Understanding Drug Purchasing from the *Hospital Perspective*

by Joseph F. Woelkers, MA , Fred Payne, RPh, and Allan Knudsen, MS, RPh

Most hospitals—from large academic medical centers to small community hospitals—purchase drugs through a Group Purchasing Organization (GPO). The centralized GPO negotiates, bids, and contracts for all medications, using the volume of drugs ordered to drive down the per drug unit cost for the entire group. This model works on the premise that the greater the volume of drug purchases, the greater the ability of the GPO to negotiate "best-tier" pricing with the manufacturers.

Purchasing drugs through a GPO is crucial for smaller community hospitals because their purchasing power is significantly less when compared with larger, multi-hospital healthcare systems and academic medical centers. By using a GPO that pools the drug purchase volumes of many different-sized hospitals, a small community hospital can take advantage of the lower unit cost negotiated by the GPO.

Hospitals do not negotiate with more than one GPO at a time; however, contracts can be renegotiated at any time. In fact, every three years hospitals should ask all the major GPOs to participate in a contract bid to see whether it's more beneficial to stay with their current GPO or sign-on with a new GPO.

Joining an integrated delivery network (IDN) is another way to enhance drug purchasing power, particularly for smaller community hospitals. Hospitals that vary in size and have different drug supply needs can form an IDN in order to obtain best-tier pricing for their drug purchases. Similar to a GPO, the IDN then negotiates, bids, and contracts for all medications for its member hospitals. The key to a successful IDN is hiring contract managers or administrators to oversee the purchasing process.

Still, the GPO and IDN models do face certain barriers to achieving lower unit costs. For example, the federal government has enacted legislation requiring that the Veterans Administration (VA), the Center for Medicare & Medicaid Services (CMS), and other government entities receive the most favorable drug pricing. This "best price" legislation has caused drug manufacturers to create "price floors" which they will not go below for non-government buyers.

Certain hospitals with disproportionate share hospital (DSH) designation and a public health mission and contract can avoid the government's best price restriction by qualifying for 340B pricing. Established as part of the Veterans Health Care Act, the 340B program enables hospitals, community health centers, clinics, and other "safety net" providers to purchase outpatient pharmaceuticals at discounted pricing, thereby expanding care to low-income populations. Hospitals designated to use 340B pricing can purchase medications for eligible outpatients at a price equivalent to Medicaid pricing, including the required vendor rebate to Medicaid. Any additional discounts negotiated by hospitals eligible for 340B pricing are also exempt from the government's best price calculations. Overall, 340B drug pricing averages 20 to 24 percent less than what most hospitals will pay for drugs through their GPO.

On Jan. 1, 2004, inpatient drug pricing was also granted exclusion from the government's best price calculations. Most of the hospitals eligible for this exclusion are considered safety net hospitals, which traditionally see a high volume of Medicaid and uninsured patients. Drug manufacturers can now voluntarily offer drug price reductions to these eligible hospitals, many of which are also academic medical centers. While it is still too early to determine the fiscal impact of this change, significant price reductions for key inpatient supportive care medications used in the oncology setting have already occurred.

When looking at financial modeling and budgets, it is vital to understand that inpatient treatments are reimbursed differently than in the outpatient setting, so cost alone should never be the sole determinant in purchasing decisions. In the end, cost is just one element in the hospital's formulary decision to purchase a certain drug. The pharmacy and therapeutics (P&T) committees consider all the relevant clinical science of a drug—regardless of the price—before making any formulary decisions.

Joseph F. Woelkers, MA., is chief administrative officer at the University of Florida Shands Cancer Center, and research assistant professor at the University of Florida College of Medicine, both in Gainesville, Fla. Fred Payne, RPh, is administrator, Pharmacy Services, at Lehigh Valley Health Network in Allentown, Pa. Allan Knudsen, MS, RPh, is director, Pharmacy Services, at Shands Health Care and assistant dean, Hospital Programs, College of Pharmacy at the University of Florida.