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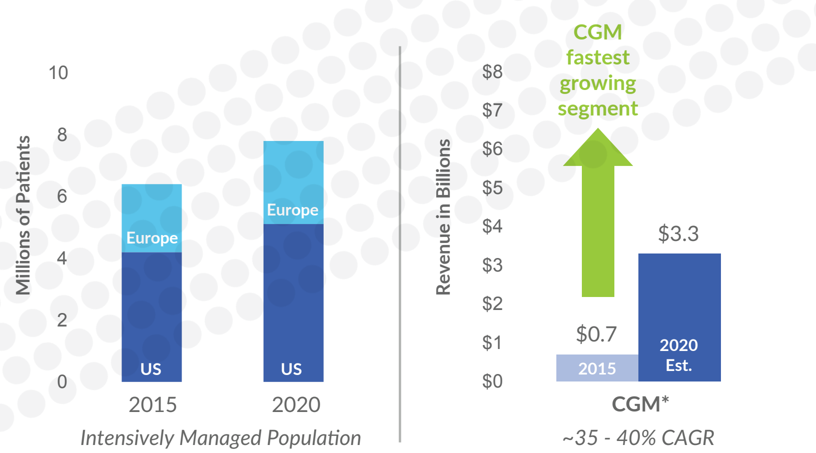

Time for Medtechs to RETHINK GPOs?

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Medtech companies have long had a complicated relationship with group purchasing organizations (GPOs), especially with the national GPOs. GPOs offer opportunity for greater market coverage and efficient contracting, both of which benefit medtechs and their provider customers. At the same time, there has always been pervasive and not-so-subtle grumbling about the market influence that GPOs can wield and the level of reciprocal value realized by medtech companies. However, relationships are changing between health systems and their GPOs, and the GPO landscape itself is rapidly evolving, offering an opportunity for medtech companies to revisit and reshape their own relationships with GPOs.

Medtech companies have long had a complicated relationship with group purchasing organizations (GPOs), especially with the national GPOs. GPOs offer the opportunity for greater market coverage and efficient contracting, both of which benefit medtechs and their provider customers. At the same time, there is pervasive and not-so-subtle grumbling about the market influence that GPOs can wield and the level of reciprocal value realized by medtech companies.

Despite these misgivings, medtechs continue to "grin and bear it." This is due in part to long entrenched practices, as well as a fear of retaliation from GPOs who can limit market access. These fears are supported by earlier high profile attempts at disintermediation by major medtechs, such as **Medtronic plc** and **GE Healthcare**, that ultimately washed out.

But like many other dynamics in healthcare, the interplay between GPOs and medtechs is poised for change. Health systems are becoming increasingly sophisticated, taking more control of their supply chains, and becoming more demanding toward their supply chain partners. The once collegial member community of GPOs is becoming increasingly transactional, with GPOs shifting focus and member engagement models. How a medtech should respond is a nuanced question, but the opportunity for change is increasingly at hand.

The Shifting GPO Environment

When GPOs originally emerged in the healthcare industry decades ago, the model was designed to bring value to thousands of fragmented hospitals by aggregating demand and negotiating lower prices among suppliers. Importantly, the model also intended to return value to suppliers via volume conversion and expanded access. This historical approach has now proliferated into many different models today.

The trade association representing GPOs, the Healthcare Supply Chain Association (HSCA), states that over 600 organizations in the US offer some form of group purchasing. Significant variability exists between these organizations, and classifying them into clear segments can be tricky. We broadly identify five categories of organizations that are negotiating contracts, four of which are types of GPOs and all of which must be managed and navigated by medtech companies (*see Figure 1*). In the figure below, the degree of affiliation between member organizations generally becomes tighter as you go down the list.

In their conversations with L.E.K. Consulting, medtech suppliers have consistently asserted that the national GPOs' ability to return value to manufacturers has diminished markedly over time. Key factors that have contributed to this deterioration include the spread of multi-source contracting and the sheer breadth of manufacturers and contracts listed. Additionally, as health systems have become larger, they are applying significant pressure on suppliers directly and using GPO contracts as a benchmark for further negotiations. This undermines the utility of the GPO contracts.

But perhaps a tipping point among medtechs may be the recent anecdotal reports of bumps in admin fees charged by some national GPOs. These increases go well beyond the longstanding industry benchmark of 3% of sales. "We're on the threshold of a very big change. The national GPOs have been pushing their fees to 5-8%, even 9% in some cases. Providers are starting to ask themselves how these increases are affecting the unit prices they see on products—and how much they're really getting back," says John Strong, former head of Consorta and long-time supply chain expert.

As Strong alludes, the debate about the value of national GPOs is growing not only among medtechs but also among the nation's hospitals and health systems. The 2015 merger between the UHC-VHA Alliance and MedAssets, which formed **Vizient Inc.**, is frequently cited as triggering the reevaluation of GPO relationships among a number of providers. Vizient is now by far the largest of the four national GPOs, with contracts representing an estimated $100 billion in annual spending volume. Core to the debate are the degree and types of value that can be realized in an era of reduced member loyalty and growing sophistication among major hospitals and health systems.

Figure 1

Contract Negotiating Organizations

1. National GPOs
2. Regional purchasing groups
3. Specialty GPOs
4. Health system-owned GPOs
5. Hospitals & health systems

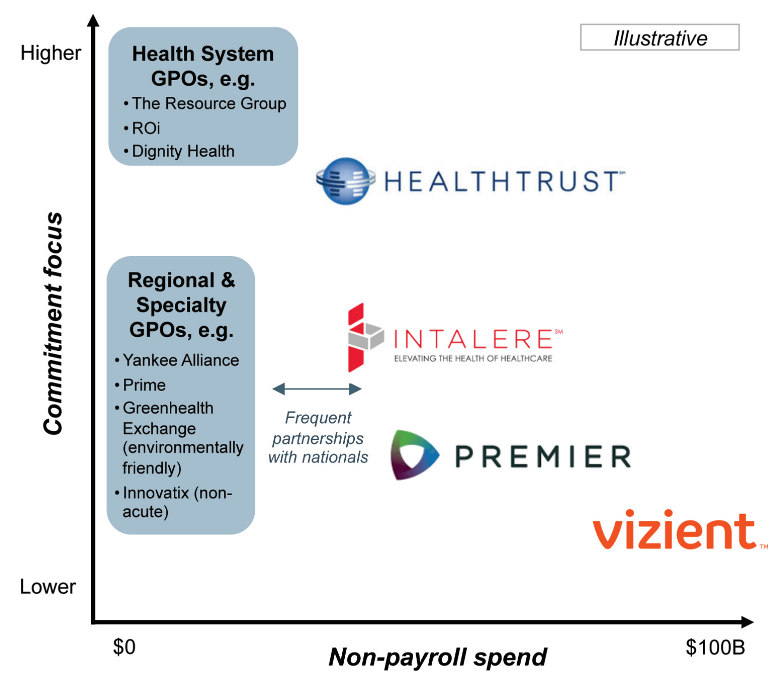
Largest national GPOs	Annual spending volume*
Vizient	$100 billion
Premier	50 billion
HealthTrust	30 billion
Intalere	9 billion

*Self-reported
Sources: Healthcare Purchasing News; Becker's Healthcare Review; company websites

Source: L.E.K. Consulting

Figure 2

National GPOs and GPO Categories: Commitment focus vs. Non-payroll Spend



Source: L.E.K. Consulting

Figure 3

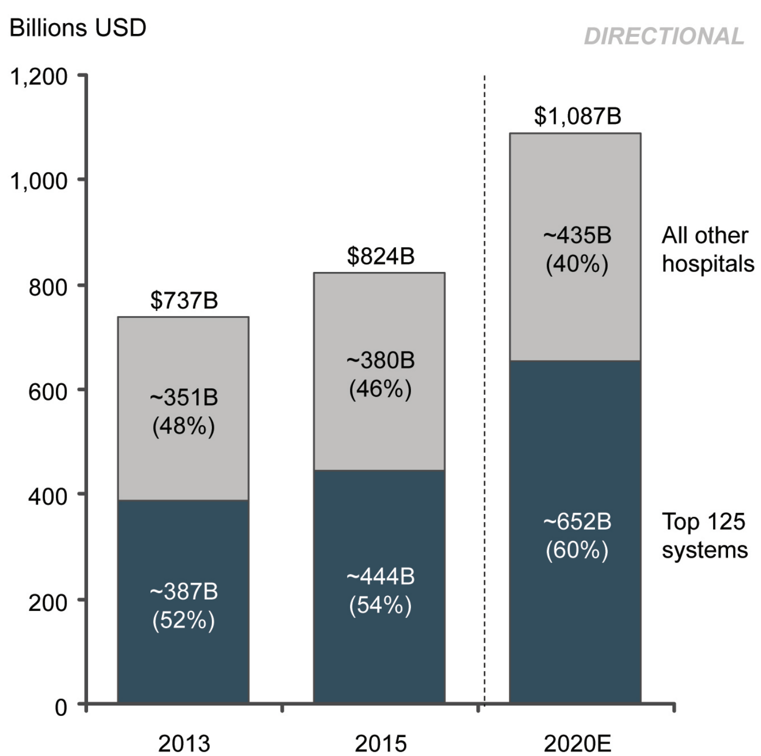
The Power of Information Technology to Disrupt Supply Chain Practices

amazonbusiness B2B Health Services	OPENMARKETS Better Together	avia
• Digital B2B commerce marketplace to connect procurement professionals to healthcare vendors and suppliers • Program optimized for business-to-business transactions including quantity discounts and business pricing	• A software-driven marketplace for healthcare equipment • OpenMarkets Exchange facilitates direct transactions between providers and medical equipment suppliers	• Health system collaborative to address shared challenges and leverage digital solutions • Issue-oriented approach for aggregating demand and gaining preferred pricing suppliers • Technology / digital solution-focused

Sources: Company websites and publicly available materials

Figure 4

Total acute care spend (2013-20E)



2020 top-line spend estimated using 2013-2015 CAGR of 5.7%
Source: AHA; L.E.K. analysis and estimates

These factors have opened the door for more highly focused, relatively smaller GPOs, which have co-existed with the national GPOs but are now growing in prominence *(see Figure 2)*. Over the last few years, regional purchasing groups (RPGs), health system-owned GPOs, and specialized GPOs have each reported strong growth.

These GPOs are exploiting their tighter focus as a means to deliver differentiated offerings and greater value. For example, regional and health system-owned purchasing groups emphasize services tailored to local needs and sole-sourcing to deliver more efficient demand aggregation and higher levels of compliance. Specialized GPOs drive differentiated value via targeted product categories (e.g., pharmacy, environmentally friendly products) and/or customer bases (e.g., non-acute, specialty specific). The buying groups also tout their ability to provide improved reciprocal value to their participating suppliers.

In response, the national GPOs are increasingly pushing their models and market positioning beyond pure contracting to more holistic management of supply chain dynamics that drive total cost of ownership. Long-time investments in data and analytics, particularly by Premier Inc. (*PremierConnect*) and Vizient (*Savings Analyzer*), are seen as key to this evolution. Each leverages large data repositories for supply chain insights.

Still, it's evident these same national GPOs are doubling down and attempting to combat competition head-on in all forms. Vizient, Premier, HealthTrust Purchasing Group LP and Intalere have all built closer ties to RPGs and made renewed investments in regional steering committees and affinity groups. Some are also offering and promoting tools to assist members with their direct contracting activity, such as *aptitude* from Vizient.

Potential Disruptors Making a Move

Strong market forces and stakeholders have kept traditional healthcare supply chain practices entrenched and incumbents focused on evolutionary, not revolutionary, changes. But today's technology and market dynamics make historical barriers seem less daunting. Moreover, the demand for price transparency and cost efficiencies continues to escalate, creating opportunity for new solutions.

Startups like **OpenMarkets** and **AVIA Innovator Network** recognize the longstanding inefficiencies and have built technology-enabled channels to connect product and service suppliers directly with providers. Their solutions promote cost efficiency and price transparency as well as stronger collaboration between providers and suppliers.

But **Amazon** is the main party to thank for putting the healthcare industry—including medtech manufacturers, GPOs and distributors—on notice. Amazon is ramping up and rolling out its B2B Health Services program. With a history of upending established business models and boasting a $475 billion market cap, this powerhouse certainly has the capability to shake up supply chain practices, including contracting (*see Figure 3*).

Balance of Power Shifting to Large Health Systems

The shape of the GPO sector, and supply chain practices more broadly, will ultimately be determined by the customers responsible for the spend—in this case, the nation's hospitals and health systems.

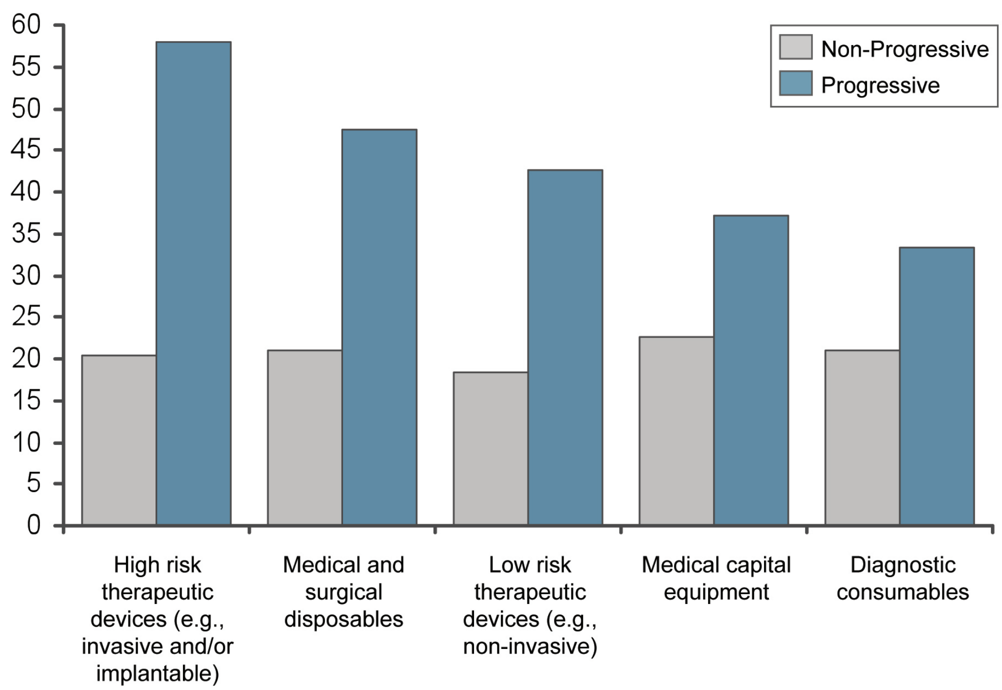
Medtech manufacturers and GPOs alike place much of their focus on the nation's largest health systems, and for good reason: The Top 125 systems represent approximately 2,200, or 43%, of the nation's 5,100 or so hospitals, and in 2015 they accounted for 54% of total acute care spend (*see Figure 4*). The Top 125 systems are an effective and critical channel for medtechs to target in order to achieve commercial success. Furthermore, the Top 125's command of medtech mindshare and resources will only continue to grow. We estimate the Top 125's proportion of spend will grow to 60-65% of total acute care spend by 2020.

Large health systems are increasingly leveraging their scale and resources to aggregate demand, push for supplier rationalization, invest in supply chain analytics, and drive product standardization and compliance. Some health systems are also increasing their investment in distribution

Figure 5

Receptiveness to Bypass GPOs by Product Category (2017, n =158)

Percent of respondents rating 6 or 7 on 7-point scale (1, not at all receptive; 7, very receptive)



% change from 2016 (overall avg)	+7.3%	+9.6%	+8.7%	+4.8%	+5.3%

Note: L.E.K. developed a segmentation model that uses a variety of organizational characteristics to identify "progressive" hospitals and health systems. The vast majority of the Top 125 health systems are characterized as progressive, and their receptivity to bypassing GPOs is quite notable and growing.

Sources: L.E.K. hospital survey of hospital administrators, 2017 / 2016 centers and logistics in order to gain broad-based ownership of the supply chain.

As the large health systems continue to consolidate the market, and as they grow their supply chain sophistication and capabilities, they are better equipped to negotiate their own high-value contracts while simultaneously establishing deeper partnerships with their suppliers. Recent multi-year, system-wide agreements are a reflection of this movement, though still relatively rare and typically involving capital equipment. Two examples: the 15-year, $500 million enterprise managed services model between **Philips Medical** and WMCHealth in New York State, and the 14-year managed equipment services agreement between GE Healthcare and Heritage Valley Health System in Pennsylvania.

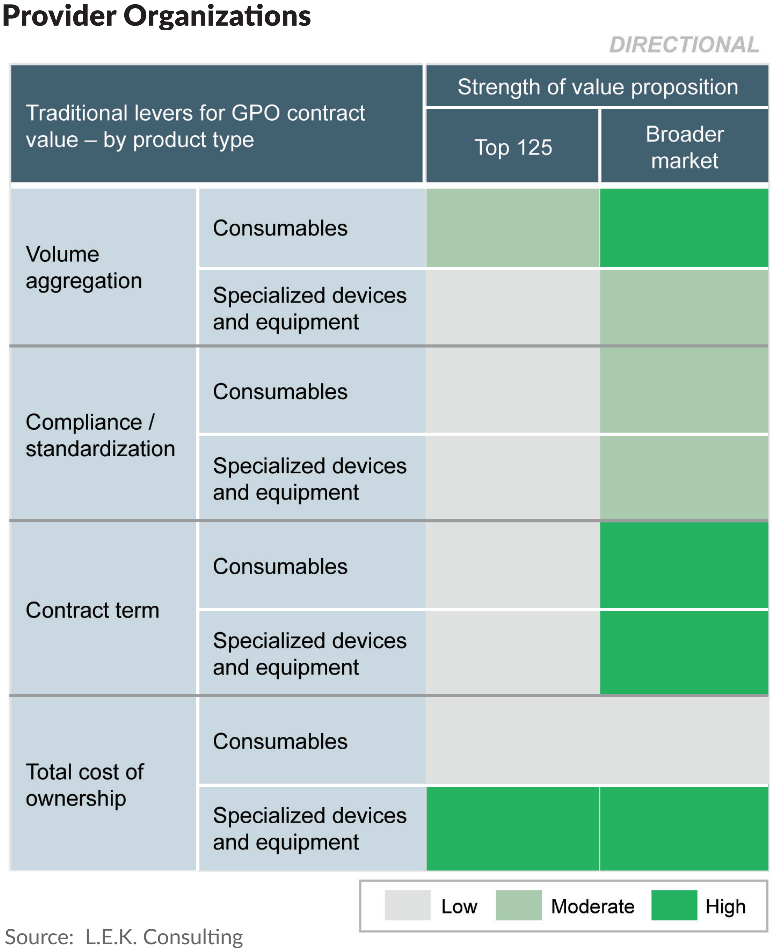
In an annual study that L.E.K. conducts with hospital administrators, we find progressive health systems are increasingly receptive to bypassing GPOs for their medtech contracts (*see Figure 5*). Additionally, some leading health systems have established their own GPOs. The Resource Group (Ascension), ROi (Mercy) and Dignity Health Purchasing Network are three prominent players born from large progressive systems, with several others emerging.

Collectively these developments are leading to growing friction in the GPO business model. Large, progressive health systems are increasingly owning and controlling their own supply chain destinies. At the same time, national GPOs are attempting to engender loyalty from these very same organizations by building out their own, sometimes similar, capability sets and providing higher value services. At risk of being lost in the middle are the GPOs' smaller-budget members in the broader market.

Correspondingly, medtech companies are increasingly finding that their top health system customers are demanding deeper and more direct partnerships, which marginalizes the role of the GPO. Medtechs, however, cannot ignore the other half of the hospital and health system market. Although significant in the aggregate, these smaller provider organizations

Figure 6

GPO Model Continues to Serve Smaller Provider Organizations



Source: L.E.K. Consulting

Figure 7

Key questions for medtechs	Sample topics / evaluations to undertake
How do we engage with GPOs today?	Range of GPOs Products covered Administrative fees paid
How do our core customers engage with GPOs?	GPO mix among core customers Products on-contract / off-contract
What are the risks and rewards of changing our status quo?	Financial trade-off analysis (i.e., admin fees vs. market access)
What strategy is right for us?	GPO channel mix and weighting (e.g., national, regional, specialized) Guidelines for product inclusion and acceptable administrative fees Rules of engagement, including when to disintermediate For top accounts, offerings and solutions to support direct relationship

Source: L.E.K. Consulting

account for the long tail of the demand curve, often reflecting a lower degree of centralized purchasing and smaller respective volumes. For these customers, the traditional GPO model continues to provide both providers and medtechs with value as well as efficiencies (*see Figure 6*).

Medtechs and GPOs: Where Do We Go From Here?

For contracting-related value, the center of gravity for negotiation leverage is being pushed increasingly toward the larger health systems as well as toward meeting regional/local and specialized purchasing needs.

These shifts are changing the dynamic between hospitals and health systems and the range of GPOs in the market, offering medtechs greater negotiation leverage and the opportunity to achieve higher retained value. Medtechs must recalibrate their existing GPO relationships as well as their willingness and determination to make some calculated trade-offs. Furthermore, the entry of potential disruptors, such as Amazon, will require medtechs to respond both proactively and strategically.

Making changes to longstanding practices will inherently increase relationship and contract management complexity, but the potential upside benefits are substantial. These include deeper and more direct relationships with key customers, greater value retention, and higher conversion rates for products that remain on GPO contract.

For hospital and health system customers, the endgame is to achieve optimal efficiency and price. If medtechs only had the Top 125 health systems to consider, they would likely transition to a direct contracting and supply model. Pragmatically, such a model doesn't align with the reality of the market. GPOs will continue to play an important role in broader market access, so medtechs need to determine how best to navigate and manage these relationships thoughtfully.

Just as "one-size-fits-all" sales models no longer suffice for medical device companies in the rapidly evolving provider landscape, nor will a singular approach work for medtechs in their dealings with GPOs. Medtechs will need to tackle a number of issues to shape a nuanced and stratified GPO strategy that is positioned for optimizing value. "Medtech suppliers need to look at it multi-dimensionally," added John Strong. "How much of the business do the GPOs really control? How much do we control due to the services, products and people that we have? What do we get in return for the fee? How much value is there in the 'hunting license' the GPO affords?"

An initial framework to guide such an effort is included above (*see Figure 7*).

Traditional relationships between GPOs and medtechs are often perceived as one-sided. A key benefit of the changing market dynamic is the potential to rebalance these relationships. Although a degree of complexity can be anticipated to achieve such a rebalancing, we believe the market environment is now at a stage for medtechs to pragmatically and successfully reshape their GPO strategies.

About the Authors: L.E.K. Consulting is a leading Management Consulting firm, with global headquarters in London and US headquarters in Boston. Ken Graves is Managing Director in L.E.K. Consulting's MedTech practice; Kevin Grabenstatter is Managing Director in L.E.K. Consulting's Healthcare Services practice and Jonas Funk is Managing Director and L.E.K. Consulting's MedTech practice leader.