

# Physician offices bring contracting execs into a new world

Distributor markups, GPO contract pricing, are just two issues raising questions

**As IDNs and physician practices move closer** together, as indeed they appear to be (see related article), *Journal of Healthcare Contracting* readers find themselves paying more attention to exam room furniture, rapid tests, tabletop sterilizers and table paper than ever before.

As they do so, they're tackling some new pricing issues. Should they expect manufacturers to extend hospital pricing to physician offices,

even though volume on the non-acute-care side is lower? How about the markup charged by the distributor? (Distributors say that servicing non-acute-care sites is more labor-intensive and expensive than servicing inpatient facilities.) And can IDN contracting executives pass on acute-care GPO contracts to non-acute-care facilities, even if those facilities are not owned by the IDN or hospital system?

*JHC* readers may find some assistance in navigating these waters from their GPOs, who have been in the alternate-site business for awhile.

## Knee deep in market

Amerinet, for example, generated \$1.6 billion of sales in 2009 among its non-acute-care customers – 11 percent more than the previous year, says Russ Ede, vice president, non-acute-care contracting. Of the GPO's almost 41,000 members, more than 16,000 are clinics, roughly 5,000 are long-term-care facilities, and more than 2,200 are ambulatory surgery centers.

"We've made an internal [decision] that we want to take care of the alternate care market," says Ede. "We have a good book of business, and we think there's good growth in that market."

MedAssets, meanwhile, counts almost 46,000 non-hospital customers, says Tonia Kraus, senior vice president, alternative care. The Alpharetta, Ga.-based GPO expanded its position in the alternate



care market about seven years ago, with the acquisition of Kraus's company, Radiology Partners, an imaging-specific group purchasing organization.

MedAssets services the non-hospital market through its own program, and also through its affiliate programs, such as MediGroup.

## Distributor's markup

Insofar as pricing goes, there are really two components: the cost of the product itself (the manufacturer's net pricing to the distributor, for distributed items), and the distributor's markup.

"I think you can argue there is a different cost of distribution [for acute-care and non-acute-care sites]," says Frank Gillespie, vice president, materials management, MedAssets. "[The distributor is] breaking up package sizes, delivering in low-unit-of-measure, maybe delivering more often. So I think there is some justification for differential markups between acute and non-acute care. Our job is to try to keep it as competitive as possible and not let it bloom way out of proportion.

"On the manufacturer's side, justification for a higher price for the alternate site market is a little bit harder to digest."

Regarding the distributor's markup, MedAssets identifies the services offered by the distributor, and assigns a cost to each. The GPO's non-acute members are then free to select the services they want, along with the associated markup. The distributors also have the ability to locally negotiate markups in order to be competitive in a specific market, according to Gillespie and Kraus.

Ede agrees that the typical markup for a non-acute-care distributor's services is higher than markups for acute-care services. In addition to low-unit-of-measure delivery and greater frequency of

deliveries, non-acute distributors sometimes add other "value-adds," such as bar code scanners, at little or no cost to the provider, whose procurement processes tend to be less sophisticated than those of the hospital or IDN.

"But here's the big thing," explains Ede. "We use a defined cost-plus for our contracted items. It provides a level of transparency. Sometimes we do give a range, some kind of flexibility. But we

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instill a cap, meaning [the distributor] can't go over a certain percentage." And on non-contract items, such as the distributor's own private-label offerings, Amerinet doesn't interfere by trying to establish a cost-plus, he says.

## 'Own use' rule

Can IDN contracting executives pass on their acute-care contracts to non-acute-care providers, such as physician practices? That depends.

The seminal court case was the 1976 Abbott Laboratories v. Portland Retail Druggists Association Inc., in which an appeals court ruled that it is unlawful for hospitals to buy pharmaceuticals at favorable prices – by virtue of their nonprofit status – and then turn around and sell them to the public at prices lower than local retail pharmacies could. In other words, hospitals could only take advantage of favorable pricing for products if those products were for their own use.



vendor has a big role in the decision as well, he adds. Often, if a non-hospital facility is owned, managed or leased by the IDN or hospital system, the vendor has no choice but to allow the IDN or hospital system to offer products to the entity at the contract price.

Adds Ede, if the hospital or hospital system can demonstrate to the vendor that it can and does influence the non-hospital facility in its purchasing decisions, then the vendor is

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– Frank Gillespie, vice president, materials management, MedAssets

Though it’s not talked about much these days, the “own use” principle still applies to contracting, and it can crop up when a non-profit entity (such as a hospital or hospital system) and a for-profit entity (such as an independent clinic) get tangled up with each other.

“All of our contracts have ‘own use’ provisions,” says Gillespie. “It is the decision of the IDN or entity doing the procurement whether [its purchases] are within the defined limits of ‘own use.’” The

inclined to buy into “own use” and extend the same favorable pricing to the non-acute-care facility. “It comes down to governance,” he says.

“There is also the issue of self-distribution,” he adds. There’s no issue if the IDN receives products and self-distributes to their own clinics. “[But] if they want the clinic to have purchasing power from the IDN, but they order themselves and have [products] shipped to a separate location, then the issue of governance prevails.” **JHC**