

Prospects and Strategies of Gaming Ventures in China

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Abstract

*This paper analyzes the prospects of gaming ventures in China and discusses the strategies for Western investors. A strong demand for gambling, changing government attitudes, increased wealth and leisure, and a fairly established foundation of tourism have created a favorable climate for gaming ventures in China. The major risks are political instability, policy inconsistency, and inflation. To develop gaming projects in China, Western gaming investors need to choose the right regions and build casinos different from those in Las Vegas. At the current stage, active involvement with a small amount of capital is recommended. **Key Words:** China, Gaming, Prospects, Strategies*

Introduction

MGM Grand Inc. recently announced its plan to build two casino resorts in China. One of the resorts will be near Haikou, capital of Hainan Province, marketed to both residents and visitors. The other will be built near the coastal city of Sanya, also in Hainan Province, and marketed as an upscale hotel-casino for high rollers from Hong Kong, Japan, Taiwan, Thailand, Malaysia and Indonesia. MGM Grand Inc. is not the only U.S. company that is planning or building gaming projects in China. International Gaming Technology Inc., a Reno-based

slot machine manufacturing company, has a joint venture with the Chinese government in Zhengzhou, capital of Honan Province to develop a slot machine entertainment center. As a partner, the company provides slot machines. The Chinese government provides land and buildings. The project has been under construction since Spring 1994 and is scheduled for grand opening soon. The IGT-China joint venture will be the larg-

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est slot machine operation open to the public in China when it is completed. It is not, nevertheless, the first slot machine operation in China. The first one was opened to the public in 1993, owned and operated by a Chinese-American entrepreneur. It seems that the country is well on its way to legalizing games of chance. The most recent development is the approval and issue of sports lotteries nationwide.

The substantial potential return on gaming investment in China has drawn the attention of the U.S. gaming industry. There are, however, different views and opinions about gaming ventures in China. While some gaming executives view China as the most favorable choice in foreign casino ventures, more sound suspicious and cautious. Some industry experts question the political stability of the country. Others are suspicious about the consistency of government policy on gaming issues. Some of the suspicions and cautions are apparently due to the lack of knowledge of the political, economic and cultural climate for gaming ventures in China. To assist the gaming industry in evaluating the investment opportunity in China, this paper analyzes the prospects of gaming investment in China and discusses the strategies for U.S. gaming companies that are interested in gaming ventures there.

Favorable Climate

In China, gambling is still officially prohibited. It is against the traditional doctrines of Communism. For many people, building casinos in Communist China is beyond imagination. It is true that China has not given up its Communist philosophy, as it claims. China is, in fact, the most pragmatic and business-minded Communist country in the world. One cannot find legalized slot machines in Taiwan, but one can legally play slot machine games in the mainland. Like stock trading, casino gaming is a risk-taking behavior. If China can tolerate risk-taking behavior in stock trading, which is against the Communist philosophy, and establish stock markets, which are typically capitalistic, why can't it tolerate risk-taking behavior on gaming tables and open casinos? Gaming investors need not to be over-concerned about the value conflicts between Communism and Capitalism.

Gambling is a traditional Chinese hobby, as is shown in the movie "Joy Luck Club" where the four ladies played "Majian," a game with a history of nearly one thousand years. Many casino games in Las Vegas, such as Pai Gow and Pai Gow Poker, originated from China. Since the communist takeover in 1949, gambling has been outlawed. The government, however, has never been successful in baring people from gambling. Although there is no available statistics on how many people gamble and how much they spend on gambling, the numbers should be significant. The frequent media reports about gambling and related arrests reveal people's zest for the games of chance. In China, it is an open secret that there exists a broad gaming population. A huge market is there waiting to be tapped.

China's economic reform has contributed significantly to the fast growth of its economy. During the five year period 1989 through 1993, the economy averaged 8.6% annual real GDP growth. Real GDP growth for 1992 and 1993 were 13.6 and 13.4% respectively. The fast growth of the nation's economy in recent years has increased the wealth and leisure time of the people. In some public and private sectors, a 5-day work week has been instituted. The population has become more entertainment and pleasure-oriented, particularly the young generation. People's taste for games of chance is growing stronger as the nation becomes wealthier. The government is feeling the pressure of increasing demand for gambling. An outlet is needed for the growing demand and legalized casino gaming is the best one.

Illegal gambling has long been a headache for the government, creating social problems and family tragedies. In many cases, gamblers bet everything on tables: money, furniture, houses and even wives. Since 1949, the government has been dissuading and baring people from gambling. The results, however, are far from satisfactory. The situation is getting worse as people are getting richer. It is apparent that baring people from gambling is not a solution. Legalized casino gaming allows people to gamble in a controlled environment. Creating an outlet for gambling demand may be an effective solution to illegal gambling. The approvals of slot machines and lotteries in China show that the government has realized the fact and is leaning toward legalizing and regulating casino gaming as an alternative solution.

China's international tourism operation started in 1978. Although its tourism infrastructure and superstructure are not comparable to those of the industrialized countries, significant progress has been made. A team of capable hotel managers and staffs has formed. With a well established foundation of international tourism already there, gaming ventures in China should not encounter great technical impediments. The costs of investing in gaming ventures in China should be reasonable and the rewards are likely to be substantial.

Casino gaming in China will attract gamblers from the Pacific Rim. The market of casino gaming in China is not limited to its border. It will include those overseas Chinese who live in the Pacific Rim from where China gets most of its international tourists. The government of China is certainly aware of the implication of gaming to its tourism industry. It is not likely that the government will give up the opportunity when other countries in the region are looking at casino gaming as a tourism leverage. Casino resorts in China will generate decent profits for gaming ventures investors. They will also bring more tourism revenues for the government. Both will be the beneficiaries of casino gaming.

Risk Factors

China is a developing nation with a political, economic, and social environment sharply different from those of developed countries. For Western gaming investors, the risks of investing in China are certainly greater than investing in their own countries. Many gaming companies are concerned about the political stability of

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China. Their concern is justifiable. Gaming investors should not expect the type of political stability of the United States to appear in China in the foreseeable future. However, as the nation continues its economic reform and strengthens its ties with industrialized countries, political stability should improve over time. At present, China is undergoing a transition from an authoritarian leadership to a collective one, a plus factor to the political stability. Collective leadership will help the nation avoid the shock or turmoil when an influential leader passes away and insure the continuity of government policy. It is possible that China can achieve the level of political stability of its Asian neighbors such as Singapore's in the near future.

Another risk is the inconsistency of government policies on gaming. Consensus on gaming issues has yet to solidify within the government. There are differences between central and provincial governments. While the latter are aggressive on gaming projects, the former is prudent. The central government tends to be more concerned about social impact. Local governments, on the other hand, are more driven by tourism and economic gains. Not long ago, the central government banned some resorts of slot machine operations that had been originally approved, a typical example of policy inconsistency. Western gaming investors, nonetheless, should not be over concerned about the incident since it was targeted at the operations involved in prostitution. As China is still in its experiment stage of gaming ventures, policy inconsistency may be a temporary phenomenon. It may diminish as the government becomes more experienced with gaming operations.

The biggest risk for casino gaming ventures in China comes from inflation. Inflation has been a threat to China's economic reform. It reduces real income and erodes the purchasing power of the people. Rampant inflation will shrink gaming demand, particularly that of small players. It also erodes the profits of casino operations in real term. Inflation threatens not only the nation's economy, but also its political stability. In the past, political turmoil was always associated with rampant inflation.

Strategies for Gaming Ventures

Location is critical to the success for foreign gaming ventures. Choosing the right regions for casino projects may help ease governmental interference and increase the potential returns on gaming operations. At present, provinces in East and Southeast China are the best for gaming development. The nation's wealth and personal income have increased significantly thanks to the economic reform. The impact of the economic reform, nonetheless, is uneven across the country. While eastern and southeastern provinces are the main beneficiaries of the economic reform and have been well developed in recent years, the inland provinces are still poor. The people living in the eastern and southeastern coastal provinces, about three billion or one fourth of the population, are fast approaching the living standards of Hong Kong and Taiwan. Those provinces represent the best opportunities for gaming ventures. Not only do they represent the most promising potential gaming markets, but also they are more independent of the central government because of their economic power.

For the gaming investors from the United States, particularly those from Las Vegas, copying Las Vegas type of casinos in China should be avoided. Las Ve-

gas still has an image problem in the world, and also in China. It is not likely that the government will allow this type of casinos to operate. Games may be revised or redesigned. There may be more restrictions on players and bets. Casinos may be called as "entertainment centers" or "clubs" and their appearances may be modified to avoid head-on conflict with Communist doctrines. Gaming operation must maintain a "clean image" in China in order to remain in operation without government interruption. Gaming ventures should never be involved in prostitution and should avoid money laundering. China's dual purpose of developing gaming projects is tourism plus solution to illegal gambling. Foreign gaming ventures who cooperate with the government in achieving its dual purpose will be rewarded for their cooperation.

Even if the government allows Las Vegas style of casinos, it would be unwise for the U.S. gaming investors to develop casino resorts similar to those of Las Vegas. Asian high rollers represent an important gaming market for Las Vegas and have contributed significantly to its gaming revenues. Casinos in Las Vegas certainly do not want to see another Las Vegas on the other side of the Pacific to compete for high rollers. Building casinos of different style in China will help reduce the risk of market erosion for Las Vegas. Gaming ventures in China should explore casinos of Chinese style, creating new Chinese markets and preserving traditional markets for Las Vegas.

The gaming experiment in China started in 1993 and is well under way at present. The trend of legalizing casino gaming in China is not likely to stop. For the U.S. gaming industry, China may be the best overseas investment opportunity. At the current experimental stage of gaming, however, a cautious approach to casino projects in China is necessary. This does not mean that U.S. gaming investors should sit on the sideline and adopt a wait-and-see strategy. While gaming venture opportunities in China are abundant, the best regions for gaming development are limited. Investing large amount of capital in gaming ventures is risky, since there are still many uncertainties. An active involvement with relatively small amount of capital is recommended. Early involvement with limited capital will enable U.S. gaming investors to obtain a good footing in the future land of casino gaming without risking too much.

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The risks of investing in gaming ventures in China are far outweighed by potential returns. Some risks are temporary risks in the initial experimental stage, such as policy inconsistency. This type of risks will diminish over time. Some risks may arise due to differences in culture, politics and economy. These risks can be reduced or avoided if foreign casino ventures have management teams who not only know the operation of casinos, but also know a good deal of China's culture, politics and economy. China is likely to become an economic superpower early next century if it continues its economic reform at the current pace. A politically mature, economically powerful and culturally colorful China can be a promising land for tomorrow's global gaming industry.

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