Retail at Indian Casinos *- Part II*

by James M. Klas

How do you add retail to your complex? In a word – carefully. For starters, detailed economic and psychographic analysis of the local and destination markets is necessary, to get the right amount and mix of retail stores in order to maximize the return on investment and benefit the larger casino complex. This analysis includes analyzing customer preferences and spending patterns in relation to the competitive supply to identify opportunity gaps between the demand for and supply of different types of retail stores.

Psychographic analysis is a critical component, using lifestyle clusters that go beyond basic demographic data with media measurements, consumer preference surveys, consumer expenditure patterns and other information to create a more comprehensive picture of the habits and preferences of the residents in the area under analysis. The result is not only more detailed predictive information, but a descriptive image of the types of individuals in the market that provides nuance and color to aid in interpreting and extrapolating the hard data.

Even the identification of a gap between supply and demand requires careful consideration to determine its true relevance. Opportunity gaps do not automatically guarantee that a new business or merchandise line is warranted, just as a lack of a gap does not automatically mean no further additions to supply can be made. Where gaps exist, they must be large enough to support a new business at a profitable level. There may also be other barriers to entry or substantial competition from outside the area that affect the profit potential of a new business trying to fill the gap.

Conversely, even if there is no gap in the local area, there may be opportunities for additional supply if the market draws from beyond normal distances and/or if the existing supply is older, complacent and functionally obsolescent. An example of the former would be Las Vegas or Orlando, where the drawing power of the local supply reaches far beyond normal boundaries. An example of the latter would be modern stadium seating movie theaters with state-of-the-art sound and projections systems replacing older style theaters.

After the types of retail opportunities have been determined, the space needs and customer profile of each type must be balanced against the needs and benefits of the other types of retail being considered and against the space availability, customer profile, needs and benefits of the associated casino. Getting a proper mix and balance of retail stores is almost as critical to the success of the stores and their benefits to the casino as identifying the best retail opportunities in the first place. Done properly, the retail mix can meet the true definition of synergy: the whole providing more benefit than the sum of the parts. If the mix is poorly conceived, the opposite can also occur.

Once the type and scale of retail to be added has been determined and its likely performance potential has been projected, at least in terms of sales per sq. ft., the next step is to decide on who will own and operate the retail establishments. Unlike most casino gift shops, most retail is located in leased space, with the owner/manager of the retail store renting from the owner/manager of the building where it is located. This allows each entity to reduce their risk and concentrate on the business in which they have the most expertise. The store owner can focus on running the retail operation without having to deal with the initial investment and complexities of developing and managing real estate. The building owner can focus on building and managing the real estate investment without having to gain the knowledge or take the risk associated with operating a particular type of retail store.

This structure works well for tribal casino retail for the same reasons. The casino gets the benefit of having the retail in the complex without having to divert management attention from its core business. This also allows for the encouragement of individual entrepreneurs, either from within the tribe or the local community, to start or expand businesses to the benefit of the surrounding economy. The downside is that the casino management has less control over the quality and service provided by the retail establishment and the tribe makes less money from rent alone than they would from the profits of the store itself, assuming it is successful. Even though the overall risk is lower, if the store does not serve its customers well or if it fails, the outcome reflects badly on the associated casino.

The other alternative is for the casino resort and its owner tribe to operate their own retail establishments, as is common with gift shops. This also carries the opposite positive and negatives: more risk and more management resources devoted to the retail in exchange for more control and higher profits if successful. Depending upon how specialized the retail niche is, the ability to hire managers and staff with appropriate experience may simply not be available without an established outside entity. In addition, unless the retail store is operated under a franchise agreement, the lack of an already recognized and established brand name may negatively affect customer perceptions and operating performance.

In some cases, joint venture agreements between the casino and an established outside retail operator can bridge the gap between the two alternatives providing some degree of greater control and profit potential in exchange for some increase in risk and oversight by casino management. Percentage rent can also provide some added upside for the owner without the increased risk. As referenced earlier, the taxing authority of a tribe can provide de facto percentage rent even when it is not included in the lease terms.

How much can the casino and its tribal owners expect to make from adding retail? Of course the answer depends directly upon the factors discussed above and the location and size of the casino and retail operations. For leased retail, net rents can range from as little as $6 per sq. ft. per year to as much as $40 per sq. ft. or more, although most tribal casino operations would likely command less than $20 per sq. ft. For retail owned directly, sales per sq. ft. can range from $250 to over $400 or more with cash flows of as little as five percent to as much as 25 percent or more for some specialty retail. In terms of incremental gaming revenue, a significant retail expansion of 10,000 sq. ft. or more with the right tenant mix can generate anywhere from $30 per sq. ft. to over $60 per sq. ft. in added gaming win per year. If the expansion includes destination retail elements, the incremental gaming win can increase to $150 per sq. ft. or more, although destination retail typically requires a much larger footprint.

Even where the amount of retail is smaller and the impact on gaming revenue is too small to quantify directly, the proceeds from the retail operation and the positive impact on customer experience, added employment and convenience for tribal members make consideration of added retail at Indian casinos worthwhile. As long as that consideration is done properly and with care, the result can be both successful retail and further economic growth for the casino and the tribe. ♣

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