

## **Understanding How Group Purchasing Organizations Work**

### ***Why Administrative Fee Payments Keep Hospital and Patient Costs Down***

#### **Summary:**

- Group Purchasing Organizations, or GPOs, save the U.S. health care industry more than \$36 billion annually – They are the ‘Unsung Hero’ in Health Care Reform!
- Small administrative fees (generally less than 3%) are paid to GPOs by vendors who provide hospitals with pharmacy, orthopedic, housekeeping and other clinical products.
- These administrative fees enable GPOs to benefit its members. Congress designed this system to make certain hospitals get the best deals.
- Administrative fees allow GPOs to fulfill their mission, which is to encourage competition and reduce overall costs for *all* players in the health care system, especially for hospitals and health care providers.
- Manufacturer, distributor and supplier fee payments keep hospital and patient costs down -- making health care more affordable to them and taxpayers.
- Fees are clear and transparent – GPOs report all fees to their customers.
- The current fee system works – it is in the best interest of the health care industry to keep this process ‘as is’ and avoid hitting struggling hospitals with additional costs.

#### **The Role of Group Purchasing Organizations: Bulk-Buying Saves Big Dollars!**

GPOs play a key role in helping hospitals and other health care organizations across the country save billions annually. An April 2009 study by Dr. Eugene Schneller, entitled, ‘The Value of Group Purchasing 2009: Meeting the Needs for Strategic Savings’, finds that **GPOs save the U.S. health care industry over \$36 billion dollars annually**. GPOs afford health care providers great leverage and bulk-buying power allowing them to buy products and services at a lower cost than they could get by individually buying the same goods and services. By using GPOs, health care providers avoid the time and money required to negotiate and execute potentially thousands of individual contracts. **For example, Dr. Schneller found that hospitals, working without their GPO, would need to spend approximately \$600,000 to \$800,000 more annually on contracting staff and operations.** GPO savings allow hospitals and health care providers to dedicate more of their scarce financial resources directly to patient care, hiring additional doctors and nurses, and purchasing more advanced products and technology.

#### **GPO Fees and Services Provide Greater Incentives and Competition**

The current vendor administrative fee process provides strong incentives for distributors and suppliers to provide deeper discounts and for hospital members to concentrate purchasing volume to obtain better prices. In 2003, the Government Accountability Office studied how GPOs operate, and found that in addition to using these fees to cover their operating expenses, GPOs distribute surplus fees to member hospitals. They may also use administrative fees to finance new ventures, such as health information technology, electronic commerce and patient safety efforts that add additional value to their core contracting functions.

**Administrative fees play an integral role in maintaining an open, transparent process with member hospitals.** Member hospitals select the most efficient and effective GPOs; competition between GPOs ensures that hospitals get the best pricing for the broadest array of services. These fees are wholly transparent and are reported on a regular basis to the GPO health care provider members, who in turn report them to the Department of Health and Human Services.

## A Complicated Process Made Simple: Understanding GPO Fees

Group Purchasing Organizations: Contracting for the Best Value for Hospitals, nursing homes and other providers



The chart shows the movement of payments and services between GPOs, health care providers, and vendors (e.g., manufacturers, suppliers and distributors).

- 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 (e.g., manufacturers, suppliers and distributors) <sup>(1)</sup>.
- **Known in the industry as administrative fees, these voluntary charges 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, uses a GPO contract for that vendor's product(s) or service(s), and not before.
- Administrative fees support a portion of GPO operating expenses. These fees are passed along to the health care provider as cash disbursement.
- Health care providers purchase products and services directly from suppliers; suppliers return rebates to health care providers.
- Vendors pay GPOs administrative fees to negotiate contracts for medical devices, products and services that will be purchased by hospitals. This helps them avoid significant costs associated with individual negotiations with thousands of hospitals, in turn lowering overall healthcare costs.
- Some organizations return administrative fees as dividends to their member health care providers; some GPOs use them to work with health care providers to improve the quality and safety of patient care.
- **Limiting GPO administrative fees would require hospitals to pay more so that GPOs could continue to operate and negotiate on their behalf. This would require billions of additional dollars and penalize vulnerable hospitals struggling to make ends meet during a time of declining reimbursements and negative economic performance.**

### The Current System Works and Should Remain Unchanged!

Enacted by Congress in 1987, the Medicare and Medicaid Patient Protection Act 1987 allows GPOs to charge administrative fees to suppliers while providing services to hospitals. In 1991, the Department of Health and Human Services produced "Safe Harbor" regulations, reflecting Congress' intent to permit contract administration fees. "Safe Harbor" regulations describe how health care providers are required to structure their financial transactions so that they comply with federal law. In addition, Congress also passed a "Safe Harbor" for "discounts" at the same time.

The "Safe Harbor Provision" 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 health care 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 continue to maintain this Safe Harbor Provision! Congress crafted this system to ensure that hospitals get the best deals possible!***

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*1. In 2005, the nation’s leading GPOs, serving the majority of America’s hospitals, founded the Healthcare Group Purchasing Industry Initiative (HGPII) to ensure total transparency into their business practices, their fees and the shared savings returned to hospitals. All results are reported publicly on the HGPII Web site. This self-regulation requires transparency of GPO-vendor relationships and allows GPOs to respond most effectively to the needs of the health care marketplace.*