***Teaching Note:* Case 2 – The Global Casino Industry**

# Case Objectives

1. To examine industry dynamics and how the structure of an industry has implications for competition.

See the table below to determine where to use this case:

|  |  |  |
| --- | --- | --- |
| **Chapter Use** | **Key Concepts** | **Additional Readings or Exercises** |
| 2: External Environment | Porter’s five forces model; strategic groups | **NOTE** additional web linked reading, view embedded **videos** about the current state of the industry. |

# Case Synopsis

For well over fifty years the casino business has been on a roll, on its way to becoming a $150 billion–a-year global industry. For much of that period, the United States has been leading the charge, accounting for nearly half the global gambling revenues as recently as 2010. Most of these revenues have come from Las Vegas and Atlantic City, magnets for gamblers from around the world. However, Las Vegas and Atlantic City have had to deal with increased competition from other locales, including waterfront casinos in over a dozen states, Native American gambling locations, and, most recently, overseas casino development in places like Macau, Singapore, Malaysia, Philippines, South Korea, and Australia. Other sites in Asia, such as Japan, Vietnam, Taiwan, and Sri Lanka, were in development as well.

In 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, yet facilities in Las Vegas, especially, had spent billions on extravagant and luxurious properties meant to attract the “high rollers” who came often and spent large amounts of money. Las Vegas casinos had tried to move beyond gambling and offer visitors many choices for fine dining, great shopping, and top-notch entertainment. This allowed higher-end casinos to generate revenues from activities other than gambling. Las Vegas, the city, was trying to brand itself as a tourist destination, but would that be enough to stem the flow of Chinese high rollers to Asian destinations? U.S. casino operators were expanding to open facilities in Asia or engage in mergers and acquisitions in an attempt to cash in on this local business, but would it be enough to return significant revenue to U.S. firms? Was there enough demand to go around?

# Teaching Plan

Most students know what a casino is, and they probably haven’t thought much about the industry beyond the glitz and the gambling. Therefore, this case becomes a good way to introduce the importance of defining the industry, and examining the dynamics of competition in the industry from the point of view of certain clusters of companies – companies that are part of “strategic groups” who compete in the same way for the same customers. The structure of the casino industry has changed in recent years due to new forms of competition and the presence of substitutes. Students may have not considered this. Therefore, this case can be positioned early in the course, right after discussion of the strategic concept, to alert students to these issues. Since companies are not passive as far as industry structure goes, but can take steps to influence the structure to their advantage, this case can be reintroduced during the discussion of competitive strategy, later in the course, to remind students how external environmental analysis is very relevant to strategic formulation.

# ICEBREAKER

This case can start with an ***icebreaker****.* Starting from the perspective of a customer may make it easier for students to transition to a strategic analysis.

*Have you ever visited a casino? If so, where was it located, and what type of casino was it? Why were you there? What did you think of the casino experience?*

It is possible that some students may have visited a Las Vegas or an Atlantic City casino, perhaps on a family vacation. Others may have been to a riverboat or Native American casino venue. It might be interesting to see students’ responses regarding the purpose of their visit to a casino location – it might not have been for gambling purposes. Reasons for the visit might include the following: because it was part of my vacation trip; because a convention was held there; to see a sports event; to eat out; to see a show; just to see it, period! The casino industry competes for the family entertainment dollar. If so, it competes with a family trip to, say, Disneyworld. Are the two experiences the same? Might some conservative families not even consider Las Vegas or Atlantic City as a vacation place for their family, because of the gaming or risqué entertainment elements?

The instructor may want to put a chart on the board: *Where* the casino was, and *Why* the visit was made. If there is diversity among responses, it may make it easier for the instructor to then ask: so if you were the owner of a casino, how would you respond to these diverse reasons for visiting? What strategic issues do you need to consider? Who is competing against whom? This flows straight into a discussion of the external environment.

Before engaging in discussion, you might want to ***test students’ basic knowledge*** regarding the case and the major concepts. Here are some multiple-choice questions to use. (This will get the student’s attention – they can’t answer these if they haven’t read the case!)

Which statement is most true?

1. A large part of growth in casino revenues comes from slot machines.
2. In the U.S., Las Vegas and Atlantic City casinos generate more revenue than all other gambling locations combined.
3. Macau, the gambling “capital” of Asia, is located in Malaysia.
4. At some Las Vegas casinos, revenue from non-gaming activities could account for over 70 percent of net revenues.

ANSWER: a. 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. 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. Macau is a former Portuguese colony, a special administrative region of China, currently under autonomous rule, similar to Hong Kong prior to 1997. Non-gaming activity at MGM Mirage in recent years accounted for almost 60 percent of net revenue.

Worldwide, the U.S. generates more casino revenue than anywhere else.

1. Yes
2. No

ANSWER: b. At over $30 billion, Macau generates six times more casino revenue than the U.S. Las Vegas strip. Also see Exhibit 1.

# Summary of Discussion Questions

Here is a list of the suggested discussion questions. You can decide which questions to assign, and which additional readings or exercises to include to augment each discussion. Refer back to the Case Objectives Table to identify any additional readings and/or exercises so they can be assigned in advance.

**Discussion Questions:**

1. Examine the structure of the casino industry. What has been the effect of the changing industry structure on U.S. casinos?

# Discussion Questions and Responses

1. ***Examine the structure of the casino industry.***

**Referencing Chapter 2: Analyzing the External Environment of the Firm**

If you recall, strategy is all about the ideas, decisions, and actions that enable a firm to succeed. See Chapter 1, Exhibit 01: *Strategic management consists of the analyses, decisions, and actions an organization undertakes in order to create and sustain competitive advantages:*

* + strategy directs the organization toward overall goals and objectives;
  + includes multiple stakeholders in decision making;
  + incorporates both short-term and long-term perspectives;
  + recognizes trade-offs between efficiency and effectiveness.

The basic question strategic management tries to answer is: *How can we create a sustainable competitive advantage in the marketplace that is not only unique and valuable but also difficult for competitors to copy or substitute?*

However, an interesting and fundamental question is *How do we define the “marketplace”? Just what business are we in?* Ask students to fill in the blank: *Casinos are in the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ industry.* Some students may say “gambling,” but some may also say “entertainment.” The various answers to this question will help students understand that a firm must have a clear idea of the purpose of its business, and who it competes with, in order to craft strategy.

During *strategic analysis*, the firm does “advance work” through *external scanning* and *monitoring* of the external environment to anticipate unforeseen environmental developments, identify unanticipated resource constraints, assess changes in his or her preferences for how to manage.Evaluating the evolution of environmental trends may be critical to crafting a strategic response.

In order to formulate a competitive strategy***,*** it’s necessary to assess the segments of the external competitive environment that include competitors, customers or buyers, and suppliers, substitutes and new entrants. Porter’s *five forces model* allows strategists to anticipate where the industry might be most vulnerable to competition. The model also helps decide where profits might be best made, or whether there is any chance of further dividing up the profit pie: how attractive *is* this industry?

To answer this question, it is very important to correctly define the industry even further. If we define the casino industry broadly to include any organization that allows people to wager money on events of chance, then we must include Native American casinos, waterborne casinos, and Internet gambling places as incumbents in the industry along with casinos in Las Vegas and Atlantic City. However, if we define it narrowly to include traditional casinos in Las Vegas and Atlantic City, those that also provide enhanced entertainment, then most Native American casinos, etc. would be substitutes. Either way, the five forces model will capture the impact of all these gambling establishments.

Help students apply Porter’s ***Five Forces of competition*** by drawing a diagram on the board similar to the following, and having students fill in the details:

**Substitutes’**

**Threat**

**High**

**Rivalry**

**High**

**Suppliers’ Power**

**Low**

**Buyers’ Power**

**Med**

*Suggested:* New casinos increase the fight for customers’ dollars. Also, the investment required has gone up significantly. Native American casinos get tax breaks. Internet gambling is currently unregulated, untaxed.

*Suggested:* If gambling is a form of leisure time entertainment, substitutes in the form of theme parks, shows, etc. abound.

*Suggested:* Ample choices; low switching costs despite attempts by casinos to provide incentives for loyalty; big spenders can bargain for prices.

**Threat of New Entrants**

**Med-Low**

*Suggested:* For traditional casinos, capital requirements and regulatory hurdles suggest that entry is not that easy.

*Suggested:* No dominant suppliers for casino equipment. Switching costs & threat of forward integration are low.

The following key points emerge from a structural analysis of the casino industry:

* There was industry growth in the U.S. up until 2010. This should typically ***decrease*** the intensity of rivalry as the potential profit pie grows larger. However, intensity of rivalry had increased due to new investment by industry players – the entrance of Native American gambling resorts and waterborne casinos – as well as the overseas development of casinos in places such as Macau. There were more players to compete for the bigger pie.
* Industry players realized that, typically, customer switching cost was low, in that a gambler could switch from one casino to another and shop for the “best” deal. This would typically ***increase*** the intensity of rivalry. However, casinos tried to maintain the business of customers by providing complimentary rooms, food, beverage, shows, and other perks. Loyalty programs also provided a means to hold on to gamblers.
* Native American casinos had a distinct advantage over traditional casinos in that they were exempt from federal taxes, even though they paid a percentage of their winnings to the state in which they were located. These casinos generated a large share of total gaming revenues – certainly a major threat for traditional casinos. Particularly for Atlantic City, the two big Native American casinos in Connecticut generated substantial business.
* Internet gambling was a growing major threat because it was a low-cost business model and therefore did not face the same entry barriers as traditional casinos did. In addition, it was unregulated, untaxed, and not legalized. Racetrack casinos were also low-cost because there was little overhead when only slot machines were involved.
* Waterborne casinos provided significant competition in the regions where they were located. They received the benefit of legislative protection after Hurricane Katrina, and the watery venue might just have been unique enough to entice and retain local customers.
* The international rivalry from places such as Macau was muted among the big players such as MGM and Wynn, as they used this as an opportunity for international expansion. A good deal of consolidation was also occurring in the industry among these big players as they pursued acquisition targets.
* All of Asia-Pacific was under development, with multiple firms hoping to grab a share of the gambling revenues worldwide.

Based on the external environmental factor analysis, the casino business is not that attractive an industry, although opportunities for diversification into other forms of entertainment and tourism may be a way to increase profits among the larger players.

**NOTE - ADDITIONAL READING, VIDEO VIEWING:**

Regarding sociocultural and demographic trends affecting the industry, read this article about the “what happens here” advertising campaign for Las Vegas, first launched in 2003:

<http://www.usatoday.com/money/advertising/adtrack/2005-04-11-track-vegas_x.htm>

What are the positives and negatives of the campaign for Las Vegas casinos? If you were the manager of a Las Vegas casino, would you be in favor of the campaign? Why or why not?

Gaming continues to be big business, as explained in a report from the American Gaming Association:  a 2014 study measures the economic impact of every facet of the casino gaming industry – commercial casinos and manufacturers and Native American casinos – as well as the industry’s significant ripple effect on the supply chain, including local businesses. The Oxford Economics’ study found that the U.S. gaming industry:

* Contributes **$240 billion** – nearly a quarter-trillion – to the U.S. economy, which is equivalent to the total state budgets of New York and Texas combined;
* Supports more than **1.7 million jobs** – more than double Washington, D.C.’s total employment – and nearly **$74 billion in income;**
* Generates **$38 billion in tax revenues** to local, state and federal governments – enough to pay more than half-a-million teachers’ salaries.

This research is being used to encourage policymakers to work with the industry as partners for more economic growth for all.

See <http://www.gettoknowgaming.org/news/groundbreaking-new-research-reveals-impressive-magnitude-us-casino-gaming-industry>

And consultants have suggestions for firms, from 2007:

<http://urbino.net/bright.cfm?specificBright=Five%20Indomitable%20Trends%20for%20the%20Casino%20Industry%20%E2%80%93%202007%20and%20Beyond%2E>

Increasingly, it appears that the industry doesn’t get its revenue from gaming – much of industry revenue comes from non-gaming activity such as lodging, food, retail shopping, shows, spas. See a 2-minute **video** snapshot of the industry at <https://www.youtube.com/watch?v=71oEugGTfVo>

What implications might that have for the “players” in this industry? Where should they expect real profits to come from?

More information on the industry is available at <https://www.americangaming.org/>

With information from 2010, here’s a 2-minute **video** naming Macau as the gaming capital of the world: <https://www.youtube.com/watch?v=8pUDCXtop_k>

And in 2014 a **video** report explains the macroeconomic environment of the Asia-Pacific gaming industry, and that although activity from China regarding anti-corruption efforts is reducing traffic in Macau, the environment remains supportive of the sector's growth and credit quality, underpinning a stable outlook on the sector: <https://www.youtube.com/watch?v=ZpeKMZLnoPk>

As of 2013 the biggest competitors, MGM, Wynn Resorts, and Sands, have all created very successful operations in Macau (Caesars did not enter the market initially, and has now been frozen out due to the lack of available gaming licenses). Although there are widespread allegations of fraud and connections to Chinese organized crime, the financial benefits from this global expansion means these major competitors won’t back off. According to I. Nelson Rose, a professor at Whittier Law School in California who writes a blog called Gambling and the Law, "Macau forced the casinos to see that they could become like other large U.S. corporations: Set up their plants and operations in other nations and make far more than they can being stuck just in Las Vegas." Sheldon Adelson, CEO of Las Vegas Sands, has described Sands as "an Asian company" with a presence in America. He makes far more in China, where a culture in which notions of luck and fate play integral roles, than in Las Vegas. As MGM CEO Jim Murren points out, "The Macau market is now larger than the entire U.S. gaming market. Unfortunately for Atlantic City, it's gone the other way. It's smaller now than when we entered it. The fortunes of the two couldn't be more different." Las Vegas would have to attract six times more gamblers each year than it does now – essentially every adult in America – in order to match the amount of money being taken in via casinos in Macau. Based on estimated numbers from 2012, Wynn Resorts now makes nearly three-quarters of its revenue in Macau. Sands, which owns the Venetian and Palazzo, earns two-thirds of its revenue there. In the U.S., companies are tweaking their flagship Las Vegas casinos to look and operate more like Macau-style properties. This is because an increasing number of Asians come to Las Vegas, especially, because of the reduced tax on earnings compared to China. Asian visitors now account for 9 percent of tourists to Las Vegas, up from 2 percent in 2008. See the AP report, “Tiny Chinese enclave remakes gambling world, Vegas” by Hannah Dreier, July 8, 2013. <http://lasvegassun.com/news/2013/jul/06/us-casinos-macau-headache-abridged/>

How can you use the above information to do an analysis of the industry? If you were in the casino business, wouldn’t you want to keep abreast of this kind of information?

1. ***Continued: What has been the effect of the changing industry structure on U.S. casinos?***

The concept of *Strategic Groups* involves two unassailable assumptions in industry analysis, based on the belief that no two firms are totally different, and no two firms are exactly the same. Strategic groups are clusters of firms that share similar strategies in their:

* Breadth of product and geographic scope
* Price/quality
* Degree of vertical integration
* Type of distribution system

The value of strategic groups as an analytical tool is that they identify barriers to mobility that protect a group from attacks by other groups; identify groups whose competitive position may be marginal or tenuous; chart the future direction of firms’ strategies; and allow strategists to think through the implications of each industry trend for the strategic group as a whole.

The casino industry can be used to illustrate the existence of strategic groups. To begin with, casino firms that had a large presence in Las Vegas or Atlantic City were more likely to compete with each other. These firms operated larger resorts, which offered a broad range of entertainment that catered to customers from around the country and even other parts of the world. By contrast, the smaller casinos, such as those on the water and on Native American lands, were more focused on gambling and catered more to local and regional customers. As such, these were less likely to compete with the larger casinos that were based in Las Vegas and Atlantic City. Each of these – the LV and AC large resorts vs. the local waterborne and Native American casinos – could therefore be considered to fall into different strategic groups.

What might Las Vegas casinos do to craft a *sustainable competitive advantage*, given the industry they’re in?

In general, the gambling companies in Las Vegas embarked on an aggressive strategy in light of the competition from various sources. They did a number of things:

* Promoted Las Vegas as the *destination* gambling city – in contrast to Atlantic City where gamblers made day trips from cities in the northeast. Las Vegas positioned itself as a magnet for both the overnight casino gambler, and weeklong vacationer, offering more than 130,000 hotel rooms, myriad dining choices, shopping, and top-notch entertainment. The infrastructure also helped in that Las Vegas was linked by air to major U.S. cities and also to countries outside the U.S.
* Casinos in Las Vegas positioned themselves as resorts for families by offering circus performances, etc. However, casinos in Las Vegas did continue to conform to their original “sinful” roots by offering adult-oriented entertainment, further differentiating Las Vegas casinos from casinos in other competing areas. This differentiation strategy was helped by the promotion slogan, “What happens in Vegas, stays in Vegas!”
* Las Vegas casinos constantly invested in refitting and renewal to continue to offer new attractions to customers. This meant that Las Vegas convention facilities competed successfully with Orlando and New York for the corporate meeting business. Las Vegas remained the top destination for overnight visitors looking for a casino experience.

By differentiating its properties, the Las Vegas casinos attracted visitors and retained their business.

On the other hand, casinos in Atlantic City played catch-up with Las Vegas casinos partly because LV had a head start – gambling was legalized in New Jersey a full 45 years *after* Nevada. From the start, Atlantic City casinos realized that they could not compete with Las Vegas’s broad range of dining, shopping, and entertainment choices. In addition, AC’s location in the Northeast highway corridor meant that the majority of customers could easily come as “day trippers.” By promoting its proximity to the beach and the fact that most casinos were located on a boardwalk, AC was originally able to carve out a competitive position in the industry. However, that competitive position had eroded. Atlantic City casinos had tried to mimic their Las Vegas competitors by sprucing up their establishments. The city attempted a makeover, with the *Borgata* leading the charge. Casinos added wings to attract overnight customers, and some added outdoor bars to take advantage of the beachfront, but additional expansion was on hold during 2009 and most of 2010, waiting for a change in economic conditions. Then, reports of hurricane damage in 2012 kept visitors away. In short, Atlantic City casinos had been trying to move toward a strategy of differentiation by providing a more attractive ambience, but overall environmental conditions were making this difficult to achieve.

The main threats Atlantic City casinos faced (as did Las Vegas casinos) were Native American casinos, slot machines at local racetracks, and Internet gambling. Two of the biggest Native American casinos were in Connecticut, within driving distance of Atlantic City. In addition, several states had passed legislation allowing racetracks to provide slot machines for their visitors. Internet gambling had a cost advantage – operators did not have high infrastructure costs, and offshore websites were immune to legislation regulating their operation. In addition, competition had grown internationally, especially in the South China Sea city of Macau where casino developers had begun to grow their portfolios. To combat these threats, both Las Vegas and Atlantic City casinos had to continue to try to differentiate themselves. Many industry observers believed that the proliferation of local casinos and the availability of Internet gambling might even be an opportunity for LV and AC, since people who developed a taste for gambling at the local and home venue would probably want to visit LV or AC eventually, to experience the real thing!

There remain challenges AND opportunities for all major competitors. See the additional reading and updates below. The major question is which of these firms, and which of these locations or *strategic groups* do you believe is better positioned for the future?

**NOTE – ADDITIONAL READING AND VIDEO VIEWING:**

Wynn Resorts, Las Vegas Sands, and MGM are some of the major players mentioned. Does their diversification into Macao and other world markets give them an edge?

In addition, the move to legalize online gaming offers another challenge AND opportunity to the big casino competitors. Online gambling will be licensed state by state, with New Jersey one of the first to allow this in 2013. As one analyst reported, “Casinos are already positioned to capitalize on the industry's paradigm shift and face the least amount of red tape in doing so. It's not often that you hear the U.S. associated with any 'emerging' opportunity, but in fact this is how online gambling can be characterized. In Boyd Gaming's 2012 annual report, the company (which trades as BYD, and is part owner of Atlantic City‘s Borgata Hotel Casino) boasts of how it's well positioned to capitalize on the "emerging domestic online gaming industry.” <http://www.newstimes.com/business/fool/article/Why-Online-Gambling-Will-Crush-the-Candy-4480839.php>

From 2015 here’s a report and **video** about mobile gaming. Although not truly gambling, this is becoming a big business, with the heaviest users spending up to $400 per person per transaction on these online games: <http://www.cnbc.com/2015/08/03/the-shocking-truth-about-mobile-gaming.html>

Regarding the major competitors, on January 28, 2008, Harrah’s Entertainment was acquired by affiliates of private-equity firms TPG Capital and Apollo Global Management. As the article below points out, this was a bad time to go private. Harrah’s is now “drowning in debt”:

<http://www.fool.com/investing/general/2009/06/24/for-casino-companies-this-is-no-panacea.aspx>

Harrah’s resurfaced as the public company Caesars Entertainment Group (CZR) in 2010. It operated over 47 casinos, hotels and 4 golf courses under several brands, and held rights to the World Series of Poker tournament activity. See more at <http://caesarscorporate.com/about-caesars/>

Compare the financial status of competitors MGM (MGM), Las Vegas Sands (LVS), Penn National Gaming (PENN), Wynn Resorts (WYNN), Boyd Gaming (BYD), and Caesar’s Entertainment (CZR) using these links:

<http://finance.yahoo.com/q?s=mgm>

<http://finance.yahoo.com/q?s=lvs>

<http://finance.yahoo.com/q?s=PENN>

<http://finance.yahoo.com/q?s=wynn>

<http://finance.yahoo.com/q?s=BYD>

<http://finance.yahoo.com/q?s=CZR&ql=0>

In 2015 the 270 Nevada casinos generated a net loss of $661,779,138 from total revenues of $24,591,388,351. These results were improved compared to FY14 when the net loss was $743,688,008 and total revenues were $23,895,954,169. “Total revenue” is the money spent by patrons on gaming, rooms, food, beverage, and other attractions. “Net income/loss” is the money retained by casinos after expenses have been paid but prior to deducting federal income taxes and prior to accounting for extraordinary expenses. Data from the Nevada State Gaming Control Board at <http://gaming.nv.gov/index.aspx?page=31&parent=4512>