

## COMPETITION ASSESSMENT THE CASINO MARKET

### AIM OF REGULATORY MEASURE

1. The Government wishes to ensure that gambling remains a safe, well conducted and crime free activity. Its regulatory proposals for casinos are set within this overall objective for gambling. The Government's policy is based around a comprehensive de-regulation of casinos with the objective of enhancing innovation, competitiveness and customer choice but in achieving this there must be:
  - o No weakening of effective regulation that is necessary to keep them free of crime, to ensure fairness to participants and to protect children and the vulnerable; and
  - o Safeguards against the proliferation of small casinos and the potential increase in problem gambling which ready access to a wide range of high street premises could entail.

### PROPOSED REGULATORY MEASURES

#### Current Regulations

2. Casinos are currently regulated by the Gaming Board for Great Britain (Gaming Board) under the Gaming Act 1968. The Act allows commercial gaming to take place on premises that are licensed or registered under the Act and allows those premises to have certain characteristics. There are also specific regulations, made under the Gaming Act, to control casinos.
3. Thus:
  - o A casino can only open between 2pm and 6am on weekdays and until 4am on Sundays;
  - o Advertising is restricted to classified advertisements. They can contain no more than the name, logo, address, telephone and facsimile numbers of the premises and factual written information about the facilities provided on the premises, the ownership of the premises, those who may be admitted and the method by which they may become eligible to take part in casino gaming;<sup>1</sup>
  - o A casino must operate as a members club;
  - o Casinos members must be over 18 years of age and have to wait 24 hours since they joined or gave notice that they intend to play before they take part in casino gaming. Members' bona fide guests may also take part;
  - o A casino can only offer specified games and the odds are regulated under the Gaming (Bankers' Games) Regulations 1994;
  - o Casinos can have up to 10 jackpot gaming machines with a maximum stake of 50p and maximum prize of £2,000;
  - o Players are restricted to payment by cash, cheque or debit card<sup>2</sup>;
  - o Casinos can only operate in 53 areas defined by the Gaming Clubs (Permitted Areas) Regulations 1971 and the Gaming Clubs (Permitted Areas) (Scotland) Regulations 1971. These are generally the areas of former county boroughs with population of over 125,000 or more at any time between 1 December 1970 and 1 October 1973. In Scotland, casinos were limited to the areas of the former counties of the cities in Scotland.

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<sup>1</sup> A passive website – one which is to be found by someone deliberately choosing to access the site concerned - based in Great Britain or abroad whose principal purpose is to provide information about gaming, including individual casinos is permitted. Advertising which takes place wholly or mainly outside Great Britain and the distribution of which within Great Britain does not exceed 20% of the total is also allowed

<sup>2</sup> Players can also use their credit cards to obtain a cheque to procure the issue of a cheque payable to the casino drawn on the account of a third party which can be exchanged for cash. The system currently applies to an arrangement with Global Cash Access. Once the player has specified an amount the machine checks with his/her credit provider before a cheque is issued

4. The Gaming Act also places a responsibility on licensing authorities to consider demand for gaming before granting a licence and gives them discretion to refuse an application if unstimulated demand is not demonstrated.<sup>3</sup>
5. The Gaming Board certifies the staff employed in casino gaming activities, for example, dealers, cashiers and pit bosses.
6. Each casino must obtain a certificate of consent from the Board and it must also obtain a licence from the appropriate licensing authority<sup>4</sup> before it can operate. In setting up a new casino, an operator must also conform to local planning requirements.
7. Casinos cannot offer unlimited stake or jackpot gaming machines and may not offer betting or bingo.

### Proposed Changes

8. The Gambling Commission to replace the Gaming Board. It will license companies that wish to start up, license their key staff and regulate the gambling products they provide. Under the proposed regulations:
  - Consents for new casinos will not be granted unless the proposal embodies a total gaming floor area of at least 5,000 square feet (in terms of area set aside for gaming tables);
  - For casinos with a gaming floor area of between 5,000 square feet and 10,000 square feet there can only be 3 gaming machines to every available table game;
  - For casinos with above 10,000 square feet and at least 40 available tables there is to be no restriction on the number of machines;
  - Limits on stakes and prizes for gaming machines will be removed, and they may be linked within the casino to provide progressive jackpots;
  - Bingo and betting will be allowed in casinos;
  - Casinos will no longer be forced to locate in permitted areas and will no longer have to pass the test of unstimulated demand;
  - It will no longer be a legal requirement to be a member of a casino or a member's guest before gaming is permitted;
  - Customers will not have to wait 24 hours before commencing gaming;
  - A full range of advertising will be allowed subject to statutory and non statutory regulation.
9. In England, Regional Planning Bodies, once they are established, will play a part in deciding the locations of the largest casino developments which may also include hotels, restaurants and entertainment. The procedures that will be adopted by Regional Planning Bodies for this purpose are not yet clear. Nevertheless, it is believed that very few leisure developments will be of sufficient regional or sub-regional importance to require specific mention in regional planning guidance. Other casinos will be subject to local authority planning procedures. All applications to set up new casinos will come forward as planning applications in the normal way. In Scotland and Wales, the planning of casinos will be a matter for the Scottish Parliament and the Welsh Assembly.
11. Existing casinos (most of which are below the 5,000 square feet size limit – see later section entitled "Size of Casinos") which was below the minimum prescribed size for a small casino licence, would nevertheless be entitled to obtain a casino premises licence in order to allow the casino to stay in business.

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<sup>3</sup> The Gaming Board can object to a licence on grounds of demand but only does so if it has reason to believe that problems of control would result. See Gaming Board Annual Report 2002/03.

<sup>4</sup> Licensing justices in England and Wales, licensing boards in Scotland.

## VIEWS OF THE SMALL BUSINESS SERVICE

12. The Small Business Service have been involved the early stages of consultation on the Gambling Bill and following production of the draft Bill and RIA. They welcome the general tenor of the proposals to deregulate the sector but are concerned on two counts:
- the proposal to set a licence threshold of 5000 square feet gaming area for new casinos is a barrier to entry to the market for smaller firms. They note that nearly 74.6 % of casinos operating at March 2003 (94 of 126) were below this gaming floor area and the Gambling Review recommended a minimum threshold for future licences of only 2000 square feet. They note and welcome that renewal and transfer of licences of existing casinos below this floor area will be allowed under "grandfather rights";
  - the proposal to limit the number of gambling machines to three per gaming table for casinos between 5 and 10,000 square feet area, considerably below the Gaming Review recommendation of 8 per gaming table, but to allow unlimited machines for casinos above 10,000 ft<sup>2</sup> with 40 or more tables also mitigates in favour of larger casinos and operating companies and against smaller operators.
13. They view these two measures as likely to act in concert to prevent entry of new small operators, more likely to be indigenous UK firms who may grow over time, and possibly to adversely affect the competitive environment for existing smaller operators. They consider that the tight licensing control that will be exercised by the new Gambling Commission, together with the revised planning regime, should prevent proliferation and criminal involvement.

## THE CASINO MARKET

### Product market

10. While patrons of casinos may also participate in a wide range of gambling activities, actual switching between gambling modes in response to changes in price, appears to be limited. In addition, there are regulatory limitations on substitution by alternative suppliers. We have taken the approach, therefore, of defining the appropriate product market as just casinos.

### *Demand Switching*

11. Demand side substitution occurs when customers would be willing to switch from one product to another if the price of the first product rose by a small but significant amount (usually 5 to 10%)<sup>5</sup>. In assessing the extent of this phenomenon in the case of casinos, consideration was given to the extent to which customers of casinos switch their expenditure between casinos and other gambling modes. Unfortunately, there is little rigorous analysis of whether or not other forms of gambling are close substitutes for casino gambling.
12. Casino gamblers tend to be involved in a wide range of gambling activities. Sproston et al found that of casino gamblers 84% also bought a lottery ticket, 58% used fruit machines, 56% engaged in private betting, 55% bet on horses and 51% bought scratch cards. Expenditure on casino gambling (measured by the house win) accounted for only about 8.5% of total expenditure on all gambling in 2002/03<sup>6</sup>.
13. Although currently casinos and other modes of gambling are subject to different regulations and tax systems there is some evidence to indicate switching between gambling modes. For example,

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<sup>5</sup> On average, the effective price of a particular gamble is the amount staked less the probability adjusted return from the gamble. Different types of gambling have different probabilities of winning and different prize structures. Hence, the effective price of one type of gamble relative to another may be difficult to calculate. This fact may make it difficult to find evidence for demand switching.

<sup>6</sup> Gaming Board, Annual Report and ONS expenditure on Games of Chance, statistical series CDEM 09.43.

Paton et al (2002)<sup>7</sup> found that the National Lottery was a substitute for casino gaming. They also found a less statistically significant relationship between casino taxes and spending on bingo. In both cases, however, the size of the effect was small.

14. Although casino gaming appears to be a substitute for the National Lottery and bingo, demand side substitution between casinos and other forms of gambling is not of significant proportions. Nevertheless, the above suggests that the demand for casino gambling may be relatively inelastic with the result that, in practice, actual switching between gambling modes by casino gamblers in response to relative price changes may be quite minor.

#### ***Supply Substitution***

15. Supply side substitution occurs when firms would be willing to quickly switch to producing one product from producing another in response to a small but significant price increase in the first product<sup>8</sup>.
16. All new casinos must be licensed by the relevant licensing authority and must meet an unstimulated demand test. Thus, it is not possible for new entrants to quickly enter into the supply of casino services and there may be elements of local monopoly sanctioned by regulation. In addition, considerable investment is required before operation can begin. For example, it is understood that the industry estimates that it costs approximately £1.4 million for a singleton operator to set up a provincial casino.

#### **Geographic Market**

17. While many casino chains operate nationally, there do not appear to be high levels of demand or supply substitutability. London has a large proportion of the total number of casinos but casino outlets are not evenly spread throughout the rest of the country. The UK casino market is, at its widest, national, but may have characteristics which potentially indicate local and/or regional geographic market in some areas.

#### ***Demand Switching***

18. Demand switching occurs in a notional geographic market when, in response to a small but significant price increase, enough customers switch to firms outside the hypothetical monopolised geographic market to make the price increase unprofitable for the hypothetical monopoly supplier.
19. There are no studies of the travel habits of UK casino patrons, however, Thompson et al (1995)<sup>9</sup> found that in Wisconsin less than 50% of casino gamblers travelled more than 50 miles to visit a casino. Given lower levels of mobility in the UK compared with the USA, it is likely that the travel limit is lower in the UK.<sup>10</sup>
20. Table I shows that in 19 permitted areas only one casino has been established. Moreover in a further 17 only two casinos operate. While normally this may not matter because it is possible to argue that links between regional markets are sufficient to ensure nationwide competition this may not be the case because casinos are not evenly spread. Hence, there may be breaks in the so-called chain of substitution. The South West, for example, has only 6 casinos (at Bristol, Plymouth and Torbay) while London alone has 24.

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<sup>7</sup> David Paton, Donald S. Siegel and Leighton Vaughan Williams: "New Evidence on the Demand for Gambling: A Report for the Department of [sic] Culture, Media and Sport", mimeo, 8<sup>th</sup> May 2002, p.16.

<sup>8</sup> Due to the difficulty in perceiving the effective price of gambling products it is likely that, in practice, any supply substitution will be the result of higher rates of return on capital obtainable through investment in casinos rather than in alternative gambling markets.

<sup>9</sup> William Thompson, Ricardo Gazel and Dan Rickman: "The Economic Impact of Native American Gaming in Wisconsin", *Wisconsin Policy Research Institute Report*, Vol 8, Number 3, April 1995.

<sup>10</sup> In private communication the Gaming Board has indicated that most customers of casinos outside London are local to the extent that local preferences for one casinos rather than another are very long-established.

**TABLE 1  
NUMBERS OF CASINOS BY PERMITTED AREA**

Number of casinos	Number of Permitted Areas
Zero	3
1	19
2	17
3	7
4	3
5	2
6	1
Memorandum Item:	
24	London

Source: Gaming Board Annual Report 2002/03.

21. At first sight, Table 1 suggests that there is a possibility of a tendency towards local monopoly in the casino market. However, if those places with either only one or two casinos are analysed many casinos are in fact closer to others than first appears. This would imply that the possibility of local monopoly may be less widespread than Table 1 might suggest. In some areas, like Lancashire, the Midlands and the South Coast a number of places with relatively few casinos are clustered within 50 miles of at least another 3 casinos.
22. Only in seven areas (Great Yarmouth (with 2 casinos), Newcastle upon Tyne (2) and Teesside (1), Kingston upon Hull (2), Margate (2) and Ramsgate (1), Torbay (1), Plymouth (2) and Swansea (1)) are there casinos located more than 50 miles from another place with at least 3 casinos.

All the major suppliers of casino services operate nationally as well as in London. However, the extent to which these national casino companies compete with one another is unclear.

#### ***Supply Substitution***

23. Substitution of supply occurs when, in response to a small but significant price increase, firms from outside a notional monopolised geographical market sell into that market sufficient quantities of product so as to quickly make that price increase unprofitable for the hypothetical monopolist.
24. Restrictions exist which prevent companies from quickly entering a particular geographical market. These include the permitted area restrictions, limitations on advertising and licence conditions (see section entitled "Current Regulations" above).

#### ***London***

25. London has a large number of casinos relative to its population. In 2002/03, 56.4% of the total casino drop and 23.3% of the casino visits was shared by London casinos. Some upper market London casinos depend on a few very wealthy customers who make repeated visits<sup>11</sup> Many of the regular gamblers at London casinos are visitors from overseas. Indeed, many London casinos employ overseas representatives to encourage wealthy individuals to visit their sponsor's establishment when in London.<sup>12</sup> Hence, it is possible that the London casinos are part of an international rather than a domestic market. However, there is a difference between London and provincial casinos.
26. Unfortunately, there is no empirical evidence to determine whether or not demand and/or supply substitution takes place internationally. The proportion of patrons of London casinos that come from overseas (whether specifically for gambling or as part of a trip for other purposes) is also

<sup>11</sup> The concomitant of this high dependence on high rollers is that some casinos have highly variable revenue streams.

<sup>12</sup> Gaming Board private communication. Such action is not illegal under the Gaming Act 1968 provided it is conducted wholly overseas.

unknown. For the purposes of this assessment we have not assumed that the London casino market is international.

## Summary

27. For the purposes of this competition assessment we have defined:
- The product market as just casinos;
  - The geographic market to be, at its widest, national but also acknowledge that there may be characteristics of the casino market which could lead to local and/or regional geographic markets.

## CURRENT NATURE OF COMPETITION

28. Because of existing regulations competition within the casino market is highly constrained. Location of premises is limited to permitted areas. Casinos cannot compete on the conduct or range of games on offer since those matters are determined by Statutory Instrument and regulated by the Gaming Board.
29. The product for most casinos is broadly similar, combining a selection of table games and gambling machines. The most popular table game is American Roulette at which 56.7% of the national drop was placed in 2002/03, followed by blackjack (16.4%), baccarat (9.4%), electronic roulette (8.7%) stud poker (4.8%) and three card poker (3.0%). Other games amounted to 1.0% of the drop. Some casinos provide facilities for members to play against each other for which service the casino charges a fee. One card club holds a casino licence for card games only.
30. Casinos can offer a choice of games because they are under no obligation to offer all the games set out in the Bankers' Games Regulations. Many offer a particular menu of games designed to appeal to their particular clientele.
31. Casinos also compete by offering gamblers appropriate surroundings in which to gamble. Some companies attempt to market a theme, such as Rank's Hard Rock casinos, others merely compete on style and service. It is now possible to serve drinks on the gambling floor and to provide entertainment provided it is incidental to the gaming.<sup>13</sup> Increasingly, there is a tendency to compete on a total entertainment package, which includes gambling at a casino.
32. The development of very large casino venues in Australasia and the USA based around machine gambling suggests that economies of scope may exist for such casinos because of the fixed costs of security, maintenance, money handling and staff training. However, UK regulations prevent progressive jackpots on gambling machines. Economies of scope may also exist when a casino is combined with stage entertainment, hotel and conference facilities.<sup>14</sup> The existence of economies of scale and scope (albeit suppressed by current regulation) may be the reason for the tendency for casinos to become parts of large national chains in recent years.
33. It appears that casino revenues are dependent upon repeated visits by a relatively small number of patrons.<sup>15</sup> In 2000/01, there were 11,288,193 visits to casinos in Great Britain.<sup>16</sup> This is the equivalent of each of the 3% of the adult population of Britain, which visited a casino during that time, making an average of 8.9 casino visits a year.<sup>17</sup> The importance of regular gamblers to the revenues of casinos is such that overseas it is common to provide a wide variety of loyalty inducements for such customers.

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<sup>13</sup> This does not apply in Scotland.

<sup>14</sup> Star City in Birmingham is the only facility of this type in the UK.

<sup>15</sup> A similar pattern was reported by the Productivity Commission in Australia in 1999. See Productivity Commission: "Australia's Gambling Industries: Inquiry Report", Productivity Commission, Canberra, December 1999.

<sup>16</sup> Gaming Board Annual Report 2000-01.

<sup>17</sup> In 2001, there were 44,209,827 in England, Scotland and Wales aged 18 years or over. 3% of this number is 1,326,295. The actual number of annual casino visits by British customers to British casinos will be less than this because of the active participation of overseas visitors in casino gambling in Britain.

34. Only since 1999, have casino operators been allowed to advertise in print and then only in a limited way. Hence, it is possible that potential customers are unaware of alternative offers from competing suppliers of casino services.
35. The gambling industry is generally the scene of intense competition between suppliers of mechanised and computerised gambling products. Each year sees new variants on existing games as well as enhanced mechanisation of back-office functions. Many of the new games have yet to be seen in Great Britain. All new games for use in British casinos must be approved by the Gaming Board and new, or variations to, bankers' games have to be approved by Parliament through the statutory instrument process (the so-called Bankers' Games Regulations). In 2002/03 three new games were approved.

## COMPETITIVE PROCESS

36. An unregulated casino market does not normally produce the level of welfare that can usually be expected from open competition for at least two reasons. First, there is the possibility of uncertainty among consumers. Second the operation of the casino market imposes significant negative side effects on the rest of society.<sup>18</sup> Because of the potential adverse effects of unrestricted competition into the casino market entry is subject to licence and its operation is subject to regulation. Although overseas experience suggests that casino firms may face economies of scale and scope and the market is highly concentrated, the operation of the Bankers' Games Regulations means that there appears to be little evidence of monopoly profits.

### Market Structure

#### Market Concentration

37. Ownership of British casinos is highly concentrated. At the end of 2002/03, there were 135 casinos which had certificates of consent to operate issued by the Gaming Board of which 126 were trading. 41 consents (30.4%) were owned by Stanley Leisure Ltd., 34 (25.2%) were owned by Rank and 29 (21.5%) were owned by Gala. Hence, 77.1% of all trading casinos were owned by three companies. In recent years, there have been considerable changes to the structure of ownership of the industry (see Table 2) through merger and acquisition. A number of overseas casino companies have expressed an interest in entering the British casino market, and some have already taken steps to this end.

TABLE 2  
CASINO INDUSTRY: Ownership Structure

(As at 31<sup>st</sup> March; 1999 and 2000 as % of trading casinos, other years as % of licensed casinos)

	1999	2000	2001	2002	2003
Stanley Leisure Group Plc	20.7	25.4	24.2	25.4	30.4
Rank Group Plc	25.9	26.3	25.8	26.2	25.2
Gala Group	n.a.	22.9	21.1	20.8	21.5
London Clubs International Plc	6.0	5.9	7.0	7.7	7.4
Other	47.4	19.5	21.9	20.0	14.8
Total Trading	116	118	118	122	126
Total Licensed			128	130	135

Source: Gaming Board Annual Reports.

38. The concentration of ownership may not reflect concentration of sales. Larger casinos or casinos which have a high proportion of high rollers among their customers tend to enjoy disproportionately larger revenues. Hence, a company with a few large or highly profitable casinos may command a larger share of sales than is reflected in the above data. The data collected by ONS do not permit calculation of a concentration ratio for casinos separately from gambling as a whole. Some idea of the concentration of turnover in the casino market can be obtained by an analysis of company results. The details of this analysis are given in Table 3. Care

<sup>18</sup> These are generally called externalities.

is required in interpreting this data since they refer to different time periods and, in one case, to different geographical areas.

**TABLE 3**  
**SALES CONCENTRATION IN CASINO MARKET**  
(£ million; %, various years)

	2001/02		2002/03	
	£ million	% share	£ million	% share
Stanley Leisure(1)	149.645	24.2	179.832	26.9
Rank(2)	140.572	22.7	163.276	24.4
London Clubs(3)	126.074	20.4	130.763	19.5
Gala(4)	91.174	14.7	124.856	18.7
TOTAL SALES(5)	619.000		669.000	
<b>CONCENTRATION RATIOS:</b>				
Largest 3(6)	67.3		70.8	
Largest 4(7)	82.0		89.5	

Sources: Annual Reports of Companies and the Gaming Board.

**Notes:**

1. Gross gaming yield received from casino gaming activities including casino gaming machines excluding VAT. Years ended closest Sunday to 30<sup>th</sup> April.
  2. Casino win plus gaming machine income before duty plus membership fees plus guest fees plus catering revenue excluding VAT. Years ended 31<sup>st</sup> December.
  3. Gaming income plus hotel and food and beverage revenues plus membership subscriptions for Europe. Years ended 30<sup>th</sup> March.
  4. Gaming and gaming machine income from casinos excluding VAT and gaming duty. Years ended 28<sup>th</sup> September.
  5. House win estimated by Gaming Board for years ended 31<sup>st</sup> March.
  6. Sales of 3 largest casino groups as % of total expenditure.
  7. Sales of 4 largest casino groups as % of total expenditure.
41. Like Table 2, Table 3 shows that the casino market is highly concentrated in four casino groups. Essentially, the pattern of ownership is closely mirrored in the pattern of sales. In 2002/03, the largest four casino companies enjoyed 89.5% of casino sales. This is significantly higher than the 82.0% recorded in 2001/02. However, since, in some cases, sales of hotel services, food and beverages are not separated from other casino revenue these are likely to be over-estimates of the actual concentration of sales revenue in casino gaming alone.
42. So far as is known there are no interlocking directorships. However, both Gala and Rank operate chains of bingo clubs and Stanley has a chain of betting shops.

**Size of Casinos**

43. Of the 126 trading casinos at 31/3/03, the smallest have gambling floors of around 1,600 square feet. 94 (74.6%) have gaming floors of between 2,000 square feet and 5,000 square feet. A further seven (5.5%) have floors of between 5,000 and 10,000 square feet while only one (0.7%) is larger than 10,000 square feet.
44. There has been a tendency for larger casinos to emerge in recent years. Applications determined by the Gaming Board in the past five years related to casinos the average size of which rose from 3,500 square feet in 1998/99 to 5,600 square feet in 2002/03.

**TABLE 4 AVERAGE SIZE OF CASINOS APPROVED**  
(Financial Years; approvals in square feet)

1998/99	3,500
1999/2000	3,700
2000/01	5,100
2001/02	4,300
2002/03	5,600(1)

Source: Gaming Board

Note:

1. In 2002/03 20 applications were determined. However, only 10 related to new premises and only those have been included in this figure.
45. It is possible that these data are dominated by a few very large projects and so may not be representative of a trend in the casino market as a whole. For instance, according to the Gaming Board, of 8 casinos opening since 1st January 2002, only 3 have had a gaming floor larger than 5,000 square feet. Unfortunately, it is not possible to obtain data on the range and distribution of the size of approvals. For this reason, the data in Table 4 should be regarded as only an indication of possible trends.

Impediments to Entry and Exit

46. Significant regulatory impediments to entry into the casino market exist at present. These have already been detailed above. They include licensing of firms, their operatives and the premises from which they operate and restrictions on the location of casinos.
47. At present, the market is dominated by many relatively small operations. Premises are generally easily converted to other uses and few suppliers have invested heavily in a national brand. The industry appears to incur few costs which cannot be, at least partially, recovered<sup>19</sup>
48. Nevertheless, it seems possible that casinos enjoy economies of scale and scope (see earlier comments in paragraph 33). For this reason, and other things being equal, larger casinos are likely to be more profitable than smaller ones. Normally, this would require large capital investments before entry into the market could be made. However, at present, this effect on the capital required to enter the market is limited. The viability of large overseas casinos is highly dependent on jackpot gaming machines of a kind which currently are not allowed in Great Britain. It is likely, therefore, that the proposed regulatory changes will make large resort-type casinos more viable in the future with the result that sunk costs are likely to become more important in the future than at present.
49. Currently, the direct costs of the licensing process do not constitute a major impediment to market entry. New casino licences cost £29,640, renewals cost £8,150 and transfers £7,855. New casino certificates of consents cost £8,200 and transfers £5,125. In the past five years the Gaming Board has not refused any applications for certificates of consent to operate a casino although it has in some cases deferred a decision until the applicant has met certain criteria.<sup>20</sup>
50. It seems that neither costs of switching between suppliers nor control of scarce resources are significant barriers to entry.
51. There appear to be no significant barriers to exit from the market.

## EFFECTS OF PROPOSED REGULATION ON COMPETITION

### Market Structure

52. It is proposed that casinos with a gaming floor of 10,000 square feet and at least 40 tables available for use will be allowed unlimited numbers of gaming machines.
53. Because of the profitability of operating machines this proposal, taken together with the question of the planning system, will favour the establishment of large casinos which may be part of a wider entertainment or holiday destination offer. It is known that large foreign companies have

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<sup>19</sup> Costs which cannot be recovered are sunk costs. They are costs which must be borne by any new entrant into a market but which cannot be recovered should the venture fail. They, therefore, act as a disincentive to potential new entrants. Examples, include custom-built buildings and software neither of which has alternative uses.

<sup>20</sup> It should be noted that the planning procedures which will be adopted by Regional Planning Bodies in respect of casinos has yet to be determined.

already expressed an interest in establishing such facilities in Great Britain. The nature of such inward investment will determine the effect on concentration of ownership in the British casino market. If the investment takes the form of stand-alone ventures<sup>21</sup> or joint ventures with smaller operators<sup>22</sup> the effect may be to reduce concentration. If, by contrast, it takes the form of joint venture with existing industry leaders the effect may be to intensify concentration.<sup>23</sup>

54. It is also possible that the fact that casinos will be able to offer bingo and betting will encourage the conversion of existing bingo facilities into casinos with bingo. This development may initially favour the position of those companies, like Gala and Rank, which already have a substantial interest in bingo clubs. However, this larger market should also encourage ownership competition from other entertainment companies and thereby ensure that the sector earns its internationally-determined cost of capital.

## **Impediments to Entry and Exit**

### ***Removal of Unstimulated Demand Test and Permitted Areas***

55. It is proposed that the present unstimulated demand test and the notion of permitted areas will be abolished.
56. This will enable casinos to be set up in any place provided other aspects of the regulatory system are met. It should mean that casinos with gaming floors of over 5,000 square feet will be established in many parts of the country where they currently do not exist. As a consequence, there is a potential for local competition between casinos to intensify.
57. Nevertheless, in parts of the country where there is relatively low demand for casino services, the proposed minimum area regulation may mean that new casino investment is not profitable. In that case, the existing state of competition between local casinos will continue. In this regard, it is important to note that the Gambling Commission will continue to approve games that casinos will be able to offer, to ensure that they operate fairly and that adequate information is made available to customers so that they are not exploited. Hence, monopoly profits are unlikely to emerge even where effective local competition does not exist or emerge.

### ***5,000 Square Feet Limit***

#### ***Impact on Competition of 5,000 Square Feet Limit***

58. It is proposed that new casinos will have to have a total gaming floor of at least 5,000 square feet. Implementation of this limit will have an impact upon competition in the market for casinos in the UK.
59. Implementing the 5,000 square feet limit will impose an absolute barrier to entry in that no new casino developments of any form will be allowed below this limit. Of the 126 trading casinos at 31/3/03, just under 75% are smaller than 5,000 square feet (see also section entitled "Size of Casinos"). Whilst the exact nature of future entry into the market cannot be predicted, given that the majority of the current industry is below 5,000 square feet in size, it is possible that future entry would have occurred below 5,000 square feet under the current regulatory regime<sup>24</sup>. Under the proposed changes entry below 5,000 square feet will not be allowed.

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<sup>21</sup> A number of overseas casino operators have expressed interest in directly investing in the UK casino market including Boyd Gaming Corporation, Park Place Entertainment Corporation and Tabcorp Holding Ltd. See Key Note: "Market Report: Betting and Gaming", October 2003, pp 77 ff.

<sup>22</sup> A possible example may be the joint venture between MGM Mirage and RJ Brown (Holdings) Ltd to develop a new casino in Bristol. See Key Note, *ibid*, p. 77.

<sup>23</sup> A possible example may be the joint venture between Harrah's Entertainment Inc and Gala Group Ltd. to develop a Las Vegas style resort. See Key Note, *ibid*, p. 76.

<sup>24</sup> Historical information from the Gaming Board indicates that, of 8 casinos opening since 1 January 2002, only three have had a gaming floor larger than 5,000 square Feet indicating that entry below this limit has recently taken place. (See also section entitled "Size of Casinos")

60. Currently 29 permitted areas have only one casino in operation and 17 permitted areas have two casinos in operation (see also Table 1). The proposed deregulations may make it easier for larger casinos to enter the market (see section below entitled "Larger Casinos"). Predicting the exact level of entry, however, is not possible and where companies do not enter (e.g. due to lack of demand, planning refusal) then the existing state of competition will not change.

#### Reasons for the Square Foot Limit

61. The Gambling Review recommended that a minimum size limit of 2,000 square feet of gaming area should be placed on new casinos.<sup>25</sup> There are three reasons for the limitation on size.
62. Firstly, the removal of the Permitted Areas and Unstimulated Demand regulations, in the absence of further rules, could lead to the establishment of many new small casinos based around the provision of machine gambling. This limit was recommended in order to prevent the proliferation of small casinos of the type that operated in the 1960s which led to infiltration of gambling by criminal elements, and the potential increase in problem gambling which ready access from a wide range of high street premises could entail. Moreover, evidence from abroad has shown,<sup>26</sup> rapid deregulation can lead to problems that is hard to control and difficult to regulate.<sup>27</sup>
63. Secondly, significantly increased competition in the casino market may increase the incidence of problem gambling. As a consequence, there is a risk that increased competition in the casino market will lead to an inferior social outcome than at present. This may occur as more people are encouraged to undertake casino gambling and as the opportunities to gamble on jackpot machines are enlarged. The regulations are designed to control the growth of externalities in a number of ways and so ensure that enhanced competition is associated with greater welfare.
64. Thirdly, to ensure that the Gambling Commission is not overwhelmed in its role as regulator. It may be argued that such regulation is unnecessary because the Gambling Commission will be able to cover the costs for inspections through licence fees. Hence, it will always be able to afford to employ all the resources required for adequate policing of any number of casinos of whatever type and location.
65. Nevertheless, the operation of all casinos will remain tightly controlled by the Gambling Commission. The Commission will continue to license staff, supervise the operation of casinos and lay down rules for games. The Commission will also investigate the investors in casinos to ensure that they are not connected to criminal activities. This will ensure that exploitation of punters by unscrupulous operators is minimised even where competition is less than intense.

#### Reasons for Increasing the Limit from 2,000 to 5,000 Square Feet

66. As indicated above the Gambling Review body recommended that a minimum size limit of 2,000 square feet of gaming area should be placed on new casinos. The Government decided after due consultation with the industry, that the limit of 2,000 square feet suggested by the Gaming Review Body would not be effective in preventing the worst effects of proliferation. It is, therefore, proposed that new casinos will have to have a total gaming floor of at least 5,000 square feet. It is true that setting the threshold at 5,000 square feet will have the effect of preventing new entry into the casino market below this limit but the Government considered that risks of accepting the lower figure were too great for the reasons set out above.

#### **Larger Casinos**

67. Casinos with more than 10,000 square feet of gaming area and with at least 40 tables available will be able to install unlimited numbers of gambling machines. Thus, it is proposed that large casinos will have considerable freedom over the number and range of games they offer. They will

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<sup>25</sup> Gaming Review Body, op cit, para 20.11, pp 112-113.

<sup>26</sup> Australian Productivity Commission, op cit.

<sup>27</sup> Gambling Review Body, op cit, paras 20.10 and 20.11, p 112. The Body stated: "... a sudden huge increase in the number of casinos could be difficult to regulate and damaging to the industry.... One of the problems of the 1960s was the proliferation of small casinos. That is a problem we must avoid recreating. In addition, the work of the new Gambling Commission must be manageable."

also be able to offer entertainment and restaurant, bar, hotel and conference facilities. We have already noted that overseas investors have shown considerable interest in the new opportunities that such de-regulation represents.

68. In two of the last five years new casino applications approved by the Gaming Board have been on average larger than the proposed minimum of 5,000 square feet.<sup>28</sup> Whilst average applications are only a rough indication of what the trend in entry to the casino industry might be, Ernst and Young have recently speculated about the possible establishment of 125 mid-scale or cruiser weight casinos with over 10,000 square feet of gaming floor and 40 tables which might be established on the outskirts of towns and about the growing profitability of local casinos of between 5,000 square feet and 10,000 square feet of gaming area.<sup>29</sup> If so, the existing local casinos will come under greater competition.
69. This de-regulation has the potential to unleash competition between resort casinos. Such competition, leading to international competitiveness, is essential to the fulfilment of the Government's expectation that the development of such resort-type casinos will lead to regeneration of communities.

### **Production Differentiation**

70. The Gambling Commission will be responsible for regulating the way in which gaming takes place, including setting minimum rule requirements to protect players. Nevertheless, there will be new scope for games and odds to be structured in ways which enable the price of gaming to be varied by competing casinos providing minimum safeguards are met.
71. Advertising by casinos will continue to be controlled by the Gambling Commission. As a consequence the incentive for product differentiation will be limited in Great Britain. Overseas, however, British casinos will be subject to advertising regulations of local jurisdictions with the result that product differentiation may be more driven by the requirements of international rather than domestic customers.

### **Innovation**

72. Although technical innovation in the industry will continue to be subject to regulation, casinos will be able to introduce new games the prices of which will be competitively set.

### **Summary**

73. The proposals for the casino market will have a mixed impact. To summarise the deregulatory aspects of the proposals - it will be possible for operators to set up new casinos with more than 5,000 square feet of gaming area anywhere demand conditions justify and the planning authorities allow. Where such new investment takes place, competition in the casino market may increase which may lead to benefits for consumers wherever the investment takes place within reasonable travelling distance of existing casinos.
74. To summarise the regulatory aspects of the proposals, no new entry will be allowed for casinos with a gaming floor less than 5,000 square feet. As a result, where demand conditions do not justify investment in, or planning permission cannot be obtained for a casino with a gaming floor greater than 5,000 square feet, no new entry will occur. The existing state of competition in those circumstances will not change purely as a result of the proposed regulation.

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<sup>28</sup> According to the Gaming Board of 8 casinos opening since 1<sup>st</sup> January 2002, only 3 have had a gaming floor larger than 5,000 square feet. (See also section entitled "Size of Casinos")

<sup>29</sup> Ernst and Young: "A Winning Hand-The Modernisation of UK Gambling", Business In Sport and Leisure Ltd, n.d., p. 22