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New Kid in Town

By Andrew Klebanow and Steve Gallaway *Fri, Jan 23, 2015*

Can Vietnam emerge as an international gaming-resort destination?

Despite the recent downturn in gaming revenue in Macau, Asia remains the region of the world with the greatest opportunities for casino development. While Japan and Taiwan remain the most enticing markets, if only enabling legislation were to be passed, other markets are attracting the interest of casino developers. Unfortunately, most of those opportunities are in markets that are loosely regulated, difficult to get to, surrounded by poor infrastructure or require border crossings that can best be described as challenging.

One market that continues to interest investors is Vietnam. With 92 million citizens, a burgeoning middle class, good airport infrastructure and airlift to a number of nearby countries, Vietnam appears poised to emerge as a regional gaming market that is capable of producing a prodigious amount of gaming revenue. Nevertheless, a number of issues must be resolved before the country can live up to its potential.

The Situation Today

Casinos in Vietnam operate under a wealth of constraints today. First, Vietnamese residents are not permitted to gamble, though holders of dual passports—referred to as Viet-Qs—can. The government currently limits the number of casino-resort licenses to six. While these properties offer a full range of table games and electronic gaming devices, the actual number of tables and slots that those casinos can operate is predicated on the amount of capital invested and/or the number of hotel rooms they provide for guests.

In addition, five-star hotels in urban centers are permitted to operate electronic gaming lounges. There are about two dozen such operations, and each has approximately 80-100 electronic gaming devices and a few electronic table games.

Vietnamese residents who wish to gamble today must travel to Cambodia, where casinos are clustered in towns along the border. Travel to those properties can be arduous by Western standards. Alternatively, Vietnamese residents can fly to Phnom Penh and gamble at NagaWorld, the most attractive property in Cambodia.

The government is slowly moving forward with a plan to allow residents that meet certain income requirements to enter casinos in Vietnam. The plan includes a pilot program in which one casino-resort would be selected to serve as the pilot project. The Grand Ho Tram Resort is the newest full-service casino resort in Vietnam, and its build quality and amenities allow it to compete with the best casino-resorts in Asia. It enjoys a beachfront location and is a 90-minute drive from Ho Chi Minh City. With its $600 million investment, commitment to spend up to $4 billion and location near Ho Chi Minh City’s 9 million residents, the Grand Ho Tram would be the ideal candidate.

Even if the pilot program proves successful and the government moves forward with opening up casinos to residents, there remains a wealth of obstacles that limit Vietnam's chances to rise to the upper echelon of gaming destinations and enjoy the economic benefits that casino-resort development can bring.

Problem 1: Taxes

Currently, casinos in Vietnam are subject to a 30 percent tax on gaming revenue. With the likely repeal of a tax on winnings paid by players, the government intends to add a 5 percent tax on top of the existing gaming tax. While the future gaming tax will rise to 35 percent, casino gaming revenue is also subject to a 10 percent VAT, which will bring the effective tax rate to 45 percent.

This onerous tax rate will inhibit Vietnam's ability to attract foreign investors for new large-scale integrated resorts, and will remain an obstacle for current operators as the amount of net gaming revenue retained by the operator will be only pennies on the dollar.

To better understand the impact of a 45 percent tax rate, one need only look at junket revenue, which is a significant source of revenue for Vietnamese casinos. Casinos in Vietnam have to pay higher commissions to junket operators in comparison to Macau (1.25 percent) and close to those paid by casinos in Cambodia and the Philippines (1.6 percent-1.7 percent), jurisdictions that have much lower tax rates. At a 1.7 percent commission, a Vietnamese casino is only keeping 22 cents on every junket dollar it earns. From this 22 percent, all operating expenses must be paid, leaving very little money for debt service.

A similar story can be found in the premium mass and mass markets. When considering that the rebate expense for premium players often equates to 30 percent of their theoretical win, dropping to 10 percent for mass-market players (not including other forms of player reinvestment such as airline tickets, hotel rooms, food and other casino-paid perks), the profit margin quickly disappears when the casino operator has to pay 45 percent of its winnings in taxes.

Problem 2: Reliance on PRC Citizens

Casinos throughout Asia rely on citizens of the People's Republic of China (PRC) for the majority of their customers. Actions taken by the government of the PRC directly impact Vietnam's gaming revenue potential, which further increases the risk to casinos in Vietnam. This impact can be seen from how junket operators are allowed to operate and the greater geopolitical relationships between China and Vietnam.

Chinese junket operators exist primarily to 1) ensure gamers have money available to gamble in casinos, 2) assist with preparation of appropriate visas and 3) provide travel arrangements.

The PRC recently instituted a crackdown on corruption, which has had a direct negative impact on junket gaming revenue in Macau and other countries in Asia. During this crackdown many junket operators have been accused of wrongdoings by the PRC and many have gone out of business.

Is the PRC doing this to prove a point, and planning to pull back some soon? Are they legitimately trying to reduce corruption, which would be good in the long run for the gaming industry but will continue to cause pain in the short term? While the answers are unknown at this time, what is known is that PRC policies have a direct impact on the ability and desire of Chinese gamers to utilize junket operators. As such, gaming revenue throughout Asia suffers.

Border conflicts also can impact gaming revenue. As evidenced with the spring 2014 conflict over China's claim of a portion of the South China Sea that Vietnam believes falls within its 200-nautical-mile exclusive economic zone, an immediate drop occurred in Chinese visitors to Vietnam.

This drop also correlated with a downturn in gaming revenue at many Vietnamese casinos. While this political situation has calmed down and Chinese tourists appear to have largely returned to Vietnam, it illustrates how PRC policies toward Vietnam, which have nothing to do with gaming or tourism, can have a direct impact on gaming and tourism dollars to the country.

As China and Vietnam have had numerous conflicts over the past millennium, it would be naive to believe that additional conflicts will not occur in the future. Given these factors, when evaluating the future potential for integrated casino development in Vietnam, one must consider the reality that PRC policies can have a direct impact on tourism and the gaming revenue that it generates.

Problem 3: Residents Not Allowed

It is a known fact that Asian cultures universally enjoy gambling. Yet despite this fact, most Asian countries do not allow their citizens to gamble within their own countries' borders. In those that do allow it, there are often other factors that impede visits, such as imposing an entrance fee (as in Singapore) or forcing their citizens to drive four hours to the nearest casino that admits residents (i.e., Kangwonland Casino in South Korea). These policies result in higher levels of risk for investors in any given casino in Asia.

One needs to look no further than the United States to see what can happen. Atlantic City's gaming revenue has plummeted, as its business plan was built around attracting gamers from surrounding states. As Pennsylvania, New York and other surrounding states expanded gambling in their jurisdictions, Atlantic City's gaming revenues declined. Similar situations have occurred in West Virginia, Indiana and Tunica, Mississippi.

Imagine what would happen to all Asian gaming destinations if the PRC legalized gambling. While no one believes that the PRC has any intention to legalize gambling, the point is made simply to illustrate that by forcing casinos to rely primarily on foreigners, the risk factor is significantly greater, as those casinos can be severely impacted when a neighboring country decides to allow casino development.

When countries allow their citizens to gamble, they reduce the risk to developers, which thereby allows for higher levels of capital investment, more tax revenue and the creation of more jobs.

The fundamental argument against allowing residents to gamble is to prevent problem gambling. The irony is that those gamblers the home country is trying to save are already gambling through other means such as visiting a casino across the border, playing at an underground casino in their home country, or hopping on a flight to a nearby country and gambling there.

All international gaming companies have experience in training their employees to recognize problem gamblers and provide the necessary assistance to those gamers. A sound gaming policy and oversight campaign can actually reduce problem gambling in a country. Banning it does nothing to prevent problem gambling.

Problem 4: The $4 Billion Entry Fee

The Vietnamese government continues to explore opening up additional regions to casino-resort development with a requirement that the developer spend a minimum of $4 billion.

This is simply unrealistic. Without the ability for residents to gamble, the only way a resort of this magnitude could potentially be justified would be through significant numbers of junkets coming to the facility. Given the issues identified above, this would present such a high level of risk that a gaming company capable of building a facility of this size would not invest that amount of money. Even if residents were allowed to gamble, expecting anyone to invest a minimum of $4 billion for an integrated casino resort in any developing nation defies business logic.

Minimum capital investments are a silly notion. To maximize the potential that casino resort development can bring, a country should develop sound gaming policy and oversight, clearly define and guarantee a tax rate and exclusivity period for a given amount of time, and then issue an open request for proposal (RFP) without a minimum capital investment requirement. A properly executed RFP process will yield qualified bidders who will put forth their strongest bids with the understanding that capital investment will be a significant factor.

Should these problems above not be addressed, Vietnam will never develop into an international gaming destination with resorts that can compete with those in Macau and Singapore. However, given the many attributes that Vietnam possesses, if the government is able to craft sound gaming legislation that offers a stable and reasonable tax rate, and includes a provision that allows residents to gamble, then casino-resort developments can prosper and serve as an engine for economic growth.

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