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## **Restructuring Hong Kong To Bet or Not to Bet?**

**Strategy & Economics Alert**

- The Jockey Club is not a declining industry that needs protectionism from the HK government – it has the potential to become a trusted and leading global company in the emerging 'virtual' casino industry.
- The Hong Kong government's move to ban betting on sports other than horse racing is not justifiable on either commercial or moral grounds.
- By joining the online gambling industry rather than trying to fight it, Hong Kong can further develop its competitive advantage in this fast-growing entertainment industry, as well as associated industries such as micro-payments.
- That the gaming industry can be a high-tech growth industry has been proven by the state of Nevada and the UK. Hong Kong should capitalise on the strengths of its Jockey Club.

### **Introduction**

*"We have not interfered with people going to Macau and Las Vegas to gamble, but we must enforce our policy if the activities happen within Hong Kong."*

*– Mr. Lam Woon-kwong, the Secretary for Home Affairs, Hong Kong SAR*

**As Hong Kong suffers from a stagnant economy and high unemployment**, there is currently a lot of discussion about how it needs to re-invent itself and how its institutions need to be restructured.

**We aim to offer some of our own ideas on the matter.** The first institution we are looking at is the Hong Kong Jockey Club, which is the monopoly that controls one of the most successful gaming clubs in the world. It is the single largest tax payer in Hong Kong but is in practice accountable to only its 4,000 plus members.

**Since the Jockey Club has been around for so long**, contributes so much to charity and has as its members many influential people of Hong Kong, there is a tendency to regard it as something above normal commercial considerations. However, a closer look reveals that the Jockey Club is just another HK institution that badly needs to change with the times.





## ***Gambling in Hong Kong***

*"Hong Kong's Jockey Club, one of the last bastions of the old order in the one-time colony, is doing its best to commit suicide in true dinosaur fashion, and the Government, which ought to know better, is helping it." – Tax-News.com, May 2002*

The Hong Kong government passed a law prohibiting betting on sporting events, such as football, on the eve of the World Cup. The government has used both pragmatic and moral arguments to justify the ban, but we think its policies are in error from both points of view.

Rather than banning other forms of gambling and thus supporting the Hong Kong Jockey Club's monopoly, the government would be better off opening up the gambling market in Hong Kong in the spirit of free enterprise.

This would not only be good for Hong Kong's resident gamblers, who would have more chances to spend their money, but would even be good for the Jockey Club, as the opening up of the industry would force it to move into the global league. The Jockey Club has consistently remained a purely domestic player, despite its heavyweight earnings.

Like it or not, the global gaming industry is moving online and going virtual. In the online gaming industry, what is most important is the trust consumers have in the website and the site's ability to service and collect small payments from millions of small punters.

It is acknowledged by IT professionals worldwide that the Jockey Club has one of the finest systems in the world for servicing and collecting 'micro-payments' from large numbers of people to tight schedules. This asset of the Jockey Club is currently under-used and can be easily leveraged to serve the global market place for gambling.

## ***Raking in the Takings***

Other than horse racing, football is one of the few sports that seems to excite the people of Hong Kong. However, the government's treatment of these two sports, originating from the former colonial power, Britain, is poles apart.

Horse racing is not only legitimate but institutionalised in the form of the Hong Kong Jockey Club, which takes in bets during the season that would be the envy of turf clubs around the world. In recent times, its takings from horse racing in Hong Kong have fluctuated between about HK\$80bn and HK\$90bn, with the season that ended in 2001 netting HK\$84bn during a recession, compared with about HK\$94bn during the boom year of 1997.

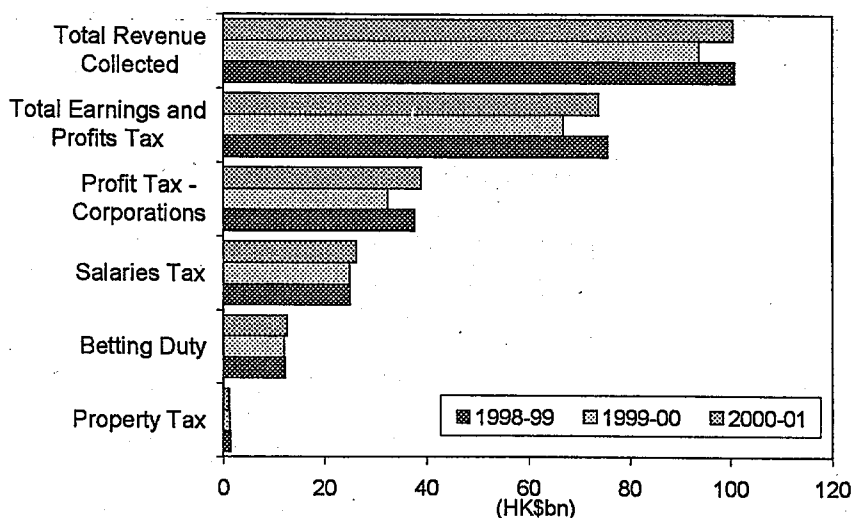
Some estimates say that if one were to include the amount taken by illegal HK bookies and that spent by HK residents in casinos in the region and around the world, the amount spent by Hong Kong residents on gambling per capita per year would be as high as about HK\$20,000, a big industry by any standards.



Official takings from horse races in Hong Kong are only below those in the US and Japan. Considering that the US and Japan are the two largest economies in the world and have populations that are about 40x and 20x larger than HK, respectively, it is clear that HK has a huge competitive advantage when it comes to horse race gambling. There are even fully-fledged daily newspapers in Hong Kong that specialise in tipping horses.

However, Hong Kong's indulgence on gambling stops when it comes to other sports. The Hong Kong Legislature has just passed a law outlawing betting on sporting events to coincide with the expected increase in online betting for the football World Cup.

### Breakdown of Hong Kong Tax Collection



Source: Hong Kong Inland Revenue Department

### Taxing the Monopoly

Hong Kong's Jockey club has a monopoly to operate the very profitable Happy Valley and Shatin race tracks, as well as the lucrative Mark Six lottery.

The influence of the Jockey Club can be seen by the amount of tax it pays. As Hong Kong's biggest taxpayer, the organisation paid about HK\$1.6bn in taxes in 2000, about 11% of HK's tax revenues.

The Jockey Club is taxed at the rate of 14% of revenues, which is mostly from bets taken, rather than profits. The club has complained that this affects its ability to pay out to punters, as the 14% tax is taken up-front. For some time now, the Jockey Club has been campaigning to be taxed on its profits, rather than its revenues.

### Betting Duty in Hong Kong

	Standard Bets*	Exotic Bets**	Lotteries <sup>#</sup>
Duty Rate	12%	19%	25%

\*Win, place, double, quinella, quinella place; \*\*Six-up, treble, tierce, trio, double trio, triple trio; <sup>#</sup>Mark Six

Source: Hong Kong Inland Revenue Department



The Jockey Club estimates, probably rightly, that Hong Kong's income tax rate, which at 15% is one of the lowest in the world, would have to rise by about four percentage points if the club's own tax contributions went missing completely.

At a time when the Hong Kong government is worried about the structural deficits in public finance, its reluctance to do anything that would upset the Jockey Club is understandable.

### *Horse-Feeding the Poor*

The Jockey Club's importance to the Hong Kong government goes beyond the massive taxes it pays. It also pays about 1.5% of its receipts to charity.

Founded in 1884, the Hong Kong Jockey Club describes itself as a 'not-for-profit organisation' that donates its surplus funds to community projects and charities. The decision on how to distribute the funds to charities is decided by the 12 'stewards', in consultation with the government.

In a city with only limited unemployment benefits and an emerging underclass of poor immigrants from the mainland, the Jockey Club's charitable contributions do not go unnoticed. It supplements the social service budget, contributes to the building of universities (such as the University of Science and Technology), and helps leisure facilities such as Ocean Park, as well as numerous other educational and medical charities. In the past ten years, the Jockey Club has contributed about HK\$8bn in charitable contributions.

To top it all, the elite of Hong Kong, i.e., the top civil servants and businessmen, including the chairman of the Hong Kong Monetary Authority, Joseph Yam, are horse owners and racing enthusiasts, and of course, members of the Jockey Club.

This cosy club is a historical legacy of the British rule that traditionally insisted that colonies finance themselves, even if that meant using revenues from horse racing and opium monopolies. However, the Jockey Club is now being threatened by the advent of online gambling.

### *Riding the Wave of Online Gambling*

An American analyst has observed that, so far, the Internet has been successful in revolutionising only the three G's: gambling, girls and greeting cards. All of these activities are best done in private over the Internet.

Online gambling emporiums allow Hong Kong bettors to wager not only on races at Happy Valley, but on just about any sporting event or game of chance. Online gambling was becoming very popular in HK until the recent passage of the Gambling (Amendment) Bill 2000.

Unfortunately, policymakers are unaware of HK's golden opportunity. Rather than assuming offshore betting companies will eat into the revenues of the Jockey Club and thus HK's tax revenues, the city can ride the crest of the wave of online gambling. Revenues from this source are expected to ultimately dwarf those obtained from capital-intensive gaming industries, such as casinos.



**The Jockey Club is big in both absolute and per capita terms, and thus it will be able to leverage its balance sheet strength both to expand into other types of betting in HK and to acquire overseas betting companies in need of capital.**

**HK's Jockey Club has already built up an impressive IT infrastructure to handle the requirements of the gaming industry. The marginal cost of expanding into other businesses and territories will be low. Meanwhile, the cost of building such an infrastructure will serve as an effective barrier to entry for newcomers to the market.**

**Instead of joining the world revolution in IT gambling, the HK government has acted like King Canute trying to hold back the waves of the ocean by passing legislation to ban offshore betting companies, such as British-based Ladbrokes and William Hill, from taking bets in Hong Kong.**

**Since these companies are not based in Hong Kong, they do not have to obey the laws of HK, which only apply within the territory. Initial reports from abroad say that, despite the legislation, the current football World Cup is attracting large sums of money from Hong Kong punters.**

**One of the first principles of law-making is that you should not pass laws that cannot be vigorously enforced, as it will otherwise encourage people to break them and brings the entire legal process into disrepute. Since everyone agrees that the 'rule of law' is one of the main competitive advantages Hong Kong has against much cheaper places such as the mainland, a law such as that banning gambling on sports events might have far-reaching ramifications.**

### ***Jockey Club Arguments***

**The Jockey Club has made some arguments in its favour that cannot be dismissed entirely as those of a cosy cartel trying to maintain its monopoly.**

**Firstly, offshore betting companies do not pay any Hong Kong taxes on income derived from bets in the way the Jockey Club is obliged to, nor are these companies compelled to contribute to charitable causes in HK. Given that the Jockey Club has to carry such a dead weight, it can never offer as good odds as the online gambling companies.**

**Secondly, by allowing offshore or online casinos to take bets from Hong Kong punters, there are higher odds of fraud, due to the lack of government regulation. The ease of access to gamble at all hours via the Internet also puts minors and those susceptible to impulse betting at risk.**

**However, even assuming that the Jockey Club, because of its financial obligations, does not give odds as good as the offshore and online companies, there will always be people willing to place bets with the club, just as there are many depositors who continue to keep their earnings with HSBC, even though the second-tier banks provide higher interest rates.**

**If betting on football and other sports were legalised in Hong Kong, it would lead to volume growth, as new demand would be stimulated. Given its strong position in HK, the Jockey Club would take at least some market share away from offshore and online gambling companies currently taking illegal bets through the Internet.**



**By way of comparison, both Singapore and China, two other Confucian societies that are vigilant over the morals of their citizens, have seen fit to allow football betting within their territories.**

### ***The Solution***

**The Jockey Club is Hong Kong's most under-utilised asset, and provided it follows the strategy of pro-actively going global and leveraging on its trusted brand name, it has the potential to bring in revenues and jobs aplenty to Hong Kong.**

**The first change needed is one of perception.** The government should stop pampering the Jockey Club with ultimately futile and protective legislation, and allow the club to take wing across the globe with its valuable assets of trustworthiness and an excellent IT infrastructure.

**The club might have to be privatised and a new management be installed** before it starts seeing the world rather than HK as its potential market. However, unlike the other monopolies and quasi-monopolies of Hong Kong engaged in real estate, power generation and urban transport, the Jockey Club has a good chance of becoming a world beater.

**After these steps are taken, the Jockey Club would be ready to expand abroad** and bring the profits into HK. Eventually, the Jockey Club could be floated as a public company on the Hong Kong Stock Exchange.

**In the interest of giving back some of the money that the Jockey Club has been taking from the Hong Kong public for generations** (which it professes is its goal), it might be worthwhile to give some of the shares to the public at discounted prices, much like the HK Tracker Fund. The latter's shares were sold back to the public after the government had used public funds to acquire them in the open market.

**Such a distribution would not only be just, but would also motivate the HK public to place bets with the Jockey Club, as partial owners, rather than with online betting companies, in which they have no equity stake.**

**As an added measure to answer those with moral objections to gambling, and also to provide some protection to those addicted to gambling, the Jockey Club could be asked to set aside a percentage of its revenues to set up an institution like Gambler's Anonymous.** Of course, Jockey Club tickets could also be required to carry warning labels about the dangers of excessive gambling.

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