



# KILLING THE GAMING EXPERIENCE

Why **free play** isn't free for either the casino or the player

By Steve Gallaway

**R**egional U.S. gaming markets continue to see month-over-month declines in gaming revenues. Analysts tend to blame the weather, the economy, market saturation, increased competition in neighboring states, and of course, Obama for this decline.

What has yet to be cited is that the gaming entertainment experience has fundamentally changed over the past few years, and many casinos no longer deliver the experiences that players have been used to historically.

Historically, consumer confidence has tracked closely with regional gaming revenues. When people perceive that the economy is strong, they spend more on entertainment activities such as gaming. When they are concerned about their economic future, they reduce their discretionary spending.

The U.S. economy is strengthening and people are feeling better about it. However, in looking at regional gaming trends, the economy is still in the doldrums. The question that must be asked: Is there something that the gaming industry is doing to cause this trend? Why is gaming revenue not growing in lockstep with consumer confidence?

To better understand what is happening, we conducted a number of analyses and identified two likely causes: machine hold percentage and the ever-increasing use of "free play."

## Reason No. 1: High-Hold Machines

Over the past decade, the largest growth in slot machine gaming has occurred on multi-line, video reel penny games. Penny games allow players an interactive gaming experience that provides more frequent payouts than more volatile, higher-denomination machines.

However, due to the game algorithms of penny games, their payouts are often lower than the gaming patron's bet. Even though the machine makes exciting sounds and flashing lights, the customer never really wins anything in many casinos. This charade continues when the player has the opportunity to play a few exciting bonus rounds, often with little in return other than an entertaining experience and a few extra credits. Eventually, the player's money runs out.

On the surface, this appears to be a win-win; players get their time on device and the casinos get their money. However, with many of these higher-hold machines, players have come to realize that too often they are going home as losers. Gone are the days when the patron went home a winner 15 percent to 25 percent of the time. With the high-hold penny games, the fundamental



sense of winning has begun to fade away.

With a typical penny game holding 12 percent to 16 percent, these games offer the worst odds on the casino floor. When one considers how much the top jackpot impacts this hold percentage, the effective hold percentage for the vast majority of players is even higher than 16 percent.

As if 16 percent isn't high enough, casino operators in certain jurisdictions are requesting that legal caps on slot hold be raised in order to allow them to put even higher-hold machines on the floor. When hold percentages approach these levels, the fundamental gaming experience is being destroyed.

Table 1 illustrates how slot hold percentages in a sample of states have been steadily increasing over the past decade. Illinois casinos increased their



**TABLE 1**

**Historical Hold Percentages**

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	10 Year Change <sup>1</sup>
Black	6.4%	6.5%	6.7%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%	8.2%	8.4%	16.2%
Indian	7.1%	7.4%	7.7%	7.9%	8.2%	8.5%	8.8%	9.1%	9.4%	9.7%	10.0%	29.1%
New Jersey	8.1%	8.2%	8.3%	8.4%	8.5%	8.6%	8.7%	8.8%	8.9%	9.0%	9.1%	10.1%
Pennsylvania	N/A	N/A	N/A	N/A	8.4%	8.7%	9.0%	9.3%	9.6%	9.9%	10.2%	14.1%
Missouri	6.5%	7.0%	7.5%	7.9%	8.4%	8.9%	9.4%	9.9%	10.4%	10.9%	11.4%	48.4%
Florida	6.5%	6.3%	6.1%	5.9%	5.7%	5.5%	5.3%	5.1%	4.9%	4.7%	4.5%	-15.7%
Average	7.0%	7.3%	7.6%	7.9%	8.2%	8.5%	8.8%	9.1%	9.4%	9.7%	10.0%	28.6%

<sup>1</sup>Florida experienced a 9.9% change.  
Source: Sands Casino Commission (SCM)

overall hold by over 36 percent; Missouri increased by more than 40 percent.

The one exception to this trend was Florida, where the hold percentage at racinos has been steadily decreasing. Not surprisingly, Florida is one of the few jurisdictions that have been experiencing an increase in gaming revenue, even when looking at the sum of only the three original racinos (Isle Pompano, Mardi Gras and Gulfstream).

So how did these high-hold games evolve? Studies by both manufacturers and operators were conducted to test whether players can tell a higher-hold machine from a looser machine. In one study, a six-person group was selected and each individual was given \$100 to play on a number of slot machines, all with the same game title. The research team set various hold percentages on those machines. After playing out their gaming budgets players were queried, and none could identify which machines were tighter.

The problem with this research is that it did not account for how the real world works. In the real world, players notice over time that their money simply is not lasting as long as it used to. They also have other empirical ways to measure their gaming experiences. Most gamers keep seven years' win/loss statements in their tax records. They also keep track of their points earned and have come to realize that they simply earn fewer points than they used to.

New players that are necessary for the casino industry to grow are often attracted to the penny games. Unfortunately, too often they seem to visit only a few times, lose their money too quickly and choose not to return. Many casinos further fail to induce incremental visits since the offers sent to those new players are based on theoretical win and not actual win, resulting in players receiving offers that do not reflect their true worth as they were not able to generate enough coin handle to qualify for a quality offer. It is not surprising that they do not return.

## Reason No. 2: Free Play

Over the past few years our industry has seen casinos issuing ever-increasing amounts of free play. Free play can be a great incentive to induce visits, particularly for those players who live a fair distance from a casino. However, too much free play can result in lower profits and fewer players. Unfortunately, in the world of high-tax jurisdictions, often the only marketing tool that casinos can use is free play.

For example, in Pennsylvania, where the effective tax rate on slots is 54 percent, casinos simply cannot afford to give players comp meals and free hotel stays.

If a Pennsylvania casino issues a \$100 player \$20 in free play, that money is not taxed and costs the casino only a nominal amount of labor and supplies to produce. However, if that same casino gives a player a \$20 food voucher, the redemption of that comp costs the casino closer to \$17, given food and labor costs. When considering the tax rate, that player would have to lose \$31.50 (\$17/54 percent tax rate) for the casino to break even on that comp. As such, it makes financial sense for these casinos to issue free play over other types of comps.

To better understand the amount of free play being issued, let's continue with Pennsylvania. For FY 2014 YTD, 20.2 percent of every dollar wagered on

slot machines in Pennsylvania was through free play. That is equal to 25.3 percent of every dollar actually lost.

At Sands Bethlehem, which issued the largest percentage of free play, 33.8 percent of every dollar cycled through their machines was free play. That means that free play was equal to 51.1 percent of actual net revenue. Hold percentages were also very high at 9.9 percent for the state and 10.2 percent for Sands.

The problem is that many casinos are not directing this overabundance of free play to the right customers. It is a reality of gaming that some players are lucky and some players are not. Statistically, it makes sense that over time a group of players win and larger group of players lose. Some players will lose a little and some players will lose a lot.

Unfortunately, the majority of casinos have a habit of basing direct mail offers on theoretical win and not actual loss. As such, it is very common for players with lower actual losses to receive higher-value offers than those who lost more cash to the casino. What inevitably happens in many casinos is that the player comes in a couple of times, puts his card in the machine, loses his \$100 in 30 minutes and has only generated \$20 in theo. He then receives an offer in the mail for \$5 in free play, which is insulting to a \$100 player. As such, he does not return.

For the new player who is not yet in the database, the experience becomes even more exacerbating. The new player, who benefits from only a minimal amount of free play for joining the club, is now faced with a floor that is holding 10-plus percent on average. If it is an inexperienced player who doesn't know that \$1 steppers have the lowest hold, then he or she will likely be lured in by a high-hold penny game.

Many new players think the penny games will be the best bet for their money to last. After all, how much money can you really lose on a penny wager? They soon find out that when you hit max-coin, the cost of each spin becomes \$3.50 or more. Before the player knows it, he has lost \$100 in 30 minutes. As they didn't have the extra play time allotted to them by the 50 percent bump in funds from free play, their play time is minimal and experience lacking.

## Let's Go Back to the Basics

There is a belief that casinos need to attract younger players to replace the older generation of gamers. That is a false premise. Casinos' core players always have been and always will be 50-plus empty nesters. Every year this market segment from a net perspective grows as people age.

They want the same casino experiences that they have always wanted—a clean environment, recognition, reasonable rewards, a game where their money will last and the real chance to win occasionally.

Let's stop trying to underestimate the player and simply give them what they want, a quality experience. Slot hold percentages in some jurisdictions have hit a tipping point and gamers no longer find entertainment value in the gaming experience. Casinos can change, collectively or individually, and reverse declines in revenues, or they can accept that their best days are behind them.