Favoring a fee-based GPO system

To the Editor,

Judging by the feedback from my previous letter ("Has the traditional GPO now come full circle?" *Healthcare Purchasing News,* May 2003, pg. 67), I sense substantial interest in returning to a simpler, more productively efficient, less adversarial time in our trade. But can the clock really be turned back?

The short answer is: YES!

How do we start? Where do we go? Who will lead the charge?

As with most fundamental shifts, the beginnings are usually humble, initiated by bold, determined people with vision and a dream.

First, let us agree that the GPO *does* have a bright future in healthcare. Almost from the start, group purchasing has been an integral part of facilitating effective and proficient delivery of healthcare to this nation, no question. Properly oriented, the modern GPO will be even more important as time marches on and financial/political pressures mount.

All right then, the task at hand is to articulate the idea, spread the word and convince the masses. Consistent with those laudable endeavors, consider for the moment the so-called "fee-based" model of doing business. The concept is well known, tried and true. In fact, practically the whole industry was founded on this principle in its purest form. It has worked for years and spawned many a success story. Unfortunately, in my opinion, a good portion of the industry has moved far off the reservation.

The advantages of retuning to this way "old" way of doing things are numerous and easy to grasp. For instance, by returning all administrative fees, incentives and rebates right back to the folks the group represents, all sorts of complications and unpleasantness can be avoided.

Think about it. No longer would there be a need to appear before powerful and frequently hypocritical politicians to justify what armies of creative accountants with green visors are doing with buckets of cash. Avoiding such privacy and embarrassment issues is just one benefit. There are many others. For example, complex transparency and ethical questions that are the current rage, resolve themselves almost immediately without so much as a whimper. There is simply nothing to conceal. The lines are clean and clear.

These other "rewards" aside for the moment, the fee-based GPO just makes excellent economic sense for everyone sitting at the table. The fee-paying member benefits by knowing the exact financial contribution necessary to belong and knows exactly what will be returned to the organization in the form of administrative fees, incentives and rebates. What this means in English is that members will no longer be at the economic mercy of intermediaries. Hoping for substantial returns from others based on nebulous promises or a guarantee that some ill-conceived pet project will be the financial savior of all concerned will be nothing but a dim unpleasant memory. Organizations belonging to a purely fee-based GPO are the captains of their respective fiscal ships, period.

From the suppliers' perspective, the fee-based model works extremely well. The full value of the economic benefit arising from the contracts involved is by definition returned 100 percent to the customer, no waste or offset. Naturally, purchasing and loyalty is greatly enhanced by the total return creating the financial incentive to drive superior compliance within the individual agreements themselves. The Holy Grail realized.

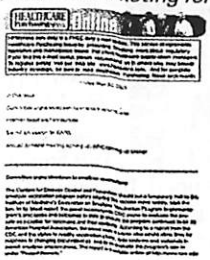
Under the fee-based model, the GPO itself makes money by having members. The more members, the more dollars, simply and ethically. Accordingly, the GPO has an extraordinary incentive to grow its roster by obtaining/maintaining an aggressive and competitive contract portfolio coupled with first-class customer service to assist those legions of members. Maximization of administrative fees funneled back to the GPO is not the goal. This represents a radical and fundamental departure from the current status quo. I suppose in a word, by adopting this new/old policy, we are talking about efficiency across almost almost 1/7th of our entire economy.

This is all very exciting stuff, a brave new/old world, if you will. I believe in it. I am living it in a professional sense. Sir Winston Churchill said it best when he quipped, "Kites rise highest against the wind, not with it." If you agree with Sir Winston and me, think about the possibilities.

Lisa/Michael Sokol

Chicago

Editor's Note: Lisa Sokol is the former vice president of marketing for Premier Inc.



To the Editor,

I enjoy your daily updates. I especially appreciate the article " AmeriNet Aglow..... Keep up the good work.

—Susan Bond

To the Editor,

I just wanted to tell you how much I appreciate receiving HPNOnline Update. The information is succinct and written in clear language. The topics are relevant and helpful.

Thanks for providing such a useful and well done product.

—Cathi Cline
Materials Management
Main Surgery
Mercy General Hospital
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Letters

Penny wise

To the Editor,

In response to AHRMM Idea column by William Stitt, ("Navigating the issue of local purchasing and its effect on the community," *Healthcare Purchasing News,* May 2003), William Stitt and Reid Hospital (Richmond, IN) are to be commended for considering the impact of their purchasing decisions on the community that supports their mission and for taking action. In our experience, many similar commitments tend to stay in the boardroom and rarely extend to where the rubber meets the road. Most organizations that understand the dynamic impact of the state and local tax base on healthcare funding seem to quickly lose their resolve if their philosophy inconveniently increases prices by a penny or two.

The chafe of a "buy local" philosophy comes when factors less tangible than price must be quantified. The approach of many organizations is to take their low-service prices to high-service vendors and say, "we really like your service; if you can beat this price, we will give you our business." Not exactly a visionary notion. Those stopping so far short of the mark expose any "buy local" philosophy as a sham.

Years ago, I was impressed by the suggestion from a supplier competing with a local company that if I felt too guilty about moving the business, I could take the substantial savings from the conversion and give half of it back to the local guy. So don't count me among those that think the survival of our endangered community hospitals is so unimportant as to throw money away just to appease a few Rotarians.

Some buyers will recognize the wisdom of paying a premium for local service, though the economically justifiable amount may be elusive. Mr. Stitt expresses a willingness to pay a "minimal premium," but his hospital's website goes further, saying that 5 percent to 10 percent is generally reasonable. This may be minimal for office supplies, but it certainly isn't minimal for med-surg products where the overall gross margin is in the same range. Logically, this premium percentage would go down as the dollars spent go up. Still, the key is for any premium to be objectively derived and not just an amount that the hospital's transient financial condition can absorb for the sake of local good will.

Everyone would agree in principle that support of local businesses is a good thing. Too often, that local support is limited to the companies owned by board members and other community movers and shakers whose oxen stand to be gored. Yet the logic and economics supporting "buy local" extend further to the county, the region, the state, and then the multi-state region most proximal to the buyer.

The buyer's location naturally affects the proximity of viable suppliers across the range of products and services. There are many more locally owned office suppliers than medical distributors, and fewer still local MRI manufacturers. Yet "the closer the better" generally applies to any supply relationship.

Why exactly is the local supplier not competitive with the "national supplier" from the "GPO/alliance"? After figuring out what your local supplier may really be "worth" in dollars that is the next best question that is too rarely asked. That can of worms contains economic, political, financial and even legal questions.

In each competitive category, there is a critical mass of investment and volume required to be "competitive" at the highest level. Where that mass is lacking, the business had better define their niche and be content to serve it or else get out of the business (often by selling to a national company). In some businesses, assumption of the risk level required to be fully competitive is unattractive to local ownership. In others, there is an emotional reason (wanting to stay "small") or Peter Principle (the business grows to a point just above the owners' level of competence) at work. Still others may be very willing and very able, but face questionable, perhaps illegal, structural obstacles to remaining "competitive." Those that are willing and able warrant more in-depth dialogue that could lead to partnerships giving the healthcare provider the best of both worlds.

It is not coincidental that even this "buy local" issue has a "Safe Harbor" and "GPO Abuse" angle. Many GPO initiatives to contract with small and disadvantaged businesses are smokescreens to deflect media criticism and gain "diversity" talking points. The truth remains that for many GPOs, there is financial benefit in cramming the large national suppliers, particularly distributors, down the throats of their docile members.

It has long been the habit of GPOs to pressure their manufacturer contract holders (those that typically sell through distributors) to restrict access to the discriminatory pricing they have negotiated to the distributor(s) handpicked by the GPO (and paying fees for the privilege). With access blocked by the manufacturer to these discriminatorily low "contract" costs, the disfavored distributor (who is not paying fees to the GPO) that is otherwise fully authorized to distribute the manufacturer's products finds they are blocked as well from being allowed to compete for the customer's business. Though Section 2(a) of the Robinson-Patman Act guarantees similarly situated and competing resellers access to equal cost from manufacturers when competing for the same customer's business, some GPOs have persuaded their manufacturing partners to risk violation of the law, or so it would seem. The mothers of the manufacturers' legal advisors must have forgotten to ask them at an appropriately early age: 'If Johnny robbed a bank, would you do it too?'

This is a complex issue that defies soundbyte explanation, but it is our tolerance for payment of administrative fees resembling sales commissions (or bribes) that fuels the GPO obsession to limit the choice of distributors available to their members. Without the Safe Harbor to protect them, and in virtually any other industry, such fees would be seen as improper or illegal kickbacks that serve the interests of the GPO at the expense of their members.

Community hospitals have enough problems without their GPO partners standing in the way of their balanced and reasoned support of local businesses.

Everything is still local and nothing is more local than healthcare. Community hospitals and community businesses are both endangered species. In many ways they will sink or swim together.

Alan Grogan
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