**Do promotional allowances actually increase profits for casinos?**

Toni Repetti
Hotel Administration Department
University of Nevada, Las Vegas

## ABSTRACT

*Casinos often give free items to customers to attract new guests to the property or to reward their loyal guests. These free items are classified as promotional allowances or complimentaries. Casino management and marketing personnel believe that these expenses are necessary to maintain customers and to also increase the property's net income. Two OLS regression models are run to determine if promotional allowances do increase earnings before income, taxes and depreciation. The results will help management better understand the effect of offering complimentaries to their customers.*

**Keywords:** Casinos, promotional allowances, net income, complimentaries

## INTRODUCTION

Promotional allowances, or complimentaries, are casino management's answer to loyalty programs that many industries, such as airlines and grocery stores, have been doing for so long. Promotional allowances have changed over time from casino logoed merchandise and inexpensive meals to the likes of high-end hotel rooms, concerts, expensive meals, free gaming play, and shopping sprees. More and more casinos are also extending complimentaries to not only their casino players, but also their loyal hotel and food and beverage customers.

Promotional allowances include the amounts given to each guest based on how much the guest has gambled or spent, and also on management's current marketing strategy which could include items such as discounts, "buy one, one get free", or free items when certain other items are purchased. Promotional allowances do not include advertising spend and only includes items that have a direct revenue contribution when redeemed. AICPA accounting standards suggest that promotional allowances can be booked one of two different ways, at retail as part of gross revenue and backed out to achieve net revenue or not booked at all (2007). Under either scenario net revenue is the same and an increase in promotional allowances would increase gross revenue.

Casino management uses promotional allowances to increase revenues in the hopes that the guests that are receiving the free item will spend more money than they would have without the complimentaries. Based on the Nevada Gaming Commission Abstract (2009), complimentary expense only decreased 1.6% from fiscal year 2008 to 2009, yet gross revenue decreased 12.0%. During 2006 to 2007, when gaming in Nevada was still increasing complimentary expense increased 3.7% and gross revenue increased 4.9%. This shows that promotional allowances may not be increasing revenue and profit margin like management would hope during downtimes. Also, maybe the increase in revenue during uptimes may not be attributable to promotional allowances but something else entirely.

From an operational perspective this is rarely analyzed and when it is management just looks at the increase in gross revenue and not the change in EBITDA. Since there may be other expenses that increase with the increased complimentaries and corresponding gross revenue, increasing promotional allowances may not be the most effective way to increase EBITDA even though revenues may be increasing. The purpose of this study is to determine if promotional allowances increase earnings before income, taxes and depreciation for casino companies and if management is making the right decision in increasing complimentaries when revenues decrease just to try and keep customers.

## LITERATURE REVIEW

There is little known research on the effect on promotional allowances in the gaming industry. There is also little research in other industries mainly due to the fact that other industries include complimentaries in revenue, while gaming companies report promotional allowances separately due to the large dollar amount. Also, most of the research available is concerned with manufacturer's promotional allowances to retailers and how those allowances affect the retail price of items and not the retailers own promotions. The research discussed here will mainly focus on firm specific price promotions and special event promotion to start to increase the amount of literature available to gaming researchers.

Srinivasan, Pauwels, Hanssens, and Dekimpe (2004) study whether price promotions actually generate additional revenue and increase margins and find that promotions do not permanently affect volume. They do find that changes happen in the short run, but these changes disappear over time. Drèze, Nizel, and Vilcassim (2004) also find that in grocery stores, price promotions do persuade customers to spend more, but this just causes customers to increase inventory levels and spend less later. The authors also find that there is a reallocation of spending across products, so they may spend more in one area due to the promotion but they are decreasing in other groups to compensate. Casino management typically evaluates marketing promotions on a short term basis, and these finding may support management's decision to implement discounts or complimentaries, but this may not be the correct decision in the long run.

Wakefield and Barnes (1996) evaluate a triple A baseball team and find that loyal customers receive greater satisfaction from the service provided than the actual promotion. This may be significant for casinos if they believe their customers are loyal or management is concerned that the customer base is not loyal and will move to the casinos with the best or most promotions.

There are only a few known studies concerning gaming companies and promotional allowances. The first study evaluates five casino companies individually for two different models with promotional allowances as the independent variable in each (McGown & Brown, 2009). Gross revenue is the dependent variable in one model and gaming revenue is the dependent variable in the other. Both models for all companies have a highly significant correlation between promotional allowances and the independent variables. This makes sense because from an accounting perspective promotional allowances are required to be booked into gross revenue and backed out when calculating net revenue. As promotional allowances increase, revenue will increase dollar for dollar. The study also found that promotional allowances explained a significant amount of the variance in gross revenue and gaming revenue.

The second study on gaming complimentaries concerns the Atlantic City market (Marfels, 2010). Marfels uses Spearman's rank correlation coefficient to see if promotional allowances as a percentage of gross gaming revenues have a positive or negative correlation to casino size. He finds a positive correlation in the 1980's but a negative correlation since then. This study shows smaller casino may have to give more complimentaries to attract customers.

Another study was done on Atlantic City casinos for 2007 and the authors find that promotional allowances are negatively correlated to total revenue, but not significant at the .05 level (O'Donnel, Lee, & Roehl, 2009). These results coincide with those of Gu (2001). In both of these studies a vertical analysis was done with total revenue is an indicator for firm size. The sign is as expected as a negative since promotional allowances are an expense but promotional allowances were not the main concern of these studies.

## METHODOLOGY

Data will be retrieved from COMPUSTAT for all firms with an NAICS code of 721120, Casino hotels, and 713210, Casinos (except Casino Hotels). Annual data for 1999-2010 will be analyzed, which is available in the COMPUSTAT industry specific database for Gaming Items. If a company does not report promotional allowances for the year or has zero promotional allowances they will be excluded. Only US based gaming companies will be included since accounting rules vary by country.

Two different models will be analyzed using OLS regression. Earnings before income taxes and depreciation (EBITDA) will be the dependent variable in one model and profit margin will be the dependent variable in the second model. EBITDA was chosen over net income because how a casino finances its obligations and how much interest it has to pay was not believed to be a factor in whether promotional allowances affect a firm's performance. Net income will also be run as the dependent variable to confirm this.

Independent variables will include variables such as promotional allowances, total assets and gaming positions as indicators for firm size, firm gaming revenue, and US gaming revenue. Gaming positions are calculated as the number of slot machines plus six times the number of table games. This is an industry standard for calculating how many gaming positions a firm has. A dummy variable will be included for the recession periods in both models in case there is a significant difference due to economic factors outside the casino's control.

***(Note: Results, implications, future research, and limitations of this study will be discussed in the full paper after feedback on the poster.)***

## REFERENCES

American Institute of Certified Public Accountants (Ed.). (2007). Accounting and Financial Reporting. *AICPA Audit and Accounting Guide: Casinos* (pp. 9-14). New York, NY. American Institute of Certified Public Accountants, Inc.

Drèze, X., Nisol, P., & Vilcassim, N.J. (2004). Do promotions increase store expenditures? A descriptive study of household shopping behavior. *Quantitative Marketing and Economics, 2*, 59-92.

Gu, Z. (2001). Economies of scale in the gaming industry: An analysis of casino operations on the Las Vegas Strip and in Atlantic City. *The Journal of Hospitality Financial Management, 9(1)*, 1-15.

McGowan, R. & Brown, T. (2009). Revenue generation at casino resorts: The use of "comp"-based promotions. *Gaming Law Review and Economics, 13 (5)*, 363-385.

Marfels, C. (2010). Complimentaries as an instrument of product promotion in U.S. Casinos. *Gaming Law Review and Economics, 14(3),* 161-164.

Nevada Gaming Commission and State Gaming Control Board. (2006, December). *Nevada Gaming Abstract 2006.* Retrieved September 13, 2010 from http://gaming.nv.gov/documents/pdf/2006_abstract.pdf

Nevada Gaming Commission and State Gaming Control Board. (2007, December). *Nevada Gaming Abstract 2007.* Retrieved September 13, 2010 from http://gaming.nv.gov/documents/pdf/2007_abstract.pdf

Nevada Gaming Commission and State Gaming Control Board. (2008, December). *Nevada Gaming Abstract 2008.* Retrieved September 13, 2010 from http://gaming.nv.gov/documents/pdf/2008_abstract.pdf

Nevada Gaming Commission and State Gaming Control Board. (2009, December). *Nevada Gaming Abstract 2009.* Retrieved September 13, 2010 from http://gaming.nv.gov/documents/pdf/2009_abstract.pdf

O'Donnel, J., Lee, S. & Roehl, W.S. (2009). *Economies of scale and the Atlantic City casino industry*. Paper presented at the 2009 International Council on Hotel, Restaurant, and Institutional Education (ICHRIE) Conference, San Francisco, CA. Abstract retrieved from http://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1258&context=refereed

Srinivasan, S., Pauwels, K. Hanssens, D.M. & Dekimpe, M.G. (2004). Do promotions benefits manufacturers, retailers, or both? *Management Science, 50 (5)*, 617-629.

Wakefield, K.L. & Barnes, J.H. (1996). Retailing hedonic consumption: A model of sales promotion of a leisure service. *Journal of Retailing, 72 (4)*, 409-427.