op/ed

by dean towers

THERE'S MORE THAN ONE WAY TO SELL A HOT DOG

I watched the CNBC special about Costco the other night. The story looked at what exactly the business does, how it brands, how it sells, and most of all, how it keeps prices low to grow.

One part of the show focused on hot dogs. Costco sells concession foot longs for $1.50 and when asked why the price is so low the (now former) Costco co-founder and CEO Jim Sinegal said (paraphrasing): 'Most businesses will sell a hot dog for $4.75, and ask themselves if they can squeeze the price up to get five and a quarter. We see a hot dog that we can sell for $1.50, but we ask ourselves "Is there any way we can get it lower?"'

Costco--a place that you and I go for TV's or cases of soda pop--sells over $100 million dollars in cooked hot dogs.

As we all know, Costco's share price has almost quadrupled in the last eight years, and it wasn't by accident. They work on a simple retail business model: Low margins are a result of low prices, but high volume is a result of low prices, too, yielding tremendous top line growth.

This week in the UK it was announced that British betting giant Betfair has agreed to pay racing, through the British Horse Racing Authority, 10.75% of their revenues from UK customers. This replaces their voluntary contribution, and they are the first betting company to strike a deal to support racing. It's simple, it's efficient, and according to Marcus Armytage of the *Telegraph* newspaper, welcomed.

"The deal is highly significant….because the British Horseracing Authority, Racecourse Association and Horsemen's Group seemed joined at the hip."

A deal like this continues to allow the market to work as intended. Betfair can charge a takeout rate of 5% or 25% or 12.5% or 1%; whichever one yields the most profit for them. They're selling their hot dog at a price the market wants, so they (and racing) can make the most money. An added bonus, again like most businesses: They sink most of that profit back into the business, trying to gain market share, and grow their enterprise. When they grow, the people selling the meat and buns will make more money in the long-term, through not only betting, but through television deals, sponsorships and on-course admissions (a significant part of UK racing revenues for racetracks and purses).

This is contrary to the way things are done in North American racing. Here, racing takes a slice of a fixed takeout rate (a margin), and because of that, more sounds better than less, and we're stuck in a high priced bog, which stifles betting growth. In effect, racing is the one asking if they can get $5.25 for a hot dog, while the casino down the street is charging $1.50. History has shown that the more of the margin racing tries to take--through industry infighting or intransigent systemic issues--the fewer customers they have, and the betting pie grows smaller. The phrase "fighting over a slice of a smaller pie" has entered the lexicon of North American racing the last 10 years for a reason. It's real.

This difference in the way two entities do business is not because there are smarter people in jurisdiction "A" than "B", or vice versa. It has everything to do with the culture of the sport, and they way it was systemically built.

In the UK, only about 1% (according to the 2010 Jockey Club Fact Book) of betting handle goes to purses. In the U.S. (despite what you continually may read about not enough going to purses here) this number is closer to 6%. The funny thing, however, is that the 1% in the UK was set in a free market, not unlike a bookie in 1897 setting a 10-cent line, the same 10-cent line that's alive and well today.

For example, while overrounds (i.e. the takeout) for a bookmaker odds line can be 1.5% per horse in the UK, the weight of money (more bet on the shorter horses), along with a tight competitive betting market looking for betting dollars, allows for customers to line shop and churn through a much lower rate than that. James Erickson, who presented at a Canadian Gaming Summit, is a professional player, who has diverted most of his horse racing volume from the U.S. to the UK betting markets.

"The favorite longshot bias can be huge in the UK, which adds to the overround, but on the most likely winners, you can find value as a horseplayer. I had heard anecdotally that bookmakers survive on 5% win takeouts, and as a professional, I can attest to that. If you are smart, and line shop, you can have success betting win at these low takeout rates. It can be even better on Betfair," he noted.

In North America, that 6% number has been set since about 1920, and it was not set by the market, in a competitive gambling landscape, it was set by government, horsemen and racetracks, in a monopoly setting. Now that racing is no longer a monopoly, but competing in a modern gambling landscape, they're setting rates exactly the same way. This is like AT&T managing to long distance charges of $2 a minute in 2012, because that is what they charged in 1965 when they were the only company with long distance lines. Would they survive at $2 a minute in the Internet age? If you listen to a lot of causal racewatchers in North America they believe UK racing looks wonderful, because racing is on television, it's on billboards, it's advertised everywhere, the stands are full, and its ingrained in the culture. "If only we could do that" they contend. Doesn't it resonate that racing is popular on television and in the culture in the UK because they've competed as a gambling game for so long? That they've taken money out at a reasonable rate from betting for purses that it encourages reinvestment in both customer retention and marketing? That instead of a high takeout tax that has people fighting over numbers made up by a state or horsemen group in 1908 ruling the roost, they let the market rule it?

I read a quote on a chat board the other day from one of those ubiquitous anonymous industry watchers. He or she said ‘we need more people in the sport who want 3% of 500 instead of 6% of 200'. I think we should all agree with that.

UK racing, or racing around the world for that matter, is not all peaches and cream. The UK, Australia and even Hong Kong, although healthier, are not setting the world on fire, and racing in those places is a different can of worms. Let face it, this is a mature industry. However, just like Costco, no matter where you are in the world, sometimes less is more, and the betting industry in other locales proves that. Racing in North America, in my opinion, needs to protect what's best for purses in the long term, by looking at their margins, and setting rates not based on what they've always done, but where they want to go. If they do, perhaps purse levels will be sustainable and growing, instead of shrinking, while heavily relying on band-aids, like slots, or instant racing subsidies for survival.

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