Does Medtronic action signal a shift?

Medtronic caused a stir in February 2011 when it canceled several contracts with the 2 largest group purchasing organizations (GPOs), Novation and Premier. The big device company ended 5 Novation contracts worth $2 billion covering spinal implants, neurosurgery power tools, bone graft materials, and cardiac rhythm management products plus a Premier spine contract.

Novation expressed “extreme disappointment” in a letter to Medtronic signed by 16 supply chain executives from major health systems such as Boston-based Partners HealthCare, BJC Healthcare in St Louis, and Sutter Health in California.

Premier referred requests for comment to the Health Industry Group Purchasing Association (HIGPA), which bluntly stated that Medtronic’s decision “puts greed ahead of patients, and is nothing short of an attack on America’s hospitals.”

Without the ability to benchmark pricing through GPOs, HIGPA said hospitals would be left “to negotiate with a device maker that will now be able to charge whatever local markets will bear.”

Rural hospitals, especially, would be at a disadvantage, HIGPA said, because they would not have the size and volume to leverage against a corporation the size of Medtronic.

Is more to come? Does Medtronic’s move signal a shift in the relationship between companies and GPOs?

Medtronic “has not, as is alleged, made a decision to eliminate all GPOs,” company spokesman Christopher Garland wrote OR Manager in an email. He said the company believes it can best meet its customers’ “varied needs” using a local approach, noting about 85% of its contracts are already negotiated that way. He said the company is evaluating its national contracts on a case-by-case basis and referred to the canceled Novation agreements as “underperforming.”

A license to fish

But supply chain experts think Medtronic’s move could break the ice, and other companies could start pulling out of GPO contracts.

“This is simply a business decision about value (or lack thereof) received. It is something that will cause companies to carefully evaluate their participation with GPOs and ask, ‘Am I getting value? Is this contract performing at the level I’m expecting?’” says Jamie Kowalski, CEO of Jamie C. Kowalski Consulting LLC, an independent supply chain consultant who’s worked with health care providers, suppliers, and GPOs.

A GPO contract is like a license to fish, he explains, but doesn’t guarantee any fish. In other words, a group purchasing contract gives a company access to potential customers under agreed-upon terms but can’t guarantee those hospitals will purchase what they commit to under a contract.

Kowalski says supplier execs have long confided their skepticism about the value
they get from GPOs and “have been looking for the first company to start the snowball rolling.”

Companies pay GPO fees of up to 3% when their customers purchase through GPO contracts, and those fees are GPOs’ main source of revenue. But increasingly, companies question whether the fees are worth their while.

More companies could now follow Medtronic’s lead, Kowalski says, including those selling high-volume consumable supplies.

Another possible motivation for companies to pull out of GPOs is the federal medical device tax approved as part of the health care reform legislation, notes Robert Yokl, a supply chain consultant with Strategic Value Analysis in Healthcare. The 2.3% tax on companies’ gross medical device sales takes effect in 2013.

If companies were to stop paying the 2% to 3% fee they pay to GPOs, “that solves their problem with the tax,” Yokl told OR Manager. He thinks another motivating factor may be the consulting GPOs do to reduce the cost of physician preference items like orthopedic implants, which has them working “at cross purposes to the device companies.”

Impact on hospitals?

If Medtronic’s action snowballs, the impact on hospitals might not be as great as some would think, comments Kowalski.

As hospitals have banded together into large health systems, they’ve gained purchasing clout.

“An IDN (integrated delivery network) can get the same pricing, and perhaps better, than a GPO,” he says. What’s more, if hospitals in a system can agree to standardize on products, particularly physician preference items, they can deliver a truly committed group of customers.

Achieving that commitment is challenging for IDNs, he notes, but “is considered extraordinarily valuable to manufacturers—more so than a ‘fishing license’” in the form of a GPO contract. Kowalski adds that price comparisons are available from other sources than GPOs, noting that several independent software companies now have technology that provides this type of service.

IDNs’ purchasing power could grow further as physician groups are acquired by large health systems, and their interests become more aligned—though getting physician buy-in on purchasing decisions “is not a slam dunk,” he says.

In Yokl’s view, “the marketplace has moved. Medicare and Medicaid payments are being slashed. The device companies have already lost market because of the recession. Hospitals are putting more pressure on them. This is the new normal.”