

TRIENNIAL REVIEW OF GAMING MACHINE STAKES AND PRIZES A SUBMISSION BY THE ASSOCIATION OF LICENSED MULTIPLE RETAILERS

The Association of Licensed Multiple Retailers (ALMR) welcomes the opportunity to comment on the Government's proposals to review gaming machine stake and prize levels, and the clear support for the sector outlined in the consultation document.

As the only national trade body dedicated to representing those companies operating pubs and bars, our members manage the majority of the machine estate in the sector, and we are therefore well placed to comment on the impact of the Government's proposals. By way of background, between them our 153 member companies operate just over 13,500 outlets – almost all of the managed pub estate in the UK - employing 325,000 staff. Members include all the major national pub retail chains, dedicated late night operators and casual dining outlets.

Licensed hospitality is one of the UK's primary economy sectors. It has a turnover of £21 billion, and in the past year its contribution to GDP increased by over 8% – the average GVA each pub makes to its local community is £190k per annum. Around half a million people are employed directly in pubs and bars alone, with jobs in all regions for all ages and all skill levels. Crucially, the sector provides the first taste of work for many young people and generated 1 in 6 of all new jobs for 18-24 year olds in the last year.

It is, however, an industry made up of small businesses, many of them independently owned and managed. Two-thirds of our members are small independent companies operating 50 outlets or fewer under their own branding, predominantly suburban community outlets. These are valuable social and economic assets – community centres, tourist attractions and significant revenue generators – as well as providing a well regulated and controlled environment for people to enjoy alcohol responsibly and socially.

With low net profit margins, these businesses face higher than average compliance costs and struggle with ever increasing levels of red tape. This is particular the case with regard to the amusement machine category, where changes in legislation in 2005 have resulted in anomalies and licence complexities and red tape. This will be exacerbated as a result of the shift from a duty based system to a gross profits tax in February 2013. We believe that it is therefore, in the context of considering the Government's proposals, for those changes relating to amusement machines in the pub sector -which are deemed to be least controversial and to fall outside the scope of general gambling regulation - to be expedited as a matter of priority.

Market Overview

Since the last Triennial Review in 2001 and the changes to Cat C machine stakes and prizes in 2008, the pub industry – and the role of amusement machines within it - has undergone significant and profound change. It is vital that this is taken into account in the assessment of changes to pub amusement machine stakes and prizes and that steps are taken to address their current competitive position.

The credit crunch, economic downturn and a series of legislative and regulatory burdens have combined to create a perfect storm which continues to threaten many of the UK's pubs and bars. Whilst the latest survey of our members suggests that the sector has weathered the worst of the economic downturn and is seeing a return to cautious growth in employment, it remains fragile. Our Annual Benchmarking Report shows a dramatic 6% decline in businesses' gross margins and profitability. The outlets which have been hardest hit have been the traditional community pubs and wet led operators; these are the ones most likely to have a significant gaming machine estate.

The smoking ban in 2007 is particularly noteworthy in its impact not just on pub takings overall but more particularly on machine play within them; smokers were traditionally heavier machine players. Coupled with changes to the alcohol licensing regime which have accelerated the sale of alcohol through the off-trade – 70% of alcohol sales are now made outside the controlled environment of the pub - at home entertainment is now a very big competitor to the pub. The boom in on-line gaming means that customers now have a more attractively priced night in with the chance to win bigger prizes.

Since 2001, the market for gambling and gambling products has changed significantly. The proliferation of varied and new lottery games, the introduction of a second national health lottery and the introduction of new FOBT machines in licensed betting shops on the high street have all increased the competitive environment. It is the revolution in online gambling through smartphones and handheld devices which has had the single biggest impact on other, softer forms of gaming. The failure of pub amusement machines to offer an attractive stake and prize proposition throughout the period has seen a significant falling away of revenues derived from gaming.

At the same time, changes to the regulatory regime governing machine licences have seen the density of machines in pubs decline over time. Amusement machine permits for pubs are not issued separately but are attached to and an integral part of the alcohol premises licence. Previously, pubs had been able to apply for an effectively unlimited number of permits, but the Gambling Act saw this restricted to 2 as of right. Whilst there was an ability to apply to the local authority for more, many local authorities have not been sympathetic to such requests and the level of bureaucracy surrounding permit transfers and management is now considerable.

For example, some local authorities say that you just need to state the number of machines eg 2 machines; some say that you must specify the Category machines present eg 4 machines, both Cat C, D and SWP and others say that you have to precisely indicate the number and category of machine. If either of the two latter approaches is adopted, then operators must submit renotifications to amend the alcohol premises licence.

Coupled with the increase in tax arising from the introduction of MGD in February 2013, and the resulting decline in machine income for smaller operators, and there is now evidence that community pubs choose to restrict machine numbers or remove them altogether as the income they attract does not compensate for the additional costs and red tape. The Triennial Review is an opportunity to seek to redress that urgently.

The ALMR has carried out a review of its members' gaming machine estate on an ad hoc basis over the past 12 years. This shows a sustained decline in machine density within the pub estate, from an average of 2.4 AWP machines per pub in 2001, to 1.5 in 2008/9 and just 1.36 now. The decline has been particularly marked in the leased and tenanted segment of the market where numbers have fallen by 12% in the last 5 years to 1.2 machines per pub on average. Equally, the density of SWP machines has also declined to just 0.58 machines per pub; this reflects the growing trend of removing less viable machines. The proportion of the overall estate with gaming machines has also fallen, down 3% to just 68% of outlets.

Machine income is so important to pub operators – particularly independent lessees or community pub operators – because the operators share of the cash in box is net profit. The machine income therefore makes a direct and real contribution to the pub's bottom line. Any changes which adversely affect or damage that fragile income stream have a consequent and immediate impact on business viability. Equally, a positive change to improve the attractiveness of amusement machine play through increased stakes and prizes and a guaranteed future review mechanism to bring stability to the market place will result in sustainability.

Response to Consultation Questions

Whilst we understand that the scope of the consultation is wider, in framing our comments we have restricted ourselves to considerations relevant to the provision of machines in pubs. We have not, therefore commented on proposals relating to machines sited in gambling premises.

1. How often should government schedule reviews?

We support the re-introduction of a systematic review of machine stakes and prizes in the round. This will provide manufacturers with the certainty to plan and invest in new technology and player innovation. Over time, it will also allow pub operators to invest in new technologies. The current piecemeal approach has undermined confidence and investment in the sector, as well as introducing competitive imbalance and we are pleased that the Government has sent a clear signal that this will be addressed.

We support the reintroduction of the Triennial Review. Three years gives time for changes to feed through the system and to have the desired effect. The impact of changes to stakes is felt more quickly in the managed pub chains than in leased or tenanted outlets and it can be as long as 14-18 months for the impact of a change in stake to be felt on the ground. Equally, the beneficial impact of a relatively small change in stake and/or prize, will be time limited; hence the need for a regular review. This cycle is roughly three yearly in the pub market. As the review of stakes and prizes should, under the Triennial Review system, have occurred in 2012 the a special review should occur in 2015 rather than 2016.

The frequency of review period is, in our view, of less importance than the certainty that it will happen and the time period between a review taking place and any changes being introduced. The need for a regular change in stakes and prizes, as appropriate, every three years is the key, not the review per se. Previously, whilst the review would take place at the appointed time it may be almost 2 years before the proposals were effected. If we are to reintroduce a regular review cycle, it is vital that the time between decision and implementation is speeded up, particularly for marginal sectors like pubs where income is in decline and the risks of changes to stakes and prizes low.

We would like to see a three-yearly review cycle matched by a guaranteed three yearly change cycle.

2. The Government would like to hear about any types of consumer protection measures that have been trialled internationally that have been found to be effective. The Government would like to hear views about any potential issues around data protection and how these might be addressed.

This question clearly relates to dedicated and high stakes gaming machines where the revenue stream and the risk of problem or harmful gambling is sufficient to justify the substantive ongoing investment required. This is clearly not applicable for pub amusement machines and we do not think it appropriate to link investment in this type of technology with changes to low risk/low stakes categories or prizes below Cat B levels.

Data collection and tracking technology in the pub machine market is still very much in its infancy and is much more limited in scope than that described in the consultation document. This is largely because pub machines are predominantly analogue rather than digital and the cost has been too prohibitive to overcome this when faced with a relatively small and vulnerable income stream. In pubs where gaming is not a primary purpose players are quite likely not to bother signing up as required by player tracking, which would be disastrous for machine play and pub income.

If, however, future changes to stakes and prizes made that investment more viable and manufacturers and suppliers offered the facility, members would be willing to trial it.

4 Do you agree that the Government is right to reject Package 1?

We wholeheartedly agree with the Government's analysis that it is not tenable to do nothing and leave stakes and prizes untouched. The absence of a regular review has inhibited investment in innovation within the sector and left businesses unable to plan effectively. Moreover, it is has seen machine incomes eroded over time both in real terms and as a result of changes in the market place. We also note in this context that the pre-consultation discussions held with interested parties and key stakeholders saw no responses from problem gambling charities, faith or community groups suggestion that there was no clear opposition to change.

The need for review and action is particularly acute with regard to pubs. As the consultation document notes, the segment is in decline both in terms of income and machine numbers. Crucially, the contribution machine income makes to overall business profitability has also been adversely affected.

The ALMR's Annual Benchmarking Report shows that, on average, gaming machine income as a proportion of total turnover has declined dramatically over the past 5 years. In 2007, it accounted for 3.6% of turnover across all pubs, rising to almost 6% in community local. Last year, this had dropped 64% to just 1.3% of turnover. The rate of decline was less severe for community local pubs – where the proportion of turnover derived from machine income is higher and hence they are more dependent on play – down 41% from just under 6% of turnover in 2007 to 3.4% by 2012.

% turnover from machine income by report year



The chart highlights the uplift – some 74% - in machine income arising from the increase to stakes and prizes in 2009, particularly in the community local sector which has the bulk of the machine estate. However, this benefit was relatively short lived and there has been a 30% decline in the contribution

machine income makes to turnover in the past 2 years. **This demonstrates the status quo is not an option for pubs.**

5. Do you agree that the government is right to reject Package 2?

A change based on an inflationary uplift alone would do nothing to address the serious decline in the machine market in pubs and the deleterious impact this has had on business profitability and viability. In particular, the stake prize ratio would remain insufficiently attractive to encourage additional investment in the sector and the proposed prize level would remain below the £100 customer expectations identified in 2009.

The Government is therefore right to reject option 2

6. Do you agree with the Government's assessment of the proposals put forward by the industry?

We agree with the government's assessment of the proposals as they relate to machines in pubs. This reflects both the serious concern about the performance of the machine category and the importance of machine income to the pub profitability. It also accurately reflects the likely impact of an increase in stakes and prizes for the category at this time.

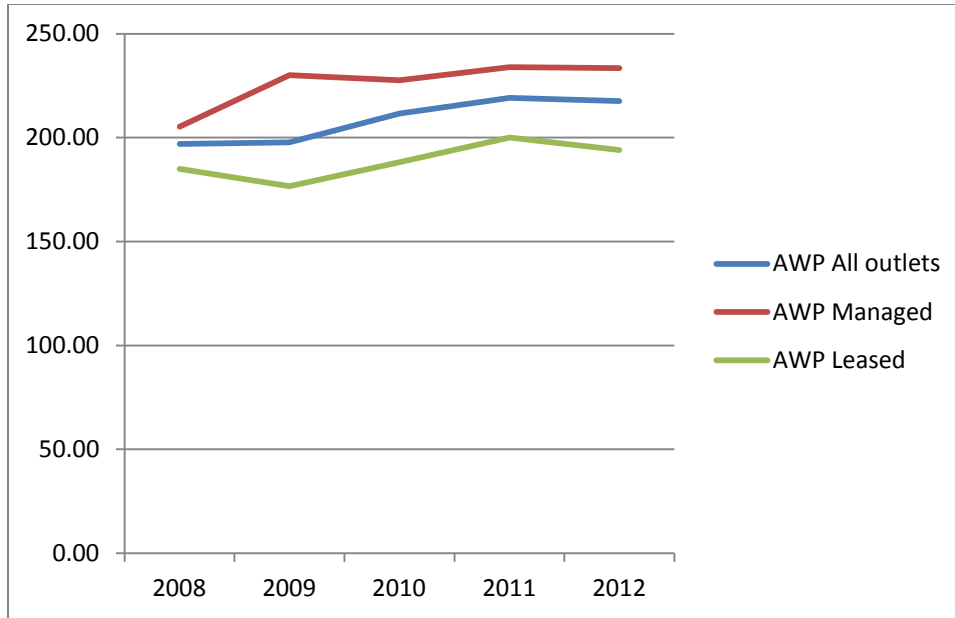
23. Do you agree with the government's proposal to increase the maximum prize to £100 for Category C machines?

We support the government's proposals for Cat C machines and note that this is in line with consumer expectations in 2009 as to the appropriate stakes and prizes. We believe that this will result in an attractive stake prize ration which will encourage manufacturers to invest in the category.

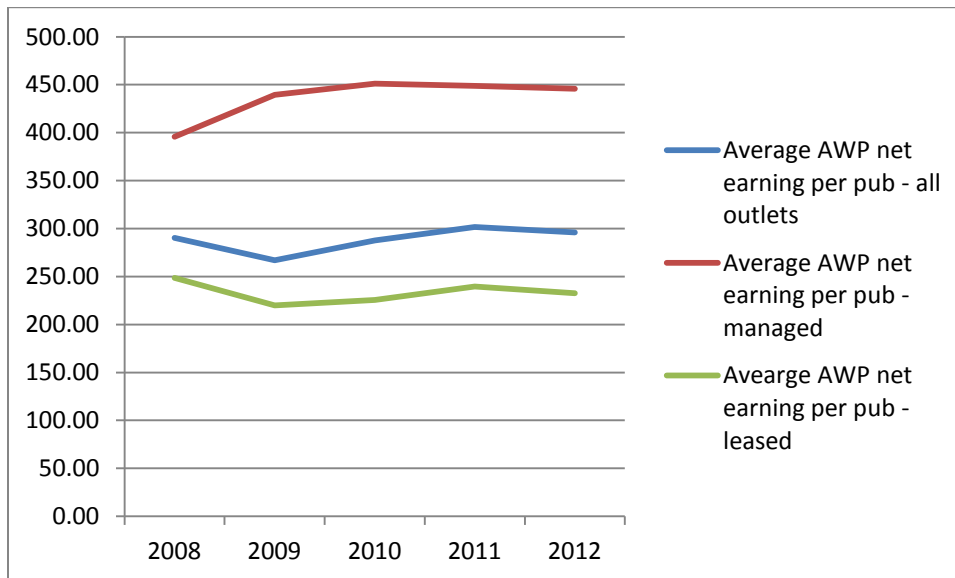
The consultation document highlights a number of issues surrounding the evidence base and justification for the proposals. The ALMR has carried out a new and in-depth survey of its members in order to assist in the preparation of this consultation response. The survey data received from members is both substantive and robust, covering a wide range of managed and leased pub operators between them operating 15,000 outlets, 70% of them with machines. The total machine estate covered by the survey is over 21,000, two thirds of those being AWP and the remainder SWP machines.

As well as information on absolute machine numbers, density and average number of machines per premises, the survey also looked at the average net weekly income per individual machine ie cash in box net of tax and other deductions and the average earnings per pub from the machine category, assuming average numbers of machines per outlet. The results were split for AWP and SWPs and by the type of ownership, managed or leased/tenanted. The results for AWP are depicted below:

Average earnings per machine - £ per week net:



Average earnings per pub from machines



Analysis from the new survey data on average net contribution from AWP machines at to individual pub profitability suggests that the benefits of the 2009 increase were felt most quickly in the managed sector of the market, where there is management skills and resources to invest and respond to regulatory change. The benefits took considerably longer to feed through into leased/tenanted profitability. Nevertheless, the above charts show a 7% increase in average weekly AWP income and an 8% increase in average contribution per pub.

The survey data also shows the lasting benefit this change delivered, with income per machine and per pub only falling away over the course of the last year (October 2011/12). Nevertheless, underlying market trends suggest that income and profitability will both fall away rapidly over the course of this year, and urgent action is now required in order to sustain the viability of those machines remaining within the estate. Given the changes in February 2012 to the tax treatment of machines, any delay could see an acceleration of the decline already noted by Government.

It must be borne in mind in considering this that both the penetration of machines in the pub sector and the density of machines in those pubs retaining them have declined dramatically. Moreover, the benefits of the 2009 increase in stakes and prizes were sustained for longer than might otherwise be expected due to changes in technical specifications in 2011.

24. Do you consider that this increase will provide sufficient benefit to industry sectors, whilst also remaining consistent with the licensing objectives of the Gambling Act?

We agree with the government that this relatively small change will have no adverse impact on the licensing objectives. As the regulatory impact assessment notes, the proposed stakes and prizes will remain low and the risk of problem gambling small as a result and in light of the declining number of people playing pub machines.

Pubs are a heavily regulated environment and are acutely aware of their obligations with regard to young people, not just in respect of gaming machines. In addition to the existing Code of Practice, the largest machine operators have voluntarily agreed to restrict any play on machines from under 18s to under 16s to further increase the protections already available; this is particularly important given the increasing use of multi-game and hybrid machines.

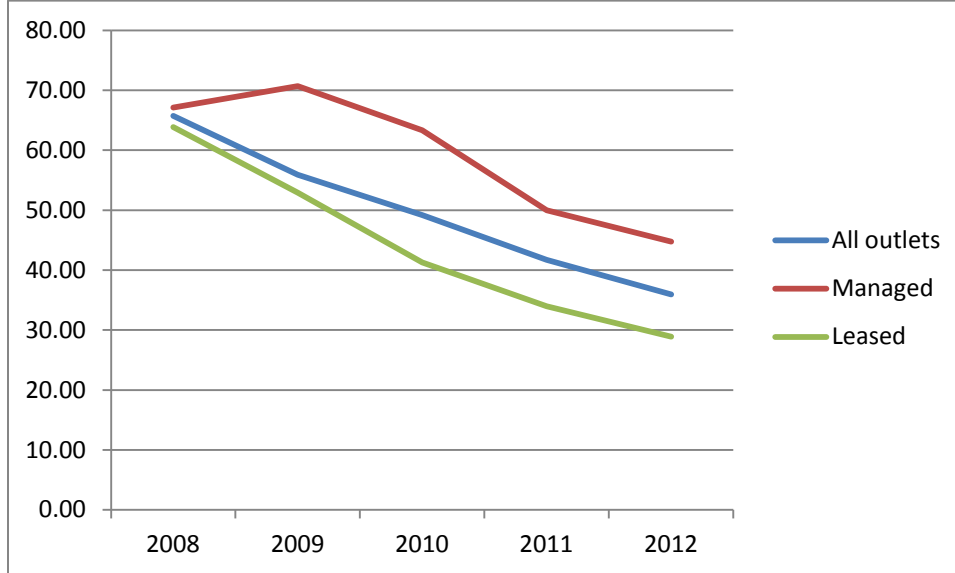
The change will, however, meet customer expectations of reasonable and realistic prize levels and provide an attractive stake prize ratio to provide an incentive for investment in the category.

26. Do you agree with the government's proposal to increase the maximum stake to 20p and the maximum prize to £6 for category D machines?

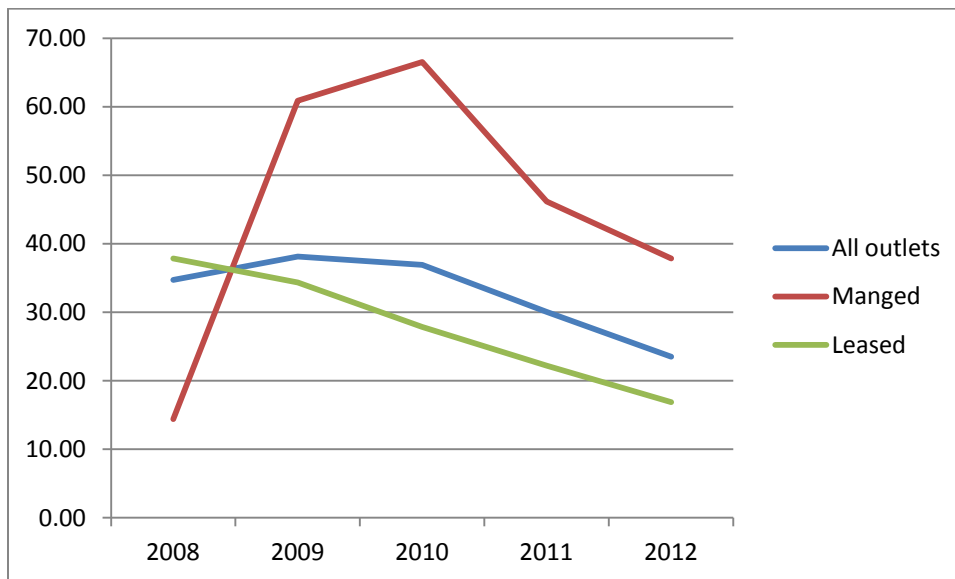
There are a small number of these machines within the pub estate – just a third of all machines and with substantially lower income levels. The results of our recent survey of members show a very serious decline in the fortunes of this category.

This category has seen a 45% drop in average weekly income per machine since 2008 and earnings per pub are down a third. The effect is even more marked in the leased/tenanted sector, where income per machine and earnings per pub have more than halved. We therefore support the broader industry representations in this area.

Average net income per machine



Average earnings per pub



Note that there is an anomaly in the managed data baseline for 2008 due to participant numbers.

Whilst we support the representations made by BACTA, we are concerned that the increased stake will mean that these games are subject to the higher level of MGD and would note that it will be important to ensure alignment of tax and licensing regimes in order to avoid reducing the benefit of changes to stakes and prizes. We also question whether a 20p stake and £6 prize is a sufficiently attractive ratio for consumers.

30. Do you agree with the methodology used in the impact assessment to assess the costs and benefits of the proposed measures?

We strongly support the methodology used in the impact assessment; this is derived from research and information previously submitted by the industry and concurs with our own internal research with members as to machine numbers, income and profitability.

31. Do you agree with the Government's approach to monitoring and evaluating the impact of changes to inform future reviews?

We also welcome the clear intention by government to ensure that the regular review of stakes and prizes is conducted according to the same methodology and will take account of the not only the state of the market but also the impact of changes in it.

We note the suggestion that future reviews from 2016/17 onwards will include bespoke analysis carried out with input from trade associations. The ALMR carries out two regular business surveys which could contribute to this analysis and we would be willing to work with the Department and the Gambling Commission to ensure that this is sufficiently tailored and reflects the key issues they wish to address. As noted in our introduction, the Association's members include all the major national pub chains and the largest proportion of the pub machine estate.

Conclusion

Machine income is a small but vital part of a pub's overall turnover, largely because as income it is pure net profit and therefore translates immediately and directly to the business bottom line, profitability and hence viability.

It is, however, a fragile income stream and has been damaged over recent years as a result of increasing competition within the gaming and, more importantly the leisure market, regulatory and tax reform. As a result, the machine category has been in serious and deleterious decline over the past 5 years in particular. The failure to adequately review stakes and prizes during the past decade has contributed to this as increases in costs or changes to play have had to be funded from machine income. A swift and significant intervention at this point in time will help to arrest this decline and underpin the health of the sector going forward.

In view of the serious situation in which pubs now find themselves, and the fact that operators are having to make decisions about machine viability now as a result of tax changes, we urge the government to expedite increases in this category.

Furthermore, the successful attainment of those objectives will inevitably be constrained by the fact that the proposals do not go far enough to regulate the supply of alcohol through the off-trade channel and thereby reduce overall levels of consumption and alcohol related crime and disorder.

It is vital that, going forward, action is focused on all businesses and activities involved in supplying alcohol – at whatever time and through whichever channel. Moreover, controls and costs should be targeted specifically at the irresponsible minority rather than penalising the responsible majority.

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