

# **Group Purchasing Organizations' (GPO) Distributor Fee Formula Requires Scrutiny**

*Current Practice Fails to Meet New Standards for Transparency, Ethics, and Integrity  
in GPO Contracting*



HEALTH INDUSTRY DISTRIBUTORS ASSOCIATION  
*Serving Medical Products Distributors Since 1902*

**This 2007 paper only examines the structure of GPO/Distributor fees for sales of medical products in the acute care hospital market. This paper does not examine or review GPO fees within the physician, long-term care, or pharmaceutical products markets.**

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## **GPO Fees Paid by Medical Products Distributors Regularly Exceed 11 Percent**

### Executive Summary

Medical Products Distributors, serving acute care hospitals, are charged a GPO fee calculated on a basis greater than the cost of the distribution service provided. Imbedded within the Distributors' basic GPO fee is a charge that is effectively a second fee calculated on the cost of the product delivered.

While the administrative fee percentage that Distributors are charged is commonly 1% or less, by charging a fee calculated on both the product cost and the value of the distribution service, Distributor fees routinely equal 11% or more of the distribution service cost.

The Health Industry Distributors Association (HIDA) believes that the current formula used by GPOs to calculate total Distributor fees fails to meet the transparency, ethical, and integrity standards established by recent Senate inquiry, the GPO industry's integrity initiatives, and the GPO Safe Harbor statute.

*To bring the Distributor GPO fee formula in line with current standards, HIDA believes:*

- 1) Distributors should pay a GPO administrative fee based only on the cost of the distribution services they provide.
- 2) All GPO administrative fees paid by Distributors should be within the 3% Safe Harbor guidelines.

*Charging distributors any GPO administrative fee based on any part of the product price is a questionable practice because:*

- 1) Medical Products Distributors have no role in setting the price of products. Prices are negotiated exclusively between the manufacturer and the GPO.
- 2) GPOs already collect a fee up to 3% directly from the product manufacturer based on the cost of the product. By charging Distributors a second fee based on the product cost, GPOs appear to "double dip" – collecting two product-based fees on the sale of a single product.
- 3) A second product-based GPO fee imbedded within the fee Distributors pay runs counter to the trend of GPO adoption of new industry-wide integrity and transparency standards - many of which have become industry "norms".

HIDA is calling for industry-wide discussion on this topic with the goal of bringing the administrative fees paid by Medical Products Distributors' to GPOs in line with currently established GPO industry standards of integrity and transparency.

# GPO Distributor Fees – Frequently Asked Questions

## 1. How Do Distributors Pay an 11%+ GPO Fee?

### HOW DISTRIBUTOR FEES ARE CALCULATED

*Illustrative example assuming a manufacturer's product price of A)\$100.00 and a distributor's service charge of B)\$5.00\**

<b>A</b>		<b>B</b>		<b>C</b>
Fee on Manufacturer's Product Price		Fee on Distributor's Service Charge		Total Fee
Approx. 0.50%	+	Approx. 0.50%	=	11% of distributor's service charge
50 cents		3 cents**		<b>53 cents**</b>

*\* The \$5.00 service charge represents 5.0% of the manufacturer's product price. The charge typically ranges between 4.0% and 6.0% of the manufacturer's product price. \*\*Rounded upward to the nearest whole cent.*

On a \$100 product, the distributor commonly charges the hospital \$5.00 for the cost of services involved in getting the product to the hospital customer. After paying two fees, one on the manufacturer's product price, and one on their service charge, the Distributor pays the GPO a fee of 53 cents. This 53 cents is 11% of their \$5.00 service charge.

## 2. What Is the Total Impact of This Fee Structure?

This structure allows for two product-based fees to be collected on the sale of a single product. Almost 95% of the fees paid by Distributors are calculated on the product price, as opposed to the Distributors' service charge. As a result, the Distributors' total fee has the appearances of a "double dip". The result is an estimated \$67 million in annual Distributor-paid, product-based fees to GPOs, over and above the amounts already paid by manufacturers – or, almost \$700 million across the last decade.

## 3. Why are the Fees Structured This Way?

This structure has been in place for many years. HIDA's inquiries into why this has become industry standard revealed no intent to obscure fees in any way. "That's the way we've always done it" was the main reason behind the structure. That said, the rapid growth of GPOs, as well as their continued adoption of new transparency and integrity standards, demands that the GPO/Distributor fee structure adhere to the higher standards outlined in this paper.

### In Conclusion

*To bring the Distributor GPO fee formula in line with current standards, HIDA believes:*

- 1) Distributor GPO fees should be based only on their Distribution services.
- 2) GPO fees paid by Distributors should be within the 3% Safe Harbor guidelines.