, reduced transaction costs, improved revenues through rebates and dividends.
- U.S. 8th Circuit Court of Appeals in 2010 found that hospitals pay 16% less when using GPO contracts, that membership is voluntary, can easily switch GPOs and most belong to more than one.
- According to the Supreme Court, GPOs “increase economic efficiency and render markets more not less competitive” and “cost savings...enable small retailers to reduce prices and maintain their retail stock so as to compete more effectively with large retailers.”
Hovenkamp contends that GPOs can potentially lead to some antitrust issues.

Exclusive dealing (sole source contracting) and some related discounting practices can be anticompetitive under certain conditions.

These conditions don’t generally exist with healthcare GPOs.

No GPO has a large enough market share to foreclose the market.

The 2 largest control around 60% of market, 33% and 27%, respectively and 6 largest around 90% of the market.
Antitrust Issues

- Burns believes that the GPO marketplace is competitive.
- There are large national GPOs, a growing number of regional and local GPOs.
- GPOs compete with each other and increase competition in the supplier’s market.
- GPOs can make IDNs more aware of new products and technology and IDNs seem to be satisfied with GPOs.
- There are several large national GPOs so monopsony power does not seem to be a problem.
Antitrust Issues

- There have been various antitrust lawsuits concerning GPOs
- GPOs account for more than 70% of hospital purchases
- Monopsony power can lead to lower prices but also antitrust concerns.
- Indeed, prices can be too low if a monopsony exists
- This is unlikely given the market shares involved but if the products are specialized, hospitals may buy a large portion
- A possible exception may be for goods purchased by only large teaching hospitals like PET scans
Antitrust Issues

• Another possible issue is the impact of buying groups on output prices.

• Given that hospitals generally operate in different markets, impacts on the selling side are unlikely.

• Bundling of complementary goods can be anticompetitive since not all suppliers provide all the products.

• There have been some antitrust issues with GPOs.

• Tyco Health Care Group use of sole source and bundling violated antitrust and led to $140 million jury verdict that was affirmed by Ninth Circuit (Masimo v. Tyco).

• Two GPOs and incumbent medical device supplier settled antitrust suit for $150 million.

• No FTC or DOJ enforcement actions against GPOs.
Antitrust Issues

- In 2010 case Southeast Missouri Hospital v. Bard, 8th Circuit Court of Appeals “ruled that sole-source provisions, tiered pricing and bundled discounts did not violate antitrust laws.”

- Court made following statements: GPO membership is voluntary and highly competitive, GPO don’t purchase supplies just negotiate contracts, GPO hospitals can purchase supplies off-contract, on average hospitals pay 16% less by buying through GPO contracts.

- Physician Buying Groups function like GPOs and in Castro v. Sanofi Pasteur Inc. the court held that “PBGs create efficiencies for their members and are not, therefore, presumptively anticompetitive.”
Antitrust Issues

• Ability to negotiate discounts with suppliers that is purpose of GPOs

• So most have some control over price but not enough to decrease competition

• Safe harbors for GPOs were enacted by Congress in 1991 but Blair recommends that safe harbors should be eliminated and rule of reason approach be taken

• Burns no merit to claim that GPOs limit innovation or decrease competition
Reimbursement

- GPOs obtain revenue by collecting fees from vendors, generally between 1% and 3% of total purchases, generated by the GPOs price negotiations.
- GPOs do not buy products
- IDNs decide which product to purchase
Reimbursement

• Some authors associate GPOs with real estate agents who represent the buyer but are compensated by the seller.

• Some have questioned whether this gives the GPOs the incentive to raise prices since compensation is based on total revenue.

• IDNs, unlike home buyers, are continual buyers so if IDNs do not get a good deal, they will switch to another GPO or buy directly.

• This makes it different from real estate, where one may use an agent every 10 years.
Reimbursement

- The percentage of revenue model leads to an incentive to have higher prices.

- As long as there is considerable competition and IDNs have more than one GPO that is selling the same product, IDNs can play GPOs off against another.

- So IDNs will look for the lowest prices and there is enough competition in the market for them to do so.
Large IDNs

- With trend towards consolidation at what point does a hospital system or IDN become large enough to bypass GPO and become its own GPO?

- IDNs have the potential to replace the current GPO model and impact the $600 billion supply chain

- Many GPOs are affiliated or owned by IDNs

- Large IDNs realized that it may be less expensive to build supporting infrastructure and not only purchase for themselves but other buyers

- So must weigh the options and where have sufficient volume negotiate directly as some IDNs are currently doing
Large IDNs

- IDNs are indirectly paying the fees for GPOs in the form of higher negotiated GPO prices
- So in some cases can save by buying directly and eliminating the middleman
- In other cases, use GPO when benefits are greater than costs
- So hybrid system developing where IDNs will use GPOs for some purchases
- This could result in a better run supply chain and better IDNs relationship with suppliers
Large IDNs

- So IDNs need to do a cost benefit analysis to determine what and when it is better to negotiate directly.

- GPOs still provide a service to the IDNs in that the GPOs price is a starting point the maximum price (price ceiling) that the IDN will pay.

- Regional Purchasing Coalitions (RPC) a group of healthcare providers that have voluntarily combined purchasing volume to access tier pricing through their directly with suppliers are also in the market.

- RPC can be a threat to GPOs.
Large IDNs

- Some IDNs are moving to self-distributing
- Intermountain believes it could recoup $40 million investment in warehouse and office building in $4\frac{1}{2}$ years through self-distributing
- Large IDNs can do it but small ones can’t
Changing Environment

- Everyone is trying to bring prices for healthcare under control
- There are so many hands touching the supply chain and all making money
- No longer just about price of inputs
- All players are no longer just looking for lowest supply costs but new ways of doing business
- No longer look at just the costs of input but need to take into account overall healthcare costs
Changing Environment

- Pressure on manufacturers to reinvent themselves and cut costs without decreasing quality
- To save money identifying customers who take deliveries via one-day ground v. overnight air
- GPOs serve as advisors to make departments more safe and effective, reduce number of errors, and promote safety efforts
- Value analysis team can recommend more expensive product that saves money
- Switching from a lower priced to a higher priced product can reduce infection rates and decrease overall costs
- For example, a certain catheter device costs 30% more but patients recover faster and are out of hospital sooner which deceases costs
Changing Environment

- Decisions on whether to refurbish machines or buy new machine or rent v. buy
- Amerinet (GPO) saves money by auditing prices
- Move towards standardization, can save money by not buying 9 different types of gloves
- Owen and Binder (distributor) sells products from 1200 manufacturers so can send one shipment v. GPO procurement with many shipments which saves shipping costs
- No longer look at just the price of input but need to take into account overall healthcare costs
Future

• Some large IDNs are actually generating revenue by doing supply chain work for other medical centers

• Thus, providing the same function as a GPO but with lower prices

• IDNs use the GPO price as the base (price ceiling) and ask for better pricing by delivering market share

• GPOs can potentially lose significant market share as this model expands
Future

• GPO's seem to be more passive and are providing a form of access as well as collecting administrative fees

• The GPO model is not delivering as much value to the hospital/medical center nor to PHARMA as the IDN model

• One would expect the GPO model to lose market share and the IDN supply chain to increase its market share

• So GPO in healthcare may eventually be replaced by the IDN supply chain
Questions?