

# **The Competition Implications of Commingling Arrangements on Local Horse-Racing**

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## **I. ISSUE**

1. The Betting, Gaming and Lotteries Commission (BGLC) was established in 1975 under the provisions of the Betting, Gaming and Lotteries Act ('Act'). The BGLC is mandated to regulate and control the operation of betting and gaming and the conduct of lottery activities throughout Jamaica. The Act is inconsistent with respect to the legitimacy of non-promoters of horse-racing offering pool-betting services on horse-racing. A Special Select Committee of the House of Representatives is currently deliberating Amendments to the Act to clarify this matter, among others. Crucial to the deliberations is determining the competition implications of restricting pool-betting services to horse-racing promoters only.

## **II. PURPOSE**

2. The purpose of this paper is to describe the likely economic impact of pool-betting services, offered by non-promoters, on the viability of the local horse-racing industry.

3. Analytic Framework: It has been demonstrated conceptually and in practice that competition is the best means of organizing economic activities. Competition provides the best incentives for suppliers to offer consumers desirable quality goods and services at the lowest possible price.

## **III. THE STRUCTURE OF THE INDUSTRY**

4. The product. Pool-betting refers to a gaming service whereby individuals ('punters') bet on the outcome of a specified event (in the matter at hand, a horse-race). An indispensable input into pool-betting, therefore, is horse-racing. The potential winnings to punters are not determined prior to the bets being placed, but are directly proportional to the sums placed on bets (i.e. the size of the pool). The expected value of accessing the service (i.e. entering the pool) therefore increases with the expected size of the pool.<sup>1</sup> It is conceivable that other gaming products such as the lottery and slot machines are close substitutes for pool-betting.

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<sup>1</sup> Economists generally classify products with this feature as a *network* good.

5. Suppliers: Currently, pool-betting services are offered by Caymanas Track Limited (CTL) only. During the financial year ending March 2008, CTL operated 70 off-track betting parlours and covered 80 local and 306 simulcast races. Bookmakers were issued licenses for 384 betting offices.<sup>2</sup> They covered 80 local race days, 52 weeks of overseas races and 52 weeks of overseas sporting events.

6. CTL is the only service provider which promotes local horse-racing; the other providers purchase racing signals from CTL and overseas promoters. Accordingly, CTL caters to two groups of customers: punters and race-horse owners. The success (profitability) of any promoter will depend on its ability to facilitate the interaction of different groups of its customers. Specifically, better racing events encourage individuals to place higher bets. In turn, the larger betting-pools would attract additional punters and the larger pool would also encourage additional race-horse owners by allowing promoters to offer higher purses.

7. Economic Linkages: The activities of CTL, as a promoter of horse-racing, spawned economic activities which are collectively referred to as the ‘racing industry.’ The racing industry is estimated to employ 3,648 individuals annually. Of this amount, CTL employs 924 persons. A breakdown of the employment generated by the staging of racing events is presented in the **Appendix**. Further, the amount of levies and duties payable by CTL during the fiscal year 2007/08 is \$119.5 million (BGLC, 2008, Betting Divisional Fiscal Report: April 2007 – March 2008).

#### **IV. DISCUSSION**

8. A review of the wider gaming industry indicates that CTL has faced more intense competition in its gaming service market than in its horse-racing facilities market. Specifically, CTL has faced no competition in the promotion of horse-racing in Jamaica since it operates the only horse-racing facility in Jamaica. Contrastingly, Tables 1a and 1b show even though real sales revenue generated by the wider gaming industry increased by percent 67.2 percent, horse-racing’s relative competitiveness has declined since 2001. Specifically, horse-racing’s revenue, adjusted to account for inflation,

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<sup>2</sup> The bookmakers are Big A Track 2003 Ltd.; Capital Betting & Wagering Ltd.; Caribbean Turf Service Ltd.; Champion Betting Company Ltd.; Charles Off Betting Ltd.; Ideal Betting Company Ltd.; Markham Betting Company Ltd.; Post to Post Betting Ltd.; Summit Betting Company Ltd.; and Track Price Plus Ltd.

declined from J\$11,976 million in 2001 to J\$7,849 million in 2008. In contrast, revenue from lotteries increased from J\$5,390 million to J\$19,476 million during the same period. Further, revenue from slot machines increased from J\$498 million in 2003 to J\$1,707 million in 2008. Accordingly, horse-racing's share of the revenue generated by the wider gaming industry declined from 69.1 percent in 2001 to 28.5 percent in 2008.

**Table 1a** Breakdown (in constant J\$ million) of Sales Revenue Generated by the Gaming Industry\*

Y/E March ....	...2001	...2002	...2003	...2004	...2005	...2006	...2007	...2008
Horse-racing**	11,976.3	11,259.9	9,697.5	8,541.3	7,987.4	7,761.9	8,480.8	7,849.0
Lotteries	5,389.6	15,269.5	27,554.6	22,911.1	21,386.2	19,601.4	20,682.8	19,476.2
Slot machines	---	---	497.7	742.3	657.8	570.0	1,728.9	1,706.5
<b>TOTAL</b>	<b>17,365.9</b>	<b>26,529.4</b>	<b>37,749.7</b>	<b>32,194.7</b>	<b>30,031.4</b>	<b>27,933.3</b>	<b>30,892.5</b>	<b>29,031.7</b>

Source: BGLC Annual Report, 2001-2008.

Notes: \*Nominal sales revenue was adjusted using the monthly CPI in March of the respective year. The base period is March 2009.

\*\* Horse-racing comprises revenue generated by CTL and bookmakers.

**Table 1b** Breakdown (in %) of Sales Revenue Generated by the Gaming Industry

Y/E March ....	...2001	...2002	...2003	...2004	...2005	...2006	...2007	...2008
Horse-racing	69.1	42.4	26.0	27.2	27.2	28.3	28.9	28.5
Lotteries	31.0	57.6	74.0	72.8	72.8	71.5	70.5	70.8
Slot machines	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.6
<b>TOTAL</b>	<b>100.1</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>99.8</b>	<b>100.0</b>	<b>99.9</b>

Source: BGLC Annual Report, 2001-2008.

9. Product Development: The rate of product innovation seems to be greater in the pool-betting service than in the horse-racing facilities service. Major innovations in the pool-betting service are: (i) In 1989 CTL acquired a new totalisator- an automated system which runs parimutuel betting, calculates payoff odds, displays odds and produce tickets based on incoming bets. During the period 1990-1996, this system allowed CTL to deliver products which are more suited to its punters as it withdrew older products and introduced a number of novel ones; (ii) CTL introduced *simulcast* (i.e. simultaneous broadcast) services whereby it offered its punters the opportunity to bet on overseas races.

10. In stark contrast, throughout the years there has been no significant development in the horse-racing facility owned and operated by CTL.

11. Prospective Entry: In seeking a license to offer pool-betting services on overseas horse-racing, Fortune Gaming (FG) is proposing to offer a product which is similar to CTL's simulcast service. The key difference, however, is that FG's product allows local punters to bet in overseas pools (referred to as *commingling*) whereas CTL's product limits punters to bet in locally created pools. All other thing constant, commingling allows local punters to enter into bigger pools and therefore increase their potential winnings relative to simulcasts.

12. We have seen no substantiated report of how the market will respond to FG's entry. Not surprisingly, FG argues that the horse-racing industry will only benefit from its entry while CTL argues that the industry could only be harmed. FG argues that its participation in the market will, among other things, "...(i) increase tax collection; (ii) grow racing with new markets and new products; and (iii) provide additional attraction in Jamaica..." (FG, 2009, Grow Racing Industry with the BGLC Legislation).

13. CTL argues that "...any downturn...in [CTL's] sales..., especially on overseas racing, will have serious repercussions for the continued viability of CTL, the future of the entire racing industry..." (CTL, January 11 2010. Letter to the Hon. Daryl Vaz, The Minister of Information & Special Projects). A review of CTL's records supports its claim. Specifically, simulcast races are "cheaper to produce" than local races. Specifically, during the year ended March 2009, costs amounted to J\$2,948.1 million for local races days but only J\$1,974.7 million for simulcast race days. Further, CTL made an overall operating profit of J\$119.1 million on simulcast races but an operating loss of J\$118.1 million on local races (CTL, August 25 2009, Letter to BGLC).

14. While we agree with the premise that a significant fall-out in CTL's sales is likely to result in operating losses for CTL, we reject the claim FG's entry would inevitably compromise the viability of CTL, and by extension the local horse-racing industry. As outlined below, we have viewed information suggesting that CTL has the ability to remain viable through its current product offerings or development of new gaming services, even with FG's entry.

15. Local horse-racing's demand advantage: There is evidence that, all other things constant, punters prefer local races to simulcast races. Specifically, a comparison of the sales generated by CTL from local and simulcast races suggest that local races represent a niche market.

**Table 2** CTL Sales from Local and Simulcast Races

Year end March...	...2005	...2006	...2007	...2008
Total local race day sales (J\$M)	1,650.2	1,857.3	2,249.9	2,834.0
# of race days	79	81	83	80
Average sales (J\$M)	20.9	22.9	27.1	35.4
Simulcast sales (J\$M)	1,372.1	1,500.2	1,689.3	1,888.8
# of race days	305	307	311	305
Average sales (J\$M)	4.5	4.9	5.4	6.2

Source: BGLC (2008)

16. **Table 2** above indicates that on any given day, the revenue CTL generates from local races is five-fold that generated from simulcast races. This explains why annual sales from local races exceeded sales from simulcast races despite the fact that there were three times as many simulcast race days. From the perspective of punters, therefore, a local race has desirable characteristics which are not readily available through simulcast races. CTL is the only promoter of local horse-racing and could use this as a basis to compete effectively with FG.

17. We argue that for at least two reasons, FG's service will be somewhat differentiated from the services offered by CTL and as such, FG's entry would not necessarily displace CTL from the market. Firstly, we provided evidence earlier in this report suggesting that punters are likely to find local races more attractive than overseas races. CTL, therefore, should be encouraged to initiate steps to generate additional revenues from staging local race days. Secondly, there is evidence that the characteristics of punters betting in local pools are unlikely to be identical to those of punters betting in overseas pools. Specifically, the sum needed to place a bet on a race in an overseas pool is likely to be significantly higher than the sum needed to place a bet on the same race in

a local pool.<sup>3</sup> This means that, all other things equal, the disposable income of punters betting in overseas pools is likely to be higher than that of punters betting in local pools.

18. Further, the punters attracted to betting in overseas pools could differ in demographic characteristics other than income. There are no CTL outlets or Bookmaker shops that specifically targets the tourism areas; for example many of our hotels have slot machines in their gaming rooms but have no facility for their guests to wager on either local or overseas races.

19. If one accepts that FG will enter with a differentiated but not necessarily a superior service, then FG's entry is at least as likely to attract new punters as it is likely to encroach upon CTL's punters. CTL's profitability ultimately will depend on, among other things, the repackaging and marketing of existing services as well as a possible introduction of new services. Competition in an open market framework provides the proper incentives for innovation to take place.<sup>4</sup>

20. By way of example, *Advance Deposit Wagering* (ADW) and *Internet Betting* (IB) are segments of the gaming sector which resulted from technological innovations of the 1990's.<sup>5</sup> The betting sector of the gaming industry grew significantly as a result of the wide scale implementation of these innovations. The concept of commingling resulted from technological advancements in the previous decade.

21. Jamaica has failed to extract the potential benefits from utilizing ADW, IB and commingling for betting on horse-racing; thereby depriving the government, consumers and investors of the potential benefits. There may well be other segments of the gaming sector which remain untapped; and it is only through innovation and the exploration of

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<sup>3</sup> For example, the minimum wager on a local pool is J\$40 while that of an overseas pool is US\$2 (J\$180). The difference in expenditure on wagers is more pronounced in bets that offer potentially high payouts or jackpot pools such as the 'Super 6' and 'Pick 4' bets. A super 6 bet comprising 216 combinations would cost US\$432 (J\$38,880) on FG's commingling product but only J\$1,080 on CTL's simulcast product. Alternatively expressed, a bet that costs J\$1,080 on FG's product would allow only 6 combinations compared to the 216 combinations allowed on CTL's simulcast product, and therefore the chance of winning would be significantly reduced.

<sup>4</sup> For a discussion on the role of competition in promoting innovation, see Barbara Lee and Kevin Harriott. 2006. "Striking the right balance: Promoting Innovation in a Competitive Environment." Article is available at the Fair Trading Commission's website at <http://www.jftc.gov.jm>.

<sup>5</sup> ADW refers to a form of wagering in which an individual deposits money into an account with an entity authorized to conduct wagering, then uses the account funds to pay for wagers made in person, by telephone, or through communication by other electronic means (source: wikipedia).

new ideas and technological advancement, that will allow these segments to be discovered and marketed.

22. Our argument that FG's entry will not inevitably lead to the demise of the local horse-racing industry is supported by the coexistence of local horse-racing and commingling agreements in other jurisdictions located on the Australian, European and North American continents. For instance, in 2007 a commingling agreement was entered into between the New Zealand Racing Board and Australia's Tabcorp. Of note is that the local horse-racing industry of both countries benefited from the agreement as it allowed for increased purses, which in turn allowed for higher fees to be paid to successful trainers and jockeys.<sup>6</sup> Additionally, in 2006 parties in Ireland, Holland, Germany, Spain, Russia and North America entered into a commingling agreement which was expected benefit the local horse-racing industry in each jurisdiction.<sup>7</sup>

## **V. CONCLUDING REMARKS**

23. An enhanced competitive environment for pool-betting services, such as that which would result from the introduction of commingling agreements, does not necessarily represent a threat to the local horse-racing industry. To the contrary, competition provides current and prospective suppliers with the proper incentives to continually develop the industry, and thereby maximize the surplus accruing to the government, punters and other industry participants.

24. Accordingly, policies should be crafted to encourage and safeguard competition. In the matter at hand, we recommend that non-promoters of horse-racing be permitted to offer pool-betting services on horse-racing. It is important to note that our recommendation to support the entry of non-promoters is not based on our conclusion that CTL could effectively compete with them. Rather, it is based on our observation that the non-promoters could only enhance the competitive environment in which pool-betting services are offered and horse-racing is promoted.

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<sup>6</sup> See New Zealand Racing Board. 2007. "Historic Agreement to Benefit Customers and the Racing Industry," Inside Running, Issue 15, p. 1. Available for download at [http://static.tab.co.nz/content/nzrb/NZRB\\_insiderunning\\_15.pdf](http://static.tab.co.nz/content/nzrb/NZRB_insiderunning_15.pdf). Last accessed January 21, 2010.

<sup>7</sup> See International Federation of Horseracing Authorities. 2006. "More commingled pool betting in Europe." Available for download at <http://www.horseracingintfed.com/newsDisplay.asp?story=329>. Last accessed January 21, 2010.



25. Our position on such an admittedly sensitive issue recognizes that industries are not valued in and of themselves, but rather for the social surplus they generate. It is always advisable, therefore, for industries to be organized in a manner that would generate the greatest possible surplus for the society given the limited resources available to produce the goods and services. There is no compelling reason that Jamaica should produce, rather than import, any given product. It is best for the competitive process to make such determination. It would be counterproductive for any policy to accommodate blocking the entry of efficient rivals, without more, as this is likely to remove any incentive for incumbent suppliers (such as CTL) to operate efficiently and, therefore, ultimately will result in a sub-optimal use of Jamaica's scarce productive resources.

26. Parallel developments in other industries. Jamaica's experience in the airline and sugar industries must be brought to bear on current discussions in the horse-racing industry. Specifically, in the not so distant past, many individuals have argued in support of using state aid to maintain the sugar industry because of the large number of persons it employed, despite the fact that Jamaica was an inefficient sugar producer. There was also widespread support for state aid to support a nationally owned air carrier because the carrier supported the important local tourism industry, despite the fact that the carrier is being operated at a significant loss. In both instances, support has waned considerably in recent times as the mounting costs of artificially sustaining an inefficient industry/ entity has become apparent over time; and suitable alternatives have been identified to serve the needs of consumers and taxpayers.

27. Many individuals have developed a strong emotional attachment to the local horse-racing industry and so we must guard against yielding to the temptation of protecting the industry due solely to sentimental reasons.

28. Competition should, wherever feasible, remain the basis for continued market participation.

## APPENDIX

**Table A** Annual Employment in the Horse Racing Industry

Entity	Particulars	Jobs
<hr/>		
CTL		
	- CTL Staff	400
	- Security	40
	-Off Track Betting (OTB)	384
	- Back stretch (vendors, hay providers, etc.)	100
		<hr/> 924 <hr/>
<u>Jamaica Racing Commission (JRC) licensed personnel at January 2010.</u>		
	- Trainers	161
	- Jockeys	109
	- Assistant Trainers	30
	- Grooms	435
	- Exercise Riders	45
	- Farriers	9
	- Stable Assistants	27
	- JRC Staff	40
		<hr/> 896 <hr/>
<u>Betting, Gaming and Lotteries Commission (BGLC, 2008)</u>		
	- Betting Shops	1,348
<u>Others</u>		
	- Stud Farms	450
	- Racing Analysts	20
	- Veterinarians	10
		<hr/> 480 <hr/>
<b>TOTAL</b>		<b>3,648</b>

Source: Compiled by Fair Trading Commission.