

# Group Purchasing Organizations

by | *Timothy L. Bauman, CDM, CFPP, DHCEA*

**Realize Savings  
and Efficiencies  
With GPOs**

## In thinking of all the ways to operate efficiently and control costs, we find real limits.

If you push portion control, you still find that a four ounce serving cannot be trimmed to three ounces and still meet the needs of a patient diet. Lowering costs through recipe redesign also has risks and, let's face it, we want to feel good about what we serve. The question of where to look for savings after you and your staff do everything "right" often lies outside the organization, where we can recruit the purchasing power of others who buy what we buy. Together we can realize savings and efficiencies by aggregating purchasing volume and use that leverage to negotiate discounts with manufacturers, distributors, and other vendors.

Group Purchasing Organizations (GPOs) do not purchase any products, but in bringing us all together, they fill a valuable need. They negotiate contracts that healthcare foodservice operations can use when making their own purchases. With input from members and clients, GPOs also implement and track contracts with healthcare manufacturers, distributors, and other suppliers which would be expensive and time-consuming for individual institutions to do on their own. After a group purchasing contract is created, it's still up to the individual food service to decide which product is most appropriate in each circumstance, and make the right purchase for their needs. This article addresses the GPO contract, which is the key instrument in bringing many buyers together to negotiate with leverage.

### History of GPOs

GPOs can be traced back to 1910, with the Hospital Bureau of New York growing slowly until the real explosion of the industry took off in the mid-1970s. The healthcare industry was under pressure on many fronts to control costs, which made forming or joining a GPO increasingly important. Today, almost all hospitals, countless long-term care centers, and related facilities belong to at least one GPO. Significant cost savings have been and can be further realized in U.S. national healthcare expenditures from the group purchasing industry. Specifically, 2009 estimates show that GPOs save the U.S. healthcare industry \$36 billion annually in price savings, and more than \$2 billion in savings associated with human resources uncommitted to the purchasing process.\* GPOs have a significant impact on the marketing and movement of healthcare commodities in the U.S., which translates into reduced healthcare costs. GPOs produce substantial savings by removing costs from across sales and supply chains, not by simply contracting for the cheapest products. GPO members and customers receive financial benefits through up-front pricing discounts and reduced administrative costs. GPOs make a major contribution to the U.S. healthcare industry as a whole by improving not only incremental costs, but

also much larger systems and processes. These benefits lead to better use of staff and lower total costs. Through their ability to command market share and negotiate volume discounts, GPOs save their members and customers 10-18 percent on their purchases.

### Knowing Your Contract is Key

Knowing your GPO contract will maximize benefits to your food service. Many managers are told by the corporate office to buy through a list of distributors with whom they have a GPO contract, without full explanation of the benefits of a coordinated approach and taking advantage of all that's been negotiated for members. This can lead to lost potential savings and unused valuable services.

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Contracts are arranged in categories, summarized below.

**Duration of Agreement:** Length of the agreement can vary, but a common timeframe is three years. This protects both the buyer and seller. The people buying realize greater stability in their purchasing, and the commitment lets sellers know there will be a market if they meet the customer's needs and fulfill their part of the agreement.

**Terms and Conditions:** This is where guidelines for ordering, delivery, and payment are spelled out. Costing formulas are outlined, such as *cost plus* and *list minus*. *Cost plus* takes into account cost as defined in the contract, plus a percentage over the cost to arrive at a final price. *List minus* uses the distributor's established price list, minus a contractually defined percent. Chemicals and beverages are often priced as list minus. GPOs audit their distributors on a regular basis to ensure pricing is properly applied as part of the contract. Handling is automated by the distributor for things such as labeling fees, coupons, and promotional discounts. Imagine all the work you save having the details taken care of with such a service!

Details also include fuel surcharges, freight charges, and often a volume threshold is set so if you buy enough (minimum order size), there's no charge. A returned goods policy is very important, and GPOs often are able to leverage their clout to allow members to avoid restocking fees and related charges. Requirements to accept emergency orders, such as when you forget something, are handy. "Substitution of product" terms give us control as to product performance and its nutrition for our medical nutrition therapy. This includes the requirement to notify someone at the facility so a good alternate goes to our at-risk populations. Payment, incentives, and value-added extras are key items, and we will discuss them more thoroughly later.

**Warranty Information:** "No disruptions in use" terms are often included. This helps with the regulations that require us to prove we can supply food and water in disaster situations. The distributor contractually acknowledges that members are providers of healthcare services; that members' use of products is vital to the business operations of members and the health and safety of members' patients; and that any interruption of any member's business could result in substantial liability to the member. Distributors are asked to provide all manufacturer warranties for the products to members and the rights of action under these warranties.



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Maximizing the value of the contract is best done by sitting down and reading it, and keeping in mind the terms and conditions for when you need them. When issues need attention, the fact that you have contractual control and an entity to assist in enforcing its legal content is powerful for facilitating business.

Beyond getting the best price for an item, following are ways to use the full breadth of your GPO to drive down your costs and help with "spend management." You manage your spending in direct correspondence to how you manage the operation.

**Volume Commitment Incentives:** Years ago the question came up as to how to incentivize members to buy as much as possible through the contracts. The more you buy, the more you save is what happens if this option is part of your contract, and the percentage also increases. For example, buying at least \$3,000 a week may be worth an additional ½ percent off your total purchases, and this can go as high as ¼ percent off total purchases for \$25,000 or more weekly volume, with step increases in between.

**Early Payment Incentives:** Paying within seven days can get you a discount on your total purchases. Setting up a credit or debit payment to give the distributor early access to the funds can yield discounts averaging ½ of a percent.

**Preferred Product Lists:** GPOs research products using operator expertise to meet user-preferred specifications, and then leverage the high volume purchases of the membership to negotiate the lowest price on the item. Many distributors that are not part of your agreement will try to compete by underpricing a specific product, but you can lose the overall competitive pricing stability of the larger portfolio in buying off contract. By utilizing this list as a road map for purchasing decisions, maximum benefit can be gained from the contract portfolio. The preferred product list includes a detailed description of the price (without mark-up) and the rebate earned.

**Private Label Incentives:** Distributors have their own private label products that they offer private label rebate incentives on to as much as one percent. These products, of course, have known specifications and you can compare with branded or other labels to see if they meet facility menu needs.

**Combined Category Purchasing:** Distributors offer several services with whole product support systems. Distributors can make these areas pay off by driving volumes and, in turn, can offer savings percentages for maximizing the customer's use. Typical agreements ask you to use the distributor's beverage systems, chemical systems, disposables, produce, dairy, and tabletop items exclusively. If you have a separate produce or chemical vendor, for example, you do not get the savings. This is typically a percent of purchases, regardless of your volume. With such tight margins in food service, this is significant money for any operator. Operators can see that when pulling such programs as chemicals from their facility, one percent of total purchases can mean almost the total product cost of their chemicals. It's hard for you to beat "free," even with a better product/service as long as you have something that is adequate.

**Value-Added Extras:** Value-added extras are services that distributors use to insulate customers from switching to competitors. Competition has caused companies to add services such as direct order entry via the Internet. This service, once considered value added, is now more of a customer expectation in B to B (business to business) e-commerce. Nutrition analysis, although still a value-added service, is increasingly becoming a customer expectation. Nutrition labeling laws are putting demands on both customer and distributor to have nutrient breakdowns available, and customers will go with the company that can support their needs. Menu systems are still definitely con-

sidered value added, and many companies still compete for that space. Broadline distributor systems can in many cases tie their database information together to give you full nutrition information on recipes and menus without as much user input. They collect the manufacturer information and link it to a product number easily available on their Internet systems. Another place the database advantage comes into play is when doing inventory, because you can click a button and with your counts, the pricing and math is completed by the computer. These systems are usually customizable for non-broadliner products as well. With the program usually free to the customer and task automation (time saved), the value is apparent. Many people get locked into these systems to the point where switching costs are too high to defect to the competition. Sales folks will tell you that getting a new customer can cost three times what it costs to maintain an existing customer. Therein lies the economics that justifies distributors offering so many things.

Trade shows, sales and merchandising materials, and the all-important educational services round out what a GPO may offer to serve you and keep customers in the fold. GPOs

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can be a powerful voice for change, and they have been part of many significant advances in our industry. Many of the above services were supported by GPOs as they evolved, and we appreciate their efforts to improve food service while delivering value.

The directions of GPOs in the future include expanding more into long-term care with the increased healthcare needs generated by the baby boomer demographic. GPOs will offer more specialized products for senior nutrition, Meals on Wheels and congregate feeding programs, and look to help those kinds of members address program guidelines and other issues so they qualify for federal funding.

Looking ahead, procurement is changing in food service. Customers want more savings on the front-end, and the days of the back-end rebate approach are ending. The willingness of facilities to standardize products has increased considerably. They have come to understand that by com-



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mitting to particular manufacturers, facilities can drive more costs out of the system. Financial controls are tighter today than ever before. At the same time, GPO members are demanding more customization of their programs. They are also looking to manufacturers and distributors for more help in generating revenue: branding opportunities, marketing, and strategies to increase traffic on the retail side.

Another area includes e-commerce, where GPOs can assist in bringing members to a single e-commerce exchange.

Members with fragmented sourcing can someday have almost everything in one place. The whole procurement process, beginning with the decision-making, leading up to initial purchase, tracking orders through the supply chain from warehouse to receiving dock, managing electronic invoicing and payment, and finally, providing reporting and analysis tools to more efficiently manage supply spending is the “one stop shop” future ahead. GPOs are building web portals where we already have considerable data available and tools to help control costs and manage spending for best results.

As time passes, we will become more dependent on GPOs with their increasingly useful data management systems, and as partners on a wide range of decisions not only on purchasing, but in many other aspects of our operations. GPOs unite us to make good use of leverage producing savings, and create efficiencies we could not do on our own. Work with them, tap their benefits, and increase your success. **DM**

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