FTC Tries to Open Black Box of Group Purchasing and Drug Distribution

David Burda:

Welcome to the 4sight Health Roundup podcast, 4sight Health's podcast series for healthcare revolutionaries, outcomes matter customers count and value rules. Hello again, everyone. This is Dave Burda, news editor at 4sight Health. It is Thursday, February 22nd. Orange Jesus is hawking gold high tops for $400, a pop blocking aid to Ukraine, stopping legislation that would secure our southern border and backing a national 16 week abortion ban. Oh, and he says he wants to be a dictator, but only for one day, yet people will vote for him. Even women, even people working in healthcare, we're beyond people are stupid. This is a new kind of stupid snap out of it all that has nothing to do with our topic today unless you believe a deep state conspiracy theories. We're talking about the Federal Trade Commission's inquiry into the business practices of group purchasing organizations and drug distributors, and how they relate to the chronic shortages of generic prescription drugs to tell us whether there's any connection, are Dave Johnson founder and CEO of 4sight Health, and Julie Murchinson, partner at Transformation Capital. Hi, Dave. Hi, Julie. How are you guys doing this morning, Dave?

David W. Johnson:

Well, speaking of stupidity, how about that Alabama Supreme Court ruling that embryos are people, there's a reason recreational golf is Alabama's number one industry. Is Texas gonna follow suit?

Burda:

<Laugh>? It is completely ridiculous. Thanks, Dave. Julie, how are you? Had to your list? Yeah, added it to the list, right? Julie, how are you doing?

Julie Murchinson:

That was top of my list to talk about this week. Oy. I am, well, I'm in sunny Boston where it is frigid. It reminds me why I don't live in the northeast.

Burda:

<Laugh>. Yeah, we hit 60 here, I think in Chicago yesterday and maybe even today. So we're enjoying it. Well, we can. Nice. Yeah. Thanks, Julie. Now before we talk about the FTC, taking a hard look at GPOs and distributors, let's talk about drug shortages. Dave, we know you don't take any prescription drugs, and that's great, but has anyone, you know, not been able to get a prescription filled because of a drug shortage?

Johnson:

I don't know anyone that's, that's run into this problem. But that doesn't minimize the obstacles con that consumers confront in this arena. It's a real problem.

Burda:

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Yeah, Yeah. It certainly is. Thanks, Dave. Julie, anyone, you know, experience a drug shortage?

Murchinson:

No. I can't say so. Although, you know, back in the day when my kids were on some prescription dermatology stuff, there were times when we couldn't get the exact generic and had to, you know, buy the branded. So, yes. I guess, but not in the last year since all this has been going on.

Burda:

Yeah, it, it's funny because you know I picked this topic and worked on the script, and as I was doing this, this happened to us. So, I don't know, maybe I shouldn't have picked this topic, but we experienced one just this week. The generic version of a maintenance drug that one of us takes here in the Burda household was nowhere to be found. A refill typically costs 10 bucks. We had to buy the brand name version for $100 out of pocket. You know, thankfully we could afford it, but how many people can't, you know, who do we blame for that? And there's your transition into today's topic. On Valentine's Day, the FTC issued a public request for information about generic drug shortages and competition amongst powerful middlemen, those powerful middlemen being GPOs and drug distributors. The FTC wants to know a few things, including how the lack of competition among GPOs and distributors affects their contracting practices, other segments of the healthcare industry, including patients, small providers in rural hospitals, and competition in the generic drug market. Among manufacturers, the big three who dominate the GPO market are Vizient, Premier and Health Trust. The big three who dominate the drug distribution market are AmerisourceBergen, Cardinal Health, and McKesson. The FTC request for Information doesn't name names, but we all know who they're talking about. The trade association representing GPOs says, GPOs, save the healthcare industry $55 billion a year. The trade association representing distributors says, distributors save the healthcare industry. $63 billion a year. Dave, we did a show on the FTC looking at pharmacy benefit managers. It's only fair we do a show on the FTC looking at GPOs and drug distributors. What's your reaction to the FTCs new line of questioning? How do you see the market shares of GPOs and drug distributors affecting the generic drug market? And what's the best possible outcome from this investigation? That's a lot!

Johnson:

<Laugh>. That is a lot. But I'm glad they're looking into it particularly the wholesale distributors. And let's, let's start there. Gpos versus wholesale distributors. It's really a David versus Goliath comparison. The three companies, the three wholesale distributors you mentioned have market capitalizations in excess of a hundred billion. Two of the three GPOs are publicly traded. The other one, Vizient is owned by its members. The two publicly traded ones have market cap, combined market cap of under $10 billion. And they've actually lost about 30 to 40% of their value since inception. So most of what the GPOs do is supply chain purchasing on behalf of, of hospitals. And that's largely been a, a losing proposition for a long time. Having said that, they're certainly not above the type of profiteering that we see in all corners of the healthcare industry. So I'm gonna reserve my particular scorn here for the for the distributors and the way the wholesale drug market works. The three companies that you're talking about. McKesson, Cardinal, and AmerisourceBergen together control 90% of the market. If that doesn't scream oligopoly, I don't know what does. They base their pricing off of what they call the wholesale

acquisition cost or whack <laugh>. And they certainly whack as they go through this, and that's usually eight to nine times their actual purchase price. And fees on top of that are 10 to 15% which effectively doubles the cost. And on top of that, they negotiate 180 day payment deals with the manufacturers, the drug manufacturers, but 30 days with the pharmacies. So they get 150 days of float on top of everything else. There's a reason behind these massive market cap valuations that they have. And I heard Alex Oshmyansky of Mark Cuban co plus drug company talking about this topic, I don't know, a year ago. And he he used as an example, this drug albendazole, I hope I'm pronouncing that right. Anyway, it's a drug that kills worms like tape worms, <laugh>, and the list price is $225 per tablet. I'd probably pay that to get rid of tapeworms, right? The wholesale price is 75 bucks, and the direct to manufacturing cost for the distributors is somewhere between five and $10. So that just shows you the amount of markup and market control that is at play here. And it's it's absurd. It's profiteering. And I hope the FTC really does dig into it. There's a quote that resonates with me today. And it was the then CEO of GM Roger Smith. And he was in a conversation with a politician that was trying to either buy or exchange land for a GM plant that had closed. And in the middle of their conversation, Roger Smith says GM is in the business of making money, not making cars. And it feels like that's the attitude that's in the executive suite of so many of these these healthcare companies in America. And they're gonna fleece us given the opportunity. Who's gonna come to the rescue of the Americans consumer? There was a penetrating op-ed in the New York Times this week that basically said, most Americans think the economy is rigged against them, causes enormous stress because of financial insecurity. And that's broadly distributed. But how much of this can we lay at the footsteps of the healthcare industry, particularly since most Americans are just one illness or injury away from bankruptcy if they have to enter into the system.

Burda:

I think your tapeworm story combined with your Roger Smith quote really captures what we're talking about today. <Laugh>

Johnson:

Warren Buffet was the one who said that healthcare was a giant tape worm eating the American economy, right?

Burda:

Yeah. Yeah. It's, it's a good way to bookend it. Thanks, Dave. Yeah.

Johnson:

The economy needs to take this drug. There you go.

Burda:

That's great. Julie, any questions for Dave

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Murchinson:

<Laugh>? I don't even know where to start, really. <Laugh> Dave let's talk about Civica Rx the health system, multi health system owned drug manufacturer. Where do you now plot some of these?

Johnson:

I actually like the Civic RX business model, Juliet. It is trying to solve a form of the tragedy of the commons that happens when there's kind of individual bad behavior of public goods. And, and most of these drugs that civic RX purchases, I put into the public good category. And what they've done to address this is get all their members together and they agree on long-term contracts, so they can't be gamed by the ups and downs of these people that control the marketplace. And that has real merit to it. And maybe just maybe that's part of the solution to stopping at least the most egregious forms of profiteering that are occurring in the marketplace. So Civica RX gets a two thumbs up from me, and and they are, I think, legitimately trying to fight this problem.

Burda:

Got it, yeah. More competition lifts all boats. That's great, Dave, thank you. Julie, what's your reaction to what the FTC is doing? What innovations in the market are you seeing that circumvent the market power of these GPOs and distributors?

Murchinson:

Well Dave, I asked about civic RX because you know, not only is it a solution or one solution that health systems have sought in an effort to take more control over drugs that patients need, but they also wanna get into the flow of all the revenue upside of the drug market, right? I mean, so that was developed well before these shortages really became so acute. And again, it just goes to show there's a lot of money to be made. I also, I mean, I think Cuban has, has shown a lot of light on this issue. You know, in many ways, both Cuban and Civic RX are kind of like gnats landing on the elephant, and they run the risk of being like, immediately swatted away by one swish the tail. Like, bye-bye <laugh>. Because like, this is a game of contractual control over sourcing and pricing as well as, you know, highly controlled distribution channels. Some of these agreements, from my understanding, are like highly, highly exclusive, right? So health systems don't have a lot of control which is a big part of the problem, you know, for larger providers or the small less well-funded providers that don't have the resources to manage to manage multiple distributors. Like these are, this is the answer. So you know, I don't know. It's, it's interesting, McKenzie I was on a call with someone from McKenzie recently, and he was talking about the two, he was big supply chain guy. And the two biggest opportunities he sees for health systems to save money, drive efficiency, all those things that we talk about are lack of effective clinical management and GPOs. So if McKinsey has it at the top of their list, you know, there's a lot of money floating around, right? <Laugh>, and they had some crazy stat about the massive price delta and supplies between systems. It's like 60% or something, 120% for trauma centers driven largely, of course, by the footprint consolidation and health systems. You know, they, they have a hard time making sense of their purchasing data. Yes, we're buying a knee implant, but what kind of meat implant are we buying? So the variety of supplies and drugs and all of these things, and the lack of transparency is real.

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And I think the issue here is transparency. We talked about this with the, the PBMs, and I think GPOs are kind of running the same risk of, they, there's a lot of black boxing, right? And on the innovation front, we are seeing marketplaces that create more transparency. And although marketplaces are themselves a new kind of middlemen they force a more transparent version of price competition among all the drug manufacturers and suppliers and the like, in a way that can make more sense of this and allow for a variety of sourcing and not just going through the black box.

Burda:

Yeah, I think the fact that the GPO business model requires an exemption from federal anti kickback laws says something right there. <Laugh>.

Murchinson:

<Laugh>, Right?

Burda:

Thanks, Julie. Dave, any questions for Julie?

Johnson:

Oh, man. Don't we all walk that fine line between cynicism and skepticism every day? <Laugh>? yeah, Julie I think I know where you might go with the answer to this question, but I'm gonna ask it anyway. 'cause your comments on transparency are just so powerful. The supposed mission of GPOs and wholesale distributors is to enable end users to be more effective buyers of medical products and their industry associations claim with a lot of flag waving that they collectively save buyers over a hundred billion dollars annually. If instead, as we've been suggesting the six companies that are the subject of the federal investigation are the equivalent of foxes in the chicken house, where, and to whom should self-insured and governmental buyers turn to become truly better buyers of drugs and medical devices? Who's out there to ride to the rescue?

Murchinson:

<Laughs> Well, this is America. And like I was just talking about, we like our efficiency. We like our easy button. And historically, you know, this has shown up in our preference for channel partnerships, so we can avoid managing all those disparate direct relationships. And today we see large healthcare organizations longing for platforms and set of point solutions. Why can't I just adopt the platform <laugh>? Well, you know, it's not, it's not how it always works. So we like our GPOs, they're efficient, but what they're not, like I said before, is transparent. So, yeah. Yeah, therein lies the problem.

Johnson:

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Yeah. You know, I, I think a Walmart as a GPO for me, right? <Laugh>, I mean, I, and they're obviously very transparent on their pricing. Why in the world we can't figure out how to do this in healthcare for all these commodity items is, is beyond me. [00:39:30] But anyway, what do I know?

Burda:

No. Well, I think at, at one point there were at least seven GPOs, maybe more. And I think the big issue is that they've all consolidated down to three, right? In both segments. So, yeah. You know, and there are no Roosevelt, Churchill and Stalin, right? <Laugh>. So well,

Johnson:

They might be Stalin.

Burda:

They might be Stalin, right? That's great. I've never been a big fan of GPOs or distributors. I do think they add cost to the system rather than reduce cost despite what they say. So whatever the FTC is doing, if that leads to more competition and less market concentration, I'm here for it. Now let's talk about other big news that happened this past week. Julie, what else happened this week that we should know about?

Murchinson:

Well, Dave, you stole my thunder at the top of the show because I was gonna comment on this…

Johnson:

Oh, please do, please do.

Murchinson:

…Absolutely unbelievable court ruling in Alabama, <laugh>, and I mean, politics aside, let's just look at the fact that, you know, within the first 12 hours, a major Alabama hospital paused their IVF services because of this ruling. I know. So now we are just rolling back science, and unfortunately, the families that sued to, for the wrongful death of their embryos from some crazy person who trashed them now is like shutting down IVF in the state. So I, I don't know. I'm having flashbacks with all sorts of, you know, changes like this we've seen in the last couple years. Something big has to happen here.

Burda:

Yeah. Providers seem to fold pretty quickly when, when things like this happen. So that to me is….

Murchinson:

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Like craziness over science. Like, how is this happening? Right? Why are they making that kind of choice?

Burda:

Right? Yeah, it's very disappointing. So I agree with you there. Dave, what other healthcare news broke this week that caught your eye?

Johnson:

Well I'm still thinking about GPOs and wholesale drug distributors. And I saw this episode of Gunsmoke when I was a kid, where Festus went into a grocery store that was failing and told the owner to raise all their prices by 10 cents and then have a 5 cents sale. And <laugh> their volume went up and everybody flocked into the store until the one shopper that actually used to shop in the store came in and said this is double what I paid last week. And, you know, transparency blew the whole thing up. So I don't know what we're gonna do about our judicial system but it, it's clearly off the rails. But my news for this week, and I've been inundating you with comments about the book. But just yesterday Wiley, the big book publisher in New York accepted our proposal to publish Gradually And Then Suddenly, which should come out this fall. So I'm gonna put all other healthcare news on the sideline this week and just do a victory dance, over that we were able to replace McGraw Hill after they got out of the business of publishing business books. So we've got a publisher.

Burda:

Congratulations. Congratulations. Yeah. That's, thank you. That's very cool. Yeah. And also, congratulations on the first mention of Festus <laugh> on the podcast. I'm not sure many people would know that, but I do. So that, that, that was great. And maybe it went on to found McKinsey with that business advice. Thanks Dave, and thanks Julie. That is all the time we have for today. If you'd like to learn more about the topics we discussed on today's show, please visit our website at 4sighthealth.com. And don't forget to tell a friend about the 4sight Health Roundup podcast. Subscribe now and don't miss another segment of the best 20 minutes in healthcare. Thanks for listening. I'm Dave Burda for 4sight Health.