



**Setting the Horserace Betting Levy –
Analysis and Commentary**

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This report has been prepared as an independent review to help inform the British Horseracing Authority (BHA) in developing its position regarding the 47th Levy Scheme (2008/09). Assistance from the BHA and LECG staff members in preparing this report is gratefully acknowledged. The opinions expressed here are those of the author and should not be taken as the views of the BHA or any other organisation.

Abstract

This report presents an economic analysis of how the horserace betting levy might be assessed applying commercial principles in a market context, and what level of levy payments might result. It develops an economic framework and uses this to derive a range of possible levy prices. The analysis indicates that a levy price based on market principles is likely to be significantly higher than the existing levy. Based on the assumptions in the analysis, it is estimated that considering just the direct contribution of racing to gross win might lead to a levy in a range of approximately 15% - 19% (£152m - £186m). A full estimate including the additional contribution of racing to sales of other betting products might be 18% - 23% (£177m - £225m). The analysis also briefly considers aspects of the impact of betting exchanges on the levy. The analysis depends on a number of assumptions regarding the basic data and the key parameters, which have been necessary in order to perform the analysis at a sufficient level of detail. If more detailed data become available we would be happy to review the analysis and apply the same method using revised data.

Executive Summary

- 1.1 This report presents an economic analysis of how the horserace betting levy might be assessed applying commercial principles in a market context and what level of levy payments might be the outcome. It develops an economic framework and uses this to derive a range of possible levy prices.
- 1.2 The analysis is based on the price that might be agreed for access to racing if this were determined in a hypothetical market. It compares the maximum value that the bookmaking industry (“betting”) might be prepared to pay for access, and the minimum that British horseracing (“racing”) might be prepared to accept, and a price is agreed within these bounds. Similar techniques are widely used in economics in determining royalty rates for technology and in other contexts. The analysis does not depend on institutional details of the levy but considers a general price for access, mimicking the key aspects of the levy in a market context. The main analysis focuses on the impact of British racing on licensed betting offices (LBOs) (UK retail) as the main component of levy income.

- 1.3 The analysis indicates that a commercially determined levy is likely to be significantly higher than the existing levy. Based on an assessment of just the direct contribution of racing to betting earnings, together with the costs to racing of providing the required level of fixtures, the analysis indicates a lower bound value of the levy in a range of 15% - 19%, or £152m - £186m in total (using 2006 figures). Other estimates may be made using different values for the key parameters.
- 1.4 However, an agreed levy is likely to be significantly higher than these figures, since they do not allow for the additional value that betting gains from sales of other products such as FOBTs and other LBO betting made possible by racing.
- 1.5 When the additional contribution of racing to sales of other betting products is included this indicates that racing's full contribution to betting revenues and profits might be up to a third or more higher than that based only on the direct effect. It is estimated this would add an additional 3% - 4% to the levy (£25m - £39m in total), leading to a full estimate of the levy of 18% - 23%, or £177m - £225m in total.
- 1.6 A review of a survey of punters' betting habits in LBOs confirms that racing is likely to have a positive impact on other betting earnings in addition to earnings from racing betting itself. A brief review of advertising patterns indicates that bookmakers actively promote other betting to racing punters, implying that racing betting may be diverted into other products.
- 1.7 These results add weight to arguments that the existing levy significantly under-rewards racing for access, both by paying less than would be agreed in a commercial setting based on its direct contribution to betting and by making no allowance for the contribution racing makes to the sales of other betting products.
- 1.8 An initial analysis of betting exchanges suggests that there is scope for further review of the appropriate levy for exchanges, which the current report has been unable to pursue in depth. Prices agreed in a commercial framework for access are likely to be higher than the existing levy cost to the exchanges and possibly higher than prices that would be agreed for LBOs. Commercially determined prices could, in theory, correct for any competitive advantage that exchanges may have compared to other betting due to a possibly lower effective cost of access to racing paid by exchanges in the existing levy system.

1.9 This analysis depends on a number of assumptions regarding the basic data and the key parameters, which have been necessary in order to perform the analysis at a sufficient level of detail. The results should be seen primarily as indicators of the level of levy payment that might result from applying market principles rather than hard figures. In particular the analysis is based on publicly available financial and other data. If more detailed data become available we would be happy to review the analysis and apply the same method using revised data.

1 Introduction

- 1.1 The British Horseracing Authority (BHA) is developing its position regarding the 47th Levy Scheme (2008/09). In preparing its submission to the government Department of Culture, Media and Sport (DCMS), BHA wishes to consider economic arguments as a partial basis for assessing a levy determined on commercial principles (i.e., market-based or economically determined rates). This approach is legitimate under the terms of the 1969 Act, which sets the Secretary of State to ‘...determine...what is reasonable for [bookmakers] to pay.’ In this context, the economic value of British racing to bookmakers is relevant.
- 1.2 This report provides an economic analysis to help understand how a levy might be assessed in a market context and what level of levy payments might be the outcome. It develops an economic framework for assessing a market-based price for the levy that might be agreed between racing and betting and uses this framework to provide insight into the possible range of prices for the levy that might result. The analysis does not pretend to consider all the many complex issues involved in determining the levy. Rather it is intended as an input to the decision process to provide some indication of how a market based levy might be assessed and some broad parameters of what outcomes might be considered reasonable in that context.
- 1.3 The report is in three main sections. Section 2 describes the background to the analysis and outlines the key features of the approach. Section 3 describes the methodology used to apply market principles to determine what level of prices might be agreed in a commercial framework. This first applies the approach to the core question of what levy price might be agreed between racing and betting in market negotiations. The core analysis focuses on betting shops business (i.e., licensed betting offices (LBOs)). This then extends the analysis to allow for the full contribution of racing to betting including its effect in enabling higher sales of other betting products than would be achieved without racing. This section also considers some aspects of the impact of betting exchanges on the structure of the betting business and an appropriate levy for exchanges in a market context. Section 4 presents the detailed data analysis of a levy using the market-determined framework. It develops broad ranges for possible market-determined prices, following the analysis described above. Finally, Section 5 summarizes the results and presents some conclusions. Tables and figures are contained in Section 6 at the end of the report. Section 7 contains Appendices 1-4 which describe the main sources and

assumptions made in preparing the data, and more detailed analyses of minimum racing costs, survey data and advertising data referred to in the text.

2 Outline

Background to analysis

- 2.1 The aim of the economic analysis is to help understand what payments might be made for access to horseracing if these were agreed in a commercial framework between racing and betting in a market place. This is based on a framework that considers the commercial value of access to betting and the willingness of racing to supply access. In this sense access is a right and the price charged for the right is determined in an economic framework.
- 2.2 This involves a rather different mechanism for determining the levy than in the original determination of the existing system in 2002. As described at the time in the OCP report to the DCMS, the levy was based on “balancing the needs of racing with the bookmakers’ ability to pay”.¹ The OCP report took the view that “the levy is not a payment for a product” and rejected proposals for commercial mechanisms for determining the levy. However, there now seems to be more general agreement that a commercially based levy is desirable. The use of market-based principals for determining prices is more generally accepted in government than previously,² and most significantly there have been major changes in the betting and gambling industries (e.g., since the introduction of gross profits tax) that make a market determined price for the levy more relevant.³
- 2.3 The betting industry benefits from having racing as a base for betting and pays for this benefit primarily through the levy. The central institutional arrangement for payments to racing is the levy paid by the betting industry based on a proportion (generally 10%) of its gross win directly attributed to horseracing betting. These payments are administered by the Horserace Betting Levy Board (HBLB) and are paid to the racing industry in various forms that contribute to the cost of providing horseracing. The level of the levy payments

¹ Organisation Consulting Partnership (OCP), “Determining the 41st Levy Scheme, Final Report”, 17 December 2001, (see pages 7, 21, 30).

² For example, market-based determination of fees is central to government reforms of legal aid as part of the Carter reforms proposed in 2006.

³ In practice there are overlaps between the earlier approach and that proposed here. The OCP analysis was concerned with balancing the needs of racing with the bookmakers’ ability to pay, which included a division of income between the two parties. (page 21) This echoes the division of value between the parties in a bargaining situation, described in this paper – the difference being that in the current analysis this ‘division’ is determined by commercial principles whereas the OCP analysis made a division based on what was considered fair.

have been determined in an administrative process, ultimately determined by the DCMS, with inputs from betting and horseracing representative organizations.

- 2.4 The levy took its existing form in April 2002, when, six months after the introduction of gross profits tax to replace the former betting duty, the levy changed from being assessed as a proportion of turnover to a proportion of bookmakers' gross win (i.e., total stakes received less returns to punters). The levy rate was set at that time, based partly on historical levels of levy receipts, and has continued at the same percentage level since. At that time it was not clear what overall effects the change from a system based on turnover to one based on bookmaker gross win would have on betting volumes, bookmaker margins and the type of betting products offered. Although there have been, and continue to be, proposals for replacing the levy with a system that would put payments for access to horseracing on a more commercial footing, these have not yet been introduced for various reasons. During this period major changes have taken place in the type of betting products offered by bookmakers and in the relative size of the markets for horseracing and other betting, notably the rising importance of fixed odds betting terminals (FOBTs) and other sports betting in parallel with horseracing. There has been other significant development in telephone and internet betting as well as in the gambling industry more generally. Despite these major changes in the betting industry, and a good deal of attention by the various bodies involved, the level of the levy has not been subject to review in terms of what might be considered its market-based value.

Economic approach

- 2.5 The economic approach proposed in this report considers factors that might be involved in determining a market-based price for access to horseracing. The approach does not assume any changes in the basic institutional mechanism of the levy, which in this context is seen simply as an administrative method that has been developed for making payments for access. The approach considers access as a general question of what may be seen as the 'right to use horseracing for betting' and what the price of access might be if it were determined in a commercial setting. Note that this right to access racing is a conceptual tool to identify what is being traded and is separate from other specific rights that may be involved in the betting industry. It is similar to an intellectual property right. For example, TV rights and pictures involved in betting are not related to access, rather they are considered a (separate) cost of the business.
- 2.6 Conceptually this may involve a similar mechanism to that often used to determine a 'fair and reasonable' price for licensing access to proprietary technology or other intellectual

property rights, namely 'hypothetical negotiations' between willing buyer and willing seller.⁴ Negotiations are assumed to take place in a commercial situation, and an agreed price would consider the costs and benefits of access to both sides. There may be additional factors that would be considered in setting prices, such as historical prices or the 'bargaining power' of the parties. This approach may be particularly helpful where there is no obvious equivalent market for rights that might be used to compare with the current market, where the service involved is unique or where there are few buyers and sellers. In such cases there may be no easily identified 'market clearing price' and the analysis may have to rely on what might be agreed in specific bargaining situation.

Detailed analysis

- 2.7 Within this framework the analysis focuses on the following aspects.
- 2.8 First, the analysis considers the direct value of horseracing to betting, in terms of its direct contribution to bookmaker profits and how these might be affected in the short and long term if British racing were withdrawn. This focuses on the Licensed Betting Offices (LBOs). If there was the ability to 'say no' and stop bookmakers taking bets on British Racing (i.e., a real product fee), what would happen to the shop business value? Together with the second part of the analysis, this gives insight into the full contribution of racing to the business of betting operators.
- 2.9 Second, it is likely that the value of horseracing to betting is higher than the direct earnings from horseracing betting. Racing and betting were to 'share in the benefits' of both gross profits tax and change of levy to gross profits basis, as stated by government upon the introduction of both in 2002.⁵ Is horseracing sharing adequately in the benefits? Setting the level of levy and tax based upon on gross win (gross profits tax) gave a short term boost to horseracing levy revenues, but may have been followed by long term decline as the shift to gross profits tax led to low margin betting and new low margin betting products. Many of these other products depend partly on racing as the anchor product that brings punters into LBOs. The full value of racing to the LBOs should reflect this.

⁴ 'Hypothetical negotiations between willing buyer and willing seller' are widely used as part of the Georgia-Pacific factors used a basis for assessing licensing royalties in patent infringement litigation. Other factors to be considered include "the portion of the realizable profit that should be credited to the invention", "the established profitability of the product made under the patent; its commercial success; and its current popularity", and "the effect of selling the patented specialty in promoting sales of other products of the licensee... and the extent of such derivative or conveyed sales." See: <http://nys-stlc.syr.edu/lawlibrary/patent/remedies.aspx>

⁵ Stephen Timms, for example, expressed the hope that "any benefits of [Gross Profits Tax] reform are fairly shared with racing." (Hansard, January 23, 2001).

- 2.10 Third, to extend the analysis to other aspects of the betting industry, the analysis tries to gain some insight into the effect of betting exchanges on the industry and an appropriate levy payment for exchanges. Existing levy rules apply the levy to the commission charged for using exchanges. This is not charged directly on winnings and may allow exchanges to pass only small charges to large layers using their site. This may have a large influence on the betting industry and on levy receipts, which were not anticipated when the levy was designed.

3 Methodology

- 3.1 The basic framework of the analysis is to determine what price of access might be agreed if it were to be negotiated in a commercial framework between horseracing and the betting industry, in whatever administrative form that access is guaranteed. A key input into the analysis is to determine the value of access to horseracing to the users in the various segments of the betting industry. A further input is the price at which racing is willing to supply access.
- 3.2 The current approach described here seeks to mimic the conditions of sale for the existing levy and to assess what market price for access might result. The levy effectively provides a uniform price of access to racing which is available to all users on a non-exclusive basis, with no further conditions on access other than to pay the levy. In this context, racing and betting are seen as two groups negotiating with each other as blocks, in which racing represents the interests of British racing as a whole, and betting represents the interests of all the bookmakers as a whole. It is not anticipated that individual bookmakers would negotiate over the levy individually.
- 3.3 In other commercial contexts, not considered here, access rights might in practice be negotiated under different conditions than the levy. Users might negotiate separately and might compete amongst themselves for specific rights, including some degree of exclusivity. Such commercial licenses are likely to include conditions on the users to invest in promoting the product and other investments to increase demand for the product being licensed and protect the rights owner's investment. In such cases, depending on the terms on which access might be offered, market determined prices are likely to be higher than in the existing approach and licences might include other conditions.⁶ The existing

⁶ Licenses for access might be required to be 'fair, reasonable and non-discriminatory', but agreed prices might still be higher than if bookmakers negotiate as a block.

approach is therefore likely to underestimate the prices for access compared to what might be achieved in contexts common for other types of rights.

- 3.4 The timescale for the analysis is that the negotiations are assumed to take place using the most recent data (in this case 2006) as the last complete year for which data are available. The agreement would apply for the next year going forward. Prices for subsequent years might be calculated using the same process, depending on whether there have been significant changes in the parameters and the underlying conditions. In effect this might be seen as a license renewable on an annual basis.
- 3.5 The two main parts of this study focus on the activities of Licensed Betting Offices (LBOs), as the main providers of horseracing betting and contributors to the levy. We consider the contribution of horseracing to betting, and vice versa, and assesses proposed levels of the levy in relation to these. The framework is then applied more briefly to betting exchanges.

Value of horseracing to betting

- 3.6 The first section of the analysis considers the theoretical maximum value that betting might place on access to horseracing and be prepared to pay, in preference to having horseracing withdraw from LBOs altogether. In the analysis the marginal contribution of racing to betting earnings is estimated by considering what profits LBOs would make if racing were withdrawn in comparison with (actual) profits including racing. In the short term withdrawing racing would reduce direct variable costs attributable to racing betting but not fixed costs. In the long term LBOs are assumed to be able to reorganize so that the share of fixed costs attributable to racing betting may also be reduced. Thus the short term, or marginal, impact of withdrawing racing on betting profits is likely to be higher than the longer term effect. Both are considered in determining the maximum value in different time frames.
- 3.7 The first section of the analysis considers only the direct effect on betting earnings of withdrawing racing, due to the loss of revenues (i.e., gross win) specifically for racing betting. This is likely to understate the impact on earnings, due to sales of other betting products in LBOs that depend on horseracing to bring punters into the LBOs. The analysis includes some estimation of this effect, based on a review of survey data for punter behaviour. However, an estimate of the full effect of horseracing on betting earnings including the effect on other betting products is the subject of the second part of this LBO analysis below.

- 3.8 In economic terms the impact on betting earnings of withdrawing horseracing is the extreme 'threat point' that could be applied against the bookmakers in negotiations. The analysis also needs to consider the opposite threat point, of what might be the theoretical minimum price that the supplier might accept and still offer services.
- 3.9 The minimum price may be seen as the minimum levy income required by racing to continue to supply horseracing at sustainable levels. In this context, it appears that racing over the past few years has increased its supply of fixtures to the point that it is no longer economic for it to add further fixtures, so that the existing level of the levy may be seen as a minimum sustainable level for racing to continue at its current activity. If racing were to reduce its level of activity it is likely that betting income would also reduce, so that it is not clear that a significantly lower level of racing would be sustainable in the long term.
- 3.10 The actual price negotiated is unlikely to be at either extreme but would be somewhere in-between. It should, however, bear a relationship to both. Where a final agreed price might rest depends on many other considerations, generally referred to as the 'bargaining power' of either side. The current analysis does not attempt to assess the relative 'bargaining power' of the two parties as such, but does consider what portion of the difference between the two extremes, which may be seen as the amount to be bargained over, might be 'claimed' by either side in commercial negotiations. Many factors may be involved in determining this division, such as the full contribution of the two parties to the net earnings from racing betting, the contribution of other inputs to betting earnings and the need to earn a return on these, the risks each side takes, and other considerations. Historically determined prices/divisions are also a significant consideration in coming to agreement, unless there are significant changes in underlying economic conditions affecting the parties.
- 3.11 Together these give an initial broad range of minimum and maximum prices for a negotiated levy that might be sustainable. An agreed price may be expected to lie within this range. Where within the range depends on many factors, including the bargaining power of the parties, experience with historical prices, and what may be considered by the parties as a fair distribution of the value of the rights compared to other contributions to the business and profits.

Contribution of horseracing to other product sales

- 3.12 A second aspect of determining the commercial value of racing is the full contribution of horseracing to betting. This may be greater than indicated by the direct earnings from

betting on racing. The value of horseracing should also reflect the value derived from sales of other products in the LBOs that depend partly on racing as the anchor product that brings punters in. Racing remains the dominant LBO product and appears to be the main reason for most punters to visit an LBO. The sales of other products, such as FOBTs and other sports betting, depend partly on racing as an anchor product and bookmakers are able to sell other products to fill the time spent by the punter in the LBO. This means that withdrawing racing from LBOs is likely to have greater impact on LBO earnings than just the direct effect.

- 3.13 Estimating the full contribution of racing to LBOs is difficult, as it is hard to identify to what extent sales of FOBTs and other sports depend on horseracing, and vice versa. These are 'joint products', and sales of one are likely to be partly at the expense of the others. In practice the impact of new betting products is likely to be partly to increase total sales revenues, by attracting new punters or encouraging existing punters to spend more, and partly to divert revenues from other products, by substituting one product for another. Horseracing may attract punters into the LBO and hence increase sales of other products such as FOBTs and other sports/numbers betting. Conversely, sales of the other products may decrease racing earnings by decreasing the amount available for racing.
- 3.14 Although separating out the impact of racing on other earnings is not straightforward, on balance it appears that racing's direct earnings may have been reduced by the diversion of punters' available stake money to other products. As the primary reason for bringing in punters, racing is contributing to LBO earnings to a greater extent than indicated by its own earnings alone. Bookmakers are actively promoting FOBTs and other sports products, apparently at the expense of racing which is largely unpromoted outside its core clientele. This may be partly to attract new clients but also may aim to encourage existing clients to shift part of their consumption away from racing into other products and hence maximize the earnings from each punter visit.
- 3.15 The strategy appears to have been successful for the LBOs, whose total revenues are increasing, but is contributing to the decline in racing LBO revenues. FOBTs are a major development in the mix of betting products, turnover and margins in LBOs. Revenues from FOBTs and sports betting singles, both of which have low margins on turnover, have grown significantly since 2002.

- 3.16 The analysis attempts to indicate the possible scale of this 'diversion' effect. In the market framework, a commercially agreed levy would take these 'convoyed sales' into account in determining a higher price for access than indicated by racing earnings alone.
- 3.17 The analysis estimates what proportion of potential racing gross win may have been 'diverted' to other products. This provides some indication of the scale of revenues that are earned on other products that without racing would not have occurred (since they are generated from racing punters). In practice these 'diverted' sales may be estimated from the difference between actual racing betting sales and sales that using historical projections might be expected to have been earned by racing betting. The difference is the racing sales that have been substituted into other products and without racing would not have occurred. The effect is to increase what may be considered a 'fair and reasonable' levy according to the commercial value of horseracing to the bookmakers.

Impact of betting exchanges

- 3.18 A third area considered is the application of the levy for betting exchanges. This includes what might be a reasonable level for the levy, what a reasonable structure for the levy might be for exchanges, and the relationship, and influence, between the exchanges and the rest of the industry. At one level this applies the 'maximum threat value' analysis to exchanges. The analysis also considers some more general implications of the existing levy system that places a levy on commissions and its relationship to levy in other areas of betting (which calculates the levy as a proportion of gross win).
- 3.19 The exchanges pay a 10% levy not on gross win for those using the exchange but on the commission the exchanges charge, itself a percentage of the amounts won by the users (whether as backer or layer). If the exchange operates efficiently in an economic sense, competition between users may be expected to drive the overall margins on bets to just enough to cover the commission. Since the commission is typically 5%, and down to as little as 2% and lower for high value punters/layers, the exchanges, through their laying customers, may offer punters lower margins (better odds) than available from bookmakers. Competition from the exchanges, including possible competition from bookmakers operating on the exchanges, appears to have put downward pressure on the bookmakers racing margins. Also, levy receipts over a period of time for a given turnover of betting are lower on exchanges than for betting via LBOs.
- 3.20 The scale of these effects is not clear, but it is apparent that exchanges can offer better odds than available from LBOs. The availability of the exchange for hedging bets by on-

course bookmakers also appears to have reduced off-course bookmakers' ability to influence starting odds, resulting in greater use for hedging purposes by the off-course bookmakers. Competition for betting business from exchanges, and the effect on on-course bookmaking, is likely to reduce margins that bookmakers can expect from racing betting.

- 3.21 In the current analysis it has not been possible to investigate these possible effects or to make any estimate of their size. Exchanges seem to be having a significant impact on the racing and betting industries. On *a priori* grounds it would seem that the effectively lower levy charged to users of exchanges gives the exchanges a competitive advantage over traditional bookmaking.
- 3.22 The analysis makes some initial estimates of what levy might be agreed between racing and exchanges using the same framework as the LBO analysis. This may be relevant to the question of the impact of exchanges on betting generally in that in a market setting, if the levy cost for exchanges gives them a competitive advantage over other betting platforms, then the exchanges would be prepared to pay a higher levy. In a competitive market, economic theory would indicate that if exchanges can earn better returns on investment than other platforms, they would be willing to pay more for their inputs, to the point that they earn normal returns. This might indicate that exchanges should pay a different levy than other betting. There is too little information available for the current report to make further input to that issue.

4 Data analysis and results

Levy price based on direct impact of racing

Maximum value to bookmaking of racing

- 4.1 The maximum value that LBOs would place on access to racing is estimated from the impact on bookmaker's operating profit if racing were withdrawn from them.
- 4.2 Data on the bookmakers' operating performance has been collected for the 'top 3' Bookmakers (Ladbrokes, William Hill and Coral, plus Stanley, which was acquired by William Hill in June 2005). These represent about 65% of racing betting, as measured by their contribution to the levy. Data for other smaller bookmakers is generally not available in the required level of detail for the analysis and these top 3 are believed to be representative of the industry. Data are available for UK retail separately for the top 3, the

object of the analysis. Even for the top 3 firms, racing gross win figures are not publicly available broken out from total retail, and it has been necessary to estimate these figures from other sources, namely shops data available from BHA and the total levy payments of the top 3, made available by the HBLB. The sources of data and methods used to estimate the key figures are explained in **Appendix 1** and in the notes to the individual Tables.

- 4.3 The UK Retail revenues (gross win) of the individual top 3 firms and estimated total UK Retail (all firms) are given in **Figure 1: UK Retail Total Gross Win**. Other figures are presented in **Figure 2: UK Retail Racing Gross Win (top 3 detail)** and **Figure 3: UK Racing Gross Win (top 3 and others)**. The UK Retail performance of the 'Top 3' Bookmakers is shown in **Figure 4: Total Gross Win (top 3)**.
- 4.4 The UK Retail performance of the top 3 is also shown in **Table 1: UK Retail performance (top 3 bookmakers)**. Figures exclude Republic of Ireland.⁷ The analysis of the marginal contribution of Racing to UK Retail operating profits (for the top 3 firms) and the net reduction in operating profits if racing was withdrawn, are shown in **Table 2: Marginal contribution of Racing to UK Retail (top 3)**.
- 4.5 The direct costs that would be reduced if racing were withdrawn from the LBOs are taken to be sum of GPT, levy, racing TV rights costs and estimated reduction in staff costs. The costs of TV pictures saved if racing were withdrawn are taken to be the rights costs only, estimated here as £4,500 per shop in each year.⁸ Other operating costs of providing TV coverage for other sports are assumed to remain. Racing staff costs saved are estimated as a proportion of total staff costs based on the share of racing in total OTC gross win. This conservatively assumes that total staff costs are related only to OTC gross win (racing and other betting), with no additional staff costs due to FOBTs.⁹
- 4.6 In the main analysis the contribution to UK Retail operating profit is estimated allowing only for those direct costs that would be expected to be saved if racing were withdrawn.

⁷ Gross win is measured as the difference between total customer stakes less customer winnings. Gross win figures used here are for UK retail (LBOs), and exclude gross win from operations in the Republic of Ireland (where significant). Gross win figures include VAT payable on FOBT/machine income. Where not available directly, some figures have been estimated from publicly available data as explained in Appendix 1.

⁸ TV direct rights costs saved if racing were withdrawn are estimated at £4,500 per shop out of total costs of TV (rights and operating costs) estimated to be about £12,500, so that other costs of providing TV coverage for other sports of about £8,000 per shop would remain. The figure of £4,500 for rights costs is believed to be conservative (high). The rights costs (based on 2006 figures) are assumed to be the same for all years 2003-07 (i.e., not adjusted downwards for inflation in earlier years).

⁹ In 2006 the proportion of racing gross win in total OTC gross win was 38.5%, so that the staff cost reduction is 38.5% of total staff costs in that year. Other years are calculated similarly. For William Hill, Coral and Stanley, staff costs are not reported separately for UK retail and are estimated as 50% of total staff and administrative costs.

For 2006, it is estimated that racing contributed £546.6m to gross win. The net reduction in operating profit, after allowing for the direct costs of racing, is estimated to be £193.5m. For comparability across different values of gross win over different years, it is convenient to express this (direct) contribution of racing to bookmaker earnings in terms of an equivalent levy %. The loss to the bookmakers would be the same if the levy were increased by 35.4% of gross win with no change in the racing gross win (i.e., all the loss absorbed by the LBOs). This implies that the maximum levy that the LBOs would in theory be prepared to pay is **45.4%** of racing gross win. This is the 'maximum threat point' in the hypothetical negotiations.

- 4.7 As a lower bound to the value of racing to the LBOs, it may be assumed that in the long term all indirect LBO costs are variable. If it is assumed that all costs associated with racing would eventually be reduced in proportion to the share of racing in total retail gross win (including racing, FOBT and other), this leads to an equivalent levy for 2006 of **38.8%** (see Table 2). Going further, if the reduction in costs is taken to be the sum of the direct racing costs of GPT and levy, and the share of remaining administration/other costs in proportion to racing's share of total gross win (racing, FOBT and other), the equivalent levy for 2006 is **31.5%**. This last is taken as the lowest bound to the 'maximum threat point'.

Minimum sustainable levy at which racing could supply fixtures

- 4.8 The minimum price at which racing could supply the required fixtures is analysed in **Appendix 2**. This argues that the minimum point for the levy analysis should be based on the costs to racing of maintaining at least the current level of fixtures, over the long term. The minimum rate for the levy that appears capable of sustaining racing at its current level and quality is at least the existing level of 10% and probably higher. At the existing levy, racing is having difficulty providing all the fixtures requested by betting, while continuing to maintain high quality and assure racing integrity.¹⁰ If the levy were reduced below 10% the current level of racing activity is unlikely to be sustainable.
- 4.9 The likely effect of reducing the levy, and hence the quantity and quality of fixtures, on betting gross win and subsequent levy payment is unpredictable. It could lead to a downward spiral in racing activity. Such a possibility is outside the scope of the current analysis, which is focused on a levy price negotiated under current conditions. However,

¹⁰ For example, the current fixture list is about 7% below the requested level.

since such an outcome is unlikely to be in the interests of either side, this potential effect strengthens the case for a levy which is negotiated to reflect the interests of both parties

- 4.10 For these reasons, the existing 10% level is taken as the base case minimum price that racing would be prepared to accept for access. This is the 'minimum threat point' in the hypothetical negotiations. Other values for this minimum price are considered in the sensitivity analysis.
- 4.11 This implies a range for the levy that might be agreed in commercial negotiations bounded by 10% below and a range of between 33% and 47% above.

Possible levy price range and total levy revenue

- 4.12 A possible split of the difference between the minimum that racing might accept and the maximum that betting might be prepared to pay could be 1:3 in favour of betting. In other words, a final levy price would allocate 25% of the difference ('available surplus') to racing. A share of 25% of incremental profits from the use of a proprietary technology is often used as a 'rule of thumb' for possible royalty rates in patent litigation, and is used here as the base case.¹¹
- 4.13 Using 2006 figures, the difference between the minimum and maximum levy (as % of gross win) is 35.4% (45.4%-10%). Taking 25% of this difference implies that the agreed levy would be 8.9% above the racing minimum. Adding this to the 10% minimum implies a levy of 18.9%. Using the lower bound case implies a levy of a 15.4%. Thus, on these assumptions, a final levy might be in the range **15% - 19%**.
- 4.14 Although the analysis is conducted in terms of a levy %, the monetised amount of the levy may be the most relevant figure over time, in terms of what levy amount is required by racing to provide a given level and quality of racing, and what levy amount betting might be prepared to pay considering its total contribution to betting earnings. Although the levy percentage has been constant since it was introduced in its existing form in 2002, and racing has incurred higher costs by increasing the fixture list, the revenue to racing has declined since 2003 as racing betting gross win has declined. Conversely, as discussed below and in the second part of this analysis, betting is likely to benefit from racing both

¹¹ Although based on a different commercial approach, this split between the bargaining points of the parties echoes the process in the OCP analysis, which sought a fair division of income between the parties that balanced the needs of racing with the bookmakers' ability to pay. The division suggested in the OCP analysis was either 50% to each party or 33% to each party when punters were included. (OCP, 2001, page 21). In the current analysis the suggested division on commercial principles is 25% to racing, a lower share of the available surplus to racing than suggested by OCP.

directly and through its contribution to increasing sales of other products. Betting may be expected to consider racing's total contribution to earnings in determining the full value of racing. Importantly, this total contribution is probably increasing as the sales of other products increase strongly, while racing gross win has declined.

- 4.15 Therefore the negotiations may be considered to be over a total amount rather than a percentage. The range for the total levy revenues corresponding to the 15% - 19% levy range is **£152m - £186m**, based on the actual 2006 figures. (See Table 3 below).
- 4.16 This implies that in subsequent years, year on year, the relevant figure is also the monetised levy. The levy might be expressed as a percentage figure, as in this analysis, but behind this the relevant figure to both sides is the total payment that the levy is expected to generate. If conditions change quickly, as they appear to be doing in the betting industry, a levy in subsequent years might require renegotiation on an annual or bi-annual basis.

Estimated levy understates the full value of racing to betting

- 4.17 The estimates given above for the levy are based on racing's direct gross win, and are likely to significantly underestimate the full price that that would be agreed in a more complete analysis. The values have been calculated considering the impact of racing on racing betting earnings only. If racing were withdrawn, there are likely to be significant additional effects on the sales of other LBO products such as FOBTs and other sports, which rely on racing as a primary reason drawing punters into the LBOs. If racing were withdrawn, punters might either stop coming to LBOs, which would decrease earnings from the other products, or continue to come in and substitute some of their betting into other products, which would increase other sales for those punters still visiting LBOs. However, the likely net effect is that LBO gross win in other products would decline. This means that the maximum impact of racing on betting earnings would be higher than the figures above, to allow for the loss in sales and profits from other products.
- 4.18 In the hypothetical negotiations, the higher maximum value point would increase the agreed levy price. As noted above, similar hypothetical negotiations used in other licensing contexts regularly take into account the value of 'conveyed' sales of other product that depend on the licensed products or rights.¹²

¹² One of the Georgia-Pacific factors to take into account in determining licensing royalties is "the effect of selling the patented specialty in promoting sales of other products of the licensee... and the extent of such derivative or conveyed sales." (Georgia-Pacific factor 6, see footnote 4 above).

4.19 The extent of reasons for thinking this are analysed in more detail in the next section. Allowing for this effect would lead to higher values for the levy than those estimated above, which may be seen as quite conservative.

Sensitivity analysis

4.20 Some insight into the sensitivity of the levy price to the assumptions in the analysis by considering what range of levy price might be agreed with different values for the following key parameters:

- maximum price betting might pay for access
- minimum price racing might accept to supply access
- portion of available surplus devoted to the levy

4.21 In the base case it has been assumed that the values for these are 47%, 10%, and 25%, as above.

4.22 A bare minimum that racing might be able to provide the required fixtures might be 5%. Or, if we consider a possible minimum level based on the number of fixtures in 2002 before this build up in fixtures began (1,158 from BHB Annual Report 2005), then the figure might be $1158/1504 * 10\% = 7.6\%$.

4.23 The effect of different assumptions on the range of possible levy prices is shown in **Table 3: Sensitivity analysis: Levy prices under different assumptions (2006)**. This shows that for a racing minimum supply point of 10%, and assuming a 25% share to racing the, levy range would be 15% - 19%, according to the high and low figures used for betting's maximum demand point. For a 5% racing minimum supply point, and a 25% share to racing, the levy range would be 12% - 16%.

4.24 Other combinations of parameters may be tried. Perhaps the main indication from the sensitivity analysis is that there is only limited sensitivity of the levy price to changes in the minimum supply point or the other parameters. Most combinations imply a significant increase in the levy.

Sensitivity of levy price to other operating costs

4.25 If total TV costs were to increase (as has been considered by the bookmakers), there might be no change in the **rights** portion of total TV costs (which would in theory need to

be paid only once). The main direct impact analysis of the levy price would be unchanged. In the lower bound analysis, an increase in operating costs, such as higher total TV costs, might reduce the 'maximum threat point' for the lower bound case (which allocates full administrative and other costs between product lines). However, since the agreed levy is based on a share of the difference between minimum and maximum 'threat points', even the lower bound levy price is unlikely to be very sensitive to modest changes in costs. Similar arguments apply to modest increases in other LBO operating costs.

Constant share of total racing levy by top 3

- 4.26 A feature of the UK racing betting market is that the share of the top 3 bookmakers in the total UK racing levy/gross win has been constant over the period since 2002 at about 65%-66%. During this time there have been significant changes in the betting industry, including dramatic increases by the top 3 in earnings from FOBTs and other betting, increases in numbers of shops and forays into online betting. There has also been a significant increase in the number of staged fixtures.
- 4.27 The stability of top 3 shares of racing gross win may be compared with increases in their total gross win (estimated to be up 70% since 2002), number of shops (up 27%) and number of actual fixtures (up 17%). During this time the share of the top 3 increased only from 64.9% to 66.5%. This is shown in **Figure 5: Top 3 share of UK Retail Racing Gross Win**.
- 4.28 A possible implication is that it may strengthen the view that betting is not competing on racing, which is left to continue as a mature product and treated almost as a 'maintenance cost' of business. Meanwhile promotional effort is focussed on other products.

Contribution of racing to other betting products

Projected growth of racing betting without other products

- 4.29 Gross win from racing in LBOs has been decreasing since 2003. Some of this decrease may be associated with long term changes in betting habits, demographics and the rise in other forms of gambling generally. However, a large part of the decrease is likely to be due to competition within the LBO from FOBTs and other betting substituting away business from racing.¹³ This diversion out of racing and into other products is especially likely to be a contributor to racing decline if one assumes fixed punter budgets. This

¹³ The large bookmakers acknowledge that there is ongoing substitution between Over-the-Counter (OTC) and FOBT trade. Ladbrokes cites "tough comparatives and FOBT substitution" as a reason for the decline in OTC gross win during the first half of 2007. <http://investors.ladbrokesplc.com/news-item?item=48500918195056>

diversion of funds is partially a consequence of decisions by LBOs to promote these other products while still relying on racing as the anchor product that brings punters into the LBOs.¹⁴

- 4.30 A possible way to estimate this 'diversion' of racing betting is to consider what the revenues from racing betting might have been absent the new products. If these other products had not been introduced racing gross win may be expected to have grown since 2003 at some rate dependent at least on the growth in incomes and possibly on other factors. As a base case it is estimated that total racing business might have grown at a rate of at least equal to the 5% nominal GDP growth rate since 2003. To this may be added a further 2.5% to allow for the fact that the analysis is relying on data from the top 3 bookmakers, and these have increased their number of shops by about 4.5% a year since 2003. Together these imply that an estimate for the growth rate of racing gross win (for the top 3), without other products, might be 7.5% a year since 2003. Projected racing gross win has been calculated assuming this annual growth rate (AGR) in the underlying 'true' demand for racing from a 2003 base.
- 4.31 In estimating the 7.5% figure, other potential effects on underlying growth in demand for racing due to changes in margins on racing betting, diversion to other products, competition from exchanges, declining base of racing punters, increased number of fixtures have been assumed to balance out for purposes of the analysis.
- 4.32 A portion of the decline in UK retail racing gross win may be due to the influence of betting exchanges competing away some LBO racing business. The overall impact of exchanges on betting is complex and is addressed below. However, the exchanges are likely to have had most direct impact on telephone betting and less so on LBOs. If bookmakers' telephone business has fallen to a greater extent than racing retail business (because of competition from exchanges) then according to the method used here to estimate retail racing gross win (which applies the 2004/05 share of retail in the total levy payments to the actual levy payments of the top 3 in other years) this could mean that estimates of LBO racing gross win in 2006 are higher than actual. This would imply a greater diversion of revenues from racing into other LBO products than calculated here.

¹⁴ The importance of racing to generating FOBT and other racing business in LBOs is supported by the following view expressed in a recent House of Lords debate: "Because the analysis has been carried out by the bookmakers themselves, undoubtedly the greatest utilisation of the FOBTs and the cartoon racing occurs during the time when conventional racing is taking place. The analysis shows that [most] of the entire stakes on FOBTs and cartoon racing is taking place during the hours when the correct conventional racing is in hand. Therefore, it is entirely due to the footfall created by conventional racing." (Lord James, House of Lords Grand Committee, 10 July 2007).

Estimated diversion of racing betting into other products

- 4.33 The projected racing gross win is shown in **Table 4: Projected UK Retail Racing Gross Win (top 3)** and **Figure 6: Gross Win Projection (top 3)**.
- 4.34 The 'diverted' business amounts to £193.8m racing revenues. This would add another £19.4m to levy revenues in 2006. This is equivalent to an additional 3.5% levy. Based just on the existing 10% levy this means that an adjusted levy would be **13.5%** (on actual gross win) in total. By 2007 the effect would be another £27.6m in levy revenues equivalent to a 15.3% levy.
- 4.35 Looked at in another way, this means that racing is contributing an additional 35% over its direct gross win (in 2006) to sales of other products such as FOBTs and other sports betting, which would not occur without racing as the anchor product which brings punters into LBOs.
- 4.36 This supports that argument made above that the range of levy prices calculated there underestimates the full contribution of racing to betting. In a market context the agreed price should reflect the full contribution that racing makes.

Impact on a negotiated levy price

- 4.37 In terms of the impact this might have on a levy price in the hypothetical negotiations, if racing were withdrawn this would exclude not only the £546.6m in direct racing sales (of the top 3) but an additional £193.8m in 2006 in lost 'convoyed' sales of FOBTs and other betting.
- 4.38 On the assumptions made in this analysis, these sales are diverted from racing but dependent on racing, so if racing were withdrawn betting would lose these sales of other products. The direct cost of these lost sales (a mixture of FOBT and other betting) is estimated to be 55.5% of gross win (i.e., residual operating profit 44.5%), using similar reasoning as for the direct cost of lost racing sales above.¹⁵ If racing were withdrawn the incremental lost operating profits on these lost sales in 2006 is therefore estimated to be 44.5% of £193.8m, equal to £86.3m. This adds £86.3m to the maximum amount that betting might be prepared to pay for access. Assuming that in the outcome of the negotiations racing receives 25% of the additional lost profit, the levy price would be increased by adding £21.6m or a further 3.9% to the levy. This is the maximum levy case.

- 4.39 To estimate a lower bound levy it may be assumed that the cost of sales on the lost sales is the overall average cost of sales for all retail of 71.2% (i.e., average operating profit 28.8%). This adds £55.9m to the maximum price that betting might be prepared to pay for access, and 25% of this would increase the levy by adding £14.0m or 2.6% to the levy.
- 4.40 Thus the contribution of racing to sales of other products would add a further **3% - 4%** to the levy, or **£25m - £39m** to the total levy (i.e., based on the total levy payments of all betting operators of £98.7m in 2006).
- 4.41 Adding this to the previous figures for the direct effect, the adjusted levy price range would be **18% - 23%**, or in money terms **£177m - £225m** for the total levy.
- 4.42 The levy prices calculated from the direct, additional and total contributions of racing to betting earnings (for the base case 10% minimum racing cost, 25% share to racing and 2006 figures), are summarised in **Table 5: Summary results - levy price ranges (base case: 10%, 25%, 2006)**.

Sensitivity to diversion rate

- 4.43 In estimating the 7.5% figure, several other potential effects on underlying growth in demand for racing have been assumed to balance out. The sensitivity of the results to this assumption about the potential growth rate absent other products is shown in **Table 6: Sensitivity of estimated diversion to growth rate (2006)**. Even with zero growth rate (i.e., flat racing gross win rather than the actual decline) the levy should be increased if the 'lost sales' are to be accounted for.

Survey data support estimating additional sales

- 4.44 Some further insight into the additional sales of other products in the LBOs that are made possible by racing but not reflected in racing gross win may be obtained from reviewing recent survey data. The BHA recently commissioned a survey of FOBT users by TNS Sport, which established that British racing remains the main draw for the clear majority of those who use FOBTs in betting shops. MORI conducted a survey of betting shop customers in 2005 (on behalf of the Association of British Bookmakers). An analysis of the implications of survey data for our estimates of the true value contribution of racing to LBO business is described in **Appendix 3**.

¹⁵ The direct cost of sales % comprise of: GPT of 15% on other betting portion of lost sales, VAT of 17.5% on FOBT portion, and share of staff costs in proportion to total lost sales (gross win). For the average mix of non-racing products in 2006 this equals 54.45% of gross win. (Calculations not shown in Table 4).

4.45 The results suggest that a substantial proportion (perhaps 50% or more) of all punters would be lost if horseracing were withdrawn. Since a proportion of these horseracing punters spend money on other products too, the impact of losing these customers would exceed the direct loss of gross win from horse racing.

4.46 This analysis estimates that at least 38% of retail gross win might be lost as a result of the lost customer volume discussed above. This exceeds horseracing's share of retail gross win of 28% in 2006, and is broadly in line with the figures above. This indicates the room for upward adjustment of the levy to reflect the contribution of horseracing to other sports betting.

Betting advertising encourages racing punters to use other products

4.47 The argument that bookmakers are, at least in part, targeting their promotion at encouraging racing punters to use other products, and not vice versa, is backed up by an analysis of advertising (see **Appendix 4**). This also indicates that there is no comparable body of punters at which to target advertising other than racing.

4.48 First, there is no comparable general or specific sports publication to the Racing Post. The fact that one can analyse the extent to which football is promoted in the Racing Post, but do not have a comparably betting-oriented football publication to analyse cross-over promotion of horse racing shows that horse racing fans provide the bedrock of the betting world. It will not be easy to rebuild betting and gambling businesses around another anchor product, given the long association of betting with racing. As a recent article in the Independent stated: "The Sportsman found that, beyond horseracing, there was no community of gamblers willing to buy a betting newspaper".¹⁶

4.49 Second, about half the advertisements by bookmakers in the Racing Post are either for other sports or for horseracing along with another sport. Thus there is pervasive promotion of other products to the racing fans. This also borne out by advertising at race-courses. The top 3 bookmakers (William Hill, Ladbrokes and Coral) show the greatest propensity to advertise or co-advertise the other sports betting that they offer.

Betting exchanges

4.50 The maximum value analysis for the exchanges is given in **Table 7: Marginal contribution of Racing to Betting Exchanges: Betfair**. For the figures used, a

¹⁶ Tim Luckhurst: "Will Sport AM follow the Sportsman? Don't bet on it...", *Independent*, October 7, 2007.

maximum equivalent levy for exchanges might be up to **69.7%** or **34.6%** (fully allocated costs) for 2006.

- 4.51 The marginal effect is sensitive to assumptions made about fixed and variable costs. For exchanges, it is likely that a large portion of costs are fixed, associated with the costs of setting up the platform. Variable costs that might be saved if betting were withdrawn are therefore low, and the corresponding marginal impact on operating profits of withdrawing racing would be high. Using the assumptions in the table, if racing is withdrawn, the remaining business is projected to make a loss for 2004 and 2005.
- 4.52 Other considerations that may need to be taken into account regarding the influence of the exchanges on the structure of the betting industry are discussed above.

5 Summary and conclusions

- 5.1 This report shows that it is possible to develop an analysis of the level of horseracing levy that might be determined applying commercial principles. We develop an economic framework and then use this to derive a range of possible levy prices.
- 5.2 The analysis focuses on the impact of British racing on licensed betting offices (LBOs) (UK retail) as the main component of levy income, which may be extended by implication to other segments of betting.
- 5.3 The analysis indicates that a commercially determined levy is likely to be significantly higher than the existing levy. Based on an assessment of the direct contribution of racing to betting earnings and the costs to racing of providing the required level of fixtures, the analysis indicates a levy in a range of 15% - 19%, or £152m - £186m in total amount. Other estimates are made using different values for the key parameters.
- 5.4 An agreed levy is likely to be significantly higher than these figures, since they do not allow for the additional value that betting gains from sales of other products such as FOBTs and other LBO betting made possible by racing. In terms of the negotiated price this might add an additional 3% - 4% to the levy, or £25m - £39m (using 2006 figures). Added to the direct effect this implies a total range for the levy of 18% - 23%, or £177m - £225m.
- 5.5 An initial analysis of betting exchanges suggests that there is scope for further review of the appropriate levy for exchanges, which the current report has been unable to pursue in

depth. Prices agreed in a commercial framework for access are likely to be higher than currently, and may possibly be higher than those that would be agreed for LBOs. Commercially determined prices could in theory correct for any competitive advantage that exchanges may have compared to other betting due to a possibly lower effective cost of access to racing paid by exchanges in the existing levy system.

- 5.6 This analysis depends on a number of assumptions regarding the basic data and the key parameters, which have been necessary in order to perform the analysis at a sufficient level of detail. The results should be seen primarily as indicators of the level of levy payment that might result from applying market principles rather than hard figures. In particular the analysis is based on publicly available financial and other data. If more detailed data become available we would be happy to review the analysis and apply the same method using revised data.

6 Tables and graphs

Table 1: UK Retail performance (top 3 bookmakers)**

| (£m) | H1 2007* | 2006 | 2005 | 2004 | 2003 | 2002 |
|-------------------------------------|-------------|---------|---------|---------|---------|---------|
| Racing gross win (est) | 259.7 | 546.6 | 543.3 | 584.1 | 596.0 | 430.2 |
| FOBT gross win | 297.8 | 521.2 | 465.4 | 426.3 | 269.3 | 141.0 |
| Other gross win (est)*** | 456.6 | 842.6 | 681.7 | 685.0 | 540.4 | 618.3 |
| Total UK Retail gross win | 1,014.1 | 1,910.4 | 1,690.4 | 1,695.5 | 1,405.6 | 1,189.4 |
| Total UK Retail operating profit | 293.7 | 550.9 | 493.1 | 524.0 | 419.2 | 321.4 |
| % operating profit | 29.0% | 28.8% | 29.2% | 30.9% | 29.8% | 27.0% |
| 'Top 3' share of total Racing levy | 66.5% | 66.5% | 65.7% | 66.2% | 64.9% | 64.9% |
| UK Retail gross win (all firms) [*] | 1,525.8 | 2,874.3 | 2,574.5 | 2,561.5 | 2,167.2 | 1,833.8 |

(Source: Bookmaker Annual Reports, HBLB levy totals, BHA analysis, LECG analysis)

* First Half 2007 actual results; may not indicate expected full year 2007 performance due to seasonality.

** Top 3 bookmakers: Ladbrokes, William Hill, Coral (plus Stanley, separately 2002-04, in William Hill from 2005). Figures for UK retail excludes republic of Ireland.

*** Other gross win calculated from reported OTC minus estimated racing gross win (may fluctuate year to year due to mismatch between levy and financial years)

[*] **Estimated** total retail gross win (all firms), from top 3 retail gross win assuming top 3 share of total UK Retail equals their share of UK Racing (including retail, telephone and Internet, derived from share of total levy). (May underestimate total UK retail if top 3 have higher share of total telephone and online than of retail).

Table 2: Marginal contribution of Racing to UK Retail (top 3)

| (£m) | H1 | | | | | |
|---------------------------------------|---------|---------|---------|---------|---------|---------|
| | 2007* | 2006 | 2005 | 2004 | 2003 | 2002 |
| Total UK Retail gross win | 1,014.1 | 1,910.4 | 1,690.4 | 1,695.5 | 1,405.6 | 1,189.4 |
| Total UK Retail operating profit | 293.7 | 550.9 | 493.1 | 524.0 | 419.2 | 321.4 |
| UK Retail levy payments | 26.0 | 54.7 | 54.3 | 58.4 | 59.6 | 43.0 |
| Share Racing in OTC** | 36.3% | 39.3% | 44.3% | 46.0% | 52.4% | 41.0% |
| Racing gross win | 259.7 | 546.6 | 543.3 | 584.1 | 596.0 | 430.2 |
| – GPT + Levy | -64.9 | -136.7 | -135.8 | -146.0 | -149.0 | -107.5 |
| – TV (est) (*) | -13.1 | -26.3 | -25.0 | -23.4 | -22.0 | -20.6 |
| – Staff (est) (**) | -89.8 | -190.1 | -186.0 | -209.6 | -203.4 | -109.0 |
| Racing marginal contrib. op profit | 91.9 | 193.5 | 196.5 | 205.1 | 221.6 | 193.0 |
| Operating profit without Racing | 201.9 | 357.4 | 296.6 | 318.9 | 197.5 | 128.4 |
| Marginal contrib. % Racing GW | 35.4% | 35.4% | 36.2% | 35.1% | 37.2% | 44.9% |
| Equivalent levy % | 45.4% | 45.4% | 46.2% | 45.1% | 47.2% | 54.9% |
| Marginal contrib. % op. profit | 31.3% | 35.1% | 39.8% | 39.1% | 52.9% | 60.0% |
| Equiv. levy % (full cost alloc) [*] | 39.0% | 38.8% | 39.2% | 40.9% | 39.8% | 37.0% |
| Equiv. levy % (dir + full admin) [**] | 33.7% | 31.5% | 31.9% | 29.8% | 28.5% | 39.6% |

(Source: Bookmaker Annual Reports, HBLB levy totals, BHA analysis, LECG analysis)

* First Half 2007 actual results; may not indicate expected full year 2007 performance due to seasonality.

** Share Racing in OTC (for top 3 firms): racing gross win (estimated from actual levy payments history) divided by total OTC (from firm Annual Reports). Figures for 2002 may understate racing gross win (and racing share of OTC) due to introduction of new levy assessment method in 2002, which may not fully reflect actual racing gross win.

(*) TV direct costs saved estimated as rights costs for racing coverage, estimated at £4,500 per shop.

(**) Staff costs saved estimated based on the proportion of racing gross win in total OTC gross win (conservatively assumes total staff costs related only to OTC gross win, no additional staff costs due to FOBTs).

[*] Contribution assuming all costs allocated to products (racing, FOBT, other) in proportion to gross win.

[**] Contribution allocating direct GPT and levy costs to racing, remaining administration/other costs allocated to products (racing, FOBT, other) in proportion to gross win.

Table 3: Sensitivity analysis: Levy prices under different assumptions (2006)

| | Short term effect* | | | | Long term effect** | | | |
|---------------------------|----------------------|------|--------------|-------|----------------------|------|--------------|-------|
| | Minimum supply point | | | | Minimum supply point | | | |
| Racing share surplus | 5% | 7.5% | 10% | 12.5% | 5% | 7.5% | 10% | 12.5% |
| 15% | 11% | 13% | 15% | 17% | 9% | 11% | 13% | 15% |
| 20% | 13% | 15% | 17% | 19% | 10% | 12% | 14% | 16% |
| 25% | 15% | 17% | 18.9% | 21% | 12% | 14% | 15.4% | 17% |
| 30% | 17% | 19% | 21% | 22% | 13% | 15% | 16% | 18% |
| Total levy (£m)*** | | | | | | | | |
| 15% | 109 | 130 | 151 | 172 | 89 | 110 | 131 | 152 |
| 20% | 129 | 149 | 169 | 188 | 102 | 121 | 141 | 161 |
| 25% | 149 | 168 | 186 | 205 | 115 | 133 | 152 | 170 |
| 30% | 169 | 186 | 204 | 221 | 128 | 145 | 162 | 180 |

* Direct marginal impact of withdrawing racing (high value). Levy based on share of difference between minimum supply point (e.g., 10%) and maximum demand point (45.4%)

** Fully allocated administration/other costs (lowest value) Levy based on share of difference between minimum supply point (e.g., 10%) and lower bound demand point (31.5%)

*** Based on 2006 actual levy £98.7m.

Table 4: Projected UK Retail Racing Gross Win (top 3) (7.5% growth rate)

| (£m) (years increase to right) | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 (est)* | Grow. rate (from 2003)** |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------------------|
| UK Retail actual gross win: | | | | | | | |
| Racing gross win (est) | 430.2 | 596.0 | 584.1 | 543.3 | 546.6 | 519.5 | -3.4% |
| Other gross win (est) | 618.3 | 540.4 | 685.0 | 681.7 | 842.6 | 913.1 | 14.0% |
| FOBT gross win | 141.0 | 269.3 | 426.3 | 465.4 | 521.2 | 595.7 | 22.0% |
| Total | 1,189.4 | 1,405.6 | 1,695.5 | 1,690.4 | 1,910.4 | 2,028.3 | 9.6% |
| Racing share of gross win % | 36.2% | 42.4% | 34.5% | 32.1% | 28.6% | 25.6% | |
| Other share of gross win % | 52.0% | 38.4% | 40.4% | 40.3% | 44.1% | 45.0% | |
| FOBT share of gross win % | 11.9% | 19.2% | 25.1% | 27.5% | 27.3% | 29.4% | |
| Shops UK | 4,583 | 4,885 | 5,197 | 5,564 | 5,837 | 5,826 | 4.5% |
| Actual Fixtures | 1,158 | 1,220 | 1,299 | 1,300 | 1,342 | 1,350 | 2.6% |
| 'Additional' Racing contribution: | | | | | | | |
| Racing gross win (est) | 430.2 | 596.0 | 584.1 | 543.3 | 546.6 | 519.5 | -3.4% |
| Projected Racing gross win*** | 430.2 | 596.0 | 640.7 | 688.7 | 740.4 | 795.9 | 7.5% |
| Proj. increm. Racing GW | - | - | 56.6 | 145.5 | 193.8 | 276.4 | |
| Increm. Racing GW % actual | - | - | 9.7% | 26.8% | 35.5% | 53.2% | |
| Equivalent increm. levy % | - | - | 1.0% | 2.7% | 3.5% | 5.3% | |
| Equivalent total levy % | 10.0% | 10.0% | 11.0% | 12.7% | 13.5% | 15.3% | |
| Increm. levy revenue (top 3) | | | 5.7 | 14.5 | 19.4 | 27.6 | |
| Top 3 share in racing levy | 64.9% | 64.9% | 66.2% | 65.7% | 66.5% | 66.5% | |
| Increm. levy revenue (all UK) | | | 8.5 | 22.2 | 29.2 | 41.6 | |

(Source: Bookmaker Annual Reports, BHB Annual Reports, HBLB levy totals, BHA analysis, LECG analysis)

* Full year 2007 figures estimated as double first half 2007 results; may underestimate expected full year 2007 performance due to seasonality.

** Annual compound growth rates 2003-07.

*** Projected Racing gross win assuming annual compound annual growth rate (AGR) of 7.5% from 2003 base. The 7.5% growth rate (for this sample of the top 3) estimated from: sum of AGR of nominal GDP of 5% plus half the AGR in number of shops of 4.5%. Other potential effects on underlying growth in demand for racing due to changes in margins, diversion to other products, declining base of racing punters, increased number of fixtures assumed to balance out).

Table 5: Summary results - levy price ranges (base case: 10%, 25%, 2006)*

| | low % | low £m | high % | high £m |
|----------------------------------|--------------|---------------|---------------|----------------|
| Direct contribution (part 1) | 15.4% | 151.9 | 18.9% | 186.1 |
| Additional contribution (part 2) | 2.6% | 25.2 | 3.9% | 38.9 |
| Total contribution (parts 1 + 2) | 17.9% | 177.1 | 22.8% | 225.0 |

* Base case: 10% minimum racing cost, 25% share to racing and 2006 figures

Table 6: Sensitivity of estimated diversion to growth rate (2006)

| Growth rate | 0% | 2.5% | 5% | 7.5% | 10% |
|--------------------------------------|-----------|-------------|-----------|-------------|------------|
| Equivalent incremental levy % (2006) | 11% | 12% | 13% | 14% | 15% |
| Equivalent incremental levy % (2007) | 12% | 13% | 14% | 15% | 17% |

Table 7: Marginal contribution of Racing to Betting Exchanges: Betfair

| | £m | 2004* | 2005 | 2006 |
|---|----|--------------|--------------|--------------|
| Total revenue (commissions) | | 66.7 | 107.1 | 144.7 |
| – GPT** | | -9.3 | -14.2 | -16.8 |
| – Levy | | -3.9 | -5.2 | -5.3 |
| – Other data rights | | -4.4 | -8.6 | -13.8 |
| Cost of sales | | -17.6 | -28.0 | -35.9 |
| Gross profit | | 49.1 | 79.1 | 108.8 |
| – Administration | | -37.2 | -60.8 | -73.2 |
| Operating profit | | 11.9 | 18.3 | 35.6 |
| Operating profit % revenue | | 17.8% | 17.1% | 24.6% |
| Racing revenue (commissions) | | 39.0 | 52.0 | 53.0 |
| – GPT | | -5.9 | -7.8 | -8.0 |
| – Levy | | -3.9 | -5.2 | -5.3 |
| – Other data rights (est)*** | | -0.4 | -0.9 | -1.4 |
| – Staff/Admin (est) (*) | | -5.4 | -7.4 | -6.7 |
| Racing marginal contrib op profit | | 23.4 | 30.8 | 31.7 |
| Other op profit (non HR) | | -11.5 | -12.5 | 3.9 |
| Marginal contrib. % Racing rev. | | 59.9% | 59.2% | 59.7% |
| Equivalent levy % | | 69.9% | 69.2% | 69.7% |
| Racing marg. contr. % op. prof. (**) | | - | - | - |
| Equivalent levy (full cost alloc) | | 27.8% | 27.1% | 34.6% |

(Source: Betfair Annual Reports, LECG analysis)

* FY ending April 2004

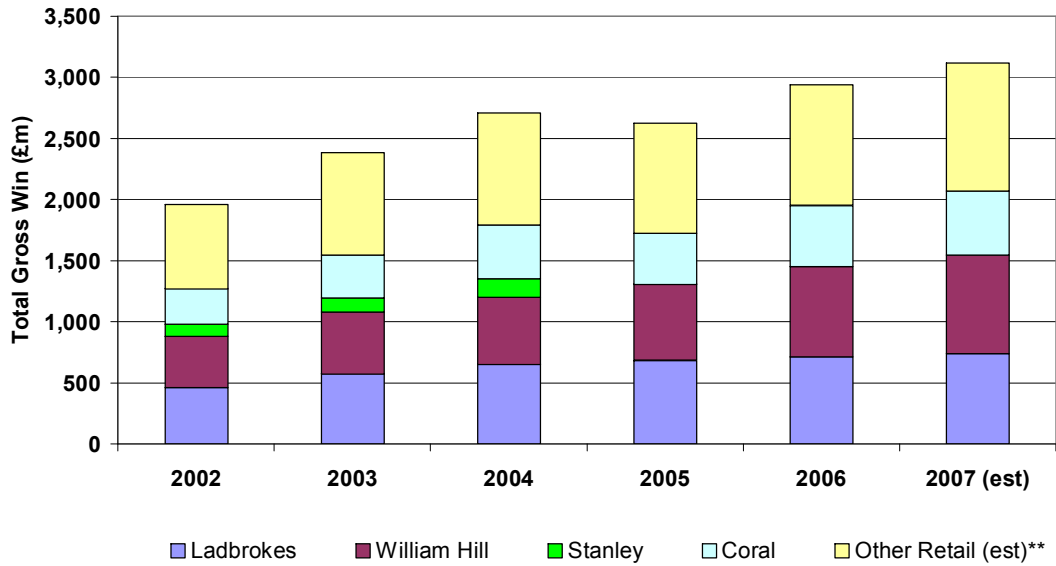
** Reported GPT slightly under 15% of total commissions; assume Racing attracts 15% GPT

*** Assume 10% other data rights costs attributable to UK Racing

(*) Assume 25% admin. variable staff/admin costs, Racing share in proportion to revenue share

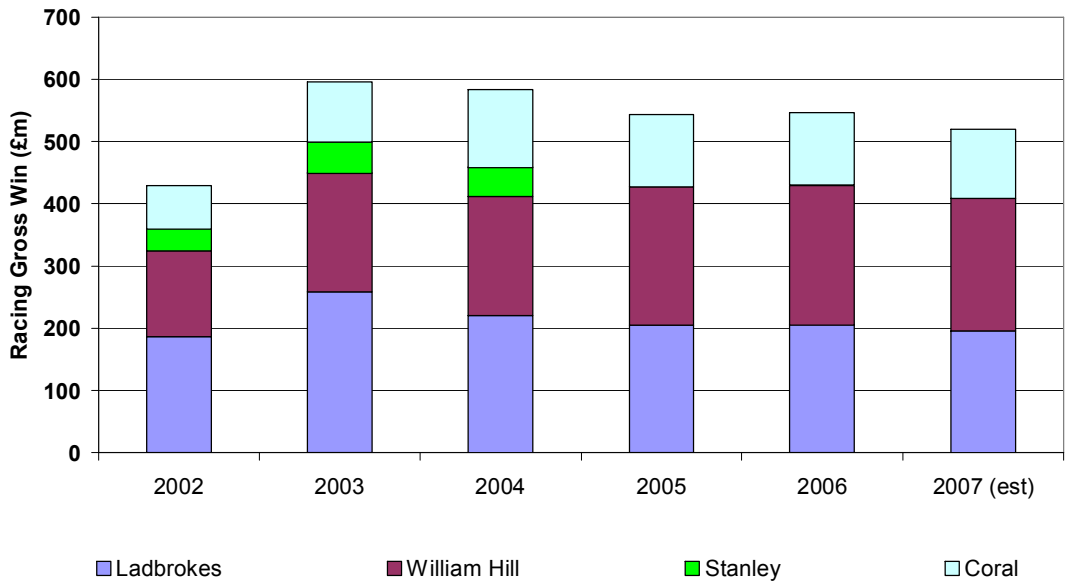
(**) Blank if net operating profit excluding Racing's marginal contribution is negative

Figure 1: UK Retail Total Gross Win



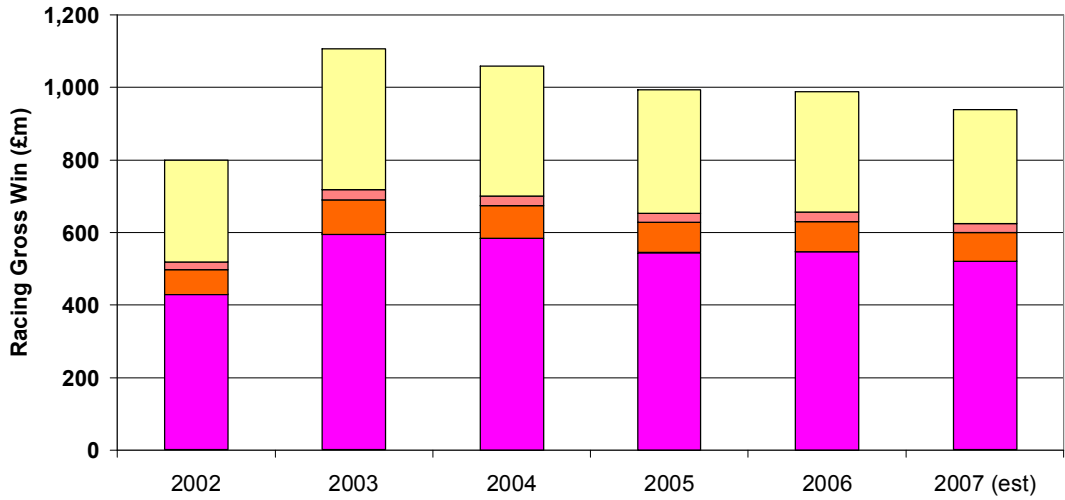
** Estimated assuming top 3 share of total UK Retail equals their share of Racing UK retail

Figure 2: UK Retail Racing Gross Win (top 3 detail)



* Total other firms racing (incl. retail, telephone, internet)

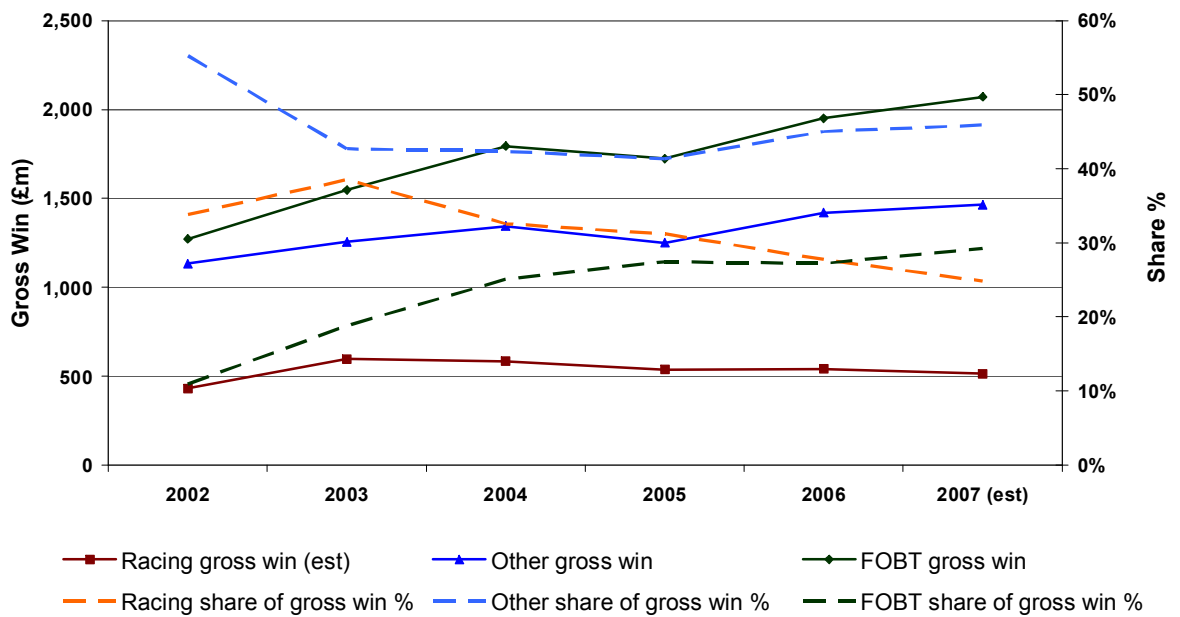
Figure 3: UK Racing Gross Win (Top 3 and Other)



■ Racing - Retail (top 3)
 ■ Racing - Telephone (top 3)
 ■ Racing - Internet (top 3)
 ■ Other Racing*

* Total other firms Racing gross win (incl. retail, telephone, internet)
 Top 3 split between retail, telephone, internet based on 2004/05 proportions detail

Figure 4: Total Gross Win (top 3)



■ Racing gross win (est)
 ▲ Other gross win
 ◆ FOBT gross win
- - - Racing share of gross win %
 - - - Other share of gross win %
 - - - FOBT share of gross win %

Figure 5: Top 3 share of UK Retail Racing Gross Win

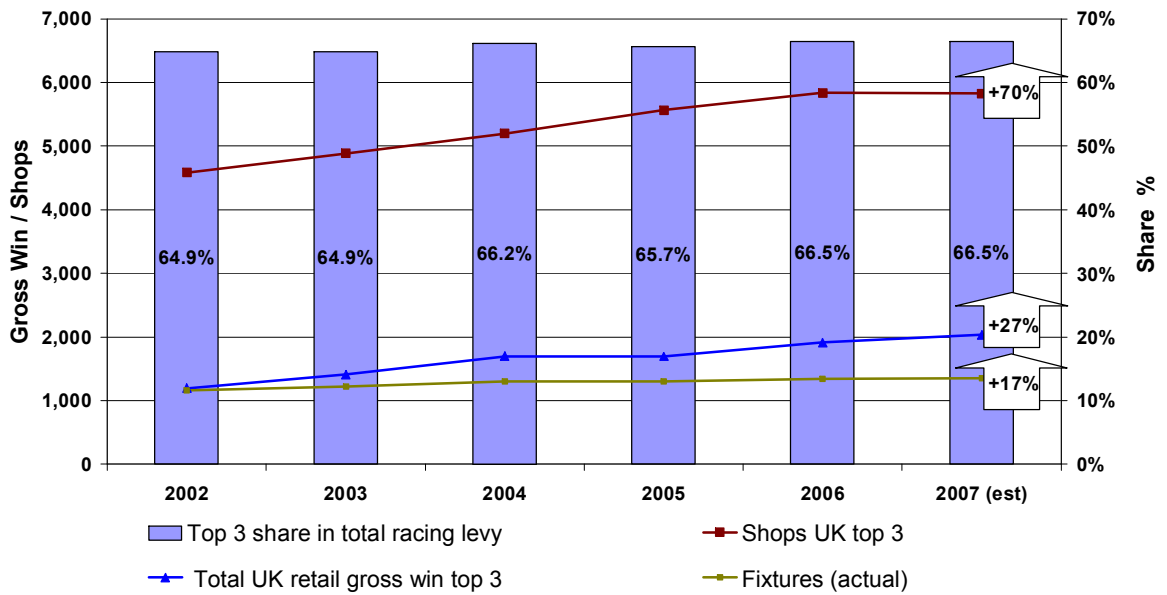
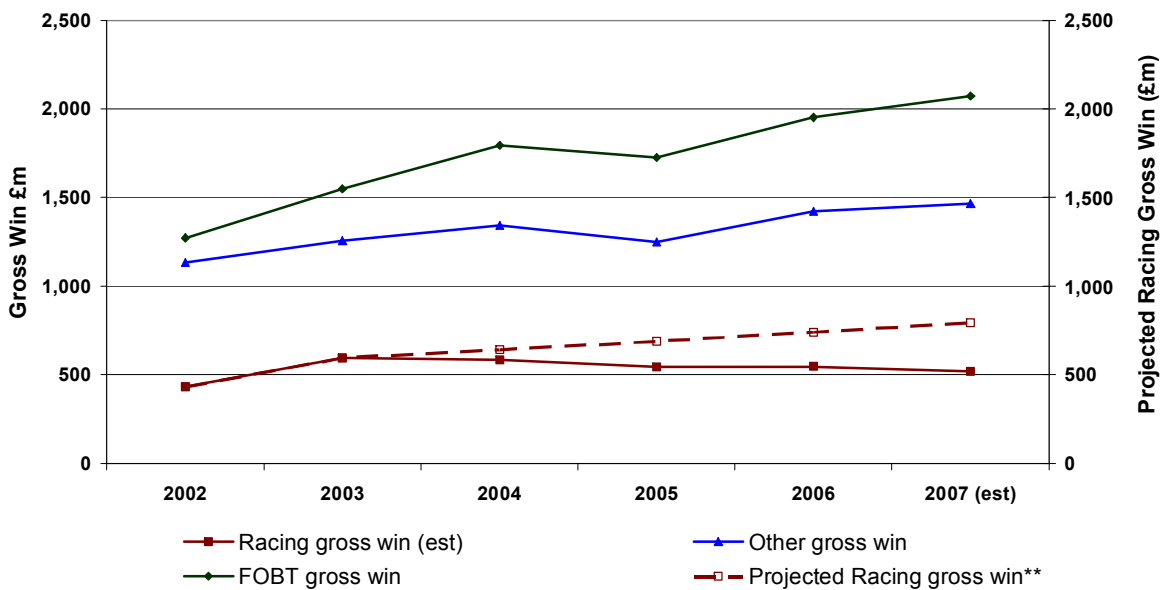


Figure 6: UK Retail Gross Win Projection (top 3)



* Racing gross win projected from 2003, growth rate 7.5%

7 Appendices

Appendix 1: Data sources

- 7.1 The primary financial data used in the analysis of LBO revenues and profits are obtained from the annual reports and public financial reports of the top 3 UK bookmakers (Ladbrokes, William Hill and Coral, plus Stanley, which was acquired by William Hill in June 2005). These represent about 65% of racing betting, as measured by their contribution to the levy. This includes the key figures for gross win, costs and operating profit broken out separately for UK Retail.
- 7.2 Gross win is measured as the difference between total customer stakes less customer winnings. Gross win figures here are for UK retail (LBOs), and exclude gross win from operations in the Republic of Ireland (where significant) and others. Gross win figures include VAT payable on FOBT/machine income.
- 7.3 Figures for UK retail excluding Republic of Ireland, are available for Ladbrokes, which reports UK retail directly. William Hill figures include Ireland in retail, but since in 2006 only 48 of its total 2,224 shops are in the Republic of Ireland the effect of these on the data is ignored for the purposes of this analysis (in 2006 William Hill had 2,165 LBOs in the United Kingdom, 9 in the Channel Islands, 2 in the Isle of Man and 48 in the Republic of Ireland: a total of 2,224).
- 7.4 Coral reports very few figures, but is understood not to have shops in Ireland. However Coral reports only total racing for Coral Bookmakers, which includes telephone but does not include online, which is included in E-business figures. It is estimated from the detailed shops data that telephone accounted for 8.1% of Coral shops gross win in 2004/05, so the Coral retail figures are reduced by 8.1% throughout to estimate UK retail figures (applied to gross win and operating profit figures).
- 7.5 The analysis of gross win and costs is carried out at the firm level then summed to the top 3 level. This was done to be able to accurately identify direct and other costs, which are recorded differently by each firm. The price analysis is conducted at the total top 3 level.
- 7.6 Gross win is available from the bookmakers annual reports only split between FOBT and over the counter (OTC) business. To estimate the gross win for racing betting it has been necessary to base this on levy payments, which themselves have only been available at a

summary level, for the top 3 bookmakers, by year. Detailed shops data made available by BHA (for 2003/04 and 2004/05) have been used to allocate total levy payments (and hence estimated gross win) between the bookmakers and between their main platforms, retail, telephone and online. This takes the proportional split in levy payments individually between the top 3 and for each firm between retail, telephone and online, and applies this to the total levy payments made by the top three for each of the years 2002 to H1 2007.

- 7.7 The racing gross win figures are thus accurate for 2004/05 but for other years the total racing gross win figures are allocated to the firms in the same proportions as 2004/05. However, since the share of the top 3 in the total levy is virtually unchanged over the period of the study, at around 65%, it seems reasonable that there have not been significant shifts in the proportions of total racing business between the three. The primary focus of the analysis is for the total of the top 3 firms, so that the split of retail is not important between firms. The assumed constant split in gross win between retail, telephone and online may have changed over the period, however. The current analysis was not able to correct for this possibility.
- 7.8 A further potential problem with this method is that the levy data and financial data do not necessarily correspond to the same full year. Also the allocation has been based on 2004/05 detailed figures so does not allow for changes in the relative mix of racing betting between the platforms that may have occurred.
- 7.9 While not perfect, this has enabled the analysis to be based on generally consistent data.

Appendix 2: Minimum cost of racing

- 7.10 The economic theory applied here demands the establishment of a lower boundary or minimum price that racing would be willing to accept from the betting operators for the supply of the race program. Inherently, this is a more difficult question than the upper boundary maximum figure that bookmakers should be willing to pay. For bookmakers it is a pure business decision about delivering a financial return to their shareholders/owners. Racing is first and foremost a sport, and participants (in this case, the owners of horses) have many reasons, not all of them financially motivated, for their involvement.
- 7.11 In the analysis, we need to establish a minimum boundary price that racing would accept to supply the same race program quantity / quality mix, and, importantly, with the same level of integrity as is delivered currently and upon which the upper boundary figures are based.
- 7.12 Through their fixture criteria, and the addition of the new winter evening betting sessions, it appears that bookmakers are still asking for more fixtures, which shows that recently added fixtures, and further increases, have a marginal value to betting operators. It is possible that part of this value is derived from profits on other products, with racing 'legitimising' the opening of the betting shop to draw punters in. At the same time racing appears to be reaching, or already at, a limit of what can be provided with the existing level of the levy. For example, there appear to be limitations on racing's ability to increase winter evening and/or summer fixtures, which an increased levy could help fund. As a result there are still 'criteria gaps' and these are expected to continue.
- 7.13 The number of fixtures has been increased significantly by racing over the past five years. This has been in response to requests from the bookmakers. Bookmakers are still seeking more fixtures and racing is still some 111 fixtures below the number that would be required to meet the bookmakers' criteria. This takes effect when betting sets its criteria for staged fixtures and the levy board only gives a full prize money allocation to those fixtures within the criteria.
- 7.14 If the total levy revenue were to decrease then it is likely that the gap would increase. On the supply side, fewer fixtures are likely to be provided. However, betting's demand for fixtures might stay the same – demand for number of fixtures is not likely to be strongly sensitive to the levy, given the high marginal contribution of racing to operating profit, the fact that the levy is assessed as a percentage of gross win, and the secondary benefits to

other products betting gains from increased traffic in the LBOs in periods not covered by fixtures.

- 7.15 If the existing levy (10% of gross win, generating £98.7m 2006/07, £94m estimated for 2007/08) were reduced, racing is likely to (be able to) provide fewer fixtures. It is not clear what impact a reduction in fixtures would have on total betting revenues and profits. The contribution of additional fixtures to betting gross win at the margin is likely to be small or at least below the average. The impact of reducing fixtures however might be large enough that the subsequent reduction in racing gross win and levy receipts might lead to a downward spiral, with less racing and less betting, and it is not clear where this might end. However, assessing what might happen in the betting industry if fixtures were reduced is outside the scope of the current analysis and would involve a broad review of the structure of the betting industry and racing.
- 7.16 It is clear that betting profits would fall by some amount, as witnessed that, at the existing 10% levy, the betting industry is still asking for more fixtures. The desired number of fixtures requested by bookmakers for 2008 season is according to figures supplied by the BHA, 1,572. Even with racing's plans to increase fixtures to 1,461 staged fixtures to meet the bookmakers' criteria, racing is currently supplying 7% fewer fixtures than requested, i.e., supplying only 93% of the request.
- 7.17 This implies that the main levy analysis should be based on the cost to racing of supplying at least the current level of fixtures.
- 7.18 In summary, for several reasons, the levy analysis should be based on maintaining at least the current level of fixtures, sustainable over the long term. Judging from difficulties experienced adding more fixtures at the existing levy levels it appears that racing would be unable to increase the number of fixtures if the levy were any lower than 10%. Indeed if it were lower then the number of fixtures would likely have to fall. This is taken as the base case for the minimum price that racing would be prepared to accept for access. Other values for this minimum price are considered in the sensitivity analysis.

Appendix 3: Survey data – contribution of racing to other products sales

Survey data

- 7.19 The following section provides a minimal estimate of the impact of withdrawing horse racing from betting shops on the gross win of the top bookmakers. We provide this minimal estimate by (a) calculating the proportion of punters who are unlikely to visit the shops if horseracing is withdrawn, and (b) providing a minimal estimate of how much retail gross win would be lost as a result of this lost custom.
- 7.20 The evidence that we deploy is based upon two sources. First, we use the results of a very recent (September 2007) study commissioned by the BHA, and conducted by TN Sport. This survey studied FOBT users and attempted to determine the main reason for these users to visit betting shops.
- 7.21 Second, we also draw upon the results of a survey of betting shop customers conducted by MORI for the Association of British Bookmakers. We look at the results of the survey as they pertain to the behaviour of punters inside a betting shop. We note that these survey results may not be perfectly consistent with the findings from aggregate data such as annual reports.
- 7.22 The first study found that among those who used FOBTs “at least occasionally”, 63% cited betting on the horses as the main reason for their visit. More than 61% of these FOBT users were regular punters who visited the shop either everyday or more than two or three times a week.¹⁷
- 7.23 The second study by MORI found that among regular betting shop customers, 73% said that they regularly bet on the horses (i.e., at least once a month). This was a far higher proportion than those who reported regularly betting on any other sport or activity within the betting shop.
- 7.24 We divide punters into four groups:
- Those who bet exclusively (more or less) on horses;
 - Those who bet primarily on horses but also spend money on other products;

¹⁷ TNS Sport, “Mapping the Impact of FOBTs—Summary Report”, September 2007.

- Those who bet primarily on other products but also spend some money on horses;
- Those who do not bet on horses at all.

7.25 The survey evidence suggests that besides horseracing fixtures only football fixtures and (to a lesser extent) dog-racing fixtures are regularly bet upon by a significant proportion of punters. It would be reasonable to conclude that horseracing is the single biggest draw for punters to visit the betting shop.

7.26 Our analysis of lost gross win is based upon estimating the size of the exclusive and primary horseracing betting population. While we are likely to have over-stated the proportion of “exclusive” horseracing punters, the impact of this over-statement is balanced out by linking the lost gross win from these customers solely to horseracing. As will become clear for our analysis, while we calculate that 20% of all punters (28% of regular horseracing punters) are in the “exclusively horseracing” category, we also calculate the lost gross win from these consumers as exactly proportional to their share of racing-only gross win.

7.27 This is effectively an assumption that this group of punters contributes to horseracing gross win at the same rate as all other punters who might bet on horses (which is clearly a conservative assumption). If the true proportion of “exclusive” horseracing punters is significantly lower than 20% but these punters are big spenders on horse racing, then there is likely to be a significantly larger group of punters who primarily come in for horse races but also spend on other products.

7.28 Comparing the gross win impact of losing these two sets of customers with the impact suggested by an analysis that potentially overstates exclusive horseracing punters and potentially understates punters who are primarily drawn in by racing but spend on other products, we find that (a) the impact of assuming a lower proportion of “exclusive” punters is (at least partially) offset by the likelihood of higher racing spending by the smaller group of exclusive punters, and (b) there is now a significantly larger impact from primary horseracing customers who also spend on other products.

7.29 The crux of our analysis is this: a large proportion of betting shop customers would be lost if horseracing were withdrawn from the shops. Consequently, the racing expenditure of this group of punters cannot be substituted into other activities, even for those punters who currently spend on both horses and other activities. The impact of withdrawing

horseracing on retail gross win would, at a very minimum, clearly exceed just the direct contribution of horseracing to retail gross win.

Analysis

7.30 **Table A1** below shows the breakdown of punters into terms of products that they regularly bet on in betting shops. It also shows our estimates of “exclusive” punters (potentially overstated for each sport or activity).

| Category | % of Sample | % spending on other activities ¹⁸ | % Exclusive to Sport** |
|--------------------------------|-------------|--|------------------------|
| Regular HR punters* | 73% | 72% | 20% |
| Punters who are not regular HR | 27% | | |
| Regular dog-racing punters | 25% | 71% | 7% |
| Regular football punters | 37% | 81% | 8% |
| Regular FOBT/Machines punters | 13% | 88% | 3% |

(Source: MORMORII/Europe Economics survey for Association of British Bookmakers, Appendices 9 to 14, Table 33.)

* Table 33 defines “regular” as betting shop customers who bet on the given activity at least once a month.

** This is calculated as overall punters for a given activity less those who do not bet on other products, as a proportion of the total sample of punters.

7.31 The results in the table show a significant amount of ‘over-lapped’ betting. The majority of those punters reporting that they bet regularly on horseracing also reported betting on other products. It is not possible, however, to definitively establish what else they bet on, or the proportion of their spend that went on activities besides horseracing. It is also not possible to say whether the primary reason for their visit was horseracing or the other activities on which they also spent money.

7.32 We have, however, provided an estimate of those who are exclusively horseracing punters. We know that 73% of the punters sampled bet regularly on horseracing. Of this 73%, at least 72% spent money on other activities too, meaning that about 53% of the overall punter sample was composed of regular horseracing punters who also (at least sometimes) spent money on other activities. Consequently, we estimate that 20% of the

¹⁸ This is calculated as the higher of the numbers who reported indulging in either (a) “mass market gambling” (e.g., pools, bingo, lotto), or (b) “betting and gaming.” Most punters indulge in both (a) and (b), but since we are interested in the contribution of each category of punters to the total takings in a shop, we need to take the higher of the two as a *minimal* estimate of their contribution to total shop spend.

sample (28% x 73%) was composed of punters who were more or less exclusively betting on horseracing.

- 7.33 On top of this “hard core” rump of horseracing followers, there are likely to be significant impacts of withdrawing horseracing on other products. Casual examination of advertising promotion in the Racing Post and on racing cards at race-tracks shows that bookmakers are heavily promoting betting opportunities on football and other sports to horseracing punters. The reverse does not appear to be true and the failure of the Sportsman newspaper to compete with the Racing Post suggests that the market for betting information and betting products is still centred on horseracing.¹⁹
- 7.34 Thus, a significant proportion of those betting on horseracing and another product (whom we label “non-exclusive” horseracing punters) are primarily drawn into the shop by the horseracing opportunities. One possible way to guess at how many of these customers might also stop betting (or betting with lower frequency) if horseracing were not available in shops is to assume that the proportion of those for whom horseracing is the primary attraction is related to the proportion of regular horseracing punters to regular dog-racing and football punters in the overall sample of punters surveyed.²⁰
- 7.35 In the overall sample, there were 1128 regular horseracing punters, 573 regular football punters, and 381 regular dog-racing punters. Thus the ratio of horseracing to football and dog-racing is roughly 3:2:1. (We assume that the proportion of punters whose *primary* attraction in the betting shop is other sports or activities is minimal). These proportions suggest that of the 53% of the punter sample that bets on both horseracing and other activities, the split of primary betting affiliations would give us roughly:
- 9% who come in primarily for dogs but also regularly bet on horses;
 - 18% that come in primarily for football but also regularly bet on horses;
 - 26% who come in primarily for horses but also bet (at least sometimes) on dogs and football (or anything else).²¹

¹⁹ A recent article stated: “The Sportsman found that, beyond horseracing, there was no community of gamblers willing to buy a betting newspaper”. (Tim Luckhurst, “Will Sport AM follow the Sportsman? Don’t bet on it...”, *Independent*, October 7, 2007).

²⁰ This is the only available evidence on the relative attraction of horse-racing compared to the two other leading betting shop products.

²¹ The set of regular FOBT customers and regular horse-racing punters do not overlap much, so are ignored for purposes of this rough estimation.

7.36 The 26% of overall punters who come in primarily for horseracing (but also bet on other products) are another “at risk” group whose custom will be severely affected by the withdrawal of horseracing. Our allocation of “non-exclusive” horseracing punters is likely to be quite generous in terms of the proportion of these non-exclusive horseracing punters we assume are primarily drawn in by other products. Overall, it seems reasonable to conclude that:

- About 20% of all punters are almost exclusively betting on horses, and perhaps another 25% to 30% of punters are primarily drawn in by horses;
- This suggests about 45% to 50% of betting shop customers are mainly there for the horses and are likely to visit much less frequently or not at all if racing were withdrawn from the shops;
- We also know from the more recent survey evidence from TNS Sport that even for FOBT users, nearly 2/3rds cited racing as the main reason for visiting the shops;
- Taking our estimates and the TNS data into account, we assume 46% (20% plus 26%) of customers are lost.

7.37 We further assume that:

- Punters betting exclusively on horseracing account for a proportionate share in racing’s gross win—that is, since 28% of all horseracing punters bet exclusively on the horses, this group accounts for 28% of retail gross win from racing, or 8.7% of total retail gross win;
- Punters who share horseracing with other sports yield the same gross win as the overall average customer. Since this group accounts for about 33%²² of all remaining punters (i.e., excluding the exclusive horse-racers) we assume they account for 33% of all remaining gross win.
- Remaining gross win is total retail gross win less gross win attributed to “horseracing-only” customers, or about 91.3% of the retail total;

²² “Primary” horse-racing punters are 26% of the overall punter population, so they account for 26/80ths of the “remaining” punter population, or 32.5%.

- It should be clear that using our methodology, had we estimated a significantly lower proportion of “exclusive” racing customers, but a significantly higher proportion of “primary” racing customers to compensate, the calculated gross win impact of losing these customers would be greater still.

7.38 For 2005, the year that the survey was conducted, the following **Table A2** shows the potential impact on overall retail gross win:

| Table A2: Calculated lost gross win from lost HR customer volume | | | |
|---|--|----------------|---|
| Line | Variable | Share % | Notes |
| [1] | Horseracing share of Retail GW | 31.1% | HR Gross Win/Retail Gross Win for Top 3 (Table 2) |
| [2] | Exclusive Punters as % of HR Regulars | 28.0% | HR exclusive punters as share of all HR regular punters |
| [3] | Exclusive Punters' share of Retail GW | 8.7% | = [1] x [2] |
| [4] | Primary HR Punters as % of remaining sample | 32.5% | Punters who bet on multiple products, but primarily drawn by HR |
| [5] | Primary HR Punters share of Retail GW | 29.7% | Assuming share of remaining GW is proportional to share of remaining population |
| | “Lost” HR Customer share of Retail GW | 38.4% | [3]+[5] |

7.39 The analysis suggests that even a minimal estimate of the value contribution of horse racing to betting shop gross win comfortably exceeds the direct gross win from racing alone.

Appendix 4: Review of advertising of other betting targeted at racing base

- 7.40 **Table A3** provides a summary of advertising in the Racing Post. This examines five randomly chosen issues of the Racing Post from this year (2007) —November 22nd, November 10th (Saturday), September 16th, July 31st and June 1st.
- 7.41 The table provides summary statistics, by individual bookmaker, of the frequency of advertising (summed across the five issues) broken down into (a) advertising on racing exclusively, (b) advertising on racing in combination with other sports, and (c) advertising on other sports.
- 7.42 The data in the table are skewed by the inclusion of November 10th, where 12 out of 17 advertisements we counted were for horseracing only. However, this was a Saturday edition, in which the majority of advertising on other sports was likely to be included in a separate pull-out supplement that we did not obtain. Had we obtained the supplement, this would have shown a preponderance of advertising on non-racing activities and would have greatly pushed down the share of “racing only” advertising.
- 7.43 It is also noted that one cannot compare advertising of other sports betting opportunities in the Racing Post with advertising of horseracing betting opportunities in, say, a football publication. This is simply because the Racing Post is a focal publication for punters in a way that no other sporting publication is – this in itself indicates the central role of horseracing in the betting and gambling landscape.
- 7.44 It would take years for bookmakers to rebuild the betting business around an anchor product in the fashion that they have been able to do with horseracing. The betting culture grew out of betting on the horses, and despite the increasing amount of money being bet on other sports, it is still the racing industry and its associated products that provide the bookmakers with the dominant products and platforms through which they can advertise and generate their business.

Table A3: Advertising in the Racing Post

| Bookmaker | HR Only | Other Sports | HR + Other Sports |
|-------------------|----------------|---------------------|--------------------------|
| Ladbrokes | 2 | 1 | 4 |
| William Hill | 1 | 1 | 6 |
| Coral | 1 | 1 | 4 |
| Tote | 7 | 0 | 2 |
| Betfred | 3 | 2 | 0 |
| Betfair | 6 | 0 | 1 |
| Bet365 | 4 | 3 | 0 |
| Stan James | 3 | 2 | 0 |
| Paddy Power | 7 | 2 | 0 |
| VC Bet | 4 | 1 | 3 |
| Extra Bet | 0 | 3 | 0 |
| Sky Bet | 2 | 2 | 1 |
| Blue SQ Bet | 4 | 2 | 0 |
| Betdirect | 3 | 1 | 0 |
| Boylesports | 4 | 1 | 1 |
| WBX | 2 | 0 | 5 |
| Betbrokers | 0 | 0 | 1 |
| Sunderlands | 1 | 0 | 0 |
| Total | 54 | 22 | 28 |
| Percentage | 52% | 21% | 27% |

(Source: Racing Post)