Are you sure you hate all participation games?

by Buddy Frank

In terms of casino gaming, 2021 was a year like no other. There was the fear of uncertainty. Would it be boom or more 2020 bust? Fortunately, it ended as a banner year for everyone, with the rare exception of those dependent on foreign travel and/or conventions.

But, it was also a year that should remind us that so many aspects of gaming are universal. The appeal of casinos is seemingly timeless. The pursuit of experiential entertainment seems to be embedded in our DNA. Even the pre-2019 fears of abandonment by Millennials now seems like a distant memory as younger demographics were just one of the many pleasant surprises of this recovery.

One other constant has been our disdain for shared-revenue products. It's been like a constant "chicken or egg" riddle. For many operators, it is blasphemy that manufacturers require that we give them some of our hard-earned profits for the privilege of putting their games on our floor (and without paying any of our light bills or payroll!).

The late Charles "Chuck" Mathewson, former CEO of IGT, told me that he never got so many angry calls as he did when he green-lighted a new agreement with legendary video poker developer Ernie Moody to launch "Triple Play Poker" on a grand scale. Almost overnight, the popularity and profitability of video poker soared. But the downside was IGT's fees jumped from Moody's $5/day to $15/day. Even though our net win on video poker games nearly doubled or tripled, we were all outraged.

The same goes for IGT's earlier Megabucks and Wheel of Fortune products, which launched the "participation" category in 1986 and 1996, respectively. Those two required sharing a percentage of coin in (resulting in substantially more than $15/day). That began the outrage. But why?

According to Nick Hogan, CEO of the analytics firm ReelMetrics[1,] "it boils down to undue fixation on the accounting." Hogan is referring to focusing on depreciation as a negative reason for hanging on to weak core products, and the failure to realize the advantages of maximizing exceptionally strong games (participation or not).

But, there's also the unspoken nature of how slot operators view their balance sheets. Capital expenditures (the dollars allocated to purchase new core slot machines, aka CapEx) are seldom reflected on the daily Profit & Loss statements. But the fees from shared-revenue games are there in black and white every morning. Those fees are listed as either a negative revenue offset or an expense. In most jurisdictions, that number can be huge. It generally ranks as the third highest expense of slot operations right behind salaries and benefits. Rarely is the incremental revenue generated by participation products listed individually. Together, those factors can have a subtle negative influence on the category, since year-end bonuses for slot managers are not tied to CapEx, but rather based on those accumulated P&Ls.

The main "public" argument against shared-revenue games has always been "substitution." In other words, "all that money we are sending to the manufacturers would have (or should have) gone into our own machines." Hogan sees it differently: "The key thing to remember is that your floor space is finite. Stocking it with zero-demand product at the expense of high-demand product is simply bad economic strategy. There's just no way to sugar coat that. It's particularly bad when you consider that the scarcities are disproportionately affecting higher-value player segments. Yes, game performance is sometimes unpredictable. Yes, CapEx budgets are also finite. Yes, there are a lot of fears about cannibalization and 'moving money around the floor'. However, when one considers the flexibility afforded by lease products, it's pretty difficult to understand how these arguments are cons, not pros," Hogan notes.

Superior analytical programs, backed by large databases, started to emerge several years before the pandemic hit in 2019. However, the artificial shutdowns and reductions in machine counts forced by the virus provided a unique opportunity to test some theories. Data had long suggested that our floors contained far too much variety and hosted too many weak machines. Any large-scale cutback just to test that hypothesis seemed risky. But, the pandemic forced the issue and also provided the proof we needed.

“As we’ve begun analyzing segments and amassing billions of player sessions, these concerns have intensified considerably,” Hogan says. “The data are conclusive: Our ‘shelves’ are dominated by products for which there is little or no material demand. These imbalances not only limit our ability to maximize and capture demand, but they expose our most valuable segments to substitute offerings that diminish it. This is what I mean by amplifying liabilities instead of depreciating assets.”

Hogan uses an unappetizing ice cream example to make his point, “When Ben & Jerry’s Cookie Dough sells out, you can’t offer liver-flavored vanilla as a substitute and expect the consumer to double-down on the resultant experience. Yet, if we look at industry-wide, Slippery-to-Sticky product ratios of 4 or 5 to 1, that’s precisely what we’re doing.”

ReelMetrics coined the term “slippery” to describe machines that are weak, disappoint players and result in them jumping from game to game. That’s as opposed to “sticky” games that generate loyalty, longer seat times and encourage return visits. As above, the pandemic provided the proof that Hogan and many other analysts needed to validate their predictions that stronger revenues could be produced by the elimination of weak games and, correspondingly, the addition of stronger titles (be they participation or not).

Countless operators re-opened their floors with fewer games, but still generated record profits. One easy method to do that without much pain was by adding participation games. Don Retzlaff, VP of Professional Services at ReelMetrics, expands on the topic: “The best lease games can not only replace the dogs on your floor, but—if chosen & positioned properly—they can also dramatically energize floors by enlivening dead zones. There are gobs of participation games pushing 80% to 100% monthly occupancy, and many need not occupy ‘A’ locations. Although some are very location-dependent (a metric we track on every single title), many can be re-positioned in ‘C’ locations with zero performance degradation. In fact, many products actually exhibit superior performance in lower location grades. Having this knowledge allows you to place high-yield lease games properly and spread their glow across the floor.”

But not all participation games are equal. Often, our own poor management of shared-revenue games results in self-inflicted pain. Almost unbelievably, many properties do not prioritize aggressive management of these games. The extreme example is allowing participation games to remain on your floor when their net performance is at, or just slightly above, house averages. That is an almost unforgivable sin since replacements can be quick and easy and hundreds of options exist. Sadly, it’s almost rare to find a floor that doesn’t have some of these weak performers lurking in the shadows.

Hogan and his team also see other opportunities. According to Retzlaff, “The most popular app in our recommendation suite is devoted to this precise topic—identifying & ranking highly-specific config tweaks for underperforming product. When you look at the rankings, a large number of the top candidates are invariably high-yield lease products trending at 1.75x to 2.25x floor, which is not a performance level that’s typically hitting your radar as a problem. However, when you look at the pan-industrial averages, you see that it should be trending closer to 3.25x. In most jurisdictions, closing that gap with a highly targeted config tweak will net you an incremental $36,000 per month (over $432k per year) on a single six-pack.”

When they talk about “pan-industrial averages” they are referring to the data his firm has collected across the country. While there are always one or two property-specific exceptions, generally what happens nationally can be a very

accurate predictor of local potential. Realizing the opportunity to improve your product, based on what's happening elsewhere can be huge. It is easy, and quite common, to overlook games that are performing "well." However, the gain from re-configuring a game from two-times to three-times house average is as impressive as launching any new hit.

Retzlaff adds, "Each property is a bit different, but—provided you have the tools to keep abreast of optimum configs—there is no reason that your threshold should be lower than 2.0x – 2.5x floor, after fees are removed ("Net" win). Detailed, up-to-date knowledge of what's available, what's performing, how to configure it, and with whom it resonates is a reliable recipe for maintaining a successful lease portfolio."

While IGT remains a leader in the shared-revenue category, today there are dozens of other strong players. "If you track our 'ReelHot' Index, you'll see that Aristocrat's 'Dragon Link' series delivers gigantic yields and has been doing so for some time," says Retzlaff. "Occupancy levels at most casinos are sky-high, and, when coupled with lofty average bets, the revenue performance is frankly astounding. We're recommending the expansion of this series at many of our clients' properties, especially when we see supply scarcities for higher value player segments. With that said, I can't think of a single supplier

that doesn't have robust lease offerings. The trick is to keep abreast of the libraries, optimum configs, and who's playing what."

While Retzlaff and Hogan may sound like slot machine salesmen working on commission, it's important to remember their motivation. ReelMetrics does well when their customers do well. Most of their customers are casino operators looking to tune their floors for maximum profitability, not to boost participation fees.

None of the positives above forgives any operator from aggressively managing their participation budgets. Have you leveraged your shared-revenue commitments to extract maximum discounts on core game contracts? Do you coldly, and without any hesitation whatsoever, quickly re-configure, replace, or banish those games that aren't performing? Do you make thorough analytic reviews a consistent weekly/monthly routine? Are you getting the best signage packages as part of your deals? Do you utilize survey firms like ReelMetrics, Eilers-Fantini, or just good shoe-leather competitive research to keep on top of participation trends? Likewise, do you read the industry journals and eNewletters for the same reason?

If you've checked all those boxes, you'll surely enjoy the many benefits and increased profit potential of strong shared-revenue games in the coming year. Just don't admit to any other operator that you no longer hate all participation games.

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1 – While ReelMetrics is a sponsor of CDC Gaming Reports, my contributions and opinions are completely independent and don't necessarily reflect the views of CDC. I have no economic or consulting interests with ReelMetrics other than I think Nick Hogan, William Schoofs, John Boushy, and Don Retzlaff, along with their analytical team based in Leiden, Netherlands, are really good at what they do. Importantly, their opinions are backed by real-world data collected from dozens of casinos and hundreds of thousands of slot machines nationwide.