Get more out of life #15

Buying power

How consortiums are changing the benefits landscape

Minnesota Life | Securian®

Buying power

How consortiums are changing the benefits landscape

Two basic fundamentals have held true over time:

- Big fish eat the little fish. Big fish get bigger.
- Employers expect maximum return on their benefits spend.

These are the basis on which group purchasing was founded. For centuries, entities have banded together to pool their resources to achieve common goals. This edition of *Get More* focuses on the composition of these strategic groups and how producers and carriers are working to satisfy their unique needs in the benefits marketplace.

The power of purchasing groups

Familiar with the names Hertz, Neiman Marcus, Toys "R" Us, RJR Nabisco or Motorola?[1] If yes, then you may know more than you think about purchasing groups. Today companies are being asked to do more with less which is forcing both benefit and purchasing professionals to look for opportunities to create more cost-efficient solutions.

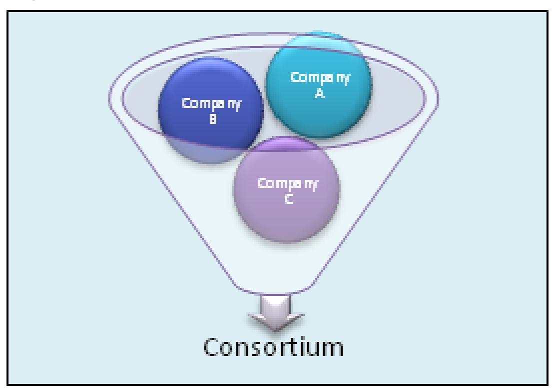
One of the primary advantages of purchasing groups is that they allow members to access already negotiated master contracts.[2] While group purchasing has been around for some time, they have been most prevalent in the healthcare and education industries.[3] Today, we see such groups in all industries and in many different forms. There are three major structures of purchasing groups:

- Consortiums
- Private equity firms
- Group purchasing organizations

Consortiums

By definition, a consortium consists of two or more independent organizations that join together to purchase materials, services and capital goods. Their goal is to leverage the purchasing power of the group to optimize cost reduction and external supplier relationships.[4] Generally, there are no membership dues for this type of purchasing group.

Figure 1



Consortiums do not have to be owned by one parent organization. They can be groups within the same industry or similar geographic region that band together. One of the oldest established consortiums in the U.S. is Five Colleges, Inc. Formed with the idea of sharing human capital and assets, five colleges in Massachusetts — Amherst College, Hampshire College, Mount Holyoke College, Smith College and the University of Massachusetts at Amherst — work together to better leverage their financial and academic resources.[5]

Five Colleges, Inc. is an example of a vertical consortium, one that's comprised of companies in the same industry. Another form of consortium is the horizontal structure, comprised of companies in diverse industries. Either structure has advantages, but also poses issues. A vertical consortium, comprised of competitor companies, may have difficulty in getting all companies in the group to agree on contract terms. Companies in horizontal consortiums are generally not competitors, but inequity among the members may arise in this arrangement. The smaller companies may feel that the needs of the larger companies come before their own.[6]

Private equity firms

A private equity group has many investors who pool their resources, management skills and experience. These groups then purchase and manage many companies under one umbrella simultaneously.[7] When purchasing companies for the short-term, the goal of the private equity firm is to fix or grow the companies and then sell them at a profit in three to five years.[8]

Companies purchased with a long-term focus are brought into the group with the goal of building another layer of strength into the private equity firm's portfolio. They are expected to produce good returns for the company over time.

In the 1980s [10], these groups were led by business titans like Carl Icahn and T. Boone Pickens — then known as "corporate raiders." It was during this time that hostile takeovers were common and well publicized. The reputation of private equity firms has changed along with the business landscape.

Top 10 Private Equity Firms

The Top 10 Private Equity Firms are:[9]

1. Carlyle Group
2. Goldman Sachs Principal Investment Area
3. TPG
4. Kohlberg Kravis Roberts
5. CVC Capital Partners
6. Apollo Management
7. Bain Capital
8. Permira
9. Apax Partners
10. Blackstone Group

Between 2005 and 2007, the market experienced a boom in the number of leveraged buyouts by private equity firms. Individuals once called corporate raiders are now known as business moguls. According to data tracked by Thomson Financial, in 2006, private equity firms bought 654 U.S. companies for a record $375 billion. This amount was 18 times the level in 2003.[11]

Group purchasing organizations (GPOs)

The last type of purchasing group is a purchasing organization or buying group. These groups are developed to simplify the purchasing process and lower operating costs for their members. Members generally pay a fee or dues to join GPOs and to gain access to their pre-negotiated contracts. The dues allow members to take advantage of the GPO's management expertise in the following areas:

- Contract negotiation
- Supplier management
- Management of direct and indirect purchasing
- Proven implementation processes and member management skills[12]

One example of this type of group is HealthTrust Purchasing Group. Founded in 1999, this group has tripled in size since its inception and includes many different types of healthcare organizations.[13] Another example is Corporate United. Founded in 1997, Corporate United has nearly 30 leveraged agreements of which its 130 member companies may take advantage.[14]

Rich together, poor apart

Weighing the gains and potential pitfalls of consortium groups

Cost savings aren't the only benefits of consortiums. [15]

- **Economies of scale** — As a part of a larger consortium, member companies are better able to achieve lower prices and increase negotiating power.
- **Economies of process** — Member companies may share purchasing and administrative information to streamline processes. The purchasing group may also assess areas for improvement with the goal of decreasing workload and expense. Areas of focus may include any outside vendors or software programs.
- **Economies of information** — Information sharing will occur among the member companies. The purchasing group also may have a strong knowledge base through its experience with the varied companies. Areas of focus may be technology, improving goods and services and reducing wasteful consumption.

Figure 2

Benefits	Potential Difficulties
• Economies of scale • Economies of process • Economies of information	• Internal resistance • Vendor resistance • Monitoring program design • Staying current on regulatory requirements

Along with the benefits, there may be some drawbacks to participating in a consortium, including:[16]

- **Internal resistance** — While purchasing groups attempt to broker deals that benefit the majority of the member companies, their choices may be met by opposition by those companies that feel their needs were not addressed.

- **Vendor resistance** — Vendors may prefer not to work with consortiums due to the varied size of their member companies and the need to work with both the individual member company and the purchasing group. There have been instances of vendors dropping clients if they join a consortium group.

- **Monitoring program design** — As many different organizations come together, so do many different benefit plan designs. During the vendor evaluation process, it is critical for the purchasing group to clearly understand and articulate the benefits they are seeking. Communication regarding potential changes or enhancements to current plan design is critical to the future success and acceptance of the benefits plan.

- **Staying current on regulatory issues** — Bringing together many different benefits plans also brings a host of different regulatory issues. It becomes the responsibility of the purchasing group to stay current on the issues and how new legislation may relate to their members' plans.

The search begins

When a private equity firm acquires a company, one of the first areas targeted for consolidation is benefit programs. [17] As consultants and brokers assist consortiums in their search for their benefit partners, it is important to focus on these key items to ensure a successful vendor search:[18]

- **Get everyone on board from the start.** Don't start the benefits evaluation process until you know which member companies you are representing. This will allow the best understanding of each group's needs, knowledge that will become key once you begin evaluating the best vendors for the group.

- **Do your homework.** Know what your member companies expect from their benefit providers and their benefit plans. This helps narrow your field of prospective vendors early.

- **Actively participate in the proposal process**. Representatives from member companies should be involved in the proposal process to ensure goodwill and less friction at evaluation time.

- **Look beyond price to find the highest overall value.** As each member company has its own needs, it is important to find vendor partners that understand the value of service, quality and client satisfaction — and can deliver.

Implementation — where the rubber meets the road

The complexity of consortiums generally hits home during the implementation process. The purchasing group may realize an important component of the plan design is missing. Or a member company may object to not having all the “bells and whistles” of the other member companies.

As part of the vendor evaluation process, it is critical to find a partner that can meet the needs of the purchasing group as well as each individual member company. If there is dissatisfaction on either level, the deal may quickly dissolve.

Because of these specific requirements, some brokerages and consultancies have dedicated teams within their practice to focus on consortium groups.

Looking to the future

It is hard to see past today’s financial turbulence. As the market has shifted, many well-known companies have come under financial stress or disappeared all together. Private equity firms do not see a quick end to our current economic crisis. Companies in which they have invested have been hurt by the credit crunch, and many investors do not expect any improvement for many months. According to David Rubenstein, the co-founder of the Carlyle Group, “The recession will be far deeper than what we’ve seen in some time.” [19]

But with change also comes opportunity. Vulnerable firms present bargain deals to private equity firms with available capital who want to grow their universe of companies. Established consortiums will look for ways to refine and bring into focus their group benefit programs.

Helping to maximize benefit dollars

Having worked successfully with a number of consortium groups, we have become experts in understanding and meeting their unique expectations of a group life insurance carrier. In particular, we have perfected our implementation and account management processes to accommodate these groups.

The philosophy underlying our success is to treat each participating company as an individual client, while providing oversight, consultation and reporting to the purchasing group. We offer technology and reporting solutions to help simplify processes and provide member companies and the purchasing group with the information they want to help evaluate the health of the plan.

We also offer a suite of enhanced services, including:

- Health and wellness programs
- Legal services
- Travel assistance services
- Identity theft resolution services
- Beneficiary financial counseling

We're here to help you and your consortium clients get more out of life with customized group life plans, service extras and proven strategies that work for both employers and employees. To learn more, contact the group sales manager in your region or call our national sales office at 1-800-606-LIFE (5433).

References:

[1] Private Equity, Private Lives, Fortune.com, November 26, 2006.

[2] Buying Consortia: A Hybrid Outsourcing Solution to Remove the Headaches of Indirect Spend, Outsourcing Center, May 2006.

[3] Empowering Purchasing Groups: Current Issues in Internet-Based Supply Chain Management, Ramesh Mehta, Journal of Contract Management, April 2003.

[4] Consortia, Buying Groups and Trends in Demand Aggression, Kevin Gray, Corporate United, Inc.

[5] About Us, fivecolleges.edu.

[6] Consortia, Buying Groups and Trends in Demand Aggression, Kevin Gray, Corporate United, Inc.

[7] The Role of Private Equity Groups in the M&A World, Fox & Fin, April 2008.

[8] Private Equity, Private Lives, Fortune.com, November 26, 2006.

[9] The List: Top Private Equity Firms, Financial Week, May 12, 2008.

[10] What (and Why) is a Consortium, consorituminfo.org, 2007.

[11] The Private Equity Boom, washingtonpost.com, March 15, 2007.

[12] Solutions for Buyers, corporateunited.com, 2009.

[13] About HealthTrust, heathtrustcorp.com, 2009.

[14] Solutions for Buyers, corporateunited.com, 2009.

[15] The Benefits of Purchasing Consortiums, E-sourcing Forum, September 26, 2007.

[16] Purchasing Consortia, esourcingwiki.com, June 12, 2008.

[17] Managing Benefits After a Merger: Lessons From Private Equity Firms, Talent Management, October 2007.

[18] Purchasing Consortia, esourcingwiki.com, June 12, 2008.

[19] Grim global forecast from private equity firms, International Herald Tribune, November 13, 2008.

Sources:

Making the Private Public, MarketWatch, March 19, 2007.

The History of Private Equity, Investment U.

Wielding a Club, The New York Law Journal, Mark Mandel, August 1, 2006.

The Economics of the Private Equity Market, Federal Reserve Bank of Dallas, Third Quarter 1998.

F62382-23 3-2009
A00356-0109