How Does Your Casino Measure Up?

by Gary Green

How is it that one casino can be off-the-charts profitable and another casino struggles to make payroll? A lazy answer might be the age-old location, location, location – but that only determines how many customers are available, not the ability to turn a profit. Geography doesn't explain clusters where winning and losing casinos are only a few miles apart. It really is not about where the reservation or trust land is located.

At the end of the day, most casinos have the same slot machines. Even the payouts are almost the same – in Class II the payouts are identical. Table games are the same and odds of winning are the same. Tribal properties have optional variations of buffets and restaurants and some form of entertainment. Most all have players' clubs and even the general managers are often interchangeable. So, what makes the difference?

Despite all the neon glitter and luck-fantasy that players see, this really is a highly formulaic business. In fact, casino revenue can be projected so accurately that Wall Street bankers and hedge funds invest in casinos.

The key to that predictability begins with a topsy-turvy rethinking of management and budgeting. Rather than focusing on generating revenue to cover casino operations and profit, the best paradigms focus on streamlining operations to meet revenue. It's an upside-down business model for most of the world, but many good casinos operate that way without even knowing it.

Consider the widely-accepted maxim that the majority of casino revenue is generated from slot machine play, not just gaming, but specifically slot machines. In Nevada, that number is actually 42.4% of all revenue (competing with high room rates, expensive shows, and over-priced food). In Indian Country, the number is closer to 80% (because most don't price-gouge at restaurants and hotels). In short, that means 80% of revenue made by the property comes from slot machines.

The Costs of Operating

Assume that the cost of operating the entire property (every department) is something less than 80% of total property revenue. If that is accurate (and it should be, unless something is terribly wrong), then all operating expenses can be viewed as a percentage of slot machine net revenue.

That means that every single expense can be charted as a percentage of slot machine income. For example, it is possible to say, "every year the property spends .00003% of slot revenue on ball point pens."

Every expense can be correlated to slot machine revenue. If the right formulas are utilized, then how much a casino can afford to spend on any budget item (from labor to food to costumes to utilities, etc.) can be projected based on how much the slot machines make.

It also means that every dollar from a source other than machines is pure profit directly to the bottom line. For example, if the restaurants gross $3 million a month, then it's all profit, because costs of food, operations, labor, etc. are covered by the slot revenue. This is radically different from the model of each revenue center focusing on its own profit/loss. It means, for example, F&B can be about quality and service rather than the bottom line, assuming all costs are covered by slot machines alone.

So, how much should it cost to operate? In this model, really good operational management can keep the costs for the entire property to around 51% of slot machine revenue. In some cases, slot machine leases are added (or bucket-purchases) and the cost of leasing systems, driving operating expense (OPEX) to about 77% of slot revenue.

For example, consider a small casino with only 500 slot machines and a win-per-machine per-day of $250.

WITHOUT SLOT LEASES	
Number of machines	500
Win Per Unit Per Day	$250
Annual Slot Revenue	$45,625,000
51% total OPEX	-$23,268,750
Net Slot Machine Profit (after all operational costs)	$22,356,250

WITH SLOT LEASES	
Number of machines	500
Win Per Unit Per Day	$250
Annual Slot Revenue	$45,625,000
77% total OPEX	-$35,131,250
Net Slot Machine Profit (after all operational costs)	$10,493,750

This technique can be extrapolated to any size casino by changing the number of slots and the win per unit per day. Add to this hypothetical example 100% of the gross revenue from F&B and from entertainment/retail, and you can accurately project how much money you have available for loan payments and for the approved tribal allocation plan.

Using this process, some important questions can be answered:

• How profitable should a casino be? Excluding leases, net profit should be about 49% of slot machine revenue plus 100% of all other revenue. If a casino is not making at least that, then it probably needs a tune-up. That does not necessarily mean new management – it simply means a new business model.

• How much debt can a casino realistically afford? Varying construction loans complicate this, but in general, take your net profit number (above) and multiply it times six years. That is a very manageable loan.

• Is it possible to guarantee tribal allocations? Absolutely. The best formulas include a line-item portion of that 49% profit to assure a monthly tribal allocation. On top of that monthly guarantee (just like any casino OPEX percentage), a bonus can be added from whatever is left after loan payments plus the additional revenue of the non-gaming amenities.

The Golden Ticket

The magic, of course, is how to keep the costs of operating the whole property to 51% of machine revenue. Regardless of amount of revenue, how much is spent for uniforms, marketing, restaurant food, etc.? Techniques for determining these items vary, but most are proprietary formulas for structuring operating efficiencies, marketing systems, and staff development/mentoring.

The methodology itself, while seemingly upside down by the way a lot of casinos are operated, really is not so crazy. The budgeting technique described here is a modification of the zero-based budgeting strategy developed by Texas Instruments in the 1970s to create a structured process to build a culture of cost management. Application of the method, especially the technique of guaranteeing a tribal allocation by line-iteming it, allows the usage of those proprietary formulas, implantation of the newest cutting-edge marketing technologies, and the ultimate elimination of guessing about revenue performance. This is a formulaic business. Stick to the formulas and don't guess. ♣

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