

**COASTAL CONTACTS' BUSINESS DEVELOPMENT IN THE NORTH  
AMERICAN ONLINE RETAIL EYEGLASS MARKET**

by

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## **Abstract**

The following paper is an analysis of Coastal Contacts Inc. and the North American retail eyeglass industry. Coastal Contacts is an online retailer of contact lenses and prescription eyeglasses. At the time of writing the company has recently entered the eyeglasses market. This industry has an underdeveloped online retail channel. The reason the channel has not developed as quickly as other products such as contact lenses is because eyeglasses are a more complicated purchase. As more purchases move online, retail market share for eyeglasses is expected to shift online. This paper looks at how Coastal Contacts can best position itself in order to maximize its benefit from this market shift.

**Keywords:** Coastal Contacts; Online Retail; E-commerce; Market Share; Eyeglasses; Optical

## **Dedication**

To Coco, if you read this I'll be impressed. Scratch that; better not to read it.

## **Acknowledgements**

Many thanks and love to Rachael; for being patient.

# Table of Contents

<b>Approval.....</b>	<b>ii</b>
<b>Abstract.....</b>	<b>iii</b>
<b>Dedication.....</b>	<b>iv</b>
<b>Acknowledgements.....</b>	<b>v</b>
<b>Table of Contents.....</b>	<b>vi</b>
<b>Glossary.....</b>	<b>x</b>
<b>1: Introduction.....</b>	<b>1</b>
1.1 Timeline .....	1
1.2 Background .....	1
1.3 Motivation for the Analysis.....	2
1.4 Purpose of the Analysis.....	2
1.5 Analysis Approach .....	2
<b>2: Company Background.....</b>	<b>4</b>
2.1 Ownership and Control .....	4
2.2 Corporate Structure .....	4
2.3 Corporate Scope .....	5
2.3.1 Businesses .....	5
2.3.2 Geography .....	5
2.3.3 Vertical Scope .....	5
2.4 Products.....	6
2.4.1 Lenses.....	6
2.4.2 Frames .....	6
2.4.3 Designer Brands .....	7
2.4.4 House Brands .....	7
2.5 Customers.....	7
2.5.1 Existing Customers .....	7
2.5.2 Geography .....	7
2.5.3 Age .....	8
2.5.4 Sex.....	8
2.5.5 Income.....	8
<b>3: External Analysis .....</b>	<b>9</b>
3.1 Industry Definition .....	9
3.2 Industry Structure.....	9
3.2.1 Industry Concentration.....	9

3.3	Supply Chain .....	10
3.3.1	Brand Owners.....	10
3.3.2	Brand License Holders .....	10
3.3.3	Frame Manufacturers .....	11
3.3.4	Lens Manufacturers.....	11
3.3.5	Optical Labs .....	11
3.3.6	Retailers.....	12
3.4	Strategic Groups.....	12
3.4.1	Independents .....	12
3.4.2	Retail Optical Chains .....	13
3.4.3	General Retailers .....	15
3.4.4	Online Retailers.....	16
3.4.5	Strategic Group Map .....	18
3.5	Industry Performance .....	19
3.5.1	All Retail .....	19
3.5.2	Online Retail .....	20
3.6	Industry Attractiveness.....	21
3.6.1	Porter’s 5-Forces .....	21
3.6.2	Attractiveness of Online Retail .....	24
3.6.3	Key Success Factors for Online Retail.....	25
<b>4:</b>	<b>Internal Analysis .....</b>	<b>26</b>
4.1	Key Success Factors.....	26
4.1.1	Cost Advantage .....	26
4.1.2	Differentiators .....	26
4.2	Sources of Competitive Advantage.....	27
4.2.1	Cost Advantage .....	27
4.2.2	Selection Advantage.....	29
4.2.3	Convenience Advantage.....	30
4.3	Current Strategies.....	32
4.3.1	Corporate Strategy.....	32
4.3.2	Business Strategy .....	33
<b>5:</b>	<b>Financial Performance Analysis .....</b>	<b>37</b>
5.1	Growth.....	37
5.2	Earnings.....	37
5.3	Shareholders Equity .....	37
5.4	Cash Flow.....	38
5.5	Financial Ratios.....	38
5.5.1	Profitability .....	39
5.5.2	Margin .....	39
5.5.3	Turnover.....	40
5.5.4	Credit and Bad Debt.....	40
<b>6:</b>	<b>Summary and Assessment of Current Situation .....</b>	<b>41</b>
6.1	Industry .....	41
6.1.1	Current Environment.....	41
6.1.2	Most Likely Future Environment.....	42

Coastal Contacts .....	43
6.1.3 Current Position .....	43
6.1.4 Most Likely and Desired Future Positions .....	45
6.2 Summary and Direction .....	45
6.3 Analyzing Alternatives.....	46
<b>7: Solution Analysis .....</b>	<b>47</b>
7.1 Goals for Evaluating Alternatives .....	47
7.2 Alternatives .....	47
7.2.1 Marketing .....	47
7.2.2 Pre-Sale .....	48
7.2.3 Post-Sale.....	48
7.3 Scenarios .....	48
7.3.1 Best Case.....	48
7.3.2 Worst Case .....	49
7.3.3 Likely .....	49
7.4 Evaluation.....	49
7.4.1 Best Case.....	49
7.4.2 Worst Case .....	50
7.4.3 Likely .....	51
7.4.4 Weighted Total.....	52
<b>8: Recommendations and Conclusion.....</b>	<b>54</b>
8.1 Recommendations .....	54
8.2 Conclusion.....	54
<b>Appendices .....</b>	<b>55</b>
Appendix 1 .....	56
Appendix 2 .....	56
Appendix 3 .....	56
Appendix 4.....	57
Appendix 5 .....	57
Appendix 6.....	58
Appendix 7 .....	58
Appendix 8.....	59
Appendix 9.....	59
Appendix 10 .....	60
Appendix 11 .....	60
Appendix 12 .....	61
Appendix 13 .....	61
Appendix 14 .....	62
Appendix 15 .....	62
Appendix 16.....	63
Appendix 17 .....	63
Appendix 18 .....	64
Appendix 19 .....	64



Appendix 20 .....	65
Appendix 21 .....	66
Appendix 22 .....	67
Appendix 23 .....	68
Appendix 24 .....	68
<b>Reference List .....</b>	<b>69</b>

## Glossary

Anti-Reflective	A lens coating that reduces glare from light.
Anti-Scratch	A lens coating that protects a lens from easily scratching.
Flow-of-Goods Diagram	An industry supply chain diagram that shows the flow of goods from the start of the supply chain to its finish with the end consumer
House Brands	A brand name used exclusively by a retailer (or a selected group of retailers) for a product or line of products that are typically sold for prices lower than that of comparable items with manufacturer brand names. (www.oxforddictionaries.com)
Hyperopia	To be far sighted, not be able to see things clearly that are near.
Multifocal Lenses	An optical lens that provides more than one focal distance, a typical example of which are eyeglasses that are used to aid with distance vision, that also can be used to aid reading. A multifocal lens will have different areas of the lens that provide different corrections.
Myopia	To be near sighted, not be able to see things clearly that are far.
Optician	A dispensing optician is a person qualified to make and supply glasses and contact lenses. (www.oxforddictionaries.com)
Optometrist	An individual who practices optometry; the occupation of measuring eyesight, proscribing corrective lenses and detecting eye disease. (www.oxforddictionaries.com)
Porter's 5-Forces Model	A framework for industry analysis and business development formed by Michael Porter from Harvard Business School. Using the forces or bargaining power of suppliers, bargaining power of customers, threat of new entrants, threat of substitute products and competitive rivalry within an industry it attempts to determine the overall competitive intensity and therefore attractiveness of a market. (www.wikipedia.org)
Progressives	An optical lens that has a smooth transition between areas with different focal lengths. This transition removes the horizontal lines that are usually visible with a standard multifocal lens.

Strategy Group Map	A presentation of various competitive positions that similar firms occupy within an industry.
UV Protection	A lens coating that provides the eyes UVA and UVB protection from the sun.
Virtual Mirror	An online application that allows a user to upload a photo of themselves and then overlay eyeglass frames on top of their photo so that they can see how they might look wearing a given pair of eyeglasses.

# 1: Introduction

The following paper is an analysis of Coastal Contacts Inc, hereafter referred to as “Coastal Contacts”. Coastal Contacts is one of the worlds’ largest online retailers of vision care products. Originally an online retailer of contact lenses, in 2008 the company launched its eyeglasses business. This paper will provide a critical analysis of the retail eyeglasses business in North America and the specific opportunities and risks the industry presents for Coastal Contacts. It will evaluate the company’s current strategies and suggest changes.

## 1.1 Timeline

Coastal Contacts was founded in 2000 by Roger Hardy, the company’s current CEO. A brief timeline of major company events follows:

**Figure 1: Coastal Contacts’ Timeline**

Timeline	
October 2000	Founded by Roger Hardy current CEO and Chairman of the Board
March 2001	\$1M in cumulative revenue
March 2004	IPO 6M common shares and trading begins on TSX Venture Exchange
June 2004	Acquisition of LensWay AB for \$18.85M
May 2006	Graduated to senior exchange on TSX
August 2006	Acquisition of Condis BV
October 2006	Acquisition of AsianZakka
October 2007	\$100M in revenue for fiscal 2007
February 2008	Launched eyeglasses business
July 2009	\$1M in cumulative eyeglasses revenue
November 2009	Coastal Contacts lists on Nasdaq OMX

(Source: Author, 2011)

## 1.2 Background

Coastal Contacts Inc. is a direct-to-consumer online retailer of vision related products. The company had revenues of \$153M Canadian Dollars (CAD) and shipped over 1.6 million orders during its fiscal 2010, ending October 31<sup>st</sup><sup>1</sup>. Coastal Contacts’ head office is situated in Vancouver, British Columbia, Canada with distribution centres in Vancouver, Stockholm and

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<sup>1</sup> Coastal Contacts Inc., 2010, p.4

Sydney. From these distribution centres the company ships to over 150 countries worldwide with special emphasis on markets in Europe, North America and Asia Pacific. The company employed 391 employees at the end of its fiscal 2010; up from 260 one year earlier<sup>2</sup>. The company has two main lines of business, the retail sales of contact lenses, and of eyeglasses. Coastal Contacts has focused on selling these two product lines into a wide range of geographic markets. Coastal Contacts is not just an online retailer. Unlike most of its competition, Coastal Contacts has vertically integrated backwards and has built optical labs so that it can manufacture eyeglasses. A full review of the supply chain for the eyeglasses industry is discussed in Chapter 3.

### **1.3 Motivation for the Analysis**

With Coastal Contacts' recent entry into the retail eyeglasses market the company has been focused on building the systems, processes and production capacity necessary to compete in this industry. Coastal Contacts is still in the learning phase of what is necessary to be successful in this market. With the large investment the company has made (and is continuing to make) into its eyeglasses business, it is important to carefully analyze the company's current strategy to see if it needs any improvements.

### **1.4 Purpose of the Analysis**

Coastal Contacts believes there is a significant opportunity for growth as it expands into the retail eyeglasses market. The size of the eyeglasses market is nearly four times that of the contact lens market (see Appendix 4). The focus of the analysis for this paper will be the growth strategy for Coastal Contacts' eyeglasses business. Specifically the question that will be answered is: "What strategy should Coastal Contacts take in order to ensure its success in the retail eyeglasses market, and what special considerations must the company take considering its online retail model?"

### **1.5 Analysis Approach**

In the second chapter the paper will provide some background information on Coastal Contacts the company. The paper will look at the company's corporate structure and business scope including what products it sells, where it sells them and in what parts of the industry supply

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<sup>2</sup> Coastal Contacts Inc., 2010, p.10

chain the company participates. The paper will then specifically analyze eyeglasses and segment this business by product as well as by customer.

The third chapter will include a detailed external analysis which will look at the eyeglasses industry and how it is structured. The industry will be defined and its performance analyzed including market size, growth rates and future projections of performance. Next the industry structure will be reviewed, strategic groups identified and the industry supply chain presented. Finally we will look at industry attractiveness by using Porter's 5-Forces<sup>3</sup> Model, both from a general perspective as well as specifically for online retail.

The fourth chapter will provide an internal analysis of Coastal Contacts. An inventory of resources, capabilities and competencies will be completed followed by an analysis of where the business has any sources of competitive advantage. The paper will look at the company's current strategy and whether these competitive advantages are sustainable over time.

The fifth chapter will provide a review of Coastal Contacts' recent financial performance and highlight any opportunities or risks that may affect the likelihood of the company's success.

In the sixth chapter the paper will summarize Coastal Contacts' current situation. The paper will forecast a most likely scenario for the future external environment. The paper will then predict Coastal Contacts' most likely future position in the industry forecast, given the company's current strategy. This chapter will conclude with the identification of the key problem or opportunity for Coastal Contacts' in the retail eyeglasses market.

The seventh and final chapter will present the specific goals the company is trying to accomplish and then present and review a number of strategic alternatives capable of accomplishing these goals. These strategic alternatives will be evaluated and ranked producing a final recommendation on what Coastal Contacts can do to better ensure its future success in the online retail eyeglasses market.

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<sup>3</sup> Michael E. Porter, 1979

## 2: Company Background

### 2.1 Ownership and Control

Coastal Contacts was incorporated under the Canadian Business Corporation Act on December 14th, 2000. The company is publicly held and trades on the Toronto Stock Exchange (TSX) as well as the Nasdaq OMX Nordic Exchange (OMX). The founder, Roger Hardy, is the current CEO and Chairman of the Board. There are staggered 3 year terms for the election of directors. As of October 31, 2010, Directors and Senior Officers owned over 29% of the aggregate voting power of the company. This level of ownership concentration has the potential to limit the action taken by other shareholders and could prevent a change in the control the company. Employees of the company take part in an Employee Stock Ownership Plan (ESOP), which further concentrates control of the organization.

The goal of the Chairman, Board and Senior Officers is to maximise shareholder value. As significant holders of company stock, this goal aligns with their self-interest.

### 2.2 Corporate Structure

The parent company Coastal Contacts Inc. is incorporated under Canadian law. The company has 4 material wholly-owned operating subsidiaries:

**Figure 2: Coastal Contacts' Subsidiaries**

Subsidiaries	
Lenslogistics AB	Swedish subsidiary responsible for all operations out of the Stockholm office and distribution facility. Created as part of a restructuring after the initial LensWay AB (2004) and Condis BV (2006) acquisitions.
LensWay BV	Dutch subsidiary created as part of the restructuring of LensWay AB. Now responsible for all revenue from the Swedish division.
Condis BV	Dutch subsidiary acquired in 2006. Restructured and now responsible for all revenue and operations from the North American division.
AsianZakka Pte Ltd	Singapore subsidiary acquired in 2006.

*(Source: Author, 2011)*

Lenslogistics AB and LensWay BV are part of the Swedish run operation, while Condis BV and AsianZakka Pte Ltd. are part of the Canadian run operation. The Swedish and Canadian operations are then consolidated under the corporate entity Coastal Contacts Inc.

## **2.3 Corporate Scope**

### **2.3.1 Businesses**

Coastal Contacts is a direct-to-consumer online retailer of eyewear products. In 2010 Coastal Contacts had revenues of \$153M CAD, an increase of 9.5% from 2009's \$140M CAD (see Appendix 1). The company specifically focuses on the contact lens and eyeglass categories. These categories are sufficiently different that they can be treated as separate businesses. This paper analyzes the eyeglass category which accounted for 12.6% of 2010 revenues and 17.6% of gross profits (see Appendix 2).

### **2.3.2 Geography**

From its distribution centres in Vancouver, Stockholm and Sydney, Coastal Contacts ships to over 150 countries. The Vancouver office runs websites that specifically market into Canada, the United States, Australia, New Zealand, the United Kingdom, Ireland and Japan. In total there are 10 separate e-commerce websites that are used to cover these markets. The Stockholm office markets into Sweden, Norway, Finland, Denmark, Holland, and Germany. They use 16 separate websites to serve these primary markets as well as a number of other countries in the Nordic region.

### **2.3.3 Vertical Scope**

Coastal Contacts operates at multiple levels within its industry supply chain (see Appendix 8). Unlike many eyeglass retailers, Coastal Contacts has invested capital to develop its own on-premise optical lab. These labs provide manufacturing and assembly services for the eyeglasses that Coastal Contacts sell through its various websites. In addition, the company often purchases frames and lenses directly from manufacturers or wholesalers; skipping over the distributor channel, and storing large volume orders in the company's own warehouse facilities. Unlike most competitors in the industry Coastal Contacts' has vertically integrated the optical lab and distribution.



## **2.4 Products**

Coastal Contacts' US eyeglasses business contributed 13.5% of US revenue and generated \$3.6M CAD in 2010, an increase of 108% year-over-year (see Appendix 2). More recently in Q1 of 2011 eyeglasses increased to 17.5% of revenue or \$1.1M CAD. This was an increase of 20% over the previous quarter where revenue was \$0.9M CAD representing 15.2% of US revenues (see Appendix 3). This growing business can be subdivided by its components: lenses and frames as well as by the frames' brand classification: designer brand or house brand.

### **2.4.1 Lenses**

Most eyeglasses are single vision, meaning the lens only has a single prescription. Single vision glasses have either a negative power and are used by people who are near-sighted, or they have a positive power and are used by people who are far-sighted. The most common type of eyeglasses is reading glasses which have a positive power. Lenses with more than one prescription are called multifocal lenses. These lenses can be broken down into bifocals (which have two prescriptions) and trifocals (which have three prescriptions). Progressives are a new type of lens that has a gradual shift over a prescription range. These lenses provide the user with access to two or more prescriptions without requiring a horizontal line across the lens. Lenses also come in a variety of indexes. An index is a measure of a lens' ability to efficiently bend light. The higher the index the more efficient the lens is, the thinner and lighter the lens can be. Lenses also have a variety of coating options which include anti-reflective, anti-scratch, UV protection as well as a variety of colour tint options such as sunglasses or photochromic lenses that change colour with the intensity of light. Lenses are available in branded and unbranded versions with the branded product selling at a substantial premium. Well known brands include Carl Zeiss, Nikon and Transitions.

### **2.4.2 Frames**

Coastal Contacts provides a wide selection of frames to choose from (over 1,500 as of April 2011) and carries a mix of well known designer brands and house brands. Coastal Contacts' US sales are split with approximately 60% of orders coming from designer brands and the remaining 40% of sales coming from house brands. This ratio changes over time and is dependent on the total collection of products and the proportion of which fall into the designer or house brand categories. In general the sales of designer versus house brands mirror the proportions on the website.

### **2.4.3 Designer Brands**

The 60% of US sales from designer brands can be broken down further into two sub-categories: top tier brands (which are well known premium brands such as Ray-Ban, Oakley and Gucci) and tier two brands (which are less known and often product line extensions from fashion brands such as Levis, Converse or Vogue). Top tier brands account for 30% of the designer brands featured on the Coastal Contacts website while tier two brands account for the remaining 70%. The opposite is true for unit sales of designer brands; top tier brands account for a higher proportion than tier two brands. Sales of top tier brands account for 60% of designer brand sales while in comparison tier two brands only account for 40%. As of April 2011 Coastal Contacts carried over 100 designer brands on its US website.

### **2.4.4 House Brands**

Unbranded frames either have no brand name at all, or they feature what is called a house brand name. A house brand is a brand that is created by a retailer. The frames are purchased directly from a manufacturer at which point the generic frames are branded with the house brand name specifically for the retailer. These frames can be sold by the manufacturer to multiple retailers or tier two fashion brands, so that a single model may appear under multiple brand names.

## **2.5 Customers**

### **2.5.1 Existing Customers**

In order to sell eyeglasses Coastal Contacts is able to leverage its existing database of contact lens customers in the US. As of April 2011 Coastal Contacts had an active US database (defined as having made a purchase in the last 24 months) of 720K customers. Of these customers 86% are contact lens customers and 26% are eyeglass customers, (12% are both). The existing customer database of active customers is growing at an average monthly rate of 1.9%<sup>4</sup>.

### **2.5.2 Geography**

Unlike traditional offline retailers, because Coastal Contacts is an e-commerce retailer the company is able to operate across the entire US market. Marketing and customer acquisition is focused at a national level. Because 46% of eyeglass sales come from existing contact lens

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<sup>4</sup> Author, 2011

customers<sup>5</sup> the geography of new eyeglass customers skew's towards the database of existing contact lens customers. The top five markets for eyeglass sales include: New York, California, Texas, Florida and Illinois<sup>6</sup>.

### **2.5.3 Age**

The typical eyeglasses customer for Coastal Contacts is between the ages of 25-40 years old<sup>7</sup>. Below this age range the end user is often not the buyer. Even though above this age range the requirement for eyewear is greater (see Appendix 11) the propensity to make purchases online is lower (see Appendix 13).

### **2.5.4 Sex**

Coastal Contacts does not require customers to specify their sex when placing an order or opening an account. Based on available prescription and customer first name data Coastal Contacts' US customer base is estimated to be 48% male and 52% female. The company's US customer base for eyeglasses specifically is estimated as 44% male and 56% female<sup>8</sup>. Coastal Contacts' customer based therefore skews female compared to the total US market for eyewear.

### **2.5.5 Income**

Very little data is available about the average income level of Coastal Contacts customers. We can only infer that people shopping online for eyeglasses at Coastal Contacts have similar characteristics to those individuals who generally shop online for eyeglasses. Appendix 13 shows that there is a slightly higher propensity for lower income people to purchase eyeglasses online. Because Coastal Contacts offers more designer brands than other online eyeglass retailers it is likely that Coastal Contacts customers are higher income than the average online eyeglass purchaser.

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<sup>5</sup> Author, 2011

<sup>6</sup> Author, 2011

<sup>7</sup> Author, 2011

<sup>8</sup> Author, 2011

## **3: External Analysis**

### **3.1 Industry Definition**

For this paper's analysis of Coastal Contacts the industry is defined as the US retail eyeglass market. This definition includes both traditional offline retail stores as well as online e-commerce retailers similar to Coastal Contacts. With the nature of online retail, the geographic boundary is the whole of the US market. While traditional bricks and mortar retailers are limited to a local addressable market, Coastal Contacts has no such limitations.

### **3.2 Industry Structure**

The retail eyeglasses industry is highly competitive and fragmented. It can be classified as a monopolistically competitive market. It has a market structure where many sellers each produce similar, but slightly differentiated products. Each producer is able to set their own price and quantity without affecting the marketplace as a whole.

#### **3.2.1 Industry Concentration**

The retail eyeglasses industry has a relatively low degree of concentration. The industry is dominated by a large number of very small independents. In 2008 the independents made up 64.2% of the market<sup>9</sup>. Conversely Luxottica is by far the largest single retailer with 17.4% of the retail market in 2008. Market share data for the largest participants in retail optical can be found in Appendix 8.

An industry trend has been the surge of new optical departments within general retailers. Large retailers like Walmart and Costco are utilizing their existing real estate to add industry capacity and grow sales. For the period 2004-2008, general retailers grew their optical sales at a compound annual growth rate (CAGR) of 8%<sup>10</sup>.

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<sup>9</sup> Packaged Facts, 2009, p:11

<sup>10</sup> Packaged Facts, 2009, p:58

Online has also emerged as a new channel for retail optical. Growth has been fuelled on a low cost value proposition. Online optical purchases continue to increase each year. In 2009 over one million eyeglasses were sold online. This represents a 300% increase from 2007<sup>11</sup>.

Finally, the eyeglass industry has been concentrating vertically. For several years, some of the major competitors have been vertically integrating as a way to grow business, realize marketing synergies and attempt to lower costs. Companies that have forward integrated into retail in the US include Luxottica, Safilo and Marchon. “Without integrated retail, leaving distribution primarily to third parties, marketers flounder for rack space. However, by operating integrated retail, marketers can offer premium positioning of their own brands thus gaining better brand awareness, better effect for their marketing dollars, and greater sales”<sup>12</sup>.

### **3.3 Supply Chain**

To analyze the vertical structure of the eyeglass industry we will look at five separate categories of businesses and see how they work together to make up the industry supply chain:

#### **3.3.1 Brand Owners**

Brand owners are the global brands such as Gucci, Dior Hugo Boss or Lacoste. These brands are highly concentrated and are subsidiaries of a large conglomerate that owns the rights of many brands. The largest of these are LVMH and the Gucci Group. Branded products are either made in-house or the rights are leased for a certain product category to a business who is more capable of developing products for that category, and who can be relied on to produce products that will live up to brand standards.

#### **3.3.2 Brand License Holders**

Brand license holders lease the right to use the brands from the brand owners. They then develop products under these brand names for sale into retail channels. Usually for eyeglass brands (such as Oakley and Ray-Ban) the owner and the holder are the same company, whereas for fashion brands the owner and the holder are usually separate companies. The brand license holders are also a highly concentrated section of the supply chain, as only a small number of large companies work with the brand owners to develop and market their products. The primary

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<sup>11</sup> The Vision Council, 2009, p:6

<sup>12</sup> Packaged Facts, 2009, p:76

players in this market include Luxottica, Safilo and Marchon who in 2008 had market shares of: 42.9%, 18.1% and 6.6% respectively (see Appendix 6).

### **3.3.3 Frame Manufacturers**

Frame manufacturers run manufacturing facilities and are either contracted by the brand license holders to produce products on their behalf, or they produce their own house brands or unbranded products. This group of companies is un-concentrated and un-differentiated. Frame manufacturers produce frames from metals and plastics in thousands of designs every year. They are labour intensive, numerous, and primarily located in China.

### **3.3.4 Lens Manufacturers**

Lens manufacturers develop and manufacture the plastic and glass optical lenses that are used in eyeglasses. These lenses are produced as “pucks” that are then cut by optical labs to fit a specific frame. Lens manufacturers are a highly concentrated group of companies that produce specialized products requiring very high standards. The largest lens manufacturers include Essilor, Zeiss, and Hoya who in 2008 had market shares of: 54.2%, 10.7% and 13.5% respectively (see Appendix 7).

### **3.3.5 Optical Labs**

Optical labs take the pucks from the lens manufacturers; surface and cut them, and then assemble the final eyeglasses. The optical lab industry is un-concentrated. While some labs are specialized and provide difficult to produce products to a larger market, most labs are smaller operations that serve local retailers in a given region.

Processes within an optical lab have been manual and the process of cutting and assembling a pair of eyeglasses has been labour intensive. More recently, highly automated equipment utilizing robotics and new cutting and finishing technologies have decreased labour requirements as well as production times. Equipment has also quickly fallen in price as equipment manufacturers continue to increase productivity. With this new technology existing labs have been able to increase capacity while decreasing labour requirements. In order to pay for the equipment labs have started competing fiercely with one another to ensure their capital investment is being fully utilized. Simultaneously, general retailers such as Walmart and Costco have made significant investments into their own optical labs. This increase in industry capacity has put a downward pressure on optical lab pricing.

### **3.3.6 Retailers**

The retailers sell eyeglasses to the end consumer. As we have seen retailers are un-concentrated with nearly 65% of revenue coming from small independents. There is however a number of larger players including Luxottica, Walmart and Costco who each have a substantial portion of market share. In fact the top 5 firms have control of 29.7% of the revenue from retail eyeglasses in the US (see Appendix 8).

Further details on the industry supply chain are outlined in a Flow-of-Goods Diagram which can be found in Appendix 18.

## **3.4 Strategic Groups**

A strategic group is a group of firms that competes against each other more intensely because their characteristic and strategies are similar. Four separate strategic groups are used to describe the retail eyeglass market: independents, retail optical chains, general retailers and online retailers.

### **3.4.1 Independents**

Independents are small traditional retailers who usually operate a single or small number of locations. They can be broken into 2 subgroups: those that are operated by optometrist and those that are operated by an optician. The former can offer an eye exam where as the later will not. There is minimal differentiation within this group and independents primarily compete on location and on customer loyalty through service level, while enjoying some barriers-to-entry created by professional licensing.

The location of an independent's store is very important. With minimal differentiation the independent must locate in high traffic locations in order to obtain customers. Once an independent has acquired a customer they use various tactics to help retain that customer and secure an ongoing revenue stream. Barriers-to-entry are also important in the optical industry. There are legal requirements for certification in order to provide eye exams and sell eyeglasses. As in other industries with a licensing requirement, optical retailers have traditionally been able to obtain higher than average rents as the professional license acts as a barrier to entry and limits competition.

Since location is one of the primary ways independents compete, high cost prime real-estate locations are essential to ensure success. With only a single or few locations, independents

purchase frames in small numbers and are unable to take advantage of volume discounts. Minimal purchasing power when sourcing product means the independent has a higher cost of goods compared to its larger industry rivals. Physical and human capital utilization is generally poor, since independents are only processing a small number of orders per-person per-hour. Finally, independents do not have their own optical labs and contract out for this service. With their high variable cost structure, independents attempt to minimize their inventory carrying costs. A smaller inventory means fewer options for a customer to choose from. Contracting orders out to an optical lab for cutting and assembly leads to increased lead times and delays for customers. Reduced frame selection and longer delivery times are two weaknesses in the independent's ability to create value.

While small individually, the independent retailer group accounts for a significant proportion of the eyeglass market share. In 2008 independents were responsible for 64.2% of revenue in the US retail eyeglass market (see Appendix 9). Their market share has slowly been slipping, however, as larger more sophisticated businesses have begun to aggressively enter the category. In aggregate retail optical chains, general retailers and online retailers saw their market share increase from 27.2% in 2004 up to 35.8% by 2008. In comparison independent retailers saw a decrease in market share over the same period; from 72.8% down to 64.2% (see Appendix 10).

### **3.4.2 Retail Optical Chains**

The retail optical chain category consists of both regional and national chains, which can have up to hundreds of locations. Optical chains can benefit from scale economies in marketing and operations. More locations equates to higher sales volume and the opportunity for increased buying power and volume discounts.

As compared to the independents, optical chains have a far larger number of retail locations, which are spread over a much broader area. Optical chains will also have a head office with support staff for human resources, finance, marketing and accounting. Optical chains benefit from lower costs made possible by scale economies. With higher sales volume optical chains are able to purchase frames in much larger quantities opening up the possibility for volume discounts. Marketing related scale economies exist, as well as economies made possible through centralizing support staff and task specialization.

These larger more sophisticated businesses are also more focused on driving growth and profitability compared to their independent counterparts. These businesses chose to differentiate themselves from their independent competitors by offering a wider selection with a better value



for dollar. Optical chains will often situate large stores in high traffic locations. These high traffic locations provide an increased level of convenience, while the larger stores allow for a broader selection of products. Many chains also put a very basic optical lab on site so that they can cut a lens and assemble a pair of eyeglasses right in the store. With a lab onsite chains are able to use speed as a differentiator, further increasing convenience. In 2008 optical chains accounted for 25.9% of retail eyeglass revenue in the US.

Examples of optical chains in the US include:

- **Luxottica** – This multi-national vertically integrated conglomerate controlled 17.4% of the US retail market or \$3,549M USD<sup>13</sup> in revenue in 2009. The company's US retail arm operates over 5,000 locations. Retail brands include: LensCrafters, Pearl Vision, Target Optical and Sears Optical (both operated under contract with the respective parent companies). Luxottica's US retail strategy is to act as the distribution arm for its manufacturing and brand licensing business. By expanding its locations Luxottica increases the distribution of its brands. Luxottica's retail portfolio focuses on the premium optical category.
- **Highmark Vision** – Principally a health benefits provider, Highmark has diversified into dental and vision care providers. The latter of which is operated under the brand: Eye Care Centers of America Inc. (ECCA). This business unit is the 3<sup>rd</sup> largest optical retailer with 2.4% of the retail market or \$490M USD in revenue in 2009<sup>14</sup>. ECCA operates nearly 400 stores in 36 states under a number of sub-brands including: EyeMasters, Visionworks, Vision World, Hour Eyes and another of others. The company's strategy is to use value oriented pricing in conjunction with in-store labs that can provide 1-hour service on basic orders.
- **National Vision** – This privately held optical retailer has 2.0% of the market or \$408M USD in revenue in 2009<sup>15</sup>. National Vision is the 4<sup>th</sup> largest optical retailer in the US with over 600 stores nation wide. Retail brands include: America's Best Contacts & Eyeglasses, Eyeglass World, Vision Centers inside select Walmart locations and, Vista Optical inside Fred Meyer. National Vision has a low cost strategy and positions itself as a cost leader.

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<sup>13</sup> Packaged Facts, 2009, p:10, 11

<sup>14</sup> Packaged Facts, 2009, p:10, 11

<sup>15</sup> Packaged Facts, 2009, p:10, 11

### 3.4.3 General Retailers

General retailers are companies that focus on selling a wide variety of products, where the optical category is only a small portion of total sales. This group includes department stores, discount stores and warehouse clubs. General retailers have hundreds or thousands of stores nationally. They are able to leverage existing foot traffic and infrastructure, and therefore the incremental cost of running an optical department is minimal as a proportion of their total operating costs. Since the optical department is only a small section within a larger store, the general retailer is able to have a lower cost-per square foot than its competitors. General retailers have made significant investments in logistics, resource management and technology. They also have centralized support staff and systems in place to help efficiently run their operations. The optical department within these stores are able to leverage these investments, many of which are non-rivalrous. This existing infrastructure allows reduced operating costs and creates economies of scope. With a large number of locations, economies of scale from purchasing are also possible. Many general retailers are also large enough to support their own optical labs. Internalizing this portion of the value chain can increase efficiency and reduce cost of goods further.

The selection of eyeglasses from general retailers is smaller than that offered by optical chains but their prices are lower. General retailers are usually known for their discount pricing and use this as their primary mode of competing, while leveraging their loyal customer base.

The general retailers' success has been even more pronounced in recent years than the chains. These discount and wholesale stores have been quickly adding optical departments to increase their store margins. In 2008 Walmart added new locations equalling 5% of total retail capacity while Costco added 2%<sup>16</sup>. General retailers in 2008 accounted for 7.9% of retail eyeglass revenue in the US<sup>17</sup>. Examples of general retailers include:

- **Walmart** – Walmart is the 2<sup>nd</sup> largest optical retailer in the US and accounts for 6.6% of the retail eyeglass market or \$1,345M USD in 2009<sup>18</sup>. Through Walmart Optical Centers' the company serves nearly 6 million patients annually from over 3,000 locations. The company's strategy is to be a low cost provider and leverage existing store traffic by targeting the value oriented consumers who are already shopping in their stores. Walmart has vertically integrated and built their own

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<sup>16</sup> Packaged Facts, 2009, p:28

<sup>17</sup> Packaged Facts, 2009, p:11

<sup>18</sup> Packaged Facts, 2009, p:11

network of optical labs, where they produced more than 5 million pair of eyeglasses in 2009.

- **Costco** – With over 500 locations in the US, Costco is the 5<sup>th</sup> largest eyeglass retailer in the US with 1.3% of the retail market or \$265M USD in 2009<sup>19</sup>. Costco operates a similar model to Walmart, using a low cost strategy. The company has vertically integrated into the optical lab business and leverages its existing in store traffic as its source for sales. Similar to the other categories Costco operates in, the company takes a low cost, no frills approach to optical.

### 3.4.4 Online Retailers

The fourth strategic group is online retailers; companies that do not operate bricks and mortar location, but instead run an e-commerce business. Coastal Contacts falls into this last category.

The online business model allows firms to sell to a large geography without the normal limitations of physical locations. The model also allows for reduced operating costs by lowering cost-per square foot and dramatically improving cost-per full time employee (FTE). Online retailers can carry much larger inventories and can therefore take advantage of volume discounts when purchasing product. These large inventories also allow online retailers to offer customers a far greater selection of eyeglasses compared to traditional offline retail channels. Large selection and discounted prices are two key components of most internet strategies.

Online retail optical is in its infancy and there are few profitable online retailers of eyeglasses. Even still, it is a quickly growing channel. In 2008 online represented 2% of US retail eyeglasses revenue<sup>20</sup>. In 2009 this group had grown 67.5% to 3.35% of total US sales<sup>21</sup>. Examples of successful online eyeglass retailers include:

- **Eyebuydirect.com** – A private company launched in 2005, Eyebuydirect is focused on the US market and has been growing quickly with sales growth of 40% in 2009<sup>22</sup>. The company has vertically integrated backwards into manufacturing and operates a facility in China where it manufactures all of its eyeglasses. Product is shipped individually from China to customers.

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<sup>19</sup> Packaged Facts, 2009, p:11

<sup>20</sup> Packaged Facts, 2009, p:11

<sup>21</sup> The Vision Council, 2010, p:21

<sup>22</sup> Vision Monday, 2010

Eyebuydirect runs its information technology (IT) and marketing from an office in California. Eyebuydirect focuses on being a low cost provider. It offers low risk (100% satisfaction guarantee), and a simplified process (virtual try-on: “EyeTry”). Eyebuydirect is well positioned to take advantage of growth in the internet channel for eyeglasses.

- **BestBuyEyeglasses.com** – Another private company focused on the US market, BestBuyEyeglasses offers a huge selection of branded products on their website. However, the company stocks very few of these products. It merely merchandizes supplier catalogues on their website. By not stocking product, delivery times are slow and products may not be available, reducing willingness-to-pay. Delivery times have been somewhat minimized since the company has historically focused its efforts on frame-only purchases. More recently BestBuyEyeglasses has put more effort towards retailing eyeglasses with the prescription lens included. In 2009 the company experienced double digit growth and launched a similar virtual try-on feature to that offered by competitors<sup>23</sup>. BestBuyEyeglasses’ strategy is clearly focused on providing customers with a large selection.
- **Framesdirect.com** – Based in Austin, Texas this online retailer operates Framesdirect.com as well as Framesdirect.co.uk. This company has taken a similar strategy to BestBuyEyeglasses by focusing heavily on selection. Framesdirect currently offers over 28,000 branded frames to choose from on their site. The majority of orders are frame only, but the company is focusing now more on selling complete eyeglasses than it has in the past. Framesdirect has relatively high prices.
- **ZenniOptical.com** – ZenniOptical is the largest online retailer of eyeglasses with over 4,000 orders a day, most of which comes from the US<sup>24</sup>. Founded in 2004, ZenniOptical has grown at a rate of over 200% year over year, up until 2009 where its growth rate dropped below 100%. The company’s strategy is to be the low cost provider in the industry. ZenniOptical manufactures its own frames and lenses and then assembles eyeglasses in a new 227,000 square foot facility located in China. Eyeglasses are then shipped individually from China directly to

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<sup>23</sup> Vision Monday, 2010

<sup>24</sup> Vision Monday, 2010

customers. The company does not offer any branded products, but is able to offer nearly 3,000 frames on its website for customer to choose from. ZenniOptical has also created a virtual try-on feature and is focusing its efforts on simplifying the purchase process.

### **3.4.5 Strategic Group Map**

These four strategic groups can be compared using a Strategy Group Map (SGM), which compares the strategic groups against one another using three dimensions: price/quality, service and selection. Here price/quality is a measure of how much value the strategic group delivers to buyers. This dimension is increasing in the quality of the product, but decreasing in the price of the product. The service dimension measures the level of service provided by the strategic group. This includes the convenience of the purchase process, the level of service provided during the process as well as after sales support. The third dimension, selection, is a measure of the size and variety of the selection offered by the strategic group. This dimension also incorporates whether the group offers designer brand eyeglasses or only house brands and tier two brands.

In Appendix 16 a bubble chart is provided which maps the four strategic groups against these three separate dimensions. Coastal Contacts is also shown separately. From this graphical view we can see that each strategic group operates in its own defined area, with its own separate value proposition. Independents are primarily focused on service. Chains provide less service, but greater value through price/quality and a larger selection. General retailers provide even greater value through price/quality however their service and selection are both lower than the chains. Finally, online provides the highest level of price/quality and selection, however its level of service is the lowest, a function of the online sales channel and a lack of face-to-face interaction. The two strategic groups which most closely align and overlap are the general retailer group and the online retailer group. Both of these strategic groups are focused on providing high price/value along with a lower level of service.

Appendix 17 provides a bubble chart specifically for the online strategic group. The graphical representation shows how Coastal Contacts compares against other direct competitors within the online retail strategic group. The graph shows that Coastal Contacts has a unique positioning amongst its direct competitors. The company provides similar value to other competitors however through a different mix of price/quality. Coastal Contacts provides more of its value through quality compared to other online retailers who score highly on price/quality through low prices. Coastal Contacts also rates higher on the service dimension, made possible

through its faster delivery times from its North American co-located optical lab and distribution centre, having all products in stock, 24/7 customer support and generous return and exchange policies. The four other competitors can be split into two separate groups. The first group provides low service, low price/quality and large selection group. This group includes BestBuyEyeglasses.com and FramesDirect.com. The low service is due to slow delivery times from no in-house lab and no product inventory. Low price/quality is due to the relatively high prices these competitors charge, and the large selection is a function of their strategy of including on their website entire product catalogues from numerous manufacturers. The second group provides a higher level of service from faster delivery times made possible from operating their own in-house optical labs and stocking inventory. This group also provides a smaller selection of products limited to house brands which provide a higher price/quality since the retail prices these products are offered at are very low. This second group includes EyeBuyDirect.com and ZenniOptical.com.

## **3.5 Industry Performance**

### **3.5.1 All Retail**

The US retail market for eyeglasses grew 10% annually from 2004 to 2007 where it reaching \$15.4B USD. In 2008 growth dropped dramatically with the recession to just under 4% ending the year at \$16.0B USD<sup>25</sup>. Consolidated industry data is not available for 2009 onwards but it is estimated that: "...the market will be down seven percent from the 2008 level ... modest growth of two percent in 2010... expect growth at between two and five percent between 2011 and 2013"<sup>26</sup>. CAGR for the 2008-2013 period is estimated at 0.9%<sup>27</sup>.

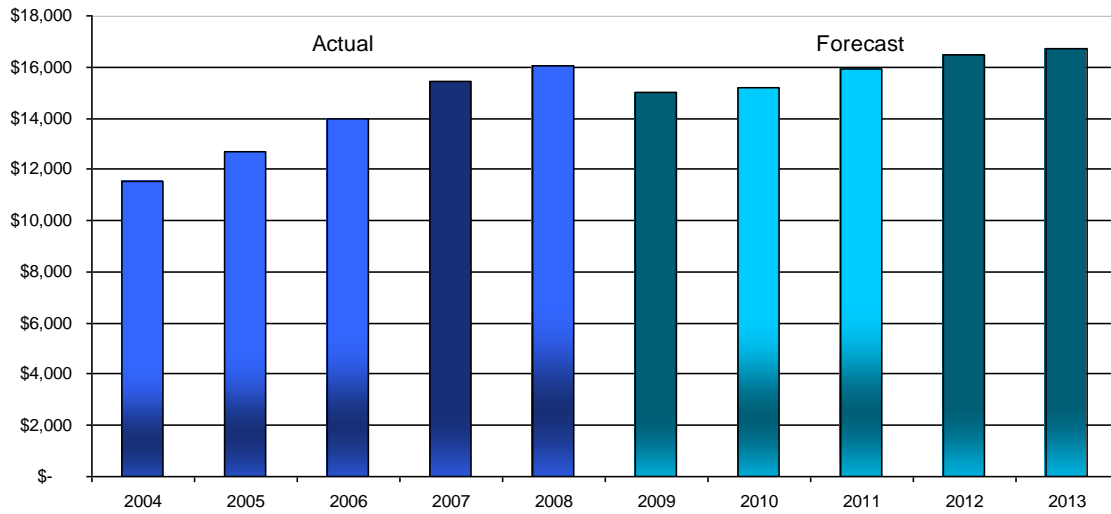
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<sup>25</sup> Packaged Facts, 2009, p:55

<sup>26</sup> Packaged Facts, 2009, p:64

<sup>27</sup> Packaged Facts, 2009, p:67

**Figure 3: US Retail Eyeglasses Market (in Millions)**



Source: *Packaged Facts, 2009*

Two significant macro-economic trends are impacting the industry. The recent recession has led to thriftier purchasing habits. As consumers re-assess where they spend their money there has been a shift away from discretionary purchases such as fashion and accessories. “It is expected that prescription eyeglasses will suffer a bit at the high end in 2009 and on a unit basis, but that low-priced products may actually see some positive results as consumers shift to lower cost alternatives”<sup>28</sup>. Also, by 2010, the 45–64 year old Baby Boomers will grow at double the national rate, or 1.9% per annum, to reach 81 million people, while those 65 and older will grow slightly faster at two percent annually to more than 40 million people<sup>29</sup>. By age 65, most people suffer some loss of visual acuity. This means the large and aging Boomer population will increasingly begin to require eyeglasses, increasing the percent of total population who wear eyeglasses.

### 3.5.2 Online Retail

From 2008 to 2009 online retail increased in market share by an estimated 34%, from 3.8% in 2008 to 5.1% in 2009<sup>30</sup>. Similar data is not available for 2010. However a Vision Monday report on March 7<sup>th</sup> 2011, stated that those contacted for a report “all claimed double-

<sup>28</sup> Packaged Facts, 2009, p:66

<sup>29</sup> Packaged Facts, 2009, p:14

<sup>30</sup> The Vision Council, 2009, p:88

digit increases in website traffic and sales growth in 2010<sup>31</sup>. The companies contacted included Coastal Contacts' main competitors: BestBuyEyeglasses.com, EyeBuyDirect.com, and ZenniOptical.com.

## **3.6 Industry Attractiveness**

### **3.6.1 Porter's 5-Forces**

The prescription eyeglasses industry can be further analyzed using Porter's 5-Forces Model. Porter's model is used to assess the future attractiveness of an industry and the ability for incumbents to earn above average rates of profit (rents). It helps understand the drivers and threats to rents and how these may change in the future. The model looks at supplier power, buyer power, the threat of new entry, the risk of substitutes as well as rivalry within the industry. A visual depiction of the 5-Forces Model for the US retail eyeglasses industry can be found in Appendix 19.

#### **3.6.1.1 Supplier Power**

Supplier power for both offline and online retail is currently low and should stay low into the foreseeable future.

The bargaining power of suppliers to the retail channel is low. Suppliers consist of the brand license holders who control the supply of frames, the lens manufacturers who supply the lenses and the optical labs who provide the cutting and assembly services to those retailers who do not have their own lab facilities. While some of the license holders produce highly sought after eyeglass brands such as Ray-Ban and Oakley, for all other products suppliers are numerous, produce products that have minimal differentiation and present a low switching cost to retailers. Lenses and optical lab services are even less differentiated than frames. In the future there is a low likelihood that supplier relationships will change greatly so the threat from suppliers of capturing retail optical rents is low and stable.

#### **3.6.1.2 Buyer Power**

Buyer power in the retail eyeglass industry does not exist and is not a threat to current or future rents. Retailers sell to a large number of individual buyers, and no buyer has any significant power over a retailer.

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<sup>31</sup> Vision Monday, 2011



### **3.6.1.3 Threat of New Entry**

The threat of new entry for offline retail is moderate and stable, while the threat of new entry for online retail is high and rising.

In the past the retail optical industry has been able to capture higher than average profits due to industry regulation which acted as a moderate barrier to entry. Retailers are required to be licensed opticians or optometrists, rather than being able to immediately open a retail optical store. Those interested must first be licensed, which requires a number of years of schooling. This limited new entrants into the industry. In recent years there has been a surge of growth from larger businesses such as Walmart and Costco who are quickly expanding industry capacity with more optical locations within their existing store networks. Licensing has not acted as a barrier to entry since these companies are easily able to hire the licensed staff they need. This trend towards higher industry capacity is likely to continue into the foreseeable future, slowly putting more downward pressure on prices and industry rents.

Online retail is subject to the same threats to industry rents from increased capacity. The channel is also subject to the additional threat of new entrants into the online channel. Searching costs are reduced and switching costs are minimized with e-commerce. This makes new entrants into the online channel particularly disruptive. New entrants are likely to come from three separate areas. Large existing offline competitors such as Walmart or Costco may decide to begin selling eyeglasses online. These competitors already have e-commerce websites and the potential exists for them to expand their offering into eyeglasses. Online contact lens competitors (such as 1800Contacts.com or Visiondirect.com) are also potential entrants. Large online retailers such as Amazon.com are a third potential entrant. Similar to the approach Walmart and Costco have taken offline, Amazon could expand into the eyeglasses category and leverage its existing store traffic and customer loyalty. The barriers to entry for these three groups are minimal. A lead time of 12 months is likely for any one of these potential entrants to launch an online retail eyeglass store. Taking this into consideration the threat to future rents for online retailers is high.

### **3.6.1.4 Substitutes**

The threat of substitutes to eyeglasses for both the offline and online retail channels is very low and stable.

People will always need some form of vision correction. Today the only other viable options are contact lenses and laser eye surgery. Neither of these are perfect substitutes.

Virtually all contact lens wearers will also have a pair of glasses to wear when they are not wearing their contacts. In 2008, contact lenses were worn by 15% of the population in the US compared to 59% for eyeglasses (see Appendix 4). During the period 2004-2008 contact lenses grew at a CAGR of 3.6% (compared to 8.6% for eyeglasses) ending the period at \$3.2B USD for 2008<sup>32</sup>. Growth is estimated for the period 2009-2013 to be moderate at a CAGR of 0.2% (compared to 0.9% for eyeglasses).

Individuals who have opted for laser eye surgery will often require reading glasses or prescription eyeglasses for certain situations such as driving. When laser eye surgery was first introduced sales grew rapidly. Over the last 10 years sales have levelled off, and in the last 5 years sales have actually declined (see Appendix 5).

Because these products are imperfect substitutes for eyeglasses and because neither product is growing at a rapid rate the threat these products pose on the eyeglasses industry in the future is minimal.

#### **3.6.1.5 Rivalry**

Rivalry is currently high and will be increasing in the future for both offline and online eyeglass retailers. Rivalry will likely be particularly high for online retailers.

Rivalry in an industry is greatest when there are numerous competitors with excess capacity, selling products that are undifferentiated to buyers who have minimal switching costs. The retail eyeglasses industry features nearly all of these aspects. The fact that the eyeglasses industry also exhibits a slow rate of growth only further exacerbates the issue. Firms must fight for market share in order to achieve a moderate rate of growth.

Firms have historically competed based on location and price. Because product differentiation is low people will choose from the available frames at a store, but will rarely choose a store based on the availability of a specific frame. This fact has increased the importance of location. With location so important, businesses that have been able to capture prime real estate have prospered. This dependence on location has helped limit the number of entrants and constrain capacity. Recently new capacity has been added by general retailers as they expand out their store networks and introduce optical departments within their existing stores. Entry by new online retailers has also added to industry capacity. This increase in capacity for an industry that

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<sup>32</sup> Packaged Facts, 2009, p:54

has differentiated by location rather than product has put downward pressure on price across all retail channels. This price pressure will lead to increased rivalry in the future.

### **3.6.2 Attractiveness of Online Retail**

The online business model for retail optical has a number of advantages and disadvantages compared to offline. The biggest competitive advantage that online has relates to cost. Online is more efficient than most offline retail optical. Online retailers are able to substitute high cost retail store locations with a single low cost warehouse and call centre facility. Economies of scale in operations are much more attainable for online since a single online store has no geographic limitations. This allows for human resources, capital and advertising dollars to be centralized and more effectively utilized. Efficiencies also exist in purchasing. Because online retailers are capable of scaling quickly purchase orders are larger, volume discounts increase and input costs decrease. All of these impacts combine to improve online retail costs compared to many of their offline competitors. Only the largest offline retailers such as general retailers (Walmart, Costco) or national chains (Luxottica) can have a similar cost advantage by leveraging scale economies.

Online retailers' business model also enables the ability for some unique points of differentiation. With a centralized business model and a large warehouse facility, online is well positioned to provide customers with a larger selection of products than would be available from a traditional offline retailer. Where the typical offline retailer will have hundreds of frames to choose from, the typical online retailer will have thousands. Online retail can also provide customers with the convenience of being able to shop from home. Rather than having to make multiple trips to a retail store, consumers can purchase eyeglasses from their home, any time of day and have them delivered to their door.

While the online channel has a number of cost and differentiation advantages it is also subject to lower consumer willingness-to-pay. Buying eyeglasses online is a new way of buying eyeglasses that consumers are not yet accustomed to. Consumers are not confident when purchasing eyeglasses; they look for the face-to-face interaction and recommendations of a professional. Buying eyeglasses without trying them on is also hard for many consumers. They are not aware that size measurements exist, and that these can be found on their current glasses. The lack of understanding about size, the presumed requirement of a professional recommendation and the need to try on frames before consumers are comfortable buying them, creates significant friction for the online business model.

### **3.6.3 Key Success Factors for Online Retail**

In order to ensure success online retailers of eyeglasses must address a number of key success factors. For consumers to buy eyeglasses online they must give up the ability to try them on, and they lose the advice and consultation normally provided during an in-store purchase. These two factors push consumers' willingness-to-pay downward when shopping online. Retailers must overcome this lower willingness-to-pay by delivering buyers more value, either through reduced prices or differentiation that consumers are willing to pay more for.

A key to success is for online retailers to grow quickly by taking advantage of their lack of geographic limitations. This larger addressable market allows for an accelerated growth rate. This growth creates scale economies and a cost advantage as the online retailer becomes more efficient in its operations and reduces its average input costs. This lower cost structure can be used to counteract consumers' lower willingness-to-pay by discounting prices while still providing the online retailer an acceptable rate of return.

Another key to success is the ability for the online retailer to take advantage of the "Long Tail"<sup>33</sup> by providing a far larger selection than would otherwise be available in an offline retail location. By providing customers with a larger selection there is a greater likelihood that a customer will find a product that suits them.

Finally, online retailers can focus on improving the convenience and simplicity of purchasing eyeglasses online. By addressing consumers' reluctance to purchase by improving the purchase process the online retailer can increase willingness-to-pay.

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<sup>33</sup> Anderson, Chris (2006)

## **4: Internal Analysis**

### **4.1 Key Success Factors**

#### **4.1.1 Cost Advantage**

Having a cost advantage is a key success factor for online retailers, since consumers have a lower willingness-to-pay. Coastal Contacts meets this requirement through a number of ways. Through scale of operations Coastal Contacts is able to take advantage of various economies of scale such as better resource utilization and purchasing.

The efficiency of an e-commerce business model requires fewer employees per order. This equates to higher revenue-per-employee and lower variable costs. This is accomplished through the company's centralized call centres (2), distribution centres (2) and optical labs (2). These facilities are much more efficient than their equivalent in offline retail which would require a very large number of store locations to process the same volume of orders. Coastal Contacts' real estate costs are also much lower since the warehouse space it leases has a much lower cost-per square foot than retail storefront.

Coastal Contacts' purchasing also provides the company a major cost advantage. Coastal Contacts purchases individual stock keeping units (SKU's) in the thousands. A traditional retailer may purchase a dozen of a particular frame and then buys lenses and assembly services on a per unit basis. This larger purchase volume allows for significant volume discounts. Because the volumes are so high, in many cases Coastal Contacts is purchasing directly from the manufacturer instead of from a distributor. This removes the distributor and its associated costs from the value chain. The net result is Coastal Contacts has a significantly lower cost of goods sold (COGS) compared to all but the very largest offline retailers<sup>34</sup>.

#### **4.1.2 Differentiators**

The key differentiators identified for an online eyeglass retailer included selection and convenience. Coastal Contacts addresses both of these key success factors.

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<sup>34</sup> Author, 2011

As of April 2011, the company's US website [coastalcontacts.com](http://coastalcontacts.com) had over 1,500 different frames available for sale. An offline retailer will typically have a few hundred frames<sup>35</sup>. Coastal Contacts is also rapidly adding to its collection, launching 50-100 new styles every week.

Coastal Contacts' shopping experience is convenient in the same way other online retailers are. The store is always open and customers can purchase from the comfort of their own home, and have the product shipped to their door. Coastal Contacts improves upon this basic level of convenience by improving shipping times through its onsite lab and next day shipping. Convenience is enhanced through a simplified purchase process that takes advantage of technologies that help guide users through the purchase process, helping them choose the most appropriate frame, lens and lens coatings based on the customers' needs. The company's "Virtual Mirror" allows a customer to virtually "try-on" a pair of eyeglasses by overlaying the image of a frame over an uploaded image of their face. Contextually relevant help videos are also provided throughout the purchase process to help customers navigate through the process. If they have difficulties online chat is available as well as 24/7 customer service. The company's post sale experience is designed to improve convenience as well by providing a lenient return and exchange policy (365 day satisfaction guarantee and free shipping both ways).

## **4.2 Sources of Competitive Advantage**

Coastal Contacts' sources of competitive advantage come from the company's cost advantage, and its ability to address the key success factors of selection and convenience.

### **4.2.1 Cost Advantage**

#### **4.2.1.1 Offline**

Coastal Contacts has a cost advantage over traditional retail due to its e-commerce business model. e-commerce businesses save by substituting cheap warehouse space for expensive retail locations. If Coastal Contacts were to sell the same volume of products through traditional retail locations the number of stores required would be between 50 and 100 stores depending on store volume. The cost to lease 50 to 100 retail stores in high traffic locations would far outweigh the cost of Coastal Contacts current warehouse and call centre facility.

Coastal Contacts also benefits from economies of scale. There are a number of fixed costs associated with running a retail eyeglasses company. Coastal Contacts' size allows it to

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<sup>35</sup> Author, 2011

spread these fixed costs over a larger number of units, pushing down total cost per unit. Fixed costs include business systems (website, fulfilment, inventory, reporting), enabling departments (such as finance, accounting, marketing, human resources) and facilities (cost per square foot decreases as facility size increases). Coastal Contacts also benefits from economies of scale with variable costs such as raw materials and advertising media. When the company purchases eyeglass frames and lenses in large quantities the per-piece price falls substantially. The majority of Coastal Contacts' frame inventory is purchased between \$2 and \$20, compared to independent retailers whose lowest product cost will start at \$20 and increase quickly to over \$50. Efficiencies in buying lenses in large volumes provide similar cost savings. Buying media in large volumes nationally also provides the company substantial price savings. Rates for cost-per-thousand (CPM) impressions online when smaller and geo-targeted to a specific region can range between \$5 and \$10 compared to larger national media buys where CPM rates are \$0.50 to \$2. Another economy of scale the company benefits from is related to the law of large numbers. As Coastal Contacts gets larger its sales become more stable and predictable, making the company's call centre, optical lab, logistics warehouse and frames inventory easier to manage and therefore more efficient.

Not all of these competitive advantages are relevant to all offline competitors. Many of these advantages are related to the size of the business and are not unique to Coastal Contacts. In particular competitors such as Walmart and Costco have many of these same advantages. However because nearly 65% of the retail eyeglass industry is still being served by small independent retailers, any strategic benefit related to size can still be considered a competitive advantage for Coastal Contacts.

#### **4.2.1.2 Online**

Coastal Contacts benefits from economies of scope with its database of over two million contact lens customers. Since virtually all contact lens customers require vision correction and will wear eyeglasses some of the time, this database provides the company a pool of potential customers to market to at little to no cost by cross selling eyeglasses either during a customer's visit to Coastal Contacts website or by email.

#### **4.2.1.3 Sustainability**

Coastal Contacts cost advantages are not sustainable in the long run. The company has a sustainable advantage against the smaller offline competitors, but the larger general retailers have

a very similar cost structure. While Coastal Contacts may be able to win market share from smaller, weaker competitors, this is likely not to continue in the long run as the company must eventually compete against larger competitors to continue growing.

The sustainability of Coastal Contacts advantage against its online competitors is even less likely. As online eyeglass retailers grow their sales and associated databases, Coastal Contacts' database of contact lens customers will become less of a factor.

The company's current cost advantages should be considered unsustainable in the future.

## **4.2.2 Selection Advantage**

### **4.2.2.1 Offline**

Coastal Contacts has a competitive advantage against offline retailers due to the size of the frame collection the company can carry. Offline retailers are limited by the confines of their store. Most retail stores will have between a few hundred and a thousand frames available for purchase. Coastal Contacts as of April 2011 has over 1500 frames on its website available for purchase. The company is focused on steadily increasing selection by adding between 50 and 100 frames to the website per week. With a larger selection customers are more likely to find a product that suits their style face shape and budget. The e-commerce business model allows Coastal Contacts to carry a larger selection of products than offline retail, and therefore be more likely to have a pair of eyeglasses that customers are interested in purchasing. The challenge for Coastal Contacts and other online eyeglass retailers is providing customers the tools to easily narrow down their choice from 1500 frames to a small number of frames that meet the needs of an individual consumer.

### **4.2.2.2 Online**

Coastal Contacts has a competitive advantage against other online retailers with the selection of products it sells. Most online retailers either sell branded product at regular retail prices, or they sell unbranded products at discount prices. Coastal Contacts sells a combination of branded products as well as private label brands, both at discount prices.

The company purchases branded product through a diverse network of suppliers the purchasing department has found and developed business relationships with. These branded products are very difficult to find and obtain, making this network of suppliers a competitive differentiator. Those online retailers who do have access to branded product are purchasing



directly from the brands themselves at higher prices and with limitations on the retail prices they can charge.

Coastal Contacts has also developed a number of private label brands that it retails alongside the designer brand products. These private label products are designed in-house and sourced from contract manufacturers in China. By creating its own brands and merchandizing these products together with well known designer brands, Coastal Contacts is able to demand higher prices for its house brands compared to the unbranded product sold by other online retailers. These higher prices can be seen by comparing Coastal Contacts house brands against the unbranded products from its key competitors<sup>36</sup>.

#### **4.2.2.3 Sustainability**

Based on the physical and economic characteristics of e-commerce compared to traditional offline retail, online retailers will always have the opportunity to create a selection advantage. Offline retailers are limited by the space in their stores, while online retailers have an unlimited amount of “virtual space”. Selection is therefore a sustainable advantage against offline competitors.

Coastal Contacts purchases products from a global network of eyeglass suppliers. This network has taken a long time to develop since the products Coastal Contacts is sourcing are difficult to obtain. In the long run, mimicking the supply of branded products is possible so selection is not a sustainable advantage against online competitors.

#### **4.2.3 Convenience Advantage**

##### **4.2.3.1 Offline**

Coastal Contacts has a competitive advantage against offline retailers where by customers can shop from home whenever they want. While the convenience of shopping from home and having your order delivered to your door is not unique to Coastal Contacts, it is a differentiator against the competitors who accounted for 98% of the market share in 2008 which was offline<sup>37</sup>.

Speed is another competitive differentiator. Coastal Contacts’ optical lab is a highly automated manufacturing facility, the most technically advanced in North America. This on

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<sup>36</sup> Author, 2011

<sup>37</sup> Packaged Facts, 2009, p:11

premise lab cuts down on manufacturing time and eliminates the need to outsource production, removing the time associated with shipping products back and forth between optical lab and retailer. After an order is placed lenses are pulled from stock, cut and assembled with frames on site, and then shipped often the next day after the order was taken. While a few large chain and general retailers have backwards integrated into the optical lab business and stock their own frames, they are still not able to have this facility on premise with their stores, adding additional transportation time to their process.

#### **4.2.3.2 Online**

Coastal Contacts has a competitive advantage over other online competitors because its lab and warehouse facility is located in North America. This allows for a shorter delivery time to customers than is possible from China, where key online competitors such as ZenniOptical.com and EyeBuyDirect.com are located.

There are other large online competitors located in North America (FramesDirect.com and BestBuyEyeglasses.com). These competitors however do not have their own optical labs. Delays are created because manufacturing must be coordinated with third party optical labs in offsite locations.

Coastal Contacts also stocks all of the products that it sells which improves delivery time and removes problems associated with products being out of stock. FramesDirect.com and BestBuyEyeglasses.com do not stock their own products, which creates long delivery times and a frequent problem with frames being unavailable after a customer has already made a purchase.

Finally Coastal Contacts tries to remove risk and improve service and convenience by offering a very generous returns and exchanges policy. Customers can return or exchange a product up to 365 days after the initial purchase. The company will pay for return shipping or in the case of an exchange, pay for shipping both ways. No online competitor is currently offering this level of service.

#### **4.2.3.3 Sustainability**

Coastal Contacts convenience advantage is not sustainable against its offline competitors. While the ability to shop from home is not something that offline retailers can currently do, it is not unique to Coastal Contacts, so an offline retailer could open an e-commerce store and remove any competitive advantage. Similarly, the speed advantage is replicable in the long term. Some

retail chains currently have small optical labs onsite. These labs could become more sophisticated in the future, allowing for all orders to be processed on premise while the customer waits.

Similarly, Coastal Contacts does not have a sustainable advantage with convenience compared to the company's offline competitors. Competitors can put strategies in place to remove any speed benefit Coastal Contacts currently enjoys, and policies can easily be adjusted to remove purchase risk and improve customer service.

Coastal Contacts does not have a sustainable advantage with convenience.

## **4.3 Current Strategies**

### **4.3.1 Corporate Strategy**

Coastal Contacts corporate strategy is designed to take advantage of a number of scale economies and scope economies to put the company in a cost leadership position.

#### **4.3.1.1 Scale Economies**

The larger Coastal Contacts grows the lower both its average fixed cost and average variable cost per unit.

Lower fixed cost per unit is achieved through the better resource utilization that comes with higher sales volume. As Coastal Contacts increases its daily sales, fixed or sticky costs like warehouse space, auditing services or website hosting remain the same or relatively similar. Therefore as the company's sales increase these costs can be spread over a larger number of orders reducing average fixed cost per order.

Variable cost per unit is made possible through volume discounts from purchasing large quantities of inputs such as frames and lenses. These volume discounts reduce the Coastal Contacts' variable cost per unit further and further as the company grows.

#### **4.3.1.2 Scope Economies**

Coastal Contacts is able to take advantage of scope economies by leveraging its existing contact lens business. This existing database of two million customers in the US allows the company to reduce its acquisition costs by cross selling eyeglasses to these existing contact lens customers. Rather than paying for expensive untargeted media (41% of the population do not wear eyeglasses), Coastal Contacts can use email marketing and target eyeglass offers to a group

of customers who require vision correction and have done business with the company in the past. This brings down the average cost per acquisition and total marketing cost for the company.

Coastal Contacts also takes advantage of scope economies by vertically integrating into the wholesale and optical lab portion of the industry value chain. The company is able to reduce delivery times by keeping inventory of all the products it sells on site, and by running its own optical lab co-located with its distribution centre. This improved delivery time increases customer convenience and willingness-to-pay. Quantifying this, Coastal Contacts' customers receive their eyeglasses in the US four to six days after they place their order. ZenniOptical.com and Eyebuydirect.com both take between 10 to 12 days where FramesDirect.com and BestBuyEyeglasses.com both take between 12 to 14 days<sup>38</sup>.

### **4.3.2 Business Strategy**

#### **4.3.2.1 Target Market**

The goal for Coastal Contacts in the US is to become the online category leader for retail optical. This end goal requires acceptance by the mass market. With 59% of the US population requiring eyeglasses, the addressable market is very large and a suitable niche is necessary if the company is to be successful. Coastal Contacts does not have the resources necessary to try to address the entire US market immediately. The company must focus its efforts and gain momentum with a specific target market. The benefits of timeliness and frequency in marketing communications can be realized, and the company is better positioned to take advantage of positive recommendations and word-of-mouth.

The eyeglasses market can be separated into online and offline consumers. Online consumers are those people who are currently willing to purchase eyeglasses online or have already done so. Survey data gathered in 2009 by the Vision Council shows that 3.2% of eyeglass purchasers had made their last purchase online<sup>39</sup>. This means that 96.8% of purchases were made offline through traditional retail channels. This shows that the customer segment that is currently purchasing offline is 30.25 times larger than the online purchaser customer segment. A much larger opportunity exists with moving offline buyers online rather than to only focus on existing online purchasers. In the same survey, buyers were asked if they would possibly or probably purchase their next eyeglasses online. 3.8% replied yes. This represents an 18.75% increase over

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<sup>38</sup> Coastal Contacts Inc., 2011

<sup>39</sup> The Vision Council, 2009, p:58

the current number, and shows that there will likely be more migration of customers from offline retail channels towards online. This supports the strategy of focusing on this larger offline purchaser customer segment.

The specific demographic of the offline target market that Coastal Contacts is focused on are: 25-40 year old females, who live in the north east United States, are above average income, college educated, fashion conscious and medium to heavy social media users. Coastal Contacts believes this target market has a higher propensity to purchase. **25-40 females** who are **fashion conscious** will be more likely to purchase eyeglasses for fashion, and purchase multiple pairs. This group is also more likely to purchase for a child. Americans in the **north east US** are more likely to defect from the offline channel and try purchasing eyeglasses online (see Appendix 15). **College educated** Americans are more likely to be higher income and are more likely to make purchases online (see Appendix 12). Finally, social media enhances peoples' ability to communicate amongst their network of friends, family and acquaintances. This enhanced ability to communicate facilitates the possibility for referrals and testimonials. Coastal Contacts is interested in targeting this group of customers with the goal of benefiting from positive word-of-mouth. Through measurable results from geographic, demographic and behavioural targeted advertising Coastal Contacts will continue to validate and refine its optimal target market.

#### **4.3.2.2 Positioning**

Coastal Contacts uses its competitive advantages when positioning itself in the market. The company focuses on delivered value, (through low prices made possible by cost leadership), selection and convenience.

The company is able to provide customers with more value than many offline retailers by providing designer brands and house brand products at significantly lower prices than are available offline. Coastal Contacts is able to provide more value compared to online retailers by providing a combination of low priced designer brands and much faster delivery times.

Coastal Contacts uses its superior selection to differentiate itself against offline retail. The company has over 1,500 styles to choose from, which is far greater than what would be available from a traditional retailer. Coastal Contacts uses selection as a differentiator against online retailers by selling branded products. Online retailers are either limited to un-branded products (ZenniOptical.com, EyeBuyDirect.com) or they have chosen the strategy of carrying branded products but at regular retail prices (FramesDirect.com, BestBuyEyeglasses.com).

Coastal Contacts in contrast is the only company that combines these two strategies and sells both branded products as well as its own house brands at deeply discounted prices.

Coastal Contacts positions itself as a more convenient alternative to buying eyeglasses from traditional retail. The company uses the benefits of shopping from home, and no pushy sales staff as key benefits of buying online versus offline. Buying online however is an issue for many consumers because they cannot try on the eyeglasses. 42.1% of people surveyed said they did not purchase their last pair of eyeglasses online because they could not try them on.<sup>40</sup> Coastal Contacts positions its “Virtual Mirror” as a way for these potential customers to virtually try on eyeglasses from home when buying online. The Virtual Mirror allows customers to see how a pair of eyeglasses would look on them; by uploading a photo and then scaling the photo to the frame so that the sizing is accurate. When Coastal Contacts positions itself against other online competitors the company emphasizes the improved speed and convenience made possible from carrying all products in inventory, having a co-located optical lab and shipping from North America.

#### **4.3.2.3 Execution**

Coastal Contacts’ competitive advantage and the target market the company has chosen to pursue are designed to coordinate together. The combination of 25-40 year old female, above average income and fashion conscious creates a consumer who is interested both in shopping online and in designer brands. The company’s focus on selection plays towards what this group is looking for. As surveyed, the US north east is the most likely geographic area to defect from offline retail and to try to make their next eyeglass purchase online (see Appendix 15). Coastal Contacts uses targeted online advertising to specifically send relevant messages to this target group, and has seen results in advertising effectiveness that supports this. The company uses geographic targeting (north east), demographic targeting (female, 25-40, above average income) and behavioural targeting (online shopper). All of these targeting options are available through online ad networks which are the principal way that Coastal Contacts communicates its offering and positions itself to this target market.

Coastal Contacts also focuses its advertising efforts on social media platforms such as Facebook. By advertising within Facebook, Coastal Contacts is able to take advantage of the platforms sophisticated targeting capabilities which allow the company to a) specifically target the exact consumers it has identified as its target market, and b) target consumers who are

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<sup>40</sup> Vision Council, 2009, p:54

connected with friends and family through social media, reducing the barriers for positive word-of-mouth to be passed on. Coastal Contacts receives over 20% of its site traffic from Facebook.

## **5: Financial Performance Analysis**

### **5.1 Growth**

Coastal Contacts' global sales for contact lenses and eyeglasses have increased 89% over the past 5 years from \$81M CAD in 2006 to \$153M CAD in 2010. Sales growth as a year-over-year % increase was: 26% in 2007, 16% in 2008, 18% in 2009 and 10% in 2010 (see Appendix 20). For eyeglasses, the growth rate is much more impressive. 2009 year-over-year growth was 281% and 2010 year-over-year growth was 258% (see Appendix 1). All company financials included in the appendices are for Coastal Contacts Inc. and unless otherwise indicated include data for all geographic markets and for both contact lenses and eyeglasses.

### **5.2 Earnings**

The company's earnings have been much more variable than its revenue. When looking at net earnings over the last 5 years, the company lost money in both 2006 and 2008. More recently, in 2009 Coastal Contacts had net income of \$2.7M CAD and in 2010 net income of \$3.1M CAD<sup>41</sup>. This improved profitability has been due in part to the improved product margins available from the company's eyeglasses business. Year-over-year earnings growth for 2010 was 12.9% compared to 10% year-over-year revenue growth for the same period. This variance shows that the company is becoming more efficient in revenue generation, primarily due to the eyeglasses business. Coastal Contacts requires stability in earnings in order to secure additional financial backing. Creditors will require a history of stable and increasing earnings if they are going to be willing to lend to the company. Since scale is a key success factor for online retail, Coastal Contacts needs to ensure it maintains stable and increasing earnings in order to access the necessary capital to fuel the company's growth.

### **5.3 Shareholders Equity**

At the end of the 2010 financial year Coastal Contacts' shareholder equity sat at \$70.3M CAD. This was a 22.6% increase over the previous year, which can primarily be attributed to share price appreciation (see Appendix 24). Prior to this period shareholder equity had actually

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<sup>41</sup> Coastal Contacts Inc., 2010, p:15



fallen from \$68.1M CAD in 2006 down to \$57.3M CAD in 2009 (see Appendix 21). This was due to two factors, a slight decline in share price up to 2009 coupled with an aggressive share buy-back program over the entire period. The value of shares issued and outstanding has decreased from \$53.5M CAD in 2006 down to \$39.2M CAD in 2010, (see Appendix 21). While the Coastal Contacts may have felt during this time that the company's shares were undervalued and a buy-back was a sound investment, with the company's short term requirement for rapid growth it may have made more sense to have invested funds into marketing programs that could help accelerate growth of the eyeglasses side of the business.

## **5.4 Cash Flow**

Cash flow improved for Coastal Contacts in 2010. The company ended the year with \$18.2M CAD in cash and cash equivalents, which were up from \$11.5M (CAD) the year previous. From 2006 to 2009 cash on hand had been on a downward trend from \$24.2M CAD down to \$11.5M CAD respectively (see Appendix 22). While the company's cash position was much stronger at the end of fiscal 2010, Coastal Contacts has since made additional investments into its call centre and optical lab to help support the growth of the eyeglasses business. These investments should put the company in a lower cash position at the end of fiscal 2011.

## **5.5 Financial Ratios**

Coastal Contacts five year financial performance can be analyzed using a number of financial ratios provided in Figure 4:

**FIGURE 4: Ratios and Earnings****Coastal Contacts Inc.  
(CAD \$000's)**

<b>Ratios</b>		<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Profitability</b>						
Return on Assets	(Net Income/Total Assets)	4.4%	4.8%	-1.4%	2.5%	-2.0%
Return on Capital	(Net Income/Total Liabilities)	9.1%	12.4%	-3.4%	8.8%	-8.0%
Return on Equity	(Net Income/Total Equity)	8.6%	7.8%	-2.3%	3.4%	-2.6%
<b>Margin</b>						
Gross Margin	(Gross Profit/Sales)	28.6%	30.6%	28.6%	27.1%	25.1%
EBITDA Margin	(EBITDA/Sales)	2.0%	2.9%	0.0%	2.5%	-0.5%
<b>Turnover</b>						
Fixed-Asset Turnover	(Sales/Property, Equipment)	27.6	49.7	39.1	37.8	29.2
Inventory Turnover	(Sales/Inventory)	6.2	6.2	8.9	8.7	5.0
<b>Credit and Bad Debt</b>						
Current Ratio	(Current Assets/Current Liabilities)	1.7	2.0	1.8	3.0	3.7
Liabilities/Assets	(Total Liabilities/Total Assets)	0.5	0.4	0.4	0.3	0.2
Quick Ratio	(Current Assets-Inventory/ Current Liabilities)	1.1	1.2	1.3	2.4	2.7
<b>Earnings</b>						
Earning		\$3,049	\$3,997	(\$9)	\$2,588	(\$385)
Shares		56,910,149	57,559,629	64,559,267	72,948,602	68,018,799
EPS		\$0.05	\$0.07	(\$0.00)	\$0.04	(\$0.01)

*(Source: Author, 2011)***5.5.1 Profitability**

Profitability at Coastal Contacts has been improving over the last five years. Return on assets and return on capital have both improved, which highlights that the investments the company has been making in eyeglasses have improved the business' profitability. Finally, return on equity has improved, but this is primarily due to the share buy-back program.

**5.5.2 Margin**

Gross margin has seen improvements over the last five years. The higher margin eyeglasses business has been a critical component of this improvement. EBITDA margin has remained relatively flat. This is due to the higher operating costs associated with running an eyeglasses optical lab which do not exist for contact lenses. Over time, the company should become more efficient in its operations as it achieves learning economies.

### **5.5.3 Turnover**

Fixed asset turnover was on the rise up until 2010 where it fell by 22.1%. This was due to increased investment into the eyeglasses business. This increased investment will continue into 2011, so similar or lower numbers can be anticipated. Inventory turnover has also fallen as the company builds up its inventory of frames and lenses. This inventory can be expected to increase in the coming years but likely at a slower pace.

### **5.5.4 Credit and Bad Debt**

The current ratio and quick ratio have both fallen over the last 5 years. This shows that Coastal Contacts is running its business more efficiently with less excess liquid assets on hand that could be better utilized working for the business. This also opens up the increased risk of becoming illiquid, and therefore cash flow becomes more important.

## **6: Summary and Assessment of Current Situation**

### **6.1 Industry**

#### **6.1.1 Current Environment**

Between 2005 and 2008 the US retail eyeglass industry growth rate averaged 8.6% annually. Since the recession growth has significantly declined and is forecast to have an average annual growth rate of -2.5% between 2009 and 2010, (see Figure 3). For 2010 the US eyeglass market was estimated to be \$15.2B USD.

In 2008 the strategic groups of independents, chains, general retailers and online had market shares of 64.2%, 25.9%, 7.9% and 2% respectively, (see Appendix 9). There has been a recent trend towards a shift in market share. Smaller independents are losing share to larger more sophisticated organizations. Between 2004 and 2008 independents lost an average of 3.1% in market share every year. Participants such as Costco and Walmart are expanding industry capacity and increasing rivalry, while online competitors are taking advantage of low barriers to entry, further increasing industry rivalry.

Obtaining market share data for the online channel is difficult, as it is normally not broken out in industry reports, instead included as “other”. This category contains both online and catalogue, but catalogue is currently not a growing or significant market so we can make the assumption that data for “other” is a strong directional representation of data for the online channel. In 2008, “other” made up 3.8% of industry revenue. In 2009, this increased 34% to 5.1% of industry revenue<sup>42</sup>. Based on this data we can make a relatively safe assumption that the internet channel is gaining market share quickly, however from a very small starting point.

Porter’s 5-Forces show that the degree of competition in the retail eyeglasses industry is increasing. There is a high degree of rivalry and low barriers to entry. Previously, even though the industry has had a large number of players, they were regionally based and competition was constrained by location and barriers-to-entry. More recently, with increased capacity brought on by the rapid expansion from general retailers, national chains and online stores, the level of competition has heightened. Even with this heightened level of competition we can still say that

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<sup>42</sup> The Vision Council, 2009, p:88

the industry is attractive, it is just not attractive to everyone. For the traditional independent retailer, the industry is quickly becoming an unattractive place to be. As margins are compressed and strains are put on a highly inefficient business model, independents will find it very difficult to survive. For the large new entrants; their high capacity streamlined business models allow them to out price the smaller players. As they do, they are gaining market share to the detriment of the independents.

For online retailers the situation is even more rivalrous. Barriers to entry impact online retailer even more, since the current addressable market (those willing to buy eyeglasses online) is low and the potential entrants are numerous (no geographic limitations).

### **6.1.2 Most Likely Future Environment**

US retail market for eyeglasses is estimated to see moderate growth over the next three years. From 2011 to 2013 the industry is estimated to have an average annual growth rate of 3.2%, ending 2013 with total revenue of \$16.7B USD, (see Figure 3).

This paper estimates that the shift in market share from independents to other strategic groups will continue at a similar rate to what has been experienced over the past five years, (3.1% annually). The general retailers and online retailers who are both adding industry capacity may benefit the most from this market share reduction.

With increased competition due to low entry barriers to entry and increased industry rivalry (particularly online where geographic differentiation does not exist) the retail eyeglasses industry will become a less attractive market, particularly for incumbents. General retailers' growth into optical is unlikely to falter. Optical provides a high margin opportunity for these retailers and the set-up cost to roll out these store-within-a-store concepts is minimal. With lower prices and loyal customers, these large general retailers should continue to take market share from the independents that are being forced to reduce prices as consumers' willingness-to-pay falls.

Online retailers will compete against offline by using price. The willingness of consumers to purchase eyeglasses online will limit the growth of this channel, putting further downward pressure on price. Online retailers who purely focus on being a low cost provider will be limited to this much smaller addressable market (3.8%)<sup>43</sup>. Those online retailers who are able to increase consumers' willingness to pay by differentiating their offer to provide customers with more value will be better positioned to retain margins and fund the growth of their businesses.

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<sup>43</sup> Author, 2011

Differentiation from offline will primarily occur as improved frame selection and improved convenience. The convenience of online shopping versus offline shopping will be a key benefit for e-commerce companies. Improvements to the pre-sales process and post-sales process will also be important for maximizing customer convenience.

## **Coastal Contacts**

### **6.1.3 Current Position**

Coastal Contacts current market share can be estimated by comparing the company's eyeglass revenue to that of the whole industry and of the online strategic group. In 2010 Coastal Contacts had eyeglass revenue in the US of \$3.6M USD. Total revenue for that same period is estimated at \$15.2B which puts Coastal Contacts 2010 revenues of \$3.6M at 0.02% of industry market share<sup>44</sup>.

If we assume that market share for online grew at the same rate for 2010 as it grew from 2009 (34%<sup>45</sup>) and we assume that online accounts for half of the "other" category (2.55% in 2009), then online would account for 3.4% of market share or \$518M. This would put Coastal Contacts at 0.7% of online market share in the US for 2010.

For Coastal Contacts there is a link between current performance and future profitability. In e-commerce the market migrates towards the industry leader. A first mover advantage is therefore very important as is building a strong brand and reputation. By increasing the number of buyers today, Coastal Contacts will increase its brand strength and its customer base which can both be leveraged for future profits. Coastal Contacts main problem therefore is to quickly gain market share. The largest opportunity to win market share is to focus on offline retail since this group accounts for over 96% of total industry market share. By attempting to move the larger offline group online for their next eyeglass purchase, Coastal Contacts will be targeting a much larger market, opening up the potential for greater market share gains.

In order to effectively move customers from offline to online, Coastal Contacts must address the needs of these customers and provide them with greater value than they are already getting when they purchase eyeglasses from an offline retailer. These pragmatic customers are open to the idea of purchasing eyeglasses online, they just have a lower willingness-to-pay and they need some basic barriers to purchase addressed, such as the inability to try glasses on when

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<sup>44</sup> Author, 2011

<sup>45</sup> The Vision Council, 2009, p:88

purchasing online. To convert these customers to online buyers Coastal Contacts must use its competitive advantages in cost leadership and differentiation.

Coastal Contacts has a competitive advantage against offline rivals with its cost leadership strategy. The company's size allows it to more efficiently utilize fixed cost and "lumpy" indivisible costs associated with administrative support areas such as accounting and human resources, as well as software and system costs. Coastal Contacts also has lower average fixed costs associated with warehousing and purchasing. The larger these costs get the lower their per-unit cost, which reduces average fixed costs. Finally, the company's size benefits its cost leadership strategy through the law of large numbers. Coastal Contacts is able to carry a wider range of products at a lower carrying cost do to higher and more predictable inventory turns. While the company's cost advantages exist against all but the largest offline retailers, when compared against other online competitors this advantage disappears as many online retailers are able to obtain the same cost advantages.

Coastal Contacts differentiates itself against offline retail by providing a wider selection of products. With a single centralized inventory instead of numerous retail store inventories which are limited by store size, Coastal Contacts is able to differentiate itself from offline retailers by carrying a much larger selection of products. Larger product selection is only effective as a differentiator when comparing against offline retailers, however, since most online retailers also carry a large selection of products.

Finally, Coastal Contacts differentiates itself from offline competitors by providing the convenience of shopping from home and having your order directly shipped to you, and the convenience of shopping when you want.. Coastal Contacts shares these differentiators with its online competitors however. The company is currently able to differentiate itself from its online competitors by providing more convenience in its speed of service. Coastal Contacts high volume on-premise optical lab and North American location allow the company to substantially reduce the time between when a customer places an order and when they receive their product. For Coastal Contacts this delivery time is approximately 4-6 days where the company's main competitors all require nearly twice this amount of time. While customers may not choose a retailer based on their delivery time, this speed of service does improve the overall customer satisfaction, which increases the likelihood of positive referrals and return customers.

#### **6.1.4 Most Likely and Desired Future Positions**

With Coastal Contacts desire to quickly grow market share, the company must convince offline customers to make their next purchase online. In order to do this the company must become a trusted and well recognized brand name and the industry leader for online retail, and it also must remove the existing barriers to purchase by simplifying the order process and making buying online more convenient for customers. Assuming online retail follows a similar pattern of concentration to offline retail for eyeglasses, the top 5 retailers should account for approximately 30% of sales<sup>46</sup>. The top retailer should account for approximately one half of this or 15%. Using the estimated market growth rate for eyeglasses, (see Figure 3) and the current estimate for online sales (\$518M in 2010), if Coastal Contacts were to have 15% of the online market share it would have an annual revenue of \$85M by 2013.

While industry rivalry will increase, Coastal Contacts' profitability should not be negatively impacted by this shift. If the company is successful in being the leader at making consumers more comfortable with the idea of buying eyeglasses online, it should be able to capture more offline market share at a faster rate than its online rivals. Online rivalry will increase with new entrants into the category and existing entrants trying to imitate Coastal Contacts strategy. Since differentiating with convenience is not sustainable, the company will need to heavily invest in advertising to grow quickly and secure its position as the industry leader.

## **6.2 Summary and Direction**

In summary, Coastal Contacts' goal is to maximize shareholder value. To do this the company focuses on profit margin and market share. Market share is seen as being of particular value since future profits are believed to be directly related to the company's current rate of growth. By building a large loyal customer base Coastal Contacts will be able to benefit from scale and reputation economies that will allow it to have a real long term sustainable advantage.

The best option for Coastal Contacts' is to quickly convince customers who would normally make their eyeglass purchases offline to instead make them online. It must convince these customers that purchasing online is not only possible but it is a better alternative, providing more value. To be successful at this Coastal Contacts must focus on a strategy that speaks to the needs of these customers and facilitates their migration to online.

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<sup>46</sup> Author, 2011



Coastal Contacts' cost advantage and large selection are not unique, they can be imitated and are unlikely to convince customers to purchase online who until now have chosen not to because of barriers to purchase. When looking at survey data, the main barrier to purchase is the inability to try on eyeglass (42.1%)<sup>47</sup>. Therefore the best alternative for Coastal Contacts is to focus on removing the complexities of purchasing eyeglasses online and to come up with a way to satisfy the desire to try on eyeglasses before they are purchased.

### **6.3 Analyzing Alternatives**

The remainder of the paper looks at alternatives to improve the convenience of ordering eyeglasses online. In order to properly compare these alternatives we will use two evaluation criteria: market share and profit margin. These two criteria will be used because they act as proxies for shareholder value, since future profitability is directly tied to market share growth, and market share growth can increase profits only if sufficient profit margins are maintained. The net result of maximizing these two criteria is to maximize shareholder value which is the corporate goal of Coastal Contacts.

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<sup>47</sup> The Vision Council, 2009, p:54

## **7: Solution Analysis**

### **7.1 Goals for Evaluating Alternatives**

Coastal Contacts' ultimate goal is to maximize shareholder value. Maximizing shareholder value occurs when the company maximizes profits today and in the future. Maximizing profits today means maximizing the product of profit margins and sales. For Coastal Contacts there is a relationship between current sales and future profits. By maximizing current sales, the company will develop reputation and scale economies. These economies will benefit Coastal Contacts, allowing the company to demand higher profit margins in the future. Therefore maximizing profits in the future also means maximizing the product of current profit margin and market share (since sales equal the product of market size and Coastal Contacts' share of market). For retail optical, the size of the market is increasing but cannot be directly impacted by Coastal Contacts. This means to maximize current and future profits future, the company must maximize profit margins and market share.

### **7.2 Alternatives**

In chapter 6 the paper identified that improving the convenience of buying online was the best strategy for improving market share. Three separate alternatives for improving convenience are now presented. These alternatives vary in their ability to improve convenience and maximize profit margins. While all these options could be undertaken simultaneously, Coastal Contacts has limited managerial and financial resources. Realistically, it can only pursue one of these at a time.

#### **7.2.1 Marketing**

The first alternative is for Coastal Contacts to invest in marketing and sell the convenience of online. The company would refocus its communications strategy around why people should consider buying their next pair of eyeglasses online rather than offline. This strategy would emphasize the convenience of buying online, such as the flexibility to place an order at anytime from the comfort of your own home.

### **7.2.2 Pre-Sale**

The second alternative is for Coastal Contacts is to invest in the pre-sales process and improve how customers order eyeglasses online. This involves making it easier for customers to choose a frame that suits them, choose a lens that is appropriate for their needs and their prescription, enter their prescription correctly and complete their order. The pre-sales process can be improved through a number of enhancements both technical and human. Applications can be created to help guide a customer through the purchase process. Human interaction can also be added to the purchase process through real time text and video chat with live customer service agents.

### **7.2.3 Post-Sale**

A third alternative is for Coastal Contacts to invest in improvements to the post-sale experience when ordering eyeglasses online. The company can improve convenience through speed of delivery, and post-sale service. Speed can be improved in two ways. The company's optical lab can be increased in size to better manage sales peaks and machinery downtime, or a new manufacturing and logistics facility could be located closer to logistics hubs for UPS or FedEx, which are located in Louisville, Kentucky and Memphis Tennessee respectively. This would remove a full day from delivery times. Post-sale service can be improved by increasing call centre staffing to reduce wait times, increasing staff training and promoting the company's customer friendly return and exchange policies.

## **7.3 Scenarios**

In order to determine which alternative best maximizes shareholder value, the three alternatives are compared using the evaluation criteria: profit margin and market share. To account for possible industry dynamics, this comparison is done using three possible scenarios: best case, worst case and most likely. The three scenarios are then weighted and a final score is provided for each alternative.

### **7.3.1 Best Case**

The "best case" is defined as what would be the ideal scenario for an online eyeglass retailer. In the best case scenario, online rivalry decreases and online market share increases. The retail eyeglass industry is increasing in rivalry but under the best case scenario it has only a minimal impact on profits for the online strategic group. Customers move online to make

purchases at a faster rate than the introduction of new online competitors. This increases the market share available to the online strategic group.

### **7.3.2 Worst Case**

In the worst case scenario online rivalry stays high and online market share remains unchanged. In this scenario customer adoption of the online channel stagnates. The idea that you can purchase eyeglasses online is never accepted by mainstream consumers. Increased industry rivalry leads to severe price competition and a fall in profit margins. New entry by e-commerce competitors increases competition for the online strategic group. This increased competition further divides up the online market share among more competitors.

### **7.3.3 Likely**

In the likely scenario online rivalry increases and online market share increases. As industry rivalry increases so does online rivalry, reducing profit margins for the online strategic group. Customers adopt the online channel as a feasible option for purchasing eyeglasses. Rivalry among online competitors increases, but at a rate that is slower than online adoption. Available market share for the online strategic group increases, however profit margins are lower due to the overall increase in industry rivalry.

## **7.4 Evaluation**

The three alternatives are evaluated on their ability to improve market share and profit margins. A weighted evaluation is used by assigning a value of 0.6 to market share and 0.4 to profit margin. These weightings are used to provide a higher level of value to future profits, which as discussed in Section 7.1 are determined in large part by current market share.

### **7.4.1 Best Case**

In the best case scenario, the alternative that focuses on the convenience of the pre-sales process scores the highest with 3.0 while the other two alternatives receive a similar score of 2.6.

Investing in marketing is very effective at increasing market share. In this scenario, customers are increasingly willing to migrate to the online channel for their next eyeglass purchase. The higher brand awareness (from advertising) compared to its online competitors ensures that Coastal Contacts is successful at capturing a disproportionate amount of the new

sales migrating to the online strategic group. Profit margin is good in this scenario, but not great since it is required to pay for the large advertising campaign necessary to increase awareness.

The pre-sale alternative is also very effective at improving market share. As more customers look online for their next eyeglass purchase, website traffic increases. With a simplified pre-sale purchase process the website conversion rate is improved. With higher store traffic and a higher conversion rate market share increases. Profit margin also performs well in this scenario since the company is not making the same sort of large investments required for a major advertising campaign.

The post-sale alternative increases market share through excellent customer experiences and positive word-of-mouth. In the best case scenario the addressable market is growing which creates the possibility for referrals and positive word-of-mouth to travel quickly and to a large number of potential new customers. Profit margin is not as high as for the pre-sale alternative, since there are larger capital costs associated with improving the post-sale experience such as a larger call centre and a larger or completely new optical lab and distribution facility.

**FIGURE 5: Best Case Scenario**

	Rating		
	Poor	Good	Great
<b>Marketing</b>			
Market Share (0.6)			3
Profit Margin (0.4)		2	
<b>TOTAL</b>	<b>2.6</b>		
<b>Pre-Sale</b>			
Market Share (0.6)			3
Profit Margin (0.4)			3
<b>TOTAL</b>	<b>3.0</b>		
<b>Post-Sale</b>			
Market Share (0.6)			3
Profit Margin (0.4)		2	
<b>TOTAL</b>	<b>2.6</b>		

*(Source: Author, 2011)*

#### 7.4.2 Worst Case

In the worst case scenario, the marketing and post-sale alternatives score the highest each with a rating of 1.6. The pre-sale alternative receives a score of 1.4.

Dollars invested into advertising are not as effective at increasing market share in the worst case scenario. The mainstream market remains unwilling to purchase eyeglasses online, and promoting the convenience of buying eyeglasses online is poorly received. The increased brand

awareness does provide some positive impact for the small number of customers who already had been willing to purchase eyeglasses online. Profit margin is hit hard since Coastal Contacts increased advertising spend fails to deliver the results necessary for a positive return on investment (ROI).

Investing in the pre-sale process in the worst case scenario does little to improve market share. New customers are unwilling to purchase online and existing customers have already figured out how to do so. Profit margin is impacted less than the marketing alternative since there is a lower level of investment required.

The post-sale alternative is only effective at improving market share among the existing group of customers who are already willing to purchase their eyeglasses online. Improvements in the post-sale process positively impacts customer loyalty. Coastal Contacts is able to retain more of its existing customers and win customers away from other online retailers through improved after sale service. Profit margin for this alternative is poor since the company must make large investments in its call centre and optical lab in order to deliver a higher level of post-sale convenience.

**FIGURE 6: Worst Case Scenario**

	Rating		
	Poor	Good	Great
<b>Marketing</b>			
Market Share (0.6)		2	
Profit Margin (0.4)	1		
<b>TOTAL</b>	<b>1.6</b>		
<b>Pre-Sale</b>			
Market Share (0.6)	1		
Profit Margin (0.4)		2	
<b>TOTAL</b>	<b>1.4</b>		
<b>Post-Sale</b>			
Market Share (0.6)		2	
Profit Margin (0.4)	1		
<b>TOTAL</b>	<b>1.6</b>		

*(Source: Author, 2011)*

### 7.4.3 Likely

In the likely scenario, the pre-sale alternative has the highest rating of 2.6 followed by the marketing alternative and the post-sale alternative both with 2.2.

The marketing alternative is effective at capturing market share through increasing brand awareness and by emphasizing the convenience of ordering online. As market share migrates

online, Coastal Contacts becomes the natural alternative for customers who are new to the channel. Profit margins are poor for this alternative since increased industry rivalry creates price competition, reducing industry profit margins.

The pre-sale alternative is effective at capturing market share from new customers migrating to the online channel. Similar to the best case scenario, as customers accept online as a viable purchase option, website traffic increases for Coastal Contacts. The company’s simplified sales process improves its website conversion rate, improving market share. In the likely scenario rivalry is higher, so Coastal Contacts profit margin is decreased as more companies compete on price.

The post-sale alternative under the likely scenario acts similar to the marketing alternative. With the opportunity to gain market share from the online channels, a post sale approach to convenience improves the customer experience, loyalty and positive word of mouth, all leading to an increase in market share. The high degree of rivalry under the likely scenario means that the profit margins are lower, particularly when factoring in the high capital costs associated with the post-sale alternative.

**FIGURE 7: Likely Scenario**

	Rating		
	Poor	Good	Great
<b>Marketing</b>			
Market Share (0.6)			3
Profit Margin (0.4)	1		
<b>TOTAL</b>	<b>2.2</b>		
<b>Pre-Sale</b>			
Market Share (0.6)			3
Profit Margin (0.4)		2	
<b>TOTAL</b>	<b>2.6</b>		
<b>Post-Sale</b>			
Market Share (0.6)			3
Profit Margin (0.4)	1		
<b>TOTAL</b>	<b>2.2</b>		

*(Source: Author, 2011)*

#### 7.4.4 Probability Weighted Total

Taking all three scenarios into account creates a total rating for each alternative. Subjective probabilities are applied to each scenario based on the author’s degree of confidence in the forecasts of the future external environment.. The most likely scenario is given a probability of 50%; the best case 30% and the worst case 20%.

Using these probability weights, the final ratings for the three alternatives are shown in Figure 8:

**FIGURE 8: Probability Weighted Total**

	Rating		
	Best (0.3)	Worst (0.2)	Likely (0.5)
<b>Marketing</b>			
Scenario's	2.6	1.6	2.2
<b>TOTAL</b>	<b>2.2</b>		
<b>Pre-Sale</b>			
Scenario's	3.0	1.4	2.6
<b>TOTAL</b>	<b>2.5</b>		
<b>Post-Sale</b>			
Scenario's	2.6	1.6	2.2
<b>TOTAL</b>	<b>2.2</b>		

(Source: Author, 2011)



## **8: Recommendations and Conclusion**

### **8.1 Recommendations**

Based on the above analysis, Coastal Contacts will be most likely to maximize its market share and profit margin and thus its shareholder value by focusing its limited resources on improvements to its pre-sale process. By improving the convenience of shopping online and simplifying the process of choosing a frame, selecting a lens and properly entering a prescription, Coastal Contacts will be more likely to meet the needs of new potential customers and grow quickly and profitably in the US retail eyeglasses market.

### **8.2 Conclusion**

Coastal Contacts is well positioned to take advantage of a potential shift in market share in the US retail eyeglasses market. If mainstream customers begin to purchase eyeglasses online Coastal Contacts must be in a market leading position to fully take advantage of this opportunity. By focusing on the pre-sale process and improving the convenience of shopping for eyeglasses online Coastal Contacts will be in an excellent position to take the position as market leader in online retail optical in the US.

## **Appendices**

## Appendix 1

Total Revenue by Product Category - Annual						
		Accessories	Contacts	Eyeglasses	Sunglasses	TOTAL
2010						
Total Revenue	\$	153,166	\$ 133,507,834	\$ 19,351,834	\$ 153,166	\$ 153,166,000
% of Total		0.1%	87.2%	12.6%	0.1%	100.0%
Gross Profit	\$	43,776	\$ 36,003,224	\$ 7,685,224	\$ 43,776	\$ 43,776,000
% of Total		0.1%	82.2%	17.6%	0.1%	100.0%

Source: Coastal Contacts Inc., 2011

## Appendix 2

US Revenue by Product Category - Annual						
		Accessories	Contacts	Eyeglasses	Sunglasses	TOTAL
2009						
Total Revenue	\$	12,181	\$ 17,614,158	\$ 1,723,667	\$ 38,870	\$ 19,435,000
% of Total		0.3%	90.6%	8.9%	0.2%	100.0%
2010						
Total Revenue	\$	54,824	\$ 23,738,792	\$ 3,590,972	\$ 27,412	\$ 27,412,000
% of Total		0.2%	86.6%	13.1%	0.1%	100.0%

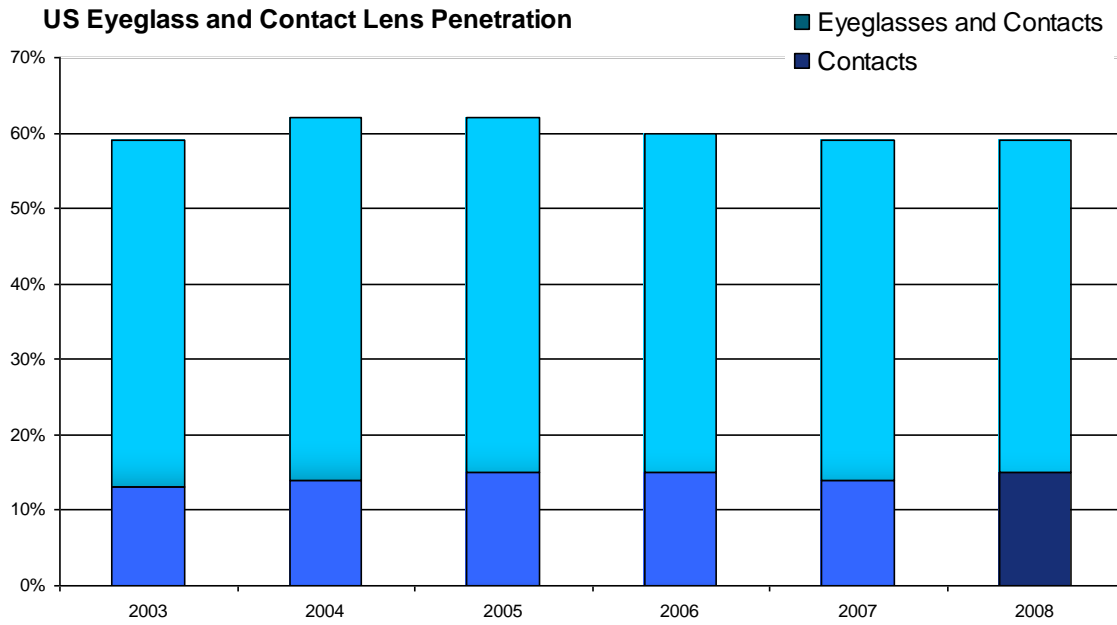
Source: Coastal Contacts Inc., 2011

## Appendix 3

US Revenue by Product Category - Quarterly						
		Accessories	Contacts	Eyeglasses	Sunglasses	TOTAL
Q4 2010						
Total Revenue	\$	12,072	\$ 5,094,517	\$ 917,496	\$ 12,072	\$ 6,036,158
% of Total		0.2%	84.4%	15.2%	0.2%	100.0%
Q1 2011						
Total Revenue	\$	12,181	\$ 5,158,739	\$ 1,100,591	\$ 5,921	\$ 6,277,432
% of Total		0.2%	82.2%	17.5%	0.1%	100.0%

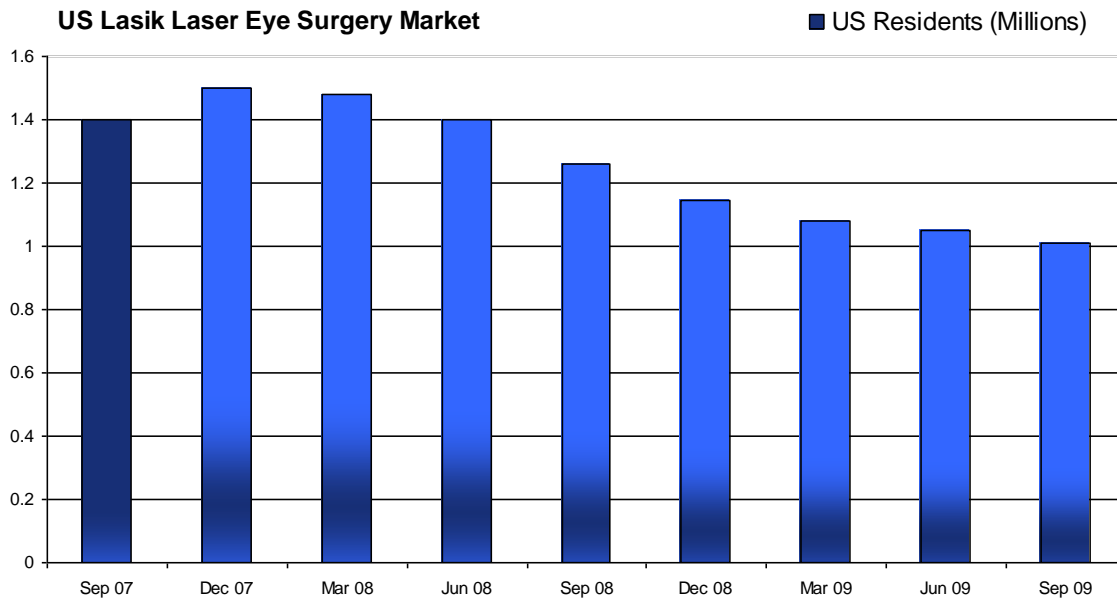
Source: Coastal Contacts Inc., 2011

## Appendix 4



Source: Packaged Facts, 2009

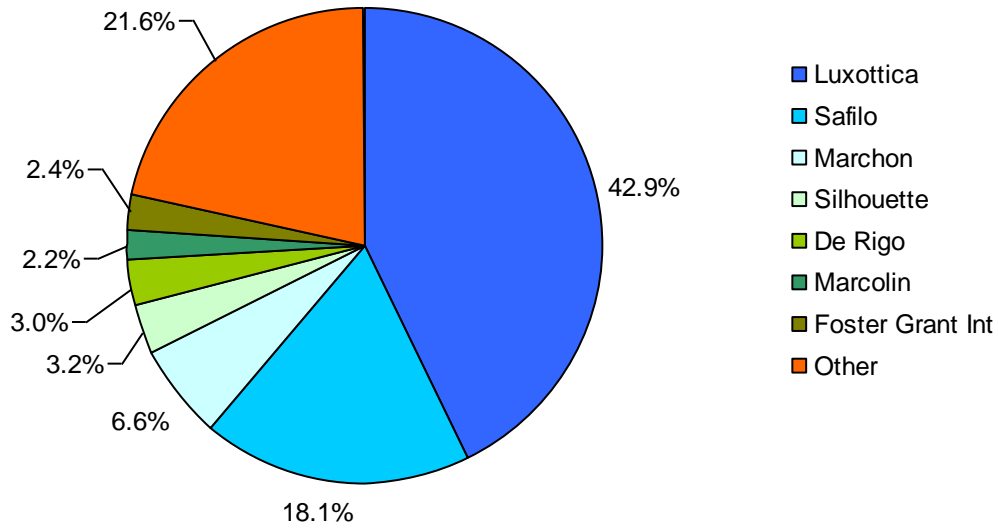
## Appendix 5



Source: The Vision Council, 2009

## Appendix 6

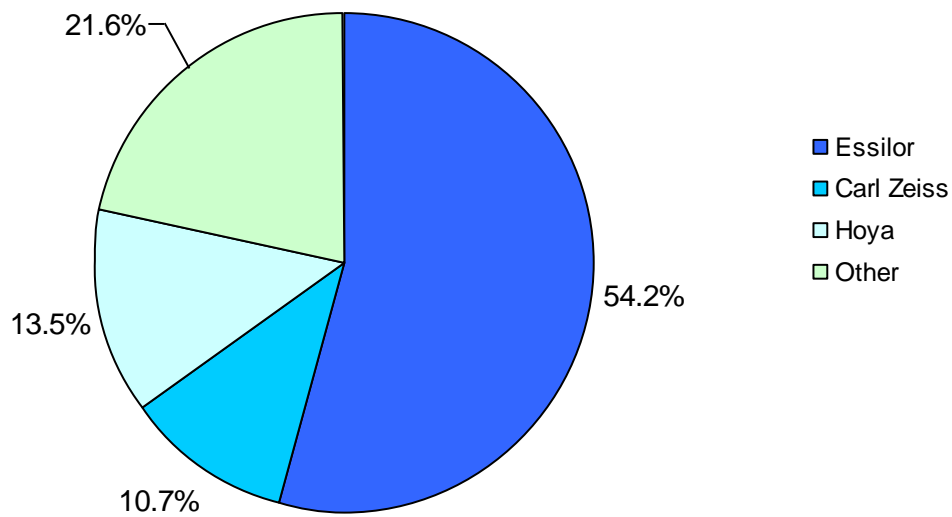
### International Frames Industry - 2008



Source: *Packaged Facts, 2009*

## Appendix 7

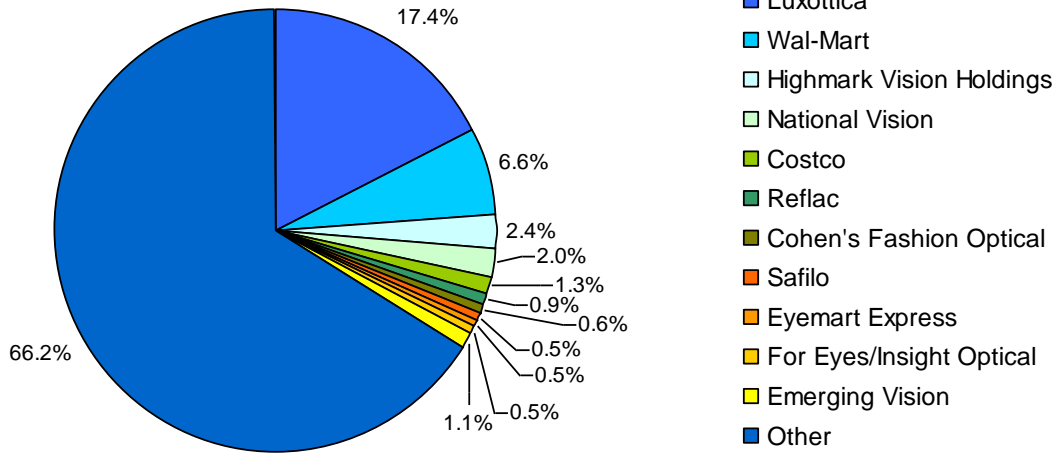
### International Lens Industry - 2008



Source: *Packaged Facts, 2009*

## Appendix 8

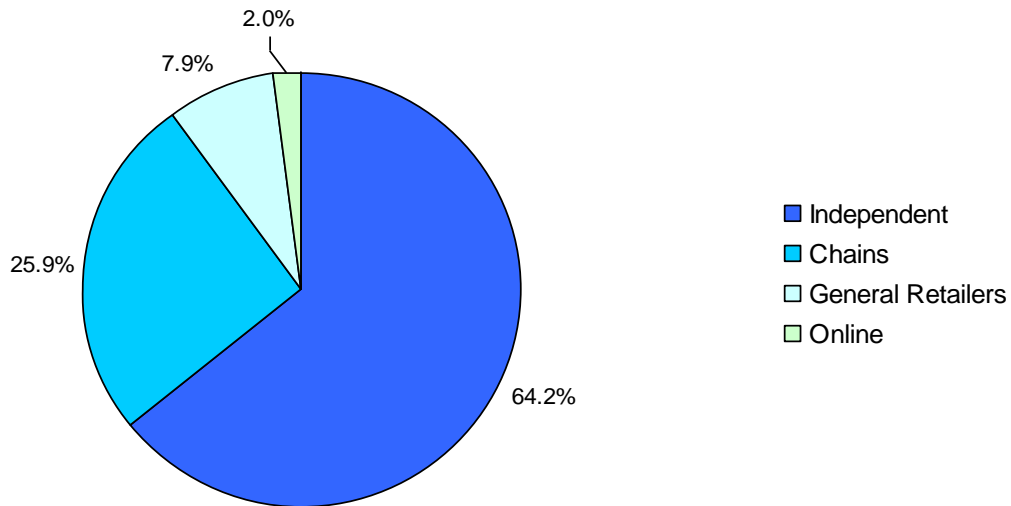
US Retail Optical Industry - 2008



Source: Packaged Facts, 2009

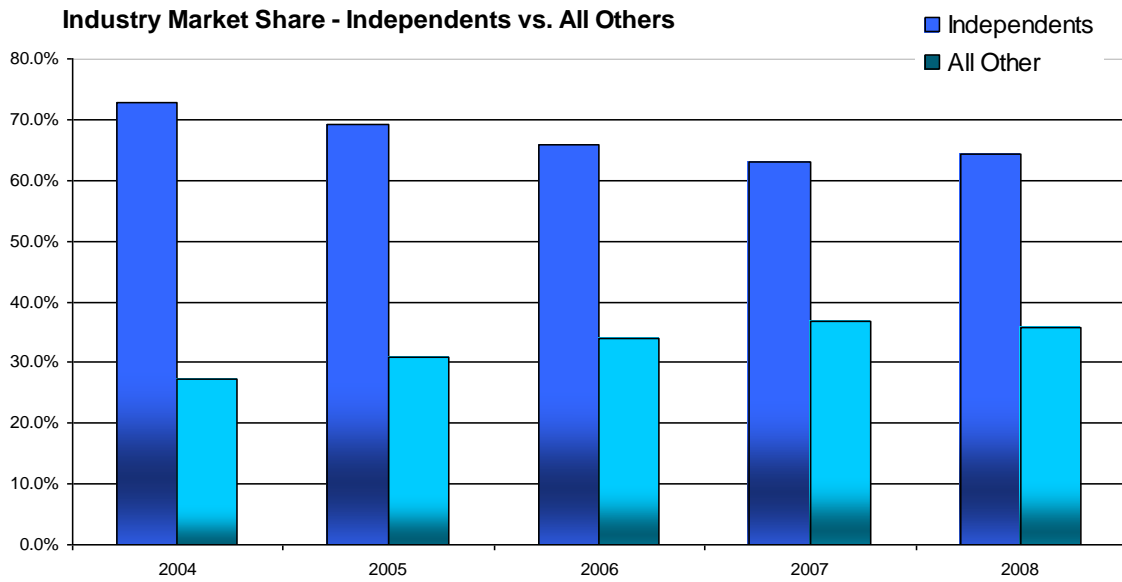
## Appendix 9

US Retail Optical Industry - 2008



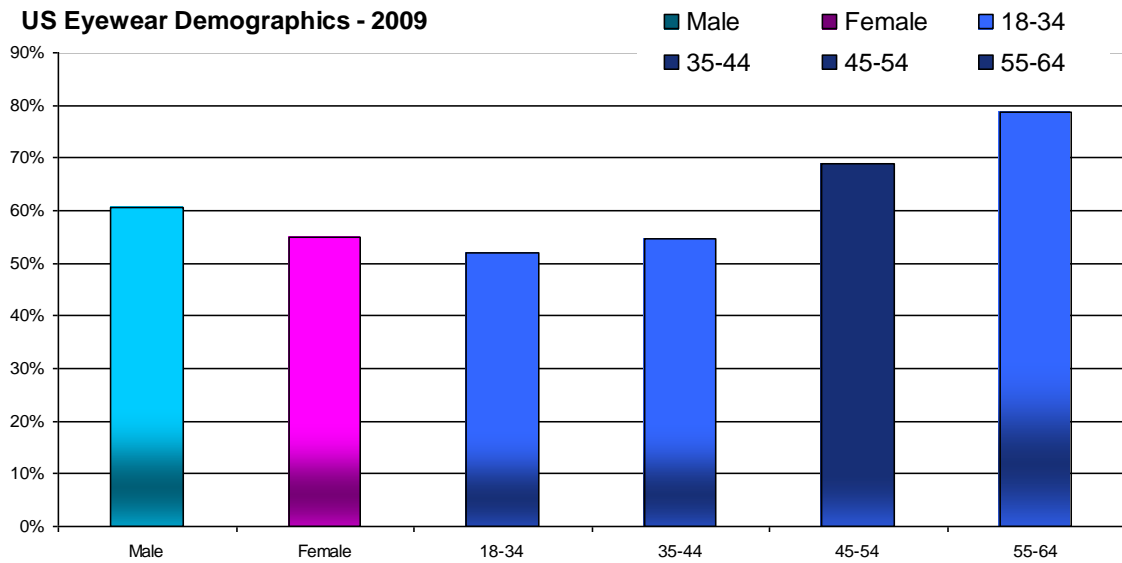
Source: Packaged Facts, 2009

## Appendix 10



Source: *Packaged Facts, 2009*

## Appendix 11



Source: *The Vision Council, 2009*

## Appendix 12

Previous Online Shopping Habits for General Goods			
	Purchase Products Occasionally	Purchase Products Regularly	TOTAL
National Average	32.3%	19.3%	51.6%
<b>Age</b>			
18-34	29.2%	24.1%	53.3%
35-44	30.9%	17.8%	48.7%
45-54	33.4%	16.0%	49.4%
55+	35.9%	16.3%	52.2%
<b>Sex</b>			
Men	29.9%	19.7%	49.6%
Women	34.1%	18.3%	52.4%
<b>Geography</b>			
Northeast	34.9%	23.2%	58.1%
Southeast	29.6%	18.1%	47.7%
Midwest	34.0%	17.3%	51.3%
Mountain Pacific	32.6%	18.4%	51.0%
<b>Income</b>			
<\$40K	30.5%	11.7%	42.2%
\$40-\$75K	34.6%	17.4%	52.0%
>\$75	32.3%	32.1%	64.4%

(Survey question: Please indicate which phrase below best describes your online shopping habits for general retail goods. (among respondents that purchased eyewear in the past 6 months, sample size: 5,213)

Source: *The Vision Council, 2009*

## Appendix 13

Previous Online Shopping Habits for Eyeglasses			
	Examine Possible Retailers	Compare Prices	Purchased
National Average	4.4%	4.6%	3.2%
<b>Age</b>			
18-34	6.8%	6.8%	4.8%
35-44	6.2%	5.5%	6.2%
45-54	4.2%	4.7%	2.8%
55+	1.6%	1.9%	0.5%
<b>Sex</b>			
Men	6.1%	5.3%	4.0%
Women	2.9%	3.7%	2.2%
<b>Geography</b>			
Northeast	3.3%	4.7%	3.8%
Southeast	5.1%	3.9%	3.1%
Midwest	2.8%	1.6%	2.4%
Mountain Pacific	5.9%	8.2%	4.1%
<b>Income</b>			
<\$40K	2.4%	2.9%	2.6%
\$40-\$75K	4.6%	5.2%	2.9%
>\$75	6.1%	5.4%	4.3%

Survey question: Please indicate how you used the internet for your last eyeglass purchase. (among respondents that purchased eyewear in the past 6 months, sample size: 5,213)

Source: *The Vision Council, 2009*



## Appendix 14

Future Online Shopping Habits for Eyewear			
	Examine Possible Retailers	Compare Prices	Possibly or Probably Purchase
National Average	14.6%	21.2%	19.4%
<b>Age</b>			
18-34	17.1%	24.6%	27.6%
35-44	15.0%	20.6%	22.4%
45-54	13.2%	22.1%	17.0%
55+	12.2%	16.5%	10.3%
<b>Sex</b>			
Men	15.9%	21.9%	22.0%
Women	13.4%	20.3%	17.5%
<b>Geography</b>			
Northeast	14.4%	20.9%	20.9%
Southeast	14.2%	20.6%	18.9%
Midwest	14.2%	19.1%	17.2%
Mountain Pacific	15.4%	24.3%	22.0%
<b>Income</b>			
<\$40K	12.8%	19.4%	15.4%
\$40-\$75K	14.4%	20.4%	18.0%
>\$75	17.4%	25.4%	27.4%

Survey question: Please indicate how you will probably use the internet for future eyewear purchases (among respondents that purchased eyewear in the past 6 months, sample size: 5,213)

Source: *The Vision Council, 2009*

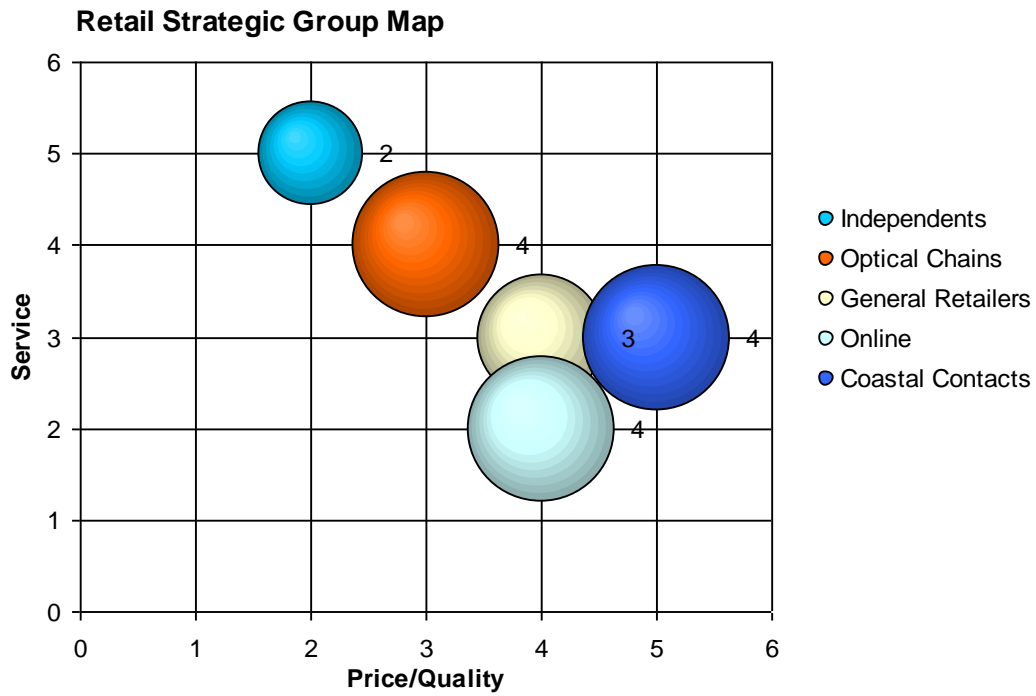
## Appendix 15

Future Online Shopping Habits for Eyeglasses			
	Examine Possible Retailers	Compare Prices	Possibly or Probably Purchase
National Average	2.9%	4.2%	3.8%
<b>Age</b>			
18-34	3.5%	5.0%	5.7%
35-44	2.8%	3.9%	4.2%
45-54	2.8%	4.7%	3.6%
55+	2.0%	2.8%	1.7%
<b>Sex</b>			
Men	2.0%	4.3%	4.3%
Women	2.6%	4.0%	3.4%
<b>Geography</b>			
Northeast	3.2%	4.6%	4.6%
Southeast	2.6%	3.7%	3.4%
Midwest	3.0%	4.0%	3.6%
Mountain Pacific	2.9%	4.5%	4.1%
<b>Income</b>			
<\$40K	2.7%	4.1%	3.2%
\$40-\$75K	2.8%	4.0%	3.5%
>\$75	3.5%	5.1%	5.5%

Derived from two survey question: Please indicate how you will probably use the internet for future eyewear purchases, and please indicate which of the following eyewear products you may purchase with the assistance of the internet in the future. (among respondents that purchased eyewear in the past 6 months, sample size: 5,213)

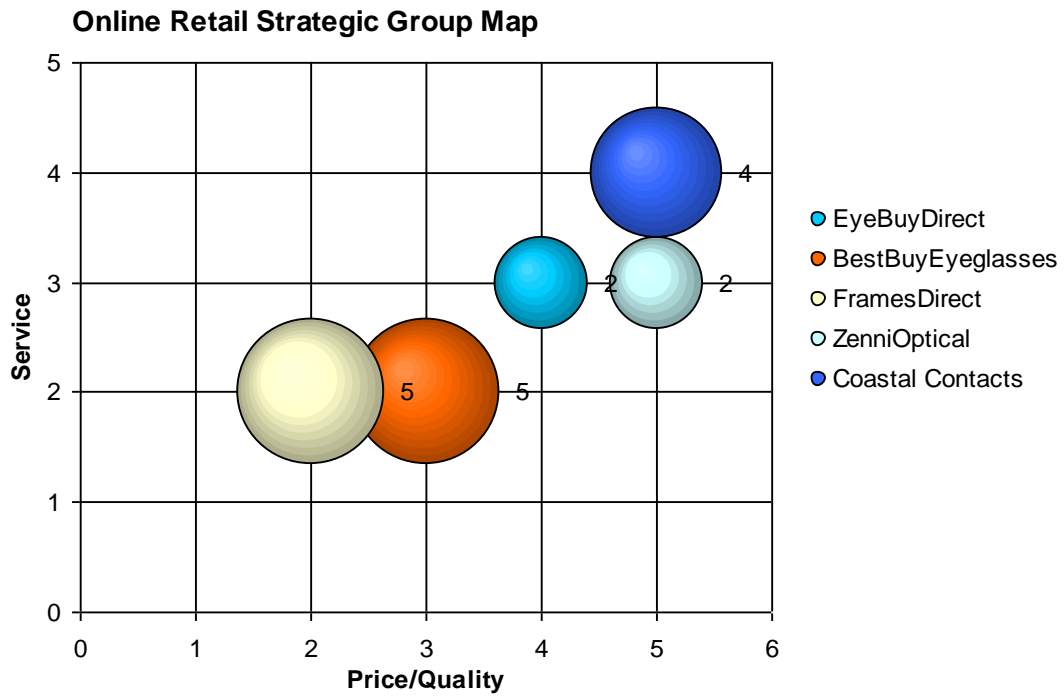
Source: *The Vision Council, 2009*

## Appendix 16



Source: Author, 2011

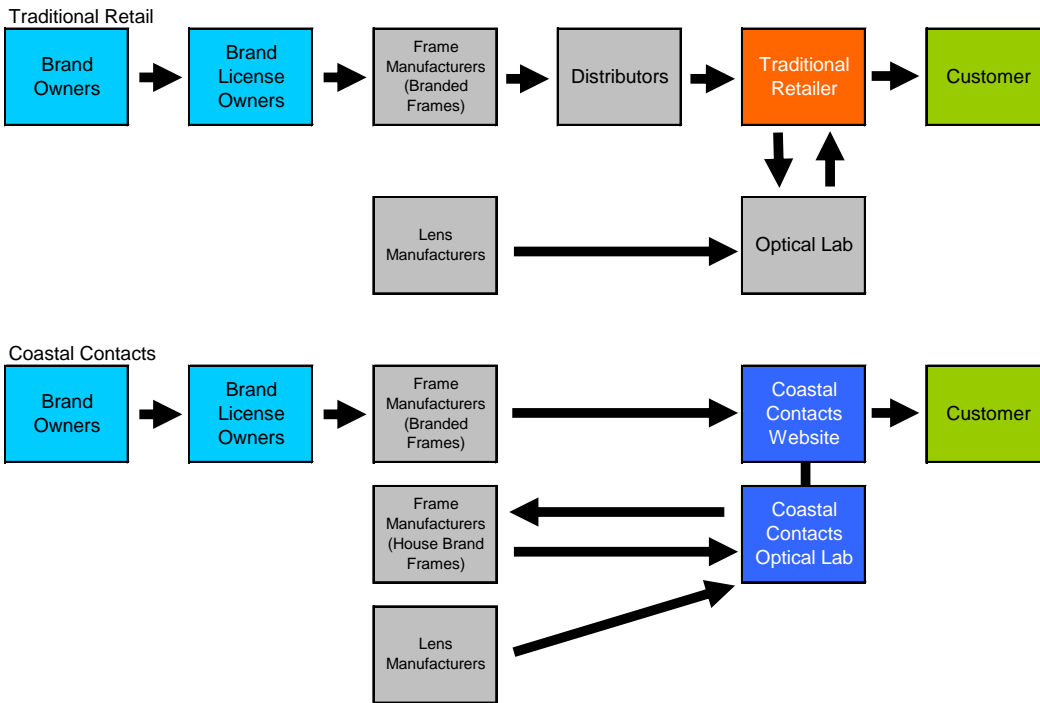
## Appendix 17



Source: Author, 2011

# Appendix 18

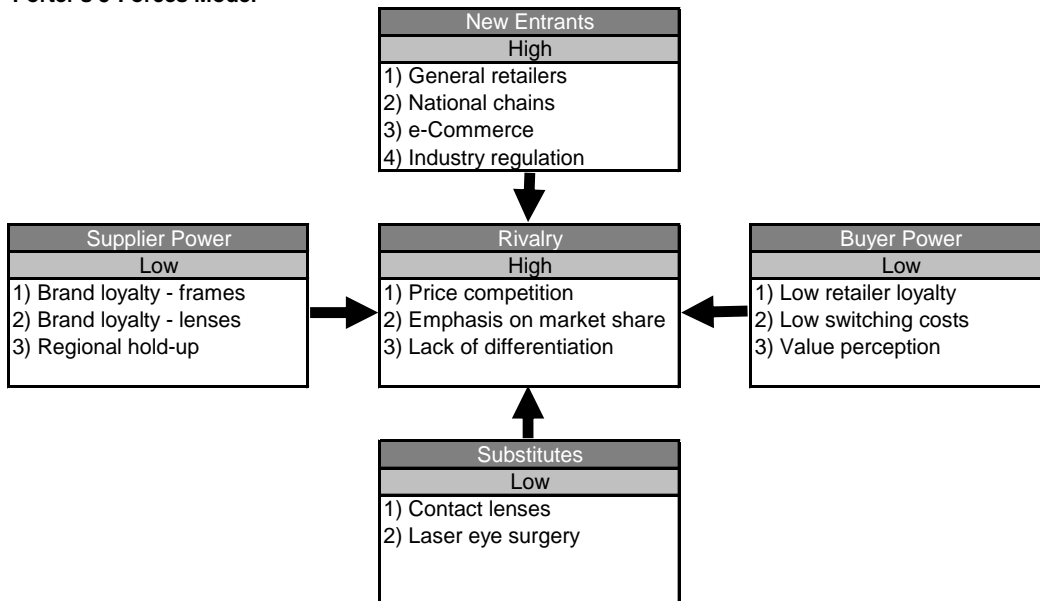
## Flow-of-Goods Diagram



Source: Author, 2011

# Appendix 19

## Porter's 5-Forces Model



Source: Author, 2011

## Appendix 20

### COASTAL CONTACTS INC. CONSOLIDATED INCOME STATEMENT (CAD \$000's)

As at October 31	2010	2009	2008	2007	2006
<b>Sales</b>	<b>\$153,166</b>	<b>\$139,870</b>	<b>\$118,759</b>	<b>\$102,174</b>	<b>\$81,014</b>
Cost of sales	109,390	97,009	84,785	74,497	60,709
<b>Gross Profit</b>	<b>43,776</b>	<b>42,861</b>	<b>33,974</b>	<b>27,677</b>	<b>20,305</b>
Advertising	18,069	18,098	14,523	-	-
Selling, general and administration	19,708	16,758	15,854	23,484	20,837
Amortization	2,272	2,585	2,580	2,032	1,311
Share-based compensation	485	694	627	443	268
Interest expense (income)	96	(67)	(547)	(833)	(890)
Foreign exchange (gain) loss	97	(110)	102	(37)	(836)
Listing costs	-	906	-	-	-
Restructuring charges	-	-	844	-	-
<b>Earnings Before Income Taxes</b>	<b>3,049</b>	<b>3,997</b>	<b>(9)</b>	<b>2,588</b>	<b>(385)</b>
Income tax expense - current	171	1,286	908	901	580
Income tax recovery - future	(224)	(36)	(131)	62	371
<b>Net Income</b>	<b>3,102</b>	<b>2,747</b>	<b>(786)</b>	<b>1,623</b>	<b>(1,336)</b>
Unrealized foreign exchange losses on translation of financial statements of self-sustaining foreign operations	(301)	(578)	1,187	(1,956)	(327)
<b>Comprehensive earnings</b>	<b>\$2,801</b>	<b>\$2,169</b>	<b>\$401</b>	<b>(\$331)</b>	<b>(\$1,663)</b>
Basic net earnings per share	\$0.05	\$0.05	(\$0.01)	\$0.02	(\$0.02)
Diluted net earnings per share	\$0.05	\$0.05	(\$0.01)	\$0.02	(\$0.02)
Weighted average number of common shares outstanding					
Basic	56,910,149	57,559,629	64,559,267	72,948,602	68,018,799
Diluted	58,101,504	57,869,238	64,559,267	73,074,756	68,018,799

Source: Coastal Contacts Inc., 2011

## Appendix 21

### COASTAL CONTACTS INC. CONSOLIDATED BALANCE SHEETS (CAD \$000's)

As at October 31	2010	2009	2008	2007	2006
<b>ASSETS</b>					
<b>Current</b>					
Cash and cash equivalents	\$18,266	\$11,532	\$15,206	\$23,367	\$24,273
Short-term investments	-	-	-	3,976	-
Accounts receivable	8,866	7,965	7,336	6,649	7,127
Inventory	17,536	15,701	9,495	8,531	12,262
Prepaid expenses	3,109	1,532	1,693	1,270	702
Future income tax	97	109	157	-	-
Related party promissory notes	204	374	361	348	610
	<u>48,078</u>	<u>37,213</u>	<u>34,248</u>	<u>44,141</u>	<u>44,974</u>
Property, equipment and leasehold improvements	5,558	2,813	3,038	2,700	2,773
Intangible assets	8,908	9,517	11,061	11,712	13,632
Goodwill	7,715	7,757	7,908	7,529	6,697
	<u>\$70,259</u>	<u>\$57,300</u>	<u>\$56,255</u>	<u>\$66,082</u>	<u>\$68,076</u>
<b>LIABILITIES</b>					
<b>Current</b>					
Accounts payable and accrued liabilities	\$27,012	\$17,908	\$18,881	\$13,972	\$12,051
Income tax payable	44	615	-	711	212
Deferred gain on sale of equipment	88	-	-	-	-
Capital lease obligation	811	-	-	-	-
	<u>27,955</u>	<u>18,523</u>	<u>18,881</u>	<u>14,683</u>	<u>12,263</u>
Deferred gain on sale of equipment	285	-	-	-	-
Capital lease obligation	2,508	-	-	-	-
Long-term lease inducements	140	18	79	158	133
Future income tax	3,359	3,614	3,825	3,661	4,227
	<u>34,247</u>	<u>22,137</u>	<u>22,785</u>	<u>18,502</u>	<u>16,623</u>
<b>SHAREHOLDERS' EQUITY</b>					
Share capital					
Authorized:					
Issued and outstanding:	39,176	40,248	41,250	50,857	53,515
Held in Treasury	-	-	-	(89)	(41)
Contributed surplus	2,663	2,294	1,600	973	530
Accumulated other comprehensive loss	(\$3,783)	(\$3,482)	(\$2,904)	(\$4,091)	(\$2,135)
Deficit	(\$2,044)	(\$3,897)	(\$6,476)	(\$70)	(\$416)
	<u>36,012</u>	<u>35,163</u>	<u>33,470</u>	<u>47,580</u>	<u>51,453</u>
	<u>\$70,259</u>	<u>\$57,300</u>	<u>\$56,255</u>	<u>\$66,082</u>	<u>\$68,076</u>

Source: Coastal Contacts Inc., 2011

## Appendix 22

### COASTAL CONTACTS INC. CONSOLIDATED STATEMENT OF CASH FLOWS (CAD \$000's)

Year ended October 31	2010	2009	2008	2007	2006
<b>OPERATING ACTIVITIES</b>					
Net earnings	\$3,102	\$2,747	(\$786)	\$1,625	(\$1,326)
Non-cash items affecting earnings:					
Amortization	2,272	2,585	2,368	2,032	1,311
Amortization of deferred lease inducement	74	(73)	-	(106)	(26)
Share-based compensation	485	694	627	443	268
Future income taxes	(179)	(19)	68	62	371
Unrealized foreign exchange (gains) losses	-	263	(289)	(418)	(863)
Changes in non-cash working capital:					
Accounts receivable	(979)	(788)	(380)	855	(1,844)
Inventory	(2,125)	(6,149)	(723)	3,502	(5,059)
Prepaid expenses	(1,240)	311	(411)	(650)	275
Accounts payable and accrued liabilities	(6,634)	(521)	4,553	1,824	1,091
Income tax payable	(514)	621	(546)	479	(138)
Deferred gain on disposition of property and equipment	373	-	-	-	-
Deferred revenue	-	-	2	(226)	128
<b>Cash provided by (used in) operating activities</b>	<b>7,903</b>	<b>(592)</b>	<b>4,483</b>	<b>9,422</b>	<b>(5,822)</b>
<b>INVESTING ACTIVITIES</b>					
Maturity of short-term investments	-	-	3,976	(3,886)	-
Repayments from (advances to) related parties)	169	(12)	4	251	-
Repayment of promissory notes	-	-	-	58	-
Business acquisition, net of cash acquired	-	-	-	(14)	(3,947)
Receipt of leasehold inducements	-	-	-	134	-
Acquisition of property, equipment and leasehold improvements	(4,033)	(721)	(1,372)	(789)	(1,509)
Acquisition of intangible assets	(424)	(221)	(391)	(1,365)	(1,383)
Disposition of property and equipment	3,411	60	-	-	-
<b>Cash used in investing activities</b>	<b>(877)</b>	<b>(894)</b>	<b>2,217</b>	<b>(5,611)</b>	<b>(6,839)</b>
<b>FINANCING ACTIVITIES</b>					
Issuance of common shares on exercise of options	146	-	8	69	3,417
Issuance of special warrants	-	-	-	-	22,500
Purchase of common shares for cancellation	(158)	(1,169)	(14,870)	(4,054)	-
Bank indebtedness	-	-	-	-	(328)
Loan payments	-	-	-	-	(379)
Share related costs	-	-	(279)	-	(1,581)
<b>Cash used in financing activities</b>	<b>(12)</b>	<b>(1,169)</b>	<b>(15,141)</b>	<b>(3,985)</b>	<b>23,629</b>
Effect on exchange rate changes on cash and cash equivalents	(280)	(1,019)	280	(732)	(305)
Increase (decrease) in cash and cash equivalents	6,734	(3,674)	(8,161)	(906)	10,663
Cash and cash equivalents, beginning of year	11,532	15,206	23,367	24,273	13,610
<b>Cash and cash equivalents, end of year</b>	<b>\$18,266</b>	<b>\$11,532</b>	<b>\$15,206</b>	<b>23,367</b>	<b>24,273</b>
<b>Supplemental disclosure of cash flow information:</b>					
Non-cash financing and investing activities:					
Assets acquired under capital lease	\$3,499	-	-	-	-
Income tax paid in cash	\$392	\$1,065	\$395	\$358	\$651
Interest paid in cash	\$24	-	-	-	\$43

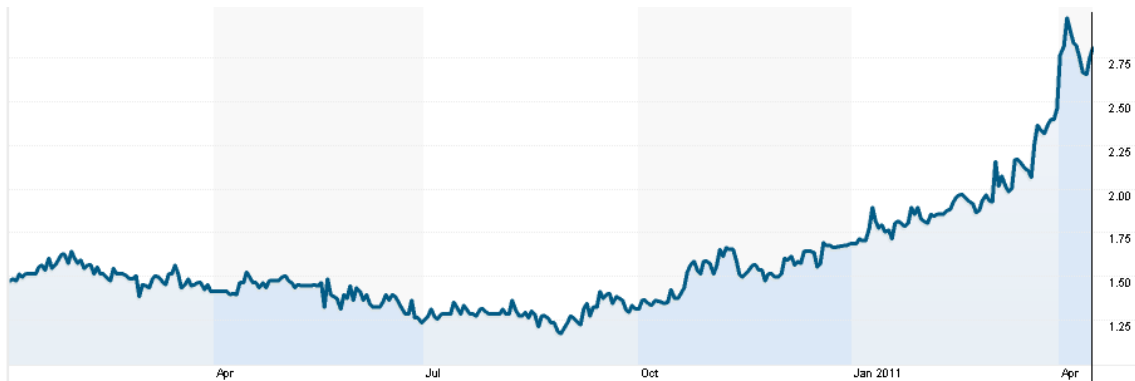
Source: Coastal Contacts Inc., 2011

## Appendix 23



Source: Coastal Contacts Inc., 2011

## Appendix 24



Source: Reuters Online, April 2011

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