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Lessons from the Airline Industry

Students of hospitality schools are often advised, as they embark on their careers, to look at other industries for emerging trends, new technologies or promising business strategies and see how they may be applied to their own businesses. This advice also holds true for students of the gaming industry. Technological advances such as wireless technologies or e-marketing were first developed by other industries and are only now being embraced by the gaming industry.

An important lesson can be learned by watching what is now occurring in the airline industry. Today, several of the so-called "legacy airlines" are either in Chapter 11 bankruptcy or on the brink of filing. This is not because there is a shortage of customers. The nation's airlines have recovered from the drop in passenger volume caused by the events of 9/11. Anyone who has traveled lately knows that the nation's airports and planes are running at or near capacity.

What is becoming evident is that the business model of the legacy airlines is flawed. The model is dependent on a small group of highly profitable customers, willing to pay any amount, to fly to a business destination on a moment's notice. Airlines had for years invested capital in order to serve this small segment, devising elaborate route structures and adding capacity (in the form of gate allowances and planes) to meet the demands of this small yet highly profitable market segment. They also incurred substantial operating costs staffing and maintaining these planes.

While there are still plenty of customers willing to fly, there are far fewer customers that are willing to pay inordinately high airfares than there were just a few years ago. The recent expansion of discount air carriers and the power of the Internet have made it far easier for consumers to find lower fares. Business travelers no longer have to pay \$1,100 to fly 1,000 miles. They now have other choices.

The recent round of problems for these airlines was certainly exacerbated by the rise in fuel costs but every airline, including discount carriers, are vulnerable to high fuel prices. The fundamental problem lies in the business model and the dependency on a small group of customers to provide profitability. While discount airlines are capable of making money on every paying passenger, legacy airlines lose money or break even on the 90% of people sitting in back of the plane and rely on the 10% up front for their profits.

Parallels to the Gaming Industry

There are similar parallels to the gaming industry. Both are capital intensive. Airlines need to lease planes, build maintenance facilities and lease gates at airports. Gaming operators must build hotels, restaurants and casinos and stock them with a variety of expensive electronic gaming devices. Both have high operating costs, primarily in the form of labor. Most important, both are dependent on a few customers for the majority of their revenues.

A cursory examination of virtually every casino's database reveals one similar trend. 80-90% of a casino's revenue comes from 5%-10% of its customers. Every casino manager has long recognized this. It is for this very reason that casinos have long focused the majority of their attention on this small group of players. Elaborate hotel suites, golf courses, private gaming salons and fine dining venues are a few of the amenities that casinos build in order to cater to these customers. They also market to them far more aggressively than to other segments. They assign personal hosts to players and devise a variety of marketing

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programs to foster loyalty and encourage repeat visitation. VIP parties, golf outings and even trips to major sporting events are all designed to keep these customers loyal to the property. And they are right in doing so because this small cadre of customers is highly profitable.

The flaw in this strategy is that the casino becomes dependent on a small and finite group of customers that are not easily replaced. The arrival of a new competitor coupled with the loss of just a few hundred premium players can have a significant impact on a casino's operating results. When these customers leave to play at a more attractive property, the casino operator is still left with paying debt service on its suites and staffing their premium restaurants. One need only look at Las Vegas to identify properties that once catered to premium customers only to have seen those customers move on to newer properties.

Not all gaming companies have fallen prey to this strategy. Harrah's success is predicated, in large part, on its ability to focus on the middle-income gambler. Their properties are attractive and nicely appointed but, for the most

part, the company eschewed elaborate suites and other expensive amenities in favor of developing properties that catered to a more stable market. Harrah's has long realized that there is tremendous value in the middle market.

Today, as casinos of all sizes rush to build VIP suites, private lounges and golf courses, they should take a moment and look at those segments of their databases that may be neglected and ask several questions. How can the middle market customer be better served? What amenities and marketing programs need to be developed to foster loyalty among this segment?

An old axiom in the hospitality industry states that the hotel that tries to be all things to all people winds up being everyone's second choice. This does not hold true in the gaming industry. Casinos need to cater to multiple market segments in order to maintain a stable flow of profits. Just look at the airline industry for evidence of this. ♣

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