

If you can stomach the self-aggrandizement and puffery, press releases and annual reports can make for some insightful reading. Looking beyond the glossy packaging, buzzwords and the creative depiction of financial statements, a trained eye can spot prescient glimpses of a company's corporate strategy and track its path toward satisfying shareholders' expectations with regard to market capitalization.

One common phenomenon plaguing most CEOs from developed countries is domestic market saturation. This is particularly true of the gaming industry where, until recently, healthy market growth enabled shareholders to routinely pocket double-digit returns on their investments and embedded in their psyche the indomitable expectation that their gaming stocks will consistently outperform the market. The sustainability of such stellar performance is now under threat for most companies and several gaming hotshots are scrambling to come up with a clear business strategy that will provide the shareholders with results to which they have grown accustomed.

Based on an exhaustive review of annual reports and press releases from gaming companies, we have concluded that gaming CEOs peg their business model to one of the three generic business strategies: cutting costs, acquiring other companies or geographic diversification. Cost curtailment can never deliver long-term competitive advantage. While mergers and acquisitions (M&A) instantaneously inject revenues into the income statement, for the most part, they tend to destroy shareholder value rather than add to it. Geographic expansion into emerging markets still promises handsome returns provided the company possesses the requisite managerial talent to deal with the cultural, structural and economic mores and nuances of the international marketplace.

## Cost Optimization

*InfoWorld* columnist Bob Lewis declares, "Don't cut off your own head: Corporate cost-cutting as a goal is always a mistake."

He goes on to elaborate, "Improved efficiency is a good goal, which may involve reducing unit costs. Improved effectiveness and increased productivity are good goals, either of which may require cost reduction as well. But cost-cutting must be a means to a different end or all you're doing is playing with numbers."

Lewis' advice is not without empirical support. Professor Gary Hamel of Harvard Business School studied the performance of *Standard & Poors* 500 companies and found that of the 50 companies where earnings growth outpaced revenues growth by a factor of five or more, 43 experienced significant downturns within three years.

Cost-cutting is intuitively appealing because these savings translate directly into improving the bottom line, at least in the short term. Once identified, the elimination of overheads and other slack resources invariably drives up a company's earnings per share (EPS). Realistically, though, most of the listed casino companies already run very efficient operations and further cost-cutting will result, at best, in modest savings, and at worst in cutting off the head.

# Follow the Yellow Brick Road

## THE ELUSIVE QUEST FOR SUSTAINABLE GROWTH

BY SUDHIR KALE AND PETER KLUGSBERGER

## Mergers & Acquisitions

Many companies seem enamored with the idea of "buying" new revenue streams rather than pursuing the path of gradual organic growth. The theory behind mergers and acquisitions is that the sum of two or more companies creates more value than each of them would be able to realize on their own. After all, a great big acquisition can provide the CEO with that shot of top-line growth that shareholders demand.

Unfortunately, experience shows that 70 percent to 80 percent of acquisitions fail, meaning they create no wealth for the shareholders of the acquiring company. Most often, they destroy wealth. The real winners in the recent M&A frenzy, it seems, were the CEOs of the participating companies and the lawyers representing the companies. Gillette Company Chief Executive Officer James M. Kilts reportedly made a cool \$165 million, including stock options and severance, when Procter & Gamble acquired the firm. But given the unfavorable odds for the shareholders, one should think twice before embarking on this uncertain endeavor.

For unsuspecting shareholders, determining whether a merger or acquisition turned out to be an appropriate strategy is not easy to figure out. In the case of one prominent gaming company whose "investor relations" section we perused, the revenue chart exhibited considerable top-line growth reminiscent of the fabled "hockey stick."

Such illustration of revenues, however, was somewhat deceptive, as it did not include the financing costs needed to acquire the new revenue streams. The true picture only became evident when we looked at other measures such as earnings per share (EPS), which factor in the incremental revenues as well as the financing costs. Comparing the pre- and post-acquisition EPS, it became readily evident that the promised synergies had yet to materialize.

In order for M&A to work, the company taking the initiative needs to think long and hard about how it will create new value for its customers. Value enhancement could occur through innovative products, new processes, building a cohesive culture founded on customer-centrism, or by providing a superior customer experience. Moreover, for a company choosing M&A as the primary means of growth, a vast pool of star performers that can easily be deployed as "cultural change-agents" in a SWOT-style manner will be needed.

The primary role of these individuals is to instill in the new corporate entity the best practices, the culture, and values of the acquirer. Success of the M&A hinges on the caliber, the experience, and the personality of the change agents. Given the scarcity of such individuals, managerial capital remains a serious bottleneck in the path to successful M&A.

## Geographic Expansion

Buoyed by the miracle that is Macau, many gaming CEOs are now convinced that the grass is greener in Asia. The Asian market with Macau, Singapore, South Korea, and possibly Thailand and India promises to fulfill every investor's dream. These markets present huge pent-up demand, low-cost labor, and relatively stable legal frameworks. But many developing countries lack the

soft infrastructure needed for markets to work efficiently. Access to capital, managerial talent, and accurate customer information still pose hurdles in the high-potential emerging markets of Asia. In light of such constraints, how realistic is it to expect that Western business models can be seamlessly and swiftly transferred to these nascent markets?

A very good example of such ethnocentric orientation was illustrated in an interview with Melco's chairman, Lawrence Ho. The reporter was curious why Melco ended up entering into a business partnership with an Australian company rather than the more obvious choice of a leading American group. Ho stated quite bluntly that he was put off by "strange" suggestions made by some U.S. casino operators, which included promoting Macau casinos by email marketing to 1.3 billion Chinese and dropping flyers into every Chinese home. U.S. operators desirous of forming a partnership with Ho were apparently unaware of the low internet penetration in China (under 10 percent) and of the fact that the majority of the Chinese population still lives in rural villages, which makes them very hard to reach. The "one size fits all" marketing approach envisaged by some U.S. casino companies demonstrates their lack of experience in tapping international markets.

To make international expansion work, casino companies will have to adapt their management and marketing strategies to suit the cultural, economic, technological, legal and competitive environment of the emerging Asian markets.

## Business as Usual?

The radical move toward a global gaming marketplace will force casino companies to take stock of their internal resources and capabilities. Corporate leadership will need to conduct an appraisal of the level of preparedness to compete internationally. Even a company with no intention of "going global" is not exempt from such appraisal, as it is getting increasingly difficult to be immune from the rifts in the global market. Look at the thriving high-end junket market in Australia. With Macau firmly and rapidly establishing itself as the "Asian Las Vegas," Australian operators will be hard-pressed to come up with an attractive value proposition for the Asian high-rollers to continue to travel to Down Under.

As of now, most casino operators from Europe and the U.S. are inadequately prepared to face the challenges inherent in doing business in Asia. A massive retooling of managerial resources is required to deal with the quirks and quandaries of Asian business. Managers with cross-cultural exposure, language skills, and an international orientation will be needed to lead the Asian onslaught. Strategic investments in people skills, cross-cultural competencies, and decision-making abilities in a multicultural context will probably spell the difference between succeeding spectacularly in the international arena and remaining a dowdy also-ran in the fast-paced casino industry. For some companies, it may be already too late to start thinking about such investments. As John Wooden, the legendary UCLA Basketball coach, liked to say, "When opportunity comes, it's too late to prepare."

*Sudhir Kale, Ph.D. is associate professor of marketing at Bond University in Australia. He is also the founder of GamePlan Consultants, a company that consults and trains for casinos on the marketing aspects of gaming. Kale can be reached at [skale@gameplanconsultants.net](mailto:skale@gameplanconsultants.net).*

*Peter Klugsberger has worked in the gaming industry for nearly two decades with one of the largest international casino operators. His past assignments have involved stints in Australia, Denmark, Slovakia, Switzerland, and Venezuela. Klugsberger holds a global executive MBA from the IESE Business School. You can reach him at [pklugs@yahoo.com](mailto:pklugs@yahoo.com).*