

GAO

Report to the Ranking Member,
Committee on Finance, U.S. Senate

August 2010

**GROUP
PURCHASING
ORGANIZATIONS**

**Services Provided to
Customers and
Initiatives Regarding
Their Business
Practices**



GAO

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Highlights of [GAO-10-738](#), a report to the Ranking Member, Committee on Finance, U.S. Senate

Why GAO Did This Study

Health care providers rely on group purchasing organizations (GPO) to negotiate contracts with vendors of medical products. In 2002, questions were raised about GPOs engaging in potentially anticompetitive business practices such as collecting excessively high contract administrative fees. In 2003, GAO reported that selected GPOs had adopted or revised codes of conduct to respond to the questions about their business practices, but that it was too soon to evaluate the impact of the codes of conduct.

GAO was asked to provide information on GPOs. In this report, GAO describes (1) the types of services that GPOs provide and how the GPOs fund these services, (2) initiatives that GPOs have implemented since 2002 to address the questions that had been raised about their business practices, and (3) the reported impact of the GPOs' codes of conduct and other initiatives. To do its work, GAO reviewed GPO documents and collected written responses to structured questions from the six largest GPOs based on their reported 2007 purchasing volume. GAO also conducted follow-up interviews with these six GPOs. GAO interviewed representatives from six GPO customers—hospitals—that varied in size, the GPOs with which they did business, and whether they had an ownership stake in a GPO. GAO also interviewed five medical product vendors of various sizes that do business with GPOs.

[View GAO-10-738 or key components.](#)
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GROUP PURCHASING ORGANIZATIONS

Services Provided to Customers and Initiatives Regarding Their Business Practices

What GAO Found

The six GPOs in GAO's review reported providing a range of services for their customers and funding these services in two ways. All six GPOs reported offering to their customers the following three services—custom contracting, clinical evaluation and standardization of products, and assessments of new technology. Other GPO services were not provided by all six of the GPOs in our review. For example, five of the six GPOs reported providing their customers with electronic commerce and benchmarking data services. Funding of these services, according to the six GPOs, was either through contract administrative fees received from vendors or by charging customers directly for the service. GPO representatives explained that the level of contract administrative fees collected from vendors can vary depending on the contract negotiated with a vendor. According to the GPOs, the average contract administrative fees paid by vendors in 2008, weighted by purchasing volume, ranged from 1.22 percent of customer purchases to 2.25 percent of purchases.

The GPOs in GAO's review reported implementing some new initiatives since 2002. Specifically, the GPOs reported that they have revised their codes of conduct and established a voluntary membership association focused on promoting best practices and public accountability among member GPOs. This association—the Healthcare Group Purchasing Industry Initiative (HGPII)—adopted a set of principles of ethics and business conduct that its GPO members are expected to follow. These include having a written code of business conduct, working toward high quality health care and cost effectiveness, working toward an open and competitive purchasing process, sharing best practices, and being accountable to the public. HGPII members are also required to annually report information on their policies and business practices.

The reported impact of GPOs' codes of conduct and other initiatives varied among GPOs, customers, and vendors. All six GPOs reported that their codes of conduct—which include conflicts of interest and other policies—and other initiatives have had impacts on GPO contracting practices, innovative product selection, contract administrative fees, potential conflicts of interest, and the transparency and accountability of GPO business practices. However, the impact of the GPO initiatives reported by representatives of customers and vendors GAO interviewed varied. For example, while some customers and vendors reported that GPOs are operating with greater transparency regarding their contracting practices, most customers and vendors did not comment on an impact associated with GPOs' initiatives to add innovative products to contracts.

In commenting on a draft of this report, representatives of the six GPOs and their trade association noted that the report was fair and balanced and most provided technical comments, which we incorporated as appropriate.

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Abbreviations

GPO	group purchasing organization
HGPII	Healthcare Group Purchasing Industry Initiative

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United States Government Accountability Office
Washington, DC 20548

August 24, 2010

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

Dear Senator Grassley:

Increases in health care expenditures in recent years have intensified congressional scrutiny of the costs of medical care. Since fiscal year 2000, federal spending for health care services provided through Medicare and Medicaid has more than doubled, from \$333.9 billion in fiscal year 2000 to \$749.9 billion in fiscal year 2009.¹ The Congressional Budget Office projects that, without any changes in federal law, federal spending on Medicare and Medicaid will rise from 5.3 percent of gross domestic product in fiscal year 2009 to almost 20 percent of the gross domestic product in fiscal year 2082.² An important component of those costs is products that hospitals and other health care providers purchase to provide health care.

Hospitals and other health care providers, including those that participate in Medicare and Medicaid, face continuing pressure to address rising health care costs. These types of providers have increasingly relied on purchasing intermediaries, known as group purchasing organizations (GPO), as one means to help keep the cost of medical products in check.³ Providers use GPOs to negotiate contracts with vendors such as manufacturers, distributors, and other suppliers to purchase a range of products—from commodities such as cotton balls and bandages to high-technology medical devices such as pacemakers and stents.⁴ According to

¹Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020* (Washington, D.C.: Jan. 26, 2010).

²Congressional Budget Office, *Budget Options, Volume 1, Health Care* (Washington, D.C.: December 2008).

³GPO customers can also purchase nonmedical products as well as services such as housekeeping services through GPO-negotiated contracts.

⁴A 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.

GPOs, pooling the purchasing power of multiple providers allows GPOs to negotiate lower prices on products from vendors.⁵

In 2002, questions were raised by members of Congress and others about some of the GPOs' business practices including the collection of contract administrative fees from vendors.⁶ In particular, questions were raised about GPOs potentially engaging in anticompetitive business practices, including collecting excessively high contract administrative fees; contracting with only one vendor for a given product when multiple vendors of comparable products are available, a practice known as sole-source contracting; linking price discounts to purchases of a specified group of products, a practice known as product bundling; and limiting customer access to new and innovative technology.

In 2003, we reported that selected GPOs had adopted codes of conduct or revised their existing codes to respond to the questions about their business practices.⁷ We also reported that at the time of our review, which was based on work we conducted in 2002 and 2003, we could not evaluate the impact of the selected GPOs' codes of conduct in addressing these business practices, because many of the codes had been recently adopted.

You asked us to describe GPO services and funding, as well as the impact of GPOs' codes of conduct and other initiatives regarding their business practices. In this report we describe (1) the types of services that GPOs

⁵In January 2010, we issued a report summarizing the peer-reviewed and nonpeer-reviewed literature on the impacts of GPOs on pricing for hospitals and other health care providers. See *Group Purchasing Organizations: Research on Their Pricing Impact on Health Care Providers*, [GAO-10-323R](#) (Washington, D.C.: Jan. 29, 2010).

⁶While the Anti-Kickback statute prohibits certain fees or payments made in connection with goods or services provided under federal health care programs, payments made by vendors of goods or services to purchasing agents are not deemed to violate that statute where there is a written contract that specifies the amount or percentage to be paid, and the amounts received are properly disclosed. A federal regulation specifically addresses the matter with regard to GPOs and establishes a "safe harbor" for certain payments made by vendors to GPOs. That is, such payments are deemed to be consistent with the Anti-Kickback statute if there is a written agreement between the GPO and each of its customers specifying a fee of 3 percent or less or, if greater than 3 percent, the amount the GPO will be paid. 42 U.S.C. § 1320a-7b(b)(3)(C)(i); 42 C.F.R. § 1001.952(j) (2009).

⁷GAO, *Group Purchasing Organizations: Use of Contracting Processes and Strategies to Award Contracts for Medical-Surgical Products*, [GAO-03-998T](#) (Washington, D.C.: July 16, 2003). In this report, we use the term "codes of conduct" to include GPO policies relating to conflicts of interest policies, ethics policies, and policies regarding GPOs' contracting practices.

provide and how the GPOs fund these services, (2) initiatives that GPOs have implemented since 2002 to address the questions that had been raised about their business practices, and (3) the reported impact of the GPOs' codes of conduct and other initiatives.

To describe the types of services that GPOs provide and how GPOs fund these services, we used a structured data collection protocol that included two parts—(1) we collected written responses to structured questions from the six largest national GPOs based on their reported 2007 purchasing volume (a measure of the amount of money that customers spend through GPO contracts), and (2) we conducted interviews with representatives from each of the six GPOs to clarify their written responses and obtain additional information.⁸ In 2007, these six GPOs accounted for almost 90 percent of the total GPO purchasing volume.⁹ We obtained information from the six GPOs about their services and funding in 2008, the most recent full year available at the time of our review. We also interviewed representatives from six GPO customers—hospitals—that varied in size, the GPOs with which they did business, and whether they had an ownership stake in a GPO. In addition, we interviewed representatives from five medical product vendors of various sizes that do business with GPOs. We judgmentally selected these GPO customers and vendors in order to provide a variety of viewpoints on GPOs; however, the information they provided is not generalizable to other GPO customers or vendors. In addition, we interviewed representatives of organizations representing GPOs, vendors of medical products, and hospitals. We also reviewed articles, books, congressional hearing transcripts, and relevant laws and regulations to further our understanding of GPOs.

To describe the initiatives that GPOs have implemented since 2002 to address the questions that had been raised about their business practices, we obtained information from the six largest GPOs by reported 2007 purchasing volume through the structured data collection protocol. We also interviewed representatives of six customers and five vendors, as described above. In addition, we reviewed the codes of conduct of the six GPOs in our review.

⁸These GPOs include six of the seven GPOs included in our 2003 statement for the record. See [GAO-03-998T](#).

⁹Health Industry Distributors Association, *Group Purchasing Organization & Integrated Delivery Network: Market Brief* (Alexandria, Va., July 2009).

To describe the reported impact of the GPOs' codes of conduct and other initiatives, we obtained information from the six largest GPOs by reported 2007 purchasing volume through the structured data collection protocol. In addition, we interviewed representatives from five vendors of medical products and six customers concerning the reported impacts of GPOs' codes of conduct and other initiatives.

We conducted our work from June 2009 through August 2010 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

Background

GPOs are organizations that act as purchasing intermediaries that negotiate contracts between their customers—health care providers—and vendors of medical products. GPOs' sources of revenue include contract administrative fees, other fees obtained from vendors, and fees resulting from direct charges to customers. According to a 2009 study, on average, GPO contracts account for about 73 percent of nonlabor purchases that hospitals make.¹⁰ In addition, the Health Industry Group Purchasing Association estimates that about 98 percent of U.S. hospitals use GPOs to purchase products, and these hospitals use an average of two to four GPOs per facility.¹¹ GPOs vary in their organizational and ownership structures. For example, while some GPOs are owned by their customers, other GPOs do not have an ownership relationship with their customers.

A relatively small number of GPOs dominate the market for products sold through GPO contracts. Although there are over 600 GPOs in the United States, in 2007, the six largest national GPOs by reported purchasing volume together accounted for almost 90 percent of all hospital purchases nationwide made through GPO contracts. The combined purchasing

¹⁰Eugene S. Schneller, Ph.D., *The Value of Group Purchasing – 2009: Meeting the Need for Strategic Savings*, Health Care Sector Advances, Inc. (Scottsdale, Ariz.): April 2009.

¹¹Health Industry Group Purchasing Association, *A Primer on Group Purchasing Organizations*, <http://www.higpa.org/> (accessed June 26, 2009).

volume of these six GPOs totaled over \$108 billion in 2008, with the top two GPOs accounting for almost 60 percent of that volume. (See table 1.)

Table 1: 2008 Purchasing Volumes of the Six Largest Group Purchasing Organizations (GPO)

GPO	Purchasing volume (dollars in billions)
GPO 1	\$35.7
GPO 2	29.5
GPO 3	14.1
GPO 4	13.5
GPO 5	9.5
GPO 6	6.4
Total	\$108.7

Source: GAO structured data collection protocol.

Note: The six largest GPOs were selected based on their reported 2007 purchasing volume in Health Industry Distributors Association, *Group Purchasing Organization & Integrated Delivery Network: Market Brief* (Alexandria, Va., July 2009).

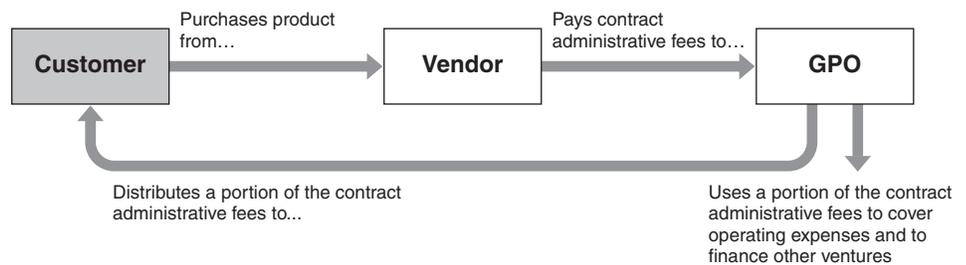
The GPO Contracting Process

A GPO's contracting process generally includes several phases: the identification and selection of products to place on contract, requests for proposals or invitations for vendors to bid for contracts, review of submitted proposals and applications from vendors, assessment of the quality of products that vendors propose, negotiation of contracts with vendors, and awarding contracts to vendors.

During the contract negotiation phase, some GPOs may use certain business practices as incentives for vendors to provide deeper discounts for their customers. For example, some GPOs may use sole-source contracting to provide one of several vendors offering comparable products an exclusive right to sell a particular product through a GPO. Additionally, some GPOs may use bundling to link price discounts to purchases of a specified group of products. Depending on the contract, bundling can combine products from a single vendor or from multiple vendors. Bundling can also combine related products, such as protective hats and shoe coverings used in hospital operating rooms, or unrelated products, such as patient gowns and intravenous solutions.

The contract negotiation phase may also include the negotiation of the contract administrative fee to be paid by the vendor.¹² This fee is designed, in part, to cover a GPO's operating expenses and serves as its main source of revenue. The amount of contract administrative fees is based on a percentage of the purchase price for a product obtained through GPO contracts. When negotiated, the contract administrative fee is paid each time a GPO's customer purchases a product through a GPO contract. In addition to using these contract administrative fees to cover operating expenses, such as providing services to their customers, GPOs may distribute a portion of contract administrative fees to customers or use them to finance other ventures such as investing in other companies.¹³ (See fig. 1.)

Figure 1: Hypothetical Flow of Contract Administrative Fees



Source: GAO.

GPO Codes of Conduct

In 2003, we reported that the GPOs in our review had drafted or revised codes of conduct to respond to questions about their business practices. Specifically, we reported that some, but not all, of the GPOs in our review included provisions in their codes of conduct to address issues such as sole-source contracting, bundling, innovative product selection, and contract administrative fees. For example, we reported that some, though not all, of the GPOs had provisions in their codes of conduct that limited the use of sole-source contracts for certain types of products. Similarly,

¹²GPOs may also negotiate contracts where there is no contract administrative fee paid by the vendor.

¹³In 2005, the Department of Health and Human Services' Office of Inspector General reported that customers of GPOs are required to report financial distributions from GPOs to Medicare as a reduction in their costs. See the Department of Health and Human Services' Office of Inspector General, *Review of Revenue From Vendors at Three Group Purchasing Organizations and Their Members*, A-05-03-00074 (Washington, D.C.: Jan. 19, 2005).

we found that some, but not all, GPOs had provisions limiting contract administrative fees to 3 percent of the purchase price for a product purchased through the GPOs' contracts. We also reported that the codes of conduct of all the GPOs in our review explicitly mentioned conflict of interest issues, such as those dealing with equity holdings and other conflicts such as receipt of gifts and entertainment from vendors.¹⁴

GPOs Reported Providing Custom Contracting, Product Evaluation, and Other Services Using Contract Administrative Fees or by Charging Customers Directly

The six GPOs in our review all reported providing a range of services for their customers, including custom contracting and services related to product evaluation. GPOs said they funded services either through contract administrative fees received from vendors or by charging customers directly for the service.

GPOs Reported Providing Custom Contracting, Product Evaluation, and Other Services to Customers

All six of the GPO's in our review reported offering to their customers the following three services—custom contracting; services related to product evaluation, including clinical evaluation and standardization of products; and assessments of new technology.¹⁵ Representatives from the GPOs explained that custom contracting services involved assisting customers with negotiating contracts for products that were not part of the GPO's overall contract portfolio or negotiating a better price for a specific product than what the national GPO contract offered. Clinical evaluation and standardization services included organizing clinical advisory committees that were made up of customer representatives with clinical backgrounds as a way for customers to make decisions or provide input about products being considered for contracts. When providing technology assessments, the GPOs reported that they consider whether a product includes an innovative technology that could provide meaningful

¹⁴See [GAO-03-998T](#).

¹⁵This includes services that were provided directly by the GPO or through an affiliate.

benefit to patients in comparison to similar products already available to the GPO's customers.

Other GPO services were not provided by all six of the GPOs in our review. For example, five of the six GPOs reported providing their customers with electronic commerce and benchmarking data services. Electronic commerce services include, for example, assisting GPO customers with purchasing products using a Web-based product ordering system. Benchmarking data services include, for example, working directly with customers to identify opportunities for cost savings and to identify processes for measuring outcomes. Half or fewer of the GPOs in our review reported providing certain services. For example, three GPOs reported providing their customers with patient-safety services, with one of the GPOs reporting that it provides its customers with clinical resource guides that address how to use products safely and in ways that optimize the products' clinical benefits. (See table 2 for a list of services and the number of GPOs that reported offering each service.)

Table 2: Services the Six Largest Group Purchasing Organizations (GPO) Reported Providing in 2008

Service ^a	GPO					
	A	B	C	D	E	F
Custom contracting	✓	✓	✓	✓	✓	✓
Clinical evaluation and standardization	✓	✓	✓	✓	✓	✓
Technology assessments	✓	✓	✓	✓	✓	✓
Supply-chain analysis	✓	✓	✓	✓	✓	
Electronic commerce	✓	✓	✓	✓	✓	
Materials management consulting	✓	✓	✓	✓	✓	
Benchmarking data	✓	✓	✓	✓	✓	
Continuing medical education	✓	✓		✓	✓	✓
Market research	✓	✓	✓	✓		
Materials management outsourcing	✓	✓			✓	
Patient safety services	✓	✓	✓			
Marketing products or services	✓	✓		✓		
Insurance services	✓	✓				
Revenue management	✓	✓				
Warehousing	✓					
Equipment repair	✓					
Other ^b			✓		✓	✓

Source: GAO structured data collection protocol.

Note: The six largest GPOs were selected based on their reported 2007 purchasing volume in Health Industry Distributors Association, *Group Purchasing Organization & Integrated Delivery Network: Market Brief* (Alexandria, Va., July 2009).

^aThis list includes services that may be offered through affiliates of the GPO.

^bOther reported services included, for example, contracting for environmentally friendly products, energy-related services and education, and public policy services.

Four of the six GPOs in our review reported adding some of the services listed in table 2 since 2002. Reasons that GPOs gave for adding services included responding to customer demand and attempting to remain competitive in the GPO market. For example, one GPO reported adding a data benchmarking service to analyze customers' quality-related data—such as length-of-stay and clinical patient management—in order to help its customers improve such areas as capacity, patient outcomes, and health care costs. Also, representatives from two GPOs described adding supply-chain analysis services to assist customers with managing their in-house pharmacies, for example by identifying opportunities to switch to lower-cost generic medicines.

GPOs Reported Funding Services Using Contract Administrative Fees from Vendors or by Charging Customers Directly

The six GPOs in our review generally reported funding services using contract administrative fees paid by vendors or by directly charging customers that used the services.¹⁶ Table 3 identifies the funding methods that GPOs reported using for the services they provided in 2008.

Table 3: The Six Largest Group Purchasing Organizations' (GPO) Reported Funding Methods for Services Provided in 2008

Service ^a	Number of GPOs offering service	Number of GPOs funding only through administrative fees	Number of GPOs funding only through charges to customers	Number of GPOs using both funding methods
Custom contracting	6	2	2	2
Clinical evaluation and standardization	6	4	0	2
Technology assessments	6	5	1	0
Supply-chain analysis	5	1	1	3
Electronic commerce	5	2	0	3
Materials management consulting	5	1	1	3
Benchmarking data	5	1	1	3
Continuing medical education	5	4	0	1
Market research	4	2	2	0
Materials management outsourcing	3	0	3	0
Patient safety services	3	2	1	0
Marketing products or services	3	2	1	0
Insurance services	2	1	1	0
Revenue management	2	0	2	0
Warehousing	1	1	0	0
Equipment repair	1	1	0	0
Other ^b	3	2	0	1

Source: GAO structured data collection protocol.

Note: The six largest GPOs were selected based on their reported 2007 purchasing volume in Health Industry Distributors Association, *Group Purchasing Organization & Integrated Delivery Network: Market Brief* (Alexandria, Va., July 2009).

^aThis list includes services that may be offered through affiliates of the GPO.

^bOther reported services include, for example, contracting for environmentally friendly products, energy-related services and education, and public policy services.

¹⁶The six GPOs in our review had a limited number of other sources of revenue, such as outside investments and fees paid by vendors to participate in GPO-sponsored trade shows. Data provided by the six GPOs showed that revenue from sources other than contract administrative fees and direct charges to customers accounted for about 9 percent of total revenue.

The GPOs we interviewed identified factors that determined when they fund a service through a direct customer charge instead of using contract administrative fees collected from vendors. These factors included the following:

- *The proportion of GPO customers that plan to use the service.* Representatives from three GPOs told us that their decision to fund a service through direct customer charges or contract administrative fees could depend on the proportion of customers that plan to use the service. For example, one GPO representative stated that if all of its customers plan to use a certain service, then the GPO would pay for the service with contract administrative fees. If, however, only a portion of its customers plan to use a service, the representative said that the GPO would charge a fee to only those customers that used the service.
- *Customers' purchasing volumes.* Representatives from one GPO told us that customer purchasing volumes can influence whether the GPOs fund a service through direct charges to customers, or using contract administrative fees. These representatives reported that customers whose purchases yield administrative fees sufficient to cover the cost of the service provided would likely receive the service without additional cost, while lower-volume purchasers might be expected to pay an additional fee. The representatives reported that the GPO negotiated the additional costs for these services with its affected customers.

GPOs reported that the level of contract administrative fees collected from vendors can vary depending on the contract negotiated with a vendor. According to the GPOs in our review, the average contract administrative fees paid by vendors in 2008 weighted by purchasing volume ranged from 1.22 percent of purchases to 2.25 percent of purchases. The GPOs in our review also reported receiving individual contract administrative fees that ranged from a low of 0.09 percent to a high of 10 percent of a product's purchase price.¹⁷ Two GPOs in our review reported collecting contract administrative fees in 2008 that were greater than 3 percent of the

¹⁷One GPO reported that it was unable to provide the lowest individual contract administrative fee it received in 2008. However, this GPO and one other GPO reported negotiating contracts with a 0 percent contract administrative fee. The GPO reporting a contract administrative fee of 0.09 percent said the contract was for rehabilitation services. The GPO reported collecting about \$35,000 in contract administrative fees from this contract in 2008. The GPO reporting a contract administrative fee of 10 percent said that contract was for energy consulting and brokerage services. The GPO reported collecting less than \$4,000 in contract administrative fees from this contract in 2008.

purchase price. One of these GPOs reported that agreements with contract administrative fees above 3 percent constituted less than 5 percent of all vendor contracts in 2008. The other GPO reported that these agreements constituted less than 10 percent of all vendor contracts in 2008. The six GPOs combined reported collecting a total of about \$1.7 billion in contract administrative fees in 2008 and about \$320 million in other revenue.

GPOs in our review reported distributing a portion of their revenue—including revenue from contract administrative fees—to their customers and owners.¹⁸ The six GPOs combined reported distributing a total of about \$1.1 billion in 2008. The GPOs reported distributing about 53 percent of their total revenue that year. GPOs reported distributing revenue to their customers based on a number of factors, such as a customers' purchasing volume or the percentage of contract administrative fees produced through customer purchases. GPOs also generally reported distributing revenue to owners, who may also be customers, based on their share of ownership in the GPO.¹⁹

GPOs Reported That Since 2002 They Have Revised Their Codes of Conduct and Formed a Voluntary Membership Association

The GPOs in our review reported that they have revised their codes of conduct and established a voluntary membership association focused on promoting best practices and public accountability among member GPOs. The GPOs reported making a range of revisions to their codes of conduct since 2002 in order to strengthen, clarify, or update these codes of conduct, which comprise the GPOs' contracting and conflict of interest policies. For example, to ensure customers' access to new and innovative products, one GPO reported revising, in 2005, a policy in its code of conduct that requires the GPO to monitor the marketplace for new and innovative technology products that could potentially be included in contracts. Similarly, another GPO reported revising in 2008 a policy in its code of conduct that directs the GPO to include in its contracts a provision allowing the GPO to add other vendors at any time if the vendors' products offer incremental benefits for patient care or safety. Further, to address potential conflicts of interest, one GPO reported revising its code of

¹⁸Revenue includes all income a GPO received from sources such as contract administrative fees, customer fees, and income from outside investments. The highest percentage of revenue that any of the six GPOs reported distributing to customers in 2008 was 86 percent. The lowest percentage of revenue that any GPO reported distributing was 32 percent.

¹⁹In some cases, these ownership interests could be indirect. For example, a customer could be part of a membership association that owned or partly owned the GPO.

conduct in 2005 to include a requirement that employees with ownership interest in a vendor remove themselves from any discussions involving that vendor.

Five GPOs in our review also reported making changes since 2002 intended to strengthen employee compliance with their codes of conduct.²⁰ For example, three GPOs reported making changes to programs used to educate their employees on the codes of conduct.²¹ Four GPOs reported implementing procedures for employees to affirm their compliance with the policies in the GPO's code of conduct. Two GPOs reported developing procedures for addressing alleged violations of the GPO's code of conduct. One GPO also reported that it had established a requirement that the GPO provide its board of directors with annual reports on the GPO's compliance with its codes of conduct.

In addition to revising their codes of conduct, the six GPOs in our review, with three additional GPOs, established a voluntary membership association in 2005—the Healthcare Group Purchasing Industry Initiative (HGPII). These GPOs established the association in order to promote and monitor best ethical and business practices in the GPO industry in response to congressional questions about GPO business practices. At its founding, HGPII adopted a set of principles of ethics and business conduct that its GPO members are expected to follow. These include having a written code of business conduct, working toward high quality health care and cost effectiveness, working toward an open and competitive purchasing process, sharing best practices, and being accountable to the public. As part of its self-governance approach, HGPII bylaws stipulate that member GPOs that fail to abide by the principles of ethics and business conduct be expelled from the organization, although a HGPII representative stated that this provision has never been used.

In order to monitor GPOs' adherence to these principles, HGPII members are required to annually report information on their policies and business practices using a public accountability questionnaire. This questionnaire

²⁰Although they did not report the following as changes since 2002, GPOs reported utilizing various activities to monitor compliance with their codes of conduct and other policies, such as establishing ethics hotlines for employees or others to report potential violations, and employing compliance officers to manage their ethics programs.

²¹One GPO reported improving its ethics and compliance communication through booklets on business conduct guidelines, an ethics and compliance Web site, and monthly staff reminders regarding conflict of interest issues.

includes over 100 questions that ask member GPOs to describe, for example, their codes of conduct and conflict of interest policies, contracting practices such as sole-source and bundled product contracts, contract administrative fees, and activities to ensure compliance with their policies.²² Each GPO's questionnaire responses are first reviewed by a HGPII representative to ensure that the responses are sufficient and complete. The GPOs' responses are then posted to an internal members-only section of the HGPII Web site for member GPOs to review and comment on before the responses are posted on the HGPII Web site for the public to view.²³

To promote GPO best practices, HGPII members have also been required to participate in annual best practices forums since 2006 to discuss ethical and business conduct practices with other GPO representatives and with representatives from other organizations. HGPII's 2010 best practices forum included sessions on conflicts of interest, compliance with policies and laws, and contracting with small vendors. HGPII representatives stated that, as a result of discussions at its most recent best practices forum, HGPII members have taken steps to establish a formal and independent process for a neutral party to review vendor grievances against GPOs and suggest resolutions, as well as an independent advisory council of ethics experts to provide guidance on best practices for compliance as well as other HGPII activities.

²²According to HGPII, the first GPO public accountability questionnaires were submitted in 2005. See *The Healthcare Group Purchasing Industry Initiative's Fourth Annual Report to the Public (May 2008-May 2009)*, The Healthcare Group Purchasing Industry Initiative (Washington, D.C.): May 1, 2009.

²³A HGPII representative stated that on one occasion, for example, a member GPO brought to his attention that another GPO's response regarding contract administrative fees was inadequate, and, after sharing this concern with the GPO, it submitted an adequate amended response. HGPII questionnaire responses are posted to the following Web site: <http://www.healthcaregpoi.com/signatorycompanies.html> (accessed June 3, 2010).

The Reported Impact of GPOs' Codes of Conduct and Other Initiatives Varied among GPOs, Customers, and Vendors

The reported impact of GPO codes of conduct and other initiatives varied. All of the GPOs in our review reported that these initiatives have had impacts on GPO contracting practices, innovative product selection, contract administrative fees, potential conflicts of interest, and the transparency and accountability of GPO business practices. However, the impact of the GPO initiatives reported by customers and vendors we interviewed varied.

Contracting practices

Each of the six GPOs reported that their codes of conduct have had an impact on their contracting practices such as sole-source contracting and bundling. For example, four GPOs reported that their codes of conduct limiting sole-source contracts have resulted in the GPOs generally negotiating multi-source contracts.²⁴ In addition, one GPO reported that its code of conduct limiting bundling of unrelated products has resulted in the GPO choosing not to bundle certain products, even when bundling could have resulted in lower prices for its customers.

Representatives from some customers and vendors that we interviewed have also reported that GPOs' codes of conduct have had an impact on GPOs' contracting practices, although the reported impacts have varied. For example, three customers and four vendors that we interviewed also told us that GPOs have expanded the number of vendors that they contract with to include more multi-source contracts. However, some customers and vendors told us that these changes in GPOs' contracting practices have affected GPO contract prices. For example, two customers and all five vendors reported that, in some cases, the negotiation of multi-source contracts has resulted in higher prices for GPO contracted products.²⁵ In order to obtain lower prices, four customers and all five of the vendors told us that GPO customers negotiate contracts directly with vendors, with the majority noting that customers use GPO prices as the starting point of

²⁴GPOs reported implementing various policies to limit the number of sole-source contracts they negotiate, such as prohibiting sole-source contracts for clinical preference products, and negotiating for multi-source contracts unless customers demand sole-source contracts.

²⁵One vendor representative explained that vendors are willing to lower their prices in exchange for the exclusivity of a sole-source contract, and will raise their prices if they have to share their business with other vendors.

negotiations.²⁶ Furthermore, customers and vendors told us that customers may negotiate sole-source contracts, bundled product contracts, or commit to purchase a certain volume of products to receive lower prices.

Innovative product selection

The six GPOs in our review reported that their codes of conduct have resulted in the GPOs developing mechanisms to support the inclusion of innovative products on contract.²⁷ For example, three GPOs reported convening forums for members to learn about new and innovative products. In addition, all six GPOs reported that their codes of conduct include vendor contract provisions to allow the addition of innovative products when they become available, and that these provisions have resulted in GPO contracts for new or innovative technology products.²⁸

While most customers and vendors did not mention an impact associated with GPOs' initiatives related to adding innovative products on contract, one vendor that we interviewed noted that GPOs' provisions for adding innovative technology products are rarely used and have not had an impact on the inclusion of innovative products on GPO contracts.

Contract administrative fees

Each of the six GPOs reported that their codes of conduct have had an impact on the level of contract administrative fees that they receive from vendors. For example, four GPOs reported that, as a result of their codes of conduct, they do not receive contract administrative fees greater than 3 percent. In addition, one GPO reported that policies in its code of conduct have resulted in an overall decrease of administrative fees in relation to its sales volume since 2002. Representatives from three GPOs

²⁶ Customers and vendors told us that some GPOs may receive contract administrative fees associated with customer-negotiated purchases, in some cases regardless of whether GPOs are directly involved in these negotiations.

²⁷ A GPO representative told us that GPOs consider innovative products both during the contracting process, as well as outside the contracting process when new products become available.

²⁸ GPO contracts contain various provisions to allow for the inclusion of additional innovative products on contract when they are available. For example, one GPO reported that its contracts allow for the opportunity to add vendors that compete with an existing contract award if a product is determined to be technologically or clinically innovative. In addition, another GPO reported that its contracts include a provision that it will not be restricted from contracting for innovative technology on behalf of its customers.

told us that, as a result of their codes of conduct, their GPOs have established generally consistent contract administrative fees for comparable products.

Most customers that we interviewed did not comment on the level of contract administrative fees that GPOs receive from vendors, although some vendors told us that GPOs' codes of conduct have reduced the level of contract administrative fees that they pay to GPOs. For example, three vendors we interviewed told us that the contract administrative fees that they pay to GPOs are generally lower than they were a few years ago, with two vendors reporting that contract administrative fees are also generally more consistent than they were in the past.

Potential conflicts of interest

All six GPOs in our review reported that their codes of conduct have impacted the potential for conflicts of interest. For example, three GPOs reported that these codes—such as policy provisions requiring that employees divest ownership interest in vendors, requirements to disclose any conflicts of interest, and procedures to resolve potential conflicts of interest—have resulted in a reduction or prevention of conflicts of interest. One of the three GPOs noted that its policy preventing ownership interest in vendors has enabled the GPO to make contracting decisions based on merits without undue influence from vendors. In addition, two GPOs reported that their codes of conduct have increased awareness among employees about the significance of potential conflicts of interest.

No customers and only one vendor we interviewed commented on the impact of GPOs' codes of conduct on the potential for GPO conflicts of interest. A representative of this vendor said that he has not seen a lot of change regarding conflicts of interest in the GPO industry.

Transparency and accountability

Some GPOs reported that their codes of conduct have resulted in more transparent business practices and that the establishment of HGPII has had an impact on both the transparency and accountability of their business practices. Four GPOs reported that their codes of conduct increased the transparency of their business practices. For example, one GPO reported that, as a result of its code of conduct, it now posts information about contracting opportunities and product selection criteria on a publicly available Web site for potential vendors to view. In addition,

five of the six GPOs that we interviewed stated that their participation in HGPII has helped bring transparency to the contracting process and made the GPOs more accountable to customers, vendors, and the public.²⁹ One GPO that we interviewed noted that the HGPII public accountability questionnaire provides customers and vendors with the ability to compare information about competing GPOs that would not otherwise be available.

Similarly, two customers and one vendor we interviewed also told us that GPOs are operating with greater transparency regarding their contracting practices as a result of the establishment of HGPII and the GPOs' codes of conduct. The vendor also stated that GPOs are operating with greater transparency regarding the negotiation of contract administrative fees. This vendor explained that since GPO customers now have a better understanding of the fees that their GPOs negotiate, customers are requesting that their GPOs return a greater portion of contract administrative fees than they had in the past.

External Comments

Representatives from the six GPOs in our review and representatives from the Health Industry Group Purchasing Association and HGPII reviewed a draft of this report and provided oral comments. Some of the representatives also provided written comments. These representatives generally stated that the report was fair and balanced. Some representatives commented on HGPII's efforts to increase transparency and strengthen oversight in the GPO industry. HGPII provided additional information about steps that the organization has taken to establish a formal process for a neutral party to review vendor grievances against GPOs, as well as an independent advisory council of ethics experts to provide guidance on practices for compliance and other HGPII activities. We incorporated this additional information into the report. The representatives from GPOs, the Health Industry Group Purchasing Association, and HGPII also provided technical comments, which we incorporated as appropriate.

²⁹However, representatives from three of the six GPOs stated that their participation in HGPII has not resulted in a change in their other business practices—such as sole-source contracting and bundling—because their codes of conduct were already in compliance with the HGPII principles when the association was established.

As arranged with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the report date. The report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-7114 or kohnl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in cursive script that reads "Linda T. Kohn".

Linda T. Kohn
Director, Health Care

Appendix I: GAO Contact and Staff Acknowledgments

GAO Contact

Linda Kohn, (202) 512-7114 or kohnl@gao.gov

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In addition to the contact named above, Kristi Peterson, Assistant Director; Kye Briesath; Kelly DeMots; Krister Friday; Julian Klazkin; and Steve Robblee made key contributions to this report.

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