



Executive Insights

Time for Medtechs to Rethink Group Purchasing Organizations in Japan?

Japan's hospitals — and medtech manufacturers' customers — are continuing to face fundamental pressures on the sustainability of their operations, rooted in the broader financial challenges to Japan's healthcare system. The demographic situation of Japan — the “oldest” country in the world and still aging, combined with negative population growth — is largely to blame, and has been compounded by increasing public indebtedness and slow economic growth. Healthcare expenditures are forecast to grow rapidly in the coming years, yet the country's ability to pay for this is increasingly compromised, as evidenced by the dependency ratio of the working-age to elderly population.

This is expected to place increasing strain on government healthcare budgets, resulting in direct and indirect price and volume measures to control costs, including in relation to medical devices.

L.E.K. Consulting has conducted an in-depth analysis of the Group Purchasing Organization (GPO) landscape in Japan and has

developed viable action steps for medtech players to fortify their GPO strategy as the landscape evolves — or risk being left behind by their competitors.

Penetration of GPOs in Japan is increasing, driven by greater financial pressures on the healthcare system and hospitals

As L.E.K. has previously noted, these pressures are resulting in a shift toward more transactional-related purchasing decisions for medical devices, which manifests in two key ways: first, greater economic stakeholder (e.g., hospital administrators, procurement departments) influence over purchasing decisions, and second, a greater focus on purchase price in decision-making around devices, across many device categories, except for the most innovative devices. This trend toward transactional purchasing is expected to continue to gain momentum. Across Japan, L.E.K. estimates ~30% of hospitals demonstrate transactional-related purchasing behavior, with a further 10%-20% likely to switch in the near term to transactional-focused purchasing decisions.

With this has come greater use of intermediaries to build scale and increase price negotiating power with medical device manufacturers and their dealers. These can take the form of centralized procurement organizations across member hospitals within a hospital group, or third-party group purchasing organizations (GPOs), such as NHA, JMGPO, Meccul and VHJ, that negotiate pricing on behalf of their hospital members (see Figure 1).

Time for Medtechs to Rethink Group Purchasing Organizations in Japan? was written by **Patrick Branch**, Partner, and **Sam Wilson**, Principal. Both Patrick and Sam are based in L.E.K. Consulting's Tokyo office.

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Figure 1
Sample group purchasing organizations in Japan

Some GPOs conduct group purchase activities mainly to develop relationships with hospitals, but gain profit through other business

	NON-EXHAUSTIVE			
	NHA	JMGPO	Meccul	VHJ
Year established	Third party	Third party	Third party	Third party
Type	(Independent)	(Independent)	(Part of Medius)	(Independent)
Geographical coverage	National	National	National	National
Product focus	Medical device, medical material and medicine	Medical material	Medical material	Medical device, medical material and medicine
Number of member hospitals	285	85	N/A	41
Hospital membership fee	Yes	Yes	No	Yes
Outcome-based commission	Yes	No	N/A	N/A
Other service lines	Consulting	Consulting	Database, analysis and consulting	Data share, provision and analysis

Source: Home page of each GPO; L.E.K. interviews and analysis

As a result, GPO participation rates have increased significantly over the past five years. Today, ~40% of institutions participate in formal GPOs (see Figure 2).

Aggregation of purchasing volume is a key feature of GPO contracts in Japan

The main role of GPOs in Japan is to negotiate pricing with manufacturers. In return, GPOs charge a membership fee as well as an outcome-based fee for the savings realized. Depending on specific contract terms, rebates may be passed directly from dealers/manufacturers to hospitals, or via the GPO, which may retain some of the rebate. These rebates are typically volume driven but may also be fixed in nature (see Figure 3).

Dealers continue to play an important role in inventory supply and management as well as payment collections and rebate payments. GPOs usually have relationships with multiple dealers for a given brand in order to ensure supply of the products.

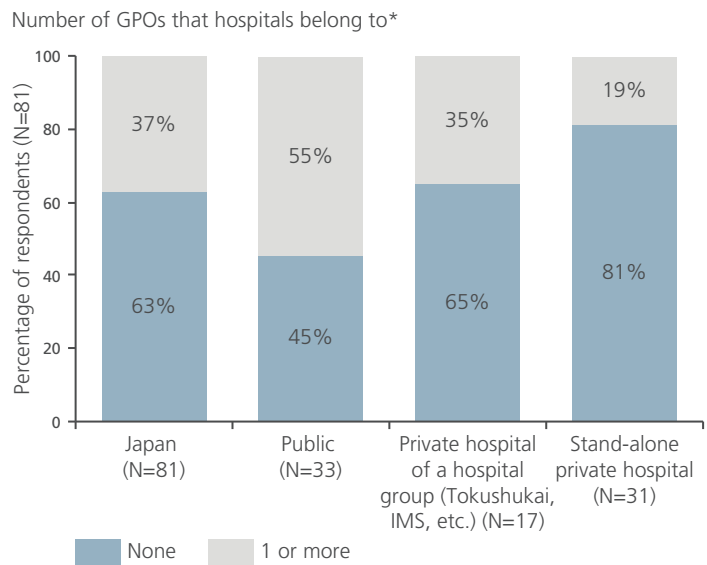
GPO agreements are designed to deliver cost savings to hospitals and the healthcare system, but along with potential benefits, these agreements pose strategic challenges for manufacturers and their dealers (see Figure 4).

The most common way for hospitals to purchase medical supplies through a GPO in Japan is by several hospitals becoming members of a GPO to purchase medical supplies together, in order to achieve volume-related price discounts (see Figure 5).

Japan's GPO agreements do not typically result in exclusivity for a single brand, and as a result, GPO agreements will typically

include two to three brands within a given product category, from which physicians can then select. Unlike in other markets, buyers typically are not required to commit to purchasing a minimum percentage of their needs from designated purchasers.

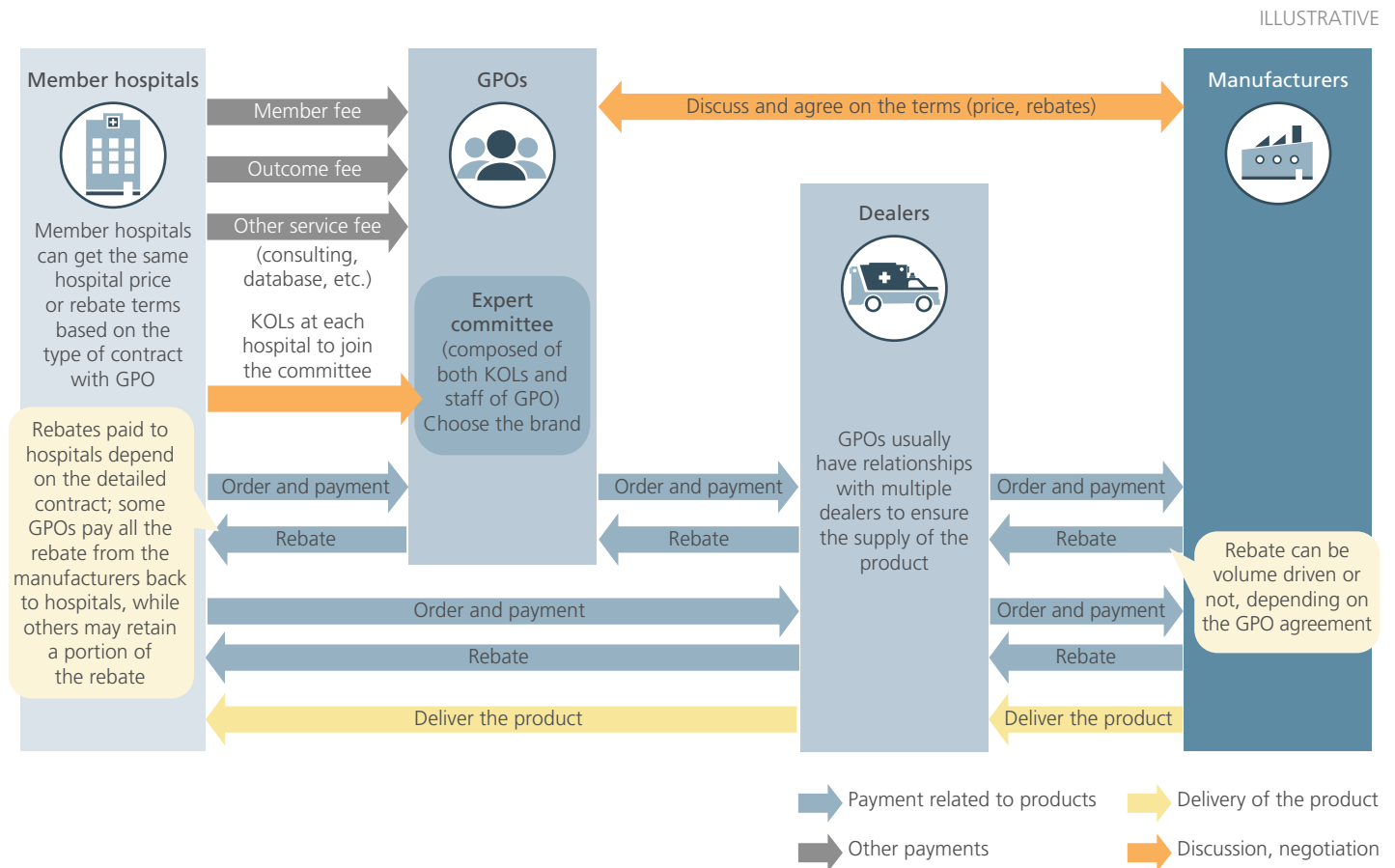
Figure 2
GPO participation rates in Japan



Note: *Question: Aside from centralized purchasing, how many GPOs (group purchasing organizations – that are not part of the hospital) does your hospital belong to?

Source: L.E.K. 2020 APAC Hospital Priority Survey

Figure 3
GPO product and payment flow



Source: L.E.K. interviews and analysis

Senior clinicians play an important role in brand inclusion in GPO agreements

The selection of brands for inclusion in GPO agreements typically focuses on four key criteria: recommendations by key opinion leaders (KOLs) (senior doctors with budgetary ownership within the member institutions) and price are the most essential, followed by manufacturer brand share within member institutions and the clinical profile of the product.

So, senior clinicians within hospitals play an important and highly influential role in selecting medical device brands for price negotiations through a GPO. Typically, KOLs from member hospitals will join the GPO's committee to review and revise the product list and to provide advice on which brands to select. After this process, GPOs will approach short-listed manufacturers and ask them to support an offer. Based on these responses, GPOs will negotiate with the manufacturers and dealers on pricing and




rebates before selecting the brands for inclusion on the GPO list (see Figure 6).

In most cases, GPOs do not indicate brand preferences to hospitals, thus limiting the control they have on each brand's volume sold. In rare cases, GPOs might suggest a given brand to member institutions based on collaboration schemes with manufacturers, but the degree to which these influence individual hospital decision-making today appears somewhat limited.

Current practices do allow physicians to use other brands not included in the GPO list; strong guidance is typically provided to physicians, however, leading them to select from the list in order for the hospital both to realize the price savings negotiated by the GPO and to minimize stock management challenges with too many brands. In rare cases, hospitals may update their hospital formulary so as to include only brands in the GPO agreement.

Figure 4
Pros and cons for stakeholders associated with GPO agreements

The GPO system is designed to benefit hospitals and healthcare providers most, and puts dealers and manufacturers under additional pricing pressure

Stakeholders	Pros	Cons
 Hospitals	<ul style="list-style-type: none"> ✓ Gain negotiation power ✓ Obtain lower device purchase price ✓ Simplify externalized negotiation 	<ul style="list-style-type: none"> ✗ Possibility of pressure from GPOs to order their listed products if GPO has the strong hand in negotiations ✗ Margin paid to GPO (generally for third-party GPOs)
 Manufacturers	<ul style="list-style-type: none"> ✓ Potentially maintain share in member hospital, though pricing incentive may be needed against aggressive competitors ✓ For institutions where there is low market share, opportunity to gain share through GPO listing at the expense of non-listed competitors 	<ul style="list-style-type: none"> ✗ Dealers may question prices offered through GPOs vs. directly to hospitals if higher rebates are offered through GPOs ✗ Average wholesale price (AWP) might decrease as a result of the lower price offered to GPOs ✗ There are no guarantees on volumes despite price reductions and rebates
 Dealers	<ul style="list-style-type: none"> ✓ Gain potential for volume uplift by offering attractive agreements to GPOs ✓ Simplify negotiation and administrative process by delegating part of it to GPOs 	<ul style="list-style-type: none"> ✗ Reduced purchase price and margin payable to GPO result in lower absolute margin

Source: L.E.K. interviews and analysis

Another feature of Japanese GPO agreements is the relatively short contract period with manufacturers. Brands chosen by GPOs are usually reviewed and renegotiated every six months, providing brands without GPO contracts an opportunity to negotiate a contract and get their product listed. For manufacturers that have provided discounts to GPOs, this limits the potential benefit period of their agreements.

The GPO landscape in Japan is expected to continue to evolve, and medtech manufacturers should develop strategies to guide GPO participation

Traditional relationships between GPOs and medtechs are often perceived as one-sided, particularly in Japan where current GPO agreements do not guarantee volume commitments for discounts offered and are frequently renegotiated.

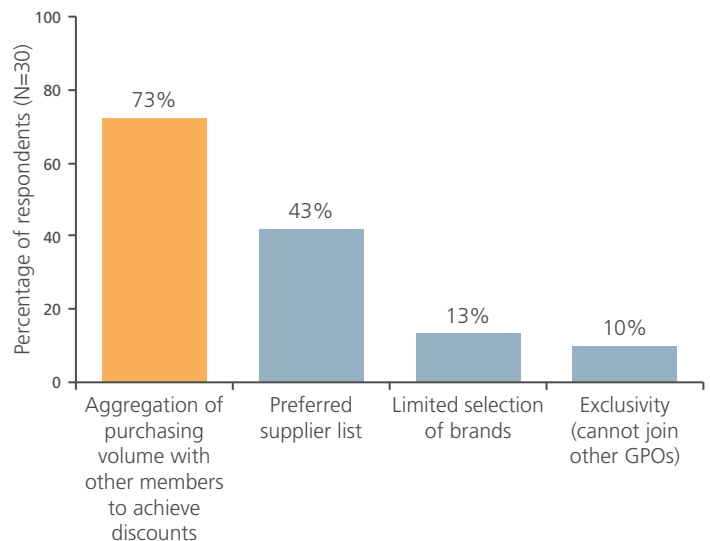
However, with the increasing financial pressures on the healthcare system in Japan and the associated increase in transactional purchasing behaviors in hospitals, hospital participation and demand for GPO services in Japan is expected to continue to increase. GPOs are expected to evolve their services as a means to deliver differentiated portfolios and greater value for their customers — with the emergence of, for example, regional-focused GPOs that provide services tailored to local needs and relationships, or specialized GPOs driving differentiated value via targeted product categories (e.g., consumables) and/or specialty-specific offerings (e.g., orthopedics).

In other markets such as the U.S., hospitals are increasingly relying on GPOs to help manage the complex system of

purchasing, and GPOs have expanded their range of services to meet this demand. Beyond cost savings, GPOs offer services that include data analysis and benchmarking, innovative technology implementation, market research, and emergency preparedness and natural disaster response. GPOs also support hospitals in

Figure 5
GPO contract arrangements

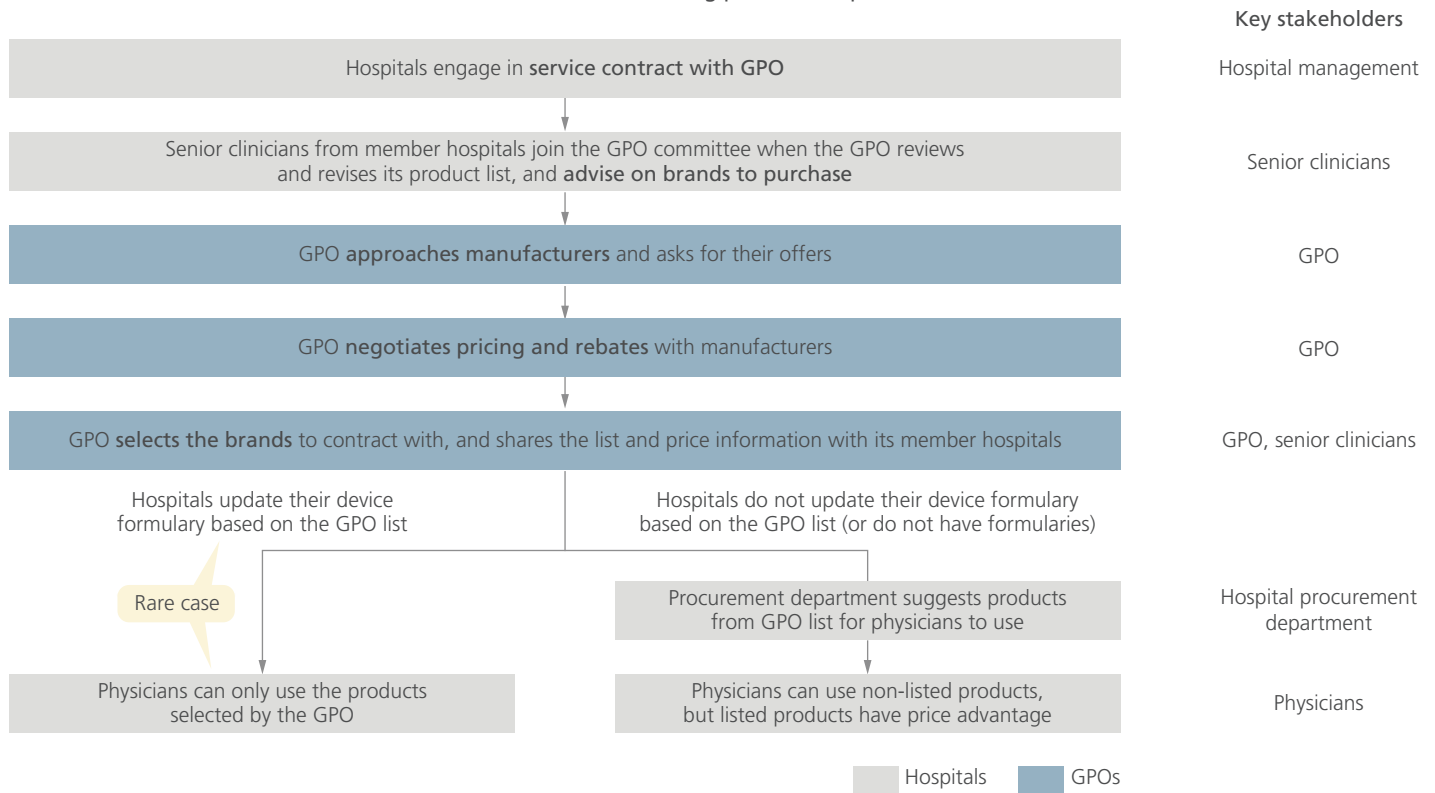
Key features of GPO contracts*



Note: *Question: What are the key features of the GPO contract(s)?
Source: L.E.K. 2020 APAC Hospital Priority Survey

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Figure 6
GPO contracting process in Japan



Source: L.E.K. interviews and analysis

reducing medical errors, by helping to standardize some of the product use in hospitals and educating clinicians on best practices.

Just as a one-size-fits-all sales model across hospital segments no longer suffices for medical device companies, nor will a single approach work for medtechs in their dealings with GPOs. Therefore, medical device manufacturers in Japan should consider the following action steps when developing their GPO strategy:

- Use GPO agreements to protect innovative products with low levels of competition or a distinct competitive advantage
- Identify GPOs where the hospital membership mix is likely to drive benefits to the organization, and to the extent possible, carve out agreements relevant to these accounts, including:
 - Accounts where the organization currently has a low market share in products appropriate for GPOs, and where GPO participation would enable the manufacturer to access the account and key decision-makers, in order to drive volume gains
 - Accounts that constitute the long tail of the demand curve, which tend to be hospitals with a lower degree of centralized purchasing and smaller respective volumes; for these customers, the traditional GPO model offers both providers and medtechs value as well as efficiencies
- Identify accounts where there are strong relationships with senior clinicians likely to be involved in the GPO provider selection process, and leverage these connections to support listing
- Create commercial capabilities to support the organization in negotiations with GPOs, to ensure pricing and participation decisions — including financial analysis and business case development, monitoring and tracking of contract performance, contract negotiations, and ongoing GPO intelligence — are well informed and consistent across the organization
- Develop guidelines for product inclusion and acceptable discounts to ensure consistency across the organization

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- Monitor the GPO landscape to identify new and emerging GPOs that might be focused on specialty or product categories aligned with the portfolio of the organization, and engage with these organizations early
- Identify opportunities in large accounts to develop direct partnerships that marginalize the role of the GPO and that provide greater opportunities to maintain share without paying GPO margins
- Partner with GPOs that are expanding their service offering beyond traditional price negotiations, and identify opportunities to work together (e.g., on reducing medical errors)

About the Authors



Patrick Branch is a Partner in L.E.K. Consulting's Tokyo office and a member of the firm's Life Sciences practice. He works with businesses and investors in the biopharmaceutical, medical device and broader healthcare sectors. He advises clients on a range of topics, including commercial strategy, corporate and business unit strategy, pricing and market access, and M&A.



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