United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Antitrust, Competition Policy and Consumer Rights, Committee on the Judiciary, U.S. Senate

For Release on Delivery
Expected at 2:30 p.m.
Wednesday, July 16, 2003

GROUP PURCHASING ORGANIZATIONS

Use of Contracting Processes and Strategies to Award Contracts for Medical-Surgical Products

Statement for the Record by Marjorie Kanof
Director, Health Care—Clinical
and Military Health Care Issues

July 16, 2003

GROUP PURCHASING ORGANIZATIONS

Use of Contracting Processes and Strategies to Award Contracts for Medical-Surgical Products

GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-03-998T, a statement for the record for the Subcommittee on Antitrust, Competition Policy and Consumer Rights, Committee on the Judiciary, U.S. Senate

Why GAO Did This Study

Hospitals have increasingly relied on purchasing intermediaries—GPOs—to keep the cost of medical-surgical products in check. By pooling purchases for their hospital customers, GPOs—in awarding contracts to medical-surgical product manufacturers—may negotiate lower prices for these products.

Some manufacturers contend that GPOs are slow to select products to place on contract and establish high administrative fees that make it difficult for some firms to obtain a GPO contract. The manufacturers also express concern that certain contracting strategies to obtain better prices have the potential to limit competition when practiced by GPOs with a large share of the market.

GAO was asked to examine certain GPO business practices. It focused on seven large GPOs serving hospitals nationwide regarding (1) their processes to select manufacturers' products for their hospital customers and the level of administrative fees they receive from manufacturers, (2) their use of contracting strategies to obtain favorable prices from manufacturers, and (3) recent initiatives taken to respond to concerns about GPO business practices.

www.gao.gov/cgi-bin/getrpt?GAO-03-998T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Marjorie Kanof at (202) 512-7114.

What GAO Found

The seven GPOs we studied varied in how they carried out their contracting processes. The GPOs were able to expedite their processes for selecting products to place on contract, particularly when they considered these products to be innovative. The GPOs also reported receiving from manufacturers administrative fees in 2002 that were generally consistent with the 3-percent-of-purchase-price threshold in regulations established by the Department of Health and Human Services. However, for certain products, they reported receiving higher fees—in one case, nearly 18 percent.

The seven GPOs also varied in the extent to which they used certain contracting strategies as leverage to obtain better prices. For example, some GPOs, including one of the two largest, used sole-source contracting (giving one of several manufacturers of comparable products an exclusive right to sell a particular product through the GPO) extensively, whereas others used it on a more limited basis. Most GPOs used some form of product bundling (linking price discounts to purchases of a specified group of products), and the two largest GPOs used bundling for a notable portion of their business.

In response to congressional concerns raised in 2002 about GPOs' potentially anticompetitive business practices, the Health Industry Group Purchasing Association (HIGPA) and GPOs individually established codes of conduct. (See figure.) The conduct codes are not uniform in how they address GPO business practices. In addition, some GPOs' conduct codes include exceptions and qualified language that could limit their potential to effect change.

Figure: Business Practices Addressed in Codes of Conduct

Business practice	HIGPA members					Non-HIGPA members	
	GPO A	GPO B	GPO C	GPO D	GPO E	GPO F	GPO G
Product selection contracting processes	●	●		●	●	●	
Contract administrative fees	●	●		●	●	●	
Sole-source contracting	●	●		●	●	●	
Bundling	●	●	●	●	●	●	
Commitment level requirements	●	●		●	●	●	
Contract durations	●	●		●	●	●	

Identified in HIGPA code of conduct

Identified in both HIGPA and individual GPO code of conduct

Identified in individual GPO code of conduct

Not identified in code of conduct

Source: Codes of conduct provided by HIGPA and the seven GPOs in our study.

Note: A code of conduct was determined to identify a business practice if it was mentioned in the code's text.

Mr. Chairman and Members of the Subcommittee:

We are pleased to have the opportunity to comment on the role of group purchasing organizations (GPO) in the marketplace for medical-surgical products. Faced with persistent pressures to cut rising costs, hospitals over the past two decades have increasingly relied on purchasing intermediaries—GPOs—to keep the cost of medical-surgical products in check. Hospitals buy everything from commodities—for example, cotton balls and bandages—to high-technology medical devices, such as pacemakers and stents,[1] through GPO-negotiated contracts. By pooling the purchases of these products for their hospital customers, GPOs may negotiate lower prices from vendors (manufacturers, distributors, and other suppliers), which can benefit hospitals and, ultimately, consumers and payers of hospital care (such as insurers and employers).

Some manufacturers—especially small manufacturers of medical devices—have contended that GPOs employ a slow process for selecting products to place on contract and establish high administrative fees that have made it difficult for some firms to obtain a GPO contract. They have also expressed concerns about certain contracting strategies that GPOs use as leverage to obtain better prices. They contend that these strategies have the potential to limit competition when practiced by GPOs with a large share of the market.

At the request of the subcommittee, we examined certain GPO business practices that critics contend have the potential to create an uneven playing field for manufacturers. This statement focuses on seven large GPOs serving hospitals nationwide regarding (1) their processes to select manufacturers' medical-surgical products for their hospital customers and the level of administrative fees they receive from manufacturers, (2) their use of contracting strategies to obtain favorable prices from manufacturers, and (3) recent initiatives taken to respond to concerns about GPO business practices. In a subsequent report for this subcommittee, we will expand our earlier work and examine the extent to which hospitals benefit from participation in GPOs. In April 2002, we

[1]A stent is a device used to provide support for tubular structures like blood vessels. It can be made of rigid wire mesh or may be a metal wire or tube.

reported that for two products in one local market, a hospital's use of a GPO contract did not guarantee that the hospital paid a lower price.[2]

We focused our current work on purchases made by acute care hospitals for medical-surgical products, including commodities, such as cotton balls and bandages, and medical devices, such as pacemakers and stents.[3] We did not investigate GPOs' business practices with regard to other products that hospitals purchase, such as pharmaceutical products, capital equipment, and food supplies. Our findings are based on structured interviews with representatives of seven major national GPOs. We also interviewed representatives of 13 medical-surgical product manufacturers of various sizes and representatives of trade associations from the following industries: group purchasing, medical-surgical product manufacturing, supply distribution, and venture capital. We also consulted with experts, including representatives from two hospitals, three venture capital firms, two industry consultants, and one technology assessment company. In addition, we reviewed literature on group purchasing and antitrust law. We did not independently verify the information we obtained. The information GPOs provided was self-reported. We conducted our work from May 2002 through July 2003 in accordance with generally accepted government auditing standards.

Results in Brief

The GPOs we studied were able to alter the duration of their process for selecting products to place on contract, particularly when they considered these products to be innovative. GPOs' product selection processes generally took 6 months, and ranged from as short as 1 month to as long as 18 months. One GPO specifically reported expediting or modifying its formal selection process when it considered a product to be innovative and wanted to award a contract quickly. The seven GPOs also reported receiving from manufacturers administrative fees in 2002 that were generally consistent with the 3-percent-of-purchase-price threshold in regulations established by the Department of Health and Human Services (HHS). However, for certain products, they reported higher fees—in one case, nearly 18 percent.

[2]U.S. General Accounting Office, *Group Purchasing Organizations: Pilot Study Suggests Large Buying Groups Do Not Always Offer Hospitals Lower Prices*, GAO-02-690T (Washington, D.C.: Apr. 30, 2002).

[3]We did not include government hospitals, such as those of the Department of Veterans Affairs, in our study.

The seven GPOs we studied, including two with the largest market shares, used sole-source contracting (giving one of several manufacturers of comparable products an exclusive right to sell a particular product through a GPO), product bundling (linking price discounts to purchases of a specified group of products), and other contracting strategies to varying degrees to obtain favorable prices. For example, while all seven GPOs reported using sole-source contracts, some GPOs, including one of the two largest, used them extensively, whereas others used them on a more limited basis. Most GPOs used some form of bundling, and the two largest GPOs used either contracts or programs that bundle multiple products for a notable portion of their business.

In response to congressional concerns raised in 2002 about GPOs' potentially anticompetitive business practices, the group purchasing industry's trade association established a code of conduct that directs member GPOs to, among other things, address their contracting processes. The conduct code also includes reporting and education responsibilities for the trade association. The seven GPOs we studied drafted or revised their own codes of conduct, but the conduct codes are not uniform in how they address GPO business practices. Moreover, some GPOs' conduct codes include exceptions and qualified language that could limit the potential of the conduct codes to effect change. It is too soon to evaluate the effectiveness of these codes of conduct in addressing concerns about potentially anticompetitive practices, as many conduct codes are recently adopted and sufficient time has not elapsed for GPOs to demonstrate results.

Background

In seeking to provide their hospital customers with medical-surgical products at favorable prices, GPOs engage with manufacturers in certain contracting processes and sometimes use certain strategies to obtain price discounts. Many manufacturers bid for GPO contracts because hospital purchases with these contracts may increase manufacturers' market share. GPOs are subject to federal antitrust laws. A statement developed by enforcement agencies helps GPOs determine whether their business practices are likely to be challenged under the antitrust laws.

Manufacturers Contract with GPOs to Sell Their Medical-Surgical Products

Many manufacturers use GPO contracts to sell their medical-surgical products. These products include two types—commodities and medical devices. Commodities such as cotton balls and bandages are examples of items for which physicians and other clinicians generally do not have strong preferences. Manufacturers commonly use GPO contracts to sell

hospitals these non-preference products because hospitals purchase these items in large quantities. In contrast, medical devices can be "clinical preference" items—that is, those for which physicians and other practitioners are likely to express a preference. High-technology medical devices such as pacemakers and stents are examples of clinical preference items. Some manufacturers prefer to sell these items directly to hospitals.

A Few GPOs Dominate the Market for Medical-Surgical Products Sold through Contracts

The GPO industry that purchases products for hospitals is large and moderately concentrated. Experts have not determined a precise number of GPOs currently in business, but some estimate that there are hundreds of GPOs. While some GPOs operate regionally, this study focused on seven national GPOs with purchasing volumes over $1 billion that account for more than 85 percent of all hospital purchases nationwide made through GPO contracts. In 2002, the combined purchasing volume of these GPOs totaled about $43 billion, excluding distribution dollars. (See table 1.)

Table 1: Seven GPOs' Purchasing Volumes for Total Customer Purchases Made through Contracts, 2002

GPO	Purchasing volume (dollars in millions)
GPO 1	$14,330
GPO 2	14,413
GPO 3	4,400
GPO 4	3,233
GPO 5	2,837
GPO 6	2,564
GPO 7	1,466
Total	**$43,243**

Source: GPO-reported data.

Note: These purchasing volumes exclude distribution dollars.

Among the GPOs in our study, the two largest GPOs account for about 66 percent of total GPO purchasing volume for all medical products (including, among other things, medical-surgical products, pharmaceuticals, capital equipment, and food). These two GPOs also account for 70 percent of the seven GPOs' total medical-surgical product volume. One of the two largest GPOs has as members 1,569 of the nation's

approximately 6,900 hospitals; the other has 1,469 hospital members.[4] One of the two largest GPOs permits its members to belong to other national GPOs, whereas the other largest GPO does not.

GPOs' Business Practices Encompass Contracting Processes and Strategies

A GPO's contracting process for manufacturers' medical-surgical products generally includes several phases—namely, product identification and selection, requests for proposals or invitations to bid, review of submitted proposals and applications, assessment of product quality, contract negotiation, and contract award. The contract negotiation phase may include the negotiation of a contract administrative fee. This fee is designed to cover a GPO's operating expenses and serves as its main source of revenue.[5] Contract administrative fees are calculated as a percentage of each customer's purchases of the particular product included in a GPO contract.

In negotiating contracts, GPOs use certain contracting strategies as incentives for manufacturers to provide deeper discounts and for hospital members to concentrate purchasing volume to obtain better prices. These strategies are not limited to use by GPOs, as some manufacturers also use them in negotiating contracts with GPOs to increase market share. Key contracting strategies include the following:

- *Sole-source contracts* give one of several manufacturers of comparable products an exclusive right to sell a particular product through a GPO.
- *Commitment* refers to a specified percentage of purchasing volume that, when met by the GPO's customer (such as a hospital), will result in a deeper price discount. Commitment levels can be set either by the GPO or the manufacturer. For example, a manufacturer might offer greater discounts to GPO customers that purchase at least 80 percent of a certain group of products from that manufacturer. Commitment requirements can also be tiered, resulting in the opportunity for the customer to commit to different percentages of purchasing volume: the higher the percentage, the lower the price.

[4]The approximately 6,900 hospitals include government hospitals such as those of the Department of Veterans Affairs and county hospitals.

[5]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.

- *Bundling* links price discounts to purchases of a specified group of products. GPOs award several types of bundling arrangements. One type bundles combinations of products from one manufacturer. A manufacturer may find this arrangement advantageous because it allows increased sales of products in the bundle that may not fare well as stand-alone products. Another type bundles products from two or more manufacturers. Also, contracts can be bundled for complementary products, such as protective hats and shoe coverings used in hospital operating rooms, while others bundle unrelated products such as patient gowns and intravenous solutions. Hospitals that purchase bundles of unrelated products receive a price discount on all products included in the bundle.

- *Contracts of long duration*—those in effect for 5 years or more—can direct business to manufacturers for an extended period.

When used by GPOs with a large market share, these contracting strategies have the potential to reduce competition. For example, if a large GPO negotiates a sole-source contract with a manufacturer, the contract could cause an efficient, competing manufacturer to lose business and exit from the market and could discourage other manufacturers from entering the market.

Federal Safe Harbor and Antitrust Safety Zone Exist for GPOs

Certain aspects of GPOs' operations are specifically addressed by federal statute, regulation, and policy. While "anti-kickback" provisions of the Social Security Act prohibit payments in return for orders or purchases of items for which payment may be made under a federal health care program, the act also contains an exception for amounts paid by vendors of goods or services to a GPO.[6] Therefore, GPOs are allowed to collect contract administrative fees from manufacturers and other vendors that could otherwise be considered unlawful. In addition, regulations issued by the Department of Health and Human Services establishing "safe harbors" for purposes of the "anti-kickback" provisions provide that GPOs are to have written agreements with their customers either stating that fees are to be 3 percent or less of the purchase price, or specifying the amount or maximum amount that each vendor will pay.[7] The GPOs must also disclose in writing to each customer, at least annually, the amount received from each vendor with respect to purchases made by or on behalf of the

[6]See 42 U.S.C. § 1320a-7b(b) (2000).

[7]See 42 C.F.R. § 1001.952(j) (2002).

customer. The Office of Inspector General in the Department of Health and Human Services is responsible for enforcing these regulations.

Recognizing that GPO arrangements may promote competition among manufacturers and yield lower prices in some cases and may reduce competition in other cases, the U.S. Department of Justice and the Federal Trade Commission issued a statement in 1993 for joint purchasing arrangements. This statement sets forth an "antitrust safety zone"[8] for GPOs that meet a two-part test, under which the agencies will not generally challenge GPO business practices under the antitrust laws. Essentially, the two-part test in the context of medical-surgical products is as follows: (1) purchases through the GPO account for less than 35 percent of the total sales of the product in the relevant market,[9] and (2) the cost of the products purchased through the GPO accounts for less than 20 percent of the total revenues from all products sold by each GPO member.

GPOs Reported Modifying Contracting Processes When Desirable and Receiving Administrative Fees That Were Generally Consistent with Federal Regulations

In recent years, some manufacturers of medical-surgical products have contended that GPOs employ a slow product selection process and set high administrative fees that have made it difficult for some firms to obtain GPO contracts. These firms tend to be small manufacturers that may have fewer financial resources available to successfully complete GPOs' contracting processes than large manufacturers. The GPOs we studied reported generally having contracting processes that can be modified for certain types of products. They also reported receiving from manufacturers administrative fees that were generally consistent with federal regulations established by HHS.

[8] *Statements of Antitrust Enforcement Policy in Health Care*, Statement 7, p. 23.

[9] Although the GPOs in this study each has less than 35 percent of total GPO purchasing volume for all medical products, it is possible, for example, that a GPO could have greater than 35 percent of the total sales of one or more particular products.

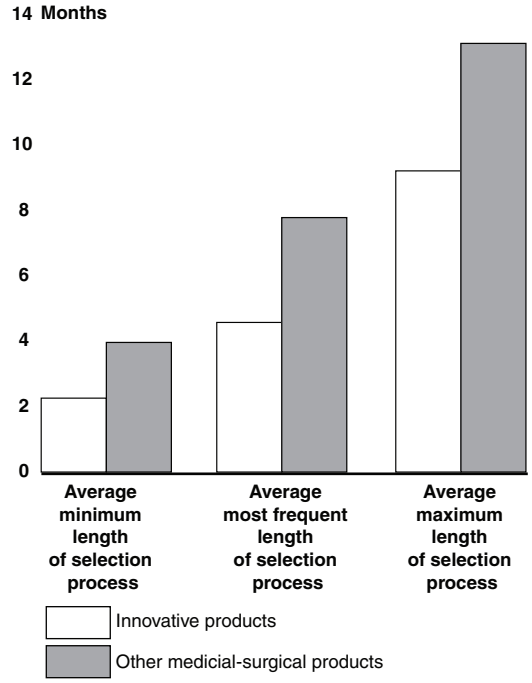
GPOs Reported Expediting Reviews and Using a Public Solicitation Process for Certain Products

In discussing GPOs' selection of products and negotiation of fees, several manufacturers we contacted pointed to the paperwork and duration of these processes as burdensome. Not all manufacturers shared the same perspective. One small manufacturer commented that the process could sometimes be relatively easy but that the selection process can be more difficult if the manufacturer is selling only one product.

The GPOs we studied were able to alter the duration of their process for selecting products to place on contract, particularly when they considered these products to be innovative. Based on their reported information, GPOs' product selection processes generally took 6 months, and ranged from as short as 1 month to as long as 18 months. One GPO specifically reported expediting or modifying its formal selection process when it considered a product to be innovative and wanted to award a contract quickly. Most GPOs did not have a distinctly separate process for selecting innovative technology but reported that these products were generally selected in a shorter amount of time compared with other products.

Figure 1 shows, across the seven GPOs, the average minimum, most frequent, and maximum times taken for product selection.

Figure 1: Duration of the GPO Product Selection Process



Source: Interviews with representatives of seven GPOs.

Note: Averages weighted by GPO-reported dollar purchasing volume, excluding distribution dollars.

The GPOs in our study reported consulting various sources before making a decision, including the GPO's customers requesting the product; published studies about the product; internal and external technology assessments; and different manufacturers of the product, both with and without a GPO contract. In all cases, the GPOs cited customer requests for products as the most important factor in identifying which products to place on contract.

In selecting a manufacturer, six of the seven GPOs, including the two largest, solicit proposals publicly—either through requests for proposals or requests for bids through their Web sites. The extent to which these processes are open to all manufacturers varies by GPO and by product. For example, one of the GPOs solicits proposals publicly for clinical preference products, but not for commodities.

GPO-reported information on new contracts awarded in 2002 suggest that GPOs' solicitations were not limited to manufacturers already on contract. Nearly one-third of all the newly negotiated contracts awarded by the seven GPOs in 2002 were awarded to manufacturers with which the GPO had not previously contracted. The percentage of such contracts ranged from 16 percent to 55 percent for the GPOs in our study. For the two largest GPOs, this share was 29 percent and 55 percent. We could not determine, from the information provided, whether these first-time contract awardees were, for example, small manufacturers or companies new to the industry or whether the products purchased through these contracts were clinical preference items or commodities.

GPO-Reported Information Indicates That Contract Administrative Fees Received Were Generally Consistent with Federal Regulations

Manufacturers have expressed concerns that contract administrative fees, which are typically calculated as a percentage of each customer's purchase of products under contract, can be too high for some manufacturers. These fees, combined with lower prices negotiated by the GPO, may decrease revenue for manufacturers and may make it more difficult to obtain a GPO contract for newer and smaller manufacturers with fewer financial resources than for larger, more established companies.

Five out of seven GPOs reported that the maximum contract administrative fee received from manufacturers in 2002 did not exceed the 3-percent-of-purchase-price threshold contained in federal regulations established by HHS. The most frequent administrative fee level that 4 out of 7 GPOs received from manufacturers in 2002 was 2 percent; the lowest fee level received by each GPO was 1 percent or less. Except for one of the two largest GPOs, the GPOs reported that they have not negotiated any new or renewed contracts in 2003 that include administrative fees from medical-surgical product manufacturers that exceed 3 percent.

In 2002, fee levels for private label products —products sold under a GPO's brand name—were an exception: The typical contract administrative fee paid by private label manufacturers was 5 percent. For one of the two GPOs in our study with private label products, the maximum administrative fee was nearly 18 percent. In addition to an

administrative fee, the other GPO charged a separate "licensing" fee for private-label products.[10]

Seven National GPOs Varied in the Extent to Which They Used Certain Contracting Strategies

GPOs use certain contracting strategies—which include sole-source contracts, product bundling, and extended contract duration—to obtain discounts from manufacturers in exchange for providing the manufacturer with increased sales from an established customer base. Manufacturers and other industry observers have expressed concerns that use of these strategies by the two largest GPOs can reduce competition. For example, when GPOs with substantial market shares award long-term sole-source contracts to large, well-established manufacturers, some newer, single-product manufacturers—left to compete with other manufacturers for a significantly reduced share of the market—may lose business and be forced to exit the market altogether.

The seven GPOs we studied, including two with the largest market shares, used these contracting strategies to varying degrees. For example, while all study GPOs reported using sole-source contracts, some GPOs, including one of the two largest GPOs, used it extensively, whereas others used it on a more limited basis. GPOs also varied in their approach to requiring commitment levels from their customers. With respect to bundling, most GPOs used some form of bundling, and the two largest GPOs used either contracts or programs that bundled multiple products for a notable portion of their business. With respect to contract duration, the two largest GPOs typically negotiated longer contract terms than the other five GPOs.

For Some of the GPOs, Sole-Source Contracts Accounted for a Substantial Portion of the Purchasing Volume

The use of sole-source contracting by the study GPOs varied widely with respect to the relative amount of sole source contracting they did and the types of products included in the contracts. For five of the GPOs, sole-source contracts accounted for between 2 percent and 46 percent of their medical-surgical product dollar purchasing volume.[11] For the rest—the two largest GPOs—the shares of dollar purchasing volume accounted for by sole-source contracts were 19 percent and 42 percent. Such levels of sole-

[10]Some manufacturers pay this GPO licensing fees in exchange for using the GPO's brand name.

[11]One GPO did not provide us information on purchasing volume for medical-surgical products through sole-source contracts.

sourcing are worth noting, given the sizeable market shares of these two GPOs.

GPOs also varied in their use of sole-source contracts for commodity products as compared to medical devices for which providers may desire a choice of products. Six of the seven GPOs in our study reported their use of sole-source contracts for commodity products as compared to clinical preference product. For one of the two largest GPOs, clinical preference products accounted for the bulk—82 percent—of its sole-source dollar purchasing volume.[12] Two GPOs reported cases in which manufacturers refused to contract with the GPO unless they were awarded a sole-source contract. In contrast, commodities accounted for the bulk—between 62 percent and 91 percent—of the dollar purchasing volume that the smaller of the seven GPOs purchased through sole-source contracts. GPO-reported data indicate that the proportion of contracts that were sole source, as a share of all contracts for medical-surgical products for the past 3 years, remained relatively consistent for GPOs.

GPOs Considered Customer Commitment to Be Important, but Commitment Requirements Varied

The seven GPOs in our study reported that hospital customers' commitment to purchase a certain percentage of their products through GPO contracts was an important factor in obtaining favorable prices with manufacturers, and all reported establishing commitment level requirements to some degree. Most of the smaller of the seven GPOs reported that customer adherence to commitment levels and contracts were the most important factor in obtaining favorable pricing with manufacturers. In principle, for GPOs with a smaller customer base, the assurance of customer commitment to purchasing helps enable them to achieve the higher volumes needed to leverage favorable prices from manufacturers. The two largest GPOs reported that volume was the most important factor for obtaining favorable prices and that customer compliance with commitment level and contracts was next in importance. For the two largest GPOs, a sizable customer base may provide the volume levels needed to obtain favorable prices.

GPOs varied in their approach to requiring purchasing commitment levels. One GPO requires customers to commit to an overall average dollar purchasing level of 80 percent for those products available through the

[12]One of the two largest GPOs in our study did not provide us information on sole-source purchases represented by the two product types.

GPO, although the percentage could vary for individual products. The GPO reported terminating the membership of at least one customer that did not meet this target. Other GPOs reported establishing customer commitment levels in certain contracts in order to obtain a certain price level, but customers were not required to buy under the contract or buy at the commitment level in order to retain GPO membership. Some GPOs' contracts include multiple, or tiered commitment levels so that customers can choose from a range of commitment levels and obtain price discounts accordingly.

Most GPOs Use Some Form of Bundling, and the Two Largest GPOs Use It for a Notable Portion of Their Business

All but one of the GPOs in our study reported using some form of bundling, including the bundling of complementary products, bundling several unrelated products from one manufacturer, and bundling several products for which there are commitment-level requirements. One bundling arrangement that GPOs reported using gave customers a discount when they purchased a bundle of complementary products, such as protective hats and shoe coverings. Four GPOs reported bundling complementary products. These bundles were included in a small percentage of the GPOs' contracts; each of the four GPOs reported having no more than three contracts that bundle complementary products. One GPO reported awarding only one bundling arrangement for two complementary products—the only bundling arrangement the GPO had in effect at the time it reported to us.

A second type of bundling reported by three GPOs, including the two largest, gave customers a discount if they purchased a group of unrelated products from one manufacturer. We define this type of bundling as a corporate agreement. One of the two largest GPOs reported that corporate agreements for medical-surgical products accounted for about 40 percent of its dollar purchasing volume for medical-surgical products under contracts in effect on January 1, 2003.

Four GPOs, including one of the two largest, used a third type of arrangement that typically bundled products from different manufacturers and required customers that chose this arrangement to purchase a certain minimum percentage from the product categories specified in the bundle in order to obtain the discount. We defined this type of bundling as a structured commitment program. A structured commitment program available through one GPO bundled brand name and GPO private label items for 12 product categories and had a 95 percent commitment-level requirement. In 2002, one of the two largest GPOs reported receiving

about 20 percent of its medical-surgical dollar purchasing volume from its structured commitment programs.

The use of bundling arrangements may be declining. For example, data reported by one GPO showed a decline in the percent of its contracts that were corporate agreements from 2001 to 2003.[13] This trend was consistent with comments made by one manufacturer and two medical-surgical product distributors. The manufacturer told us that GPOs are less interested in bundling different manufacturers together. Two distributors' representatives told us that since the summer of 2002, GPOs have fewer bundling arrangements and that some bundles were "pulled apart."

The Two Largest GPOs Typically Award Contracts with Longer Terms Than the Other Five

Our analysis of data reported by the study GPOs showed that, in 2002, the two largest GPOs typically awarded 5-year contracts, whereas the other five GPOs typically awarded 3-year contracts. For some of these contracts, potential renewal periods constitute a portion of the contract duration. Those contract terms remained fairly consistent between 2001 and 2003, although two of the five GPOs reported that their most frequent contract term declined by about 1 year. Some GPOs reported implementing policies that may lead to a future reduction in contract terms. One of the two largest GPOs began in the first quarter of 2003 to exclude from new contracts the option for two 1-year contract extensions, so that when a contract expires, this GPO will solicit proposals for a new contract.

GPOs Have Taken Initiatives to Address Concerns about Business Practices, but It Is Too Early to Evaluate Their Efforts

In response to congressional concerns raised in 2002 about GPOs' potentially anticompetitive business practices, the group purchasing industry's trade association established a code of conduct that directs member GPOs to, among other things, address their contracting processes. The conduct code also includes reporting and education responsibilities for the trade association. The seven GPOs we studied drafted or revised their own codes of conduct, but the conduct codes are not uniform in how they address GPO business practices. Moreover, some GPOs' conduct codes include exceptions and qualified language that can limit the potential of the conduct codes to effect change. It is too soon to evaluate the effectiveness of these codes of conduct in addressing concerns about potentially anticompetitive practices, as many conduct codes are recently

[13]This period reflects contracts in effect on three dates—January 1, 2001, January 1, 2002, and January 1, 2003.

adopted and sufficient time has not elapsed for GPOs to demonstrate results.

Trade Association Code of Conduct Laid Groundwork for Industry Self-Regulation

On July 24, 2002, the Health Industry Group Purchasing Association (HIGPA) adopted a code of conduct providing principles for GPO business practices. HIGPA represents 28 U.S.-based GPOs—including five of the seven major GPOs that we studied. HIGPA members also include health care systems and alliances, manufacturers, and other vendors. The HIGPA code of conduct principles address GPO business practices and actual, potential, or perceived conflicts of interest. Among other things, the HIGPA code of conduct provides that GPOs

- allow hospital and other provider members to purchase clinical preference items directly from all vendors, regardless of whether the vendors have a GPO contract;
- implement an open contract solicitation process that allows any interested vendor to seek contracts with the GPO;
- participate in processes to evaluate and make available innovative products;
- address conflicts of interest, such as disallowing staff in positions of influence over contracting to hold equity interest in, or accept gifts or entertainment from, "participating vendors";[14] and
- establish accountability measures, such as appointing a compliance officer and certifying annually that the GPO is in compliance with the HIGPA code.

The HIGPA code also includes several provisions regarding the trade association's education and reporting responsibilities, including

- assessing and updating the code of conduct to be consistent with new developments and best business practices;

[14]Participating vendors are those that have a contract or submit a bid or offer to contract with a GPO.

- implementing industry wide educational programs on clinical innovations, contracting strategies, patient safety, public policy, legal requirements, and best practices;
- making available a Web-based directory that posts manufacturers' and other vendors' product information; and
- publishing an annual report listing GPOs that have certified their compliance for the year with the HIGPA code of conduct.

As of May 19, 2003, HIGPA's 28 U.S.-based GPO members certified that they are in compliance with the HIGPA code of conduct principles.

Variations Exist in GPOs' Efforts to Address Business Practices

Although the HIGPA code of conduct laid the groundwork for many GPOs to change their business practices, its guidelines do not comprehensively address certain business practices. Specifically, the HIGPA code of conduct requires GPOs to address business practices associated with contracting, conflicts of interest, and accountability, and it grants GPOs discretion in using contracting strategies. It recommends that GPOs consider factors such as vendor market share, GPO size, and product innovation when using multiple contracting strategies. However, the HIGPA code of conduct does not directly address levels of contract administrative fees or the offering of private label products.

Since August 2002, the seven GPOs we studied, even those that were not HIGPA members, drafted and adopted their own codes of conduct or revised their existing conduct codes. One GPO stated that its revised code, while consistent with the HIGPA code, was more specific than HIGPA's principles, particularly in the GPO's rules on stock ownership, travel, and entertainment. Another GPO reported expanding on HIGPA's code by including provisions to cap administrative fees and prohibit bundling. Similarly, GPOs who were not HIGPA members said they had revised their existing codes of conduct and that their conduct codes were in some respects stronger than HIGPA's.

Nevertheless, GPOs' individual codes of conduct varied in the extent to which they addressed GPOs' business practices, such as contracting processes and strategies. Figure 2 provides an overview of the seven GPOs' conduct codes with respect to their business practices. The table indicates whether a business practice was identified in a code of conduct, but not how the practice was to be addressed.

Figure 2: Business Practices Identified in GPOs' Codes of Conduct

Business practice	HIGPA members					Non-HIGPA members	
	GPO A	GPO B	GPO C	GPO D	GPO E	GPO F	GPO G
Product selection contracting processes	●	●		●	●	●	
Innovative product selection	●	●	●	●	●	●	
Contract administrative fees	●	●		●	●	●	
Sole-source contracting	●	●		●	●	●	
Bundling	●	●	●	●	●	●	
Commitment level requirements	●	●		●	●	●	
Contract durations	●	●		●	●	●	
Private labeling	●	●		●		●	
Conflicts of interest-equity	●	●	●	●	●	●	●
Conflicts of interest-other	●	●	●	●	●	●	●
Internal accountability	●	●	●	●	●	●	●
External accountability		●		●			

Identified in HIGPA code of conduct

● Identified in both HIGPA and individual GPO code of conduct

● Identified in individual GPO code of conduct

Not identified in code of conduct

Source: Codes of conduct provided by HIGPA and the seven GPOs in our study.

Note: A code of conduct was determined to identify a business practice if it was mentioned in the conduct code's text.

As figure 2 shows, the conduct codes of all the study GPOs explicitly mentioned conflict of interest issues such as those dealing with equity holdings and other conflicts such as receipt of gifts and entertainment and the need for internal accountability. In addition, the conduct codes of most GPOs, including the two largest, included provisions dealing with the contracting strategies, such as sole-source contracting and bundling. For GPOs that are HIGPA members, the lack of additional provisions in their individual conduct codes for certain business practices such as contracting processes may not be significant, as provisions covering these areas are included in the HIGPA code. However, for one of our study GPOs that is not a HIGPA member, the conduct code lacked any provisions pertaining to contracting processes, product selection, administrative fees, sole-source contracting, commitment level requirements, contract duration, and private labeling.

The code of conduct provisions for the GPOs in our study were not uniform in how they addressed business practices. For example:

- Four GPOs, including one of the two largest, had unqualified provisions for capping administrative fees at the 3-percent threshold contained in federal regulations established by HHS. The other largest GPO had a provision for capping administrative fees at 3 percent only for clinical preference items and only for contracts awarded after the establishment of the GPO's conduct code.

- Four conduct codes had provisions limiting the use of sole-source contracts for clinical preference items specifically. Another conduct code limited the use of sole-sourcing to contracts meeting certain criteria, such as approval for use by a 75-percent majority of the GPO's contracting committee. The language of one of the remaining GPO's conduct codes was vague with respect to sole-sourcing, stating that the GPO will provide customers with choices for each product or service, without explicitly mentioning the use of sole-source contracts.

- In their conduct codes, two GPOs had provisions prohibiting the practice of bundling of unrelated products, two GPOs prohibited and two limited bundling for clinical preference items, and three GPOs prohibited the practice of bundling products from different manufacturers. One GPO's conduct code stated that the GPO would not obligate its customers to purchase bundles of unrelated products, allowing the possibility for bundles to be available to customers on a voluntary basis.

Exceptions and qualified language in the provisions have the potential to weaken the codes of conduct. Table 2 shows examples of exceptions and qualified language that can limit the potential of the individual GPOs' conduct codes to effect change.

Table 2: Examples of Exceptions and Qualifications in Code of Conduct Provisions for the GPOs in Our Study

Business practice	Specific provision including exceptions and qualifiers (in italics)	Potential implications
Product selection contracting processes	Will use public request for proposal process for clinical preference products but not for most commodities.	Contract bids for most commodities will not go through public solicitation process.
Contract administrative fees	Will reduce contract administrative fees that are greater than 3 percent to 3 percent for clinical preference products on a prospective basis.	For clinical preference products, contract administrative fees negotiated prior to adoption of conduct code are not subject to provision; in future contracts, administrative fee for all other items may continue to exceed 3 percent.
Sole-source contracting	No sole-source contracts for clinical preference products unless there is no other means by which the GPO can obtain access to the product for customers.	Manufacturers have incentives to link price discounts in return for exclusive contract awards.
Bundling	No bundling of clinical preference products on a prospective basis, and no bundling of products across different vendors.	For clinical preference products, bundled contracts awarded prior to adoption of conduct code are not subject to provision; contracts for bundles of unrelated, non-clinical preference products with one manufacturer are not subject to the provision.
Commitment level requirements	No commitment level requirements for clinical preference products, on a prospective basis.	For clinical preference products, commitment levels negotiated prior to adoption of conduct code are not subject to provision; all other products could have commitment requirements.
	Commitment level requirements not to exceed 80 percent of purchasing volume for clinical preference products, unless relevant committee approves otherwise.	Commitment-level requirements for clinical preference products have potential to remain as high as 80 percent of purchasing volume and, under certain circumstances, may be higher.
Conflicts of interest-equity	No equity interests may be held by GPO management and other staff with influence over contracting in any participating vendors.	Other GPO staff may hold equity interest in participating vendors, that is, those on contract or bidding for a contract. GPO staff with influence over contracting may hold equity interest in nonparticipating vendors.

Source: Individual GPOs' codes of conduct.

Too Soon to Evaluate Impact of GPOs' Codes of Conduct

Given the individual GPOs' relatively recent adoption of codes of conduct—since August 2002—sufficient time has not yet elapsed for GPOs to develop a history of compliance with certain conduct code provisions. Two of the manufacturers and two distributors we interviewed reported noticing improvements, stating that some GPOs are no longer using certain contracting strategies. This observation is consistent with the suggestion that the use of bundling may be declining. One manufacturer

that had difficulty in obtaining a contract with a large national GPO prior to 2002 said it has since been awarded a contract for a clinical preference item. The manufacturer also noted that, since September 2002, it has been awarded several new contracts. However, two other manufacturers told us they are skeptical that improvements have been made with regard to business practices. Notwithstanding such anecdotal evidence, because of the recency of GPOs' actions taken, the ability to assess the impact of the conduct codes systematically remains limited. One year is not sufficient time for the codes of conduct to produce measurable trends that could demonstrate an impact on the industry.

Contact and Acknowledgments

For more information regarding this statement, please contact Marjorie Kanof at (202) 512-7101. Hannah Fein, Mary Giffin, Kelly Klemstine, Emily Rowe, and Merrile Sing made key contributions to this statement.

GAO's Mission

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, Managing Director, NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street NW, Room 7149
Washington, D.C. 20548