

# Formal Rules, Informal Constraints, and Industrial Evolution—The Case of the Junket Operator Regulation and The Transition of Macao’s Casino Business

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*A major role of informal constraints is to modify, supplement, or extend formal rules. Therefore, a change in formal rules or their enforcement will result in a disequilibrium situation, because what makes up a stable choice theoretic context is the total package of formal and informal constraints and enforcement aspects....A new informal equilibrium will evolve gradually after a change in the formal rules.*

– Douglass C. North, 1990, 87-88.

*A critical factor in bringing about “progressive” institutional change is a sensed awareness within the community that there is a need to modify habitual patterns of thought and behavior in order to achieve a higher level of instrumental efficiency.*

– Paul D. Bush, 1987, 1102.

## Abstract

Following the approach of institutional economics to study the interaction between the changing formal rules and the evolving informal constraints, alongside the dynamics leading to industrial evolution, this paper will firstly examine the particular social and economic settings which bring about the informal constraints for the business practice of Macao’s casino junket operators, and the feedback from the system which in turn triggered the evolution of the informal constraints since the middle of the 1980s. Extending from our understanding of the custom and practice of this business in the “old Macao”, this paper will further discuss the role of the recently promulgated Junket Operator Regulation in the transition of Macao’s casino industry from a culturally defined to a more formally regulated business. In this context, impact from the change in the formal rules on the evolving informal constraints, and the dynamics giving rise to the changing structure and performance of the casino industry will also be explored.

**Key words:** Junket Operator Regulation, formal rules, informal constraints, industrial evolution, casino business, Macao

## Introduction

The changing structure and performance of an industry is largely affected by the alteration of formal rules and evolution of informal constraints. As to re-institutionalize the structure of the casino industry from monopoly to oligopoly, the Macao Special Administrative Region (SAR) Government of China introduced a new piece of regulation on March 20, 2002 – Administrative Regulation no° 6/2002 – outlining the qualification and rules of conducting agency’s business for games of chance in casino (this piece of

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regulation is to be termed as Junket Operator Regulation in this paper).<sup>1</sup> This signified the first set of formal rules to regulate the business practices of the casino junket operators in Macao.

In essence, the Junket Operator Regulation was an attempt made by the Macao SAR Government to normalize the practice of the casino junket operators, who had been conducting their business in a lawless area for almost two decades (Leong 2002, Eadington and Siu 2007). Before the promulgation of this Regulation, informal constraints were the principal rules followed by the junket operators to conduct their business. Given that the business run by the junket operators contributed the largest part of the gross casino revenue (GCR was defined as the net win derived from the provision of casino games) as reported in Macao, the change of the formal rules for governing how the junket operators conducted business, hence the subsequent evolution of the informal constraints, would be of great consequence to the future structure and performance of this industry.

To the institutional economists (i.e., institutionalists) who are interested in the interrelationship between the institutional aspects of a society (e.g. the social structure and public policy system) and the evolution of its economy, the interaction between formal rules and informal constraints generates a dynamic force driving to the changing structure of an industry, hence altering its performance over time. Broadly speaking, “formal rules include political (and judicial) rules, economic rules, and contracts” (North, 1990, 47), whereas “informal constraints...come from socially transmitted information and are a part of the heritage that we call culture” (ibid, 37). Indeed, “while formal rules can be changed overnight by polity, informal constraints change very slowly. Both are ultimately shaped by the subjective perceptions people possess to explain the world around them, which in turn determine explicit choices of formal rules and evolving informal constraints” (North, 1997, 1).

The institutionalist approach to studying the dynamics of industrial evolution will be adopted in this paper whereby the evolution of the junket operator business in Macao’s casino industry would be disclosed through a systematic analysis of historical evidences. In addition, recent changes in the formal rules introduced by the Macao SAR Government to regulate the junket operators in conducting their business, the evolution of the informal constraints before and after the regulatory change, as well as the dynamics generated to alter the structure and performance of this industry, will be examined. To reveal the changing trends in the junket operator business since the introduction of the Junket Operator Regulation, data as released by the Gaming Inspection and Coordination Bureau (DICJ), and the Statistics and Census Service (DSEC) of the Macao SAR would be applied for running statistical analysis.<sup>2</sup> Expectantly, findings presented in this study would enrich our understanding about the unique features and evolution of Macao’s casino industry in the past, present and foreseeable future.

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1 Official documents in Macao are available only in Chinese and Portuguese. In this paper, the title of a legal document is translated from the official Chinese version by including all the key terms while simultaneously preserving its underlying meaning. In addition, the short title of a legal document is stated in the most common terms/meanings as a reflection of the nature of the document as applied in the world market.

For example, the term “prompter” is applied in certain translations of the Administrative Regulation no° 6/2002. On the other hand, in a seminar held by the Gaming Inspection and Coordination Bureau on April 19 2006, this Regulation is simply termed in English as “Defining the eligibility of junket operation”. From the academic and practical point of view, “agent” or “junket operator” is reckoned as a more precise term to represent the subject in the casino business being considered by this piece of regulation.

2 Unlike the US and some other well-regulated casino jurisdictions, quantitative information about Macao’s casino industry had largely been unavailable to the general public before the handover of Macao to China as of December 20, 1999. Subsequent to the handover, although more data were released by the Gaming Inspection and Coordination Bureau of the Macao SAR, quarterly data were made available only starting from year 2005.

### Evolution of the casino junket operators and their business in the “old Macao”

Throughout the evolution of our modern economic society, its structure and performance are complexly determined by interactions among various parties who are simultaneously in the pursuit of their own material ends. During the process, formal rules define the broad scope of businesses and form the majority-approved (legal) relationship among the various economic participants. To materialize individual exchanges in the markets, however, informal constraints always play an important role in bringing together the buyers and sellers, and specifying their “ways of business” over time. In other words, informal constraints are the “extensions, elaborations, and qualifications of rules that ‘solve’ innumerable exchange problems not completely covered by formal rules and that in consequence have tenacious survival ability.” (North 1997, 4) This concept about the attributes of informal constraints provides a sound analytical framework which is especially critical to enhance our understanding about the evolving business practices of service industries ranging from hospitality, tourism, recreation, and not surprisingly, also gaming.

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In principle, Macao's gambling business was legalized by the Macao-Portuguese Government in 1847. Nevertheless, the regulatory system was weakly structured and rules were loosely enforced. Archives of the Macao-Portuguese Government's rules in relation to granting contracts of gambling business (mainly various forms of Chinese lotteries and fantan game) between the 1880s and the 1910s,<sup>3</sup> revealed that the content of those documents was simply for defining the permissible scope of gambling business, which in turn was for the obvious purpose of tax imposition. In addition, the first piece of Gaming Law was not promulgated until 1961.

Because of the weakness of the regulatory system in controlling and monitoring the practice of the gambling business, informal constraints had long been the dominant elements governing the daily interactions of these participants.

Among all the business activities that were largely shaped and guided by informal constraints, an important form of business was the service provided by the agents (i.e., junket operators) who led players (mainly high rollers<sup>4</sup>) from the neighboring regions to gamble in Macao. In addition to earning gaming commission, many of the agents were simultaneously pursuing their individual interests from conducting the business with the casino operator – especially those involved in various forms of underground business. At the end of the 19<sup>th</sup> century and the first half of the 20<sup>th</sup> century, as a result of the social and political instability in Mainland China, and the Chinese government's intention to prohibit gambling, players from the Mainland were organized by a group of agents – *jinke* – to gamble in this Portuguese enclave (Liu 2002, 406). In Chinese, *jinke* means the *introduction (jin)* of *customers (ke)*. Indeed, those *jinke*s were the ancestors of junket operators in Macao's gambling history. The nature and organization of this business had been proved much more complicated than the junket operators' business as commonly understood in North America and Australia.

Given that the majority of those junket operators possessed extensive social connections (including their association with the underground economy, or even with various triad groups), and their businesses were not policed by any form of government regulation, their business practice and interrelationship with the casinos were largely bound by informal constraints. Throughout a long period of time, the various junket operators and the casino operators were pooled together by the common incentive (value) of reaping the monetary benefits associated with the gambling business. While the junket

3 For example, (Contract) No° 22, Attachment 2, June 6 1882; (Announcement) No° 42, October 12, 1885; ..... (Contract) No° 48, December 2 1911. Chinese-translated version of these documents is released in Tang and Wu (Eds.), June 2002.

4 In the history of Macao's gambling business, “high rollers” are generally referred to those who bring in large sums of money to gamble. There is no specific criterion (e.g., USD20,000, USD40,000, etc.) as to define or differentiate this group of players.

operators contributed to enlarging the customer base of the casinos, the casino operators, armed with the exclusive rights to run casino gaming, provided junket operators with the necessary conditions for their pursuit of their respective business objectives, through arranging players to gamble in Macao.

The middle of the 1980s marked a crucial change in the structure of the junket operator business. In 1984, the STDM (i.e., the gaming monopoly before the opening of Macao's casino industry in 2002) informally outsourced<sup>5</sup> some of its gaming rooms – called the “private VIP rooms” or simply “gambling rooms” – to certain third parties who possessed the social network to attract high rollers to gambling in Macao on a continuous basis, and were offered certain conditions (e.g., rent and charges). On top of the conventional entitlement to junket operators (i.e., commissions for sale of gaming chips), a private-VIP-room contractor was able to share, for instance, 30% to 40% of the net win derived from running the gambling rooms. To reap this portion of gaming revenue, the private-VIP-room contractor had to enter into an informal contract (e.g., an oral agreement) with the gaming monopoly to underwrite a substantial amount of non-redeemable chips (for instance, 10 million Macao dollars<sup>6</sup>) on a monthly basis. With the introduction of the private VIP rooms, the gaming monopoly could secure the flow of gaming revenue at the least possible business cost. By retaining the private VIP rooms as part of their properties (they were never formally contracted out to any third party), they asserted their full compliance with the Gaming Law - Law no<sup>o</sup> 6/82/M: Games of chance law (1982), which prohibited a casino concessionary from contracting its business out to any third party (as stated in article 18, 1b).

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In addition, although a casino operator was disallowed by law to grant casino credit, the operating practice of a junket operator and his VIP players was never restrained (nor defined) by any regulation. Consequently, while most junket operators were running their business in a grey area, “gambling credit” was commonly adopted as a key measure to attract high-end players. The casino operator remained in a position to allege the full legitimacy of its practices. Nevertheless, the conventional “casino operator/junket operators” relationship evolved to a much more complicated “casino operator/private-VIP-room contractors/junket operators” hierarchy (Leong, 2002; Siu, 2006; Eadington and Siu, 2007). As a matter of fact, the private-VIP-room contractors were also junket operators; it was just that they were at the height of the hierarchy of this business and were the ones who dealt with the casino operator directly.

Under the private-VIP-room structure, the nominal performance of Macao's casino industry was notably elevated – between 1985 and 1997,<sup>7</sup> gross casino revenue recorded a compound annual growth rate of over 20% (increased from an approximately USD0.225 billion business to an USD2.346 billion business).<sup>8</sup> Despite the impressive business achievement in monetary terms, the unavoidable drawbacks were the business activities of those private-VIP-room contractors and their business relationship with other junket operators at the lower hierarchy, operating in a lawless area. Tempted by the high cash transactions associated with this barely regulated business, the endeavors of these various participants to maximize their benefits from running the private-VIP-room business set the stage for the wide-spread and uncontrolled organized crime as evident in the second half of the 1990s (Brady 1998). Indeed, the indirect relationship evolved between the

5 In accordance with the Macao-Portuguese Government's regulation, a firm gained the concession of exclusiveness (i.e. the gaming license) to operate the gambling business in Macao was not permitted to lease (or contract) its business to any third party.

6 The denomination of Macao dollar is MOP, and 1USD=8MOP.

7 The period from 1985 to 1997 fairly reflected the contribution of the private-VIP-room business to Macao's casino revenue. In 1998 and 1999, Macao's casino business was badly hit by internal social chaos and economic downturn in the neighboring regions (especially Hong Kong). Then, the performance of the casino industry was influenced by Macao's handover and its opening in 2002.

8 The rate is calculated by data as released in *Aomen Shuizhi* (in Chinese) 2000, Table VIII. 169: *Aomen Bocaiye Zongheng* (in Chinese) 2002, 305.

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private-VIP-room business and the organized crime in Macao's casino industry in the 1990s was in parallel with Schelling's view on the nature of organized crime in a society (Schelling 1984, 179-194). During the process, the various individual groups' efforts to fight for the dominant informal "rule-making role" in the private-VIP-room business inevitably turned out as "the organized use of violence".

### **Promulgation of the Junket Operator Regulation – a change in the formal rules and the evolution of subsequent informal constraint**

In response to the public interest to open the casino industry following the handover of Macao to China on December 20, 1999, alongside the mounting concern over the deficiencies in the regulatory system, the Macao SAR Government revised the existing Law no° 6/82/M and promulgated Law no° 16/2001 "The legal regime applicable to the operation of games of chance in casino (2001) – the new Gaming Law, on September 19, 2001. Under Article 52 of the new Gaming Law, it is stated that the government would assume the future responsibility to promulgate complementary regulations as necessary to control and monitor the practice of the casino business. These complementary regulations encompass the operations of gambling rooms and the activities of participants in the casino business. Subsequently, the Junket Operator Regulation was promulgated on March 20, 2002. This constitutes the first piece of regulation in an attempt to govern the qualification and activities of the junket operators (including the private-VIP-room contractors) through a formal licensing procedure.

Under the Junket Operator Regulation, the relationship between i) the private-VIP-room contractors (called "junket promoters" in the Regulation) and the casino operators, ii) the private-VIP-room contractors and their associated junket operators at the lower hierarchy of this business (called "junket collaborators") are formally defined. In addition, the procedures for application and renewal of a junket operator license, and the procedures for government to approve a license are also explained in the document. In spite of the fact that the promulgation of this Regulation marks a progressive change in Macao's regulatory system, this Regulation is still far from complete or sufficient by international standard, in terms of blocking Macao's gambling room business from its conventional relationship with underground economic activities. For example, although disclosure of personal information is required for an application, and disclosed information is treated as a crucial determinant of final approval, there is neither specific criterion for background check, nor clear indication about how disclosed information would be applied to evaluate whether an applicant meets the qualifications to be a casino junket operator. In Article 10 of the Regulation, although it is stated that "it is the responsibility of the Gaming Inspection and Coordination Bureau (DICJ) to carry out the procedure of examining the proper qualification, and this procedure is to be concluded by a report as compiled by the Director of the DICJ", the criteria for the DICJ in completing the report are yet commonly known to the general public.

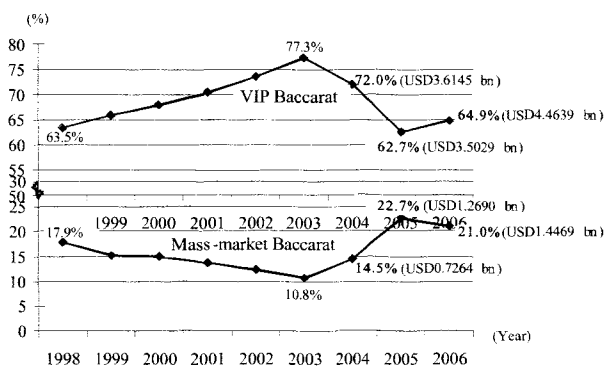
Despite the incompleteness of the first version of the Junket Operator Regulation, the public urge for formalizing the structure and performance of the junket operators is evident. Although the custom of this business was bred in a lawless area in "old Macao" for almost two decades, and the long-established informal interrelationship between the gaming monopoly, the VIP-room operators, and their associated junket operators at the various levels could hardly be re-instituted immediately with the promulgation of a single piece of regulation, the evolution of this business was indeed showing gradual and crucial changes. The progress was gradual, because when Macao's casino industry was first opened and the Regulation was promulgated, a significant number of the existing junket operators were still yet ready to mold themselves and their business to

meet up with the formal requirements. To minimize the possible shock which might lead to serious contraction in the turnover of the existing casinos, the Regulation allows a transition period before full enforcement. According to Article 36, "The entities, who are carrying out the junket business at the date (i.e., March 20, 2002) when this Regulation is enforced, may temporarily continue to carry out their junket business until the first licensing process for junket operation as carried out in accordance with this Regulation is completed". Consequently, junket operators and their associates were only required to submit their applications for business licenses from May 2004; and the Junket Operator Regulation is to be enforced in principle from July 2005 (*Macau Daily News*, May 8, 2004 and June 16, 2005).

Between the promulgation of the Junket Operator Regulation in 2002 and its enforcement in July 2005, the practice of the junket operators and their business underwent significant changes. For instance, instead of operating on individual bases, a formal association was established in October 2004 as a collective representation of its members' interests. In addition, as the informal activities (especially those related to the underground economy in the "old Macao") of the junket operators started to be regulated, and aggressive business strategies were undertaken by the new casino operators, business performance of the existing private VIP rooms showed obvious deviation from the traditional pattern since 2003. As depicted in Figure 1, although VIP Baccarat remained the dominant source of income to Macao's casino industry, its share in the industry's GCR decreased significantly from 77.3% in 2003 to 64.9% in 2006. On the other hand, the share of mass-market baccarat was almost doubled from 10.8% to 21.0%.

Before the opening of the Las Vegas Sands Casino in May 2005, reported revenue from VIP baccarat (or VIP play) mainly referred to the part of GCR derived from the baccarat tables based in the traditional private VIP rooms. According to the official statistics, VIP baccarat was different from the mass-market baccarat (or non-VIP play) in terms of the premium charge per table which was payable to the government on top of the gambling tax imposed on GCR. While annual premium fee charged for a baccarat table based in a private VIP room was MOP300,000 (which was payable proportionally on a monthly base), the fee for the same table positioned on the gaming floor (i.e., the mass market) was MOP150,000. Although the traditional private-VIP-room operating system is kind of being phased out, the differentiation between VIP baccarat and mass-market baccarat remains common to the other new casinos. For example, even the Sands Casino runs in strict compliance with the Nevada Government's requirements in conducting its VIP business, its tables based in the VIP area (or VIP rooms) are required to pay the same MOP300,000 annual premium fee, hence included in the gross amount of VIP baccarat revenue as released by the Macao Gaming Inspection and Coordination Bureau.<sup>9</sup>

**Figure 1: Changing contribution of VIP Baccarat and mass-market Baccarat to the GCR**



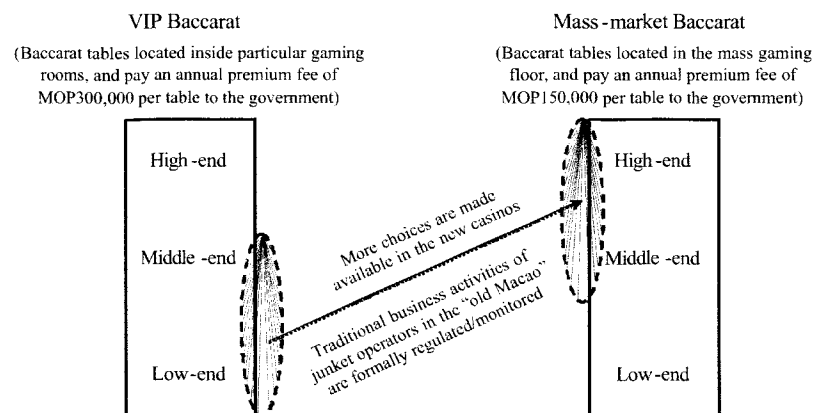
The percentages are calculated on the data released in the website of the Gaming Inspection and Coordination Bureau. <http://www.dicj.gov.mo/EN/index.htm>

<sup>9</sup> Currently, no breakdown is available from the DICJ or individual casino operators as to indicate the VIP baccarat revenue derived from the traditional private VIP rooms and the VIP rooms of the US operators respectively.

An interesting phenomenon revealed in Figure 1 is that, as the single form of game producing over 85% of Macao's GCR, the shares of VIP baccarat and mass-market baccarat in Macao's casino industry are largely negatively correlated (the correlation coefficient of their shares in the GCR between 1998 and 2006 is -0.8853). A possible explanation of this phenomenon is the rotation of a certain group of players between the VIP play and the non-VIP play. Since the tradition of the VIP rooms involved sharing of gaming revenue between casino operators and VIP-room contractors, as well as informal commission sharing between the VIP-room contractors and their associated junket operators, it had been a common practice of the junket operators (especially those in the lower hierarchy of this business) to "informally" approach high- and middle-end players in the mass market and "lead" them to gamble in the VIP rooms. For example, personal credits or "personal protection" were offered to players who were persuaded to switch their play to the private VIP rooms. Following the promulgation and enforcement of the Junket Operator Regulation, and the promulgation of Law no° 5/2004: Juridical system for credit granting for gaming or gambling in casino (2004) – the Casino Credit Law in May 2004, the "informal" activities of the existing junket operators started to be regulated. In addition, as more choices were available to the players since the opening of the casino industry (e.g., the Las Vegas Sands Casino was opened in May 2004 and Wynn Resorts in September 2006), it was noted that a portion of the existing VIP-table players chose to return to the mass market, as middle-end or high-end players.

As illustrated in Figure 2, it was due to the unique classification of VIP play and mass-market play in Macao (i.e. determined by the premium fee charge for a gambling table instead of players' betting amounts), gambling expenditure of the low-end and middle-end "VIP players" outside of the traditional private VIP rooms were not accounted as VIP baccarat revenue, irrespective of their spending level. Moreover, the success of the Sands Casino in cultivating the mass market of various levels largely explained the migration of players from the existing private VIP rooms to the mass market in 2004 and 2005. In 2006, the slight rebound of the VIP baccarat share could be attributable to the aggressiveness of the Sands Casino in expanding its VIP play and the opening of the Wynn Resorts in September 2006. Although no breakdown is available, it is fair to expect that while total turnover of the traditional private VIP rooms is shrinking, the formal VIP play as introduced by the two American casino operators is on the track to expansion.

**Figure 2: Primary forces responsible for the changing performance of the VIP baccarat and mass-market baccarat in 2004 and 2005**



Moreover, as shown in Table 1, while the correlation coefficient between the number of visitor arrivals and the VIP baccarat revenue was weakened between 2002 and 2005, the coefficient with the mass-market baccarat revenue was getting increasingly stronger (increased from 0.2109 between 1998 and 2001 to 0.9552 between 2002 and 2005). Although the coefficient with the VIP baccarat bounced back to its 1998-2001 level with the inclusion of 2006 data into the calculation (this was in line with the phenomenon as revealed in Figure 1), it was still lower than the coefficient with the mass-market baccarat (i.e., 0.9513 v. 0.9748). Indeed, even the changing business performance of the VIP baccarat and mass-market baccarat in relation to the changing number of visitor arrivals can be attributed to more than the factor of the Junket Operator Regulation, the latter does form an essential element to exercise control over the informal ways practiced by the businesses in the “old Macao,” especially the part of casino-related businesses with high correlation with the underground economy and organized crimes. By weakening the traditional informal influence of the junket operators over the casino business, the room which is necessary for development of the mass market is reinstated.

**Table 1: Changes in the correlation coefficients between the number of visitor arrivals, VIP baccarat revenue and mass-market baccarat revenue**

	Corr(visitor, VIP baccarat revenue)	Corr(visitor, mass-market baccarat revenue)
1998–2006	0.9771	0.9431
1998–2001	0.9515	0.2109
2002–2005	0.8987	0.9552
2002–2006	0.9513	0.9748
2005 1q–2005 4q	-0.7621	0.9558
2005 1q–2006 1q	0.2557	0.7305
2005 1q–2006 2q	0.4816	0.7405
2005 1q–2006 3q	0.7065	0.7377
2005 1q–2006 4q	0.8845	0.8182

\* The correlation coefficients presented in the first 4 rows are measured by employing annual data, while the last 5 rows are on quarterly data (quarterly data in relation to breakdown of casino revenue are available only from the first quarter of 2005). Data of VIP baccarat revenue and mass-market baccarat revenue are retrieved from the website of the Gaming Inspection and Coordination Bureau. <http://www.dicj.gov.mo/EN/index.htm>  
Data of visitor arrivals are retrieved from the website of the Statistics and Census Service. [http://www.dsec.gov.mo/index.asp?src=/English/htm/e\\_tourism.html](http://www.dsec.gov.mo/index.asp?src=/English/htm/e_tourism.html)

Based on the second part of Table 1, it is reasonable to project both the VIP and non-VIP markets to undergo significant changes. In the first four quarters of 2005, although the number of visitor arrivals increased substantially under the Individual Visit Scheme (IVS) (an initiative undertaken by the Chinese Government which substantially simplified the visa application process for Chinese residents in the selected cities to visit Hong Kong and Macao), business performance of the VIP baccarat was surprisingly correlated negatively with the number of visitor arrivals (the correlation coefficient was -0.7621). On the contrary, the mass-market performance was highly correlated with the number of visitor arrivals (the correlation coefficient is 0.9558). Entering into year 2006, it was then evident that the VIP business had started a close relationship with the increasing number of visitor arrivals. Nevertheless, the changing performance was largely contributed by the growth of the formal VIP business as conducted by the new casino operators (e.g. the Sands Casino and Wynn Resorts), instead of the re-expansion of the traditional private VIP rooms. Indeed, the business scale of the latter was downsizing – “Mr. Ho (Macao’s gaming tycoon who controlled the former gaming monopoly and obtained one of the 3



new gaming licenses through his newly formed gaming company in 2002 – SJM) once said that 50 of the SJM's total VIP halls of 150, might be forced to close down" (Yi 2006, A3).

### Two parallel VIP markets under the Junket Operator Regulation and foreseeable evolution

A remarkable result of the opening of Macao's casino industry is the entry of such world-class casino operators as Las Vegas Sands, Wynn Resorts and MGM from North America, as well as PBL from Australia.<sup>10</sup> Nevertheless, the fundamental differences in the legal framework and implementation of the regulatory system between North America and Macao lead to emergence of two parallel VIP markets in Macao's casino industry. On the one side of the market, the local casino operator (i.e., the SJM) and the non-American operators (e.g., Galaxy) are running their VIP business largely on the traditional model, especially in terms of the revenue sharing model under the practice of the private VIP rooms (Chang 2007), while simultaneously making gradual modifications as to correspond with the Junket Operator Regulation. As of the end of January 2007, for example, 92 corporate entities (i.e., a company or a partnership) and 68 individual entities were registered and approved by the DICJ as legal junket operators (the same were talking about 41 and 35 respectively in January 2006).<sup>11</sup> Yet, as compared to the thousands of junket operators who are practicing at the lower levels of this business (especially those so-called chip rollers at the lower hierarchy of this business, see Leong 2002, Figure 1; Siu 2006, Figure 1; Eadington and Siu 2007, Figure 3), efficacy of this Regulation is evidently in question, and the evolution of the informal "way of business" in the "old Macao" is obviously changing only at a gradual pace.

In addition, the long-established and customary-defined private-VIP-room businesses add further to the complication, causing difficulties to policy makers to draft the first version of the Junket Operator Regulation. Precision and enforcement of this Regulation are confined. For example, to assess if a corporate entity is qualified for a junket operator

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license, Article 8 of the Regulation states that shareholders who own 5% or more of the capital, the directors, and the main employees of the company must submit the corresponding "Information Disclosure Form" to the DICJ for investigation. However, the term "main employees" is never defined by the Regulation, nor could it be clarified in details by the DICJ or the Macao SAR Government.

As a matter of fact, the above is a classical demonstration of the institutionalists' argument that "while formal rules can be changed overnight by policy, informal constraints change very slowly" (North, 1997, 1). In other words, although the opening of Macao's casino industry and the subsequent promulgation of the Junket Operator Regulation formally mark a new era for the traditional private VIP-room business, the transition from the informal way of business to a well-regulated layout may not be completed within a short period of time. Considering the scale of the business in the "old Macao", it is reasonable to project that the traditional private-VIP-room business will not be completely removed in the coming decade, even though its scale may be contracting over time.

On the other side of the market, the new entrants from North America are running their VIP-play business in strict adherence to the Nevada gaming law, which prohibits them from employing the "casino operator/private-VIP-room contractors/junket operators" model in their oversea business. For example, according to the NRS (Nevada

<sup>10</sup> After granting the 3 concessions to SJM, Wynn Resorts, and a joint venture of Galaxy from Hong Kong and Venetian from Las Vegas in 2002, the Macao SAR Government approved the restructuring of Galaxy to become the formal concession holder and Venetian the sub-concession holder in 2004. In addition, MGM from the US and PBL from Australia also obtained the formal approval of sub-concessions in 2005 and 2006 respectively, through their deals with SJM and Wynn Resorts.

<sup>11</sup> The official list is available only from the Chinese website of the Gaming Inspection and Coordination Bureau (<http://www.dicj.gov.mo/CH/LicPromJogo/lista/20070122.htm>).

Revised Statutes) 463.720: Prohibited Practice, "A licensee shall not, in a foreign gaming operation, knowingly: ..... 2. Fail to conduct the operation in accordance with the standards of honesty and integrity required for gaming in this state (Nevada); .....". Under the NRS 463.720 and the related regulations, a Nevada-based casino licensee is disallowed to run its business through a gaming-room operator by offering benefit of sharing gross gaming revenue. In addition, procedures/requirements of background check are very strict by the Nevada law, which may deprive the North-American casino operators of the right to employ the existing junket operators from the "old Macao". Therefore, while the non-American casino operators are conducting their VIP-baccarat business on the Junket Operator Regulation in Macao, the American casino operators "must adhere to Nevada state regulation on top of any other local regulation" (Leonard 2005) in conducting their business in Macao.

Given the long-established, well-enforced regulatory system imposed by the Nevada Gaming Control Board (as well as the Casino Control Commission in New Jersey), and in view of the highly-invested world-class brand names, it is unlikely that the American operators would step back by employing Macao's traditional revenue sharing model in their VIP business. On the one hand, periodical detection conducted by the Nevada Gaming Control Board serves as an influential external force to recapitulate the standard of the American operators in their oversea business at Macao, and to a certain extent, insulate their business from being infected by the informal activities as commonly practiced during this transition period. On the other hand, opportunity costs (i.e., risking their casino licenses in the States and their world-class brand names) may also be far too high for the American operators to outsource their VIP business to a third party.

These two factors may also serve as the guiding force to any American operator who is conducting its casino business in Macao through a joint venture or partnership with a local operator. For example, after MGM announced its joint venture agreement with Pansy Ho (who obtained a sub-concession from SJM which was owned by her father, the Macao gaming tycoon Dr. Stanley Ho) in June 2004 (MGM in Macau casino deal, June 23, 2004, and Coleman, February 3, 2005), it took almost 3 years for the MGM to settle all the legal requirements with various gaming control authorities in the States. The comprehensive review process undertaken by the Nevada and New Jersey governments clearly signals to the market that the traditional Macao casino operation model employed by the local operators could not be reconciled with the North American model. Although the final approval is gained by the MGM in 2007, its joint venture business with the local operator in Macao is in principle strictly monitored by the US gaming regulations. To the American operators and the gaming control authorities, running and monitoring the casino business in this Chinese enclave of Macao is definitely a "discovery" which is associated with lots of challenges. In the foreseeable future, proactive public policies must be devised by the American gaming control authorities to tackle the new issues that may come into place during the transition of Macao's casino industry.

Given the tradition of Macao's casino business, and the expansion of the modernized and formally regulated casino business lately introduced by the North-American casino operators, it is foreseeable that the phenomenon of two distinctive markets running in parallel, would last for at least another decade. In view of the institutional and structural disparities between these two markets, their economic performances are also evidently divergent. In 2005, for example, the operation results reported by the local operator (the SJM), the non-American operator (the Galaxy Waldo) and the American operator (the Las Vegas Sands Casino) well illustrate the co-existence of these two markets.

**Table 2: Business performance of the 3 casino operators in 2005**

	GCR (billion USD) ①	①/Total of ①	Gross profit after tax billion USD) ②	②/Total of ②
SJM	4.3011	74.63%	0.6950	70.04%
Sands	0.9633	16.72%	0.2965	29.88%
Galaxy Waldo	0.4985	8.65%	0.0008	0.08%
Total	5.7629	100.00%	0.9923	100.00%

\* Data presented in the columns “GCR” and “Gross profit after tax” are derived from *Macao Daily News*, April 27 2006, p. A1. USD1 = MOP8

According to the business performance as presented in Table 2, it is reasonable to highlight that:

i) In terms of GCR, over 80% of the market share goes to the operation of the traditional business (i.e. the sum of SJM and Galaxy Waldo). Although the local operator has introduced various programs to diversify its existing business (e.g., investment in the expansion of slot business and improvement of the existing mass-market business) since 2002, the existing private VIP rooms remain as the dominant source for sustaining its overall business turnover. In addition, it is also well known that the first casino (Galaxy Waldo) of the new non-American operator also gives emphasis to the traditional private-VIP-room business.

ii) By assessing the business performance in terms of “GCR” and “gross profit after tax”, it is found that the business efficiency of the “old Macao” is much lower than that of the “new Macao” – the profit margin of the American operator is much higher than that of the other two participants. In terms of GCR, the Sands Casino shared 16.72% of the market in 2005; it reaped almost 30% of the industry’s gross profit after tax. A possible explanation to this difference is that as the traditional revenue sharing model of the VIP rooms are not employed by the Sands Casino, a significant amount of operational expenses is saved, especially the share of GCR to the VIP-room contractors, as practiced by the casino business in the “old Macao.”

Since the formal rules guiding the practice of the private-VIP-room business in Macao “may” not be permissible by the Nevada gaming law, the North American operator deploys effective and aggressive strategies to develop the mass market which was however overlooked by the local operator before opening of the industry. For example, the mass market recorded 44% cumulative growth as compared with the VIP market of only 3% growth in the first quarter of 2006 (Tang & Ye, April 19 2006). In fact, the success of the new entrant in developing the mass market paves the way for the development of high profit-margin market, which co-exists with the low profit-margin market as revealed in Table 2.

In principle, evidence suggests that the two parallel markets (i.e., the traditional private-VIP-room market of the local operator and the formal VIP-play market of the North American operators, or the low and high profit margin markets), will continue to co-exist for a long period of time. While it is projected that the formal and high profit margin portion would be expanding, it is also believed that the traditional and low profit margin portion would not that easily be phased out due to its absolute size and long-established social foundation in Macao society, particularly the interrelationship between the casino operators, the private-VIP-room contractors, and the associated junket operators.

Before concluding this paper, it is worthwhile to give some highlights about the Casino Credit Law (Law no° 5/2004). Although the role of this law in the evolution of Macao’s casino industry is by itself, another essential topic warranting comprehensive study, its structure and enforcement are highly correlated with the Junket Operator Regulation. Similar to the Junket Operator Regulation, promulgation of the Casino Credit Law in 2004 represents the first attempt of the Macao SAR Government to monitor the

practice of this informal business as operated in the “old Macao” for decades, and to better align them with the formal ways of business as conducted in the global casino markets. Since casino credit was prohibited in accordance with the Macao-Portuguese Government’s regulation and before the enforcement of the Casino Credit Law, informal credits made available to casino players were granted by the junket operators and their associates at various hierarchies of the private-VIP-room business. All these historical setups laid down the blueprint of the Casino Credit Law. For example, while stated in n.º 1 of Article 3 that the “concessionaries” (i.e., casino license holders) and “sub-concessionaries” (i.e., casino sub-license holders) are legal entities to operate as “credit grantors”, it is added in n.º 2 of this Article that “game prompters” (i.e., registered junket operators) “may also operate as credit grantors” with the consent from the “concessionaries” or “sub-concessionaries” to operate the casino credit business.

Indeed, two parallel markets are also operated under the Casino Credit Law. By the law, although the American operators are allowed to apply casino credit in their Macao businesses, the scale is relatively small as compared with that of the local operators. A major reason is that in evaluation of the American operators’ application for credits without employment of the local junket operators, they have to rely on formal credit history of the applicants (as what they do in the United States). Different from their business in the States, most of the potential credit applicants in Macao’s casinos are Chinese who do not possess any US-required credit history. On the other hand, since most of the existing junket operators who work with the local and non-American operators have been running business in the Chinese community for years, they are backed by a strong social network and with knowledge about channels to access the potential candidates for casino credits; most of them are simply continuing their traditional way of business, with the only exception that their legitimacies are now ratified.

To a large extent, promulgation of the Casino Credit Law is a positive action taken by the Macao SAR Government for attending the request by the American operators, particularly answering to the argument that casino credit serves as a common and essential measure to conduct their VIP-play business. Constrained by the Government’s inexperience and time pressure, the Law is however far from completion, not to mention perfection. Similar to the Junket Operator Regulation, effective enforcement of this Law is largely restricted by its ambiguities and shortage of operational details. For example, it is stated in n.º3 of Article 3 that if a credit grantor “seriously violates” the regulations in conducting the business, or shows “a clear lack of the technical qualifications” for operating the business, its business qualification will be suspended or terminated. Simultaneously, the credit grantor may also need to assume any civil or criminal liability from its business activity. In principle, the intent of this Law is indisputable, its enforcement however is evidently restricted by the lack of guideline/criteria for determining how the regulations are “seriously violated”, or how the “technical qualifications” of a business entity are defined. Besides, as traditional junket operators could be qualified as credit grantors by this Law, detailed revision and completion of this Law may be required before their business activities could be effectively monitored.

According to the evidence as revealed in this study, it is clear that the introduction of the Junket Operator Regulation marks the outset of a form of progressive institutional change (Bush 1987, 1101-1107) which reinstates the instrumental efficiency (i.e., the problem-solving capacity) to Macao’s casino industry. Nevertheless, this transition process is far from completion. Diffusion of the new instrumental values throughout Macao’s junket operation still requires a real modification of the “habitual patterns of thought and behavior” so that “a higher level of instrumental efficiency” could ultimately be achieved.

*Although the American operators are allowed to apply casino credit in their Macao businesses, the scale is relatively small as compared with that of the local operators.*

*The introduction of the Junket Operator Regulation marks the outset of a form of progressive institutional change.*

### Concluding remarks

The promulgation of the Junket Operator Regulation is a necessary measure to furnish the opening of Macao's casino industry. Nevertheless, as new participants were admitted to the market immediately after the changes of the public policies, the existing participants could hardly change their customary ways of running business within a short period of time. For example, the existing structure of the junket operation had been practicing in a lawless area in the "old Macao" for almost two decades. The custom of this business, especially the long-established interrelationship between a casino operator and its private-VIP-room contractors, and between the private-VIP-room contractors and their associated junket operators, could impossibly be changed all at one time.

To accommodate with the formal requirements as introduced by the Junket Operator Regulation, the existing participants in the traditional sector need to modify the structure and the ways of their business even though the process may take time. In view of the synergies carried with the American operators who conduct their VIP-play and mass-market business under a set of much stricter US rules, it is foreseeable that the market would urge for modification to the custom of the existing gambling rooms of the local operator, which in turn, will call for revisions of the Junket Operation Regulation, as well as the way it is enforced in the coming decade. Consequently, interaction between the evolving informal constraints and the changing formal rules associated with the practice of the junket operators' business in Macao will lead to continuous modification to the structure, hence affecting performance of the industry.

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