Title: An Eye-Opener Into The Eyewear Industry

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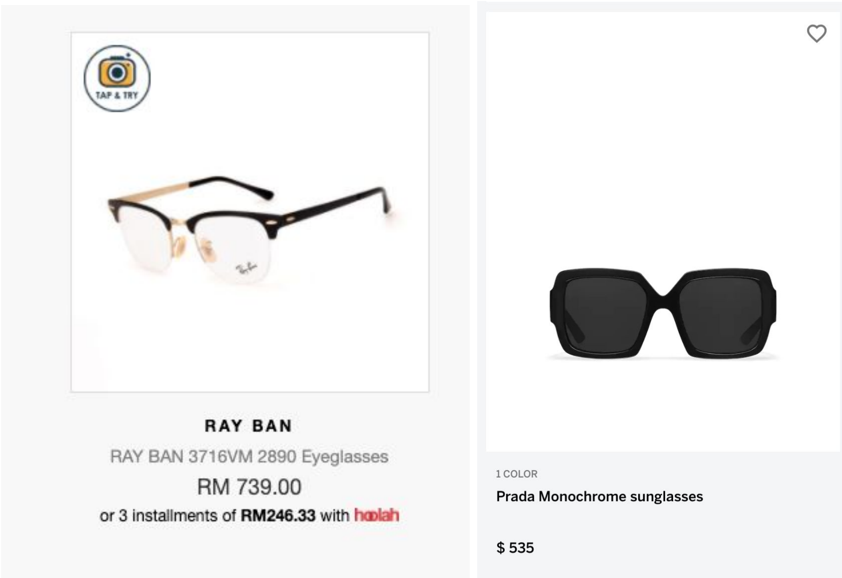
Introduction



(Source Prada.com and Focus Point)

For a few pieces of plastics moulded into a frame and lens, the newest Ray-Bans can cost up to RM739 and designer brands like Prada retail for around $535 (RM2,167). Even though there's a huge price divergence between the two, they actually are manufactured by the same brand, the Luxottica group. Luxottica also manufactures other brands as well such as Oakley, Versace, BVLGARI and Burberry.

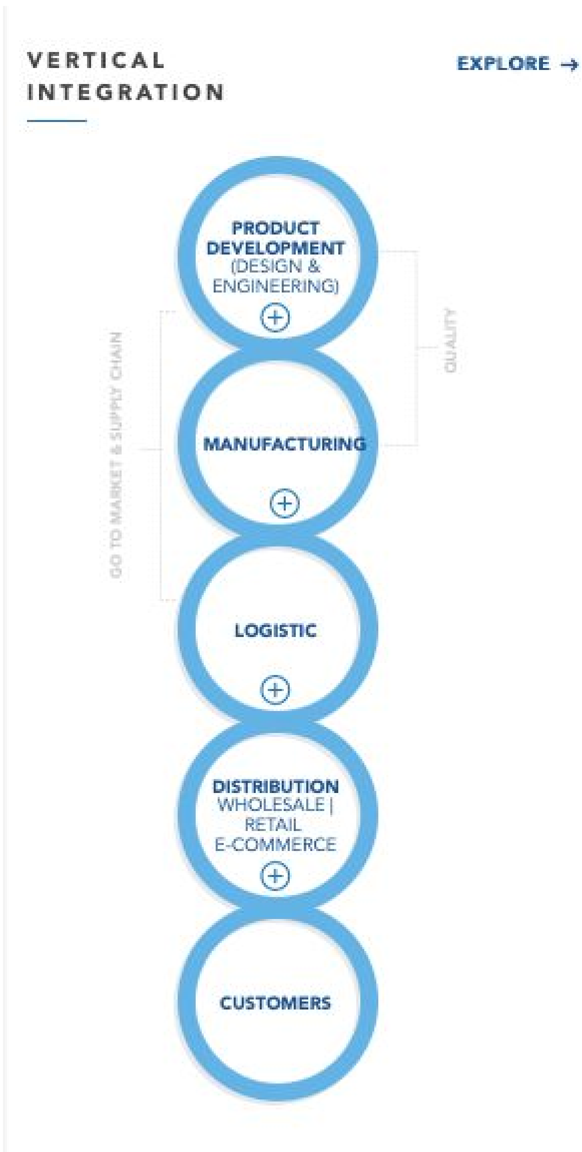
In a recent interview by the LA Times, former industry heads revealed that in the 80's and 90's it would only cost around $10 to $16 for the frame and around $5 for the lens.

What has brought about this huge mark up in prices for this product which to some is a necessity? This report highlights the tale of Luxottica, whose vertically integrated model and monopolistic practices have allowed them to dominate the eyewear market while profiting billions.

Luxottica's Business Strategy - Vertical Integration

In 2017, Essilor, the largest prescription lens company in the world bought Luxottica for $24 billion. Combined, they "will be worth around $50 billion, sell close to a billion pairs of lenses and frames every year, and have a workforce of more than 140,000 people". In 2018, it's said that Essilor has around 45% of the prescription lens market, and Luxottica 25% of the frames. (Knight, 2018)

This is an example of vertical integration. Vertical integration is a process in which a company owns or controls its suppliers, distributors or retail locations. It is said that this in turn will allow the business to control and streamline the process, reduce costs and improve efficiencies (Wheaton, 2020).



(Source : Luxottica.com)

In the case of Essilor Luxottica, they would manufacture the glasses in house and if necessary, add power to prescription lenses. These glasses would then be shipped to retailers which they own such as Sunglass Hut and Target Optical in the U.S and John Lewis Opticians in the UK. Besides the retailers which they own, it is estimated the entity that is Essilor Luxottica supplies around 300,000-400,000 stores worldwide.

Vertical integration is done through acquiring and merging with other firms. By merging, the combined entity, Essilor Luxottica, would have 50 manufacturing facilities, produce 650 lenses and have over 30 distribution centres with over 9,000 patents (Televisory, 2017). These mergers have benefited Luxottica greatly which include:

- By buying Sunglass Hut in 2001, it immediately resulted in reduction of expenses of about $17 million
- Acquiring Oakley became an entry into the lucrative sports eyewear market and increased revenue and cost synergy (reducing costs) of up to 100 million Euros by 2010 (Luxotica purchased Oakley in 2007)
- The acquisition of Cole National (Pearle Vision) in 2004, doubling Luxottica's owned stores to 6,266 and increasing earnings by 14% in 2005

(Televisory, 2017)

By streamlining and acquiring all forms of the production process for glasses, costs can be reduced through economies of scale (the reduction of costs per unit as a result of increasing output) and supply disruptions are alleviated. This also allows them to have more, or in this case, all control of the final retail price.

Consumer exploitation

The almost obscene markup seen in the eyewear industry was revealed in an interview by the LA times with Charles Dahan and E. Dean Butler, both founders of Lenscrafters, a company later purchased by Luxottica (Lazarus, 2019). They revealed that the frames in the 80's and 90's, would only cost around $10 to $16 to make, and $5 for the lenses.

Even with inflation being accounted for, the use of machines would cause the manufacturing process to be cheaper and more efficient, thereby bringing costs down.

Butler also shared some insight from a factory visit to China that you could get “amazingly good frames for $4 to $8”. When it came to designer frames including licensing, it would cost around $15, and “first quality lenses” could be purchased for as low as $1.25.

Although costs are as low as they are, why is there such a divergence between the cost and the price? This can be seen through the lens of a “monopoly power”.

Monopoly power

Now, they may not be a traditional monopoly or fit the exact definition. The idea of “high barriers to entry and a single seller with many buyers” does not fit as lower cost options like bootleg glasses are available to purchase. Nevertheless, Luxottica is still able to exert “monopoly power”.

Monopoly power is the ability of a firm to change its price higher than the cost. In the absence of the government, firms that are a monopoly are “price-makers”, and consumers are at the whim of the price they set.

Firms and particular shareholders may benefit from higher dividends, or employees if they are linked to business profitability. However, on the other side of the spectrum, consumers are faced with higher prices and a reduction in their consumer surplus (the amount they are willing to pay minus the amount they actually pay).

Inelastic demand

Monopolies can further drive up the prices if the good is inelastic, meaning a change in the price will not see a huge change in the quantity demanded.

To put this into perspective, let’s say a good’s inelasticity is -0.5. If the price of the good were to rise by 1%, the quantity demanded would only fall by 0.5%. Therefore, firms can afford to raise the prices and increase their revenue, as the fall in demand is smaller than the profit from the rise in prices.

The eyewear industry is inelastic, as they are a necessity to more than one billion people worldwide. Add to this the vertical integration model and the monopoly power, Luxottica would be able to raise the prices of their eyewear and would not have to match rivals because of the loyalty found in customers to these branded names, like Ray-Ban.

Bigger is better?

Big firms do have an advantage, as more profits can be funnelled into research and development. Luxottica's research and development budget is around 200 million euros, which is three times the size of the rest of the industry. Through funding extensive research, the quality of products increases. For instance, Luxottica manufactured better lenses for UV protection against harmful rays and created the first progressive lens which removes the need to change between reading and regular glasses for people with presbyopia (ageing of the eye).

Corporate Social Responsibility, which is done by firms to "give back" to society, has been exercised by Essilor Luxottica. They aim to provide up to 200 million pairs of free ophthalmic lenses (which correct vision) to the estimated 900 million people living in the commonwealth that can't afford glasses.

Bigger, for the worse.

However, this "monopoly power" can be abused, namely to undercut rivals and engage in behaviour to reduce competition. The best example of this is Oakley.

Oakley's biggest customer was Sunglass Hut, who in 2001 was purchased by Luxottica. Oakley was informed that Sunglass Hut (which was owned by Luxottica) , wanted to pay significantly lower wholesale prices (which would increase their margins) or they would reduce the sale of Oakley's and push their other brands.

Sunglass Hut was hugely important to Oakley, accounting for about 1/3 of the total volume of sales in 1996. After announcing that Sunglass Hut had cancelled all purchase orders, the stock plummeted and lost 33% of its value (Oakley, n.d.).

Oakley’s troubles continued, with falling revenues and the emergence of new competitors like Nike entering the eyewear market. In 2007, Luxottica then purchased Oakley which was at a 23% premium (paying more than the stock was valued at) and added it to its collection of brands.
Yet, it still stands. Luxottica does not control “100%” of the market, or fit the textbook definition as bootleg or cheaper eyewear is plenty. Antitrust enforcers, who ensure that the market's business is fair, have found nothing substantial and have halted investigations into Essilor Luxottica (Staff, 2020). There have been some pushbacks such as Senate Democrats, who condemned the merger of Essilor Luxottica citing as a result of consolidation in the supply chain, glasses are becoming “increasingly difficult to afford " (Shedd, 2019).

Conclusion

Even with this information, knowing that glasses are heavily marked up, a part of me would still probably buy a pair of Ray-Bans, that is, if it’s at a discount.

After all, it’s hard to say you don’t look “cool” donning a pair of wayfarers against the scorching heat. For better or worse, seeing Tom Cruise or Joe Biden so stylishly wear those aviator glasses, it’s hard to not want one just for style.

As aforementioned, Essilor Luxottica has done impressive and innovative work, such as creating the first progressive lens which removes the need to change between reading and regular glasses for people with presbyopia (ageing of the eye) and further protection against harmful rays.

Ultimately, there is nothing wrong with purchasing these glasses sold way above cost, because they look good on you. But what is wrong, is perhaps companies presenting an illusion of choice. When your eyes are opened behind the curtains, it allows for more informed decisions to be made. If you’re undecided between two frames, you’ll know virtually there’s little to no difference in quality, and can make a more “rational purchase”.

In the words of Luxottica's CEO during an interview, responding to whether these prices were exorbitant, he replied , "everything is worth what people are ready to pay". Perhaps it's time for us to look deeper into the item's true intrinsic value when purchasing.

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