

# CASE 19

## THE GLOBAL CASINO INDUSTRY\*

For well over 50 years, the casino business had been on a roll, on its way to becoming a \$160 billion–a-year global industry. For much of that period, the United States had been leading the charge, accounting for nearly half of the global gambling revenues as recently as 2010. Most of these revenues came from Las Vegas and Atlantic City, which had become magnets for gamblers from around the world. Over the last couple of decades, these two locations accounted for almost one-third of the total revenues generated by all forms of casinos throughout the U.S.

Over the past decade, Las Vegas and Atlantic City had to deal with increased competition from other locations, as casinos opened in a number of states that legalized gambling in order to generate more tax revenues and promote tourism. Over a dozen states now generate substantial revenue from their casinos, many of which have opened on waterfronts such as rivers and lakes. When combined with Native American casinos, gambling revenues in other parts of the U.S. now exceed the amount that is generated by casinos in Las Vegas and Atlantic City.

Nevertheless, casinos in Las Vegas and Atlantic City had been able to rely upon gamblers who came from all over the world, as far away as China. Although casinos had operated for a long time in various locations in Europe and the Caribbean, no single location was able to compete with Las Vegas or Atlantic City. Las Vegas, in particular, offered more than two-dozen large casinos on its strip that had spent lavishly to differentiate themselves from all others. Luxor's pyramids and columns evoke ancient Egypt, Mandalay Bay borrowed looks from the Pacific Rim, and the Venetian's plaza and canals re-created the Italian city.

However, the dominance of Las Vegas and Atlantic City in the global market was challenged by the development of several casinos along a strip in the former Portuguese colony of Macau. Casinos had existed in Macau for decades, but they had basically served a local population. After a monopoly on casinos by a single local tycoon was terminated in 2002, there was a proliferation of mega-sized high-end casinos, developed and managed by some of the world's largest casino operators, including those from Las Vegas. This allowed Macau to grow from a tiny backwater territory to a booming center of gambling, with casinos

generating over \$40 billion, more than six times the revenue of the Las Vegas strip (see Exhibit 1).

More recently, the growth of casinos spread to other locations across the Asia-Pacific region. Singapore managed to generate substantial revenues from its two new casinos; casinos were being developed in the Philippines on a large plot overlooking Manila Bay; and efforts were under way to legalize casinos in Japan and build them in bustling Tokyo. All of these new locations were hoping to grab a share of the gambling revenues that had been generated by casinos in places such as Las Vegas and Macau.

### Riding an American Wave

Although some form of gambling existed in the U.S. since colonial times, the recent advent of casinos stemmed from the legalization of gaming in Nevada in 1931. For many years, this was the only state in which casinos were allowed. After New Jersey passed laws in 1976 to allow gambling in Atlantic City, the large population on the east coast had easier access to casinos. However, the further growth of casinos was possible only since 1988, as more and more states legalized the operation of casinos because of the tax revenues that they could generate.

As casinos spread across the U.S., there was a growing tendency to regard casino gambling as an acceptable form of entertainment for a night out. A large part of the growth in casino revenues came from the growing popularity of slot machines. Coin-operated slot machines typically accounted for almost two-thirds of all casino gaming revenues. A major reason for their popularity was that it was

**EXHIBIT 1** Top Casino Revenue Locations, 2014 (\$ billions)

Location	Revenue
Macau	\$48.0
United States	35.0*
Singapore	6.0
Australia	4.2
South Korea	2.0
Malaysia	1.8
Philippines	1.8

\*\$6.5 billion comes from Las Vegas.

Source: Morgan Stanley.

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easier for prospective gamblers to operate a slot machine than to understand the nuances of various table games.

For the most part, casinos in Las Vegas and Atlantic City had been trying to draw gamblers over the years by developing extravagant new properties. The most ambitious new development in Las Vegas was MGM Mirage's City Center, an \$8.5 billion minicity spread over 67 acres that includes luxury hotels, condominium units, restaurants, and shops. Even some of the older properties underwent extensive renovation; for example, Caesars Palace added a new Colosseum and a new Roman Plaza. Atlantic City welcomed the much-ballyhooed opening of the \$2.4 billion Revel Hotel built on 20 acres of beachfront. It followed the opening several years earlier of another lavish resort, the Borgata Hotel, which offered amenities such as penthouse spas and tropical indoor pools.

Aside from ramping up the appeal of their particular properties, most casinos offered incentives to keep their customers from moving to competing casinos. These incentives could be particularly helpful in retaining the "high rollers" who came often and spent large amounts of money. Casinos also tried to maintain their business by providing complimentary rooms, food, beverages, shows, and other perks that were worth billions of dollars each year. Gamblers also earned various types of rewards through the loyalty programs that were offered by the casinos, with the specific rewards tied to the amount that the gamblers bet on the slot machines and at the tables.

Some of the larger casinos in the U.S. tried to fend off competition by growing through mergers and acquisitions. In 2004, Harrah's announced that it was buying casino rival Caesars, thus becoming the nation's leading operator of casinos, with several properties in both Las Vegas and Atlantic City. This deal came just a month after MGM Mirage had stated that it was buying the Mandalay Resort Group, enabling MGM Mirage to double the number of casinos it held on the Las Vegas strip. Firms that owned several casinos could pitch each of their properties to a different market and allow all of their customers to earn rewards on the firm's loyalty program by gambling at any of its properties.

## Exploiting the Chinese Market

Though gambling had been legal for over a century in Macau, which was a former Portuguese territory, its casinos were typically small and seedy. In part, this was due to the monopoly on gambling in the territory that was held by Stanley Ho, a local tycoon. However, this began to change in 2002, as the liberalization of casino licensing led to the development of new casinos by some of the world's largest casino operators, including many of the U.S. firms that wanted to find markets outside Las Vegas. "The Las Vegas of the Far East" is how Sheldon Adelson, head of Las Vegas Sands, described the recent development of Macau.

As more and more casinos began to open, Macau grew explosively, with a tripling of casinos from the dozen or

so that existed before 2002. Many were situated on the Cotai Strip, land that was once a stretch of water between the islands of Coloane and Taipa. Las Vegas-based firms such as Sands and Wynn were plowing billions of dollars into new casinos there. Sands, which already had a super-sized version of the Las Vegas-based Venetian with a Grand Canal and a Rialto Bridge, was adding a complex called the Parisian with a version of the Eiffel Tower. Even locally based Sociedade de Jogos de Macau was opening a \$3.9 billion complex that would feature three hotels, including one modeled on the Palace of Versailles.

Macau's dramatic rise in the casino business owed much to a collision of geography and history. Despite the Chinese love of gambling, the leaders in Beijing had long forbidden casinos on the mainland. The government did, however, let the casinos continue to operate in Macau after the Portuguese handed over sovereignty in 1999. Like Hong Kong, Macau retained a degree of legal autonomy and was only a few hours' flying time or less from a billion potential gamblers in China. "We sit next to the biggest market in the world," said Edward M. Tracy, chief executive of the Hong Kong-based subsidiary of Las Vegas Sands. "It's one billion more people than the U.S."<sup>1</sup>

In fact, Macau was attracting a growing number of visitors from mainland China. Nearly 20 million people, or one in five Chinese, who ventured outside mainland China in a recent year went to Macau to gamble. Many came from neighboring Guangdong province, usually on day trips. But bigger spenders who came from as far away as Beijing clearly played an important role in fueling Macau's growth. These high rollers would spend as much as \$10 million on gambling in a single trip. They accounted for up to 65 percent of the revenues for Macau's larger casinos (see Exhibit 2).

Even as Macau had shown remarkable growth over the last decade, its prospects for the future remained quite bright. Analysts at securities firms forecast that gambling revenue from Macau casinos could easily reach \$80 billion by 2018. In part, this rise would be driven by an increase in visitors from mainland China because of rising affluence and improved transportation. China had increased the capacity of roads and high-speed trains to the territory, providing access for more visitors. Visitors from all over the world would also have better access because of a series of bridges that would connect Macau with Hong Kong's huge international airport.

**EXHIBIT 2** Financials of Macau Casinos, 2014

	Share of Revenues	Share of Profits
High rollers	63%	35%
Low rollers	31	52

Source: Deutsche Bank.

## Spreading across Asia

The growth of gambling revenues in Macau led countries across the Asia-Pacific region to abandon their hostilities to gambling and encourage the development of casinos. Casinos were developing in several countries, including Singapore, Philippines, Malaysia, South Korea, and Australia, and were likely to take off soon in other places such as Japan, Vietnam, Taiwan, and Sri Lanka. A group of investors even made a deal to open a casino near Vladivostok in Russia's Far East. They claimed that it took less time for a high roller in Beijing to fly there than to steamy Macau.

Singapore, in particular, was extremely successful with its two new up-market casinos. In 2010, the island state had issued permits to two large casino operators: The Marina Bay Sands was part of the Las Vegas-based Sands casino operations, and Resorts World Sentosa was run by Malaysia's Genting group. Even though Singapore limited the size of its casinos and discouraged locals from visiting them, they earned more than \$6 billion, almost as much as all of the casinos on the Las Vegas strip.

Among the other contenders, Philippines looked as if it was poised to claim a substantial share of global casino revenues. Malaysia-based casino giant Genting kick-started Manila's casino craze when it opened Resorts World Manila opposite the capital's main airport in 2009. The opening of the new casino represented a departure from the older smoke-filled gambling dens and lured other casinos. Four new casinos were developed on a large plot overlooking Manila Bay. The first of these, Solaire Resort and Casino, is a sleek, plate-glass building with a suitably flashy interior created by Paul Steelman, a casino designer from Las Vegas.

Efforts were also under way to boost gambling in Japan by getting the government to lift its ban on casinos. At the time, gambling was confined to seedy places such as Kabukicho, a 1-kilometer block in Tokyo. However, the prime minister, Sinzo Abe, was likely to approve legalization of casinos as a way to boost Japan's sluggish growth. Proponents of casinos argued that they would boost the country's earnings from foreign tourists and deliver a tax windfall to the heavily indebted government. A Japanese business magazine argued that the country was being left behind as neighboring countries rushed to build upscale casinos with luxury hotels, designer shops, and cultural attractions.

The casino operators that were developing casinos all over the region were hoping that they could lure Chinese high rollers away from Macau. A Chinese businessman who visited Macau's casinos stated that the new Chinese leadership's crackdown on official corruption and flaunting of wealth would drive clients to other locations. "Beijing has too many cameras watching us in Macau," he explained.<sup>2</sup> Solaire, which recently opened in Manila, was willing to send a private jet to pick up big spenders from

all across China. "If we can get 7% of Macau business to come here," said the casino's chief operating officer, "then we all achieve our goals for the market."<sup>3</sup>

## Moving beyond Gambling

Over the last couple of decades, Las Vegas managed to move beyond gambling and offer visitors many choices for fine dining, great shopping, and top-notch entertainment. This allowed most of its higher-end casinos to generate revenues from offering a wide selection of activities apart from gambling. At MGM Mirage, for example, revenue from nongaming activities typically accounted for almost 60 percent of net revenue in recent years. During the 1990s, Las Vegas had tried to become more receptive to families, with attractions such as circus performances, animal reserves, and pirate battles. But the city was very successful with its recent return to its sinful roots, with a stronger focus on topless shows, hot nightclubs, and other adult offerings that were highlighted by the new advertising slogan "What happens in Vegas, stays in Vegas."

By comparison, visitors were drawn to Atlantic City mostly because of gambling. Although it offered a beach and a boardwalk, along which its dozen large casino hotels were lined, the city was never able to develop itself as a beach resort. The opening of the much-ballyhooed Revel a few years ago was part of a drive to make Atlantic City much more competitive with Las Vegas. But it failed to replicate the success of the Borgota Hotel, the major resort that had opened there in 2003. The failure to develop other forms of entertainment led to the closing of several big casinos, including the Revel, as casinos that opened in several neighboring states drew gamblers away from Atlantic City.

Macau had also been trying to reduce its dependence on gaming. By 2014, gambling revenues at its casinos accounted for almost four-fifths of the territory's economy. But these revenues began to decline, in part because of China's economic slowdown. Another factor was the country's sweeping crackdown on corruption. Many of the high rollers from the mainland were gambling with the proceeds of shady deals, which were now subject to greater scrutiny. This was forcing the casinos to shift their focus away from the older, hard-core gamblers, who came primarily to gamble, and toward younger, passionate gamblers, who saw gambling as only one part of their Macau experience.

The newer casinos offered more nongambling activities by including restaurants, shops, cinemas, spas, and even concert arenas. The shops inside Sands casinos in Macau, for example, generated as much as \$2 billion of revenues. Edward Tracy, the head of Sands China, also brought in shows ranging from boxing matches to Bollywood award ceremonies. One of the newly opened casinos even had an enormous "fortune diamond" that emerged from a fountain every half hour to the delight of photo-snapping onlookers. "There's an opportunity for Macau to attract a new breed

of customer, one that is looking for a more holistic experience," said Aaron Fischer, a gambling analyst at a brokerage firm.<sup>4</sup>

Macau was trying to overcome one of the most serious limitations of its small land area—just under 30 square kilometers—by expanding onto the thinly populated island of Hengqin. The island, three times the size of Macau, had been declared a special economic zone by Chinese officials so that it could develop accommodation and entertainment that would support Macau's aspirations for mass-market tourism. "Hengqin is the game changer for Macau," insists Sands China head Tracy.<sup>5</sup>

## Gambling on the Future

In spite of growing competition from many other locations, Las Vegas and Atlantic City were fighting for visitors to come for various forms of entertainment in addition to gambling. Casinos were offering attractive restaurants, clubs, stores, and concerts and shows. "I think we're seeing a shift away from Las Vegas as the only gaming destination," said Stephen P. A. Brown from UNLV. "But it is holding up as a tourist destination."<sup>6</sup> Genting, the Malaysian gaming group, recently took over the site of the Echelon, which was abandoned because of lack of funds during the recession. Genting intended to develop a stronger presence in the U.S. market by building one of the biggest new resorts in Las Vegas, with a 3,500-room hotel and 175,000 feet of gambling space.

Casino operators in Macau were similarly continuing to place their bets on gambling, even as competition grew in neighboring countries. Eight new casino complexes, all

of which would also offer many forms of entertainment, were in the works, promising to almost double the supply of hotel rooms on the strip. Galaxy Entertainment, a local casino firm, claimed that when its \$7.7 billion expansion was finished, its already-huge Macau casino would be bigger than the Pentagon. Another local operator, SJM, developed a huge new resort on the Cotai strip that included a hotel designed by Versace, an Italian luxury-fashion house.

As gambling spread outside the United States, particularly to countries in the Asia-Pacific region, casinos were targeting visitors to come for their many offerings, including gambling. Their emphasis was shifting away from older customers, who came mainly for high-stakes gambling, and to younger customers, who enjoyed gambling but were also interested in eating, drinking, shopping, and taking in shows. "Gambling won't go out of fashion. It will just become part of a wider offering," said Ian M. Coughlan, president of Wynn Macau. "We've not really tapped all the demand that exists—we're far from it."<sup>7</sup>

## ENDNOTES

1. Bettina Wassener. A hot streak for Macau. *New York Times*, March 26, 2014, p. B7.
2. The rise of the low rollers. *The Economist*, September 7, 2013, p. 63.
3. *Ibid.*, p. 64.
4. Chris Horton. All in on gambling? Not for Macau. *International New York Times*, December 20–21, 2014, p. 1.
5. The rise of the low rollers, *op. cit.*, p. 64.
6. Adam Nagourney. Las Vegas bounces back, with caveats. *International New York Times*, August 2, 2013.
7. Wassener, *op. cit.*