Additional Question for the Record

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Questions From the Honorable Yvette Clarke

1. **The current average price for a pair of eyeglasses is now around $400 per pair. Even as the price of eyeglasses is rising, the eyewear industry is considering further consolidation. As it stands now, the market for eyeglass frames in the US is largely dominated by one company, Luxottica, which owns and manufactures many of the top eyewear and sunglass brands. Notwithstanding it's market dominance, Luxottica has proposed a merger with Essilor, a French company that controls around 70% of the market share for lenses and the equipment to produce them. Together, a combined Luxottica-Essilor company would control and dominate the entire supply chain in the eyewear market.**

   Response:

   Our panel did not address consolidation in the eyewear marketplace, and there is little medical literature addressing this market.

   In the business literature, reports suggest that Luxottica holds an estimated 60-80% market share of the retail eyewear market.[1] As you suggest, this market position includes control over retail outlets (including Lenscrafters, Pearle Vision Center, and Sunglass Hut, and Sears Optical[2])), and eyewear brands (28 including Ray Ban and Oakley[3]). Essilor controls 13 brands of eyeglass lenses and eyewear products.[4]

   However, there are reasons to believe that the retail market may not be as concentrated as these data suggest. One analysis reports a 2016 market share of eyewear sales of 45.8% for independent outlets, 26.6% for chains, 16.3% for mass merchandisers, 4.5% for department stores, 4.2% for internet sales, and 6.8% other retailers, with modest increasing share since 2013 for independent outlets and internet sales, and modest decreasing share for chains, mass merchandisers, and department stores since 2013.[5]

   The proposed merger of Luxottica-Essilor was cleared by the US Federal Trade Commission on March 1, 2018.[6]

   a. **How do you think this merger will impact the price of eyeglasses?**

   Response:

The economics literature provides a sophisticated assessment of the potential implications of such a merger. Consumers may benefit depending on the pricing decisions of the integrated firm (highlighted below), but as with any economics model there are significant caveats to this result.

> "Vertical externalities: A classical explanation for vertical integration is as a response to inefficiencies that arise when there is market power in both the upstream and downstream markets.[1] This in turn implies that market prices will be greater than the marginal cost of production in both upstream and downstream markets as firms exercise market power. The polar case is one where there is a pure monopoly upstream ("manufacturing") and another pure monopoly downstream ("retailing") and where the upstream monopoly has all of the bargaining power over the price that will be charged for goods or services sold by the upstream firm to the downstream firm. The monopoly at the upstream "manufacturing" level has a marginal production cost c and seeks to charge a monopoly input price PM > c to the downstream firm. The downstream "retail" monopoly takes the price PM as its input cost and exercises its monopoly power by charging a retail price PRM > PM. The upstream monopoly has added a monopoly markup to its production costs and then the downstream monopoly has added another markup to the price it pays to the upstream firm for its inputs. This phenomenon is known as double-marginalization. When making its pricing decisions, the downstream monopoly ignores (because it does not see) the actual costs of production incurred by the upstream firm. This behavior of the independent monopolies results in aggregate profits that are smaller than they would be in the firms set prices so as to maximize their joint profits. It also leads to higher prices downstream than would maximize the joint profits if the upstream and downstream firms. Tirole refers to the failure of the downstream firm to take upstream production costs into account as a vertical externality (Tirole, 1988, Chapter 4).
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> If we assume that vertical integration is costless, the aggregate profits of the two monopolies will increase if they merge since the distortion from double marginalization will disappear. The integrated firm will set the profit maximizing downstream monopoly price properly taking into account the actual costs of production at the upstream level. Moreover, prices charged to consumers will fall and, as a result, consumers are made better off by vertical integration. This is the classic example of the maxim that a single monopoly is better than a chain of monopolies.
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> [1] Market power as that term is used in economic theory. Firms face downward sloping demand curves and are not pure price takers. There need not be supra-normal profits in equilibrium, however."

b. Do you think this merger will make it more difficult for smaller frame manufacturers, rival lens producers, and independent optometrists to compete and negotiate for market-based prices?

Response:

As an independent firm, Essilor, the lens manufacturer, would want to maintain a competitive retail market for it's products to ensure that it had negotiating leverage and marketing options if retailer Luxottica tried to exert pricing pressure on Essilor, although as the literature suggests Essilor could still exert it's market power in setting the price for their products.

As an integrated firm, there may be significant pricing advantages offered to their internal retail customers compared with smaller volume external retailers. This could serve as a barrier to entry to the retail market and could result in increased prices for consumers. Further efforts by the merged firm to continue the horizontal integration of the retail or lens market should carefully consider the market power and marketing and pricing activities of the merged firm.

The one caveat to this concern is the emergence of a novel, vertically-integrated rival, Warby Parker.[7] This start-up has spawned a more competitive market for eyewear using an internet-based retailing model (now supplemented by retail stores), and suggests that barriers to entry into the eyewear space are not insurmountable for novel entrants. Their success should impose significant price pressure on existing retailers in the market, and on the merged Luxottica-Essilor entity. However, this price pressure will only exist if consumers learn to shop for eyewear products across brands and retail outlets. It also requires consumers to have access to their lens prescriptions so that they can shop for the best prices on their eyewear products.

Many of the existing independent retailers in this market may feel increasing pressure on their margins from the expanded market power of existing retail chains as a result of the Luxottica-Essilor merger and from the emergence of a new, internet-based eyewear retail channel.

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[1] https://www.gurufocus.com/news/318329/is-competition-in-the-eyewear-segment-preying-over-luxotticas-bottom-line
[2] http://www.luxottica.com/en/retail-brands
[3] http://www.luxottica.com/en/eyewear-brands
[4] https://www.essilor.com/en/brands-and-solutions/our-brands/
[5] https://www.statista.com/statistics/256255/sales-share-of-the-frame-market-for-eyewear-in-the-us-by-retail-chain/

[6] https://www.essilor.com/en/medias/press-releases/proposed-combination-essilor-luxottica-receives-clearance-us-federal-trade-commission-without-conditions/
[7] https://www.forbes.com/sites/stevedenning/2016/03/23/whats-behind-warby-parkers-success/#2deb3ced411a