

By Robert Betz, Ph.D.

Medtronic and GPOs - Everything Old is New Again



Peter Allen, the song writer, wrote “Everything old is new again.” That musical observation is also true about the chain of events starting in late February when Medtronic announced it was walking away from some of its national group purchasing organization (GPO) contracts. Following a lackluster third quarter showing to Wall Street, Medtronic responded by announcing plans to cut up to 2,000 jobs, put the kibosh on some GPO relationships, and focus their sales and marketing efforts on individual providers. Love ‘em or hate ‘em, this is one of the gutsiest moves by a major device manufacturer in about three decades.

If you hang around long enough in health care, things have a way of coming round again. Therefore, I was not surprised by reactions to the announcement by Medtronic. Pete Allen, (not the songwriter, but Novation’s Senior Vice President of Sourcing Operations and apparently no relation) said in released remarks “This move will likely raise costs for member organizations by eliminating the price protection that members benefit through Novation’s national agreements.” He got that right. Further, I will bet what’s left of the kids’ college funds, many of the big GPOs also feel just like Novation.

Curtis Rooney, President of the Health Industry Group Purchasing Association (HIGPA) said in a released statement that “Medtronic’s recent decision to cancel its GPO contracts puts greed ahead of patients, and is nothing short of an attack on America’s hospitals.” The Medical Device Manufacturers Association (MDMA) indicated rather that companies were “fed up” with paying fees to reach customers contracted through GPOs. There has never been

a lot of love between HIGPA and MDMA. The bloom is definitely off the rose at this point.

Leading investment firms like J.P. Morgan Chase & Co. referred to Medtronic’s decision as a “watershed moment” for the healthcare supply chain. Speculation on Wall Street is that other device manufacturers may follow Medtronic’s lead. On the Gerson Lehrman Group website a contributor wrote “I expect that St. Jude Medical and Boston Scientific will likely follow Medtronic’s example for their cardiac devices. The ortho/spine industry may

follow Medtronic’s example as well as the major device companies struggle to maintain their average sales prices.”

GPOs should be worried about what Medtronic’s action may ultimately mean for small and rural hospitals going forward. No doubt, this is the beginning of a very acrimonious discussion in the healthcare supply chain, especially if some other large medical device manufacturers follow suit – as I suspect.

Problems with PPIs

Short term, this action will likely raise prices for some Medtronic products. Healthcare costs will rise. Nevertheless, GPOs may be focusing on the wrong issue here. Review the record – GPOs deliver sentinel pricing on drugs, medical surgical supplies, consumables, and an array of other products. But their track record on physician preference items has not demonstrated the same results. Pricing for these products remain stubbornly high, according to many providers I have spoken with.

Medtronic, and the other medical device companies likely to follow, are reacting to the dichotomy which exists in today’s group purchasing model. The initial value proposition



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GPOs offered to manufacturers was market share. This value proposition changed from market share to access. GPOs tried to drive commodity pricing model principles into higher technology products and, for the most part, this strategy has not worked. The result – manufacturers did not receive the expected volume as market share went away while IDNs and large systems used the GPO price as the new list price for negotiations with device manufacturers.

As a major medical device manufacturer, doing business with a national GPO should result in higher sales. Shoe-leather sales guys would compare a national GPO contract to no more than a “hunting license.” Many medical device manufacturer bosses have not seen the expected expense reduction in sales force and marketing either. To the contrary, even with a national GPO contract, as marketplace competition has gotten fiercer, device manufacturers have had to increase sales force and marketing capabilities while still paying administrative fees. As it specifically relates to higher technology products, in the view of the manufacturer, the middleman no longer brings real value to the equation

Medtronic’s thinking

Here is a simplified version of what I think Medtronic’s decision points might have been:

- We are an international profit maximizing manufacturer of high quality physician preference items. The United States is an important market to my company, but it is only one part of a bigger marketplace.
- We have to field a large sales force even if we have a national GPO contract.
- The GPO track record of steering business to my company has not been great.
- Our products are physician driven, so why not just skip paying the administrative fee payments to the GPO and concentrate our sizable sales force on the surgeons?

The Medtronic conclusion must have been that there is little or no value proposition to continue doing business with some of the GPOs. No doubt the decision of “when

do we recognize this reality” got solved after the 3rd quarter results arrived in the corner suite.

Playing to their strengths

I have maintained for many years that the real strength of group purchasing has always been at the local/regional level. The national GPOs provide an important benefit to health-care today. However, as consolidation among the GPOs has continued, it is fair to ask what has happened to the strength of the local/regional presence. This has become a real issue for Medtronic and some other medical device manufacturers. They want specific penetration in certain markets where their competitors dominate. Back in the old days, medical device manufacturers thought partnering with GPOs would help them achieve this penetration and they were willing to make some price concessions and pay administrative fees to do so.

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However, with the consolidation among GPOs, the local/regional magic has apparently begun to wear off. IDNs and large health systems will continue to directly contract. Also, it would be reasonable to conclude that new local/regional models, possibly with insurers and payers, will evolve to address the higher prices of physician preference items.

As Peter Allen (song writer) mentions “Don’t throw your past away. You might need it for some rainy day.” Medtronic and others are going to enhance their targeting of market relationships with hospitals and their doctors – just like in the old days before the rise of the national GPOs. Local/regional purchasing models worked before. Let’s see if the model used successfully by providers in the past to respond to medical device companies, will make a reprise. **JHC**

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