

# Regular research papers and articles providing sector specific insights and issues analysis – Hospitality sector.

May edition 2011 – Hospitality

## Industry Intelligence Unit

Grant Thornton's Industry Intelligence Unit (IIU) blends the latest information and analysis of specific industries drawn from publicly available sources (including the Australian Bureau of Statistics and the national press) with pragmatic, commercial and practical initiatives to improve stakeholder value.

**Welcome to our latest hospitality IIU publication, which will focus on problem gambling in the pub and club industry.**

On 2 September 2010, in an attempt to secure the balance of power in the parliament, the Honorable Julia Gillard, Prime Minister, came to an agreement with Mr Andrew Wilkie, Independent MP for Denison that sent shock waves through the industry with its potential to impact gaming revenues.

In the absence of agreement with the states by 31 May 2011 on any of the reforms contained in the agreement, it was understood that the Government would, based on legal advice, seek to legislate in order to achieve the reforms.

On 1 February 2011, the Federal

Families Minister released legal advice that outlines a range of options available to the Commonwealth that would enable it to deliver the proposed gambling reforms. These include direct regulation, taxation-based regulation or a combination of both.

Mr Wilkie has welcomed the legal advice noting "it's clearly in the interests of the states that they now co-operate to bring about these very important reforms" and has warned "it's well beyond time for the industry to either start co-operating with us and be honest with their patrons or just get out of the way and let the government and myself get on with the job."

Is the deal a silver bullet to problem gambling?

In this edition of our IIU we will specifically focus on:

- The Gillard deal
- Problem gambling in the industry
- What is a pre-commitment system and how does it work?
- Impacts / costs on the industry, and
- Tips for stakeholders



# The Gillard deal...

On Thursday, 2 September 2010 the Honorable Julia Gillard, Prime Minister, and Mr Andrew Wilkie, Independent MP for Denison, executed an agreement that fundamentally secured his support for the Gillard government during last year's federal election.

A significant part of the agreement centered on problem gambling, poker machines and how the government can assist with gambling reform.

The deal, which will last for the duration of the Gillard government, provides for the following:

- Increased co-operation between the Commonwealth, State and Territory governments and, if required, legislative authority to address the issues of problem gambling, which historically has been predominately regulated by the State and Territory governments
- No later than 1 February 2011, the Commonwealth will commission comprehensive legal advice about its constitutional competence and prospects for successfully legislating in this area
- The Government will commit to the following measures:
  - Implementing a best practice full pre-commitment scheme that will be uniform across all States and Territories and machines. Implementation of pre-commitment arrangements is to commence in 2012, with the full pre-commitment scheme commencing in 2014

- Supporting the Productivity Commission recommendations in relation to poker machine dynamic warning displays and cost of play displays, and
- Implementing a \$250 daily withdrawal limit for ATMs in venues with poker machines (excluding casinos)

In the absence of agreement with the States by 31 May 2011 on any of the reforms detailed above, the Government will, subject to legal advice, seek to unilaterally legislate in order to achieve the reforms.



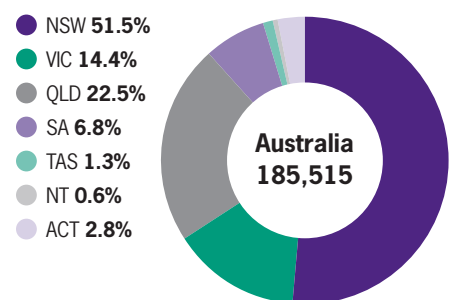
# Problem gambling in the industry

On 23 June 2010, the Productivity Commission (“the Commission”) released its inquiry report into Gambling in Australia, which noted the following:

- During 2008-2009, consumers, including international visitors, spent approximately \$19bn on Australian gambling products, which include electronic gaming machines (EGMs), lotteries, keno and table games. This amount represented 3.1% of household consumption expenditure (down from 3.9% a decade ago in 1998-1999). To put this figure into context, Australians spent approximately \$23bn on footwear and clothing in the same year
- Expenditure on gambling is dominated by EGMs with \$10.5bn (55%) spent in pubs and clubs and a further \$1.4bn (7%) in casinos. As a consequence, EGMs have featured heavily in the ongoing debate over problem gambling
- The concept of problem gambling is not easily defined and is an abstract and contested issue. As a consequence, it is difficult to accurately measure the number of ‘problem gamblers’
- Without definitively defining problem gambling, characteristics of a ‘problem gambler’ are those consistent with ‘addiction’ and may include difficulties in controlling gambling, chasing losses, borrowing to gamble and the need to increase stimuli to maintain the same level of excitement
- Whilst difficult to measure, the Commission estimates that there are between 80,000 and 160,000 Australian adults suffering significant problems due to gambling (representing 0.5% to 1% of adults) with a further 230,000 to 350,000 experiencing moderate risks that may make them vulnerable to problem gambling (representing 1.4% to 2.1% of adults)
- It is estimated that problem gamblers account for 40% of EGM expenditure in Australia

## Number of operational EGMs (pubs and clubs) by state

Source: Productivity Commission Inquiry Report No. 50, 26 February 2010



## Gambling expenditure by jurisdiction (2008-09)

State	Expenditure (\$m)	Expenditure as a proportion of household consumption (%)	Average expenditure per adult (\$)
NSW	7,150	3.5	1,319
VIC	5,110	3.3	1,229
QLD	3,344	2.8	1,016
SA	1,136	2.6	921
WA	1,129	1.8	672
TAS	429	3.4	1,124
NT	500	7.5	3,129
ACT	243	2.0	901
<b>Australia</b>	<b>19,042</b>	<b>3.1</b>	<b>1,147</b>

Source: Productivity Commission Inquiry Report No. 50, 26 February 2010

# The pre-commitment system

## What is it?

In simple terms, a pre-commitment system provides a restriction on poker machine expenditure to prevent players spending more than they originally intended.

It is intended to provide players with greater information and choice to allow them to make an informed decision regarding the amount of money they spend on gambling. Often, players find it difficult to stop gambling or spend more than they originally intended once they start. Factors that influence their decision making include the consumption of alcohol or certain emotional states, such as bored, lonely, stressed or sad.

## How does it work?

There are differing models of pre-commitment, which can range from the extreme, being self exclusion, to partial pre-commitment, whereby players are not obliged to use the system to gamble or, if they do use the system, they can choose to breach their limits.

The Gillard government is committed to introducing a full pre-commitment system and whilst the system could take a variety of forms, fundamentally players cannot gamble without being in the system. If they set limits, however, they are bound by them. It is important to note that even under this system it is likely that players will have the option for unlimited gambling but would receive periodic checks that this remained their preference.

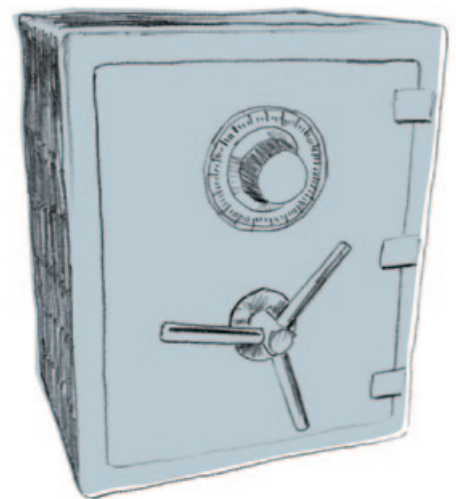
An illustration of a potential structure

of the system is provided below:

- Players are identified in order to play. This may take the form of a personal id card, USB, mobile phone, finger prints, a PIN or password.
- The identification would allow players to set predefined choices/preferences that would be 'remembered' each time they play.
- Players could have the option to pre-commit on any feature of an EGM, including:
  - Setting a limit on expenditure
  - Setting a limit of time allowed to play in a day, week or month
  - Time management warnings for work hours, to go home and other responsibilities
  - Stopping play when winnings exceed a certain amount – banking their winnings
  - Setting a limit on the intensity of play (e.g. number of lines, credits, dollars per button push), and
  - Breaks in play
- Determine whether any pre-determined preference has been breached

## Will it work?

In recommending pre-commitment, the Commission concluded "that pre-commitment is a strong, practicable and ultimately cost-effective option for harm minimisation. It overcomes some of the existing severe deficits in achieving self-control for problem gamblers and for genuine informed consent by many other consumers."



The Commission recognized that whilst "a full pre-commitment system cannot be a 'silver bullet', it may ultimately take pressure off other regulations aimed at harm minimization", which could allow some of the more prescriptive regulations to be relaxed or revoked.

Whilst in theory the regulations may be viewed as a step in the right direction, their effectiveness on problem gambling as a whole is not certain. It is noted, however, that Australia is certainly not the first country to consider and implement such measures.

The following is a summary of similar regulations introduced in overseas jurisdictions:

<b>South Africa</b>	Smartcards are used for gambling on poker machines in casinos in South Africa and have been generally well accepted by patrons. In addition, there are no ATMs allowed in any gambling venue under South African law.
<b>Austria</b>	All casinos in Austria use smartcard operated poker machines and there are a series of harm minimisation measures in place including player tracking.
<b>Norway</b>	<p>On 1 July 2007 the Norwegian Government removed all of the countries 15,000 poker machines and reintroduced the machines 12 months later under a card based and cashless system.</p> <p>Smartcards are now required for the national lottery, in gambling venues and for internet gambling via the government owned site, Norsk Tipping. There are many other controls incorporated to the gambling facilities to ensure harm minimisation.</p> <p>Research has shown, however, that the proportion of people with gambling problems has not changed, but rather, their focus has simply shifted to other, more accessible, gambling mechanisms (e.g. online gaming).</p>
<b>Denmark</b>	The Danish government issues smartcards to all applicable users of its gambling services and is thought to have the most comprehensive harm minimisation measures, including restrictions on the type of games certain gamblers can play.
<b>Sweden</b>	<p>Sweden's state-owned gambling operator, Svenska Spel, introduced a mandatory 'Player-card' for internet poker players. To play, customers are required to set time and money limits and have access to their spending history.</p> <p>The Player-card is made available for voluntary use in other forms of gambling, including bingo, lotteries and sports betting, and incentives, such as free lottery tickets, are provided to encourage customers to register.</p> <p>Player-cards are now operated by 1.3 million Swedish customers and are described as a well-accepted technology (Responsible Gambling Council (RGC 2009)).</p>
<b>Nova Scotia (Canada)</b>	Currently rolling out a pre-commitment system that uses card technology following trialling. During the trials there were generally positive responses from users about the capacity for the technology to help gamblers in setting and keeping to a budget, and to be aware of how much they had spent in time and money. However, venue owners and staff were much more negative about the technology.
<b>New Zealand</b>	MyLotto (New Zealand's online lottery) incorporates pre-commitment features, including a requirement to set spending limits, self-exclusion options for one or more games, and access to gamblers' transaction histories.



# Impacts / costs on the industry

The opposition to the proposed pre-commitment scheme from key industry bodies has been significant with much criticisms centered around the impact on the ongoing viability of pubs and clubs, the likely costs to comply with the regulations and an opinion that the changes will not combat problem gambling as a whole, but rather, those with problems will simply use other forms of gambling that are not so heavily regulated.

On a national scale it is difficult to quantify the total cost of the reforms as states are at different stages of the pre-commitment process and the levels of EGM technology vastly vary from pub to pub. To this end, the Gillard Government has commissioned a cost-benefit analysis of the proposed gambling reforms on the industry.

The costs of the transition are likely, however, to be primarily incurred in the following areas:

- Reduction in revenue
- Increased capital expenditure
- Increased compliance costs; and
- Adverse impacts of uncertainty

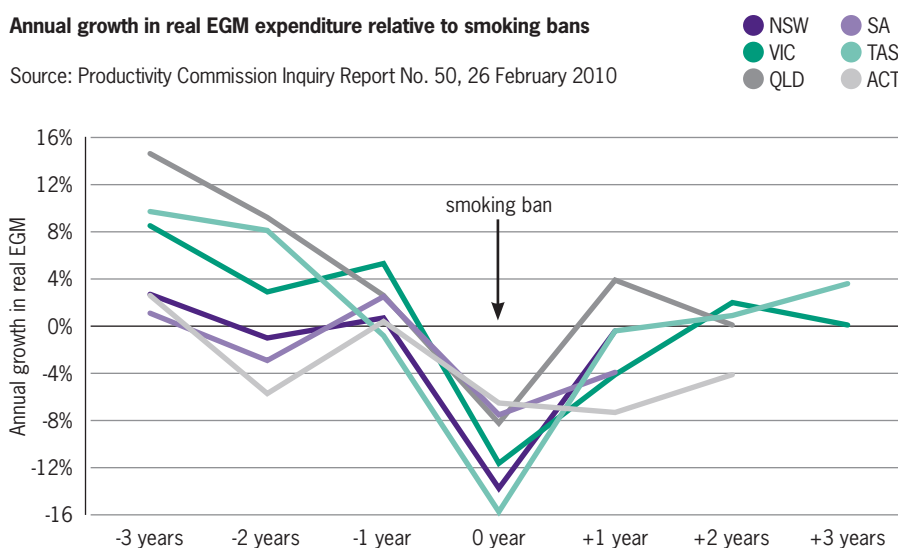
## Reduction in revenue

Whilst it has been widely reported that problem gamblers account for 40% of all money spent on EGMs, it is difficult to confidently predict the likely impact of a full pre-commitment system on gaming revenues.

One of the main regulatory changes to have a noticeable impact on EGM

Annual growth in real EGM expenditure relative to smoking bans

Source: Productivity Commission Inquiry Report No. 50, 26 February 2010



expenditure, which therefore may provide a useful proxy in this instance, was the introduction of smoking bans in gaming areas of clubs and pubs. These bans were introduced in the majority of Australian jurisdictions over several years with Victoria leading the way in 2002.

Smoking bans were followed by sudden and major declines in EGM expenditure in each jurisdiction that instituted a ban. It is difficult to assess the ongoing impact of smoking bans as subsequent policy changes in the industry are likely to have had an impact on EGM expenditure. However, as detailed in the graph above, whilst expenditure rebounded after the initial decline, the Commission notes that real growth rates in EGM expenditure have not returned to pre-smoking ban levels.

## Increased capital expenditure

To be able to deliver and comply with a full pre-commitment system a venue will require the appropriate hardware and software. The extent to which upgrades to hardware and/or software will be required is unknown as the age of EGMs and the technology currently used vastly differs from venue to venue, and state to state.

The costs, however, that are likely to be incurred for the differing levels of upgrades required are as follows:

Upgrade	Estimated cost
Obsolescent machines:	\$15,000 to
Retirement and purchase of new machines	\$25,000 per EGM
Major hardware and software retrofit	Approximately \$9,000 per EGM
Software upgrade	\$500 to \$2,000 per EGM

A venue will ordinarily budget for capital expenditure to maintain and upgrade its EGMs on a regular basis as part of its gaming strategy. It is therefore important to note that some, if not all, of the above costs for the majority of venues will have ordinarily been incurred at some stage. Therefore, the underlying risk is that the proposed regulatory changes may accelerate and/or increase such costs.

### **Compliance costs**

Given the significant differences from venue to venue, the increased cost of compliance is difficult to quantify. However, it is likely that a large number of venues will incur additional costs for in-venue and monitoring systems to implement a full pre-commitment system.

### **Uncertainty**

Irrespective of the actual impact, the uncertainty caused by the Deal will undoubtedly impact all key stakeholders in the industry.

The flow on effects of such uncertainty are likely to adversely impact values, M&A activity and the willingness of financiers/investors to return to the sector.



# Tips for stakeholders



**Tips for publicans** to mitigate the potential impact the change in regulations on their business.



**Tips for financiers** to manage the potential impact the regulations may have on their clients.

Key issue	Action
<b>Cash flow</b>	<p><b>Forecast cash flow</b> – Prepare a six to 12 month cash flow forecast to assess and analyse the potential impact of a reduction in revenue and increased compliance costs and Capex associated with a full pre-commitment system.</p> <p>This will assist in highlighting any potential temporary periods of cash shortage and/or permanent cash deficiencies and provide time to formulate any necessary strategies to manage this risk.</p>
<b>Capex</b>	<p><b>Forecast Capex</b> – Review the existing gaming strategy, assess the current technology of each EGM and determine the Capex required to adhere to the proposed gambling reforms.</p> <p>Identify any funding gaps as a consequence of the acceleration of scheduled gaming Capex. These should be included in any assessment of forecast cash flow.</p>
<b>Review strategy</b>	<p>Venues most at risk are those that are reliant on gaming revenues to be profitable. It would be prudent for such operators to assess their current strategy and look at ways to <b>balance revenue streams</b> and reduce dependency on gaming.</p>
<b>Financier</b>	<p><b>Open the lines of communication</b> with your financier(s) with regard to any perceived funding issues and/or financial stresses as a result of the proposed gambling reform.</p> <p>Such communication should be open and frank, and provide the financier(s) with a clear strategy to manage any perceived risks.</p>

Key issue	Action
<b>Reliance on gaming</b>	<p>Identify clients who, from a financial perspective, have a heavy reliance on gaming revenues.</p>
<b>Covenants</b>	<p>Review and assess the level of compliance with current covenants.</p>
<b>Cash flow</b>	<p>Review headroom and/or free cash under current facilities to assess risk of a reduction in revenues and/or an increase in compliance costs and Capex.</p>
<b>Creditors</b>	<p>If available, review quantum and aging of statutory creditors, including the ATO, relevant state revenue authority and superannuation to identify potential cash flow difficulties.</p>
<b>Communication</b>	<p>Seek feedback from the client on the proposed regulatory changes, potential financial consequences and, if required, proposed mitigation strategies.</p>

# Industry Intelligence Unit

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## What is the Industry Intelligence Unit?

The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and sub-industries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

## Industry focus

The IIU utilises the industry experience and expertise of Grant Thornton partners and staff across Australia. The IIU is predominantly focused on the following industries and their related sub industries:

- Property
- Retail
- Aged Care
- Automotive
- Hospitality
- Financial Services
- Professional Services

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