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The True Cost of Marketing

When trying to understand how much a casino spends on marketing, most casino managers look at specific departmental expenses on the profit and loss statement including marketing expense, advertising expense, player rewards program expense and total comps (which often appear as line items on the P&L). The sum of these is considered the total amount a property spends on marketing. And while this methodology is valid, it leaves out several hidden expenses that must be considered when trying to understand the true amount that a casino spends to attract new customers to the property and foster loyalty among existing customers.

Two areas of a casino's business operations that are not normally considered as part of the marketing equation are food and beverage and entertainment. They are normally considered stand-alone revenue-generating departments that, for the vast majority of casinos, produce negative results every month. They are allowed to operate at a loss because they serve a supporting role to casino operations. Yet, the operating losses that they produce each month are never considered a form of marketing expense. To better explain why they should in fact be considered as part of the marketing equation, two hypothetical scenarios are offered.

A general manager, tired of seeing his food department losing $250,000 a month, instructs his food and beverage director to make his restaurants profitable. The general manager is convinced that the buffet, which is the biggest contributor to the department's operating loss, primarily serves non-gamblers and their families. The coffee shop, which offers a graveyard $2.99 steak and eggs special, also contributes to the department's operating loss. He decides that the casino can no longer afford to serve food for less than it costs to produce. The food department should therefore operate for profitability. To comply with the general manager's mandate, the food and beverage director re-aligns his buffet prices and eliminates most of the coffee shop's loss leaders.

One month later, at a weekly managers meeting, the slot director expresses his displeasure at the new restaurant pricing strategy. He says that he has been fielding numerous complaints from regular players. He presents various charts and graphs to bolster his argument that headcounts are down because of the new restaurant pricing strategy. The general manager relents and orders his food and beverage director to roll back prices.

In the second scenario, the entertainment director is mandated to bring quality headline acts into the casino's multi-purpose room six times a month. With 1,500 seats on a flat floor, the showroom has a sizable number of seats with poor sight lines. To compensate, the entertainment director creates a number of pricing tiers, allowing customers to pay premium prices for premium seats or value prices for less desirable seats. In addition, casino marketing agrees to "buy" 20% of each concert's seats. The entertainment director then develops a pricing scheme where an act will break even if it sells 80% of the available seats.

With some 'A' level acts costing $100,000 per show, it quickly becomes apparent that the market is not willing to pay $110 for a show's best seats. Casino marketing is asked to buy more premium seats. The entertainment director also starts to re-price his shows downward in order to assure that the room will be full, confident that, if he can achieve 90%-100% occupancy, he will be able to break even on his acts.

Despite this pricing strategy the entertainment department generates significant operating losses. With the costs of contract riders and labor added, the department ultimately generates a loss of over $100,000 a month.

The general manager is faced with a dilemma. Should he cut back on headline entertainment or continue with the current program? He shares his thoughts at a managers meeting. Once again it is the slot director, with support from the table games director, that makes the argument that their departments depend on entertainment to generate increased traffic in the casino. And again, the general manager acquiesces and keeps the entertainment program in place.

The Business Problem

Every casino is faced with the same business problem that is described above. Why would a manager of any business dedicate valuable floor space to a business enterprise that consistently fails to produce a profit? Any freestanding restaurant would quickly go out of business if it could not operate profitably as would a theatre that hosts live entertainment. Nevertheless, casinos routinely allocate precious floor space to business enterprises that operate at a loss so that another operating department can benefit.

The reason this happens is for the sake of marketing. The food and entertainment departments are used to attract people to the casino. Yet

Table 1. Property Results

Revenue	
Gaming Revenue	$7,000,000
Non-Gaming Revenue	$3,000,000
Total Revenue	$10,000,000
Less Comps	-$900,000
Net Revenue	$9,100,000
Total Expenses	$6,825,000
EBITDA	$2,275,000
EBITDA Margin	25%

the costs of these marketing efforts are not borne by the operating departments that benefit from them. The slot and table game departments are never held accountable for the losses generated by these other departments yet they are the sole beneficiaries of them. In fact, in many casinos, the P&L statements of the food department and entertainment department are not shown to the directors of table games and slots. While they vaguely know that those departments lose money, they do not know how much. They are not given the information.

Information is the Solution

For any business to succeed, its managers must have sound information. More important, that information must be presented in a format that shows the impact certain decisions have on a business's profitability. The two tables offer examples of how to present meaningful marketing information in a way that allows key constituents in the decision making process to better understand the relationships of various marketing expenses to both revenues and EBITDA (earnings before interest, taxes, depreciation, and amortization).

Table 1 shows the hypothetical operating performance of a casino. Table 2 illustrates all of the casino's marketing expenses including restaurant loss and entertainment loss, and their relationship to both property revenue and EBITDA.

As is the case in most casinos, comps represent the largest component of marketing expense followed by promotions. However, in this analysis, restaurant loss is the third largest marketing expense, representing 2.5% of total revenue and 11% of the property's EBITDA.

With this information shared among department heads, can a slot director justify $250,000 in marketing expense found in restaurant loss? How much additional slot revenue does that marketing expense generate? Better yet, what would happen if the property were to experiment and eliminate the restaurant loss for three months just as if it were to cancel promotions for a period of time? Would the diminution in slot revenue be greater or less than the increase in EBITDA caused by the elimination of that marketing expense?

Only by sharing the true costs of marketing among key managers and by monitoring those costs each month can casino leadership understand what the impact of reducing certain marketing expenses, including restaurant loss and entertainment loss, will have on overall property performance. ♣

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Table 2. Marketing Expense Analysis

		% Total Rev	% of EBITDA
Comps	$900,000	9.0%	39.6%
Club Points	$220,000	2.2%	9.7%
Free Play Offers	$210,000	2.1%	9.2%
Casino Marketing	$85,000	0.9%	3.7%
Slot Marketing	$95,000	1.0%	4.2%
Host Services	$10,000	0.1%	0.4%
Promotional Expense	$400,000	4.0%	17.6%
Advertising Media	$120,000	1.2%	5.3%
Advertising Department	$40,000	0.4%	1.8%
Restaurant Loss	$250,000	2.5%	1.0%
Entertainment Loss	$100,000	1.0%	4.4%
Total Marketing Expense	**$2,430,000**	**24.3%**	